TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JANUARY 17, 18, AND 19, 1995

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TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

TUESDAY, JANUARY 17, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

[The advisory announcing the hearings follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
January 3, 1995
No. FC-1

PRESS CONTACT: Ari Fleischer or Amy Tucci
(202) 225-8933
ALL OTHERS CONTACT: (202) 225-1721

ARCHER ANNOUNCES DETAILS ON STRENGTHENING THE AMERICAN FAMILY HEARINGS

-January 17, 18, 19-

Congressman Bill Archer (R-TX), Chairman-Designate of the Committee on Ways and Means, today announced that the Committee will conduct hearings on January 17, 18, and 19, 1995, on the tax provisions in the *Contract with America* that are designed to strengthen the American family. On Tuesday, January 17, and Wednesday, January 18, the Committee will receive testimony on the proposed tax credit for families with children, marriage tax penalty relief, refundable tax credit for adoption expenses, and refundable tax credit for home care of the elderly. On Thursday, January 19, the Committee will receive testimony on two tax provisions in the Senior Citizens' Equity Act: the proposed repeal of the 1993 tax increase on social security benefits and a proposal to allow tax-free accelerated death benefits under life insurance contracts. The hearings will feature invited witnesses from the general public, Members of Congress, and other interested parties. **All hearings will be held in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

The American Dream Restoration Act contains a $500 per child tax credit and a credit to offset partially the "marriage penalty." The $500 tax credit would be available for each qualifying child under age 18. The full credit would be available to families with adjusted gross incomes of $200,000 or less, with the credit phased out for incomes exceeding $200,000. The credit would be effective for tax years beginning in 1996. Also beginning in 1996, two-earner couples who file joint returns would be eligible to claim an income tax credit. The credit would mitigate unfavorable tax consequences which arise when two single workers marry. This latter provision would provide $2 billion of tax relief over each of the first five years.

The Family Reinforcement Act includes a refundable tax credit for adoption expenses and a refundable tax credit for home care of the elderly. Families may claim an income tax credit (up to $5,000) for qualified expenses paid for legal child adoptions. The full credit would be available to families with annual adjusted gross incomes of $60,000 or less, with the credit phased out for incomes exceeding $60,000. Families caring for an elderly member in their home would be eligible for a credit equal to $500 per parent or grandparent who is mentally impaired or disabled and who, without assistance, is unable to perform daily living activities, such as eating, bathing, and dressing. Both credits would be effective for tax years beginning after 1995.

The Senior Citizens' Equity Act includes a repeal of the 1993 tax increase on social security benefits and a provision allowing for accelerated death benefits under life insurance contracts. The 1993 tax increase requires senior citizens who earn more than $34,000 (singles) or $44,000 (couples) to pay income taxes on up to 85% of their social security benefits. The proposed repeal would lower (over a five year period) to 50% the amount of benefits potentially subject to tax, restoring the level of taxation that existed prior to the 1993 tax increase. Beginning in taxable year 1996, terminally and chronically ill individuals would be able to use tax-free distributions from their life insurance policies to pay medical bills and living expenses.

Chairman-Designate Archer stated, "I look forward to hearing what American families have to say about these provisions in the *Contract with America*. There is no question that tax relief is needed. The *Contract with America* shows our commitment to provide lower taxes for hard-pressed and hard-working American families."

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearings must be made by telephone to Diane Kirkland or Traci Altman (202) 225-1721 no later than the close of business, Monday, January 9, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the staff at (202) 225-1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Committee office, room 1102 Longworth House Office Building, no later 48 hours before hearings.**

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Friday, February 3, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 300 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

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

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

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

*****

Chairman ARCHER. The committee will come to order.

I invite our witnesses to move up to the witness chairs. We have your names in front here, Senator, if you would sit right there. Tim Hutchinson, if you would sit right there, we will get your names lined up with your physical beings.

I am pleased to begin the first of 3 days of hearings on provisions in the Contract With America that are designed to strengthen the American family. As a society, we are committed to the well-being of our children for the simple reason that they represent America's future. It is for this compelling reason that the centerpiece of the American Dream Restoration Act is a $500 tax credit for each child under the age of 18 years.

Over 69.5 million children and their families will benefit from the child tax credit, and that relief is long overdue. Over time, we have seen the real value of the personal exemption for dependents erode substantially. In 1948, close to 80 percent of family income was excluded from income tax due to personal and dependent exemptions. Today those exemptions shield only about 20 percent of family income from taxation.

It is essential we recognize the burdens American families shoulder today. According to the Tax Foundation, over 40 percent of average family income is consumed by Federal, State, and local taxes. This is unacceptable, especially when one considers that the average expenditures for rearing a child approach roughly $5,000 annually.

I am particularly pleased that President Clinton has joined our call for family tax relief. Although the President's proposal is less far reaching, nonetheless, it sends an encouraging signal that the administration will work with Congress to provide long-awaited relief, paid for with spending reductions instead of tax increases.

Today's hearing will also address the so-called marriage tax penalty. A perfect example of the marriage tax penalty was raised by Speaker Gingrich when he spoke before the committee. He spoke of two heads of household each earning $11,000 and both eligible for earned income tax credits. Now, to this couple, the cost of getting married is $4,600 each year. We don't think Uncle Sam should charge a fee when people meet and say "I do."

The American Dream Restoration Act also directs $10 billion in tax relief for working couples over the next 5 years. Although this amount will not erase the marriage tax penalty, the proposal represents an important first step to minimize unfair taxes on marriage.

At this point, I would like to recognize the minority for an opening statement. Mrs. Kennelly, you are the ranking minority member today, so I recognize you for an opening statement.

[The prepared statement follows:]

Opening Statement of Chairman Bill Archer
Hearings on Tax Provisions to
Strengthen the American Family
January 17, 1995

I am pleased to begin the first of three days of hearings on provisions of the Contract with America designed to strengthen the American Family.

As a society, we are committed to the well-being of our children for the simple reason that they represent America's future. It is for this compelling reason that the centerpiece of the American Dream Restoration Act is a $500 tax credit for each child under the age of 18 years. Over 69.5 million children and their families will benefit from the child tax credit. This relief is long overdue.

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Today's hearing will also address the so-called "marriage tax penalty". A perfect example of the marriage tax penalty was raised by Speaker Gingrich when he testified before the Committee. He spoke of two heads of households each earning $11,000, and both eligible for earned income tax credits. For this couple, the cost in getting married is $4,600 every year. We don't think Uncle Sam should charge a fee when people meet and say "I do".

The American Dream Restoration Act also directs $10 billion of tax relief for working couples over the next 5 years. Although this amount will not erase the marriage tax penalty, the proposal represents an important first step to minimize unfair taxes on marriage. At this point I'd like to turn to the Ranking Minority Member Sam Gibbons, for any opening comments he might have.

Let me extend a warm welcome to all of our witnesses. We will begin today's proceedings with a bicameral panel -- Senator Rod Grams and Representative Tim Hutchinson. We look forward to your testimony.

Mrs. KENNELLY. Thank you, Mr. Archer.

I am very pleased that this committee is revisiting the issue of marriage penalty, because this is an issue which many members of the committee have worked on, especially in 1986 when this committee considered major tax reform. Those of us who served on the committee then will recall that I strongly supported the steps we took in 1986 to lessen the tax burden on married couples.

Like my colleagues, I did so because I strongly believe that the Tax Code should not penalize marriage, which is fundamental to our society. I also believe that the Tax Code should not work against those parents who, because of death, divorce, or abandonment, must struggle to raise children by themselves.

For that reason, in 1985, I introduced and the committee adopted an amendment that increased the standard deduction for heads of households from the single rate to a rate much closer to what joint filers receive.

Recognizing a problem exists is not the same as finding a remedy. Generally, fixing the marriage penalty is an extraordinarily expensive proposition. I know that in 1993, when I was concerned about the impact of the President's deficit reduction plan on upper income couples, I asked Joint Tax to estimate the cost. I was informed that merely by not making the marriage penalty worse in that bill would cost in the range of $180 billion.

So my point today is that goodwill and good resolution will only get us so far. The marriage penalty is a multibillion dollar problem and I do not believe any one of us in this room has a multibillion dollar solution.

In fact, I would point out that the proposal in the Contract allocates $2 billion in each of the next 5 years and directs the Secretary of the Treasury to allocate it as a credit to those affected by the marriage penalty. The Secretary is also required to ensure that no couple gets more of a refund in the marriage penalty than they paid. In other words, the Treasury Department is asked to calculate the marriage penalty paid by every couple in America and then divvy up the $2 billion among them.

This will be an expensive and time consuming process. The approach will not end the penalty. At best, it will slightly ameliorate it.

Taking all the problems into account, any benefit received by America's married couples would be at least 1 year late and billions of dollars short. It seems to me that our focus should be on how best to help American families and I can think of nothing more important, including rectifying the marriage penalty, than continuing to reduce the deficit.

When I go home, people aren't asking me to reduce the marriage penalty, though they would very much like us to do that. But they are asking us to be responsible with their money, to restrain spending, and to keep taking a disciplined approach to deficit reduction. The marriage penalty is a fact. The Contract addresses the existence of the marriage penalty. However, it is disingenuous to claim that the problem is resolved by the solution in the Contract.

We must continue to wrestle with this situation but, unfortunately, the deficit reduces our options in this area. So too with the child tax credit.

The election sent many messages, including that Americans want a tax cut. However, as I said, Americans also want the deficit reduced and interest rates held as low as possible.

In Connecticut, we are still fighting a recession. The $10 per week per child would be welcome of course, but we must ask the real price of this benefit. I would hope that this committee would look long and hard at the $500 child tax credit before taking this route and not knowing what exactly it would do to the deficit and interest rates.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF CONGRESSWOMAN BARBARA B. KENNELLY
COMMITTEE ON WAYS AND MEANS
JANUARY 17, 1995

Thank you, Mr. Chairman. I am very pleased that this committee is revisiting the issue of the "marriage penalty," because it is an issue on which many members of the Committee have worked, especially since 1986, when this Committee considered major tax reform.

Those of us who served on the Committee then will recall that I strongly supported the steps we took in 1986 to lessen the tax burden on married couples. Like my colleagues, I did so because I strongly believe that the tax code should not penalize marriage, which is fundamental to our society.

I also believe that the tax code should not work against those parents who, because of death, divorce, or abandonment, must struggle to raise children by themselves. For that reason, in 1985, I introduced, and the Committee adopted, an amendment that increased the standard deduction for heads of households from the single rate to a rate much closer to what joint filers receive.

But recognizing that a problem exists is not the same as finding a remedy. Genuinely fixing the marriage penalty is an extraordinarily expensive proposition. I know that in 1993, when I was concerned about the impact of the President's deficit reduction plan on upper-income couples, I asked Joint Tax to estimate the cost. I was informed that merely not making the penalty worse would cost in the range of $100 billion.

So my point today is that good will and good resolutions will get us only so far. The marriage penalty is a multi-billion dollar problem, and I do not believe that any one of us in this room has a multi-billion dollar solution.

In fact, I would point out that the proposal in the Contract allocates $2 billion in each of the next five years, and directs the Secretary of the Treasury to allocate it as a credit to those affected by the marriage penalty. The Secretary is also required to ensure that no couple gets more of a refund than the marriage penalty they paid; in other words, the Treasury Department is asked to calculate the marriage penalty paid by every couple in America and then divvy up the $2 billion among them. Imagine what an expensive and time-consuming process that would be.

This approach will not end the penalty; at best, it would slightly ameliorate it. Taking all the problems into account, any benefit received by America's married couples would be at least a year late -- and some billions of dollars short.

It seems to me that our focus should be on how best to help America's families. And I can think of nothing more important -- including rectifying the marriage penalty -- than continuing to reduce the deficit.

When I go home, people aren't asking to fix the marriage penalty. They are asking us to be responsible with their money; to restrain spending; and to continue to take a disciplined approach to deficit reduction.

The marriage penalty is a fact. The contract addresses its existence. However, it is disingenuous to claim that the problem is resolved by the solution in the contract. We must continue to wrestle with this situation, but, unfortunately, the deficit reduces our options in many areas.

So too with the child tax credit. The election sent many messages including that Americans want a tax cut. However, as I said, Americans also want the deficit reduced and interest rates held as low as possible. In Connecticut, we are still fighting a recession. The $10 per week per child would be welcome, but we must ask the real price of this benefit. I would hope that this Committee would look long and hard at the $500 a child tax credit before taking this route.

Chairman ARCHER. The Chair will now recognize the gentleman from Minnesota, Mr. Ramstad, for an introduction of one of our witnesses.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Chairman, it is my privilege to welcome my former colleague and my good friend Rod Grams to the committee today. Although Rod was with us only one term, he certainly made his mark in the House. Along with his other good friend, our other witness today, Tim Hutchinson, they introduced the Putting Jobs and the American Family First Act.

As we all know, the centerpiece of this legislation, the $500 per child tax credit for American families, found its way into last year's Republican budget proposal and into our Contract With America. Should anyone doubt that the American people strongly support family tax reform, I would just suggest they look at the results of the 1994 Senate race in Minnesota. Rod ran a strong campaign centered on the overtaxation of families and was handily elected in a State which had gone Democrat in the last five presidential elections.

But far more important than politics, reducing the tax burden on American families is the right thing to do and I am glad to see both President Clinton and Minority Leader Gephardt have recently agreed.

Rod, we are grateful for your hard work to promote family tax relief and for your willingness to testify before the committee today. Welcome. Glad to have you back.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON FAMILY TAX REFORM
January 17, 1994

Mr. Chairman, I appreciate you holding this hearing to discuss one of the most important issues in our Contract With America -- tax relief and reform for American families.

Families with children are among the most overtaxed in our country. In 1950, the average American family with children paid only 3 percent of its income in taxes. Today, the same family pays 24 percent of its income in taxes.

It is little wonder that parents are frustrated by the difficulties of providing for their children and their children's future. Deductions for children have simply not kept pace with the rate of inflation and rising taxes.

Even as wages have increased, people find more and more of their hard-earned dollars ending up in the government's coffers rather than their own pockets.

Added to this dilemma is the incredible injustice of the "marriage penalty," which forces many married couples to pay higher taxes than they would if filing as two single persons. The U.S. tax code has no business discouraging the formation of families by unfairly placing married couples at a financial disadvantage.

I am particularly pleased that my colleague from Minnesota, U.S. Senator Rod Grams, will testify before the committee today on his idea to provide a $500 per child tax credit to American families. This proposal in the Contract With America is based on legislation Rod first introduced as a freshman in the 103rd Congress.

And once again, Mr. Chairman, I'm delighted we will be hearing from a range of policy experts whose opinions were rarely heard during hearings in past sessions of Congress. The witnesses before us today hail from a number of pro-family organizations, which represent literally millions of Americans. The membership of these organizations had a powerful impact on the 1994 elections, and they rightly believe family tax relief is long overdue.

I thank you all very much for being here today and look forward to your testimony.

Chairman ARCHER. I join Congressman Ramstad in welcoming both of you warmly to the committee. We would encourage you to keep your oral presentation to 5 minutes and should you have any more lengthy written statement, that would be included in the record without objection.

Senator Grams.

STATEMENT OF HON. ROD GRAMS, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator GRAMS. Well, thank you very much, Mr. Chairman, for this opportunity to testify today before the House Ways and Means Committee to discuss an issue of great importance to me, and that is middle-class tax relief. I want to also thank Jim for his kind words and congratulate him on the committee. I am pleased to be joined this morning by my colleague from Arkansas, Tim Hutchinson, with whom I introduced the $500 family tax credit, the cornerstone of our families first bill.

Mr. Chairman, it was just about 1 year ago that Congressman Hutchinson and I were testifying on this very subject before the House Budget Committee, then chaired by my colleague from Minnesota, Martin Sabo. As you might guess, our bill and our ideas were not very well received. Our arguments then were simple. Taxes were too high. The burden of tax increases fell disproportionately on the middle class and big government was forcing more workers out of the working class and into the welfare class.

Today, those same problems remain and the arguments for tax relief are still the same. Taxes are still too high. The tax burden still falls too heavily on the middle class and the big difference, however, is, in this year, with this Congress, we can do something about it. We promised tax relief, now we have got to deliver. We have got to do it for what Garth Brooks calls the hard-hat, six-pack, aching-back, flag-waving, fun-loving crowd.

In 1993, when Congressman Hutchinson and I introduced the $500 family tax credit, we did so in a tax environment that was not exactly middle-class friendly. Consider the facts. Most middle-class American families pay more in Federal taxes than they spend for food, clothing, transportation, insurance, and recreation combined.

Since World War II, Federal income and payroll taxes have increased from 2 to 24 percent of the median income of a family of four. Despite this, however, while Congressman Hutchinson and I were making the case for tax relief, Congress was in the midst of passing the 1993 Clinton tax proposal, which was the largest tax increase in American history.

Far from providing tax relief for the middle class, the Clinton proposal actually increased their tax burden making it more difficult for the middle class to care for themselves and their children. The message from Congress then was clear. Give us your money and we will solve your problems. But the American voter said no to this message in November and we now have their support to let them keep their money.

Now, it is 1995 and the cry for middle-class relief was taken up last year when House and Senate Republicans adopted the families first $500 per child tax credit in their alternative budgets and that

is spread across this country and across the aisles. President Clinton and Minority Leader Gephardt have offered their own plans for middle-class tax relief and to them I say, Welcome aboard.

When Washington gets serious about getting government off the backs of the American taxpayer, the taxpayers are clearly the winners. We promised tax relief in the Contract With America and we are going to deliver on it. The question is, How much?

I stand strongly behind the original families first proposal for a $500 per child tax credit. It would mean $25 billion annually to families across America and that is $500 million to families in my home State of Minnesota and $2.1 billion in tax relief to the home districts represented by members on this panel. Ninety-plus percent of that tax relief will go to working Americans making annual salaries of $60,000 or less.

Others have proposed means testing in the tax credit reducing the amount of the credit, limiting the ages of the children eligible for the credit, for substituting an increase in the personal deduction for the credit. The families first tax credit, however, is the largest, fairest, most progressive way of providing tax relief for families and lives up to our commitment of reducing the size of the Federal Government.

By cutting government spending to pay for family tax relief, families first is the strongest response we can send to the American people that we have heard their message, we accept their mandate, and we will deliver on our promises.

Mr. Chairman, what we do in this Congress will determine the makeup of the next Congress. Mr. Chairman, what we do in this Congress will be judged by the middle class. We have made a contract with them and I urge this committee to uphold it as we fight for the middle class and as we fight for fairness.

Thank you, Mr. Chairman, and members of the committee. I welcome any questions that you might have.

Thank you.

Chairman ARCHER. Thank you, Senator.

Congressman Hutchinson, we would be pleased to hear your testimony.

STATEMENT OF HON. Y. TIM HUTCHINSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. HUTCHINSON. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you and before the committee today.

Almost 2 years ago now—Senator Rod Grams, who was then Congressman Grams—and I started talking about drafting legislation that would significantly ease the financial burden on America's middle-class families. We began with the recognition that our Tax Code has become decidedly hostile to families with children. In fact, every study of the American family has concluded that they are more strapped, more squeezed, and more pressured under a heavier tax burden than ever before.

For instance, in 1950, the average American family with children paid only 2 percent of its income to the Federal Government in taxes. Today that same family pays 24.5 percent. When State and local taxes are included, the government now takes 37.6 percent of the income of the average family.

When you look at what has happened over the past four decades, you see that the Federal income tax burden on a family of four has increased by over 300 percent as a share of family income. Tax relief in the past has targeted senior citizens, the poor, single parents, and the business sector. The result has been that a disproportionate share of the increased tax burden has fallen on middle-class families with children.

In addition, rising inflation has eaten away at the value of the standard deduction and personal exemptions. I point out that if the dependent exemption was indexed for inflation, it would be over $8,000 today instead of just over $2,000. It seems to me we have said through our tax policy that children just aren't as important, that children just aren't as valuable today as they were in 1948, and that is the wrong message.

In response to this inequity, in June 1993, Senator Rod Grams and I introduced the putting families first bill. It was introduced in the Senate by Senator Coates and we are delighted that the $500 tax credit is included in our Contract With America. Senator Grams and I believe strongly that parents know best what their children need.

This tax credit will empower parents in the areas of health care, education, and the other necessities of daily life. Currently, we take from families with the left hand through confiscatory taxes and then we give it back with the right hand in the form of middle-class entitlements minus a big Washington surcharge. Let's let families keep more of their hard-earned money.

Family tax relief has had many proponents over the last several years, from candidate Bill Clinton's endorsement of an $800 tax credit back in the campaign, to the National Commission on Children chaired by Senator Rockefeller who endorsed a $1,000 per child tax credit to the Progressive Policy Institute which has advised increasing the dependent deduction for children and/or providing a targeted child tax credit.

In addition, in 1991, then-Senator Lloyd Bentsen introduced legislation which included a $300 per child tax credit. The Family Research Council has supported a targeted child tax credit of $500 to $1,500 per child. But in spite of all this support, nothing has been done. The time is now.

During the 103d Congress, the polling firm of Fabrizio McLaughlin & Associates conducted a survey which found that Americans not only favor family tax relief by a margin of 3 to 1 but they are willing to accept cuts in entitlements to offset the lost revenues.

Mr. Chairman, on November 8, 1994, the voters made sure we got their message. They told us they want less government, less taxes, and less interference in their lives. The American family wants relief. They want their purchasing power restored. They want to be able to spend more of their paycheck as they see fit. Isn't it about time we make the Federal Tax Code family friendly?

Mr. Chairman, this $500 per child tax credit is not a panacea for the family. It will not nearly solve all of the financial problems that the American family is facing today. It will, however, be a step in the right direction. If we say we believe in family values, then we must at least acknowledge the value of families in our Tax Code.

Last week, here on Capitol Hill, mayors and Governors testified before this committee and other committees on the Hill. What their messages seemed to be was this: Give us the resources, no strings attached, and we can do the job better than Washington. Today, on behalf of millions of American families, I say to you, give American families the resources, no strings attached, and they can do the job better than Washington.

Thank you, Mr. Chairman. Thank you, members of the committee.

[The prepared statement follows:]

THE HONORABLE TIM HUTCHINSON

JANUARY 17, 1995

THANK YOU MR. CHAIRMAN. I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU AND THE COMMITTEE TODAY.

ALMOST TWO YEARS AGO NOW, SENATOR ROD GRAMS (WHO WAS THEN-CONGRESSMAN GRAMS) AND I STARTED TALKING ABOUT DRAFTING LEGISLATION THAT WOULD SIGNIFICANTLY EASE THE FINANCIAL BURDEN ON AMERICA'S MIDDLE CLASS FAMILIES.

WE BEGAN WITH A RECOGNITION THAT OUR TAX CODE HAD BECOME DECIDEDLY HOSTILE TO FAMILIES WITH CHILDREN. IN FACT, EVERY STUDY OF THE AMERICAN FAMILY HAS CONCLUDED THAT THEY ARE MORE STRAPPED, MORE SQUEEZED, AND MORE PRESSURED UNDER A HEAVIER TAX BURDEN THAN EVER BEFORE.

FOR INSTANCE, IN 1950, THE AVERAGE AMERICAN FAMILY WITH CHILDREN PAID ONLY 2 PERCENT OF ITS INCOME TO THE FEDERAL GOVERNMENT IN TAXES. TODAY, THAT SAME FAMILY PAYS 24.5 PERCENT. WHEN STATE AND LOCAL TAXES ARE INCLUDED, THE GOVERNMENT NOW TAKES 37.6 PERCENT OF THE INCOME OF THE AVERAGE FAMILY.

WHEN YOU LOOK AT WHAT'S HAPPENED OVER THE PAST FOUR DECADES, YOU SEE THAT THE FEDERAL INCOME TAX BURDEN ON A FAMILY OF FOUR HAS INCREASED BY OVER 300 PERCENT (AS A SHARE OF FAMILY INCOME). TAX RELIEF IN THE PAST HAS TARGETED SENIOR CITIZENS, THE POOR, SINGLE PARENTS AND THE BUSINESS SECTOR. THE RESULT HAS BEEN THAT A DISPROPORTIONATE SHARE OF THE INCREASED TAX BURDEN HAS FALLEN ON MIDDLE CLASS FAMILIES WITH CHILDREN.

IN ADDITION, RISING INFLATION HAS EATEN AWAY AT THE VALUE OF THE STANDARD DEDUCTION AND PERSONAL EXEMPTIONS. IN 1948, THE AVERAGE INCOME FOR A FAMILY OF FOUR WAS $3,468. AT THAT TIME, $2,667 OF THIS INCOME WAS TAX-EXEMPT -- THAT MEANS THAT OVER THREE-FOURTHS OF THE FAMILY'S INCOME WAS TAX-EXEMPT. COMPARE THAT WITH 1983 FIGURES WHERE AVERAGE FAMILY INCOME WAS $29,184, BUT ONLY THE FIRST $8,783 OF THAT INCOME WAS EXEMPT FROM TAX. THAT'S LESS THAN ONE-THIRD.

FINALLY, I WOULD POINT OUT THAT IF THE DEPENDENT EXEMPTION WAS INDEXED FOR INFLATION, IT WOULD BE OVER $8,000 TODAY INSTEAD OF JUST OVER $2,000. IT SEEMS TO ME THAT WE HAVE SAID THROUGH OUR TAX POLICY THAT CHILDREN JUST ARE NOT AS IMPORTANT TODAY AS THEY WERE IN 1948. THIS IS THE WRONG MESSAGE.

IN RESPONSE TO THIS INEQUITY, IN JUNE 1993, SENATOR GRAMS AND I INTRODUCED H.R. 2434, THE "FAMILIES FIRST" BILL. AT THE CORE OF THIS LEGISLATION WAS A $500 PER CHILD TAX CREDIT FOR EVERY FAMILY IN AMERICA. THIS TAX CREDIT WOULD RESULT IN AN AVERAGE OF $59 MILLION BEING RETURNED TO EACH CONGRESSIONAL DISTRICT NATIONWIDE. IT WOULD ALSO BE TRUE MIDDLE CLASS RELIEF WITH 78 PERCENT OF THE TAX RELIEF GOING TO FAMILIES WITH INCOME BELOW $60,000.

THE BILL WAS INTRODUCED WITH 45 ORIGINAL COSPONSORS, MOST OF THE REPUBLICAN LEADERSHIP, AS WELL AS STRONG SUPPORT FROM THE PRO-FAMILY GROUPS AND A NUMBER OF TAX REFORM GROUPS.

IN THE SENATE, SENATOR COATS INTRODUCED COMPANION LEGISLATION, WHICH AGAIN HAD STRONG SUPPORT AMONG SENATE MEMBERS.

WE WERE DELIGHTED THAT THIS $500 TAX CREDIT IS INCLUDED IN OUR "CONTRACT WITH AMERICA." SENATOR GRAMS AND I BELIEVE STRONGLY THAT PARENTS KNOW BEST WHAT THEIR CHILDREN NEED. THIS TAX CREDIT WILL EMPOWER PARENTS IN THE AREAS OF HEALTH CARE, EDUCATION AND THE OTHER NECESSITIES OF DAILY LIFE. CURRENTLY, WE TAKE FROM FAMILIES WITH THE LEFT HAND THROUGH CONFISCATORY TAXES AND GIVE IT BACK WITH THE RIGHT HAND IN THE FORM OF MIDDLE-CLASS ENTITLEMENTS -- MINUS A BIG WASHINGTON SURCHARGE. LET'S LET FAMILIES KEEP MORE OF THEIR HARD-EARNED MONEY.

FAMILY TAX RELIEF HAS HAD MANY PROPONENTS OVER THE LAST SEVERAL YEARS FROM THEN-CANDIDATE BILL CLINTON'S ENDORSEMENT OF AN $800 PER CHILD TAX CREDIT, TO THE NATIONAL COMMISSION ON CHILDREN, CHAIRED BY SENATOR ROCKEFELLER, WHICH ENDORSED A $1,000 PER CHILD TAX CREDIT, TO THE PROGRESSIVE POLICY INSTITUTE WHICH HAS ADVISED INCREASING THE DEPENDENT DEDUCTION FOR CHILDREN AND/OR PROVIDING A TARGETED CHILD TAX CREDIT. IN ADDITION, IN 1991, THEN-SENATOR LLOYD BENTSEN INTRODUCED LEGISLATION, S. 1921, WHICH INCLUDED A $300 PER CHILD TAX CREDIT. THE FAMILY RESEARCH COUNCIL HAS SUPPORTED A TARGETED CHILD TAX CREDIT OF $500 TO $1,500 PER

CHILD AND THE COMMUNITARIAN POSITION PAPER ON THE FAMILY HAS RECOMMENDED A $600 PER CHILD ALLOWANCE FOR CHILDREN, WHICH COULD COME IN THE FORM OF A CREDIT OR OTHER TARGETED TAX MEASURE. BUT IN SPITE OF ALL THIS SUPPORT, NOTHING HAS BEEN DONE. THE TIME IS NOW.

DURING THE 103RD CONGRESS, THE POLLING FIRM OF FABRIZIO, MCLAUGHLIN AND ASSOCIATES CONDUCTED A SURVEY WHICH FOUND THAT AMERICANS NOT ONLY FAVOR FAMILY TAX RELIEF 3 TO 1, BUT ARE WILLING TO ACCEPT CUTS IN ENTITLEMENT SPENDING (OTHER THAN SOCIAL SECURITY) NEEDED TO OFFSET THE REVENUES LOST TO THE FEDERAL TREASURY FROM A $500 PER CHILD TAX CREDIT.

LAST YEAR, SENATOR GRAMS AND I WORKED WITH JOHN KASICH, BUDGET COMMITTEE RANKING MEMBER, AND THE FAMILY GROUPS TO INCORPORATE THE $500 TAX CREDIT IN THE FY 1995 REPUBLICAN BUDGET.

DESPITE THE HARD WORK DONE BY THE FAMILY GROUPS AND A NUMBER OF MEMBERS, WE FELL SHORT IN GETTING THE MESSAGE TO THE MAJORITY OF OUR COLLEAGUES THAT AMERICAN FAMILIES WANT SOME RELIEF.

WELL, MR. CHAIRMAN, ON NOVEMBER 8, 1994, THE VOTERS MADE SURE WE GOT THEIR MESSAGE. THEY TOLD US THEY WANT LESS GOVERNMENT, LESS TAXES, AND LESS INTERFERENCE IN THEIR LIVES. THE AMERICAN FAMILY WANTS RELIEF. THEY WANT THEIR PURCHASING POWER RESTORED. THEY WANT TO BE ABLE TO SPEND MORE OF THEIR PAYCHECK AS THEY SEE FIT. ISN'T IT ABOUT TIME WE MAKE THE FEDERAL TAX CODE FAMILY FRIENDLY.

MR. CHAIRMAN, THIS $500 PER CHILD TAX CREDIT IS NOT A PANACEA FOR THE FAMILY. IT WILL NOT NEARLY SOLVE ALL OF THE FINANCIAL PROBLEMS THAT THE AMERICAN FAMILY IS FACING TODAY. IT WILL, HOWEVER, BE A STEP IN THE RIGHT DIRECTION AND WE OWE IT TO THE AMERICAN FAMILY TO DO EVERYTHING WE CAN TO MAKE IT EASIER FOR PARENTS TO RAISE THEIR CHILDREN IN OUR SOCIETY TODAY. IF WE SAY WE BELIEVE IN FAMILY VALUES, THEN WE MUST AT LEAST ACKNOWLEDGE THE VALUE OF FAMILIES IN OUR TAX CODE.

LAST WEEK YOU HAD MAYORS AND GOVERNORS TESTIFYING BEFORE YOU. THEIR MESSAGE IT SEEMED TO ME WAS -- GIVE US THE RESOURCES -- NO STRINGS ATTACHED AND WE CAN DO THE JOB BETTER THAN WASHINGTON. TODAY, ON BEHALF OF MILLIONS OF AMERICAN FAMILIES I SAY TO YOU -- GIVE AMERICAN FAMILIES THE RESOURCES -- NO STRINGS ATTACHED AND THEY CAN DO THE JOB BETTER THAN WASHINGTON.

THANK YOU MR. CHAIRMAN.

Chairman ARCHER. Thank you, Congressman Hutchinson.

Very briefly, let me ask both of you, why did you elect to push a tax credit rather than an increase in the personal exemption?

Senator GRAMS. I just think the credit is a good, fair way of doing it rather than trying to put it into increasing the exemption. I think it sends a real clear message that as Tim mentioned, and I mentioned in the opening statements, children are important and if we would have just kept pace over the last four decades, the child credit today, if you put it in terms of the tax deduction, would have been over $8,000.

So to put a $500 per child credit on the tax forms to help support this and to really give support to the American family I think sends a good, clear message.

Mr. HUTCHINSON. I would agree. I don't really quibble which way you go on it. I think if you do the calculations and numbers on it, you probably come up with a little more relief for the middle class with the credit than you would with increasing the exemption. I think 90 percent of this relief falls to people making less than $75,000. It is a very fair way of doing it.

Chairman ARCHER. Would it not be true that an increase in the personal exemption or, in effect, a tax deduction helps the wealthy a lot more percentagewise than the tax credit?

Mr. HUTCHINSON. I think if you do the figures on it, that's exactly right, that higher income people benefit more from increasing the exemption while the middle class benefit more from the tax credit.

Chairman ARCHER. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. I don't know of a Member of Congress that won't advocate a tax cut for somebody. I never in my 34 years here found a Congressman that would say no to a tax cut.

Let me ask you, you say your tax cut goes to the six-pack, fun-loving crowd. Is it more important to give the six-pack, fun-loving crowd a tax cut than to continue reducing the Federal deficit by $25 billion a year?

Senator GRAMS. In the same respect, you haven't seen a Member of Congress who wouldn't want to give a tax cut. We haven't found too many Members of Congress who haven't advocated tax increases over the past four decades. When we are talking about the hard-hat, six-pack, aching-back, fun-loving crowd, we are talking about average Americans, family people out there who, over these last four decades, have seen their tax burden go up.

Now, to say that we can't have tax relief would be to buy into the assumption that we are not already paying too much in taxes. I believe American families are overtaxed and do need relief, and we can do that but at the same time, we can't ignore the problem of having spending cuts to go along with this. We can't give tax cuts without looking at the spending side, as well. So we do have to do it.

I think the main thrust of this is to make sure that we leave American taxpayers with more of their money in their pocket. I disagreed with one statement that was made recently that said we will allow the taxpayers to keep more of their money. Who are we to say that we should take more of their money? I am a strong sup-

porter of the philosophy that Americans today are paying too much in taxes.

We need tax relief to start with and then we have to back that plan up with the spending cuts that are going to allow us to balance the budget and reduce the deficit at the same time.

Mr. GIBBONS. You would rather give the tax relief before you get the spending cuts?

Senator GRAMS. No, no. It has to go hand in hand.

Mr. GIBBONS. That is what you said.

Senator GRAMS. I said these go hand in hand. You can't escape one without the other. The tax cuts have to go hand in hand with the spending cuts or we will have deficit spending, there is no doubt about it. So we have to have the spending cuts first.

Mr. GIBBONS. We tried that in 1981 and all we got were the tax cuts. We never got the spending cuts.

Senator GRAMS. That is why it is incumbent upon this Congress to make sure that those spending cuts go hand in hand with the tax cuts.

Mr. GIBBONS. Don't you think we ought to do the spending cuts first?

Senator GRAMS. I will take the spending cuts first if the tax cuts are very close behind them.

Mr. GIBBONS. We are right on the edge of inflation, although no one likes to talk about it. It is not popular to talk about it. We are at full employment, we are at full industrial capacity. The next step, unless we rein ourselves in, will be inflation.

Which do you think will be the most important, to give $25 billion extra to spending or to avoid inflation?

Senator GRAMS. I think the bottom line is they are both very important, but I think it is best to leave that discretionary decision up to average Americans to make those cuts rather than the government. So the money and the dollars are out there and they are going to be spent in some way. Let's leave the taxpayer to decide how best to spend their money.

Mr. GIBBONS. How about your priorities. Is your priority first to cut inflation or to cut taxes?

Senator GRAMS. Right now, I want to cut taxes and that is not to say while cutting taxes that we are advocating that we would support inflation or that inflation would be the result.

Mr. HUTCHINSON. If I might just comment. I don't think that they are mutually exclusive. What we are talking about is not some kind of profligate tax break to go out and do consumer spending. What we are talking about are middle-class families that are already overburdened, strapped, and need some relief. This is essential tax relief. It is—I don't think essentially inflationary.

Mr. GIBBONS. Well, as I read the statistics, we are right on the verge of inflation. It seems to me the most damaging thing for the American middle class is inflation. They cannot cope with it. They are always the big losers. You are sending $25 billion out to who you call the six-pack, fun-loving crowd. I just think cutting inflation is more important than pandering to the six-pack, fun-loving crowd.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

I thank you both for your testimony. I think it is important to keep in mind, if you are talking about freeing up $25 billion, that that money is going to be spent by responsible parents, as opposed to being spent by irresponsible bureaucrats down here. I would infinitely prefer to see it spent back home.

My wife and I had eight children, and believe me, it was a struggle. I was just calculating if that personal exemption had been indexed through the years, that today that would be about $7,500 at least or close to $8,000, which with my wife and myself and my eight kids, we would have had about an $80,000 personal exemption rate.

That sounds staggering today, I am sure, to many people. But the fact of the matter is, that is the equivalent of what it was back then after World War II. Even when I brought up my kids—and that was mostly in the decade of the sixties and seventies, there had been no indexation and it was a struggle, a major struggle. Our Tax Code has been biased, profoundly biased against families.

So I salute you both for what you have done. This is a good first step as far as I am concerned. We have a long way further to go down that pike. Keep up the good fight.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

I would like to ask both Senator Grams and Representative Hutchinson, isn't it true that Federal, State, and local taxes add up to about 40 percent of our income and all other things, housing, food, transportation, health care, clothing, recreation, all eventually get to 100 percent and that we had tax-free day last year on May 5, 1994?

This proposal, in my opinion, would have a direct impact on the middle class, the average family that has children. I don't want to one-up Congressman Crane at all, but in raising nine children, the deduction that I got on my Federal income tax didn't even come close, didn't come close to taking care of the expenditures for those children.

With a tax credit, you impact your tax returns directly. If these changes were in effect when I was raising my children—now they are all raised and have families of their own—don't you believe that it would have made the Tax Code a heck of a lot more family friendly than it is presently?

Mr. HUTCHINSON. Absolutely. I couldn't agree with you more, Mr. Bunning. I think the figure I have is 37.6 percent of the income of the average family is taken in taxes at some level now, and I was amazed back in the district this past weekend how many people walked up to me at the mall or on the street and said, please fight for that tax credit for children, that we forget—it is very easy for us to lose touch with what clothing costs and how that is hitting the family, and the automobiles and tuition and food costs and everything else and how that has squeezed the middle-class family.

We do the EITC (earned income tax credit) for the low-income people and we try to target tax relief. The middle-class family just gets hit over and over again. This is the first step toward providing

some real relief, leaving the money back in the pockets of those parents.

Mr. BUNNING. Senator Grams, could you possibly answer the critics which say, you are only giving the tax relief to married couples who have children? I would like to know how you would answer those critics of this tax relief in regard to that.

Senator GRAMS. Well, basically the families have been the ones most under attack in the Tax Codes over the last four decades going from 2 to 24 percent. I would say that if we added in all the taxes, property, sales, Social Security, income taxes, we are at close to 50 percent—49 point some percent of money made by Americans today goes to some form of supporting government, which is 2 percent growth over the last 2 years, by the way, from 47 to 49 percent.

But to the critics who complain, I think families are the ones that need the relief. Where would that $500 per child go? Would some of it go to savings? Yes. The rest would go to help support the child in food, clothing, shelter, a better education. Those are a lot of the services now that government wants to offer.

The only thing is they want to take the money, send it to Washington, then send it back to provide the services that the individuals can provide for themselves. But on the other hand when the critics would say only families would benefit, as we begin to reduce the deficit, reduce the role of government, everybody in society is going to have some benefit from that. So there are also other benefits to other people who do not have children or who have children now that have left home.

Mr. BUNNING. One last thing. According to the information I have, over 50 million families would be included. Do you know how many would be left out?

Senator GRAMS. The vast majority of people in this country are family people or have children, and, as I said, they are the ones that even if you look at just the Tax Code and the child credit from 1940 till now, as Mr. Crane mentioned a short while ago, that it is only about 25 percent of what it could have been if it would have just kept pace with inflation.

So I think to put more emphasis on giving these credits, as you said, helps families to raise their children without having to rely more on government. So in this respect, I think we are putting responsibility and also accountability back to families and taking some of it away from the Federal Government.

Mr. BUNNING. Thank you, Mr. Chairman.

Chairman ARCHER. Mrs. Kennelly.

Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman ARCHER. No questions.

Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Gentlemen, thank you very much for being here with us. I am in general agreement with what you are trying to do. I have got a couple of questions, though.

The first—I am a little confused why you don't do all this through the earned income tax credit. Maybe it touches a little bit on what Mr. Archer was saying. But you have a cap on claiming

the credit. You have your income tax liability, your total payroll tax and then that is offset by EITC (earned income tax credit), and I just don't know how those two things interact. So that is one thing.

Another thing is, I don't know how this helps, specifically, the people in need in my district. Let me just give you some figures. Of the three largest towns—and this again is in a rural area, the average annual income goes from $18,500 to $24,100. So really, in effect, about 40 percent of the people who really need help can't get it through this process. If it will work through an earned income tax credit, they might be able to do it.

Mr. HUTCHINSON. Mr. Houghton, I am not a tax expert and I will leave that to you all. I think that this is only going to minimize the impact of the ITC which is currently available, that what we are really doing is playing catchup. We are trying to level the playing field on how we have, over the last 40 years, gradually made the Tax Code more and more hostile to the family.

People say, well, why are you picking families with children? Why are you giving them the special benefits? It is not a special benefit. We are just trying to catch them up with where they should have been had we indexed things back since 1948. They are the ones being squeezed. They are the ones being hard hit.

I really think that it will hit the vast majority of middle-class Americans, that it will leave that money in their pocketbooks, allow them to make the choices that we currently are making with that $25 billion and the numbers are there for how it will impact each congressional district in this country, how much will be returned to middle-class families. I think it is a good way.

Mr. HOUGHTON. Congressman, I agree with the basic thrust here. There isn't any question about it. But you know, what is middle class? It goes anywhere from $15,000 to $115,000 in terms of how you ask. But the people who are closer to $15,000 are the ones that need it, don't quite get it the same way. They might have gotten it through a different process.

Senator GRAMS. Right now, most of those with earned income tax credits are getting that type of relief. Those are built into the Tax Codes. But it is the families over that poverty level or over that amount, the $20,000 and up, as you talked about.

Mr. Houghton, in your district alone, you would get about $60.7 million a year in tax relief just in your district. I think if you went and asked the average family if $500 or $1,000 or $1,500, depending on the size of the family, wouldn't mean something to their bottom line or their quality of life, I think you would have some strong arguments.

That, again, is not the cure-all. It is not the panacea for the problems, but it is a good start and it is a way of emphasizing support for those who I believe have been shouldering the burden. We have offered so much in government programs and cuts and programs for those below the poverty line. We seem to have forgotten the middle class. What we have asked for them to do is pay the tab and not get any relief. So this is strictly, or one of the areas pointed at, those above that line.

Mr. HOUGHTON. Thanks very much.

Chairman ARCHER. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. I will be extremely brief.

Thank you for your testimony. I support you all the way. I have ever since you started the idea. I just hope that we can—in addition to this, come up with incentives for savings that will apply to everybody, rather than just concentrating on the middle-income members that have family only, because we have got to come up with some tax relief to encourage the savings programs that the Tax Code has stopped middle-income people from being able to utilize.

Thank you very much for your testimony, gentlemen.

Mr. HUTCHINSON. Mr. Hancock, I appreciate those comments. I think all of us ought to be concerned about the low savings rate in the United States. I think we have the lowest savings rate in the world. That needs to be addressed.

But I think also that if a family has two children, they have $1,000 more disposable income because of this tax credit, they are going to have something to put in that savings account or in that savings bond and start setting it away for college tuition so it is at least a step in the right direction.

Mr. HANCOCK. But you do agree we have to make those savings plans available and give the citizens an incentive to put them into effect. Thank you.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. I want to thank my colleagues for their testimony today.

Senator Grams, congratulations.

Senator GRAMS. Thank you.

Mr. PAYNE. My question really goes back to what Congressman Gibbons was asking about earlier, and that has to do with this whole notion of responsibility and fiscal responsibility, which is something that this committee is charged with and something that we certainly take a great deal of pride in.

As we have learned in terms of the balanced budget amendment, which we will be voting on next week, in order for us to successfully find a way to a balanced budget by the year 2002, we know that we will have to find $1.2 trillion of reductions in cost between now and the year 2002. That is a very substantial number and it is a very substantial undertaking to accomplish.

We are now proposing in the Contract as we—as one of the first things we do—to add to that $1.2 trillion through various tax cuts. This, of course, is the one that is viewed by the Treasury as the most expensive. Those tax cuts cumulatively add about four-tenths of a trillion dollars, which is $400 billion. So we are now talking $1.6 trillion.

I know you have thought about this in your proposals last year as you thought about how we would find our way to a balanced budget, because I believe you both support that notion. My question is: What specific recommendations do you have or what can you say about reducing the cost of government that would offset numbers such as $1.6 trillion between now and the year 2002?

I think that is where we are headed some time during this Congress as we begin to make these decisions. Tim, maybe you could just comment on that.

Mr. HUTCHINSON. OK. Thank you for the question. Let me just say, in my view, deficit reduction and family tax relief are not mutually exclusive, that we can do both. We must do both. In the Republican budget which was submitted last year, we had the $500 tax credit. We also had the spending cuts to offset it. I don't want to face the American people and say we can't—because we can't control our spending, we can't afford to give you tax relief. I think we have got to do both.

In our Contract With America, there is a commitment that the specific spending cuts will be there to offset the tax relief. But too often these things are presented like they are new spending programs. This isn't a spending program that is costing the Treasury more money, it is leaving money in the pockets of hard-working Americans where it ought to be, letting them make the decisions. They are going to spend some of that. It will be good for the economy. Most of all, it will provide some much-needed relief. I think we can do both. We must do both.

We have a big job between now and the year 2002. I hope we put the disciplinary mechanism of the balanced budget amendment in place and then set about the hard task of doing some entitlement reform and identifying specific spending reductions. I am willing to make those hard votes but I think we have to look at the eyes of the American people and say you deserve this relief and we are going to do it.

Senator GRAMS. Mr. Payne, I would just like to briefly add to that, when we talk about $1.2 or now $1.6 trillion in spending cuts over the next 8 years, you have to put that in the context where this government is going to be spending over $13 trillion at the same time. What we are looking at is an 8-percent or less than 8-percent cut in the budget over that period of time.

Now if we, in our own private lives, had to make an 8-percent reduction in our spending habits to ward off a catastrophe that our family was facing, we would do it. In the private sector, General Motors has done it, IBM has done it, Sears is doing it to try to stay profitable and in business. The Federal Government has no less of an obligation.

When you are talking about tax cuts, you talk about productivity. We did double revenues in the eighties with the tax cuts proposed under President Reagan. President Kennedy knew the value of tax cuts that he offered in the early sixties. We didn't get the high deficits in the sixties because we didn't increase spending at as foolish a rate as we did in the eighties.

So, again, I go back to Mr. Gibbons and his remarks about how we need the tax cuts, which I believe are better for families. It is going to increase productivity, and can even increase revenues to the Treasury. But we have to have, on the other hand, the spending cuts to balance them and then use them for deficit reduction. I think we can do both.

Mr. PAYNE. I do appreciate your comments. I would say two things. One is that certainly we have to offset these costs and we all recognize that. But second, we are also on another track and that is a track to balance the budget that says not only do we offset these costs, we have a lot of other costs we are looking at as well.

I think we always need to keep that in mind as we are making these decisions.

Two, I think that we can say in general that there will be cuts. You have mentioned 8 percent and I have heard other numbers, as well. But when we begin talking specifically about how is it that we are going to achieve those $1.2 trillion in cuts, it seems that is where we have much less discussion about the specifics. But I know we will be getting into more detail later.

I too support the middle-income tax cuts, but I am really concerned about how it is that we maintain fiscal responsibility, because I think that is very, very important as well.

Thank you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Chairman, just a followup comment. I like the way our distinguished colleague put it yesterday on one of the talk shows, or rather Sunday, when he—when Chairman Kasich said we are not cutting anything. Instead of increasing spending over the next 7 years by $3 trillion, we are going to increase spending over the next 7 years by $2 trillion. I think that puts it in perspective.

I am glad to hear both of you talk about doing it right this time, unlike the eighties when the commensurate spending cuts were not made during the go-go years. Things were fine. Congress kept spending the money like there was no tomorrow and, of course, we saw the results in the deficit. But I am glad that both of you talk about the need to make the commensurate spending cuts.

As an economist who sat in that chair last week put it, "As long as the spending cuts are real, then it will be a wash from a macroeconomic standpoint and the standpoint of the deficit."

My question is this to either or both of you: In looking at the Clinton tax cut proposal that was recently put on the table, which cuts off the child tax credit after age 13, would you care to comment on that proposal as contrasted to yours?

Mr. HUTCHINSON. I will just comment briefly that I think it is too little and it is spread out over too long a period of time. It does not provide the kind of relief that is necessary. As a father of three teenagers, I can tell you that the highest costs in child rearing occur after they reach the age of 13, not before. I really think that it is phased in over too long a period of time. It is not a sufficient amount. The cutoff is too early at the age of 13.

Senator GRAMS. I agree, too. I don't think we can just pay lip service to this or bite around the edges or make it look good and go in the back rooms and say what can we do to fool the American public into thinking that some kind of tax cut or tax relief is enough. I think we have got to provide tax relief and cuts that are meaningful and that when they open their wallets at the end of the month, they can see that there is a difference. Not just to have the headlines read that there was a tax cut and it doesn't show up at the kitchen table when they are figuring out their budget.

So, I think it is too little, and I think we have got to make a meaningful statement and that is a minimum of $500 per child.

Mr. RAMSTAD. I thank you both for your responses. I must say I am not surprised by them but I concur with them. Thank you very much.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I guess I snuck in before the gavel went down. I appreciate that. I thank my colleagues present and former for being here this morning for your good testimony.

I really enjoyed that dialog you had with the Members of both sides of the aisle here this morning. I think it has been interesting. I think there is a general consensus we need targeted relief. I think middle-class families need the relief. It is interesting, to just reiterate, that there are other proposals on the table. There is a Gephardt tax credit for children, as well. The Clinton administration advanced its own proposal. The question is not so much do we do this but how we do it and how we pay for it.

I think there is also a consensus this morning that we do need to pay for it. For that reason, I have a couple of questions. One is, do you think the $124 billion figure is a sound one? This gets into the dynamic versus static scoring issue, and I have been instructed this morning by hearing both of you say at different times that people will use this money in part to increase their savings. I think, Mr. Hutchinson, you mentioned at one point the benefits to the economy. So it seems to me there would be some increased revenue.

Do you have a comment on that $1.4 billion figure?

Mr. HUTCHINSON. I think economists differ on the economic impact of family tax relief. They would probably say a capital gains tax relief would have more economic stimulus than the family tax relief. It has been so long since we did it, I don't know if anybody can really project what the impact will be.

I am more optimistic. I think we have to have more spending cuts to balance it. I don't think you can go to dynamic scoring on family tax relief. We have to assume it is a genuine loss to the Treasury. But I am more optimistic about what the real impact of the economy would be and that consumer spending, investment in savings, all of that would result from leaving more money in the pockets of American families. I think it would have a beneficial impact and the numbers will not be as bad as what we have seen.

Senator GRAMS. Also, Mr. Portman, I agree with Mr. Hancock that Tax Codes can be written to encourage savings. If you give people an incentive, they are more likely to do something than if you provide the hammer. But also, I think when we are talking about $24 or $25 billion, putting that into the pockets of parents to make those decisions, I think they are going to make decisions closer and better to their family needs than a bureaucrat in Washington. So if the money is going to be spent, I think the decisions for the family are best made by the parents, rather than in Washington.

So to say that we are going to cut this money loose and give to it a bunch of irresponsible Americans to spend at will rather than having a smart government tax it away from them and spend it in their best interest, I would opt for the former and let the parents make the decision.

Mr. PORTMAN. The second question I have relates really to Mr. Gibbons' comments with regard to the current economy. I think he described the economy as being in full employment and full capacity, and he questioned whether there was a need for tax relief at this point and even questioned the potential inflationary impact.

I guess my question to you is: When would these tax credits begin to affect the economy? When would they kick in?

Senator GRAMS. Well, I think by the time you get them into your pockets. I mean, when you have either in your paychecks reduced withholdings or the refund that you get in 1996, I think would be the earliest. But I still think it is important that we look at this as not hurting programs or people who need it. It is just to add extra relief, an extra spending discretion to those people who earn that money.

Mr. HUTCHINSON. I think that is a good point that you are making that in fact those refunds will not come for some time. So to speculate now as to what the impact may be in the next few months on inflation is almost a moot point.

But I don't want to face the American people and say we are afraid it may be inflationary so we can't afford to give you a tax break at this time. We can always find an excuse if we don't want to give tax relief. So to speculate on how it might impact inflation down the road seems to me to not be a good basis for not passing them.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman. Good morning.

Senator GRAMS. Good morning.

Mr. LEVIN. I believe there is some strong general agreement on letting the individual family make the decision. Let me ask you, if there weren't the savings to pay for the $125 billion, somewhere between $120 and $125 billion and we had to choose between reducing the amount of the credit or reducing income eligibility for the credit, which of the two would you choose? Which course would you select?

Senator GRAMS. Well, I think we are looking at a scenario that you are saying "what if" or maybe we don't want to give this tax credit for some reasons.

Mr. LEVIN. Let's assume that when you put all the tax proposals together that there has to be some give, that the amount simply can't be found and there have been increasing statements that we have to end up with a balanced budget here. Let's assume that the scoring—there is agreement on the scoring and it doesn't meet some of the expectations and a choice has to be made between reducing the credit or reducing the amount of income for which there is eligibility.

Which of the two would you choose?

Mr. HUTCHINSON. Mr. Levin, I don't want to climb into that box. I heard that word "assume" several times. If you are in a ball game, you are playing to win. You don't assume a loss. I think right now we have to find the spending cuts. We have to determine that this is something worthwhile doing, that the middle-class American family needs relief and we are going to find the money

to do it. That is the approach I would take on it. Let's do what we promised we would do for the American people.

Mr. LEVIN. Because I think it raises the question why you go up to $200,000 and phase it out at $250,000, rather than a lower figure. So let me ask you, Representative Hutchinson, you said the public says that they would prefer entitlement cuts to sustain a middle-income tax cut. Which entitlements do you favor cutting?

Mr. HUTCHINSON. I don't know if I am in the position to make that decision. But the poll that I quoted said that the American people support middle-class tax relief, family tax relief by a 3 to 1 margin, including the necessity to make entitlement cuts. I don't know that they were listed, given a list of what potential cuts would be.

Mr. LEVIN. What would your preference be in terms of entitlement cuts?

Mr. HUTCHINSON. I don't think that that is a proper thing for me to respond to. I am not going to present a budget today. I am committed to make the kind of votes that are necessary to find the spending reductions to allow us to give tax relief to American families. I am willing to do that. But for me to sit here and say that I have made some kind of evaluation, I made some kind of study as to where the most abuse and fraud is or where the most waste is or where we can hurt people the least by making the reductions, I am not in the position to do that.

I am in the position to say I will make the hard votes to find the spending cuts to give the middle-class families the tax relief. I think we have to keep the focus in mind. The focus is the American family deserves tax relief. They need tax relief. They are burdened and they are stretched and we have got to find a way to do it.

Mr. LEVIN. Well, I agree with that sentiment. I do think that each of us has to begin to figure out what cuts we would be willing to vote for. That day is pretty imminent, thank you.

Senator GRAMS. I think we have to set goals, Mr. Levin, and follow it up with action. We might run into some of those tough questions. I think if we go without answering those tough questions, we are going to face more retribution from our children and grandchildren for not having done what is fiscally responsible and not to pass these debts and burdens on to them.

Mr. LEVIN. I couldn't agree with you more.

Senator GRAMS. All cuts have to be across the board. All entitlements have to be across the board. I think what Mr. Ramstad said, quoting Mr. Kasich, "We are not talking about cuts in a lot of programs. We are not talking about endangering the lives of many individuals or a lot of the programs, only the growth of those programs. We are not going to spend $3 million or billion or trillion in increases, only $2 trillion in increases."

So a lot of the question is going to be how much do we increase spending, not how much do we cut. So I think those assumptions are going to be the hard questions and the hard votes that you said are coming in the very near future.

Chairman ARCHER. The gentleman's time has expired.

Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman, and welcome, gentlemen, Congressman Hutchinson and Senator Grams, and congratulation

on your ascension to the other body. My background is as a single mother, and I raised two boys from the ages of 6 and 8, and they are in their early twenties now. I must say it was at a rate of income far below any of the limits listed on any of the options here. I would like you to explain to me, both of you, how this child tax credit would affect a single parent. What would be the requirements?

Senator GRAMS. There would be no differences between a single parent or a two-family, two-parent household. But the thing is, for many single parents that face a lot of these problems and are trying to make ends meet, the $500 per child credit could mean maybe not having to take in the second job for that single mom or single dad and being able to spend more time with their children, rather than having to meet the obligations of not only having one full-time job, but maybe having to take on a second job.

So this is where some of the relief really comes in, that it allows the single person not to have a part-time job in order to try to provide what he or she feels is necessary for the family. Or maybe in a two-parent household, that maybe the second parent doesn't have to work or maybe only work a part-time job. Again, allowing more time for the family to be together. Those are really some of the trigger mechanisms and the goals behind this program.

Mr. HUTCHINSON. I think, Jennifer, in a sense that it is going to be more beneficial for the single parent, because they are so strapped now. My sister is a single parent and she said pass that. I asked her what $500 more disposable income would mean, and she has one child, and it would mean a great deal, she made it very clear. So I think the principles are the same. The impact will be at least as great for the single parent.

Ms. DUNN. I certainly feel it would have been in my case. You have talked about some of the incentives, some of the goals behind the $500 tax credit for each child. Could you summarize those so that we have a good clear view on how the ramifications would work from this tax credit? What are we trying to do, what is behind it?

Senator GRAMS. Well, I think the goal is to really put support into the families, and again to go back to the wage earners that when you have husband and wife working, that means less time to spend with the child or the children in the home.

This way, maybe one of the family members can stay home or only work a part-time job or in a single parent's instance, maybe only a part-time job rather than two. So it is trying to strengthen the family, provide them money where it is needed the most, and that is for food, clothing, shelter, and in the education of our children. Rather than looking to the government for a program that is going to provide me some assistance, when we have the money to begin with, why send it to Washington and then go begging to get some of it back to help? So really it is to put discretionary spending back where I think the best decisions are made and that is to the closest point, that is the family.

Mr. HUTCHINSON. I agree. I think we need two things. For one thing, we put the U.S. Congress and the Federal Government on record as being in support of the family. So often, our policies have

indicated that we are hostile to the traditional American family. So we do that.

It is certainly an empowerment bill. It empowers the American family. Where now we take through confiscatory taxes on Friday and give it back to them in a middle-class entitlement of one sort or another which Washington, D.C., has made the priorities, and we have made the decisions as to what is the best way for them to spend it. We are saying you have the wisdom to make those kinds of decisions and those kinds of choices, whether it is education or whether it is the priorities for their own family. So it is very much an empowerment bill.

Ms. DUNN. Also, that choice could be to save that money, so that it would take us a step further toward one of our goals here in this congressional term of increasing the ability of families to save.

Thank you.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman, and thank you for your testimony. I find it both very interesting and very informative. Both of you mentioned time and time again about the fact that this could not only help accrue money in the family's budget for spending purposes, but also for savings purposes.

We heard testimony last week about the fact that the savings rate in this country has really dropped. There is also mention of the fact that for those who don't have children—what type of relief are we going to be giving them? Is it not true that the repeal of the marriage penalty would help many families, couples who don't have children? Is it not true, too, that if we put in place the deductibility of the IRA at the beginning or end, that will help families who do not have children?

Also, will the repeal of the Social Security tax increase of 1993 help families who do not have children, as well as the earnings limit? The question too was posed about whether we should go with a credit route or exemption route or increase the exemption.

Is it not true that in order to reach a $500 credit based on a 24-percent rate of family income, that we would have to increase the dependent deduction to $2,000 to reach that $500 credit? Also, the question has been posed about the earned income tax credit. The earned income tax credit was passed in 1975, I believe it was, with a twofold purpose. One was to offset Social Security tax deductions for those of low income, and the other purpose was to encourage people to work and keep them off of welfare.

But recent reports have shown that those who do work and receive the earned income tax credit have a tendency to work 2.1 hours less each week than those who don't receive the earned income tax credit. These recipients slow down their work rate when they reach the phaseout threshold. They understand that if they continue to work and accrue hours, the value of the credit decreases. So they try to hold the credits as high as they possibly can.

Is it not further true that any type of tax credit given to any one individual becomes a tax liability for another individual or another family to cover those credits? It has been mentioned about entitlements and what entitlement programs that you would like to see cut or abolished. I believe I understand the fact that if we go to block grants to States, we in effect will be abolishing a lot of enti-

tlement programs and making the Congress come back and address those proposals each year in the budget process.

Again, I appreciate your testimony. Thanks again for the work you have done. Hopefully, this Congress will give the people and the families of this country a $500 tax credit per child.

Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I just want to understand. First of all, I want to offer my condolences to you, Senator Grams, having to go over to the Senate. Everybody's making that out to be a good deal, but I can't see what the good deal is, really.

I want to understand that the idea of this is that you think that the people at the bottom who would not receive a refundable credit because they haven't paid any income tax, they already have it made so we don't need to think about them anymore. It is the people above them that you are worried about.

Is that a fair statement of your fundamental underlying principle under which you propose this?

Senator GRAMS. No. My belief is that under past Congresses we have offered some form of relief or help in the earned income tax credit area to those people making under $16,400 a year, but, at the same time, we have forgotten those who make $16,401 and more a year.

Under this plan, over 90 percent of it goes to middle-class Americans making under $60,000 a year. They are going to get this. So this is for those making between the $20,000 and the $60,000 wage or combined income for a household, that we have forgotten and have not offered any tax relief.

All we have asked them to do is to continue to pay more in taxes. So this was an effort to make sure that there was some tax relief across the board that was going to include millions and millions of Americans. It is not to say that we are going to ignore them.

Mr. MCDERMOTT. OK.

Senator GRAMS. It is not at their expense that this program is being implemented.

Mr. MCDERMOTT. Let me ask another question, because I think it is an interesting proposition you have here, as you have already heard. There isn't anybody up here who is going to say we don't want to give a tax cut. I mean there isn't anybody that stupid in the Congress, right? It is a question of priorities.

If you take the $500 a year tax credit, and I figure, you know, $5 for a bottle of wine, that is 100 bottles of wine for a family, or I guess you think that that is what people pick up in a second job, but when you look at it as $83 a month that that family's going to get, if you put a vote to the American people, do they want this tax cut or would they like to have guaranteed health benefits, which do you think they would take?

Senator GRAMS. How much are those guaranteed health benefits going to cost them? That is not free either, Mr. McDermott. But you ask them if $83 isn't going to make the difference.

Mr. MCDERMOTT. No, we are talking about money you are going to cut from the budget somewhere. Someday you are going to tell us where from. OK. So we got that money. Now we have to lay it

on the table. Your decision is to hand it back to people as a $500 tax credit that they can do whatever they want with. You cannot buy a health benefit package for $500 a year for a family of four. It isn't worth a thing.

So the question is, wouldn't they rather have that money used for the funding for a guaranteed health benefit package? Because you have got half the people who are out there working full time—half the people who don't have health insurance are working full time, and they can't get into the insurance market. So you are taking this money and saying the priority that we think is appropriate is just hand it back to them. They can't buy what they really need.

Mr. HUTCHINSON. Let me just cite, first of all, the family of four, if I figure correctly, there is $1,000 available for them, not $500.

Mr. MCDERMOTT. OK. But that $1,000——

Mr. HUTCHINSON. What we are saying is that is $1,000 they ought to make the decisions about, not us. I think in the elections this past year, in my opinion, they spoke about what they wanted on tax relief. They made their will very clear on that. I think that——

Mr. MCDERMOTT. So you would be willing to offer that as an alternative?

Mr. HUTCHINSON. I don't think you need to offer that as an alternative. I don't think the American people see it in that kind of stark this-or-that terms. But I do——

Mr. MCDERMOTT. You are not selling the idea that you, for $1,000 for a family of four, could go out and buy a meaningful health care package?

Mr. HUTCHINSON. I don't think anybody's saying that. What we are saying is right now we are a taking the $1,000 and deciding how it will be spent.

Mr. MCDERMOTT. But these people are working full time and they can't get health insurance. So why take that money and just cut it out of the budget and give it to them in a way that they can't—they can't individually buy?

Mr. HUTCHINSON. Because they know better how to use this than we do, and whatever they do with that $1,000, whether they apply that toward their health care premiums or whether they decide they are going to use it in savings or some other way, that ought to be their decision and not ours.

Mr. MCDERMOTT. I would disagree with you. I think that we have a responsibility, when we are setting priorities, to deal with the problems that really face the American people, the debt on their kids, continued debt reduction, and providing health care benefits for all the middle class who work. Nobody in this country should work 40 hours a week, full time, and not have health care benefits. Nobody should be threatened by any kind of——

Chairman ARCHER. The gentleman's time has expired.

Mr. HANCOCK. Would the gentleman yield?

Chairman ARCHER. The gentleman's time has expired.

Senator GRAMS. I just wanted to quickly say that I held about 100 town meetings over the last 2 years during the campaign. Most meetings would start out by saying keep government out of my health care.

So I think by advocating that government can provide a better service—and I disagree that the government is smarter and should tax the dollars away and spend it in their best interest. I think it is not what most Americans agree with. If we are going to make mistakes, let us make them, rather than taxing that ability away from us.

Mr. MCDERMOTT. The cutting of Medicare to get this money is going to be a real problem for you folks.

Senator GRAMS. Nobody is advocating that. You are right, we have got to set a list of priorities. That includes everything on the table.

Chairman ARCHER. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. Senator, Representative Hutchinson, thank you very much for appearing before us today to shape the discussion here and offer your views. You have clearly played a very significant role in this debate.

Last year one of the things I found in my district was that working families were paying substantially more for the operations of the Federal Government than their parents had. This was a powerful issue in my district. What I discovered as I campaigned was there was a real demand for middle-class tax relief and tax equity. As a result, I adopted your proposal as one of the planks of my platform and found that it was extremely effective.

One of the things that I think we have touched on in this discussion, and I would like you to amplify in your testimony on, is the fact that the traditional mold for families was that there was one earner. What we have seen is a dramatic shift to two earners. Part of the equity argument here, I think, is that many things that were traditionally done in the household off the tax rolls will now have to be paid for out of a two earner's income.

As a result, there has been an artificial expansion in the tax base, working families are paying a lot more in taxes, but they are also paying for child care, they are also paying for other household activities, and they are taking a substantial tax bite on it.

As a result, I think this has made a significant contribution to the perceived problem, and I think it is a real one, that people are earning more in some respects but have a lower standard of living than the prior generation.

I was wondering if you could speak to the effect of your credit in your view on how this problem would be addressed through your proposal.

Senator GRAMS. I would just like to say that is why the tax cut or benefit has to be substantial and really make a difference. The $500 is a minimum that we would advocate. I think we go bipartisan, when you look across the aisle, and Senator Lloyd Bentsen a number of years ago had advocated a $1,000 per child tax credit.

When you look at numbers, and they could be debated, but 90 percent of the second income, to maintain a standard of living that we don't want to slip below or that a family has been used to, 90 percent of that second income has gone to pay the additional tax burden and the additional cost associated with that job, whether it is child care, transportation, or clothing.

So basically that second job has meant trying just to keep pace, to pay the burdens of the increasing taxes and associated costs. So

that is why if you have three children and a $1,500 credit, it might be very appealing to a couple to have the second wage earner stay at home, rather than going out for that second job. So it can make a big difference. It can make a big difference in the quality of life.

Mr. HUTCHINSON. I certainly agree. Every family ought to have the right to make the choice as to whether both parents are going to go into the marketplace and work. But they also ought to have the choice to have a single wage earning family. Most families today don't have that choice. They both have to go out and work. And for two children at $1,000, or three children at $1,500, with everything else that is impacted by what they pay in child care and additional taxes, that $1,000, $1,500, could be the difference between the mom being able to stay at home or the mom having to go out into the workplace.

Mr. ENGLISH. That has been my experience as well. I wanted to leave you with one last question, because I see our time is running low. In my own experience on the election trail last year, I found that this particular plan was criticized by some as tax cuts for the rich because of what is viewed as the comparatively high threshold.

My concern is that by phasing down that threshold there might be an increase in the work disincentives at an area of say $75 to over $1,000. Could you please comment on that and suggest a way around that?

Senator GRAMS. Well, again I agree because more than 90 percent of the credit goes to families making $60,000 a year or less. To say that there should be a cutoff, you are advocating then that those of higher incomes aren't taxed enough. I think all Americans are paying too much in taxes and all need some relief.

Mr. ENGLISH. So your proposal will improve the equity of the system?

Senator GRAMS. I think it will. It also provides the incentive. It doesn't penalize somebody for working harder and trying to earn more money than under some of the other proposals.

Mr. ENGLISH. Thank you, gentlemen.

Chairman ARCHER. The gentleman's time has expired. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. I just want to make a comment, I want to congratulate the gentleman from Minnesota in your election win. It is great to have you on the other side. Mr. Hutchinson, I want to thank you also for your work in this area.

I really feel that the last comments are really the basis of the importance, really get down to what you are doing is all about. I think about when I was growing up during the fifties, late forties, very early sixties, very few mothers worked at that time. I was blessed, my mother did not work, she was home taking care of myself and my three sisters. There was someone there when I left for school, there was someone there when I returned. I believe that there are so many, and I don't just believe, I hear it as I go out, as I campaign, as we have just finished an election, as the two of you have, as each of us have, there are so many mothers there who would like to be home just as my mother was. There are many who want to work and by choice they should be allowed that opportunity.

But the point again, getting down to the real basis and the real crux of why your legislation is so very important, I believe gets down to what we have just been talking about, allowing us an opportunity to go back to that point where we were during the fifties or early sixties in which at that time each personal—the value of each personal tax exemption was about 25 percent of their personal income.

Today it is only—or in the early eighties, it was only about 9 percent. Again, as you mentioned, that second income really is not for helping the family live better. It is for paying for the cost of government. What you are proposing certainly is not going to put us back to that point where the mother really has the choice again. It at least makes it a little bit easier for that mother to have the choice of whether or not she is going to work and be away from her children when they come home or whether she is going to be there or not.

So for that major reason, I thank you for what you are doing. I commend you. You certainly have my support. Thank you very much.

Senator GRAMS. Wally, I would just like to comment that I agree with you, because back at that time, 20, 30 years ago, if a woman decided to go to work, a lot of times it was to provide the washing machine that they wanted or maybe go on a family vacation, or something that they could add or a benefit to the family.

Today so many are forced into the workplace in order to try and maintain a standard of living that is being taken away from them through higher taxes. So again, it has taken some of those options away. I agree.

Mr. HERGER. Thank you.

Chairman ARCHER. Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman, and welcome to the witnesses. I am sorry I missed the beginning of your testimony. But I have had a chance to review it and the testimony of others who will follow.

I notice that Mr. Burtless, from the Brookings Institute, is concerned that your idea is good in the abstract, but it creates $100 billion deficit over the next 5 years. I am not hearing very great specificity, as to how you would tend to that. Mr. Burtless says it makes no sense to saddle future generations with heavier bills for interest on a larger Federal debt. There is a sound case, as you so eloquently make it, for tilting the income tax more in favor of families, especially those with limited incomes, but he goes on to say that tax relief for families with children only makes sense if it does not reduce the overall revenue collected under the personal income tax, not from other cuts, but under the personal income tax.

Then Mr. Zelenak from the University of North Carolina Law School is going to talk to us, and he is going to raise the issue that is of some interest to Mr. Crane and me, and that is the question of limiting this adjustment to only those with two children. Mr. Crane gets gypped by three-quarters, me by half.

Now perhaps there is a credit implied for birth control devices, which I would support, and training to get families to plan. Why did you determine that you should encourage smaller families, Mr. Hutchinson?

Mr. HUTCHINSON. I am not sure I understand—why did——

Mr. STARK. Why are you limiting this to only two children? You have something against big families?

Mr. HUTCHINSON. We don't limit it to two children.

Mr. STARK. Oh, yes you do.

Senator GRAMS. There is no place in our proposal that says only two children.

Mr. STARK. I believe that you will find that the credit disappears after two children. You are not in favor of that, huh? It should be for all children?

Mr. HUTCHINSON. I think, yes, it should.

Mr. STARK. Senator, would you agree?

Senator GRAMS. Yes.

Mr. STARK. All right. Now, you see, we have got some of the bipartisan changes here, Mr. Chairman. I agree, and I am sure Mr. Crane will introduce the amendment, as the most experienced father I think on the committee.

But getting back in a more serious note, the marriage penalty is something that has troubled us on this committee for a number of years. Quite frankly, it is like a teeter-totter. You aren't going to help one group of people even it out, you are going to penalize the other. You just can't—unless you spend an awful lot of money and cut taxes for everybody.

I wish that you wouldn't just kick it back to us. I wish you would come up with a way within the Tax Code so that we could keep everything nice and neat in this committee as to where we should raise a little more revenue to direct it to families. That would be of great help to us.

Senator.

Senator GRAMS. You are assuming then that you have to raise revenue to do this and implicating that you are going to have to make cuts. Let's leave that to the Budget Committee and not take so much on your job then because I don't think that the Federal Government has to continue to grow as fast as it has, and I don't think we need a Federal Government as large as it is today.

Mr. STARK. We need more defense you have told me.

Mr. GRAMS. We can use more defense, but that will be set on a list of priorities, and then the committees are going to have to make that decision. The defense will be on the table with everything else, but I think if we put defense in a list of priorities, the safety of my children and not having to send my sons or daughters to war is a high priority of mine as well.

Mr. STARK. Who are you worried about attacking us? Do you have news I don't have? Are you worried about anybody attacking us? You think Canada's going to come across Lake Superior?

Senator GRAMS. No, but I don't want to send my sons or daughter to the Persian Gulf or Bosnia if we don't have to.

Mr. STARK. Unless we go to three-fifths majority vote on that, that is not likely to happen.

Thank you.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman. Well, I was glad to hear your comments about $500 being a minimum, because I agree that this is just a good start. We certainly need to go further.

I would like to get your comments. I have read various studies that since the early fifties, late forties, if you compare the amount of money that people pay for staple items, milk, bread, the various things around, housing, cars, whatever it is, if you adjust that for inflation, people are actually paying around the same or maybe even a little less for most of the items that we use to determine what the standard of living is.

But when you take into account the amount of money that they are paying in taxes, that is the difference in their standard of living. We talk about the American standard of living, it should be much higher because technology, for instance, in farming allows costs to come down to the average American person, average American person when adjusted for inflation. So I would like your comments on how you think that we could go back to giving people more freedom, whether to work or not work as far as a two-parent family is concerned, and when we can adjust this tax credit for inflation.

Mr. HUTCHINSON. Well, I think—Mr. Ensign, I think you are right, that the reason that the middle-class American family's standard of living has stagnated is because of the growth of government and the burden, the taxation burden that has been placed upon the middle-class family.

I think that this is how the middle-class family under this legislation is being targeted for some kind of special benefit when, in fact, what we are doing is recognizing the disproportionate burden that they have shared over the years and that while the tax burden has increased, their personal tax exemption for their dependent children has not increased.

We are trying to do some catchup, and, as you said, the $500 is merely a first step toward that, but it begins to balance, level the playingfield some.

Senator GRAMS. It also could reduce their dependency on the Federal Government for programs. I mean maybe more young families could afford that first home without having to go to a government program if they had more disposable income. Maybe they wouldn't need school lunch subsidies if they were allowed to keep another $500 in their pocket where they could pay for their own child's lunches. So it would really—basically it is trying to reduce the dependency on the Federal Government and put more of the discretion back into the pockets of individuals.

Mr. HUTCHINSON. Fewer of them would need the student day programs if they could begin to set aside some tuition savings earlier when their children are young. So Rod's right, there are so many of these programs that we will lessen the demand and the utility of them if we will give more of the money for the American family.

Mr. ENSIGN. We hear, obviously this committee is also dealing with welfare reform, about illegitimacy in this country as being one of the biggest problems that we have; single-parent families have a very difficult time. Do you think that our tax system has led or at least helped with the breakdown of the American family?

Mr. HUTCHINSON. I don't think there is any doubt that our welfare system has a kind of insidious incentive built into it that encourages out-of-wedlock births and has contributed to, not the sole

cause obviously, but has contributed to the incredible explosion of out-of-wedlock births in our country. That the ending of the welfare system as an entitlement, the cutting off of cash benefits to moms with out-of-wedlock children——

Mr. ENSIGN. Obviously, it is much harder to have a successful marriage when both parents work. I don't think there is any question that the financial strains are much greater, the time away, it is just much more difficult.

It seems to me that the Tax Code has basically forced, in a two-parent family, both parents into the workplace. It should be their choice about which parent works or which parent stays home, but I don't think that we as a government should be forcing both parents into the workplace.

Senator GRAMS. I would say, Bob, it would be hard to debate how much it has been detrimental, but it would be very clear to say that it has not helped to promote family in any way.

Mr. HUTCHINSON. Excuse me, Rod. Marriage counselors say the No. 1 cause of divorces is financial pressures. There is no doubt our Tax Code, our antifamily Tax Code, has contributed to the kind of financial pressures that lead to family breakup.

Mr. ENSIGN. Thank you, Mr. Chairman.

Chairman ARCHER. Less there be any lingering question as to the provisions in the Contract relative to the per child credit, there is no limit as to the number of children who are eligible for this credit, nor should there be. Because of the cost——

Mr. STARK. Mr. Chairman.

Chairman ARCHER. The cost of——

Mr. STARK. At that point, he is quite right. It is the current credit that limits it, it is not this new credit and I misspoke.

Chairman ARCHER. The next gentleman for inquiry is Mr. Rangel. Mr. Kleczka.

Mr. KLECZKA. No questions.

Chairman ARCHER. Mr. McCrery is recognized to inquire.

Mr. MCCRERY. Thank you, Mr. Chairman. Thank you, gentlemen, for your excellent testimony.

One thing that continues to come up, though, that I am curious to hear your views on, is the question of why we extend this child tax credit to taxpayers making up to $200,000 a year. Let me first hear your views, and then I will respond with maybe some of mine.

Senator GRAMS. I will just go back again to quickly say this: They need tax relief, all Americans are overtaxed. When you are talking $200,000 a year incomes, you are talking less than 1 percent of the population. So you are talking a very small number compared to the vast majority, being 90-plus percent of this going to incomes of $60,000 or less.

So while that can be an argument, it might be thrown as a roadblock. If we are going to look for ways to obstruct this tax cut or this credit, there are going to be a lot of proliferous arguments to obstruct that type of movement. But I just think if you look at it in the context of all Americans can stand some tax relief, no matter what income, the majority of this has got to be focused on where it is going to do the most good and the majority is covered under this plan.

Mr. HUTCHINSON. We have all of these debates that go on about what middle class really is. I think we need to make this as broad as possible to ensure that the middle class, where there is no doubt that the vast—the overwhelming majority of this 90-plus percent will go to middle-class families under $60,000 per year.

We hear this class warfare thing that keeps coming up where we try to pit one class against another in our society. If anything, this ought to be broader, but certainly people, even though they may be making more money, they still have faced the same kind of increased costs in rearing children that lower middle-class families have faced.

Mr. MCCRERY. So you are suggesting that we take off the cap at $200—I mean just say you make $10 million a year?

Mr. HUTCHINSON. I suggest that we pass the Contract bill. The American people gave us a clear mandate to provide tax relief.

Mr. MCCRERY. Well, what is the purpose of the child tax credit?

Senator GRAMS. Well, just briefly, I think we can go over it real quickly again, but trying to emphasize the importance of families and to keep them together. Also, just the fact that Americans are overtaxed, but again, a decision may be able to be made where there is only one wage earner instead of two in the family, where one can spend more time, as Wally mentioned, was so important.

I grew up, too, where my mother was always in the home and it was great to come home smelling that baked bread or to know that she was going to be there, rather than going to a day care in the morning and being dropped off at a day care at night until my mother got off from work. So it is really I think to help rebuild some of the binds that have been cut because of the families being forced to have two wage earners or maybe a single mom having to have another part-time job, just to try to maintain some kind of a standard of living that we want for our families.

Mr. HUTCHINSON. I see the tax credit as a first step toward empowering American families in restoring their ability to make choices that have been eroded through the years because of the increased tax burden that they face.

Mr. MCCRERY. Well, I agree—you stated the purpose, and I am not sure that that purpose really fits the family making $200,000 a year or $150,000 a year. The purpose for the child tax credit is a very worthwhile purpose, and I understand that, and I am for it.

I am also for reducing the overall tax burden on all income earners, no matter what they make, because I think that is going to contribute to a more robust economy and a more protective economy. But I am just wondering if we ought not consider the purpose of the family tax credit, the child tax credit, and satisfy that purpose in the most efficient way, and then take what is left, if it is only $5 billion, I don't know what it is, I think it is 95 percent of the total revenue goes to families under $75,000, so we are not talking about a lot of money, but if it is only $5 billion, why not add that to the capital gains give-back? That is a more targeted tax credit, if you will, for productive investment to create jobs and so forth.

I am just thinking through this. I am not saying that I disagree with the $200,000 or the $150,000, but I think it is something we

ought to think about and think through before we actually put it in the Tax Code.

That is all I am saying and I appreciate your comments.

Senator GRAMS. Thank you.

Chairman ARCHER. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. I am appalled by the way this questioning has gone to you, gentlemen, because it is the same old routine we hear all the time. Let's take the money away from the individual taxpayer and bring it to Washington and spend it any way we want to.

I know one of our Members has said that no one Congressman can say that they would never be for a tax cut, but I will tell you, the administration is not for a tax cut. In fact Secretary Reich said that yesterday. I think that we have got to get the money back in the people's pockets, in the pockets of the citizens, and that will strengthen our families. I think that is what your proposal is all about.

Would you like to comment, Senator, or Representative?

Senator GRAMS. I agree with you, Sam. If you lined 100 families up in this room today and asked each one of them, would $500 a year make a difference to you or could you use that money in some way, whether it is even just to take the family out for a pizza once a month or something, I think you would hear a resounding yes, that it is going to make a difference. I think Mr. Reich should ask that question, not what is good for the Federal Government or how is it going to limit the Federal Government in spending as it wants to, but how is it really going to benefit the families, no matter how small a scale. This is not going to be the panacea or the answer to all of our problems, but it is a good first step.

Mr. JOHNSON. The other question that keeps coming up is that we know how to manage the money better than the people do. I don't think that is true, and the fact that we are going to create "a deficit." Nobody's talking about a deficit here.

We are talking about putting more money in every citizen's pockets, and we are talking about not increasing the increase at the same rate it has been going up in Federal spending and we then will balance the budget.

Go ahead, Tim, excuse me.

Mr. HUTCHINSON. Well, exactly right, Sam. I think the American people on November 8 rejected the notion that Washington, D.C., is the fount of all wisdom. The question in this legislation is whether or not Washington is going to continue to set the priorities for the American family or whether we are going to let mom and dad set the priorities for their own family.

Mr. JOHNSON. I tell you something I would like for you to think about that has been brought to my attention. Mrs. Dunn and I agree that if we get the families down to the point where you don't have to have both of them working to maintain a quality of living, that the parent who is not at work can get out and volunteer. Perhaps the volunteer force will improve our relationship with the poor and help the American economy overall.

Mr. HUTCHINSON. Well, this legislation already at least makes those kinds of choices a little more feasible than they are now.

Mr. JOHNSON. Thank you. I appreciate what you are both doing.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. I didn't intend to ask any questions of the panel, but based on some of the comments made to Congressman McCrery, I am compelled now to do so.

The panel indicates, and, gentlemen, you have indicated that you believe Americans are overtaxed and the tax relief proposal should be as broad as possible. Senator, you indicated that if we lined 100 families up in this room, that all of them would agree that we should have a tax cut akin to what you are proposing here. But know full well that if you had 100 families in this room, two-thirds of them under your proposal would get zero, since one-third of the families in this country have children and it is geared to only children.

Why not provide this relief to all families, whether or not they have children? How about the newly married couple who are trying to save a couple bucks for the downpayment on a home, and eventually planning a family? You can make the case that they are overtaxed also, but they get nothing.

I think of the proposal, as it stands now, wherein only one-third of the Americans will receive this tax benefit, is ill conceived, and the fact that it goes up to $200,000 and phased to $250,000, in my estimation, is a heck of a lot higher than middle income. I think this committee will have to look long and hard at making that more responsible and maybe use a $60,000 or $70,000 cap on that, versus your new definition of middle-American incomes, which is now $200,000 plus a year.

Senator GRAMS. Well, again, I would say to that young family, it might provide a tax credit for them in the future, because for most, and I am a grandfather of three, and I sure would like to see my son-in-law and my daughter have that tax credit so they could pay for things that they do, like right now, send their children to a private school. So that gives them that type of an opportunity. So overall, you can say one-third, I think it covers a broader base than that. Maybe not today, but tomorrow or the next day.

So again, why argue about tax cuts or how they are going to come about? Let's look and focus on the goal of reducing the tax burden.

Mr. KLECZKA. Well, then let's do it for all, let's be fair and do it for all Americans and not for only a select few, and especially those $250,000 wage earners in this country.

Mr. HUTCHINSON. If I might add, I think there is a misimpression. In 1948 our government said that we want to recognize that there is a cost, an expense that goes with rearing children. Because our government said we want to be profamily, we want to be on the side of families with children, they granted an exemption, a deduction for those children.

Mr. KLECZKA. Which is current tax policy.

Mr. HUTCHINSON. But we have not kept pace at all. If we had, it would be over $8,000 instead of a little over $2,000. So while costs have gone up, the burden has gone up, the squeeze has gone up, the tax burden has increased enormously. We have said your children aren't worth as much as they were a generation ago. That is what—we are playing catchup. This isn't some kind of special

break for families with children. It is saying we need to again recognize what we recognized in the forties.

Mr. KLECZKA. But if you are sincere in what you say that all Americans should share in this tax relief, then make sure all Americans do. Your proposal, my friends, does not.

Thank you very much.

Mr. GRAMS. Well, this could only be part of one. There are other means here that you can put into practice as well in addition to this. Is this the only tax cut on the table? I don't think so.

Mr. KLECZKA. Well, for those same families you are talking about, your capital gains proposal surely won't touch them to any great degree. So it is sort of slanted.

Chairman ARCHER. Has the gentleman completed his inquiry?

Mr. KLECZKA. Yes, sir.

Chairman ARCHER. Mr. Christensen.

Mr. CHRISTENSEN. Morning. My hats are off to you for introducing this legislation because I truly believe it is needed. I agree with my colleague earlier who said we are giving money back to responsible, hard-working middle Americans, versus letting more irresponsible bureaucrats spend it. I find it hard how some people this morning have stated that we are pandering to the six-pack crowd, when in fact, it is rightfully their money and not the government's. I would like to know where your proposal differs from the Clinton administration's proposal, and does it help families more?

Senator GRAMS. Well, basically it doesn't have an age cap on children or the number of children. It is, I think, a better proposal across the board because it does provide more dollars in tax relief for middle-class families. About $25 billion a year compared to somewhere around $10 or $12 billion a year.

So if we have got to set goals, let's try. These are the contracts that we made with Americans. This is what Americans made a loud and clear decision about in November. To break that or to come tinkering with something that looks like a tax cut but offers no real tax relief or will not make the difference that it should, I think that is breaking the Contract.

Mr. HUTCHINSON. John, I would add that not only does the Clinton plan cut it off at age 13 for the children, but the $300, if I understand correctly, they are recommending a $300 credit, is below what every study dealing with the family has recommended, whether it was the Rockefeller Commission, whether it was the Family Research Council, or whether it was the Bentsen proposal or the Clinton proposal during his campaign in which he advocated a $3,500 tax credit, that to drop below that $500 credit, you really make it less than meaningful.

Mr. CHRISTENSEN. As I understand it, the Clinton administration considers a family consisting of a $40,000 bricklayer and say a $35,000 public schoolteacher, a rich family. Is that correct?

Mr. HUTCHINSON. The cutoff is much, much lower, you are exactly right. So it would impact far fewer families.

Mr. CHRISTENSEN. Your proposal would not consider that family rich, but more middle income?

Mr. HUTCHINSON. Exactly.

Mr. CHRISTENSEN. Thank you.

Chairman ARCHER. Gentlemen, thank you for spending the time with us this morning and giving us excellent input by your testimony and responses to the questions. We are very grateful to you.

Mr. HUTCHINSON. Thank you, Mr. Chairman.

Senator GRAMS. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you. The committee will stand in recess for 5 minutes until the next panel is seated at the witness table.

[Recess.]

Chairman ARCHER. Will our next panel of witnesses please take their seats at the witness table. This panel was supposed to have four witnesses. Dr. Besharov unfortunately could not stay, and we did not anticipate the length of inquiry for the previous panel. So without objection, Dr. Besharov's statement will be inserted in the record at this point.

[The prepared statement and attachment follow:]

American Enterprise Institute for Public Policy Research

AEI

DOUGLAS J. BESHAROV

STATEMENT BEFORE

WAYS AND MEANS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

January 17, 1995

Mr. Archer, members of the committee, it is my great pleasure to come before you today to discuss the important topic of tax relief for families with children.

My name is Douglas Besharov. I am a resident scholar at the American Enterprise Institute for Public Policy Research where I conduct research on issues concerning children and families. I am also a visiting professor at the University of Maryland School of Public Affairs where I teach courses on family policy, welfare reform, and the implementation of social policy.

There are other people here who have much more technical expertise on this matter. Therefore, in the time I have, rather than discuss the technical details of your proposal, I will address the conceptual issues surrounding it.

Over the last 30 years, a greater portion of the federal payroll and income taxes has been shifted to (1) low- and moderate-income workers and (2) families with children. As you know, one of the main reasons for this shift has been the decline in the relative value of the personal exemption. Gene Steuerle, who is also on this panel, has provided some of the best analysis of this issue. Rather than steal his thunder--and his data--I will let him detail this 30-year decline.

As I described in the attached article from the Wall Street Journal,[1] this greater tax burden on lower-income workers and families puts added financial stress on them--and creates more pressure in two-parent households for both parents to work.

Some experts justify this shift in tax burden on the basis that low- and moderate-income families now receive additional benefits from the federal government. But why do we need to take money from families in order to give it back to them? Although many reasons are offered for why we do so, when you get right down to it, the answer is simple: social engineering.

Taking money from families (or all taxpayers, for that matter) and giving it back to them in the form of categorical assistance is a way of controlling their spending decisions. So, for example, when tax funds are used to provide student loans to middle-class families, we are taking money from

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[1]Douglas J. Besharov and John C. Weicher, "Return the Family to 1954," Wall Street Journal, July 8, 1985, Op Ed page.

one pocket and putting it into another--because we do not think that parents can (or will) save the money themselves.

This kind of forced saving, or inter-temporal redistribution of wealth, sometimes makes good policy sense. But we do it far more than we should.

In fact, the process can easily get out of hand, and can hook Americans on a never-ending upward spiral of tax increases to pay for programs designed to relieve the very burdens created by those taxes.

Lest you think I exaggerate, let me remind you of what almost happened two years ago with the original Clinton proposal to expand the Earned Income Tax Credit (EITC). If you remember, the administration proposed providing a welfare-like "benefit" to families earning almost $30,000--even as we tax the same families to help pay for the benefit. The administration quickly withdrew this proposal, although I must add that the current EITC has many problems that should be addressed.

So, I am a strong supporter of the kind of tax relief that you have proposed because--besides aiding families--it comes with no strings. It empowers families to decide how best to use their own money.

That, by the way, is why I would be concerned about the president's proposed tax deduction for college and other post-secondary tuition. As the parent of a child about to enter college and another about to enter graduate school, I suppose that I have a real interest in seeing his proposal become law--and soon.

But his proposal has many technical drawbacks which others have cited. For example, it is regressive and will likely result in higher tuition charges. More importantly for me, it is a form of social engineering that tries to control how families allocate their own resources.

Some experts object to your proposal because, even assuming deficit neutrality (which I take to be an economic and political necessity), they think any tax cut should go to reducing marginal tax rates. I, too, believe that lower marginal tax rates could be an engine for great economic good. Nevertheless, I think that you can pursue both goals--given the beating that low- and moderate-income families have taken in the last three decades.

Before closing, I would like to make three subsidiary points. First, given the current tax structure, I think that budgetary prudence and political sensibility argue for a cap or phaseout of the credit. I leave to you the decision of where to draw the line, but I would note that many families earning $100,000 are comprised of two hard working parents each making the less grand sum of $50,000. They do not feel rich at all. Instead, they feel stretched in time and finances.

Actually, again given the current tax structure, you might consider phasing out the credit at the same rate as the personal exemption. This is not a perfect solution but it at least avoids creating yet another phase out rate--and utilizes a politically acceptable precedent.

By the way, the tax distribution tables have always been the enemy of thoughtful decisions about where such credits and other tax provisions should be phased out. I recommend that you present the distributional effects of the credit on a per capita basis or by family size.

Second, if you have the money, I hope that you will not limit the credit to younger children. Children do not suddenly become less expensive after age thirteen, although there is a difference in costs between children who require day care and those who are old enough to be left alone. Your objective should be to return decision-making to families.

Third, I do not think that you should not make the credit refundable to families with no income tax liability. Such families are in great need, but, as I mentioned, there are enough worries about the operation of the EITC to pause before creating even greater reason to file false claims while also further distorting work incentives.

I hope that you will start thinking about the long-term problem of marginal tax rates for workers and families near the poverty line, which Gene Steuerle has studied extensively. But this is a complex problem involving the interaction of a number of tax and welfare programs.

Finally, even though I am an amateur in these things, I would like to make one more political point: There will likely be great opposition to the cuts that you plan to make in the funding of various programs--many of which provide benefits to lower- and moderate-income families. I hope that, as you propose these cuts, you show their connection to the tax credit that you have also proposed. For, as I have tried to describe, they really are two sides of the same reform agenda. If you succeed, more of the money that now goes from one pocket to the other will stay where it belongs--with America's families, who will use their own good judgement about how to spend it.

Thank you.

Return the Family to 1954

By Douglas J. Besharov
And John C. Weicher

President Reagan proudly describes his tax-reform proposal as "pro-family." And the substantial tax relief for families with dependent children that it would provide has gained wide support. But there is another "pro-family" element of his proposal: It would reduce the present tax benefit to mothers in middle-income families who decide to work. Advocates for working mothers have mounted a campaign against this aspect of the plan, and the administration is reconsidering it. The administration was on the right track in the first place; the plan need not be changed.

First, the noncontroversial part. By almost doubling the personal exemption from $1,080 to $2,000 and by raising the Zero Bracket Amount (the minimum standard deduction) for married parents from $3,670 to $4,000, the president's proposal lowers the tax rate for all families with children. Families at or below the poverty line, about $12,000, would pay no taxes. Under present law, a typical family of four at the poverty line pays about $450 in taxes.

Exempt From Income Tax

Half of all of poor families are headed by single parents, whether widowed, divorced, or unwed. By raising the minimum standard deduction for heads of households from $2,480 to $3,600, the proposal also exempts these families from the income tax. When it comes to child care, the proposal makes no attempt to legislate morality.

The president's proposal would reverse an almost continuous postwar increase of the tax burden on middle-income families with children, caused by the failure to index the personal exemption and the standard deduction. At the end of the war, the $500 personal exemption was the equivalent of $3,000 in today's dollars. It was increased to $600 in 1947, then left unchanged for the next 20 years. By 1967, its value had eroded to about $2,000 in today's dollars. Over the next few years, it remained roughly constant, as Congress periodically raised it about enough to offset continuing inflation. But since 1973, its value has fallen steadily. The 1980 increase to $1,000 ($1,300 in today's dollars) did not offset the high inflation of the late '70s, and the 1981 tax cut did not increase the exemption, so that its real value declined still further. Right now, it is as low as it has ever been.

As a result, there has been a major shift of the tax burden onto families with children. According to an American Enterprise Institute study, over the last 30 years, the average effective tax rate on middle-income married couples with two children nearly tripled, while that for single people and married couples without children increased only by one-sixth.

Over the last 30 years, the average effective tax rate on middle-income married couples with two children nearly tripled, while that for single people and married couples without children increased only by a sixth.

Thus, the president's proposal would return families to the position they enjoyed until the ravages of inflation devalued the personal exemption. In 1954, typical married couples with two children paid about 4% of their income in taxes. By 1980, they paid 14%. Under the president's plan, assuming average deductions and both spouses taking full advantage of the IRA deduction, their tax rate in 1986 would again be about 4%.

The redistributive effects of the tax plan have won support across the political spectrum. For example, Marian Wright Edelman, president of the Children's Defense Fund, described them as "a giant step toward providing poor working families with children desperately needed federal tax relief."

The proposed tax treatment of a working mother's earnings is another matter. By reducing overall tax rates and by raising the personal exemption, the president's proposal would lower the tax on the prime earner's income, usually the husband's, whether or not the other spouse works. On the other hand, by repealing the "marriage penalty" deduction (the 10% deduction for the second earner's income), by changing the child-care credit to a deduction, and by allowing a *full* IRA deduction for non-working spouses, the proposal in effect raises the tax on the wife's income.

In upper-income families, the overall reduction in tax rates is large enough to offset this effect, so that their tax rate declines. But for families with incomes between $20,000 and $35,000, with the wife earning from $5,000 and $10,000, the tax on her earnings would rise by between $100 and $500, and her take-home pay would decline by between 2% and 20%, depending on the deductions taken.

Consider one "typical" middle-income family: both spouses working, two children, a combined income of $27,500, with the husband earning 70% of the total and the wife the rest. Under current law, if this family takes full advantage of the IRA deduction and receives the maximum child-care credit, they pay no income tax on the wife's earnings. Her net income, after subtracting her Social Security tax and child-care expenses, is around $2,900 for the year. Under the president's proposal, there would be a $550 tax on her earnings, and her net income would be reduced to around $2,350.

These are extreme assumptions. But even if the family claims the average child-care credit and takes no spousal IRA at all, taxes on the wife's income would still go up, from about $950 to $1,025, and her take-home pay would fall from about $5,300 to $5,200. For many middle-income married mothers, then, the proposal reduces the financial rewards of working.

There are two ways to view this aspect of the president's tax proposal. Its opponents see it as a new penalty on working mothers, designed to encourage them to stay home and care for their children. As evidence, they point to the president's emphasis on "traditional family values" and the New Right's intensive lobbying in favor of this aspect of the plan.

The work-force participation of middle-income mothers would undoubtedly decline under the president's plan. Research has shown, not surprisingly, that wives' decisions about working are affected by the net wages they earn. Estimates of the wage elasticity vary. A reasonable estimate is that for every 1% reduction in after-tax earnings, they would reduce hours of work by the same percentage. Thus, the president's tax plan could reduce the amount of time a middle-income married mother works by up to 20%, depending on the deductions taken by the family. In some families, the effect would be enough to cause the mother to stay at home, rather than work at all.

As It Should Be

It is more accurate, however, to view the proposal as remedial. Between 1975 and 1981, responding to widespread recognition that marginal tax rates on working wives were too high—in 1975, a typical wife was in the 20% bracket—their tax rates were progressively lowered. However, many would be surprised how far this much-needed reform was taken. Remember that in our hypothetical, extreme case, there was no income tax on the wife's earnings. The proposal would raise her tax rate from 0% to 7%. For the family claiming the average child-care credit and no spousal IRA, the wife's tax rate merely rises from 11% to 12%.

By fairly taxing a mother's earnings, the president's proposal more nearly neutralizes the tax code's impact on her decision about entering the work force. This is as it should be. A mother's working should be a personal choice, not affected by tax incentives.

Mr. Besharov is an adjunct scholar at the American Enterprise Institute, where Mr. Weicher holds the Weyerhaeuser chair in public policy research.

Chairman ARCHER. We are pleased to have the other three of you here this morning. You are well known to this committee and well known to many people in this country. We would like to recognize you for your input on this part of the Contract With America.

We would like to start off with Dr. Steuerle, please, if you will.

STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, URBAN INSTITUTE

Mr. STEUERLE. Mr. Chairman and members of the committee, providing a credit for children is at its heart an issue of how the tax system should be adjusted for family size, and how to treat individuals who move beyond welfare by working or marrying someone with income.

In that regard, the simple notion of providing tax relief to the middle class by itself is not adequate to tell us how to provide such relief. For example, the case for relief for a family with children is compromised substantially if increased debt burdens are left to those children to pay off in the future.

Fortunately, as I understand it, almost everyone is committed to ensuring that deficits do not rise and that debt does not increase. Given that commitment toward a more fiscally responsible budget, I would like to outline to you the primary cases for a credit.

The first case is restoring the value of the dependent exemption. If the dependent exemption had been adjusted since 1948 to grow at the same rate as income per person, today it would be about $9,600 per person, and next year, in excess of $10,000, rather than the $2,500 being provided in the Tax Code today.

The value of a dependent exemption in excess of $9,600—that is the value if converted to a credit—would also be in excess of $1,500 per child. Far from being radical, therefore, proposals being considered today do not even come close to restoring the types of adjustments that used to be made for the presence of children.

The income tax is meant to adjust for the ability to pay of households. Ability to pay, in turn, is affected by the size of the household. An adjustment for dependents can be made either through credits or exemptions. If this year's dependent exemption of $2,500 were adequate, then in theory it would imply that a couple with two dependents and $50,000 of income, that is with $12,500 per person, had the same ability to pay taxes of the family with half as many members, that is a couple with no dependents and $45,000 of income.

Now, it doesn't take much reflection to realize that most families are required to spend more than $2,500 per year on the food, clothing, housing, education, insurance, and health care of their children.

In this regard, Mr. Chairman, I hope the committee will give special attention to the presentation of distributional tables on tax burdens. These tables can be very misleading unless adjusted for family size. There is substantial evidence that the failure to make family size adjustments in the design of itemized deduction phaseouts, the earned income tax credit, and many other tax items and phaseouts, are driven in part by distributional tables that often do not adjust for family size. A great many decisions made by this Congress will depend significantly upon whether a family of four

with $50,000 of income is compared with a household of one with $50,000 of income, with the household with per capita income of $12,500, or something in between.

The second major reason for favoring a credit for children is that as long as we live in a society that is going to provide some minimum amount of well-being to children, we must worry about the pernicious signals, "don't work, don't marry," that apply especially to low-income individuals who have the potential to move beyond welfare.

This is a structural issue that cannot be avoided. It is not an issue of liberal or conservative leanings. Many lower and moderate income individuals who move beyond welfare find that their family income goes up by $1 due to work, but then they must return 70, 80 cents or more to the government in direct taxes and reduced benefits.

In many cases, especially where account is made for transportation and child care, people who work are actually made poorer as a consequence of working. For almost all welfare situations, marriage causes them to be significantly poorer, and marriage causes their combined income to fall by almost 20 percent or more.

Finally, Mr. Chairman, there are two other issues that I hope this committee will consider in the process of adopting a credit for children. First, adjustments for the presence of children are appropriate at all income levels and need not reduce the progressivity of the income tax. Second, a child credit might be integrated more fully with efforts made at welfare and health reform. I hope that the committee will consider what they do in the welfare and health areas at the same time that they consider many of these adjustments for families and children.

Thank you.

Chairman ARCHER. I should have mentioned earlier that we do appreciate your holding your verbal testimony to 5 minutes, but should you have a longer written statement, without objection, that would be inserted in the record. Further, Dr. Steuerle, I should have told the members of the committee that you are with the Urban Institute where you are a senior fellow and we are particularly delighted to have your institute represented.

Mr. STEUERLE. Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

TESTIMONY OF C. EUGENE STEUERLE, SENIOR FELLOW THE URBAN INSTITUTE

Mr. Chairman and Members of the Committee:

Providing a credit for children is at its heart an issue of how the tax system should be adjusted to account for family size, and how to treat individuals who move beyond welfare by working or marrying someone with income. As you may know, my research on the decline in the value of the personal exemption and the taxation of the family was used by President Reagan to support a doubling of the personal exemption in the mid-1980s, by the National Commission on Children to support a child credit in 1991, and by proponents in both the Congress and the Executive Branch to support a child credit today. As a father of some of these bipartisan efforts, therefore, I would like to take the liberty of urging that close attention be paid to the principles that underlie the case for a child credit.

The simple notion of providing tax relief to the middle class, by itself, is not adequate to tell us how to provide this relief. Since most government activity can be seen as payments from the middle class to the middle class, that class can receive more expenditures over time only if it eventually pays for them, and it can reduce its taxes only if it cuts the expenditures it receives. Thus, the case for relief for a family with children is compromised substantially if increased debt burdens are left to those children to pay off in the future. Fortunately, almost everyone is committed to insuring that deficits do not rise.

Given a commitment toward a more fiscally responsible budget, my testimony outlines two primary cases for a credit. First, much of tax policy is concerned with the allocation of the tax burden rather than its total level -- the slicing of the pie, not merely its size. A strong case can be made that the current system adjusts inadequately for the presence of children and that households with children pay substantially higher taxes than other families with equal ability to pay. Even a credit of $1,500 would be insufficient to restore the relative value of the dependent exemption provided in 1948. Second, a credit for children provides one way to attack the extraordinarily perverse incentives of our combined welfare and tax systems. For individuals on welfare, the return to work is often close to zero, while couples typically will find their combined income fall by 20 percent or more simply for taking a marriage vow.

Restoring the Value of the Dependent Exemption

If the dependent exemption in the income tax had been adjusted since 1948 to grow at the same rate as income per person, today it would be about $9,657 rather than $2,500 (Figure 1). The value of a $9,657 dependent exemption -- that is, its value if converted to a credit -- would be worth about $1,642 per child (Figure 2). Far from being radical, therefore, proposals being considered today do not even come close to restoring the types of adjustments that used to be made for the presence of children.

The income tax is meant to adjust for the ability to pay of households. Ability to pay, in turn, is affected by the size of the household. An adjustment for dependents can be made either through credits or, as at present, through exemptions. If this year's dependent exemption of $2,500 were adequate, then in theory it would imply that a couple with two dependents and $50,000 of income ($12,500 per person) has the same ability to pay tax as a family with half as many members -- that is, a couple with no dependents -- and $45,000 of income. After all, the current tax Code charges them the same amount of taxes.

It doesn't take much reflection to realize that most families are required to spend more than $2,500 per year on the food, clothing, housing, education, insurance, and health care of their children. On a per person basis, the current tax Code implies that the family in the example with $22,500 per person is not any better off than the family with $12,500 of income per person.

The argument here is not that the government should cover the normal costs of raising children, only that the tax burden be adjusted to take some of these costs into account. The goal in the income tax is primarily to measure ability to pay tax according to family size and then to tax equally those who have equal ability. All tax systems explicitly or implicitly must decide how

to treat different size families and how to vary that treatment according to the presence of spouses and dependents.

Note, in this regard, that the presentation of distributional tables on tax burdens and tax changes can be very misleading unless adjusted for family size. There is substantial evidence that the failure to make family size adjustments in the design of itemized deduction phase-outs, the earned income tax credit, and other tax items and phase outs are driven in part by distributional tables that do not adjust for family size. A great many decisions made by this Congress will depend significantly upon whether a family of four with $50,000 of income is compared with a household of one with $50,000 of income, with a household with per capita income of $12,500, or something in between.

The relative decline in the value of the dependent exemption over the past few decades led to a significant expansion of the personal income tax base, at least relative to income in the economy. A large expansion in the use of credits, deductions, and exclusions also occurred over the same time, leading to a reduction in the tax base. These historical changes, however, did not apply equally to all types of taxpayers. They increased substantially the share of the tax burden for households with dependents. Meanwhile the share of the tax burden declined for others, in particular, those would could make use of other tax breaks.

A primary reason for providing a child credit or allowance, therefore, is simply that it would be a means of adjusting for ability to pay by family size -- a principle of equity that has been ignored for some time now.

Reducing Welfare's Penalties on Work and Marriage

As long as we live in a society that is going to provide some minimum amount of well-being to children, we must worry about pernicious signals and incentives -- Don't Work! Don't Marry! -- that apply especially to those low-income persons who have the potential to move beyond welfare. This is a structural issue that cannot be avoided; it is *not* an issue of liberal or conservative leanings.

Under current law, many benefits are provided for children through welfare or welfare-like payments. To help pay for these benefits, they are phased out at very high rates of implicit tax on additional income of the family. Many lower- and moderate-income individuals find that if their family income goes up by $1.00 due to work, they must return 70 cents, 80 cents, or more to the government in direct taxes or reduced benefits (Figure 3). In many cases, especially when account is made for costs of transportation or child care, people who work are actually made poorer as a consequence of working.

For almost all welfare recipients, marriage will cause them to be significantly poorer. Marriage will typically cause the combined income of a couple to fall by 20 percent or more (Figure 4). Thus, a couple who marry must simultaneously decide to force their children to live a much poorer life. By the same token, divorce of many middle-income couples would increase their combined income substantially under current law.

A child credit need not increase the payments made to those already on welfare. Nor would it eliminate their participation in the welfare system. The approach mainly provides a mechanism to reduce from confiscatory levels the combined tax rates for low-, moderate-, and middle-income individuals who decide to work or marry.

The perverse nature of incentives in the current system weakens our ability to work together as a society. Many welfare recipients, for instance, work part-time for low amounts in an "informal" sector where wages are not recorded or reported to the government. Many others live in informal relationships and share households in ways that avoid formal marriage

commitments. Still others combine their resources in ways common to any family. In a backhanded way, some of this behavior contains social benefits; at least it involves cooperative, productive, and community-sharing efforts. When it is made to violate the tax and welfare laws, however, it breeds discontent for the law and restricts individuals from engaging in more formal personal relationships where commitment is recognized through marriage and work contracts.

A More Systematic Approach

Here I would like to suggest three further issues for your consideration. First, a credit provides a reasonable way of adjusting lifetime tax burdens according to ability to pay over a lifetime. Second, adjustments for the presence of children are appropriate at all income levels and need not reduce the progressivity of the income tax. Third, the child credit might be integrated more fully with other efforts at welfare and health reform. In that regard, attention needs to be given to those low-income individuals who are not on welfare and would receive neither welfare nor tax benefits for a child. With respect to health reform and reducing the number of those without health insurance, we ought to consider whether child credits and other family-type allowances should be paid to middle- and upper-income families who do not buy health insurance for their families.

Adjusting Taxes for Lifetime Circumstance. In some ways, the goal of a child allowance is merely to adjust taxes and expenditures according to the lifetime circumstances of individuals. The child-rearing years are normally among the poorer years that individuals face over their lives. A child is usually born during the parents' earlier years in the workforce -- before they have acquired seniority and much of the human capital that comes with work experience. For couples, of course, child-rearing either requires significant outlays for child care or a decline in personal income. For single heads-of-household with only one adult to handle both child care and work in the marketplace, the cost of rearing children may be even higher relative to total income in the household. Whatever the reasons, recent statistics demonstrate that children are now the poorest group in the population mainly because of their prevalence in younger households with lower wages. By the time that children are gone from the household, on the other hand, other economic circumstances usually have improved. Wages tend to be higher. In addition, assets are usually greater and debt lower: substantial equity may exist in a house and a car or two.

The provision of a child credit or allowance, therefore, simply attunes the tax system more to the life cycle circumstances of most households. When income is lower and the costs of child care higher, the tax system would provide a modest reduction in tax. In later years, when the household is usually better off, taxes would be higher because of the absence of such an adjustment.

Family-Size Adjustments and Levels of Income. If there is to be a child credit, some argue, it should be phased out as families move into middle- or upper-income status. At fairly high income levels, this philosophy is reflected slightly in current law through a phase-out of the dependent exemption. Family-size adjustments, however, are appropriate at all income levels since children reduce the average income within the household, lessen average consumption levels, and leave less discretionary income out of which taxes can be paid. A closely associated mistake is to believe that child allowances shouldn't go to middle-income or high-income persons because somehow this would reduce progressivity. This is incorrect.

Suppose, for instance, that society believes that two families with $50,000 of income each (or $100,000 in total) should together pay total taxes, after child allowances, of $20,000. Suppose additionally that one family has two children and the other none. A choice still remains: society can decide that taxes, less child allowances, should be $10,000 each or $9,000 for the family without children and $11,000 for the family with children. In either case, child allowances have no effect on the total tax burden paid by those with $50,000 of income. The child allowance simply recognizes that costs of raising children is one source of differentiation in the needs and

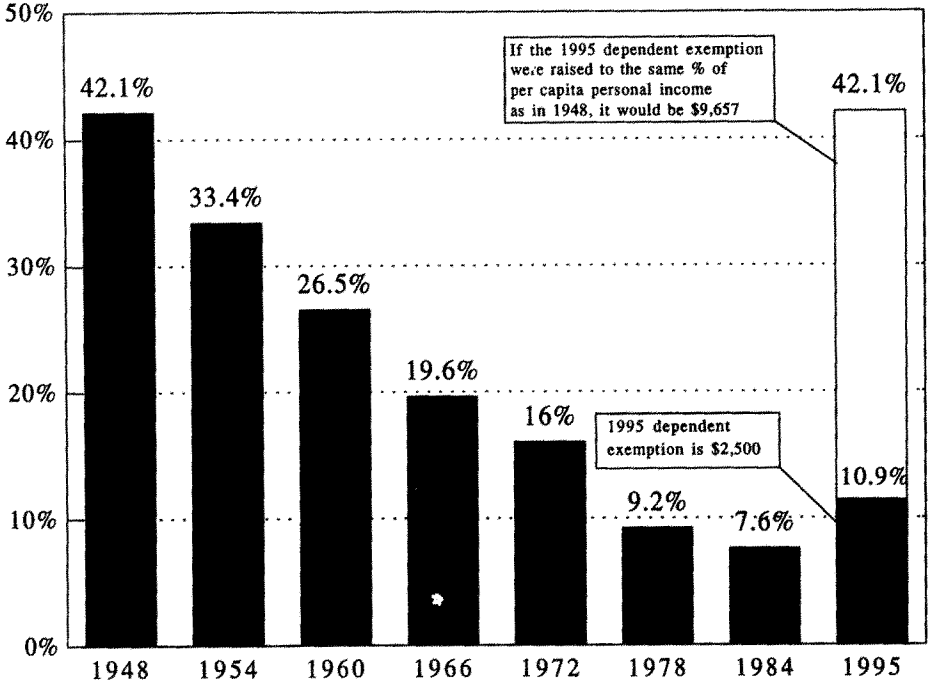
abilities of all households. Indeed, a strong case can be made that treating the two families with $50,000 of income the same is quite inappropriate. It is equivalent to treating children as nonentities or consumption goods of adults rather than living members of the community.

Relationships Among Tax, Welfare, and Health Policy. Finally, over time I hope that this Committee will give some consideration to seeing how child credits integrate with the welfare system and with the health system. Some early attention to these issues could reap some large dividends when these later reforms are considered.

Let me start with the welfare issue. If a non-refundable tax credit is provided through the tax system, and welfare payments are provided through welfare, then one important group is left out of the calculation -- those low-income individuals who neither receive welfare nor pay enough tax to receive the credit. Indirectly the earned income tax credit might be argued to fill this gap somewhat, but there remain some administrative problems with that credit that have not been resolved. An integrated view of welfare, child credits, and earned income tax credits might help us to set up a structure that both reduced some of the perverse incentives of current law and dealt more equitably with this group of low-income individuals not on welfare.

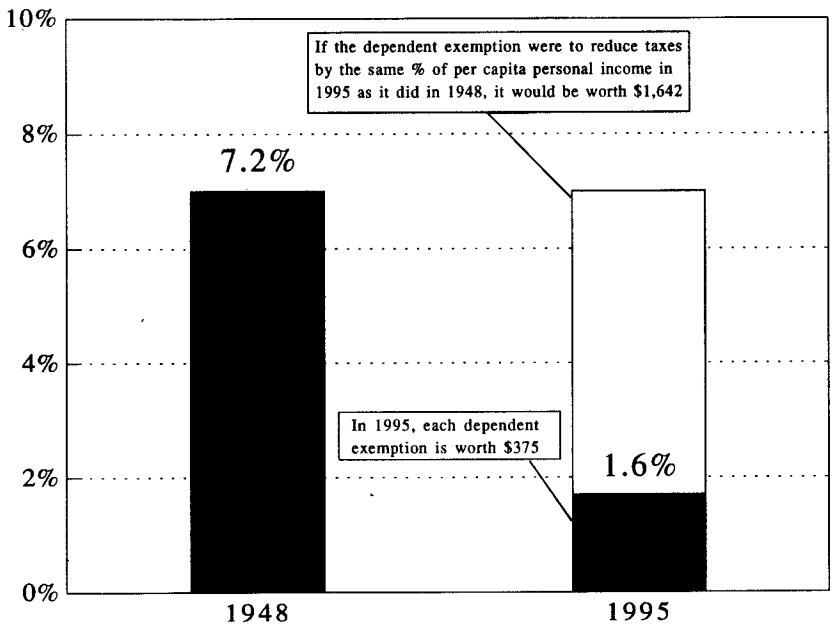
With respect to health reform, last year there was considerable attention given to ways that individuals might be induced to purchase health care -- as opposed to putting mandates on employers. Although a modest step, I suggested that middle- and higher-income households might be denied some tax benefits or made to pay a modest penalty if they did not buy some form of health insurance for their families. In the context of a child credit, some consideration might be made to limiting the availability of the child credit -- or other exemptions -- for middle- and higher-income taxpayers who do not purchase insurance for their children.

Figure 1: Dependent Exemption as a Percent of Per Capita Personal Income, 1948-1995



SOURCE: Eugene Steuerle and Gordon Mermin, The Urban Institute

Figure 2: Amount of Tax Reduction Provided by Each Dependent Exemption, as a Percent of Per Capita Personal Income 1948 & 1995 *

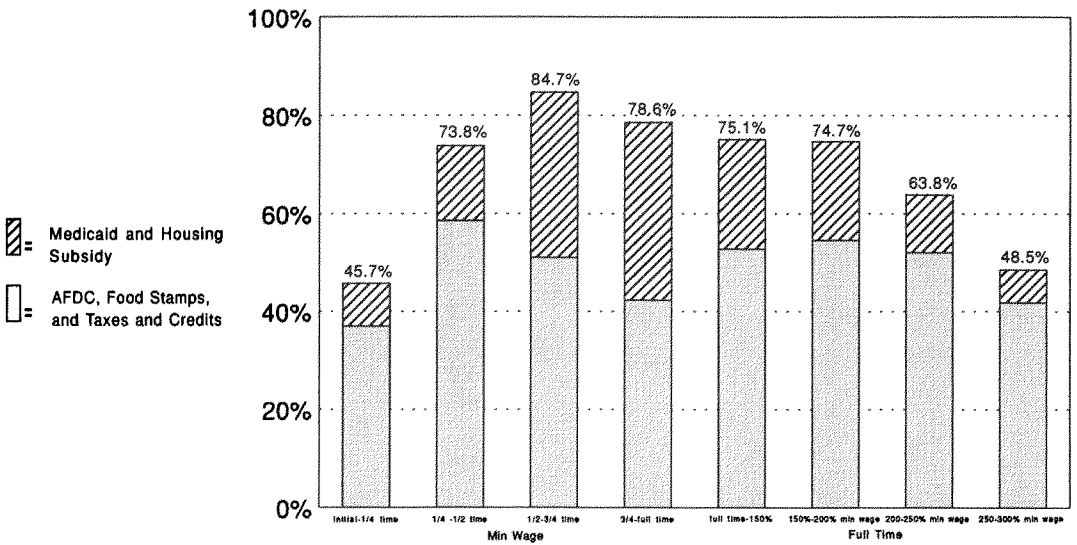


* Minimum amount of tax reduction for those with positive tax liability, i.e., the value of each dependent exemption at the lowest positive tax rate (15% in 1995).

Source: Eugene Steuerle and Gordon Merminn, The Urban Institute

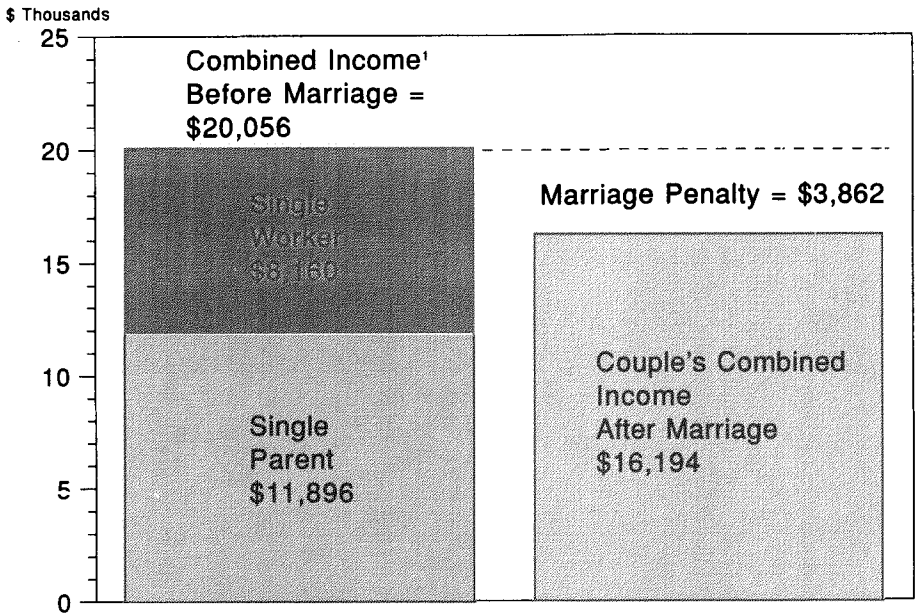
Figure 3: Incremental Tax Rate on Additional Earnings

Sample: All AFDC Households
(Without Work Expenses)



Bars show the proportion of increased earnings that would be lost due to taxes and changes in benefits from the indicated programs over the long-term under 1996 EITC rules. Sample weighted by (household weight) * (change in earnings).
Source: Linda Giannarelli and C. Eugene Steuerle, The Urban Institute.

Figure 4: Marriage Penalty for a Single Parent on Welfare with Two Children Who Marries a Minimum Wage Worker



[1]Income = after tax earnings + welfare benefits.

Source: C. Eugene Steuerle and Gordon Mermin, The Urban Institute

Chairman ARCHER. Our next witness is Professor Zelenak, with the University of North Carolina School of Law. We would be pleased to hear your testimony.

STATEMENT OF LAWRENCE A. ZELENAK, J.D., PROFESSOR, UNIVERSITY OF NORTH CAROLINA SCHOOL OF LAW

Mr. ZELENAK. Thank you, Mr. Chairman, members of the committee. In evaluating the child tax credit proposal in the Contract With America, there are two key questions. First, does the income tax currently make adequate adjustments for differences in family size? Second, if it does not, should an additional adjustment take the form of an increase in the amount of the dependency exemption, or a child tax credit added to the current exemption?

The theory behind the dependency exemption is that ability to pay tax comes only from income above subsistence, sometimes referred to as clear income, and that the cost of subsistence is a function of family size. Thus, the dependency exemption, if it accurately reflects the cost of supporting a child at subsistence, properly adjusts income subject to tax for differences in family size.

If, for example, the subsistence cost of a child is $2,500, then a childless couple with $50,000 income has the same clear income and the same ability to pay tax as a two-child couple with $55,000 income. There is near-universal agreement, however, that the current $2,500 exemption level is unrealistically low, despite the fact that it is based on official poverty level figures. Since their inception in the sixties, the poverty thresholds have been adjusted for inflation, but not for growth in real income or for changes in consumption patterns.

Because of growth in real income, the thresholds have declined from about one-half to about one-third of median income. To the considerable extent that poverty is a relative rather than an absolute concept, people living at the poverty level today are poorer than people living at the poverty level in the sixties.

The thresholds also have not been adjusted for changes in consumption patterns. The sixties study on which the poverty level was based arrived at the total subsistence cost of a child by multiplying the cost of feeding a child by three, because, at that time, food was one-third of the typical family budget. Today the appropriate multiplier would be five, because food is now only one-fifth of a typical family budget, resulting in an exemption of over $4,000.

The ideal solution to the inadequacy of the current exemption would be to increase the exemption to perhaps $4,000 or $5,000. At the same time, the current phaseout of the exemption at high-income levels should be repealed, since family size differences result in differences in ability to pay even among high-income taxpayers.

Standing alone, however, these changes would have a regressive effect, because the tax savings from an increase in the exemption is a function of one's tax bracket. For example, a $2,000 increase in the exemption would save a 36-percent bracket taxpayer $720 per child, but a 15-percent-bracket taxpayer only $300.

This regressivity could be eliminated by combining the increased exemptions with increases in upper income tax rates, so that upper income taxpayers as a group pay the same amount of tax before

and after the legislation, but with less tax from those with larger families and more tax from those with smaller families.

Mr. ZELENAK. With such a rate adjustment, dependency exemptions are not about fairness between different income levels, but about fairness between different size families at the same income level. The problem with this, my preferred solution, is that rate increases are decidedly not on this year's legislative agenda, and without compensating rate increases, I would not support an increased dependency exemption.

The $500 child tax credit added to the existing exemption isn't appropriate under the clear income analysis. Converted to an exemption equivalent, the combined exemption—credit illogically assumes the subsistence cost of a child of a 15-percent-bracket taxpayer is almost $6,000, but the subsistence cost of a child of a 36-percent-bracket taxpayer is less than $4,000. Thus, the credit produces family size differences in incomes subject to tax that are arguably too high at lower incomes and too small at higher incomes.

Despite this objection, I somewhat reluctantly support the proposed credit. I do so because the income tax family size differentiation is currently far too small at all income levels and because the politically realistic alternative to the credit—an increase in the exemption without an increase in rates—is unacceptably regressive.

Thank you.

[The prepared statement follows:]

Statement of

Lawrence A. Zelenak
Reef C. Ivey Research Professor
University of North Carolina School of Law

before the

Committee on Ways and Means
United States House of Representatives

January 17, 1995

Thank you Mr. Chairman and members of the Committee. I am Professor Lawrence Zelenak of the University of North Carolina School of Law. I am testifying today on my own behalf. I have recently completed a comprehensive study of the various ways in which Congress might adjust income tax liabilities on account of taxpayers' family responsibilities, which will be published in a forthcoming issue of the Tax Law Review of the New York University School of Law. My testimony is based on that study.

In evaluating the child tax credit proposal of the Contract with America, there are two key questions. First, does the income tax currently make adequate adjustments for differences in family size? Second, if it does not, should an additional adjustment take the form of an increase in the amount of the dependency exemption, or a child tax credit added to the current exemption?

The theory behind the dependency exemption is that ability to pay tax comes only from income above subsistence--sometimes referred to as "clear income"--and that the cost of subsistence is a function of family size. Thus the dependency exemption--if it accurately reflects the cost of supporting a child at subsistence--properly adjusts tax liability for differences in ability to pay based on family size. If, for example, the subsistence cost of a child is $2,500, then a childless couple with $50,000 income has the same ability to pay (the same clear income) as a two-child couple with $55,000 income, and the current $2,500 exemption (the inflation-adjusted amount for 1995) will result in the two couples paying the same amount of tax.

There is near-universal agreement, however, that the current $2,500 exemption level is unrealistically low, despite the fact that it is based on official poverty level figures. Since their inception in the 1960s, the poverty thresholds have been adjusted for inflation in the Consumer Price Index, but not for growth in real income or for changes in consumption patterns. In her excellent study of the problems in defining and measuring poverty, Patricia Ruggles argues convincingly that simply updating decades-old poverty thresholds for inflation is insufficient.[1]

Because of growth in real income, the thresholds have declined from about one-half to about one-third of median income. To the considerable extent that poverty is a relative rather than an absolute concept, people living at the poverty level today are considerably poorer than people living at the poverty level in the 1960s. The thresholds also have not been adjusted for changes in consumption patterns. The 1960s study on which the official poverty level was based arrived at the total subsistence cost of a child by multiplying the cost of feeding a child by three, because at that time food was one-third of a typical family's budget. Today, the appropriate multiplier would be five (because food is now only one-fifth of the typical budget), resulting in an exemption of over $4,000.

Although I join in the consensus that the $2,500 exemption level is too low, I do not agree with those who argue for a much larger exemption--$8,000 or more--on the grounds that only such a

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[1] Patricia Ruggles, **Drawing the Line: Alternative Poverty Measures and Their Implications for Public Policy** (Urban Institute Press, 1990).

large exemption would be of equal value to the $600 exemption of 1948. The problem with the 1948-based argument is that it never explains what was so special about the 1948 exemption level. Child tax policy in 1995 should be based on 1995 costs of living (and on 1995 revenue needs), not on blind adherence to the tax law of almost half a century ago.

The ideal solution to the inadequacy of the current exemption would be to increase the exemption substantially, to perhaps $4,000 or $5,000. At the same time, the current phaseout of the exemption at high income levels should be repealed, since family size differences result in differences in ability to pay even among high income taxpayers. Standing alone, however, these changes would have a regressive effect, because the tax savings from an increase in the exemption is a function of one's tax bracket. For example, a $2,000 increase in the exemption would save a 36% bracket taxpayer $720 per child, but would save a 15% bracket taxpayer only $300. This regressivity could be eliminated by combining the increased exemptions with increases in upper income tax rates, so that upper income taxpayers as a group paid the same amount of tax before and after the new legislation--but with less tax from upper income taxpayers with larger families and more tax from those with smaller families. With such a rate adjustment, dependency exemptions are not about vertical equity (fairness between different income levels) but about horizontal equity (fairness between different size families at the same income level).

The problem with this solution, of course, is that rate increases are decidedly not on this year's legislative agenda, and without compensating rate increases I do not support a substantial increase in the dependency exemption, because of its regressive effect.

A $500 child tax credit added to the existing $2,500 exemption is not appropriate under the clear income analysis. Converted to an exemption-equivalent, the combined credit-exemption illogically assumes the subsistence cost of the child of a 15% bracket taxpayer is almost $6,000, but the subsistence cost of the child of a 36% bracket taxpayer is less than $4,000.[2] Thus the credit produces family size differences in income subject to tax (clear income) that are arguably too large at lower incomes and too small at higher incomes.

Despite this objection, I somewhat reluctantly support the proposed credit. I do so because the income tax's family size differentiation is currently far too small at <u>all</u> income levels, and because the politically realistic alternative to the credit--an increase in the exemption without an increase in rates--is unacceptably regressive. I should add that my support is conditioned on the assumption that Congress will find a way to pay for the credit, so that it does not increase the deficit.

Finally, I hope that in the near future Congress will undertake a thorough review of all the other provisions of the income tax relating to dependent children, including head of household status, the child care credit, the exclusion for dependent care assistance programs, and the earned income tax credit. Many aspects of these provisions are difficult to explain or justify. I would especially call your attention to the failure of the child care credit and the earned income tax credit to provide adjustments for family size beyond the second child.

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[2] A deduction of $3,333 would save a 15% bracket taxpayer $500; thus a $500 credit is the equivalent of a $3,333 exemption to that taxpayer. Adding the $3,333 exemption-equivalent to the $2,500 express exemption produces a total exemption-equivalent of $5,833. A deduction of $1,389 would save a 36% bracket taxpayer $500; thus a $500 credit is the equivalent of a $1,389 exemption to that taxpayer. Adding the $1,389 exemption-equivalent to the $2,500 express exemption produces a total exemption-equivalent of $3,889.

Chairman ARCHER. I assume that J.D. means doctorate, so I will refer to you as Dr. Zelenak. I thank you very much.

Dr. Burtless. Dr. Burtless is with the Brookings Institute. We are pleased to have you and welcome your testimony.

STATEMENT OF GARY BURTLESS, PH.D., SENIOR FELLOW, ECONOMIC STUDIES PROGRAM, BROOKINGS INSTITUTION

Mr. BURTLESS. Thank you and thank all the other members of the committee for the invitation to testify. I am going to confine my remarks to just a couple of the parts of my longer testimony that I submitted for the record, mostly dealing with the child tax credit.

First of all, I see a reasonable case for tilting the income tax in favor of families with children, especially families with limited incomes. Young families headed by adults with little schooling have experienced real erosion in their living standards over the past 20 years. This has occurred in part because of the decline in wages that young men can earn. Adverse wage trends have pushed up poverty rates among children. They have made it harder for young families to buy their first homes. It would be ironical, however, if we provided tax relief to these families mainly by piling extra Federal debt on the shoulders of their youngsters. Tax relief for families with children only makes sense if it does not reduce the total revenue collected by the Treasury.

Second, a generous child tax credit is going to make deficit reduction much harder. The credit will reduce immediate financial pressure on families with children, like my own, but it will worsen the long-term prospects of our kids and grandkids. The reason is very simple. The plan adds to the amount of resources the Federal Government is going to have to borrow to pay its bills. Future taxpayers must pay interest on the additional debt that will be incurred, raising the financial pressure on taxpayers tomorrow.

The credit offers tax relief for parents today, but it represents a tax increase, I think, on future generations. We already have good reason to be concerned about the financial prospects of those future generations. They are going to have to support a huge generation of baby-boom generation retirees. Since wages are climbing slowly or are stagnant, future workers may not have higher incomes with which to support all those extra older people. We are not really sure our children will enjoy higher incomes than we do today.

Many of us are concerned that the future burden of supporting a large population of the elderly, combined with slow wage growth will leave our children with lower aftertax incomes than we receive today. Under these circumstances, it seems to me wrong to lighten current tax burdens only to make the burdens on future taxpayers even heavier. If we describe the tax credit accurately, we would label it as a tax increase on our children and grandchildren.

Third, many of you are going to object that the child tax credit should not be viewed in isolation. The credit is part of a package of proposals that also includes spending reductions and a balanced budget amendment to the Constitution. Now, it is certainly true that if a child tax credit were accompanied by a reduction in overall Federal spending, it would be less objectionable. If revenue losses were matched by spending reductions, the Federal debt we leave our children and grandchildren would be unaffected.

But I see that as a serious problem, not a virtue of the proposed credit. If we care about the well-being of our children and grandchildren, our central goal in fiscal policy should be to reduce the Federal deficit, not to leave it unchanged. Painful spending cuts should yield deficit reduction, not a deficit that remains constant in relation to the size of national income.

The present deficit is too high in view of today's low unemployment rate. In the long run, large deficits represent a threat to the well-being of taxpayers even if deficits spare them from paying taxes today. National saving fell sharply in the eighties. This occurred both because of reduced private saving and because larger Federal deficits absorbed a sharply larger percentage of the savings that we had. The reduction in national saving was reflected in lower spending on private investment. If we want to see private investment return to the levels of the sixties and seventies as a proportion of national income, we should reduce net Federal borrowing.

When you find yourself stuck in a deep hole, it doesn't make much sense to make the hole any deeper. Fiscal policy is in a hole. We should not dig a deeper hole. The first step toward a sustainable fiscal policy is to avoid measures which make the deficit larger. The generous tax credit for families would make our hole that much harder to climb out of. I would like to get out of this hole.

[The prepared statement and attachment follow:]

TAX CREDITS FOR CHILDREN AND TAX REFORM TO REDUCE THE MARRIAGE PENALTY

Testimony for the
Committee on Ways and Means
U.S. House of Representatives

January 17, 1995

by
Gary Burtless[1]

Summary

Tax relief for families with children is a good idea in the abstract, but it will make more difficult the process of reducing the deficit. The immediate effect of the credit is to raise the federal deficit by over $100 billion in the next five years and by nearly a quarter of a trillion dollars within ten years. Tax reductions may be welcome to today's parents, but they leave an unwanted legacy of greater debt to our children and grandchildren. The next few generations of workers already face huge bills connected with the retirement of the Baby Boom generation. It makes no sense to saddle them with even heavier bills for interest on a larger federal debt.

There is a sound case for tilting the personal income tax more in favor with families with children, especially families which have limited incomes. Young families, especially those headed by men with a limited education, have seen some erosion in their living standards over the past 20 years. This trend is partly due to stagnation or actual decline in the hourly wages that young men can earn. Adverse wage trends have pushed up poverty rates among children and made it harder for young families to buy their own homes. It would be ironical, however, if we provided tax relief to these families mainly by piling extra federal debt on their youngsters. Tax relief for families with children only makes sense if it does not reduce overall revenue collected under the personal income tax.

New Tax Credits for Children

The family tax credit proposed in the American Dream Restoration Act offers the wonderful virtue of simplicity. Taxpayers can easily calculate how the proposed credit will affect their own financial circumstances. Families with one child who pay at least $500 in federal income taxes will see their taxes fall by $500 if their annual incomes are below $200,000. Families with two children who pay at least $1,000 in income taxes will see their taxes fall by $1,000. As the number of children in a family rises, the potential credit rises by $500 per child. Families with no children, with no income tax liability, or with incomes over $250,000 a year will obtain no tax relief under the plan.

Making a bad problem worse. Because the child tax credit will make deficit reduction much harder, I oppose the plan. This opposition is not based on financial self-

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[1] Senior Fellow, the Brookings Institution, Washington, D.C. The views expressed are solely my own and should not be ascribed to the staff or trustees of the Brookings Institution.

interest. (I have children, so would receive a big tax reduction under the proposed credit.) The credit will reduce immediate financial pressure on families like mine, but it will worsen the long-term prospects of our children and grandchildren. The reason is simple: The plan adds to the amount of resources that the federal government must borrow to pay its bills. Future taxpayers must pay interest on the additional debt that will be incurred, raising the financial pressure on those taxpayers. The credit offers tax relief for parents today, but it represents a tax increase on future taxpayers.

We already have good reason to be concerned about the financial prospects of future generations. They will be asked to support a large generation of retirees through payroll taxes needed to finance Social Security and Medicare. They will be asked to pay substantial income taxes to support a large number of aged and disabled who are too poor to pay for their own medical and nursing home bills.

As recently as the 1970s it was easy to be optimistic about the prospects of future generations. Wages and compensation were growing strongly because of steady improvements in worker productivity. Even if future generations of workers were obliged to support larger generations of retired elderly, we were confident that the living standards of future workers would be higher than our own. The rapid growth in wages meant that future workers would be left with more after-tax income to spend on themselves, because their *before*-tax incomes would climb fast enough to support a larger number of retired elderly.

The confidence of most Americans in the future has been shaken. We are less certain that our children and grandchildren will enjoy more comfortable lives than we do today. Many of us are concerned that the future burden of supporting a large cohort of elderly, combined with slow wage growth, will leave our children with lower after-tax incomes than workers receive today. Under these circumstances, it seems wrong to lighten our current tax burdens only to make the burdens on future taxpayers even heavier. If we described the tax credit accurately, we would label it a tax increase on our children and grandchildren.

Budget cuts. Many people who read these comments will point out that the child tax credit cannot be viewed in isolation. The credit is part of a package of proposals that includes spending reductions and a balanced budget amendment to the constitution. The President has proposed a similar though less generous child credit, and he promises to match the tax cut with some spending cuts.

It is certainly true that if the child tax credit were accompanied by a reduction in overall federal spending it would be less objectionable. A $500-per-child credit is expected to cost the Treasury $107 billion in lost revenue over the next five years and $137 billion in lost revenue over the following five years. If the revenue losses were matched by the same amount of spending reductions, the federal debt that we leave our children and grandchildren would be unaffected by the combination of tax and spending cuts. But I see that as a serious problem, not as a virtue of the proposed credit. If we care about the well-being of our children and grandchildren, a central goal of fiscal policy should be to *reduce* the federal deficit, not to leave it unchanged from its current level. Progress toward reducing federal spending should yield deficit reduction, not a deficit that remains constant.

Two Presidents and the last three Congresses have made progress toward reducing the burden of the deficit. After averaging more than 5% of GDP in the mid-1980s, the federal deficit has been brought down to less than 3% of GDP today. But the current deficit is large relative the peace-time average deficit over the post-war period. And it is depressingly high in view of today's low unemployment rate. In the long run, large deficits represent a threat to the well-being of taxpayers, even if deficits spare them from paying some taxes today. National saving -- the share of national income that we collectively set aside for investment and future consumption -- fell sharply in the 1980s. This occurred both because of reduced private saving and because of larger federal deficits, which absorbed a sharply higher percentage of private saving. The reduction in national saving was reflected in lower spending on private investment. Productivity growth during the 1980s and early 1990s was almost certainly affected by this development. Productivity improved more slowly than it would have if the investment share in GDP had been higher. If we want to see private investment return to the levels of the 1960s and 1970s, we should reduce net federal borrowing.

Veterans on this Committee know how painful it has been to reduce the deficit to its current level. No one should be under the illusion that substantial future reductions will occur painlessly. Congress will find it difficult, if not impossible, to achieve the deficit target enshrined in the balanced budget amendment. Giving favored taxpayers an annual tax reduction exceeding $20 billion will only make achievement of a balanced budget that much more difficult. Far-sighted voters and financial markets will question Congress's determination to achieve budget balance if the current Congress adds to the long-term problem by passing a major tax cut this year.

When you find yourself stuck in a deep hole, it doesn't make any sense to make the hole any deeper. Fiscal policy is in a hole; we should not dig a deeper hole. The first step toward a cure is to avoid measures that make the deficit larger. A generous tax credit for families with children makes our hole that much harder to climb out of.

Tilting the tax code toward families with children. Many people believe the world has become a more hostile place for American children. Statistics on child poverty support this view. After declining sharply during the 1950s and 1960s, the official child poverty rate rose modestly in the 1970s and increased about a third after 1978. Adjustments in the poverty count to reflect more accurate measurement of price change and a more inclusive definition of family income would probably show that child poverty fell during the 1970s but rose substantially in the 1980s and 1990s.

Two trends have pushed up child poverty rates -- the increasing percentage of children who live with only one parent and worsening job prospects among young men, especially men who have received no education beyond high school. Families with children depend overwhelmingly on wage earnings to support themselves. When real earnings fall, as they have for many families headed by young men and young women, child poverty rates tend to rise.

Of course, the proposed child tax credit would do nothing for poor families containing children. The Tax Reform Act of 1986 permanently changed the tax code to remove poor families from the tax rolls. Because poor families do not pay income taxes, they will not

enjoy any tax savings from a nonrefundable tax credit. (Poor families with wage incomes received substantial tax benefits as a result of the liberalization of the Earned Income Credit in 1993, however.) Nonetheless, the credit would lift the tax threshold well above the poverty line for families that contain children, helping families whose incomes are somewhat above the poverty line. Table 1 below shows estimated poverty thresholds and tax thresholds for 1996, with and without the $500-per-child tax credit.

TABLE 1. ESTIMATED POVERTY THRESHOLDS AND TAX THRESHOLDS FOR FAMILIES WITH CHILDREN, 1996

HOUSEHOLD TYPE / NO. OF CHILDREN	POVERTY LINE	TAX THRESHOLD UNDER CURRENT LAW	TAX THRESHOLD WITH $500 CREDIT
MARRIED COUPLE / JOINT RETURN			
Number of children			
0	$10,574	$11,935	$11,935
1	12,710	14,535	17,868
2	16,081	17,135	23,802
3	18,844	19,735	29,735
4	21,100	22,335	35,668
SINGLE HEAD OF HOUSEHOLD			
Number of children			
0	$8,215	$8,540	$8,540
1	10,844	11,140	14,473
2	12,723	13,740	20,407
3	16,069	16,340	26,340
4	18,556	18,940	32,273

Source: Author's calculations for households claiming the standard deduction based on assumption of 3% annual inflation.

Under current law, the income level at which families begin to pay positive income taxes is above the poverty threshold. Families containing no children will not be affected by the tax credit, but families with children will see their tax thresholds lifted significantly as a result of the credit. A married couple with three children will see its tax threshold increase from $19,735 to $29,735, for example. Families with incomes in this range will be removed from the tax rolls. Childless couples and single persons will be left on the rolls, however, and they may question the fairness of being denied any tax relief.

On the whole, I favor easing tax burdens on low-income families with children if this could be achieved without reducing revenues from the personal income tax. I question the rationale for offering tax relief to families earning annual incomes of $60,000, $100,000, and even $200,000, however. It would be hard to argue that these families have suffered losses in purchasing power as a result of major tax increases or income reverses over the past 15 years. Census and income tax statistics and Social Security earnings records suggest that these

families have enjoyed at least modest income gains since the early 1980s. Their children have not been harmed by heavier taxation or wage decline. If Congress believes it is desirable to tilt the tax schedule in favor of moderate- and high-income families containing children, it should achieve this goal holding overall personal income tax collections unchanged. Since this involves imposing major tax increases on at least some classes of taxpayers, I do not think voters will find this option very attractive.

Incentive effects. Apart from tax relief, a common motivation for tax reductions is to improve economic incentives. In the case of the child tax credit, only one incentive is clearly changed for a broad cross-section of Americans -- the incentive to have children. In comparison with a childless couple that has the same income, a married couple with one child would pay $500 less in taxes than is the case under current law. The same incentive for additional child bearing is offered to both married couples and single people (see Table 1). If it is thought desirable to encourage Americans to have additional children, a child tax credit offers the advantage of simplicity and clarity. I am not aware, however, that increased childbearing is considered highly desirable either by Congress or the general public.

Tax reductions are sometimes justified because they improve taxpayers' incentives to work and save. The proposed credit can clearly have this kind of effect for taxpayers who are removed from the tax rolls. Because their tax liabilities will fall to zero, the marginal income tax rate imposed on their wage and interest income also drops to zero. Some taxpayers may respond by working longer hours or setting aside more of their current income as saving. But most taxpayers who receive tax relief under the plan will not see their taxes reduced to zero. They will pay lower income taxes, but they will continue to face the same marginal tax rate on income that they face today. They will receive higher after-tax incomes but will face unchanged marginal tax rates. Most studies of work behavior suggest that affected taxpayers will probably work somewhat less than they currently do, although I would be surprised if the effect is particularly large. Economists do not know the likely effects of the reform on personal saving.

One group of affected taxpayers will face *higher* marginal tax rates as a result of the credit. Under both the Republican plan and the alternatives that have been proposed by Democrats, the child credit would be eliminated over some income range. House Republicans propose to eliminate the credit for families receiving between $200,000 and $250,000 per year. Families in this income range will face a higher marginal tax rate than they do under current law. Since their after-tax incomes will be improved by the credit, while their marginal tax rates will be raised, economic theory and empirical evidence suggest that their earned incomes will probably decline, though modestly.

Among the incentive effects mentioned, only one is thought to be desirable by a large majority of Americans. Most of us probably believe it is desirable to encourage moderate-income breadwinners with children to boost their earnings through increased labor supply. Low- and moderate-income breadwinners who are removed from the tax rolls will be offered improved incentives for added work under the credit. The other incentive effects I mentioned are ambiguous in value or are widely believed to be undesirable. It seems safe to say that the child tax credit is being proposed to provide tax relief and to tilt tax burdens away from families with children. It has not been advanced because proponents believe it offers desirable incentive effects.

Reducing the Marriage Penalty

A second plank of the American Dream Restoration Act offers up to $2 billion per year in tax relief to reduce the so-called marriage penalty. Many two-earner married couples perceive the current tax schedule to be unfair. They realize that they pay higher income taxes jointly than they would pay separately as single individuals. Under a progressive income tax system, it is difficult to treat married and single people equitably while still maintaining the principle that tax burdens should rise with ability to pay.

Alicia Munnell, currently in the Department of the Treasury, has shown that is logically impossible to achieve all three of the following equity goals of taxation:[2]

1. *Impose equal tax burdens on couples with equal incomes,* regardless of how income is divided between the spouse with lower earnings and the spouse with higher earnings.

2. *Marriage neutrality,* so that a man and a woman who each earn $25,000 owe the same taxes whether they are single, married, or divorced.

3. *Progressivity,* which implies that a single person earning $50,000 should pay more than the combined tax imposed on two single people who each earn $25,000.

Our present income tax system sacrifices goal #2 in order to achieve goals #1 and #3. In the past, our system has sacrificed goal #1 in order to achieve goals #2 and #3. Some people propose that we eliminate progressivity in the tax system. If this occurs, we can easily achieve goals #1 and #2. However, as long as we seek to achieve all three goals, some compromise between the goals will be necessary.

The marriage penalty in the present system has practical consequences besides the perceived unfairness of the penalty. The spouse with lower earnings often faces a higher marginal tax rate on earnings than he or she would face if unmarried. The penalty may thus discourage employment or reduce work effort below the level it would be under a system that is neutral with respect to marriage. (The penalty may also discourage or delay marriage for some couples.)

A crude but tolerably effective remedy for this problem is to offer a special tax deduction to married couples where both spouses work. In 1981 Congress offered a special deduction equal to 10% of the earnings of the spouse with lower earnings, up to a maximum deduction of $3,000. The deduction was eliminated in the 1986 Tax Reform Act. Congress and the Administration believed the deduction was less needed after marginal rates and the number of tax brackets were reduced. However, the penalty on dual-income married couples remains. If Congress wishes to reduce the penalty, one way to proceed is partially to restore the special tax deduction in effect between 1982 and 1986.

The American Dream Restoration Act proposes to give up only a small amount of revenue to reduce the marriage penalty -- $2 billion a year. The amount is so small that I do not think the revenue loss and resulting deficit increase are particularly significant. However, the small revenue loss ensures that the reform will not make a very big dent in the marriage penalty, either.

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[2] Alicia H. Munnell, "The Couple versus the Individual under the Federal Personal Income Tax," in Henry Aaron and Michael Boskin, eds., *The Economics of Taxation* (Washington: The Brookings Institution, 1980), p. 247.

Chairman ARCHER. Thank you, Dr. Burtless.

Dr. Steuerle, considering that we perhaps do not have a complete open door to do whatever we want to do, do you think that the $500 per child credit, which goes up to 18 years of age and up to $200,000 of family income, is a reasonable approach? Is that a fair statement that I have drawn from your testimony? If not, would you correct me?

Mr. STEUERLE. I think that is a fair statement, Chairman Archer. There are some other adjustments that I might make. I don't know whether this committee would want to consider them. Again, as I have noted and I believe Professor Zelenak has also noted, I think it actually would be simpler to grant the credit at all income levels and then, if one is worried about the impact on progressivity, trying to make an adjustment elsewhere. I think that would be simpler and it would avoid this problem of these phaseouts, with their additional tax rates, hidden tax rates, and marriage penalties and other things.

If you can't find the adjustments elsewhere, then I understand why they have to phase out. I also suggest in my testimony the consideration of other items, such as how one might integrate with what is going to be done in welfare. Since I don't know what is going to be done in welfare, it is hard for me to get into a great deal of detail.

But I am worried about the gap between the people who are on welfare and getting welfare credits and those who might get tax credits. There is a group in between that is not going to get anything. So I would like to think about if we are going to make payments to States, for instance, some way of making sure this group in between is also accounted for.

I also suggest that in the context of health care reform, I would even consider such adjustments as, at least for middle and upper income taxpayers, requiring that if they get a credit that they buy health insurance for their children. At least those people have income levels where we feel that such a requirement would be reasonable.

All these things add complexity to what you are trying to do. The reason I add them here is because the credit is probably the major item that I see which is going to give something back to taxpayers, as opposed to the expenditure reductions, which are going to take something away from individuals.

So the time, it seems to me, to make these other adjustments—and you may have many of your own, is at the time that we do the giveaway, if we want to call it a giveaway. When we give the money back to the taxpayer, we ought to think about how we balance these things as a whole. If we give the credit now and we decide we need to do some other things later on, we will have a harder time explaining how the balance is achieved.

Chairman ARCHER. Well, the one area that some of us might take a little bit different semantic approach to is we are not really giving anything. We are letting people keep more of their money, and that was adequately articulated by the previous panel. But you think it is not unreasonable to have a phaseout begin at $200,000.

Mr. STEUERLE. As I said, Chairman Archer——

Chairman ARCHER Taken by itself.

Mr. STEUERLE [continuing]. I would have no phaseout at all. The theory of family-size adjustment says that it is not a question of how much people of $200,000 of income pay. It is a question of if we have two families with $200,000 of income, does the one with children have less ability to pay than the one with none, or with a different number of children? One has children, one has no children. Do they have different abilities to pay? Yes, they do and, therefore, it is appropriate to adjust for family size even at that level.

Chairman ARCHER. Thank you very much.

Mr. Crane.

Mr. CRANE. I thank the gentlemen for their testimony. I just want to raise one question that is a concern to me, as Dr. Burtless expressed it, and that is that we not be put in the position of passing the buck, in effect. I reared eight children with my wife and we have four grandchildren so far and a fifth due. The major responsibility that those of us involved in making the laws for this country have is living within our means down here.

There are times in an international crisis when obviously there is an excuse for going into debt. But otherwise, I don't see the basis for having extended that burden and passing it on—especially the magnitude of dollars we are facing today. We are imminently approaching a $5 trillion national debt, and the projections are that it could go to $7 trillion by the end of the century.

On the other hand, it does seem to me one of the concerns addressed by Mr. Kasich is that instead of a projected $3 trillion increase in spending between this year and the year 2002, with the balanced budget amendment, we would only be spending $2 trillion. I think there is a way to provide long overdue relief, especially to families.

My kids grew up in the sixties and seventies. I think there is a way to avoid in effect inflicting real hardship on families with multiple children and simultaneously biting that bullet that does not in turn pass the burden and the hit onto my grandchildren and my great grandchildren when they come along. I would simply be interested in your comments on that.

Mr. BURTLESS. Well, I think that when I heard Senator Grams speak to the question of how he could identify cuts in spending that would match this reduction in taxes, he was very hard pressed to think of where he would go. He has been in the House. He has campaigned, so he has thought long and hard about these issues.

I think it reflects the great difficulty of identifying exactly what you would cut. I heard some people say that they would rather have taxpayers spend money on their own rather than send it down to irresponsible bureaucrats in Washington. I think that is a direct quote. We should remember some of these things people are spending money on through their taxes: Social Security benefits, Medicare, interest on the debt, national defense. That is a lot—that is a lot of the spending and it also represents a lot of the projected increase in spending.

A lot of that additional $3 trillion is going to be for these items. I don't know how you view it, but I don't view sending a Social Security benefit check to someone as a bureaucrat controlling the spending of that money. Social Security permits our elderly people

to live a decent living and partially receive back some of the tax contributions they made earlier on.

Chairman ARCHER. I don't think Social Security belongs in the debate at all. There is a separate tax that goes into the Social Security trust fund, and we have, by incorporating that Social Security trust fund in our total budget, made it look less offensive than it really is.

But beyond that, we could have a big debate here about whole departments of government that I would lop out of existence. I know we could get into keen debate on that issue. But I remember, for example, in 1980, Ronald Reagan campaigned on the pledge that we were going to abolish the Departments of Education and Energy promptly after he took office. These two new departments had just been created by President Carter. We, unfortunately, did not do that. But as I say, it is not just cuts but putting full freezes in place.

I know that Congressman Burton from Indiana a couple of years ago had a proposal just to put a freeze in place. It wasn't a total freeze. It preserved COLAs, and it had a 2-percent-per-department provision for annual increases in spending. That was projected out to produce a surplus shortly after the turn of the century. I think it is more tightening the belt and ideally tightening that belt across the board.

I don't think that necessitates invading what are designated trust funds. In fact, trust funds, I think, have to be preserved as such, and that is a separate issue as to how you finance them.

I thank the gentleman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. Dr. Steuerle, you mentioned that perhaps if there were to be a $500 tax credit, then there might be some kind of a requirement to purchase health insurance for children. Did I understand that correctly?

Mr. STEUERLE. Mr. Payne, I am jumping into another topic here and obviously it is something that I think the committee staff would have to consider in detail. But during the health reform debate, there was an issue of whether we wanted to have employer mandates and I think as a country we decided that was inappropriate.

But the alternatives were to consider things like individual subsidies and individual mandates; that is, some requirements on individuals that they buy health insurance. One tentative way of approaching that issue is to take middle and upper income taxpayers and to say to them if you are not buying health insurance for your family, or your children, then you are going to be denied certain tax benefits. The reason we do this is because—because by not buying insurance, if you face some catastrophe, you may indeed fall back upon the public sector. You could have bought your insurance. You didn't. Now the public is going to have to pay.

So a tentative way of getting at that is to deny something like a child credit or a dependent exemption or a personal exemption for middle and upper income taxpayers who don't buy health insurance. It doesn't solve the problem for the majority of the people who don't buy health insurance, but it is a way of getting at a small piece of that puzzle.

Mr. PAYNE. So this would then be one element of dealing with a second issue which we will be dealing with this year, which is health reform and how is it that we are able to find a way to make public policy decisions that assist us with health care and particularly the rising cost of health care.

Mr. STEUERLE. That is correct, Mr. Payne.

Mr. PAYNE. I just wanted to understand you because I had not heard of that sort of proposal as we have listened to the elements of the tax credit. Dr. Burtless, you talked about the conflict between reducing the deficit and tax credits. Are you suggesting that there is no kind of tax credit here that makes any sense from a policy point of view?

Mr. BURTLESS. Well, I think there is. I think that I expressed my agreement with the other people who have testified that there is a good case for tilting the income tax schedule more in favor of families who have children.

But I think that because the credit is so clearly directed at children, we should also think about the obligations that we are imposing on those children later on in their lives. We are already expecting a lot of them. We are expecting them to pay for my Social Security benefits and the benefits of people older than myself. If we add to the debt in order to finance this credit for families with children, we are not actually making their circumstances better off over their entire lifetime. The children, I think, end up worse off.

I think that if we finance a more favorable treatment of families with children through a reallocation of the tax burden, that is a very sensible policy. But it doesn't make sense to add to the long-term burden on these kids by adding to the debt.

Mr. PAYNE. Next week we will vote on the balanced budget amendment, an amendment to balance the budget of the United States by the year 2002. We have learned, according to the Congressional Budget Office, $1.2 trillion is the amount of deficit reduction that will have to take place in order to meet that objective. This contract will add some $400 billion, and so it raises from $1.2 to $1.6 trillion the amount that would have to be reduced.

Just quickly, because my time is almost up, do you have any comments generally about the difference between a $1.2 and a $1.6 trillion hurdle as it relates to achieving this goal?

Mr. BURTLESS. Just figure out what the interest payments are that we have to make in perpetuity to finance that $400 billion addition to the debt. Or alternatively, think of all of the additional spending cuts above and beyond $1.2 trillion that you are going to have to find in order to achieve the deficit reduction that is going to be necessary to offset the cost of the credit. It is just a very steep mountain to climb.

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

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. I would like to just ask this question: Isn't this another form of social programming in a way, that we have been historically, at least the Republican party, has been trying to get away from for a long time?

If in fact we considered that this might be—I will leave it up to you, whether you would determine that to be considered some social programming, what about the flat tax? I would appreciate, if

you would, one by one, just tell me—is the flat tax something that the Federal Government ought to be taking a real good look at?

Mr. BURTLESS. Well, the flat tax largely eliminates I think the problem of the marriage penalty. So it does get you around one problem. But I don't think it spares you the problem of thinking about how you want to make an adjustment to make an equivalent tax assessment on households that have different sizes. You still face that problem.

Even if you want to impose a flat tax, presumably it is a flat tax on income above a certain minimum amount. You have to decide what should that minimum amount of income be that is going to be exempt from taxes? There I think most Americans believe we should make an adjustment that reflects the responsibilities of different kinds of families. So I think you still have the problem of adjusting for family size.

Mr. HANCOCK. In other words, what you are basically saying is that the flat tax is again not a flat tax. Talking about a flat tax, but then adjusting it based on the numbers or members of families which in effect you don't have a flat tax then.

Mr. STEUERLE. That is correct. Most flat taxes either have some sort of personal exemption or some sort of credit per person.

Mr. HANCOCK. A minimum tax, but not necessarily based on the number of people in the household, a minimum amount.

Mr. STEUERLE. Whether you do it based on the number of persons in the house or not, you are correct, it doesn't become flat at the bottom because you are imposing effectively a zero rate on some taxpayers.

Mr. ZELENAK. Every flat tax really has two rates, a zero rate and then one positive rate.

Mr. HANCOCK. Dr. Burtless said that he thought it ought to be looked at. I didn't hear the other two. Do you think we ought to be looking at a flat tax up here in the Congress or do you think we ought to just say that is just some figment of somebody's imagination, it will never work?

Mr. ZELENAK. Oh, I think clearly it can work. It is just the philosophical question of whether—to what extent you believe in progressivity. I happen to favor progressivity. For purposes of this panel, maybe the more important issue is that even under a flat tax, presumably you want family size adjustments—at least I would.

Mr. STEUERLE. First, I think the term flat tax is actually four or five proposals wrapped up in something called flat tax. One is the issue of how much do you want to change the system, vis-a-vis how progressive do you want it.

The second issue is do you want an income tax versus a consumption tax. The third issue, which is important to this committee, is whether you want some of the simplification you get from a flat tax because you can withhold at source. The bank can pay the tax. You don't have to file. That is a simplification. It also tends to often lead to larger government. People don't see what they are paying.

So there are a lot of issues of the flat tax, some of which I think I favor, some of which I am less agreeable toward. But I think it is not just the one issue. In regard to, as this panel has said, things

like child credits or family size credits, flat tax proposals make some adjustment anyway.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. Dr. Burtless, on page 4 of your written testimony, you—in the second paragraph, reference giving favored taxpayers an annual tax reduction. Who are these favored taxpayers that you are referring to?

Mr. BURTLESS. Well, I just meant that the credit is tax relief that is targeted on a particular kind of family—namely, families that have children and whose incomes are high enough so that they actually owe taxes.

Mr. CHRISTENSEN. You go on in your written testimony to say that people with annual incomes of $60,000, $100,000, and even $200,000 should not be able to receive this kind of tax relief. You question the rationale. I guess I would question your reasoning on the fact that you take two people, as I questioned Senator Grams earlier, a bricklayer making $40,000 a year and a school teacher making $35,000 a year, under your scenario, they are rich.

If you talk to the hard-working people out there that are middle-income earners, they will tell you that they are not rich by any means. How do you define your rich category and how do you define your middle-income category.

Also, I would like to ask you when you are doing your various analyses, do you use a static or a dynamic analysis? Which have you done in the past and which do you favor in the future?

Mr. BURTLESS. Well, first of all, the $60,000, $75,000, $100,000 comment only reflected what I take to be income levels where the financial pressures have been most severe on American households. I do not mean to suggest that people with $100,000 or even $150,000 are not middle-class people. I actually have a very expansive definition of the middle class myself.

It is just that in that income range (above $60,000), American households have not faced particularly higher tax burdens. They have not seen a loss in their income because of adverse economic trends. That is all I am saying.

With regard to dynamic forecasting, it is interesting, when I first came to Washington in the late seventies, that is the very first thing I worked at. I tried to estimate how much reform of the welfare system of the United States would cost, taking into account the fact that if you made benefits more generous or if you reduced the marginal tax rates on low-income taxpayers, they might be expected to respond. As a result, I have tried very hard over my life to figure out what the best estimates are that we can use in order to make reliable predictions of what the cost to the Treasury would be of changing the welfare or tax systems.

Mr. CHRISTENSEN. I have a question related to that. It is concerning GAO estimates, CBO estimates, Joint Tax Committee estimates, and this is a quick question for all three of you.

For example, the GAO has some 4,700 employees, a $400 million budget to produce studies, which outside groups are already doing. Is there a way that you would suggest we go at taking a scalpel to some of these government organizations and could we eliminate

a good majority of them or all of them and instead rely upon private organizations?

Mr. STEUERLE. Mr. Christensen, I happen to be very much a fan of these various agencies. I find that the committees, like Ways and Means, that have the joint tax staffs often end up to be the strongest committees in part because I think of the knowledge base that that type of committee staff gives them, vis-a-vis some of the other committees in Congress that don't have joint staffs or nonpartisan staffs to support them.

Again, I have not looked at the levels. Certainly I understand that there is going to be some attempt to look at GAO, which I think is the only large agency of the ones that you mentioned—to look at their size of staff and see whether all the audits and types of things they do are necessary.

I can say as an outsider many of these studies are very, very helpful at looking at ways of cutting expenditures, looking at issues like a child credit as I said. The nonpartisan staff help empower Congress to do some of the types of changes that it is very much looking forward to doing.

Mr. ZELENAK. I am sure there is room for cutting. I have been generally impressed with the product that has come out of those agencies.

Mr. CHRISTENSEN. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. Let me just ask you, since the present exemption is related to income so that those in the higher income bracket receive a greater benefit than those in the lower, why do you say that the tax credit proposal should go forth without relationship to income level?

Mr. STEUERLE. Mr. Levin, we are dealing with what is perhaps one of the toughest sets of issues of taxation. One issue is how progressive does one want this system to be? A second issue is how much do you want the system to collect? The third issue is, given those, how do you distribute burdens among people at the same income level?

The point I am making is that once we decide the amount we want to collect and we decide the amount we want to collect, say, from wealthy taxpayers, there is still a legitimate issue of how do you distribute the burden among those wealthy taxpayers. So, for instance, we could take two families. Let's say each has $100,000 of income, so they have $200,000 of total income. We could say we are going to charge each of those families $20,000 in tax. Or we can say, in fact, that one family has children, the other doesn't, and there is a difference in their ability to pay tax. So, instead, we will charge one $19,000 and the other $21,000. What you can see I have done is I have collected the same amount of revenue. I have gotten the same amount of progressivity, but I still have adjusted for family size within those families.

So the point, again, that I am making is there is legitimate reason to look at the burden within that income group, just as, for instance, when we provide public education, we may charge wealthy families more than they get back in public education, but there is a legitimate issue of whether we want to provide public education to all families at that level. There is a difference between what we

want to do on net for wealthy families and how we want to distribute the burden among them.

Mr. ZELENAK. Mr. Levin, if I could take a stab at the same question.

Mr. LEVIN. Go ahead.

Mr. ZELENAK. My preference would be to increase the dependency exemption to a level that more realistically reflects the basic cost of supporting children and then retain the current progressivity by increasing tax rates at the upper brackets. So people making $200,000 are paying the total tax they pay now, but more from people without children, less from people with children. Given that is not going to happen this year, the question becomes, is it still appropriate to make some adjustment for family size even at upper income levels? I think it is.

The final question is, will it be paid for? My support for the adjustment is premised on the assumption that it will not increase the deficit, it would be paid for. Ideally, I would like to see it be revenue neutral within the tax system so that the cost that we are relieving from larger families is being paid for by an increase on the tax on smaller families—and perhaps I should add I have no children, so this isn't self-interested.

But given my ideal proposal isn't going to be enacted this year, does it make sense to provide more family size differential even at high-income levels? Yes, it does, especially given the current tax system that provides absolutely no family size differential at high-income levels.

Mr. LEVIN. But your answer indicates that equity among families of the same income brackets is more important than equity between taxpayers of different brackets. I think you need to take another look at that issue. I think what it points to, if there is going to be equity, is to use a different system for dependent allowance. It would make more sense to change it.

What you are doing with mixing an exemption and a credit is, while you are perhaps getting more justice within tax brackets, you are really increasing the differential between them.

I am not sure why you kind of pull your punches on that. That goes for either of you.

Mr. ZELENAK. Well mixing an exemption and a credit is not to my mind the ideal way to do it.

Mr. LEVIN. So why aren't you here testifying as to what makes sound tax policy?

Mr. ZELENAK. I am, but I am also testifying that since what I think makes the soundest tax policy isn't on the table, I think the proposal in the Contract With America is better tax policy than current law.

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

Mr. MCDERMOTT. Thank you. Appreciate your coming and testifying. It is nice to have a panel of experts here to sort of throw some stuff to and let you respond to it. I talked to the Joint Tax Committee about this proposal, and it looks like about 10 million families out of the 37 million families in the United States would receive no benefit whatsoever from this proposal.

It is—and they are the people at the bottom. They are the people at $15,000 in income and below. I asked the proponents in the staff

before if they thought that was good policy that those people didn't have a problem. But it seems to me that in a zero sum game that we are talking about here, and you are obviously talking about a zero sum game, we are not going to increase the deficit. So we are going to find someplace to get this money to make this tax credit.

Does it make the most sense to hand back to people who earn above $15,000 the money when most of the people at the bottom don't have health care which produces a cost shift in the health care system? Wouldn't it make more sense to use this money, as at least one of you suggested, requiring people to buy health insurance with the money that they received?

I would like to hear all of you respond to it, because I would like to get your ideas about the social safety net we are talking about here—we are trying to help families.

Mr. ZELENAK. I would like to respond, not so much on the health care issue, but on the question of people making below $15,000 a year who won't get a benefit from a nonrefundable credit. In my written testimony, I make reference to the fact that the earned income tax credit, which does help people making below $15,000 a year, makes no adjustment for family size beyond the second child. I think that is very inappropriate and it is a somewhat separable issue from this.

But I hope, if not in connection with the Contract With America, that Congress very soon will look at that issue. If family size adjustments beyond two children are appropriate for middle-class wage earners, as I think they are, they are also appropriate for beyond the second child for low-income wage earners. I strongly would support a change in the earned income tax credit to that effect.

Mr. MCDERMOTT. Just as an aside, I think those decisions were made because of money. The last time we only could find so much money and that is how much—if we went to three or four, I mean, family size adjustments, it would have cost a whole lot more money and I think that is why it is done.

Mr. ZELENAK. It also may be a quirk of the way the distributional tables work—that they don't properly reflect the differences in family size.

Mr. MCDERMOTT. Somebody suggested that they thought it would—I think it was the first speaker, that it would make sense to require this money to be spent for health care benefits.

Mr. STEUERLE. Again, I realize that this is a difficult area. This area, including the refundability issue, raises a lot of administrative issues that there is just not time to get into detail.

In the health care arena, yes, I think we ought to start thinking about ways to require at least middle and upper income individuals, if they are going to get something like a child credit, to buy health insurance for their families. Again, this doesn't solve the problem at the bottom.

But there is a portion of those without health insurance who have the incomes—they are capable of buying health insurance. Other people at lesser or equal income levels buy it, but then this one group doesn't. So, yes, I would consider some requirement.

With respect to the fundability issue, which is the main issue with the 10 million people you mentioned, in theory I believe the

credit like this ought to be refundable. But having said that, I would want to think about what we do with our welfare system, what we do with the earned income credit, and how all of these integrate together.

I am not sure, for instance, that we can just say we can make it refundable and tell the IRS that they have to send out checks, because I am not sure the IRS is ready to administer that type of system. One thing we might think about, for instance, is how we are going to go toward making block grants to States. One criteria might be to make an adjustment that some amount of credit be available to those families who aren't on welfare and who do not get the tax credit also.

As I said, there is a lot of complexity in trying to integrate this credit with other welfare and health issues. I am sorry if I have done inadequate justice to it in this short time.

Mr. CRANE. The time of the gentleman has expired. Mr. Ensign.

Mr. ENSIGN. Pass, Mr. Chairman.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. Dr. Burtless, your major concern is that we should not increase the deficit and that you have some fears that this tax cut might do that. The majority party has indicated forget about the increase in the deficit, that they are going to provide up front the savings as relates to spending cuts before we even get to the question of deficit.

So for purposes of our discussion, we can assume that they still have that as their goal. The first question, it would seem to me, is before they find out how much money they have to spend, they have to find out how much this tax cut and the other capital gains tax cut will cost.

There is a lot of discussion about static scoring and dynamic scoring. This dynamic scoring by some people is considered cooking the books. I know it is an extreme. But do any of you support what they mean when they say dynamic scoring so that we can first find out how much this thing is going to cost? Do all of you support whatever they are talking about?

Mr. BURTLESS. Well, in my testimony, I tried to indicate what I thought the incentive effects arising out of this would be. I don't have the capacity of the Congressional Budget Office or the Treasury to do any simulations.

Mr. RANGEL. But you talk with your colleagues and this is—what they are doing is speculating on how much revenue is actually going to be raised in the long run as a result of the capital gains tax cut. I mean, I can understand what they are saying because I kind of go along with you, invest in young people in education, in the long run, you are going to raise a lot of revenues. I can't score that way, however. It is a tax hit. It is increasing the deficit if I did it. But I mean, can any of you have enough imagination to say that this concept makes any sense at all, I mean, without defending it?

Mr. ZELENAK. I think it depends somewhat on what kind of tax proposal you are talking about. I don't think even the stronger adherents of dynamic revenue scoring think that there is a great deal of dynamic revenue scoring involved in the child tax proposal, at least not until 20 years when people are making more money now

because more was spent on them when they were children. I would not support a strong dynamic revenue scoring approach to this child tax credit, but I don't think it is being taken as far as I am aware of.

Mr. RANGEL. OK. Now, that is my opinion. Having said that, then we have to go back to the old-fashioned, acceptable scoring method. Now comes a middle-income tax cut. Believe me, I am for earned income tax credit. I am for cuts for the middle class, for the rich. That is not a problem.

The problem that I am going to face is what cuts are going to be necessary under regular, accepted scoring methods in order for the Congress to do what we love to do, and that is reduce constituent taxes? It bothers me that people can talk about the merits of the tax cut and not even suggest that if indeed the cutting in spending are cuts that will cripple the services that are rendered to the poor. They say that Social Security is off the table, and it should be. Military is off the table, and I guess the Republicans know something about a Communist threat, so I assume it should be off the table.

But they say that if you accept all of these things, that you are going to have to cut the remaining programs some 38 to 40 percent across the board. Now, how can we even talk about the merits of a middle-income tax cut without all of you professors and doctors and economists asking what are you going to cut before I can even comment on what is best for the Nation?

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

Mr. RANGEL. Can I get one response? Just one response.

Mr. CRANE. Time for one response.

Mr. ZELENAK. As I said before, my preference would be to make the Tax Code more family favorable in a revenue neutral way, and that is not this proposal.

Mr. FORD. I spoke to the Americorp Group over the weekend. It is part of a national service program that was implemented under the Clinton administration. Some of the volunteers who were present that particular night raised some of the questions that have been raised for members today to this panel.

It relates to a tax cut versus programs similar to the national service programs, or things that Mr. Rangel has been talking about. This Contract With America is all about a constitutional amendment to balance the budget by the year 2002. We are talking about families who—naturally those with children would love this type of tax relief. I am included in that group.

But at the same time, are we—are we in a position to really talk about this type of tax relief when we know so many other programs that are reaching out to the human needs of the people of this country and trying to touch the neglected children, the abused children, and those who live way below the poverty thresholds in this country?

Mr. BURTLESS. Well, I think the burden of my testimony is that unless you understand that this tax reduction is going to involve even greater spending reductions than would otherwise be necessary to achieve whatever long-term budget goal you have—and as I understand the goal of many Members, it is a balanced budget—

then you shouldn't proceed with it unless you are really willing to make the spending reductions that are involved.

I agree with you. I don't think that in fact most of the population or most Members of Congress are really willing to make the spending reductions that would already be required, let alone the additional ones needed to offset this credit.

Mr. FORD. If we don't make those cuts, according to your written testimony, you have indicated that we are going to pass that debt problem to our children and grandchildren. It is obviously clear that is what would happen if we passed this tax cut that is before this Congress with the Republicans' Contract With America is that we are going to shift that financial responsibility to the next generation and the generation following.

Mr. STEUERLE. All of us have testified that we would—we believe that a child credit is appropriate. Even Dr. Burtless says, given everything else, he thinks that it would be nicer to make the Tax Code a little more friendly toward households with children if we would do a lot of other things at the same time.

The difficulty here is deciding what is the total size of the pie and how to slice the pie. I happen to think that we can discuss the issue of how to slice the pie at the same time we discuss its total size. For instance, suppose we were looking at the expenditure budget and we discovered that educational expenditures were going predominantly to men and were not going to women. Someone came before the expenditure committee and said, "I think that is an unfair slicing of the pie and that we ought to make sure that a fair proportion of the pie also goes to women." I think most of us would accept that as a reasonable argument to make and would not necessarily say, "Well, we can't do it. We can't create this more equitable system because it is going to cost us too much." I think that has been what the testimony here has enhanced. We believe that the tax system does not make adequate adjustment for households of larger sizes, that have children and have substantial burdens. We ought to reslice the pie. That is an appropriate issue to raise, even while we recognize that the question of whether the deficit is going up is something that cannot be ignored.

Mr. FORD. Right. If I am in that income bracket and I had children, I would get a tax credit. But if the welfare mother has an additional child, the proposal under the Contract With America is talking about capping and cutting the funds off for an additional child. But under this particular proposal, a tax credit is in order if a couple would have a child and work within the work force and earn $50,000 a year, then that person is entitled to an additional tax credit. But if the welfare mother would have another child under the same proposal under this Contract With America, then they would be denied any benefits. I am saying on one hand we are giving a tax cut for the working middle class and for the poor and the downtrodden of this country, we are removing their welfare funds and capping their family size.

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

Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman. I think the institutional memory here is really shaky. For 40 years now, the other side of this committee has controlled the tax policy in this Con-

gress, and we have built the deficits on the tax policy that was created by the now minority party, and so we have an institutional memory lapse here in trying to come to grips with who should spend their money.

Remember, as you all know as well as I do, the Federal Government has no money. It only has what it takes from the wonderful people in this country to provide some type of services to those people—namely, the services that they can't provide for themselves. We seem to have a lapse in memory in coming to grips with the decision of the American people last November to balance our Federal budget and set those priorities that are necessary to do that. I don't think you will find that the majority Members now are afraid to face up to the reality of the cuts that are necessary to get to a balanced budget by the year 2002.

Now, you have made many suggestions in your testimony. You didn't think there was enough will to do it or you didn't think there were enough people that realized what it would take to get there. I think you are wrong. I think exactly the opposite has occurred. I think the November 8 elections sent a clear message that what we must do is return more dollars to the people of this country to allow them to spend their own money and have the Federal Government do less. So I think the message we got on November 8 was very clear. Now, if—are you here to dispute that message or am I misunderstanding your testimony?

Mr. BURTLESS. Well, I hope you are right, Representative Bunning. My impression is that in the past, there have been firm promises from the Hill of a balanced budget, including, I can remember, back in the early eighties. Yet it has not occurred. I hope that perhaps I am wrong this time around in my forecast.

I also think that a lot of the spending that looks as though someone in Washington controls the pocketbooks of American citizens in fact has a different reality. The programs are doing very much what American citizens want. They want to receive Social Security benefits, and no bureaucrat tells them how to spend those benefits. They would like to collect Medicare benefits, and no one tells them what doctor to see or what hospital to go to. So I think a lot of the spending does not represent interference of people here in Washington as much as it reflects really what Americans would like to see their money spent upon.

Mr. BUNNING. Then you are disagreeing with the message I got last November 8. You disagree that the fact of the matter is that the new majority of Republicans were sent to Washington to reconsider the amount of taxes we are taking from people and the priority list that we have as far as expenditures?

Mr. BURTLESS. I think that is right. But the question is, is there enough in the Federal budget that we can identify what the public really does want to see reduced that would permit this tax reduction, the child care tax credit, to occur without adding to the debt that we hand down?

Mr. BUNNING. I believe that we have to cut the spending first before we do it, and I think that is the opinion of the majority of the people that sit on this committee. There is no question that we have to cut out the spending to allow the tax reduction to occur. The same goes with all other tax reductions that we are looking at

in the Contract With America. Now, that message came through clear to me. Does anybody else disagree on the panel?

Mr. STEUERLE. No, Mr. Bunning. If I can push aside some veils on the expenditure side, I think the major issue that faces the Congress over the intermediate term is going to be with one of the issues that your subcommittee deals with, which is health care. I have generated some numbers that show if we look at real spending on health and we add together Federal, State, and local expenditures and tax subsidies, we are scheduled to increase something like $150 to 200 billion annually our expenditures on health in just 5–6 years. So we have this enormous built-in growth rate in certain expenditure programs, and as Representative Kasich says, it is getting these types of growth rates under control that is going to allow us the freedom to do other things, such as providing a child credit, which, by the way, is relatively small in size compared to those real health cost increases.

Mr. BUNNING. Thank you, Mr. Chairman.

Mr. CRANE [presiding]. Thank you.

I want to thank the panel for their testimony today.

I would like now to call to the next panel, Anne Alstott, Alan Reynolds, and Marjorie O'Connell, please.

Following our general practice, it is always ladies first, so Ms. Alstott, you may proceed.

STATEMENT OF ANNE L. ALSTOTT, ASSOCIATE PROFESSOR OF LAW, COLUMBIA UNIVERSITY SCHOOL OF LAW

Ms. ALSTOTT. Thank you, Mr. Crane.

Mr. Chairman and members of the committee, my name is Anne Alstott and I am a member of the law faculty at Columbia University. Thank you for the invitation to discuss possible legal rules for alleviating the Federal income tax marriage penalty. I have submitted written testimony for the record and will summarize it very briefly here.

I would like to make four points: First, both the income tax and the earned income tax credit, or EITC, create marriage penalties. In both cases, the marriage penalty is distributionally arbitrary. It imposes a greater tax burden on certain married couples than on unmarried people in similar situations. In addition, empirical evidence suggests that the marginal tax rates applied to married couples by the income tax and by the EITC may create significant work disincentives for married women.

Second, although the marriage penalty is undesirable, it is not easily eradicated. Completely eliminating the marriage penalty, in either the income tax or the EITC, would require significant and costly changes in the Federal income tax system, which could compromise other important policy goals.

For example, in the past, some policymakers and scholars have advocated a system of individual filing, in which each person's tax liability would be determined without regard to marital status. While this kind of tax system would by definition eliminate the marriage penalty, it could undermine the accuracy of the income tax and the EITC and would raise serious administrative issues.

Third, in light of these tradeoffs and the limited revenue available for marriage penalty reform, I believe it is appropriate to ad-

dress the marriage penalty through incremental rather than sweeping change. This is one of the most difficult areas of the Federal income tax to reform.

Theoretical purity is difficult and expensive to achieve and, in my view, is not necessarily desirable. Tax policy toward married couples is inevitably an uneasy compromise, as history demonstrates.

Finally, I recommend that the committee give serious consideration to a tax deduction for two-earner couples similar to the deduction allowed under prior law. Ideally, the deduction should be structured to extend relief to recipients of the EITC as well as to income-tax payers. Extending relief to the EITC population is appropriate because the distributional incentives and concerns that motivate marriage penalty relief apply with equal force to EITC recipients.

My written testimony describes some conceptual and technical issues which arise in coordinating the two-earner deduction with the EITC. Although the two-earner deduction would reduce rather than eliminate the marriage penalty, it is an incremental policy that can be structured to fit within the budget constraints that the committee determines are appropriate.

The principal disadvantage of the two-earner deduction is that it is not precisely targeted. The deduction in its simplest form may offset all the marriage penalty for some couples, a portion of the marriage penalty for others, and even increase the marriage bonus for still others. Truly precise targeting is difficult to achieve without significant administrative cost, however.

In my written testimony, I have described for your consideration an intermediate solution which would help target the deduction to couples facing marriage penalties, with the cost of a slight increase in administrative complexity. My written testimony also describes other alternatives that the committee may wish to consider.

For example, it would be possible to use a tax credit rather than a deduction for two-earner couples. It would also be possible to target the two-earner deduction with a credit to particular income groups, for example, to EITC recipients. Final conclusions must await empirical analysis, but I hope that these suggestions are helpful to you.

Thank you.

[The prepared statement and attachment follow:]

STATEMENT OF ANNE L. ALSTOTT
ASSOCIATE PROFESSOR
COLUMBIA UNIVERSITY SCHOOL OF LAW
BEFORE THE
WAYS AND MEANS COMMITTEE

January 17, 1995

Mr. Chairman and Members of the Committee:

I appreciate the invitation to testify before the Committee today. My testimony will focus on the portion of the Contract with America that promises to bring to the House floor legislation to reform the federal income tax marriage penalty. The views I express today are my own and are not necessarily those of Columbia University.

In the past, the marriage penalty created by the federal income tax has been largest for middle-income and upper-income taxpayers. The federal income tax now incorporates a very large earned income tax credit ("EITC"), which can create marriage penalties that are large both in absolute dollar terms and relative to the incomes of low-income taxpayers. Although the policy issues created by the marriage penalty in the income tax are familiar, the marriage penalty created by the EITC is less well understood. In fact, the traditional distributional and incentive concerns that give rise to criticism of the marriage penalty in the income tax apply with equal force to the EITC. The policy analysis accompanying the Contract with America acknowledges that the marriage penalties created by both the income tax and the EITC are subjects of concern.

My testimony makes four main points:

o The marriage penalty created by both the income tax and the EITC is distributionally arbitrary, imposing a greater tax burden on certain married couples than on similarly-situated unmarried people. Empirical evidence suggests that the marginal tax rates applied to married couples by the income tax and the EITC also may create significant work disincentives for married women. The marriage penalty clearly creates a financial disincentive for marriage, but it is not clear whether that disincentive significantly changes people's decisions to marry.

o Although the marriage penalty is undesirable, it is not easily eradicated. Completely eliminating the marriage penalty in either the income tax or the EITC would require significant and costly changes in the federal income tax system, which could compromise other important policy goals. For example, a system of individual filing, which would determine each person's tax liability without regard to marital status, could undermine the accuracy of the income tax and the EITC and would raise significant administrative issues.

o In light of these tradeoffs and the limited revenue available for marriage penalty reform, it is appropriate to address the marriage penalty through incremental rather than sweeping change. I recommend that the Committee give serious consideration to a tax deduction for two-earner couples, similar to the deduction allowed under prior law. Ideally, the deduction should be structured to extend relief to recipients of the EITC, because the concerns that motivate marriage penalty relief apply with equal force to EITC recipients.

o Although the two-earner deduction would reduce, rather than eliminate, the marriage penalty, it is an incremental policy that can be structured to fit within the budget constraints that the Committee determines are appropriate. The two-earner deduction is not precisely targeted; it may offset all the marriage penalty for some couples, a portion of the marriage penalty for others, and even increase the "marriage bonus" for others. Truly precise targeting is difficult to achieve without significant administrative cost, although intermediate solutions, which enhance precision with some increases in administrative complexity, are possible. The Committee may also wish to consider a tax credit for two-earner couples or a two-earner deduction that

is more narrowly targeted to particular income groups.

Final conclusions and comparisons of these alternative policies require empirical analysis of concrete proposals. This analysis is beyond the scope of my testimony but can be performed by your staff. My goal is to outline the advantages and disadvantages of the most promising legal options and the empirical questions that should be addressed in choosing among these options.

Distributional and Incentive Effects of the Marriage Penalty

Two individuals face a "marriage penalty" when their federal income tax liability is greater (or their refund attributable to the EITC is smaller) if they marry than if they remain single. A "marriage bonus" occurs when two individuals pay a smaller federal income tax if they marry than if they remain single. The current federal income tax imposes a marriage penalty on some couples (typically when the two individuals have similar incomes) but awards a marriage bonus in others (typically when the two individuals have disparate incomes). Under current federal income tax law, two-earner couples are more likely to suffer marriage penalties, while single-earner couples are more likely to receive a marriage bonus. Recent research by Harvey Rosen and Daniel Feenberg suggests that in 1994 52% of married couples faced a marriage penalty, while 38% received a marriage bonus.[1]

Policy makers and scholars have long criticized the current federal income tax treatment of married couples for reasons relating both to distribution and to incentives. Critics of the marriage penalty argue that marital status should be irrelevant to determinations of the income tax. They view any distinctions based on marital status as arbitrary and thus would ideally eliminate any marriage penalty or marriage bonus. Further, analysts note, the marriage penalty tends to be largest for two-earner couples with relatively equal earnings. In contrast, many single-earner couples receive a marriage bonus. Thus, the tax law seems to reinforce traditional gender roles within the family.

Critics of the marriage penalty also criticize two potential behavioral effects. One claim is that the marriage penalty discourages marriage. This argument, although intuitively appealing, typically is made without empirical support. Like any economic incentive, a marriage penalty's actual effects on behavior are unknowable in the absence of empirical evidence. People make decisions about whether to marry or not based on a number of social and emotional factors, and it is impossible to predict, without empirical evidence, how a monetary penalty in the form of a higher tax bill may change those decisions.[2]

A second incentive claim is that the marginal tax rate structure facing married couples may also discourage work by second earners, typically married women. The problem arises from the system of joint filing. When a married woman with an employed husband enters the workforce, her very first dollar of earnings is taxed at the marginal tax rate applicable to the couple based on her husband's earnings. In contrast, an unmarried person entering the work force faces a marginal tax rate determined by her own earnings alone. Thus, a married woman may face a higher marginal tax rate on earnings than a single woman, and the higher rate may discourage work. Once again, however, the actual effects of the incentive on behavior require empirical evidence. Available studies suggest, however, that this work disincentive may have a relatively large effect on married women's labor supply. Critics argue that this aspect of the taxation of married couples also tends to reinforce traditional gender roles by encouraging married women not to work at all or to work fewer hours.

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[1] Daniel R. Feenberg and Harvey S. Rosen, *Recent Developments in the Marriage Tax*, NBER Working Paper No. 4705 (April 1994).

[2] Harvey Rosen and Daniel Feenberg point out that the marriage penalty may also encourage married couples to misreport their status as single. Rosen and Feenberg, *supra* note 1.

Extending the Critique of the Marriage Penalty to the EITC

Historically, the federal income tax marriage penalty has been relatively small for low-income families, because the federal income tax exempts those with very low incomes. In 1995, for example, the federal income tax threshold for a married couple with two children is $16,550. The EITC, however, can create a large marriage penalty for some low-income workers. For example, consider two individuals, each with two children and earnings of $10,000. In 1996, each individual would be entitled to the maximum EITC of $3,560, for a combined EITC of $7,120. If these individuals marry, however, they would be entitled to a joint EITC of only $1795, which represents a marriage penalty of $5,325, or 27% of income. This example is probably somewhat extreme, but it illustrates the potentially large marriage penalties the EITC creates.

The EITC, like the income tax, may also award a marriage bonus in some circumstances. *See* Example 1 in the Appendix to this testimony. Actual marriage penalties and bonuses for EITC recipients depend on the pattern of earnings and number of children of EITC recipients.

The EITC's marriage penalty and marginal tax rate structure are open to the same criticisms levelled at the income tax. The EITC, like the income tax, arbitrarily penalizes marriage, which is particularly incongruous when other public policies, including welfare policy, increasingly seek to encourage marriage. While the EITC's marriage penalty is distributionally arbitrary, once again it is not known whether the penalty actually affects low-income workers' decisions about marriage. I know of no empirical evidence on the effects of the EITC marriage penalty, but evidence from the welfare context suggests that even seemingly large financial incentives do not automatically translate into behavior.

The EITC may also impose relatively high marginal tax rates on secondary workers. For example, in 1996, a single mother with two children who is considering going to work actually faces a negative 40% marginal tax rate (or earnings subsidy) on wages up to $11,620 thanks to the EITC (and ignoring any phaseout of welfare benefits to which she may be entitled). If that woman marries, however, her husband's earnings may push the couple into the EITC phaseout range (or may be high enough to preclude EITC eligibility altogether), thus reducing the net gain from her work.[3]

Policy Tradeoffs that Constrain Reform in the Income Tax and the EITC

Given these problems, why do we tolerate the marriage penalty? Virtually no one is affirmatively in favor of the marriage penalty, and yet it has been a consistent feature of the federal income tax since 1969. The well-known answer is that the marriage penalty is an unavoidable product of other policy choices incorporated in our federal income tax system. As Boris Bittker has elegantly demonstrated, an income tax system cannot simultaneously have progressive marginal tax rates, equal taxation of married couples with equal incomes, and marriage neutrality. In opting for the first two, we have chosen to sacrifice the third. *See* Example 2 in the Appendix. The corollary is that marriage neutrality is difficult to achieve. Complete marriage neutrality would require either flat marginal tax rates or a system of income taxation in which each individual pays taxes on his or her income alone, without regard to marital status.

Both of these changes would require drastic alterations in the federal income tax. Adoption of flat marginal tax rates clearly could have significant distributional and efficiency implications and is presumably beyond the scope of the Committee's immediate agenda. A system of individual filing may appear to be an easier change, but it is objectionable on grounds of both equity and administration. Such a system would impose the same tax on

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[3] *See* Stacy Dickert, Scott Houser, and John Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, paper prepared for the November 1994 NBER conference on Tax Policy and the Economy (November 10, 1994) (predicting that the EITC may lead secondary workers to reduce hours of work).

(or award the same EITC benefit to) an individual earning $15,000 per year, whether that individual is the sole source of support for a large family or is married to someone who earns $100,000 per year. It would also assess a higher tax on a family in which two workers earn $10,000 and $40,000, respectively, than on a family in which two workers each earn $25,000. The basic point is that the adoption of individual filing would change the distribution of tax liabilities, perhaps significantly, in ways that are arbitrary, because they are based on a faulty measurement of income. The current income tax, of course, does not measure income perfectly; for example, it does not require aggregation of income of unmarried persons who pool their income. Individual filing would, however, further decrease the accuracy of the income measure. Individual filing also raises serious administrative issues, principally questions of allocating joint deductions and unearned income between spouses.

The EITC marriage penalty also is difficult to eliminate. The EITC marriage penalty arises in part because the EITC provides the same dollar benefits to a single individual as to a married couple with the same earnings, adjusted gross income, and number of children. The result is that marriage can reduce or eliminate the EITC, if the couple's combined income is in or above the EITC phaseout range. This marriage penalty could be reduced by restructuring the credit to provide lower benefits to single individuals than to married couples. Such a revision would, however, conflict with other policies that the EITC serves by reducing the potential work incentive and income support benefit of the EITC for single workers. The 1993 increase in the EITC, which received strong bipartisan support, was intended to "make work pay". Cutting EITC benefits for single workers, and particularly single parents, a group which is disproportionately poor, would reduce their well-being, both in absolute terms and relative to married-couple families. Reducing EITC benefits for single parents could also undermine the EITC's work incentives; a recent study indicates that the EITC's greatest success in increasing labor force participation is for single parents.[4]

Further, even amending the EITC to provide benefits to married couples that are twice as large as those awarded to single parents would not eliminate the EITC marriage penalty completely. This remaining marriage penalty is inherent in the EITC and in many other income-tested transfer programs because of the structure of the marginal tax rates that arise from the phaseout of the credit. *See* Example 3 in the Appendix. As I have noted elsewhere, the EITC faces a fundamental tradeoff that is entirely parallel to the tradeoff Bittker demonstrated for the income tax: it cannot simultaneously have high phaseout rates, equal benefits for families with equal incomes, and marriage neutrality.[5] Eliminating the EITC marriage penalty entirely would require adopting either flat marginal tax rates or a system of individual rather than joint filing, which have the disadvantages noted above.

Thus, the marriage penalties created by the income tax and by the EITC both reflect difficult tradeoffs among competing policy goals. Purity is extremely difficult to achieve and is not necessarily desirable. Tax policy toward married couples is inevitably an uneasy compromise, as history demonstrates, and policy makers may reach different conclusions after weighing the competing advantages and disadvantages of alternative policies. My own judgment is that it is reasonable to take incremental measures to reduce the distributional arbitrariness and work disincentives of the marriage penalty, but that these distributional and incentive problems do not warrant drastic or costly actions, such as adoption of individual filing or reductions in EITC benefits for single parents.

Further, the draft legislation accompanying the Contract with America contemplates marriage penalty relief that does not cost more than $2 billion per year. Given this revenue constraint, any relief must by definition be incremental. In contrast, the repeal of the two-earner deduction in 1986 was estimated to raise about $6 billion per year. The comparison is a rough one, but it does suggest that the Contract contemplates modest rather than

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[4] Dickert, Houser, and Scholz, *supra* note 3.

[5] *See* Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 559-64 (1995).

sweeping changes.

Accordingly, I recommend that the Committee give serious consideration to implementing the relevant provision of the Contract with America through a tax deduction or credit for two-earner couples, as described in the next section.

Alleviating the Marriage Penalty Through a Two-Earner Deduction or Credit

Between 1981 and 1986, the federal income tax permitted married couples filing jointly to deduct 10% of the earnings of the lower-earning spouse up to $30,000 per year, for a maximum deduction of $3,000. The Tax Reform Act of 1986 repealed the two-earner deduction.

The EITC is now substantially larger than it was in the early 1980s. It would be appropriate to modify the two-earner deduction so that it provides relief not only for the income tax marriage penalty but also for the EITC marriage penalty. As the preceding section notes, the distributional and incentive effects that fuel concern about marriage penalties in the income tax also apply to the EITC. Ideally, then, any solution will provide relief from marriage penalties in both the income tax and the EITC. The practical importance of extending relief to the EITC population may, however, depend on data which I do not have, in particular the prevalence and magnitude of actual marriage penalties among EITC taxpayers and how effective the two-earner deduction would be in alleviating the penalty. These are empirical questions and depend on the patterns of earnings of EITC recipients.

Technically, the two-earner deduction could be made available to EITC recipients by making the two-earner deduction an "above the line" deduction, as under prior law. An above the line deduction is taken into account in determining AGI, which governs phaseout of the EITC (unless "earned income" is greater). Whether the deduction should be taken into account in determining earned income is a more difficult issue. EITC recipients in the EITC phaseout range would benefit from a deduction that reduces earned income; indeed, many of them might not benefit from the reduction in AGI unless earned income were also reduced (because phaseout would be based on the higher earned income). However, reducing earned income would actually leave EITC recipients in the phase*in* range worse off by reducing the EITC. The matter could be left to the election of the taxpayer, but any election potentially increases complexity. In resolving this issue, it would be helpful to know how many two-earner married couples are in the EITC phasein range.

The two-earner deduction thus represents an incremental change that would reduce rather than eliminate the marriage penalty and would reduce work disincentives for secondary workers. It can be structured so that its revenue cost is modest. The percentage of the second earner's earnings that should be deductible, and the cap on eligible earnings, if any, should largely be structured to meet revenue constraints. A larger percentage exclusion, with a smaller earnings cap, would tend to benefit lower-income families. My testimony does not address how much revenue ought to be devoted to marriage penalty relief or how that revenue ought to be made up elsewhere in the budget.

The principal disadvantage of the two-earner deduction is that it is not precisely targeted. All two-earner couples are eligible for the deduction, but not all such couples face a marriage penalty; some face a marriage bonus. The size of the marriage penalty depends on the individuals' relative earnings and their tax bracket (and, for EITC recipients, the range of the EITC in which their earnings fall). Thus, while the two-earner deduction reduces marriage penalties for some two-earner couples, it may create or increase a marriage bonus for others. The degree of mistargeting is another empirical question: the Committee's staff may be able to provide further information on the degree of mistargeting under alternative versions of the two-earner deduction. It may be that particular combinations of percentage exclusions and earnings caps are better targeted than others, given the distribution of earnings among the population.

Some mistargeting of benefits occurred under prior law and is inevitable with any deduction that applies to all two-earner couples. The only way to target the deduction with complete precision would be to require couples to calculate their marriage penalty and then provide a deduction tailored to that penalty (*e.g.*, some percentage of the penalty). This sort of rule would create considerable administrative complexity, however. It would require taxpayers (and the IRS) to make three *pro forma* calculations (of the couple's tentative joint tax liability and each individual's separate tax liability) before calculating the marriage-penalty deduction and then calculating final tax liability. Further, the *pro forma* calculation of individual tax liabilities raises the administrative issues relating to the allocation of joint income and deductions that would arise in a system of separate filing.

An alternative that may be worth exploring is to target marriage-penalty relief to two-earner couples who are likely to face the largest marriage penalties (*e.g.*, to couples in which the two workers have relatively equal earnings). One solution that was discussed in 1980 but not incorporated into prior law was to create tables that would indicate the allowable deduction based on the relative earnings of the husband and wife. Such tables might be more precise than a simple two-earner deduction but less precise than individual calculations of actual marriage penalties. These tables would, however, avoid the need for numerous *pro forma* calculations by each couple. In general, it should be relatively easy to determine the separate earnings of two-earner married couples. Tables based solely on earnings would simply omit unearned income from the marriage-penalty computation, avoiding the worst administrative problems of separate filing.

Another possible disadvantage of the two-earner deduction is that it increases the complexity of the Code by creating another specialized deduction. This concern may be somewhat greater for the EITC, because of the modification of the "earned income" definition described above. For both the regular income tax and the EITC, however, the additional complexity appears modest, although the Internal Revenue Service could provide more information on exactly how the additional deduction would be reflected on the tax return and Schedule EIC. Concern about complexity would be greater if tables, like those described in the preceding paragraph, are used to improve targeting.

The prior-law two-earner deduction was sometimes justified on the ground that it helped redress the tax code's failure to allow a full deduction for the costs of working -- a failure that hurts two-earner couples more than single-earner couples. While the marriage penalty is conceptually distinct from the treatment of costs of working, the two-earner deduction in effect links the two problems by limiting marriage penalty relief to those couples who also face inadequate relief for costs of working. The two-earner deduction clearly is not a comprehensive solution to this problem, which affects every worker, regardless of marital status. Nevertheless, the disadvantage suffered by two-earner couples relative to one-earner couples does provide some justification for targeting marriage penalty relief to the former group (and for providing no relief for marriage penalties suffered by single-earner families due to unearned income). In addition, if secondary workers incur particularly large costs of working or are particularly sensitive to the potential work disincentives created by the lack of deductions for costs of working, targeting relief in this way may be sensible.[6]

Given the limited revenue available for marriage penalty relief, additional targeting of relief to certain groups of taxpayers may be appropriate. It would be possible, for example, to allow the two-earner deduction only for purposes of calculating the EITC, and not for regular income tax purposes (or to allow a larger deduction for EITC purposes). Targeting relief to EITC recipients is intuitively appealing, because this group faces such potentially large marriage penalties relative to their low incomes and is the object of other social policies designed to encourage marriage. However, any final judgment on whether such targeting is appropriate turns, once again, on how prevalent marriage penalties are among EITC recipients, and how effective the proposed deduction would be in alleviating

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[6] *See* Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 U.C.L.A. L. REV. 983, 1009 (1993).

these marriage penalties.

An alternative would be to award a tax credit, rather than a deduction, to two-earner couples. The value of a two-earner deduction increases with the marginal tax rate. In contrast, a refundable tax credit would provide the same tax benefit to all eligible couples. A *nonrefundable* credit would provide the same tax benefit to all eligible couples, except those with insufficient tax liability to offset the credit. While a tax credit is often preferable to a deduction for precisely this reason, in this context a deduction may be the better choice, because marriage penalties tend to rise with marginal tax rates (which are highest for some EITC recipients and high-income couples). On the other hand, the marriage bonuses awarded to some two-earner couples also rise with marginal tax rates, and so a two-earner deduction tends to increase those bonuses. Thus, the question of targeting is, once again, an empirical one. While my intuition is that a deduction is probably a better-tailored remedy, any firm conclusion should be based on empirical simulations of the two alternatives, taking into account the distribution of incomes and marriage penalties and bonuses.

If a credit is the preferred solution, further thought should be given to coordinating it with the EITC. A refundable credit would provide relief to EITC recipients who face a marriage penalty but do not have any income tax liability. Consideration should be given to integrating the new credit as simply as possible with the EITC application procedure. A nonrefundable credit would provide less relief to the EITC population and, at a minimum, should be drafted so that income tax liability first offsets the new, nonrefundable credit before being offset by the EITC.

I hope my testimony is helpful to the Committee in its deliberations. I would, of course, be happy to continue to work with your staff on any legal issues that arise as they examine these or other options.

Appendix to Statement of Anne L. Alstott, January 17, 1995

All examples assume that earnings are the only source of income, that all children are "qualifying children" under the EITC and dependents under the income tax, and that taxpayers take the standard deduction. EITC parameters are for 1996, as estimated by the Ways and Means Committee's 1994 Green Book. Income tax parameters, including rates, standard deductions, and personal exemptions, are for 1995.

Example 1. EITC Marriage Bonuses. If a childless worker earning $10,000 per year marries a non-worker with two children, the couple's total EITC, net of federal income tax, actually rises from $0 to $3560. If two workers, each with one child and earning $5,000 per year marry, their total EITC rises from $3,400 to $3,560.

Example 2. The Impossibility of Simultaneously Having Progressive Marginal Tax Rates, Equal Taxation of Married Couples, and Marriage Neutrality. Consider a simple income tax that imposes tax at a rate of 10% on income less than or equal to $10,000 and at a rate of 25% on income above $10,000. Consider four single individuals:

Name	Income	Tax (single)
A	$10,000	$1,000
B	$10,000	$1,000
C	$ 4,000	$ 400
D	$16,000	$2,500

If A and B marry and C and D marry, an income tax that preserves marriage neutrality would leave unchanged the aggregate taxes (positive or negative) paid by each couple. That system, however, would treat the two equal-income couples very differently. The A/B couple would pay tax of $2,000, while the C/D couple would pay tax of $2,900. Adjusting the rate schedule so that both couples pay the same tax would necessarily impose a marriage bonus or penalty on one or both couples. This example is found in Boris I.

Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1395-96.

Example 3. An EITC Marriage Penalty Remains Even If Benefits for Married Couples are Twice As Large As Those For Single Workers. Suppose, for example, that the EITC benefit for a married couple with two children remains $3,560, but that the benefit for a single parent with two children is half that amount, or $1,780, and that result is achieved by applying the EITC parameters (40% phasein rate, 21.06% phaseout rate) to thresholds that are half those for married couples (phasein ends at $4,450 instead of $8,900; phaseout begins at $5,810 instead of $11,620; phaseout ends at $14,262 instead of $28,524). Consider two single parents, each with two children and earnings of $10,000. If they remain single, each is entitled to an EITC of $898, for a total EITC of $1,796. If they marry, they will be entitled to a total EITC of $1,796. This couple thus faces no EITC marriage penalty. If, however, one of the single parents earns $10,000 and the other earns $20,000, they face an EITC marriage penalty: a total EITC of $898 if single but $0 if married.

Mr. CRANE. Thank you very much, Ms. Alstott.

Let me reassure all of you that your entire written testimony will be put into the record.

Ms. O'Connell.

STATEMENT OF MARJORIE A. O'CONNELL, ATTORNEY, O'CONNELL & ASSOCIATES, WASHINGTON, D.C.

Ms. O'CONNELL. Thank you, Mr. Crane.

Gentlemen of the Ways and Means Committee panel, thank you for the opportunity to talk to you this afternoon about the marriage penalty credit in the American Dream Restoration Act.

I come to you I hope as a little bit of a refreshing exception from all of the economists and Ph.D.s. I am a practitioner. I am a tax attorney who for almost 25 years has specialized in the practical problems faced by families trying to file accurate Federal tax returns.

With respect to the marriage penalty tax and its repeal, something which I also advocate, I understand that this legislation only goes partway, but it is an important partway to begin. I have made some assumptions in my written testimony about how the marriage penalty repeal or alleviation as a credit would operate, and it is the practical aspects of the operation of that credit that I would like to elaborate a bit upon today.

First of all, for the naysayers that tell us it would all be too difficult to figure out, I would have to say baloney. We figure out some terribly difficult things administratively in this tax system. When it comes to this part of the population who typically comes before you without its PAC (Political Action Committee), things get awfully costly and awfully difficult, and sometimes they don't happen. I urge you to ensure that this does happen. It is not too difficult for our Treasury Department to figure out how to allocate among married couples the amount of a flat dollar credit and to announce that credit as they distribute the 1040s during the year.

We always adjust for past years' estimates that deserve some adjustment when they trickle down through the economy. When you use a flat dollar credit, if you stop and think about the arithmetic, you will know that you are more advantaging, as a ratio of taxes paid, lower income families.

To the extent that is the policy you seek to enforce, you should stick with a flat dollar credit. But it would be just as easy for the Treasury Department to figure out that in a world where they know they collected some $10 billion of marriage penalty taxes and they only want to give back $2 billion of those taxes to married people, there should be a credit which is 20 percent of the tax that couples would calculate is their marriage penalty. That is a little easier, it is not a flat dollar amount, and it gets us to the same place. It also spreads the benefit differently among the populice. So I leave to you the policy decision of advantaging more lower income married couples or spreading that benefit.

You have to consider, too, as you think of the other rate changes that you may institute this year as you change phaseouts of other kinds of benefits for deductions, the extent to which you are changing the impact of the marriage penalty in the populice. Your staffs, I am sure, can give you a chart that tells you easily where that is.

Those decisions may help you determine whether you still want to skew a flat dollar penalty to lower income couples or rather spread the percentage penalty credit relief among the populice.

When it comes to calculating the amount of income that individuals will need, which one party or the other has to figure out what they would pay had they not been married, when they calculate their taxes, they are going to have to decide whether to itemize deductions, each of them, or whether to use a standard deduction. They ought each be able to be itemizing. They are going to have to allocate deductions between them. That is not hard stuff. They do that for lots of purposes now.

They ought to be able to freely allocate. They are going to have to deal with phaseouts, should that be their joint return number or an individual number. It should be an individual number. They understand what their individual income is. They figure that out for a lot of State law purposes and other kinds of marital property purposes.

They are going to have to look at their unearned income as well as earned income. Don't be led to believe that when you open the door for unearned income, hundreds of thousands of wealthy taxpayers will march through and skew their family wealth. First, they won't, because it is not enough of an incentive.

Second, if it were a great incentive, the way you have designed the credit, it is going to cut in either with a flat dollar or percentage that is going to keep that abuse from being meaningful.

So I applaud the work that you do for the marriage penalty credit. I urge you as you give people the opportunity to attribute to each their actual earned income, you think about giving them an opportunity each to be personally responsible for their liabilities to the government as opposed to picking up each other's on that joint return.

Thank you.

[The prepared statement follows:]

TESTIMONY
OF
MARJORIE A. O'CONNELL, ESQ.
O'CONNELL & ASSOCIATES, P.C.
Washington, D.C.

Before the
U.S. House of Representatives
Committee on Ways and Means

January 17, 1995

CONTRACT WITH AMERICA

The American Dream Restoration Act

"Credit to Reduce the Marriage Penalty"

The amount of additional tax which a husband and wife each having income pay on such income because of marital status, the so-called "marriage penalty", depends upon the amount of the aggregate income of the husband and wife and the ratio of their incomes, one to the other. The marriage penalty is caused by the relationship between the rate schedules for married individuals filing jointly or separately and the rate schedule for an unmarried individual. This relationship, established by the Tax Reform Act of 1969, was specifically designed to alleviate the disparity between taxes paid on equal income by married individuals and an unmarried individual. The relationship assures that an unmarried individual does not pay a tax more than 20 percent greater than the tax paid by married individuals with taxable income equal to the unmarried individual's taxable income.

Congress realized that, in alleviating the disparity between tax rates for married individuals and an unmarried individual, it would cause married individuals each of whom had income to pay more tax on their aggregate income than they would on their separate incomes if they were not married. However, Congress justified this result on the grounds that married individuals expenses were likely to be less than two unmarried individuals expenses. Congress concluded that since married individuals had a greater ability to pay taxes than unmarried individuals, it would impose higher tax rates on the income of married individuals than on the income of an unmarried individual.

Family demographics changed radically in the years following the institution of the marriage penalty tax. In the intervening generation the old laments about "traditional family" were turned on their heads. Those creaking with paranoia about tax evasion's arrival with marriage penalty relief found no political refuge in the 1993 election year mandate. The Contract with America repudiates penalizing the "two career family" and calls for broad relief from the marriage penalty tax.

Section 3 of "The American Dream Restoration Act" provides for a credit to reduce the marriage penalty tax. Specifically, in the case of a "qualified married couple", there would be allowed as a credit against the tax imposed on income for the taxable year an amount equal to an "applicable dollar amount". The term "qualified married couple" means a husband and wife who file a joint return for the taxable year and who but for this credit would be required to pay more in income taxes because of the fact they were legally married during such taxable year than they would be required pay if they had not been legally married. The term "applicable dollar amount" means an amount which the Secretary estimates will result in a $2 billion reduction of revenues for the taxable year in which such credits would be taken. In no event may the amount of the credit to reduce the marriage penalty for which a taxpayer may qualify exceed the marriage penalty which that taxpayer actually suffers in any taxable year.

In examining this provision it is helpful to assume how the credit would operate and then examine based on that assumption issues raised by the credit's operation.

We assume marriage penalty tax relief would operate as follows. Each married couple filing jointly would determine whether they qualified for the credit by (1) calculating the tax on the joint return (using the married filing jointly rate schedule); (2) calculating the tax each would have paid had he or she not been married, and adding these taxes together; and (3) comparing (1) and (2). If (2) were less than (1), the couple may claim the new credit up to the "applicable dollar amount," but not more than the difference between (2) and (1). The "applicable dollar amount" would be the amount determined to be allowable by the Secretary which would result in an estimated revenue cost of $2 billion for the year in which the credit would be claimed.

First, amount of revenue reduction for a given amount of credit, assuming that the Service will know which taxpayers who file joint returns will be eligible to claim the credit, must be estimated for the same year in which the credit amount based on that revenue reduction must be determined. The technique employed in the legislation would require a determination of the amount of the increase in tax resulting from married couples each having income, and the number of joint returns on which there is (or would be) such an increase. Moreover, the method of tax reduction employed in the statute is a flat credit subject to a limit which will vary from joint return to joint return depending upon the absolute amount of aggregate income shown on the return (the marginal tax bracket) and the relative contributions by each spouse to the total. This will be a difficult number to determine with any precision at any time within the year following the year for which the tax is to be calculated, but it must be estimated by the time the return must be filed.

Second, the benefit of the tax reduction is allocated in a way which favors lower income couples. Recent information is that certain higher income couples contribute a larger amount to the revenue increase resulting from higher income tax liabilities being imposed on married couples with two incomes, yet the credit is allocated as a flat dollar amount. This, of course, is the advantage of a credit in that it may result in a larger benefit relative to the tax liabilities of taxpayers in lower income brackets. Recent data shows that for some lower income taxpayers, the marriage penalty tax can be high relative to income, as much $3,000 in one year (by one calculation, 18% of income), but for higher income taxpayers, the penalty tax can be as high as $10,000. For some in the low to middle income ranges, the flat amount credit would eliminate 100% of the "marriage penalty." For those in higher income brackets, the amount of the penalty climinated by the credit would be relatively smaller. Assume that the applicable dollar amount is $3,000. For a highly taxed, low income couple the credit technique reduces the marriage penalty tax by 100%; for the high income couple the reduction is 30%. This has some advantages, and, we assume, is intended.

Consider an alternative approach as the second point interacts with the first point. If the aggregate amount of the increase in revenue resulting from two married taxpayers, each with income, being compelled to file as married taxpayers can be estimated from past statistics with relatively good accuracy, then the amount of the reduction proposed would be easy to determine as a proportion of each married couple's contribution to the total. So, assume that $10 billion is the revenue increase resulting from being married. The amount of the marriage penalty tax which would be credited on each return may be determined as percentage of the increase. In this example, the credit would be 2/10 or 20% of the marriage penalty tax shown on each affected couple's income tax return. This would be easier to determine, but would not benefit lower income families as much.

Third, the amount of the penalty tax is rate sensitive. This means that changes in marginal rates, which are anticipated as well, will affect both the amount of the marriage tax credit and how it is allocated. The 1993 tax changes, including the increase in rates and variations in the phase-outs to which a taxpayer might be subject, had a major impact on the marriage tax penalty, greatly increasing it in some inappropriate ways. Presumably, the projected tax rate changes could have the reverse impact as marginal rates are reduced. It may also be that rates which apply to unmarried individuals will rise (or, to be more precise, will not be reduced as much as rates on married individuals by bracket shifts). Sophisticated rate schedule design could have the effect of changing the tax distribution by imposing relatively more tax on married couples not eligible for the credit than on those for whom the credit is available.

Fourth, the amount of the marriage penalty tax to which the credit applies is determined by calculating the tax each of the married partners would pay if each had filed separately. For most taxpayers, this will not be as easy as it sounds. There is the question, first, of deductions. If deductions are itemized on a joint return, should the separate tax be calculated using only itemized deductions, or should either spouse be permitted to use the standard allowance if that spouse's itemized deductions are less? This, of course, is precisely what would have happened had they really not been married. If both must itemize (or not, depending on the filing status elected on the joint return), then how should deductions be allocated? We really cannot pretend these taxpayers are unmarried, because they are not and presumably would make economic decisions about the payment of expenses taking into account their married status and potential tax liability.

Present law contains phase-outs of allowable itemized deductions and dependency exemptions based on income. How should these phase-outs be taken into account? Should phase-outs be applied to each taxpayer as if he or she were unmarried, or should the actual amount of phase-outs as reflected on the joint return be reflected in the calculation of the marriage penalty? Should taxpayers be allowed arbitrarily to allocate dependency exemptions in order to obtain the largest marriage penalty tax credit, or should dependency exemptions (and the new Family Tax Credit) simply be ignored in making the calculations?

We assume that for community property purposes, the parties will be treated as unmarried in calculating their marriage penalty tax. Thus, the earned income of each spouse will be treated as earned by the earner, and will not be treated as community income. This result overrules Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58 (1930) to the extent of the benefit of the credit. It opens an attractive door to "go all the way" and eliminate joint and several liability of taxpayers who file joint returns for tax on income attributable to their spouses.

The proposal applies to all kinds of income. Investment income might then be advantageously allocated between the spouses, shades of Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144 (1940) and other hoary assignment of income precedents from the time before income splitting. We assume inclusion of unearned income is thoughtfully intended, and the credit mechanism discussed above designed to offset high income benefits which would otherwise result. Potentially, however, it will be a source of difficulty, depending on the amount of rate relief which can be achieved by income-splitting devices.

We applaud the effort to reduce the marriage penalty and urge the Committee to report out favorably Section 3 of the American Dream Restoration Act.

We would like to thank Professor Thomas R. White, 3RD, of the University of Virginia, for his assistance in preparing this testimony.

Mr. CRANE. Thank you for your testimony.
Now Mr. Reynolds.

STATEMENT OF ALAN REYNOLDS, DIRECTOR OF ECONOMIC RESEARCH, HUDSON INSTITUTE

Mr. REYNOLDS. The marriage penalty is one of many work penalties in the Tax Code and also in the transfer payment system that arise from high marginal tax rates. That includes the earned income tax credit, where marginal tax rates for about two-thirds of the people can reach 49 percent, or if they stand to lose food stamps, they can reach 75 percent. That includes the AFDC–UP program, which limits work hours to 100 hours a month. It includes the earnings test on Social Security.

We have a lot of work penalties built into our tax and transfer system. These have been greatly complicated, particularly the marriage penalty, by the increased marginal tax rates enacted, to some extent, in 1990, but mostly in 1993.

For example, if one earner earns $150,000 taxable income, that means $10,000 of that person's income is taxed at the 36-percent rate. If that person's spouse goes to work and makes, say, $30,000, all of his or her income, the second earner's income, will be taxed at the 36-percent rate. Then you throw in State income tax, Social Security tax, the phasing out of deductions and exemptions, and that person can easily face a marginal tax rate of 50 percent or more on a rather modest income which is a pretty punitive penalty indeed.

I do believe that the proposed tax credit for two earners would help a bit, but it is a much more roundabout and complicated method than simply getting to the root of the problem and cutting the marginal tax rates—in the Income Tax Code, but in the welfare system, as well, through appropriate welfare reform.

It matters from an economic point of view—and I am not going to discuss fairness much, I never did that well in philosophy in school—but from an economic point of view, we are running short of labor. That is pretty clearly tied to some of these labor incentives. We need to encourage older people, wives and everybody else, to get back to work.

From 1981 to 1989, the labor force grew by almost 1.7 percent a year. The past 5 years, that has been cut in half.

Why does that matter? Well, if the labor force had grown only by 0.5 percent faster, which would still be lower than the eighties, just half a percentage point faster for 5 years, the labor force would be 2.5 percent larger; the unemployment rate would be 8 percent. Would anybody think we are running out of room to grow with an 8-percent unemployment? Would the Federal Reserve worry that economic growth would be straining our resources? Probably not.

In fact, we are running close to capacity in labor markets and elsewhere, and need to encourage working and saving to remedy that problem. It is impossible for the economy to keep adding 2 or 3 million workers a year if only 1 million of them are showing up, which has been the trend the last couple years, despite rapid increases in immigration, which is quite amazing.

I present in my paper, in my written testimony, quite a few recent academic studies that suggest that labor force response to

marginal tax rates is quite high, particularly among secondary earners. That means that the static revenue estimates do mislead in this case. They do not, as Mr. Rangel suggested, in the case of the child credit; it has no marginal effect. But in the case of marginal tax rates, they have enormous effect.

So if someone is to propose something that will in fact reduce the marriage penalty and encourage women to work, then we are going to have a larger labor force, less constraint in that regard, and the government will in fact receive quite a bit more revenue. You collect more revenue when you are collecting 28 percent of the income of someone that is working, than when you are collecting 40 percent of the income of someone who is not working. Because 40 percent of nothing is nothing.

Many of the current proposals approach average tax rates without affecting the marginal tax rate. That, I think, is a mistake. It fails to get at the nature of the problem.

Many of the past and current proposals have income caps. Income caps, as Gene Steuerle and Gary Burtless argued in their testimony, in fact, raise marginal tax rates. If you put a cap on the child credit, as you are approaching that cap you lose the credit if your income rises. All of these marginal effects have to be taken into consideration more than they have been, in my judgment.

When you are considering the effect of any tax change, ask what the effect will be on incentives to work and incentives to save. If, in fact, they are favorable, it is not going to cost you a lot of money, and a lot of the budgetary problems you are worried about will vanish.

I get the impression that many of the proposals that are being proposed are taking for granted that the high tax rates must stay where they are, and we will then try to fix that problem with deductions and credits and exemptions. This is a reversal of the message of 1986, which is that we should approach that problem directly by reducing the tax rates in a frontal way. It would be more efficient and more effective.

[The prepared statement and attachment follow:]

TESTIMONY OF ALAN REYNOLDS
SENIOR FELLOW AND DIRECTOR OF RESEARCH, HUDSON INSTITUTE

Work Penalties

The "marriage penalty" is part of a much larger problem of *work penalties*. There are many elements of the tax code and transfer payment system that penalize added work effort and savings by imposing high marginal tax rates on any effort or investment that results in higher income. The tax code does not exactly penalize marriage, *per se*, but instead penalizes *added work* by tens of millions of so-called "secondary workers" (mainly wives).

The biggest "marriage penalty" by far is high marginal tax rates themselves. If a small portion of one spouse's income falls into one of the higher tax brackets, then *all* of the second earner's salary is taxed at that rate, regardless how modest the second income may be. If the first earner's taxable income is $150,000, for example, then $10,000 of that would be subject to a 36% federal tax. If that person's spouse then earns an additional $30,000, all of that salary is taxed at 36%, plus state income taxes, Social Security taxes, and the increased loss of deductions and exemptions as income rises above $108,000. Filing separately cannot solve this problem, because in that case all income above $70,000 is taxed at 36% -- in marked contrast with single people, who do not face such a punitive tax until taxable income rises above $115,000.

A single man and woman with a taxable income of $125,000 apiece will each face a 31% federal tax on anything they do to increase income, such as work harder or save. If they married, however, they would be in the highest tax bracket of 39.6%, or 42.5% with the Medicaid tax included. The newlyweds would also find that many more deductions and exemptions would be phased-out by combining their incomes, thus facing an even higher marginal rate.

The number of married couples with two or more earners per family rose by 3.25 million from 1980 to 1990 (from about 19 million to more than 22 million) as marginal tax rates on such families declined. The number of two-earner families suddenly stopped growing between 1990 and 1993, despite the economic recovery since then.[1] The higher marginal tax rates legislated in 1993, and to a lesser extent in 1990 (mainly by shrinking deductions and exemptions as income rises), were most punitive toward working women, particularly middle-aged, college educated women who happen to be married to someone with a relatively high income. While primary workers pay the steep marginal tax rates on only a small fraction of their salaries, their *spouses pay the highest tax rates on their entire incomes.* Static revenue estimates assume that such "secondary workers" will continue working -- an assumption that is already proving false, even for primary workers. Instead of collecting 28% of the additional income produced by millions of new secondary workers, as in the late eighties, the federal government is now collecting 36-40% of zero -- the income that would have been earned had tax rates not discouraged labor force participation.

The simplest and most effective solution to such problems as the marriage penalty is to flatten the schedule of steeply rising marginal tax rates, as was done to a limited degree from 1987 to 1989.

If the high 1993 tax rates are kept in place, a second-best solution to the marriage penalty might be to eliminate the categories of "married filing separately" and "married filing jointly" and simply allow married individuals to file under the same tax schedule as single people. Yet the fact that tax rates are steeply graduated makes this simple solution much more complicated. Even if the low-income member of a high-income family was allowed to file at a tax rate suitable to his or her lower salary, the couple would then lose the benefits of a joint return. The income thresholds at which each increase in tax rates begins to apply are higher for joint returns because the old adage that "two can live as cheaply as one" is not true. A single person with an income of, say, $100,000 is more affluent than a married couple living on the same income, so the schedule for joint returns attempts to take this into account. Even a much larger personal exemption would not solve this problem, because it would still leave most of the affected couples in high *marginal* tax brackets.

The American Dream Restoration Act offers a partial solution, though not an ideal one. Beginning in 1996, it would allow an extra tax credit for two-earner couples who file a joint return. Although a tax credit for a second earner would reduce the *average* tax burden for two-earner families, the impact on marginal rates would be relatively small and rather arbitrary. Secondary earners with relatively low incomes in high-bracket families would still face higher *marginal* tax rates than single people with similar incomes. Since such families can easily get by on one income, the impact of high marginal taxes on the second income would continue to deprive the economy of the labor

services of a sizable group of potential workers who are likely to have invested considerable time and money in acquiring education and job skills.

The best solution would be to roll-back the highest marginal tax rates to no more than 28-30% (or preferably even lower, with a flat tax). The second-best solution would be to double the income thresholds at which the highest tax rates of 36% or more apply, and also offer a tax credit for second earners. The two-earner credit by itself would be a significant improvement over the current situation, but no truly effective solution is possible with tax rates as steeply graduated as they have been since 1993.

A starting date of 1996 is not advisable for the two-earner credit or any other tax relief. Just as high-income individuals and small businesses accelerated income into December of 1992 to avoid the higher tax rates of 1993, they would surely *delay* receiving 1995 income until 1996 to take advantage of any tax relief expected in that year. This could weaken the economy in 1995, or at least create that impression in the national income statistics. *The incentive to postpone income until 1996 would certainly worsen tax receipts in calendar 1995*, possibly jeopardizing tax relief. Any reduction in tax rates, or increase in deductions and credits, should be made retroactive to January 1995.

Static Revenue Estimates Are Wrong

The static revenue estimate of the revenue lost from the proposed tax credit for two-earner families amounts to $2 billion per year for the first five years. It is a mistake to measure the economic impact of tax relief by the amount of revenue lost, because programs that are effective in encouraging added work and/or saving must raise potential GDP and thus result in little or no revenue loss over time. Not all tax cuts have such beneficial effects, of course, but reduced taxation of secondary earners will undoubtedly increase labor force participation.

In economics, as opposed to accounting, there is no longer any serious doubt that decisions among secondary workers about whether to work or not, and whether to work part-time or full-time, are quite sensitive to marginal tax rates.[2] Attempting to impose high marginal tax rates on spouses with not-so-high incomes will, in fact, discourage many wives and some husbands from working. It is doing just that right now. A lower *marginal* rate on two-earner households would unquestionably increase the supply of labor, particularly among those now facing tax brackets of 36% or more. People who work are far more likely to pay a wide variety of taxes than those who do not work. Since the economy is currently operating at a very low unemployment rate, an increase in the labor supply would also alleviate that constraint, raising potential overall economic growth and therefore tax receipts from many sources, including the corporate income tax. Whether or not one believes that such "dynamic" revenue gains would exceed the static losses, it makes no sense to argue that obvious and well-known behavioral responses should be totally ignored, as they usually are today.

The main reason labor force growth in the eighties exceeded demographic projections is that "most of the increase in women's labor supply [participation rates] took place among the wives of husbands with high earnings."[3] This is precisely what a huge body of theory and evidence would lead us to expect at a time when the highest marginal tax rates on secondary earners was reduced from 70% to 28%. Women in higher-income households are often college-educated, so the fact that they were induced to rejoin the labor force from 1982 until 1990 provided the economy with a sizable new source of valuable skills. Because the labor force grew so rapidly, employment was also able to grow by 2.4% per year for an exceptionally long period -- from 1983 to 1989 -- accounting fro two-thirds of the 3.7% average rate of growth of real GDP during those years.

The Looming Labor Shortage

In the immediate future, and for at least the coming decade, the U S. faces a serious shortage of willing workers, not a shortage of jobs. In the absence of policies to restore and improve work incentives, potential economic growth in the United States is very likely to be constrained by slow growth of the labor force and inadequate incentives for personal investment in human capital.

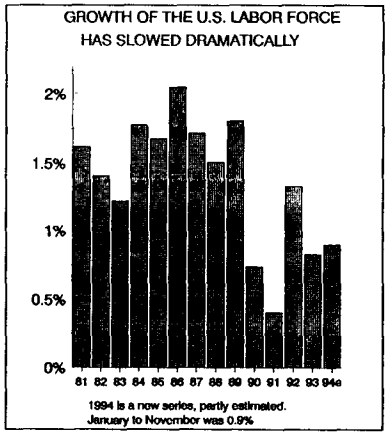
Economic growth can be usefully divided into two components: Growth in the number of workers

plus growth in output per worker, or productivity. There are practical limits to how low unemployment rates can be pushed, due to the inherent frictions of people quitting their jobs, young people seeking first jobs, mature women reentering the labor force, and mobility of workers between cities and industries. Except for periods of war, when unemployment was artificially reduced by removing many young men from the civilian labor force, unemployment in the postwar years has never been sustained much below 5.5% for very long. With the unemployment rate already at 5.4% nationally, and substantially lower in many cities, further growth of employment in the near future will mainly depend on enticing more people into the ranks of job seekers.

The issue was adeptly explained by the Congressional Budget Office, in the January 1994 Economic and Budget Outlook, as follows:

> Growth of the labor force has been unusually slow in the past three years. This slowdown was caused not by a slump in population growth but by a leveling off of the growth in the percentage of the working-age population who desire to work, that is, the participation rate of the labor force.

The number of Americans who were either working or seeking work grew by nearly 1.7% a year from 1981 to 1989, but slowed to about half that pace over the past five years, apparently remaining below 1% even in the mature phase of expansion in 1993-94. This is particularly remarkable considering the fact that annual immigration in recent years has been several hundred thousands higher than in the eighties. Most immigrants are of working age, and tend to have *higher* than average labor force participation rates (particularly those from Mexico).



If employment grows by only 2% a year in the near future (much slower than in the eighties), and the labor force grows by only 1% a year, that means the unemployment rate has to fall by one percentage point every year. When starting with an unemployment rate of 5.4%, this becomes quite impossible very quickly. Nobody seriously believes that unemployment can fall to 4.4% over the next year, and to 3.4% the year after that.

With unemployment already lower than it was during the cyclical peak of 1987-89, employment cannot possibly grow much faster than the labor force -- which means 1% or less with current policies. With such a job slowdown, it would require implausibly large productivity gains to generate economic growth much above 2%. Big productivity gains are particularly unlikely in the next few years, because brutal tax rates on "the rich" have shrunk the personal savings needed to finance additions to the economy's strained capacity. The economy is rapidly approaching binding constraints on *supply* -- the supply of labor and savings. These problems are classic symptoms of excessive marginal tax rates.

It is not simply that we cannot add more jobs without inflation. We cannot add more jobs than there are workers with or without inflation. Inflation provides no solution to this dilemma. Inflation has never improved economic growth. When faced with scarcity of labor and savings, "stimulating demand" cannot do anything but raise imports, sink the dollar and inflate prices.

Why are so few people looking for jobs at a time when unemployment is near a record low? As the CBO observed, there has been a levelling-off or decline of previously rising "participation rates" (the

percentage of those over age 16 who are either working or looking for work), particularly among women and young people. The problem of growing work disincentives affects both the high and low ends of the income distribution. Those with above-average incomes face new tax brackets if they do anything extra to raise family income, while those with low incomes face the equivalent of marginal tax rates of 50-100% because adding to earned income results in losing welfare or the earned income tax credit, and also food stamps and Medicaid.

Dropping out of the labor force has not been confined to married women. The participation rate among single women rose from 64.4% in 1980 to 68% in 1989, but then fell to 66.4% in 1992-93. The participation rate among married men older than 35 actually increased a bit from 1985 to 1989, in contrast to previous trends, but has declined in all age groups since then.

For all the attention being paid to the "middle class," that is the only income group that has *not* suffered an increase in *marginal* tax rates in recent years, aside from the increase in Social Security tax rates and (more importantly, at the margin) the amount of income affected by those rates. Those earning less than about $100,000 (before deductions) are still in a 28% bracket, and do not have their deductions and exemptions whittled-down if they add to their incomes through work or saving.

In 1994, the problem of slow labor force growth persisted. A new and more-inclusive measure of the labor force was adopted, which cannot be properly compared with the different figures for 1993. In the first eleven months of 1994, however, labor force growth was below 1% -- extremely low, considering the fact that labor markets are tight. The argument that people have dropped out of the labor force because they are "discouraged with their job prospects," rather than discouraged by taxes, is difficult to reconcile with the fact that the slowdown has gotten worse as unemployment fell -- in marked contrast with the rapid increase in participation rates in the eighties, when unemployment was often much higher.[4]

Estimates of potential economic growth -- how fast the economy can grow after reaching full employment -- typically treat labor force growth as "given" by demographics, and productivity as given by past trends. This is a convenient but misleading simplification, because both labor force and productivity can be affected by economic policies.

Income and payroll tax rates affect the percentage of the working-age population that is willing to work ("labor force participation rates"). Labor force participation is also affected by "entitlement" policies that offer cash and non-cash benefits on the condition that recipients either do not work (unemployment benefits, and the work test on Social Security retirement), work only limited hours per month (the AFDC-UP program), or keep earned income below certain limits (the Earned Income Tax Credit, food stamps, Medicaid, housing allowances, and AFDC).[5]

The labor force consists of the number of people who are either working or seeking work. It is a measure of labor supply, not demand. Public policy cannot do anything about demographics -- the number of births 18-20 years ago -- but that is only one source of added labor. Many adults not currently looking for work are nonetheless capable of working, if the after-tax rewards looked more appealing than alternatives (such as relying on a spouse's income, pensions or transfer payments).

Because of rising participation rates until 1989, demographers *under*estimated actual labor force growth in the eighties (it was expected to be no more than 1.5%, but turned out close to 1.7%). Demographers have *over*estimated labor force growth since 1989, because participation rates have responded to different tax incentives. For demographic reasons alone, the labor force "should" be growing by at least 1.3% a year. But the actual increase in 1993 and 1994 was only about 0.9%. If continued, that means the economy's potential future economic growth will be nearly a half percentage point below what demographic projections have led many to expect, and even further below the experience of the eighties (when labor force growth was above the demographic trend).

Tax policy can do something about weak labor force participation. This just requires lower *marginal* tax rates -- particularly on secondary workers and prospective retirees, but preferably on affluent primary workers (who can easily afford to work less, or retire) and welfare recipients as well.

A Brief Survey of Some Evidence on Work Incentives

In the past, it was common for economists to be skeptical about the impact of high marginal tax rates on work effort. Early studies were rather crude, sometimes just surveys. Even the more serious studies usually focused on people with low or moderate incomes, rather than those in the highest tax brackets, and studied only the effects of tax rates on hours worked among those who did work, rather than on the decisions about whether to work at all (participation rates), where recent studies find a strong response among women.

What follows is a brief sample of recent research on the labor supply response to marginal tax rates:

- Robert Triest finds "the participation decision is more sensitive to economic incentives than hours worked." Despite problems with existing studies that tend to underestimate the response, Triest nonetheless finds the evidence clear that "increasing the higher tax rates results in sharply higher efficiency cost, and raises less revenue."[6]

- An econometric study by the research staff of the International Monetary Fund nonetheless estimated that work hours too would be greatly affected: "An increase of 1 percentage point in either consumption or labor income taxes may induce a reduction in the hours of work between 1/2 and 1 1/2 percentage points."[7]

- James Ziliak of the University of Oregon estimated that a 30% increase in marginal tax rates on the top 1% of U.S. taxpayers [smaller than the actual 52% increase -- from 28% to 42.5%] would eventually reduce hours worked by as much as 11% and reduce revenues by a comparable amount.[8] People with very high incomes have a great deal of discretion over how much they work and invest, in what forms they are compensated, and so on.

- Martin Feldstein, President of the National Bureau of Economic Research, notes that increases in marginal tax rates induce people "to alter their taxable income in a wide variety of ways including changes in labor supply, changes in the form in which employee compensation is taken, changes in portfolio investments, changes in itemized deductions and in other expenditures that reduce taxable incomes, and changes in taxpayers compliance."[9] Feldstein uses data from the 1986 Tax Reform to estimate that the 1993 increases in the higher marginal tax rates are quite unlikely to increase revenue in the longer run, as Ziliak and Triest also found, but due here to greater tax avoidance as well as reduced work effort.

- Alan Auerbach argues that Feldstein's research on the surprisingly favorable effect on tax revenues from reducing the highest tax rates in 1986 is likely to *understate* the revenue losses from the 1993 increases in tax rates. "Because the 1993 Act is very progressive," Auerbach wrote, "its income effects on labor supply and saving . . . would lead to a greater behavioral response . . . than occurred after the 1986 Act."[10] The CBO has observed that the tax schedule is now as steeply graduated as it was back in 1977 (tax rates *appear* lower today partly because we forget how many "loopholes" there were back then).

With so many of these distinguished economists predicting that the 1993 increases in marginal tax rates would lead to reduced revenues, an obvious question is why has this not yet been apparent? First of all, there was a huge surge in reported income, and tax receipts, in December of 1992 [fiscal 1993]. That was because many clever people arranged to receive bonuses, investment income and accounts receivable paid into the 1992 calendar year in order to avoid the expected 1993 tax hike. That is, the revenue surge in fiscal 1993 was paid at the *lower* tax rates of calendar 1992. There was a second surge in tax receipts in April of 1994, when payment became due on taxes retroactively imposed on 1993 income. Aside from the few who chose to take three years to pay the surprise additions to their 1993 tax bill, this was a one-time revenue windfall that will not be repeated.

Finally, it should be pointed out that not all responses to higher tax rates are immediate. Decisions to retire early, for example, will be affected for many years by the tax rates enacted in 1993.

Philip Trostel of the University of North Carolina finds that decisions to go to college or graduate school are also *extremely* sensitive to expected future tax rates on income later in life -- particularly

graduated tax rates that fall most heavily on the rewards to education at the peak earning years (middle age).[11] Each 1% increase in tax rates leaves the economy with nearly a 1% smaller stock of human capital, Trostel estimates. Punitive tax rates on "the rich" (that is, on mature two-earner families with college degrees) gradually leave the economy with fewer rich people to tax. But that also means fewer educated people left in the work force, and a less productive and prosperous economy.

What we can already observe is that the labor force is not growing nearly as fast as it used to, and the slowdown is too large and sudden to explain by demographic trends. The inclination to drop out of the labor force (or at least not drop in) appears concentrated where work penalties have most clearly increased since 1990 -- among married women in families where the husband earns more than about $100,000, and also among single women with children who are caught in a "poverty trap" -- risking the loss of many benefits if they work.[12] The combined system of tax rates and transfer payments thus imposes huge *work penalties* on women, married or not. Steep marginal tax rates are unduly harsh on men too, which helps explain why the *male* participation rate has begun falling again, from 78.5% in 1989 to 77.3% in 1993. Labor force participation also dropped in Canada after they imposed higher marginal tax rates on upper-income families in 1990, and tax revenues then *fell* for four years despite the addition of a national sales tax.

Child Tax Credits With An Income Ceiling Would Raise Marginal Tax Rates

Proposed tax credits per child -- even if they were extended to college-age dependents -- would reduce *average* taxes without lowering the *marginal* rate.[13] If someone is in a high tax bracket before calculating such a tax credit, she is still in a high tax bracket *after* the credit. With no added incentive to increase labor effort or savings, tax credits can promise no dynamic feedback effect on revenues.

Ceilings on the income at which tax credits for children would be available would, in fact, *increase* marginal tax rates for those whose income approached the ceiling. Any efforts to raise income would be punished by losing the credit. The lower the income ceiling, the more families would be affected by this disincentive. The more children such families had, the higher the effective marginal tax resulting from phasing-out the tax credit. If a tax credit or enlarged deduction for children is adopted, as a matter of social rather than economic policy, there should be no ceiling on the income of taxpayers eligible for the ceiling.

Taxing Social Security Benefits Is Not Exactly The Problem

If people work beyond age 65, and earn more than a trivial sum, they lose half their Social Security benefits. In a society with an aging and slow-growing population, a more perverse penalty on working can scarcely be imagined. Proposals to double the amount of income that older people are "allowed" to earn are far too modest. There should be no earnings test at all. Once again, static estimates of what this would supposedly cost, in terms of increased Social Security outlays, are worse than useless. Clearly, many older people would keep working if there was no earnings test -- often earning very high incomes and paying high income, payroll and sales taxes as a result.

In 1993, retired couples with incomes above $44,000 (or singles with incomes above $34,000) were subjected to income taxes on 85% of their Social Security benefits. This further penalizes work among older people, since earned income could easily push income above these very modest thresholds.

The income thresholds at which benefits become 85% taxable *penalize prudence* as well. Putting "too much" savings away for old age, or contributing "too much" to defined contribution pension plans, will push income up to the point where Social Security benefits become heavily taxed. The message to those not yet retired is this: Do not save too much for retirement, or the government will tax-away most of the Social Security benefits you have been promised. In a society that is aging fast, this policy is a dangerous encouragement to irresponsibility and dependence, even aside from the effects of weak savings on capital formation.

The Senior Citizens Equity Act would gradually roll back the tax to 50% of benefits within five

years, rather than 85%. The long phase-in period makes the change appear more vulnerable to political reversal during that time, which means it is apt to have a less beneficial effect on retirement planning than outright repeal.

The most serious problem, however, is not the taxation of benefits *per se*, since those benefits certainly are income. The perverse incentives arise from the much higher taxation of benefits for those who have foolishly saved for retirement, or who continue to work. If all Social Security retirement benefits were taxed at the same rate regardless of income, then older people with low incomes would still pay taxes at a zero or 15% rate on their total incomes, including whatever proportion of benefits is counted as income, while those with higher total incomes would (under the current rate schedule) pay a higher percentage of their incomes in taxes. As with the income ceilings on deductions and exemptions, and the proposed income ceilings on child tax credits, the income ceilings on what proportion of Social Security benefits is taxed constitutes a very steep marginal tax on activities that would add to income.

Incentives Matter

The economy cannot keep adding several million jobs a year, as we became accustomed to in the eighties, if the labor force continues to grow by only about one million a year, as has been true in the recent past. Labor is rapidly becoming quite scarce, and skilled labor even more so. The economy cannot afford tax and transfer policies that virtually force two earner families to become one-earner families, bribe one-earner families to go on welfare, or slash and tax the Social Security benefits of older people if they dare to keep working. The economy needs better incentives to both work *and* save, which are two activities that normally depend on each other. If many people stop trying to earn a salary, they can't very well save..

There are two basic alternative strategies for repairing the tax code. One technique is to leave high marginal tax rates in place and attempt to repair the resulting inequities and inefficiencies by extending tax deductions and credits. While such a piecemeal approach is often better than doing nothing, it is almost always less efficient than the second strategy -- rolling-back the highest, most distortive marginal rates to the pre-1993 level.

In the debates over tax legislation of 1986, 1990 and 1993, economic efficiency and incentives often took a back seat in recent years to competing definitions of tax "fairness." Yet the foundations of economic progress -- labor and savings -- have been rapidly eroding since 1992, and a solution cannot prudently be delayed much longer. Labor force growth is very slow, savings have fallen, and U.S. investment opportunities are not attracting sufficient foreign capital to finance needed investments or the current account deficit. Without prompt improvement in labor and savings incentives, the U.S. economy is likely to run out of room to grow before 1996, when many of the proposed tax changes begin to take effect.

Marginal tax rates are simply too high, particularly on the poor, the semi-rich and their spouses, and the aged. Tinkering around the edges of the tax code may help, but not much.

1. *Statistical Abstract of the United States*, 1994, Table 666, p. 430.

2. Jerry A. Hausman & James Poterba, "Household Behavior and the Tax Reform Act of 1986," *Journal of Economic Perspectives*, Winter 1987.

3. Frank Levy, "Comments and Discussion" *Brookings Papers on Economic Activity*, 2:1993, p. 329.

4. This argument is cited in Steven Pearlstein, "What's the Speed Limit on Economic Growth?," *The Washington Post*, January 15, 1994.

5. This is documented in Alan Reynolds, "The Incredible Shrinking Labor Force," *Hudson Briefing Paper* No. 168, September 1994.

6. Robert K. Triest, "The Efficiency Cost of Increased Progressivity," National Bureau of Economic Research [NBER] Working Paper No. 4535, November 1993.

7. E. Mendoza, A. Razin & L. Tesar, "An International Comparison of Tax Systems in Industrial Countries," *Staff Studies for the World Economic Outlook*, IMF, December 1993, p. 101.

8. James P. Ziliak, "three Essays on The Effect of Taxes and Tax Reform on Life-Cycle Labor Supply," *Proceedings of the Eighty-Sixth Annual Convention of the National Tax Association*, St. Paul, 1994, p. 126.

9. Martin Feldstein, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act," NBER *Working Paper* No. 4496, October 1993, p.3.

10. Alan Auerbach, "The U.S. Fiscal Problem," NBER Working Paper No. 4700, April 1994.

11. Philip A. Trostel, "The Effect of Taxation on Human Capital," *Journal of Political Economy*, April 1993.

12. Social Security taxes are a particularly strong work disincentive for "women whose earnings are so low that they would receive more as their husband's dependent than they would based on their own earnings." Martin Feldstein & Andrew Samwick, "Social Security Rules and Marginal Tax Rates," NBER *Working Paper* No. 3962, 1992.

13. Several recent proposals, such as the idea of increasing the exemption from estate taxes while leaving the *marginal* rate at 35-55%, suggest widespread misunderstanding of how taxes affect behavior. See Alan Reynolds, "Marginal Tax Rates" in David R. Henderson, ed., *The Fortune Encyclopedia of Economics*, Time Warner, 1993.

Mr. CRANE. Thank you very much for your testimony.

The first to inquire is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

Prior to the 1986 Tax Reform Act, working couples could claim a deduction of up to $3,000. Ms. O'Connell, you said that we could do something like that or something else.

I wanted to understand exactly what you were proposing. You propose that we may bring that back or do you think it is a good idea to bring that back or to do some kind of percentage, like you were talking about?

Ms. O'CONNELL. Mr. Bunning, the credit operates most simply in the minds of taxpayers, in my opinion, and it gets at the problem most readily. The deduction at the lower levels is simply less relief for the penalty.

The ratio that I discussed is a little bit different notion from making the credit a flat dollar amount. I made some assumptions about how that, which I have read in the Contract With America, and in the statute, the American Dream Restoration Act, would have to work for taxpayers to be able to figure out what their marriage penalty was and then figure out a credit.

They are going to have to calculate income as if each had that income individually, then figure a tax as if each were unmarried individuals, then calculate their joint return tax and subtract the lower unmarried individual sum from the higher joint return tax to get a marriage penalty.

When they come up with that number, there are a few things that they could do. One is know that under some other formula they can take up to whatever the government says, whether it be $3,000 or $2,500, depending upon where the revenue limit cuts in.

But another thing the government could do is estimate what that total marriage penalty was for that year and then know that the cost that will be relieved in this year is, for example, $2 billion, as is currently proposed for 1996. So if the Treasury Department made an estimate, as we have heard alluded to, that the total marriage penalty were a $100 billion, and then we knew we were going to relieve $2 billion of it, when people calculated their marriage penalty, they would reduce that amount by 2 percent and that would be their credit. So there is an opportunity, once people walk through what they are going to have to walk through to calculate their penalty, we can't avoid that, they could be given some 2 percent number in that example for them, instead of just a flat dollar amount.

Mr. BUNNING. Currently, the marriage tax penalty falls particularly hard on low-income workers since marriage means the loss of earned income tax credit and means-tested benefits. In essence, doesn't our current income tax system tell these groups not to work or to marry?

Anyone.

Ms. O'CONNELL. Well, if I may continue——

Mr. REYNOLDS. Yes.

Ms. O'CONNELL. It certainly may——

Mr. BUNNING. The answer to the question is yes?

Mr. REYNOLDS. Yes, the tax and the transfer payment system do that, including the EITC.

Mr. BUNNING. If Congress passes new work requirements in the context of welfare reform, doesn't marriage penalty relief come as a priority?

Ms. ALSTOTT. As I have said in my testimony, I think that if we are going to have marriage penalty relief, it is appropriate to direct it to EITC recipients.

Mr. REYNOLDS. I agree.

Ms. O'CONNELL. I agree, too, up and down the board.

Mr. BUNNING. OK. We don't do the whole thing, and we can't because of the cost, obviously. But the thrust and the direction we are trying to take in the Contract is $10 billion over the next 5 years. Is that too little, too small, or too large, or is there a happy medium that we could find? Obviously, to make a bigger impact on it, the number ought to be larger. But in reality, the cost gets into what is the ability of what we can do and what we can't do.

Mr. REYNOLDS. If it works, it shouldn't cost anything.

Aren't we trying to encourage people to work?

Mr. BUNNING. Absolutely.

Mr. REYNOLDS. Don't they pay Social Security tax, income tax, sales tax?

Mr. BUNNING. We are trying to do that on many sides of this whole thing here.

Mr. REYNOLDS. You have got to encourage work. It certainly won't cost much.

Ms. ALSTOTT. I suppose that gets us squarely back into the issue of dynamic scoring.

Mr. REYNOLDS. I was doing some dynamic scoring.

Ms. O'CONNELL. How broad the analysis is going to be. To confine yourself solely to the marriage penalty, I would say the relief ought to be more. It is probably a 2-percent drop in the budget.

Ms. ALSTOTT. On the other hand, as the previous panel pointed out, the committee is considering these proposals in the area of deficit reduction. So in my judgment, incremental relief is appropriate.

Mr. BUNNING. OK.

Thank you, thank you panel.

Mr. CRANE. Mr. Hancock.

Mr. HANCOCK. Just a real brief comment.

Ms. O'Connell, when you first started your statement, you said that you had been working for several years helping people accurately fill out their income tax return.

Ms. O'CONNELL. Yes, sir.

Mr. HANCOCK. You stressed the word "accurately" it seemed like. Is this—a part of what we are doing here, even though I am very much in favor of doing something about the penalties, is there anything we can do to simplify the tax return? I mean, the compliance cost is just getting absolutely ridiculous. You may make a good living doing it, filling out returns, but the average Ph.D. ought to be able to fill out his own income tax return.

Ms. O'CONNELL. I think some of the best minds the Treasury Department can bring to bear works on making that simple as possible. It is an extraordinarily difficult system about which it asks people to report.

Unfortunately, there is a lot of data on that return for which most of the people you are hoping to help with marriage penalty

tax relief have no interest. We have tried to pull most of that more complicated data out on to schedules and have EZ returns and such, so that most of the people all of the time never see the full-blown complexity of the 1040. We should always continue to be achieving that goal.

I want to underscore that this calculation that you ask people to make, it is my experience from practice, will not be one that they will find either too time consuming or too complicated because they think they are going to get money back. That always causes an enthusiasm for recordkeeping from the outset.

Americans forget to find a lot of records, but everybody I know this month is looking for that statement from their bank about how much mortgage interest they paid. So we know that if we design a relief provision that facilitates the family's economic situation, however those very brilliant people in the Treasury Department stress it on one more form, it will be something that people will look for, that they will carefully report about, and that they will be able to do.

I urge on you that some of these allocations, for most of the families all of the time, are things they simply know. They know the interest on Mary's account is Mary's, and the interest on John and Mary's joint account is theirs, 50/50. This is not end-of-the-world complexity for them.

Mr. REYNOLDS. I would like to comment.

I think most of the people on the previous panel as well as this one have made the point that high marginal tax rates complicate your chores. We get a bigger marriage penalty, this includes marginal tax rates in the welfare system. The marriage penalty becomes a problem because you have got high marginal tax rates.

From 1982 to 1986, we alleviated that by giving a credit of 10 percent of the second-earner salary up to a lid of $3,000, which effectively meant up to a lid on income of $30,000. That sounds a little low to me right now.

Second, it was certainly simple and clean and a lot easier to figure out than this proposal, which I still can't figure out. Reviving the pre-1987 two-carrier credit is one way out.

Ms. O'CONNELL. I will help you.

Mr. REYNOLDS. But in 1986, when the rates came down to 28, or 33, or 31 percent, I have a feeling not many people cared any more. We certainly had a tremendous increase in work effort, and particularly among wives of high-bracket taxpayers. We had a tremendous increase in the formation of two-earner families. I think that the obvious solution is we made a mistake in 1993, and I think that the recent election had something to say about that question, too.

Mr. HANCOCK. I just came back this last weekend and they informed me of what went on, not only with 1993 and what it has done to subchapter S companies, but also I happen to be from the State of Missouri, and I am convinced that Governor Mel Carnahan and Bill Clinton must have belonged to the same fraternity or something, because he did it in the State of Missouri, and it is a 50-percent increase in the amount of Missouri income tax, all corporations, a substantial increase.

In fact, you can no longer take the deductibility of the Federal tax from your Missouri tax, which is a double whammy. They were both passed, in fact, at the same time, in May 1993, by the Missouri State Legislature and the U.S. Congress. I don't know what is going to happen, but there is going to have to be something done about it. The Chairman is not there so I can go ahead and use the time.

Mr. BUNNING. The Chairman is here.

Mr. HANCOCK. Oh, you are still here.

OK, I didn't see him there in the middle.

I am sorry, Mr. Bunning.

Mr. BUNNING. That is all right.

Mr. HANCOCK. May I ask one final question?

Mr. BUNNING. Go right ahead.

Mr. HANCOCK. Just real quickly; should we consider the flat tax? I mean, should we get into it with both feet and look at what is going on there, or should we just say, well, it sounds good?

Ms. ALSTOTT. I would like to really concur with the answer you got last time from Dr. Steuerle. Flat tax means some different things to so many people, income versus consumption and so on. I think there are some intriguing proposals out there that would combine a flat rate of tax for a lot of people, which does help with administrative simplification, with a fair amount of progressivity by increasing personal exemptions and so on.

Mr. REYNOLDS. The best should not become the enemy of the good, and you are not going to be passing a flat tax any time soon. We've got problems ahead right now: a $50 billion annual shortage in personal savings compared to 1992, a big drop in labor force participation, a slowdown in labor force growth.

You are not going to make it to 1996, when most of these proposals kick in. The economy is going to run up against a wall. A flatter tax is in order right now.

We had one prior to 1989. It was working pretty well. It was muffed in 1990 and 1993, in my judgment. Go back and take a look. Not all the changes that were made were bad, but the ones that had the effect of discouraging additional work and savings were bad, and have been ineffective and will prove to be revenue ineffective as well.

Ms. O'CONNELL. I think there are enough of us to consider more than one thing at a time. I wouldn't let us be distracted by the flat tax.

I urge you to do these kinds of things that the public expects and understands. They heard about this, they are looking for this.

A flat tax becomes interesting to them, I think, as they hear about it in the press, but let's not get off on a sidetrack where we could park our engines for years. I think we ought to go forward down the main track.

Mr. BUNNING [presiding]. The time for the gentleman has expired.

Mr. McDermott will inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I always listen to these and read these proposals that are put forward by the Republicans. They don't believe in social engineering. So I try to figure out what is behind what they are doing.

It sounds to me from listening to you, like the purpose of this is to get women into the work force, to make women go to work so that we will have enough employees or something. I can't understand what this is directed at.

Is this directed at people at the bottom who are on welfare, to get them into the work force? Or is it dealing with two attorneys who are married, each making $100,000 apiece, are they the ones this is directed at, so we will keep that woman at work at a $100,000 apiece, or what is it you are—what do you think the principle is that drives this proposal? Because as the gentleman says, it is not fairness we are worried about here, so it is something else. What is it?

Mr. REYNOLDS. Is the question addressed to me?

Mr. MCDERMOTT. Well, to any of you.

Mr. REYNOLDS. The two groups you mentioned, low income and high income, are the people that face the highest marginal tax rates. That is to say, if they do anything to add to their income, save, work longer hours, second person goes to work, they are very, very heavily punished for their efforts.

One could make a fairness case that this is not very nice, that to tax the $30,000 income of a wife whose husband makes $150,000 at a 36-percent rate isn't very nice. But I don't particularly care about the fairness issue.

What I care about is that we have effectively discouraged a lot of people—encouraged them to drop out or discouraged them from dropping into the labor force. That is actually an economic problem. That is a constraint on economic growth.

We are at 5.4 percent unemployment. The previous cyclical peak, 1987 to 1989, and it is also the peacetime peak, is about 5.5 percent. You can't knock it down very far from there.

So now, from now on, any growth of the economy has got to come from productivity growth or more workers. We don't have more workers, we are running short. You have got a problem. If you add 1 percent labor force growth to even an optimistic 1.5 percent productivity growth, the best you can hope for is 2.5 percent GDP growth.

Mr. MCDERMOTT. So the real purpose is to drive women into the work force, is that what you are talking about?

Mr. REYNOLDS. Not to artificially discourage them from working in the same way that we do not artificially discourage other people, like men.

Ms. ALSTOTT. I would also say that I am concerned about both distribution and incentives. Distributionally, it is simply arbitrary to impose a marriage penalty on people.

Mr. MCDERMOTT. I agree with that. I mean, it is arbitrary. We have arbitrary stuff all through the code, we have the notch that we deal with with senior citizens. Maybe we should pay for this by taking away the marriage bonus from the other people and pay for the people who are getting the penalty.

Ms. ALSTOTT. If that were administratively feasible, I think it might not be a bad idea. A marriage bonus is at least as arbitrary as a marriage penalty.

Mr. MCDERMOTT. So you don't have any real problem with that. It is simply that it is arbitrary and you would like to get rid of the arbitrariness by giving everybody a bonus for getting married?

Ms. ALSTOTT. I would like to at least reduce the arbitrariness. Eliminating would cost a lot more money.

Mr. MCDERMOTT. You all raise this. I mean, everybody should understand that the Treasury says this thing would cost $72 billion to do properly over the next 5 years. That is about $14 billion a year. We are putting in $2 billion, and it is very nonspecific.

Do you trust the Treasury to design the kind of thing? I mean, they are unwilling to put forward any language about how it should be done. Do you trust the Treasury to do something better than what is already there?

Ms. ALSTOTT. I actually don't support the proposal as written in the act now. I understood the committee would be considering that proposal and others.

My own testimony goes into a number of variants on the two-earner deduction and the two-earner credit, and one thing the committee might want to consider is targeting it, based on empirical information from your staff, to different income groups and/or in other ways, in other words, to get the most money you can out of the $2 billion a year that is allotted.

Mr. MCDERMOTT. So if you use the $2 billion entirely for the people who are in the lower end of the economy, that would make more sense to you?

Ms. ALSTOTT. I would want to see numbers. It gets a little bit complicated because, as you know, marriage penalties and marriage bonuses depend on the distribution of income within the couples, and I think your staff might be able to give you some better information. But sort of subject to that kind of information, and seeing how well targeted the two-earner deduction or credit would be, it might make some sense to target it to the low end of the population.

Ms. O'CONNELL. It is my opinion that women haven't stayed out of the labor force just because of the marriage penalty. In 4 years, you ought to across the board try to eliminate this problem. The credit is not too complicated a way to do that. People will understand it. Treasury can show them how to do it on a form. It is just not that hard to do.

Mr. MCDERMOTT. Would you think, though, it would be better to have this very targeted at those people at the bottom, those people making $15,000, $20,000? If a man making $15,000 and a woman making $15,000 marry, they are going to get in this penalty situation. So would it be better—wouldn't it be better, in my opinion, at least, to target it at that couple than the one making $100,000 and $100,000?

Ms. O'CONNELL. Well, it certainly sounds appealing. It is a policy question about progressivity. When I last looked at the public data about this, it turned out that for the couples who were paying the marriage penalty tax, something like 90 percent of the people who were paying it were paying it in respect of earned income alone. So if you take out people who have investment income, which you think of as the higher end of the economy usually, you are helping

most of the people all the time. So I think you could spread the marriage penalty pretty broadly, give significant help——

Mr. MCDERMOTT. As long as it was only on earned income.

Ms. O'CONNELL. That is right, give significant help to the lower ends of the marketplace about which you are concerned, and yet give a lot of help to some other families I have heard described here who are starting out with two—whether they be professional or professional Bachelor of Arts degrees, who are getting their first job. They are closer relatively in income and that penalty hurts them the most. As they walk through our system now with its higher rates and its phaseout of other benefits, it keeps hitting them harder and harder and harder.

So you have to pick a policy place from where to stop it, and you maybe have to pick a practical place for what it costs to stop it there. But you can go a long way down the road doing a lot of good, even at the numbers you are talking about now.

Mr. BUNNING. The gentleman's time has expired.

Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. Reynolds, you mentioned during your oral testimony that we should attack the Tax Code in a more frontal way, rather than deductions, credits, exemptions and so on. I would like to know your best-case scenario for a frontal attack and does that include all the alternatives on tax provisions we have heard for the upcoming year that we are going to be looking at?

Mr. REYNOLDS. Well, the best-case scenario would be something like Representative Armey's plan. But I just made the point that I don't think the best should become the enemy of the good. If, for example, we were to restore a credit similar to the one we had for two earners up until 1986, considering the high marginal tax rates we have in place today, that, of course, would be folded out later if we went to a flat tax.

Mr. CHRISTENSEN. Well, I know the——

Mr. REYNOLDS. The best I think I would expect to accomplish in this session of Congress is to repeal the 36-percent tax bracket. I would also like to see repealed the "temporary" 1990 provision that was made permanent in 1993, that folds out deductions and exemptions as your income exceeds $108,000. That, too, is an increase in marginal rates, a very sneaky one, and part of the marriage penalty, as was just pointed out.

As your income rises, whether it is from one earner or two, you begin to take a step from the 28- to the 31- to the 36-percent bracket, and you are losing your deductions and exemptions. Pretty soon the message is very clear: let's play more golf, one of us should stay home. The economy is deprived of the services of some very highly educated, competent professional people who would, were they not being so heavily punished, go to work.

Although I said I wouldn't dabble in fairness, I don't think it is particularly fair that just because one spouse happens to make over $140,000 of taxable income that the other one, regardless of his or her income, is taxed at that same rate. I don't see that as fair. That is not two people making the same income. Very often the second person is making only $20,000 or $30,000, yet they are in the highest tax brackets.

Mr. CHRISTENSEN. You mentioned Dick Armey's flat tax. Some day I hope we will be able to sit down on April 14, the night before our taxes are due, and on a 4 by 6 card or a 3 by 5 card be able to put down earned income or unearned income and go ahead and put down the 17-percent tax, fill out this little card and have it all done with.

My question to Ms. O'Connell would be, on that idea, there are probably 70,000, 80,000-plus accountants in your profession that belong to the AICPA and other organizations. As a tax attorney, what kind of ramifications do you see for your own profession?

Ms. O'CONNELL. We would love it, and there is plenty to do. You know, the gentleman has left the dais who asked me questions about helping people prepare returns accurately. Tax attorneys rarely prepare returns. We tend more to follow the elephants, I am afraid, after the returns have been filed.

But in thinking about how to make it easier for a nation to understand what is on the returns, and thinking about how to advise my clients how to keep those receipts in the first place, what to look for, how to conduct themselves in the most advantageous way when they don't have sophisticated financial situations, something like the marriage penalty tax is doable.

What do we think about a simpler tax system with simpler returns? There is a wonderful thing to be accomplished there, for individuals in particular. The business return, whether it be a subchapter S or a small C corporation and major corporations' returns will give this profession enough to do as long as any of us in this room would be doing it, I think.

Mr. CHRISTENSEN. I thank you.

Ms. Alstott, what kind of law do you teach and what did you do prior to your tenure at Columbia?

Ms. ALSTOTT. I teach tax law and tax policy and social welfare policy. Before I became a law professor at Columbia, I was in the Office of Tax Policy of the Treasury Department as an attorney advisor.

Mr. CHRISTENSEN. I really enjoyed your remarks.

Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Ramstad will inquire.

Excuse me, Mr. Rangel.

You are next, Charlie.

Mr. RAMSTAD. That is right, Charlie. They get us confused more than once.

Mr. BUNNING. Mr. Ramstad.

Mr. RAMSTAD. I will be glad to yield.

Mr. BUNNING. Go ahead.

Mr. RAMSTAD. Thank you, Mr. Chairman.

First of all, I want to commend this panel for its pragmatism and wisdom as well. It is refreshing to hear the input of the type we have just heard. Let me ask one question.

In view of what I think is a consensus of the panel and most experts that phaseouts or targeting of tax benefits aggravate marriage tax penalties and produce work disincentives, I would ask the panel, how would you evaluate the administration's proposal to limit child tax credits to families with incomes of less than $60,000?

Ms. ALSTOTT. I think when we are talking about phaseouts, I mean, revenue is always important and I am sure that the administration's proposal was driven by that. Clearly, whenever you have a phaseout, whether it is in the tax system or the welfare system, you do get work disincentives.

On the other hand, it is important to distinguish between disincentives, which are financial penalties on actual earnings, and the actual effects of those disincentives, which is a much more complicated question. The task of the committee is a very difficult and complex one, which is to weigh the additional revenue cost of giving some relief to people over $60,000 or $65,000, against the marginal disincentives. So my point is just that I think it is a little harder question than Mr. Reynolds does.

Mr. RAMSTAD. What you are saying really, it is difficult to generalize as to the effect of the disincentives? Conceding the disincentive aspect, it is difficult to generalize behavior there from?

Ms. ALSTOTT. I think that is right. Although I am not an economist, it depends on which kind of group and at which income level the disincentives are falling on. Married women at all income levels are relatively sensitive to work disincentives, married men I believe are less sensitive to them.

Mr. RAMSTAD. Would the other two witnesses care to comment?

Mr. REYNOLDS. Yes, I would.

I have quite a few studies that you can go and check yourself that show the incentive effects are quite strong. I believe they are also stronger on primary earners than people think, primarily through the process of early retirement. But we will leave that aside.

The lower the threshold at which you cut off this benefit, any benefit, or the lower the threshold at which you begin to tax Social Security, for that matter, the more people are affected, obviously. So your $200,000 cap, although I object to it in principle, isn't going to affect very many people, because most people who earn over $200,000 don't have young children anymore. They have old children, who by the way, are more expensive. But as you approach—let's say you phase it out between $60,000 and $75,000, which is what I think the President's proposal is. To be losing a $500 credit that quickly, that is a very sharp marginal rate. The more children you have, the sharper it is.

With four children, that is $2,000 of tax breaks lost by raising your income $15,000. You would think twice about increasing your income. It encourages you to do almost anything but do that. To the extent you can, you will fudge your tax return. But when that is not possible, one person is not going to work, or you are going to work a little less, or you are going to not bother to save, or something—something bad happens.

Ms. O'CONNELL. I think the phase-out limit is strictly driven by budget considerations. It doesn't make a lot of sense to me that that, per se, affects people's conduct. My practical experience is they found out that it happened after it happened to them, when they in the spring of the succeeding year file a return about last year's activity. Then they are close to halfway through that year and they have to decide what to do about it, they can't necessarily do something about it immediately. So these ties are very hard to

make. Practically speaking, these kinds of family linked benefits have gone in and out, up and down, cut in and not cut in. I think a lot of people are saying, I am going to live the best life I can and cross my fingers. That is what I think.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Thank you all three of you.

Mr. CRANE [presiding]. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Professor Alstott, you said that you taught social policy as well as taxation. As a matter of social policy, does it make any sense for us to consider the tax cuts that are presently in the Contract With America, if the cost in terms of revenue of the tax cut is to be made up by cutting spending in order to reach a balanced budget? If you assume that Social Security is not going to be cut and neither the military, and if you assume further that at least 50 percent of the rest of the spending—since we can't cut interest on the debt that has to be paid, is it good social policy to cut into those existing programs, many of which are called entitlements, that provide for the services for the poor?

Ms. ALSTOTT. Let me just say that my written testimony was limited really to the merits of this proposal. I understand that your question goes more broadly. I am not in favor of cutting domestic, certain domestic programs, in particular, welfare programs. I am not in favor of taking welfare programs out of their current entitlement status.

It was my understanding that the committee was not particularly interested in my judgment on that. If that is your question, that is true. Certainly the committee needs to weigh what cuts are going to be made in order to come up with the $2 billion a year for this proposal.

On the other hand, I believe there are other areas in which we might, by changing the tax system or other areas of the budget, make up the revenue. So it is a difficult question.

Mr. RANGEL. Well, you didn't sound like it was difficult. You said that if you have to cut social programs, it doesn't make sense. It would seem to me that others might have said earlier that if it didn't cut the deficit, it doesn't make sense.

I didn't ask you that question, because you were not in that area. So your response—you are saying that you are only responding to this particular tax policy as it affected people married with children. But whether or not it is sound economic policy, based on the hypothetical I gave you, it would not be.

Ms. ALSTOTT. Based on the hypothetical you gave me, if there were an opportunity to make up for the revenue in other areas, for example, by curtailing the home mortgage interest deduction, you would get a different answer. I think that this policy is a good policy in the hypothetical you gave me. I think I gave you my answer.

Mr. RANGEL. All right.

Now, for the others, the Census Bureau and the IRS indicate that there are 14.3 million couples that experience a marriage penalty. This contract is very vague, they just say that $2 billion a year is supposed to be allocated toward relief of this penalty. So division would say that then you get about $140 a couple relief.

Now, if that matter is correct, should we be going through all of this for $140? I mean, is it really worth the administrative costs and the other problems that we would face, or at least IRS claims they would face, in changing the system, if indeed it turns out that they get $140 out of the $2 billion for the families affected?

Ms. O'CONNELL. If I may first, I think it is really worth it, Mr. Rangel. First, I am not sure about how many dollars on any particular couple's return it would mean.

Mr. RANGEL. This is only IRS. They hardly know either, but you know it is hard to know. We are just basing this on the little information that has been given to us by those that support this. They have no bill, so they just say take $2 billion and give relief to the married couple, couples who are penalized. So we said, OK. If that breaks out to $140, you can say, well, it is a start.

Ms. O'CONNELL. Well, Mr. Rangel, what I would urge on you is that at the lower income levels, while it might be $140 on the average for every single couple, if everybody was going to get the same credit, it could be at the lower income levels that you could do the arithmetic in such a way that it would be $500 or $1,000 for a particular couple. That then makes a big difference. So while it is a drop in the bucket on the average, for some couples it is going to be a lot more than that. For some families, it can mean a lot more than that.

Mr. RANGEL. Would you suggest that income cutoff at the high levels, where you don't think the $140 would make that much difference, and apply it to the lower income, make it progressive, so that it really would be something for the low-income people?

Ms. O'CONNELL. I dislike this result so much in the code that I would like to open it up to everybody without limit. But I realize that there is a cost of it somewhere, where that just becomes unreasonable. I would urge you to push it as far as you can to help some, every single couple that is paying a tax, just by virtue of the fact that they chose to be married; that is wrong.

Mr. RANGEL. But you would agree with the professor that if indeed it meant cutting deep into programs that the poor depend on, that we shouldn't even be discussing this at all?

Ms. O'CONNELL. Well, you are going to have to get the $2 billion somewhere. I think it is silly to meet—well, I would not think it would be appropriate to somewhat meet yourself coming and going. If you skew a credit to help lower income people who are seriously disadvantaged by a marriage penalty tax, it doesn't make sense to put it in their left pocket and take it out of their right pocket.

Mr. RANGEL. Makes a lot of sense to me, counselor.

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

Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

I think that what we are talking about as far as eliminating the marriage penalty, first of all, we have to look at what as a country we want to say when we are dealing with our Tax Code. Do we want to say that we don't want to encourage people to stay married?

I think that over the course of the history, obviously the family is the foundation of this country and I think a lot of us when we were looking at repealing the tax penalty on marriage, are really

looking at this in more general terms. We want to start reversing some of what the last 30–40 years has done to the family in this country.

We want to say we are looking for policies that will strengthen the family. We don't want to give incentives to break down the family.

Addressing some of the flat tax issues that we have heard brought up today, I want to echo my support for a flat tax. I think that it, first of all, automatically eliminates the marriage penalty. You don't have to do any figuring. If everybody's paying a flat tax, there is no marriage penalty, there is no single penalty, there just are no penalties in that regard. Obviously, it addresses some of what Ms. O'Connell talks about, and that is the simplification.

One item that I would like addressed maybe by you, Mr. Reynolds, is the GAO was in my office this morning briefing me on some tax policies and they talked about the earned income tax credit, that they are going to have a study coming out next week that will show approximately $1–$5 billion in fraud. When we are talking about some of these tax credits, could you address, the problems of fraud? Once again—versus the flat tax. When you don't have to worry about the fraud, you have more people coming into the system.

Mr. REYNOLDS. Yes. I am actually somewhat sympathetic about the earned income tax credit. It is, after all, kind of a negative income tax, an old Milton Friedman idea.

I was with George McGovern recently, he was pumping the old "Democrat" idea he proposed in 1972. I said, "We enacted that, you know, and it was greatly increased in 1993." There are a lot of problems with it. One of them is fraud. Another one is that it imposes high marginal tax rates. The more generous we get with it, the higher the tax penalties on work become. Why? Because you have to peel it away as income rises.

There is really no alternative to that. Unless you are going to be giving the EITC to people who make $60,000 a year, you have to peel it off fairly quickly. If you then combine it with some other program such as food stamps, extra work can face a 75-percent marginal tax rate. The EITC family is probably not poor enough to qualify for Medicaid, but if they were, it is all over: They just can't increase family income by extra work.

I can't over emphasize the importance of thinking at the margin. The Republicans are talking about increasing the amount of money exempt from inheritance tax. But once you reach that limit, the marginal tax rate is 35 to 55 percent, like it always was. So you have a very strong incentive to limit the amount of savings to avoid ending up with a big estate, and to do a lot of estate planning that probably ends up losing the government a lot of money. This failure to keep marginal tax rates reasonable permeates all of these issues.

We are starting to use the Tax Code to try to redistribute income. There is no evidence in any country, at any time, that this has ever worked. The only thing redistributive tax policy has ever done is put a lid on prosperity. It can do that, it can keep people from getting up there. It doesn't help poor people to know that rich people are being punished for being rich. Basically, the whole no-

tion is goofy. It leads to all sorts of other problems, including the EITC, which also has high marginal tax rates.

Mr. ENSIGN. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Mr. Chairman, I have got one question for professor, is that Alstott?

Ms. ALSTOTT. Yes.

Mr. FORD. Yes, you concluded your testimony in saying: "If a credit is the preferred solution, further thought should be given to coordinating it with the earned income tax credits. A refundable credit would provide relief for earned income tax credit recipients who face a marriage penalty but do not have the necessary income." There has been a lot of talk on the welfare reform package in reference, joined with, I guess, out-of-wedlock births by a number of members on this committee and others throughout this country. We are talking about low-income people having family breakup and family values, talked a lot about over this last campaign.

Should we target this marriage penalty credit directly to low-income families, this marriage penalty? Should it be applied only to low-income families as we take a look at the teenage pregnancy problem in the welfare package, or will we see family breakup among low-income families in this country?

Ms. ALSTOTT. Two points, I guess. First of all, again, drawing this, I recognize, academic distinction, but I think an important one between incentives and behavior, it is not all that clear to me to what extent out-of-wedlock births really are encouraged by financial penalties in the welfare system or the tax system. But that being said, clearly it is inconsistent for us, on the one hand, to tell low-income people through our welfare policy that they ought to be getting married, and then, on the other hand, through our welfare and tax policies take money away from them if they do. As to the question whether we should——

Mr. FORD. But the refundable credit would be a credit directly, even if they did not have the income. They would be receiving a credit, a refundable credit, I guess, in terms, would mean that they would receive the amount of money from the Federal Government.

Ms. ALSTOTT. A transfer payment, just like the EITC.

Mr. FORD. Which would, in essence, reduce the welfare payments on families; is that correct?

Ms. ALSTOTT. It would depend on the language you enacted, basically. The EITC, for example, does not directly reduce welfare payments, at least in the first months after it is received. It depends on how quickly it is spent.

You could adopt that or you could coordinate it differently with welfare. But it would be possible to give welfare families some credit, at least if they were two-earner couples. That is an empirical question, how many of them are two-earner couples.

Mr. FORD. But we don't know all of the reasons why paternity is not established at or before birth. We really don't know whether the marriage penalty, applying only to that population that would qualify for the earned income tax credits, whether or not it would reduce the payments or reduce the out-of-wedlock births. I mean, we are faced with the problem in this country and when we talk

about those out-of-wedlock births, we know that there is not only a problem at the upper income or middle-income people in America, but the lower income people who are getting all of the blame for the teenage pregnancy problems, as well as the out-of-wedlock births.

Ms. ALSTOTT. Right. I think you are right, that we simply don't know. I think of the best social science evidence that we have suggests if there is, if any, a very weak relationship between marriage penalty and welfare programs, there is clearly a lot of factors that go into the decision to have a child out of wedlock. Whether tax and welfare policies contribute in a big way, it is not at all clear.

Mr. FORD. When you talk about the refundable credit, what do you really mean?

Ms. ALSTOTT. By a refundable credit, I simply mean, if we are going to do this through a tax credit, that we ought to ensure that at least some of the relief is available to people who get the EITC or who are otherwise so poor that they do not owe income tax.

Mr. FORD. What if they do not owe income tax, would any of that apply for a direct——

Ms. ALSTOTT. Yes, a refundable credit would mean if they are too poor to owe income tax, whatever extra credit they have would simply be a cash refund to them from the IRS, they would get a check.

Mr. FORD. Most AFDC or public assistance programs are means-tested programs, which would reduce any other Federal payment going to them through food stamps or through AFDC.

Ms. ALSTOTT. It wouldn't necessarily do that. You could write into the legislation language that we now have the current EITC which limits the extent to which the refund is treated as an asset or a resource for the transfer payments.

Mr. FORD. It would not have impact overall?

Ms. ALSTOTT. Exactly, if that is what you want.

Mr. FORD. Thank you, Mr. Chairman.

Mr. CRANE. I want to thank the panel for their testimony. We appreciate your appearing here today.

Now I adjourn this panel and convene panel No. 4, Thomas Bloch, Phyllis Schlafly, Gary Bauer, Beverly LaHaye, and Robert Shapiro.

If you folks will come up here, please.

Mr. CRANE. Proper etiquette dictates that ladies shall go first. I want to welcome this panel, but especially I want to welcome a very dear and longtime friend, a fellow Illinoisan, Phyllis Schlafly.

Phyllis, if you would be so kind to kick it off, we will work down the line with the fellows.

STATEMENT OF PHYLLIS SCHLAFLY, PRESIDENT, EAGLE FORUM

Ms. SCHLAFLY. Thank you very much, Mr. Chairman—and I am very happy to see you there as chairman—and members of the committee.

Among the many dramatic changes that have taken place in America over the last 40 years, the changes in taxes are one of the most important. It is difficult to avoid the conclusion that the Federal Tax Code has been waging a silent war on traditional families,

the kind of families that stay together, work hard, raise their children, and pay their taxes.

When I was having my children, the typical couple with two children paid 2 percent of its annual income in Federal taxes. Today, the same type of family pays almost 25 percent of its annual income in Federal taxes. That means one-fourth of everything they earn goes right off the top to the government here in Washington.

When we hear wives and mothers assert that today's economy requires two incomes, that they have to take a paid job in order to maintain a reasonable standard of living, and that they therefore need subsidized day care, let's be blunt about what this means. Mothers don't have to work in order to support their families. They have to work in order to pay their taxes and support the Federal bureaucracy.

Of course, we all know that everybody's taxes have gone up. But the tax burden on traditional families has risen out of all proportion to taxes on other segments of our society. The skewing of the Federal income tax came about because of the change in the way that children are valued and treated.

When I was having my children in the fifties, each child enjoyed a $600 income tax exemption, which then amounted to 17 percent of the median family income. A family consisting of a father, a mother, and two children thus had exemptions of $2,400, or 72 percent of the then median family income.

When my grandchildren were born in the eighties, a child had an income tax exemption of $1,000 but factoring in the changes in the median income, the value of money and the tax rates, the $1,000 child exemption was then only 4 percent of the median family income. The per-child exemption had been devalued by three-fourths.

Since Eagle Forum started exposing this discrimination in November 1982, the per-child exemption has been slowly raised to its present level of $2,450. But if a child were to have the same worth in today's income Tax Code as it did 40 years ago, the child's exemption would have to be at least $7,500. However, the per-child exemption starts to be phased out at the $83,850 level.

Meanwhile, the Federal Tax Code has been powerfully skewed to favor single-parent families. The head-of-household tax status provides single mothers virtually the same benefits as the joint return. The huge expansion of the refundable earned income credit has tended to make a wage-earning father irrelevant. The Democrats have falsely called the earned income credit a tax reduction, but it is actually just more welfare to single mothers because it is a cash payment scaled up to $2,528.

Also, families that use hired day care for their children instead of in-home mother care are favored with the dependent tax credit of up to $960. This is available to parents without any income cap for wealthy parents. Incidentally, it is the only tax benefit that is not capped. This means that the higher income two-earner couples get a credit for higher child care but in-home mothers are even deprived of the ordinary child exemption.

These factors have resulted in the situation that traditional families, the ones who are keeping their families together and raising their children, have borne an enormous and discriminatory share

of the great expansion of government spending over the last 40 years. This result is not only unjust and unfair, it is counterproductive for society because all social data confirm that children from traditional families cost the taxpayers much less in remedial social problems than children from broken families.

The devaluation of the child in traditional families in the Federal income Tax Code was done really without any public debate or discussion whatsoever. I, therefore, thank this Ways and Means Committee for holding this hearing to flesh out this issue for public discussion. I hope you will consider this $500 tax credit for children just one step on the way to a large tax reduction and tax relief for all Americans.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT TO THE U.S. HOUSE WAYS AND MEANS COMMITTEE

by PHYLLIS SCHLAFLY, President, Eagle Forum

January 17, 1995

Among the many dramatic changes that have taken in America over the past 40 years, the change in taxes is one of the most important. Taxes are not merely a means of raising revenue for the government; taxes provide incentives and disincentives that induce or inhibit human behavior in a powerful way. It is difficult to avoid the conclusion that the federal tax code has been waging a silent war on traditional families, the kind of families that stay together, work hard, raise their children, and pay their taxes.

When I was having my children, the typical couple with two children paid 2 percent of its annual income in federal taxes. Today, the same type of family pays almost 25 percent of its annual income in federal taxes. That means one-fourth of everything they earn goes, right off the top, to the government here in Washington.

When we hear wives and mothers assert that today's economy "requires two incomes," that they "have to take a paid job" in order to maintain a reasonable standard of living, and that they therefore "need subsidized daycare," let's be blunt about what this means. Mothers don't "have to work" in order to support their families; they "have to work" in order to pay their taxes and support the federal bureaucracy.

Of course, we all know that everybody's taxes have gone up. But the tax burden on traditional families has risen out of all proportion to taxes on all other segments of society. This skewing of the federal income tax came about because of the change in the way that children are valued and treated.

When I was having my children in the 1950s, each child enjoyed a $600 income tax exemption, which then amounted to 17 percent of the median family income. A family consisting of a father, a mother and two children thus had exemptions of $2,400, or 72 percent of the then median family income.

When my grandchildren were born in the 1980s, a child had an income tax exemption of $1,000. Factoring in the changes in the median income, the value of money and tax rates, the $1,000 child's exemption was then only 4 percent of the median family income. The per-child exemption had been devalued by three-fourths.

Since Eagle Forum started exposing this discrimination in November 1982, the per-child exemption has been slowly raised to its present level of $2,450, but if a child were to have the same worth in today's income tax code as it did 40 years ago, the child's exemption would have to be at least $7,500. However, the per-child exemption starts to be phased out at the $83,850 income level.

Meanwhile, the federal tax code has been powerfully skewed to favor single-parent families. The "head-of-household" tax status provides single mothers virtually the same benefits as the joint return. The huge expansion of the refundable earned income credit has tended to make a wage-earning father irrelevant. The Democrats have falsely called the earned income credit a "tax reduction," but it is actually a cash payment scaled up to $2,528, i.e., more welfare to single mothers.

Also, families that use hired daycare for their children instead of in-home mother care are favored with the dependent-care tax credit of up to $960. This is available to parents without any income cap for wealthy parents (incidentally, the only tax benefit that is not capped). This means that higher-income couples get a credit for hired child care, but in-home mothers are even deprived of the ordinary child exemption.

These factors have resulted in the situation that traditional families, the ones who are keeping their families together and raising their children, have borne an enormous and discriminatory share of the great expansion of government spending over the last 40 years. This result is not only unjust and unfair, it is counterproductive for society because all social data confirm that children from traditional families cost the taxpayers less in remedial social programs than children from broken families.

The devaluation of the child in traditional families in the federal income tax code was done without any public debate or discussion whatsoever. Politics has been my lifetime hobby, but I never heard a single Congressman or commentator discuss this massive change in the income tax code during the years when the U.S. tax burden was shifted onto the backs of traditional families with children. It was done covertly, behind closed doors, by the Congressional committees that wrote the fine print of the income tax law.

I thank the House Ways and Means Committee for holding this hearing to flesh out this issue for public discussion. We support the $500 per-child tax credit as a first step toward fairness for families. It should be just as available to upper-income families as the dependent care tax credit.

The Congressional election last November contains many lessons, but one of them surely is a loud cry for tax reduction — for everyone. I urge the Committee to look upon the $500 per-child tax credit as just one step along the way to tax relief for all Americans.

Mr. CRANE. Thank you for your testimony.
Ms. LaHaye.

STATEMENT OF BEVERLY LAHAYE, PRESIDENT AND FOUNDER, CONCERNED WOMEN FOR AMERICA

Ms. LAHAYE. Mr. Chairman, members of the committee, as president of the Nation's largest profamily women's organization, I represent the over 600,000 members of Concerned Women for America, or CWA. CWA is a grassroots organization with local and State chapters across the United States and our commitment is to the preservation of the American family. I am here today to testify in favor of the American Dream Restoration Act because for too long, government has placed an undue tax burden upon the shoulders of families.

CWA is primarily a woman's organization, and as president, I travel frequently across the United States meeting and speaking to many different women from all backgrounds and interests. But I am consistently overwhelmed and saddened by the untold numbers of women who tell me they wish they could stay at home to raise their children, but for economic reasons they must work. When you look at the figures, it is clear why so many of these women must remain in the work force.

In 1948, only 3 percent of a family of four's median income went to the Federal Government in taxes. But by 1992, that family was paying almost 24.5 percent of its income to the Federal Government. Add to that figure the amounts paid for State, local, and indirect Federal taxes and that same family of four paid 37.6 percent of its income in taxes. While an unmarried, median-income American's Federal taxes have risen 31 percent since 1948, a median-income family of four's taxes have increased 2,500 percent in the same time. Furthermore, the current Tax Code discriminates against those mothers who choose to remain at home instead of pursue a career. Two-income households are given the DCTC, dependent care tax credit, of $480–$720 per child for up to two children. But this credit is not available to those families where one parent remains at home. What kind of message does this send to American families?

Families are the cornerstone of this Nation. In recent years we have all heard a great deal about family values and the importance of strengthening families. Americans are waking up to the fact that without families, we will fall as a nation.

I was particularly heartened by this Congress' actions to create a family friendly environment. I think that is just one example of a growing realization in America that not only are families vital, but government cannot provide an adequate substitute for the family. Families instill values, tradition, discipline, and serve as the best agency for health, education, and welfare. So when American families cannot prosper, neither can the future of America.

Currently, in a two-parent, two-income household, two-thirds of the average working mother's salary goes toward increased taxes. That means the additional income she brings in does not go toward paying for a house mortgage, braces for the children, or groceries. This may be one very good reason that so many voters opted for a change in Congress last November.

It is not difficult to understand why so many parents who must work are frustrated when you consider that they watch their money being consumed by a government that spends six times the amount each year of what it did in 1948.

I believe the American Dream Restoration Act would begin to rectify the unfair tax burden on the family and would instead empower them. Thirty-five million American families would be eligible for this 500-dollar-per-child tax credit. For a family of four earning $40,000 a year, that would mean their tax bill is reduced by 10.4 percent. But all American families should be able to receive this tax credit, regardless of their level of income. By means-testing this credit now, the door stands wide open for the level to be decreased in future years. Furthermore, I think it is helpful to remember that this money belongs to the men and women who earn it, not to the government. This tax credit is not entitlement money; if anything, it serves as a handcuff to keep the government from reaching deeper into the pockets of American families.

It has been reported that some Members of Congress are questioning whether or not this tax credit is a good idea. Some have estimated it would cost the Treasury $110 billion over 5 years. There are, without doubt, many difficult decisions that will have to be made in order to bring the deficit down and put our country's finances back in order. But families cannot continue to shoulder the responsibility of paying for government's insatiable appetite. Spending cuts must be made and Concerned Women for America will support you in that process.

Mr. Chairman, members of the committee, thank you for allowing me to—the opportunity to present our views on this important issue. Tax relief for American families is critical and its time is certainly overdue. Concerned Women for America supports the American Dream Restoration Act fully and hopes that this committee and Congress will pass it quickly. Thank you.

[The prepared statement follows:]

Testimony of Dr. Beverly LaHaye
President of Concerned Women for America
to The Committee on Ways and Means
United States House of Representatives
January 17, 1995

Mr. Chairman, Members of the Committee, as President of the nation's largest pro-family women's organization, I represent the over-600,000 members of Concerned Women for America (CWA). CWA is a grassroots organization with local and state chapters across the United States, and our commitment is to the preservation of the American family. I am here today to testify in favor of "The American Dream Restoration Act" because for too long government has placed an undue tax burden upon the shoulders of families.

CWA is primarily a woman's organization, and as President, I travel frequently across the United States meeting and speaking to many different women from all backgrounds and interests. But I am consistently overwhelmed and saddened by the untold numbers of women who tell me they wish they could stay at home to raise their children, but for economic reasons, they must work. When you look at the figures it is clear why so many of these women must remain in the work force.

In 1948 only three percent of a family of four's median income went to the federal government in taxes. But by 1992, that family was paying almost 24.5 percent of its income to the federal government. Add to that figure the amounts paid for state, local and indirect federal taxes, and that same family of four paid 37.6 percent of its income in taxes. And while an unmarried, median-income American's federal taxes have risen 31 percent since 1948, a median-income family of four's taxes have increased 2,500 percent in the same time. Furthermore, the current tax code discriminates against those mothers who choose to remain at home instead of pursue a career. Two-income households are given the Dependent Care Tax Credit (DCTC) of $480 to $720 per child for up to two children. But this credit is not available to those families where one parent remains at home. What kind of message does this send to American families?

Families are the cornerstone of this nation. In recent years we have all heard a great deal about "family values" and the importance of strengthening families. Americans are waking up to the fact that without families, we will fall as a nation. I was particularly heartened by this Congress' actions to create a "family friendly" environment. I think that is just one example of a growing realization in America that not only are families vital, but government cannot provide an adequate substitute for the family. Families instill values, tradition, discipline, and serve as the best agency for health, education and welfare. So when American families cannot prosper, neither can the future of America.

Currently, in a two-parent, two-income household, two-thirds of the average working mother's salary goes toward increased taxes. That means the additional income she brings in does not go towards paying for a house mortgage, braces for the children, or groceries. This may be one very good reason that so many voters opted for a change in Congress last November. It is not difficult to understand why so many parents who must work are frustrated when you consider that they watch their money being consumed by a government that spends six times the amount each year of what it did in 1948.

I believe that "The American Dream Restoration Act" would begin to rectify the unfair tax burden on the family and would instead empower them. Thirty-five million American families would be eligible for this $500-per-child tax credit. For a family of four earning $40,000 a year, that would mean their tax bill is reduced by 10.4 percent. But all American families should be able to receive this tax credit, regardless of their level of income. By means-testing this credit now, the door stands wide open for the level to be decreased in future years. Furthermore, I think it is helpful to remember that this money belongs to the men and women who earn it, not to the government. This tax credit is not entitlement money; if anything, it serves as a handcuff to keep the government from reaching deeper into the pockets of American families.

It has been reported that some Members of Congress are questioning whether or not this tax credit is a good idea. Some have estimated that it will cost the Treasury $110 billion over five years. There are without doubt, many difficult decisions that will have to be made in order to bring the deficit down and put our country's finances back in order. But families cannot continue to shoulder the responsibility of paying for government's insatiable appetite. Spending cuts must be made and Concerned Women for America will support you in that process.

Mr. Chairman, Members of the Committee, thank you for allowing me the opportunity to present our views on this important issue. Tax relief for American families is critical and its time is certainly long overdue. Concerned Women for America supports "The American Dream Restoration Act" fully and hopes that this Committee and Congress will pass it quickly.

Mr. CRANE. Thank you for your testimony. Let me reassure all of the witnesses that if you have any remarks that go beyond presentation time, all of your remarks will be included in the record.

Mr. Shapiro.

STATEMENT OF ROBERT J. SHAPIRO, VICE PRESIDENT, PROGRESSIVE POLICY INSTITUTE

Mr. SHAPIRO. Thank you, Mr. Chairman. I want to thank the members of the Ways and Means Committee for the opportunity to appear here today and offer the views and analysis of the Progressive Policy Institute and the Democratic Leadership Council regarding tax relief for American families with children.

We believe, first, the Tax Code should be reformed to exempt from Federal income tax the private resources which a moderate-income or middle-income family needs to raise its children. This can be achieved by replacing the current $2,400 dependent exemption with a $720 per-child tax credit for families in the 15-percent income tax bracket, covering all families with incomes of roughly $45,000 a year or less. For these families, this credit would be equivalent to doubling the current children's exemption, excluding from income tax $4,800, or roughly the amount an average-income family spends each year raising a child. This reform would reduce Federal revenues by roughly $55 billion over 5 years.

This relief is especially pressing given the gradual and steady deterioration over the last 20 years in our economy's underlying growth rates for net investment, productivity, and overall output which has reduced opportunities for upper mobility by most American families.

Consider the following data. The average person entering the work force at age 20 or age 30 in 1950 doubled his or her income over the next 20 years, even after adjusting for both inflation and the cost of raising a child. Unhappily, these opportunities for mass upper mobility ended in the seventies. An average American entering the work force at age 20 or age 30 in 1970 found that after 20 years of hard work in 1990, his or her family income had grown by barely 10 percent after adjusting for inflation and the cost of raising a child. As a result, for some time, the vast majority of two-parent families have required two working parents just to maintain their incomes and a large share of single parents are forced to hold two jobs.

The first responsibility of the Congress and the President should be to restore the economic conditions for mass upward mobility by reducing the deficit, actively promoting personal savings, and expanding vital public investment in education and training, the economic infrastructure, and basic research. Until these reforms are achieved, the Federal Government at the least should not burden the child-rearing efforts of average-income families by taxing the resources they need to raise their children.

Second, we believe that at this time tax relief should be focused on families in the 15-percent tax bracket. To begin, the economic case for tax relief for higher income people is less pressing. The data showed that through the seventies, eighties, and into the nineties, while most working families have been struggling with protracted stagnation in their standard of living, highly educated

and highly skilled people have been able to maintain the rates of economic progress open to everyone in the fifties and sixties. Roughly the top 20 percent of the work force, principally professionals and managers, have continued to enjoy annual income gains averaging 4 to 6 percent a year over the last 20 years, sufficient on average to double their incomes, after accounting for inflation and the cost of raising a child. Moreover—and I would like to emphasize this—the current tax system already provides nearly comparable support to higher income families. For families in the 28-percent tax bracket, the present $2,400 per-child deduction is already equivalent to a $672 per-child tax credit.

Every dollar of tax relief approved this year will reduce the pool of private capital available for business investment in the plant, equipment, training, and technological advance necessary to restore mass upward mobility. Providing additional tax relief to these higher income families as well would reduce potential private investment by $10 to $12 billion a year, more than 10 percent of the average annual net business investment over the last 5 years. At this time, it would be a serious error in economic and social policy to reduce potential private investment in order to increase the post tax incomes of families whose incomes have been rising substantially and steadily, who already earn the resources necessary to provide their children significant advantages, and who already enjoy a tax exclusion for children nearly comparable to the reform we propose for those with lower incomes.

Finally, Congress must provide a permanent stream of resources to finance any tax relief for moderate- and average-income families with children. The only way to ensure that family tax relief does not expand deficit borrowing and thus reduce the long-term economic prospects of these same children is through permanent revenue or entitlement changes. Reductions in discretionary spending cannot provide this assurance since at any time Congress could increase the same appropriated accounts.

In order to promote the economic prospects of America's children in both the near term and the long term, Congress should provide family tax relief as part of a much larger package of spending and tax changes which reduce the deficit by at least $2 for every $1 of tax reduction. These resources should come first from current spending and tax programs which actively undermine the economy's basic efficiency and productivity, principally spending and tax subsidy programs for particular industries which in the past have been able to exercise inordinate influence over the budget and tax-writing process.

One year ago, the Progressive Policy Institute published a report, "Cut and Invest To Compete and Win: A Budget Strategy for American Growth," identifying 68 instances of spending and tax subsidy programs serving no overriding social or economic purpose and which, if eliminated, would yield $225 billion over 5 years. I would note this program was endorsed this morning in the lead editorial of the New York Times. Previously, it was endorsed by the Wall Street Journal. Next month, we will publish a second edition of this report cataloging additional unproductive subsidies which, if reformed, could provide the resources for deficit reduction and public investment as well as family tax relief.

We at the Progressive Policy Institute are gratified that the President and both parties in Congress now endorse tax relief for financially strapped American families. We urge you to enact this reform on a sound and proper basis. Until the deficit is eliminated, tax relief should be provided to those families which most need it. It should be financed on a permanent basis and it should be part of a larger effort to reduce the deficit, focused on subsidies and other ineffective Federal activities that undermine American growth and the long-term prospects of all American children.

Thank you.

[The prepared statement follows:]

Statement of Robert J. Shapiro
Vice President, Progressive Policy Institute

before
The Committee on Ways and Means
United States House of Representatives

Washington, D.C.
January 17, 1995

I want to thank the members of the Ways and Means Committee for the opportunity to appear here today and offer the views and analysis of the Progressive Policy Institute and the Democratic Leadership Council regrading tax relief for American families with children. It is a matter of genuine social and economic significance.

I will first state our conclusions and then offer our underlying analysis and evidence.

First, the federal tax code should be reformed to exempt from federal income tax the private resources which a moderate-income or middle-income family needs to raise its children. This can be achieved by replacing the current $2,400 dependent exemption with a $720 per-child tax credit for families in the 15 percent income-tax bracket, covering all families with incomes of roughly $45,000 a year or less. For these families, this reform would be equivalent to doubling the current children's exemption, and so excluding from federal income tax $4,800 or roughly the amount an average-income family spends each year raising a child. This tax credit, like the current dependent's exemption, should be indexed for inflation. This reform would reduce federal revenues by roughly $55 billion over five years.

Second, at this time this tax relief should be focused on families in the 15 percent tax bracket. The current tax system *already* provides nearly comparable support to higher-income families: For families in the 28 percent tax bracket, the current $2,400 per-child deduction is equivalent to a $672-per child tax credit. Moreover, in the current budget environment in which any tax reduction, by itself, would reduce the store of investment capital needed by American business to generate jobs and increase their productivity and output, family tax relief should be focused on those families whose limited incomes constrain their ability to raise their children.

Third, family tax relief should be financed by other revenue reforms which raise equivalent resources, in order to preserve the existing federal revenue base and ensure that this reform does not inadvertently undermine the economic prospects of the children we wish to help, by expanding the federal deficit in later years.

If and when Congress and the President eliminate the federal deficit or otherwise substantially increase the national savings rate, we would urge the Congress to expand the extent and coverage of tax relief for all families with children.

Since its founding, the Progressive Policy Institute has advocated federal reforms to relieve the economic stresses facing moderate-income and middle-income families raising children. In this effort, we urge the Committee to recognize certain economic developments of recent decades which threaten the prospects of most American children. First, a gradual and steady deterioration over the last 20 years in

the U.S. economy's underlying growth rates for net investment, productivity, and overall output has reduced the opportunities for upward mobility by most American families. Consider the following data. The average person entering the work force at age 20 or age 30 in 1950 doubled his or her income over the next 20 years, even after adjusting for both inflation *and* the costs of raising a child. These broad opportunities for mass upward mobility, however, ended in the 1970s. An average American entering the work force at age 20 or age 30 in 1970 found that, after 20 years of hard work, his or her family income had grown by barely 10 percent, after adjusting for inflation and the cost of raising a child.

This radical deterioration in the long-term income gains of American parents has significantly reduced the time and care many parents can provide their children. For some time, the vast majority of two parent-families have required two working parents just to maintain their incomes, and a large share of single parents are forced to hold two jobs. The first responsibility of the Congress and the President should be to restore the economic conditions for mass upward mobility, through broad economic reforms that can elevate the economy's underlying growth rates of investment, productivity and output: Reduce the deficit; actively promote personal savings; and expand vital public investment in education and training, the economic infrastructure, and basic research. Until these basic economic reforms are achieved, the federal government, at the least, should not burden the child-rearing efforts of average-income families by taxing the resources they need to raise their children.

The economic basis for family tax relief provides guidance for its coverage as well as its extent. Through the 1970s, 1980s and into the 1990s, while most working Americans have been struggling with a protracted stagnation in their standards of living, highly-educated and highly-skilled people have been able to maintain the rates of economic progress open to everyone in the 1950s and 1960s. Roughly the top 20 percent of the work force, principally professionals and managers, have continued to enjoy annual incomes gains averaging four-to-six percent a year over the last 20 years; sufficient on average to double their incomes, after accounting for inflation and the costs of raising a child. In any event, as noted earlier, for these families, in the 28 percent tax bracket, the current $2,400 per-child exemption is already nearly equivalent to the $720 per-child tax credit we propose to eliminate tax liability on the income a moderate- and middle-income family needs to raise a child.

Every dollar of tax relief approved this year will reduce the pool of private capital available for business investment in the plant, equipment, training, and technological advance necessary to restore mass upward mobility. At this time, it would be a serious error in economic and social policy to reduce potential private investment in order to increase the post-tax incomes of families whose incomes have been rising substantially and steadily, and who already earn the resources necessary to provide their children significant advantages. Providing comparable additional tax relief to these higher-income families as well would reduce potential private investment by $10 to $12 billion a year, or more than 10 percent of average annual net business investment over the last five years.

Finally, Congress must provide a *permanent* stream of resources to finance any tax relief for moderate- and average-income families with children. The *only* way to ensure that family tax relief does *not* expand deficit borrowing, and thus reduce the long-term economic prospects of these same children, is through permanent revenue or entitlement changes. Reductions in discretionary spending cannot provide this assurance since at any time Congress could increase the same appropriated accounts. Financing family tax relief through a legislative cap on discretionary spending also will not protect the economy and our children from the deficit implications of tax relief, because a cap represents only a promise to find the necessary resources in the future.

In order to promote the economic prospects of America's children in both the

near-term and the long-run, Congress should provide family tax relief as part of a much larger package of spending and tax changes which reduce the deficit by at least $2 for every $1 of tax reduction. These resources should come, first, from current spending and tax programs which actively undermine the economy's basic efficiency and productivity—principally spending and tax subsidy programs for particular industries which in the past have been able to exercise inordinate influence over the budget and tax-writing processes.

These subsidies—from public payments to profitable agribusinesses and below-market-priced power from federal hydroelectric facilities, to federal payments to Amtrak and special tax breaks for oil and gas firms, business entertainment, and large credit unions—weaken our national economic base in two principal ways. First, industries receiving these taxpayer-financed favors gain an artificial edge in the economy, leaving other sectors and companies at a competitive disadvantage and preventing labor and capital from slowing to their most efficient uses. And second, like a narcotic, these subsidies ultimately weaken the firms and industries that come to depend on them, by artificially underwriting their rates of return and so insulating the, from competitive pressures to figure out how to be more efficient, productive and innovative.

A year ago, the Progressive Policy Institute published a report, *Cut and Invest To Compete and Win: A Budget Strategy for American Growth*, identifying 68 instances of spending and tax subsidy programs serving no overriding social or economic purpose and which, if eliminated, would yield $225 billion over five years. Next month, we will publish a second edition of this report cataloguing additional unproductive subsidies which, if reformed, could provide the resources for deficit reduction and public investment as well as family tax relief.

Reforming industry subsidies will not be easy. As former budget director David Stockman learned in 1981—and President Clinton learned again in 1993—Congress almost never withdraws special treatment for special interests on a one-by-one basis. Therefore, we urge the Congress and the President to tackle this problem by using the all-or-nothing model of the Military Base Closing Commission. A Commission on Industry Subsidies and National Competitiveness should be created to evaluate all industry-specific programs in the budget and the tax code, recommend their reform or repeal if they serve no overriding social or economic purpose, and present the entire package of changes to Congress. As with base closings, Congress would have to vote these recommendations up or down *without amendment.*

We at the Progressive Policy Institute are gratified that the President and both parties in Congress now endorse tax relief for financially-strapped American families. We urge you to enact this reform on a sound and proper basis. Until the deficit is eliminated, tax relief should be provided to those families which most need it; it should be financed on a permanent basis; and it should be part of a larger effort to reduce the deficit focused on subsidies and other ineffective federal activities that undermine economic growth and the long-term prospects of all working Americans.

Mr. CRANE. Thank you.
Mr. Bauer.

STATEMENT OF GARY L. BAUER, PRESIDENT, FAMILY RESEARCH COUNCIL

Mr. BAUER. Yes, sir. Mr. Chairman, it is a real pleasure to be here this morning. I suspect by now that you probably have all heard all the figures that could possibly be put in this debate, so with your permission, I would like to submit my statement and use my time to just make a couple of points about the overall debate.

Mr. Chairman, the last couple years, there has been a lot written about cynicism in America and why Americans are so cynical. I don't think you have to look much further than the debate over profamily tax relief than to find a reason for that cynicism.

Back in 1986, Ronald Reagan asked me to head up a working group on the family and to come up with some recommendations to help the family. We spent months looking at all the issues and a major—one of our major recommendations was exactly this kind of family tax relief.

The public responded very positively, but within a couple of weeks, it was absolutely obvious that there was no political consensus in the Congress for helping families. Rather, there was more interest in protecting the Washington bureaucracy than there was in allowing families to keep more of their own money.

A few years later, in 1991, Senator Rockefeller headed a bipartisan commission on children. Bill Clinton served on that commission. They spent over 1 year looking at the problem. Lo and behold, they came up with the same solution: Major tax credits and increases in the exemptions.

The public loved it. Within a few weeks, the issue died down again because there was no political will to deal with it.

I have been traveling around the country the last couple of months trying to tell folks that this time it will be different, that, in fact, this Congress really is serious about doing something to help American families keep more of their own hard-earned money. I would hope that as this debate gets more heated, which inevitably it will, that you all will not back down on that goal.

The second point I would like to make is about how Washington almost always has it exactly backward. In the last 10 years, there have been a number of tax increases that have hit the American family. Every time those taxes have been increased, the Washington establishment has praised the politicians who voted the increases. In fact, you even got more praise if you ran on a platform of lowering taxes and then came to Washington and raised them, because then the Washington establishment inevitably said that you had grown in office by reversing your position.

Compare that rhetoric to the rhetoric of the last 2 months on this issue. The entire Washington establishment and even some Members of the House have accused you of pandering to the American people because you want to allow them to keep some of their own money. Now that is extraordinary. Take money away from the American family and you have grown. Let the American people keep their hard-earned money and you are pandering to them. So

again, I would urge you just keep in mind that whatever this city is saying is probably a good signal to do the exact opposite.

My final point I would like to address to those on Wall Street, because there is some skepticism on Wall Street about this kind of tax break. Many on Wall Street would like to see only a decrease in the capital gains tax, which I also support, and some economists and some business magazines have said that profamily tax relief isn't good because it really won't do much to generate economic growth. I think we need to remind Wall Street that the wealth of a nation is not measured only by what the close was in the Dow Jones average. The wealth of a nation is not measured only in the last incremental dollar in the gross national product. That the wealth of a nation is measured by the health of its families. That, in fact, today in America, the most important decisions will not be made in committees like this but they will be made around the dinner table.

Too many American families making those decisions are finding themselves hemmed in by big government and high taxes, and I can't think of anything that would be better for you to do for those families than to reverse that burden.

Thank you very much.

[The prepared statement follows:]

Testimony of Gary L. Bauer
President, Family Research Council

before the
United States House Committee on Ways and Means

January 17, 1995

Mr. CHAIRMAN, thank you for the opportunity to address your committee today. I appreciate your willingness to consider my input.

Mr. CHAIRMAN, nine years ago, President Reagan asked me to chair a White House Working Group on the Family to explore ways that federal policymakers could help strengthen America's families. That task force issued a report in 1986 entitled, The Family: Preserving America's Future, which had as its central recommendation a dramatic expansion in per-child tax benefits. Five years later, after much talk but no action on this issue, the bi-partisan National Commission on Children (on which then-Governor Bill Clinton served) issued a 1991 report which also had as its central recommendation a dramatic increase in per-child tax benefits.

Given that leading officials from both parties have been talking about pro-family tax relief for nearly a decade, the debate we now should be engaged in is one of whether the House GOP's proposed $500 children's tax credit offers adequate relief to America's families or whether instead Congress should move in the direction of the National Commission on Children's call for a $1,000 per-child tax credit.

Sadly, that is not the debate taking place in Washington today. During the last two months, a noisy chorus of critics and naysayers have been raising all sorts of objections to pro-family tax relief. Their criticisms -- which are sometimes contradictory -- advance six myths. Let's examine them one at a time.

Myth #1. Pro-Family Tax Relief Is An Extravagant Political Giveaway At Odds With The Larger Public Interest.

This idea is advanced frequently by members of the media, who realize just how popular pro-family tax relief is. Rather than thoughtfully considering the merits of various tax-cutting proposals, these reporters and pundits smugly sneer at public officials, accusing them of "pandering" to middle Americans.

Mr. CHAIRMAN, I do not often find myself in the position of defending politicians, but this sort of activity must be recognized for what it is -- an attempt by members of the liberal media elite to make you feel guilty about doing what the people elected you to do. It is the flipside to the liberal media's reaction to politicians that advance unpopular tax increases, who are routinely hailed as "profiles in courage."

Mr. CHAIRMAN, may I remind the members of your committee that voters see nothing courageous about broken campaign promises. Indeed, few things have contributed to voter cynicism more than President Bush's failure to keep his "no new taxes" pledge and President Clinton's decision to abandon his promised "middle-income tax cut" soon after the 1992 election.

The American people strongly support pro-family tax relief. They want to keep more of the money they earn. They sense that the well-being of their families -- and the well-being of the nation -- would improve if they had greater control over their lives.

On this point, they are right. To acknowledge as much is not pandering.

Myth #2. Pro-Family Tax Relief Will Increase the Deficit and Cause Interest Rates to Rise.

It is quite true that the deficit would rise if a pro-family tax cut were adopted by itself. It is also quite true that an increase in government borrowing would contract the supply of funds available for private lending, thereby putting upward pressure on interest rates.

But it is important to point out that no one is talking about adopting a pro-family tax cut by itself. All of the sponsors of major legislation have pledged to offset pro-family tax cuts with dollar-for-dollar reductions in government spending.

Pro-family tax cuts "paid for" by spending cuts cancel each other out on the balance sheet. They should have no effect on the deficit or on interest rates.

Myth #3. Pro-Family Tax Relief Won't Spur Economic Growth.

This concern comes from many of my conservative friends who believe that tax policy should only serve economic ends, that it should steer clear of social considerations and focus exclusively on promoting economic growth.

There are two problems with this viewpoint. First, much of what is called "economic growth" isn't growth at all. It is a movement of economic activity from the non-market home economy to the quantifiable market economy. For example, when a family that once cared for its own child enrolls the child in a paid day care program, there is no increase in the amount of economic activity. There is simply a shift from the non-market economy to the market economy. Yet this shift is counted as "positive" economic growth even though it often has a "negative" effect on the child's well-being.

True economic growth involves an increase in productivity, not simply in market activity. Until our nation's economic debate is built around this fact, much of what is advanced in the name of "growth" ought not to be adopted.

The second problem with the "pro-family tax cuts don't spur growth" myth is that it pretends that economic policy can be separated from social policy, that the size of a family's tax burden simply affects its economic well-being and decision-making. The truth, of course, is that tax policy not only affects people's economic decision-making (about working, saving, spending, investing, etc.) but also their "non-economic" decision-making (about marrying, childbearing, childrearing, etc.).

While it is true that economic policy should strive to exert as little influence as possible over "non-economic" decisions (so that, for example, people who otherwise would not marry won't get married just for the tax breaks), it is also true that our nation's current economic policy exerts considerable influence over "non-economic" decision-making and that this influence is almost always in an anti-family direction.

For example, Allan Carlson of the Rockford Institute has shown that the Social Security system has a pernicious anti-child bias because it robs parents of the social insurance value of their children, thereby creating a disincentive for young couples to invest in childrearing. Indeed, if Congress were to seek to offset this bias via the tax code (which is the only option given Social Security's sacrosanct status), it would have to raise actual per-child savings to roughly $2,100 per child. When one considers that the net value of the current child tax exemption is less than $400 per child (for the average family) and that the high water mark in the current debate is an additional $500 per-child tax credit, it is easy to see why pro-family conservatives like myself are disappointed that the proposals before you aren't even bolder -- or to use the media's phrase, more courageous.

Of course, the reason some are reluctant to adopt even a $500 credit is because they are intimidated by the economic "cost" in lost revenue to the government. While I understand that anti-family policies that took more than 50 years to develop cannot be wiped out in 50 (or even 100) days, I do want to remind the committee that there is a social "cost" to inaction or compromise. The social "cost" of weak families is measured in things like divorce rates and crime statistics. And lest the "green-eye shade types" forget, these social problems impose enormous economic costs to our society and our government. Indeed, the best way to reduce the demand for government services is to free families to care for themselves. Conversely, the best way to hinder the dismantling of the welfare state is to leave the tax burden on families with children at or near their current levels.

Myth #4. Pro-Family Tax Relief Should Only Go To Middle-Class Taxpayers.

This concern makes the mistake of viewing tax issues through the prism of class rather than through the prism of family. It is true that middle class Americans often get the shaft in current tax policy. For example, when combined employer-employee payroll taxes are added to income taxes, some middle-income couples actually have a higher marginal tax rate than affluent individuals in the 28 percent bracket.

But it is even more true that families with children are shortchanged in current tax policy. For example, during the first four decades after the end of WWII, the income tax burden on singles and childless couples increased only slightly, while it increased more than 200 percent for families with two children. Reagan-era reforms helped to reverse this trend moderately, but the dramatic shift in tax burden from non-parents to parents still dwarfs any shift in tax burden along income lines.

Thus, it is important that policymakers view this as a debate over "pro-family tax cuts," not simply "middle-income tax relief." This is the way my 1986 Working Group viewed the issue and the way then-Governor Bill Clinton's 1991 National Commission on Children saw the issue. Indeed, neither of these reports advocated some type of means-testing on per-child benefits. Both recognized that the principle being advanced was tax relief for families of all incomes to use in raising children, not tax relief to people who happen to fall into an income category that no one considers upper-class (a category that invariably shrinks as public debate progresses).

The fact that tax relief should be first and foremost pro-family does not mean that policymakers should be unconcerned about the distributional impact of these cuts. To its credit, the House GOP plan extends relief in the form of a per-child credit rather than an increased per-child exemption. In actual dollar terms, a credit provides equal relief to all taxpayers; but in percentage-of-tax-burden terms, it offers greater relief to working-class and middle-income taxpayers than to wealthier taxpayers. (Tax exemptions, conversely, skew savings up the income scale offering greater per-child savings to those in higher brackets.)

This is not to say that tax exemptions are always inferior to tax credits (indeed, one of the virtues of the current exemption is that its value rises if tax rates rise, thereby guaranteeing continued horizontal tax equity between parents and non-parents at any income level).

Still, given the tax code's current problems, a non-means-tested tax credit is the best mechanism for helping families with children. Indeed, if Congress wanted to maximize its distributional bang for buck, it might want to consider a non-refundable version of the 1991 National Commission on Children's $1,000 credit (which replaced the existing exemption, thereby offering $600+ in net per-child relief to those in the 15 percent tax bracket, but less than $300 in net per-child tax relief to those in higher tax brackets). Moving in this direction would make it easier for Congress to lift the existing (and newly-proposed) income caps on per-child benefits -- a problem that definitely needs addressing since income caps at any level produce marriage penalties.

Speaking of marriage penalties, the income caps on the Earned Income Tax Credit have created such a serious anti-marriage effect that Congress should use all of the monies set aside in the marriage penalty section of the American Dream Restoration Act to address the marriage bias facing families earning below the median income. The Talent-Faircloth welfare reform initiative from 1994 called for a $1,000 pro-marriage tax credit. This would be a constructive, problem-solving first step. It ought to be adopted.

Myth #5. Pro-Family Tax Relief Should Tie Benefits to Family Expenses (Like Education) That The Government Should Promote.

This concern springs from the notion that the government knows more about what families should spend their money for than parents do.

Not only is this a false premise, but it leads to all sorts of unproductive economic distortions. Indeed, one of the chief reasons college tuition costs have risen at a pace exceeding the general inflation rate for some time is that many students have been given grants and loans that could only be used for educational purposes. Knowing this to be the case, college administrators have raised the cost of higher education beyond what it would be if students' economic resources were completely fungible and available for multiple uses.

While no one wants to discourage bright young people from pursuing a higher education, the sad truth is that tax cuts earmarked for this or any other family expense will have the effect of increasing the cost of that good or service, thereby exacerbating current problems and putting a college education out of the reach of some interested students.

While it would be counter-productive for Congress to provide tax cuts for specific expenses, it would be helpful for Congress to modify existing Individual Retirement Account (IRA) rules to permit taxpayers to enjoy tax-favored savings for a wider variety of purposes (college tuition, first-time home-buying, etc.). In the first case, Congress would be limiting families' economic freedom, in the second, it would be expanding it.

This is not to say, however, that the Super IRA included in the House GOP Contract should be adopted in its current form. The "back-loaded" nature of its design obligates future generations to an economic promise made today. Given the size of the federal debt, and the pernicious anti-family influence of intergenerational entitlement programs, Congress should steer clear of repeating past mistakes. If tax-favored savings are to be expanded, they should be expanded within the context of a "front-loaded" savings mechanism.

Myth #6. Pro-Family Tax Relief Will Solve America's Family Problem.

While it is important for Members of Congress to recognize the virtues of pro-family tax relief, it is also important for you to recognize the limitations of pro-family tax relief.

Pro-family tax relief will not make husbands love their wives or children respect their parents. It will not clear up filthy TV or remove child predators from our streets. In short, pro-family tax relief, by itself, will not magically solve the myriad social problems facing America's families, neighborhoods, and communities.

But pro-family tax relief will make it easier for families to thrive by reducing economic stress. It will make it easier for parents to monitor their children's TV viewing habits or to shield them from other harms by freeing them to spend more of their time with their children and less of their time frantically chasing the almighty, overtaxed dollar.

In short, pro-family tax relief will empower parents to address many family needs that only they can meet.

Mr. CHAIRMAN, America needs parents who want to raise their children well. But we also need policies that empower them to act upon these sentiments. I implore you and the members of your committee to adopt nothing less than $500 in per-child tax relief for all taxpaying families.

Thank you very much.

Mr. CRANE. Thank you, Mr. Bauer.
Mr. Bloch.

STATEMENT OF THOMAS M. BLOCH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, H&R BLOCK, INC.

Mr. BLOCH. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you today to present H&R Block's views on certain tax provisions contained in the Contract With America.

H&R Block is the Nation's largest tax preparation firm. We serve approximately one out of seven U.S. taxpayers. We have over 9,000 offices and employ over 89,000 people during the tax-filing period.

I am here today because the vast majority of our customers are middle and lower income taxpayers. We have more experience working with and listening to middle- and low-income taxpayers than any other firm. We believe that middle-income families are not being treated quite as fairly by the Federal Tax Code as they were in past years. For many of our clients, the Tax Reform Act of 1986 increased their tax burdens. In particular, they saw the elimination of many personal deductions.

H&R Block commissioned its own study, which was released in April 1992, to investigate the shifting tax burden onto middle- and low-income taxpayers. Our findings showed significant increases over the previous decade in the tax burden for middle-class taxpayers. A summary of our study is attached to my testimony.

First, I would like to commend the authors of the Contract With America. A number of its provisions will bring tax relief for middle and lower income families. The American Dream Restoration Act, H.R. 6, would offer families with an income of less than $200,000 a year a $500 refundable tax credit for each child under age 18. Fewer taxpayers would receive benefits from President Clinton's proposal of a $500 tax credit for each child younger than 12 for families earning up to $60,000 a year.

Representative Gephardt's $300–$600 tax credit proposal would apply to the greatest number of our low- and middle-income clients, because it would be available to all taxpayers earning less than $75,000 who do not take the earned income credit. We favor this approach because it does not exclude lower and middle-income taxpayers who do not have dependent children.

In contrast, Senator Gramm's proposal to double the dependent exemption to $5,000 is not one H&R Block would favor in the form proposed. A refundable tax credit would generally benefit lower income taxpayers more than increasing the personal exemption for children. Increasing the personal exemption for children has merit, but it gives the largest dollar benefits to upper income families with children.

Another provision in the American Dream Restoration Act, which assists middle-income families, is the credit to reduce the marriage penalty. This is currently structured as a nonrefundable credit and would help married couples who file joint returns. We would recommend changing it to a refundable tax credit, since as a refundable credit, it would be more beneficial to taxpayers affected by the marriage penalty by increasing the size of their refunds or directly reducing the amount of their tax liability.

The Family Enforcement Act, H.R. 11, provides taxpayers with a maximum $5,000 refundable tax credit for adoption expenses and a tax credit of $500 per parent or grandparent for custodial care. We encourage Congress to enact both of these proposals because of the benefits they would bring to the affected taxpayers.

I would also like to address a tax provision contained in H.R. 9, the Job Creation and Wage Enhancement Act. The expanded home office deduction included in H.R. 9 would allow taxpayers to deduct more costs attributed to maintaining a home office. This would help many taxpayers who incur expenses from conducting businesses in their homes.

I want to mention one additional tax proposal which H&R Block supports. It is the college tuition tax deduction proposed by President Clinton. The deduction would be up to $10,000 per year for families with an income of $120,000 per year or less. The deduction would be used for many forms of education, including college, vocational school, and worker training.

One of the criticisms of this proposal is that as a deduction, it would benefit higher income taxpayers more than the middle class. This criticism could be addressed by converting it to a credit. We encourage you to consider doing so. This proposal, like many of those included in the Contract With America, would help to make many taxpayers optimistic about their economic future.

H&R Block firmly believes that middle and lower income taxpayers deserve a break in the Federal tax system. We have witnessed our customers' concern that their economic future is at risk for them and for their children. Providing tangible tax relief to middle and lower income Americans will go far to restore confidence in their future.

Thank you for allowing me to appear before you today. I would be happy to answer any questions you may have.

[The prepared statement and attachments follow:]

TESTIMONY OF THOMAS M. BLOCH
PRESIDENT AND CHIEF EXECUTIVE OFFICER OF H&R BLOCK, INC.

Mr. Chairman and members of the Committee, my name is Thomas M. Bloch, President and Chief Executive Officer of H&R Block, Inc. I appreciate the opportunity to appear before you today to present H&R Block's views on the provisions of the Contract With America concerning tax credits for families with children, marriage tax penalty relief, refundable tax credits for adoption expenses and refundable tax credits for home care of the elderly.

H&R Block is headquartered in Kansas City, Missouri and is the nation's largest income tax preparation firm. We serve approximately 1 out of 7 U.S. taxpayers. H&R Block has 9,511 company-owned and franchised offices worldwide employing over 89,000 people during tax filing season. Last year, we prepared 12% of all individual U.S. tax returns for a total of over 13 million returns. In addition to our U.S. operation, we have offices in several other countries.

We have been serving America's taxpayers since 1955 when my father, Henry Bloch, and his brother founded the company. I am here today because the vast majority of our customers are middle and lower income taxpayers. We have more experience working with and listening to middle and low income taxpayers than any other firm. As a result, we are in a unique position to learn of the particular problems and concerns faced by America's taxpayers.

We believe that middle-income families are not being treated quite as fairly by the federal tax code as they were in past years. For many of our clients, the Tax Reform Act of 1986 increased their tax burdens. In particular, they saw the elimination of the deductions for personal interest and sales taxes, as well as restraints on deductions for medical, job related, and moving expenses, as contributing to this burden.

We strive to provide more than quality tax preparation services. We are also committed to listening to our customers' concerns and, in turn, using our expertise to help them get a fair shake from the federal tax system.

H & R Block commissioned its own study, which was released in April 1992, to investigate the shifting of the tax burden onto middle and low income taxpayers. Our findings showed significant increases over the previous decade in the tax burden for middle class taxpayers. A summary of our study is attached to my testimony.

THE AMERICAN DREAM RESTORATION ACT, H.R. 6, AND OTHER TAX CUTS

Mr. Chairman, I testified in favor of middle class tax relief before this Committee in February of 1992. At that time, we recommended Congress enact a tax relief proposal to benefit the largest cross-section of low to middle income Americans and to enhance tax equity in the federal tax system. In particular, I noted that, in our experience as America's largest tax preparation service, tax credits that are refundable will benefit the largest number of taxpayers in the most evenhanded way. The advantage of refundable tax credits is that more lower income taxpayers would get some relief, as compared to nonrefundable tax credits which can shut out lower income taxpayers. Ideally, a middle income tax credit should not be limited to families with children, but be available to all lower and middle income workers, regardless of their family size or situation.

My testimony today addresses those tax credits that are part of the "Contract with America," and include comments on tax cut plans offered by others including President Clinton, Minority Leader Richard Gephardt, and Senator Phil Gramm.

First, I would like to commend the authors of the Contract With America. A number of its provisions will bring tax relief for middle and lower income American families. The American Dream Restoration Act, H.R. 6, would offer families with an income of less than $200,000 a year a $500 refundable tax credit for each child under the age of 18. Millions of taxpayers, including many of our clients would be eligible for this credit and consider this a reasonable reduction in their federal taxes. Fewer taxpayers would receive benefits from President Clinton's proposal of a $500 tax credit for each child younger than 12 for families earning up to $60,000 a year. Representative Gephardt's $300 to $600 tax credit proposal would apply to the greatest number of our low and middle income clients because it would be available to all taxpayers (not just those taxpayers with children) earning less than $75,000 who do not take the earned income credit. Again, we favor this approach because it does not exclude lower and middle income taxpayers who do not have dependent children.

In contrast, Senator Phil Gramm's proposal to double the dependent exemption to $5,000, is not one H&R Block would favor in the form proposed. A refundable tax credit would generally benefit lower income taxpayers more than increasing the personal exemption for children. Increasing the personal exemption for children has merit, but it gives the largest dollar benefits to upper income families with children. Adjusting the amount of increase in the personal exemption so it is greater for those in the lower income brackets would help to provide some equity to this type of benefit. However, it still limits the relief for those in the lower and middle income brackets to households with dependent children.

Another provision in the American Dream Restoration Act which assists middle-income families is the credit to reduce the marriage penalty. This is currently structured as a nonrefundable credit and would help married couples who file joint returns. We would recommend changing it to a refundable tax credit, since as a refundable credit, it would be more beneficial to taxpayers effected by the marriage penalty by increasing the size of their refunds or directly reducing the amount of their tax liability.

THE FAMILY REINFORCEMENT ACT, H.R. 11

The Family Reinforcement Act, H.R. 11, provides taxpayers with a maximum $5,000 refundable tax credit for adoption expenses and a tax credit of $500 per parent or grandparent for custodial care. Although the refundable tax credit for adoption would benefit a small portion of H&R Block's clients, we nonetheless encourage Congress to enact this proposal for those taxpayers who incur adoption fees and expenses, court costs, attorney's fees and other related expenses.

The custodial care credit would be available for taxpayers who care for a disabled parent or grandparent and would assist many of our clients. This type of refundable credit would assist those taxpayers caring for elderly parents or grandparents in their homes with the expense involved in providing the necessary care.

THE JOB CREATION AND WAGE ENHANCEMENT ACT, H.R. 9

I would also like to address a tax provision included in H.R. 9, The Job Creation and Wage Enhancement Act. The expanded home office deduction included in H.R. 9, would allow taxpayers to deduct more costs attributed to maintaining a home office. This would help the many taxpayers who incur expenses from conducting businesses in their homes.

TAX RELIEF FOR HIGHER EDUCATION AND TRAINING

I want to mention one additional tax proposal which H&R Block supports. It is the college tuition tax deduction proposed by President Clinton. The deduction would be up to $10,000 per year for families with an income of $120,000 per year or less. The deduction could be used for many forms of education including college, vocational school, and worker training. Many taxpayers would be eligible for this benefit and would greatly appreciate the assistance in educating their children. One of the criticisms of this proposal is that, as a deduction, it would benefit higher income taxpayers more than the middle class. This criticism could be addressed by converting it into a credit. We encourage you to consider doing so. This proposal, like many of those included in the Contract With America, would help to make many taxpayers optimistic about their economic futures.

CONCLUSION

H&R Block firmly believes that middle and lower income taxpayers deserve a break in the federal tax system. Specifically, we recommend tax relief in the form of a refundable tax credit, marriage penalty relief, the custodial dependent care credit, the adoption credit and the expanded home office deduction. We have witnessed our customers' concern that their economic future is at risk for them and for their children. Providing tangible tax relief to middle and lower income Americans will go far to restore confidence in their future.

Mr. Chairman, we would be happy to provide any assistance to you as you consider the tax-related proposals of the "Contract With America." As I stated earlier, we have more experience with American taxpayers than anyone else, except the IRS. Because of this, we have extensive expertise and information we can offer to you and the rest of the Committee about both taxpayer attitudes and the mechanics of specific tax proposals. Thank you for allowing me to appear before you today. I would be happy to answer any questions you may have.

The Shift in Federal Tax Burden onto the Middle Class

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Executive Summary

American citizens are aware of the on-going debate regarding middle class tax cuts, but are not likely to find the results of econometric studies which focus on methodological nuances relevant to their individual economies. The approach undertaken in this study is centered on describing the tax burden imposed by those tax provisions readily perceived to affect taxpayers directly - i.e., personal federal income tax and employee contributions to social security. Therefore, to investigate the distributional equity of the federal tax burden across various income levels, illustrative cases are utilized to determine the effective tax rates experienced by US taxpayers filing as single, married joint, and head of household.

The ultimate objective of this study is to produce a resource from which taxpayers may judge for themselves (1) the impact of specific tax provisions on the taxes they pay in relation to other taxpayers within their income class (horizontally) and taxpayers across income classes (vertically); and, (2) how their relative positioning has changed over the course of the last fifteen years.

Trends in the effective rate of taxation on American taxpayers were determined through the development and analysis of thirty-two (32) illustrative cases. Four distinct filing statuses were employed in the study and are presented in Table E-1 with the number of dependents assigned to each.

Table E-1. Types of Filing Status and Assumptions Used in Illustrative Cases.

Filing Status	Number of Exemptions
Single Filer	1
Head of Household, 1 Dependent	2
Married Filing Joint, No Dependents	2
Married Filing Joint, 2 Dependents	4

For each type of taxpayer shown in Table E-1, eight income groups were selected to represent the range of income distribution in the United States from the lower end of the middle class to that representing wealthy persons. Table E-2 presents the various income groups for the four tax years of interest to this study; namely, 1977, 1984, 1988, and 1990. The income levels shown represent adjusted gross income.

Table E-2. Income Groups for Each Tax Year and the Treatment of Deductions.					
Income Group	Type of Deduction	Adjusted Gross Income, Nominal Year $ 1977	1984	1988	1990
I	Standard	$ 7,250	$ 11,920	$ 13,580	$ 15,000
II	Standard	12,090	19,870	22,630	25,000
III	Standard	16,920	27,820	31,680	35,000
IV	Itemized	24,180	39,750	45,260	50,000
V	Itemized	36,270	59,620	67,880	75,000
VI	Itemized	48,360	79,500	90,510	100,000
VII	Itemized	72,530	119,240	135,770	150,000
VIII	Itemized	96,710	158,990	181,030	200,000

The overall shift in federal tax burden may be described by changes in effective federal tax rates on taxpayers within varying income groups. Several trends in effective tax rates are described by the findings of this study:

- The percentage change in the effective income tax rates and effective total (income tax and social security) tax rates showed the taxpayers reporting $100,000 or more had a large percentage decrease in tax rates from 1977 to 1990 while rates for the middle income taxpayers rose (see Figures E-1 and E-2).

  EXAMPLE: Taxpayers earning $50,000 (in 1990 dollars) from 1977 to 1990 showed an average percentage *increase* in total tax rates of over 7 3/4 percent for the four filing statuses. Taxpayers earning $200,000 from 1977 to 1990 showed an average percentage *decrease* in total tax rates of over 27 3/4 percent for the four filing statuses.

- The overall trend in federal income tax has been to flatten its rate structure across income levels. The difference between the effective income tax rate for the wealthiest income group ($200,000 in 1990 dollars) and the median income group ($35,000 in 1990 dollars) in 1990 was half that in 1977.

  EXAMPLE: In 1977, a married taxpayer filing a joint return with two dependents earning $35,000 (in 1990 dollars) had an effective income tax rate of 10.64 percent. A married taxpayer filing a joint return with two dependents earning $200,000 had an effective income tax rate of 29.30 percent, or a difference of 18.66 percent. In 1990, a married taxpayer filing a joint return with two dependents earning $35,000 had an effective income tax rate of 9.16 percent. A married taxpayer filing a joint return with two dependents earning $200,000 had an effective income tax rate of 20.98 percent, or a difference of 11.92 percent.

- In conjunction with the lessening progressivity of the tax rate schedule, the middle income taxpayers suffered effective total tax increases due to the increased FICA effective tax rates from 1977 to 1990 (see Figures E-3 and E-4).

- The percentage changes for married filing joint with no dependents or two dependents showed an increase in effective total tax rates through the middle income groups (see Figure E-2).

  EXAMPLE: A married taxpayer filing a joint return with two dependents earning $50,000 (in 1990 dollars) from 1977 to 1990 had a 5.26 percent *increase* in total taxes. During the same time period, a married taxpayer filing a joint return with two dependents with adjusted gross income of $200,000 had a greater than a 24.29 percent *decrease* in total tax liability.

  EXAMPLE: Using 1990 dollars, a married taxpayer filing a joint return with two dependents earning $50,000 from 1977 to 1990 had an *increase* of $4,649 in total taxes. During the same time period, a married taxpayer filing a joint return with two dependents with adjusted gross income of $200,000 had a *decrease* in total tax liability of $16,583.

- The changes in effective tax rates from 1988 to 1990 reflect the implementation of the general tax increases of the Tax Reform Act of 1986. However, the middle income taxpayers experienced a larger increase in taxes than did the lower or higher income taxpayers.

  EXAMPLE: A married taxpayer filing a joint return with two dependents with earnings of $75,000 (in 1990 dollars) had a percentage increase of 4.18 percent in total tax rates from 1988 to 1990. A married taxpayer filing a joint return with two dependents with earnings of $200,000 had a percentage increase of 2.4 percent from 1988 to 1990.

- Uniform tax rate adjustments have not occurred across all income classes.

  EXAMPLE: In 1990, the difference in effective total tax rates between single taxpayers and married taxpayers filing a joint return with two dependents earning $35,000 (in 1990 dollars) was 7.3 percent. The difference in effective tax rates between single taxpayers and married taxpayers filing a joint return with two dependents earning $200,000 was 1.5 percent. In 1977, these same differences between filing statuses at the same earnings levels were 7.3 percent for $35,000 incomes and 7.0 percent for $200,000 incomes.

- Changes in the standard deduction allowances for head of household filers assisted in reducing their effective federal income and total tax rates between 1977 and 1990.

- A much larger portion of the middle income taxpayers are subjected to the maximum FICA tax rate due to the increase in the FICA earnings cap to 145 percent ($51,300/$35,353) of the median income amount in 1990 as compared to only 103 percent ($16,500/16,009) of the median income amount in 1977 (see Figures E-5 and E-6).

The impact of flattening the federal income tax structure, i.e., the loss of federal revenues, was countermanded by the increased rate of FICA taxation. The result

has been a tax savings for the wealthy while increasing the amount of federal tax paid by middle class taxpayers.

Figure E-1

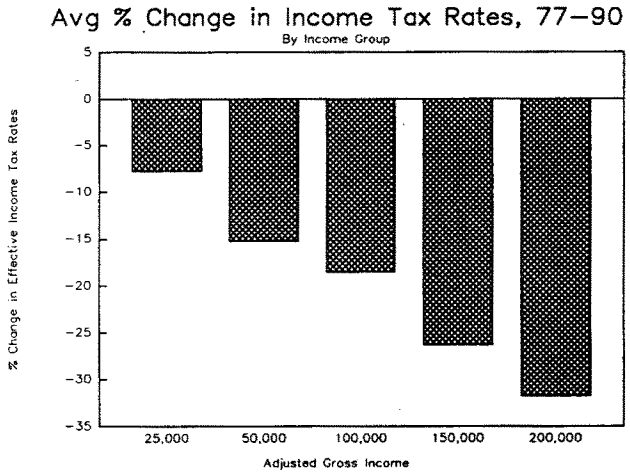


Figure E-2

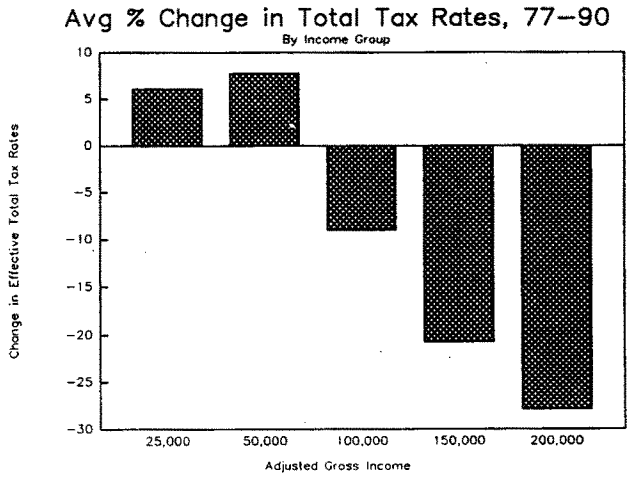


Figure E-3

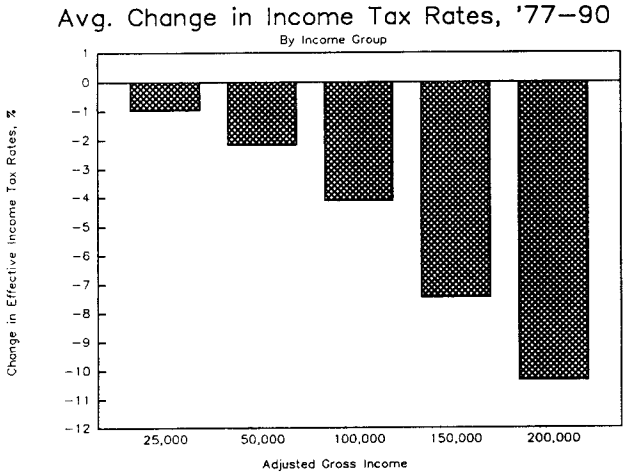


Figure E-4

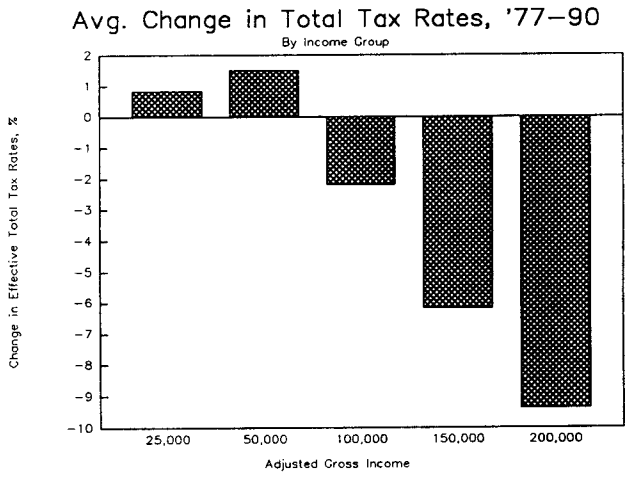


Figure E-5

Difference in FICA Earnings Cap and the Median Income Level by Tax Year

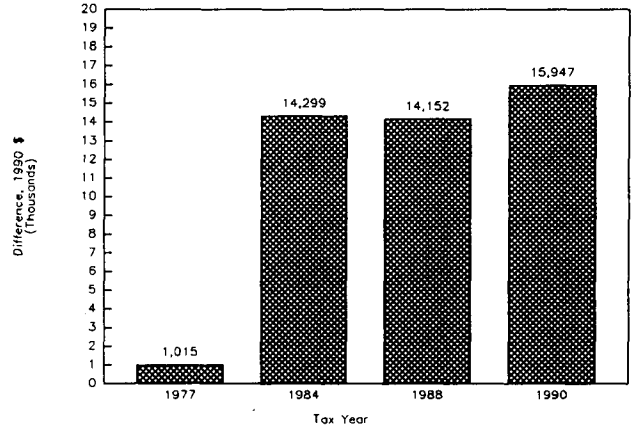
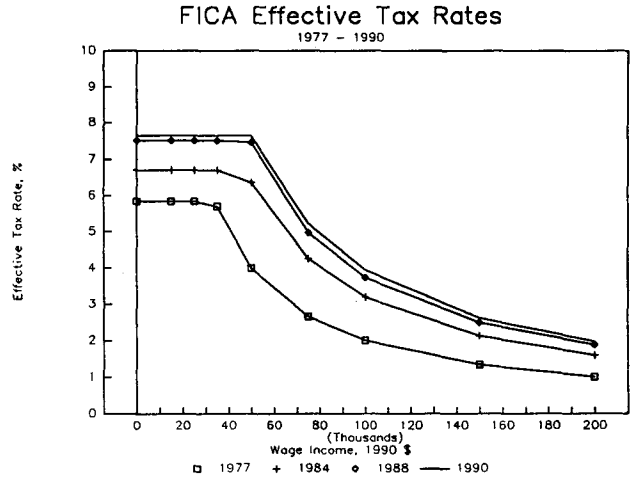


Figure E-6



Mr. CRANE. Thank you, Mr. Bloch.

The first to inquire is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

I want to ask the panel generally, as the father of nine children, anybody who thinks that they can raise a child on $4,800 is sadly mistaken. I had three children in college, three children in high school, and three children in grade school at the same time. Now, do you think $4,800 is enough to pay for raising that child when the tuition at the university usually was well over $4,800? Does anyone on this panel think that $4,800 is a reasonable figure for raising a child, anyone? Mr. Bauer.

Mr. BAUER. Only in the rarified atmosphere of think tanks do you think that $4,800 is enough to raise a child.

You raise another interesting point. If you are a family with nine children and you are making $75,000 a year, in fact you are not upper class. That is the other problem with this debate of cutting off the benefits at a certain income level. For struggling Americans with nine children and that kind of income, without the credit, you are not going to have the benefits that you ought to have.

But your point is well taken, $4,800 does not come anywhere close to covering expenses.

Mr. BUNNING. Mr. Shapiro.

Mr. SHAPIRO. The $4,800 figure was developed in a survey by sociologists at the University of Chicago and Columbia University. It certainly does not apply to higher income people who are sending children to college. It is a national average. It is the average cost for an average-income family in America, which is a family with an income—a pretax income of roughly $35,000.

Mr. BUNNING. Let me ask you a basic question. Do you all feel that tax relief for families should take priority over the budget deficit and the approach that we are taking with the budget deficit? Or do you think that the budget deficit should take priority over relief for the tax for the family, tax relief for families?

Mr. BAUER. Well, Congressman Bunning, my opinion is that the two ought to go hand in hand. That American families also suffer from a deficit out of control, and we all know that that deficit, in contrast to the rhetoric of recent months, is, in fact, headed back up. My anticipation is that the Congress would fund this tax break with budget cuts, as well as other cuts to address the budget deficit. Our organization for one is certainly ready with a long list of programs that can be cut, we believe, without harming the American family or without harming those groups that are supposedly served by those programs.

Mr. BUNNING. Can I ask the two women that are testifying, do you feel that many working women feel their earnings are supporting government instead of family, instead of their family by working?

Ms. SCHLAFLY. Oh, well, I certainly do, Mr. Bunning. I think that when the wife and mother goes into the work force, such an extraordinary percentage of what she is making is going for taxes. I feel that taxes are the great burden on them, and I would hope that we can give relief to this kind of family, and your $500 tax credit is a very good way to start.

Ms. LAHAYE. I would like to add to that that I work with women who are very much family oriented and they are very aggrieved because they have had to leave their children and go to work. This would—a tax credit like this would get their attention immediately and they would see that this Congress really was family friendly and striving to help the family be stronger. So, yes, I believe that women would be better equipped to take care of their children and care for their family if we could give them this kind of a tax benefit.

Mr. BUNNING. One last question. The administration tax credit is limited to children under age 13. It is my experience that ages 14, 15, 16, 17, 18, and on up to 21 are the more expensive years for raising children and the payout at that time is almost at the height of what you pay for raising your children. Do you have that same experience?

Ms. LAHAYE. I have raised four children that have gone through that same stage, and they eat more, their clothes are more expensive, their education costs more, and everything they do is more costly. So a family needs greater help when they are in the teens.

Mr. BUNNING. Go ahead, Mr. Shapiro.

Mr. SHAPIRO. Congressman, while I think that the administration's approach to limiting the children's credit on the basis of age is not the soundest way to go about it, the economic basis of it is that as children age, their parents also are aging, and as the parents age, their incomes rise. So the logic behind it and the data behind it is that at a younger age, parents feel the greatest economic stress in raising their children.

Mr. BUNNING. Unfortunately, my time has expired. But the fact of the matter is that the income of those people as they age has not kept pace.

Mr. SHAPIRO. All people's incomes over the last 20 to 25 years, except for professionals and managers and owners of capital, have been growing very slowly.

Mr. BUNNING. Thank you.

Mr. CRANE. And baseball players.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. I want to thank this distinguished panel for coming. It is quite an opportunity to be able to visit with Mrs. LaHaye, Gary Bauer, Mrs. Schlafly, and some of the best tax policy minds around.

I have two questions. One is, Mr. Bloch, I was in a meeting about 1 year ago where your father was sitting in the room in Kansas City and Jack Kemp facetiously remarked that it was his goal someday to put your father out of business by way of a flat tax. I earlier spoke about someday being able to figure taxes on a 3 by 5 card and sending it in. How would that affect your business? You say you have 80,000 employees across this country during tax time. Could you just give me some quick thoughts on——

Mr. BLOCH. I think I can read the lines on that form from here, and I would say based on that it would be devastating to our business. But I think it is important to put that aside, and I try to do that when I think about a tax return such as that. My biggest concern about it is fairness. I just am afraid that a tax system like that would be terribly unfair. When we talk today and in the fu-

ture about middle-class tax relief and making sure the tax burden is distributed fairly——

Mr. CHRISTENSEN. Who would it be unfair to?

Mr. BLOCH. To the middle class.

Mr. CHRISTENSEN. If no one pays taxes under $38,000 in income, how would it be unfair?

Mr. BLOCH. I think what you would see is a tremendous shift in the tax burden from the wealthy onto the middle class.

Mr. CHRISTENSEN. I am sure we will have a lot of time to talk about this over the next year.

I wanted to ask Gary Bauer if you could give us information on how tax cuts for families would affect the economy and whether that effect would be similar to that of the capital gains tax cut. Would we see some pickup in the economy?

Mr. BAUER. I have been in Washington a long time, unfortunately. Over the years, I have come to have very little confidence in these projections, regardless of which side they are on. Trying to predict what literally millions of people will do with a few more dollars in their pocket is a very problematic thing. My common sense, however, tells me that the money has to go somewhere. Either some families will save the money, at which point lending institutions will lend it out in loans for economic activity, or they will spend the money and its circulation through the system, presumably, would have some positive impact on jobs, on economic activity, and produce revenue that could be taxed through the system. So my gut instinct tells me there will be a positive impact economically but I doubt if anybody is going to be able to prove it one way or the other.

Mr. CHRISTENSEN. My final comment would be to Mr. Shapiro. I listened to your comments and I read your testimony. Then you said it was endorsed by the New York Times and that told me exactly what to do. I thank you, Mr. Chairman.

Mr. CRANE. Next is Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I keep hearing this flat tax talked about. Now, Mr. Bloch, I got a couple questions for you. I just heard from my colleague, Mr. Christensen, that for $37,000 you wouldn't pay any taxes. Now, Mr. Armey's proposal would add $186 billion to the deficit each year and would take away the deduction for home mortgage interest and would take away the deduction for medical insurance and would actually cost taxpayers under $200,000 more money than they are paying today, and people above $200,000 less.

Does that seem like a fair proposal to the American people?

Mr. BLOCH. I think it sounds terribly unfair. I think, if I understand the Armey proposal, certain types of income are exempt from tax, such as some unearned income.

Mr. MCDERMOTT. Yes.

Mr. BLOCH. I think people in this country are concerned about how much they pay in taxes today, and what they want is to be treated fairly. I think the initial appeal of a flat tax is what we are experiencing today in the country. It just sounds good. But I think when people really begin to understand it, as you do, Representative, and really see how will the wealthy be affected, how will the middle class be affected, and really understand what is going to

happen, I think that is when taxpayers say this is not good for this country and it is not good for me. I think if such a tax bill were enacted, it would be just a matter of time before the various deductions and credits that currently exist creep back into the system because they are there for a good reason.

I think the No. 1 goal we must have with our tax system is fairness. Yes, I can understand the argument for simplification. It would be great to have a fair and simple tax system. My fear is you can't have both. If you can't have both, the first priority has got to be fairness.

Mr. MCDERMOTT. So you are really saying that the reason this has appeal is because it is simple. It sounds great.

Mr. BLOCH. It sounds great.

Mr. MCDERMOTT. But the devil really is in the details.

Mr. BLOCH. Exactly.

Mr. MCDERMOTT. The Citizens for Tax Justice say if you make $30,000 under the Armey proposal, you would pay $1,700 more in taxes. But if you made $530,000, you would pay $44,000 less in taxes. To me, that seems like a proposal that is doomed from the outset if the American people ever understand that.

Mr. BLOCH. I think that is the key point. Once the American people understand that, I think they are going to say no, that is wrong.

Our tax system should be based on a person's ability to pay. The higher your income, the greater your ability to pay. That is my opinion.

Mr. MCDERMOTT. Let me ask Mr. Bauer, you have—I would like to understand your philosophy of what government ought to be about. I would assume that you only would collect taxes for the Army, for the military, for the defense, and is there anything else that you think government has a legitimate right to be in?

Mr. BAUER. My goodness, Mr. McDermott, you assume a lot. I think there are quite a few things that government can legitimately do.

Mr. MCDERMOTT. I want that list of cuts. I want the list of cuts. If you want to leap to that, tell me what you want to wade into.

Mr. BAUER. Sure. I would be happy to submit for your consideration a list of cuts. In fact, I suspect in the weeks ahead there are going to be so many cut suggestions that you will hardly know where to begin, because I suspect a lot will be on the table.

[The following was subsequently received:]

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President

1995 GOVERNMENT SPENDING NEEDS FAR MORE OVERSIGHT

by
Robert L. Maginnis

The 1995 federal appropriation bills which were approved by the last Congress are filled with duplication, political favoritism, social agendas, and questionable grants. The alarming misuse of taxpayer money should encourage citizens to demand more accountability.

Consider some government spending already approved for 1995:

• The Corporation for Public Broadcasting may pay a single individual $438.000 for a once-a-week, 30-minute TV appearance.[1]

• Federally financed Howard University gets $5.5 million to prepare practicing attorneys to do pro bono work in Washington, DC.

• NIH will spend $2.5 million to build playgrounds for monkeys.

• DOT will spend $400,000 to help Russians build roads.

• The Pentagon will spend $18 million for new homes at an Army base that is losing one third of its existing personnel.

• The State Department will give Russians $15 million for "family planning."

• The State Department will spend $750,000 to study tropical bird migration.

• The EPA will spend $250,000 to control zebra mussels in the City of Chicago.

• The EPA will spend $70,000 to study a European fish in Lake Superior.

• HUD will spend $53 million for a sewage plant in Mexico.

• The Forest Service will spend $635,000 to build a visitor center on a remote and inaccessible by road peninsula on Alaska's panhandle.

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DETAILS FROM 13 APPROPRIATION BILLS

1. Foreign aid in non-foreign bills: The appropriations bill for "The Foreign Operations, Export Financing, and Related Programs for the Fiscal Year Ending September 30, 1995" includes funding for most foreign aid programs. Foreign aid, however, can be found in other bills.

• The Federal Highway Administration was given $400,000 to provide technical assistance to Russia.[2]

• The Department for Housing and Urban Development (HUD) was given $52.5 million to finance the construction of a waste treatment plant in Tijuana, Mexico.[3] HUD is funding a second wastewater facility near Micicali, Mexico for $47.5 million.[4] (Congress also appropriated $1 million through the International Boundary and Water Commission to reimburse the City of San Diego for treatment of Tijuana sewage.[5])

• Funding for the Smithsonian Institution includes a $50,000 grant to the Mpala Center, Kenya for facility and equipment purchases.[6]

2. Suspect foreign aid.

• The State Department will provide $15 million for "family planning" to Russia in 1995.[7]

• It will give $50 million to the United Nation Population Fund (UNPF) with the intention that none of this money will be used to fund abortions in China.[8] The UNPF is expected to give $7 million for "voluntary family planning programs" in China.[9]

• The State Department will grant $750,000 to the Fish and Wildlife Foundation to study neotropical migratory bird conservation.[10]

3. Duplication of programs. Our government should look to eliminate redundancy. Consider:

• The Treasury Department's plan to build a training facility near Tuscon, Arizona. There will be a dormitory, a dining facility and $2.9 million in firearm ranges.[11] Just outside of Tuscon is the Army's Fort Huachuca, which has many modern firearm ranges. Treasury should arrange with the Army to use existing ranges rather than building duplicate firing facilities. After all, the FBI Academy's entire campus is located on Quantico Marine Base in Virginia where it has joint use of all ranges.

• The Department of Housing and Urban Development (HUD) was appropriated $175,000 for a special purpose grant to be given to Domestic Violence Prevention, Inc. in Bowie County,

Texas.[12] Why is housing money used for this project when the 1994 crime bill authorizes $324 million for the Family Violence Prevention and Services Act?[13] The crime bill also has $10 million for nonprofit organizations to establish projects that coordinate intervention and prevention of domestic violence, and authorizes $30 million for rural domestic violence and child abuse enforcement.

• The Department of Interior received $800,000 to monitor salmon on Alaska's Yukon and Kuskokwim Rivers.[14] The National Oceanic and Atmospheric Administration (NOAA) will spend another $700,000 to collect information on salmon in the Yukon River as well.[15] NOAA collects information on salmon at other locations as well.

• The Small Business Administration is directed to grant $3.25 million for three incubator facilities.[16]

• The Justice Department is appropriated $29 million for "Drug Courts" which is a program that provides drug treatment during and after incarceration for non-violent offenders.[17] This replicates ongoing programs both inside prisons and in many communities.

• The National Science Foundation was appropriated $2 million to establish in 1995 an interdisciplinary center to support research on violence.[18] The 1994 crime bill authorizes many programs to research violence:[19]

•• Title IV-Violence Against Women Act of 1994 requires the Attorney General to study campus sexual assaults, the "battered women's syndrome," the abusive spouse, and domestic violence.[20]

•• Title III-Crime Prevention includes research grants to investigate juvenile violence, drug use, and gang violence.[21]

•• Virtually every section of the crime bill requires at least one federal agency to either study or research special aspects of violence.[22]

• HUD will award housing money for six substance abuse programs and eight crime prevention programs.[23] The 1994 crime bill includes duplicate grant programs.

• Congress has already appropriated $20.4 million for federal support of the 1995 Special Olympics in New Haven, Connecticut and both the XXVI Olympiad and the X Paralympiad in Atlanta in 1996.[24] The GSA and HUD will contribute $3 million to the X Paralympiad. (The Paralympiad was established in 1960 to create awareness of athletes with physical disabilities.) The X Paralympiad will take place in Atlanta August 16-17, just after the Olympic Games. Some 4,000 athletes representing 110 countries are expected to participate. HUD's contribution goes to assist disabled veterans to participate.

• Congress appropriated $5.6 million for the taxpayer funded District of Columbia School of Law ignoring Mayor Sharon Pratt Kelly's recommendation to close the school. Two of the best law schools in the nation are in Washington, D.C. - Georgetown University and American University and another is in nearby Baltimore. Additionally, the appropriation bill lists the other reasons to close the school: it must dramatically expand its library before it can earn full accreditation; it must increase faculty salaries and other staff and student services; and the school needs a permanent facility of at least 125,000 square feet.[25]

4. Spending to remember former Congressional Leaders.

• The National Historical Publications and Records Commission is giving $2 million to the Thomas P. "Tip" O'Neill, Jr. Library at Boston College.[26] The money will be used to organize Mr. O'Neill's personal papers.

• Two million dollars was also granted to the Robert H. and Corinne W. Michel Congressional Education Fund.[27] Michel was for many years the House minority leader.

• The Merit Systems Protection Board granted $10 million to the Morris K. Udall Scholarship and Excellence in National Environmental Policy Foundation.[28] Udall was a liberal congressman and environmentalist from Arizona.

5. Other questionable expenditures.

• The Army recently announced that the 1st Infantry Division headquartered at Fort Riley, Kansas will be removed from the force. This means approximately 5,600 soldiers or a third of the post's population will leave. Meanwhile, Congress has appropriated $12.6 million to build 126 new homes at Fort Riley.[29]

• The 6th Infantry Division headquartered at Fort Wainwright, Alaska was deactivated in July, 1994. Cuts in the Army's presence in Alaska will be felt at both Fort Wainwright and Fort Richardson which is near Anchorage. Yet, Congress appropriated $5 million to build 72 new homes at Fort Richardson and $66 million to replace the nearby and jointly used Elmendorf Air Force Base hospital.[30]

• The Department of Agriculture's Forest Service will spend $635,000 to build a visitor center at Ketchikan, Alaska. Ketchikan is located on a remote peninsula reachable only by boat and small plane. Ketchikan county has a population of 14,000 inhabitants scattered among numerous small villages. The Department also gave $500,000 to Alaska because "many timber mills have closed."[31]

• The National Institutes of Health, National Center for Research Resources, was directed by the conference committee to reserve $2.5 million for playgrounds for monkeys used in research.[32]

• The federal government helps to fund Washington, D.C.'s Howard University. Part of the University's 1995 appropriations ($5.5 million) are for the creation of a Law School Clinical Center to provide legal assistance to supplement the Legal Services Corporation and to conduct training for practicing attorneys to perform pro bono (free) services.[33]

6. Did you know? Here are some of the various and sundry federal spending programs.

• $46 million to build and operate military child development centers, including one in Germany and one in Great Britain.[34] These federally subsidized centers are part of a growing network of child care facilities that include every military activity worldwide.

• $45 million will be spent by the Library of Congress for books for blind and physically handicapped people.[35]

• The Department of Transportation will give $26 million for employee bonuses and cash awards.[36]

• $2.7 million to the Pennsylvania Avenue Development Corporation.[37] This 34 person organization oversees construction projects along Washington's Pennsylvania Avenue.

• $27 million annual operating expenses for the U.S. Holocaust Memorial Council, which is a private organization that oversees the Holocaust Museum.[38] This relatively small but popular museum was first opened to the public two years ago. It was built with $168 million in private donations raised in just four years.[39] The Council continues to receive donations from many national and local organizations.

• Child Nutrition Programs include $500,000 in state grants for special dietary needs of children with disabilities.[40]

• $7 million for the private organization American Printing House for the Blind.[41]

• The State Department oversees a $533 million United Nations peacekeeping appropriation. This money can be spent with one stipulation: that American manufacturers and suppliers are given an "equal" opportunity to provide equipment, services, and materials to the United Nations peacekeepers.[42] The Senate amended this appropriation to transfer $350 million to unspecified "International Organizations" for peacekeeping activities.[43]

• HUD will grant the City of Chicago $250,000 to control zebra mussels which originally came from the Black Sea area of Europe.[44] The Department of Interior will continue to study zebra mussels at St. Croix, Virgin Islands.[45] The National Oceanic and Atmospheric Administration

was appropriated $3.7 million to research zebra mussels.[46] If the zebra mussel is truly endangering our oceans and lakes, then a more focused effort should be undertaken.

7. Legislating inside appropriation bills. Five appropriation bills contain social legislation.

• The Architect of the Capitol is directed to hire a "diverse labor force."[47] This means hiring quotas.

• The National Science Foundation is directed to award at least 20 percent of all grants to small colleges and universities that consist of "predominantly underrepresented groups" in science and technology.[48]

• When hiring investigators the John F. Kennedy Assassination Records Review Board is directed to give preferential treatment to former Office of Personnel Management employees.[49]

• The Office of Personnel Management is encouraged to promote "diversity." OPM's definition of "diversity" includes people of different sexual orientation.[50]

• The appropriation bill for the Department of Agriculture deletes Senate language aimed at ending the use of taxpayer funds to promote homosexuality.[51]

• Health and Human Services is directed to increase quotas for black nurses nationally.[52]

• The Federal Bureau of Investigation was appropriated funds to restore special agents "eliminated in prior years associated with background investigations."[53] A former marker for elimination based on a background investigation was identifying the candidate as a homosexual. The FBI Academy has started training for homosexuals previously rejected.

8. Please explain these appropriations. Many programs are funded without adequate explanation.

• The Department of Education is awarding $4 million to the Mary McLeod Bethune Memorial Fine Arts Center on the campus of Bethune Cookman College in Daytona Beach, Florida.[54] The facility will allow students to be trained for the fields of entertainment and hotel management.[55]

• The U.S. Institute of Peace gets $11.5 million.[56] The ten year old institute has received $76 million in federal grants. In 1991 it shifted from discussing peace to teaching conflict resolution in America's classrooms. There are more than 300 violence-prevention programs and 100 conflict resolution curricula available to America's 28,000 high schools and 78,000 grade schools.[57] The 1994 crime bill contains many grants for anti-violence programs.

• The Bureau of Mines is directed to do "essential Arctic research" in Anchorage, Alaska.[58] Anchorage is 400 miles south of the Arctic Circle and has no arctic characteristics like permafrost. Why not conduct the research nearer the Arctic Circle, perhaps at the University of Alaska, Fairbanks?

• The National Telecommunications and Information Administration is appropriated $1.5 million for the Pan-Pacific Educational and Cultural Experiments by Satellite Program.[59]

• Washington, D.C. received $720 million from the federal government for public education. The appropriation bill states, "the Board of Education has overspent its appropriation for personal services by millions of dollars while underspending its appropriation for other-than-personal-services by an equal amount. The chronic recurrence of such an imbalance suggests that the Board of Education habitually submits budgets to the Congress that the Board knows to be unrealistic and that the Board intends to disregard."[60]

• The Department of Housing and Urban Development will award 261 special purpose grants worth $291 million.[61] These include:

•• $450,000 to construct the Center for Political Participation at the University of Maryland.[62] The Center "is the first academically-sanctioned program in the country to support young leaders seeking elective office."[63] The advisory board includes actress Morgan Fairchild, Congressman Steny Hoyer, Congresswoman Connie Morella, *ABC News'* Sheila Kast, and the wife of Maryland governor Parris Glendening.[64]

•• $500,000 to the Maine College of Art for renovations to a Portland building.[65]

•• $1 million to develop the Center for Pacific Rim Studies in San Francisco.[66] The Center will do research on competition and offer training for professionals. It is focused on trade development, including foreign language and culture, legal systems, commercial practices and data links.[67]

•• $6.5 million for the Points of Light Foundation.[68] The *Los Angeles Times* found that the Foundation in its first four years spent $22 million on administrative expenses and $4 million on grants to service organizations. Expenses included $1.4 million for a kickoff celebration and more than $108,000 paid to the Hill and Knowlton public relations firm to promote the party, as well as a $160,000 salary for its top executive. In the first four years, it received $26 million from the government.[69]

•• $500,000 for the National Invention Resource Center in the City of Akron, Ohio.[70] The Center is part of the nonprofit Inventure Place which opens July, 1995.

•• $70,000 to study the European Ruffe in Lake Superior.[71] The Ruffe was introduced in 1986 to Duluth Harbor which is on Lake Superior. The Ruffe now makes up 65 percent of the harbor's fish population. Why is federal housing money being used to study the spread of this fish? Possibly some of the $450,000 appropriated for the Great Lakes Fishery Commission could be used to study the Ruffe.[72]

•• $750,000 for a center to coordinate academic training for physical therapists at the Veterans' Administration hospitals in Brooklyn, NY.[73]

•• $2.5 million for Project Social Care MB, Inc. to serve elderly Holocaust survivors in Brooklyn, NY.[74] There are about 2,000 Holocaust survivors in the greater New York metro area. Another organization, Selfhelp Community Services, has a $51 million annual budget and has the prime focus on helping survivors.[75]

•• $250,000 for port modernization at Davisville, Rhode Island.[76]

•• $300,000 to expand the science and mathematics complex at the University of South Carolina.[77]

•• $1.2 million for the Fire Safe Cigarette Act.[78] These funds go to the Consumer Product Safety Commission and the National Institute of Standards and Technology to measure the cigarette's ignition propensity.[79]

•• HUD special purpose grants also fund: 5 child care centers, the restoration of 5 theaters/museums, restoring or building 5 libraries, running a summer camp program, and building a bicentennial and media activities center for a city.[80]

9. AIDS money scattered among bills. Most AIDS money is found in the appropriations for HHS, but AIDS money is in other bills as well.

• The Department of Agriculture will grant Indiana $250,000 to study HIV/STD prevention in rural areas.[81]

• The Pentagon is being given $33 million to study AIDS.[82]

• HUD is appropriated $186 million for housing people with AIDS.[83] HUD also is awarding special purpose grants worth $4.3 million for other HIV housing facilities.[84]

10. Politics and agriculture appropriations. The 1995 agriculture appropriations appear to be based more on politics than merit. The top three states to receive agriculture grants earmarked by state were Arkansas, Iowa and Mississippi.[85] Arkansas received $17.7 million, Iowa received $11.9 million, and Mississippi received $10.45 million.

Senators from these states were on the conference committee for appropriations. Additionally, President Clinton is from Arkansas and former Secretary of Agriculture Mike Epsy is from Mississippi.

The U.S. Department of Commerce reports that the highest net farm income for 1991 came from California which ranked seventh in discretionary agriculture grants. Mississippi ranked 21 in net income and Arkansas was ninth.[86] But Arkansas received almost 300 percent more discretionary grant money than California, the highest farm income state. Arkansas grants included:

• $462,000 for a National Center for Agricultural Law Research and Information at the Leflar School of Law in Fayetteville, Arkansas.[87]

• $1.2 million for a new agriculture building and $946,000 for an Alternative Pest Control Center at the University of Arkansas.[88]

• $4.8 million for the Rice Germplasm Center, Stuttgard, Arkansas.[89]

• $1.1 million for the Arkansas Children's Hospital.[90]

CONCLUSION

Taxpayers should demand that the 104th Congress review and rescind appropriations that waste money or promote a political agenda.

***

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ENDNOTES

1. "Making Appropriations for the Departments of Labor, Health and Human Services, and Education, and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-733, September 20, 1994, p. 43.

2. "Making Appropriations for the Department of Transportation and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-752, September 26, 1994, p. 47.

3. "Making Appropriations for the Departments of Veterans Affairs and Housing and Urban Development, and for Sundry Independent Agencies, Boards, Commissions, Corporations, and Offices for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-715, September 1, 1994, p. 40.

4. Ibid.

5. "Making Appropriations for the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Programs for the Fiscal year Ending September 30, 1995, and Making Supplemental Appropriations for These Departments and Agencies for the Fiscal Year Ending September 30, 1994, and for Other Purposes," House of Representatives Conference Report 103-708, August 16, 1994, p. 83.

6. "Making Appropriations for the Department of the Interior and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-740, September 22, 1994, p. 54.

7. "Making Appropriations for the Foreign Operations, Export Financing, and Related Programs for the Fiscal Year Ending September 30, 1995," House of Representatives Conference Report 103-633, August 1, 1994, p. 3.

8. Ibid, pp. 20-21.

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11. "Making Appropriations for the Treasury Department, the United States Postal Service, the Executive Office of the President, and Certain Independent Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-741, September 22, 1994, p. 26.

12. Conference Report 103-715, op. cit., p. 16.

13. "Title IV-Violence Against Women," "Violent Crime Control and Law Enforcement Act of 1994," Public Law 103-322, September 13, 1994.

14. Conference Report 103-740, op. cit., p. 31.

15. Conference Report 103-708, op. cit., p. 47.

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19. "Violent Crime Control and Law Enforcement Act of 1994," op. cit.

20. Ibid.

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22. Ibid.

23. Conference Report 103-715, op. cit., pp. 11-24.

24. "Making Appropriations for the Department of Defense for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-747, September 26, 1994, pp. 5-6; Conference Report 103-715, op. cit., p. 24; and Conference Report 103-741, op. cit., p. 50.

25. "Making Appropriations for the Government of the District of Columbia and Other Activities Chargeable in Whole or in Part Against the Revenues of Said District for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-671, August 4, 1994, p. 5.

26. Conference Report 103-741, op. cit., p. 10.

27. Ibid.

28. Ibid, p. 51.

29. "Making Appropriations for Military Construction for the Department of Defense for the Fiscal year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-624, July 27, 1994, p. 36.

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31. Conference Report 103-740, op. cit., p. 43.

32. Conference Report 103-733, op. cit., p. 18.

33. Ibid, p. 38.

34. Conference Reports 103-747 and 103-624, op. cit.

35. "Appropriations for the Legislative Branch for the Fiscal Year Ending September 30, 1995, and for other Purposes, House of Representatives Conference Report 103-567, June 28, 1994, p. 11.

36. Conference Report 103-752, p. 77.

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38. Ibid, p. 56.

39. Rachel Kaplan, "Walls That Speak," *The Ethnic NewsWatch Inside*, December 31, 1993, Vol. 14, No. 4, p. 76.

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59. Conference Report 103-708, op. cit., p. 65.

60. Conference Report 103-671, op. cit., p. 18.

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71. Ibid, p. 34.

72. Conference Report 103-708, op. cit., p. 44.

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80. Conference Report 103-715, op. cit., pp. 11-24.

81. Conference Report 103-734, op. cit., p. 16.

82. Conference Report 103-747, op. cit., p. 149.

83. Conference Report 103-715, op. cit., p. 9.

84. Ibid, pp. 16-18 & 21.

85. Conference Report 103-734, op. cit., pp. 7-21.

86. "Farm Assets, Debt, and Income, by State: 1990 and 1991," No. 1113, U.S. Department of Commerce, Statistical Abstract of the United States 1993, p. 661.

87. Conference Report 103-734, op. cit., p. 17.

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DEFUNDING TITLE X: A STEP IN THE RIGHT DIRECTION

The House of Representatives will soon vote on the Labor/HHS/Education Appropriations bill. The bill includes a provision to defund Title X, the federal family planning program, and transfer its allotted $193 million to two other block grants which aid mothers, infants, and communities.

Pro-abortion groups such as Planned Parenthood are crying "Foul!" They say that defunding the Title X family planning program will only increase abortions. (It is ironic that Planned Parenthood claims to be so interested in decreasing abortions when it performed ***more abortions*** than any other organization in the country -- 134,277 in 1993 and referred for another 80,743. And by the way, Planned Parenthood also received $33 million in Title X funds last year.)

But pro-family and pro-life groups know that cutting off Title X funding, while a small step, is an important first step in helping stem the tide of out-of-wedlock pregnancy which leads to abortion. And such a step is long overdue.

Title X's Legacy of Devastation

Title X of the Public Health Service Act should be defunded because it is a dismal failure. Enacted in 1970 as a categorical grant to fund family planning projects throughout the country, the program was supposed to help reduce the unplanned pregnancy rate, especially among teenagers. But while more teenagers have been exposed to these family planning "services" -- reaching more than 1.5 million teenagers this last year -- teenage reproductive health has drastically ***worsened*** in every category. This is Title X's legacy:

- **Out-of-wedlock births** -- ***Since the introduction of Title X, the teenage out-of-wedlock birth rate has doubled.*** The out-of-wedlock birth rate per 1,000 unmarried girls aged 15-19 rose from 22.4 in 1970 to 44.6 in 1992. When Title X began, only 3 in 10 teen births were out-of-wedlock; now 7 in 10 occur outside marriage.

- **Pregnancies** -- ***Since the introduction of Title X, the out-of-wedlock pregnancy rate among 15-to 19-year-old girls has doubled.*** In the same time span, the overall teenage pregnancy rate (marital and nonmarital) increased 23 percent, climbing from 95.1 per 1,000 girls aged 15-19 in 1972 to 117.1 in 1990. Not only did the overall teenage pregnancy rate increase, but a greater proportion of these pregnancies are now out-of-wedlock.

- **Sexually-Transmitted Diseases** (STDs) -- ***Sexually-transmitted diseases among teenagers are at an all-time high. In fact, teenagers now have higher rates of gonorrhea than any other 5-year age group between 20 and 44.*** Currently, one in four sexually experienced teenagers -- about 3 million -- becomes infected with an STD every year.

- **Abortions** -- ***Over the lifetime of Title X, the teenage abortion rate has more than doubled.*** In 1972, the abortion rate per 1,000 girls aged 15-19 was 19.1; in 1990, the rate was 40.6. While the abortion rate grew rapidly from 1972 to the early 1980s, the rate has apparently reached a plateau, hovering between 40 and 43 abortions per 1,000 teenage girls over the last 10 years. Interestingly, the women whom Title X clinics target -- low-income women, minorities, and unmarried young people -- have the highest abortion rates. And, the Alan Guttmacher Institute reports that half of all women having an abortion used contraception in the month during which they conceived.

Increased rates of teenage pregnancy, illegitimacy, STDs, and abortion are all products of increased rates of sexual activity among the young. And teen sexual activity is correlated to contraceptive counseling and the distribution of contraception -- primary duties within Title X clinics.

- For example, a 1993 Public Health Reports article found that adolescent males who had been instructed in sexual biology and birth control were more likely to engage in intercourse than were those who had received no instruction.

- Furthermore, research from Planned Parenthood shows that the number one reason, by far, that teenagers initiate sexual activity is peer pressure. By promoting contraceptive use among teenagers, Title X clinics reduce the number of outside forces bolstering teenagers' resolve to save sex for marriage.

- Even Dr. Robert Kistner of Harvard Medical School, one of the developers of the oral contraceptive, subsequently acknowledged that use of contraceptives among teenagers is stimulating higher levels of promiscuity: "About ten years ago I declared that the pill would not lead to promiscuity. Well, I was wrong," he said (Family Practice News, 1977).

Stop Subsidizing Illegitimate Programs

Beyond its correlation to worsening reproductive health indicators, there are additional reasons to remove Title X funding. First, ***Title X's authorization expired in 1985, and unauthorized programs should not be allowed to receive federal dollars.*** At a time when taxpayers are already paying too much money to the federal government, unauthorized programs such as Title X should be eliminated. Secondly, Title X has never been evaluated for effectiveness -- for 25 years, it has received increased funding without ever having to give an account of its record or be measured for effectiveness. Third, the federal government has no reason to run a categorical family planning program when state governments are capable of setting health care priorities within the parameters of alternative block grants.

Conclusion

Defunding Title X will not halt teenage pregnancy or out-of-wedlock births as we know them, but it is a first step in the right direction. Eliminating Title X sends a signal that the federal government should not be in the business of funding social experiments that have failed nor in granting federal sanction to the distribution of contraception for unmarried minors without parental consent. For the sake of future generations, Congress should vote to defund Title X without delay.

TITLE X'S IMPACT ON TEENAGE BIRTHS AND ABORTIONS

Year	Title X Funding (per fiscal year)	FP Enrollment	Number of girls aged 15-19	Pregnancy rate per 1,000 girls aged 15-19 (married and unmarried)	Rate of out-of-wedlock births per 1,000 **unmarried** girls aged 15-19	Abortions to girls aged 15-19
1970	n/a		9,517,000		22.4	
1971	6,000,000	518,000	9,741,000			
1972	61,815,000		9,985,000	95.1		191,000
1973	100,615,000	894,000	10,193,000	96.1		231,900
1974	100,615,000		10,350,000	98.8		279,700
1975	100,615,000	1,143,000	10,466,000	101.1	23.9	326,780
1976	100,615,000		10,582,000	101.1		362,680
1977	113,000,000	1,303,000	10,581,000	104.6		396,630
1978	135,000,000		10,555,000	105.4		418,790
1979	135,000,000	1,478,000	10,497,000	109.4		444,600
1980	162,000,000		10,381,000	111.0	27.6	444,780
1981	161,671,000	1,306,000	10,095,000	109.9	27.9	433,330
1982	124,176,000		9,809,000	109.8	28.7	418,740
1983	124,088,000	1,255,000	9,515,000	109.3	29.5	411,330
1984	140,000,000		9,287,000	107.9	30.0	398,870
1985	142,500,000	1,277,000	9,174,000	109.0	31.4	399,200
1986	136,372,000		9,205,000	106.7	32.3	389,240
1987	142,500,000	1,386,000	9,139,000	106.6	33.8	381,640
1988	139,663,000		9,029,000	111.4	36.4	392,720
1989	138,320,000		8,840,000	114.9	40.1	370,900
1990	139,135,000		8,645,000	117.1	42.5	350,970
1991	144,311,000		8,371,000		44.8	
1992	149,585,000		8,312,000		44.6	
1993	173,418,000		n/a		n/a	
1994	190,918,000		n/a		n/a	
1995	193,349,000		n/a		n/a	

Sources: The Alan Guttmacher Institute; U.S. Bureau of the Census; Division of Vital Statistics, National Center for Health Statistics, Centers for Disease Control; Office of Population Affairs, U.S. Public Health Service.

Insight

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Gary L. Bauer
President

THE FAILURES OF REFORM: WHY CPB, NEA AND NEH MUST BE ZEROED OUT

by
Robert H. Knight

Federal arts funding, much like the welfare system, has created a class of beneficiaries who are hostile to conservative, pro-family causes. Recipients of federal aid all too often become cheerleaders for big government, the family's natural enemy. Big government strips families of their incomes through confiscatory taxation and diminishes their autonomy through intrusive social welfare and educational programs designed to wean children from their parents (and parental values) at earlier and earlier ages.

The same taxpayers who suffer the indignity of seeing their own earnings used by bureaucrats to undermine their families also pay for a federally-subsidized artistic and media elite to cheer on their tormentors: the Corporation for Public Broadcasting, the National Endowment for the Arts and the National Endowment for the Humanities.

It is long past time that the federal arts and humanities endowments be de-authorized and de-funded. Spawned during the 1960s' Great Society years, these agencies, despite whatever good they have done, have damaged American culture, ripped off the taxpayer, waged war on the family and religion, and politicized the academy and the arts.

CURRENT PROPOSALS TO TRIM THE ENDOWMENTS ARE ILL-ADVISED AND COUNTER-PRODUCTIVE.

Merely cutting the budgets and stretching out the life of the agencies will cause more mischief. When Proposition 13 was enacted into law in California, hostile government officials began cutting back on essentials, such as police and fire departments, leaving the waste and fat untouched. The object lesson to the voters was that challenging government growth meant the onset of anarchy. Similarly, if the federal budgets for public broadcasting and the arts and humanities are merely reduced, the truly offensive offerings will be the last to be de-funded. Vengeful bureaucrats will trim where it will cause the most pain and where patrons would complain most loudly. A couple of years ago, when Congress stalled in passing an appropriations bill for the federal government, the Smithsonian closed its

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doors, as did some national parklands, enraging taxpaying visitors. But the long-obsolete federal Helium Reserve suffered no loss of gas. Again, the message to the voters was: we will punish you if you don't lobby your elected representatives to reinstate our funding -- with increases.

SOME POLITICIANS THINK THEY CAN BUY PEACE BY APPEASING THEIR OPPONENT. INSTEAD, THEY CREATE A HARDENED ENEMY.

In terms of the federal endowments, the political price is actually higher for merely cutting instead of eliminating them. Recipients of federal aid are the natural foes of budget cutters and will continue to use their taxpayer-provided subsidies to wage political war on them. Hundreds of arts organizations are being lobbied to bring pressure on individual members of Congress to preserve art pork in their own districts.

A case in point is a letter from Independent Television Service Executive Director James Yee to public broadcasting advocates. The taxpayer-supported (and, therefore, in no way independent) ITVS was created in 1988 to provide new programming for public broadcasting. Yee urges his "independent colleagues" to "become involved in future efforts to drum up support for public broadcasting, especially with your local and national elected officials...." Yee warns that "an extensive informational outreach campaign will have to be waged." Such campaigns cost money, but are easier to mount when federal subsidies pour in to handle other costs.

The current House plan to phase out the endowments serves only to give welfare artists some time to restore their subsidies. Indeed, subsidy supporters have acknowledged, through their accord, that the phase-out plan is their best hope for saving the agencies and returning to business as usual.[1]

CUTTING BACK THE ENDOWMENTS WILL NOT LEAD TO SIGNIFICANT REFORM.

Congress repeatedly has slapped NEA on the wrist, and still the NEA sends money to The Kitchen, Franklin Furnace and other centers of blatantly offensive "performance" art that denigrates religion, families and traditional morality. Indeed, a *Washington Post* critic observed recently that the 1993 Biennial Exhibition at the NEA-funded Whitney Museum was "one long whinging [sic] whine of political correctness, suggesting as it did that the only art that counts is art produced by lesbians, inhabitants of barrios, sufferers of AIDS and others on the margin." Two years later, at the 1995 Biennial, "[h]omosexuality's still hot, especially the kinds involving punctures of the flesh, accessories of leather, bondage and cross-dressing, but so too are the subtlest of painterly abstraction. Nuances and nipple-rings are both themes of this exhibit, if it can be said to have any themes at all."[2]

NEA chairwoman Jane Alexander has boasted of using the endowment to promote homosexual themes[3] and has even defended a public bloodletting by an HIV-infected performer at an NEA-

subsidized venue.[4] Despite many assurances by past and present NEA officials that excellence and artistic merit are the criteria for grant allocation, this is clearly not the case. More than $9 billion in private giving sustains arts in communities all over America.[5] The NEA's $175 million is important more for its symbolism than for the actual dollars involved. An NEA grant validates an artist, and the government should not be putting its imprimatur on much of the anti-family, anti-religious propaganda that counter-culture activists brazenly categorize as art. The entertainment industry has revenues in the tens of billions of dollars each year. Time-Warner alone took in $15.9 billion during 1994. Clearly, Hollywood is in a better position to subsidize the endowments for arts and humanities than US taxpayers who struggling to get out from under $200 billion in annual deficits.

CORPORATION FOR PUBLIC BROADCASTING

In 1967, President Lyndon Johnson signed the Public Broadcasting Act creating CPB. The agency oversees the Public Broadcasting Service, which was formed in 1969, a year before the creation of National Public Radio. CPB's total appropriation in fiscal 1969 was $5 million. In 1992, Congress re-authorized CPB with a three-year, $1.1 billion appropriation. By 1993, CPB's annual federal appropriation was $318.6 million, which rose to $386 million for fiscal 1995. There are 349 public TV stations and 200 TV grantees receiving CPB funding.[6] PBS claims to reach 1.8 million teachers and 29.5 million students through educational programming and services, and 97 million Americans overall each week with some PBS programming.[7] National Public Radio is carried on 595 stations, and CPB awards money to 391 public radio grantees.

The basis for CPB's existence has always been an anti-free market philosophy. Proponents have said that the market is incapable of providing good programming, so the government must step in and do it, to the tune of hundreds of millions of dollars annually.[8] Yet the shows that register high ratings on PBS turn out to be the very programs that the public perceives to be excellent: *Sesame Street*, *Barney and Friends*, *The MacNeil-Lehrer NewsHour*, and *Masterpiece Theatre*, for example. All of these shows are generating more than sufficient revenue from sponsors, donors, grants and product marketing. They do not need taxpayer subsidies.

But there is other CPB programming that probably would fail to attract a sufficient viewing/listening audience or donor support. These programs are so bad that their creators must dig into the public purse. Subsidizing bad art is a donor's prerogative, of course -- unless the "donor" is the taxpayer, who has no choice. (For detailed examples, see FRC's Policy paper entitled "Public Broadcasting? Let's Free Big Bird.")

NATIONAL ENDOWMENT FOR THE ARTS

NEA was established in 1965 when President Johnson signed the National Foundation on the Arts and Humanities Act, which also created the National Endowment for the Humanities. NEA's initial budget was $2.5 million, but grew over the years to about $175 million annually (fiscal 1995 appropriation is $167.7 million). A fiscal 1995 rescission bill, HR 1158, would reduce 1995 funding to $162.5 million.[9] All told, NEA has spent more than $3 billion of tax money in its 30-year history.

The plan approved by the House Economic and Educational Opportunities Committee on May 10, 1995 would reauthorize NEA through fiscal 1998 but eliminate funding in fiscal 1999. Funding would be reduced by 40 percent in fiscal 1996, another 40 percent in fiscal 1997 and by 20 percent in fiscal 1998. The NEA would get no money in fiscal 1999.[10]

NEA would also face a $5 million cap on administrative expenses, which would entail an 80 percent reduction in budget for staff. Currently, NEA spends $24 million annually on administration.[11]

Beginning in 1996, grants to individuals would be eliminated, with all grants going to institutions. Eighty percent of annual appropriations to the state art councils would be in the form of block grants.[12]

A Senate bill (S 856) introduced by James Jeffords (R-VT) and co-sponsored by Nancy Kassebaum (R-KS), Alan Simpson (R-WY), Edward Kennedy (D-MA) and Claiborne Pell (D-RI) would reauthorize NEA for five years (FY 1996-2000) at gradually reduced funding levels. Forty percent of the NEA's program budget would go to "partnership" grants with the states, local and regional groups; 40% more would go toward organizations of "national significance;" a final 20% would go to direct grants to organizations, such as theaters or museums, and to individual artists.

Most significantly, the bill keeps intact much of the current peer review system, in which panelists award federal tax dollars to their friends and associates. It also locks in place the conditions under which the NEA would reject a grant over "obscenity." An artwork would have to be found legally obscene in a court of law before the NEA could move to recover funds. Given that a grant from the NEA automatically gives an artwork "artistic" significance no matter how offensive, the provision is meaningless in terms of curbing abuses of taxpayer funding.

The bill also directs the current NEA director to give "Distinguished Lifetime Service for the Arts" awards to "each of the former Chairpersons of the Endowment." This means that federal taxpayers would honor, among others, John Frohnmayer, the NEA chief whose tenure ended

when he was forced by President Bush to resign over NEA's continued funding of anti-Christian and pornographic works.

Finally, the bill creates an entirely new federal agency to nationalize standards for all public libraries and museums. The "Institute for Museum and Library Services" would be authorized for five years, beginning with a budget of $75 million in fiscal 1996 "and such sums as may be necessary for each of the 4 succeeding fiscal years," and would have grant-making authority. This is a potentially lucrative source to be abused by well-connected left-wing groups like the American Library Association, would give the federal government potential control over the nation's local public libraries, and would do to libraries and museums what the NEA has done to art -- redefine it using federal tax dollars to further a radical cultural and political agenda.

NATIONAL ENDOWMENT FOR THE HUMANITIES

NEH was established at the same time NEA was born, in 1965. The fiscal year 1966 budget was $5.9 million, and the agency had a staff of 13.[13] The agency expanded over the years until it reached a budget of $177 million in fiscal 1995.

Officials at the NEH are hardly contrite for sponsoring a widely-denounced set of national history standards that, among other things, emphasize the role of the Ku Klux Klan (17 references) and exalt Soviet advances in space while ignoring Albert Einstein, the Wright Brothers, Paul Revere, Robert E. Lee and the American moon landing.[14] The NEH also specializes in promoting cultural relativism, feminist studies and other Marxist and neo-Marxist theoretical quagmires on the nation's campuses.[15]

The current plan approved by the House Economic and Educational Opportunities Committee would reauthorize NEH with an annual 20 percent funding reduction through fiscal 1998 starting with the 1995 appropriation of $172 million (which includes a recent House-approved $5 million rescission). No funding would be allocated to NEH in 1999. The 5 percent cap for administrative expenses would also apply to NEH, as well as the termination of direct federal grants to individuals (scholars would continue to receive grants through recipient organizations such as universities). Eighty percent of appropriations would go to state humanities councils in the form of block grants. Senate bill S 856 would reauthorize NEH for five years at gradually reduced funding levels, beginning with $168.6 million in fiscal year 1996. Each state would get a minimum of $200,000 in funding each fiscal year. Grants would continue to be made to "groups, individuals, and State agencies or entities."

SUMMARY

Attempts to curry favor with the welfare broadcast media and arts groups are useless and only embolden the political enemies of budget cutters. So, we must ask budget-cutting Members of

Congress: why give the very people who will never love you enough subsidies to stay in business so they can continue taking shots at you? The federal arts subsidies must end once and for all.

***

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LEGAL SERVICES CORPORATION'S WAR ON THE FAMILY

by
Daniel S. Garcia

The Legal Service Corporation (LSC) is an independent, non-profit corporation funded by the federal government to the tune of $415 million a year. LSC's purported purpose is to provide poor people access to expensive legal services. But, actually, LSC has become a deep well for anti-family litigation. By using carefully-selected "test cases" in carefully selected courts, liberal activists have used the LSC to litigate their agenda, sidestepping democracy and the legislative process.

Since 1974, LSC has spent $5 billion working against the interests of the family on many fronts. Following are some examples:

PROMOTING ABORTION AND DIVORCE

The Legal Services Corporation Act, as amended in 1977 and in subsequent appropriations acts, prohibited LSC from being involved in abortion related cases. Nonetheless, LSC has remained firmly committed to abortion on demand and has worked around the law in an attempt to secure unlimited taxpayer-funded abortions. In several cases throughout the country, LSC programs have worked against waiting periods, physicians' consent, parental consent, parental notification and spousal notification.

In *Planned Parenthood Association, Inc. v. Department of Human Resources*, Oregon Legal Services represented Planned Parenthood in a challenge to a limitation on the number of elective abortions that the state's medical assistance program could fund. OLS argued that poor women should have access to an unlimited number of taxpayer-funded abortions.[1] LSC grantees took a similar line in a Pennsylvania case, arguing that such limitations were an unconstitutional infringement of a woman's right to have an unlimited number of abortions.[2] In another Pennsylvania case, an LSC grantee filed a class action suit to discard spousal and parental consent for minors.[3]

In testimony on the reauthorization of LSC, Linda Jones of Concerned Women for America of California testified that LSC programs have been involved in most major abortion cases. According to Jones, "The list reads like a virtual hall of fame for abortion rights litigation."[4]

LSC seems to be more interested in facilitating divorce in troubled families than in helping to repair them. An example of LSC's lack of commitment to keeping families intact is their view on mediation. The National Center on Women and Family Law, an LSC-funded center, argues that mediation, one important means of resolving domestic disputes, should be avoided because the woman is always at a disadvantage.[5]

EXPANDING WELFARE, SUBSIDIZING DESTRUCTIVE BEHAVIOR

LSC has also been active in blocking attempts to reform welfare and in increasing the number of people dependent on public assistance programs. In the case of *C.K. v. Shalala,*[6] LSC filed a class action suit with the ACLU and the National Organization of Women's Legal Defense Fund to block New Jersey's law capping welfare payments to mothers who have additional children while on welfare. LSC grantees argued that such a law was an unconstitutional violation of a woman's right to procreate at will. LSC grantees have filed similar suits against California, Massachusetts, Maryland, Rhode Island, Tennessee, Iowa, Kansas and Maine.

Lawsuits filed by LSC programs have also helped to subsidize the destructive habits of alcoholics and drug addicts. In recent years LSC programs have helped some 250,000 substance addicts obtain monthly disability checks.[7]

AIDING THE HOMOSEXUAL AGENDA

In the case of *Rush v. Parham,*[8] the Atlanta Legal Aid Society, an LSC grantee, tried to force the state of Georgia to pay for a sex change operation. The suit challenged the Georgia Department of Health's prohibition on Medicaid reimbursement for such operations.

The Legal Aid Society of Kentucky, another LSC grantee, represented a lesbian mother who contested the custody of a two-and-a-half-year-old child to the father, who had remarried. In the case of *S. v S.*[9] LSC-funded lawyers challenged the customary preference for the traditional family as the best environment in which to raise children.

In a 1986 New York case involving a lease agreement,[10] LSC grantees claimed that a "gay life partner" should be treated as a family member. Arguing that equal protection required that the gay partner be treated as a family member, attorneys from the Legal Aid Society successfully appealed to the New York Supreme Court, calling into question laws that favor and protect the traditional family.

PUSHING THE CHILDREN'S RIGHTS AGENDA

"Children's rights" is another area where LSC-funded lawyers have pursued an anti-family agenda. The notion that children have rights independent of their parents is a concept that undermines parental authority and opens the door to state interference in the raising of children. In the case of *Nafzinger v. Blum,*[11] LSC-funded lawyers successfully argued that minors who no longer wanted to live at home should get their own welfare benefits. The Legal Aid Society of

Central Texas, an LSC grant recipient, filed a suit to force public housing officials to rent apartments to minors.[12] In 1992, Legal Services of Greater Miami argued that children should have standing to sue their parents.[13]

GOING SOFT ON CRIME AND AIDING CRIMINALS

Criminals often find a friend in LSC. In a bizarre and disturbing case from Pennsylvania, Lehigh Valley Legal Services represented a convicted rapist in prison who was suing for custody of the child he fathered by the rape of a 13 year old girl. A psychologist found the rapist unfit to be a parent and determined that any child in his custody would be endangered. After a 3-day non-jury trial the judge ruled that the rapist had no parental rights.[14] In cases like *Duran v. Elrod*[15] LSC grantees have worked hard to make sure that prisons look more like country clubs than places to rid society of dangerous people. Such lawsuits have had the additional consequence of increasing the costs of incarcerating criminals, and putting many of them back on the street, often in neighborhoods where the poor become their main targets.[16] LSC-funded lawsuits have also made it difficult to evict drug dealers from public housing units and to keep them out in the first place.[17]

CONCLUSION

By advancing this radical, anti-family agenda, LSC has done far more to hurt poor people than to help them. The poor, as well as the rest of the country, can't afford LSC. In recent testimony to a House Judiciary Subcommittee Howard Phillips, former head of the Office of Economic Opportunity, said that the true cost of LSC should include the impact of actual, threatened and feared LSC-related suits as well as increased federal state and local government spending. According to Phillips, "viewed in this way, the LSC is properly seen as a central player in our current national deficit and debt problem."[18] Attempts to reform LSC have failed and it should be abolished. The poor are better served by state and local initiatives as well as private foundations and bar associations. These institutions have demonstrated the ability to adequately meet the legitimate legal needs of the poor. Non-federal contributions to LSC-type programs amounted to $255 million in 1994.[19] At a time when Congress needs to carefully assess budgetary priorities it makes no sense to continue funding LSC.

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17. Isaac, *op cit.*, p. 35.

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Mr. BAUER. But there are, clearly, a number of things that it is legitimate for government to do. Defense, of course, is a top priority. A safety net under people who cannot deal with certain circumstances in their lives is something that I think conservatives and liberals do agree upon. I guess I would almost be tempted to turn it around, Congressman. Is there anything—is there anything in Washington, other than defense, that you are willing to cut?

Mr. MCDERMOTT. Let me turn this to my question. You say a safety net. We have millions of people homeless in this country. Do you think the government should be involved in trying to put money out to get subsidized housing for people so people can get out from living under bridges, families?

Mr. BAUER. Well, I think what we need to do is look at the fact that spending on the homeless has trended up for years and we seem to have more people living under bridges, not fewer. Ask what is——

Mr. MCDERMOTT. It is because the Reaganesque style went from $40 billion down to $8 billion in the amount of money this country spends on housing. It is no wonder there are people under bridges.

Mr. BAUER. I think if you take all the funds that deal with homelessness in one fact or the other, the figures are quite different than the figures you just gave.

What I would like to see is more effort by churches, the private sector, and government in a partnership with them, to help the homeless. I would like to see reform in our legal system so that we are not releasing on the streets people who are mentally ill and then pointing to them as they cannot function in society and suggesting that what we have is a homeless problem instead of an ACLU problem, which is what we have on that particular issue. I think we need to address things with drug addiction and alcoholism, which basically is at the core of why so many people seem to wander our streets unable to get jobs.

Mr. CRANE. Time of the gentleman has expired.

Mr. MCDERMOTT. We will talk later about your list. Thank you.

Mr. CRANE. Mrs. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

Mr. Bauer, I was very interested in your history of family-friendly tax proposals that were begun some years ago, and you mentioned in the eighties and then Rockefeller's commission later on. I would like you, for our information, to put together for us right now your best shot at a composite tax relief program that would best help the families of the Nation and middle class.

How would you—and also considering who holds the majority in this Congress and the political situation, what we could do.

Mr. BAUER. Right. Well, Congresswoman Dunn, I must submit that I am somewhat sympathetic to the flat tax approach because I think eventually that will solve a lot of problems and particularly if you set the personal exemptions and the dependent exemptions high enough so that middle-class families would essentially be shielded from a good bit of those taxes.

I don't know, however, given how much time it takes in the public policy process to build on an idea and raise it up so that people understand it, whether that is something, realistically speaking, we

can do in the next 6 months. I suspect it is more something that we are going to look at over the next couple of years.

Failing to do that, then, I am very much in favor of either a child credit of some level to be determined after looking at all the priorities that you have and the concerns about the deficit and so forth, or a further major increase in the personal exemption. As I know you have heard over and over again, the exemption really ought to be at the level of around $8,000 if it is going to keep up with the inflation that has occurred since the end of World War II. So the fact that it is around $2,500 now is far short of where it needs to be. I am certainly very positive about the possibilities of either moving that up or taking the credit approach, which I think is probably even better.

Ms. DUNN. Good. Thank you very much.

Mrs. Schlafly and Mrs. LaHaye, you touched on a sensitive issue to me, that is, the right of a mother to stay at home if she wishes to do so. There is a group of folks who have done work for a long time in this Nation who have never received the sort of respect I believe they should receive, and that is the volunteers.

My history is one of intensive volunteer involvement at a time when I was able to stay home with my children. I wonder if you could take a few minutes to talk to us about what can be accomplished as a volunteer.

The mother has a choice to stay at home. She wants to be using her talents. I found there are a great many leadership opportunities in that area and the results are always simply terrific. I just think we need to give a lot more respect to the volunteer. Could you speak to us about that?

Ms. SCHLAFLY. Well, thank you very much, Congresswoman, and my life is a whole life of volunteerism. I am a lifetime, full-time volunteer. I think what I have done is a record of what can be accomplished and what opportunities there are for good service and for leadership and all those things. Our whole organization is an organization of volunteers. So thank you for pointing that out.

In addressing the larger issues that are here, we heard a lot of talk about fairness, and I think that the $500 child credit is a step toward fairness, because I believe that families with children are the ones who have borne the biggest burden of the—of the shift, of the massive increase in government spending over the last few years. So I would urge you to do that.

If you want to go farther, a next good plan would be to repeal the Clinton tax increase of 1993.

Ms. LAHAYE. I will just add a word to that. I agree with what Phyllis Schlafly just said. We are also volunteers in Concerned Women for America. I will just have to say because of the burden on families, we have lost some of our volunteers who are excellent, but they have had to leave the volunteer life and go into industry where they have had to get a salary just to assist with the family expenses. So we will have stronger volunteerism when we really address the tax credit for children.

Ms. DUNN. I think, just as a followup, that the whole direction we want to go is to relieve the families and to provide them with a greater choice of what they want to do. It seems to me through the whole effort of volunteerism, a woman or a man's talents can

be used. If we can go a little bit more in this direction, then we can get back on the emphasis of volunteerism and how many good things it can do for us.

Ms. LAHAYE. Excellent. I agree.

Mr. CRANE. Mr. Collins.

Mr. COLLINS. No questions.

Mr. CRANE. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

I want to commend these panelists that we have for talking about the family. So often on this committee we do not see those coming in speaking on behalf of the family. Regrettably, we hear so many that are supporting the type of policies that so often are damaging to our American families. So again, I commend you.

I might ask to begin with you, Ms. Schlafly. What societal benefits would you expect from a $500 per-child tax credit?

Ms. SCHLAFLY. Well, I think it is a proposition for fairness. I think the way the tax burden has been skewed over the last 40 years has been detrimental to families and unfair, and I think it is a step back in the right direction to recognize the importance of families.

Now, we also hear a lot about middle-class tax relief because they are a group that has been hurt very much with the increase in taxes, and I would like to say that I disagree completely with Mr. Bloch calling for refundable credits. In fact, I don't even think refundables should be discussed in a hearing about tax reduction. Refundables are not tax reduction; refundables are welfare. The earned income tax credit has been significantly expanded in the last few years and I—if you read the election any way, I think you read it as calling for a tax reduction. That is what we want, tax reduction.

Mr. HERGER. I appreciate that.

Mr. Bauer, do you have any comments?

Mr. BAUER. No. I would agree. I think Phyllis makes a really key point here. I mean, there is a debate that can be made about refundable credits, but it is not a tax debate. It is a welfare debate and it ought to be properly discussed in that regard. I think in all due respect to Mr. Bloch that there is going to be, by his industry, a great deal of resistance to simplified taxes for obvious reasons, which he has already pointed out himself.

Mr. HERGER. Mrs. LaHaye.

Ms. LAHAYE. There is already discrimination against women who choose to stay at home and take care of their children, so I think, as Phyllis said, fairness is the real key. Let's be fair to all and particularly those who have been discriminated against.

Mr. HERGER. Since your name has been brought up several times, Mr. Bloch, would you like to comment?

Mr. BLOCH. The only comment I would make is I think the $500 child credit is excellent and I am completely in favor of it. I do believe making it refundable would be desirable; not necessary, but desirable just because it will assist low-income people. But if the money is not there in the budget to do something like that, then I would be very happy with the way it is presented in the Contract With America.

Mr. HERGER. I am happy to hear that. I am not sure if I understood your earlier testimony to be such.

Mr. BLOCH. Yes.

Mr. HERGER. I appreciate your clarifying that. Thank you.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you.

I assume that everyone that supports the tax cuts also supports balancing the budget. I further assume that the way we have to pay for this is going to be by cutting back in spending. Ms. Schlafly said that in the past it was her opinion that the congressional committees would go in the back room when they were dealing with taxes and put the things there that Americans couldn't understand in fine print, and I know that you know those committees you talked about, one of them is Ways and Means, and I plead guilty. But I assume you also meant the Senate, as well, the Senate Finance Committee. Did you not?

Ms. SCHLAFLY. Oh, sure.

Mr. RANGEL. You meant liberals and conservatives, Democrats and Republicans, the whole batch of us, right?

Ms. SCHLAFLY. Well, the shift, the three-fourths devaluation in the worth of a child in the income Tax Code, by the decline in the child's exemption, was not a matter of public discussion before the eighties. It was not publicly debated and discussed before—or while and during the time it was taking place. That was my point.

Mr. RANGEL. I pled guilty. I am saying I assume you include as part of this——

Ms. SCHLAFLY. The Senate. The Senate is certainly part of the Congress, yes.

Mr. RANGEL. Because I think something like this is about to happen again, except I am not in the majority so I am going to be on your side and make certain that we shine some light on these things. Because if we are all in accord that we would want to make certain that we have less Federal spending, we are all in accord that the taxpayers should really have more of their disposable income because it is their hard work, then, it would seem to me if we are not going to increase the deficit, we ought to know where the cuts are going to be.

Now Mr. Bauer, you said that there are going to be so many proposals that we won't even know where to start. Ms. Schlafly and I want you just to start, just to give us an idea, because so many other people have said that as much as they want this sound tax policy because of the repugnant things that have occurred in the past, they wouldn't want to start and embark on something that is worse, which makes sense to everybody. But you never know if all we are going to get, Mr. Bauer, is you wait and see, we are going to do it because we promised we would do it.

Mr. BAUER. Right.

Mr. RANGEL. We deserve better than that. I mean, we want to shine some light on what our options are.

Mr. BAUER. Well, I mean, I am not in charge of the Federal budget, which probably gives you a great sense of relief.

Mr. RANGEL. No, no. Let me help you with that. We have no control over the interest on the debt, right?

Mr. BAUER. Hm-mmm.

Mr. RANGEL. We are not going to think about Social Security, right? You share with me later why we have to increase military spending because I know there is a sound reason for that.

Now, when you look at the rest of it, you are dealing with entitlements and it is not so bad that we reform even those things. I mean, just because we are spending money doesn't mean we are spending it correctly. But why will you hide from me what is on that list? Because I know that you are not in charge of the budget, but you have a pretty close working relationship with those people who are in charge now.

Mr. BAUER. Well——

Mr. RANGEL. At least you act like you do on television.

Mr. BAUER. Congressman Rangel, I am not going to give you that list in this hearing but I will be happy to supply it to you.

Let me give one example. If the Congress cut the discretionary spending at the Departments of Education, Energy, Labor, Health and Human Services, Housing and Urban Development, and Transportation, if you did that, if you cut it by 16 percent over the next 5 years——

Mr. RANGEL. My God.

Mr. BAUER [continuing]. You would raise $124 billion. You may decide that is not something you want to do.

Mr. RANGEL. I sure fire wouldn't let you say cut something across the board. I would say cut what is not working. Put more money in what is working, make it more efficient and productive. Nobody would say cut it across 15, 20 percent. That doesn't make any sense at all. There may be a couple good programs out there, notwithstanding 40 years of Democratic control.

Mr. BAUER. I am sure there are a couple of good ones. You asked me for——

Mr. RANGEL. Name a couple.

Mr. BAUER. You asked me a question and I can only give a couple hypotheticals. I guess what I am concerned about——

Mr. RANGEL. Ms. Schlafly and I are going to be waiting. Because from here on in for the next 40 years, we are going to have some light on the fine print.

Mr. BAUER. Right.

Ms. SCHLAFLY. Congressman——

Mr. BAUER. Congressman, let me say I guarantee you that the Congress will not have to wait as long for the details as it did on health reform, which it debated for 1 year before it had a bill.

Mr. RANGEL. But I am carrying this TV Guide thing in my pocket and it has the contract on it and there is no fine print on it. Now I have been carrying this card around since November.

Mr. BAUER. That is 2½ months.

Mr. RANGEL. OK. Just a little fine print and then I can join with you in some of these tax reforms.

Ms. SCHLAFLY. Congressman, I don't mean this to sound impertinent, but I really think you are the ones that got elected to address this problem. I don't think it is the task of Mr. Bauer and myself to come up with your cuts. I think that that is what you are all elected to do. Yes, I do think when business downsizes, the head of IBM may call in his managers and say, you are all going

to be cut 16 percent this year and find out how to do it. That is what we elected you to do.

Mr. RANGEL. I was really doing this for you. Strike out all that I have said. We will now do it in the backroom as we have been doing it and you will find out later where the cuts are coming.

Ms. SCHLAFLY. You can give us some options.

Mr. CRANE. The time of the gentleman has expired. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Bloch, we are contemplating here a series of profamily tax changes, including a child tax credit, a marriage penalty revision, a simple IRA, an elder care credit, and an adoption credit. I was wondering in terms not as the think tanks but as the perspective of a middle-class person either with or without your help filling out their tax return, how would these changes affect tax simplicity? Would it still be easy for people to fill out their own tax forms?

Mr. BLOCH. I don't think it would make it simpler because what we are talking about, I believe——

Mr. ENGLISH. Sure.

Mr. BLOCH [continuing]. Are additional credits which mean additional computations on the form. So I don't think it will improve the effort to simplify the tax system.

Mr. ENGLISH. But in terms of the average person sitting down to fill out their forms, these individual provisions are not going to make it much more difficult.

Mr. BLOCH. Assuming the calculations are pretty straightforward, I don't think it would add a lot of complexity to the tax preparation process.

Mr. ENGLISH. Thank you very much.

Mr. Shapiro, in your testimony, you talk about targeting family tax relief to the 15-percent income tax bracket. I was wondering, if we do take that kind of a targeted approach, what sort of disincentive effects would there be for people entering the tax bracket above that?

Mr. SHAPIRO. Virtually none, Congressman, because the current deduction provides virtually the same tax reduction to someone in the 28-percent bracket, as this increase would provide now to people in the 15-percent bracket. That is, a $2,500 children's exemption is equivalent in value to a $700 per-child tax credit for someone in the 28-percent tax bracket. In effect, you could replace the dependent's exemption for both the 15- and 28-percent bracket with a $700 or $720 tax credit, and you would have much the same effect.

Mr. ENGLISH. Thank you.

Mr. Bauer, I enjoyed reading your testimony and listening to your presentation. You make the sage point that profamily tax relief is certainly not a panacea but that—potentially, tax changes that are good social policy, that are socially sensitive also have a spillover effect on economic growth. I wonder if you could amplify on that a little bit and also give me your assessment, given that the President has talked about limiting the credit to children under the age of 13, whether that is good social policy or whether, in fact, there isn't a very substantial need to provide tax relief for children above that.

Mr. BAUER. Congressman English, I am not sure how much I can elaborate on the economic impact. We did discuss it a little bit earlier. It seems rational to me and obvious to me that there will be a positive economic impact any time you allow the American people to keep more of their money.

Short of putting it under their pillow, it is bound to have some kind of a ripple effect when they use it. Banking it results in increasing the amount of money that can be lent out for productive economic activities, or spending it, obviously, results in a multiplication factor as the money passes through the system. So there is some impact, I just can't quantify it in a way that some economists, I think, pretend that they are able to quantify it.

On the issue of social policy and making the cutoff at age 13, that just doesn't make any rational sense to me. It makes some budgetary sense, if your fear is that you can only put so much money into this.

Mr. ENGLISH. You think that threshold is arbitrary?

Mr. BAUER. Yes.

Mr. ENGLISH. Ms. Schlafly, how do you feel about it?

Ms. SCHLAFLY. I agree with Mr. Bauer, yes, I think the age 13 is arbitrary and there couldn't be any argument for it, except the argument that you don't have enough money. Again, I feel that the family, the traditional family, has borne the biggest burden of the expansion of Federal spending and is entitled to a significant redress of that grievance.

Mr. ENGLISH. Thank you very much.

Mr. CRANE [presiding]. Mr. Hancock.

Mr. HANCOCK. Thank you very much.

There has been a lot of talk about how well the progressive income tax works, and there have been some people that don't like a progressive income tax. In fact, they go back to the area when it first was advocated, they don't even like the people who advocated it. But let's talk about compliance costs.

With our present tax law, especially for Mr. Bloch here, there are people who estimate that merely the compliance with our tax law is almost equal the amount of money that the government actually collects. Isn't that a little ridiculous, to spend that kind of money to—with this so-called voluntary tax law, rather than not coming up with some form of a flat tax, to where you could say, I had 100,000 dollars' worth of income and I owe $40,000, rather than having to do, like with my tax return, which I think had about 120 pages to it last year, and my CPA sent me a bill for $1,660, which I just paid. I borrowed the money to pay it, but shouldn't we address that a little bit, Mr. Bloch?

Mr. BLOCH. Your point is well taken. But I still believe that we have got to—we have got to prioritize things. I mean, some believe it would be great to have no income tax. But an income tax is something I think we must have in this country. So when you get to the realization that we do need an income tax, to me, the overriding objective has to be to make it fair.

Yes, it is possible to throw out fairness and say, well, let's just go for simplification, let's not have the bureaucracy and the necessary costs that are involved in the compliance area. But I think you would have something close to a tax revolt in this country if

people felt that they were not being treated fairly in the tax system. To me, that has got to be No. 1 one on the list.

Mr. HANCOCK. Well, it appears to me, though, that based on the level of telephone calls that I have been getting, that everybody thinks that they are not being treated fairly, and everybody else is. It still gets back to the saying: Exact from everyone according to his ability. I think we all know where that came from.

I think that the fair tax is to where that people—that the productive people benefit from being productive, rather than saying, no, if you are productive, we are going to take it away from you and give it to somebody else.

Mr. BLOCH. I would only offer one suggestion. That is, if there was a real need to simplify the tax system, if you felt that way, to me the best way to accomplish that is to leave the Tax Code alone for a while and not change it. Because I think that would give people an opportunity to——

Mr. HANCOCK. Thank you very much.

I have said we need a 5-year moratorium on tax law, period. I mean, to where the businesspeople, the individuals, understand what they are dealing with, and leave it alone.

Thank you very much.

Mr. BLOCH. If I could add one thing; I am afraid if the kind of flat tax that we discussed earlier were enacted, I think right after that time would be a period of tremendous change in the tax system, with credits and deductions reappearing in the Tax Code, which would really cause a lot of confusion on the part of taxpayers.

Mr. HANCOCK. One other thing that I would like to mention, though, in my time here. You mentioned tax relief for higher education as part of your statement, and I agree that we need tax relief for higher education. I would like to point out, though, that a tax credit or a tax deduction, in my judgment, is not really the answer. Because once you do that, immediately the colleges are going to raise their fee by whatever the amount of the tax credit is.

Wouldn't it be better to include as part of the so-called super-IRA, a method where people can accumulate the money from the time the baby's born, either on a tax-deductible basis, up until the child is 18, and then spend their own money, wouldn't that be a better approach than a credit which—every time I have seen the Tax Code come through with a credit, the supplier raises the price, the law of supply and demand. Wouldn't that be a better approach?

Mr. BLOCH. I think your concern is valid, and I don't know for sure but I think your suggestion may be very appropriate.

Mr. HANCOCK. I would appreciate if you would take a look at that. I would like to see a survey, say, with your customers, how many of those individuals would put up $50 or $100 a month toward an individual deductible education account for their children. That would be a very interesting thing for your company even to look at.

Mr. BLOCH. We will look at it.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

I wanted to talk a bit about the proposed tax credit.

Before I do that, I just would like to say to Gary Bauer, and I read your testimony, I didn't hear your oral presentation, but you know, I don't think it is a fair division of labor to say you propose the tax cuts, Congress should propose the spending cuts. It seems to me that there is a responsibility all around; that each of us needs to look both at the tax side and the expenditure side; that you need to be as specific about expenditure cuts as you are about tax cuts.

You said that it is our business, the expenditure side. Why should we not ask those who come before us to be as specific as they are on expenditure reductions as they are on tax cuts?

Mr. BAUER. Well, Mr. Levin, I would only remind you that we are commenting on a tax cut proposal made by Members of Congress. We didn't come here today pushing the tax credit. Members of Congress have proposed a tax credit, we are here today testifying in support of it.

I have said several times, and I don't know how else I can say it again, we will supply the committee with suggested tax cuts. I just didn't come prepared today to give you a list of each one of those cuts.

My suspicion is, however, I must tell you, is that once again family assistance is being held to a higher standard when it comes to this issue than other spending in Congress. Just in the past week, the leadership in Washington has come to an agreement that we ought to bail out Mexico to the tune of $40 billion.

I don't recall anybody running to say where are we going to find the money if Mexico defaults on those loans that the American taxpayer is going to have to make up. It is only when we come here, talking about family tax relief, does everybody start yelling about where the cuts are.

Mr. LEVIN. Well, but, look, you have been involved for a number of years, and you know that there are struggles over such issues all the time. When it came to extension of unemployment compensation benefits for people, working families, bills were vetoed over the issue of where the funding would come from. So I don't think it is—it is a telling point to say it is only when it comes to children or to families that there is exacted that kind of a standard. That sure isn't where I come from. I think where it comes to families, if anything, there should be a lower standard of proof. But still there is a standard of proof.

Mr. BAUER. I totally——

Mr. LEVIN. We need as much guidance on expenditure cuts as we do anything else. I mean, you have been working in this field for a number of years. I think it is important for everybody who comes forth with support for reductions in taxes, no matter how meritorious, they have got to also come forth with specifics on where we cut programs.

So let me just ask Dr. Shapiro, because there was reference to your testimony earlier, where we talked about the tax credit. Take the typical family in the 28-percent bracket, it is true they have done—they do better with the exemption than in the lower tax bracket. But if you look at how they have fared the last 15, 20 years, isn't there a case for doing more?

Mr. SHAPIRO. Well, the 28-percent bracket includes some people who have been caught in the structural down draft of the economy, and others who have not. Again, when we look at the distribution of rates of growth of income, as people age—not looking simply at the median family income, which is just a line drawn through the data—when we track how fast people's incomes are rising as they age, through the seventies and eighties, the rates of increase in people's income after adjusting for inflation were, on average, less than 1 percent a year.

But when we look at those people who are classified by the Labor Department as professionals or managers, we find that their incomes continued to rise through the seventies and eighties at a post-inflation rate of between 4 and 6 percent a year. So that we do have 15 to 20 percent of the work force that has continued to be upwardly mobile at a robust rate—the rate that virtually everyone enjoyed in the fifties and sixties. Again, this was accomplished by a very sharp reduction in the rate of growth of incomes for people who are not professionals or managers. This is not a controversial analysis. It has become very clear through many statistical analyses, and nonstatistical analyses, that there is significantly increasing demand throughout the economy for people with high skills and high education and eroding demand throughout the economy for people with lower skills and less education.

This does not have to do with manufacturing versus services; rather, it has happened across the economy. On balance, the significant majority of people in the 28-percent tax bracket fall in the updraft part of the economy. But as I say, we would be perfectly comfortable with a tax reform for families with children which replaced the current deduction with a $700 or $720 per child tax credit for everyone in the 15- and 28-percent bracket. That would represent a significant increase in tax support for people in the 15-percent bracket, and roughly the same amount of support we are providing today for people in the 28-percent bracket.

I do want to say that, in our view, one of the failings of many of the proposals is that they provide a tax credit on top of the current deduction. Consequently, these proposals maintain at least in part the current arrangement which provides nearly twice as much tax relief, for a family with a child, if the family earns higher income than for families with lower incomes. The entire deduction should be replaced with a tax credit, which at least would provide the same tax support to raise a child for a family earning $20,000 or $30,000, as for a family earning $60,000, $70,000, or $80,000.

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

Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

I am impressed with Mr. Shapiro's liberal New York Times article and the fact that he likes taxes. If you change it, you want to replace it with something else and do away with something that is already being taxed. I suggest that families need a break and I think that your proposal doesn't give them that break. If you want to respond, you can.

Mr. SHAPIRO. Well, Congressman, it would provide significant relief for all families with incomes of $45,000 or less; it would be the equivalent of doubling the current children's exemption for those

families. It would, in effect, exempt from tax $4,800 per child, by providing a $720 tax credit, double the support for those families with children under the current system. That is clearly additional support.

Mr. JOHNSON. Well, I think we will have to argue that out. I think that the families in America perceive that they need tax relief, and tax relief doesn't include changing one for another. I think that is what has happened in the past.

Mr. Bauer, I might be able to help you a little bit on your question, when you are asked what the Federal Government ought to be doing. If you remember, George Washington said we ought to take care of foreign affairs and defend the country and carry the mail, none of which I think we are doing very well today. If that were all we were doing, perhaps we wouldn't be having this tax argument.

I like what you are doing and I think that it is our responsibility to come up with cuts. Your proposal of a cut across the board is not unreasonable. As a matter of fact, maybe we ought to do away with whole agencies, which might help take care of some of the problems you mentioned.

Mr. BAUER. I didn't want to send anybody into shock by actually suggesting that, so I thought I would go with a more moderate 15-percent cutback, which still had a rather emotional reaction.

Mr. JOHNSON. Well, thank you, and I think of the paperwork people have to go through just to take care of their taxes, entering kids in school, getting them a driver's license, even getting a chance to vote, is just government bureaucracy run amuck.

So I thank you all for your comments, and I don't have any further questions.

Mr. CRANE. Mr. Ramstad.

Mr. RAMSTAD. I, too, want to thank the panel for being here today.

I like your spirited defense, Mr. Bauer. It is true, I mean, nobody does back flips around here when we are talking in terms of raising spending in these various areas. All of a sudden we want to provide some tax relief for families and try to cut down the size and scope of government, which I think was the very clear mandate on November 8, and we are being cruel and heartless. I think what the distinguished chairman of the Budget Committee pointed out Sunday needs to be reemphasized. We are not talking really about cuts as normal people in the real world understand them but rather about reductions in the level of spending. Instead, say that over the next 7 years, to balance the budget, we must increase spending by $2 trillion instead of $3 trillion. I think that perspective is a proper one with which to operate.

Let me ask you, Mr. Bauer, your evaluation of the administration's proposal wherein tax relief for families phases out for those families with incomes over $60,000. Do you think this limitation is fair and appropriate?

Mr. BAUER. Well, I don't——

Mr. RAMSTAD. I will ask the other witnesses to comment as well.

Mr. BAUER. I don't think it is fair and appropriate, but I, obviously, look at these issues with I think a different prism than the folks in the White House. In my view, there seems to be a tendency

to turn every one of these issues into a class struggle, that instead of focusing on tax relief for families, let's pit one group of families against another group.

My view is that as long as families at different economic classes are arguing with each other, they lose the sight, they lose the target of how much money is going into Washington out of the pockets of every American family. So I would hope that somewhere along the line, the White House, in fact, would read the election results a little more closely and see that it was not an election about class differences, it was an election among other things, I believe, where the American people were saying families are overtaxed and we want something done about it.

I think the cutoff at $50,000 is totally arbitrary, in addition to everything else, and as was pointed out earlier, for larger families it makes no sense whatsoever. A family of eight or nine children making $50,000, $55,000, is not a high-income family.

Mr. RAMSTAD. Thank you.

Ms. SCHLAFLY. Congressman, I will comment on that. I would point out that there is no phaseout for wealthy families of the DCTC, the dependent care credit. That is, if you hire somebody else to take care of your children, it doesn't make any difference how rich you are, you get the exemption.

At the same time, there is a phaseout at the present time for the per-child exemption. So the in-home mother doesn't even get that.

I think we did have the tax revolt that Mr. Bloch talked about. It was November 8, 1994. People are calling for tax reduction and they want tax reduction across the board and they want tax reduction on families. They don't want more welfare and they don't want more rearrangement of the taxes. They want it cut.

Mr. RAMSTAD. Thank you.

Anybody else care to comment?

Mr. Bloch.

Mr. BLOCH. I would only say that I think it is a question of what can be afforded. If more than the $60,000 level can be afforded, I think that would be great. Because I think there are a lot of people making $70,000 or $80,000 who may be considered middle class, who could use that cut very well and view it as great tax relief.

Mr. RAMSTAD. Well, my time is up. But let me just finally comment that given the cuts that will be forthcoming, the real cuts, and provided in the national savings account prior to passing the tax relief, we will be able to provide more, I can assure you. At least the majority of the members of this committee did read and hear loudly and clearly the American people speaking on November 8, and I think your assessment, Mrs. Schlafly, is exactly correct.

Thank you.

Mr. CRANE. Thank you.

Mr. Zimmer.

Mr. ZIMMER. Thank you, Mr. Chairman.

I think one reason why the debate over changes in the Tax Code is so contentious is because different people come to the question with different goals that they want to achieve. Mr. Bloch and Mr. Shapiro seem interested mostly in redistributing income through the changes in the Tax Code. The other members of the panel are interested in helping the family.

There are those mainly in the economics profession, but others as well, who see it as an opportunity to increase growth by stimulating or encouraging savings and investment, or as Dick Armey and others would say, removing the penalties for savings and investment. These are at loggerheads with each other as goals. I would like to use the time that I have to explore some of these tensions.

First of all, Mr. Bloch, you deal with individual taxpayers one by one. Do you believe that their decisions on whether to save and invest are influenced by the Tax Code?

Mr. BLOCH. I think the customers that we see day in and day out, who I would describe as middle and lower income individuals and families, are generally looking at trying to make ends meet. I remember years ago we offered a service as a test to provide financial planning assistance to our customers. The overwhelming response we got to that offer was—I would love to have some advice as to how I can plan for my financial future, but really today I am just trying to make ends meet. So I don't think many of them really spend a lot of time thinking about what are the best financial investments and what are the tax implications of these investments, for example.

Mr. ZIMMER. Could the converse of that observation be that most savings and investment is done by people who are wealthier than lower and middle-income classes, and that perhaps if they were allowed to keep some of the returns on investment they might create better jobs, more jobs, higher paying jobs for your clients?

Mr. BLOCH. I am not an expert in that area, but I do believe that our clients feel that some form of tax relief is important. As they look at their future, it would give them a great deal of confidence to know that they receive some kind of a benefit in the tax system. That could provide them with a greater sense of optimism about the future.

Mr. ZIMMER. Mr. Shapiro, last week Congressman Gephardt told me that he didn't think that the Tax Code had much of an impact on people's savings and investment decisions. Do you share his view?

Mr. SHAPIRO. I can give you the general consensus of economists, and it is one I share. Tax rates do have an effect on overall savings decisions and investment decisions. That is, the quantity. But the effect is fairly modest.

What seems to drive people's savings rates—and we are in the midst of a historic collapse of the personal savings rate for about 10 years or 12 years—what seems most to drive increases in people's savings is increases in their incomes. People save more when their incomes are rising quickly. The reason that we saw such a disappointing result in the early and mid-1980s to a series of savings incentives was that it occurred at a time in which most people's incomes were not rising.

It creates a very serious, vicious cycle for the long-term health of the American economy. That is: American growth and productivity can't increase until the rate of increase in investment accelerates. Investment can't accelerate until national savings increase. But the personal savings rate, at least, is driven by rates of growth

of people's incomes, which depend on growth in productivity. So we have a vicious cycle.

The only way out of it that I know, that would be within the reach of government, over the short-term, is very significant reductions of the deficit. Because the deficit represents national dissaving. In 1993, the national savings rate was 1.1 percent. It is impossible for America to have any hope for a prosperous future with a national savings rate of 1, 2 or 3 percent.

Mr. ZIMMER. Well, I agree with that proposition. I agree with the need to reduce the deficit, but I think you will defeat your purpose if you do it by increasing taxes.

Thank you.

Mr. CRANE. Before we adjourn this panel, I would like to yield to our distinguished colleague from Washington, Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

I am sorry that the gentleman from New York is no longer present, because I hoped to alleviate some of his concerns that the business we do here in cutting taxes and cutting spending will be done behind closed doors. I want to suggest that there is a difference, a very definite difference, between the 103d Congress and those that preceded, and this 104th Congress. I will just also suggest that in April 1993, it was his majority party who closed the doors of this meeting room and opposed to a unanimous vote on the minority side. During that set of meetings we received the highest tax increase in the history of the United States, and certainly information was not available there.

As a result of that situation, there was a bill developed that would require open meetings and open hearings. That piece of legislation was passed as part of the rules of the new Congress of the United States on January 4, 1994—or 1995.

I will commend Congressman Zimmer, who helped to cosponsor that legislation, along with me and many, many other Members of this House. It did pass on the floor 434 to 0. We will not again be bothered by closed doors of the Ways and Means Committee, or any other committee meeting or hearing in this Congress. So I suggest that the people of the United States are going to get the information that is used to develop the logic behind all of these tax cuts. I appreciate all of your testimony today.

Thank you, Mr. Chairman.

Mr. CRANE. I, too, want to express appreciation to all of you. Your input has been very valuable and with that, we will adjourn this panel.

I would like to call up next, Marshall Wittmann, Midge Decter, and Michael Pitts.

Mrs. JOHNSON [presiding]. Welcome.

Marshall Wittmann, if you will proceed.

STATEMENT OF MARSHALL WITTMANN, LEGISLATIVE AFFAIRS DIRECTOR, CHRISTIAN COALITION

Mr. WITTMANN. Thank you very much, Madam Chair.

On behalf of the 1.4 million members of the Christian Coalition, we wish to express our appreciation to the committee for this opportunity to testify today on this critical item in the Contract.

We strongly believe that this hearing is unique. Unlike many who have testified before this committee in the past, we are not asking for something. Our request is not for a new spending program, a new entitlement, or a new subsidy. Rather, we are here today urging that American families simply be allowed to retain something that belongs to them: Income they have earned through their own sweat and toil.

It has been said that the family is the first and most effective Department of Health and Human Services. As you know, in the past few years, much has been made of the issue of family values. Yet we do not expect, nor do we want, the Federal Government to legislate family values. But we do urge that Washington value the family.

Unfortunately, far too often the government subsidizes family dissolution and taxes family stability. It is time for this dynamic to end. The Christian Coalition views the $500 per-child tax credit as the most significant provision in the Contract With America, and it has our strong support.

Allowing families with children to retain a larger share of their hard-earned income will be a first step toward freeing American parents from the national treadmill of working long hours at the expense of time with their children.

There is a genuine crisis of family income. Yet the tax bite out of earnings has soared. Unfortunately, the impact of today's high taxation level on families is not solely a financial one. Rather, it has an equally disturbing ramification on the time which parents can spend with their children, which has been referred to as the family time famine.

As more and more families are forced to have two sets of income, in part to meet the growing tax liability, the time parents can share with their children is dwindling. We believe that the $500 per-child tax credit, although a modest step, is a step toward increasing family budgets so that families will have greater freedom in structuring the balance between employment and the family.

President Clinton has proposed a child credit of up to $500 for children, but imposes an arbitrary age limit of 13 years. We believe that the President's proposal is insufficient.

When a child reaches age 13, expenses do not decline. They actually increase for such big-ticket items as educational expenses, braces, and clothes. It does not take a Washington policy wonk to figure this out. Just ask the parent of a teenager.

The Christian Coalition submits that this tax credit should be paid for with spending cuts and not by raising taxes on other taxpaying Americans. You and your colleagues can count on the support of our organization in this year's important undertaking to dramatically limit government. Cutting government is a necessary step toward returning control over spending decisions on children's health, education, and well-being to parents and communities. This is the family dividend of budget reduction.

Thank you very much.

[The prepared statement and attachment follow:]

STATEMENT OF MARSHALL WITTMANN
LEGISLATIVE AFFAIRS DIRECTOR, CHRISTIAN COALITION
BEFORE THE
WAYS AND MEANS COMMITTEE, U.S. HOUSE OF REPRESENTATIVES
JANUARY 17, 1995

On behalf of the 1.4 million members of the Christian Coalition and their families, we wish to express our appreciation to the Committee for the opportunity to testify today on behalf of family tax relief. Family tax relief has been a critical priority of our organization, and we applaud you, Chairman Archer, for holding these important hearings.

We strongly believe that this hearing is unique. Unlike many who have testified before this Committee in the past, we are not asking for something -- our request is not for a new spending program, a new entitlement or a new subsidy. Rather, we are here today urging that American families simply be allowed to retain something that belongs to them -- income they have earned through their own sweat and toil working in our factories, running their own businesses, teaching in our schools, working in our hospitals, and patrolling our neighborhoods. We are here in support of allowing parents, not bureaucrats, to determine how best to spend their income on behalf of their children.

As President Clinton acknowledged in his 1994 State of the Union address, "[w]e can't renew our country until we realize that governments don't raise children, parents do." Indeed, the family is the most vital institution in our society. It is where the next generation of Americans will be raised and nurtured. The family is the first and most effective Department of Health and Human Services. If the family is strong, many legislative initiatives -- confronting the rising juvenile crime rate, instituting educational reform to address the nation's declining test scores and rising behavioral problems in the schools, reforming our welfare system to discourage out-of-wedlock births -- will have a greater chance of success.

In the past few years, much has been made of the issue of family values. We do not expect, nor do we want, the federal government to legislate family values. However, we do urge that Washington *value* the family. Unfortunately, far too often, the government subsidizes family dissolution and taxes family stability. It is time for this dynamic to end.

Christian Coalition views the $500 per child tax credit as the most significant provision in the *Contract With America*. Allowing families with children to retain a larger share of their hard-earned income will be a first step towards freeing America's parents from the national treadmill of working long hours at the expense of time with their children, only to fail to meet the standard of living of the prior generation of one-parent wage-earners. There is a genuine crisis of family income. For the past two decades, income for the average American family has remained stagnant. Yet the tax bite out of their earnings has soared.

Working to Support the Government, at the Expense of Our Children

In many families today, both parents work by necessity, not by choice. A 1988 *USA Today* poll found that 73 percent of two-income families would prefer to have one of the parents stay home if they could afford it. Unfortunately, many parents don't realize just how much of their earnings are going to support the government, and not their families. In 1948, the average American family paid only *3 percent* of its earnings to the federal government; today, this same family pays 24.5 percent of its income to support our expansive federal government with its massive programs. When local, state, and indirect federal taxes are considered, well over a third of the average family's income -- *37.6 percent* -- goes to the government. Moreover, the Tax Foundation has shown that the average family's expenditures for federal, state, and local taxes are higher than what they spend for food, clothing, and housing combined.

The fact is that the government is the ultimate beneficiary of the long hours our nation's mothers and fathers are working. The Heritage Foundation compared the earnings of families today with

those in 1948, and found that two-thirds of a working mother's income in a typical double-income family goes to pay the increased federal taxes that families pay, and not towards putting food on the table or saving for retirement. If the federal tax burden on the average American family returned to 1948 levels, the average primary earner today would earn only $6,687 less than the double-income family's current post-tax income. Since the average working mother today earns $19,453, only one-third or $6,687 of her earnings increase the family's income over the 1948 level. The other two-thirds of her earnings go to pay the increased federal taxes that have been levied since 1948.

Families with children have particularly felt the impact of today's high taxation level, for two reasons. First, the personal exemption, which in 1948 protected 68 percent of the average family of four's earnings from taxation, has not kept up with inflation and higher income. If the exemption had been indexed for inflation, it would today be between $7,000 and $8,000. Second, today's high Social Security payroll taxes do not take into account the number of children in a family. Therefore, the impact of these taxes on a wage earner with four children will have a greater impact than on an employee earning comparable wages who has no dependents. Moreover, these payroll taxes have risen dramatically, consuming approximately 15.3 percent of gross income, in order to fund programs providing retiree benefits, disability insurance, and Medicare.

In addition to the higher taxation level and wage-growth stagnation, the cost of family expenses has risen dramatically. As the 1991 final report by the National Commission on Children, chaired by Senator Jay Rockefeller, showed, the cost of buying a home took 44 percent of a family's income by the mid-1980s, compared to 25 percent in 1970; buying a new car increased to 48 percent, rather than 35 percent in 1970; and tuition at a private college consumed 38 percent of the average family's income, compared to 28 percent in 1970.

Mr. Chairman, unfortunately, the impact of today's high taxation level on families is not solely a financial one. Rather, it has an equally disturbing ramification on the time which parents can spend with their children -- what has been aptly referred to as "family time famine." As more and more families are forced to have two sets of incomes, in part to meet their growing tax liability, the time parents can share with their children is dwindling. Children today are given 40 percent less time and attention by their parents than were children in 1965, with parents spending approximately 17 hours per week with their children compared to approximately 30 hours per week in 1965. This precludes parents from playing a greater role in their children's development.

Moreover, family time in general is becoming increasingly scarce. Parents often have to work piggyback shifts or simultaneous shifts. Coordination of schedules between parents, children, and nannies has become a fine art these days. The family meal at dinnertime is a thing of the past. Scheduling time to help children with homework is often difficult. Relationships with neighbors and a sense of community in neighborhoods are disappearing. We believe that the $500 per child tax credit, although a modest step, is a start towards increasing family budgets so that families will have greater freedom in structuring this balance between employment and family.

The $500 per Child Tax Credit Will Provide Important Relief to America's Families

Legislation to provide a $500 per child tax credit is long overdue. Four years ago, in 1991, the National Commission on Children, of which Governor Bill Clinton was a member, urged the adoption of a $1000 refundable child tax credit (as well as the abolishment of the personal exemption for children in order to reduce the costs of the tax credit) in an effort to strengthen families.

The $500 per child tax credit also has the broad support of the American people. A 1993 poll by Fabrizio, McLaughlin & Associates revealed that 59 percent of Americans favor enactment of a $500 per child tax credit even if it means cutting entitlements other than Social Security. Moreover, the level of support rose to 67 percent when the respondents were told that two-thirds

of the tax relief would aid families earning less than $50,000 per year.

Although a $500 tax credit does not meet the Children Commission's recommendation of a $1000 per child tax credit, it would still provide significant relief to our nation's families. For example, the $500 credit would reduce *by one third* the federal tax burden, which includes both income and social security taxes, of a family of four with an income of $18,000 per year.

President Clinton has proposed a child tax credit of up to $500 for children, but imposes an arbitrary age limit of 13 years. We believe that the President's proposal is insufficient. When a child reaches age 13, expenses do not decline -- they actually increase for such big ticket items as additional educational expenses, braces, and clothes. It does not take a Washington policy wonk to figure this out -- just ask a parent of a teenager. Moreover, the President's proposal would preclude families earning over $75,000 from being entitled to the credit, despite the fact that these families already pay a progressively higher income tax, which means the credit has a diminishing impact.

Since the effect of this credit decreases as family income increases, there is no need for means testing criteria. A family of four earning $40,000 per year would only see its tax liability reduced by 10 percent; a family of four earning $200,000 per year would see its tax liability reduced by 1.5 percent. Due to this progressive reduction in impact on wealthier families, means testing is not necessary, and Christian Coalition strongly urges the Committee to resist any efforts to institute such a requirement.

Mr. Chairman, it is also important that we not lose sight of the real-life benefits which this tax credit will provide to low-income families. For instance, a family of four earning $17,000 per year may still have a tax liability, despite receiving the Earned Income Tax Credit and taking appropriate deductions. By providing this family with an additional $1000 in tax relief, it would assist them in eliminating their tax liability entirely. Moreover, it has been projected that 4.7 million families would incur no tax liability as a result of this credit.

It is estimated that 50 million families will profit from this tax credit, 90 percent of whom have incomes less than $75,000 per year. Moreover, this credit will provide the average congressional district with approximately $59 million in tax relief each year, to assist an average 117,000 children per district (see attached table summarizing the projected tax relief for Ways and Means Committee Members' districts). In Chairman Archer's district, the parents of approximately 141,271 children would benefit from $70,635,500 in tax relief. In Congressman Gibbons' district, the parents of approximately 99,247 children would benefit from $49,623,500 in tax relief. Clearly, the number of children and their parents served, as well as the real-life benefits, merit enactment of the credit.

We realize that some Members may be concerned about the costs involved in providing a $500 per child tax credit, but it is important to remember that this is not another entitlement or subsidy. We are merely asking that parents who are taxpayers be allowed to retain a larger share of their own income to help support their families. Moreover, although the federal government spends approximately $13.7 billion per year for Aid to Families With Dependent Children (AFDC), a welfare program which subsidizes single-parent families, it does very little to further, and even penalizes through the tax code, what it should be encouraging: the two-parent nuclear family.

We are aware of the budgetary impact of this proposal. Christian Coalition submits that this tax credit should be paid for with spending cuts. We cannot burden future generations with the mounting national debt, and we believe that we have good credentials in the deficit reduction fight. Last year, we actively supported the Kasich budget which paid for tax relief. We were in the forefront of the effort to pass the bipartisan Penny-Kasich amendment. Moreover, we don't believe that higher taxes should be levied on other Americans in order to pay for this credit. The funding should be taken from wasteful spending in the federal government budget, and not the budgets of tax-paying Americans.

Mr. Chairman, you and your colleagues can count on the support of our organization in this

year's important undertaking to dramatically limit government. We are not summertime soldiers in the deficit reduction battle. Entire departments, agencies and programs should be reevaluated, eliminated, cut, or sent back to the states. We realize that bold cuts in government spending will need to be taken. Cutting government is a necessary step towards returning control over the spending decisions on children's health care, education, and well-being to parents and communities. This is the *family dividend* of budget reduction.

Thank you again for the opportunity to present our views today. Christian Coalition is pleased that the Committee and Congress are seriously committed to providing tax relief for America's families. We hope that this proposal will have bipartisan support, uniquely uniting liberals and conservatives. Enactment of a $500 per child tax credit is a necessary and important measure that we hope will gain swift passage.

PROJECTED TAX RELIEF FOR WAYS AND MEANS COMMITTEE MEMBERS' DISTRICTS*

Member	Number of Eligible Children	Projected Tax Relief Per Year
B. Archer, TX	141,271	$70,635,500.00
P. Crane, IL	143,836	$71,918,000.00
B. Thomas, CA	130,982	$65,491,000.00
C. Shaw, FL	60,815	$30,407,500.00
N. Johnson, CT	114,695	$57,347,500.00
J. Bunning, KY	130,811	$65,405,500.00
A. Houghton, NY	121,460	$60,730,000.00
W. Herger, CA	113,046	$56,523,000.00
J. McCrery, LA	120,161	$60,080,500.00
M. Hancock, MO	112,250	$56,125,000.00
D. Camp, MI	123,960	$61,980,000.00
J. Ramstad, MN	139,540	$69,770,000.00
D. Zimmer, NJ	132,994	$66,497,000.00
J. Nussle, IA	123,116	$61,558,000.00
S. Johnson, TX	137,856	$68,928,000.00
J. Dunn, WA	138,841	$69,420,500.00
M. Collins, GA	139,487	$69,743,500.00
R. Portman, OH	135,699	$67,849,500.00
P. English, PA	113,128	$56,564,000.00
J. Ensign, NV	117,892	$58,946,000.00
J. Christensen, NE	126,081	$63,040,500.00
S. Gibbons, FL	99,247	$49,623,500.00
C. Rangel, NY	72,898	$36,449,000.00
P. Stark, CA	130,767	$65,383,500.00
A. Jacobs, IN	107,244	$53,622,000.00
H. Ford, TN	92,859	$46,429,500.00
R. Matsui, CA	110,893	$55,446,500.00
B. Kennelly, CT	102,938	$51,469,000.00
W. Coyne, PA	87,209	$43,604,500.00
S. Levin, MI	125,130	$62,565,000.00
B. Cardin, MD	118,927	$59,463,500.00
J. McDermott, WA	75,747	$37,873,500.00
G. Kleczka, WI	114,365	$57,182,500.00
J. Lewis, GA	94,211	$47,105,500.00
L. Payne, VA	105,742	$52,871,000.00
R. Neal, MA	122,431	$61,215,500.00

*Source: The Heritage Foundation, Washington Should Turn Bipartisan Talk of Family Tax Cuts Into Action (Sept. 27, 1994).

Mrs. JOHNSON. Thank you, Mr. Wittmann.
Ms. Decter.

STATEMENT OF MIDGE DECTER, MEMBER, BOARD OF FELLOWS, JEWISH POLICY CENTER, ON BEHALF OF THE NATIONAL JEWISH COALITION

Ms. DECTER. Thank you very much, Madam Chairman.

As you know, I am here representing the National Jewish Coalition as a member of the Jewish Policy Center Board of Fellows, and I am very grateful for this opportunity to testify.

What a curious condition we Americans nowadays find ourselves in. Here we are, people completely at ease about engaging in such technologically advanced activities as driving automobiles, traveling in airplanes, using computers, while at the same time we find it necessary to engage in a heated national debate about whether and how to deal with the family, which is, after all, the very bedrock of our existence. That this is a very serious fix to be in, is undeniable.

For one thing, we can no longer even agree among ourselves about what is a family. Some decades back, you may remember, a White House conference on the family, attended by experts and activists from all around the country, foundered on this very point of difficulty.

The arguments then were quite heated and have, if anything, grown more heated since. Is a family, as tradition would have it, a mother, a father, and their offspring? Or is it two mothers and their artificially inseminated children? Or is it two fathers and their adopted children? Or is it any group of people who happen to be living under the same roof?

This new inability to live in a natural, unthinking relation, to what is the very ground of our being, is a symptom, as well as the source, of a serious kind of social dislocation. Now it would be grossly unfair to declare as many people nowadays do, that government policy is largely responsible for this dislocation. Government policies are only a part of, indeed, are themselves often merely an expression of the culture in which they are formulated. For many years now, that culture has not, to put it mildly, been friendly either to the formation of or to the proper appreciation of families.

Among those who have so cleverly been dubbed "the chattering classes," getting married and having children has come to be understood as little more than another stage on the long bumpy road to self-fulfillment. That is no doubt why the average age for marriage in this society has risen substantially and why divorces have become commonplace.

Moreover, for at least a quarter of a century, a powerful antinatalist wind has been blowing across the land. This wind has been blowing from two main directions. First there is the women's movement, which in its more radical formulations characterizes marrying and having children as no more than a means of bringing about the oppression of women, ensuring their enslavement to the species, as they say. In its milder form, urges women to demand that motherhood impose upon them no special obligations. Almost simultaneous with the rise of the women's movement has been that of the environmental movement, which has among other things

warned that human population, particularly of the Americans variety, is destroying the Earth. The only way to hold off the apocalypse, say the members of this movement, is by whatever means necessary to achieve zero population growth.

Moderated though both of these movements have over the years become, at least rhetorically, antinatalism, the antinatalism they set blowing through this society, has gone very hard indeed on American families. For it is more difficult to lean against a social wind than to protect one's self from an actual hurricane.

I am mindful that we are not here today to discuss American culture, although indeed you have heard from experts in economics and family economics, which I am not one. But it seemed to me important to place government tax policy where it rightly belongs, not in the realm of revenue collection or economic policy, but rather as an expression of a society's relative valuation. Thus, while government did not create this antinatalist and thus antifamily pressure, it has by not resisting, by not holding firm to the terms and needs of ordinary middle-class life, added to it.

One of the ways in which the government has contributed to the pressure on stable working families has been an antifamily bias written into the Tax Code. As you may know, I am testifying before you today as a member of the Jewish community, a community the strength of whose families has long been the subject of song and story, not to mention many jokes. The Jewish sense of family, of course, derives from the most foundational teachings of Judaism, indeed, from the very earliest chapters of the Book of Genesis, which as scholars have said, are nothing other than a blueprint for the family.

No doubt certain social factors such as the fact that for so much of their history, Jews were forced by circumstance to remain tightly bound in intimate communities, have contributed an extra measure of family centeredness. Be all that as it may, and although perhaps more mindful than other communities within this society of the special blessings attendant on our membership in it, and rightly so, Jews are at the same time of course not immune from its predicaments. Thus, despite the fact that in today's America, family life remains relatively strong among us, relatively, alas, is the operative term here.

While no society that regards children as something to be equally afforded with, say, housing and automobiles, can long remain healthy, for Jews, an ever-dwindling minority in this society, this is of course doubly the case. One often hears it quipped in discussions of welfare and illegitimacy that what the government pays for, it gets more of. In the same way, it could be said that what the government taxes, it gets less of.

It seems to me vital to understand that this is not simply an economic issue, as I said before. It is also a matter of granting or withholding of public approval. Consciously or unconsciously, taxation is one of the means and far from the least of them, through which a society expresses its relative valuation.

In the days when the representatives of those "chattering classes" viewed marriage with something, shall we say, less than full-floated approval, it was objected that the income tax was unfairly

discriminatory against the unmarried. As we have seen, the government all too hastily conceded that point.

How many voices in this chamber or elsewhere in this city were raised to say, "Yes, we discriminate in favor of the married, and we are right to do so." People who marry and bring up children in stable homes are entitled to special consideration.

Discrimination, of course, is a bugaboo word, just like unfairness is today. Everyone here conceded very much too rapidly, in my opinion, to the idea that, no, no, whatever we do, we must not be unfair. People have been known to fear being called discriminatory, or unfair, or even to be associated with a whisper of the word. Thus, have culture and government policy come together.

In declaring our support for the American Dream Restoration Act, we are saying nothing less than that the government must restore its original, rightful role, as discriminator on behalf of families.

The amount proposed for the child tax credit is by itself hardly enough, after all, to put really significant money into the pockets of middle-class families. It would not pay the mortgage, say, or even begin to touch the problem of college tuition, a neuralgic problem in this society these days. But it would be giving these families something they need and lack, far more than money. It would be giving them confirmation. Confirmation that society wishes them, nay, needs them to live as they are living and values them highly for doing so.

People need to be confirmed. They cannot make up their own lives, or what is more important, bring up their children out of whole cloth all by themselves without support from the society around them. Ever since the educated young of the sixties made it fashionable to sneer at the conditions and necessities of ordinary every day life, the members of the American middle class have taken a terrible moral beating. Their sensibilities have been trampled. Their way of living sneered at, their children constantly seduced in their schools as well as by popular culture into alien modes of dress, thought, speech, and behavior.

While sympathy of all kinds has been extended to those who traduced their standards of decency, which are after all still the putative official standards of this society, they are the ones who keep on being denounced as either heartless or mindless.

After the recent election, you may know, Peter Jennings declared that the electorate had been having, "a tantrum." Had ordinary Americans in fact been having a tantrum, rather than as was the case, engaging in a legitimate exercise of their franchise, it would have been small wonder, in my opinion.

The American Dream Restoration Act then is nothing less than a proposal to extend a much-needed and much-deserved act of recognition to all those who continue to live by the rules, who make families and work to support them, and by so doing excise the single most essential underpinning of a democratic society. This country can no longer afford not to afford such a bill.

Let me close by thanking you, Madam Chairman, and the members of this committee, for permitting me to testify here today.

[The prepared statement follows:]

STATEMENT OF MIDGE DECTER, MEMBER BOARD OF FELLOWS, JEWISH POLICY CENTER ON BEHALF OF THE NATIONAL JEWISH COALITION

Mr. Chairman and members of the Committee, what a curious spectacle we Americans would nowadays make for that proverbial visitor from outer space. Here we are, people completely at ease about engaging in such technologically advanced activities as driving automobiles, traveling in airplanes, watching television, using computers, while at the same time we find it necessary to engage in a heated national debate about whether and how to deal with the family, which is, after all, the very bedrock of our existence. We are, in short, completely at home with the complexities of technology and completely at sea with our own natures as human beings.

How we got this way is a long and complicated story--too long and too complicated for our purposes here today. But that we are in a serious fix is undeniable. First of all, we can no longer even agree among ourselves about what *is* a family. Some decades back, you may remember, a White House conference on the family, attended by experts and activists from all around the country, foundered on this very point of difficulty. The arguments then were quite heated, and have if anything grown more heated since: is a family, as tradition would have it, a mother, a father, and their offspring; or is it two mothers and their artificially inseminated children; or is it two fathers and their adopted offspring; or is it any group of people who happen to be living under the same roof? And even if we were to reach consensus on the answer to this question--which would not be easy, because there are interests as well as emotions involved--we would still find ourselves engaged in a possibly even more deracinated public debate about what should be the family's role in the ordering of our society. As if whether the family or our public as well as private entanglements with it were a matter of public choice, like, say, instituting military conscription or raising or lowering interest rates. In any case, our inability to live any longer in a natural, unthinking relation to what is the very ground of our being is the symptom as well as the source of a very serious social dislocation.

Now, it would be grossly unfair to declare, as many people do, that government policy is solely responsible for this dislocation: government policies are only a part of--indeed, are themselves often very much merely an expression of--the culture in which they are formulated. And for many years now, that culture has not, to put it mildly, been friendly either to the formation of, or to the proper appreciation of, families. Among those who have so cleverly been dubbed "the chattering classes", getting married and having children has come to be understood as merely another stage on the long, bumpy road to self-fulfillment, usually following one's settlement into a satisfactory or promising work life. In other word, making a family has come to be seen as merely another of life's options. That is why the average age for marriage in this society has risen substantially and why divorces have become commonplace.

Moreover, for at least a quarter of a century, a strong anti-natalist wind has been blowing across the land, resulting in a disturbingly low birth-rate. This wind has been blowing from two main directions. First there is the women's movement, which in its more radical formulations characterizes marrying and having children as no more than bringing about the oppression of women--insuring their enslavement to the species--and in its milder form urges women to demand that motherhood impose upon them no special obligations. And almost simultaneous with the rise of the women's movement was the environmental movement, which declared that human population, especially of the American variety, was destroying the Earth. The only way to hold off the apocalypse was, by whatever means necessary, to achieve zero population growth.

Moderated though both of these movements have become--or shall we say, now pretend to be--the wind of anti-natalism they set blowing through this society has gone very hard indeed on American families. *It is more*

difficult to lean against a social wind than to protect oneself from a hurricane.

I am mindful that we are not here today to discuss American culture, but it seemed important to me to place government tax policy where it rightly belongs: not in the realm of revenue or economic policy, but rather as an expression of society's relative valuation. Thus while government did not create this anti-natalist pressure, it has, by not resisting, by not holding firm to the terms and needs of ordinary middle-class life, added to it. One of the ways in which the government has contributed to the pressure on stable, working families has been an anti-family bias written into the tax code. Over the past 45 years, experts tell us, families with children have come to be taxed more than any other group of Americans.

As you may know, I am testifying before you today as a member of the Jewish community, a community the strength of whose families has long been a subject of song and story. The Jewish sense of family, of course, derives from the most fundamental teachings of Judaism, indeed, from the very earliest chapters of the book of Genesis--which, as one scholar has said, are nothing other than the blueprint for the family. From there, and on down through history, a key principle of Jewish faith and Jewish practice has been that a man has an obligation to marry, marriage being that which turns his energies from destructive to creative. No doubt certain social factors--such as the fact that for so much of their history Jews were forced by circumstance to remain tightly bound in intimate communities--have contributed an extra measure of family-centeredness.

Be all that as it may, and although perhaps more mindful than other communities within this society of the special blessings attendant on our membership in it -- and rightly so -- Jews are at the same time of course not immune from its predicaments. Thus in today's America, when we state the fact that family life remains relatively strong among us, "relatively" is, alas, the operative term. Furthermore, I would be so bold as to say that the ideas and attitudes feeding into that sense of the family and its attendant childrearing as a merely voluntary arrangement for pleasure and convenience hold a special measure of danger for Jews: we are people who have willy-nilly had to incorporate into our collective consciousness the fact of the murder of one million babies who, but for the privilege of finding ourselves in this blessed country, might have been our own. Thus while no society that regards children as something to be equally afforded with, say, housing and automobiles can long remain healthy, for Jews this is doubly the case. One often hears it quipped in discussions of welfare and illegitimacy that what the government pays for, it gets more of. In the same way, it could be said that what the government taxes, it gets less of. It seems to me vital to understand that this is not simply a financial issue; it is also a matter of the granting or withholding of public approval. Consciously or unconsciously, taxation is one of the means -- and far from the least of them -- through which a society expresses its relative valuation.

In the days, hopefully now receding from us, when the representatives of those "chattering classes" held marriage, shall we say, in less than high esteem, it was objected that the income tax was unfairly discriminatory against the unmarried. And, as we have seen, the government has all too hastily conceded the point. How many voices, in this chamber or elsewhere, were raised to say, "Yes, we discriminate in favor of the married, and we are right to do so -- people who marry and bring up children in stable homes are entitled to special consideration"? "Discrimination," of course, is a bug-a-boo word; people have been known to fear more than anything else to be associated with it. Thus culture and government policy come together.

In declaring our support for The American Dream Restoration Act, we are saying nothing less than that the government must restore its rightful role as a discriminator in behalf of families. The amount proposed for the child exemption is in itself hardly enough to put really significant money into the pockets of middle-class families; at the same time it is also

no doubt more than the government can afford at this point without taking funds away from some other of its accustomed outlays. Nevertheless, it would be giving these families a value far more important than money. It would be giving them confirmation: confirmation that society wishes them, nay, needs them, to live as they are living, and values them highly for doing so.

People *need* to be confirmed. That is why they live in communities. They cannot make up their own lives out of whole cloth or, what is more important, bring up their children, without support from the society around them. Ever since the educated young of the 1960s made it fashionable to sneer at the conditions and necessities of ordinary, everyday life, members of the American middle class have taken a terrible moral beating. Their sensibilities have been trampled, their way of living sneered at, their children seduced, in their schools as well as by popular culture, into alien dress, thought, and behavior. And while sympathy of all kinds has been extended to those who traduce their standards of decency -- which are, after all, still the putative official standards of society -- they are the ones who keep being denounced as either heartless or mindless. After the recent election, Peter Jennings declared their electoral behavior to be no more than a "tantrum." Had they in fact been having a tantrum, rather than, as was the case, engaging in the legitimate and responsible exercise of the franchise, it would have been small wonder.

The American Dream Restoration Act, then, is nothing less than a proposal to extend a much needed and much deserved act of recognition to all those who continue to live by the rules, who make families and work to support them, and by so doing, comprise the single most essential underpinning of a decent democratic society. This country can no longer afford not to afford it.

Let me close by thanking you, Mr. Chairman, and the members of this committee for giving me the opportunity to testify before you today.

Mrs. JOHNSON. Thank you very much.
Mr. Pitts.

STATEMENT OF T. MICHAEL PITTS, EXECUTIVE DIRECTOR, CHILDREN'S RIGHTS COUNCIL

Mr. PITTS. Thank you, Madam Chairman, members of the committee. I appreciate the long hours that you have spent here today. I will try to be very brief.

My written testimony has been submitted and I ask that it stand as is. I just wanted to say some things as I sat through the committee today, some important points that came upon me.

I may not have the membership that my brother does, or the eloquence of words that my sister at the table does. But I would say this, that the Children's Rights Council for the past 10 years has been very concerned with family formation and family preservation. From the Department of Health and Human Services to the Justice Department, we know certain things are true, that if parents wait until the age of 20, if they have high school educations and jobs before they marry, and have a child, the child has less than an 8-percent chance of living in poverty at any time during its life. Yet government policy continues to discourage two-parent families and family formation. There is no debate about it.

I sat here last Tuesday and heard Minority Leader Gephardt say that not only was this the finest committee in the Congress, but that there is no debate that there is a marriage tax penalty. I think Christopher Dodd said a number of years ago in a Senate speech that the kind of programs we subsidize only stimulates the results that we get.

In this situation, we have a basic problem in America and it is that families no longer form. Even when they do, they don't stay together. Now, sometimes families form and problems arise, people don't get the deal they thought they were getting. It is tragic. But what is even more tragic is the number of issues that people have to consider before marrying.

Years ago, when my parents married, they considered how many children they would have, where they would live, what school district was best. Today we have a plethora of problems that plague society. When I went to marry, I sat in the Back Bay of Boston with my friends and we discussed what it was going to be like. One of the discussions came around to, "Gee, how are you going to handle your taxes going up."

It is a real consideration, in a day and age where the dollar gets less mileage than it got in previous years, where government continues to tax and tax and tax and gives less in services to those people who actually pay for the services.

Now, we know we have to pay for every tax cut, and I don't want to go out there and run up the debt, as some people would say is the wise thing to do just to form families. But I do know one thing is clear, that we can't afford not to give this tax cut to parents when they decide to marry.

I just want to leave you with a couple statistics that I think are quite telling, and these are the kind of problems we get when we don't follow through on our spoken policy of family formation. The Justice Department, those nice people down the street, say that 30

percent of all children born, are born to unmarried women. Among the African-American community, it is 68 percent nationwide, spiking to over 80 percent in certain areas, basically in urban environments.

Children raised in two-parent families rarely experience poverty, less than 8 percent. Even after divorce and separation, we know if both parents stay actively involved in the child's life, they are less likely to live in poverty.

Sixty percent of America's rapists, 72 percent of our adolescent murderers, and 70 percent of long-term prison inmates, grew up without two-parent involvement. We can't be surprised that families disintegrate when the very policy that government supposedly stands behind, family formation, is then in turn punished through the Tax Code.

While I don't think that we can wait to pass this tax cut, I think it must be done over several years. I think we need to be fiscally prudent and responsible. But I think we need to pass it and I think we need to pass it now.

In closing, I would say that this is not only the view of myself and the Children's Rights Council, but from each one of your districts we have collected petitions. American voters sent a strong message last November. It was that we wanted something done and we wanted something done about our taxes.

Each one of these people that signed these are people who believe in family formation and family preservation. All this nice verbiage basically boils down to this: Give us the tax cut we need to form families and stay families so that government doesn't have to take care of our children.

I thank you for the opportunity to be heard today and especially in consideration of the late hour and all the tax experts that appeared before me.

I would be glad to answer any questions if you have any, and we at CRC remain willing and available to any member of the committee or the Congress who would like our assistance. If there is anything that we can do for you, we would be glad to.

Thank you.

[The prepared statement follows:]

Testimony Before
Committee on Ways and Means
United States House of Representatives
104th Congress - 1st Session
Honorable Bill Archer (TX) - Chairman
Tuesday, January 17, 1995

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Government's Punishment of the American Two-Parent Family

Introduction:

Mr. Chairman, I appreciate the opportunity to be heard before the Committee that Minority Leader Gephardt described as the "best Committee in the Congress. . . ".

Many witnesses have appeared before the Committee, submitting literal avalanches of paperwork, statistics, research and memoranda defending their position. I come before you armed only with the petition signatures of thousands of Americans. The petitions simply say, government should stop punishing the formation and preservation of the two-parent family. These signatures are those of American voters. The same voters that gave Congress a mandate to change welfare for the better, discourage welfare dependence and to stop arguing about family values and start to value families.

Implicit in that mandate is the desire of the American public for government to stop intruding into family life and punishing the American two-parent family. Mr. Chairman, the Earned Income Tax Credit and the Marriage Tax-Penalty punish family formation and hurt our family preservation efforts.

It is undisputed among parties, between ideologies, and among the public, that family formation and preservation should be our society's goal. Still, government has continually enacted laws and made regulations that punish the formation of the two-parent family. Welfare, namely AFDC regulations, is filled with incentives that discourage Americans from our goal of forming long-lasting and healthy families. We have literally created a system in which our macro-level goals are subverted by perverse micro-level incentives.

Welfare:

Today's welfare state was created at a time when unemployment and extreme poverty were increasing exponentially. Currently, the federal government administers over 75 programs designed to aid poor and low income families. Many of the programs overlap creating a maze of eligibility requirements, benefits programs and transition to self-reliance projects. This highly complex set of programs from AFDC to Urban Community Aid Programs present obstacles to self reliance. The myriad programs raise the question, "is government's job to care for a citizen or to care about a citizen".

Causes of Welfare Dependence - Including the Marriage Tax-Penalty:

Social engineers and scientists of both the left and the right have written extensively on the cause of welfare dependence being poverty. Poverty, however, is a mere symptom of a much larger problem, the failure of our society to promote family formation and preservation. Despite our knowledge that children born to two-parent, in-tact families are less than 8% likely to live in poverty, the government continues to punish family formation through wayward tax

disincentives.[1] The decision to marry is a hard one, based upon the evaluation of many personal and social considerations. No young couple should have to weigh the intrusion or punishment of the federal government in the decision to marry by means of levying a tax upon their union. In a day and age when financial resources are ever more consumed by rising taxes, higher costs and more demand to provide for one's own retirement, the marriage tax-penalty is truly a great consideration. That government punishes the achievement of a recognized and pronounced goal is absurd.

We should not be surprised that family formation is subverted by government assistance programs thus creating poverty and therefore cyclical welfare dependence. Barbara Defoe Whitehead, a noted social researcher wrote, "It is risky to ignore the issue of changing family structure and the associated problems. Overall, child well-being has declined, despite a decrease in the number of children per family, an increase in the educational level of parents and historically high levels of public spending"[2]. The Marriage Tax-Penalty is at its heart an evil and disruptive mechanism that is a contributing factor to social decay.

Both Minority Leader Gephardt, you, and your fellow Republicans on this Committee acknowledge that the Marriage Tax-Penalty is a problem. Mr. Chairman, I urge this Committee and this Congress to correct this long-standing problem.

Earned Income Tax Credit (EITC):

Currently, EITC has the unintended consequence of rewarding the over-reporting of income to maximize benefits. This is often done as a self-corrective measure by citizens in an attempt to correct the marriage tax-penalty. Currently, many working-class couples are ineligible for EITC but, by simply splitting into two equally dysfunctional fragments, both become eligible. This is part and parcel of government's enactment of programs that have unintended consequences. Again, we should not be surprised when family preservation is subverted because of micro-level incentives not matching our macro-level goals.

Caring for Welfare Dependents:

We know that a child held too close to the breast becomes dependent and not self-reliant. Yet government continues to hold our poor and needy too closely, making them dependent on the continued assistance of the government through welfare programs. Government must encourage welfare recipients to quickly transition back into the workforce. However, there exists disincentives to work in the current welfare bureaucracy.

Disincentives to Self-Reliance:

Monetary and Non-Monetary Transfers: Federal programs that provide assistance without requiring a value exchange do not encourage self-reliance. Welfare recipients must provide a service for their benefits to promote a sense of self-worth and accomplishment. While these types of aid are designed to contribute to an individual or family's standard of living, Health and Human Services (HHS), the Government Accounting Office (GAO), the Census Bureau and other agencies within the government all show that direct assistance has little effect on promoting self-reliance. In fact, those Americans that we look to as role models, Abraham Lincoln, Mary McLeod Bethune and others all grew-up in poverty and still achieved success. Government aid programs did not assist these people in their rise to greatness, family, work ethic and self-reliance did.

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[1] Kids Count Data Book, Annie E. Casey Foundation & Center for the Study of Social Policy - 1993. If parents wait until the age of 20, have jobs, complete high school and marry, their children are less than 8% likely to live in poverty at any time in their life.

[2] Dan Quale Was Right, Atlantic Monthly Magazine, April, 1993.

Promoting Self-Reliance: Welfare programs continually have perverse, if not unintended consequences. We continually make a devil's deal with welfare recipients -- if you do not work, we will pay you. When welfare cheats are caught working they are simply required to repay grafted moneys and services out of future benefit payments. Instead of being made to transition off of welfare into the jobs they held they are simply told to quit working in order to receive future benefits. The best training for placement and advancement in the workforce is the old fashioned job. Still, few government programs are directed at job assistance and work requirements. Work is always better than non-work. Yet, a teenage mother's welfare benefits package is often much greater than the benefits derived through social security after forty to forty-five years of work. We should not be amazed that welfare recipients find the dole more attractive than work. Sen. Christopher Dodd once said, "Whatever social behavior government rewards and subsidizes, we end up with more of that behavior. . .". Programs that give assistance without real work or service requirements promote inactivity and regressed work ethic.

Aid to Economically Disadvantaged Communities: While these programs are intended to stimulate local job growth and general opportunities, there is little belief that such programs directly benefit the poor Americans they are designed to help.

Solutions to Welfare Dependence:

Eligibility: One of the greatest deterrents to welfare dependence is never entering the welfare state. This need not mean that government not care *about* an economically disadvantage person. It need only mean that government not care *for* the poor or disadvantaged.

While there is great hyperbole about cutting-off benefits to certain dependents and its "punishing" of children, we must balance our cures with an evaluation of the disease. Literally, in the case of welfare and children, our medicine is often more fatal than the disease of poverty. Eligibility, therefore, must be re-evaluated cautiously.

Before the advent of the welfare state, families took care of their own without the intervention of government. If parents were unable to care for a child physically or financially, other family members stepped-in to provide relief. The idea that a government that can't deliver the mail can deliver on family support is unreasoned.

Eligibility must therefore be limited to only the most extreme cases.

Teenage Parents and Eligibility: It is unquestionably the law in every state that children are the undisputed dependents of their parents until the age of 18. Yet, federal welfare programs subvert state law, providing separate moneys, housing and other benefits to teenage mothers and disrupting the rights and responsibility of the family. Teenage parents should be excluded from eligibility for welfare programs as long as their exists a family that is capable of caring for the child and minor parent without government aid.

Kinship Care: In keeping with rhetoric from the left and the right about the importance of family, the federal government should deny eligibility to any potential recipients who have available, capable and willing family members to care for the children. The use of the Kinship Care network in determining welfare eligibility is not only significantly financially appealing, but it is socially, morally and ethically responsible.

No child has ran-away from home, committed suicide, joined a gang or used drugs because they suffered from too much good parenting, supervision or familial involvement, in fact, just the opposite is true.[3]

Accountability:

AFDC and other programs are intended for the benefit of the dependent children. Adults receive the benefits and are expected to participate in programs in support of the children's needs. Failure, or refusal to participate in required programs or to spend the cash payments for the benefit of the children should be seen as evidence of child neglect or abuse. Such irresponsible behavior clearly indicates that children in such welfare situations do not benefit from the program as is happening with increasing frequency.

All recipients should be required to reimburse the value of benefits received. Currently, only child support paid by non-custodial parents is used for reimbursement after a $50 per month pass-through. The custodial parent and welfare recipient must also should the responsibility of supporting their children. Job placement and retention or community service of forty hours per week will give these recipients the necessary training, develop the requisite work ethic and instill a sense of self-reliance and productivity desperately needed. There is no better qualification for entry-level work placement than job/volunteer experience.

Reforming Welfare Now:

Mr. Chairman, the American public drastically changed the face of this great institution for one reason, they want government to work for the people. I urge this Committee to abolish the Marriage Tax-Penalty and correct the failures of the EITC with the dispatch that the American people demanded last November. Not only do I encourage this action on behalf of the millions of American families punished by these penalties, but for the countless millions of children affected by these bad laws. Congress need not debate family values to the exclusion of valuing families. It must value families to promote family values.

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[3] The Justice Department states that more than half of all children will spend part of their childhood in a home without a father. 30% of all children are born to unmarried women. Among African-Americans the figure is 68% nationwide, spiking to over 80% in certain urban areas. Children raised in two-parent families rarely experience poverty (even if both parents are involved after separation and divorce). Children who grow-up in single-parent homes are 83% likely to experience poverty. 60% of America's rapists, 72% of adolescent murderers, and 70% of long term prison inmates grew up without two-parent involvement.

Mrs. JOHNSON. Thank you, Mr. Pitts, for your eloquent statement.

I thank the panel for your very thoughtful input.

Mr. Christensen will inquire.

Mr. CHRISTENSEN. I agree with Madam Chairman. I am very impressed, Mr. Pitts. Thank you for coming, Mr. Wittmann, Ms. Decter.

I want to ask a question concerning a statement that was brought up in the last panel by Mr. Shapiro of the Democratic Leadership Council. He said that it was probably "not the soundest way to go about it," referring to not allowing the $500 per-child tax credit from the administration's point of view to families with children ages 13 on up.

I wanted to know what your feelings were on that. Maybe you could enlighten us a little bit on that, Mr. Wittmann, Mr. Pitts.

Mr. WITTMANN. Well, Congressman, it bedevils us. Perhaps this is the kind of idea that is discussed at a Renaissance weekend. As we said in our statement, that is probably an idea only a Washington policy wonk could figure out playing with numbers. But as we indicated in our testimony, clearly the expenses for moms and dads doesn't decline at age 13.

Ms. Decter and I were discussing beforehand in Jewish families, actually at age 13, there is a major religious event, the bar mitzvah that usually incurs expenses. But seriously, there are expenses that continue to increase for children age 13 and above. Our view is simply this: That moms and dads have seen the depreciation of the standard deduction for children over the last 40 years, and this is only a modest step and it shouldn't be cut off at arbitrary ages.

Mr. CHRISTENSEN. Any thoughts, Ms. Decter?

Ms. DECTER. Well, it is an absurdity in a situation in which ordinary parents in this country understand that the—it is the better part of prudence for their children if they get bachelor degrees. How anyone can imagine that having a dependent child age 18 is less expensive than having a dependent child age 8 is someone who is either nice and young or childless or has a lot to learn yet.

Mr. CHRISTENSEN. Well, I would agree. I have had a hard time figuring out where the administration would come up with that proposal. I sure don't think it does the American family justice, who we are here trying to fight. I know I was sent here on November 8 to fight for that working family, to fight for that middle-income earner who has been under the burden of confiscatory taxation and regulation over the last several years. We are going to win this fight. We appreciate your testifying.

Ms. DECTER. Now he is not even permitted to smoke.

Mr. PITTS. Mr. Christensen, I would just state I am not a soothsayer. It is not one of my many talents. I think my talks with the administration were that they were trying to drive home the point that we need to spend a lot of time focusing on the early, formative childhood years. If we give kids a decent start in life, they are more likely to be successful as adults. But I do agree that the administration did not go far enough. The cost expenditures for a teenage child are greatly increased over that of an infant child.

I have a little boy Noah whom I am really pleased with. But I know as he gets older there will be many things I will have to pro-

vide that aren't necessarily luxuries, like a suede jacket or $100 sneakers. I know there will be such things as a better book or a CD–ROM drive for computers so he can take a look at multimedia events. I think we need to increase the age cap. Up until the age of 18, I think it is a responsible thing to do.

Mr. CHRISTENSEN. Thank you, Madam Chairman.

Mrs. JOHNSON of Connecticut [presiding]. The gentlelady from Washington, Ms. Dunn, will inquire.

Ms. DUNN. Thank you, Madam Chairman.

I have one simple question. We have had a wonderful advantage today with several panels testifying on the child tax credit and the family incentive that we have discussed in the Congress. I wonder if each of you might think out loud for our benefit and tell us how you would construct a family-friendly tax cut program. Mr. Pitts?

Mr. PITTS. I would think that the $500 credit is the first step. I think we need to take a look at when our families were strongest last. I refer to the year 1948, in my estimation. It is a magical number. But we were doing pretty well then. If we take a look at the tax incentives for parents to stay home, to parent children, to be there in their formative years, we can see that we have greatly devalued the benefit the two-parent family has in staying intact in the young years especially.

I do not diminish your idea about volunteerism, Ms. Dunn. I think a lot of mothers and fathers who stay home with their children in the formative years spend that time being active, whether it be at the PTA or home school network or the Sierra Club. It makes no difference what they are involved in. I think it is important the children see their parents being involved in the community.

I think in large part we need to take a look at the structure in which the Tax Code allows us to get back to that situation by which parents can actually stay home. It need not be the woman. It could be the man. I don't think it matters which parent stays home. All I care about is that children see productive parents leave the house every day, earn a living, display a work ethic and come home, instead of seeing two parents leave the house and come home almost literal strangers.

I think we have a problem in America when bus drivers and day care workers, as wonderful as they may be, spend more time with their children than the parents do. I think we need to have more parental supervision. I think it will cure a lot of ills.

In my time working on the streets or in social programs, not one child has come to me and said, "I ran away from home or joined a gang because, darn it, I was being loved too much, my parents were too involved." Those things never happen. So I think we need to get the family back involved in the family.

Child care is good. We can do a lot of things to assist single parents, but we have to go back to what we know works and that is the two-parent family.

Ms. DUNN. Thank you. Mr. Wittmann.

Mr. WITTMANN. I would echo what has been said before.

I would also add that over the last 40 years, we have seen this depreciation of the exemption.

One of the great frustrations I think right now, and probably over on the campaign trail just a few months ago that you ran into, is the stagnant family income over the last 20-some odd years. The question has been raised, where are the spending cuts? It is an interesting proposition. I was thinking about it.

Over the past 40 years when Washington has spent the money of moms and dads, no one asked the moms and dads how are they going to change their spending to accommodate the increase in Federal spending. I think the basic point is that we have to look at things from a new paradigm. Spending is going to take place for education, for welfare, and for health. The question is, who does the spending. Do bureaucrats do it in Washington or do moms and dads do it in their homes? Because when it comes to the end of the day and as one who worked in the bureaucracy, no bureaucrat loves my children more than I do. Only moms and dads can make the best decisions about their spending, and I think that that is what the voters are saying to Washington, let us make those decisions.

Ms. DECTER. I would like to add something. Excuse me. I have been sitting here all day listening to the testimony and it was most interesting. I noticed that everybody got caught up short, with the possible exception of Alan Reynolds who doesn't care about these things and says he is no philosopher on the issue of fairness.

I am sorry that Mr. Rangel, who is a compatriot of mine from New York, is not here, because he brought this up, too. I would be delighted to give him the spending cuts list, and unlike Gary Bauer, I would be willing to tell you right now that we should shut down the Department of Energy, the Department of Education, the endowments. I mean, I would be delighted to give him a list. But it seems to me that everyone got thrown off the track a little bit by exceeding to the idea that whatever else happens we must have fairness, which means that those who have less money must not perceive that those who have more money are getting a break. I don't think that that is a sound economic principle.

There was talk before about what has interfered with the savings rate of Americans, and obviously what has interfered with the savings rate of Americans is taxing at the margin. Marginal taxation has done that. Everyone in the entire economy would benefit if the economy grew, and we know what is necessary to make economies grow, and it is not egalitarianism. The poor would do better in an expanding economy. In order for the economy to expand, the rich also have to do better. That is the way it is. It seems to me that by now that should be established as a fact of life. So again, I think it is very important that this society honor two-parent families and their children who live stable, companionate, loving lives. I don't think it matters if they make $30,000 a year or $80,000 a year.

Mrs. JOHNSON of Connecticut. Thank you, Ms. Decter. In view of the time, I would like to move on to Mr. Neal of Massachusetts.

Mr. NEAL. Thank you very much, Madam Chairperson.

Welcome. I thought that your testimony was certainly enlightening today. Let me ask you, since we talked about the issue of real income and we connected that to a two-parent household and we connected the idea that there should be no difference in affection in the household between those that make $30,000 and $80,000 a

year. The hard truth of the matter is, however, that the people that make $30,000 a year with one income are finding it harder year after year after year. As a result, the woman in the household, typically during the last 10 or 15 or 20 years, has found it necessary to seek work or to enter the workplace and that, certainly in my region, New England, has allowed for the maintenance of income to remain where it is.

Let me just throw this out to the three of you because I think it is worthy of some focus and discussion. What about the morality of taking American manufacturing jobs offshore for lower wages? What about corporate decisions across America during the last 10 years that have literally helped to destroy urban areas? Does Corporate America bear any responsibility for some of these decisions where they seek wages in the vicinity of $1 an hour or $1.25 an hour? What does that do to the dignity of the individual and the human being who sees that job leaving despite the fact that productivity standards have gone way up in America, primarily because people are working harder all the time?

I have four children, so nobody here corners the market on trying to raise a family. My wife works, as well. My point is that all Americans find it harder and harder to keep that family together, that family time that is so critical.

My broader question is: What about those decisions to move those jobs offshore that have driven people in New England and old cities like Lawrence and Lowell and Worcester and Boston and Springfield? Is it just to see those manufacturing areas devastated in the name of profit-making?

By the way, I don't come from the left of my party. People would consider me to be in the center of the Democratic Party. But I am troubled by these decisions in recent years. I think you three are well-positioned to speak to it.

Mr. PITTS. Let me start off because I, too, am from Massachusetts. I lived in Boston. I, too, have been troubled by seeing my peers in longtime manufacturing jobs, their wages decrease exponentially, I believe, over the last decade, jobs moving out of New England in droves.

But I am not an economist. I went to school and I studied philosophy, theology, and law. These are the areas that I know and some would argue I don't know them very well. But what I do know is this: That there is always dignity in work and there is always dignity in family.

I was thinking the other night about this debate on the War on Poverty, has it had an effect. One thing I did realize is that there are some great figures in American history that grew up in what could only be described as abject poverty and turned out to be wonderful people. The fact that parents feel a need to keep up with the Jones' next door I think is unfortunate in our society. But what I would say is that there are a number of issues that have contributed. But the issue that I came to speak about today and I think that is squarely before the committee is tax relief for families.

Mr. NEAL. But is it not tied to the broader question—I don't mean to interrupt—is it not tied to the question of family time if the woman has been compelled to go to the workplace?

Mr. PITTS. I don't know that they are, first of all, compelled. I don't think both parents need to work all of the time. I think we have this idea that we have to wear designer clothing, that our children have to have——

Mr. NEAL. How old are your children?

Mr. PITTS [continuing]. That they have to have video games. I have a 2-year-old.

Mr. NEAL. A 2-year-old. Let me tell you what it is like to get ready for the cost of college and say two parents don't have to work.

Mr. PITTS. Having recently completed my education, I am concerned about the cost of education. I go to bed at night and I worry about Noah getting a college education. I worry about him getting a high school education. More importantly, I worry about him getting values and parenting and supervision so that he won't become a gang member, so that he won't do drugs, so that we won't have an out-of-wedlock birth in the family. These are things that I think will become essential in helping him become a successful adult.

Ms. DECTER. Look, it is not a new invention that women have needed to work. Women have needed to work down through the ages. There is some kind of ideological formulation that suddenly they have been—and it is a misfortune if they are forced to do it. Government cannot account for all human misfortunes. It is a misfortune if a certain industry becomes obsolete because it cannot compete with other industries; then new ones come to take its place. This is a process that has been going on in this country over the centuries.

Mr. NEAL. What has been taking the place of the manufacturing industry in America?

Ms. DECTER. Highway 128. You are in Massachusetts. That is one of the things that has been taking its place.

Mr. NEAL. Highway 128 has lost more jobs in the last 5 years than any other sector in the Massachusetts economy.

Ms. DECTER. But it is—I know there are women who need to work. As I say, there have always been women who needed to work and there were always widows and orphans who needed to work, and this is very—and this is something worthy of enormous sympathy, help, respect, and every other thing. But it is not the same thing as making light in the name of justice and equality—of making light of what it is families are and do. I maintain that the American culture has been doing that. It is not only women who—a family with an income of $30,000 a year. The women in the household where the family income, where the husband is earning $85,000 a year also needs to go to work because they feel they are not respected.

I have two daughters—three daughters, actually; one doesn't live in the United States so she doesn't have the problem—who are home raising my beautiful, wonderful, marvelous grandchildren. Everywhere they go, they feel obligated, especially since they live in this town, which is a terrible place for women, they feel obligated to apologize for the fact that that is what they are doing. That is the influence of the culture, and lawmakers have got to be very careful to examine themselves and make sure that they aren't simply taking on these fashionable attitudes.

Mrs. JOHNSON of Connecticut. Thank you. Mr. English will inquire.

Mr. ENGLISH. Thank you very much, Madam Chairman.

I wanted to explore with the panelists the issue of the growing burden of taxation in America on working families, on family structure, and the effects of changes in that family structure over the last 20 or 30 years on the equity of the tax system. I know that is a very broad subject. But for example, we have touched on the fact that more and more families are needing two incomes. To some extent, I think that the growth of taxation has contributed to that trend. Also, it has had the perverse effect of moving a great deal of activity traditionally done within the family out of the family, into the market economy and into the clutches of the tax man.

I think that we have all talked to constituents who have had a great deal of difficulty making ends meet and that the second income in the family is heavily consumed by the expenses of child care, associated expenses, and taxes. I wanted each of you to comment on what you consider the implications of this and how significant it is for the family structure and ultimately for American culture.

Mr. WITTMANN. One thing that we mentioned in our testimony was the concept of the family time famine. Moms and dads are only able to spend considerably less time with their children because of the fact that one of those wage earners is spending a large part of their income, up to two-thirds, paying the tax liability that has increased over the last 40 years.

No professional care giver can replace the love of a mother or father. I think that most child psychologists would attest to that. That is one thing that is going to have ramifications in the future as moms and dads have less time to spend with their children and in tending to their needs and all the things that come with childhood. But the thing to keep in mind is that no government, no matter how well the service is delivered, can replace the mom and dad. No program can be shaped so expertly to replace a mother's or father's love and attention to their child. I think we are going to pay a price for less parental time with their children down the road. We probably already are. So I think that the ramifications are not just financial ones. They are cultural ones that impact upon the next generation.

Mr. ENGLISH. Ms. Decter, would you care to comment on the cultural implications? Would you agree that the growing tax burden is having some impact on family structure?

Ms. DECTER. Well, obviously it is among those who are struggling to make ends meet, certainly it is. But there is something else to be added into the equation. One of the things, I think, that happened last November 8 was that people are angry. They are angry not because the tax structure is unfair or favors the rich. I think that is a very serious misunderstanding. There is not a whole lot of envy in this society, especially compared with other societies—excuse me, in Europe and so on. What there is is bitter resentment on the part of people who work hard that they are spending—that so much of their money is being taken to support people who are not working at all.

This is a very critical issue, it seems to me. It is the issue that is called welfare or the great society or something. But I think it can be spelled in very simple terms, which is I am breaking my back in order that that woman can hang around and have an apartment of her own and babies or in order that that guy can hang out on the street corner. That is where the bitterness and the anger is coming from. That is why I think the issue of—that is the issue of justice as people—as working people in this country see it.

Mr. ENGLISH. Let me beg the Chair's indulgence in a followup. Do you feel that the changes in the family structure that are at least partially the result of growth of taxation, particularly on the vast middle class, are having an impact on the ability of families to act as incubators for culture?

Ms. DECTER. Oh, of course. That is part of it. Of course it does. That is only one part of it. I mean, the schools are acting against it. Every—everywhere you look, there is some official agency or public display or celebration or something which is militating against this which the tax structure is just one part, but it is an essential part.

Mr. ENGLISH. Thank you very much.

Mrs. JOHNSON of Connecticut. I thank the panel very much for your presentation today. I do have one question that I would like to pose.

I am very pleased that this panel is finally going to address some of the problems in the Tax Code as far as families are concerned and reverse some of the disincentives that have placed such a heavy burden on families and penalized marriage and family formation. I also would like to point out that a lot of this is bipartisan. In the past, some of my Democratic colleagues, particularly my colleague Barbara Kennelly from Connecticut, has been a strong proponent and has worked very, very hard to try to do something about the marriage penalties. We are all concerned, however, with the cost of tax changes. Since the deficit does impose very significant, both direct and indirect, burdens on families, it is important that we try to proceed through this package in a way that assures that we can pay for it.

One of the things that has interested me today is that the three proposals before us cut off the tax credit at different levels of income. Now, I strongly oppose treating children of 12 different from children of 13. But I do think we have to think very seriously about whether a $500 credit is as important to a family with a $200,000 income as it is to a family with a $125,000 income, both of which are Republican proposals, or to a $75,000 income, which is the Speaker's proposal.

In my own part of the country, $75,000 is not a lot of income to some families. We are a very high cost part of the country. In a family with a policeman and a teacher, you can easily be over that income level, and with two children that is a real struggle. So I think trying to look realistically, both at the short-term burden of the deficit on families and the long-term burden for us as a society, I am personally looking at where the most appropriate cutoff might be—$200,000, $150,000, $225,000?

Do you have any thoughts on that? Should we take seriously the responsibility to accommodate the child credit for very high-income people as we do for middle-income people?

Mr. WITTMANN. Congresswoman, if I could just add, I personally would even eliminate the $200,000 cutoff. First and foremost, 90 percent of the money goes to families earning less than $75,000, so I don't really think that you save that much money by extending the cutoff over $200,000 or even eliminating the $200,000 cutoff.

Second, our grave concern is that the term wealthy will become very fungible in Washington. Wealthy could be $75,000 in the President's mind and it can be a very fungible, slippery slope, if you will, and soon we will find ourselves with no tax relief or minimal at all. So we would strongly urge the Congress to go actually the route of what the Senate budget bill had last year, which was not a means test. Because, No. 1, you don't pick up that much money, and No. 2, our fear is that there will be a slippery slope by which the number will keep dropping.

Mrs. JOHNSON of Connecticut. I do appreciate both those arguments, Mr. Wittmann, as sound. It is, however, a matter of $13 billion. As we get into the other provisions in this Tax Code and the fact that while we talk about relieving the earnings penalty for seniors, we actually don't relieve it for seniors from 60 to 65, which is probably peak earning years that you don't want to penalize. So when you look at what we are able to accomplish in this package and really aren't able to accomplish as well as we want to, I do worry about that. But certainly both of the arguments you make are solid and sound, if any of the other panel would like to comment.

Mr. PITTS. I would say this, Madam Chair, if I may, that I read a couple of months ago, Marian Wright Edelman said that if it is wrong for a teenage child to have a child out of wedlock, it is wrong for a Hollywood star with millions of dollars.

I don't want to sound like I am giving anything away to the wealthy. It is not my agenda. However, I think that we can't punish family formation discriminantly. If family formation is good for the poor, it is also good for the wealthy. In that regard, I would agree with my brother that the cap is somewhat ridiculous in the sense that family formation is always good.

One of the things that I would encourage Members to take a look at is something I haven't heard much of and that is the uncalculated savings of other expenditures. Like I said, we know that when families form, they have a less than 8 percent chance of living in poverty. The more we encourage marriage through the removal of the marriage tax penalty, I think the more we will see families form, and I think the more they will preserve, the more we put the Tax Code in a more family and child-focused format.

With all of that comes savings in drug treatment programs, in prison buildings, and the number of other social ills that, in my opinion, as I look at society, are a direct consequence, if albeit an unintended consequence, of not forming families. I think there is tremendous savings to be made by giving a tax cut if you can call it that. I see it as a penalty, removing the tax penalty, for family formation.

Ms. DECTER. Well, I am not a policy expert, but I am a housekeeper. I know that if there is something I want to afford, the first thing I do is figure out what it is I can afford to give up in order to do that. It seems to me that this is something that has not really been seriously done before, and as I sense is about to be seriously done. I think if it is truly seriously done, probably no one has yet estimated how much saving there will be and what could be afforded on that basis. But, obviously, nothing more should be done than what can be afforded. That is clear.

Mrs. JOHNSON of Connecticut. Yes. We will have to look broadly at this as we move forward and be sure that we don't provide more benefits to one group than to another.

Thank you very much for your testimony, and I hope in 6 months you will be pleased with our work. Thank you.

Mr. WITTMANN. Thank you.

Mr. PITTS. Thank you very much, Madam Chair.

Ms. DECTER. Thank you.

[Whereupon, at 4:22 p.m., the hearing was adjourned to reconvene on Wednesday, January 18, 1995, at 10 a.m.]

TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

WEDNESDAY, JANUARY 18, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:03 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Will you ask our guests to take their seats. This is our second day of hearings on provisions that are designed to strengthen the American family, and we will focus on the Family Reinforcement Act, H.R. 11.

This act would provide refundable tax credits for adoptive parents and for families who provide custodial care for invalid parents and grandparents at home. It is a very important part of the bill that has not received a great deal of attention in the press, so I am delighted that we will be having this hearing devoted to it today. As a parent myself, and also as a grandparent—and those numbers seem to grow every year or two—I can speak personally of the joys which children bring into a family. I now have seven children and eight grandchildren, with two more grandchildren on the way, and they are the greatest blessing that can come to any human being.

Sadly, there are many families in America who face difficulties sharing the enrichment of parenthood. For them, the financial barriers of adoption are too great to overcome.

Today, the average cost of adopting a child can range from $10,000 to $12,000 in fees and legal expenses. For families of modest means, this dollar figure can translate into a childless home. For the children who need a home, this can mean an intolerable wait. To address this dilemma, the Family Reinforcement Act, as part of the Contract With America, would allow these families to claim refundable tax credits of up to $5,000 for legal adoption expenses.

Later on today, we will turn our attention to tax relief for families who care for parents and grandparents at home. It is time for us and the Tax Code to recognize the financial strains placed on families who provide custodial care to invalid parents and grandparents. The Family Reinforcement Act begins by permitting families to claim a refundable tax credit of $500 for each parent or grandparent in need of custodial home care.

We have many expert witnesses today, some who have come to share their personal experiences with us, and we look forward to their testimony.

Now I would recognize Mr. Ford for any opening comments that he would like to make on behalf of the minority.

Mr. FORD. Thank you, Mr. Chairman. As we receive testimony on the adoption credit contained in the Contract, I would like to encourage my colleagues to focus on the group of intended beneficiaries who are in dire need of these incentives. An adoption credit has always received support from the Democratic side of the aisle, as indicated in 1991, when a credit was included in the Family Preservation Act, a legislative proposal that was vigorously pursued on the Human Resources Subcommittee.

In 1991, as well as today, we had limited resources for this relief; thus, we focus any relief on those children who traditionally would not otherwise be adopted, children with special needs. As we move forward with this proposal today and hear from witnesses, Mr. Chairman, I would impress upon my colleagues how important it is that we retain this portion of the credit, should our limited resources require a reduction of dollars, and allocate those dollars to the areas where they are definitely needed. Let us not lose the opportunity to do something very meaningful in this area at the expense of doing all things for all people.

As we consider this legislation, Mr. Chairman, I look forward to working with you and my colleagues on this committee in making this tax relief a reality for the families who badly need the funds and the resources to make sure that those adoptions do, in fact, take place where those dire needs exist in this country.

Thank you, Mr. Chairman.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON FAMILY TAX REFORM
January 18, 1994

Mr. Chairman, as a strong supporter of the Contract With America's provisions for adoption and eldercare assistance, I look forward to this second day of hearings on the importance of providing needed tax relief to American families.

The Contract's Family Reinforcement Act (H.R. 11) would establish a refundable tax credit of up to $5,000 for adoption expenses such as adoption fees, court costs and attorney fees.

Mr. Chairman, I am very familiar with the often exorbitant costs of adoption. My own sister and brother-in-law chose to adopt two wonderful children from Korea, as well as one from the United States. As experts will tell you, the expense of international adoptions is even greater than that of domestic adoptions.

Across the country, there are many middle income families that want nothing more than to provide a loving home for an adopted child, but are afraid they simply can't afford it.

By enabling more people to adopt, we can give more children the opportunity to be reared in the stable environment of a two-parent family. Increasing the number of adoptions in America may, in turn, cut future costs to the taxpayers by reducing the number of children on welfare or in the juvenile justice system.

As a member of the bipartisan Congressional Coalition on Adoption, I know that pro-adoption policies are advocated by Members of Congress across the political spectrum. I hope they will all come forward to support this provision.

By the same token, the Contract's $500 refundable tax credit for individuals who care for a parent or grandparent at home also will serve to relieve an often heavy financial burden on Americans.

Families that have made the sometimes difficult decision to care for a loved one at home should be commended. Not only do their extraordinary efforts help keep families together, but they lower our nation's health care costs by reducing the number of people who require nursing home care.

Once again, Mr. Chairman, I am very pleased to be hearing today not only from experts on adoption and eldercare, but from a number of private citizens who can tell us whether the Contract's initiatives to reduce the tax burden will make a real difference in their lives and the lives of their families.

I thank you all very much for being here today and look forward to your testimony.

Chairman ARCHER. I thank you for your comments and am pleased that we can work together on this provision on a bipartisan basis.

We have before us today our first panel, five of our colleagues in the House. Welcome to the Ways and Means Committee. We would encourage each of you to limit your verbal comments to the committee to no more than 5 minutes. Any written statement that is lengthier than that will be inserted in the record, without objection.

We will be pleased to receive your input, beginning with the Honorable Robert Dornan of California.

STATEMENT OF HON. ROBERT K. DORNAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. DORNAN. Mr. Chairman, permission to paraphrase a little Shakespeare, Julius Caesar. This committee is really the big time. It does bestride the Hill like a giant colossus, and we mere mortal Congressmen do walk through its legs and peek about and conduct our affairs.

This is the committee that rewards or punishes Americans with economic incentives on their 1040 form. I have done my own income tax without the help of H&R Block or anybody else for 47 years, since I was 14 years of age and had my first job. Each year—because the memory does wane and rules change a lot, each year I will take the 1040 guidance booklet and read the brief changes in the front. Even in the brief changes, it says what you cannot and can deduct as an exemption or a deduction. One of the things that has jolted me for years is that you can deduct an abortion, but you cannot deduct an adoption.

This was not always so. At some point over the last four decades, when our Grand Old Party was in the minority, somebody in this very beautiful chamber struck the tax deduction for adopting a special needs child. I have done research on that and I will submit it to the committee at some point, but I have been able to find out this: that when the 1985 adoption fact book was published, 1985, Federal tax law permitted up to a $1,500 deduction for adopting a special needs child. This runs a whole range of areas of needs for children, but let's say a Downs syndrome child. This deduction was then repealed and efforts to include any deduction and deductions for all types of adoptions have stalled in Congress after Congress.

Now, I hesitate to claim that it was all buried in the abortion debate, but I asssume the liberal reasoning was that by having a tax deduction for the adoption of any child, people would always want the perfect child and therefore would not adopt the special needs child. As is the way with the Ways and Means Committee driving economic and social policy, they said, if we only give the deduction for special needs children, that will up the adoption rate for special needs children and that will take it away for the other.

But, as the years evolved, here we were with this option to encourage abortion financially, but not to encourage adoption. Absolutely absurd.

I am going to submit my statement for the record. I see that there are very few minority members here, and I can only assume that they are out trying to adopt consultants for the 1996 election cycle or something. But I wish that they would reflect upon how

peculiar it was that this foot-dragging went on on this, and point out one set of statistics in closing.

According to the National Committee for Adoption, there are 1.5 million American couples wanting to adopt. While each year there are over 1.5 million children being terminated by abortion, only 50,000 new children are made available for adoption. That means that for every fortunate couple that begins a loving relationship with a selected child, another 40 couples wait in line.

Just think of how similar those two statistics are. If every pregnant mother carried her child to term, there is a loving, waiting couple there to nurture that child into adult life and provide who knows what spectacular benefits to the United States of America.

When I was asked by those forming the Contract With America for my suggestions, an adoption tax credit was it. I suggested a $1,500 exemption; we are now properly up to $5,000. Most adoptions cost between $8,000 and as high as $20,000, and I have only, to all of our Members, majority and minority, to point out the uplifting and sometimes very tragic stories of Americans going to a collapsing Romania, a tragic Russia, adopting children, anywhere in the world to bring them back to this Nation and raise them as American citizens.

This is one tax issue that has waited a long time to come to fruition; I pray for victory.

[The prepared statement follows:]

Testimony of Rep. Robert K. Dornan

House Ways and Means Committee

Adoption Tax Credit

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Mr. DORNAN. Thank you, Mr. Chairman and members of the committee. It is a pleasure for me to be here today to talk about the importance of including tax relief for adoptive families through the Family Reinforcement Act.

The expenses associated with adopting a child, whether domestically or internationally, have escalated dramatically in the past decade. In fact, despite a lack of research in the area of adoption, we know that some adoptions can cost upwards of several, if not tens of thousands of dollars. This is an overwhelming financial burden for families considering adoption.

As a result, many prospective adoptive parents have to work two or three jobs or take a second mortgage on their home just to pay the bills associated with an adoption. And many low-to middle-income childless couples, no matter how hard they try, are simply incapable of absorbing the exorbitant costs of adopting a child -- not to mention adopting more than one child. Along with the emotional stress of being infertile or otherwise incapable of having a child of their own creation, they must face the reality that adoption is possible only for those who can afford the long list of expenses. Unfortunately, our tax code offers no relief for these couples, many of whom end up in severe financial debt simply because they long to become parents.

Just as families who give birth to a child may receive tax relief for some medical expenses, adoptive families need to be relieved of some of the financial burdens associated with their child's adoption through meaningful tax legislation. That is why it is so important for Congress to enact this legislation that includes tax relief in the form of a $5,000 refundable tax credit for adoption-related expenses. This is a relatively small investment that will give thousands of children the security of a caring home.

For years, adoptive families have been looking to Congress for leadership on this issue. During the past two congresses I have myself introduced similar legislation so that adoptive families could receive some financial relief. I am hopeful that with dynamic new leadership in the House, we can finally facilitate the "adoption option," as so many like to call it. This much-needed provision will go a long way toward making adoption an affordable choice for thousands of America's families.

Thank you again, Mr. Chairman, for giving me the opportunity to testify today. In light of the many couples wanting to provide a loving home for children waiting to be adopted, I am very grateful to the Republican leadership for including this in the "Contract with America."

Chairman ARCHER. Thank you for your testimony.

Our next witness is the Honorable Chris Smith from New Jersey.

Congressman Smith, we would be pleased to hear your testimony.

STATEMENT OF HON. CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. SMITH. Thank you very much, Mr. Chairman.

First, I would ask that my full testimony be made a part of the record.

Mr. Chairman, I would like to thank the committee for holding this very important hearing and inviting me and my colleagues on this matter that is critical to helping middle-class families, and especially kids—the adoption tax credit.

As you may know, I have been a very strong advocate of the loving option of adoption since coming to Congress in 1980. I have authored and cosponsored a number of adoption bills that would have provided tax credits or deductions for adoption expenses. Most notably, I have introduced in the past two Congresses what we call the Omnibus Adoption Act, a comprehensive bill that would create and reform a number of adoption-related services, including maternity homes and maternal health certificates, graduate education on adoption issues, and a national data collection system. In fact, the adoption tax credit provision of the Family Reinforcement Act was taken directly from this Omnibus bill.

I would also point out, parenthetically, at times we had in excess of 100 Members from both sides of the aisle who were cosponsors. In previous years, I have been before this committee, asking that this legislation be enacted; and unfortunately, that never came to fruition; but thankfully, we are on the verge of doing that.

Mr. Chairman, according to the National Council for Adoption, Americans adopted 51,157 children in 1986. Other sources suggest that by 1993, approximately 56,000 children were adopted in that year. In addition, the latest figures available show that approximately 6,500 foreign-born children are adopted by Americans annually. This number reflects an increasing trend toward foreign adoptions because children simply are not available in the United States.

Despite these recent incremental increases, Mr. Chairman, adoption as a whole is down. Only 25 years ago in 1970, Americans adopted 89,200 children, yet in the same 25-year period, the number of out-of-wedlock births has steadily increased and the number of children in foster care reached a staggering 407,000 children in 1990, nearly a 50-percent increase since 1985. According to the American Public Welfare Association, these children account for 99 percent of the population that is dependent in this country.

Mr. Chairman, according to the National Council for Adoption, approximately 5 percent of all unmarried teens place their child for adoption. Let me say that again. Only 5 percent of all unmarried teens place their child for adoption, while about 40 percent abort their child and 45 percent choose to parent their child.

In like matter, a 1982 study by Dr. Christine Bachrach indicates that only 6 percent of all babies born to all unmarried American mothers were placed for adoption. So that the data is about the

same, 5 to 6 percent of unmarried mothers put their children up for adoption. That study also showed, however, that this breaks down dramatically—there is a very modest number of people who are actually putting their children up for adoption—breaks down dramatically according to race, with black mothers placing their babies for adoption only 0.4 percent of the time, while white mothers place their children a little over 12 percent. Unfortunately, while black children constitute about 14 percent of the child population in America, they account for more than 30 percent of the children in foster care and more than 38 percent of the children that are awaiting adoption.

Clearly, Mr. Chairman, there are needy children that are out there waiting to be adopted.

Meanwhile, as my friend Mr. Dornan pointed out, there are between one and one-half and two million couples who would like to adopt, but very often they are encumbered by the fact that the up-front cost of the adoption is too cost prohibitive.

Let me also point out that these families would like to adopt children with AIDS, with terminal illnesses; children that have Downs syndrome and spina bifida.

Mr. Chairman, the concept of the adoption tax credit is very simple. Middle-class families could receive up to a $5,000 tax credit to offset the up-front, one-time adoption expenses. The credit is means tested so that families earning between $60,000 and $100,000 would receive a partial credit.

The tax credit will bring children and families together. The costs are relatively small, but the benefits are limitless.

The Republican staff of the Budget Committee last year estimated that the adoption tax credit would cost about $900 million over 5 years; a modest price for helping to bring homeless children and loving parents together. In return for our relatively small investment, Mr. Chairman, thousands of children could have the opportunity to live with the security of a caring family, and thousands of families would be able to afford opening up their loving homes to these needy children. Unfortunately, and I repeat, the only obstacle to many of these families and these children getting together is the up-front expenses of the adoption.

Let me just also point out, Mr. Chairman, that no one suffers more than the innocent child because of the financial hurdle that this current situation places on these families. These children are kept out of these homes simply because of these up-front costs.

Let me also point out, Mr. Chairman, because I know my time is coming to an end, that evidence suggests that the benefits of adoption to all concerned, including the birth mother, are overwhelmingly positive. In fact, some research indicates that those women who do choose to make an adoption plan for their children will be less likely to live in poverty, more likely to complete high school, and less likely to have additional unplanned pregnancies. We must provide Federal support for these pregnant women and all pregnant women who lack the means to pay for prenatal and maternity health care, and that is something I think this committee needs to look at, as well.

Mr. Chairman, there has been editorial support for this. The Boston Globe recently chimed in very strongly in favor of this adoption

tax credit. It is an idea that has not reached the floor in the past. Again, it is an idea that had bipartisan support, but did not get the push from the chairman and from others to make it to the floor, so it would be enacted into law.

I thank you. I thank you strongly personally for your leadership in helping to make this a possibility and to make it a reality in the very near future.

[The prepared statement and attachment follow:]

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Congress of the United States

House of Representatives

Washington, DC 20515-3004

Testimony by Rep. Chris Smith
Before the Ways and Means Committee
on The Family Reinforcement Act
January 18, 1995

First, I'd like to thank the Committee for holding today's hearing and inviting me to testify on a matter critical to helping middle-class families -- the adoption tax credit.

As many of you know, I have been a strong advocate for the loving option of adoption since coming to Congress in 1980. I have authored and cosponsored a number of adoption bills that would have provided tax credits or deductions for adoption expenses. Most notably, I have introduced in the past two Congresses the Omnibus Adoption Act -- a comprehensive bill which would create or reform a number of adoption-related services, including maternity homes and maternal health certificates, graduate education on adoption issues, and a national data collection system. In fact, the adoption tax credit provision of the Family Reinforcement Act was taken directly from my Omnibus bill.

According to the National Council for Adoption, Americans adopted 51,157 children in 1986. Other sources suggest that by 1993, approximately 56,000 children were adopted per year. In addition, 6,500 foreign-born children were adopted by Americans in 1992. This number reflects an increasing trend to look towards foreign adoptions.

Despite these recent incremental increases, Mr. Chairman, adoption as a whole is down. Only twenty-five years ago, in 1970, Americans adopted 89,200 children. Yet, in that same twenty-five year period, the number of out-of-wedlock births has steadily increased and the number of children in foster care reached a staggering 407,000 in 1990 -- a nearly 50% increase from 1985. According to the American Public Welfare Association, these children account for 99% of the population of dependent children in the U.S. The National Council for Adoption estimates that only 10% of the children in foster care will eventually be placed for adoption.

According to the National Council for Adoption, Mr. Chairman, approximately 5% of all unmarried teens place their child for adoption, 40% abort their child, and 45% choose to parent their child. The remaining pregnancies end in miscarriage.

A 1982 study by Dr. Christine Bachrach indicates that only 6% of all babies born to all unmarried American mothers -- of all ages -- were placed for adoption. Dr. Bachrach further determined that this number breaks down dramatically by race, with black mothers placing their babies for adoption 0.4% and white mothers 12.2%. Unfortunately, while black children constitute about 14% of the child population, they account for more than 30% of the children in foster care and more than 38% of the children awaiting adoption.

Clearly, there are needy children out there waiting and hoping to be adopted.

Meanwhile, an estimated one to two million infertile and fertile couples and individuals want to adopt children. And these loving couples and individuals are waiting by the listful to adopt children regardless of race; children with terminal illnesses, like AIDS; and children with special medical needs, like Downs Syndrome and Spina Bifida.

Mr. Chairman, the concept of the adoption tax credit is simple. Middle class families could receive up to a $5,000 tax credit to offset up-front, one-time adoption expenses. The credit is means tested so that families earning between $60,000 and $100,000 would receive a partial tax credit. The tax credit will help bring children and families together.

The costs are relatively small; but the benefits are limitless. The Republican staff of the Budget Committee last year estimated the adoption tax credit would cost $900 million over five years -- a modest price to pay for helping to bring homeless children and loving families together.

In return for our relatively small investment, Mr. Chairman, thousands of children could have the opportunity to live with the security of a caring family. And thousands of families would be able to afford opening up their loving homes to needy children. Unfortunately, all too often, the only obstacle to getting these families together is the up-front adoption costs.

For instance, when a family with an already-tight budget is faced with the average cost of more than $14,000 to adopt just one child, up-front finances become an insurmountable hurdle. In fact, it is not altogether uncommon for these costs -- which often include prenatal care for the birthmother and child, counseling for the adoptive families, and legal fees -- to reach more than $25,000. [I have attached to my testimony, a copy of the average costs for domestic and international adoption as reported in the National Council for Adoption *1989 Adoption Factbook* for a detailed list of these expenses.] While these families have a wealthy reserve of love and can meet the monthly costs of raising another child, the one-time, up-front fees have often proven prohibitive to the rest of the process.

Mr. Chairman, no one suffers more than the innocent child because of this financial hurdle. But society suffers as well when we neglect our responsibilities to our children. And children without families are all of our responsibility.

There can be little doubt that a child who grows up in a stable family environment can be a more productive, healthy adult. Congress -- to its credit -- has long recognized this relationship and supported means to reach this laudable end. Immunization programs, lunch programs, and Head Start are all fine examples of how we try to help enrich the lives of our children. Now it's time to take care of the most basic of needs and help parentless children move into homes.

Adoption is truly a loving option. Evidence suggests that the benefits of adoption to all concerned, including the birth mother, are overwhelmingly positive. In fact, some research indicates that those women who do choose to make an adoption plan for their children will be less likely to live in poverty, more likely to complete high school and less likely to have additional unplanned pregnancies. We must provide federal support to these pregnant women and all pregnant women who lack the means to pay for prenatal and maternal health care.

Mr. Chairman, adoption also provides a child who might otherwise face a bleak or less than positive childhood the prospect of having loving parents, a stable home, a higher standard of living, and enhanced career opportunities as the child matures into adulthood. In fact, according to the 1982 National Survey of Family Growth, only 2% of adopted children lived in poverty compared to almost 62% of children living with mothers who have never been married. A study in the *Journal of Personality and Social Psychology* in 1985 by Kathlyn Marquis and Richard Detweiler noted that adopted children frequently enjoy more socio-economic advantages than those raised by their unmarried birthmothers. We must make it easier for these children to find families.

The *Boston Globe* noted on January 3, 1995 in its editorial supporting the tax credit provision of the Family Reinforcement Act that Congress needs to move affirmatively in this regard. *The Globe* said and I quote:

> "The credit also signals that the federal government is serious about promoting adoptions, just as tax deductions for charitable giving and mortgage interest indicate support for gift-giving and home ownership."

Mr. Chairman, I have been dedicated to this much-needed proposal for years and know that I have been joined in this regard by hundreds of my colleagues from both sides of the aisle. I was pleased that the Republican leadership recognized the importance of this proposal and included it in the legislative agenda of the first 100 days. I urge support for this proposal and would like to briefly address one additional topic.

I would also like to take this opportunity, Mr. Chairman, to express my support for the eldercare tax credit provision in the Contract with America. Again, this is a proposal which I have long supported. As society ages, more and more families will have to face the difficult questions of how to care for aging relatives. Currently, 12.5% of our population is aged 65 and older. By 2030, when the baby boomers peak as seniors, fully one-fifth of our population will be aged 65 and older.

Many aging adults, particularly those suffering from Alzheimer's and other dementia, cannot lead a quality life without assistance. And this assistance is often more than seniors' housing communities can offer. These seniors need full-time individualized care such as can be received in a nursing home facility or at home. In fact, last year, the Alzheimer's Association reported that more than one-half of all working Americans have either provided long-term care for their friends or relatives or believe that it will be likely in the future.

Keeping your aging parents in your home has other advantages as well, for your children and your family as a unit. Older Americans have a wealth of experience and knowledge to share with their younger relatives and friends. Children can only benefit from the cohesion which the presence of an extended family offers.

But, as in adoption, it is often a highly prohibitive cost which prevents a family from this loving option. The $500 eldercare tax credit can go a long way toward this worthy goal.

I look forward to working with you to assist families, children, and their elderly relatives in forming loving and stable relationships. You can count on my active and wholehearted assistance in gaining swift approval of these family friendly proposals.

Domestic Adoptions

Core Costs:

Maternity home care for birthmother @ $40-80 per day (3 months of pregnancy and 10 days post partum)		$5,000
Normal prenatal and hospital care for birthmother and child		5,000
Preadoption foster care for infant		600
*Counseling for adoptive parents (20-40 hours of home study and post placement supervision @ $30-70 per hour)		2,400
Legal fees		1,000-1,400
	TOTAL	14,000-14,400

Special Considerations:

Cesarean Section		additional 2,000
	TOTAL	16,000-16,400
Interstate Adoption		additional 500
	TOTAL	$14,500-14,900

International Adoptions:

*Counseling for Adoptive Parents (home study and post placement supervision)		2,400
Legal fees		1,000-2,400
Travel		1,500-5,000
Fee to foreign agency		2,000-3,000
	Additional TOTAL	$6,900-12,800

*For each couple who is approved for adoption, the agency must do a home study for 1½ couples.

Chairman ARCHER. Thank you for your input.

Our next witness is the Honorable Barbara Vucanovich from Nevada. We would be pleased to hear your testimony.

STATEMENT OF HON. BARBARA F. VUCANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEVADA

Mrs. VUCANOVICH. Thank you very much, Mr. Chairman.

Mr. Chairman and members of the committee, I appreciate your allowing me to be here today to speak in strong support of H.R. 11, the Family Reinforcement Act. Today, America's families are facing their greatest crisis. Everywhere you turn, there is something discouraging the family unit. Our past policies have failed our families and our children. We need to redirect our efforts and construct a policy that strengthens and encourages the family. This is where America's future lies.

H.R. 11 is significant. It is much-needed legislation which provides refundable tax credits for adoption expenses, as well as caring for elderly family members. It takes a strong first step in aiding an already overburdened and overtaxed middle class that cares for two segments of the population that seem to be easily overlooked—children and seniors.

H.R. 11 includes a $5,000 refundable tax credit for adoption expenses. If we are to work to strengthen the American family, then helping lower and middle-income families adopt should be addressed. The expense of adopting a child has eliminated the possibility of these families adopting, yet these income groups comprise the largest percentage of our population. Our refundable tax credit offers all parents a chance to enrich their lives and the lives of needy children.

Parents choosing natural childbirth usually have health insurance to help them financially. Adopting a child does not mean the costs are any less. Instead, in most cases, the costs involved are substantial. The adoption tax credit provision contained in H.R. 11 is a significant step in encouraging couples of all income levels to adopt children.

I have a valued friend who is raising two adopted children, now in their teens. He and his wife are wonderful parents and have raised their children to be intelligent, thoughtful, and well mannered. They will grow up to be assets to our society. However, he has often commented on the expense of adopting. At the time, he and his wife were just making ends meet financially, and they struggled to bring these children into their home. Detailed testimony of his personal experiences with adoption will be inserted as part of the record. I would urge all of you to read his story.

An adoption tax credit such as the one proposed in H.R. 11 would have greatly benefited this family. Those who are willing to sacrifice so much should not be financially penalized. Families such as these are the foundation of our society.

H.R. 11 also includes a provision for a $500 refundable tax credit for families who care for an elderly parent or grandparent in their home. We are a nation that is seeing its population growing older, and we are facing the largest population of seniors ever in our history. Unfortunately, out of financial necessity, many families have

to place their loved ones in retirement homes. It is wrong when we encourage families to place elderly family members in retirement homes because the costs are paid by Medicaid, yet we do nothing to help a family that wants to stay together.

Later this afternoon, you will hear testimony from Nancy Summerfield of Reno, Nev., about how she cared for her mother with Alzheimer's disease in her home. She sacrificed personally, professionally, and financially. We should do what we can to assist everyone like Nancy who made the tough choice to keep her mother with the family.

Although this tax credit will not automatically solve every American's cost problem, it is a significant step in recognizing the needs of many American families. Encouraging elderly parents to stay in the home benefits all generations. At a time when family values are increasingly important, this tax provision will be beneficial to all Americans, not just the taxpayer.

As the team leader of the working group charged with producing profamily proposals, I have worked to develop this bill since its inception. H.R. 11 recognizes the need we have in society to keep our families strong. If we can keep our families intact, we strengthen the future of America. A strong America will lead to a brighter future for everyone.

Thank you very much, Mr. Chairman, for the opportunity to testify.

Chairman ARCHER. Thank you for your testimony, Mrs. Vucanovich.

Our next witness is the Honorable Stephen Buyer.

We welcome your testimony, and are pleased to have you with us this morning.

STATEMENT OF HON. STEPHEN E. BUYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BUYER. Thank you, Mr. Chairman. I would like to congratulate you on your rise to the Chair. I also appreciate the accommodation, testifying here on the $500 tax credit, when I was unable to testify yesterday, and I appreciate that.

Mr. Chairman, American families are in fact hurting as we seek to bring family tax fairness to the Tax Code. I believe the families have shouldered the brunt of the unfair Tax Code, which continues to take more money from their pockets, leaving less for families.

In my hometown of Monticello, Ind., and across northern Indiana, people continue to ask that government work for them, not against them. Mr. Chairman, I am always careful not to judge—whether it is your district or, likewise, any of my colleagues' districts—but not to judge the dimension of America through my own district. But I recognize that working families do need tax relief. They deserve the peace of mind which comes from knowing that the government is on their side, delivering on promises made. Mr. Chairman, I believe that this is a historic opportunity to do just that.

I stand before you, sitting here, in unwavering support of the $500 per-child tax credit for American working families. American families feel, and rightfully so, that their government is working against them, not for them.

I referred earlier to an unfair Tax Code due to the inequities that have not been addressed over the years. Over the past four decades, the Federal tax burden on a family of four has increased by over 300 percent. In fact, in 1950, only 2 percent of a family's income went to Federal taxes; today, 25 percent. When it is all said and done, local, State, Federal taxes take an average 38 percent of the families' income.

Mr. Chairman, the 1993 budget included one of America's largest tax increases. Current policies of this administration will create additional costs and increase taxes to my district in Indiana by over $1,500 per person. My district felt the jolt of these tax increases as much as anyone. In fact, the fifth district of Indiana saw income, Medicare, and the State tax increases cost residents over $126 million, and the gas tax increase took almost $78 million out of their pockets; and that is not counting the Social Security tax increases and the marriage penalty. I believe it is a sad statement that Hoosier families in my district now spend more on taxes than they spend on food, shelter, and clothing combined.

The $500 per-child tax credit is true middle-class tax relief that helps scale back the heavy burden imposed on families. Hoosier families need this tax relief, like many across America. Almost 130,000 children in my congressional district alone would be eligible, with an annual dollar value of almost $65 million. While there are some who seek to discredit this proposal of including $500 per-child tax credit of those earning less than $200,000, this tax credit will benefit over 51 million children; 45 million of these earn—belong to families that earn less than $75,000 per year. That means 90 percent of this tax credit will benefit hard-working families. The Contract With America proves that we are standing up for children and fighting for working families.

Earlier you mentioned your being a father. I am not a grandfather, but as a father of two, Mr. Chairman, I know very well the cost also of raising a family, like many of you. The two-income family is now at an all-time high in our country. The spouse who might otherwise stay at home is now instead supplementing the family's income just to make ends meet. No longer is a second income a luxury; it has become a necessity.

The fifth district of Indiana, which I represent, the rural, the economy is largely dependent on agrabusinesses, services, manufacturing, and small business. The median income is less than $28,000. The per capita income is around $12,000. Simply put, my district is middle-class America and the heartland of America. The $500 tax credit means that nearly $25.5 billion annually will remain in the hands of parents across this Nation to spend or save as they see fit. It enables a family of four to have $80 or more every month for groceries, school clothes for their children, or savings for education. This empowers families to make more of their own choices.

Since November, there has been one trial balloon after another on tax credits and changes in the Tax Code. I believe the family is the foundation of our society, Mr. Chairman, and it is my best judgment that we must start at the foundation and a $500 working-family tax credit is the best place to begin.

Thank you so very much.

Chairman ARCHER. Thank you for your testimony.

Our next and last witness on this panel is the Honorable Jerry Weller.

We are pleased to have you before the committee and pleased to receive your testimony.

STATEMENT OF HON. JERRY WELLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. WELLER. Well, thank you, Mr. Chairman, members of the committee. Thank you for inviting me here today to testify in strong support of H.R. 11, the Family Reinforcement Act, of which I am a chief sponsor.

Families in my district and American families across the Nation feel that they are under siege from a government that has grown unresponsive and, in fact, antagonistic to their day-to-day struggles. We, in Congress, must act quickly and decisively to restore, encourage, and protect this most basic unit of our society.

H.R. 11 is important legislation that provides much-needed tax relief to poor and middle-income Americans who work feverishly to keep their families intact. The bill incorporates refundable tax credits for adoption expenses and in-home care provided to elderly family members.

For years the extreme costs associated with adoption and in-home care have gone unnoticed by Congress. The burden has landed squarely on the shoulders of honest, hard-working Americans who have made the conscious decision to place the needs of family above their own desires. We have the chance, by enacting H.R. 11, to send a clear message that we respect these decisions and want to enable others to do the same.

H.R. 11 includes a $500 refundable tax credit for families who provide in-home care for a disabled parent, grandparent, or spouse. As the population of our Nation is growing older, the need for this credit is increasingly urgent.

For instance, one of my constituents, Patti Overight of Burbonnais, Ill., would have benefited from this provision. Patti's mother, who has suffered from Alzheimer's disease for 10 years, and her husband required daily care. Consequently, Patti would travel multiple times each day to care personally for the couple. The time and cost involved left Patti and her family financially and emotionally strapped.

Another constituent, Eileen Johnson of Minooka, Ill., has her grandmother, who suffers from dementia and is bedridden, living with her and her family. The cost of having her grandmother live with her is borne by Eileen in the form of inflated electric bills, which are a result of special health care equipment, supply costs, and medication costs.

The elder care tax credit would provide some long-overdue tax relief to Mrs. Overight, Mrs. Johnson, and the numerous other families who are caring for ailing family members. According to the Congressional Research Service, in-home care may reduce current expenditures made through Medicaid and the Medicare expenditure deduction.

As I have already suggested, H.R. 11 also includes a refundable adoption expense tax credit. This dollar-for-dollar credit to offset

expenses up to $5,000 is phased out for taxpayers whose adjusted gross incomes are from $60,000 up to $100,000.

The adoption tax credit will help many couples who cannot have children biologically, but are also unable to afford the cost associated with adopting a child. David and Mary Przybylski of Frankfort, Ill., are a working-class couple who felt strongly that they wanted to provide a loving environment to children who would have no opportunity to escape the orphanage life they had been living. They saved for years so they would have the money necessary for all the expenses involved and their desire to adopt three Polish orphans. While they were successful in their efforts, the cost incurred by David and Mary totaled about $25,000. To meet this excessive cost, the Przybylskis were forced to borrow from their families and are still paying them back.

David and Mary do not hesitate to say that they would do it again, but the adoption tax credit, H.R. 11, would go a long way to help loving couples like them who are eager to adopt children. Moreover, the extent to which the tax credit provides homes for children in State programs should reduce State foster care costs.

Mr. Chairman, thank you once again for allowing me the opportunity to testify in support of this historic legislation that is an important step to restoring our commitment to America's families.

Chairman ARCHER. Thank you for your testimony, Congressman Weller.

Mr. WELLER. Thank you, Mr. Chairman.

Chairman ARCHER. It is my understanding that none of my Republican colleagues have asked to inquire. There may be one or two inquiries on the Democrats' side.

If I might, I would like to ask any Democrats that wish to inquire to raise their hand.

Three. So we will take you in order. Charlie Rangel will inquire.

Mr. RANGEL. I want to thank those Members that have taken time out to testify on behalf of the refundable tax credit to encourage and make it easier to adopt. Obviously, the only one left is Bob Dornan, and I would want him to tell his colleagues that the lack of questions certainly does not indicate a lack of interest. I hope perhaps we can get together and see how many other people, in view of all the complexity involved in this Contract, can get together and make certain that the kids are not forgotten; and two, I want to thank you, Bob Dornan, for the passion that you bring to this issue—and probably most other issues, some that I disagree with. But those that I do agree with we won't mention because it would hurt my reputation, as well as yours, for people to know this.

But I do want to state for the record, it is so important that we as a nation, as a civilized nation, try to bring human beings together, especially to remove the stigma of adoption. The only people who have no feeling at all about the stigma are the adoptive parents who have forgotten completely that their children were adopted, and of course, the children themselves that were the beneficiaries of this type of love, knowing that they were selected, even as other children were not expected. So to make it easier for people to get together to love is certainly something that falls right into the family value concept.

Congressman Smith touched on the subject of at-risk children and hard-to-place children, and unfortunately, I have to really study these terms, because they mean me and people who look like me. I would want you to know that as we look at the problems of adoptability that one of the major problems that average Americans have is that the children who are placed for adoption come from communities where most of the people around them can't afford to adopt; and two, the unwanted children come from communities that, if you take a look at it and forget black and white, are the areas of the highest poverty, the highest unemployed, the highest high school dropout, the highest drug addiction, the highest crime, the highest violence, and the highest number of people who go to jail. So there is no wonder why the children are at risk or hard to place.

I hope that we, Bob, can work together to alleviate those conditions and to use, not tax credits for the problems we face in our community, but to use education credits to make certain that these kids have hope that they don't have to have children in order to have expectations in America.

If you take a look at the kids from these communities that are employable, that are working, they are not making the babies, they are not doing the drugs, they are not doing the violence. So we can create an atmosphere where, just like family values say, kids say, I can't mess around because it would ruin my life. If they have no life expectations to ruin, then the question is, what difference does it make?

In working with you over the years, Bob, I know that you understand exactly what I am talking about. I know it is consistent with your views, and I want you to know I support 100 percent the legislation you and others have sponsored over the years. I hope I can depend on you to interpret to other Members what they really mean when they say at-risk and hard-to-place children. Thank you, Mr. Chairman.

Mr. DORNAN. Mr. Chairman, could I respond to my colleague?

Chairman ARCHER. Yes.

Mr. DORNAN. One of the reasons I have gotten along so well with you, Mr. Rangel, over the years is you know I sincerely mean it when I say you are the preeminent voice on Capitol Hill and across America on fighting back against the scourge of drugs in our country and what it has done to literally turn some neighborhoods into what would more properly resemble a war zone.

Your excellent remarks give me an opportunity to discuss a statistic buried in the statistics that I and Mrs. Vucanovich and Mr. Smith have used that really shows the literal potential to turn around some of the social problems in our country by adoption, and why it is truly an investment in the future of our country; and it has to do with families and young children born of African-American heritage. In one of these studies—and unfortunately, all the studies on adoption are not really current; they are not the last 2 or 3 years. This one is over 10 years old. It says that as you break down the numbers of 5 to 6 percent of unmarried teens placing their children for adoption, you see a dramatic difference by race. African-American young mothers place their babies for adoption at less than 1 percent—far less, 0.4 percent—and with white

mothers, 10 years ago, it was 12.2. Again, I don't know how that is skewed by those of Hispanic heritage or not.

Unfortunately, black children constitute 14 percent—again, this is 10 years old—of the child population; probably more now. They account for 30 percent of the children in foster care and more than 38 percent of the children awaiting adoption. Well, as a grandfather of nine and a father of five, I can tell you that in my family, if we had had the opportunity to adopt—and we did try to go for a number six and were told the odds are impossible against you because you interfere with childless couples who are dying for their first child. Among my five, I had four redheads and a brunet. I can tell you that if that brunet were an adopted child of African-American heritage, he would have blended into my family equally as well as my brunet trying to be raised with four redheads.

When I would go to the beach, I am lathing on sunblock on the four redheads and my brunet is running in, getting a nice tan. I think we are going to have to push, push, push for Americans of Caucasian heritage to adopt black children. Otherwise, it becomes a heart-breaking situation—particularly older children 2, 3, 4, up to 12 years of age where parents come in and the white children are adopted out and the black children are left heartbroken.

We are going to have to resolve this problem, and it seems so sad that the first step we have to take is to give a small tax break, even one that seems big of $5,000, when the expenses are sometimes $20,000 or more.

Let me just conclude by saying, a few months ago, I am at a soccer game for one of my grandkids in San Juan Capistrano. Here is a beautiful 4 year old watching her brothers who were stars of one team. I said, What a beautiful little girl; what is her name? They said, Alexandra. The mother says, I adopted her on my birthday in Russia, this gorgeous little Alexandra. I thought, with all the American children that need to be adopted, this poor mother had to go into Russia to get this beautiful little girl.

That one story, as I listened to it, tells the whole tale of why this tax exemption is so needed. We can't have Americans running to this hell hole of a situation that exists in Romania after the Communist collapse there and have these little American children just wasting away, craving for love, in our homes around this country.

Let's you and I work together on it, Mr. Rangel.

The CHAIRMAN. The gentleman's time has expired.

Mr. Jacobs.

Mr. JACOBS. Thank you. Chairman Archer and I have some things in common. First of all, we do not take PAC contributions. Second, we both complete and submit our own income tax returns, as you do. Third, we are both either from Texas or Indiana, which I want to mention in the case of Steve Buyer. Thank you for coming.

Bob, I just wanted to say for the record, I take a great deal of pride in having cast a vote against the 1986 tax act for a number of reasons. I will only mention two. One is that somebody from some network came in—I guess he may have interviewed Bill, too; I don't know—interviewed the members of the Ways and Means Committee who made out their own taxes. His first question to me

is, Don't you find it awfully complicated? I said, It was no problem at all until they simplified it in 1986.

But the most egregious offense, it seems to me, in that so-called Tax Reform Act—it was precisely that Act that repealed the provision you are talking about. I considered that an unqualified outrage. The motive for it was that a nun with her rosary beads wouldn't have been safe that last night when they were trying to make the numbers work for a 28-percent marginal rate. Everything went over the side for it. I would hope that all of us would take a closer look at that, because that was clearly a case of getting the cart before the horse. I commend your concern about this.

I might add that when President Bush was elected, I was standing in my workshop out in Indiana, and I listened to his first news conference. One of the first things he said was that he wanted to restore this exemption.

Bob, that was beautiful.

That is all.

Chairman ARCHER. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. I want to thank all my colleagues for their testimony this morning. I regret that their schedules prevented several of them from staying here for questioning. As has been pointed out by Mr. Ford, there is bipartisan support for the credits concerning adoption and custodial care, and Democrats and Republicans look forward to working together in order to advance these proposals.

I would like to make just a couple observations, and I welcome any comments from our colleagues.

There is an anomaly that we confront. There are more parents who want to adopt than there are children available for adoption. The only exception for this is hard-to place children. The previous provisions that were in the code recognized that fact and provided special help for difficult children because of their physical conditions or other problems of age, et cetera. I would hope that as we look at this particular provision, in establishing a new entitlement in the code, that we look at trying to make sure that the relief goes to provide the best benefit for those children who otherwise would find it difficult to be adopted.

The second point I would just like to make—and I welcome your comments—is that I find it somewhat ironic, that as we are looking at this total tax provision and establishing new entitlements for custodial care and adoption, which I fully support, which will provide an entitlement for families with income up to $172,000, we are eliminating the entitlement program that is most important for low-income people, AFDC.

Many of us understand that welfare needs to be reformed, but in the process, the recommendation is to eliminate AFDC as an entitlement program. Yet we are creating new entitlement programs here for adoptive care and custodial care. We should be working to establish entitlement programs for our poor people as well as middle-income people.

Mr. DORNAN. I wouldn't want to play one off against the other. I have to admit my concentration has been on this, not on the other; and that is why we are all here, I guess, to work this out. This one literally screams out to be revisited and brought back into

our House code. I hope on the House floor we don't play one against the other but argue each on its separate merits.

Mr. CARDIN. Bob, I agree with you completely. I don't want to play one group off against the other.

It is somewhat disappointing that the recommendation is to eliminate an entitlement for the poor and create a new entitlement here today. That is one of the issues I hope we can work on, Republicans and Democrats, and come forward with proposals that are fair to all Americans.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Chairman, for appearing before the committee.

Mr. MCDERMOTT of Washington. Mr. Chairman.

Chairman ARCHER. I am sorry, Jim; I didn't see your hand up. Dr. McDermott will inquire.

Mr. MCDERMOTT. Like Mr. Cardin, I regret that some of the Members who testified didn't stay, because I think you raise some very interesting issues.

Like Ben, I see some real ironies because many Members who are here testifying today were voting against the family leave bill several years ago—which is a bill to deal with the issue in many families of taking care of a family member. When we proposed in this committee a $400 elder care tax credit in 1991, it was laughed off as too little by the other side. So we add $100, and it is now OK.

But I think there is a deeper problem here than those ironies, and Ben alludes to it. When I was a freshman in the Washington State legislature in 1971, I passed a bill for an adoption subsidy for people who were adopting hard-to-place kids, which we defined as mentally handicapped, physically handicapped, or mixed racially. If you could demonstrate to the State that you had a cost above those costs of normal child rearing—because nobody gave me $5,000 when I had my two kids—so if you could justify costs above the normal cost of raising a child, the State would subsidize that. To me, that makes sense; that is the kind of specific program I could support.

The proposal here is just to fire up in the air a couple billion dollars and hope it comes down on the right people, and in my view, that is not a good way to use the taxpayers' money. I really—the question I have, and I keep asking myself is—if you are going to deny welfare to young women under the age of 18, what do you think the impact of that will be? Will that drive them to abortion or to put the children up for adoption? What do you think the impact of that particular part of the Contract With America is?

You are going to take welfare payments away from young women under 18 who have a child. Is the effect that they will give it up for adoption, or are they going to say, I can't pay for this so I am going to get an abortion? Which do you think will be the effect of that public policy? Because when you socially engineer from the Congress, you have to have some idea of what you are trying to create out there.

Mr. BUYER. I would say to the gentleman we are trying to create a stronger family base, stronger family unit. We know doing it your

way over 40 years of social engineering has created an atmosphere which has not been conducive to the American family.

When you say about doing a shot in the air, what we are trying to do is much narrower focus, whether it is taking nutritional programs in the welfare plan—we are not here on the welfare program. If you are throwing this up in this discussion, whether it is trying to take our 10 nutritional programs and send them back to the States, bringing—bringing government, whether it is to the States and to local communities, we want to not only empower local governments, but we also want to give—empower people and parents. So that is why I came here to testify on the $500 tax credit, and what it does to working families.

If you want to get into a discussion of, well, if—in fact, if we do this, will this mean there will be more abortions versus strengthening of the families, I don't want to get into quibbling with you. But that is a matter of discussion.

Mr. MCDERMOTT of Washington. Thank you, Mr. Chairman.

Chairman ARCHER. The Chair recognizes Mr. Shaw for 30 seconds.

Mr. SHAW. Thank you. Thank you, Mr. Chairman. I only did ask for 30 seconds.

I just wanted to place in the record a problem that does exist and is an impediment toward adoption. It is State law that concentrates on reunification of the family, which is a noble goal. There are, however, literally thousands of kids in foster care that could be adopted if State law would try to measure the benefit to the child; that is, look primarily at the benefit of the child and the future of the child where adoption is the only logical alternative.

All of us want family reunification where it can work, but I think we need to encourage the States to expedite the procedures they go through to make the determination as to the future of these kids that could otherwise be adopted. People are going to Russia to adopt a child while knowing that there are kids here in foster care that are every bit as adoptable, and should be made available for adoption.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, both of you gentlemen, for coming and giving us your time, and for your excellent testimony and pointing out one of the very, very important provisions in the Contract With America, that is, a facilitator to create a support mechanism of love and help for children, which is probably the most important thing that we can do with our lives.

There is a true story that occurred in Houston about three little boys who were playing together, one of whom was adopted. Within a couple of hours, the other two were going home in tears. When they got home, they told their parents that they really were inferior because little Jimmy, who was adopted, had told them he was very special, that his parents picked him out voluntarily, and that the other two children's parents had no choice. I think that is a beautiful story that can occur when adoption is handled in the right way, and these children realize how very special they are because their parents chose them voluntarily. We should eliminate the monetary roadblocks that might exist to permit every parent,

every set of parents that wishes to adopt, the opportunity, economically, to adopt every child that is up for adoption.

Thank you very, very much.

Mr. DORNAN. Thank you, Mr. Chairman.

Chairman ARCHER. If our next panel would please take their seats. I want to announce a change in the committee, a change in the normal way that we proceed.

Two of the witnesses on our panel have asked that they not be filmed or photographed during their testimony in order to preserve their privacy and that of their child. I feel that it is essential that we accommodate them. So without objection, we will receive the testimony of the other members of the panel and go through their questioning period; and thereafter, we will take the testimony of Doug and Valerie, adoptive parents, separately so that the pool camera can be removed from facing them head on.

If the three witnesses will take their places, and our colleagues.

At this time, I would like to call on our colleagues, Dan Burton and Deborah Pryce, to introduce our first witness, who really is no stranger to any of us in this room, I am sure. But since he is from your area of the country, I recognize you to make that introduction to the committee.

STATEMENT OF HON. DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BURTON. Mr. Chairman, it is a great honor for me today, even though I don't represent Mr. Thomas' district, to introduce one of—I think, one of the finest people in this country. He is a great success story.

Dave Thomas started with nothing and has built one of the most successful businesses in the world. I think they have over 4,500 outlets now, maybe even 5,000. He started as an adopted child. He really didn't have anything to start from; he had a tough childhood, and he did it on his own. He is a real credit to the free enterprise system and himself.

He has become not only a great businessman, Mr. Chairman, but he is a great human being, as well. Many people, when they make a lot of money, become very successful, forget their roots, forget where they started. Dave Thomas has been very, very concerned about children who started like he did, children who don't have parents, children who need parents, who need adoption. As a result, he started the Dave Thomas Foundation for Adoption, and he has raised a tremendous amount of money to help in this regard.

He has several programs that he sponsors every year. One is the Three-Tour Challenge. I am a golfer, and I love that. He has the women's tour—the LPGA, the PGA, and the senior tour—play in competition. I think this year they raised over $465,000 to help in the area of the adoption of children.

He is just one of the finest Americans we have in this country. It is a real pleasure for me to be able to introduce him to you today.

Chairman ARCHER. Congresswoman Pryce.

STATEMENT OF HON. DEBORAH PRYCE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Ms. PRYCE. Thank you, Mr. Chairman and members of the committee.

I want to thank you for holding what I regard as a very, very important hearing today and it is my pleasure to cointroduce David Thomas, the founder of Wendy's International Food and international spokesman for adoption issues.

I am proud to have Wendy's corporate headquarters located in my Ohio congressional district and to be friends with many in the Thomas family. Mr. Thomas is a leader in promoting adoption. In 1990 he began an awareness program at Wendy's that included posters, tray liners, and commercials promoting the adoption of children. In addition, the corporation provides each employee a benefits package that may be used to defray the costs of adoption.

In 1992 the Dave Thomas Foundation was established to promote public awareness of adoption, and today I would like to commend Mr. Thomas for his leadership in this area and for raising the issue to this level of debate, because as many of you know, I am an adoptive mother of a 4-year-old and the issue has a very important place in my heart.

In the debate about policy and taxes, as they apply to adoptive parents, it is easy oftentimes to lose sight about whom we speak. After all, these are our Nation's children. Adoptive children come into our lives for many different reasons, but in the end, what an adopted child brings are all the joys and all the pains of parenthood. When we speak of adoption, we speak of commitment and hope and sharing. We speak of the values we, as Americans, hold most dear—the willingness to help others, birth parent and child alike at uncertain, frightening, and often difficult times; the commitment to build strong and enduring families, families that are filled with love and filled with laughter; and a choice to nurture a child and help it reach its dreams. They are, after all, our children, our Nation's children.

There are approximately 1.5 million adoptive families in the United States, equal to 2.2 percent of all U.S. families. Every year more than 60,000 adoptions take place in the United States, while another 8,000 Americans adopt an international child. By providing families a tax credit for adopting, more children will come into loving homes and loving families. There are tens of thousands of children waiting to be embraced into caring families, willing to raise them in an atmosphere of love, self-respect, and responsibility. Adoptive families are 100 percent functional, happy, and whole.

I look forward to my continuing work with Mr. Thomas on this issue so that permanence becomes the norm in all our Nation's families, and foster care and group settings should only be for transition.

As a member of the Congressional Coalition on Adoption, I look forward to working on promoting rational, caring adoption policies, and I applaud this committee for its work. At this time, I give you Mr. Thomas.

Chairman ARCHER. Mr. Thomas, you are a very popular person, because our member up here on the committee dais, Mr. Shaw, also wants to claim you as a resident of Fort Lauderdale.

Mr. THOMAS. Thank you very much.

Chairman ARCHER. I don't want him to lose out on the ability to claim you, too. We are most pleased to have you here with us.

STATEMENT OF R. DAVID THOMAS, WENDY'S FOUNDER; CHAIRMAN, DAVE THOMAS FOUNDATION FOR ADOPTION; AND CHAIRMAN, WENDY'S INTERNATIONAL, INC.

Mr. THOMAS. Thank you very much.

Thank you, Congresswoman Pryce and Congressman Burton—appreciate your being here.

Mr. Chairman, members of the committee, good morning. I am Dave Thomas and I'm here on behalf of the Dave Thomas Foundation for Adoption. I appreciate the chance to talk to you today about adoption, because it is a subject that is close to my heart. I know firsthand how important it is for every child to have a home and a loving family.

I was born out of wedlock and adopted when I was 6 weeks old. I never knew my birth parents. Life wasn't easy. My adoptive mother died when I was 5 years old, and my father remarried and moved from town to town, looking for work. But without a family, I would not be where I am today.

Right now, in America today, there are about ½ million boys and girls in the foster care system and 100,000 more are waiting to be adopted. Many of these youngsters are special needs children—they are older, they come from minority cultures, they have brothers and sisters who want to stay together, or they have physical or emotional challenges.

It takes an extra effort for families to find and adopt a special needs child. The Dave Thomas Foundation for Adoption works very hard to let people know about these boys and girls and share the success stories of those who have been adopted. We've developed special service announcements for radio and TV on adopting children with special needs. We put posters in all our Wendy's restaurants and feature special needs children who are available for adoption. You would be surprised how many calls we get from parents who want to adopt kids on these posters, and many of these potential parents don't know where to start. That is why we created a Beginner's Guide to Adoption, to help them understand the adoption process. We distributed nearly ½ million copies across America.

I really believe there is a family for every child who is waiting to be adopted in this country, but to reach this goal, potential parents need your help. We need to make adoption more affordable. The average adoption in this country costs about $9,000 or more. Most families have to pay for this alone and many simply can't afford it. That is why I support a $5,000 tax credit for parents who adopt. It is a great way for government to help build families without creating more programs. For parents who adopt a special needs child, I want to ask you to aim for even a bigger step of providing an additional $5,000 refundable tax credit.

Now, many of these kids come with special costs, like long-term counseling or extra doctor bills. I think $10,000 is a fair amount and a wise investment. I wouldn't be here today if it didn't make

sense and if it wasn't the right thing to do. We have to make adoption available to Americans who can't afford it right now.

There is another way you can help. As the largest employer in America, if a Federal Government employee has a baby, the costs of the child's birth are covered by medical insurance. Isn't it fair to cover legal or medical costs for an employee who adopts a child? For several years, I have been asking employers throughout the country, both public and private, to offer employees who adopt the same benefits and paid leave they provide for the employees who give birth. Now I am asking the same of the Federal Government.

Wendy's is one of hundreds of companies that offer adoption benefits, and the number grows every day.

Last year I spoke to the National Governors Conference and asked them to provide adoption benefits to State employees. Today, at least 30 States provide adoption benefits or plan to. These ideas are so simple and so fair, and it is so important for us to make them happen.

In closing, for all the young boys and girls waiting to be adopted, I ask you to remember this: It is not their fault. They can't change their situation; they can't solve their problem alone. But as partners—business, government, and local communities—we can make it easier for these children to become part of a loving family.

Adoption gave me a solid start in life. Let's help parents adopt special children. They grow up to be special people.

Thank you very much.

[The attachment to the prepared statement is being retained in committee files.]

Chairman ARCHER. Thank you, Mr. Thomas. We are very pleased to have you here today. I am glad you will be able to stay for some questions from the panel.

Mr. BURTON. Mr. Chairman, we can't hear you. Is your mike on?

Chairman ARCHER. Yes, it is. I have noticed that when your hair begins to turn a little gray, you also have a little trouble sometimes with the functions of your ear.

Mr. BURTON. I know, because I suffer from the same things.

Chairman ARCHER. Dr. Pierce, we would be pleased to have your testimony.

Dr. Pierce is the president of the National Council for Adoption, Inc., and we are delighted to have you with us today. You may proceed.

STATEMENT OF WILLIAM L. PIERCE, PH.D., PRESIDENT, NATIONAL COUNCIL FOR ADOPTION, INC.

Mr. PIERCE. Thank you, Chairman Archer, and thank you, distinguished members of the Committee on Ways and Means, several of whom we have had the opportunity to testify before about the need for tax equity for families who want to adopt.

I have a long prepared statement, Chairman Archer; and with your permission, could we have it put in the record?

Chairman ARCHER. Without objection, it will be inserted in the record; and we appreciate your keeping your verbal comments to the committee as succinct as possible.

Mr. PIERCE. Thank you, Mr. Chairman.

The issue of tax credits for adopted children is truly a bipartisan issue. It has been heartwarming to once again sit out in the audience and hear both from you, Mr. Chairman, and from Mr. Rangel, who has had a distinguished history in support of tax breaks for adoptive families.

It has been a bipartisan issue that has been endorsed by the Congressional Coalition on Adoption, several members of whom, including Congresswoman Payne here, is a member. I would invite all of you who are in the Congress to take part in that caucus. It is one of those caucuses that is not funded by any tax dollars, so it is, hopefully, not controversial. It is bipartisan and bicameral. Here in the House, since its founding, it has had distinguished Republican, Mr. Bliley of Virginia, distinguished Democrat, Mr. Oberstar of Minnesota, as the cochairs. Both of those people are adoptive dads. So adoption is something that is close to their hearts, and they have been very helpful.

We also like to claim Dave Thomas, as well, because Dave is one of the distinguished Americans who serves on our board of directors. In fact, Dave is in charge of the special needs committee work that we do in our organization.

This is really a very simple bill when you get down to it. It is very helpful. I hope that as the debate continues, consideration continues, that you will keep your eye on the main issue here, and that is, are kids waiting? Are there children who need to be helped? Are there children that are babies that we need to prevent ever getting into that foster care system?

When we hear people talk about, "Why do you want some kind of a tax break for babies?", the answer is because if we don't get babies adopted, then they will end up in the welfare system. They will end up in foster care. They will end up these expensive special needs adoptions that we are all familiar with. We are talking about the most basic humane kind of prevention here when we are talking about tax breaks for everybody who adopts any child.

Today's healthy white child that is born in Appalachia and ends up in the welfare system and rattles around that system for 5 years will be tomorrow's special needs kid. You are going to have all kinds of witnesses come up here and say, yeah, we need $10,000 or $15,000. We don't know how much it will cost to get a family for that child. Because he has been abused, he has been neglected, he has been ruined.

We say, spend $5,000 early on before the kids are ruined. Let them be adopted at 6 weeks, like Dave Thomas was. The battle here is not between two equally good choices for kids. It is really a battle between business as usual, which is to basically turn the kids over to a system that is funded by hidden tax dollars, dollars that are off the ledger.

When we had that tax change—and I heard Mr. Jacobs talk about it earlier; when we had that tax change in 1986, we had a piddling amount of money going for our little tax deduction. We tried to broaden it, and instead, we got creamed and the people took it off—off the front page and hid it as a multimillion dollar multiple in the public welfare system. It has been a tremendous disaster.

We have tried, in the Ways and Means Committee and technical markups, year after year after year to clean up that 1986 mistake. This is your opportunity to do it now. There are parents all across this country that need help.

I hope when Congressman Weller was testifying you heard about the Przybylskis, a family in Chicago who went over to Poland and adopted three kids. They ended up having $25,000 in costs. This family needs help, too.

I think, as you look through the testimony today, you are going to see that not only does Dave Thomas, not only does the National Council for Adoption, but Adoptive Families for America, the American Academy of Adoption Attorneys, Families for Private Adoption—they represent the vast majority of Americans that don't often agree on all these issues, who say this is an issue whose time has come.

If you want to add to this bill, and that is obviously your prerogative, that is fine. There may be things that you can add to make it even better. But I can tell you that, for us, after waiting for 15 years, we would be very glad to have this particular piece of legislation—which, thank goodness, was part of the Contract With America—become law just as is. You can come back in the second 100 days and improve it, if you want, add fine tunings. But we would be just happy if you do this piece of legislation.

Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

STATEMENT OF WILLIAM L. PIERCE, PH.D.
PRESIDENT, NATIONAL COUNCIL FOR ADOPTION, INC.

Mr. Chairman and members of the Committee on Ways and Means, my name is William Pierce and I am the President of the National Council For Adoption. Here today with me is Cassie Statuto Bevan, our Vice President for Public Policy. Thank you, Chairman Archer, for inviting us to testify today before the Committee.

The National Council For Adoption was formed in 1980. Today it represents 130 agency locations across the United States as well as several thousand individual members -- those who have been adopted, people who have placed children for adoption, adoptive parents, social workers, lawyers and people from all walks of life.

We are a non-sectarian and non-partisan organization, with our headquarters here in Washington, D.C. and formal affiliates in Texas, Pennsylvania and New Jersey and informal state affiliates in many other locations.

We strongly support the Family Reinforcement Act, which would provide tax benefits for those who adopt children, as many of the members of this Committee well know because we have been before the Committee on previous occasions. In fact, when we work with those who are members of the Congressional Coalition on Adoption, a bipartisan and bicameral caucus -- not supported by any tax funds, I might add -- the issue of tax fairness for adoptive families is always on the agenda.

This is the first time we have had a chance to testify on the kind of bill we have always preferred -- a refundable tax credit. This bill, preferably without any phase-out or "cap," is something we wholeheartedly endorse.

We endorse this bill for many reasons. It is needed by children. It is needed by parents. It is needed by the agencies and others who are not supported by tax dollars. It is needed by America.

It is needed by children because without a refundable tax credit, many children who would otherwise be adopted will be denied loving, permanent adoptive families. It is our estimate that there are 100,000 children who are waiting for adoptive families in this country -- stuck in the system, often because of financial reasons. These children are disproportionately of mixed ethnicity, or of African-American, Hispanic/Latino, Native American or Asian background.

These children are in the custody of or are placed by either the public or private sectors. A February, 1991, CRS report, Adoption: Federal Programs and Issues, says that about 15 percent of the children who are adopted in the U.S. come through the public child welfare system. Therefore, the tax credit could benefit about 85 percent of the children adopted each year.

It is needed by parents because without this financial help, many who could handle the day-to-day expenses of rearing a child who needs adoption can't handle the full fee for adopting. $5,000 would make all the difference in the world to them. And for others, like Valerie and Doug who are with us at this hearing today, a tax credit could mean the difference between adopting one child or two. This credit, in our view, should be available to every family who adopts, regardless of their income because it subsidizes an appropriate, family-building activity. It sends a clear signal that adoption is a legitimate way to reinforce the principle that children grow up best when they have a permanent, competent, loving family.

The tax credit is needed by the agencies and others who are not supported by tax dollars but who serve pregnant women and women in crisis and help find adoptive families for children. These agencies and people want to serve every woman and every child who comes to them, but without at least some minimum guaranteed level of fee that they can count on, they have to make a terrible choice. They can either continue serving everyone for a while, operating at an ever-deepening deficit and then bankrupt themselves leaving no one to help those women and children -- or they can operate on a sound fiscal basis, help those they can afford to with the contributions and money they can raise, and stay alive to serve some of those who come to them. If they know at least $5,000 per placement is available to reimburse part of the agency, legal and medical expenses that are incurred most of the agencies and people in the private arena will be able to drastically decrease the numbers they have to turn away. They turn away those who are likely to deliver children who will be difficult to place for adoption for a fee equal to cost outlays. Sometimes, they have to make placement decisions not on the basis of who would be the preferred parents but who has the $5,000 to partially reimburse costs.

It is needed by America, and doubtless is part of the "Contract With America" because it makes common sense. This kind of approach is something people with very differing philosophies and politics can agree on. Let me give you an example of what I mean. Two weeks ago, we convened a Conference at Hershey, Pennsylvania, and brought together about 30 experts from across the country to look at some of the issues that are in the Contract With America. These experts were from the fields of law, medicine, social work, psychology, and education. They were from the public and private sectors. They were ethnically diverse. By the end of the Conference, we had hammered out 20 recommendations. Recommendation number 16, which reads "To promote adoption, a refundable tax credit for adopting parents of $5,000 per adoption should be created," was accepted by a vote of 22 for, 1 no and 1 abstention. In a day when consensus is difficult to reach, it is highly significant that 90% of those voting endorsed the refundable tax credit. Such a plurality goes well beyond a landslide in public opinion.

The reason an adoption tax credit is good for America is that it translates common sense into public policy. Currently, the federal government is paying thousands of dollars per year per child, with tax dollars, and the results are miserable for the children. Most are not growing up to be healthy, productive citizens. Many go on to dependency status on welfare or in prisons. The price tag could easily average, even taking some of the absurdly low estimates we have seen from the Department of Health and Human Services, that welfare only costs $300 per month. Spending a maximum of $5,000 on a one-time tax credit to help kids get good families and to avoid the destruction of hundreds of thousands of young lives is far better. It is better for the children. It is better for a society that is increasingly fearful of the angry, violent children that are a feature of nearly every community. It is even better for some childless couples who would rather adopt than go through the painful, costly and often ethically-questionable process of infertility treatments.

There is a history of tax discrimination against adoptive parents, with only one true bright spot, that enacting this legislation would put aright.

There has been bipartisan interest in giving adopting parents a tax break for more than 15 years. Some of those who worked long and hard for such breaks have retired from the House -- like Bill Lehman of Florida. Others, and I include some on this Committee, like Charles Rangel, have long had an interest in getting some sort of tax break enacted. Among Republicans, Chris Smith of New Jersey certainly has been one of the leaders and was one of the first to speak about the need for a tax credit, going beyond the tax deduction approach.

So there is a history of bipartisan support for tax help for adopting parents.

Nearly 15 years ago, largely through the efforts of a Republican Senator from Iowa, Mr. Jepsen, a modest tax deduction for children with "special needs" made it through the Congress and was signed into law.

But it wasn't long until, under the guise of "simplification," those who were opposed to parents who adopt from non-government sources struck back. They convinced the Congress to wipe out the tax deduction for children with special needs and to give the public sector a blank check to help some families and some children. In the process, the intent of Congress was lost and we spent two sessions trying to get the problem fixed up through a technical amendment. The problem never was really fixed. We are in 1995 treating adoptive families who adopt from non-public sources more inequitably and unevenly than we did 10 years ago. So much for "improving Sen. Jepsen's simple, clear legislation"!

That is why we are so pleased to have the refundable tax credit as part of the "Contract With America". We certainly endorse this provision, and would ask that it be extended to all families, regardless of their income.

Why do this? How is this common sense, when people making over $200,000 a year would get a tax credit? Let me give you a real example, without using names or locations, to protect the privacy of the family involved.

I know a family that does have gross adjusted income in excess of $200,000. They have adopted several children, all from non-public sources. None of them are getting any subsidies or government help. Some have special needs. The last child has very challenging medical needs. Those needs are such that this family is putting out $3,000 per month for health care assistance so that the baby can be cared for at home by the stay-at-home Mom, with help, as the baby develops and its health status improves. Even with an income of $200,000, $36,000 in extra medical help for one child takes a big bite. Even at this income level, a $5,000 tax credit could make the difference between some child who needs a home getting one or not. Had this family not been financially able to pay the initial agency fee, the child would have had to have been referred to a public agency, where the baby would have likely languished for years at a great cost to taxpayers.

I think it is also important to keep in mind that the tax credit will help provide real options to families who would like to adopt, who have modest incomes, and who are members of racial and ethnic minorities. There are many families, working at low wages, often in rural areas who would be glad to adopt but they want nothing to do with the public welfare system, the child welfare system or the foster care system, which have too often been hostile and unresponsive to the option of adoption. They would adopt if there were a private agency they could go to, and they had some financial help to enable them to go with their heads high rather than their hats in their hands.

Let me give you an example from one of our member agencies in Houston, Texas, Los Ninos International Adoption Center. This agency used to provide services, as part of its program for American kids who need to be adopted, to a variety of children, including special needs children and healthy babies. Many were African-American or Latino/Hispanic. The combination of state regulations and a 100% tax-subsidized public sector which could offer "free" services to everyone drove them away from serving American kids. And this was true even though this agency had found a foundation that gave them a grant to help subsidize some of the costs of some of the adoptions. Many of the pregnant women that used to use this private agency's services now must go to the only other place they think will make adoption services available to them -- public agencies. They then are offered welfare and family preservations services and, generally, adoption services as a last and belated resort. Or they make choices other than adoption, choices they would rather not make, choices that are not in the best interest of children. One of those choices, when the young

woman is fearful enough, or has received no decent counseling, or sees no way to preserve her or her family's privacy, is literally throw the child away.

The refundable tax credit is at the top of our domestic "wish list" for this Congress. But this tax credit will also benefit families who are adopting children from other countries, children who are desperately in need of homes. These families often have very high costs because of the need to travel to those countries and complete the adoption, and they sometimes need to stay there for two to 12 weeks while their papers are being processed. These Americans are doing something tremendously heart-warming and humanitarian. They are Polish-Americans and Lithuanian-Americans and Russian-Americans and they have backgrounds from the Philippines or India or Korea or China and they have a special bond with the children who need families and who in those countries. That's why this makes so much sense. Why not help American families with a $5,000 tax credit so they can adopt children who are already born and in need of families rather than subsidize the infertility treatment industry, where in vitro fertilization and other exotic interventions provide a $50,000 price-tag for a 25% chance of having a healthy pregnancy? I would suggest that someone look at the tax consequences at the federal and state level of mandating broad insurance coverage for the infertility treatment industry and compare it with the social, ethical and fiscal alternative of a $5,000 tax credit.

I also hope that some of you who are concerned about the children languishing in foreign countries, and I know this is important to many ordinary Americans who are your constituents, will keep in mind one other issue that is not in the Contract With America but is at the top of our agenda for international programs. A new international treaty to smooth adoptions between countries has been drafted at The Hague and the U.S. needs to set up a system to fit into that treaty and then ratify that treaty. Ideally, both of those things should take place in the same 100 days that the Speaker has indicated will be spent focusing on the Contract With America. So, please consider slipping this priority in among the other work you are doing in those first 100 days and if that's not possible, please make it your first adoption priority for the second 100 days.

Thank you again for inviting us to testify. I would be glad to answer any questions you may have about our statement, about the recommendations that came out of our Conference two weeks ago at Hershey, or any other matter within the jurisdiction of this Committee.

THE FINANCES OF ADOPTION: A LOOK AT REVENUES AND EXPENSES

THE FINANCES OF ADOPTION: REVENUES

As consideration of a refundable tax credit for expenses incurred by those who adopt children begins in the Congress, it may be useful to review the sources of revenue which support adoption.

Public agencies

Commonly, the various public agencies providing adoption services are supported by tax revenues. It is our estimate that the mix is about 50% federal and the remainder of the tax revenues are a combination of state and local taxes, predominately state taxes in most instances.

Rarely, public agencies will seek fees for service from those they serve. This is most common in respect to fees for "home studies" -- usually a series of screening and orientation sessions for prospective adoptive parents conducted by a staff member of the public agency, usually a licensed social worker with a master's degree.

Private agencies

There are two broad types of private agencies: not-for-profit and for-profit, but the lines between the two types of agencies have been blurring in recent years as some for-profit providers of service, mostly attorneys, have created or formed alliances with not-for-profit agencies.

Most agencies, whether not-for-profit or for-profit, obtain the majority of their revenues from fees. Most of those fees are collected from adoptive parents. Generally speaking, adoptive parents are expected to put together, from a variety of sources, the funds needed to pay fees. The most common sources are: a) adoptive parents themselves, either from savings or from various forms of borrowing, including refinancing of their homes; b) loans or gifts from relatives, usually the parents of the adoptive parents; c) reimbursements from adoption benefit plans provided by employers.

Other major sources of assistance to those who adopt are: a) subsidies and other forms of support from the sponsoring organization of the adoption agency, often a sectarian organization; b) grants or loans from organizations that are set up to assist adopting parents.

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One of the major sources of support provided to adopting parents is in the form of donated services from the agency itself, or pro bono help. Depending on the agency, the child which is to be adopted, and a variety of other factors, this may range from as little as 5 percent of the fee to 100 percent of the fee. The agencies which subsidize adoptions for parents usually are enabled to do so because they have other revenue streams to draw from. Those alternative sources of revenue are: a) fund-raising activities of the agency; b) donated services and goods provided by staff and volunteers, especially board members; c) endowment income; d) sale or rental of assets, especially real estate.

Increasingly, for-profit agencies are attempting to model themselves, in respect to diversifying their sources of income, on the not-for-profit agencies. That is why increasing numbers of these agencies are engaging in fund-raising and other related activities.

At the present time, it is our estimate that at least 90 percent of agencies are not-for-profit.

Attorneys

Although there are several professions involved in adoptive placements, or helping people with adoptions, by a huge margin attorney predominate. In general, these attorneys may be divided into two groups: those who specialize in adoption and those who do adoption as part of their overall practice.

Attorneys who specialize in adoption often attempt to diversify their sources of income, much as for-profit agencies do. But their chief source of income remains the fees collected from their clients, the adoptive parents. Some of these attorneys provide substantial pro bono assistance to their clients.

Attorneys who do not specialize in adoption may be more likely than the other group of attorneys, because they have other sources of income to rely on, to reduce or waive entirely the fees they charge adoptive parents. This is particularly true of the attorneys who help with only a handful of adoptions each year.

Other facilitators

In rank order, we estimate that the others facilitating non-agency adoptions are: a) social workers; b) "counselors"; c) adoptive parent support groups; d) physicians; e) clergy.

Social workers, "counselors," and physicians largely depend on fees for their assistance. Of the three categories, it is our estimate that the fastest-growing are the "counselors," usually persons with baccalaureate degrees in fields other than social

work or law. Adoptive parent support groups operate generally like "cooperatives." Most clergy help out pro bono.

THE FINANCES OF ADOPTION: EXPENSES

As complex as the revenue streams that feed adoption is, expenses are even worse. The National Council For Adoption has received a first-hand report of a fee charged by a facilitator that is not an attorney or a social worker that is $40,000. At the other end of the scale, one of the member agencies of the National Council For Adoption charges no fee whatsoever, relying instead on the goodwill of the families it serves, along with its fundraising and its revenues from its endowment, to support its activities. In both instances, the child being adopted may be a healthy baby.

There are a dizzying array of variables as one considers what the expenses may be for an adoption. However, an attempt will be made here to provide some basic rules-of-thumb.

Adoptions of children with special needs

The term "special needs" is used by the adoption field to describe what formerly were called "hard-to-place" children. The definition of children with special needs is generally left to the states but generally includes children who have physical or emotional problems, children who are over age 10, children who are siblings and must be placed together and children who are members of racial or ethnic minorities, including children who are multiethnic. A child may be defined as having "special needs" by one state and not by another; no federal definition currently exists.

Public agencies not only place these children without charging a fee -- in most instances, "adoption subsidies," funded largely by federal tax revenues, are paid to the adoptive parents. These subsidies may range from as little as $1 per month, thereby qualifying the child to continue receiving needed Medicaid services, to several hundred dollars per month in the instance of children living with HIV/AIDS.

Private agencies which operate on a not-for-profit basis often place these children without a fee, relying on excess revenues generated from other sources -- including fund-raising or dipping into capital reserves.

Reportedly, some for-profit agencies and some adoption attorneys also place these children without a fee.

If there is a general rule-of-thumb about adoption of children with special needs, it is that the fees, if any, for the placement of these children are modest. A good-faith effort exists to find homes for them without charging parents fees. This rule-of-thumb also applies frequently to children adopted

from other countries, when the child or children have severe physical or emotional problems, when a sibling group is involved or when the child is over age 10.

It is our estimate that in calendar year 1994 about 15,000 children with special needs were adopted by U.S. citizens.

Adoptions of children without special needs

Certain costs, which we called "Core costs" in Adoption Factbook, are present in all adoptions and are seldom waived in these adoptions. Very few of the estimated 45,000 adoptions in this category are arranged by public agencies at the present time; therefore, the costs incurred to place these children are largely incurred by the private agencies, adoption attorneys, facilitators and adoptive parents themselves.

Residential maternity care

A percentage of the children who are placed for adoption as infants come from women who received residential maternity care. Some of this care is fairly informal, such as that provided by friends, relatives, etc., and may have been provided without charge. Such services are provided for women in other countries as well as here in the U.S. There are residential maternity care services in countries as diverse as Korea, Taiwan, Indian, the Philippines, Colombia, Romania and Russia. Care in the U.S. is provided by maternity service organizations ranging from The Nurturing Network, an organization founded by Mary Cunningham Agee which has served about 500 women who have placed their infants for adoption since its creation, to one of the 300 or so "maternity homes." The costs of providing such care vary dramatically, from country to country and within each country depending on the types of services provided to the women. Costs are much more modest if only shelter, food and basic maintenance is provided. But many residential maternity care programs offer education and job training, courses to help women learn how to care for their babies and counseling aimed at helping them arrive at an informed choice about whether they will try to parent their baby or plan adoption for the child.

In a low-wage, developing nation the cost may be $1 per day. In a major metropolitan area, the cost may be $120 per day. Since the time that a woman needs to spend in such a setting may vary from seven months to none, the corresponding cost factors vary tremendously.

If there is a rule-of-thumb for such programs, it probably is that women are admitted once they reach their third trimester and they are provided services 10 days after delivery.

Taking the least expensive level of reimbursement currently in place for Texas, $1,700 per month, three and one-third months' care would result in direct costs of $5,661.

Many of those who discuss adoption fees do not even include these costs in their computations.

Hospital and medical care for mother and child

As with residential maternity care, these costs vary dramatically from country to country and within countries. In some few countries, all costs are absorbed by the host country. In other countries, in order to maintain a minimal standard of care assistance is needed externally and that help comes from international donations and payments.

In the U.S., it is estimated that about 85 percent of women placing children for adoption have normal, uncomplicated pregnancies. We have no estimates for the international placements.

As recently as 10 years ago, one could generalize and say that most public agency clients were on Medicaid and most other women were not able to qualify for Medicaid to underwrite these health care expenses. Some shift has taken place, however, so that today we estimate that perhaps half of the children being placed for adoption and their mothers were receiving Medicaid assistance.

Not every locality has obstetricians available who wish to participate in the Medicaid program. Not every pregnant client wishes to be on Medicaid. Not every parent of a pregnant client wants a daughter planning adoption to be on Medicaid.

This means that an average bill for prenatal care, hospital care for mother and child and postnatal followup may be $5,000 for a normal delivery. In some instances, agencies can negotiate reduced rates for these services.

It is our estimate that the costs for Cesarean Section may add $2,000 to the average. And a major complication, especially for the newborn, can add $100,000 in a matter of days.

The result is that costs which the adoptive parent's representatives may have to pay -- whether an agency, an attorney or a facilitator -- may range from nothing to hundreds of thousands of dollars.

For purposes of our rule-of-thumb, a normal delivery in the U.S. may factor out at about $3,000 per adoption. In international adoptions, these costs are often absorbed and less easy to break out.

Preadoption foster care

Perhaps half of the children go immediately from the hospital to the adoptive parents, so that no costs are incurred for preadoption foster care. But in most adoptions across state

lines, many agency adoptions and nearly all international adoptions of infants, there are such costs.

In adoptions across state lines, delays resulting from the Interstate Compact on the Placement of Children may require a child to spend several days in foster care. With agencies, even when the Compact is not involved, a delay of 10 days is not uncommon. In intercountry adoptions, foster care of six months is common.

The result is that costs of providing preadoption foster care may be substantial. Rates vary substantially from country to country and within countries. In the U.S., some providers are able to recruit volunteers and they only have to pay for food and supplies for babies. But whether in the U.S. or abroad, the general rule is that the care must be paid for. In some instances, international adoption may result in foster care charges of several thousand dollars.

Given the fact that these costs may vary from $200 to $3,000, our estimate is that the average direct cost may factor out to $600.

"Home studies" or counseling for adoptive parents

In all international adoptions and in most adoptions in the U.S., a process is required to be completed prior to the child being placed for adoption that can be quite expensive. This is called by many names but usually involves a series of meetings with the prospective adoptive parents, the obtaining and review of a variety of documents and records, education and orientation about adoption and, less frequently, psychological testing. Once the pre-placement process is completed, a detailed, written report is provided. After the child is placed with the adoptive family, one or more post-placement visits are required. In some international adoptions, such visits and written reports to the country of origin are required for several years. Depending on the rigor of the process and the person or agency providing the service, a "home study" may cost as little as $250. The most expensive home study that the National Council For Adoption has knowledge of is nearly $6,000.

Consider that an orientation session, four pre-placement sessions, and three post-placement sessions are not unusual. It is not uncommon for the person doing the home study to need to spend two hours in preparation and report writing for each hour of direct contact with the clients. Therefore, if each of the eight sessions lasts two hours, there are 16 direct contact hours to be paid for and 32 indirect contact hours. Forty-eight hours of staff work must be paid for, at rates ranging from at least $30 per hour to well over $100 per hour in some unusual instances. At a rate averaging only $50 per hour, this would translate into direct costs of $2,400.

Indirect costs or "overhead"

A variety of indirect costs are incurred by any provider of services. These include such costs as administrative staff, telephones, travel, insurance (including, sometimes, malpractice, directors' and officers, and errors and omissions coverages) and all the attendant expenses of running any organization.

Most important, especially for the agencies that serve women who may not decide to place their children for adoption, are the costs incurred -- often as much as for those who plan adoption. For instance, one of our Texas member agencies reports that last year it provided extensive and expensive services for free to two women who went through its program and did not decide to place their children for adoption for every woman who chose adoption. Oversimplifying the calculations, that means that if the average cost of serving a pregnant client is $8,000 and if one of every three clients decides on adoption, the cost per adoption is $24,000. It is these very costs which account for the financial crisis being faced by many adoption agencies today, and why they must try to recover some portion of those costs through indirect costs added to the actual costs per client.

Most agencies today do not include attorney's charges as part of their "package." Those costs, which average $1,000 for an uncomplicated situation and add $1,000 for many cases involving the Interstate Compact, are usually paid directly by the adoptive family. However, to economize, some agencies are resorting to in-house legal staff and when this is the case, those direct but reduced costs are added to and factored into the fee.

Another cost that may not be immediately obvious is travel. An agency or attorney may have a pregnant woman travel from her home state to another state for the final months of her pregnancy. Her round-trip air fare, as well as the air fares of the adoptive couple (for the "home study" as well as placement, court hearings, etc.) would need to be added. These costs could easily range up to $4,000 if the delivery took place in California and the pregnant woman was from Minnesota and the adoptive parents were from New York City.

The number of variables are such that it is difficult to estimate what the indirect cost factor is that should be added to the computation. Our guess is that this should be not less than 15 percent and could be as much as 60 percent, and the range would be entirely appropriate given what the particular situation is of an agency. Perhaps 40 percent would factor out as average.

International costs

International adoptions add still another level of complexity. Certain basic costs, ranging from translations to authentication to passports, can be predicted and range from $300

to $3,000. Immigration and Naturalization Service has certain users' fees, as well. Other charges depend on whether the child was escorted to the U.S. to be adopted, as about half were last year, or whether the parents traveled abroad to adopt and bring the child home. In either instance, the costs are substantial. If both parents must fly, the air fare is roughly twice as expensive as if the child is escorted. If one or both parents are required to spend days (or weeks) in the country while the adoption process goes forward, several thousand dollars could be spent and the housing would not be extravagant. In addition, an increasing number of countries are levying varying kinds of fees or requesting consideration of donations which can run from $3,000 - $5,000.

In summary, an international adoption, when all factors are considered, may legitimately cost $7,000 - $10,000 more than an adoption from the U.S.

Attorney-arranged or facilitated adoptions and other options

In adoption, as in all services, there are fairly comparable costs for the same services no matter whether it is an agency or an attorney or a social worker or the adoptive parent who is coordinating the situation. Someone must pay for the expenses of the pregnant woman, especially costs related to the delivery of the child. Someone must pay for well-baby care and various pediatric examinations. Someone must pay for foster care. Someone must pay for travel, housing, etc.

It is claimed by some who represent not-for-profit agencies that the costs charged to parents are relatively similar between all providers, with the edge going to the non-agency providers. Those who represent these agencies point out that the basic laws of economics still apply and that usually the reason that such adoptions cost less is that the adoptive parents or someone receives less in the way of services, or in the quality of services.

In this paper, that particular debate is not appropriate. Rather, there is a need to arrive at some estimated costs of services. Given that need, it is our estimate that the costs are roughly similar, but that if there are differences, it would be fair to say that non-agency adoptions may be 10 percent less costly.

Summarizing the costs

It is difficult to summarize the costs of adoptions with so many variables, but given the need to illustrate the range of costs incurred by adoptive parents, we have laid out some numbers on the chart that follows. The chart is based on an earlier version which appeared in Adoption Factbook. It should be remembered that costs do not necessarily translate into collected fees. Indeed, NCFA agencies averaged under $10,000 in 1993.

Domestic Adoptions

Core Costs:

Maternity home care	$5,661
Normal prenatal and hospital care for mother and child	3,000
Preadoption foster care for infant	600
"Home study" or pre and post-adoptive counseling for the adoptive parents	2,400
Legal fees	1,000

Minimal Direct Core Costs:	$12,661
Indirect Costs (@ 40%):	5,064
Minimal Total Costs:	$17,725

Special Considerations:

Cesarean section	2,000
Interstate Adoption	1,000

With complications, an interstate adoption could result in costs (15,661 direct, 6,264 indirect) of: $21,925

International Adoptions:

"Home study" or pre and post-adoptive counseling for the adoptive parents, including reporting for country of origin	3,600
Legal fees (U.S. and abroad)	1,000-3,000
Travel and related costs	1,500-8,000
Translation, government fees, etc.	500-1,000
Fees to foreign agencies, governments	500-5,000
U.S. agency direct costs	2,000-5,000
Direct costs (range)	9,100-25,600
Indirect costs (range)	3,640-10,240
Total costs:	$12,740-$35,840

Chairman ARCHER. Thank you, Dr. Pierce.

The last witness on this panel is Mr. Totaro. Mr. Totaro is the Legislative Chairman of the American Academy of Adoption Attorneys from Pennsylvania.

We are pleased to have you with us and you may proceed.

STATEMENT OF SAMUEL C. TOTARO, JR., ESQ., LEGISLATIVE CHAIRMAN, AMERICAN ACADEMY OF ADOPTION ATTORNEYS

Mr. TOTARO. Thank you, Mr. Chairman. Good morning, Mr. Chairman, and ladies and gentlemen of the committee. My name is Sam Totaro. I am here today on behalf of the 275-member American Academy of Adoption Attorneys. The purpose of the academy, whose membership is by invitation only, is to study, encourage and improve the adoption laws and the practice of adoption law throughout the United States and abroad. The academy has members in all States of the country plus Canada. The academy is here today to strongly endorse H.R. 11. By enacting this piece of legislation, adoptive parents will take another step forward in establishing parity between themselves and biological parents. I would like to point out here that I also have a personal involvement in adoption. My wife, Andrea, and I are proud parents of two children who became members of our family through adoption—Juliana, who is now almost 12, and Christopher, who is 9; and they are both here with me today at this hearing.

Adoption can be a costly process. In almost every State in this country, it is legal for adoptive parents to pay agency fees that now average over $10,000, plus the actual cost for medical expenses for prenatal care of the birth mother and the birth of the child. These medical expenses can easily reach $8,500 or more. On many occasions, the adoptive parents' own health insurance will not cover these expenses. If this were a biological child, there would be no question at all that the family would be able to deduct these expenses on their own tax returns, but because their family is created by adoption, adoptive parents must bear the burden of these expenses without the benefit of any tax relief. By doing so, many young couples who are willing to adopt shy away from the process because they simply cannot afford it.

In all States, the courts that approve adoptions require all attorneys, agencies, as well as adoptive parents, to certify that only legally allowable expenses have been paid. These include those qualified adoption expenses as itemized in H.R. 11. There should be no fear, therefore, that those involved in the adoption process will raise fees to offset any tax credit given to adoptive parents. The courts would not allow any increase in fees or expenses without justification for doing so.

The Family Reinforcement Act would provide for lower taxes to young couples when they are most needed and, therefore, will strengthen the American family and encourage couples to create their families through adoption, thereby reducing the number of children in foster care awaiting permanent homes.

The American Academy of Adoption Attorneys stands strongly in favor of this very important piece of legislation. H.R. 11 should be enacted.

Thank you.

Chairman ARCHER. Thank you very much, all of you, for appearing and being with us today. We will proceed into our inquiry portion of this hearing.

Mr. Rangel.

Mr. RANGEL. I think we all agree, at least those testifying, that we should try to make it easier for people who want children to adopt them; and certainly, it is a beautiful experience for the child.

We have a major problem in inner cities where children are being born that are not wanted. Whether they have mental or physical defects, they are still at risk, and we provide stipends to encourage people to place these at-risk kids. I believe, and I am asking some professionals to challenge me, because it is only a belief, that most of these unwanted children—and there is very little consideration statistically for abortion—that most of these kids come from teenage parents, unmarried mothers. They come from communities of high unemployment, high dropouts, and produce unemployable people that get involved in antisocial behavior.

Is there anyone that has any statistics or reason to believe that this is untrue?

Mr. PIERCE. No.

Mr. RANGEL. So if it is true, as we try to facilitate the adoption, would we not all agree we should also facilitate the birth of children who are unwanted by their parents? Then, if you agree that young people and others who are employable and are working are not having these kids, should we not invest in them to make them responsible and to have a life that they would not want to destroy by having a child prematurely, before marriage? Of course, if you agree with me on that, then tie me in with the Contract With America, because we probably all are looking for the same type of family values, but we have to work closer together.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Shaw will inquire. Let me alert the committee that at the conclusion of Mr. Shaw's inquiry, we will break to vote, because with the new rigid restrictions on voting time, I think we should not wait any longer. So Mr. Shaw is now recognized to inquire, and at the conclusion of that inquiry, we will break temporarily and go to the floor and vote and then return.

Mr. SHAW. Thank you, Mr. Chairman. I was particularly struck by Mr. Thomas' testimony with regard to the kids with special needs. We have in Fort Lauderdale, Mr. Thomas, a nonprofit group called Kids in Distress, which has done just a remarkable job. I was over there going through the facility about 2 or 3 weeks ago, and I saw a situation which was incredible, and it is just unbelievable that this kid has survived.

This youngster, as an infant, lived in the streets with her 3-year-old older sister caring for her for—we think for in excess of 1 week. The child was very, very small. They find that the older sister was putting diapers made of grocery bags on the child before somebody finally called the police and the children were picked up. Since then, the older sister has been adopted. Both the parents have died with AIDS. The kids are clean; they don't have the AIDS problem. But the younger sister is still there at Kids in Distress because she is afflicted; I think it is multiple sclerosis. It is a mild case, but she is afflicted.

Darling little African-American girl. She—when I came in, she just threw herself to hug me and other people who came into the facility. A wonderful, loving child, but that child will always be in a group home setting or a foster care setting, because it is just human nature to try to get as perfect a child as you can get when you are trying to adopt.

I think perhaps she would be a perfect applicant for a picture at one of the Wendy's, because she certainly is a very special child with very, very special needs. If you would like, I would get further information to you and see if maybe we can follow up and something good can happen to this child whose life has been absolutely nothing but tragedy. They call it a "little miracle child." It was an infant taking care of an infant in the streets for a substantial period of time, anywhere from 1 week to several weeks, and they survived. It is absolutely—absolutely an incredible story, and it is hard to believe, but that is exactly what happened.

Mr. THOMAS. If you give me the information, we would like to.

Mr. SHAW. Yes, sir.

Mr. THOMAS. We also built a home there, the Eilareen Thomas Home, Children's Home Society.

Mr. SHAW. Yes.

Mr. THOMAS. Have you been there? We just opened. We have got to get you there.

Mr. SHAW. No. I hope that is an invitation.

Mr. THOMAS. It is an invitation.

Mr. SHAW. I will look forward to that.

Thank you, Mr. Chairman. I yield back my time.

Chairman ARCHER. Since we still have some time before the second bell, if Mr. Bunning would like to inquire briefly.

Mr. BUNNING. Briefly.

I am familiar with this situation. I have two daughters who have adopted. One daughter has adopted a foreign-born, severely handicapped child with cerebral palsy. I also have a daughter who has adopted biracial babies. So it is a problem that we should address in the Tax Code and give those that need it the help. Both of my daughters were able to afford it, thanks to their ability to pay. But as has been stated by Dr. Pierce, the ability to pay up front for the cost of in-home care and hospitals and things can amount to a severe penalty for those trying to adopt if we don't address it in the Tax Code.

Mr. Thomas, I am amazed at the things that you have been able to do in such a short period of time with this high-profile position you have taken on adoption, and I encourage you to continue because it is a severe problem in our society. I only hope that the rest of our Members are as aware of this problem as this committee is, and—because we hear constantly about it; and I thank you for your testimony and yield back the balance of my time.

Chairman ARCHER. I am told that this vote will be a single vote, so we will recess to vote, and I encourage every Member to come back as quickly as possible so we don't keep the witnesses waiting. We will stand in recess until we return. It is 11:28; recess until 11:43.

[Recess.]

Mr. HOUGHTON [presiding]. Could we begin questioning?

Mr. BUNNING. Mr. Chairman, we have another vote coming up.

Mr. HOUGHTON. OK. Well, we will proceed until we get the second buzzer. Mr. Jacobs will inquire.

Mr. JACOBS. Actually, I won't, Mr. Chairman, but I do have an observation to make. That is—we all know in Indiana; people who have read certain national publications know it also, but I think the record ought to show that Mr. Burton himself is a product of some experience in an orphanage, and he is among the very few Members of Congress who are in a position to testify with a great deal of authority. Consequently, he is an invaluable asset to the Congress, as I see it, in terms of raising the consciousness of the other Members of Congress on this issue.

I happen to be Operation Late Start myself. I was never a father until 5 years ago. My wife and I have a 5- and a 3-year-old son; and what I say about that is, the reason our children are special is that they are children, no other reason. God put that in nature; God put that in universally, and all of us that listen to ourselves, our inner selves, that is the No. 1 responsibility. That is the No. 1 morality; that is the No. 1 religious obligation that we all have. I don't care whether you know the child or not. If you see a child on the street and your head's screwed on right, if you think that child is disoriented, you drop everything.

I was driving out in Indianapolis the other day either at Kmart or WalMart; let's not play favorites. Suddenly, in that parking lot, a woman turned around and dashed right in front of the car I was driving, and I was barely able to stop without hitting her. Why did she do it? Because she saw somebody else's little child headed my way toward the path. That is what God put us on Earth to do before anything else, is to look after children. Danny Burton is another example of enormous success over an enormous handicap. So you have something besides the fact that is he a carnivore, and I am a vegetarian.

Mr. BURTON. Thank you, Andy.

Mr. HOUGHTON. Thank you, Mr. Jacobs.

Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Mr. Thomas, I want to follow up on your comments a little bit. In your opening remarks, you talked a little bit about the special needs child; and you mentioned this committee should report out a $5,000 tax credit for adopted kids and also a refundable tax credit for parents adopting special needs children.

Is it either/or, or should we—what happens if we are working under tight budget restraints and can only pass the $5,000 tax credit for——

Mr. THOMAS. We should do both.

Mr. FORD. We should definitely do both?

Mr. THOMAS. Definitely do both.

Mr. FORD. If not, what happens to the special needs child?

Mr. THOMAS. Special needs children, because of age, come with a lot of problems, sometimes doctor bills and counseling, and it is a higher risk—I mean, as far as medical bills. To have the incentive for people to adopt them affordablely, I think they need the $5,000.

Mr. FORD. You think there are families ready to adopt the special needs children?

Mr. THOMAS. I know there are. There are people there if they could afford it. I think that is one way to give incentives for people to afford it.

Put a price on a family, I just don't think you can do that. I mean, families are so important and incentive to adopt is so important.

Mr. FORD. Mr. Chairman, I would like to follow through on it, and I know time is of the essence right now. We have a vote, about 8 minutes now.

Mr. HOUGHTON. I am going to ask a question myself of the panel, and then I think we will recess.

Dr. Pierce, you talked about the Tax Act of 1986, and I guess there was some sort of disagreement that you had with it. The concept, if I remember correctly and in reading the act itself, which I have in front of me, was that they took help for the adoption process away from the Tax Code and put it into a direct subsidy. The language here was that the deduction for adoption expenses gave relatively more benefit to higher income-track taxpayers and no benefit to nonitemizers. So now, what we are doing is, we are going to go back.

Why is it better to go back to the Tax Code as it was, rather than giving the direct subsidy through HHS?

Mr. PIERCE. We had a number of problems, Mr. Houghton. When that particular change in the Tax Code took place—and I was then, as now, with this organization—we attempted to broaden it from a tax deduction to a tax credit at that time, because obviously a tax credit benefits people regardless of their income. We were opposed by, basically, the public welfare lobby; and you will hear from some people here today who get their money from public welfare organizations and from tax dollars. They basically said, give the job to the public welfare departments. Give us money under administrative costs to pay for the lawyers, for all of the costs that these parents have. Any of the unusual expenses, we will just pick up as part of our administrative costs.

They have refused in the years since 1986 to recognize either the adoptions done by private attorneys that are helping to find homes for kids, including special needs kids, or most of the voluntary agencies, the charitable organizations—Jewish Child and Family Services, Catholic Charities, Lutheran Social Services, et cetera. There is basically a monopolistic approach there for just a few of the children in a few of the States.

If you have a tax credit, it takes it out of the control of the public welfare department and puts it in basically the private sector where there can be all of the people trying to help kids find families, get some help for those families. Now, Dave Thomas as an example is one of the corporations.

Mr. HOUGHTON. Doctor, I have got to go because we have got a vote.

Mr. PIERCE. OK.

Mr. HOUGHTON. We will recess and we will come back.

Just one other thought here—and I know you have got some other things you would like to share with us—that as it stands

now, we will have a two-tiered system. We will have part of the process going through the Tax Code and then we will still have, in special cases, the direct subsidies going out through HHS. I am wondering whether that is a good idea. We will be right back.

[Recess.]

Mr. HOUGHTON. Ladies and gentlemen, can we continue the hearing? I am sorry for the witnesses that more people aren't here. There is a bit of a controversy going on over in the House, and I just thought it might be better to complete our questions and answers.

I had asked a question. Dr. Pierce, you were answering it. Maybe you can complete that, and if Mr. Thomas or Mr. Totaro would like to add anything to that or anything else, fine; and then after that we will dismiss the panel.

Mr. PIERCE. In our testimony, Mr. Houghton, we are not addressing the issue of whether the committee should do away with the current benefits for special needs kids and subsidies and all the rest of that. As a nonlawyer and as a nonlegislator, as I read what is in the Contract With America, it seems to say that this $5,000 tax credit would be available. But if some adoptive folks have gotten some other benefits through tax dollars, then they couldn't—they couldn't be a doubledipper.

So as I read it, it seems to mean, yeah, we are going to continue to have some subsidies and accounts available through the public welfare system, but we want to empower the private side. We want to give benefits to the voluntary agencies and those who adopt privately so that we can get homes for every kid that needs them.

Mr. HOUGHTON. Yes. I guess, Doctor, my feeling was, who can argue with the general thrust of the argument? It is absolutely right on target. People want it; it is the humane thing to do. I think the question is in the mechanics, how we do this. I know there is an antidoubledipping concept that applies here.

But I guess my feeling is that there was a body of opinion, of which I was not part, in 1986, that decided that going through the Tax Code was not either the most efficient or the fairest way of doing it. Now we are throwing it back. I mean, the major benefit going through the Tax Code. I just want to know what your feelings are on that.

Mr. PIERCE. That body of opinion was reflected by very distinguished Members of the other body, like Senator Bentsen and many others who just said, philosophically, we don't want to use the Tax Code to encourage or discourage behavior.

Well, we use the Tax Code all the time to encourage or discourage behavior, and all we are saying is, we have been hearing that excuse for 10 years. Let's use the Tax Code to do something that makes sense for kids and taxpayers, because right now, for want of $5,000, there are lots and lots of kids that are stuck in the system. We are spending lots of money we don't need to spend for them.

Mr. HOUGHTON. Right. All right. Well, thank you very much. That helps.

Mr. Thomas, would you like to add anything about this or any other issue?

Mr. THOMAS. Yes. What we have done at Wendy's, we have put adoption benefits right in with our maternity benefits, so people either can have their biological child or they can adopt; and they can adopt special needs children, which we pay additional. So I would like to see that in the Federal Government, as well; anybody that has maternity benefits, just add adoption benefits, give people a choice.

Mr. HOUGHTON. So you would urge that in any legislation that we come out with, when we are tackling the health bill that we would put adoption procedures in that?

Mr. THOMAS. Right. It is——

Mr. HOUGHTON. Thank you very much.

Mr. Totaro, have you got anything to add?

Mr. TOTARO. We would also urge that any legislation consider the Tax Code—go through the Tax Code, and that any doubledipping that may occur would be taken care of as it normally is taken care of. You won't find that happening.

We think that it would be best to provide it the way the legislation is drafted now.

Mr. HOUGHTON. All right. Thank you very much.

Mr. Burton, would you like to add anything?

Mr. BURTON. Thank you, Mr. Chairman.

I am not officially a part of this panel, but I have had some personal experience in my life with people who were in welfare homes, in welfare centers. I was in a children's guardian home in Marion County when I was a boy for some time because of a family incident that took place, and I recall vividly the expression on young people's faces, particularly those in my dormitory. My brother was in one dormitory, my sister was in another, and I was in the older children's dormitory; I was about 12 years old. We had kids in there from the ages of about 9 until maybe 13.

Prospective adoptive parents would come through and everybody would have their beds made, and we would all be standing up, and the ones who were up for adoption would be really looking with eager anticipation at the prospective parents. All I recall is the terrible look of disappointment when the people would come through and look at each child and then leave, and there was never any response and nobody was adopted.

The look of despair on those kids' faces remains with me to this day, and if we can do anything in this Congress to help kids find a home, I think it would be a giant step forward. It would be a feather in the cap of every Member of this body, and I think it would help go a long way toward helping solve some of the delinquency problems that we have in our society. If kids have a loving home, I don't think they are likely to get in trouble, but if they don't have a loving home, you are going to have a real problem in society.

Mr. HOUGHTON. OK. Well, thank you very much.

The chairman chided you, I think, in terms of when your hair gets white, many times your hearing is impaired. When your hair gets white, maybe your eyesight is impaired. But I don't see anybody here who wants to ask another question. So I thank the panel very much for their contribution.

Mr. HOUGHTON. OK, a 5-minute recess.

[Recess.]

Chairman ARCHER [presiding]. The committee will come to order.

My apologies to you, Doug and Valerie, and to the previous witness, Dr. Pierce. This was unavoidable. We thought we were going to go to the floor for one vote. When we got over there, we saw that parliamentary procedure had begun to get into disarray, and the result was that we really couldn't come back here and still do our duty over there. But we do appreciate your coming today to be with us, and as I specified earlier, we are going to ask the cooperation of video and still photographers to respect your privacy and not photograph your faces or that of your child.

VALERIE. Thank you.

Chairman ARCHER. We welcome you to the committee. We are pleased to hear your testimony, and you may proceed. We normally ask witnesses to try to limit their testimony to 5 minutes or less, and if there is anything in addition that they would like to insert into the record, in writing, then that would be permitted. We hope that you will be able to hold your testimony to 5 minutes.

DOUG. I think we can.

Chairman ARCHER. You may proceed.

STATEMENTS OF DOUG AND VALERIE, ADOPTIVE PARENTS

DOUG. OK. Mr. Chairman and members of the committee, my name is Doug and with me is my wife, Valerie. We recently watched your committee on C–SPAN. Let me tell you we live outside the Washington Beltway in a typical suburban community on the eastern seaboard. Valerie is a full-time, stay-at-home mom. I work full time, as I have for the last 15 years, for a publishing company.

We are here today as fairly ordinary American citizens who have adopted a child and who support the provision in the Contract With America that would provide a refundable tax credit for people like us. My wife and I have never testified before Congress or any other legislative body, so we hope you will bear with us.

Valerie and I were married 9 years ago. At that time, like many couples, we hoped and prayed for children. When we were unable to conceive, we went to infertility specialists. Those treatments, a portion of which were covered under our health insurance, proved to be fruitless for us. We then thought about adoption, got advice from friends and professionals about the pros and cons of adoption, tried to discern what was best, and eventually decided we wanted to build our family through adoption.

VALERIE. Working through a wonderful, licensed, nonprofit agency, we learned of a waiting child, a child of mixed ethnic background. This was a child the agency could not place because their pool of waiting African-American parents either wanted a female or were unwilling to adopt a racially mixed child. So we adopted that child, and he is with us today. His name is Michael and he is nearly 2 years old, and he is here because of the brave and self-sacrificing young woman who gave him the gift of life.

DOUG. Thank God for Michael and what he has meant to us. Adopting Michael was one of the most wonderful things that ever happened to us, but the financial side of it was very difficult. Even with Valerie working full-time last year, until we brought Michael

home, what with the cost of living, money was tight. We did not have the cash to pay the $7,000 fee that our agency needed to collect for the placement. The only way we could get the money was to refinance our modest home. Given the help we got before this adoption happened, we did not feel right about going to relatives to ask for a gift or a loan to do this adoption. Besides, it was personal, just as personal as our infertility treatments. As Valerie and I told the agency, we have the income to raise a child, good insurance and so on, but not a lump sum of $7,000.

What frightens us is that there are so many children like Michael, babies that are male and of mixed ethnic background, who never get adopted here, stuck in the public welfare system simply because there is no way many of the people who are willing to adopt can afford the fees.

VALERIE. People kept telling us and encouraging us to adopt through the State because that would be free. We are not expert on taxes like you folks are, but we know nothing is free. Tax dollars pay the salaries and pick up the costs of the supposedly free adoptions from the welfare department and social services people, plus we are the wrong color. In the opinion of many of those in the public welfare system, at least in our State, to adopt a child like Michael in a world that is celebrating the end of apartheid in South Africa, racism still exists in adoption. Whites are not supposed to adopt black children. African Americans are not supposed to adopt white children. As we read in the paper, that is one of the reasons thousands upon thousands of children who could be growing up in good, adoptive homes are stuck in the welfare and foster care system instead. Too many social workers insist on same-race adoption, even at the cost of making children wait and wait.

DOUG. I guess Mike wants his voice heard, too. Valerie and I would like to have at least two children. But with Valerie caring for Michael, our family income is certainly going to be less than last year. We certainly will gross less than $60,000. We live in a high-cost area of the country. If you pass this refundable tax credit, we would have $5,000 to help pay the fees when we adopt Michael's brother or sister. Otherwise, that child might have to grow up in foster care, costing the taxpayers at least $5,000 per year.

Worse than the money loss, that child would not have the love, support, and supervision of two parents, the most wonderful difference between children who are productive citizens and those who end up in jail or on welfare. I don't need to tell you welfare or prisons are expensive.

Finally, let us explain why we are not giving our last names and where we live at this time and why we have only provided that information to your staff. Privacy and confidentiality in adoption is important to us and to the birth mother of our child.

Our time is up, and we thank you for asking us to testify today. Valerie and I would be glad to answer any questions you may have.

Chairman ARCHER. Thank you for coming to us with your real-life story. Often we in this committee room hear from experts who speak with authority from ivory towers, but the real world lies in your hearts and in your home, and you clearly represent what should be a goal for every child that does not have a supportable home in this country.

There is a clear message there—not just the economic part, which is very, very important and which this committee must deal with; but there is another message, because there are other roadblocks out there that would attempt to prevent, in some way or another, no matter how well-meaning, children from being adopted by parents that are of a different cultural or ethnic background. That, in itself, can be a denial of opportunity to a young person.

So I am very, very pleased that you have come to this committee today, and I will at this time recognize Mrs. Kennelly from Connecticut.

Ms. KENNELLY. I don't have any questions, but I thank you very much; and I also thank you for bringing Michael, so we could see him also and share in your joy.

VALERIE. Thank you.

DOUG. Thank you.

Chairman ARCHER. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

It was delightful to hear your story. I am curious, as we talk about the goals that would be achieved through this tax credit for parents who are adopting, do you think it would break down that wall that exists right now between adoptive parents and a child of a different race?

DOUG. I know from experience. We know many couples who have adopted. What they have indicated to us over the last couple of years is that they would have liked to have adopted more children. It is just quite cost prohibitive. I know, for us, scraping together the money to adopt Michael is like trying to scrape together the money for a downpayment on a house. I think that is one of the biggest obstacles to any kind of adoption, that it is just so difficult to come up with the funds for the adoption.

In terms of helping to break down that wall, I really hope it would. I really do.

VALERIE. Can I add something to that?

Chairman ARCHER. Surely.

VALERIE. Along with that, we really surprised ourselves with Michael. We simplified the process here but had pursued adoption a number of years ago, which proved fruitless. At the time that my husband first told me about Michael, it was one of those rare moments in time where we were given the opportunity to abandon our reason and our preference. All the notions and dreams and aspirations that we have—and found something that flows from deep inside of us—the deepest part of our humanity from where our own heart cries out. I surprised myself and was just so happy that what cried out in the bottom of my heart was love.

That love was colorblind. That wasn't an issue. In fact, that wasn't even raised until much later in the process until which time it just perhaps wasn't an issue. Perhaps if I thought about it logically, maybe a few years before, maybe I would have made it an issue. I don't know.

DOUG. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

Let me add my thanks for your being here. We hear the statistics; you put a face on the issue. You make us understand the is-

sues. I know it is a sacrifice for you to be here. We want you to know how much we appreciate your testimony today.

You have indicated in your testimony the problems that you went through in adoption, the financial cost, as well as the bias of local agencies on a mixed-race child. Were there other problems that you confronted in the adoption process and how long did it take?

VALERIE. This particular adoption went very well. Again, I think that is a credit to the agency that we worked with. It was a wonderful process. The folks there were very supportive and things moved along quickly. But again, remember, Michael was "hard to place" for the agency because no one—none of their candidates at the time wanted him for the reasons that I outlined previously in my testimony. They were racial reasons.

DOUG. One thing I would like to add is that a few years back, we had attempted to work with another agency. After we began working with that agency, their policy seemed to change. They were encouraging us toward an adoption where the birth parents would play a role in the upbringing of any child that we might adopt. We found that to be an obstacle because in adopting a child, we are taking sole responsibility for him. We need to be the sole authority in his life. So that was one obstacle we ran into previously that was really a deterrent to us adopting.

Mr. CARDIN. Mr. Thomas, in his testimony, pointed out the recommendation that there should be a differential in the credit for children with special needs. In your experience of dealing with other adoptive parents, would it be a good policy to provide a larger credit for adopting parents who are willing to take children in special needs, such as Michael, because of the mixed-race background.

VALERIE. Well, I would think about that three ways. Again, we are not expert testifiers here; we are just ordinary folks. This is my opinion and my impression.

But remember that Michael would have become a special needs child within a couple of years down the road because he would be older. Last night as I was holding him, the thought that Michael would have been to this day shifting around from foster home to foster home is unimaginable to me.

Mr. CARDIN. Let me just stop you one moment.

VALERIE. Sure.

Mr. CARDIN. We can define special needs as we see fit, so it does not necessarily require an age requirement to meet special needs. Adopting parents of a different race of the child can be special needs; a handicap, a disability, or age can be a special need. So we could refine that.

In order that we don't get Michael locked out of an adoptive circumstance sooner, would it make sense to offer certain incentives to try to deal with children who otherwise may go without being adopted?

VALERIE. Again, my experience with other families is special needs frequently develop. I don't know what the statistics are. I would defer to Dr. Pierce on that. But because of limited information on medical backgrounds of the child or the biological parents, oftentimes very significant special needs are not known but do de-

velop. Although a child doesn't start out as special needs, he is a special needs child.

All children need to be adopted. Age is part of the special needs criteria. Personally, I would feel that would be a mistake.

Mr. CARDIN. Mr. Chairman, thank you again for the time and thank you for your presence here.

Chairman ARCHER. Again, thank you for representing what I believe is the great strength in America. I think there are an awful lot of people in this country that share the same feelings that you do.

I am curious, beyond the economic impediment of the cost of adoption, when you began the process to adopt Michael, did you sense that there was any reluctance on the part of the adopting agency to consider you because of the color of your skin?

DOUG. No. Our experience was entirely opposite of that. We were totally supported every step of the way in this adoption. It is to the credit of the agency.

Chairman ARCHER. Well, that, to me, is the way all of the agencies should operate around this country. We should do everything that we can to assure that that will be the case. Because I believe, as you believe, that our society should be colorblind in determining where they should go, what they should do, or anything in their life based on the color of their skin.

My compliments go out to you. Michael is a very lucky young man.

DOUG. Well, actually we keep telling people. They keep saying that, too, but we are the ones who have been blessed by his presence in our lives.

Chairman ARCHER. There is no question that that is true, because there is no greater pleasure than seeing young people grow up, develop, and know that you have had a hand in that. I know because I have watched seven of them in my own house. It is the greatest treasure that I have today for anything that I could have done in life.

We are very grateful to you for coming and bringing your story to us, and God bless you.

DOUG. Thank you for inviting us, and God bless you.

Chairman ARCHER. The committee will recess for 5 minutes while the cameras are rearranged.

[Recess.]

Chairman ARCHER. We welcome our next panel, and we would ask our guests and witnesses to take their seats so that we may continue with today's hearings. We have some excellent witnesses before us today in the field of adoption, and we are pleased to hear your testimony. To begin, Ms. Freivalds. Did I pronounce that correctly?

Ms. FREIVALDS. Freivalds.

Chairman ARCHER. Ms. Freivalds, I apologize, is the executive director of Adoptive Families of America from Minneapolis, Minn., and we are pleased to have you with us and you may proceed with your testimony.

STATEMENT OF SUSAN A. FREIVALDS, EXECUTIVE DIRECTOR, ADOPTIVE FAMILIES OF AMERICA

Ms. FREIVALDS. Thank you, Mr. Chairman and committee members. Thank you for the opportunity to be here to represent adoptive and prospective adoptive families. I am executive director of Adoptive Families of America. We are a national support organization for adoptive and prospective adoptive families.

We provide education, information, and support. We have a membership of about 17,000 families and are the umbrella for about 300 local adoptive parent support groups. I, myself, am the mother of a 20-year-old daughter we adopted as an infant.

I am asking your support today for H.R. 11, title I, concerning a refundable tax credit for adoption expenses. This issue is one that concerns adoptive families deeply, and I want to thank the committee for giving it high priority, because the current inequity in tax treatment of family building methods not only serves as a hardship on adoptive and prospective adoptive families, but it also serves as a significant barrier to the adoption of America's children.

As you have heard today, the expense of adopting a child is significant. We are currently advising families that they need to plan on costs of $10,000 to $12,000 for the adoption of a healthy newborn. The adoption of a child from overseas will typically cost about $10,000 to $18,000. The adoption of a child with special needs can vary from having no unreimbursed expense to a cost of perhaps $10,000, depending on the circumstances of the child.

These expenses include agency and attorney fees, legal expenses, medical costs, foster care, support for the birth mother, and more. All these expenses, of course, are necessary and legal, but they serve to shut out from adoption many families, particularly some families that we think would be the best possible parents. For example, moderate income helping professionals, such as teachers, nurses, social workers, and the clergy.

Families cope and borrow as best they can to afford to adopt. There is no insurance you can buy to cover this cost and there are no extended payment plans. Adoptive parents deplete their savings, borrow from relatives, take out second mortgages, apply for additional credit cards. All these strategies serve to place the young parents in a precarious financial position as they start out their life as a family.

These high adoption costs and other inequities that adoptive parents face, including the inability to obtain paid or even unpaid leave when they adopt, remain a significant barrier to the adoption of America's waiting children.

We have in place currently several important programs to facilitate the adoption of children with special needs, including title IV–E adoption assistance, and these programs should not be disturbed by other changes we might enact. However, we must not lose sight of the fact that these current programs have limitations, typically applied by the States, that restrict the children with special needs to whom they apply.

In other words, all children with special needs who would benefit from adoption are not eligible for these special programs. H.R. 11 correctly applies to all adoptions, ensuring that some of America's

most vulnerable children are not disadvantaged in their search for an adoptive family.

I also want to address the fact that employers in the private sector can be encouraged to participate in providing aid to adoptive families and awaiting children.

I urge the committee to consider providing tax exemption for payments and reimbursements for adoption expenses made by employers to their employees who adopt. These plans represent a praiseworthy way the private sector is stepping forward in aid of America's children and should be rewarded with beneficial tax treatment.

However, these adoption expense reimbursement payments are typically taxable as regular income to the employee and are not deductible as a business expense to the employer. H.R. 11 could be improved by incorporating provisions to make these benefit payments tax exempt both to the employer and to the employee.

A Wendy's International survey of Fortune 1,000 corporations found that for corporations not offering employee adoption assistance benefits, concern about their cost was the single most important reason cited. Tax deductibility of adoption benefits would be a powerful means of removing this barrier to private sector participation.

As you consider these issues, please keep in mind the families and the children that you will be helping. Adoptive parents take children who are not our own and we make them our own. We raise them to be productive citizens of this country. We do this at tremendous initial expense and then give our children everything we can thereafter. We ask that our government recognize this by working toward the tax equity we deserve. Thank you.

[The prepared statement follows:]

Statement of
Susan A. Freivalds

Adoptive Families of America
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Thank you for the opportunity to speak to you on behalf of adoptive and prospective families throughout the United States. It is a pleasure to be here.

I am Executive Director of Adoptive Families of America, a national support organization for adoptive and prospective adoptive families. We are not a child-placing agency, rather we provide education, information, and support to families built through adoption. We have a membership of 17,000 families and individuals, and are the umbrella organization for 300 local adoptive parent support groups, representing thousands more families. Our membership makes us the largest adoption organization in the nation. Personally, I am the mother of a 20-year-old daughter adopted as an infant. Ours is one of many adoption successes. This is a matter dear to my heart.

I am asking your support today for H.R. 11, Title I, concerning a refundable tax credit for adoption expenses. This issue is one that concerns adoptive families deeply—tax equity for family-building methods. I want to thank the committee for giving this issue high priority, because the current inequity in tax treatment of family-building expenses not only serves as a hardship to adoptive and prospective adoptive families, it also serves as a significant, substantial barrier to the adoption of America's waiting children.

1. Adoption expenses are a significant barrier for families hoping to adopt. A tax credit would address this concern, and help move adoptive families toward tax equity for their family-building expenses.

The expense of adopting a child is significant. We are currently advising prospective adoptive families to plan on costs of $10,000 to $12,000 for the adoption of a healthy newborn, whether through an agency or in an independent adoption. The adoption of a child from overseas will typically cost between $10,000 and $18,000. The adoption of a child with special needs can vary from having no unreimbursed expense to a cost of perhaps $10,000, depending on the circumstances of the child.

No one will disagree that these costs represent a lot of money. These expenses may include agency and attorney fees, legal expenses, medical costs of the child's birth and subsequent care, foster care for the child before placement with the adoptive family, support for the birthmother (as permitted by state law), travel of the adoptive parents and/or the child, and more. All these expenses are necessary and, of course, perfectly legal.

For many American families, these expenses are astronomical. The dream of a family for many American couples and singles has become a nightmare of rising expense. These costs can work to shut out from adoption many of those whom we might consider the best possible parents: moderate-income helping professionals, such as teachers, nurses, social workers, the clergy.

Families cope and borrow as best they can to afford to adopt. There is no insurance to cover this cost; there are no extended payment plans. Adoptive parents deplete their savings, borrow from relatives, take out second mortgages, apply for additional credit cards. All these strategies serve to place the young parents in a precarious financial position as they start out their life as a family.

Provisions in H.R. 11, the "Family Reinforcement Act," allowing a tax credit of up to $5,000 for qualified adoption expenses, would go a long way to addressing these concerns and to providing a measure of equity to adopting families. We receive calls daily from parents who wish to add to their family through adoption. Typically they tell us that they have the resources to raise a child or another child, but do not have the $10,000 or so they need to complete the adoption. I believe this tax credit would greatly aid these families and prove a powerful incentive to the adoption of children.

2. An adoption tax credit should be available for *all* legal adoptions, not only as a matter of equity, but also because some children with special needs are not eligible for other incentive programs.

High adoption costs, and other associated inequities adopting families face, including but not limited to the inability to obtain paid or even unpaid parental leave when they adopt, remain a significant barrier to the adoption of America's waiting children. We have in place today several important, necessary programs to facilitate the adoption of children with special needs, including Title IV-e adoption assistance, and these significant programs should not be disturbed by other changes we might enact.

However, we must not lose sight of the fact that these current programs have limitations, typically applied by the states, that restrict the children with special needs to whom they apply. In other words, *all* children with special needs who would benefit from adoption are not eligible for these special programs. H.R. 11 correctly applies to all adoptions, insuring that some of America's most vulnerable children are not disadvantaged in their search for an adoptive family.

Adoptive Families of America member Debra McElroy of New Mexico illustrates the need for tax equity to apply to all adoptions. She writes:

> It is always assumed that children with special needs, once a family who wants them is identified, come into that family without adoption expenses and with government subsidies that cover all their needs. But this is not always the case.
>
> My own son, Nathaniel, is in every way a child with special needs, but because he was in the custody of a private agency—instead of the State of Florida—there was no help for us in the cost of his adoption or with his medical needs. Nathaniel was born 1-1/2 months prematurely—his first two weeks were spent in a pediatric ICU—with "failure to thrive" and developmental delays. Because the State of Florida did not have control, there was little cooperation in processing the paperwork. There was also no purchase of services available, no medicaid or state coverage of the child's medical bills at any time, and no travel expense reimbursement to see our child or to bring him home. But we loved him from the moment we saw him.
>
> It took all of our savings and some borrowing from relatives, but we finally were able to bring him home and finalize his adoption. Our total cost for his adoption, not including medical exams required prior to finalization, was $16,000.
>
> But we were lucky. We have a beautiful son to love. Friends of ours were not so fortunate. They tried to adopt a 5-month-old girl classified as special needs from Washington State. This child was born two months prematurely, with a club foot requiring some amputation, cataracts needing surgery, and dwarfism. The State of Washington offered no travel expense, no subsidy, and no purchase of services. Because she was special-needs classified, however, they would have reimbursed some of the medical co-payments, but only up to $1,000.
>
> My friends wanted this little girl. Her physical situation was not a difficulty for them, since they had previous experience with most of her defects. But the estimated cost of almost $8,000 for the adoption, plus the expense of all the child's medical needs, were severe hardships, particularly when they considered the financial risks that could arise from the medical needs of their two other adopted children with special needs. In the end, they had to make the painful decision not to adopt this little girl.

These cases illustrate how imperative it is that a tax credit for adoption expenses not be restricted to only certain children. Too many children with special needs fall through the cracks of our system. Any tax credit put into place to help children should not have the unintended result of disadvantaging any special needs child.

3. A tax credit is a fiscally responsible way to provide incentives for the adoption of children.

Can we afford to support adoption this way? Where will the dollars come from to support the proposed adoption tax credit?

Study after study shows that adoption is not only the preferred solution for children who cannot be cared for by their birth families in terms of their emotional and mental health, but adoption is also the least-cost solution. Figures from Iowa comparing out-of-home care costs in 1994 find that, on a per-child, per-year basis, family foster care costs $10,000; independent living, $21,455; shelter care, $30,111; and group care, $40,414. A $5,000 maximum one-time benefit to support a child's adoption pales in comparison to these yearly expenditures to support non-familial care of children.

4. Employers in the private sector can be encouraged to participate in providing aid to adoptive families and waiting children. Congress should exempt from taxation employee adoption assistance benefits provided by employers.

In examining ways that equity can be achieved for family-building methods, I encourage the committee to consider providing tax exemption for payments and reimbursements for adoption expenses made by employers to their employees who adopt. A 1993 study by employee benefits consultant Hewitt Associates, cited in "The State of Corporate Adoption Benefits" published by Wendy's International, Inc., found that approximately 18 percent of 1,000 large U.S. corporations now offer adoption-related benefits, up 6 percent from 1991. The average benefits plan provides an estimated $2,000 maximum reimbursement per adoption.

These plans represent a praiseworthy way the private sector is stepping forward in aid of America's children and should be rewarded with beneficial tax treatment. However, these adoption expense reimbursement payments are typically taxable as regular income to the employee, and are not deductible as a business expense to the employer. H.R. 11 could be improved by incorporating provisions to make these benefit payments tax exempt both to the employer and the employee. A Wendy's International survey of Fortune 1,000 corporations found that, for corporations not offering employee adoption assistance benefits, concern about their cost was the single most important reason cited. Tax deductibility of an adoption benefit, on a par with other employee benefits, would be a powerful means of removing this barrier to private sector participation.

As you consider the fiscal and equity issues presented by the proposals you are hearing today for beneficial tax treatment of adoption expenses, please keep in mind the children and the families you will be helping. It is indisputable that in current law and regulation the standing of families formed through adoption is unequal to that of families formed through birth. In spite of this, we take children who are not our own and make them our own. We raise them to become productive citizens of this country. We do this at tremendous initial expense and then give our children all that we can thereafter, just as any real parent would do, because we are real parents. Just ask our children. We ask that our government recognize this as well by working toward the equity we deserve.

Mr. HOUGHTON [presiding]. Thank you very much. Thank you very much, Mrs. Freivalds.

I wonder if Mr. Molock could talk and then Mrs. Molock. Is it Mrs. Molock? Women first.

STATEMENT OF SHERRY DAVIS MOLOCK AND GUIZELOUS O. MOLOCK, JR., FORT WASHINGTON, MD.

Mrs. MOLOCK. My name is Sherry Davis Molock and I am accompanied here today by my husband, Guy Molock, Jr., to urge that Congress support the tax credit for adoption expenses that is included in the Family Reinforcement Act. I am a clinical psychologist by training, currently employed at Howard University in the department of psychology, and I also have a small part-time practice in Fort Washington, Md.

But perhaps the most important experience that I bring here today is that I am also the proud adoptive parent of a 4-year-old and a 2-year-old: Amber, who is 4; Jelani, who is 2 years old, and we also have a biological child who is 3 months old.

In my professional work, I constantly run into families who are interested in pursuing adoption, but who simply cannot afford the considerable fees that often accompany adoption. Adoption is perceived by many families as a way upper middle income and rich people can build a family.

The cost of adoption, which can be as high as $15,000 at some nonprofit agencies, is simply out of reach for most American families. It seems inherently unfair that only a few privileged people can build families via adoption when there are so many needy children who are currently languishing in the child welfare system. There are many people who would love to provide a nurturing environment for a child if given the opportunity.

Many of the families who would like to build a family through adoption are couples who experience infertility. That is certainly true of my husband and myself. They have often spent their life savings on expensive diagnostic tests and/or infertility treatment, which is not covered by health insurance. Other families decide not to pursue treatment at all because they cannot afford it. Many of these families are devastated because they cannot build a family they would love to have.

When these same families decide to build families in an alternative way, namely through adoption, they are then confronted with another set of astronomical fees that are simply out of their reach. It seems no matter what they do they are confronted with insurmountable odds.

One family I have worked with professionally has been attempting to get pregnant off and on for 5 years. The husband is a custodian and his wife is a teacher. After enduring four surgeries, his wife still has not become pregnant.

After deciding that it was more important to them to be parents and not necessarily to be biologically related to their children, they began to pursue adoption only to find that they could not afford the fees at most nonprofit agencies, which range from $5,000 to $16,000. The wife tearfully told me 2 months ago that by the time we save up the money to pay for the adoption we will be too old to meet the age criteria for most agencies.

The income tax credit may be particularly helpful to African-American families who have considered pursuing adoption because African-American families on average earn less and have less income available to them to afford adoption and the adoption fees associated with this.

The income tax credit for adoptive families would also send a message that adoption is considered to be a viable and legitimate way to build a family. Adoption continues to be stigmatized in the mass media as something that is either second best or a process that is frayed with illegalities and problems.

The income tax credit provides a means of acknowledging that Americans can build their families in many different ways, and one viable way is through adoption. We cannot stress enough the important impact we think the tax credit will have on prospective and current adoptive families. It will mean more families will be able to build a family through adoption and many couples will now be able to consider adopting a second child.

One of the greatest joys in our lives has been the honor and privilege we have had from parenting our three children. We hope you will pass the income tax credit so that other families can also share the joy that we experience each day. Thank you.

[The prepared statement follows:]

STATEMENT OF SHERRY DAVIS MOLOCK AND GUIZELOUS O. MOLOCK, JR., FORT WASHINGTON, MD.

My name is Sherry Davis Molock and I am accompanied here today by my husband, Guizelous O. Molock, Jr. to urge that Congress support the tax credit for adoption expenses that is included in the Family Reinforcement Act. I am a clinical psychologist and am currently employed as an Associate Professor of Psychology at Howard University in Washington, D.C. I also have a small, part-time practice in Ft. Washington, Maryland where one of my specialties entails issues in infertility and adoption in African American clients. In addition to my clinical work, I am a professional member of RESOLVE of the Washington Metropolitan Area, Inc., have written the "Ask the Expert" column for the RESOLVE national newsletter for the last two years, am a member of the Board of Trustees of The Barker Foundation, a local adoption agency servicing the Washington, D.C. metropolitan area, and am a member of the Board of Directors of Adoptive Families of American (AFA). In a professional capacity, I have had numerous opportunities to work with African Americans individuals and families who may be interested in adoption. However, perhaps the most important experience I have had with adoption is that I am the proud parent of three children, two of whom are adopted. Amber Najee, age four, came to join our family at the age of seven weeks in February, 1991 and Jelani LeAndrew, age 2 joined our family at five months old in March, 1993. We most recently gave birth to our youngest child, Diarra Marie Imani, age three months in October, 1994.

In my professional work, I constantly run into families who are interested in pursuing adoption but who simply cannot afford the considerable fees that are often accompany the adoption process. Adoption is perceived by many families as a way that upper middle income and "rich" people can build a family; the cost of adoption, which can be as high as $15,000 at some non-profit agencies, is simply out of reach for most American families. It seems inherently unfair that only a privileged few can build families via adoption, when there are many needy children who currently languish in the child welfare system. There are many families who would love to provide a child with a loving and nurturing environment. Allowing families to claim an income tax credit for qualified adoption expenses would be an important step in helping to alleviate the financial burden that adoption often entails.

Many of the families who would like to build a family through adoption are couples who have experienced infertility. They have often spent all of their savings on expensive diagnostic tests and/or infertility treatment that are not covered by health insurance. Others decide to not pursue treatment because they simply cannot afford it. Many of these families feel devastated because they have been unable to have children biologically. When these same families decide that there is an alternative way to become parents, namely via adoption, they are confronted with another set of astronomical fees that often accompany the adoption process. It seems that no matter what they do, there are

insurmountable obstacles to building a family.

One family that I have worked with has been attempting to become pregnant off and on for five years. The husband is a custodian and the wife works as a teacher's aide. They already provide a loving home to three foster children who are between the ages of six and fourteen; these children are not eligible for adoption. While they enjoy parenting their foster children, they want to experience the joys of parenting an infant. After enduring four surgeries, the wife still has not become pregnant and the couple has exhausted all of their savings. After deciding that it was more important to them to be parents and not necessarily biologically related to their children, they began to pursue adoption only to find that they could not afford the fees at most of the non-profit agencies, which ranged from $5,000 - $16,000. The wife tearfully told me, "by the time we save up the money to pay for the adoption, we will be too old to meet the age criteria at most of the agencies!"

This income tax credit may be particularly helpful to African American families who have considered pursuing adoption because African Americans, on average, earn less than White Americans, even when one controls for educational levels and occupational experience, and they are less likely to be able to afford some of the fees associated with adoption. The initial reaction that I get from many African American families when I ask them to consider adoption is "it costs too much" or "adoption is for rich white folks". As one client put it: "when you see movies or TV, you only see rich white people involved with adoption; it always involves large sums of money or the kidnapping of someone's child. The media doesn't portray black families as having any money or as being stable; we just have babies and get on welfare".

The income tax credit for adoptive families would also send a message that adoption is considered to be a viable and legitimate way to building a family. Adoption continues to be stigmatized in the mass media as something that is "second best" or as a process that is plagued with problems and illegalities. The income tax credit provides a means of acknowledging that Americans can build families in many different ways, and one important alternative in family building is through adoption.

We can not stress the important impact that we think the tax credit will have on prospective and current adoptive families. It will mean that many more families will be able to build a family through the adoption process. Many families who have only been able to adopt one child can now consider adopting a second child. One of the greatest joys in our lives has been the honor and privilege that we have had in parenting each of our three children. We hope that you will pass the income tax credit so that other families can also share the joy that we experience each day.

Mr. HOUGHTON. Thank you very much, Mrs. Molock. Mr. Molock, would you like to add.

Mr. MOLOCK. No, Mr. Chairman, I will not give any independent testimony. Mine was a part of my wife's testimony.

Mr. HOUGHTON. All right. She is a good spokesman for you; is that right?

Mr. MOLOCK. Very good.

Mr. HOUGHTON. All right. Good. How about Mr. McDermott.

STATEMENT OF MARK T. MCDERMOTT, ESQ., COUNSEL, FAMILIES FOR PRIVATE ADOPTION

Mr. MARK MCDERMOTT. Thank you. I want to thank the members of the committee for allowing me to address you today. I speak from a number of different perspectives, as an adoptive parent and also as an attorney who handles adoption cases, also as the past president of the American Academy of Adoption Attorneys and as a board member of a group known as FPA (Families for Private Adoption).

You heard earlier this morning from my good friend and my colleague, Mr. Totaro, who spoke to you on behalf of the American Academy of Adoption Attorneys. I am here today to speak to you on behalf of Families for Private Adoption.

Families for Private Adoption is a support group consisting of parents which comprises about 400 families. FPA supports the income tax credit for adoption expenses contained in the Family Reinforcement Act. It will enable persons with lower incomes to form families through adoption and, thus, provide nurturing environments to children in need of homes. The size of one's income is not a reliable measure of one's aptitude as a parent.

Our society will benefit if we encourage the formation of stable, loving families through adoption. At the same time, our Nation's economy will benefit because the alternative for many of these children, who would be adopted, would be to grow up in a welfare system supported by public funding.

The sponsors of this measure are to be applauded. FPA sincerely encourages you and all of your congressional colleagues to work as hard as you can for the passage of this measure. I thank you and I would be glad to entertain any questions if you have any.

Mr. HOUGHTON. Thank you, Mr. McDermott. I think we will wait until the panel has testified.

Ms. Veney.

STATEMENT OF RHODA L. VENEY, EXECUTIVE DIRECTOR, FAMILY AND CHILD SERVICES OF WASHINGTON, D.C.

Ms. VENEY. Thank you. Family and Child Services of Washington, D.C., the agency that I represent, is a private, not-for-profit organization that has been around for 113 years. The agency now serves over 20,000 children, families, and older adults in programs that include child adoption.

I am going to skip around on this testimony.

The modern child welfare system is largely concerned with the care of an increasing number of children, ages birth to 21, who are in need of alternative placements because of parental neglect, abuse, and abandonment.

Professional, custodial, and other services needed to care for these children present a complexity of problems not only because of the sheer number of children in out-of-home care, recently estimated by the Child Welfare League of America to be 450,000, but escalating costs for their care at a time when public dollars are scarce.

Child welfare administrators, as well as the managers of tax dollars, have been severely criticized over the years for not adequately addressing issues involving children who need placement outside of their birth families. One type of permanent placement for children who cannot return to the birth family is adoption.

Children between the ages of birth and 18 are placed with adoptive families through three primary sources: public child welfare agencies (39 percent); voluntary agencies, like Family and Child Services of Washington, D.C. (29 percent); and independent practitioners (31 percent). While child adoptions have increased by about 1 percent in the United States between 1987 and 1990, the studies for 1992 estimate that approximately 91 percent of all adoptions that year were domestic and 8 percent were foreign.

Among domestic adoptions, 50 percent involved relatives of the birth parent and 49 percent were unrelated adoptions. Of the unrelated adoptions, 48 percent were children under age 2, 25 percent were healthy children over age 2, and 26 percent were children with special needs.

While the majority of adoptive placements involved infants, most of the children waiting for permanent families are older, racial minority, and have medical and physical conditions. Last year in the District of Columbia, for example, 99 percent of the adoptions completed by the city's legal child care representative, the Department of Human Services, and 93 percent of those handled by Family and Child Services, our agency, were special needs.

The 1993 profile on children in the District of Columbia revealed 1,918 children in foster care due to parental neglect, abuse, and abandonment. Ninety-five percent of them were African-American, and 11 percent had adoption as a permanent goal.

If what is happening in the District of Columbia is typical, families adopting special needs children may neither need nor should they be eligible for a refundable tax credit since they can either request reimbursement or receive no cost legal services and qualify for monthly stipends.

In conclusion—I think that bell means my time is up, doesn't it?

Mr. HOUGHTON. No.

Ms. VENEY. In conclusion, the credit as currently drafted may be very expensive to finance. Therefore, if there are limited resources, it would seem that they should be used for children who are, in fact, in need of permanent families. Children with special needs and children who are the racial minority.

Thank you.

[The prepared statement follows:]

FAMILY & CHILD

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January 17, 1995

The Honorable Bill Archer
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to the request for comments regarding the Family Reinforcement Act's inclusion of a refundable tax credit for adoption expenses.

INTRODUCTORY STATEMENT

Family & Child Services of Washington, D.C., Inc., (the Agency) is a private, not-for-profit organization that has been in existence for over 113-years. The Agency is now serving over 20,000 children, families and older adults in programs that include child adoption, day care, family preservation, mental health counseling, residential camping, and foster care. We also provide a broad-range of services enabling frail, elderly adults to remain in their own homes. The operating budget of $7.3 million is derived from three major funding sources: government grants and contracts (73%); the United Way of the National Capital Area (22%); and private donations (5%).

BACKGROUND STATEMENT

The modern child welfare system is largely concerned with the care of an increasing number of children, ages birth to 21, in need of alternative placements because of parental neglect, abuse and abandonment. Professional, custodial and other services needed to care for these children present a complexity of problems not just because of the sheer number of children in out-of-home care, recently estimated to be 450,000, but escalating costs for their care at a time when public dollars are scare.

"EQUAL OPPORTUNITY EMPLOYER"

Child welfare administrators as well as the managers of tax dollars have been severely criticized over the years for not adequately addressing issues involving children who need placements outside of their birth families; e.g., the long period of time that children must wait before permanent homes can be recruited and investigated and the children placed.

One type of permanency placement for children who cannot return to their birth families is adoption.

Family & Child Services of Washington, D.C., Inc., has long offered formal legalized adoption as a favored resource for children deprived for whatever reason of life with their birth parents. Traditionally, children adopted have been infants relinquished in the early years of life. Now agency responsibilities in child adoption have expanded to include older children, sibling groups and wards of the District of Columbia.

During the past 48-years, the Agency has initiated a number of projects to improve adoption programming in the District of Columbia:

- the 1st cash subsidy to a low-income family adopting a "special needs" child, in 1960;
- the 1st major recruitment project for African American families to adopt children in public custody, in 1980; and,
- the 1st organized pool of attorneys willing to give pro bono legal services to low-income families seeking to adopt children.

Children between the ages of birth and 18 years are placed with adoptive families through public child welfare agencies (39%), voluntary agencies like Family & Child Services of Washington , D.C, (29%) and independent practitioners (31%). And while child adoptions have increased by 1% in the United States, between 1987 (117,585) and 1990 (118,779), studies for 1992, estimate that approximately 91% of all adoptions that year were domestic and 8% were foreign. Among the domestic adoptions 50% involved relatives of the birth parent and 49% were unrelated adoptions. Of the unrelated adoptions, 48% were children under age 2, 25% were healthy children over age two and 26% were children with "special needs".

While the majority of adoptive placements involve infants most of the children waiting for permanent families are older, racial minority and have medical and physical conditions. (Last year in the District of Columbia, for example, 99% of the adoptions completed by the Department of Human Services and 93% of those handled by Family and Child Services were children with "special needs.")

A 1993 a profile on children in the District of Columbia, revealed 1918 children in foster care due to parental neglect, abuse and abandonment. Among those in public custody over 95% were African America and 11% had adoption as the permanency plan.

STATEMENT ON THE TAX CREDIT

If what is happening in the District of Columbia is typical, families adopting "special needs," children may neither need nor should they be eligible for a refundable tax credit since they can either request reimbursement (of between $1000-$2000) or receive no-cost legal services and qualify for monthly stipends of between $437-$874 for children classified as hard-to-place due to age, race, physical or mental handicap or combination of circumstances making an adoption placement difficult.

IN SUMMARY

Many child welfare advocates and practitioners in human services programming have said that minority and "special needs" children have not been well served by the child welfare system. An examination of the history of children in public funded out-of-home care "...reflects a perpetual march down a road of good intentions with the failure to check the quality of the road, and, indeed, whether the interim goals to be accomplished coincide with those of the final destination". Given the fiscal realities of today some question the rationale for a tax credit that may benefit so few of the 50,000 children in America who were awaiting families in 1993.

If the goal is in fact to encourage American Families to adopt American children it would seem that any refundable tax credit should benefit the greatest number of those awaiting for permanent families.

In conclusion it is unclear given the fiscal demands on our tax dollars how a refundable tax credit for adoption expenses will facilitate efforts to find permanent homes for the most needy among children awaiting adoption; i.e., children who are public wards, members of sibling groups, African Americans and physical or mentally challenged.

Sincerely,

Rhoda L. Veney
Executive Director

RLV:jmr

Mr. HOUGHTON. Thank you, very much, Ms. Veney.
Now, Mr. Kroll.

STATEMENT OF JOE KROLL, EXECUTIVE DIRECTOR, NORTH AMERICAN COUNCIL ON ADOPTABLE CHILDREN

Mr. KROLL. Mr. Chairman and members of the committee, I want to thank you for the opportunity to speak today. I represent the NACAC (North American Council on Adoptable Children), which is an organization of adoptive parent groups, adoption agencies, and individuals who are committed to improving opportunities for permanent homes for special needs children who wait for adoptive families.

I am glad that Congressman Ramstad could be here because the two organizations that represent the largest number of adoptive parents in the country are based in Minnesota, in Golden Valley, which I believe is in your district, and I am in St. Paul, and I think we have a lot to say on this issue and I am glad you are here to hear that.

I am here today because I am an adoptive parent. In 1974, after the death of our second child, we began the adoption process. That ended about 2 years later with the adoption of a 5-month-old infant from Korea, named Mei Lin. Mei Lin is now a freshman in college and is one of those real success stories, I think, in adoption.

We have a birth child and an adoptive child and if someone said what is the difference, I would say their looks. Other than that, they are both our children and treated the same. Some would say that as somewhat of a doting father I am closer to my daughter than I am to my 24-year-old son.

NACAC supports this legislation. We have on the books supported a tax deduction or tax credit since 1989 because it is fair to adopted families. It is fair to adopted families because families with medical coverage get maternity benefits that are by and large unavailable to adopted families. Without the leadership of Dave Thomas, I don't think that that issue would be in the forefront that it is today.

I would like to comment on who I think will benefit most by this piece of legislation. We did a study in 1991 examining barriers that families of color face in accessing the adoption system. We discovered that within the arena of infant adoption by private agencies, that 50 percent of the black infants and 66 percent of the Latino infants were being placed transracially, which led us to believe that somehow there were no families of color out there.

So we began to examine the barriers that families of color faced and discovered that the No. 1 barrier that families of color faced in adopting healthy infants of their race were fees. So it is my belief that this piece of legislation will be a great advantage to families of color in adopting children within their own communities. I would like to again highlight the fact that many children are placed transracially by private agencies in this country.

I don't think transracial adoption is so much an exception as it is fairly normal in this country, as I adopted transracially, as Susan adopted transracially, as many families in our organization have adopted transracially.

I would also like the committee to take a look at two amendments. I am giving committee staff rough drafts of the language. The first one dealt with the availability of this tax credit to special needs adoptive families who do not necessarily have the requirement to pay the $5,000. I would like to see this as an incentive to families who adopt special needs children, regardless of the cost to them, so that they would have a tax credit that would not be refundable, but would be a tax credit available to them because they adopted a special needs child.

Second, and this is very complicated, so I will try to read it from my testimony, there is a small group of people in this country who receive adoption assistance payments who are ineligible—or who have trouble claiming their child as a dependent. The reason they have trouble is because they cannot meet the 50-percent support requirement of IRS rules.

IRS requires that a family receiving adoption assistance payments be able to document that they provide 50 percent of the financial support. Some families get a large subsidy, have children with severe medical problems, and cannot get that tax dependent status. I think we should consider treating the adoption assistance payment as nontaxable income as a possible amendment.

Finally, and I want to make it real clear, that we are very concerned of the possibility of tightening of the title IV–E program; the possibility, as the Governors suggested 10 days ago, of block granting that program. We believe the adoption assistance program for special needs kids is the best program to get kids out of foster care that exists.

Families who adopt these children have limited means. The children have many requirements. If the IV–E program were cut in any way, as a possible offset against this program, I think it would be disastrous to the kids who we have got to care for within the foster care system in this country.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOE KROLL, EXECUTIVE DIRECTOR NORTH AMERICAN COUNCIL ON ADOPTABLE CHILDREN

Mr. Chairman and Members of the Committee, I thank you for this opportunity to appear before you today to discuss the needs of adopted children and their families. My name is Joe Kroll and I am the Executive Director of the North American Council on Adoptable Children (NACAC). NACAC is an organization of adoptive parent groups, adoption agencies, and individuals who are committed to improving opportunities for permanent homes for "special needs children" who wait for adoptive families. For over twenty years NACAC has been involved at the local, state, and national level providing advocacy for children who wait.

I am here today to ask you to support H.R. 11, the refundable credit for adoption expenses and suggest amendments as a way to encourage adoption of special needs children. By passing expanded legislation, you will serve three groups: parents seeking children; families adopting waiting children; and older and handicapped children who now wait in foster care. I firmly believe that by helping to build families through adoption, you will be passing the most positive and cost effective legislation of 1995. Please let me explain further:

SUPPORT FOR REFUNDABLE TAX CREDIT FOR ADOPTIONS

NACAC supports the H.R. 11 refundable adoption credit section because it helps middle income families contend with the increasing cost of adoption.

Perhaps my most relevant qualification for appearing today is that I am the parent of two children, one of whom is adopted. Adoption provided a way for my wife and I to have the family we dreamed about at a very difficult time in our lives. In 1974, following our second child's death soon after birth, my wife and I began the adoption process. We needed to raise nearly $2,500 to adopt our infant daughter from Korea. Today Mei Lin, as we named her, is a freshman in college and one of those real adoption success stories. Anyone who knows me is tired of my countless "Mei Lin" stories.

Since 1989, NACAC has supported a tax deduction or credit for adoption expenses, therefore it is easy to support the proposed tax credit for adoptive families. One welcome outcome of H.R. 11 is that it would expand opportunities to adopt for many working families who would otherwise find it very difficult to raise the necessary funds to adopt a healthy infant through an agency or intermediary.

Adopting an infant from Korea today would cost up to $15,000, six times the fees my wife and I paid twenty years ago. Fees for American infant adoption now range from $7,000 to over $20,000. Not many families' incomes have increased six-fold in twenty years, making adoption increasingly difficult. Most families with health coverage have maternity coverage for biological children but no way to offset the costs incurred in adopting an infant. This tax credit provides such support.

BENEFITS

HR 11 will eliminate fees as a barrier to adoption for African American, Native American, and Latino families.

The tax credit would be helpful by easing access to adoption for African American, Native American, and Latino families who because of prohibitive fees have been unable to adopt infants in their own communities. In 1991, NACAC researched the issue of adoption in communities of color to better understand why there were inordinate numbers of minority children available for adoption. As a result of the research, we wrote *Barriers to Same Race Placements*. In that research brief we documented that minority communities utilized informal or extended family care at a much greater rate than the majority community. However, 50% of African American infants and 66% of Latino infants were placed transracially because large fees form a significant barrier to formal minority family adoptions. This credit will help eliminate that barrier for African American and Latino parents and level the playing field for adoptive families.

We support the sliding schedule which phases out the credit at higher incomes. The program should primarily benefit families for whom cost disallows access to adoption.

AMENDMENTS

1. Tax credit for families adopting waiting special needs children.

At any given time there are approximately 452,000 children in foster care in the United States. Over 35,000 of them are legally free for adoption and waiting for permanent families of their own. More than half of these waiting children have special needs that require additional services and support in order to overcome past traumas and abuse, physical, mental or emotional handicapping conditions, or other characteristics historically marking them as "hard to place." Approximately half the children waiting for families are over the age of twelve. Some of them need to be placed with their siblings. Almost half of waiting children are of minority heritage.

NACAC, as well as other organizations in the adoption community, is actively involved in helping to create innovative methods of recruiting families to adopt these needy or "interesting" children. In the twenty years of our existence, we have learned that there are many special families in this country who are willing and eager to take on the responsibility of loving and raising a special needs child. Many more could be recruited but they need your help.

I suggest that to encourage adoption of hard-to-place children, you should extend the tax credit to families that adopt special needs children, but in a way that would provide for a tax return even if the family had not incurred $5,000 worth of expenses. Families would be eligible if their child fit the state special needs definition. The credit would be a fully refundable credit, much the same as the existing earned income tax credit.

In South Carolina Governor Campbell has also proposed a state employee adoption recruitment program. If passed, each employee who adopts a special needs child will receive $10,000 and an employee who adopts a non-special needs child will receive $5,000. The federal government should consider following Governor Campbell's leadership.

Adoption of special needs children will generate a substantial cost saving. A child in out-of-home care costs the government approximately $5,000 to $10,000 if placed in family foster care or $36,000 if housed in an orphanage. Even if an adoptive family is granted adoption assistance payments which typically are less than family foster care, the cost saving for each special needs child adopted will very quickly return the lost revenue.

2. Treat adoption assistance payments as non-taxable income.

Although adoption assistance payments are not directly taxable, adoptive parents who receive adoption assistance must prove 50% support to claim adopted children as dependents. Or, if they do claim a child as dependent an cannot meet the 50% support test, the income must be reported under the miscellaneous section. The problem is further complicated by the fact that if a child is not claimed as a dependent, insurance companies can deny coverage to that child. The matter could be simply solved by including adoption assistance payments as excludable income for all purposes such as is currently done for Foster Care, AFDC and SSI payments.

CURRENT FEDERAL ADOPTION PROGRAMS

I want to encourage you to continue support for adoption through the Adoption Opportunities Act and through Title IV-E Adoption Assistance.

When considering income offsets to finance H.R. 11 we ask you not to cut these invaluable federal adoption programs that support the placement of special needs children. You should not cut or eliminate programs serving children caught in the foster care system to fund a tax credit that would primarily serve healthy infants for whom there are many families interested in adopting them. It would be inappropriate for this middle class tax entitlement to replace an entitlement program for dependent and neglected children (Title IV-E.)

Since 1978, the Adoption Opportunities Program sponsored by the late Senator Heinz has provided demonstration projects, research, training, and national resource centers for families and professionals who serve America's waiting children. This project is currently funded at $13.1 million dollars. It serves public and private agencies, adoptive parent groups, researchers, and state adoption units.

Since 1980 the federal government has supported adoption assistance agreements with families who adopt special needs children. The Title IV-E Adoption Assistance Program currently serves over 100,000 children and is funded at $399 million in FY' 95. The government contracts with adoptive families to care for children who would otherwise be in foster care. These adoption subsidies can provide families the wherewithal to meet the often severe and costly physical or emotional needs of their adopted children. Thus, many families who would otherwise have been unable to consider adoption are now providing loving homes for some very special children. Elimination or reduction of this program would violate the contract with these valuable families. They have stepped forward to meet the needs of America's most vulnerable children and have made lifelong commitments. Block granting of this program endangers its continuation.

EMPLOYER SUPPORT FOR ADOPTION

Employee adoption assistance benefits are presently taxable as regular income. I would urge you to also classify this benefit as excludable income. NACAC endorses the efforts of Dave Thomas, founder of Wendy's and the most visible promoter of adoption in this country as he works to convince corporate America to offer adoption benefits. I ask Congress to join corporations in their efforts.

CONCLUSION

Adoption legislation always needs to be viewed in individual terms. Right now, a 9 year old girl named Angel is waiting for a family. She has cerebral palsy and a seizure disorder and is fed through a G tube. Angel likes to have people pat and talk to her. There is also a little boy waiting. His name is Jarod. He is a mixed race black and white child - four years of age. His mom had some problems with substance abuse which resulted in developmental delays. He plays well by himself and loves cars and musical toys. Jarod wants a home.

If your work today facilitates finding either child, Angel or Jarod, a forever family - they and their families will owe you a debt forever.

Mr. HOUGHTON. Thank you very much, Mr. Kroll. Thank you very much, members of the panel. Now we will start the questions. Mr. Herger will inquire.

Mr. HERGER. Thank you very much, Mr. Chairman. If I could ask whoever would want to answer this, we hear about these astronomical costs for adoption. I believe some of the numbers that were used, and we heard varying numbers here, but in the vicinity of $10,000 to $12,000 to adopt here in this country, and I think we even mentioned up to $18,000 for overseas. Would one of you maybe go into what we are talking about?

What is it that costs so much and could you break that down; someone?

Ms. FREIVALDS. I would be glad to do that. The adoption of an infant in the United States typically happens either through a private agency or as an independent adoption. The agency has a certain fee that can be as much as $8,000 to $10,000, because they are covering all the expenses of the birth parent, the expense of giving birth to the child, the expense of counseling the birth parent. They have the legal expense involved as well as the expense of maintaining a child or children in foster care. These moneys also can go toward their programs to place children with special needs where they would want to keep the expenses down. So those are the kinds of costs that are involved.

With an independent adoption, a family will typically be paying the medical expenses of a particular birth mother. Of course, there is no insurance in most States that covers this.

Some States do require the adopting parents' health insurance policy to cover the expenses of the baby's birth, but that is very rare. So, typically, they are paying this medical expense dollar for dollar out of their pocket.

Typically, they have to put up quite a large deposit at the hospital before the baby is born, and then there is the legal expense of completing the adoption, the expense of the home study, by which you are studied and educated and approved to be an adoptive parent. So those are the expenses that go into it.

For an overseas adoption, they have all that expense plus, typically, the expense of traveling to the child's country of origin and completing the adoption there. Typically, they will need to stay a few weeks, so that is why that adoption costs typically more.

Mr. HERGER. Now, overseas, a lot of that is travel and staying expenses. Are there other expenses that are somewhat the same as here?

Ms. FREIVALDS. The other expenses are the same. The expense of the home study, the fees by the agencies. Typically, there will be a fee to the agency or orphanage overseas that cares for the child. You will not be typically paying just for the care of your child. It will be a lump sum that the orphanage will use for the care of all the children, including those who cannot be adopted.

Mr. HERGER. Well, I thank you, and when we are thinking about what the American taxpayer is paying if these children are not adopted, the cost over a period of years, which is really the least of the cost, most of the cost is really to that individual child who is going without a loving parent or parents who can care for them,

and not that those where they are do not care for them, but it is obviously never the same.

It would certainly seem that a $5,000 tax credit, even that only goes—it is not even 50 percent, or barely of what the real costs are—it would seem to be a minimum—it would seem to be a very good investment to make early on for many thousands of dollars saved, I would think, over the long run.

So I thank you for what you are doing. I thank each of you. I certainly support you very much and, again, thank you for being here.

Ms. FREIVALDS. Thank you.

Mr. HOUGHTON. Thank you. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. Ms. Veney, let me thank you for informing me of special problems that your agency faces in the District of Columbia. Is it your understanding that, by law or by definition of the rules and regulations, that an African-American child, because he or she is African-American, is at risk or hard to place automatically?

Ms. VENEY. Yes.

Mr. RANGEL. So, therefore, this child, all of the fees and all of the funds that are available that would be paid automatically just because of the child's status.

Ms. VENEY. No, it is not automatic. But any child who reaches age 2 and is not placed can be classified as a special needs child and, therefore, the family is eligible for the benefits that I have described.

Mr. RANGEL. But you would not encourage the expense of a tax credit, refundable tax credit, because you think the special needs child, that most of these services and fees are waived so that there is no expense?

Ms. VENEY. My position, Congressman, is that in this time of very scarce resources, you need to direct the resources where you will get the greatest bang for the buck, I guess that is the expression that I would like to use. If you look at the 50,000 children, the Child Welfare League of America is saying were waiting in 1993——

Mr. RANGEL. I understand that. I have to get to my point, though. If I had no income problems and I wanted to adopt a black kid, are you just saying that I can rest assured I will have no fees to pay, that these fees will be picked up just because of the background of the child.

Ms. VENEY. No, I am not saying that. You may incur some expense. I am saying that at Family and Child Services, and in Washington, D.C., the likelihood is quite slim. In fact, at our agency, while the city allows a charge, $5,000, $2,500 would be the maximum fee.

Mr. RANGEL. I understand that. But you don't have a problem with families that want to, but they cannot afford these fees that they would get tax credits for the fees.

Ms. VENEY. Absolutely not.

Mr. RANGEL. Your problem is it expands beyond that of the child with special needs.

Ms. VENEY. Yes.

Mr. RANGEL. Now, Mrs. Molock, did you have the same understanding as Ms. Veney as relates to the child of color; that seldom if ever would you have any expenses? If you have no expenses, of course, you cannot take advantage of the credit?

Mrs. MOLOCK. My experience has been it depends on the agency and the jurisdiction. We live in Prince George's County, and in Prince George's County we adopted both of our children through social services there. There were no fees involved with the agency, but even those families have attorneys' fees they have to pay plus the expense of just raising their child.

Mr. RANGEL. Well, I would rather be on the side that says that no matter what the status of the child is that if we can facilitate the adoption of that child, that it helps society, it helps the child, it helps the parents. So I am for it.

But let me ask this, Ms. Veney. Isn't one of the problems we have with these at-risk children that many of them are born unwanted?

Ms. VENEY. No, that is not our experience. We have had a waiting list of 60 to 70 single people and couples waiting for African-American children for the last 5 or 6 years. The problem is getting the children for placement, freeing the children for placement, and that is a whole separate hearing.

Mr. RANGEL. Let me try——

Ms. VENEY. The African-American family is out there.

Mr. RANGEL. Let me interrupt, because I did not frame my question correctly. What you are saying is that you can do your job if you have the tools to do it. My question should have been and in my opinion and I hope yours, that there should not be the need to have so many children seeking parents out there. Would you agree to that?

Ms. VENEY. Yes.

Mr. RANGEL. OK. Would you agree that most of the children that end up without parents come from communities that have the highest unemployment, the highest dropout, the highest crime, the highest homelessness?

Ms. VENEY. Yes.

Mr. RANGEL. So one way to alleviate the problem of even placement would be to create conditions where those having the children would avoid it—having children—because they feel that they have a stake in life and opportunity and could not afford for their own sake to have a child that they could not take care of?

Ms. VENEY. I fully support that.

Mr. RANGEL. So we would not even have to think about the expenses involved in making this transition with the expenses of even the at-risk child if we made an up-front investment so that every child that finds themselves in this case would not be at risk, and it would be less expensive and easier for people to take these children into their home and their hearts.

Ms. VENEY. Yes.

Mr. RANGEL. Does anyone disagree with this exchange we have had?

Thank you, Mr. Chairman.

Mr. HOUGHTON. Thank you.

Mr. Ramstad.

Mr. RAMSTAD. Well, thank you, Mr. Chairman, and I want to thank all of you on this wonderful panel for your very important testimony here today. I particularly want to welcome my two fellow Minnesotans, Susan and, you, Joe, and thank you for being here today. I have long been an admirer of your two organizations, Adoptive Families of America and the North American Council on Adoptable Children.

I particularly appreciate, Susan, the line in your testimony and your statement that this is a matter dear to my heart. I know it is dear to the heart of everyone on this panel and it is also dear to my heart in that the three children closest to me are all adopted. My sister, my only sibling, and her husband, adopted the two Korean-born nieces that I have, and one nephew. So this is a very, very important matter to all of us here today.

I noted also, Susan, in your statement, that you say every day you receive calls from parents who wish to add to their family through adoption and typically they do not have the resources because they do not have the $10,000 to meet adoption expenses.

Let me ask you or any of the other witnesses, hopefully, we will in a bipartisan way, enact the $5,000 tax credit for adoption expenses and assuming we do that, do you have any studies, anything, any research or have you kept any numbers, do you have any estimates as to how many children could be adopted who are not currently being adopted if we enact this tax credit?

Ms. FREIVALDS. I am not aware of any studies that would give us hard numbers.

Mr. RAMSTAD. In other words, how many people do you think are actually not adopting now because they just cannot afford it?

Ms. FREIVALDS. Well, there is some evidence that there are maybe a million couples who are thinking of adopting. I think there also are many adoptive parents who would adopt more children than there are.

Adoption agencies have told me that they are not seeing the number of adoptive parents fall off for children as much as they are seeing the size of adoptive families shrink because of the expense of adoption as well as the cost of raising children, obviously. I wish I could give you a hard number, but we do not have that.

Mr. RAMSTAD. Well, that corroborates what I have been led to believe, certainly in talking with people from your respective organizations in Minnesota, as well as Roger Toogood and others from Children's Home Society and other organizations like this.

Well, I just, again, want to thank all of you for your very important testimony, for what you are doing in terms of education, information, and support to adoptive families and certainly we appreciate your testimony in support of the tax credit for adoption expenses. Thank you very much.

Ms. FREIVALDS. Thank you.

Mr. HOUGHTON. Mr. Payne will inquire.

Mr. PAYNE. Thank you very much, Mr. Chairman. I, too, want to thank all the panelists for being here and for the testimony today.

I would just like to go back and try to understand, Mr. Kroll, you mentioned that you felt that the title IV–E program was one that is very important and that we should continue to fund it. I think in your testimony you mention the funding for fiscal year 1995 is

$399 million. You mention that that should be level funded or funding should be increased in that particular program.

Mr. KROLL. Yes. Right now that program is an entitlement program uncapped, and it is really meeting the needs of children who are in the foster care system with special needs who are coming out of the foster care system and are adopted by families, and that program serves the kids who are most in need.

One of the things we have not talked about today very much is the fact that there is competition to adopt children in this country when they are healthy infants; that there are more adoptive families than there are adoptive children who are in the healthy infant category. When it comes to special needs kids, that is not the case. We need to recruit, we need to prepare, and we have to make sure we have the right family and then we need to provide them support. The title IV–E program does that very well.

Mr. PAYNE. Mrs. Veney mentioned in her testimony that we are looking at scarce resources; that one of the things we have to be cognizant of here is that as we have tax credits for various purposes, unless we are increasing the budget deficit, which we do not want to do, we have to find ways to decrease expenses correspondingly. Programs such as title IV–E and others all will, I am sure, be reviewed.

The question then becomes if there is a tradeoff, if a decision is being made about do we do more to fund the title IV–E program or should we have tax credits, I would be interested in anyone's comments about the tradeoff between those two. Where you think we would best spend the money: on tax credits or on title IV–E programs?

Ms. VENEY. Title IV–E.

Mr. KROLL. As an adoptive parent, I think the fairness issue is critical. I want it all, but I think the special needs kids really have got to be a focus, as they have been by the Federal Government for the last 15 years.

Ms. FREIVALDS. We all want to be fiscally responsible, and we certainly do not want to do anything with title IV–E, but I believe that a tax credit will prove to be a fiscally responsible way to move children into adoptive homes sooner so that they can be adopted as babies and do not grow up to become special needs children merely because of their age.

The cost of maintaining a child in out-of-home care is so great and is incurred on a per-year basis, that a one-time $5,000 tax credit, at a maximum, is, I think, really going to pale in comparison to $30,000 a year for group care or $10,000 for foster care per year per child. I would hate to see it come down to a competition between these two programs, as if either one of them is expendable, because I do not believe they are.

Mr. PAYNE. I do not think we want it to come down to competition between these two programs. But given the fact we now borrow more money than we should and we are looking at a balanced budget amendment and we need to reduce that deficit, as we look at the provision of tax credits, then we also have to look at corresponding ways we can reduce the costs. Whether it is in this program or another, there will have to be tradeoffs that are being made.

Ms. FREIVALDS. Well, let us try to look elsewhere than to our kids, if we can.

Mr. PAYNE. I think you are right, and I think you make a good point that this could be considered an investment, because as you invest the $5,000 today, it actually says to the Federal Government or State or local governments that there are less moneys perhaps that will be spent in the future.

Ms. FREIVALDS. Right.

Mr. PAYNE. I think your cause is one that is certainly one I support and it is a very good one. But we always need to think about how it is we are going to be able to be as fiscally responsible as we need to be. I thank you again very much.

Mr. COLLINS [presiding]. We thank the gentleman.

Ms. Veney, in your statement you refer to the fact that when special needs children are adopted, there are stipends that assist those families.

Ms. VENEY. Yes.

Mr. COLLINS. What stipends are those?

Ms. VENEY. Adoption subsidy payments that the family can receive up until the child reaches age 18. They are monthly. They are received monthly. In Washington, D.C., the lowest amount that a family would receive is $437 a month and the maximum would be $874.

Mr. COLLINS. Do those stipends come through SSI or some other agency?

Ms. VENEY. It is IV–E, yes. IV–E money, Social Security. But, in addition, Washington, D.C., has pulled together a pool of attorneys to provide free legal services, also, to cut down on that exorbitant expense that relates to adoption placements.

Mr. COLLINS. My interest is in the stipend. Does that stipend come regardless of the income level of the family?

Ms. VENEY. Yes.

Mr. COLLINS. Thank you.

Mr. Christensen, you are next.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I have a question concerning something Ms.—is it Veney?

Ms. VENEY. Veney.

Mr. CHRISTENSEN. Veney said earlier, but I do not know who can address it best. It is dealing with interracial adoptions and I do not know if there are other problems related to interracial adoptions.

I have heard of things where it is hard sometimes to, through regulatory things that we have done here, to make it harder to have interracial adoptions. Is there any truth to that? What can this body do to help in that area, if there is a problem?

I support everything you have said here today. I believe we need to have this kind of legislation put through, but I am also wanting to see if we can help—we hear about the terrible stories in Michigan and Iowa and some of the heart-wrenching things that have gone on, and I, for one, would sure like to see adoption be an alternative to what has been going on and to make it an easier alternative. I am open for ideas. Anybody.

Mr. KROLL. I think Senator Metzenbaum, last year, had legislation called the Multiethnic Placement Act that addressed two sides of that issue and it is probably the most gut-wrenching issue in the

adoption field today. One side that was addressed was the fact that in some agencies there are delays of children who are legally free for adoption in being placed on the basis of policies that would try to match a child with a family of the same race, and really trying to limit that as much as possible.

At the same time, we are well aware that families of color have a harder time accessing the system. All families of color do not have an agency like Family Services in Washington, D.C., to go to. They may have agencies that they are not comfortable with that have a number of children of their own race.

So it dealt with trying to get access for those minority families, at the same time making sure that children would not wait too long. I think that is where the policy in the country should be, do not delay placements, but make sure that the adoption system is open to everybody.

Mr. CHRISTENSEN. Any other thoughts?

Ms. FREIVALDS. That is Adoptive Families of America's position as well; that we need to put some efforts into working on the barriers to adoption by families of color. Because that is a significant problem, especially when the issue comes up where there are waiting families, such as at this agency, and waiting children in another jurisdiction and they cannot seem to get together.

As we said, this is probably a whole other set of hearings, but it is a significant problem.

Mr. CHRISTENSEN. OK.

Mr. MCDERMOTT. Families of Private Adoption would like to concur in that also. We would like to promote transracial adoption, but, at the same time, promote same race adoption. I think this would—Mr. Kroll made the point well in his earlier testimony that giving this tax credit to families of color will bring more of them into the system and promote adoption.

On your point about the tragic contested cases that have occurred in places like Iowa, the problem with trying to address that on the Federal level is that adoption is largely a product of State law. Each State has its own separate set of laws on how one goes about doing an adoption or freeing a child up for adoption, and there is some progress being made on that at this time.

There is a Uniform Adoption Act that has been proposed by the National Conference of Commissioners on Uniform State Laws, and that is up for consideration by each of the States to see if they wish to enact that into their own legislation. If that happens, there will be more uniformity across the country, and, I feel, fewer problems like we saw in some of these media attention cases.

Ms. VENEY. If I might add just one point, let me dispel the myth that African-American families are not available. There are African-American families available waiting to adopt. One of the tragedies is what you heard this morning with the biracial youngster who was placed not too far from Washington, D.C., in a white family while there are families here in Washington, black families waiting to adopt.

The problem with the transferring of these children is that if we have, for example, a black family waiting to adopt and there is a biracial or a black child in a private agency, we will have to pay

the cost that that agency incurred in taking care of that child before that agency will transfer the child to us for placement.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, Mr. Christensen.

Mr. McDermott.

Mr. MCDERMOTT of Washington. Thank you, Mr. Chairman. I spoke earlier about the whole question of subsidized adoption for hard-to-place kids, and I have a fundamental problem with this proposal in that it is not specific enough. If you take a family, let's say an aerospace mechanic and his wife, who are 35 years old, and he makes $55,000 a year working at the Boeing Co., and he and his wife want to adopt a child, and you have another family making, between the husband and wife, $15,000 or $20,000 apiece, why should you spend what little bit of money we have on subsidizing somebody, the first couple, who, obviously, are capable of taking a child into their home and subsidizing them?

Why should you have this across-the-board kind of program rather than one that relates to the needs of the child beyond those of normal child rearing?

I referenced earlier the program in the State of Washington for subsidized adoption for mentally handicapped, physically handicapped, and mixed racial kids. Seems to me that a targeted program is the only kind of thing that really makes sense. I would like to hear anybody give a justification for this across-the-board thing.

How do you know who that helps? Isn't it really a windfall for some people?

Ms. FREIVALDS. Well, I think the cap on income, on the adjusted gross income that is part of the bill, addresses your issue. Perhaps you feel it is too high at $60,000 phasing out at $100,000, and perhaps it is, but I think that is why the bill includes that provision so that it is not a windfall to people who can obviously afford this expense.

The other issue for adoptive families, though, is an equity issue; that our family building expenses are not seen as legitimate expenses that should receive beneficial tax treatment like the family building expenses of people who give birth to their child.

Mr. MCDERMOTT of Washington. But give me the example of what—besides attorneys' fees, what other family building expenses——

Ms. FREIVALDS. That is what I am talking about.

Mr. MCDERMOTT of Washington. You are saying it is attorneys' fees; you want to limit attorneys fees' in this country?

Ms. FREIVALDS. I am sorry, I thought you said maternity fees.

Mr. MCDERMOTT of Washington. Attorneys' fees.

Ms. FREIVALDS. I am talking about the fact that it does not seem fair to adoptive families that all of the expenses that they have, that we have gone through here today, the fees of the adoption agency, the fees of having their home study done so that they are approved to adopt, even the medical expense. They pay for the birth of their child. Because the child is not a dependent at that time, it is not deductible to that family. However, for the family that gave birth to the child, all of that would be deductible as a medical expense.

That is the equity issue that really does not seem fair to us; that we have these very significant expenses that if we had given birth to the child would be deductible, but because we have not, they are not.

Mr. MCDERMOTT of Washington. Then you would be open to the idea of us limiting the amount that any adoption agency could charge, would you?

Ms. FREIVALDS. Oh, I think that is problematic. I would have to see a specific proposal, I guess, on that. Most adoption agencies are nonprofit to start with. I know that they do, some of them, use the fees that they get for adoption to do other good work.

For example, they will charge more for the adoption of a healthy child than they will for the adoption of a child with special needs as a way of subsidizing the adoption of the child with special needs. Absolutely, a laudatory kind of thing to do, but it does result in these high fees that we have for the adoption of some children.

Mr. MCDERMOTT of Washington. So you are saying that the reason kids do not get adopted in this country is because they cannot pay the up-front $5,000?

Ms. FREIVALDS. I think that is part of the reason, absolutely. I think that we have seen that, for example, in the study that Joe Kroll referred to with African-American families. They name that as their No. 1 reason they were unable to adopt.

Mrs. KENNELLY. Would the gentleman yield?

Mr. MCDERMOTT of Washington. Yes, surely.

Mrs. KENNELLY. May I ask a question? What about white infants. Do you think the $5,000 makes any difference? It is my understanding there is a waiting line for——

Ms. FREIVALDS. No, I think white infants will be adopted.

Mrs. KENNELLY. I understand that there is still a waiting list to adopt white infants in this country.

Ms. FREIVALDS. I think that is true. They will be adopted by the higher income people, though. That is just I think a given; that we are shutting out some of the lower and moderate income folks to adoption of babies because they just cannot afford it.

Mr. KROLL. I was at a training session for adoptive parents and we got into the discussion of race, which is a very controversial issue, and as we were describing the situation that African-American families face trying to adopt infants, the lower income white families said that is us, too; that we do not have the same resources to adopt a healthy white infant that other people might have. So there are large numbers of couples who are, and singles, who would be very good parents, but who do have a fiscal barrier and I was saying in my testimony there are a lot of families of color who fit that description.

Mr. MCDERMOTT of Washington. I think——

Mr. COLLINS. The gentleman's time has expired.

Mr. MCDERMOTT of Washington. If I may say one thing, that is my point. If this were a more targeted thing so the fact that people who actually cannot pay for it—at a $60,000 income, you can pay for having a kid come into your home, or you should not be considering it. You are living too high. But at $25,000, then those maternity fees—and I think there has to be some recognition it is not a

black and white question here, it is a poor versus rich question. That is what the question is.

Thank you, Mr. Chairman.

Mr. COLLINS. Thank the gentleman.

Ms. Kennelly.

Mrs. KENNELLY. Yes, thank you. Let me just take a moment. One of our earliest witnesses more or less insinuated that was a question about party or choice, and I want to say for the record I think any Democrat here is very much in favor of adoption, and those of us who are pro-choice certainly encourage adoption.

Having said that, I am sure all of you have been following in the press and everywhere, I guess, the Contract With America, and one of the pieces of it is the suggestion that anybody 18 and under who has a child, an illegitimate child, not married, will return to live with their families and will not receive cash assistance. They can continue to receive food stamps and Medicaid, but not the AFDC check. We all agree this is not a situation for a child to set up their own household.

However, what impact do you think this will have? Will there be more children being put up for adoption? Have you thought about this as you have read about the Contract, and know what a fast track this is on? If you would help us with that, I would appreciate it.

Ms. VENEY. The impact will be many more sickly babies than there are now because the mothers who will be having these children will not have the wherewithal for prenatal care and nutrition and those things are of concern.

If you look at the medical records of the mothers who are now leaving their children for adoption, you will see children who did not receive prenatal care prior to delivery of the child. So while I will not speculate on the number of children who will hit the market as a result of that, I will speculate the children that we will see will be much sicker.

Mr. KROLL. I would have a fear that more children will come into the foster care system for neglect primarily but also abuse, and those children won't necessarily be relinquished for adoption. They will come into the foster care system and then be processed forever and ever and may become a special needs kid when they are 8, and that isn't a goal that anyone should have. I think we need to provide support to a child from birth through whatever program that is appropriate.

But getting the child—getting more children into the public foster care system is not a goal that anyone should have.

Mrs. KENNELLY. Have you got any suggestions for us? Is there any other alternative solution? Because I am really struggling with this. It is fine to say go back to the home, live with the family. But if the family is dysfunctional, what is the alternative?

Mr. KROLL. There was a program highlighted in the Minneapolis Tribune just Monday, and in that paper they highlighted a program where young mothers with children were taken in as a group with positive parenting models. It was like foster care, but it was—the young mother, the teen mother and the child, so that they had a support system and that that family then, maybe after the young woman graduated from high school, could then go out on her own.

But it was working—it wasn't separating that mom and kid. It was keeping them together with an older couple who was providing support and guidance.

Mrs. KENNELLY. Mr. Kroll, would that older couple be subsidized?

Mr. KROLL. That was a foster care placement, yes. They received State and I assume Federal support for that.

Mrs. KENNELLY. It is hard to see how you do this without any backup or any support.

Mr. KROLL. Oh, you absolutely have to have backup, yes.

Mrs. KENNELLY. Thank you. I thank some of you for mentioning the fact that 72 percent of the children waiting for adoption have special needs. When the gentleman in the chair was talking about subsidies, I think I am right. Subsidies are the reason people do adopt, are able to adopt. They take a special needs child who is desperate for affection and a family. With the special needs comes the subsidy that is necessary so that the adoption does in fact occur.

Mr. KROLL. I think if you look at the description of the children at the end of my testimony you are talking about kids with severe problems, physical problems, children who have been abused so they have serious emotional problems. We have to support the families who step forward to take those kids in.

Mrs. KENNELLY. So the program we have now is working.

Mr. KROLL. Yes, it does work.

Mrs. KENNELLY. Thank you.

Mr. COLLINS. Mrs. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman, and thank you, panel, for coming. I am sorry there aren't more of us. But, as you have heard before, there has been debate on the floor, and we have had to be present for that.

I am coming at the young unwed mother issue from a different direction from Mrs. Kennelly, and I have a great fear of a young teenage unwed mother who chooses to keep her child and moves on to welfare. I believe that that creates a cycle, exactly the cycle we want to tear ourselves away from.

I would like your help in understanding this situation. I want to make a connection mentally in my own mind. If we move ahead with the Contract welfare plan, which would restrict any kind of welfare payments, not all but most kinds, from an unwed mother, do you think the effect of that would be that fewer unwed mothers would keep their children in their home if, for example, they did not have a home, a family to move back into? Do you think that they would give that child up for adoption?

If you think that would be the effect, how would that affect the business that you are in of helping loving parents find a child to adopt? It is an effect—what I am looking for is a connection that is different from what we have been discussing, the effect of the high costs on parents.

Mr. MARK MCDERMOTT. I don't think that eliminating welfare payments to mothers will necessarily increase the incidence of adoption. I think that concept sells the birth parents short who are involved in these cases.

I think most of the professionals that are with me will agree with this. There are many dynamics that go into the decision of a birth parent to make an adoption plan for a child. While economics is certainly a part of it, perhaps an important part, I don't think the birth parents that I have had the good fortune to come in contact with over the years in my profession would make a decision solely on that basis. They do not say I am going to relinquish my child for adoption because I can't get welfare benefits. I think they do—they do it because they love that child, and they want what is best for that child. They make a loving, sacrificing decision that is not going to be made just because they can't get a welfare payment.

Ms. FREIVALDS. I agree with that as well. When you ask birth mothers why they choose to place their child for adoption, the fact that they couldn't support the child is not typically at the top of the list. It is a choice for other reasons. I agree that this is likely to increase the number of children in foster care rather than the number of children in adoption.

Mr. KROLL. My father's father died when he was very young, and my father spent 6 years in orphanages in the twenties. My father died when I was 9, and my mother raised four children between the ages of 3 and 14. Fortunately, at that time she had a welfare program available to her, Social Security, widow's benefits. That was a change over 50 years in the way government has looked at families, and I have to say that that support that my mother had was invaluable.

I think that we have to look at the value of some of the welfare programs as well as the problems. I think that we have to support families, and if they are poor families, we have to look at what we can do to help those mothers raise their children because, typically, they are single moms. Employment opportunity is very important.

In my children's school, young mothers were brought back into school to finish their high school education, and day care was provided on the campus. I am not sure if it glamorized that situation or if it said to some of the other young women I don't want to get into this situation. But there was a support system there set up for those young mothers so they could maintain their families, graduate from high school, and move on.

Ms. MOLOCK. In my professional work as a psychologist, most teenage mothers that I work with don't get pregnant and keep their children because of welfare checks. Usually, the money is the last thing they are concerned about. That is something that is presented in the media a lot. I don't think that will have an impact on adoption.

Most of these mothers are chronically unemployed. They are living in hopeless situations. Oftentimes, although it is unrealistic, they look a lot to their role as a mother as the only meaningful role that they are going to have in their life. Getting a welfare check is not something that they are considering.

Ms. DUNN. Thank you. Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, gentlelady.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Just a quick question for Mr. Kroll. I do appreciate the time that the panel spent. We have sufficiently explained that there has been

work on the floor that has kept most of the Members away. I intended to ask this question or at least make a suggestion, but I will in the followup.

I know what that Social Security program is about because that kept our family together. My sisters and I lived with an elderly aunt rather than go to alternative forms of living, and it was very, very important to us. I would like to think in some measure that I have become one of the chief defenders and protectors of Social Security in the House.

You did raise a question before I would like you just to elaborate on. You talked about special needs children. You talked about parental preparation. Would you just elaborate on that for a couple moments?

Mr. KROLL. Yes. Families who are adopting children from the foster care system (who have been in care for a number of years, who have got the problems, as I illustrated) need to be prepared for those children. They need to be aware of the conditions of the kids. They need to make an active decision that they can care for that child. They need support, both in training as well as medical services, counseling services, et cetera.

But there are excellent programs now that prepare families, because, in the last 20 years, kids who used to be in institutions are now adopted. We have those programs all over the country, in every State that serves families who adopt these special needs kids.

Mr. NEAL. Thank you very much.

I will just close on this note that before the Reagan administration cut those Social Security benefits, one of my sisters and I, we were able to go to college while we received those benefits as well. Terribly, terribly important.

I know that the press would like to have the public believe that everybody that came to the House was born to come to the House. That is not the way this institution works. The House is a very careful reflection of American life. The truth of the matter is that, in some measure today, I give great thanks to Mr. Roosevelt who the new Speaker of the House has proclaimed as the great President of this century. I give great credit to Mr. Roosevelt for going to college, having stood against the forces that would have denied those kind of basic benefits to the American people.

Thank you.

Mr. COLLINS. Thank you, Mr. Neal.

Mr. McDermott has requested to ask another question.

Mr. MCDERMOTT of Washington. Ms. Molock raised the question which prompted me to think of something I watched on television. I watched Phil Donahue one day talk to a woman who had put as many as six kids into the adoptive system. The program was about how they had made deals with people to kind of carry them along on an income basis during that process.

One has to be very careful to draw one's conclusions from what one sees on Phil Donahue. So I would like to hear from you how much of a problem you think that really is in the whole adoptive scene. Because if you are going to put $5,000 out there and some people know that adoptive parent is going to get a $5,000 tax credit, you have set up a situation where there is a pot of money. I would like to hear your comments because you are all experts in

this field and are actually working in the field today. I would like to hear what you think.

Mr. MARK MCDERMOTT. I can start off, I guess, and address that.

I don't think it is a legitimate problem. It is one of these things that we see in the media. It is sensationalized. It makes for good copy on the Donahue show.

In my experience as an adoptive parent and an adoption attorney and my broader experience as the past president of the American Academy of Adoption Attorneys, I see a lot of what goes on around the country. If you are talking about illegal payments being made by adopting parents to birth parents, while of course there are some cases—isolated cases—where that happens, that is certainly not commonplace. It is not the norm.

Mr. Totaro in his earlier testimony made the point that all of the courts that review these cases and finalize these adoptions require financial accountings under oath that are reviewed by the judge and approved by the judge before an adoption can be finalized. So there are controls on this.

The people that do adoptions are not, except in some exceptional situations, doing anything other than following the letter of the law. They would be crazy to do otherwise because the aspect of taking a child into your home, making that child a part of your family and having some serious legal cloud like that hanging over your head. That would create a risk of your adoption being disrupted which is the sort of risk that only a fool would take.

Ms. MOLOCK. Plus I think one of the things adoptive families have to deal with is when you are home studied you go through an FBI check. So I think that those cases that are on the Donahue show are aberrations. It is not the norm.

Mr. MCDERMOTT of Washington. That was my opinion, but I wanted to get it into the record, because some might think that that was a common practice, and I really think that that is not what generally goes on. I think it is a difficult job making an adoption work in the first place. But that is really a very, very rare kind of case. Thank you.

Thank you, Mr. Chairman.

Mr. COLLINS. We thank the gentleman. We would also like to take this time to thank the panel for taking time to come and express your views and opinions about the legislation. We appreciate you very much and, at this time, you are dismissed.

Mr. COLLINS. We will call the next panel: Nancy Summerfield, Val Halamandaris, and Suzanne G. Mintz. We want to thank each of you for being here today.

Nancy Summerfield from Reno, Nev. We will start with you, Ms. Summerfield.

STATEMENT OF NANCY SUMMERFIELD, RENO, NEV.

Ms. SUMMERFIELD. Thank you. Mr. Chairman and members of the committee, I would like to thank you for giving me this opportunity to be here. I would especially like to thank my Representative, Barbara Vucanovich, who has taken the lead in putting the issue of long-term care into the Contract With America.

I am here because I cared for my mother in my home for 8 years. Mom recently died during the holidays from Alzheimer's disease.

As a matter of fact, if she were still living I wouldn't be able to attend this hearing. I am speaking to you on behalf of not only Alzheimer's but other millions of Americans caring for loved ones with other disabilities. My experience is not unique.

I would like to say that the $500 tax credit is an indication that our country and representatives are becoming aware of the financial burden of care giving. It will help some Americans. However, there is a greater need than a tax credit. What is needed is financial help on a regular basis. The $500 is a start in the right direction.

My mother was a strong, independent woman. She raised four daughters by herself, and she worked full time as a civilian for the Armed Forces. As a matter of fact, this is kind of ironic because she dedicated her life working for government, and when she finally needed help. the government wasn't there.

During her illness with Alzheimer's disease, she qualified for Medicaid, but because it was my choice to keep her at home, she received no financial assistance. Her income was used for her care. Other expenses such as utilities, food, clothing, housing, and many other expenses were provided by my husband and myself. If my mother had been admitted into a long-term care facility, Medicaid would have paid the expenses.

It always baffled me that the laws provide assistance for care in a licensed facility, yet to keep a person in their own home or with family members the law provides little or no assistance. It stands to reason that an ailing person will do much better and be much happier if they are with friends and family rather than strangers.

I am using Alzheimer's disease as an example because that is what my mother was afflicted with. However, there are many other diseases and disabilities where individuals require care giving and the expenses are not in many cases recognized as medical or are not tax deductible. As an example, my mother could not even qualify for the definition as disabled for income tax purposes yet she could not eat by herself, speak, bathe, or even walk.

The expenses of care giving are not necessarily for medicine or physician costs. Often, as in my case, the largest expense was the cost of paying someone else to care and stay with my mother so I could continue to work, make a living, and stay productive in society.

In order for many families to keep their loved ones at home, a family member must often sacrifice their living standard. I myself gave up a 26-year career with the government in order to continue to care for my mother.

During the 8 years my mother lived in our home, my mother-in-law also lived with us—with my husband and I—for more than 1 year. She was bedridden due to complications from diabetes and cancer. It was necessary for both of us to provide care for each of them, continue to work, and manage to provide care giving in our absence. It became very costly.

I realize that in order to provide more benefits there is additional cost to the government. However, if some of the existing laws were modified, the government could save money. If Medicaid benefits were changed to assist home-bound patients rather than just li-

censed facilities, it would be less expensive. Costs in the home for the same care or better would be much less.

The first 3½ years I cared for my mother, she was able to attend an adult day care facility during the hours I worked. This was a lifesaver for me. The program was funded through county and Federal grants. These programs need to continue to receive government funding and be expanded.

There is a proposal in the Contract With America that could have made an important difference to us, to make long-term care tax deductible. I paid the bills willingly, but it made me angry I could not deduct these expenses from my mother's nor my income tax. The costs were a result of my mother's illness and should have been considered medical expenses. Mother needed care because she was ill.

Long-term care is a huge problem in this country for millions of families facing Alzheimer's and other diseases and disabilities. Not all of them are elderly. What we need to do in this country is develop community services that people need and give them real financial help to pay for them, whatever their age, whatever the reason for their disability.

I cannot sit here and say that a $500 tax credit would have made a big difference to us. It is a gesture, a step toward recognizing that families are taking on a big job, and they need help. It would be better if it were more money and if it was not just for people caring for parents and grandparents.

There are just as many people providing this kind of care for spouses, adult children, siblings, and other family members. They face the same kind of financial burdens we did.

Once again, I would like to thank Representative Vucanovich for taking the lead in recognizing the long-term care issue. The $500 tax credit is a good start.

Thank you for giving me this opportunity to tell my story.

[The prepared statement follows:]

STATEMENT OF NANCY SUMMERFIELD
of Reno, Nevada

House Ways and Means Committee
January 18, 1995

Mr. Chairman and Members of the Committee. Thank you for giving me this opportunity to be here. I would especially like to thank my representative, Barbara Vucanovich, who has taken the lead in putting the issue of long term care into the Contract with America.

I am not an expert on tax law. I am here because, for the past 8 years, I took care of my mother who came to live with my husband and me when she got Alzheimer's disease. My mother died last Thanksgiving. I am speaking to you on behalf of the families who are out there today taking care of the 4 million Americans living with Alzheimer's disease. I am also here to speak for the millions of families caring for loved ones with other disabilities. I am President of the Alzheimer's Association for Northern Nevada and my experience of caring for my mother is not unique. I'm sure that many of you have constituents who could tell you a similar story.

I would like to say that the $500 tax credit is an indication that our country and representatives are becoming aware of the financial burden of caregiving. It will help some Americans. However, there is a greater need than a tax credit. What is needed is financial help on a regular basis. This $500 is a start in the right direction. It will probably mean the most to low income families, but it is the middle class American that really needs assistance.

My mother was a strong independent woman. She raised 4 daughters by herself and she worked full time as a civilian for the armed forces. In a way, that is the most frustrating part of the story. After a lifetime of working for the government, when she finally needed help, the government wasn't there for her.

During her illness with Alzheimer's disease, she qualified for Medicaid. But because it was my choice to keep her at home with loved ones where she received love and individual care, she received no financial assistance. Her income was used for care. Other expenses such as utilities, food, clothing, housing and many other expenses were provided by my husband and me.

Alzheimer's disease is a medical disease. It is a deterioration of the brain, yet many costs related to caring for victims of the disease are not recognized as medical deductions.

If my mother had been admitted into a long term care facility, Medicaid would have paid the expenses. It always baffled me that the laws provide assistance for care in a licensed facility, yet to keep a person in their own home or with family members, the law provides little or no assistance. It stands to reason that an ailing person will do much better and be much happier if they are with friends and family rather than strangers.

I am using Alzheimer's disease as an example because that is what my mother was afflicted with. However, there are many other diseases and disabilities where individuals require care giving and the expenses are not in many cases recognized as medical or are not tax deductible. As an example, my mother could not even qualify for the definition of <u>disabled</u> for tax purposes and claim the disability deduction. Yet, she could not eat by herself, speak, bathe, or even walk.

The expenses of caregiving are not necessarily for medicine or physician costs. Often, as in my case, the largest expense was the cost of paying someone else to care and stay with my mother so I could continue to work, make a living, and stay productive in society. In order for many families to keep their loved one at home, a family member must sacrifice their living standard. I, myself, finally gave up a 26-year career with the government in order to continue to care for my mother.

During the eight years my mother lived in our home, my mother-in-law also lived with my husband and me for more than a year. She was bedridden due to complications from diabetes and cancer. It was necessary for both of us to provide care for each of them, continue to work, and manage to provide a caregiver in our absence. It became very costly.

I realize that in order to provide more benefits there is additional cost to the government. However, if some of the existing laws were modified, the government could probably save money. If Medicaid benefits were changed to assist home bound patients and not just licensed facilities, it would be less expensive. Costs of long term facilities can be $3000-$4000 monthly. Costs at home for the same care, or better care, would be much less.

The first three and a half years I cared for my mother, she was able to attend an Adult Day Care facility during the hours I worked. The program was funded through county and federal grants. This was a life saver for me. These programs need to be expanded. My mother was released from the program because she became incontinent and advanced into another stage of Alzheimer's disease. If these programs continue to receive government funding and are expanded to accommodate more advanced individuals, this would also save money because it would allow families to keep their loved ones home for a longer time.

There is a proposal in the Contract with America that would have made an important difference to us. That is the proposal to make long term care expenses tax deductible. I paid the bills for my mother's care willingly. But it made me angry that I could not deduct those expenses from either my mother's or my income tax. The costs were a result of my mother's illness and should have been considered medical expenses. Mother needed care because she was ill.

Long term care is a huge problem in this country for millions of families facing Alzheimer's and a lot of other diseases and disabilities. Not all of them are elderly. What we need to do in this country is develop community services that people need and give them real financial help to pay for them -- whatever their age, whatever the reason for their disability. That is a much bigger discussion than the one we are having here today.

I cannot sit here and say that a $500 tax credit would have made a big difference to us. It is a gesture, a step toward recognizing that families are taking on a big job and they need help. It would be better if it was more money, and if it was not just for people caring for parents and grandparents. There are just as many people providing this kind of care for spouses, adult children, siblings, and other family members. They face the same kind of financial burdens we did.

Once again, I would like to thank Representative Vucanovich for taking the lead in recognizing the long term care issue. The $500 tax credit is a start, especially when it is combined with the provision to make long term care expenses deductible.

Thank you for giving me a chance to tell my story. I would be happy to answer your questions.

Mr. COLLINS. Thank you, Ms. Summerfield.
Mr. Halamandaris.

STATEMENT OF VAL J. HALAMANDARIS, PRESIDENT, NATIONAL ASSOCIATION FOR HOME CARE

Mr. HALAMANDARIS. Thank you, Mr. Chairman. It is a pleasure to be here with you this morning.

I would like to begin by commending you and the members of this committee for holding a hearing and focusing on the most crucial problem that we have in America, which is keeping families together. Families are the bedrock of American society. You are here to be commended for looking and seeing what we can do to help support them.

We also want to commend you for recognizing the changes in the tax law and the Tax Code inevitably affect and influence social policy in this country. So we think that you are on the right track. We thank you for that, and we support what you are doing here and your suggestion to offer a tax credit for people that need help and assistance in caring for parents and grandparents.

My long history as chief counsel with the House Aging Committee and before that with the Senate Aging Committee, some 20 years of experience in that field—I wrote a similar bill back in 1974, which went nowhere, and I am glad to see the concept resurrected for your consideration.

It has been said by other witnesses this morning, and I would like to reiterate, that—things that I am sure you already know—long-term care is a massive problem that we face in this country. We are presently spending about $58 billion in long-term care, most of that in nursing home care and most of that in the Medicaid program.

If you ask the Governors, Republicans and Democrats alike, what the biggest problem they have in their State budget is, they will say the Medicaid program. It is difficult to keep up with that. Most of it goes to provide nursing home care.

The Governors in 1992 and again in 1993 passed a resolution asking the Congress for more flexibility and for the ability to use some of those Medicaid dollars in home and community-based care. They figured out they could spend similar dollars and cover more people.

With specific reference to the program in Mr. Rangel's State, New York State has a program called the Nursing Home Without Walls. You probably know very well, sir. This was something that was created by the legislature. Individuals who are about to gain admittance to a nursing home, if their care can be met for 75 percent or less of what the State deems it would pay to put them in a nursing home and there are qualified home care agencies who can provide comparable care, they are allowed to do so.

There have been numerous studies by the legislatures and indeed by the auditors of New York State that have documented that they saved over 50 percent what they normally would have spent in community-based care as opposed to what they would have spent by putting people in institutions. I commend that program for your interest. I would just like to have us look at the system in general terms and what it encourages.

The Medicare program, as we all know, valuable as it is, does not pay for long-term care at all. Private insurance only pays for about 5 percent of the cost of long-term care—it is growing, thank goodness, but it still is inadequate. It is difficult to protect yourself for dealing with the cost of a long-term illness.

I heard Senator Rockefeller talk about Alzheimer's with his mother in saying we have resources. Everybody knows we have resources, but it stretched those resources to the limit to care for our mother who needed long-term care. If he and his family have trouble, I suggest most of America is going to be beyond troubled with the problem.

So there is basically nothing you can do to protect yourself right now against the costs of long-term care. You can't save enough money to deal with it. You can't buy private insurance to protect you. Medicare doesn't cover it. The only way you get help or assistance is by going on the dole, going on the welfare program, and then what is offered is the Medicaid program.

Well, I just want to suggest to you that we can do better than this. If you think about it, what is the cost of placing somebody in a nursing home in this country? The average person who goes into a nursing home is in there 30 months, and the cost is about $2,100, on average, nationwide. Some States a lot more. Every individual we place on the Medicaid program costs us $100,000.

Now, when you compare that with the tax credit that could be given to people, and if they share the costs of caring for their mother or their father or if they don't pay taxes, there is some sort of a negative tax credit, it would be indeed very, very helpful to keep some of those people at home where they prefer to be, as opposed to placing them in an institution and having them go through this elaborate gaming of the system.

There are books and there are lawyers that teach you how to make your parents eligible, your grandparents eligible for the Medicaid program, basically to divest themselves of all their assets. Wouldn't it be much better to give families a tax credit to care for their parents and indeed to be able to share it among several children, which is beyond the scope of the bill that has been introduced?

I would suggest to you if it costs $100,000 on average to put somebody into a nursing home, then the $500 tax credit is small by comparison, and that amount needs to be adjusted.

But I again would like to reiterate and commend this committee for looking at this problem. We do think that the system we have in place is flawed and needs to be changed and needs to be adjusted.

I am not here advocating that Medicare be retrenched or that the Medicaid program be cut dramatically. I am suggesting some reallocation of the dollars that we are currently spending along the lines that have been suggested by the Governors and others.

One final comment that I have suggested, the Tax Code already allows a one-time $120,000 tax credit if you sell a home, your principal residence, in your retirement years. You can have that escape capital gains tax, at least up to $120,000. I see nothing wrong with allowing families to take that credit incrementally year by year in the form of an annuity.

There are a series of programs now called reverse annuity mortgages where people slowly draw down the proceeds of their home, provided that it is used—and I emphasize this again—provided that it is used to provide for your long-term care. In that instance and only in that instance do I believe that it should be possible.

Again, the Tax Code currently allows it one time. I am suggesting that we ought to be able to allow people to do that incrementally over a period of time provided the care goes to meet their long-term care needs.

Again, I commend this committee and the Members for looking at what are some very important problems and looking beyond that at the value to society, because that is what unites us as a society.

Thank you, Mr. Chairman, members of the committee.

[The prepared statement follows:]

Testimony of Val J. Halamandaris, President

National Association for Home Care
Washington, D.C.

My name is Val Halamandaris. I am President of the National Association for Home Care (NAHC), which represents our nation's home care providers -- including home health agencies, home care aide organizations and hospices -- and the people they serve. NAHC is committed to assuring the availability of humane, cost effective, high-quality home health services to all individuals who require them. In short, NAHC's principal mission is keeping families together.

I would like to take this opportunity to commend the Chairman and the Committee for examining ways to assist families. We are delighted to work with this Committee on ways to help families care for parents and other loved ones at home. We believe in individual responsibility and family responsibility to care for the aged, infirm and disabled to the extent it is possible to do so. We believe the problem of long-term care is so great that private insurance as well as state and federal governments must share their resources now and in the future in order to deal with it.

As one who served as counsel to both the House and Senate Aging Committees, I have a long history with family caregiver issues and understand both the financial and physical toll that providing for a dependent loved one has on American families. In fact, in 1974, I helped write a bill that would have provided tax credits to families for health care costs, much along the lines of H.R. 11.

Long-Term Home Care: The Growing Need

I want to stress our views that long-term care is one of the most devastating problems America faces today. Estimates indicate that between 9 and 11 million Americans of all ages require long-term care because of chronic illnesses or disabilities that render them unable to perform basic tasks of daily living without assistance. This number could double by the year 2030 to more than 19 million.

Today we are spending some $57.8 billion on long-term care, mostly for nursing home care. Medicare does not provide for long-term at all and Medicaid limits its reach largely to institutional care for individuals whose income places them below the poverty line. Private insurance does not begin to provide adequate protection for the cost of long-term care. As a consequence, many families exhaust their physical, emotional and financial resources providing and purchasing long-term care. A million Americans a year are impoverished trying to meet the cost of long-term care. Only the most wealthy Americans are insulated from potential financial devastation caused by the need for long-term care which can happen to anyone. The sad truth is that there is nothing most Americans can do to prevent their lifetime savings from being wiped out in a matter of months paying for long-term care.

After more than 32 years of experience, I am a strong advocate of long-term home care because it improves the quality of life, is cost effective and most of all, keeps families together. It reinforces and supplements the care provided by family members and friends and maintains the recipient's dignity and independence, qualities that are all too often lost in even the best institutions.

I would like to call to the Committee's attention the positive experience of the states with long-term home care and their judgment that it is highly cost effective allowing the same or fewer dollars to be used to provide higher quality of care for more people.

Long-term home care is also often much less costly than institutional care. New York State's experience with its Nursing Home Without Walls program has been a great success. It takes individuals who are eligible for Medicaid and allows them to be cared for at home if the costs so incurred are 75% or less than the cost of comparable nursing home care. Well-documented studies by the New York State Senate have proven that the program has allowed the state to save them 50% of the cost for these patients which would have been incurred had they been placed in a nursing home.

I would also like to call to the Committee's attention other models that work. Medicaid waiver programs have increasingly made use of home care services as a way to reduce their Medicaid costs. For example, New Mexico's waiver program for people with AIDS estimates a savings of $1100 a month for patients who use home care rather than skilled nursing facility care. The average patient plan of care costs $1000 a month for home care compared to $2100 a month for skilled nursing facility care. Moreover, New Mexico reports that only about 47% of patients receiving waiver services are hospitalized in a given year, compared to 70% of those not under waiver.

The National Governors' Association (NGA), after years of study, recognized this and adopted a resolution in 1992 stressing the importance of home- and community-based services as a key component of health care reform. NGA recommended elimination of the current institutional bias in public programs such as Medicaid. The Governors, both Republican and Democratic alike, are asking for more flexibility to make greater use of home care as the more preferred and cost effective method of meeting the growing need for long-term care.

In many ways, the problem we face with long-term care is the direct result of the success this Nation has had in promoting longer, healthier lives through medical advancements, which have been supported by programs such as Social Security and Medicare. Any efforts to meet the Nation's long term-care needs should build upon these national success stories.

The tax credit for family caregivers as envisioned in H.R. 11, The Family Reinforcement Act, is a good first step toward providing the proper incentives to encourage family members to care for loved ones in the home. It appropriately uses tax policy to help shape social policy. For example, the deductibility of Individual Retirement Accounts (IRAs) is specifically geared towards encouraging Americans to save money. We would go even further than the Committee in saying that when an individual in retirement years draws on his or her IRA for purposes of paying for their long-term care bills, these funds should be exempt from taxation. Whereas current laws encourage individuals to resort to unethical behavior of hiding assets or spending-down their income in order to become eligible for Medicaid, a program largely limited to coverage for institutional care, a tax credit for individuals who take on the burdens providing care for a parent or grandparent is an excellent idea which would keep families together by caring for loved ones at home.

The very nature of home care and hospice is to help keep families together; to help care for individuals in the least costly, most effective setting; and to help individuals retain their dignity and independence. This Act, therefore, will work towards a goal upon which all Americans can agree: keeping families together.

Expanding H.R. 11

It should also be stated that long-term care is an intergenerational problem which is defined not by age or family relation but by disability. All family members are vulnerable -- children born with disabilities, parents paralyzed in an accident, grandparents stricken with Alzheimer's Disease. Approximately one-third of those who need long-term care services are under 65 years of age. Rather than limiting the tax credit to parents, grandparents and spouses, the Committee should extend these incentives to families who care for a disabled child, brother or sister. Through the tax code, we should encourage families to care for their own at home.

The tax credit should also be available to adult children who shoulder their parents' health care costs, even if the parents are able to continue to live in their own homes. And the credit should be available in cases where adult children share the costs of their parent's long-term home care needs. Under current tax law, even in cases where children share the costs, only one child can claim the costs on his or her income tax return. Changing this policy will make it easier for families to work together to meet these needs, without asking any one family member to bear the full weight of these costs. According to sociological studies, one sibling often becomes the burden bearer, whereas we believe all children in a family should be encouraged, through the tax code to participate.

By limiting the credit only to some family members, and only in cases where parents live with their adult children half the year, whole segments of society will be denied an incentive for providing care in the home. Expanding the credit as we have suggested here will help fulfill the commitment to American families as promised in the "Contract with America."

Tax Credits Can Complement Other Federal Programs

The tax credit proposal in H.R. 11 will help families care for their loved ones at home. While a good and worthwhile first step, it will not fill the need millions of Americans face every day in their struggle to care for family members -- young and old -- who need long-term home care. A $500 tax credit, while certainly worthwhile, will not significantly offset the tremendous costs involved in caring for a loved one in need of long-term care. Only a national long-term home care program can ensure that all individuals in need of care have access to high quality, affordable home care. Tax credits should be viewed as an addition to, and not a substitute for, further action.

Neither should it be viewed as a substitute for any part of the Medicare or Medicaid programs. The tax credits should not be paid for through any reductions in these programs. Any incentives provided through a tax credit could easily be wiped away if the credit is financed through cuts in the Medicare program. For example, a 20% payment on Medicare home health services would require the average home health beneficiary to pay $965 in increased out-of-pocket costs. The $500 tax credit provided to the taxpayer, therefore, will be dwarfed by the increased cost to the beneficiary.

I would like to stress that the primary option currently available for families who need long-term care is to require a spend down and impoverish themselves so Medicaid will step in and pay for the cost of nursing home care. There are even numerous handbooks on the market which do a lively business teaching people how to establish eligibility. Once a patient enters a nursing home, their average length of stay is about 30 months at an average cost of $2100 a month. That means the taxpayer will pay an average of $100,000 for every person so placed. We believe it makes a great deal more sense as a matter of social policy to increase the amount of tax credit available to families so they will be encouraged to combine their resources and provide the care needed by their relatives. To be meaningful, the amount of the tax credit should be a great deal higher than $500.

The tax code presently allows a one-time exemption from capital gains coming from a sale of a primary residence of a senior citizen. I see no reason not to allow the same exemption from taxation for reverse annuity contracts in which seniors slowly draw down the equity in their homes provided this money is used to pay for the cost of medical care and especially long-term care.

Conclusion

I want to again thank the Chairman and the Committee for inviting the National Association for Home Care's views on this important matter and for your leadership and interest in helping meet the very real and compelling needs of American families. A great many improvements can be made today, and in keeping with the Contract with America, ones that can bring real and immediate improvements to families struggling to keep their families together and shoulder the emotional and financial burdens of long-term care.

I look forward to working closely with you in this Congress on H.R. 11 and other issues the Committee will consider.

Mr. COLLINS. Thank you. We would like to inform each panelist that your full statement will be entered into the record.

Ms. Mintz.

STATEMENT OF SUZANNE G. MINTZ, PRESIDENT, NATIONAL FAMILY CAREGIVERS ASSOCIATION, ON BEHALF OF THE HOME CARE COALITION

Ms. MINTZ. Thank you, Mr. Chairman, for this opportunity to testify today.

My name is Suzanne Mintz, and I am president of the National Family Caregivers Association, an organization dedicated to improving the lives of the Nation's approximately 18 million family care givers. In case you are unfamiliar with that term, family care givers are those individuals who care for a loved one who is chronically ill or disabled.

When I was 28 years old, I became a family care giver. It was then that my husband, Stephen, age 31, was diagnosed with multiple sclerosis, a debilitating and incurable neurological disease. In the ensuing 20 years, we have struggled to redefine normalcy while living with the increasing disability. Stephen uses a wheelchair and needs assistance with the basic activities of life, such as dressing and transferring.

I am pleased to testify here today on behalf of the Home Care Coalition and its more than 100 national organizations. The Coalition is a diverse group, dedicated to enhancing consumer access to quality home services, supplies and equipment. The Home Care Coalition is delighted that the Contract With America includes a $500 refundable tax credit for individuals caring for a parent in their home since help for care givers is one of our legislative priorities.

I have to question, however, why the Contract considers those care givers who assist an elderly parent to be more deserving than those care givers such as myself who care for a spouse or those who care for a chronically ill or disabled child. We, too, are in need of equal help and support.

Care giving cuts across all generations and family relationships. To dissect us into groups makes neither good economic sense nor good policy.

I know a couple here in Washington, both of whom are in their seventies. They are not being cared for by anyone. Rather, they are caring for their own adult child who is bedridden with multiple sclerosis. In this case, the elderly are caring for the middle aged. Are not these people entitled to a tax credit?

I implore the committee to examine carefully the complete spectrum of family care giving. It is a mistake and poor policymaking to single out one group of care givers for support.

Collectively, family care givers provide two-thirds of all the home care services in this country. We provide it for free with love and based on a sense of duty.

The National Family Caregivers Association estimates that the market value of care giver services is over $190 billion a year. The number is so staggering let me repeat it—over $190 billion of free service every year.

Let me make clear this is not our replacement value. That amount would be a great deal higher. It is only an estimate of what

we would be paid at market rates for providing basic, nonmedical care giving services 4 hours a day, 7 days a week.

Family care givers provide a wide range of services, such as dressing, feeding, bathing and toileting, activities that most people take for granted. We provide other services as well: transportation, shopping and management of financial affairs. We dress wounds, give injections and, with the increasing sophistication of medical technology, we can now even give people IV therapy at home.

In addition to care giving, many family care givers are employed full time. Those who work part time or not at all face significant financial burdens which are compounded in their own old age because care giving does not accrue Social Security benefits. These care givers, in effect, are being doubly penalized.

There are many debilitating aspects of care giving, financial drain just being one of them. Others include depression, isolation, negative changes in family dynamics and complex decisionmaking for another person's life.

The proposed $500 tax credit is a gesture toward lessening these conditions. It is a first step. Some people will use it to get much needed respite care, a few hours away on a regular basis.

Getting a break from care giving is what many surveys show care givers want most and find most beneficial. In fact, protecting care givers from burnout is the most cost-effective thing that you can do.

Some people will use the $500 tax credit to pay for basic medical expenses. Many care giving families do not have any insurance and those that do are often confronted with significant out-of-pocket expenditures for the patient's therapies or medications. Because of this, many care givers forego their own medical care.

Some people will use the $500 tax credit to pay for equipment and other items that promote independence and enhance the quality of life. My husband has hand controls in his car. These have enabled him to continue to go to work, earn a living, and pay taxes. The cost was $500. We have just spent $5,000 to make our home more accessible so that he can shower and use the toilet without my help. Neither of these costs are covered by insurance.

Because of all these reasons, Mr. Chairman, the proposed elderly care tax credit is a critically needed first step in recognizing the contribution of America's family care givers and our need for help in caring for our loved ones. But recognize it is only a first step and a small one at that.

The Home Care Coalition has again defined other significant measures that it believes will strengthen the family and improve home care, and we hope you will consider these additional proposals which are in our written testimony.

In conclusion, I would like to read a quote from a family care giver, a woman who should be in the prime of her life who is caring for her spouse.

> I feel that my life has become a day-to-day existence with no hope of a happily ever after. I feel like a very old 46-year-old. I am needed but get no strokes or warm fuzzies. I care for him, but who cares for me?

Please help us find an answer to that question.

[The prepared statement follows:]

STATEMENT OF SUZANNE G. MINTZ
PRESIDENT
NATIONAL FAMILY CAREGIVERS ASSOCIATION
ON BEHALF OF THE
HOME CARE COALITION
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
January 18, 1995

INTRODUCTION

Good morning, Mr. Chairman, and thank you for giving me the opportunity to testify today. My name is Suzanne Mintz, and I am President of the National Family Caregivers Association, an organization dedicated to improving the lives of the nation's approximately 18 million family caregivers. Family caregivers, sometimes referred to as informal caregivers, are those individuals who care for a loved one who is chronically ill or disabled.

I am pleased to testify here today on behalf of the Home Care Coalition. NFCA is an active participant in the Coalition which is comprised of more than one hundred national organizations. I am here to express the Coalition's strong support for the proposed Elder Care Tax Credit in the House Contract with America.

I would like to begin my testimony by sharing with you some background on my life and why the issue of family caregiving is so important to me. When I was 28 years old, my husband Steven, then 31, was diagnosed with multiple sclerosis, a debilitating and incurable neurological disease. In the ensuing 20 years, we have struggled to redefine normalcy while living with his increasing disability. Today Steven uses a wheelchair and needs assistance with some of the basic activities of life, such as dressing and transferring. During the past twenty years I have suffered from two bouts of clinical depression and our marriage was disrupted by two periods of separation. It is because of my own experiences that I co-founded the National Family Caregivers Association with my long time friend, Cindy Fowler, who cares for her 82 year old mother who is afflicted with Parkinson's disease.

Cindy and I both know the personal and financial toll that caregiving takes on American families, regardless of whether they are caring for a loved one who is elderly, middle aged or still a minor. We know full well why a tax credit for family caregivers would be so beneficial. Proposals such as the Elder Care Tax Credit enhance the quality of life for both the caregiver and their loved one, and thereby reinforce the family unit.

THE HOME CARE COALITION

The National Family Caregivers Association is an official member of the Home Care Coalition, which was founded in January of 1991. The Coalition is a diverse group of organizations representing consumers and patients, family caregivers, health care professionals, providers, and manufacturers dedicated to serving people in their homes. The mission of the Coalition is to enhance consumer access to quality home care services, supplies, and equipment, and it focuses attention on providing education and communications advocating the benefits of home care to policymakers and the public.

HOME CARE COALITION'S SUPPORT OF THE ELDER CARE TAX CREDIT

The Home Care Coalition has identified specific ways to improve access to home care. The Elder Care Tax Credit provides an excellent first step towards achieving our goals. There are other critically needed approaches as well, and we look forward to presenting to Congress this year legislative initiatives which recognize and support home care as a cost-effective and patient-preferred alternative to institutional care. Legislative initiatives to encourage home care that the Coalition supports include patient choice of provider, caregiver issues, coverage of home IV and respiratory therapy serivces, reimbursement issues, and quality assurance controls for the patient receiving home care services, supplies and equipment.

Specifically, the Home Care Coalition supports the following legislative initiatives:

I. Caregiver Issues

Caregiver Tax Credit - Provide $500 refundable tax credit for individuals caring for a chronically disabled grandparent, parent, spouse or child in their home.

Personal Assistant Services/Attendant Care Demonstration - On a demonstration or pilot project basis, require all payors (Medicare, Medicaid and private payors) to provide defined period of personal assistant services/attendant care services to persons with disabilities requiring assistance with activities of daily living.

Caregiver Safety and Well-Being - Require all payors to take into consideration the safety, health and well-being of the primary caregiver when determining the medical necessity of, and prescribing, appropriate home health services and home medical equipment (HME). Authorize payors, including Medicare, to pay for specific items and upgrades of otherwise medically necessary HME when, in the clear and documented clinical judgment of the prescribing health care professional, the HME recommended will significantly reduce the risk of injury to the unpaid primary caregiver.

II. Patient Choice

Patient Choice of Provider - Require health plans to allow a patient to go to a provider of their choice outside of their health plan's network at no more than a reasonable charge to the patient.

Patient Choice/Upgrade - Amend the Medicare law to authorize beneficiaries to pay suppliers who agree to take assignment on their claims the balance above the Medicare allowable for the equipment which has functional or other features exceeding those of the item determined by Medicare to be covered. Further amend the Medicare statute to clearly continue to allow a supplier to submit any claim for payment under assignment for an item the beneficiary chooses to upgrade.

III. Coverage and Reimbursement Issues

Home Care Benefit Package - Include legislatively defined comprehensive home care services, supplies and equipment in any standard health benefit package.

Medicare Coverage for respiratory therapy services - Cover respiratory therapy services under Medicare.

Medicare Coverage for home intravenous (IV) therapy - Cover home IV therapy services under Medicare.

Medicare Coverage for occupational therapy - Cover occupational therapy under Medicare.

Non-Discrimination against home care - Provision would eliminate any financial or other disincentives for utilization of home care under Medicare or private payor systems. (Requiring home care beneficiaries to pay a co-payment for care is a disincentive to use home care when there is no co-payment required for institutional care.)

Reimbursement for physician home care visits - Medicare and other payors should reimburse the physician at a reasonable fee for medically necessary home care visits to a patient in the home.

IV. Quality Assurance

Certification of Suppliers; Quality Standards - Establish Medicare supplier standards based on the complexity of the services provided for suppliers to be able to bill Medicare for durable medical equipment, prosthetics and orthotics (DMEPOS). For example, suppliers providing respiratory equipment and related services would have to meet more rigorous standards than suppliers providing only "traditional" HME such as hospital beds and canes. Further, suppliers providing

certain "life-supporting" equipment and related services would be required to meet even higher standards.

V. Miscellaneous

Home Care Data System - Provide for a series of data management improvements, including administrative simplification, standard claims processing forms (paper and electronic) for all public and private payors, and standardized home care data management to facilitate communications among providers, payors, *etc.*

Home Care Council - Establish a national council on home care to make recommendations to Congress, and to develop proposed changes in regulations and policy related to the provision of home care. The national council would make recommendations on simplifying consumer understanding of home care benefits and payments. The Council would include consumers, providers and fiscal intermediaries. The Council would make recommendations to the Secretary on streamlining procedures for approving coverage criteria and appropriate reimbursement for new technology products.

The Home Care Coalition is delighted that the Contract With America includes a $500 refundable tax credit for individuals caring for a dependent parent or grandparent in their home, since this provision is one of our legislative priorities. This very family-friendly proposal will provide some needed support for our nation's family caregivers.

I have to question, however, why the Contract considers those caregivers who assist an elderly person to be more deserving than those caregivers, such as myself, who care for a middle aged spouse, or those who care for chronically ill or disabled children. We, too, are in need of equal help and support. Caregiving cuts across all generations. To dissect us into groups makes neither good economic sense, nor good policy.

I know a couple here in Washington, both of whom are in their 70's. They are not being cared for by anyone; rather they are caring for their own adult child who is bedridden with Multiple Sclerosis. In this case, the elderly are caring for the young. Are not these people entitled to a tax credit?

I implore the Committee to examine carefully the complete spectrum of family caregiving. It is a mistake and poor policymaking to single out just one group of caregivers for support.

WHY THE TAX CREDIT IS NEEDED

Family caregivers provide two thirds of all the home care services in this country. We provide this service out of love and duty, and we provide it for free. The National Family Caregivers Association estimates that the market value of caregiver services is over $190 billion a year. The

number is so staggering, let me repeat it - over $190 billion dollars of free service every year. Let me make clear - this is not our replacement value. That amount would be a great deal higher. It is only an estimate of what we would be paid at market rates for providing basic non-medical caregiving services, four hours a day, seven days a week.

Family caregivers provide a wide range of services. These include helping people with activities of daily living, such as: dressing, feeding, bathing, toileting and transferring - things that most people take for granted. These 'ADL's'- as they are called - often become major aspects of our lives, and take hours of time, and become major topics of conversation. We provide other services as well, such as: transportation, shopping, housekeeping, help with financial affairs and filing insurance claims. We dress wounds, give injections and, with the increasing sophistication of medical technology, we can now do procedures that previously could only be done in the hospital. A good example of this is intravenous or IV therapies.

For many caregivers, caregiving is a part-time job. Many caregivers, such as myself, are employed. Many are the principal or significant breadwinner in a family. Many others have dependent children at home. Those caregivers who are not employed, or who are underemployed, face significant financial burdens, burdens which are compounded in their own old age. Their caregiving prevents them from accruing social security benefits so they are, in effect, being doubly penalized.

Family caregivers are the invisible link in the health care chain. We are not only helping our loved ones, we are also assisting the health care industry, both public and private. Studies show that those patients who have family caregivers follow their medical regimens more completely and return to the hospital and emergency rooms much less often than those individuals who lack a family caregiver.

Caregivers receive no recognition for their service and virtually no help. This tax credit is a significant first step in rectifying this inequity. What you have to ask yourselves is what is the cost to the country if caregivers fall apart? What is the cost to the country if we too become ill in the process of caregiving? It is staggering compared to the cost of a $500 tax credit.

This is not an idle question. In a recent survey conducted by the National Family Caregivers Association, 49% - virtually half - of all respondents said they had experienced prolonged depression because of their caregiving experiences. It is very difficult to care for another when you are in the throes of depression. I know; I was there, and I dread the thought of ever being that sick again.

Depression can be just one of the debilitating aspects of caregiving. Others include isolation, changes in family dynamics, loss of friends, loss of personal time, complex decision making for another person's life, and financial drain. The $500 tax credit will not change all of that, but it certainly will help. It will give people the opportunity to get assistance.

THE ELDER CARE TAX CREDIT PROVIDES ASSISTANCE IN MANY FORMS

Respite Care

Some people will use the tax credit to get much needed respite care, a few hours on a regular basis, or an actual mini-vacation. Getting a break from caregiving is what our survey showed caregivers want most.

Listen to what one caregiver says on the need for respite:

> "The hardest thing is to make family understand you need time away on a regular basis. You talk; they agree; but after several times it becomes a chore to them and you feel guilty for asking. I wish there was a movie, tape or book I could give them to make them understand the importance of time away."

Hiring a home care aide to provide much needed respite, that's one of the things the $500 tax credit will be used for.

The Cost of Care

Even for those of us who have health insurance, many therapies and pharmaceutical needs are not covered. Insurance most often pays far less than actual medical costs. Out-of-pocket expenses in reality can be significant, and in some cases, catastrophic. Many people who are ill or disabled don't have any insurance, and neither do many of their caregivers. The $500 tax credit will be used to pay for medication, at home therapies, and other aspects of medical care that caregiving families use in abundance. Many people in fact forego therapies just because they cannot afford them.

As one caregiver eloquently told us:

> "I have been caring for my husband for five years. He is a double amputee and paralyzed. I need health insurance for myself because I cannot afford to pay for it with a part time job."

Paying for basic medical care, for both themselves and their loved one -- that is what some caregivers will do with the $500 tax credit.

The Cost of Equipment and Enhancing the Quality of Their Lives

I am convinced that the people who draft the rules about what health insurance covers - whether private insurance or Medicare - are not caregivers. My husband has hand controls in his car. These have enabled him to continue to go to work, earn a living, pay taxes. The cost of the hand controls are not covered by our insurance. We have a stair glide in our house. It cost $3,000. It was not covered by our insurance. We have a lightweight wheelchair. It costs a great deal more

than a standard wheelchair - the type that Medicare would reimburse, for instance. We were lucky with that. Our insurance paid 80%. But no insurance will cover the $5,000 we just spent to make our home more accessible so that my husband can shower without my help.

Paying for things that provide the ill and disabled - and their caregivers with a better quality of life, these are the things that will be purchased with the $500 tax credit.

CONCLUSION

The proposed Elder Care Tax Credit will assist a great many people. It is a critically needed first step towards recognizing the contribution of America's family caregivers and their need for help in caring for their loved ones. The extra money may be spent on respite care, doctor's bills, at home therapies, better medical equipment or quality of life items. It will even be spent by some on paying the rent and buying nourishing food.

The Home Care Coalition is firmly convinced that the Elder Care Tax Credit is money well spent. The Coalition has identified a number of other similar legislative initiatives that it believes will strengthen the family and that recognize and support home care as a cost-effective patient-preferred alternative to institutional care. Once the Committee completes consideration of the Contract and moves on to other legislative issues, we hope that you will consider these additional proposed changes.

The Home Care Coalition applauds your initiative and appreciates the opportunity to testify on this important provision which will provide needed relief to America's family caregivers and recognition of their valuable contribution and the benefits of home care.

Finally, I would like to read you one more quote from a family caregiver - a woman who should be in her prime of life, who is caring for her spouse.

> "I feel that my life has become a day to day existence with no hope of a "happily ever after" - I feel like a very old 46 year old. I am needed, but get no strokes or warm fuzzies. I care for him - but who cares for me."

Help me, and other caregivers, find an answer to that question. Thank you. I am happy to respond to any questions you may have.

The Home Care Coalition

Advocate for the Elderly and Disabled
American Academy of Home Care Physicians
American Society of Consultant Pharmacists
American Association for Continuity of Care
American Association for Respiratory Care
American Cancer Society
American Federation of Home Health Agencies
American Red Cross
Daughters of Charity National Health System
Health Industry Distributors Association
Help For Incontinent People
National Association of Retail Druggists
National Hemophilia Foundation
United Ostomy Association
The ALS Association

Mr. COLLINS. Thank you, Ms. Mintz.

We will first go to Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman. Mrs. Summerfield, Ms. Mintz, Mr. Halamandaris, thank you very much for being here.

Ms. Mintz, I am not sure we can answer the question which you pose to us, because that is far broader and has much deeper implications than anything we can discuss today. But I would like to ask all of you—maybe you would like to make a comment on a couple of things.

I guess we all feel that if you had a preference, the home care issue is something we really ought to wrestle with and tie down because people would prefer to be at home than other places. But in terms of the ongoing considerations about the cost, about speed of recovery, is it better there? I mean, is this something that we really should be putting a major push toward? Or is it sort of a marginal consent? What about it? What about those specific things?

Ms. MINTZ. Studies have shown that people do better at home with a care giver than if they are left on their own, that people follow their medical regimens more successfully and return to hospitals or emergency rooms much less often.

Mr. HOUGHTON. What about the costs? Do you find that on an overall basis in terms of the care given over a period of time really the costs are less or much more? What is your experience?

Ms. MINTZ. Well, what you have to realize is that dealing with home care isn't just a medical issue. A lot of the things that people do to care for somebody are what are generally referred to as custodial kinds of things. So it is not strictly a medical—a medical issue that we are dealing with. If I am interpreting your question correctly, you are asking this on a medical level. Am I misinterpreting?

Mr. HOUGHTON. Absolutely. On a medical level.

Ms. SUMMERFIELD. May I answer that or try?

Mr. HOUGHTON. Yes.

Ms. SUMMERFIELD. On a medical level, like Suzanne said, a lot of times the home care is not—you don't need a professionally trained registered nurse for home care because it is custodial care. So it is going to be less expensive to keep a person in your home versus a rest home when the average cost of a rest home is, in our State, in Nevada, is about $3,100 a month. It does not cost $3,100 a month to keep somebody at home.

For my mother, it didn't cost me that much. It probably cost me about $1,000 a month because you don't have to pay as much for custodial help as you do a registered nurse, for instance.

Mr. HALAMANDARIS. If I could chime in, Mr. Houghton. Thank you for asking the question.

Our studies indicate that home care is always, to the extent that you can generalize, always less expensive than providing similar care in a hospital. This is because hospitals are very expensive places. I have not been able to find one example of where it costs more to take care of somebody at home than in a hospital.

Take, for example, chronically ill children. The cost of taking care of a child with a ventilator is over $50,000 on average in the hospital and, at home, the same child can be cared for for about $5,000.

With respect to nursing home care, generally it is less expensive. All the studies indicate that. But there are some circumstances where some of these needs are so acute it becomes more expensive to take care of somebody at home than it does in a nursing home setting.

Mr. HOUGHTON. Well, there is an argument that the health care—present health care reimbursement is skewed toward caring for people in institutions. So, therefore, I would assume that you feel that this tax credit is going to try to have a better balance.

Mr. HALAMANDARIS. Yes, sir. I think that is exactly right. All the studies, as you have said yourself, indicate that people prefer to stay at home. Whether you poll the seniors or whether you poll children or families, the fundamental part about home care and about these hearings and the reason they come together is the Contract With America is about keeping families together. That's the best argument I can give you for home- and community-based services.

Because when you place somebody in a hospital or a nursing home, any kind of institution, by definition you shatter your family. You put your mother into a nursing home or an institution of any kind, the families are broken apart. That always is more expensive in the long run, not only to society but to the individuals involved.

Mr. HOUGHTON. Well, also, if I understand from Ms. Summerfield, that in addition to keeping families together it costs about one-third of what it would in an institution.

Ms. SUMMERFIELD. In my particular case. As he said, it really depends on the medical problem. My mother had Alzheimer's. She didn't have any medical expenses. Her expenses were for paying a care giver while I continued to try to work and support my family—the rest of my family.

Mr. HOUGHTON. Well, that is very helpful, and I appreciate it very much, your comments.

Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, gentlemen. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. I have no questions at this time.

Mr. COLLINS. Thank you. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

I appreciate all three of you being here today.

I happen to be a veterinarian by profession, and I know some people compare animal behavior to that of people, and in my experience, even animals that are boarding in an animal hospital are not nearly as happy. They don't do nearly as well, especially some different breeds of dog.

Certainly I think that different animals are like different people. I mean, they function much better, they are happier. I think it has been proven in medical circles across the board that the happier that people are and the more satisfied that they are, the healthier that they are. I don't think that there is any question in any medical circles about that.

So I appreciate your being here. I think that this is the first step toward encouraging as much home health care as we possibly can because it is cheaper and more compassionate.

When we ask how the government can help, this is one way the government can quit hurting people by directing them toward institutionalized type care.

I applaud your efforts for being here today. I don't really have a question for you other than just to say thanks for your efforts, and, hopefully, this is just a good first step for us.

Thank you, Mr. Chairman.

Mr. COLLINS. We thank the gentleman.

Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

I just want to say that I agree very much with the gentleman from Nevada, and I would like to just express some of my own personal experiences. Not only are we saving the taxpayer—I think we mentioned that it is probably about one-third—I don't know what it breaks down to, but at least one-third I believe you mentioned, Ms. Summerfield, in the State of Nevada.

But I believe there is another aspect that really we can't put monetary value on, and I am thinking of my own experience growing up. My own grandmother lived with us. She finally passed away at the age of 84 when I was 12.

But the value to children of having their grandparents or loved ones with them in the home, the extra love, the affection, the hearing of stories that went on, family history, we can go on and on and on of what it adds to a family atmosphere, being able to have these loved ones around, in addition to the monetary saving, many, many taxpayer dollars, again I think is really value. We cannot really put a value on that. So I want to commend you for what you are doing and lend my support to it.

Thank you.

Mr. COLLINS. We thank the gentleman.

Ms. Summerfield, you used a name earlier that I haven't heard used in a long time, and that was rest home.

Ms. SUMMERFIELD. Oh.

Mr. COLLINS. What that brings to mind is my boyhood days, because my mother and father opened our big two-story house in Georgia to senior citizens, and it was called the Bessie Collins Rest Home. It is a phrase I have not heard in a long time. Not especially since the nursing home came into play.

Mr. Halamandaris, you mentioned the States and the cost of providing institutional care and the cost of Medicaid. Of course, the States bear a big portion of that cost. We had a couple of Governors here last week, and they mentioned, too, the cost of Medicaid. They mentioned the fact that States can obtain waivers. Do you have any idea how many States do have waivers?

Mr. HALAMANDARIS. Sir, I don't have that exact number, but I will be very happy to submit it for the record. I know the number is increasing, and the administration early on liberalized the waiver procedures and made it possible for more States to get them. So I don't have the exact total, but I will submit it.

Mr. COLLINS. Very good.

[The information was not received at the time of printing.]

Mr. COLLINS. Why is there so much resistance to the fact that States be allowed to use Medicaid funds for other than just institutional care?

Mr. HALAMANDARIS. I can't really tell you.

I have been in this town, as you have, many, many years. I go back some 30 years. We helped write the Medicaid program when I was counsel to the Senate Aging Committee. At that time, we decided to start slow and to begin with hospital and institutional care.

Years later, some of the architects of both Medicare and Medicaid—Wilbur Cohen and Wilbur Mills and others—testified before Claude Pepper's committee when I was counsel there and said the biggest mistake we made when we enacted those programs is that we did not allow for greater use of long-term care and community-based care.

As you remember, Congressman Pepper spent most of his final years in the House arguing that we should do exactly what you said, give the Governors more flexibility and broaden the scope of long-term care coverage to make up for some of the gaps in the existing programs. But I think there was just an early resistance and that resistance has not been overcome until just lately.

Mr. COLLINS. There is evidence by most States that have obtained waivers that they have reduced their costs. Is that not true?

Mr. HALAMANDARIS. Yes, sir. That is correct. There are very good studies. I referenced previously the State of New York that in many ways has been ahead of us, not to say that they have totally reduced all their problems. But they have reduced their costs a great deal, as I understand it.

Mr. COLLINS. Very good. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. I am sorry I haven't been able to get here earlier. I have worked with most of you in some context in home care and am very pleased with this portion of the Contract. It is beginning to reshape the package of health care subsidies that seniors but also families need in America as we learn to care for people outside of institutional settings and help people live satisfying lives, even with serious disabilities, over many years but also needing far more support care. So I just wanted to recognize the good work that you all do in the area of home care and appreciate your support of these provisions. Thank you.

Mr. HALAMANDARIS. Thank you, Mrs. Johnson.

Mr. COLLINS. Thank you, Mrs. Johnson.

If there are no further questions, the panel is dismissed; and we appreciate your coming and sharing your thoughts and testimony with us.

Ms. SUMMERFIELD. Thank you.

Mr. HALAMANDARIS. Thank you, Mr. Chairman.

Mr. COLLINS. The next panel: Richard Lank, Elizabeth Liska, Carol Abaya, Carmen Queen-Hines, and Barbara Adolf. Come forward. We will receive your testimony.

OK. We appreciate each of you joining us this afternoon. We will go by order.

Richard Lank, executive director of the National Eldercare Coalition. Mr. Lank.

STATEMENT OF RICHARD LANK, EXECUTIVE DIRECTOR, NATIONAL ELDERCARE COALITION

Mr. LANK. Thank you, Mr. Chairman, ladies and gentlemen of the committee. I want to congratulate you all for recognizing elder care as an issue that must be addressed in this year's Congress.

Elder care is a term that redefines the way America accepts the reality of an aging population and increasing longevity. Instead of isolating the concerns of the elderly from the general population by couching all policy discussions in the passive terms of long-term care and dependency, elder care is a term that actively involves the adult children of the elderly, and it emphasizes the interdependence of the generations.

The Contract With America calls for a refundable tax credit of $500 per eligible taxpayer. As admirable as this provision is, let's examine the specifics of the proposed credit in view of the laudable goals of this committee and this Congress.

First of all, we will begin with the premise that amending the Tax Code has one of two basic objectives: No. 1, to increase revenue for the Treasury or, No. 2, to modify a specific behavior or set of behaviors in the marketplace.

Clearly, this committee is not seeking to increase taxes. If the intent, then, is to encourage families to provide care to elderly relatives in a home environment in lieu of a nursing home, or at least to postpone placement into a skilled nursing facility, then it has fallen short of the mark, and here is why.

No. 1, the tax credit is too narrow in defining eligibility. The language of the proposed credit is similar in every way to section 129 of the IRS Code, known as the Dependent Care Assistance Program, which was originally drafted as a flexible benefit for employed persons with child care responsibilities.

Because children are by definition "dependents," living with the taxpayer or the parent, section 129 codifies total dependence. It was broadened to allow for elder care also, but is so restrictive that very few employees can qualify for eligibility. No one, elders and adult children alike, would want their circumstances to become so severe that the elder becomes a dependent in the same way as a 3-year-old child.

In order for a family to be eligible for this new $500 credit, the elderly parent or parents must be living in the same primary residence as the taxpayer or care giver, must be disabled or mentally impaired, and must be incapable of taking care of themselves. Mr. Chairman, relatively few taxpayers are in this situation, and fewer still would want to be, if other choices are viable.

Many people are caring for an elderly parent who is still living independently but who could not remain independent without the efforts of the younger family members.

No. 2, the tax credit would be too small to offset significant elder care support costs which are nonreimbursable.

The $500 in tax credits is definitely helpful to offset some nonreimbursable expenses and may actually replace income lost to taking nonpaid leave for care giving, but unless working families have other relief, then nursing home placements with Medicaid coverage will remain the less expensive, though frequently least desirable, alternative.

No. 3, most elder care pressure is felt by women. The majority of working-aged women are now in the work force. Most of the new jobs created since the recession has abated have gone to women. Therefore, both section 125 and section 129 of the IRS Code should be amended to enable more employees to have access to tax-advantaged earnings for elder care benefits in conjunction with the proposed $500 credit.

Regardless of intent, our current Tax Code and the Medicare and Medicaid program have skewed the choices of the care for elderly toward dependency and nursing home care. The Federal system does not yet provide incentives for families to choose elder care over institutional long-term care, nor does it reward employers to add meaningful benefit plans to active or retired workers, but it can.

A rational policy for addressing an aging population should seek to reduce the drain on the Treasury for outlays by HCFA for institutional long-term care by providing relief through the Tax Code and Medicaid waivers long before an older person becomes eligible for "dependent care" status. Such a policy should reinforce, No. 1, ongoing management of chronic, not acute, health care conditions; No. 2, wise management of financial resources of the entire family unit; No. 3, the coordination of applicable benefits between the generations; No. 4, reviewing medications through drug utilization review; and, No. 5, assessing home safety and making home modifications to accommodate aging.

Therefore, I am recommending that a selective tax credit be allowed for all wage earners who are expending money out of pocket for elder care support when the parent is still living in his or her own home. This credit should not be allowed for a random grab bag of services, determined solely by the taxpayer, but rather for private case management to oversee the implementation of the care plan.

Case management provides advocacy for the family, arbitration and mediation in the event of a conflict with a vendor of services in the community, and can provide the accountability that is needed when the constraints of time and distance make it difficult for the adult child to oversee the parent's situation.

Mr. Chairman, I thank you very much for this opportunity to present these recommendations. I know that the committee is looking at multiple approaches to financing services for the elderly, which we have addressed in written testimony. Ultimately, this tax credit is a very important part of the solution. A thoughtful combination of tax strategies and managed care waivers will meet the needs of older Americans and their families in choosing the best prospects for a long life in this and the coming millennium.

Thank you, sir.

[The prepared statement follows. Due to the size of attachments, they are being retained in committee files.]

TO: HOUSE COMMITTEE ON WAYS AND MEANS
Ms. Norah Moseley, Joint Committee on Taxation

FROM: THE NATIONAL ELDERCARE COALITION
Mr. Richard Lank, Executive Director

RE: WRITTEN TESTIMONY
for Hearings held on Wednesday, January 18, 1995

Ladies and Gentlemen of the Committee:

As this Congress endeavors to develop new approaches to the most vexing challenges facing this society now and into the next millennium, members of the Committee on Ways and Means will be examining the inter-related topics of long-term care and eldercare benefits. As you have begun in earnest to address all of the many issues that face our aging population, you are investigating the means by which tax credits and tax incentives can assist working people and other relatives caring for older family members. I respectfully suggest that, while such tactical moves are urgently needed, what has been proposed so far is not a whole strategy. Before sending any legislation to mark-up, I urge you to first look at the larger perspective, and see the connection between all of the confluent trends that should impact your decisions in shaping public policy during the 104th Congress.

In light of the demise of employer mandates in the sweeping health care reform proposals made last year, and in acknowledgement of the goals of the more recent Contract with America, it is obvious that the keystone to the new Congress's legislative agenda will be encouraging solutions to many problems in private sector innovations. For eldercare and long-term care issues, the family is recognized as one critical force in caring for the nation's elderly citizens; H.R. 6, H.R. 8, H.R. 9, and H.R. 11 do address tax strategies designed to assist families care for older, frail relatives.

However, the nation's employers, voluntary associations and labor unions remain central players in providing benefits to vast numbers of people; employers have an enormous role to play in financing benefits and pensions that complement every entitlement program that the federal government offers. Businesses, big and small, must be given every incentive to offer new approaches to eldercare and group long-term care benefits.

The National Eldercare Coalition ("The Coalition"), in analyzing this matter for Congress, had to first establish a list of pertinent issues and trends that each should be factored into the public policy equation. By articulating each issue (trend/policy) as a preface to the recommendations contained herein, it is the intent of the Coalition to give the Committee on Ways and Means a broad context in which to understand the critique of the pertinent proposals contained in the Contract with America and the additional recommendations made by the Coalition.

<u>The Market Value of Eldercare -- Paid and Unpaid</u>

The Health Care Financing Administration (HCFA) estimated in 1982 that 4.6 million elderly people relied upon some form of assistance to remain living independently and in their own home. Without the assistance, this population is "at risk" of being placed in a nursing home or equivalent institutional facility. The help required was in the form of either IADL or ADL assistance* -- some formal (paid), some informal.

It was further estimated that about 100,000 elderly persons are joining the ranks of these older people (with moderate-to-severe functional impairments) each year; thus, by 1995, another 1.3 million elders need help to stay in their own homes. That means the number now stands at about 6 million and is rising steadily.

HCFA estimated in that survey that 73.9% of all elderly persons who were then living at home, who fit this profile, received some kind of informal (unpaid) eldercare support, provided by family members and/or volunteers with a community-service organization. 5.2%

of that group was receiving help solely through paid services. The remaining 20.9% of that "at-risk" population received a combination of paid and unpaid services. Eldercare services were pre-dominantly paid for by the recipient of care and his/her family, then Medicare, Medicaid, and private non-profit ("helping") organizations -- in that order, with about ten other sources trailing behind. Private long-term care insurance had not yet made a dent in this market niche at that time.

Based on HCFA and Administration on Aging (AoA)** reports, the Coalition has estimated that paid services, supporting elders in their own homes, cost families and the government about $39 billion in 1992. Since the paid services constitute about one-fourth of the volume of all such support services, the market value for the unpaid or informal support provided by family and friends would have a value of about $117 billion. The less care that can be provided by the family, the more that will have to be paid. Either mode -- formal or informal care -- contributes mightily to keeping older people from pre-mature institutionalization.

Given the fact that nursing home admissions rose 24% between 1980 and 1990, and given the fact that Medicaid outlays for elderly recipients alone rose from $1.9 billion in 1972 to $29 billion in 1992, it is apparent that nursing home costs are hemorrhaging the public till. Demographics show the 85+ age group -- those most likely to need nursing home care -- doubling between 1990 and 2000, strongly suggesting that this trend towards more outlays for institutional long-term care will continue unabated.

The demographics won't change, but the federal policies and incentives can... and they must.

As a countervailing force (to pre-mature and inappropriate nursing home placements) in today's marketplace, what is needed now is a cohesive and compassionate public policy supporting (1) the expansion of workplace eldercare benefits through tax incentives for employers and (2) tax relief for family caregiving that is instrumental in preserving the independence of the elderly. These federal actions would demonstrably enhance the economic viability of a full range of options to institutional (SNF) care. After all, now is the time when the tax code must be amended to truly affect behavior in the marketplace -- and make alternatives to nursing home care more realistic and sustainable.

By simply slowing the growth of nursing home admissions, there will be savings realized to HCFA. By adding eldercare benefit programs, the additional productivity in the workplace (through better recruitment, retention and job satisfaction among workers with eldercare responsibilities) will assist in strengthening the existing tax base. New private services will emerge to serve the eldercare market, thus creating new jobs in the private sector and additional tax revenues. These goals are compelling in their universal appeal. By adopting the general principals outlined herein, the resulting tax policies give the eldercare provisions of the Contract with America the best prospects to ultimately be truly revenue neutral.

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* Though the distinction isn't made in any of the Congress's currently proposals -- and probably should be -- there are technically two complementary systems for measuring independence. ADLs (activities of daily living) are all regarded as personal care skills, such as bathing, dressing, eating, getting out of bed, toileting, and so forth. IADLs are Instrumental ADLs, a term which includes managing financial affairs, shopping, getting to appointments, and taking medication. These IADLs deal more with managing a person's personal affairs rather than bodily functions and grooming activities. ADLs and IADLs are distinct, but thoroughly integrated in everyone's daily life.

** The Administration on Aging, in its newly released State Source Book on Home and Community-based Services (HCBS) for the Functionally-Impaired Elderly, documented that Medicaid outlays for all HCBS services for elderly persons living in the community was $6.43 billion in 1992. Medicaid payments account for approximately one sixth of all paid eldercare services, according to the 1982 HCFA study cited above.

Other significant factors to consider include:

1. SUPPORT RATIOS: The support ratios between those in the workforce (in the peak earning and spending years) and those who are retired (drawing pensions, relying on major federal entitlement programs) are shrinking rapidly. In certain industries, the number of retirees equal or exceed the number of active workers. For example, among the United Steelworkers members at the Bethlehem Steel Plant in Baltimore, Maryland, there are 4,500 active workers and 22,000 retirees represented by five locals. Eldercare and group long-term care take on a special significance in these instances, where the workforce is mature and the retiree population is swelling.

2. ELDERCARE AS A WORKPLACE BENEFIT; PART OF THE BENEFIT PACKAGE FOR ACTIVE AND RETIRED WORKERS:

   (a) Most people rely on their employer or their spouse's employer to have access to health care benefits and pensions/annuities. It is evident that the workplace will continue to be the engine driving the health care system, since group benefits are where the big dollars are for insurance carriers, HMOs and other managed care plans. Eldercare services for the middle-aged generation and retirees should be designed as a conventional benefit, and purchased by employers/employees through traditional benefit channels, just like health plans and dental riders.

   (b) Most eldercare pressure is felt by women; they have been the traditional caregivers. Now a majority of working-aged women are in the workforce. Most of the new jobs created since the recession has abated have gone to women. Therefore, pertinent tax incentives for both employers and employees are crucial to addressing eldercare requirements and should be advanced vigorously. Both Section 125 and Section 129 of the IRS code should be amended to enable more employees to have access to tax-advantaged earnings for eldercare and related long-term care insurance benefits, in conjunction with the $500 refundable credit proposal. As a combination, this tax strategy will have the greatest impact.

   In 1994, the U.S. General Accounting Office released two excellent reports on workplace eldercare: one for public sector employers, one for the private sector. The following paragraph is from GAO/HEHS-94-64 Public-Sector Elder Care:

   "Because women's participation in the workforce and the number of disabled elderly have grown, more employees are caring informally for older Americans in their homes and communities. Approximately two million working Americans provide informal caregiving assistance to their disabled elderly relatives, including help with eating, bathing, moving around the home, housework, and financial management. Nearly three-quarters of all caregivers are women, many of whom are employed outside the home. An additional six million employees have a disabled spouse or parent who may also require help with these and other activities. As the population ages, the number of employed caregivers are expected to grow. Potential caregivers, spouses and children of disabled elders currently account for about 9 of the workforce of full-time employees."

   (c) At least 9.3 million retirees and their dependents rely on their employer for extended health care benefits, according to the Employee Benefit Research Institute (EBRI) in Washington. Further, approximately 25% of the population over 65 years of age receives an employer-provided retiree benefit (health care and/or pension plan), according to Boston University researchers. They found that even though well over 90% of the largest employers do provide such benefits (those that employ 10,000 people or more), the 25% estimate includes those who have never worked, have worked part-time only, and those who worked for smaller employers who do not offer retiree benefits.

3. THE FASB REGULATIONS: During the late 1980s, the Financial Accounting Standards Board (FASB) issued a complex and controversial ruling concerning the

pre-funding of retiree health care benefits and their tax treatment. This entire issue is comparable to the current debate over unfunded federal mandates: programs are promised that have no current funding pledged to them. In this situation, companies have been promising current employees a retiree health care package as part of their employment contract, but the company had not yet funded these future obligations. Corporate balance sheets looked much better than the reality that these companies faced because these costs were not shown anywhere as a current liability.

Under the provisions of the FASB ruling, there would be several phases in establishing a pre-funding mechanism. The first phase required companies to treat a portion of the future costs as a current expense each year, regardless of the employee's age or length of service. In the second phase, all companies would be required to create a reserve to fund benefits for retirees and active employees eligible for retirement under company plans; this reserve is to be shown as a liability on the balance sheet. This would put the retiree health care obligations in much the same category of treatment as pension plans. The Coalition has not been tracking the FASB regulations and their implementation recently, but is aware that court challenges have delayed some of the phasing-in of the compliance activities.

The Coalition also researched earlier models of pre-funding retiree obligations, in order to create the following recommendations in the next section. In this research, there were references to Voluntary Employees' Beneficiary Associations (VEBAs), a tax-advantaged means for employers to set-aside funds for retiree obligations. The Congress apparently eliminated this method of pre-funding in 1984 with the Deficit Reduction Act (DEFRA).

In light of the long-term implications of the FASB ruling and the ever-mounting pressure on companies caused by swelling retiree populations, the Coalition recommends that the tax committee exhume and seriously re-examine the VEBA model, among other options. Employers must be given every means to pre-fund retiree health care obligations. Otherwise there will continue to be tragic stories of companies ruthlessly cutting off benefits to deserving workers days before they are fully vested in their retirement plans.

Therefore, those shaping federal eldercare policy should take into account that all employers -- especially those with fiduciary responsibilities to large retiree populations, including all levels of government -- would benefit from a new system that can mitigate retiree health care cost liabilities.

4. <u>DEMOGRAPHICS for population 85 and over:</u>

(a) Those aged 85 and over will double from 1990 to 2000, according to the U.S. Census Bureau.

(b) Only 25% of those over 85 are in nursing homes. The balance are either still living independently or with an adult child.

(c) The oldest age cohorts require the greatest number of community-based services to remain independent, as functional ability declines and chronic care requirements grow.

The costs associated with providing community-based services are variable, but are most likely to be in the $5,000 to $10,000 range for those requiring a moderate levels of home health and domiciliary care. Nursing home care (in a skilled nursing facility or SNF) costs between $25,000 and $50,000 per year.

(d) According to the Census Bureau, there will be 9 million people over age 85 by 2040. However, their projections are based on extrapolation of static data concerning mortality and morbidity. Researchers have demonstrated that a decline of mortality of just 2% per year, due to the anticipated steady advances in technology and

treatment modalities, would increase the numbers of those 85 and over to 25 million by 2040. Source: "Projecting the Older Population of the U.S.: Lessons from the Past and Prospects for the Future," The Milbank Quarterly (Volume 66, No.2, 1988).

5. ASSISTED LIVING ARRANGEMENTS: Finally, because most elderly persons are likely to have a slow, steady decline of ADL functions, there must be more options in the continuum of care between the elder's residence and the nursing home. In recent years, a form of congregate care called "assisted living" has become an important niche in the long-term care continuum. Many tens of thousands of elders who need some assistance and a live-in "supervisor" of care could manage very well in an assisted living environment. However, assisted living is not defined in the medical terminology needed for third-party reimbursement; such care would not be allowable, for example, as a "qualified facility" as defined in the Contract for America.

   Therefore, such residential alternatives, though very desirable, are not covered under the definitions applicable under Medicaid or private long-term care insurance. The minimum charge to stay in such a residential facility in the Washington, D.C. area is about $2,500 per month and is private pay. Those who are affluent can afford such an alternative... and they do. Despite the lack of third-party payments, this niche is one of the most rapidly growing segments of the residential long-term care industry.

   The Coalition is not proposing extending the entitlement programs to cover assisted living, though some exceptions may be examined through the various experimental Medicaid waiver programs as supplements. What is being proposed is an entirely new way to entice middle-income families to save through tax-advantaged accounts and new risk-pooling methods for the options of assisted living and similar congregate living arrangements. For these proposals, see Part Two, Section One -- "A Multi-Employer Trust Model for Portable Retiree Benefits."

PART ONE: CRITIQUE OF RELEVANT PORTIONS of H.R. 6, H.R. 9, H.R. 8, & H.R. 11

In the report entitled "Description of Tax Proposals contained in the "Contract with America," prepared by the Joint Committee on Taxation and dated January 9, 1995, four separate tax issues were presented, which were all scheduled for hearings. The four pertinent items the Coalition reviewed were:

1. The so-called "Refundable $500 Eldercare Tax Credit"
   (referred to "Refundable Credit for Custodial Care...")

2. Tax Treatment of Accelerated Death Benefits under
   Life Insurance Contracts

3. Treatment of Long-term Care (LTC)

4. American Dream Accounts (variation on the IRA)

In general, the Coalition supports the principles embodied in each proposal. But the particulars of certain proposals leave many questions. To maintain our focus on advancing eldercare benefits, the Coalition's critique will center on items One and Two above. Item Three -- which addresses the ability to deduct LTC coverage in much the same way as health care insurance premiums -- is a good idea. Item Four -- the "Dream Accounts" -- has merit, but as a vehicle for meeting long-term care needs per se, the Coalition is recommending a more thorough approach through a multi-employer trust model.

One characteristic we noted was that the proposals were internally inconsistent with each other, in certain cases, with respect to terminology and qualifying for the tax treatment being proposed. Most of the questions below pertain to the $500.00 eldercare credit.

1. Refundable Credit for Custodial Care of Certain Elderly Dependents
(sec. 201 of the bill & new sec. 36 of code)

Currently, an exemption for a "dependent" -- whether a child or a parent -- does exist in the IRS code. It does allow for an exemption of $2,500.00 to be subtracted from Adjusted Gross Income (AGI), with phasing-out of the exemption at specific six-figure income levels.

The refundable tax credit of $500.00 is presumably in lieu of the exemption; if the credit is adopted, then the exemptions will be eliminated concurrently. At least, that is how this language is interpreted. The guaranteed $500 tax credit is certain to provide cash-flow relief for those tax payers who are in the low- and middle-income brackets, whose tax liability will not be significantly altered by the exemption. The credit would be tantamount to a reimbursement for out-of-pocket costs associated with providing the eldercare in the tax payer's home.

As meritorious as that outcome is, unfortunately the language of the proposal raises many troubling questions and it raises doubts about the efficacy of the proposal as written:

1. For determining eligibility, why does the proposed credit rely on the same severe dependency test (e.g., residency and disability) as the present law?

2. The Present Law cited involves a personal exemption for dependents. Does this law remain on the books or is it eliminated? If it is eliminated, isn't that a little bit like throwing out the baby with the bath water? Why not keep the current dependent exemption for eldercare purposes as written and then add the refundable (or guaranteed) credit, as proposed, in one of the following two scenarios:

> (a) For the taxpayer who is the son/daughter/guardian of the elder and who incurs out-of-pocket expenses, travel expenses and/or experiences loss of income for unpaid leave associated with caring for the elder who still is residing in his or her own home, or
>
> (b) For the taxpayer who is the spouse and caregiver sharing the same primary residence with the "qualified individual" and who needs to be reimbursed for associated costs, including, but not restricted to, respite services. For this category, whether the spouses file a joint return or if they file individually, then the caregiving spouse can claim both the $2,500 exemption and receive the credit.

3. Why should the professional who is qualified to determine the ADL deficits (hence, the tax payer's eligibility) be only a physician in this proposal and yet the person can be a "licensed health care practitioner" in the Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts proposal? A registered nurse (RN) or a licensed clinical social worker (LCSW) seem to be the most appropriate choice to conduct an assessment of ADL functioning in the home setting.

4. Who pays for the licensed health care practitioner or physician to conduct the initial assessment for determining ADL deficits, which in turn determine eligibility for the credit? Assuming a physician or a nurse/social worker combination costs $200.00 to conduct an assessment in the home, which is required for the taxpayer to qualify for the tax credit, bear in mind that the taxpayer may be declined. With no guarantee of getting the proposed $500.00 credit, regardless of the outcome and determination of the assessment, a bill for the services rendered will be presented to someone for payment. It is not fair for the taxpayer to pick up the tab. They may be out $200.00 with no tax credit in a worst case scenario or end up with a net $300.00 benefit in a best case scenario. As written, is this not an unfunded federal mandate?

Why not re-write the eligibility parameters of the credit, increase the credit to cover the cost of the initial assessment and then the credit itself can reimburse the tax payer for the RN or LCSW in full? If the taxpayer does not qualify for the credit, a Medicaid waiver will pick up the tab.

5. Why does the "qualified individual" have to undergo a test to determine "disability" in this proposal and yet the criteria is to be a "chronically ill individual" in the aforementioned Accelerated Death Benefits proposal? The latter phrase is more accurate and less troubling.

6. Again, borrowing from the technically superior language of "Accelerated Death Benefits," the $500.00 refundable credit should apply to situations wherein the taxpayer is (a) a younger family member, such as a son or daughter, (b) the elderly parent is still in his/her own home, and (c) if a licensed health care practitioner certifies that, without the paid and unpaid assistance with IADLs/ADLs* provided (in part or in full) by the taxpayer, then the elderly individual would have to be cared for in a qualified facility (nursing home, etc.).

7. Why does the proposal read "maximum refundable credit" of $500.00? There is no language in the proposal that suggests any conditions upon which the credit is to to a nickel less than $500.00.

8. Treatment for Long-term Care (secs. 301-305, and 307 of the bill). Specific LTC plans are vital as an employee benefit-- especially those that have a cash payment that can allow the adult child/caregiver income replacement for providing informal caregiving as part of the overall eldercare support system. This is a natural complement to the Family Leave Act. This proposal does not permit any Qualified LTC coverage to be provided through Section 125 cafeteria plans (pg.27). This blanket exclusion is a mistake and the code should be amended to permit their inclusion (subject to the conditions expressed below in Section Two -- "Section 125 - Cafeteria Plans.")

This Section concludes the summary of questions raised in the review of pertinent portions of Contract with America, as provided to the Coalition in mid-January, 1995.

PART TWO: THE COALITION'S PROPOSALS AND RECOMMENDATIONS

I. A Multi-Employer Trust Model for Portable Retiree Benefits, featuring provisions for a Group Long-term Care Benefit:

The Coalition strongly urges Congress to examine a new model for financing specific long-term care benefits, while also providing working men and women a portable benefit during their lives. The foundation of the vehicle being proposed is based on variations of a multi-employer trust, now most commonly utilized in collectively-bargained contracts in the construction trades industries.

This trust model would rely upon a tax-exempt status for all of the elements of the corpus. Some of the features for this trust would include:

(1) Individual savings accounts for all participants: Called an Individual Eldercare Account (or IECA), this is a savings account for all members of a participating union or employee group. These individual accounts, in an aggregate trust model, would provide the portability for the benefits and the individual would be free to work for different employers within the same industry, so long as the employer of choice is making contributions to the trust.

(2) Individual savings accounts for participating families: for accumulating, tax-free, the entrance fees needed to gain admission into a Continuing Care Retirement Community (CCRC) or to create an annuity capable of paying the monthly fees required for residing in an assisted living facility. This would be called an Entrance Fee Account (or EFA).

(3) A Consolidated Trust Mechanism for the pre-funding of corporate retiree health care benefits, as they relate to sustaining the independence and well-being of eligible retirees of covered plans.

The Group Long-term Care benefit is created by establishing an accumulated fund from earnings of the Trust and re-insuring the group with a qualified LTC program.

Plan details for the Trust are proprietary, but available to the Committee upon request.

II. Section 125 - Cafeteria Plans: Using the Committee's term of Qualified Long-term Care Insurance ("Qualified LTC"), the Coalition advocates certain new LTC products that are based on a disability model, rather than a medical model. These plans feature the use of ADLs as the trigger point for commencing the payment of a cash benefit; this is not a reimbursement for a medical or clinical service. The home care component of the cash benefit does not require previous institutionalization, in either a hospital or a nursing home. The monthly cash payment is assignable, if need be, to prevent abuse of funds.

Such a plan is available today through one carrier, but obtaining the eldercare benefit requires a group plan and individual "add-ons" for the beneficiary's parents. But it can provide a cash benefit, available for any eldercare expense, including income replacement for working middle-aged children acting as an informal caregiver for the elderly beneficiary. The proceeds can be used for any eldercare expense, including case management, estate planning or architectural modification to the home.

Therefore, the Coalition strongly, yet conditionally, urges amending Section 125 of the IRS code to permit inclusion of the premiums for such long-term care coverages as a Qualified LTC elective benefit selection in cafeteria plans. The Coalition is aware of the fact that there are other implications and considerations involved in deciding to amend Section 125 to allow long-term care (LTC) insurances to be so qualified. Generally, the Coalition does concur with the industry-held position that prices of individual LTC policies will go down if ever-larger pools of younger cohorts are given the incentive to buy them. As an option on a "cafeteria plan," this effect can be accomplished to a considerable degree by making the premiums available on a tax-advantaged basis. Some industry analysts also maintain the premise that opening the market in this way will then compel underwriters to tailor more variety into the plans, as well.

LTC insurance is already going through a big transition period as it is, responding to the financial and social imperatives to add more alternatives for eldercare support outside of institutional care, though mostly the benefit amounts to some variation of home health care coverage. Many long-term care policies, for example, do have a home health benefit that can be triggered by "ADL" deficits and do not require a prior hospital stay as a condition to trigger the benefit.

As an industry trend, this is meritorious. But simply making any LTC plan a qualified benefit under Section 125 is a specious act. Because we want to help the middle-aged child care for a parent now, by providing new incentives, we ask you to examine the extent to which the language and intent of this proposal advances eldercare specifically. Long-term care insurance is notorious for its exclusions; the Coalition is diligent in its efforts to carefully phrase eldercare definitions and be certain they are eligible for coverage.

Eldercare benefits can be a part of long-term care coverage, especially a plan with a straight monthly cash payout. The Coalition wants applicable benefits to enure to the middle-aged beneficiary now, to enable people in their peak years of productivity to carry out duties that come with eldercare and their work. Everyone is arguing whether or not a policy will provide home health care (over nursing home care) to a typical 45 year old employee forty years from now at the age of 85. For employees who are thirty and forty years old, coverage for an event that may (or may not) happen 40 years hence is a bit of an abstraction, especially in contrast to the need of having protection against immediate risk: disability, life and health insurance all rank high for people in their middle years. To the extent that eldercare means an exposure to financial loss that could be imminent, people will seek insurance to offset lost income for taking time off without pay and for out-of-pocket expenses associated with taking care of an aging parent.

Accordingly, the Coalition recommends that the Congress look closely at the following language for amending Section 125 to permit long-term insurance to be a qualified tax-advantaged benefit:

1. Let's use the tax code to modify behavior, and that includes the behavior of insurance companies, not only the U.S. taxpayer.

(a) Broadly speaking, in order to meet the criteria needed to be added to a Section 125 cafeteria plan, all insurance companies should have their plans evaluated for suitability by an independent review board.

(b) Specifically, there should be an extra incentive given to those insurance companies whose policies give a cash payout, based on a disability model. As already mentioned, the emphasis should be on income replacement for the middle-aged beneficiary, providing the eldercare support personally.

2. Let's broaden the definition of what can qualify as "long-term care insurance" to be inclusive of other pre-paid programs that aid in meeting the needs of older people and their middle-aged children, such as managed care plans for seniors and other emerging models designed specifically to carry out the many duties that are a part of providing eldercare support. Everything the federal government can do enable families to keep their eldest members independent and active should be considered at this juncture.

III. Section 129 - Dependent Care Accounts: Rewrite the provisions of S. 129 to drop all "dependency" language from eldercare cases and instead permit a functional assessment of the elderly parent and an analysis of the eldercare support system, both formal and informal, for the parent(s) in question. As the functional deficits increase, so do the tax-advantaged dollars available to the beneficiary/working caregiver.

For example, in a plan where a $5,000 maximum limit exists for contributions into the Dependent Care Account, the eligibility for the set-aside (from taxable income) could be as follows, with the ADLs expressed as deficits in function:

- **One-to-Two ADLs = maximum available benefit is $2,500**
- **Three-to-Four ADLs = maximum available benefit is $3,750**
- **Five-to-Six ADLs = maximum available benefit is $5,000**

IV. Tax Credit for Case Management: The Coalition is recommending that a selective tax credit be allowed for all wage earners who are spending money out-of-pocket for eldercare support when the parent is still living in his or her own home. This credit should not be allowed for a random grab-bag of services, determined solely by the taxpayer, but rather for private case management to oversee the implementation of a care plan. The case manager would assess the need of the elder in the community in which they reside; they then match appropriate services with a thoughtfully prepared budget. Case management provides advocacy for the family, arbitration and mediation in the event of a conflict with a vendor of services, and can provide the accountability that is needed when the constraints of time and distance make it difficult for the adult child to oversee the parent's situation.

V. The Power of Federal Procurement Practices

The federal government has other immensely strong forms of persuasion at its disposal to encourage private firms to adopt specific benefits through contracting policy. A case in point is the rapid expansion of employee assistance programs (EAPs) within the last ten years. In the mid-1980s, a federal mandate was passed that made it a necessity to have a certifiably "drug-free" workplace in order to be a successful bidder on a federal contract, and the way to ensure compliance was for the bidder to contract for the services of an EAP. The government itself had to be in compliance with this mandate, and so installed an EAP

in each agency to be available to all federal employees, military and civilian. I can cite one example of the impact that that law had: a small hospital-based EAP in the D.C. area served only 1,000 hospital employees before the law passed; five years and one federal contract later, this same EAP firm was serving over 75,000 clients, mostly federal workers and employees of firms that had (or wanted to have) federal contracts.

The Coalition does advocate that the EAP is the best place to begin an effective "managed care" kind of approach to introducing eldercare benefits at the workplace. Therefore, why not use a variation of the "drug-free" campaign that caused the EAP industry to blossom in the 1980s to further the introduction of eldercare EAP enhancements. The procurement process could award those vendors whose EAPs have a well-defined eldercare program with some preferences over those who do not. It is a given that government contractors must have an EAP to be in compliance with federal law; why not give an extra consideration to those with eldercare adjuncts in addition to the EAP requirements?

As a matter of compliance, these programs should be well-advertised to the employees/beneficiaries.

In Conclusion

At the Coalition's conference last December, which was a pre-White House Conference on Aging event, Jim Musselwhite of the U.S. General Accounting Office observed, in response to a question from the audience, that providing tax assistance and other incentives would increase home care utilization -- but there would also be some increase in applicable Medicare and Medicaid expenditures for a higher volume of intensive home care. Nonetheless, the overall effect would be lower nursing home admissions and lower federal outlays for skilled nursing home care, which is by far more expensive per capita.

For the U.S. Treasury, such a policy of tax credits and Medicaid waivers may not yield major net savings for the Medicare/Medicaid program in the long-run, but the same number of tax dollars spent would provide services to far more people in the community -- and by providing "early intervention," fewer serious problems would arise, which have far higher per capita costs.

The value to both the quality of life and to the U.S. Treasury in providing meaningful incentives to families and employers alike to in turn provide for eldercare is incalculable and compelling. Please analyze all the trends and options; a comprehensive strategy -- not a piece-meal approach -- will yield the greatest results. Thank you.

Mr. COLLINS. Thank you, Mr. Lank.

Elizabeth Liska, the executive director of Prince William Interfaith Volunteer Caregivers Program, Manassas, Va.

STATEMENT OF ELIZABETH LISKA, EXECUTIVE DIRECTOR, PRINCE WILLIAM INTERFAITH VOLUNTEER CAREGIVERS PROGRAM, MANASSAS, VA.

Ms. LISKA. Thank you. I am testifying in favor of the $500 tax credit for families caring for an elderly member as a beginning of providing assistance to families who care for elderly members. At this point, the $500 tax credit would cover some small portion of costs that would give encouragement to families, acknowledgment, recognition that families are caring for each other. Often these families become so absorbed that they feel that no one knows of their plight nor cares.

Currently, I serve as executive director of Prince William Interfaith Volunteer Caregivers Program, am a founding member and regional facilitator for the National Federation of Interfaith Volunteer Caregivers. There are 400 interfaith volunteer care giver programs across the country and Guam. We are in the process of developing another 900 funded by the Robert Wood Johnson Foundation.

For 11 years, these programs have worked primarily with elderly persons and their care givers to identify and meet needs and to bring formal and informal resources together to meet them, with a focus on allowing care givers to continue over the long term and enable independence for as long as feasible.

Family care giving begins with simple tasks, responsibilities, and progresses to full care. A phone call now and then, or daily, transportation to appointments, buy the groceries, help with housework and other household chores, escalating to hands-on daily care. Responsibilities continue to escalate while the health of the older person becomes more and more fragile. Financial, emotional energy costs escalate.

Recent information shows that children are likely to be care givers of a parent for at least 9 years. Because we are all living longer, the time that we care for parents may exceed the time that we actually rear children in the home.

We know that 85 percent of care given to the elderly is given by families even when formal services are in place. At the same time that a person cares for a parent, they are caring for children and often grandchildren. For the first time, 50 percent of American families are comprised of four generations. The cost of caring for a parent or grandparents is added to the cost of physical and educational needs of children. At the same time college tuition is due, mom may need a walker, a wheelchair, an added prescription. We need not to forget that family members other than parents and grandparents are cared for with the same costs and that traditionally we do not live with the person cared for, unless a spouse. Long-distance care givers have the additional cost of travel and phone expense.

A shift is needed to allow elderly persons to remain independent for as long as possible in their own homes or in the home of another family member, to allow families to continue to care for each

other, to reduce unnecessary institutionalization. The cost of home care, even assisted by formal care providers, would still be less costly than institutional care. The cost of care giving in the home is high but not as high as care in an institution.

By making it financially feasible for families to care for elderly members in the home, a full program of assisting family to care for elderly at home, costs to government will be reduced greatly, unnecessary emergency room visits will diminish, the actual dumping of some elderly can be stopped, and we can reduce the hurting these families are experiencing.

Many care giving families with two incomes have no other alternative than to give up one income because they cannot afford to pay for in-home care, and someone must be there. Even so, that family will still not be able to remain financially stable. A family assisted to provide 8 to 10 hours of care during working hours will be less costly than providing total 24-hour nursing home care. Helping a family to provide assisted living care would also be less costly and appropriate in many cases.

What might the proposed $500 cover? The most frequent and highest costs are for prescriptions, equipment, and home care supplies.

Thank you for this opportunity, and God bless you. You have a difficult task.

Mr. COLLINS. We thank you.

Next, Ms. Abaya.

STATEMENT OF CAROL ABAYA, PUBLISHER, SANDWICH GENERATION

Ms. ABAYA. Yes. I sincerely appreciate the opportunity to speak to you today because what Congress does or does not do will impact skyrocketing health care costs and the quality of life for millions of our elderly as well as the sandwich generationers, those involved in elder care.

I come before you as a sandwich generationer, a working woman with elderly parents who in 1991 was forced to give up my own work so that my parents—then 85 and 90—were taken care of. My sister and I were thrown into elder care giving without warning or preparation. I live 55 miles away. I lost my own business clients as I could not service them, nor could I develop new business because of my care giving responsibilities. I struggled then to make ends meet financially and am still doing so.

My sister, a nurse, came up from Florida and stayed 5 weeks. She took a leave of absence from her work. She came up again in March, May, August, and November.

Travel expenses mounted. But more important was the fact that she was unable to put enough work hours in to qualify that year for her pension benefits. This impacts the number of years she has to work to be eligible for full benefits. During that time, no contributions were made to her Social Security account, and the government lost income tax. If she is unable to make up the work time over time, it will impact her ability for care when she gets older.

I won't go into the details of 1991 here, but more are in my written statement. As a result, in 1992, I founded a magazine called

The Sandwich Generation. Since then, I have spoken with family care givers and professionals in geriatrics across the country.

But this begs the issue we are here to discuss today. You undoubtedly have reams of statistics in relation to the aging of America and the cost attached.

I would like to point out that the 85-plus age group is the fastest growing sector of our population. For every such person, there is a sandwich generationer, a care giver, today or tomorrow. Seventy-three percent of women who are today 65 will live out their last years in poverty unless you people take positive action.

Some more important facts. The top three reasons older people go to costly emergency rooms, are admitted and then may go into nursing homes are, No. 1, adverse interaction from medicine; No. 2, malnutrition and dehydration; No. 3, falls which result in broken bones.

The health dollar cost as a result of just these three things is $40–$50 billion a year. This is no small number. Probably 90 percent of these costs don't have to be because all three of these illnesses can be prevented with early intervention and better home care services.

Wouldn't it be better to overhaul the preventive and home care service systems now than to continue as we are with the future costs skyrocketing even faster because the number of seniors is increasing so dramatically?

It certainly would be more cost effective to have someone go into a senior's home even 1 hour a day to make sure medicine is taken properly and at least one good meal is prepared.

Allowing a small tax refund each year, such as is being proposed, will do little to solve the overall problems, as noted above.

A major change in public policy is needed. Today's policies, focusing on ADLs and approved agencies, defeat the basic objective of keeping older people safely in their own homes, healthy and independent as long as possible and, importantly, affordably. By using the ADL criteria, it is already too late. The objective must be to establish a framework for early intervention in relation to custodial care types of needs.

What can you do to help families better take care of aging relatives and yet preserve the integrity of their nucleus family, the older person's self-image, and the sandwich generationers—what I call the "I" Self?

No. 1, allow seniors themselves to itemize deduction for home care services from their income taxes. This would help more people remain at home at a lesser cost than being hospitalized or institutionalized. It would help prevent the three top reasons why seniors end up in costly emergency rooms.

No. 2, if another member of the family is paying for services or expenses of a parent, grandparent, aunt or uncle, regardless of where the elder lives, allow that person to deduct the cost from their income tax.

No. 3, change the ADL criteria and broaden it to include various nonpersonal care items such as shopping, cooking, cleaning, supervising, medicine. Early intervention must be actively promoted and must be affordable.

No. 4, set up a tax relief framework for private companies that supply needed services to seniors so that user costs can be kept down. Such services could include home health care, home chores, transportation, meals on wheels.

Words of caution. It is not wise to legislate family living arrangements. Moving an elder from his or her home, unless there is no alternative, jeopardizes the elder's emotional well-being. Emotional negatives equals depression equals medical problems equals higher health care use and cost. Such a policy will end up costing the government dramatically more in Medicare.

In closing, I would like to say that I was talking to a friend of mine who is an RN and community social worker about my coming before your committee. When I told her the subject and the amount of proposed relief, her immediate reaction was, that is a joke. We hung up, and 1 hour later she called back. I have been talking with my 20-year-old daughter about that $500, she said. We have come up with some words you should tell the committee.

So in following her suggestion and my own gut feelings when I read the proposal, here are words we feel are appropriate in describing 500 dollars' worth of relief: an insult to millions of dedicated care givers, denigrating the care giver's responsibility and hard work, demoralizing. We sandwich generationers and adult children care givers, as well as the millions of senior care givers, certainly need relief, but it must be meaningful.

I thank you for your time, and I would be willing to answer any questions you might have.

[The prepared statement follows. An attachment is being retained in committee files.]

FOR ADULTS CAUGHT IN THE MIDDLE
THE SANDWICH GENERATION
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HOUSE WAYS AND MEANS COMMITTEE

Testimony January 18, 1995

by Carol Abaya, Publisher and Sandwich Generationer

I sincerely appreciate the opportunity to speak to you today because what Congress does -- or does not do -- in the next year or so will impact the skyrocketing health care costs in this country and the quality of life for millions of our elderly as well as the Sandwich Generationers -- those involved in elder care.

It will take great courage on your part to initiate dramatic changes both in public policy and the public's perception of what aging means today and more importantly in the years to come.

I come before you as a Sandwich Generationer -- a working woman with elderly parents who in 1991 was forced to give up my own work so that my parents (then 85 and 90) were taken care of properly. My sister and I were suddenly thrown into the situation of having to take over total care responsibilities for elderly parents. We were forced to learn a lot -- and fast -- about aging and the needs of elders when my mother became ill and almost died

I won't go into the details of 1991 -- which to date was the worst year of my life. But as a result of my own experiences, in 1992 I founded a magazine called **The Sandwich Generation.** Editorial deals with aging issues from the financial to legal, health and most importantly, the emotional.

Being a Sandwich Generationer is the most difficult role on what I call the stage of life. No one can rehearse for it. No one prepares you for it. Because this is the first generation to have the longevity factor as a generation, there are no societal role models.

My sister and I were thrown into elder care giving without warning or preparation. I live 55 miles away. I lost my own business clients as I could not service them nor could I develop new business because of my caregiving responsibilities and tasks. In addition I had to take over the day to day operations of my mother's business. I struggled then to make ends meet financially and am still doing so, both personally and professionally.

My sister, a nurse, came up from Florida when my mother became ill and stayed 5 weeks. She took a leave of absence from her work. She came up again in March, May and August and then a couple of other times during the year.

Travel expenses mounted. But more important was the fact that my sister was unable to put in enough work hours to qualify that year for pension benefits. This impacts the number of years she has to work to be eligible for full benefits. In addition, during that time no contributions were made to her social security account, and the government lost income taxes because she wasn't working. And if she is unable to make up the work time over time, it will impact her ability to pay for care when she gets older.

At that time, my niece (whom I had helped raise) began her own business. A child day care center. She could have used our help, both in the marketing aspects, using my expertise, and financial from both my sister and I. Because our own income streams were reduced, we were unable to help her -- hence being caught in the middle.

When my mother was in the hospital, given her pain and confusion level, we had health aides two shifts, when my sister was not there, at a cost of $1,500 a week. Insurance refused to pay for it. At the time my father's savings account had maybe $12,000, and that was his only liquid asset. He did not have enough income to pay for such nursing either in the hospital or when she got out, two months later. And neither my sister nor I had that kind of money - or even assets that we would sell to pay for my mother's care.

Most American families -- the 30+ million over 65 and accompanying Sandwich Generationers -- cannot pay for such extensive care and also pay taxes and pay their daily bills. The numbers, the dollars, just aren't there.

While my sister was at the hospital, I was running my mother's real estate business and trying to figure out my parents total financial picture. It took me 4 months to do this.

Let me tell you, that aside from the financial considerations, the emotional stress took a great toll on all of us that year. On myself, my sister and my father. Many a night I cried myself to sleep.

But this begs the issue we are here to discuss today.

As a member of this committee, you undoubtedly have read reams of statistics in relation to the aging of America and the costs attached. But I would like to just mention a few here, perhaps to give a broader picture of reality and what society's challenges are going to be within the next decade.

Of all the people in the history of man who ever lived to the age 65, half are alive today. Why? The installation of public sanitation in the beginning of this century, greater availability of food, and last but not least, medical advances have resulted in the first generation in substantial numbers to live well into their 80s and 90s.

As a result, the 85+ age group is the fastest growing sector of our population. For every such person there is a Sandwich Generationer -- a caregiver, today or tomorrow.

73% of women who today are 65 will live out their last years in poverty -- unless you take positive action.

CRISIS TO COME

Let's take a look at the future if relief and help are not made available to families.

57% of women today work outside of their home. They now contribute both to the productivity of this country and the tax base. Many will have to leave their jobs to take care of aging parents. This means a great loss of taxes, because many of those who will have to leave their work are in key organizational, managerial and executive positions.

This also means families will have less money to pay for their children's education and less money to save for their own retirement years and aging care. The next generation of young could well have fewer educational opportunities or have to borrow (from public coffers which are increasingly empty), thus being less prepared to face the work place of the 21st century and/or starting out life burdened with high debts.

Sandwich Generationers will have less money put away for their own retirement needs -- thus making them more vulnerable.

With so many working women leaving their jobs to care for parents (12% have already done so) , business and industry will face shortages of qualified and reliable employees. This then could have a dire dramatic impact on productivity and business in this country and in the country's basic ability to meet the challenges of a world marketplace in the 21st century.

I need not go into the snowball effect on the loss of taxes and increased pressure on public expenditures.

The problems attached to elder care giving compromises the ability of millions of Americans (today's Sandwich Generationers, including the baby boomers who are becoming Sandwich Generationers) to live out their elder years in comfort -- not luxury -- but having the money for basic necessities and care.

$40 BILLION IN HEALTH COSTS CAN BE AVOIDED

Some more important and very key numbers -- and they are all tied into the cost of health care. The 3 top reasons older people go to expensive hospital emergency rooms, are admitted, and may then go onto nursing homes are

- adverse interaction from medicine;
- malnutrition and dehydration; and
- falls, which result in broken bones.

The health dollar cost as a result of just these three things is $40 to $50 BILLION a year. This is no small number. Quite frankly it is a national tragedy because probably 90% of these costs don't have to be. Because all of these three illnesses can be prevented with early intervention and more affordable home care services.

Wouldn't it be better to overhaul the preventive and home care system now than to continue as we are, with future health care costs skyrocketing even faster because the number of seniors is increasing so dramatically??

It would be cost effective to have someone go into a senior's home even 1 hour a day to make sure medicine is taken properly and at least one good meal is prepared. Also, the safety proofing of a home or apartment . Removing electric cords or scatter rugs. Increasing the size of light bulbs so the senior can see better and not trip over something. Simple things. Very inexpensive to do. But very costly repercussions if not done.

It certainly would be cost effective from a federal point of view to have the adult woman -- the Sandwich Generationer -- maintain her higher paying job -- and hence continue to contribute to the tax base -- and at the same time, provide the opportunity for someone else to earn at a lower level -- also contributing to the tax base -- by caring for older people.

Allowing a small tax credit as now proposed each year will do nothing to solve the overall problems, as noted above.

A major change in public policy and perspective is needed. Today's policies, focusing on ADLs and approved agencies, defeat the basic objectives of keeping older people safely in their own homes, healthy and independent as long as possible. By using the ADL criteria, it's already too late. The objective must be is to establish a framework for early intervention in relation to custodial care types of needs.

As more and more women have to give up their jobs -- like my sister and I did -- to care for aging parents and other relatives, the economic situation of American families is going to deteriorate. While women traditionally have been the nurturers, the care givers, today they are an integral part of the working fabric of the country. Families desperately need help and tax relief. Women cannot be super people. And only you can provide that help.

What can you do to help families take care of aging relatives and yet preserve the integrity of their own immediate family, the older person's self image and the Sandwich Generationer's "I" Self??

1. Allow seniors themselves to itemize deductions for home care services from their income taxes. This would allow more people to remain at home, at a lesser cost than if hospitalized or institutionalized. It will help prevent the three top reasons why seniors end up in costly emergency rooms -- and therefore would help control health care costs.

2. If another member of the family is paying for services or the expenses of a parent, grandparent, aunt or uncle, regardless of where the elder lives, allow that person to deduct the costs from their income tax.

3. Change the ADL criteria and broaden it to include various non-personal care items such as shopping, cooking, cleaning, supervising medication, etc. Early intervention MUST be actively promoted and must be affordable.

My father, who passed away last year at age 94, was a prime example of this need. At 93, he could still do all the ADLs, and even take his own breakfast and lunch. It was only in the last year that he needed ADL help. But he couldn't shop, cook, clean the house and do laundry -- all tasks which directly impact health. When my mother was in the hospital,, he was totally dependent on my sister and myself. Later, he was dependent on the housekeeper. If a person does not eat properly, all kinds of physical and mental health problems arise.

Words of Caution! It's not wise to "legislate" family living arrangements. Moving an elder from his or her own home -- unless there is indeed no alternative -- jeopardizes the emotional well being of that elder. Emotional negatives = depression = medical problems = higher health care use and cost. These negatives also apply to the Sandwich Generationer, the care giver. Increased stress impacts all facets of a person's life. Attached here are articles about families who took in aging relatives and some of the problems that developed.

Such a policy, forcing elders to move in with children in order to qualify for help, can only backfire and end up costing the government dramatically more in Medicare and the American economy more in lost productivity and taxes.

I sincerely hope today's discussion is only a beginning of your looking at family needs in relation to elder care. What you do -- or don't do -- will set the stage for life of Americans forever in the future. What you do -- or don't do -- will effect America's ability to compete in a highly technical world market. This is an enormous challenge.

In closing, I would like to say that I was talking to a friend of my mine last week who is a RN and community social worker about my talking before your committee.

When I told her the subject and the amount of proposed relief, her immediate reaction was "That's a joke." We hung up, and an hour later she called back.

"I've been talking with my 20-year-old daughter about that $500," she said. "We've come up with some words you should tell the committee."

So, in following her suggestion and my own gut feelings when I read the proposal, here are the words we all agree are appropriate in describing $500 worth of relief. An insult to millions of dedicated care givers. Denigrating the care giver's responsibilities and hard work. Humiliating. Demoralizing.

We Sandwich Generationers and adult children caregivers as well as the millions of senior caregivers certainly need relief. But it must be meaningful .

Mr. COLLINS. Thank you.
Ms. Queen-Hines.

STATEMENT OF CARMEN QUEEN-HINES, BALTIMORE, MD.

Ms. QUEEN-HINES. Good afternoon, Mr. Chairman and members of the committee. I appreciate this opportunity to share my personal experiences in the area of elder care.

I would like to begin by describing myself to you. I am a wife, a mother, and daughter, daughter-in-law, aunt, niece, and cousin to a very large and extended family. I have been a care giver in each of those roles, with the exception of cousin, but I am sure that will happen soon.

I will be sharing with you my family's experience in caring for my mother-in-law who suffers from glaucoma, diabetes, and high blood pressure. In addition, 4 years ago she underwent a triple bypass. She also takes a variety of prescription medications to control her various diseases and illnesses.

Two years ago, when my mother-in-law indicated that she was not feeling well, my husband encouraged her to get her blood pressure taken at a local health center. When she went to the health center, she was informed that her blood pressure was high and she was instructed to contact her physician. However, while driving home from the center, she was involved in an accident and subsequently was transported to the hospital.

While being examined by her physician, she admitted that instead of taking the full dosage of her medication, she had only been taking half doses to extend the medication because of the cost.

Of course, we were shocked to learn this. We contacted various information and referral services provided by our employers. initially, we thought, because of her age, which was 69 at the time of the incident, we would be able to find a discount pharmaceutical program to meet her needs. However, we found from the information and referral service that because my in-laws lived together and owned their own home, their combined pensions must be considered and, therefore, they are not eligible for any discounts other than the standard 10 percent senior citizen discount. But if my mother-in-law were considered separately based on her own pension, she would qualify.

Some of the options presented to us included putting their home in our name, considering a legal separation and divorce, or caring for her in our home. None of these options were acceptable to us, because we feel that a contributing factor to their mental health is their independence, which we do not want to take away unless it is absolutely necessary. While the information on the pharmaceutical services was not utilized in this situation, we were provided with valuable information on meal services and senior citizen programs which we were able to use.

So the only viable option that we felt left to us was for us to subsidize her medical expenses ourselves. As a result, during calendar year 1994, we spent more than $2,000 on prescription drugs and related medical costs. In addition, we have also subscribed to Blue Cross/Blue Shield supplemental medical coverage which complements their Medicare.

In closing, while my husband and I have been able to manage our care giver responsibilities, it has been a strain financially and emotionally. A person in this situation must have support from their spouse and their employer. A supportive employer is one that will allow you to take leave to accompany family members to medical appointments and will provide information and referral services. Finally, what we have found is you need a sense of humor that will help you balance work and family responsibilities.

I appreciate this opportunity to share my personal experience, and I hope my testimony will be beneficial to you in making decisions on health care benefits for the elderly. Thank you.

Mr. COLLINS. Thank you and we appreciate your sharing those comments.

Ms. Adolf.

STATEMENT OF BARBARA P. ADOLF, CONSULTANT, TOWERS PERRIN, NEW YORK, N.Y.

Ms. ADOLF. Good afternoon. My name is Barbara Adolf. I am a work and family consultant with Towers Perrin, which is a management and benefit consulting firm. My area of expertise is work and family, and what I do is address issues that employers face in helping their employees balance work and personal life. In my testimony, I would like to point out some key issues in employer—supported elder care. I am not advocating a specific position, but I am just providing information.

Towers Perrin recently conducted a study of more than 100 work/life benefits of our clients. Our goal was to identify trends in employer support of work/life benefits. Elder care benefits are among the work/life benefits that we looked at and we found that elder care benefits are growing. They are not commonplace yet, but many are in the pilot or the planning stages, so we are predicting that they will become baseline in the next few years, given certain conditions.

There are two reasons for the growth. First, elder care is starting to be seen as a business issue that affects a company's bottom line. It can affect employee productivity, absenteeism, and recruitment, for example. The second reason is the financial incentives in employee benefit legislation.

In my experience, between 10 percent and 25 percent of employees at a given company have elder care needs and these numbers are growing. This means that they assist usually their aging parents with a wide range of activities. Often they provide care on an emergency basis.

The dependent care spending account, one of the most prevalent of the elder care benefits, and this is also the benefit that is for child care, is used for elder care by less than 1 percent of a typical employee population where it is offered. The reason for the low utilization is that to qualify for the tax favored treatment, the employee's elder must live with him or her at least 8 hours a day and be the financial dependent of the employee. These requirements are similar but not exactly the same, as those in the proposed tax credit.

Long-term care, another area of growing interest among employers, is not tax favored, as I am sure you know. This limits employer funding of the benefit. Cafeteria plans, which allow employees to select among a menu of benefits, currently cannot include the benefit.

Elder care resource and referral programs, which employers provide to help employees access elder care services, are also growing, but their growth may be thwarted as elder care services are reduced as a result of budget pressures on government.

Government policy could stimulate corporate involvement in the creation of new programs and services. For example, senior day care and transportation services. Tax credits and grants that encourage the development of consortia would also allow smaller employers to get involved.

These are some of the ways that the government could stimulate the private sector to get involved in elder care support. But, of course, any initiatives should take into account revenue pressures on government.

Thank you.

[The prepared statement follows. An attachment is being retained in committee files.]

STATEMENT OF BARBARA P. ADOLF
CONSULTANT, TOWERS PERRIN, NEW YORK, NY.

Good morning. My name is Barbara Adolf. I am a work/life consultant with Towers Perrin, a management and benefits consulting firm. We consult to employers on management and employee benefit issues.

My area of expertise is work/life — also called work and family. Work/life addresses issues that employers face in helping their employees balance work and personal life. Consultants like Towers Perrin identify the barriers to productivity and design programs to remove these barriers. An important aspect of our work is employee-needs research. We also research existing employer programs, as companies frequently benchmark their programs against competitors'.

In my testimony today I will discuss trends in employer — particularly private sector — support for elder care and the incentives for employer action in this area. I will draw on research we have done with clients on their employees' elder care needs. I will relate this discussion to the proposed elder care tax credit. As a consultant I do not advocate a specific position. Rather, my goal is to inform the discussion with facts and observations gleaned from practicing in this field for more than ten years.

PURPOSE AND DESIGN OF THE WORK/LIFE BENEFITS STUDY

Towers Perrin recently completed a study of more than 100 work/life benefits of our clients. One hundred seven companies are represented, from small businesses (130 employees to very large organizations (96,000 employees). With the average employee population in the survey at about 7,000 we feel the group is representative of companies in general.

Many of the work/life benefits, directly or indirectly, relate to the elder care needs of employees and, in some cases retirees. We identified the current prevalence of these benefits, including those that are *baseline* — offered by a significant number of employers in our study. In addition, we tried to predict the future trends in employer-provided work/life benefits. We did this by identifying those benefits that are to a great extent in the pilot or planning stage. We expect that in this emerging field, such programs are likely to become *baseline* within the next few years.

Many of these benefits are relatively new — developed within the last 10 years. They are sometimes called "life cycle" benefits, because they address issues employees face at critical points throughout the life cycle. Often, they are integrated with the more mainstream benefit programs — such as medical, disability, life insurance and retirement plans — through "flexible benefit" or "cafeteria" benefit plans. Flexible benefit plans allow employees to choose from an array of offered benefits. Life cycle benefits can also be provided to all employees; in this case they are called "core" benefits.

The benefits can be paid for entirely by the employer, the employee or by some combination of the two. When provided through a flexible benefit plan, in some cases the benefits can be paid on a pre-tax basis.

In our study, we also identified a group of employers — approximately 20% of the survey group — who have implemented a large number of work/life programs. Compared to the survey group in general these High Commitment Companies employ more people, have higher average salaries and employ higher percentages of female employees and employees under 40. We conducted in-depth interviews with employers in this group to determine what lay behind their greater commitment to work/life. I will share these findings with you, as well.
In our research methodology, we positioned elder care as an employee need that is addressed within the following work/life areas:

- **Supporting employees through the financial life cycle**
- **Helping employees take care of dependents**
- **Making work more flexible**
- **Keeping employees physically and mentally fit**
- **Saving employees time**
- **Aligning the environment with "the deal."**

FINDINGS OF THE STUDY

Elder Care Benefits Are on the Rise

Our study showed that along with other work/life benefits *elder care benefits are increasing.* While most elder care benefits are not *baseline* yet, we expect rapid growth because so many are in the planning or pilot stage. Significantly, we found that once elder care benefits had been implemented virtually none were ever eliminated.

Reasons for Growth of Elder Care Benefits

From an employer perspective there are two major forces behind the expansion of elder care: *1) elder care is starting to be seen as an issue that affects a company's bottom line* and 2) *financial incentives in employee benefit legislation encourage employer-involvement.*

- Elder Care as a Bottom Line Issue

Work Force Demographics
The U.S. population and work force are changing in profound ways. We are aging — the fastest-growing segment of the overall population is the over 85 year olds. Most of the "traditional" caregivers — women — are no longer at home available to care for elderly and disabled family members on a full time basis. The full time female homemaker is now rare — the vast majority of women work because their earned income is crucial to their families' well-being.

Elder Care Responsibilities of Employees
Approximately 10% to 25% of employees in a given company have elder (adult disabled) care needs. This means that these employees spend at least some time during most weeks caring for disabled relatives. The care they provide includes a wide range of activities: monitoring aging parents, doing chores, shopping, transporting them to medical and other appointments, taking care of their finances, and assisting with personal care, such as bathing and feeding. Besides the various types and levels of physical and medical assistance, care often involves negotiating complex tax and insurance systems, such as Medicare and Medicaid. Some provide elder care on a regular basis throughout the week. The largest group — more than one-third of employee-caregivers — provide care on an emergency or as-needed basis. Financial expenditures for a small proportion of caregivers can be substantial, up to several hundred dollars per week, just for part-time assistance.

Many employees are responsible for family members who live far from them. For these employees, the stress of having to negotiate arrangements for elders from a distance can be especially difficult.

Impact on Productivity and Recruitment
Employee-caregiving can be costly to the employee not only in time and money spent; the demands are often emotionally and physically draining. Employees say that the distress they feel witnessing an elder's deterioration and not knowing exactly what to do about it can make them ill or depressed.

At work, such problems cause low morale, reduced productivity, increased absenteeism and turnover. The impact on employers can be great; managers say that employees with the greatest elder care problems — those who feel the strongest commitment to their elders — are often among the employees most committed to their jobs.

According to employers, more and more employees are asking for work/life benefits, including elder care benefits. In surveys, many employees say they are willing to contribute financially to programs that help them better manage work and caregiving. These concerns are not limited to older employees. In our research we find that an increasing number of younger employees are taking care of aging relatives, such as grandparents. At the same time, surveys show that employees' values and expectations about work are changing; increasingly, younger employees want more life cycle benefits. As a result, employers are starting to promote these benefits in their strategy to recruit certain employee groups.

Tie-in to Business Objectives
The employers in our survey reported that work/life benefits contribute positively to the work environment, specifically the following:
- employee perception that the company is a good place to work
- employee appreciation for human resource programs
- enhanced job satisfaction
- productivity and loyalty
- reduced absenteeism.

Nearly twice as many of the High Commitment Companies we identified, which have a large number of programs in place, reported these advantages. For example, 65% of the High Commitment Companies reported that these programs increase employee loyalty, compared to 35% of the total group and 40% said they improve employee productivity compared with 24% of the total group.

- Financial Incentives in Employee Benefit Legislation

The dependent care tax exclusion (Section 129 of the Tax Code) has, to some extent, encouraged employers to support dependent care initiatives. The most significant plan affecting elder care is the dependent care flexible spending account (Section 125). I will discuss this plan in detail in the next section.

Except indirectly through general savings vehicles, such as the 401(k) plan exclusion, employees are not encouraged to save for elder care "custodial" expenses in the future. Non-medical care expenses do not receive tax favored treatment. Premiums for long term care coverage and the cost of care itself are not tax favored.

CURRENT ELDER CARE BENEFITS

■ **Financial Supports Throughout the Financial Life Cycle**

- The Dependent Care Spending Account (Sections 129, 125 of the Tax Code)

This allows employees to use pre-tax dollars, to $5,000, to pay qualifying dependent care expenses, expenses that cover care of a dependent — child or elder — so the employee can go to work. The money is deducted from the employee's pay check. The plan also saves the employer payroll taxes on the money. Approximately eight in ten of the employers in our survey offer this benefit to their employees.

The utilization rate of the benefit is approximately 3% to 5% of an employee population. Reasons for the low utilization include:

1) the "use it or lose it" provision (the requirement under Section 125 regulations that any amount set aside in a flexible spending account be either used or forfeited at the end of the plan year)
2) the fact that payments to caregivers (particularly for child care) frequently are not reported for tax purposes as they must be as a condition for the tax exclusion
3) availability of the child care tax credit
4) confusion about how the benefit works.

Of the small number of users of this benefit, only about 20% qualify for elder care tax exclusions, less than 1% of the employee population. The reason for this is that the dependent eligibility requirements are so narrowly defined. To be eligible the employee's parent must be *financially dependent on the employee and live with the employee at least eight hours a day* — such dependency is a condition of receiving the dependent care tax exclusion.

We understand that you are considering implementing a $500 refundable tax credit for custodial care of dependents, specifically, for a taxpayer's parent or spouse who is disabled — certified by a physician as being unable to perform at least two *activities of daily living*. The dependent would have to reside with the taxpayer for more than half the year. The taxpayer would also be required to have primary financial responsibility for maintaining the household.

Given the financial and residential requirements of the proposed legislation, the same problem that currently bars many employed caregivers from using the dependent care exclusion (and therefore, the spending account) would still apply. If one purpose of the credit would be to provide employed caregivers with financial relief, the law as proposed would not do this for the vast majority. In addition, the amount proposed — $500 — is minimal, considering the typical expenditures incurred by employees who assist elderly/disabled persons.

Should the proposed tax credit be implemented, employees who qualify and also have access to a dependent care flexible spending account, as with child care, would probably have to choose between the two. Making such a choice can be confusing.

In any case, the value received from extending an elder care tax credit must be balanced against the cost in revenue.

- Long Term Care Insurance for Relatives

Long term care is non-medical care (feeding, moving, bathing, and so on) of a disabled individual. The care may be provided in an institution — usually a nursing home — or private home. This care can be extremely expensive. One solution is for individuals to purchase insurance coverage for long term care. Another is to save to pay for the care. In either case, starting young can make a big difference in the cost to the individual; the older a beneficiary is when first purchasing the insurance, the more expensive. Also, the longer the period of saving the larger the accumulation of funds to pay for the care.

Employers can help employees with the insurance by providing long term care insurance at group rates. In our study, we found that 15% of the employers provide long term care insurance as an option for employees, their spouses and parents. About the same number offer this only to employees. Another 15% are piloting or planning to implement this benefit. In our work, we find that a growing number of our Fortune 500 companies provide this benefit. Therefore, we expect long term care insurance to become *baseline* in the near future.

This benefit is almost always employee-pay-all. Its appeal to employees is that, as a group plan, it costs less and provides a richer package of benefits than the employee could obtain individually. In addition, the benefit is designed to fit within a total benefits scheme, thereby reducing the potential for gaps in service options or duplication of services.

Interestingly, few employees purchase the benefit. Among the reasons are: 1) a lack of disposable income, particularly among younger employees and 2) a lack of awareness of the potential value. Among our larger clients, however, utilization of the benefit is increasing. This reflects growing awareness of its importance.

If the benefit received tax-favored treatment, employers would be encouraged to contribute to its funding. Also, if the benefit could be included within a flexible benefit plan employees would have the option to purchase it with pre-tax dollars, and to the extent they did it would reduce the employer's potential liability exposure.

Any such tax-favored treatment must be weighed against the revenue cost.

■ **Helping Employees Take Care of Dependents**

- Elder Care Resource and Referral Programs (ECRR)

These programs provide employees with information about elder care programs and services. Vendors that offer this service usually inventory a wide array of programs and providers — including "meals-on-wheels" (services that deliver a hot meal to a disabled person during the day), practical nursing services, case management services and attorneys who specialize in elder law.

Although this is a relatively new benefit, one-quarter of the companies in our study provide the service, which has been offered to employees only within the last few years. Since nearly 20% of the companies are piloting or considering implementing this program we expect it to become *baseline* relatively soon. Ironically, many of the social service programs that employees access through resource and referral programs are likely at risk of elimination with the increasing budgetary pressure on government expenditures. Such an action could initially inhibit the growth of elder care resource and referral programs in corporations, as employee-users register frustration at not receiving the care "promised."

- Elder Care Fairs, Support Groups

Elder care fairs, usually held once or twice a year, are forums in which representatives from elder care agencies provide employees with information directly at the work site. While only 8% of employers currently provide these programs another 7% are piloting or planning them. Similarly, elder care support groups, which enable employees with elder care problems to help one another, are provided by 4% of the respondents; however, another 5% are likely to have these programs in place in the next few years.

- Use of Sick Days to Care for Ill Dependents

One-third of employers allow employees to use their own sick days to care for dependents, including disabled relatives. This benefit is the result of employer recognition that when an elder or other dependent is ill, the employee caregiver takes the time off anyway, reporting the absence as personal illness. Employers are saying that such "forced" deception conflicts with the organization's values.

■ **Making Work More Flexible**

- Personal Days, Vacation Day Carryover, Purchase of Additional Vacation Days

A majority of employers in our study allow employees personal time off (62%) and the ability to save unused vacation days (59%). About one-third of employers have implemented programs which put all paid time off — vacation, illness and personal — into one package for the employee to access as needed.

Approximately 12% of employers allow employees to purchase additional vacation time, frequently as part of a flexible benefit plan. Such a benefit is often used by employees with caregiving responsibilities. Another 7% of employers are piloting or planning to implement this benefit, placing it among the fast-track group.

- Alternative Work Arrangements

Alternative work arrangements have been developed in response to a wide range of employee lifestyle needs. These options are particularly helpful to employees caring for the aging and disabled. They include: flextime, compressed work week, job-sharing, part-time work and telecommuting.

Flextime allows an employee to vary starting and ending times of the work day. Forty-four percent of employers offer flextime within a one-hour time band and another 12% are planning to do so, making flextime an option that will become *baseline* very soon. Wide-band flextime, in which employees are given greater leeway in starting and ending the work day, is offered by 38% of employers and another 12% are planning or piloting it.

The compressed work week, usually consisting of four ten-hour days, is popular among employees with caregiving responsibilities. This, along with job-sharing in which two employees share one job, will also become *baseline* in the near future. At the same time, employers are expanding benefit coverages for part-time employees. Forty-one percent offer at least pro-rated benefits for these employees, while one-quarter provide full benefits for part-time workers.

Telecommuting allows employees to work at home. While currently 23% of employers offer this, another 26% are planning or piloting this option. In addition, programs in which employers provide equipment for work-at-home are increasing.

- **Keeping Employees Physically and Mentally fit**

- Employee Assistance Programs (EAP)

These confidential information/counseling programs help employees cope with personal and family problems, including the difficulties of elder care. EAPs, the most prevalent of the benefits we researched, are provided by nearly nine in ten of the survey respondents.

Numerous other benefits can apply to elder care needs of employees. However, for our purposes here, I have touched on those most relevant.

- **Saving Employees Time**

Employers, aware of the time pressures many employees feel trying to balance work with family responsibilities, are providing services at the work site. Banking and company medical services are programs offered by a substantial number of employers in the survey. A company store, which is offered by one-quarter of employees, and dinners-to-go demonstrate awareness that employees have limited time to shop for the basics. A corporate concierge service, although offered by a small number, is under consideration by several. This information service gives employees access to such services as errand runners and ticket vendors, and can help employees access recreational facilities appropriate for the disabled.

- **Aligning the Environment with the Deal**

There is growing recognition among employers that benefits and programs are not enough; employees must feel comfortable about using them. In some companies employees believe they cannot admit that they have a personal problem. In others, they feel comfortable about discussing a solution to an elder care problem.

A majority of companies conduct employee attitude surveys, and the numbers are growing. More than a third now give managers work/life sensitivity training, and another 13% are planning to do so. Similarly, nearly one-third conduct employee focus groups or surveys on work/life issues and another 17% have these in the works. One in five has a work/life manager to attend to employees' work/family needs and 6% have the position planned or piloted. All are indications of corporate cultures poising themselves for change.

STIMULATING PRIVATE SECTOR ELDER CARE INITIATIVES

Findings from our study suggest that employer-involvement in elder care will continue to grow. However, the question arises: What impact will changes in government policy and funding have on these initiatives and subsequently on employees' needs for elder care relief? Further, what impact would the proposed tax credit have on employer-involvement and the growth of programs and services in elder care? What other programs might be considered?

Tax Exclusions, Credits and Grants

- Making Custodial Care A Tax Excluded Benefit

Few would disagree with the need to encourage employees to purchase "protection" against the immense costs of long term care for themselves and their elders. Making long term care insurance tax advantaged to employee and employer would encourage employees to purchase the benefit and employers to contribute funds to the benefit.

It would also be to everyone's advantage if employees were encouraged to save to cover the costs of long term care needs. A tax advantaged vehicle specifically set up for this would focus attention on the need and enable employees to accumulate the monies to cover expenses in the future.

If either or both long term care insurance and a savings vehicle were included in a flexible benefit plan, employers would more likely contribute to the extent that the plan they have designed limits their liability to the amount already funded. With effective plan design, they can limit their liability to each year's contribution.

- Changing Eligibility for the Dependent Care Spending Account

In many families, several adult children share financial and other caregiver responsibilities for parents. Because no one person is responsible for more than 50% of the cost of care, none is eligible for the dependent care spending account. To alleviate this problem, and encourage employees to assist aging parents, some relief might be offered. For example, a partial tax exclusion might be allowed based on a schedule of expenses and income — not unlike the child care tax credit. Such relief might help keep some elders out of nursing homes and off public assistance.

- Encouraging Private Sector Elder Care Initiatives

As elder care needs increase, and government support comes under further pressure, it is unlikely that the slack can be picked up by family members, particularly those who are in the work force. The challenge will be to find a way to establish new or expanded programs and services will be needed if we are to maintain quality of life for employees and their aging relatives.

The proposed tax credit will provide little relief in the long run for the increasing numbers of caregivers and elders. One way government policy might make a greater impact would be to use tax credits and grants to stimulate corporate involvement in developing programs and services. Corporate child care initiatives might serve as a model for some programs. For example, an effective structure for establishing a child care center is through a consortium, in which several employers jointly sponsor a program. A major advantage to this arrangement is that the participants, by sharing costs and risks, reduce their potential liability and commitment. This is a particularly appealing option for smaller employers, who might otherwise be unable to provide support.

Although our study identified a small number of employers (1%) who participate in child care consortia, we also found that this is one of the greatest areas of growth — 12% of the survey group is piloting or planning such a program. Another model, emergency (temporary, drop-in) child care — centers and in-home services — could be a model for elder care development. While 4% of employers currently have implemented emergency child care, 12% are planning or piloting it.

Adult day care, a relatively low cost form of care, might be targeted by providing companies that develop such programs with grants or tax credits. Similarly, intergenerational day care, in which programs are designed for children and elders together, transportation programs for the aging, or emergency elder care, are other initiatives that could be encouraged.

SUMMARY

The proposed elder care tax credit would provide some financial relief to a small percentage of the work force. For some employees it would duplicate a benefit already available, the dependent care flexible spending account. The employee would have to determine which benefit would save him or her more money (similar to the current flexible spending account option and the child care tax credit available to employees with dependent children).

Employers are implementing elder care benefits, recognizing that such life cycle benefits meet a wide range of employee needs that, if unmet, can cost employers in reduced productivity and other human resource losses. However, their initiatives are limited by the lack of tax advantage of certain benefits, specifically those that relate to long term care. As always, such initiatives must take into account revenue pressures on government.

Another issue that should be considered is pressure on elder care services coming from budget pressure on government. Certain elder care benefits, such as resource and referral services, will have fewer programs to meet an increasing need. Monies freed up by the proposed tax credit are not likely to make a difference in the availability of these services.

Government policy could stimulate corporate involvement in the creation of new programs and services, for example, senior day care and transportation services. Tax credits and grants that encourage the development of consortia would also allow smaller employers to become involved.

Mr. COLLINS. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. I thank you for your testimony. I did want to point out that this package, while the section that you are testifying on is the $500 tax credit, there are other provisions in the bill that we intend to move forward that would allow a deduction of home care expenses to be treated as medical expenses and therefore deducted if it exceeds 7.5 percent of adjusted gross income. There are an awful lot of seniors who that will really help and who are probably going to be more greatly assisted by it than by the $500 credit.

There is also in this legislation the right to deduct the premiums of long-term care insurance, up to $2,000, if you are 60 to 65 or 60 to 70, I have to look, and $2,500 above that. So that, combined with some other things that make it easier to purchase long-term care insurance, and most long-term care insurance now does address long-term home care as well as long-term institutional care, should begin to significantly expand the resources for our seniors to protect themselves against the burden of long-term care and/or to help them with that burden of long-term care.

As one of the sandwich generation who is struggling with these very problems, we certainly do need to recognize them and we need to reshape that concept of health services as more of our citizens are living longer.

Ms. ABAYA. May I respond to that? The long-term care insurance is also tied in with ADLs, which are eating, bathing, dressing, toileting, getting up and down. Many elderly people who are still able to live in home and still able to do the ADLs, and my father was an example of that, still at 93 he was able to do everything except he needed some help in bathing, but he was not able to shop, he was not able to cook, he was not able to clean, he was not able to do laundry, and all those kinds of chores impact basic health.

If somebody is not able to cook, then they are not going to eat properly and they are going to end up sick. If they cannot do laundry, then they are going to wear their clothes until they are falling off and then that impacts various kinds of sores on elder's skin, which is much frailer than ours, et cetera.

So that is why I have said that the ADL criteria should be broadened to include the support, the kinds of help that are needed to maintain the ADLs and to enable a person, then, to live healthier, particularly with nutrition and medication.

Long-term care insurance, when it is applicable to the home, is, as I said, tied in with the ADLs, but also most are tied in with an approved agency. The cost to use an approved agency is two to three times more than if you hired somebody privately.

Mrs. JOHNSON. Those kinds of things I think we can certainly look at in the section on deductibility of medical costs.

To hold out to you that we could be quite as flexible in the definition of needs-based services, as you are suggesting, would be to mislead you. The Federal Government did do very significant studies in this area in the seventies and found the cost to be extraordinary if we really went as far as shopping services, cleaning, and

things like that. Some of those tasks can be managed by families in a way that is more periodic than daily.

But I do think the point you make, that the ADL requirement is too restrictive for our seniors today is a very good point and we will look at that as we examine these provisions in detail.

Ms. ABAYA. I think if you compare the costs of providing these kinds of services or the availability to deduct compared with a working woman who has to give up a $30,000 or $40,000 a year job to be able to do all these errands and be able to cope, that the cost is going to be a small percentage of the loss of income tax and the loss of all these other things that a woman is able to provide her family by going out there and working.

Mrs. JOHNSON. Thank you.

Mr. COLLINS. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

I would like to welcome all of our witnesses and thank them for being here to give us accounts of real examples in our community where we need to provide more incentives for people to provide appropriate care for their loved ones.

I particularly want to welcome Carmen Queen-Hines from Baltimore. Since I represent Baltimore, it is nice to have a person from my city here. I really want to compliment you for what you have done to take care of your parents. Your testimony demonstrates vividly the problem we have in this country.

If I understand it correctly, your mother-in-law was not taking the right medication because she could not afford it so she was taking half the prescription thinking it would do the job while trying to save money. These are stories that we often hear but it is important that you testify to show that those types of circumstances exist in our community. People literally cannot afford the medication they need in order to remain healthy.

Of course, if they take the prescriptions, then they are less likely to need more intrusive medical care. This will save us all money. They will be happier and healthier and everyone comes out better.

I am not very encouraged that the legislation before us will help in your circumstance. What we should be doing is looking at ways of expanding the health care system to cover prescription drugs for our people. It is a less costly alternative. We know medicine can really perform miracles today. We should remove that financial burden from those who cannot afford to take their right medication because of cost.

Unfortunately, health care reform is not on the front burner any longer, and it does not look like we are going to be dealing with that issue, at least in the first part of this Congress. I regret that because I do think that health care reform would take care of the problems that many people have similar to yourself.

The legislation before us would provide some incentives for people to provide health care to loved ones in less restrictive environments. I would hope as this legislation works its way through, Mr. Chairman, we would carefully scrutinize the testimony of all the witnesses on this panel to try to tailor the legislation to meet the real-life examples that have been brought forward. I am very grateful for all of your testimony today, and want you to know how important your testimony is to those of us trying to do the right thing

to help you in the very difficult struggles you and they have today in taking care of family members.

Thank you for your testimony.

Mr. COLLINS. We thank the gentleman. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman, and, again, I also want to join in thanking each of you for coming here and for your testimonies. I believe if there is one thing I have heard this afternoon, it is that there is a role for the Federal Government to play in helping to encourage and assist individuals to be able to save and provide for their senior family members.

Perhaps a question I might have for you, Ms. Adolf, if you might expand a little bit, if you would, on your recommendation regarding how we can best implement this $500 dependent care credit.

Ms. ADOLF. I am not recommending anything. What I am trying to do is give somewhat of an employer perspective. I just see a connection between what already exists, the dependent care flexible spending account, which allows an employee to reduce their salary by up to $5,000 for qualifying dependent care expenses. The elder care expenses are limited based on the fact that the elder has to live with the employee at least 8 hours a day and be their financial dependent.

What we are seeing is a very, very low utilization of that benefit. The main reason is that many of the elders do not actually live with the employee. The elders are often not technically the financial dependent. For example, you might have several siblings sharing in the responsibility financially and in terms of living or helping out.

So what we are saying is there is a whole group of employees who really are not getting access to at least some financial support. I think that employers are looking at this group of employees because they are having trouble with absenteeism and lateness and even leaving the job because of elder care burdens.

One of the examples you might look at is the child care tax credit. Employees receive a credit based on a schedule of expenses against income. Therefore, they can receive a partial credit. The idea would be to design the benefit so that employees who are contributing to their parents support can get some tax relief.

Mr. HERGER. Fine. Thank you very much.

Mr. COLLINS. We thank the gentleman.

We also would like to thank each of you for taking your time to be with us this afternoon. Your input is very valuable to us. This Congress and this committee, and on behalf of Chairman Archer, who is very committed to seeing the aspects and provisions of the Contract With America move forward, as they do move forward to the floor of the House. Hopefully, the full House will vote favorably on behalf of these provisions which will help seniors, and the other provisions of the Contract which will help those families with dependent children, as well as the provision of the Contract With America that will also help married couples and these provisions that will help the elderly.

Again, we thank you for being here. We appreciate your input and your time. The committee is dismissed.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

TAX PROVISIONS IN THE CONTRACT WITH AMERICA CONCERNING THE SENIOR CITIZENS' EQUITY ACT

THURSDAY, JANUARY 19, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. For the benefit of the Members, we did not anticipate that there would be a vote. It would be preferable for us to go and vote and come back as soon as possible so that we can commence the hearings without interruption. So the committee will not commence its activities until we are back from this vote.

[Recess.]

Mr. THOMAS [presiding]. If we can ask our guests to take their seats, please, we would like to begin the hearing.

Today we will consider the Senior Citizens' Equity Act in the Contract With America with particular focus on two provisions in that act—the repeal of the 1993 increase in the tax on Social Security benefits, and the proposal to allow terminally ill or chronically ill individuals to receive tax-free accelerated death benefits.

Both of the provisions we will consider today are of extreme importance to our senior citizens, and they are a vital part of this committee's agenda for the next century. In addition, the accelerated death benefits provisions will also be of assistance to many younger taxpayers and their families.

According to calculations based on Census Bureau data, the 1993 increase in taxes on Social Security benefits will amount to $3.68 billion in the first year alone. Twenty-one percent of this amount will be shouldered by seniors with total yearly incomes under $50,000, and 57 percent by those with incomes under $75,000—not the usual category of the so-called rich.

This tax increase does not benefit Social Security in any way. In addition, it is bad news for retirees of all ages who have earned average wages or above. The 1993 tax increase on benefits will rapidly increase the number of retirees who will never get their money's worth from the Social Security system.

This is, of course, because of dramatic increases in the amount of payroll taxes average workers pay—and because of taxation of Social Security benefits.

The 1993 tax increase places far more retirees, current and especially future, in the situation of not living long enough to get a fair return on what they paid in.

The accelerated death benefit provision in the Contract With America responds in a balanced and reasonable way to a current development in the field of life insurance.

To assist extremely ill individuals and their families meet various medical and general living expenses, some life insurance companies have allowed these individuals to receive the proceeds of their life insurance policies prior to their death.

To meet the needs of those extremely ill individuals whose life insurance policies do not provide for accelerated death benefits, viatical companies also have been formed to purchase life insurance policies from severely ill individuals.

Unfortunately, the current Tax Code does not specify whether these benefits are taxable or not taxable. Today's hearing is intended to provide the committee with the background and information needed to clarify the tax treatment of accelerated death benefit transactions so that those in need can receive their benefits tax free, as intended.

The Chair wants to especially thank the witnesses who will be testifying on our first panel concerning accelerated death benefits. It is the Chair's hope that the witnesses on the first panel, most of whom are in a weakened condition, will be questioned in a relatively brief period of time so that their appearance before the committee can be as pleasant and comfortable as we might be able to make it because their testimony is important, and we do want to receive it.

Prior to going to our colleague from Wisconsin, I would yield to Mr. Jacobs for an opening statement.

Mr. JACOBS. Thank you, Mr. Chairman. The second part of the hearing today dealing with the insurance proceeds makes all the sense in the world to me. The first part makes almost none of the sense in the world to me. In fact, I might even, when we mark it up, move to have it amended to say the Social Security Payroll Taxpayers Inequity Act of 1995.

First, we should consider a little history on this subject. In 1983 the Social Security system was in dire danger of, for the first time in history, being unable to pay its obligations, and there was a so-called Social Security bailout. This bailout was an agreement among President Reagan, then Majority Leader Dole and now Majority Leader Dole, and Tip O'Neill, the Speaker of the House at the time. They had a problem. They needed more money to pay the trust fund obligations, and they struck a reasonable agreement which was, a reduction in Social Security benefits for those best off on Social Security, and an increase in the payroll tax for everybody else, people still in the work force.

Contrary to fairly established opinion, the 1972 enactment of the cost-of-living formula for the Social Security system was not for the purpose of aiding retirees. It was for the purpose of aiding taxpayers because each of the election years and some of the off years preceding the enactment of that formula, Members of Congress had tripped over each other to see how much they could prove with other people's money, taxpayers' money, that they loved the senior

citizens. These senior citizens, of course, have a tendency to vote in great numbers. That was one of the weakest points of democracy about which de Tocqueville wrote in his Democracy on America.

There was an error made, of course, and we all know about that, in the formula, and some people are even now being vastly overpaid in benefits. But the fact is that on average, those who are today retired under Social Security have paid in on average about 5 percent of the benefits they can expect to receive. That 5 percent has earned interest untaxed in an amount equal to about another 10 percent of those benefits.

Eighty-five percent, then, of the average person's benefits who is now retired under Social Security is a freebie. It is something that is a strict transfer payment that does not reflect previous payments. Now—I mean payments into the system.

Now, we come, 1983, up to 50 percent of the freebie could be included in one's taxable income. If somebody hit the lottery, nobody would question whether there should be tax on that windfall. This is a windfall. It is not a windfall I oppose. I fully support it, but the fact is that it is income that is a gift from the taxpayers to retirees. So in 1993, the amount exempt from Social Security for people at a certain level of income was reduced to 15 percent that had been paid into the system and earned interest, but only in the case—I am confused, Bill, about that statement of 21 percent of the people under $50,000 because by definition let's say a person had $13,000 in Social Security income. I mean a couple had $13,000 in Social Security income. If you add the $44,000, you take half of the $13,000, you would still be above the $50,000 point.

In order to include the entire 85 percent of one's benefits, the entire freebie, in one's taxable income, not at any higher rate, just whatever that individual's rate might be unless, of course, there was some bracket creep, went into another bracket, a person would have to have, or a couple would have to have income up around $80,000, including all of the Social Security benefits, not half. So for those—and I might add that it is a contribution. It is another reduction of benefits, without a doubt.

It is means testing of the Social Security system. The proceeds are returned to the trust fund, the one of the three trust funds that is in most trouble, the Medicare trust fund. So everybody says we have to do something about the entitlements. It is logical that if you did something about this entitlement you would use means testing.

Many Members of Congress have said that Medicare should be means tested. Why should a Rockefeller, to pick a name, be subsidized by the taxpayers, even in old age, for medical expenses? So it is logical that if you were going to do anything about the entitlements, you would start by a kind of means testing with the people, who are best off in retirement. That is what this was all about.

So I just want to put in a word for the Social Security taxpayers and especially the baby boomers who will be retiring 20 years from now or so and where will Medicare be by then? I thank you.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON CONTRACT WITH AMERICA

Mr. Chairman, as a strong supporter of the Contract With America's provisions for accelerated death benefits and a strong opponent of President Clinton's 1993 Clinton tax increase on social security, I look forward to today's hearings on these important reform issues.

The Contract provides terminally and chronically ill individuals with a new means of paying their drastically increasing medical bills and living expenses by allowing them to receive tax-free distributions from their life insurance policies prior to their death.

By enabling the terminally ill to use their own means to cover medical expenses, they will maintain the dignity and financial independence they deserve at the most trying time of their lives. In addition, this provision could substantially reduce the incredible financial drain on the families of terminally ill people.

It is also important we hear from middle-income senior citizens who were impacted by increased taxes on Social Security benefits. The 1993 Clinton tax bill requires individual senior citizens who earn more than $34,000 or couples who earn more than $44,000 to pay income taxes on up to 85% of their Social Security benefits.

The federal government should not be in the business of discouraging middle income seniors from continuing to be active members of the working community beyond the normal age of retirement. I am anxious to hear how the tax relief included in the Contract -- which would lower the amount of benefits potentially subject to tax to 50% -- would impact the witnesses before us today.

I thank you all very much for being here today and look forward to your testimony.

Mr. THOMAS. Thank the gentleman for his comments. Prior to the first panel, we have our colleague, Toby Roth, from Wisconsin who wishes to address the committee on a number of issues and Toby, the floor is yours.

STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. ROTH. Well, thank you very much, Mr. Chairman. Mr. Chairman and members of the committee, I applaud your diligence in working on this Contract With America. I know you have been putting in many long hours and a majority of the Contract With America rests heavily on your shoulders, and we are all very thankful to you for your work and your diligence.

I appreciate the opportunity to testify in support of those areas in the Contract which fall under the jurisdiction of the Ways and Means Committee.

Mr. Chairman and Members, I know you have a panel of people who have come here at a great sacrifice in many ways, and so I will abbreviate my remarks, but as Chairman of the Republican Task Force on Social Security last session, I welcome the opportunity to speak about the Senior Citizens' Equity Act. This act will make a big difference in the lives of average seniors by protecting their earned Social Security benefits.

Under an archaic policy dating back to the thirties, as you so well know, Social Security recipients aged 65 to 69 are denied $1 in benefits for every $3 they earn over $11,160. Seniors earning above that limit face an additional effective tax rate of some 33 percent on top of Federal, State, and local taxes they already pay.

As a result, hundreds of thousands of skilled and talented seniors are being driven from our work force. This is a blatant age discrimination. Moreover, the earnings test hurts our Nation's competitiveness by discouraging seniors with valuable work experience from contributing to society. It is time to stop this inequity.

From President Clinton to the senior citizens in my district, to many of us here today, we are all in agreement on this, and I would like to point out that President Clinton pledged to lift the earnings limit. You will recall in his book, "Putting the People First," the President wrote, "Bill Clinton and Al Gore will lift the Social Security earnings test limitation so that older Americans will be able to rebuild our economy and create a better future for us all."

Mr. Chairman and Members, today in America senior citizens who work are the highest taxed people in America. I ask you is that fair to our senior citizens or fair to any American to be so singled out? That is why I am here before this committee, to urge you to bring the fairness back to our tax system. By allowing seniors to keep more of their hard-earned money, we are restoring that fairness that is so essential.

Beyond that, let's make sure that we cut government spending so all Americans, yes, all Americans, can keep more of the money they earn. I thank you, Mr. Chairman and members of this committee, for allowing me to appear, and I would like to insert into the record my entire testimony.

[The prepared statement follows:]

STATEMENT BEFORE
HOUSE COMMITTEE ON WAYS AND MEANS
BY CONGRESSMAN TOBY ROTH

Mr. Chairman and members of the Committee, I appreciate the opportunity to testify in support of those areas of the Contract With America which fall under the jurisdiction of the Ways and Means Committee.

Specifically, I am glad to have the opportunity to speak about the Senior Citizens' Equity Act, H.R. 8. This Act will really make a difference in the lives of average senior citizens by protecting their earned Social Security benefits.

Social Security represents a trust between government and its citizens. Social Security is not a welfare program, but a benefit that workers earn through their contributions in order to plan for a secure retirement. In fact, most seniors look at Social Security as a kind of annuity.

When government takes away those earned benefits, however, government breaks this trust with its citizens. Unfortunately, in two instances the government does confiscate the earned Social Security benefits of senior citizens. The first instance is the earnings limit, which causes seniors to lose Social Security benefits if they continue to work in the labor force. The second is the tax increases on Social Security that became law in 1993.

Thankfully, this Congress can undo these unfair Social Security penalties and taxes by passing the Senior Citizens' Equity Act. As the past chairman of the Republican Task Force on Social Security, I take particular satisfaction in being able to finish our work during the last Congress. In the next 100 days, we can at last accomplish the agenda so many of us have worked on for years.

First, the Senior Citizens' Equity Act raises the Social Security earnings limit for working seniors.

No American should be discouraged from working. It's a betrayal of the American Dream to penalize people for their hard work. Yet, that's exactly what the earnings limit does. It penalizes seniors for attempting to be financially independent.

Under an archaic policy dating to the 1930's, Social Security recipients aged 65 to 69 are denied $1 in benefits for every $3 they earn over $11,160. Seniors earning above that limit face an additional effective tax rate of 33 percent, on top of the federal, state and local taxes they already pay.

As a result, hundreds of thousands of skilled and talented seniors are being driven from the work force. This is blatant age discrimination. Moreover, the earnings test hurts our nation's competitiveness by discouraging seniors with valuable work experience from contributing to society.

Is that the message we want to send to seniors--that their skills are unwanted and unneeded, and that we will actually take away 33 percent of their Social Security benefits if they earn too much?

Furthermore, as one couple in my district noted, the earnings test taxes seniors twice--first when wages are earned while working, and a second time when those benefits are paid. This couple wrote: "These funds have already been taxed when earned as income. In fact, we believe Social Security benefits received after retirement should be exempt from any penalty by the earnings limit."

The earnings test exempts wealthy seniors who receive dividends and interest payments. The earnings test hits working seniors who toil at low-paying jobs, however, by punishing them for attempting to remain financially independent. The earnings test hurts those citizens who need that extra income the most.

I will point out that President Clinton pledged to lift the earnings limit. In his book Putting People First, the President wrote:

> Bill Clinton and Al Gore will...lift the Social Security earnings test limitation so that older Americans are able to help rebuild our economy and create a better future for all.

It's time to stop this inequity. President Clinton, the senior citizens in my district, many of us here today, and I, are all in agreement on this.

The Senior Citizens' Equity Act will raise the earnings limit threshold over five years to $30,000. This reform is long overdue, and I am delighted that Congress will finally take action in the coming weeks.

The Senior Citizens' Equity Act also will roll back the unfair Social Security tax increases that were passed in 1993. As we all know, these Social Security taxes affected 5.4 million senior citizens.

These retirees are set to lose $24.6 billion of their earned Social Security benefits over five years. I remind the Committee that the Social Security taxes unjustly singled out seniors in particular. Seniors were the only middle income group required to pay higher income taxes by the 1993 tax bill. This is particularly unfair to those seniors who planned their retirement finances under the assumption that their Social Security benefits would not be taxable income. Of course, seniors are the one group least able to afford this kind of tax burden. That's why H.R. 8 is such an important part of the Contract with America.

The Senior Citizens' Equity Act will roll back this undeserved tax increase on older Americans, and let them keep the money they worked so hard to earn for retirement.

My constituents in Wisconsin overwhelmingly support this tax repeal. Let me just read a few comments I received in my annual questionnaire as examples.

One senior citizen in Green Bay wrote: "Social Security benefits should never be taxed." Two more seniors write simply: "Repeal the Clinton tax on Social Security benefits." And from another: "Reverse 1993 Social Security tax increase."

Mr. Chairman, I am delighted that this Congress will finally hold a vote to raise the earnings limit and roll back the Social Security taxes to allow seniors to keep the retirement benefits they earned.

The taxpayers of America--including senior citizens--have sent us a message loud and clear. I look forward to implementing the changes they have called for--the changes that are contained in the Contract With America.

In conclusion, Mr. Chairman, I look forward to working with you and the Committee to return our government to a government that is truly of the people, by the people, and for the people.

I thank you for your consideration.

Mrs. JOHNSON [presiding]. Thank you, Mr. Roth, for your testimony. Are there questions by the committee? If not, thank you very much.

Mr. ROTH. Thank you, Madam Chairman. I appreciate, again, all the work you are doing and all the diligence you are bringing to the Contract With America. Thank you.

Mrs. JOHNSON. If our first panel will come forward, Annette Keown of Birmingham, Ala.; Don Paul of Austin, Tex.; Rosemary Paul accompanying him; Paul Phinney of Santa Rosa Beach, Fla., and Teresa Kane Rawoot of Timberville, Va.

I want to welcome also Mrs. Carballo. Thank you for being with us. I want to welcome this panel because some of you have come at great personal effort, and we value your input and we are looking forward to it. Let's start with Annette Keown.

STATEMENT OF ANNETTE KEOWN, BIRMINGHAM, ALA., ON BEHALF OF HER HUSBAND, DAVID B. KEOWN

Ms. KEOWN. Good morning and thank you, Madam Chairman. Thank you for inviting me to appear before the committee today to read a statement from my husband, David. He regrets that he is not well enough to be here to testify in person. He asked me to come because of how strongly we feel about people having the option of using the money from their life insurance while they are still alive. It truly saved us. This is my husband's statement.

In February 1993 my physicians suggested that I make every effort to put my affairs in order. They told me I had less than 6 months to live.

None of us knows what the future holds. I learned as a Golden Gloves boxer in high school and from having graduated from the U.S. Army Artillery Officers' Candidate School to never, never, never give up.

I am a Christian with absolutely no fear of dying—I know where I am going.

But the last days of my life and the lives of my wife, son, and daughter would be very different today, very difficult, if we did not have the money we received from my Prudential insurance policy.

In early 1990 my wife and I were asked by our agent if we wanted a new policy option called "living needs benefit." We were told that if we chose to include the option in my life insurance policy, at no additional premium cost, an accelerated death benefit would be paid in the event that I was confined to a nursing home for 6 months and was expected to remain there permanently or if I became terminally ill and was expected to live less than 6 months.

At the time, I was 56 years old and in relatively good health. While we were not especially impressed with the option, we decided to add it to our policy. The decision seemed insignificant at the time. Now, it has proven to have been one of the most important decisions we ever made.

That November I suffered a major stroke. I was hospitalized for 2 weeks. After extensive physical rehabilitation, I overcame most of the adverse effects of my illness and was able to return to part-time employment in January 1991. Just 2 months later, I was able to return to work full time.

Then in the fall of 1991, I suffered another stroke. This time, it took me nearly 6 months to return to work.

My third and most serious stroke occurred on September 24, 1992. This time, a blood clot developed on the left side of my brain that left me comatose for 8 days and paralyzed on my right side. During the next 2 years I have experienced abnormal heart rhythm and heart pauses. I have a pacemaker, but my heart problems, diagnosed as terminal, continue.

My wife and I own a small business, Health Care Staffing Services, Inc. It was incorporated in 1986 to provide temporary staffing services to business and industry and occupational health staffing and management services to industrial clients in Alabama.

I was the primary marketing person, and my illnesses began to impact the business. Prior to my third stroke, we asked our son, Richard, and our daughter, Kathy, who is a registered nurse, to help us manage our company. We also took out a significant small business loan because of the increased marketing and management costs.

Just 2 weeks after my son joined the business, I had my third stroke.

Our personal financial situation was becoming acute and our business was suffering because my wife and daughter were giving me 7-days-a-week, around-the-clock care. My medical expenses were piling up because our employee health insurance policy refused to include me when we tried to renew the policy.

We were in a personal and business crisis of major proportions. What made it worse was that because of my condition, there was nothing I could do to help.

We had managed to save during our married life, but those savings had been seriously eroded when I became ill and we began to eat into the equity we had in our business.

Following my diagnosis of terminal illness, my wife contacted our Prudential agent and requested the accelerated death benefit. Had we not received this money from the accelerated death benefit, our lives would have been devastated. We would have lost the business my wife and I worked so hard to establish. I would have ended up in a nursing home, leaving my wife with little or nothing to live on.

We received the money from Prudential in April 1993. That allowed us to repay bank loans, meet past-due medical bills, and make it possible for my son to assume ownership of the temporary help portion of our business in early 1994. Our daughter manages the remaining part of the business.

What was most important to me and my wife was that the money made it possible for me to remain at home and to be cared for by my wife, instead of being in a nursing home. That part has been a blessing.

Madam Chairman, what I want to say to you today is that the money from the accelerated death benefit really helped us. It helped us keep our business, our home, and our dignity. I know firsthand how important the benefit has been for me and for my family. I know it can help other people, too.

Please, whatever you do, keep this important benefit available for all the people who find themselves in the same situation I am in.

Thank you again for inviting us to address you and for taking the time to listen.

Mrs. JOHNSON. Thank you very much for your testimony.

Mr. and Mrs. Don Paul and Mrs. Carballo.

STATEMENT OF DON PAUL, AUSTIN, TEX., ACCOMPANIED BY ROSEMARY PAUL, WIFE, AND MARTHA CASTILLO CARBALLO, MOTHER-IN-LAW

Mr. DON PAUL. Madam Chairman and members of the committee, my name is Don Paul. I have traveled here from Texas with my wife, Rosemary, for the privilege of talking with you today. We both wish to urge you and your fellow legislators to help individuals take full advantage of all the scarce resources that remain once a terminal illness has devastated their emotional and financial lives.

We encourage you to enact legislation that allows people to receive, tax free, the critical financial resources gained by accelerating the death benefit of their insurance policy or, as in our case, if they sell a life insurance policy outright through a process called viatication. I would like to briefly share our story with you so you can better understand the perspectives of the many people in our position.

In April 1992, Rosemary developed Lou Gehrig's disease, a debilitating and terminal neuromuscular disease for which there is no known cure. I am retired, and when my wife first fell ill, I worked very hard to take care of her, to make her comfortable, and give her what she needed. We believed that together we could handle anything that would eventually come our way.

Among other things, we were able to involve Rosemary in an experimental drug treatment program at the University of Texas Health and Science Center in San Antonio. The drug they are testing is supposed to stimulate the neurons that manufacture the food for the nerves that haven't been damaged in her body and hopefully double the life expectancy for someone with her condition.

The normal course of the disease ranges from 2 to 5 years and is usually terminal in 3 years. Rosemary's illness became very expensive, requiring us to remodel our home and purchase a modified van to accommodate her electric wheelchair. Those changes alone cost more than $60,000. I was soon dipping into our savings just to pay basic living expenses. I can hardly describe to you how frightening it is to see your entire life savings rapidly evaporating, knowing that there is much more ahead. But what was, perhaps, worse was the terrible emotional cost of caring for Rosemary 24 hours a day.

Because of our financial situation, I needed to be her sole care giver. It took a very heavy toll on me. When you watch the person you love die a little bit every day, it is worse than anything you could imagine. Things really hit bottom after 2 years when I also started getting sick from the stress of the situation. But then we learned of a new financial option called the viatical settlement.

Before she became ill, Rosemary was general manager of Grandy's Restaurant in our town. She had been with Grandy's 10 years. The last 6 months of her illness she worked there from a wheelchair. When Rosemary could no longer work, we had gone to the benefits coordinator of the company to see what our options were.

My wife had paid a little extra out of her paycheck for years to buy extra life insurance coverage, but it was for a group term policy that had no cash value at all, nor did it offer an accelerated death benefit. At that point we really believed we had exhausted all of our options.

Then out of the clear blue sky the company's benefits coordinator called and said that she had heard about something called viatical settlements on a radio talk show. In fact, it turns out that the gentleman being interviewed was John Banks from a company called Viaticus, who will also be talking with you today.

We called the company and found out that we could viaticate Rosemary's policy. The company paid a percentage of the policy based on my wife's life expectancy, which in her case is 2–5 years. Right now we say that she is living on time that God has given us.

I don't want to go into the specifics of the transaction, but I can tell you that we received money we would not have had access to, and we both believe we were treated very fairly. I can also tell you that the money has allowed us to enjoy our remaining days together and relieve much of the terrible stress that comes from facing the type of physical and financial hardships life has dealt us, suffering I wouldn't wish on my worst enemy.

We are now able to have a nurse come in 2 days a week to help care for Rosemary. Her mother has come up from Mexico City to stay with us. These two things have given us great freedom to travel around Texas in our van, enjoying Rosemary's time up to the very end. In short, we feel this option has literally given us new life.

Again, we are here today to ask you to please consider making this kind of benefit part of any legislation you are considering that would make accelerated death benefits and viatical settlements tax free. It just isn't fair for people who have worked and saved their whole life to be stripped of everything as they face a terminal illness. To then further tax them on the last remaining funds they can use to maintain a sense of dignity, security, and a simple sense of enjoying their last remaining days on Earth is simply, we believe, not what this great country is about.

Thank you, Madam Chairman, and to the entire committee our thanks for this opportunity to talk with you today.

[The prepared statement follows:]

Statement of Don Paul

BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

My name is Don Paul. I've traveled here from Texas with my wife Rosemary Paul to talk with you today. We both wish to urge you and your fellow legislators to help individuals take full advantage of all the scarce resources that remain once a terminal illness has devastated their emotional and financial lives.

We encourage you to enact legislation that allows people to receive, tax-free, the critical financial resources gained by accelerating the death benefit of their insurance policy or--as in our case--if they sell a life insurance policy outright through a process called viatication. I'd like to briefly share our story with you so you can better understand the perspectives of the many people in our position.

In April of 1992, Rosemary developed Lou Gehrig's disease, a debilitating and terminal neuromuscular disease for which there is no cure. I'm retired and when my wife first fell ill I worked very hard to take care of her, to make her comfortable and give her what she needed. We believed that together we could handle anything that would eventually come our way.

Among other things, we were able to involve Rosemary in an experimental drug treatment program at the University of Texas Health and Science Center in San Antonio. The drug they are testing is supposed to stimulate the neurons that haven't been damaged in her body and hopefully double the life expectancy for someone with her condition; the normal course of the disease ranges from 2 to 5 years, and is usually around 3 years. This, combined with the sense of stability we had achieved through years of hard work and savings made us feel like we were in control of the situation.

I was terribly wrong. We had both worked hard for years and had bought a house, saved a few dollars and started to receive a small Social Security pension. For these reasons, they told us we were too well off to receive any social services because our income was considered too high.

But Rosemary's illness required a lot of medical equipment, and insurance only covered about 80 percent of the costs. First there was a cane, then a walker. Next we needed to widen the doorways in the bathroom to accommodate her electric wheelchair, which she needed after she began losing control of her legs and back muscles.

We also had to trade in our station wagon for a special vehicle, build ramps into our home, purchase a lift to help Rosemary in and out of her bed. These changes alone cost more than $60,000. I was soon dipping into our savings just to pay basic living expenses. I can hardly describe to you how frightening it is to see your entire life savings rapidly evaporating--knowing that there is much more ahead. But I had promised that as long as I was able to find a solution Rosemary would not have to leave our home. Even if it took our last cent, I'd keep her there to her dying day.

What was perhaps worse was the terrible emotional cost of caring for Rosemary 24 hours a day during this period. Because of our financial situation I needed to be her sole care giver. It took a heavy toll on me. When you watch the person you love die a little bit every day it's worse than anything else. She used to do small craft projects or do painting after she became confined. But eventually each activity predictably became progressively more difficult for her. She would say "look how the muscles are going in my hands, honey, I guess I can't paint anymore."

Things really hit bottom after two years, when I also started getting sick from the stress of the situation. I began breaking out in large ulcers on my leg, which was complicated by the fact that I'm diabetic. My health has since gotten worse. We were broke and new problems were mounting.

Then we learned of a new financial option called the viatical settlement. Before she became ill Rosemary was general manager at Grandy's restaurant in our town. She'd been there 10 years--from the time they opened. The last 6 months she worked there she did her job from a wheelchair.

Grandy's is part of a large company and they offered good group health and life insurance policies. When Rosemary could no longer work, we'd gone to the benefits manager to see what our options were. My wife had paid a little extra out of her paycheck for years to buy extra life insurance, but it was for a group term policy that had no cash value at all, not did it offer an accelerated death benefit. At that point, we really believed we had exhausted all of our options.

Then out of the clear blue sky the company's benefits manager called and said that she had heard about something called viatical settlements on a radio talk show. In fact, it turns out that the gentleman being interviewed was Mr. John Banks from a company called Viaticus, who will also be talking with you today. We called the company and found out that we could actually sell the policy to receive a significant amount of money. It really was like a gift from God.

We began working with the viatical settlement company to assess her case. The company paid a percentage of the policy based on my wife's life expectancy, which in her case is 2 to 5 years. Right now we say that she is living on time that God has given.

I don't want to get into the specifics of the transaction, but I can tell you that we received a lot of money and we both believe we were treated fairly. I can also tell you that the money has allowed us to enjoy our remaining days together and relieve much of the terrible stress that comes from facing the type of physical and financial hardships life has dealt us--suffering I wouldn't wish on my worst enemy.

In addition to allowing us to spend quality time together and enjoy our remaining life together, Rosemary has also had the joy of personally making a legacy to her grandchildren--she always wanted to start a college fund for them. Most importantly, and what is really beautiful, is that she can now enjoy what is left of her remaining days on this earth. There is nothing I want more than this.

We are now able to have a nurse come in 2 days per week to help care for Rosemary. And her mother has also been able to come to stay with us for a while. These two things have given us great freedom to travel around Texas in our van--enjoying Rosemary's time up to the very end. In short, we feel this option has literally given us new life.

Again, we're here today to ask you to please consider making this kind of benefit part of any legislation you are considering that would make accelerated death benefits and viatical settlements tax free. It just isn't fair for people who have worked and saved their whole life to be stripped of everything as they face a terminal illness. To then further tax them on the last remaining funds they can use to maintain a sense of dignity, security and simple sense of enjoying their last remaining days on earth is simply, we believe, not what this country is about.

Thank you Mr. Chairman and to the entire Committee for this opportunity to talk with you today.

Mrs. JOHNSON. Thank you very much, Mr. Paul, for your excellent testimony.

Paul Phinney.

STATEMENT OF PAUL PHINNEY, SANTA ROSA BEACH, FLA.

Mr. PHINNEY. Madam Chairman and members of the committee, my name is Paul Phinney, and I am HIV positive. I am also a certified public accountant and a member of both the American Institute of CPAs and the New York State Society of CPAs.

Currently, I am retired on disability and have received proceeds from viatications of several of my life insurance policies. A viatical settlement or viatication is different from an accelerated death benefit in that proceeds from the former are paid by a third party viatical settlement company, whereas proceeds from an accelerated death benefit are paid directly from the life insurance company.

Accelerated death benefits were not an option for me since either my life expectancy was too long or else the specific insurance company did not offer accelerated death benefits. Through receiving proceeds from life insurance policy viatications, I have been able to afford better health care and am able to avoid being a financial burden upon society.

In my experience, insurance companies only consider entering into an accelerated death benefits transaction if the applicant's life expectancy is 6 months or less or 1 year or less. This limits individuals with longer life expectancies to only have recourse to viaticate life insurance policies to third-party viatical settlement companies.

I feel that it is unfair to individuals with longer life expectancies to have to pay income taxes on viatical settlement proceeds received from third-party viatical settlement companies. Whereas individuals with very short life expectancies would not, under proposed tax regulations, have to pay income taxes on accelerated death benefits received directly from the insurance company.

A terminally ill individual who is viaticating a life insurance policy or receiving an accelerated death benefit should not be penalized just because their life expectancy is 6 to 12 months longer than an arbitrary cutoff point. The point is that viatical settlements should be nontaxable just as certain accelerated death benefits are to become.

Additionally, eligibility for nontaxable status should extend to all viatical and accelerated death benefit settlements, which are by definition in connection with a terminal illness, irrespective of whether the proceeds are paid directly by the insurance carrier or by a third party viatical settlement company, and eligibility should not be based on any further cumbersome or needless requirements, but solely upon a physician's diagnosis of terminal illness.

As a CPA and tax specialist, my work regimen was very stressful and demanding, and the pressures of tax season, I feel, were leading me to an early grave. My decision to leave work on disability was a difficult decision to make fraught with major uncertainties, but viatical settlement proceeds have provided me with the means to financially support myself after ceasing work due to disability, and by doing so to be able to reduce my stress and to dedicate more time to the maintenance of my health.

I feel that my longevity has been increased in this way, and I feel that leaving work and viaticating my life insurance policies sooner rather than later was the right thing to do. Further, this approach has allowed me to remain financially solvent and to make and implement plans for the future, such as my plan to move to Florida to a healthier climate and to be closer to my family.

There is a significant positive correlation between financial solvency and longevity for individuals afflicted with HIV. Adequate financial resources can provide the means for a more comfortable existence with reduced stress and the means to afford better health care, both of which increase longevity and quality of life.

I clearly believe that it is better to viaticate sooner rather than later, since this allows viators to afford better medical care and to realize other lifetime goals while they still have the time and health to do so. They shouldn't have to wait until they are in the hospital.

For many, HIV disease means suffering through an agonizing decline, leading to despair, impoverishment, bankruptcy, and then death. Many terminally ill individuals do not have adequate disability insurance on which to live once they are entitled to leave work on disability, and so they delay disability retirement to the point that their health deteriorates more rapidly due to increased stress from continuing to work, sometimes continuing working until they are fired due to deteriorating work performance.

Although I am no saint, I would like to make reference to Matthew 26:7 and Mark 14:3 in the King James version of the Holy Bible, to the time just before Jesus' crucifixion when a woman knelt to anoint Jesus' feet and body by pouring upon him a very expensive ointment prior to his burial.

There was indignation among some of those present, including his disciples, that such an expensive ointment would be wasted instead of sold for much and given to the poor. But Jesus commended the woman for her good deed, and pouring the expensive ointment on his body for his burial. To paraphrase how this was depicted in the movies, he asked them whether they would begrudge him this one small act of anointment, and he said they would always have the poor with them, but that he would not always be with them.

By the same token, I strongly believe that it would not be right to begrudge a terminally ill individual the full enjoyment of the proceeds of a viatical settlement by subjecting it to an income tax. I want to thank the committee for allowing me this opportunity to express my views today. Thank you.

[The prepared statement follows:]

TESTIMONY BY
PAUL PHINNEY ON 01-19-95
BEFORE
THE COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

My name is Paul Phinney, and I am HIV positive. I am also a Certified Public Accountant and a member of both the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants. Currently, I am retired on disability and have received proceeds from viatications of several of my life insurance policies. A **viatical settlement** (or viatication) is different from an **accelerated death benefit** in that proceeds from the former are paid by a third party viatical settlement company, whereas proceeds from an accelerated death benefit are paid directly from the life insurance company. Accelerated death benefits were not an option for me since either my life expectancy was too long, or else the specific insurance company did not offer accelerated death benefits. Through receiving proceeds from life insurance policy viatications, I have been able to afford better health care and am able to avoid being a financial burden upon society.

In my experience, insurance companies only consider entering into an accelerated death benefits transaction if the applicant's life expectancy is six months or less or one year or less. This limits individuals with longer life expectancies to only have recourse to viaticate life insurance policies to third party viatical settlement companies. I feel that it is unfair to individuals with longer life expectancies to have to pay income taxes on viatical settlement proceeds received from third party viatical settlement companies, whereas individuals with very short life expectancies would not, under proposed tax regulations, have to pay income taxes on accelerated death benefits received directly from the insurance company. A terminally ill individual who is viaticating a life insurance policy or receiving an accelerated death benefit should not be penalized just because their life expectancy is six to twelve months longer than an arbitrary cutoff point. The point is that viatical settlements should be non-taxable just as certain accelerated death benefits are to become. Additionally, eligibility for non-taxable status should extend to all viatical and accelerated death benefit settlements which are by definition in connection with a terminal illness (irrespective of whether the proceeds are paid directly by the insurance carrier or by a third party viatical settlement company), and eligibility should not be based on any further cumbersome or needless requirements, but solely upon a physician's diagnosis of terminal illness.

As a CPA and tax specialist, my work regimen was very stressful and demanding, and the pressures of tax season, I feel, were leading me to an early grave. My decision to leave work on disability was a difficult decision to make fraught with major uncertainties, but viatical settlement proceeds have provided me with the means to financially support myself after ceasing work due to disability, and by doing so to be able to reduce my stress and to dedicate more time to the maintenance of my health. I feel that my longevity has been increased in this way, and I feel that leaving work and viaticating my life insurance policies sooner rather than later was the right thing to do. Further, this approach has allowed me to remain financially solvent and to make and implement plans for the future, such as my plan to move to Florida to a healthier climate and to be closer to my family.

There is a significant positive statistical correlation between financial solvency and longevity for individuals afflicted with HIV. Adequate financial resources can provide the means for a more comfortable existence with reduced stress and the means to afford better health care, both of which increase longevity and quality of life. Individuals with private medical insurance coverage live longer than those receiving only Medicaid benefits. Additionally, the Gay Men's Health Crisis organization in New York City conducted a small study of terminally ill patients and found that approximately seventy-five percent of the long term survivors had private health insurance. Therefore, access to viatical funding means access to good medical care and increased longevity.

I clearly believe that it is better to viaticate sooner rather than later since this allows viators to afford better medical care and to realize other lifetime goals while they still have the time and the health to do so. They shouldn't have to wait until they are in the hospital. Also, viaticating sooner rather than later allows a terminally ill person to afford quality mainstream and alternative medical care continuously from an earlier point in time.

For many, HIV disease means suffering through an agonizing decline leading to despair, impoverishment, bankruptcy, and then death. Many terminally ill individuals do not have adequate disability insurance on which to live once they are entitled to leave work on disability, and so they delay disability retirement to the point that their health deteriorates more rapidly due to increased stress from continuing to work, sometimes continuing working until they are fired due to deteriorating work performance. Due to the current taxable status of viatical settlements, prospective viators may unfortunately delay viatication and continue to work past the point of diminishing returns until they meet the arbitrary twelve month maximum life expectancy required for non-taxability status for accelerated death benefits. Non-taxability of viatical settlements would provide additional financial resources to these individuals, allowing them to leave work on disability earlier with more financial security and without becoming a financial burden upon society. While approximately eighty-five percent of employees have employer-provided medical insurance, only about forty-seven percent have employer-provided disability insurance, and only about eight percent have private long term disability insurance. Long term disability insurance coverage typically pays only sixty percent of regular earned income. However, afflicted individuals need more financial resources once they have ceased working since they generally have dramatically increased health care costs and other increased living costs associated with their health afflictions.

In the following section of my written testimony, I would like to share my thoughts and experiences by focusing on the best way to approach the viatical process so that others may benefit from the distillation of my experiences, as summarized in conjunction with my recent interview in a television documentary about HIV and viatical settlements soon to be aired on major European networks.

INSURANCE ISSUES AND RULES OF THUMB

1) **OBTAIN BIDS FROM SEVERAL VSC'S:**
APPLY FOR BIDS FROM SEVERAL VIATICAL SETTLEMENT COMPANIES (VSC'S) AND SELECT HIGHEST OFFER.

2) **ADDITIONAL PAID UP INSURANCE:**
DON'T OVERLOOK ADDITIONAL PAID UP INSURANCE WHICH IS IN ADDITION TO THE REGULAR FACE AMOUNT OF THE POLICY.

3) **SELL SMALLER POLICIES FIRST ONLY AS YOU NEED THE MONEY:**
SELL SMALLER POLICIES FIRST, ONE AT A TIME, AS YOU NEED THE MONEY, AND "SAVE" THE LARGER POLICIES FOR LATER. THIS WAY YOU REALIZE MORE MONEY SINCE THE VIATICAL OFFERS WILL INCREASE (AS A PERCENTAGE OF THE POLICY FACE VALUE) AS TIME ELAPSES AND YOUR LIFE EXPECTANCY DECREASES.

4) **ENGAGE A QUALIFIED ATTORNEY TO REPRESENT YOU:**
ENGAGE A QUALIFIED ATTORNEY TO REVIEW ANY VIATICATION CONTRACTS BEFORE YOU SIGN THEM. ONLY SELECT AN ATTORNEY WHO IS EXPERIENCED WITH VIATICATIONS AS WELL AS INSURANCE AND DISABILITY MATTERS.

5) **ENGAGE A QUALIFIED FINANCIAL CONSULTANT:**
A QUALIFIED FINANCIAL CONSULTANT (ONE WHO IS EXPERIENCED WITH VIATICATIONS AND INSURANCE AND ONE WHO HAS A NETWORK OF ESTABLISHED BUSINESS CONTACTS) CAN BE EXTREMELY HELPFUL IN

NEGOTIATING HIGHER VIATICAL BIDS, IN HELPING YOU THROUGH THE VIATICAL APPLICATION PROCESS, AND IN SELECTING APPROPRIATE VSC'S TO CONSIDER. ONLY SELECT A CONSULTANT WHO IS EXPERIENCED WITH VIATICATIONS AS WELL AS INSURANCE AND DISABILITY MATTERS.

6) **PAY LEGAL & FINANCIAL CONSULTANT FEES ON HOURLY BASIS ONLY:**
FEES PAID TO AN ATTORNEY OR FINANCIAL CONSULTANT SHOULD BE ON AN HOURLY BASIS RATHER THAN BASED ON A PERCENTAGE OF THE VIATICAL SETTLEMENT PROCEEDS.

7) **INCLUDE ESCROW AGREEMENT:**
IT IS USUALLY BEST FOR THE VIATICAL CONTRACT TO INCLUDE AN ESCROW ARRANGEMENT WITH AN INDEPENDENT ESCROW AGENT IN ORDER TO SAFEGUARD YOUR INTERESTS.

8) **AVOID BROKERS:**
AVOID VSC'S WHICH ARE BROKERS (BROKERS ARE USUALLY "MIDDLEMEN" WHO DO NOT HAVE ANY MONEY TO INVEST AND WHO RECEIVE A COMMISSION PAID BY WHOMEVER ACTUALLY BUYS YOUR POLICY). IT IS BETTER TO DEAL DIRECTLY WITH VSC'S WHICH HAVE THEIR OWN MONEY TO INVEST SO THAT THERE IS NO NEED TO PAY FOR A BROKER'S COMMISSION, AN UNNECESSARY EXPENSE THAT WOULD NO DOUBT EFFECTIVELY REDUCE THE AMOUNT OF THE VIATICAL SETTLEMENT PROCEEDS THAT YOU ULTIMATELY RECEIVE. NOTE THAT CERTAIN STATES ARE BEGINNING TO REGULATE THE VIATICAL SETTLEMENT INDUSTRY, ENFORCING GREATER ETHICAL STANDARDS.

9) **LIFE EXPECTANCY ESTIMATE & SELECTION OF PHYSICIAN:**
SELECT A PRIMARY PHYSICIAN WHO NOT ONLY PROVIDES YOU WITH QUALITY HEALTH CARE, BUT ALSO IS HELPFUL IN FILLING OUT INSURANCE FORMS, IS DILIGENT IN MAINTAINING YOUR MEDICAL RECORDS TO PROPERLY DOCUMENT YOUR HEALTH ISSUES, AND IS COOPERATIVE IN QUICKLY PROVIDING DOCUMENTATION (MEDICAL TRANSCRIPTS AND LAB TESTS) AND OTHER INFORMATION AS NEEDED. FIND A PHYSICIAN WHO IS SYMPATHETIC TO YOUR SPECIAL NEEDS AND WHO UNDERSTANDS THAT HIS ESTIMATE OF YOUR LIFE EXPECTANCY WILL HAVE A SIGNIFICANT IMPACT ON THE SIZE OF YOUR VIATICAL SETTLEMENT OFFERS.

10) **OBTAIN COMPLETE MEDICAL RECORDS:**
JUST BEFORE YOU START THE VIATICAL APPLICATION PROCESS, OBTAIN FROM YOUR PRIMARY PHYSICIAN (AND ANY OTHER PHYSICIANS YOU HAVE CONSULTED) PHOTOCOPIES OF COMPLETE AND UP-TO-DATE MEDICAL RECORDS, INCLUDING MEDICAL TRANSCRIPTS WRITTEN BY YOUR DOCTORS AND LAB TEST REPORTS. THIS WAY, YOU CAN EASILY AND QUICKLY MAKE MULTIPLE PHOTOCOPIES OF THESE RECORDS TO SEND ALONG WITH EACH OF YOUR VIATICAL SETTLEMENT APPLICATIONS.

OTHER IMPORTANT CONSIDERATIONS

1) IF YOU HAVE GROUP TERM LIFE INSURANCE COVERAGE PROVIDED THROUGH YOUR EMPLOYER AND YOUR EMPLOYMENT ENDS, YOU GENERALLY CAN CONTINUE THE INSURANCE COVERAGE, BUT YOU MUST APPLY TO CONVERT IT TO AN INDIVIDUAL WHOLE LIFE POLICY, AND THE APPLICATION (AND FIRST PREMIUM PAYMENT) DEADLINE TO CONVERT IT IS USUALLY 20 TO 30 DAYS AFTER THE DATE YOU LEAVE WORK.

2) IF YOU ARE HIV+, BY ALL MEANS KEEP ANY EXISTING LIFE INSURANCE POLICIES AND DISABILITY POLICIES IN FORCE. KEEP PAYING THE

PREMIUMS ON TIME SO THAT THE POLICIES DO NOT LAPSE. IF FOR SOME REASON A POLICY LAPSES, YOU MAY BE ABLE TO HAVE IT REINSTATED.

3) IF YOU ARE HIV+ AND ARE EMPLOYED, YOU CAN USUALLY OBTAIN HEALTH (MEDICAL) INSURANCE, LIFE INSURANCE, AND DISABILITY INSURANCE THROUGH YOUR EMPLOYER. OBTAIN THE MAXIMUM INSURANCE COVERAGES AVAILABLE SINCE YOU MAY NOT BE ABLE TO OBTAIN THIS LATER.

4) MOST INSURANCE COMPANIES WILL NOT OFFER TO SELL LIFE INSURANCE OR DISABILITY INSURANCE TO INDIVIDUALS WITHOUT EVIDENCE OF INSURABILITY, INCLUDING BLOOD TESTS. HOWEVER, EVEN IF YOU ARE HIV+, YOU MAY STILL BE ABLE OBTAIN CERTAIN LIFE AND DISABILITY INSURANCE POLICIES, BUT PREMIUMS FOR THESE ARE USUALLY MORE EXPENSIVE AND THE COVERAGE IS MORE LIMITED. YOUR FINANCIAL CONSULTANT CAN PROVIDE YOU WITH MORE INFORMATION ON THIS.

5) MOST VSC'S WILL ONLY CONSIDER BUYING YOUR LIFE INSURANCE POLICY IF YOUR LIFE EXPECTANCY IS TWO YEARS OR LESS; HOWEVER, THERE ARE VSC'S WHICH WILL CONSIDER A LIFE EXPECTANCY UP TO FIVE YEARS. GENERALLY, THE LESS YOUR LIFE EXPECTANCY IS, THE LARGER THE VIATICAL SETTLEMENT OFFER WILL BE, AND VICE-VERSA.

6) INDIVIDUAL TERM OR WHOLE LIFE INSURANCE POLICIES ARE USUALLY EASIER TO VIATICATE THAN GROUP TERM LIFE INSURANCE POLICIES. MOST VSC'S WILL ACCEPT A GROUP TERM LIFE POLICY AS IS, BUT SOMETIMES ONLY IF THE POLICY IS FIRST CONVERTED TO AN INDIVIDUAL LIFE POLICY. IF THE VSC REQUIRES THAT THE POLICY MUST FIRST BE CONVERTED, THEN THE VSC SHOULD AGREE TO PAY THE INITIAL PREMIUM AND ALL LATER PREMIUMS ON THE CONVERTED POLICY. NOTE THAT A DISABILITY WAIVER OF PREMIUM PROVISION IS USUALLY NOT AVAILABLE FOR A CONVERTED INDIVIDUAL LIFE POLICY.

7) MOST VSC'S WILL CONSIDER PURCHASING A LIFE INSURANCE POLICY ONLY IF IT IS AT LEAST TWO YEARS OLD (FROM THE POLICY EFFECTIVE DATE), SO THAT THE USUAL TWO YEAR PERIOD OF CONTESTABILITY HAS EXPIRED.

8) **VIATICAL SETTLEMENT BIDS ARE USUALLY COMPUTED AS FOLLOWS:**

   A) ADD: VALUE OF POLICY TIMES % OFFERED BY VSC
   B) ADD: ADDITIONAL PAID UP INSURANCE TIMES % ABOVE IN (A)
   C) LESS: OUTSTANDING LOANS AGAINST POLICY (APPLIES TO INDIVIDUAL LIFE POLICIES, NOT TO GROUP TERM POLICIES)
   D) LESS: PREMIUMS TO BE PAID FOR TWO YEARS (UNLESS DISABILITY WAIVER OF PREMIUM IS IN EFFECT; NOT ALL VSC'S DEDUCT THIS ADJUSTMENT)

9) IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY WHICH YOU OBTAINED THROUGH MEMBERSHIP IN A PROFESSIONAL OR TRADE ASSOCIATION, MAINTAINING YOUR MEMBERSHIP IN THE ASSOCIATION MAY BE ESSENTIAL FOR THE POLICY TO REMAIN IN FORCE. ALSO, YOU MAY HAVE TO MAINTAIN FULL-TIME WORK STATUS FOR THE POLICY TO REMAIN VALID. IF YOU STOP WORKING, YOU MAY BE ABLE TO KEEP THE POLICY IN FORCE DEPENDING UPON THE POLICY'S REQUIREMENTS (SUCH AS CONTINUED MEMBERSHIP IN THE ORGANIZATION AND TIMELY PAYMENT OF PREMIUMS). ALSO, YOU MAY HAVE THE OPTION TO CONVERT THE GROUP TERM POLICY TO AN INDIVIDUAL LIFE POLICY, AND THE CONVERSION APPLICATION USUALLY MUST BE FILED WITHIN A

DEADLINE TIME PERIOD ONCE YOU BECOME ELIGIBLE TO CONVERT THE POLICY. CONSULT YOUR FINANCIAL CONSULTANT IN THIS REGARD.

10) IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY WHICH YOU OBTAINED THROUGH MEMBERSHIP IN A PROFESSIONAL OR TRADE ASSOCIATION, AND IF THE VSC REQUIRES THAT THE POLICY BE CONVERTED TO AN INDIVIDUAL LIFE POLICY IN ORDER FOR YOU TO VIATICATE IT, YOU WILL NEED TO MEET THE POLICY'S REQUIREMENTS IN ORDER FOR YOU TO BE ELIGIBLE TO CONVERT IT. IF YOU ARE REQUIRED TO TERMINATE YOUR ASSOCIATION MEMBERSHIP BEFORE YOU COULD BE ELIGIBLE TO CONVERT THE POLICY, MAKE SURE THAT YOUR ASSOCIATION MEMBERSHIP TERMINATION DOES NOT UNEXPECTEDLY CAUSE YOU TO LOSE OTHER MEMBER BENEFITS. SPECIFICALLY, IF YOU HAVE DISABILITY INSURANCE THROUGH THE SAME ASSOCIATION, YOU WOULD PROBABLY LOSE YOUR DISABILITY COVERAGE IF YOU EITHER STOP WORKING (WITHOUT SIMULTANEOUSLY GOING ON DISABILITY) OR IF YOUR ASSOCIATION MEMBERSHIP TERMINATES. IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY FOR WHICH THE DISABILITY WAIVER OF PREMIUM IS IN EFFECT, THERE MAY BE NO NEED TO CONVERT IT TO AN INDIVIDUAL POLICY IN ORDER TO VIATICATE IT. A VSC'S REASONS AND CONCERNS FOR WANTING YOU TO CONVERT THE POLICY (BEFORE THEY WOULD CONSIDER BUYING IT FROM YOU) SHOULD MORE THAN LIKELY DISAPPEAR ONCE THE DISABILITY WAIVER OF PREMIUM IS IN EFFECT; HOWEVER, CONSULT YOUR FINANCIAL CONSULTANT IN THIS REGARD.

11) IF YOU PLAN TO STOP WORKING AND GO ON DISABILITY, BE SURE TO CONSULT WITH YOUR PRIMARY PHYSICIAN, ATTORNEY AND FINANCIAL CONSULTANT WELL IN ADVANCE BEFORE YOU DO SO THAT YOU CAN ADEQUATELY PLAN THE TIMING OF YOUR ACTIONS AND AVOID ANY PITFALLS WHICH MIGHT CAUSE YOU A LOSS OF ANY BENEFITS OR INSURANCE COVERAGE FOR WHICH YOU ARE ELIGIBLE.

12) YOU DO NOT HAVE TO WAIT UNTIL YOU ARE IN THE HOSPITAL TO VIATICATE A LIFE INSURANCE POLICY. MANY HIV+ INDIVIDUALS VIATICATE THEIR POLICIES WHEN THEY ARE ASYMPTOMATIC, WHILE THEY ARE STILL WORKING, AND WHILE THEY HAVE THE TIME AND THE HEALTH TO ENJOY THE FINANCIAL BENEFITS OF VIATICATION ENABLING THEM TO ENSURE THAT THEIR HEALTHCARE NEEDS ARE MET AND TO REALIZE LIFETIME GOALS PREVIOUSLY UNATTAINABLE.

13) **INCOME TAX AND ESTATE TAX PLANNING:**
CASH PROCEEDS RECEIVED BY A VIATOR (THE PERSON SELLING A LIFE INSURANCE POLICY) IN CONNECTION WITH A VIATICATION ARE GENERALLY CONSIDERED TO BE TAXABLE INCOME SUBJECT TO FEDERAL INCOME TAX FOR WHICH THE VIATOR IS LIABLE. IN CERTAIN CASES, A VIATOR'S LIFE EXPECTANCY OF ONE YEAR OR LESS MAY RESULT IN NO INCOME TAX LIABILITY ON ACCELERATED DEATH BENEFITS PAID TO THE VIATOR DIRECTLY FROM THE INSURANCE COMPANY. NOTE THAT CURRENTLY PENDING FEDERAL TAX LEGISLATION AND REGULATIONS MAY RESULT IN NON-TAXABLE STATUS FOR PROCEEDS RECEIVED IN CONNECTION WITH THE VIATICATION OF A LIFE INSURANCE POLICY. ALSO, CERTAIN STATES (SUCH AS NYS) SPECIFICALLY EXEMPT VIATICATION PROCEEDS FROM INCOME TAXATION IF CERTAIN CONDITIONS ARE MET. TO ADEQUATELY PLAN FOR INCOME TAX AND ESTATE TAX CONSEQUENCES WITH REGARD TO ANY CONTEMPLATED VIATICATION, CONSULT A QUALIFIED PROFESSIONAL EXPERIENCED IN TRUSTS, TAX LAW, AND ESTATE PLANNING FOR ADVICE ON ESTATE AND INCOME TAXES FOR FURTHER GUIDANCE IN THIS REGARD BEFORE YOU ENTER INTO A VIATICAL CONTRACT.

My message today is that I believe that income taxation of viatical settlements unjustly reduces the financial resources of terminally ill individuals who viaticate their life insurance policies. Income taxation as such is counterproductive since it serves to motivate terminally ill individuals to avoid income taxation by postponing life insurance viaticating and waiting until their life expectancy drops to a low point which qualifies them to later receive non-taxable accelerated death benefits instead of taxable viatical settlement proceeds. In the meantime, though, receipt of additional financial resources is delayed, and the stricken individuals are deprived of the financial means with which to meet rising medical costs for quality health care and are deprived of the ability to afford to leave work earlier on disability in order to reduce stress to enhance their longevity.

Although I am no saint, I would like to make reference to Matthew 26.7 and Mark 14.3 in the King James Version of the Holy Bible to the time just before Jesus' crucifixion when a woman knelt to anoint Jesus's feet and body by pouring upon Him a very expensive ointment prior to His burial. There was indignation among some of those present, including His disciples, that such an expensive ointment would be wasted instead of sold for much and given to the poor. But Jesus commended the woman for her good deed in pouring the expensive ointment upon His body for His burial. To paraphrase how this was depicted in the movies, He asked them whether they would begrudge Him this one small act of anointment and said that they would always have the poor among them, but that He would not always be with them. By the same token, I strongly believe that it would not be right to begrudge a terminally ill individual the full enjoyment of the proceeds of a viatical settlement by subjecting it to an income tax.

I want to thank the Committee for allowing me this opportunity to express my views today.

Mrs. JOHNSON. Thank you, Mr. Phinney. I want to thank you for your testimony which, in its detail, does tell how these settlements are calculated and will give us a lot of information that will be useful to us.

Mrs. Rawoot.

STATEMENT OF TERESA KANE RAWOOT, TIMBERVILLE, VA.

Ms. RAWOOT. Thank you, Madam Chairwoman and members of the committee. My name is Teresa Rawoot. I am an attorney. I practiced in Northern Virginia and in Georgetown and more recently in the Shenandoah Valley, but I am appearing before you this morning as a private citizen who has personally benefited from a viatical settlement of life insurance.

I have with me this morning my husband Abbas Rawoot, and children Safia and Damian, ages 14 and 8. My practice as an attorney never gave rise to the opportunity to attend a congressional hearing, so I am particularly pleased to be here this morning and to allow my children this wonderful firsthand civics lesson.

I appear before you this morning to add my voice to those requesting the modification of H.R. 8 to allow for the tax-free treatment of proceeds from a viatical settlement. Viatical settlements appropriately regulated to avoid any abuse are truly reflective of the free enterprise system working at its best. There arises a tremendous need for ready funds when a life insurance policyowner, such as myself, has to deal with a terminal illness and is unable to continue working. It is a greater tragedy still when someone in that position has to deal with the added burden of realizing that their loved ones will be relieved of great financial need only upon the policyowner's death. Companies offering viatical settlements have emerged just in the past several years to fill that need. They provide life insurance policyowners with lifetime funds through a purchase of all or a portion of their life insurance policy. Thus, they truly help to fulfill the promise of life insurance, the hopes that are contemplated by an individual when they purchase a life insurance policy; namely, to provide for the financial needs of their loved ones when they are no longer able to do so themselves.

By exempting from taxation the death benefit of life insurance, our Tax Code reflects the value that society has always placed on individuals making financial provisions for their loved ones in order that they not become wards of the State upon the death of a breadwinner.

Clearly, the same rationale exists for exempting the proceeds of a viatical settlement. There is no cause for concern here that a policyowner would be able to take unfair advantage of the tax-free buildup in a life insurance policy, since viatical settlements are available only under very specific circumstances and, indeed, only under very tragic circumstances.

In my case, at a time when I was in the process of establishing my law practice in our newly adopted hometown of New Market, Va., in the Shenandoah Valley, I received the devastating news that my increasing back pain and flagging energy were due to a cancer that had already spread throughout my spine and liver. Soon I was no longer able to pursue my law practice in any appreciable way. At the same time, my husband was forced—had to

leave his job with a major hotel company because of the amount of time it required him to travel away from home, and he was just needed too much. For a short period of time we were able to depend on our savings. Thereafter, while my husband commenced establishing an accounting practice, we ran up considerable debt. I can tell you that the stress of dealing with the accumulating debt on top of the complete upheaval of a terminal illness just truly brings you near the breaking point.

Because viatical companies were fairly new, I was unaware of their existence. I desperately began trying to pursue obtaining some lifetime benefit from my life insurance policy, truly the only remaining asset that we had once our savings were depleted, apart from our home. But my policy had no advanced death benefit, and it had no significant cash surrender value or loan value.

Finally, upon learning of the availability of the viatical settlement mechanism, I cannot begin to describe to you the relief that my husband and I experienced. It was with great dismay, however, that we learned that the viatical settlement proceeds were not accorded the same tax-free treatment that are accorded to death benefits under the same life insurance policy. Nevertheless, I assure you, at that point we had no choice. Some funds were certainly better than no funds.

I worked with a very fine firm, Benefits Advocates from California, that was able to negotiate with their various funding sources to arrive at favorable terms for the purchase of a portion of my life insurance policy. That was last spring. Since that time we have been able to breathe much easier.

We have been able to rejoice at the time we have had and continue to have with each other. We were able to pay off our accumulated debts. We were able to purchase a van that allows me to recline whenever we travel. I have been able to purchase costly vitamin and mineral supplements which I am quite certain have been helpful in controlling my pain and increasing my stamina.

By the grace of our Lord, I am doing much better than any of my doctors had predicted. We have, as a family, been able to enjoy several lovely excursions with each other, and my children have rejoiced in being able to do these things with their mom, and these times we have spent together have made for some very special memories. Thus it is that I heartily repeat to you now that I am truly delighted to be here this morning with my family, and I thank you for the consideration of this request.

Mrs. JOHNSON. I thank the panel for your excellent input. As one of a number of members on this committee who have introduced and worked for the passage of legislation providing favorable tax treatment for accelerated death benefits on a bipartisan basis, the testimony you have given us both as to how important those benefits have been and how useful they are in managing terribly difficult challenges in life has been very helpful, but also this testimony on viatical settlements was very useful to us and will enable us to structure this legislation in an appropriately supportive fashion.

Mr. Bunning will inquire.

Mr. BUNNING. Thank you, Madam Chairman. For the record, and I know that you all are not experts in insurance, but it has come

to my attention that less than 5 percent of the policies in this country have accelerated death benefits included in their policies, and less than 1 percent of the population with insurance policies have any kind of settlements, viaticated settlements as some of you have experienced.

Do you know if that is anywhere near the correct figures? I got that figure from other insurers and insurance companies, but the accelerated death benefits language in H.R. 8 doesn't make the viaticated settlements tax free. It is my understanding from your testimony that you really strongly believe that a viaticated settlement should be the same as a death benefit. Am I correct?

Ms. RAWOOT. That is correct.

Mr. BUNNING. The parameters in H.R. 8 are restrictive within 1 year. In other words, for an accelerated death benefit it says if a terminally ill—or if certain types of illnesses are diagnosed that a person must be diagnosed to have a 1-year life expectancy or less to receive an accelerated death benefit.

I think those are rather restrictive, and I think that they ought to be looked at in relationship to doing something and also to making that viaticated settlement a tax-free settlement because, obviously, we all know if it were a life insurance settlement, it would not be taxable, so I deeply appreciate your testimony. It is part of H.R. 8, which I am a cosponsor of, and, obviously, with the addition of your testimony we will obviously look at viaticated settlements and we will look at expanding or lessening the restrictions on them with the proper documentation from physicians of people who have terminal illness. I deeply appreciate your coming so far to testify for our committee and thank you for your testimony.

Ms. RAWOOT. We thank you for the opportunity.

Ms. KEOWN. Thank you, sir.

Mrs. JOHNSON. Mrs. Kennelly, an author of this kind of legislation over many years will inquire.

Mrs. KENNELLY. Thank you, Madam Chairman. We have on this committee looked at this situation and worked very hard to make it better.

As you said, Mrs. Rawoot, it has just been a couple years that viatical companies have been in existence. It has only been a brief amount of time that the large insurance companies have addressed this problem, and it has been very tedious to move this legislation forward.

We have seen solicitations that are really questionable mentioning the T-cell count of an individual. This practice is individuals buying and selling insurance policies. Also we have seen cases where the insurance policy, because of your testimony saying that you really had no other choice, have been discounted to such an extent that it really is unfair. Yet both your stories are good stories, and you are very happy. You seem satisfied.

Can you give us—I don't want to get into your personal business, the discount rate and whether it was satisfactory or not: Could you help us so other people could profit by your experience?

Ms. RAWOOT. Yes. In my case I felt very keenly the potential for abuse there and was concerned about an uneven bargaining power. I satisfied that concern myself by, when I checked with various viatical companies, I concluded that I would feel much safer work-

ing with a company, more of a brokerage type operation that dealt with several funding sources.

In order to obtain a viatical settlement, it requires quite a bit of paperwork, your medical records, and for people with terminal illnesses, quite often it entails having to visit several different medical institutions, getting second opinions and whatnot, and all those records need to be submitted and reviewed and, obviously, they are all very confidential records.

Once you do that and you only have so much energy as well at that point, that I felt if I were going to be working with a company that actually did the bargaining for itself, I felt that I would have been committed to staying with that company because I wouldn't have wanted to have to repeat the whole process with someone else. Whereas working with a brokerage company where they collect all this information and then are able to approach their various funding sources to arrive at the most favorable terms for you, and there was some negotiation involved.

They came back to me with an offer, and, frankly, my doctor thought I was crazy to viaticate my policy because he just didn't think there was enough time. The prognosis was too poor for my family to give up any amount on a viatication, so with that tension on this side I did not accept the first offer that was communicated to me, and benefits advocate, Nancy Kane, with Benefits Advocates negotiated further for me and came up with a more favorable discount rate, and just the checking that I had done, I realized that that was just about the best discount rate that I could possibly arrive at.

I think, just with the life insurance industry in general, regulation is needed to avoid abuses. Clearly there is regulation needed in this area as well, because certainly the potential is there for abuse, but I also think that there are market forces there that are at work that tend to support the integrity of the entire industry and the entire effort, and I would just hope that anyone in my situation would do the checking around and the homework or would have someone to do it for them.

I know that is a concern for someone that is really ill and, of course, I am an attorney and have that background, but you can never have a completely fail-safe situation in any aspect of life, and there is always going to be some potential for abuse, but I think overall my experience, the experience of the other panelists here was highly, highly favorable, and I think that the risk of abuse is outweighed by the great potential for being a tremendous service to individuals in our position and warrants this sort of favorable tax treatment.

Mrs. KENNELLY. Thank you. Mr. Phinney.

Mrs. JOHNSON. The gentlelady's time has expired. It is Mr. Herger's time to question.

Mr. HERGER. Thank you very much, Madam Chair. I would just like to thank each of you for the courage that you have shown for coming before us and sharing with us. The information that you have shared with us has been very helpful to me.

I certainly intend to do everything I can, working with this legislation and with others, to be able to help you and those that are in similar situations be able to access funds that they have already

contributed to. I really don't have a question, but maybe during my time, Mr. Phinney, were you going to comment?

Mr. PHINNEY. Yes. I just wanted to state my experience in obtaining viatical settlements. I approached several viatical settlement companies each time. I have done this more than once, and in using a bidding process I was able to obtain what I think were fair bids, and I accepted the best bid. However, I am no politician, but I would like to see some kind of regulation of the industry possibly in the form of a model act which could be adopted by the States with a national insurance association which might promulgate any standards for the industry, such as the same way as generally accepted accounting principles are governed by the American Institute of CPAs, but that is all I wanted to say. Thank you.

Mrs. KENNELLY. Thank you.

Ms. KEOWN. May I speak? David received accelerated death benefits, and I was so devastated physically, emotionally, and financially to be faced with a situation like this that I can't imagine having to take bids on life insurance as opposed to the accelerated death benefit. I speak only for myself. Emotionally, I couldn't have handled it. Thank you again.

Mr. DON PAUL. I second that, madam.

Mrs. JOHNSON. Thank you. Mr. Hancock will inquire.

Mr. HANCOCK. Thank you very much. You know, listening to this panel reminds you of the old statement, "There, but for the grace of God," I think we have all heard that.

Let me ask a question. In today's issue of the National Journal there was a letter written to Chairman Archer that was published in here—signed by the ranking member, Mr. Gibbons, and 14 Members of the minority party criticizing our hearings that we are holding now, currently holding on what is called the Contract With America.

In fact, they are quoted as saying none of the witnesses have been expert in the Contract's provisions. I would just like to ask this panel, in your judgment, should we, as the Ways and Means Committee, be talking to members from the academia and from the bureaucracy or should we be talking to people like you?

I have been on this committee for just 2 years now, and for the last 2 years almost all of the panels started with either bureaucrats or people that have Ph.D.s behind their name rather than actual people. What is your opinion? Are we handling this wrong or should we be going and talking to the experts?

Mr. DON PAUL. We are the experts.

Mrs. ROSEMARY PAUL. We are the experts.

Mr. DON PAUL. We know what it is all about. If I could just interject, there was nobody twisting our arms in this. We solicited this ourselves from the viatical company, and out of all fairness to them, you don't have to accept this immediately. If you do, you still have 30 days in which to make up your mind as to whether you want to keep the money or not, and if you don't want to keep it and have second thoughts, return it and it is all over. There is nobody out to get you on it. The settlement was very fair.

Ms. KEOWN. I appreciate being called an expert. I know more about death and dying than I ever wanted to know, but I appre-

ciate your listening to us, and I agree, unfortunately, we are the experts, and there, but for the grace of God, you might be one, too.

Mrs. JOHNSON. Thank you. Mr. Ford will question.

Mr. FORD. Thank you, Madam Chairman. Mr. Phinney, you support the tax-free treatment of all payments due to terminal illness with no time limitation in your testimony.

Would such a proposal have a negative impact on the current disability insurance market, and how would such treatment be reconciled with the basic premise that the recipient of the benefits will die soon or have exhausted all other resources and have no other financial resources available to him or her?

Mr. PHINNEY. I am sorry, would you restate the question?

Mr. FORD. Well, you talked about the tax treatment of all payments due to a terminal illness, with no time limitation. How would you treat—how would you reconcile the payment of this with a person dying, a person dying or collecting the benefits or paying taxes and you, with the government, having exhausted, I guess, all resources. At the same time there is no time limit or time schedule for a person who might have 1 year, 2 years, or 3 years and the government not knowing whether there are any other resources available to that person at the time of death or at the time of settlement with these claims.

Mr. PHINNEY. Well, I feel that once a person is diagnosed with a terminal illness, their entire life changes, and from there it is a downward spiral. It depends on the situation.

Some people have a longer period than others, but I think it would be unfair to create artificial measurements or standards by which to judge when one terminally ill person should receive nontaxable benefits as opposed to another just based on the length of their life expectancy, the remaining life expectancy. It is a time when people need these resources, they have paid——

Mr. FORD. How do you determine that life expectancy?

Mr. PHINNEY. By a doctor's diagnosis.

Mr. FORD. What happens in cases where it is not the case, what happens if the life expectancy is 2–4 years longer than anticipated by the physician?

Ms. KEOWN. You say, thank God.

Mr. FORD. I understand that, absolutely.

Ms. KEOWN. That is exactly what you do, but I think having received the accelerated death benefits, in our case, my husband has heart disease, and I think that his survival has been longer from having received this because of relieving the stress that is involved.

I feel it is a safe assumption that we all know that relieving stress does improve the quality of our life and most of the time the longevity, but I don't think that you can set a time or I certainly can't.

David has lived at least 2 years, I mean from day one they said he can't live through the weekend, and we sat with crisis, after crisis, after crisis on a daily and hourly basis, and he continues to live. I would hate to think that we had received this and then we would have to pay it back because it is not all there now. We need that to continue to buy his medication and to provide the care that has allowed him to live this long.

Mr. FORD. Have your experiences caused you to think any differently on our national health care policy in this country as to whether we should have a strong national health care plan with full protection with all medical expenses provided?

Ms. KEOWN. Mr. Ford, I prefer personally—we have a need for health care reform. I personally would rather work, have an opportunity to work to buy and to get what we pay for without being taxed to provide for that care so that we, as reasonable human beings, can make our own decisions regarding the welfare of our families.

The road that we have chosen and the road David has chosen to live out his life, I am not—I would never say that is how someone else should do it. All I can say is that is what is best for us, and all we want are options and the ability to make those decisions ours.

Mr. FORD. My time has expired, but could I get Mr. Phinney to just respond to that question, if you don't mind.

Mrs. JOHNSON. Perhaps we can come back to that. It is Mr. Ramstad's opportunity to inquire.

Mr. RAMSTAD. Thank you, Madam Chair. I would be happy to yield to the gentleman for the purpose of that response.

Mr. FORD. I really appreciate it. Mr. Phinney, could you respond to that question, please?

Mr. PHINNEY. Yes, I agree that when financial resources, more financial resources are made available by the nontaxability of viaticationsit allows people to have more funds available to avoid being on public assistance, being a burden on society, and also to be able to afford better health care. It is a fact that people who have private insurance policies, who have their own health insurance, live longer than those who are merely on Medicaid, and there is also a statistical positive correlation between financial solvency and longevity.

Mr. FORD. That is comparing the Medicaid of the health care benefits in the Medicaid program versus the private sector. We are speaking of a national health care plan that would be across the board, a plan that would be universal to all Americans, so it wouldn't be a difference in the provision of the policy.

Mr. RAMSTAD. Reclaiming what is left of my short time, if I may.

Mr. FORD. Thank you very much.

Mr. RAMSTAD. Just let me say to each of the panelists that I, too, admire the great dignity and courage that each of you personifies here today, and like my colleague from Missouri, I appreciate real-world witnesses, people with experiences like yours, much more than the bureaucrats from these gray buildings up and down the avenues.

Let me ask the question briefly. As a strong supporter of the provision relating to accelerated death benefits in our Contract With America, I think it is not only the humane thing to do, but it is the cost-effective thing to do. My question relates to that premise. If you didn't have accelerated death benefits, which, if any of you, would find yourself in a nursing home? Could you just elaborate on that or comment on that?

Mrs. ROSEMARY PAUL. My husband is handicapped, as well, so it took a lot of stress for him to take care of me, and he ended up

in the hospital right after Christmas because of the stress that my illness has provided. Luckily Viaticus was able to settle with us right at that time.

Just the knowledge for me to know that when my time is gone, I will not leave him with more medical bills and for him to worry, for me, that has taken a big burden off my shoulders, knowing that he is going to be able just to live and maintain our lifestyle that we have worked so hard for just with his disability pension. Because believe me, with the money that we have gotten from Viaticus, it will be gone by the time I am gone, but he will be left without any financial debt.

Mr. RAMSTAD. I certainly appreciate that response. Let me just ask if there are any of you who are in imminent danger of being placed in a nursing home if we don't pass the Contract's provision relating to accelerated death benefits, given the tremendous expenses that you are, obviously, facing?

Mr. DON PAUL. Sir, without the money that we got on the viatical settlement, our resources were gone. I would have had to—both Rosemary and I are on Social Security. With me not being able to take care of her, she would have had to go into a nursing home and probably at government expense.

Ms. KEOWN. My husband would not choose to go to a nursing home, and as long as there is a breath in my body, he will not go.

Mr. RAMSTAD. Well, we think you and your husband should enjoy the dignity of independent living and that is why we support the provision in this Contract. I thank you, again.

Ms. KEOWN. It is more cost effective. My labor is very inexpensive.

Mrs. JOHNSON. Thank you. Mr. Payne will inquire.

Mr. PAYNE. Thank you very much, Madam Chairman. I, too, want to thank all of the witnesses who have testified this morning, because I think this is very helpful to us to understand the impact on your lives and certainly the lives of many other people who aren't here, and it helps us as we look at how to make good public policy, and certainly it is policy that I support.

I don't have a question, but I wanted to follow up on something that Mr. Bunning mentioned. He mentioned that in his research only 5 percent of the policies now contain some sort of accelerated death benefit. It is my understanding that the Prudential Insurance Co. has pioneered this concept and now offers it without any increase in premium to their policyholders. I certainly hope that other insurance companies, after hearing the kinds of testimony we have heard today, would understand how beneficial this is to their policyholders and would pursue this same kind of accelerated death benefit. I thank you all again, and I yield back the balance of my time.

Mrs. JOHNSON. Thank you. Mr. Zimmer will inquire.

Mr. ZIMMER. Thank you, Madam Chairman. I would like to say that not only are you experts on the specific insurance issue on which you are testifying, but you are expert in something more important, how to confront dying and death with dignity, with courage, with faith, and with practicality.

I served on the board of my local hospice for a number of years, and I can tell you that I regret that for the first time in our hear-

ings TV cameras aren't present because the public really needs to know how to deal with the major problems you are facing personally, the insurance and tax issues aside, and you are all excellent models for people, for all of us who are going to be confronting these tremendous challenges later in our lives.

I would like to ask Mrs. Keown, who is the only member of the panel who has actually received a direct accelerated death benefit, you said that you had to go through—you couldn't go through a bidding process, and it would be difficult for you to work out a viaticated settlement.

Do you believe that we in the committee should somehow through the Tax Code favor accelerated death benefits in preference to viatication because of the ease of availability and the ease of accessibility to the insured?

Ms. KEOWN. Mr. Zimmer, I only have experience with accelerated death benefits. I think it is wonderful. I think it should—I think everybody should have it like us. Who thinks you are going to use it? But I think it should be given favorable consideration because I think if there is perhaps competition, that maybe a greater percentage of that would go to the policyholder under this situation. I am just not familiar enough to speak as an expert, but I think any benefits that a terminally ill person receives or their family most definitely needs not to be taxed.

We need every penny that we can get, and to fall back on public assistance as the very last resort, so anything that can be done would help us.

Mr. ZIMMER. Mr. Paul.

Mr. DON PAUL. Mr. Zimmer, that may be all and well for people that are purchasing their insurance. Our insurance was a group life insurance, and I think you would probably not be able to get restrictions on that.

Mr. ZIMMER. That is something I hope we can pursue with the subsequent panel, with representatives from the insurance industry. I would hope that they could make it available, but, obviously, in the current situation where not all the insurance companies have followed the Prudential's example, we have got to be mindful of that. I thank you for bringing that to my attention.

Yes, Mr. Phinney.

Mr. PHINNEY. For some individuals, their policies do not offer an accelerated benefit provision, and most of those are only available if a life expectancy is 6 months or less or 1 year or less.

The individuals who only have the 6-month accelerated death benefit available to them, if their life expectancy is 1 year or just over 1 year, they can only do a viatical settlement, not an accelerated death benefit, and that would throw them into an income taxation situation, so I just wanted to make that point.

Mr. ZIMMER. Well, we would hope to make the income tax situation as fair as possible by our actions.

Mrs. Rawoot.

Ms. RAWOOT. Yes, I would like to say as well that the ADB (accelerated death benefit) is also such a new mechanism that I would venture to say that the overwhelming majority of baby boomers, the baby-boomer generation with life insurance policies in place do

not have any ADB provision, and I was never approached by an agent to add it on.

This individual was approached actually by their Prudential agent. So I think it would be terribly unfair for legislation that was being written now to allow tax-free treatment for something that insurance companies, for all intents and purposes—that the public, rather, would only, for all intents and purposes, would only be able to take advantage of by future insurance contracts. But all those insurance contracts that are out there now for people of my generation, a generation that is finding itself increasingly faced with diagnoses of terminal illness with the increased, the relentless increase of cancer and AIDS, I think it would be a terrible tragedy to leave out all those insurance contracts where ADBs were just simply not available to the policyowners at the time they were purchased, and I really don't see the logical rationale for it whatsoever.

Mr. ZIMMER. Thank you very much. I want to thank everybody on the panel for giving us this very important testimony.

Mrs. JOHNSON. Thank you.

Mr. Collins will inquire.

Mr. COLLINS. Thank you, Madam Chairman. I really don't have any questions, but I do want to say that I appreciate each of you being here. Your information has been very valuable. We appreciate your taking the time, and I know it was somewhat of a stress to do this and to even talk about the situation, but thanks very much for your input.

Mrs. JOHNSON. Thank you.

Mr. Kleczka will inquire.

Mr. KLECZKA. Thank you, Madam Chair. I have no questions either of this panel except to show my appreciation for their coming down and relating some very heart-wrenching stories. Thank you very much.

Mrs. JOHNSON. Thank you.

Mr. Neal will inquire.

Mr. NEAL. No questions, Madam Chairman. I believe Representative Kennelly has offered legislation similar to this in the past. I have been a sponsor of it and applaud the panel for their forthright attitude today.

Mrs. JOHNSON. Mr. Ensign will inquire.

Mr. ENSIGN. Thank you, Madam Chair. I would like to thank you for coming and sharing the testimonies that you have shared today.

Mr. Phinney, I do have a question for you just to clarify this in my own mind. When you talk about being diagnosed as having a terminal illness, if you are diagnosed HIV positive, but you don't have AIDS, for instance, would that be something that should be included, or would you have to actually be to the AIDS stage when you are no longer allowed to work or carry on a normal work schedule?

Mr. PHINNEY. Well, I think the definitions, the definition of AIDS has changed recently. It used to be based on T-cell counts or CD–4 counts.

Mr. ENSIGN. Right, and it is evolving and who knows what it will be in the future.

Mr. PHINNEY. I don't know what the definitions are now, but I don't know what the cutoff point should be or if there should be

one, but I think that people with a terminal illness should be given the opportunity to enter into a viatical settlement that is nontaxable.

As to whether their life expectancy should be under 5 years, under 2 years, under 1 year, I really can't make that determination. I would think that perhaps whether they are actually disabled such that they cannot work, that might be another definition of whether or not they have met the—that might be another criteria to use for nontaxability, but I think anybody who viaticates because they have a terminal illness should be at some point allowed proceeds that are nontaxable.

Mr. ENSIGN. I would agree with that, and I would like to further add that as I see it, with the payments that you received, as far as a cost-to-benefit ratio, I know we are looking in real terms on the way you have received these benefits, but you are able to stay home longer. You are able to take care of your own families longer. That seems, to me, in the long run to also save our government money.

I mean, there doesn't seem to be a losing situation here. I see nothing but a positive situation. I thank you all for coming today.

Mrs. JOHNSON. Mr. Christensen will inquire.

Mr. CHRISTENSEN. Madam Chairman, I echo the sentiments of my colleagues and thank this panel for coming, and as my colleague from Missouri quite eloquently said, this is definitely the panel of experts. I thank you for your time here today.

Mrs. JOHNSON. Mr. Phinney, I would like to follow on with one question. I would guess that the diagnosis would play a big role in what kind of settlement offer you received.

In other words, if the diagnosis indicated that you might live 6–8 years, you might not have many offers, so isn't there some mechanism within the viatical settlement process that deals with the issue of time more effectively than we might by defining 12 months or 15 months or 24 months?

Mr. PHINNEY. I think I have an answer for it now. I think that the individual who is contemplating a viatication should be able to make the decision whether they are going to viaticate based on whether they need the money depending upon what their condition is, whether they need the money for alternative medical treatment, which is not covered by health insurance, if they have to travel to Paris to get special medical treatment or whatever, but an individual is not going to accept an offer that is ridiculous, I wouldn't think, if they have any degree of intelligence. So I think that there is a—that each individual really should have the decisionmaking power as to whether they want to enter into a viatication.

If they need to because they have a terminal illness and they have the financial need to do so and they want to accept an offer, they think it is fair, I really think it should be up to them to make that decision whether they enter into the viatication, and then if they do, I think it would make sense to have it nontaxable.

Mrs. JOHNSON. The viatical settlement, like an accelerated death benefit, continues until you die, correct?

Mr. PHINNEY. Normally, you get a lump sum payment and you assign the policy so you don't own it anymore, and you have got a lump sum amount.

Mrs. JOHNSON. I see. So it does differ from the accelerated death benefit in that regard. Mrs. Keown.

Ms. KEOWN. With the accelerated death benefit, we received a very large percentage, I think, of the total policy. We were most satisfied, and the ease with which it was handled really relieved not only the financial strain, but also the emotional strain of having to deal with it.

With David's condition and heart disease, in response to your time period, none of us know, but with some disease processes that I have become more familiar with that are terminal, they are a little bit easier to define because of the way the disease progresses.

The miracle is that David is still alive, but his will come probably in the snap of a finger because it is heart disease. He had to have lived 6 months or less, but again he has been here 2 years, and it is because of the care that he has received. I am patting myself on the back.

Mrs. JOHNSON. Mr. Paul.

Mr. DON PAUL. Madam Chairman, I hope we are not complicating this by going into a lot of redtape, which I think is happening right here right now. This is very simple. The company does not solicit your business. You solicit the business from them on a viatical settlement.

Like any other insurance company, they use actuarial figures to determine the percentage amount of the policy you are going to get based on your physical condition and based on all of your medical records to determine from there, and you also know just about how much life expectancy you have.

Mrs. JOHNSON. So you are saying there is no necessity for government to get involved in setting those criteria?

Mr. DON PAUL. I don't think so. I think we need to keep it simple. We don't need to complicate it with a lot of redtape because even with AIDS or anything else, they are not going to settle on a policy.

The viatical settlement is not going to settle on a policy if you have got 15, 20 years, and you are not going to have to accept what they offer you, so we could keep it very simple. They base it on actuarial figures as to how long you have to live, and you have the option to either accept it or reject it. It is just that simple.

Ms. RAWOOT. Just to second that, I would just add that this really seems to be one of those areas where the natural market forces at work would be the best regulator because the viatical company will offer a financial settlement only based on the hard data made available to it from the medical records and the medical doctors, and, obviously, no one can predict with certainty when anyone is going to pass away from a given illness, but—so they do, they assume a fair amount of risk, as well.

Mrs. JOHNSON. If there are no further questions from the committee, I do want to thank you for your courage day in and day out and for your willingness to share your experience with us. It has been very helpful.

Ms. Paul, did you have a comment?

Mrs. ROSEMARY PAUL. I just want to second something my husband mentioned, the life insurance company, they are going to pay the money to us after we are dead, OK? Why not give them a

chance to enjoy the money before we are dead, before we go? To us, it is more beneficial.

I am enjoying my life, and I am sorry if I don't leave anything to anyone else, but I am enjoying my life by being with them. Later on, after I am gone, I am not going to worry. Let them worry about it.

Mrs. JOHNSON. You have certainly made clear all the many ways in which accelerated death benefits and other solutions improve the quality of your lives and are a good deal for everyone. We thank you very much.

Mr. SHAW [presiding]. I see our old friend and former colleague, Dan Mica. Welcome. Glad to have you with us on this panel today.

Mr. Pardo, who is president of the National Viatical Association and president of Life Partners, Inc., of Waco, Tex.

By the way, Dan Mica is executive vice president of the Federal Affairs American Council of Life Insurance; Per Larson, Highland Mills, N.Y.; Alan B. Perper, president, Dignity Partners, San Francisco, Calif., on behalf of the Viatical Association of America; and John Banks, chief executive officer. Your written statement will be made a part of the record. You may summarize or proceed as you see fit. Dan, why don't you start.

STATEMENT OF HON. DANIEL A. MICA, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN COUNCIL OF LIFE INSURANCE

Mr. MICA. Thank you, Mr. Chairman. Let me start out by saying I am accompanied by Stephen Kraus on my right, chief counsel, Pensions, at the ACLI (American Council of Life Insurance). Indeed, since my written statement is a part of the record, I will summarize.

We are very pleased to express our strong support for the provisions in the Senior Citizens' Equity Act that would treat accelerated death benefits as nontaxable death benefits. The moving testimony we all heard early this morning clearly demonstrates that accelerated death benefits can play an important and sometimes critical role in providing individuals with the timely financial support they need to deal with major health problems.

I am pleased to report today that over 215 life insurance companies offer accelerated death benefit protection to more than 18 million policyholders, and I might add that that is quite an increase from just a few years ago. Therefore, I think it is important that Congress act as quickly as possible on this issue so that the current uncertainty for our policyholders regarding the tax treatment of these benefits will be clarified.

Accelerated death benefits or "living benefits" allow policyholders to access the face amount of their policies prior to death in response to the growing need to ease the financial burdens and strains on Americans and their families, and you have all heard this. I will summarize some of this here. You have heard about it in detail this morning.

This cost-effective approach was a life insurance policy as the foundation to provide benefits under the following circumstances—terminal illness, long-term care, or permanent confinement to a nursing home, and I might also add that companies have acceler-

ated death benefits to treat a broad range of specific medical conditions such as strokes, life threatening cancers, and major organ transplants. There is also substantial public support for accelerated death benefits.

Almost three-quarters of those interviewed by the Roper Organization in a May 1993 poll sponsored by ACLI approved of the concept of accelerated death benefits. In addition, almost 70 percent of those holding individually purchased life insurance policies indicated interest in being able to accelerate the benefits of their policies.

Mr. SHAW. Mr. Mica, would you suspend just a second? There is an undercurrent of conversation in this room. If any of our guests would like to talk, I would appreciate your taking your conversation out into the hall. Individually you may not be making much noise, but when I see about 10 or 12 conversations going on in the room, it does make it difficult for us to hear. If you could proceed.

Mr. MICA. Thank you, Mr. Chairman.

Mr. Chairman, as an aside at this point, I just wanted to point out, we have conducted these polls. They indicate strong public support, but another measure—and this is something I had in my file from 5 years ago when these policies, these types of policies were first introduced, is the strong editorial support from all over the Nation—the Minneapolis Star and the Atlanta Journal and the Boston Globe, the USA Today—that these types of policies have and continue to receive.

I kept this file for years because this really is a product that the American public, the American community that takes an interest in this, the editorial and business community have all had strong support for. I might also say that a substantial majority of individual policies in our survey already in force, as well as new policies, now offer accelerated death benefits.

There has also been a notable increase in the number of group contracts which offer this benefit. While the actual number of policyholders receiving accelerated death benefits so far has been relatively small, the benefits, as we have heard today, are obviously very important for those who do need them. We are pleased that several bills have been introduced that deal favorably with the tax clarification of accelerated death benefits, and we would contemplate providing your committee with technical suggestions designed to ensure that the Contract With America legislation operates as we believe you intend it to operate.

The potential devastating cost of terminal or catastrophic illness is a critical issue that must be addressed. The life insurance business can help meet that challenge in an efficient and, I would say again, cost-effective manner. Congress, for its part, can help by providing appropriate tax clarification with respect to accelerated death benefits. Mr. Chairman, I thank you. That is a summary of my comments. I would be happy to take any questions.

[The prepared statement follows:]

STATEMENT OF HON. DANIEL A. MICA
EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS
AMERICAN COUNCIL OF LIFE INSURANCE

Good morning Mr. Chairman and members of the Committee.

My name is Dan Mica and I am Executive Vice President - Federal Affairs of the American Council of Life Insurance. I am accompanied today by Stephen Kraus, Chief Counsel, Pensions at the ACLI.

I am pleased to testify today on behalf of the American Council of Life Insurance which represents 640 life insurance companies, holding nearly 90% of the life insurance in force in the United States. We are pleased to express our strong support for the provisions in the Senior Citizens Equity Act that would treat accelerated death benefits as non-taxable death benefits.

GENERAL COMMENTS

Life insurers have been increasingly active in adding accelerated death benefit provisions to their life insurance products. Today, over 215 companies offer this protection to more than 18 million policyholders. Therefore, it is important that the Congress act quickly on this issue, so that the current uncertainty for our policyholders regarding the tax treatment of these benefits will be clarified.

ACCELERATED DEATH BENEFITS

In the late 1980's and early 1990's, the life insurance industry developed an exciting and innovative way to ease the financial burden and strain imposed on Americans and their families in the case of terminal or chronic illness. Called accelerated death benefits, these features of life insurance policies allow their holders to receive the full value of their policies before death in certain circumstances.

The financial and emotional strain that a final or chronic illness can cause is irrefutable. The dramatic escalation in expenses associated with such illnesses is also common knowledge. Accelerating death benefits allows insurance companies to provide Americans in such situations with their death benefits before death, thereby hopefully easing the financial strain and preserving the policyholder's dignity to the greatest extent possible. Clarifying the tax treatment of accelerated death benefits encourages terminally ill and chronically ill individuals to use their own resources to pay for the expenses of final or chronic illnesses, instead of relying on government programs such as Medicaid. By accelerating death benefits, the insurer can help with little, if any, additional cost.

Accelerated death benefits currently offered by the life insurance industry include payments under the following circumstances:

- terminal illness -- a medical condition which results in a drastically limited life-span, usually twelve months or less
- long-term care -- personal care, health and social services needed by individuals who experience a chronic illness or disability
- permanent confinement to a nursing home -- an illness or physical condition which can reasonably be expected to result in an individual remaining in a nursing home for the rest of his or her life

There is substantial public support for accelerated death benefits. Almost three quarters of those interviewed by the Roper Organization in May 1993 for an ACLI-sponsored study approved of the concept of accelerated death benefits. In addition, almost 70% of those holding individually purchased life insurance polices indicated interest in being able to accelerate the benefits of their policies.

A substantial majority of individual policies in force, as well as new policies, now offer accelerated death benefits. There has also been a notable increase in the number of group contracts

which offer accelerated death benefits. While the actual number of policyholders receiving accelerated death benefits so far has been relatively small, the benefit is obviously important for those who do need the benefits as you have already heard earlier this morning. Clarification of the tax treatment of such benefits is also vitally important to these Americans, and their families.

CURRENT LEGISLATION

We are pleased that several bills have already been introduced that favorably deal with the issues outlined above. In this regard we strongly support H.R. 8 and H.R. 99, which was introduced by Congresswoman Kennelly. We will provide your Committee with technical suggestions designed to ensure that the Contract with America legislation operates as we believe you intend. We urge, however, that we work together to make the legislation as simple as possible in order to facilitate the provision of these important benefits.

The potential devastating cost of terminal or catastrophic illness is a critical issue that must be addressed. The life insurance business can help meet that challenge in an efficient and cost-effective manner. Congress, for its part, can help by providing favorable clarification of the tax law with respect to accelerated death benefits.

Thank you, Mr. Chairman, for the opportunity to present our views. We look forward to working with you and your colleagues to enact tax clarifying legislation as quickly as possible.

Mr. SHAW. Thank you. We will proceed now to Mr. Pardo, please.

STATEMENT OF BRIAN D. PARDO, PRESIDENT, NATIONAL VIATICAL ASSOCIATION, AND PRESIDENT, LIFE PARTNERS, INC., WACO, TEX.

Mr. PARDO. Mr. Chairman, members of the committee, my name is Brian Pardo. I am president of Life Partners, Inc., a Texas-based company that has purchased more viatical settlements than any other entity in the Nation. That amounts to more than 2,000 policies over the last 5 years.

I also have the pleasure of serving as the president of NVA (National Viatical Association), which is located here in Washington. Last year NVA members and other members of the industry purchased an estimated 300 million dollars' worth of policies, and we expect that this year that number would grow to $400 million and our view is that by the year 2000 that number could on, an annualized basis, be approximately $1 billion.

I would also like to point out briefly we have worked very closely with the National Association of People With AIDS. We have served as the national voice for people living with HIV in the United States, and have collaborated with them on our position regarding this matter.

Today, there are over 400,000 Americans diagnosed with full-blown AIDS in the United States, and this is the end stage of the disease. There are another million Americans plus that are HIV positive who will progress to the full-blown AIDS status unless there is a medical breakthrough which is seen as being very unlikely.

The cost of health care for people living with AIDS is staggering. The American Medical Association estimates that the treatment costs from the point of full-blown AIDS diagnosis to death is $69,000, and I emphasize this is only for the end stage portion of the disease, not the preliminary years which also require a great deal of medical care. This will amount, under the current scenario we have in the United States, to about $96 billion required in health care treatment and most of that, in our view, will be spent over the next 5 years.

Unfortunately, most PWAs (people with aids) and other people with terminal illness, as we have seen in the earlier panel, face a serious financial dilemma as well as a medical dilemma. HIV disease, in particular, is among the most costly of medical conditions, and currently the vast majority of people that are affected by HIV disease do end up on public assistance programs, Medicaid, and welfare.

The ability to make their own decisions regarding treatment, sustained health, and longevity remain the foremost concerns of people living with HIV disease, and in our view, in fact, all people dealing with terminal illness. Yet the high cost of medications and treatment remain the most pressing barrier to their remaining life with dignity.

Fortunately, a large number of terminally ill people in the United States have an asset that they generally do not realize is an asset, and that is their life insurance policy. It is estimated that 40 percent of all Americans have a life insurance policy, and we

feel that this percentage applies ratably or even perhaps in proportionally greater numbers among HIV positive Americans and other Americans with terminal illnesses.

Therefore, through the viatical process, a meaningful financial contribution amounting to billions of dollars annually can be applied from the private sector, using the resources of the insureds themselves and relieving financial pressure on public assistance programs.

In essence the viatical process provides a private sector solution to a looming public sector problem. The ability to sell one's life insurance policy for a lump sum payment of cash, which is known technically as a transfer for value, is a long-recognized right of policyholders, which allows them the unique opportunity to turn a nonliquid asset into cash now, and to provide dignity and financial security to millions of terminally ill Americans without expense to the taxpayers.

We estimate that more than 20 billion tax dollars can be saved over the next 5 years alone by maintaining a free viatical market process such as it exists today. Insurance companies-sponsored accelerated benefits programs, while on the right track, currently fall way short of providing a meaningful financial impact.

As we could see in the earlier panel, four out of five individuals viaticated policies rather than accelerated them. Of the 2,000 or more insurers in the United States today, only about 200 offer any form of accelerated benefits program. Those that do generally limit those programs to short life expectancies, qualifications on policies, and lower payouts than are commonly seen with viatical companies. Therefore, it is our view that the viatical process should be left to the free enterprise system, which is an environment in which the industry has grown and flourished, and I might add it has been substantially free of abuse or misconduct.

Providing a tax exemption on the sale of proceeds of life insurance policies by terminally ill Americans is without a doubt in the best interest of the sellers and the taxpayers alike. I would stringently argue that terminally ill sellers can better manage their own financial affairs rather than recycling tax dollars through the government for the ultimate same purpose. By providing for tax-exempt sales of policies, Congress can allow individual citizens to realize substantially greater net proceeds to help cover medical costs and subsistence needs.

In the past, bills have been proposed that would allow tax exemption only to an accelerated benefit program as proposed by the insurance companies. We feel this would only serve to discriminate against a class of taxpayers, those who would not qualify for those programs which make up the bulk of people afflicted with terminal illness, and it would also allow the insurance industry to compete unfairly with the viatical industry at the expense of the taxpayers.

Since there is very little fundamental difference in these two forms of realizing cash from a viatication or acceleration of the death benefit, they should be treated, in our view, the same for tax purposes. Therefore, it is our recommendation, which is endorsed by the National Association of People With AIDS as well, that this committee recommend tax exemption for all forms of viatical transactions for any person who is diagnosed terminally ill, regardless of illness or regardless of life expectancy. Thank you.

[The prepared statement follows:]

TESTIMONY OF BRIAN D. PARDO, PRESIDENT
NATIONAL VIATICAL ASSOCIATION
BEFORE THE
COMMITTEE ON WAYS AND MEANS
REGARDING TAXABILITY OF PROCEEDS FROM
VIATICAL SETTLEMENTS AND ACCELERATED BENEFITS

January 19, 1995
10:00 AM

Mr. Chairman, Committee Members;

My name is Brian Pardo and I am the president of the National Viatical Association (NVA). The NVA was incorporated in 1993 to serve as a trade association for the viatical settlement industry. We have operated continuously since then in the best interests of our member companies and their clients. Our membership represents well over half of the total viatical transactions executed in the United States to date. The scope of our experience has provided us with a unique perspective of where this industry has been, and where it is going in the future. Conservatively, the NVA membership will collectively purchase more than $400 million in policies this year. Moreover, viatical transactions in general are growing at a tremendous rate in the United States.

VIATICAL SETTLEMENTS : A BRIEF DESCRIPTION

A viatical settlement is simply the sale of an existing life insurance policy by a terminally ill person in return for a percentage of the face value of the policy paid immediately.

The viatical settlement is an effective estate planning tool which permits a person dealing with a life threatening illness to ease the financial stress often associated with a terminal condition. In short, a viatical settlement allows a terminally ill person to enjoy the benefits of his or her life insurance policy while he or she is still alive and to transform a non-producing asset into immediate cash which can be used to improve the quality of his or her life.

Terminal illnesses, in addition to their detrimental health effects, exact a tremendous financial toll upon insureds and their loved ones. With the rapid increase in the number of, and the spread of, many terminal illnesses, especially AIDS and certain types of cancer, the use of this type of sale and assignment by insureds has become more widespread and has developed into the viatical settlement industry.

As these transactions are currently regarded, both viatical settlements and accelerated benefits are taxable. Actually, viatical settlements are taxable on both sides. The seller has been paying taxes on the basis of the difference between the amount which has already been paid into the policy in premiums and the amount which was received as payment for the policy. The purchaser pays taxes on the basis of the difference between the purchase price for the policy and the amount of the death benefit.

COMPARISON OF VIATICAL SETTLEMENTS AND ACCELERATED BENEFITS

Fundamentally, there is little or no difference between independent viatical settlements and accelerated benefits programs of insurance carriers... in both cases a terminally ill owner of a life insurance policy turns over the policy in return for a given sum of cash now. The specific amounts available and qualifications which must be met vary greatly, but the basic outcome is the same.

Practically speaking, however, there are many differences that are very meaningful to terminally ill policy holders.

1. Very few insurance companies offer any form of accelerated benefit program. According to an article in the May, 1994, issue of the Journal of the American Society of CLU & ChFC, (hereafter referred to as "May, 1994") only about 160 companies out of approximately 2000 companies in the United States offer any type of accelerated benefit. Further, most that do offer such programs do so primarily as an inducement in their marketing programs.

2. Viatical settlement companies purchase a much wider range of policies. Of the insurance carriers that offer accelerated benefits, most severely restrict the type of policies that qualify. For instance, 55% of the accelerated benefits programs listed in the Life Association News (February, 1993) survey applied **ONLY** to universal or Whole Life policies.

3. Insurance companies' accelerated benefits programs generally have very narrow life expectancy parameters. Most companies offer benefits only to policy holders with less than 12 months life expectancy (May, 1994), whereas viatical companies purchase policies from individuals with life expectancies of as much as four to five years.

4. Insurance companies' accelerated benefits programs also generally have additional restrictions which prevent the majority of policy holders from qualifying. Many cover only specified diseases. Curiously, none of those requiring the policy holder to suffer from one of a list of specified diseases include AIDS as a qualifying illness. Most also have a minimum size requirement for the base policy. Viatical settlement companies will purchase any size policy from any individual with any terminal illness.

5. Insurance companies generally offer less money to policy holders than viatical companies. The vast majority will not offer more than 75% of the face value of the policy. Additionally, most have maximum payout restrictions. Viatical companies do not limit payout.

Viatical companies generally bid for policies in a free market atmosphere, thereby assuring the policy holder of the highest possible payout. When the viatical industry was first getting started, no one knew what to expect when entering into a settlement and there were very few companies in operation. At that time offers tended to be rather low because there was so little competition and participants had so little experience in this market. As the industry has grown, the very nature of a competitive, free-market atmosphere has driven the offers up, resulting in viators receiving much more for their policies. It has also served to ensure that the companies in operation are continually refining their analyses of the market so that they can make offers that are as competitive as possible.

Insurance companies introduced accelerated benefits as a response to the appearance of viatical settlements on the scene. Payouts available under their programs have thus far consistently been lower and harder to get than payouts through viatical settlements.

I am not pointing out these differences to criticize the insurance industry. The NVA firmly believes the decision to viaticate a life insurance policy must be made on a prudent business basis. The insurance industry has taken steps to address the needs of policy holders in ways which they consider financially prudent.

On the other hand, the viatical industry is a competitive alternative to insurance companies' accelerated benefits programs. The winners in this competitive process are the policy holders, who are the citizens and taxpayers of America. Therefore, the NVA believes it is in the best interests of the public for this competitive stance to continue to exist in a **level playing field environment.**

IMPACT OF PAYOUTS ON HEALTH CARE COSTS

The payouts viators receive from viatical settlements and accelerated benefits provide them with the funds they need to finance their own living and medical expenses. According to the study conducted by the National Association of People with AIDS, *HIV in America: A Profile of the Challenges Facing Americans Living with HIV*, over half the respondents indicated

that their primary area of concern was their need for financial assistance. These settlements relieve them of much of the stress associated with living under such limited conditions.

That same study indicated that 62.3% of people with an AIDS diagnosis are covered by some form of public insurance, primarily Medicaid. The Journal of the American Medical Association estimates that the cost of caring for an individual from the point of AIDS diagnosis to death is $69,000. The latest CDC estimate of the number of people in America infected with HIV is 1 million. Over the course of the next five years, the cost to taxpayers for caring for individuals moving into the final stages of this disease alone will surpass twenty billion dollars.

The life insurance industry estimates that 40% of Americans own life insurance. If that estimate holds steady for this population, that would mean 40% of that cost could be lifted off the shoulders of taxpayers and met through viatical settlements. In this manner, viatical settlements provide a private sector solution to a public sector problem. In addition, viatical settlements also benefit the federal coffers because they are taxable to the purchaser. When the insurance company pays the death benefit to the purchaser, the difference between the price paid for the policy and the amount received from the insurance company is taxable.

Individuals who viaticate policies enable themselves to meet their own needs, medically and otherwise. They are empowered to control their own lives, exercise choice and live with dignity. Their lives are no longer dominated with concern over where they will get the money to pay for next month's medications. They are not forced to alter the manner of living to which they have become accustomed, accept public assistance, wait for hours to see a doctor who is not necessarily even familiar with their cases. These payouts allow them to continue **living now.**

DISCRIMINATORY TAX POLICY IS NOT IN THE PUBLIC INTEREST

While we realize neither the Internal Revenue Service nor the Committee members examining this issue have any intention of discriminating against a class of taxpayers, which would be the inadvertent result of approving any regulations which would establish unevenness in the treatment of one transaction relative to another.

The various tax exemption proposals I have seen previously have **only applied to benefits under insurance company programs** and have remained silent on other forms of viatical settlement options which policy holders may find more attractive.

Also, since accelerated benefit programs are being highly touted by the insurance industry as a **marketing tool,** providing a tax advantage solely to their programs would unwittingly aid the marketing programs of insurance carriers who offer such programs. The NVA does not feel that is the desire or intention of any member of this Committee.

The differences that do exist between viatical settlements and accelerated benefits are purely quantitative (how soon and how much), **not** qualitative. It would truly be tragic to establish a policy which would discriminate against terminally ill individuals who do not have an accelerated benefits rider available to them on their policies, those who do not qualify for the programs offered by their insurers, or those for whom a viatical settlement would offer a better purchase price.

As stated in this Committee's own advisory announcing this hearing, the purpose of this provision would be to make it possible for "terminally and chronically ill individuals... to use tax-free distributions from their life insurance policies to pay medical bills and living expenses." Considering that is exactly what viatical settlements do, it appears to be within the intentions of this Committee to include both types of payouts. I hope bringing the oversight of not specifically mentioning the inclusion of viaticals to the Committee's attention will be sufficient to get the situation corrected.

WHAT SHOULD BE DONE ?

The NVA believes there are two courses of action which would be fair and impartial to all concerned with the viatical process. Of those two options, one is much more adamantly endorsed than the other. I have conferred with Bill Freeman, Executive Director of the National Association of People with AIDS, and have been given the authority to include here that NAPWA, along with the NVA, highly recommends that this Committee choose option 1 to follow.

1. **APPROVE THE TAX EXEMPTION FOR ALL TYPES OF VIATICAL TRANSACTIONS.** Obviously, treating all viators equally is in the public interest. Should this Committee recommend adopting regulations making early payouts for terminally ill policy holders tax-exempt, the proposal should be broadened to include all people who viaticate a policy, whether it be through an accelerated benefits program or through the sale of the policy to a viatical company. The NVA and NAPWA would definitely support such a recommendation from this Committee.

In both cases the motivation to viaticate the policy and the end result are the same: the seller receives a current financial payout in exchange for the transfer of a future death benefit. By qualifying all such transactions, no single class of policy holders would be disadvantaged.

The classes of policy holders which would be disadvantaged if the current proposal were approved consist of all individuals who fall outside the parameters of insurance companies' accelerated benefits programs... and, I would represent to this Committee that that is the vast majority of those coping with terminal illness. **The NVA strongly urges the Committee to take this approach and make proceeds to all terminally ill sellers of policies tax exempt, whether they were acquired through a viatical settlement or an accelerated benefit.**

2. **IF OPTION 1 ABOVE IS UNACCEPTABLE, LEAVE THE CURRENT REGULATIONS INTACT.** The NVA understands that the *Contract with America* is designed to provide the majority of Americans some tax relief. While these transactions could easily become one point of relief (especially considering the fact that the purchasers of policies would still be paying taxes on their gains), the NVA does not consider current tax regulations to be unreasonably burdensome.

There is no question, a tax-exempt status would be preferable to viators. However, most viators are able to receive large, meaningful cash settlements as a result of the viatical process. These settlements are far in excess of premiums paid. Uninfluenced by any form of bias toward another segment of the market, I would expect the number of individual citizens benefiting from viatical settlements to continue to increase for many years to come.

Over the last six years the practice of selling policies for current value has grown from practically nothing to as much as $300 million per year today. Further, the growth rate of the process in general is staggering. Many industry participants feel the volume of viatical transactions could reach a billion dollars or more annually by the year 1998. This growth is occurring under current regulations and is unlikely to be impeded if a level playing field is maintained.

Therefore, the National Viatical Association strongly recommends **1) that the tax exemption be approved for all viatical transactions, regardless of type, thus treating all viators equally and fairly, or if that cannot be done, 2) leave the current regulations intact and refuse to create the imbalance which would result from bestowing preferential status for any one segment of the market.**

Thank you.

Mr. SHAW. Thank you.
Mr. Larson.

STATEMENT OF PER LARSON, HIGHLAND MILLS, N.Y.

Mr. LARSON. Mr. Chairman and members of the committee, since 1992 I have advised approximately 200 seriously ill people on how to use private benefits to help them fight their disease and maintain the quality of their remaining life. Rather than be forced onto public assistance, my clients want to be able to pay their bills and are more than happy to do so with the life insurance proceeds obtained through either accelerated or viatical settlement benefits. This is why I and Affording Care, a nonprofit I cofounded to provide financial education for the seriously ill, applaud this committee's efforts to exempt ADBs from taxation and urge the committee to consider tax-free status for viatical settlements.

My written testimony addresses many questions regarding viatical and accelerated benefits. Let my remarks today focus on the need for viatical settlements to be tax free. Because viaticals are available for all dread diseases, and because they will drastically decrease the incentive for terminally ill people to seek public assistance, I recommend them.

People seek financial advice from me as soon as they are aware that their lives are in danger. In my experience, this is usually when they have 2–4 years to live. This is a time when they are motivated to act, when their actions will have the most impact, and when the funds from viatication, for example, have the best chance of keeping them off public assistance, not later.

Why do the seriously ill have this need for increased financing? Well, it is because Social Security is low, it is because they were hit by illnesses too early or it is because their nonreimbursed expenses are too high. When the option of viaticating is discussed, inevitably my clients ask me bitterly why it is that proceeds from their life insurance are tax free the day they die, but taxable in the time they have left to live.

Perhaps I can give a poignant example supporting the necessity for tax-free treatment of viatical settlements. Imagine your parents sitting at their kitchen table. Your father has Alzheimer's or any other of the dreaded diseases. Because of current tax policy they are faced with a gruesome decision.

If they viaticate his $100,000 policy for, let's say, $80,000, to take care of him and the family, the government is due one-third of this. If they don't do that and choose to impoverish themselves to go on public assistance, the money passes tax free.

If the proceeds were tax free, as I recommend, there would be no such forced choice, and much less gaming the system. They could viaticate whatever they needed repeatedly when they needed it with no tax penalty. This is real, and this is a decision that could confront anyone who is seriously ill.

The current system encourages individuals to spend down and resort to public assistance rather than privately care for themselves. Doesn't it make sense to allow individuals tax-free access to this same money 36 months earlier so that they can avoid dependency, indignity, and a lower quality of care?

Viaticals extend the range and the number of individuals who can avoid public assistance because only a very small percentage of people with life insurance have ADB riders. Even though many individuals have group insurance through their employers, these funds are largely untapped due to the fact that many insurers and employers do not have accelerated benefit riders on their group policies, and they are very reluctant to adopt them.

Viatical settlements are available to all of these individuals and could help more of them avoid public assistance if they were tax free. The fact of the matter is that extending the limit for viatical settlements to 36 months and subjecting the process to State regulation will provide the individual with funds during the entire period of their illness when they can prevent problems better and not just have it at the end of their life.

Mr. Chairman, this is a win-win proposition for the government and a class of individuals in desperate need of consistent, fair tax treatment. In closing, I thank you for the opportunity to testify before this committee. I ask you to carefully consider the testimony provided to the committee today, and I welcome any questions that you or the committee members may have. Thank you.

[The prepared statement follows:]

Testimony
before
The House Ways and Means Committee
from
Per Larson
Financial Advisor and Advocate for the Seriously Ill

Mr. Chairman and Members of the Committee:

I help seriously ill people find and use the non-governmental resources available to them through accelerated and viatical benefits to help them fight their disease and maintain the quality of their remaining life. In so doing I help them stay off of government entitlement programs such as SSI and Medicaid. I have found that my clients are happy to be able to pay their bills with life insurance proceeds obtained through accelerated or viatical benefits instead of simply bequeathing their life insurance and being forced to have the government pick up their medical bills. This is why I urge the Committee to consider tax-free status for both accelerated and viatical benefits.

My testimony is going to focus on why viatical and accelerated benefits need to both be tax-free transactions; why it makes sense to apply this tax-free treatment to viatical settlements for terminally ill people with life expectancies of up to 36 months or for people with dread diseases; why any professionals dealing with people in this situation need to be made aware of these options; and why states should be regulating both of these tools as insurance products.

I help my clients prevent or solve financial problems that may be triggered by a disabling condition. This usually includes mobilizing private medical, disability and life insurance, employment benefits supplemented possibly by appropriate volunteer-run or state-run programs of assistance.

I do not help people get public entitlements. One of the reasons I began my practice is that I believe many middle-class Americans are often wrongly advised that their only option is to impoverish themselves in order to qualify for public entitlements.

My professional experiences have taught me that most people want to avoid public assistance programs if at all possible in order to have better quality of care; to give themselves and their families more independence; and to maintain their dignity.

In retrospect, it's hard to believe that until the end of the 1980s, financial professionals had not realized that many common practices and conventional wisdoms often don't apply when life is threatened. Many rules are reversed; the usual advice often no longer works. New techniques such as accelerated and viatical benefits needed to emerge in order to enable private citizens to obtain adequate resources to deal with the increasing cost of today's life-threatening illnesses.

I began my private practice in 1992. I have advised approximately 200 seriously ill people since that time. As far as I can determine, there are few people like me who regularly give this type of help as the mainstay of their work.

I co-founded an organization called Affording Care in that same year to offer financial education to those facing serious illness. We retrain professionals in the realities of how life-threatening illness, and its impact on personal finances.

I was one of the first who received training in this area from the people who went before me and pioneered this work. These pioneers are no longer able to do this work or training. Tney have themselves become disabled or have died. One of these pioneers includes a financial planner who advised the first policy holder to carry out a viatical settlement.

Early in my practice, I assisted in two-hour seminars for consumers on Personal Finance and Serious Illness for Body Positive, a not-for-profit organization, for two years. In September 1993, I spoke on estate planning during Affording Care's daylong workshop on Personal Finances & Serious Illness for the International Association of Financial Planning.

Because few financial professionals have chosen to practice in this area full time, I have chosen to train the non-financial professionals who serve those seriously ill, including social workers, psychotherapists and voluntary health organization staffs, in how to spot these problems before they occur or become severe. This includes people at the American Cancer Society, Memorial Sloan Kettering, New York Hospital, ARCS, Brooklyn AIDS Task Force, and Mothers with Children with AIDS.

I have written over 25 articles or columns in this area, including the guidelines for the hotline of the Gay Men's Health Crisis when they receive inquiries regarding viatical settlement. I've been quoted on these topics in financial journals such as Worth, National Underwriter & Financial Planning. In June of last year I was one of three panelists on "Premium Dollar Today", a half-hour television program, focused on "Accelerated Death Benefits."

My previous specialization was in health care benefits and particularly health care cost containment. I chaired several conferences for Business Week, including the first conference on corporate health cost management in 1980 and another on health data in 1985, both while I was Marketing & Planning Director of the Actuarial and Benefits Consulting Group of Coopers & Lybrand. In a joint venture backed by a major insurer between 1984-1986, I designed and created the Corporate Health Audit, an employee health planning system.

My MBA is supplemented by a postgraduate certification as an HMO director (sponsored by the Robert Wood Johnson Foundation), both of which I received from Wharton School.

Serious illness places special requirements on financial advice

People turn to a person like myself or to techniques such as these as soon as they are clear that their lives are in danger. In my experience, this can easily range up to a point where they have 2-4 years of life expectancy. Few are able to do much about their lives financially if life expectancy is below 12 months. Most of my clients would want to use viatication after they had reached a point of 36 months life expectancy. This is also the point where I believe the results of this are most effective. As a result, I believe this is a natural working limit for the tax-free status of such settlements.

I have found that much standard advice given healthy people, reinforced by messages of our popular culture, often turns out to be irrelevant or even damaging when applied to the situation of seriously ill people.

I have been forced to devise other ways to help people who inquire about financial strategies in the face of serious illness nationwide. I have determined that the entire process of offering financial advice in the financial planning profession needs to be altered to meet the needs of those facing life-threatening illness. For example: it is often inappropriate to produce multi-year plans; the seriously ill often are unable to endure traditional face-to-face meetings; there may be so many rapidly changing health factors in their situation that comprehensive planning becomes too costly and misleadingly out-of-date; they may benefit more from planning that is focused on specific concerns even though this is not recommended practice for healthy people.

Serious illness usually increases financial need dramatically

Many people whose lives are threatened with serious illness are in the prime of their lives. They often have incomplete or missing insurance coverage or employment benefits that could help them fight the disease and maintain the life they have struggled so hard to achieve.

Many of the dreaded diseases are new. Reimbursement for their treatment is frequently rejected on the grounds that they have not yet become standard practice. This is particularly true as cost-containment measures enter into force. Many people in this situation understandably turn to alternative forms of treatment such as acupuncture and chiropractic for which there is no reimbursement at all.

When we talk about costs and serious illness it is important to differentiate between reimbursed and extraordinary costs. We also need to include in the definition of extraordinary cost all types of costs triggered in some way by the illness. This can include many measures not normally considered to be medical yet which are undertaken in good faith by people who are seriously ill to literally fight for their lives.

Here are some examples: shift to a lower-stress job or a job with fewer hours, or to disability status; alterations to the home environment since people are home more; expenses to lift the spirit; expenses related to non-vocational interests that are now more important; improvements in diet; alternative treatments; support groups; attempts to realize long-postponed life dreams; actions to reconcile and interact more with family and friends; home services for impaired activities of daily living; medication setups and administration.

Major illness increasingly imposes extra financial burdens that are not reimbursed at all. It is not unusual for a seriously ill person to have several hundred medical visits in any one year; the travel costs for those visits is itself a significant budget item. Many people have to move because their disease requires ground floor access or because they are discriminated against. Even without moving, living facilities often need modification to help them with simple activities of daily living.

In many areas of the country it is difficult if not impossible to secure medical, disability or new life insurance coverage. In this case the major tool that can help them is viatical settlement of existing life coverage.

I find that in many cases it's necessary for people facing serious illness, particularly those with illnesses with a sporadic impact, to go out on disability earlier than usual with traditional chronic disease or accidents, in order not to worsen their health. With today's new diseases, expenses often mount to 40% more than income rather than the traditional 40% less that disability insurance usually pays.

In today's competitive job climate people must perform 100% of their job 100% of the time. While the Family Medical Leave Act and the Americans with Disabilities Act provide for leave from work, there are no provisions for increased employer financial contributions as part of these benefits. People need these funds and employers are not expected to provide them. The fact is that today's dreaded diseases force those in today's working environment people to go out on disability much earlier than was the case before. This means they have a much longer period of life that must be financed through means other than employment. By providing for tax free access to life insurance policies through viatical settlements and ADBs, individuals are able to privately supplement lost potential earnings.

Debt often accompanies disease, especially when past expenses were to be offset by future earnings. Without viatical settlement it is almost inevitable that individuals will default on their obligations since under most state laws disability income is exempt to some degree.

I have noticed that the sudden onset of life-threatening illness reminds people of life dreams unrealized, relationships untended and values unfulfilled. It is natural and proper, I believe, for them to need funds to provide meaning for their life in these ways.

Needs differ with different diseases

The needs of people who are seriously ill differ in several major aspects:

1. when extraordinary costs are incurred;
2. uncertainty about life expectancy;
3. degree of chronicity and manageability; and,
4. impact on competency.

When costs incurred and how much cost is incurred depends on the disease. Many people have no experience and training in these matters. Their need for information to help them make decisions about these costs is as important as the resulting need for resources. For example:

- People with Alzheimer disease tend to be hit with continuously increasing costs that can turn the end of life into a nightmare.
- People with cancer tend to be hit with major costs at the time of their diagnosis; treatment is often immediate. Then there is a lull after which it is concluded that the cancer is in remission or again needs treatment.
- People with AIDS, in contrast, have few costs up front upon diagnosis. Initially, they may need preventive measures. Then an infection may strike and they may need hospitalization. Then homecare needs become prominent. It is important to remember that reimbursed and extraordinary costs differ in major ways during this process.

No matter what the cost pattern, however, all of these situations would be markedly improved by both viatical and accelerated benefits.

The special needs of those faced with life-threatening illness

People with serious illness have diminished or unpredictable capacity.

People with illnesses considered terminal are overwhelmed.

People at risk of dying require clarity, consistency, predictability, and reliability as well as simplicity, normalcy and dignity.

Clients ask me bitterly why it is that proceeds from their life insurance are tax-free the day they die, yet taxable in the time they have left to live. Those who provided for the costs of disease and death through middle class benefits like life insurance or employment life insurance do not understand this incongruity.

As I said at the beginning, my clients come to me because they do not want to have to fall back onto SSI, Medicaid, welfare, food stamps and similar public programs. They want to remain self-sufficient as much as possible; they want to pay for the best care available; they want to provide for their families to the end.

Making viatical settlement and accelerated benefits tax-free would make it more likely for this to happen by making more funds available for these catastrophic expenses.

Instead of forcing people to rely on public programs and then pass on the full-value of their life insurance to their heirs tax free, viatical and accelerated benefits will permit the seriously ill to pay their bills while fighting their illness and maintaining their dignity and former way of living. This would make it less likely that government and hospital charity funds would need to pay for their care. The costs and profits of furnishing these funds constitutes a new industry that pays its taxes by meeting this need. I believe this is a net gain to society overall.

Most important, granting tax-free status to both viatical and accelerated benefits would be a clear signal to the American public that it is possible for them to prepare for and prevent the catastrophic costs that life-threatening disease now precipitates - and that they do not have to experience insult on top of their injury when they fall seriously ill.

Accelerated and viatical benefits should be treated equally

Tax-free treatment of viatical settlements will produce savings for the government by reducing government entitlements while at the same time maintaining the individual's quality of life or at least life-style.

Instead of forcing people to rely on public programs and then pass on the full-value of their life insurance to their heirs tax free, viatical and accelerated benefits will permit the seriously ill to pay their bills while fighting their illness and maintaining their dignity and former way of living. This would make it less likely that maintaining their dignity and former way of living. This would make it less likely that government and hospital charity funds would need to pay for their care. The costs and profits of furnishing these funds constitutes a new industry that pays its taxes by meeting this need. I believe this is a net gain to society overall.

Most important, granting tax-free status to both viatical and accelerated benefits would be a clear signal to the American public that it is possible for them to prepare for and prevent the catastrophic costs that life-threatening disease now precipitates - and that they do not have to experience insult on top of their injury when they fall seriously ill.

Accelerated and viatical benefits should be treated equally

Viatical settlements can establish life on a new financial footing for someone whose life is at risk. This can then prevent people from having to impoverish themselves in order to qualify for SSI, Medicaid, Food Stamps, etc. It is simply a matter of getting the financing to people who are seriously ill at the right time.

I believe some people with longer life expectancies are afraid to viaticate now because they will then be more likely to live with the tax consequences. Others, in fact, are tempted to impoverish themselves and then seek accelerated benefits when death is palpably near - a time when they may be more willing to ignore the tax consequences. This is bad for individuals and bad for society.

If tax treatment is unequal and viatical settlements are taxed, I believe there will be further misunderstanding. It is already difficult for people to comprehend all the ways serious illness changes their lives financially. It is very difficult for them to learn new ways of handling financial problems. I believe different tax treatment of viatical and accelerated benefits will generate further confusion.

I believe the societal benefit of viatical settlements is potentially greater because they can be effected with virtually any type of policy. As a result, many lower and middle class individuals that have group insurance through their employers could access funds currently unavailable to them. These funds are now unavailable due to the fact that many employers have not added accelerated benefit riders to group policies and are reluctant to do so. This is true even for disease support organizations staffed

largely by people who have that particular life-threatening illness. It takes a long time for benefit managers and union plans to adopt changes like this.

I also believe that one reason the life insurance industry, unions, and employers have not gone ahead with accelerated benefit actions and communications is largely because their tax status has remained in limbo.

Insurers have many different restrictions on acceleration. Some companies allow acceleration of 25, 50, 75, 100 or some other percent of the policy. Whatever the reason, the result is confusion. These are the craziest restrictions I have ever seen. Consumers do not understand why accelerated benefits exist on some policies but not on others - why they are offered after a certain date, above a certain amount, only on a certain type of policy, or on only part of a policy. One person I am currently helping has a $18,000 policy which falls short of the $25,000 threshold this policy requires to qualify for an accelerated benefit.

This may be one case where insurers should have been held to one single standard in exchange for their ability to unilaterally set limits on the amount granted and to determine whether any accelerated benefit is to be offered at all.

In my opinion, the bottom line is that accelerated benefits have very little impact on consumers. I have been able to successfully complete far fewer accelerations than viatical benefits.

The tax-exempt period for viatical settlements should be 36 months.

Viatical settlements should be tax-exempt for individuals who have a life expectancy of 36 months and/or who have a dreaded disease. The policy reasons for this exemption have been discussed throughout this testimony -- individuals who are dying have an immediate need for access to funds, funds that are unavailable to most of these individuals without draining their resources.

The impact of viatical settlements will be potentially greater than the impact of accelerated benefits. The reason is that viatical settlements can be obtained 2-4 years before death is expected (compared to 6-12 months for accelerated benefits.) Since accelerated benefits are possible only for people with less than 12 months of life expectancy, at that point they are much more likely to already be impoverished, on SSI, and on Medicaid.

It is important in this context to note the fundamental difference between viatical settlements and ADBs. An ADB is only available to an individual who has purchased such a feature from one insurer, almost universally long before that individual knows that he or she is dying. As I just stated, this feature is also only accessible to these individuals within 6-12 months of death. While as a consumer advocate, I would welcome the extension of this period to 36 months, I understand the pragmatic business concerns behind the 6-12 month limit. I do not actively seek such relief.

In contrast, viatical settlements are conducted by third party entities that purchase these policies and do not force any payment from an insurer other than the proceeds on the same timetable already contracted for between the insurer and the insured. This process does not involve any increase in actuarial risk assessment or capital requirements by the insurer.

The fact of the matter is that extending the limit for viatical settlements to 36 months and subjecting the process to state regulation will provide the individual with funds during the entire period of his or her illness, not just at the end of it. At the same time, this is accomplished without forcing any increased obligations on the insurer.

Furthermore, by increasing the time accessible window and delineating dreaded diseases, market access to these policies increases for buyers and sellers. An incentive system is created that increases the bids for these policies. At the same time, this system prevents those without legitimate illnesses from taking advantage of this new system. Viatical settlement companies will not profit by purchasing policies from individuals who in all likelihood would not meet the 36 month threshold or have not been certified to have a dreaded disease.

Accelerated Benefits are Administratively Complicated.

While I always seek to learn whether accelerated benefits are an option, this is often difficult to find out. Because these benefits are frequently an addition to policies already in force, the agent often doesn't know about them. Because they're new, customer service clerks sometimes say they don't exist. Because they're rarely requested, inquiries to claims should go to a supervisor. Because they're introduced slowly, it may be worthwhile checking with public relations or the President's office to see if they're about to be approved. (State approval can itself take 6-12 months.)

People with group coverage - which is to say many working people - are not informed or ill-informed about this additional benefit. If they are well-informed it is usually at a time when they are healthy - and there is a tendency for most people in good health to avoid thinking about disease and death.

Many people I see have thrown away the notifications they received about accelerated benefits because they looked like product solicitations, often coming as a flyer with a bill. Some people with serious illness simply do not even have the time, patience, attention, interest or ability at various times to thoroughly process their mail. Insurers and benefits managers need to be aware that these important notices are not being effectively communicated. Response measures should be simplified. People should be able to respond to an "800" telephone number that is promptly answered by someone patient and knowledgeable. Mail response is sometimes simply not possible.

It might be pointed out that such inconsistencies and complications are often encountered in administrative dealings. The point to remember however is that these seemingly small problems become insurmountable barriers to obtaining funds to those who are hampered by life-threatening illness.

Many of the same procedural problems exist in completing a viatical settlement. However, market mechanisms are in place in this industry that should correct them over time. In the case of accelerated benefits these matters are decided between regulators and insurers with no input from the market or consumers.

I have written elsewhere on the need for state regulation of the viatical industry along the lines of what has been enacted in California and New York. I shall include in my recommendations broad outlines of what the Committee should expect to develop in the industry over the next 1-2 years. I believe that providing a tax-exemption for viatical settlements will serve to bring in new sources of funding which will in turn promote the increasing regulation and professionalization of this industry.

The tax status of accelerated and living benefits is confusing

The tax situation is complicated. Because of the lack of IRS regulations and because accelerated benefits are structured in these two very different ways, insurers can give little tax guidance - only vague recommendations that consumers seek tax counsel.

Yet there are no training courses for tax counsel. No pamphlets or procedures are furnished by any agency or insurance company for tax advisors. Furthermore, many tax advisors are trained primarily for simplified cases. Major articles have been

published stating that the revenues received are taxable as capital gains; others have stated revenues are taxable as income.

Virtually no information exists for consumers as to what principles and practice govern the tax liabilities for those at risk for their lives.

- The IRS originally proposed regulations making accelerated benefits tax free. The IRS then appears to have suspended its efforts when many bills were introduced in Congress in early 1994.

- While it is true that the IRS can pursue heirs for taxes past due, there is little case experience and only one private letter ruling. This lack is remarkable because many viatical settlements have occurred during this same period.

In the meantime, both California and New York have made accelerated benefits and viatical settlements free of state and local tax. Trained professionals are making arguments in widely different directions. Faced with these differing interpretations and differing state regulations, many consumers ignore the tax and by so doing become tax scofflaws. We need definitive guidance from the government.

For many people a living benefit is the largest one-time sum they have ever handled. Most consumers have been used to passive measures such as withholding on W-2s to ensure they have met their tax obligations. Few of these consumers are used to hiring the professional and expensive tax advice they probably need in this situation. In all likelihood, most tax advisors will tell them that tax-treatment is clearcut in principle but complicated in practice. In many cases, estimated taxes are required. In special cases involving large sums, a situation most consumers are not used to dealing with, the deadline dates for having to pay such estimated taxes are extended. In many cases while estimated taxes are based on last year's taxes, if the estimated tax is much greater than the previous year, a further estimated tax is required. We are hitting terminally-ill consumers with some of the most complicated, little-used sections of the tax code at a time when they have difficulty opening and replying to their mail.

I go into this detail here because I have learned how important it is when serious illness strikes to have clarity and consistency. And I have learned that the lack of clarity and consistency in tax policy on accelerated benefits and viatical settlements is very unsettling indeed to those with life-threatening disease.

Recommendations

Viatical and accelerated benefits should be tax-free

These benefits should be made tax-free for those who have either a diagnosis of a "dreaded disease" that is generally considered to be terminal, an estimated life expectancy of less than three years, or who are confined permanently to a long-term care facility.

If not, then regulations should be issued by the IRS on both accelerated and viatical benefits. We need a revenue ruling.

The tax-exempt period for viatical settlements should be 36 months.

Viatical settlements should be tax-exempt for individuals who have a life expectancy of 36 months and/or who have a dreaded disease. The policy reasons for this exemption have been discussed throughout this testimony -- individuals who are dying have an immediate need for access to funds, funds that are unavailable to most of these individuals without draining their resources.

Regulation should be encouraged at the state level

While the following recommendations are not within the scope of the Committee's focus on taxes, as an advisor and advocate for the seriously ill, I wish to enter into the record recommendations which I feel are needed at the state level for the protection of consumers.

Within the context of state regulations:

- **Viatical and accelerated benefits should be strictly regulated.**
- **Protections similar to those enacted in New York (under Article 78) should be encouraged.**
- **All viatical settlement firms and sales brokers should be licensed and regulated.**
- **Advertising and written communications should be factual and educational.**
- **Sellers should receive uniform, complete financial information.**
- **Sellers should be encouraged to examine their overall financial options.**
- **Brokers should fully disclose their role and compensation as commissioned sales agents.**
- **Brokers should be strictly regulated as sales agents of the viatical settlement firms.**
- **Insurers should respond within reasonable time to authorized requests for policy information.**
- **Assignment restrictions should be eliminated to the extent permissible by law.**
- **Sellers with government entitlements should receive specialized counseling by their advisors, brokers or the funding source.**
- **Sellers should not be coerced into selling to satisfy debts or as a requirement for government entitlements.**

Mr. SHAW. Thank you, Mr. Larson.
Mr. Perper.

STATEMENT OF ALAN B. PERPER, PRESIDENT, DIGNITY PARTNERS, SAN FRANCISCO, CALIF., ON BEHALF OF THE VIATICAL ASSOCIATION OF AMERICA

Mr. PERPER. Mr. Chairman, members of the committee, my name is Alan Perper, and I am the president of Dignity Partners. Our company has been involved in the viatical settlement industry for more than 3 years and is one of the largest and oldest companies in the industry.

Our company cofounded the Viatical Association of America, which is an industry trade association representing 60 proregulatory companies. The association is comprised of a group of high quality companies and individuals.

Mr. Banks' company, for example, is owned by CNA Insurance Co., one of the largest insurance companies in the United States. My two partners went to West Point and have been involved in the financial services business since the mid-1980s. I have graduate degrees from Chicago and Duke and practiced corporate law with Jones Day for a number of years.

Further, our industry is an evolving regulated industry. It is not today the same industry it was even 2 years ago. Fourteen states have adopted or are considering the adoption of viatical licensing legislation. Dignity Partners is currently licensed by the departments of insurance in California and Kansas and has applied for a license in New York.

My point is that despite what you may have read in the newspapers and seen on television, for the most part, the participants in this industry are responsible businesspeople. I know I speak on behalf of all the high quality companies that comprise our association in saying that we are proud of the way in which we are bringing a needed service to our clients in a professional and responsible manner.

Today, we have heard testimony from Teresa and others about desiring to live their remaining lives with dignity, not desiring to turn to the welfare programs. Welfare programs are under a tremendous amount of stress today, and the terminally ill add to this stress.

A terminal illness plays a devastating role on one's financial resources. Often people are unable to work, some lose their health coverage or must supplement payments for costly medications and the care of their disease. A report prepared in 1992 by the National Association of People With AIDS showed that approximately 60 percent of the people survive on monthly incomes of less than $1,000.

In addition, many of our clients have been shunned from their families. They have nowhere else to turn, but to the welfare program. A few weeks ago we received a thank you note from a client saying thank you for the bottle of wine and Christmas card. They were the only gifts I received this Christmas.

In short, we believe that the addition of viatical settlements to H.R. 8 and its passage will greatly reduce the need for our clients to resort to entitlement programs.

Finally, I would like to close by stating that such legislation would not be without precedent. In 1990 California adopted legislation making viatical settlements tax free. Similarly, the State of New York followed suit, and I suspect that as more States consider viatical legislation and the model NAIC Act recently adopted, they will amend their tax provisions as well. Thus, the passage of Federal legislation addressing this issue will enhance the efforts now under way among the States. Thank you.

Mr. SHAW. Thank you, Mr. Perper.

Mr. Banks.

STATEMENT OF JOHN BANKS, CHIEF EXECUTIVE OFFICER, VIATICUS, INC., CHICAGO, ILL.

Mr. BANKS. Good morning, Mr. Chairman and members of this committee. My name is John Banks, and I genuinely appreciate the opportunity to talk with you today about the tax-free treatment of certain insurance benefits to terminally ill individuals.

I am chief executive officer of Viaticus, which is a wholly owned subsidiary of CNA Financial Corp., which is the parent of the CNA Insurance Companies. By virtue of my role with the company, I believe I am well positioned to bring a broad perspective to today's issue. I think perhaps a more important qualification is that my wife of 21 years died 4 years ago after fighting breast cancer for many, many years.

It was exhausting, and I can tell you that the challenges of dealing with terminal illness are many and severe. I can also tell you that if people must face these challenges in the midst of extreme financial crisis that problems can become impossible to bear.

I think you have heard that today from the earlier panelists. I am here today for one fundamental reason, and that is to encourage legislation that creates an effective system to put the most resources possible in the hands of terminally ill people, each of whom desperately need our assistance.

Specifically, I want to strongly support the enactment of the accelerated death benefit provisions of H.R. 8, the Senior Citizens' Equity Act, but to suggest that it be modified also to include the tax-free treatment of proceeds from viatical settlements, which are another primary means that many terminal ill individuals are currently using to access critical financial resources.

I should note that three of the four brave panelists from whom you heard earlier received their financial assistance through a viatical settlement. The viatical settlement is already a State-regulated insurance activity which involves the sale of a life insurance policy from a person with a life threatening illness to a third party, a viatical settlement company.

As you have already heard, New York and California already treat viatical settlements as tax-free transactions under their State income tax laws. As you know by now, a viatical settlement can be undertaken by anyone who has been diagnosed as having a life threatening illness such as cancer, heart disease, AIDS, amyotrophic lateral sclerosis, commonly known as Lou Gehrig's disease like Rosemary Paul or of particular relevance to senior citizens, Alzheimer's disease.

A viatical settlement can involve almost any type of insurance policy, including term, whole, universal and group life. From our experience with people facing a wide array of terminal conditions, what they want more than anything, and I know my wife felt this way, is to bring a sense of normalcy and control back into their lives.

Our clients have told us on a number of occasions that finding new financial resources which allows this to happen is a God send. Having listened to the others on today's panel ranging from people themselves suffering from terminal illnesses to other industry representatives, financial planners, I am sure it is clear to you that there are several technical means through which financial resources can be delivered to the terminally ill, based on some translation of their life insurance policy.

Regardless of any differences that exist within this group as to the technical issues surrounding this point, what I hope will emerge as paramount is that, No. 1, the viatical settlement, as another specific vehicle through which terminally ill individuals have the option to access the financial value of their life insurance policy, should be mentioned specifically along with the accelerated death benefit as an element of the Senior Citizens' Equity Act; and, No. 2, from a larger perspective, that all reasonable means through which terminally ill individuals can now access the value of their policies, whether it be through an accelerated death benefit or a viatical settlement, should be formally made a tax-free benefit through the enactment of the same act.

It is estimated that approximately two-thirds of the Nation's families would quickly face financial distress if one of the primary wage earners in the family was unable to work because of serious illness. In addition to causing the many hardships outlined by our earlier panelists, this lack of income also very often results in the lapse of a life insurance policy due to the lack of funds for premium payments. Such outcomes are neither good for individuals nor for our society, which must ultimately bear the financial and collective spiritual costs of such human tragedies.

By making the changes all of us here today are suggesting, the act would ensure fair and equitable treatment of all individuals and their families unfortunate enough to have to endure terminal illness. More importantly, it would expand the number of individuals who could access the single remaining financial resource they may have to bring dignity and hope to their final days.

In summary, as you already heard here today, ADBs and viatical settlements are tax free in New York and California. You also heard that we feel that therefore there is a precedent for making these benefits Federal tax free. Due to the fact that a very broad spectrum of the U.S. population may at one point benefit from such a tax status, we feel the Federal tax laws should also be changed to provide Federal tax relief of viatical settlements. It truly has been an honor and a privilege to be here this morning. Thank you.

[The joint statement of Mr. Perper and Mr. Banks follows:]

JOINT STATEMENT OF
JOHN BANKS
CHIEF EXECUTIVE OFFICER
VIATICUS, INC
(Unit of CNA Financial Corp.)
and
ALAN PERPER
PRESIDENT
DIGNITY PARTNERS

BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

This is a joint statement by Mr. John Banks and Mr. Alan Perper. Mr. Banks is the Chief Executive Officer of Viaticus, Inc., a wholly owned subsidiary of CNA Financial Corp. ("CNA"). CNA is the parent company of CNA Insurance Companies, a multi-line insurer, who pioneered nearly 30 years ago the long-term care policy for the elderly which is still considered to be the industry standard.

Mr. Perper is President of Dignity Partners, one of the oldest and largest viatical companies. The views expressed herein also represent the views of the Viatical Association of America ("VAA"). VAA represents over 60 industry participants.

We very much appreciate the opportunity to appear before you today to discuss the tax-free treatment of certain accelerated death benefits ("ADBs"). In the insurance industry, ADBs include third-party viatical settlements and certain accelerated insurance payments made directly by insurers to their policyholders under a life insurance policy.

We are here today to strongly support the enactment of the accelerated death benefit provisions of H.R. 8, the "Senior Citizens Equity Act" ("the Act"), with necessary modifications to allow for the tax-free treatment of viatical settlements, the primary form of accelerated death benefits.

We believe we speak on behalf of the entire group of individuals who make up this emerging sector of the insurance industry in saying that what we most want is the creation of an effective system to put the most resources possible in the hands of terminally and chronically ill people who desperately need assistance.

I. Viatical Settlements

A viatical settlement is a state regulated insurance activity which involves the bona fide contractual sale, exchange or assignment of a life insurance policy covering a person with a life-threatening illness, to a third party. The third party is typically known as a viatical settlement company. New York and California already treat viatical settlements as tax-free transactions under their state income tax laws.

Although viatical settlements are considered by many as the primary form of accelerated death benefits and are tax-free in certain states, they are currently not covered under the ADB provisions of H.R. 8. Unlike the ADB provisions in H.R. 8 (which only apply to select policies

with an ADB feature), viatical settlements are available for virtually all insurance policies of virtually any size, from almost any carrier, and on both individual and group policies.

A viatical settlement can involve a senior citizen who has been diagnosed as having a life-threatening illness, such as cancer, heart disease, Alzheimer's Disease, or ALS ("Lou Gehrig's Disease"). Viatical settlements can also apply to persons with leukemia, AIDS and other dread diseases. Most of these individuals are chronically or terminally ill. Many of these individuals and their families are in great financial need at the most critical time of their life, due to their illness.

From our experience, people in this condition want more than anything to bring a sense of normalcy and control back into their lives. Our clients have told us on a number of occasions that finding new financial resources which allows this to happen is a Godsend.

A viatical settlement is generally available as long as ownership in the policy can be transferred. In a viatical settlement, an individual sells, exchanges or assigns a portion or all of the face amount of a transferrable insurance policy to a viatical settlement company for a cash payment. The cash payment is an amount derived from the face value of the policy and is regulated in many states by state insurance law which mandates a fair and reasonable payment.

A viatical settlement can involve almost any type of life insurance policy, including term, whole, universal and group life. Moreover, a person in need can access a viatical settlement with a number of viatical settlement companies, creating a free market approach to achieve an extremely humanitarian goal. Unlike the ADB provision currently in H.R. 8, an individual using a viatical settlement is not restricted to dealing only with his or her own insurance company.

Also, unlike a policy with a strict ADB feature which can include caps and limitations, a viatical settlement can be extremely flexible in its timing and terms. Individuals using viatical settlements are often able to immediately access a much greater sum of money than that which would be available under typical ADB provisions.

Viatical settlements are subject to regulation in many states throughout the country. A Model statute and Model regulations were adopted by the National Association of Insurance Commissioners ("NAIC") in 1993 and 1994. Many states are already adopting regulations based on these NAIC Models.

We have worked and will continue to work with the NAIC Commissioners and various state regulators to help craft regulations that will bring this entire industry into the mainstream of American insurance products. The industry is being regulated and we welcome the security and consumer confidence such regulation brings.

Viatical settlements were virtually non-existent five years ago. However, the industry has grown recently in response to a proven and existing market demand for additional financial options which may be available at times of need. It is expected that in 1995, policies with a face value of $300 million will be viaticated, providing invaluable financial resources to persons at the most critical time of their life.

II. Modification Consistent with Principles of "Contract with America"

Modification of the ADB provisions of H.R. 8 to include viatical settlements is consistent with the underlying principles of the "Contract with America."

In essence, we are proposing that a terminally ill or chronically ill person, who otherwise meets the requirements of the Act, should be permitted to obtain the same tax benefits from his or her life insurance policy that would otherwise pass to his beneficiaries -- tax-free access to their life insurance policies.

Our proposal is timely and consistent with the five basic principles underlying the "Contract With America:" (1) individual liberty, (2) economic opportunity, (3) limited government, (4) personal responsibility and (5) security at home and abroad. Our proposal

embodies the first four of these principles and is not in any way inconsistent with the fifth. It is also consistent with the rationale of the Senior Citizens Equity Act, which we believe was formulated because of the well founded belief that our tax laws impose harsh penalties on our senior citizens.

INDIVIDUAL LIBERTY -- Our proposal would embrace individual liberty by allowing one to obtain something which is rightfully theirs without having to worry about the Federal government taking a share just because the individual chose to access these funds when they need them during their lifetime instead of passing them on to their beneficiaries after their death.

ECONOMIC OPPORTUNITY -- Our proposal would provide economic opportunity to those individuals who desire to provide themselves with a guaranteed and predictable source of funds if they find themselves in financial need due to a terminal illness. Rather than being forced to deal with only one entity -- an insurer offering and providing an ADB rider -- an individual could work with a variety of potential viatical companies and thus obtain the true market price. This modification would increase competition in the industry and thus maximize each individual's return.

LIMITED GOVERNMENT -- Our proposal is consistent with the principle of limited government because it would essentially get the government out of the way of the individual if and when the individual finds it necessary or desirable to utilize something for which he or she has paid. Since the government has already agreed that it is not entitled to these funds when they are passed through to the beneficiary, why should the government interfere with an individual's right to obtain these same funds when they are needed most -- when he or she is still alive with a terminal illness?

PERSONAL RESPONSIBILITY -- Our proposal is consistent with the principle of personal responsibility. Our proposal would enable a person to invest in a policy that would not only provide for their loved ones after their death, but could also be utilized as a resource to provide funds to pay for his or her medical expenses during a period in which they are suffering from a terminal illness. Our proposal would make it possible for individuals stricken with dread diseases to pay for their own medical and living expenses and to avoid becoming destitute and relying on government welfare programs and Medicaid during the last months of their lives.

III. Senior Citizens Equity Act, H.R. 8

H.R. 8 as currently drafted provides a benefit for only a small, select number of taxpayers who need financial resources available through accelerated death benefits paid by insurers to their own policyholders. The bill would allow an exclusion from gross income for amounts paid or advanced to an individual under a life insurance contract only if the insured under the contract is either: (1) terminally ill (the individual must be certified to have an illness or condition expected to result in death within 12 months) or (2) chronically ill and confined to a "qualified facility." Inherent in the provision is the requirement that the insured must have an insurance policy which contains this form of ADB feature.

The presently drafted statute is very narrow and restrictive, and does not cover: (1) individuals who do not have an ADB provision in their policy; (2) individuals who are diagnosed as terminally ill but are expected to live longer than 12 months; (3) individuals who are chronically ill but are confined to something other than a "qualified facility" (or are living at home and not now confined); and (4) individuals with "dread diseases."

Moreover, the current language of the proposed statute does not allow individuals to take advantage of market competition and free enterprise. It only applies to individuals who are fortunate enough to have an ADB provision in their policy, and further confines the individual to deal only with the insurance company with which they have the requisite policy.

The vast majority of life insurance policies do not have an ADB feature. A recent research paper by the Life Office Management Association ("LOMA") states that "[t]here is an enormous gap between the number of people who are covered by living benefits under a life insurance policy [e.g., a typical ADB feature] and those covered by all sorts of life insurance".

It has been estimated that approximately 3 million of the 366 million life insurance policies in force (or only about 1%) have ADB features.

The narrowness of the presently drafted statute is inconsistent with "model" state rules and discriminates against terminally, chronically and seriously ill individuals at the most critical time of their life.

Moreover, it creates an artificial tax preference for insurance policies with a strict ADB feature. Without a level playing field, an individual may be forced to choose a less favorable ADB feature because of the tax preference, when a more favorable viatical settlement is available. Depending on the terms of an ADB feature, an individual may also be in the unfortunate position of dying while waiting for the maturation of an ADB feature that never occurs. Such an individual may have instead taken advantage of a viatical settlement but for the adverse tax consequences.

To underscore the inequity by example, if a company has a six month ADB rider and a policyholder is expected to have a life expectancy of twelve months, the policyholder will fall outside the policy's ADB eligibility requirements. Such an individual cannot under the terms of the policy apply to the company for early benefits, eventhough under the current version of H.R. 8, the payments, if available, would be tax-free. Although a wide variety of viatical settlement companies would be willing to purchase the company's policy, the policyholder's receipt of the sales proceeds would be taxable under the current version of H.R. 8.

In contrast, other competing companies may provide a similar policyholder with a twelve month ADB rider. In these cases, the policyholder not only can take advantage of an available ADB feature, but does so tax-free. We see no discernable reason for this inconsistent tax treatment. This inequitable result should not be allowed under the tax code.

IV. Discussion

We believe it is essential to expand the tax-free coverage of ADBs to cover all ADBs including viatical settlements for a number of very important reasons which are summarized below.

Financial Resources at a Time of Greatest Need

It is estimated that approximately two-thirds of working Americans would quickly face financial distress if one of the primary wage earners in the family was unable to work because of serious illness. This lack of income often results in the lapse of a life insurance policy due to the lack of funds for premium payments.

This notion has been confirmed both by market research and by the anecdotal comments we have repeatedly heard from viators, case managers, insurance professionals and a wide range of other individuals familiar with the situations faced by the terminally ill.

Life threatening illnesses are particularly financially devastating for the elderly, many of whom live on a fixed income. A recent survey published in the December 21, 1994, edition of the AMA Journal ("JAMA"), showed that fully 25% of patients aged 65 and older with terminal illness lose all of their savings and income.

In many cases, the ill individual and his or her family are forced to rely on Medicaid, food stamps, welfare or dwindling hospital charitable funds. Many times this results in greatly limiting their choices of medical care and treatment.

The viatical settlement option allows these distressed individuals to maximize the use of existing personal financial assets and private insurance to cover critical costs, rather than turning to government services and programs. In many cases, individuals can allocate the viatical settlement proceeds to maintain the premiums for private health insurance, Medi-Gap insurance and nursing home insurance which they already have purchased, as well as to assist with burdensome co-payments.

Individuals can use the proceeds from a viatical settlement: (1) to pay for much needed medical expenses; (2) to pay for care givers, nursing home care and home nurses; (3) to pay off mounting debt incurred during the illness; and (4) to pay for food and nutritional supplements. This humanitarian service also allows individuals to continue to pay rent and mortgage payments, thus giving the individuals the freedom and dignity to remain in their own home rather than a government run institution.

Broad Spectrum of the Elderly and Terminally Ill Can be Helped

The benefits of the viatical settlement option accrue to a wide spectrum of American people, including the poor, middle class, dual income married families, and senior citizens. Many of these individuals have little or no income earning potential at this critical time of need.

Under a viatical settlement, speedy access to unrestricted private funds is provided to those with cancer, heart disease, Alzheimer's Disease, stroke, pulmonary conditions, AIDS, chronic kidney disease, chronic liver failure, ALS ("Lou Gehrig's Disease"), leukemia, those in need of costly organ transplants, and many other life threatening conditions.

Already Tax-Free in Certain States and Cities

New York and California have already taken the initiative to exempt viatical settlement payments from income tax. New York City has also excluded viatical settlement payments from the city income tax.

New York and California are also the states with the largest viatical settlement activity. These states have taken a pro-active role in promoting the viatical settlement concept in a responsible and reasonable manner. Despite their relatively high state income tax rates, budget constraints and financing needs, these states have decided to forego a tax on viatical settlements for the benefit of their residents. We expect many other states and cities to follow suit in the months to come. Clearly there is precedent for including viatical settlements under the rubric of all living benefits, and ensuring that it receives tax-free status at the Federal level.

Regulated by the States

Leaders of the viatical settlement industry have worked with the NAIC and with numerous State insurance legislators and regulators to develop a reasonable and fair regulatory framework for this new industry. This effort culminated last year in the successful adoption of the NAIC Model Act and Model Regulations for viatical settlements. The primary purpose of these Model rules is to provide fair treatment for viators (e.g., the seller of an insurance policy to a viatical settlement company) and adequate industry oversight by State insurance departments.

State regulation addresses major issues such as adequate disclosure to viators, reasonableness of payments, confidentiality, minimum capital requirements, sanctions against companies engaging in deceptive practices or advertising, applicability of Unfair Trade Practices Acts, rights of rescission by the consumer, broker oversight, and viatical settlement company/broker licensing and examination.

Along with the Viatical Association of America and others involved in viatical settlements, we welcome state regulation of this emerging industry. Constructive work continues to take place on a daily basis between the industry and the NAIC.

Reduced Use of Medicaid

Many distressed families turn to Medicaid to pay for the enormous burden of medical care associated with a chronic or terminal illness. Even worse, because Medicaid is a means-based entitlement, it requires individuals to spend down and make worthless almost all assets before becoming eligible for Medicaid payments.

An individual so situated would almost always be forced by economic necessity to surrender or lapse his/her life insurance policy for little or no value in order to receive benefits

under Medicaid; thus, rendering a lifetime of prior premium payments immediately worthless. The emotional trauma is great as lifelong plans are destroyed.

With a viatical settlement, the distressed individual would be much less likely to rely on Medicaid or any other government service or program.

Strong Public Policy Justification

Viatical settlements offer a beneficial private sector alternative for distressed individuals at the most critical time of need. If a financially encumbered individual facing a life-threatening illness were aware of the viatical settlement option, he or she might choose to transfer his/her policy to a viatical settlement company for a significant immediate payment of money. This option would preserve the insurance asset, allow for the immediate transfer of funds, and allow U.S. taxpayers a constructive alternative to access their own assets to meet medical and other necessary living needs.

Under existing law, the pre-death benefits received under a viatical settlement are generally fully taxable. This is particularly ironic in light of the fact that if the insurance proceeds are paid to designated beneficiaries on the death of the insured they would be tax-free under the current Federal income tax laws.

Stated otherwise, current Federal tax law encourages ill individuals to look to government programs as their primary source of funding for medical care. Tax-free viatical settlements offer a dignified, private sector solution.

Fairness, equity, and reasonableness demand that this form of free market alternative to government programs and intervention be given tax-free treatment similar to that provided for other more limited forms of ADBs under the current draft of H.R. 8.

V. Overview of Necessary Modifications

In order to achieve fairness and equity for all intended beneficiaries of the ADB proposal currently contained in H.R. 8, the following modifications to the proposed statute need to be made by the Committee.

Section 306 of the current draft of H.R. 8 needs to allow for the tax-free treatment of all accelerated death benefit payments, specifically including "viatical settlement payments." This change would allow for fair and equal tax treatment of pre-death benefit payments as between payments made directly by insurance companies and those made by third parties (e.g., viatical settlement companies.)

Section 306 should be modified to add the term "viatical settlement payment" to the type of accelerated death benefit payments which are given tax-free treatment. To accomplish this, the implementing language should be changed to state that "any amounts paid or advanced to an individual (from an insurance company, viatical settlement company, other third party or otherwise) as a result of a sale, exchange, assignment or other transfer of a life insurance contract on the life of an insured -- (A) who is a terminally ill individual, (B) who is a chronically ill individual, or (C) who is an individual who has a dread disease, shall be treated as an amount paid by reason of the death of the insured."

The current definition of "terminally ill individual" should be modified to mean "an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 36 months or less, or in a drastically limited life span." This language is generally consistent with the language currently contained in the NAIC "Viatical Settlement Model Act" and the NAIC "Accelerated Benefits Model Regulations."

The current language describing a "qualified facility," which is part of the "chronically ill individual" definition, should be slightly modified to allow more flexibility for ill individuals living at home during their illness.

The individuals qualifying for tax-free treatment should include individuals with a "dread disease." The definition of "dread disease" means "a medical condition which has required or requires extraordinary medical intervention without which the insured would die, or a medical condition which would, in the absence of extensive or extraordinary medical treatment, result in a drastically limited life span."

Section 306 should also clarify that tax-free treatment is also available to owners of insurance policies who are not "the insured." Also, regulation of the viatical settlement industry, like that of other insurance products, should be specifically left to the States, which is generally consistent with current Federal law.

VI. Positive Revenue Estimate

Consistent with the desire of this Committee for deficit reduction and the need to strictly scrutinize the revenue impact of all tax proposals, Viaticus, Inc. has commissioned a revenue estimate of our proposal for tax-free treatment of viatical settlements from Milliman & Robertson, Inc. ("M&R"), a leading health and tax insurance actuarial firm.

In a static model, this expert report shows that "if the tax status were changed and there was no resulting growth in viatical settlements [a highly unlikely event]," Federal revenues from viatical settlements would increase by over $390 million between 1995 and 1999.[1] The M&R report also shows that in a dynamic growth scenario, the revenue increase would be substantially more.

Much of the revenue comes from savings in Medicaid and SSI which is also under the jurisdiction of this Committee. To the extent an individual can use private money from a life insurance policy which he or she may own, it is less likely that the ill individual will rely on Medicaid or other government spending programs and services.

The M&R report demonstrates that Federal spending would be reduced and Federal revenues would increase from the following sources:

(1) Savings from Medicaid -- with funds available from private viatical settlements, afflicted individuals will either delay or not use Medicaid, thereby reducing Medicaid spending;

(2) Revenues from Medical providers -- the use of viatical settlements would increase the taxable profits of medical providers that receive full payment for services that would otherwise be paid by Medicaid at a discounted rate.

(3) Revenues from Wages -- if funds were available from viatical settlements to hire a caregiver, taxable wages of working relatives of the viators would not be reduced in cases where such relatives cease employment to act as a non-paid caregiver; additional revenue would come from the increased taxable revenue of paid caregivers; and

(4) Revenues from Viatical Companies -- the use of viatical settlements will increase the amount of tax revenue generated by viatical settlement companies.

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[1] Under a static scenario, Federal revenues would increase from a change to tax-free treatment of viatical settlements by the following amounts:

	(In Millions)				
	1995	1996	1997	1998	1999
Revenue Change	+65.9	+71.5	+77.7	+84.2	+91.3

Five-year total (1995 to 1999) equals $390.6 million.

VII. Conclusion

The accelerated death benefit provisions of the current version of H.R. 8, the Senior Citizen's Equity Act, should be modified to allow for the tax-free treatment of viatical settlements, a primary form of accelerated death benefits. By taking this step, the Act would ensure fair and equitable treatment of all individuals unfortunate enough to have to endure a terminal illness. More importantly, it would expand the number of individuals who could tap the single remaining financial resource they may have to bring dignity and hope to their final days.

It has been an honor and privilege to be here this morning. We stand ready to work with you, Mr. Gibbons, the members of this Committee, and your staffs to ensure fair and equitable use of these pre-death benefits for individuals in great financial need at the most critical time of their life. We will be pleased to answer any questions you may wish to ask.

Mr. SHAW. Thank you, Mr. Banks.

I would like to thank each of our panelists. We have a vote on the floor. I hope the panelists can remain with us for a few minutes while we recess to go vote. We will recess now until 12:30.

[Recess.]

Mr. BUNNING [presiding]. I would like to reconvene the hearing if the panel would please come back and take their seats. It is my understanding that everyone has completed their testimony.

I would like to start out briefly by asking Mr. Mica, you quoted some different numbers than I have seen as far as accelerated death benefits. The last numbers that I had seen and the last numbers that I had been able to research was that only 5 percent of the insurance policies in the United States had accelerated death benefits. Are you telling me something different today?

Mr. MICA. Congressman, let me put it this way. We did a survey, and we have found an increased number. From 1994 the number went from—let me give you that number here. In March 31, 1994, we had more than 18 million policyholders who had accelerated death benefits available to them, and in 1991, which was data that has been frequently quoted up until recently, it was 1.3 million. I would be happy also to submit either for the record or to you our latest study, and this is a very current study, so it may be more current than the information you have. I don't know.

Mr. BUNNING. I would really appreciate that because that is important in our consideration of what we do in consideration of H.R. 8 and what we include or do not include and how many years are included. I would like to know specifically what type of accelerated death benefits are being offered, whether it is restricted to 1 year or just generally speaking how the industry is handling accelerated death benefits.

Mr. MICA. The breakdown by year, 6 months, no limit and so on is all broken down in this study.

Mr. BUNNING. That is fine, if you will submit that for the record.

Mr. MICA. It is the most current information, and it does cover that. I think the standard, if I might say, appears to be more and more 1 year, some with 6 months, and in answer to the question you offered to the panel earlier and what you are referring to now, it is my belief, and I think it is the belief of the leaders of our industry, that if Congress enacts favorable tax clarification, that accelerated death benefits will become almost, I won't say instantly, but very quickly, universally available.

Mr. BUNNING. Standard, in every policy?

Mr. MICA. All of the trends are in here. It has been added as riders to existing policies and an intrinsic part of new policies in the last few years in phenomenal numbers that we quote here, and so we see a bright future for this. The committee and Congress act as we expect them to.

Mr. BUNNING. I would like to address this to Mr. Banks or Mr. Pardo. I would like to know if the National Association of Insurance Commissioners has adopted a model regulation for viaticated settlements and for the viatication companies? Do those regulations contain minimum payout requirements and also require a viaticated settlement company to be licensed by each State in

which it operates? Would your company have any problems complying with the NAIC's model request or regulations?

Mr. BANKS. Maybe I can answer that. For Viaticus, we worked closely with the NAIC in helping develop that regulation, and we comply with all aspects of it now. If I could just refer back to these other statistics, if the number was 18 million insurance policies are covered now; is that right? I think there are 400 million insurance policies in force, so that would be about 4.5 percent.

The other thing is that we would hope that the ADB would become universal and it would put more money in people's pockets and it would be tax free. It still is going to be limited to 12 months, and we would like to think that viaticals would also be able to be given tax free because they reach far more people than the ADB does.

Mr. BUNNING. Mr. Banks, is your company currently regulated by State regulators where you operate?

Mr. BANKS. Regulation is being put in force by States right now. California and New York are the leaders in that. I think there are 14 States currently considering regulation. I spend quite a bit of my time traveling from State to State meeting with regulators to encourage them to enact this regulation.

When you are dealing with ill people who—and this might be their one major asset they have left, we feel that strict regulation of the industry, including pricing guidelines is absolutely crucial.

Mr. BUNNING. Well, since you mentioned California and New York, where I understand now that the settlements are tax free from State tax, what has your experience been in those two States? Do you see an increase, a quick increase in how many people would choose to——

Mr. BANKS. I think it is too soon to answer that, and I don't know whether the ADBs are offered more extensively in California.

Mr. PERPER. If I may add, I believe that California in 1990 amended its Tax Code at the same time that it enacted the viatical licensing legislation so that the two were tied, so it is kind of hard to see the distinction with a rise in accessing the viatical settlement to the tax-free treatment.

Mr. PARDO. Mr. Chairman, I would have to say that the National Viatical Association sees some significant problems with the NAIC model act. We have no problem with the disclosure elements of the act, and that is universal among the industry anyway. The fact of the matter is that my company, which has been in business for more than 5 years, has seen that in California only 11 companies in the United States since the inception of their law have been licensed at all.

It has been a very slow, very, very slowly progressing process in our view that has set it back. We don't see a need to regulate people in the disposition of their own private property, and we feel it violates certain private property issues.

As the former panel up here spoke of, they are quite capable of making their own decisions. We do agree with the disclosure elements and fair play, but the industry has operated for about 5 years without any real misconduct or problems whatsoever.

I would like to point out one thing, though, in the difference between viatical settlements and accelerated benefits, and that is to

my knowledge no accelerated benefit program of an insurance company lists AIDS as a disease which qualifies under an accelerated benefit program.

Mr. BUNNING. The big problem I am having is that you are testifying that you would like us to change the Tax Code, and not be regulated, and not have any regulations or any type of restrictions. I think if we are going to make it a tax-free benefit, even though the person, if they did not do—didn't viaticate a policy, would eventually have a tax-free settlement at death.

Mr. PARDO. That person wouldn't.

Mr. BUNNING. But someone would and therefore the Federal Government wouldn't receive any tax benefits from that or any income from that.

Mr. PARDO. Yes, but I don't see the nexus connection between complete regulation. Keep in mind we are dealing with——

Mr. BUNNING. I didn't say complete. I just said some guidelines where we have some type of understanding exactly what is going on.

Mr. PARDO. There are two elements essentially. One is that the viatical process operates essentially within a regulated framework. Insurance is regulated in every State in the United States already, and these transactions cannot occur without insurance companies, title departments, recognizing and agreeing and, so to speak, acting as the recorder of the transaction, so there is an element there already of regulation and regulation framework in which it works.

Mr. BUNNING. Let me ask Mr. Banks one more question, then I will yield. How many people come to your company through a third party, in other words, through a broker like some of the prior testimony indicated?

Mr. BANKS. Very few.

Mr. BUNNING. Very few. They come to you by themselves, without an intervenor?

Mr. BANKS. Right. Mostly we hear from care givers, and just to address the pricing issue of ADBs versus viaticals, when we hear from people who have the short sort of time spans or diagnosis that the ADBs are looking at; namely, 6 months, our pricing is as competitive or better than ADBs.

We had someone come to us last year who had an 8-month diagnosis, and they were paid in excess of 90 percent of their policy, and I would be happy to document that.

Mr. BUNNING. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. Earlier panels have raised the issue of the 12-month limit, and that raises the issue of whether these contracts should be available just for terminally ill patients or also for chronically ill patients. Do you have any comment on that?

Mr. PARDO. I don't think that it would be possible, Mrs. Johnson, to viaticate a policy of somebody who is not terminally ill, so I think that is more or less self-regulating. Either through an accelerated death benefit or through the viatical process, essentially that process is going to remain the same.

Mrs. JOHNSON. If someone is chronically ill and wants the right to buy out their policy and someone is willing to buy it out, are you

saying there would be no market to buy it out if it wasn't clear that the buy-out date was going to be somewhere near on the horizon?

Mr. PARDO. What is at play here and the underlying process essentially is merely an extension of the concept of insurance itself, and that is the time value of money and an actuarial estimate of life expectancy. So what is happening here is that that life expectancy is being shortened prematurely, and therefore that gives additional present value to that contract. I know this is a very technical way of looking at it.

Mrs. JOHNSON. I follow what you are saying. You are just saying that unless it is pretty clear what the time involved is, then there is no advantage.

Mr. PARDO. Yes. Otherwise, the ratio the insurance companies are charging currently is the present value of it, and there is no spread, you might say, in there available to the individual.

What we are finding is that most individuals who become terminally ill don't know they can sell their insurance policy and capture a large percentage of its face value in advance.

Mrs. JOHNSON. But do you have any objection in the viatical contract area to eliminate the 12-month designation?

Mr. PARDO. Yes. I think it should be eliminated because I think if somebody is terminally ill, as the panel before us testified, it is their decision based on their condition, based on their financial circumstances, and also we see that when somebody sells their policy, many times, many of the times they live longer because they are stress free, but sometimes people who think they are going to live longer live shorter, and so you don't really know. You are terminally ill.

Mrs. JOHNSON. It is better to leave that decision about at what point this is a doable deal up to the individual and the companies involved?

Mr. PARDO. Yes.

Mr. PERPER. If I may add, I believe you have a compliance issue because often the terminally ill person does not want to know what his life expectancy is, and since the onus on paying the tax would be on the terminally ill person, he wouldn't know whether his proceeds were tax exempt by virtue of having a life expectancy of less than 12 months or more than 12 months.

Mr. BANKS. If I could just add to that as well, in the example I gave earlier of giving 90 percent on a $100,000 policy, as the Tax Code is presently written, the government would then take a further $30,000 from the person viaticating, so the person ends up with $60,000.

Mrs. JOHNSON. Correct. Thank you. Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman. I would just like to point out for the record that a viatical company isn't regulated like an insurance company. It is very different. Also, I would like to urge some caution here.

When I first introduced this legislation, I thought there was nothing more reasonable than if you were terminally ill, the doctor certifies you only have 1 year to live, that you should be able to move on and get the profits from your insurance company and not

have to have the public pay for things that you could pay if you had the option. I have to inject a note of reality here.

It took us a long time, almost 5 years, to get to 1 year terminally ill certified by a doctor. Now, if we open it up to chronically ill, 1 year, 2 years, 3 years, I guarantee this legislation will not be seen in the first 100 days and nobody wants to see it more than I do. I inject this note of reality because when I first began there was a company, not an insurance company, but a company called the Grim Reaper cruising hospital wards, finding people.

Mr. Pardo, you say there have been no troubles. I am afraid there have been troubles. Some companies were taking 45 percent, and some individuals were being taken advantage of. We had SEC complaints for misrepresentation and illegal sale of securities. All these things were happening, and that was the reason we couldn't move forward with this very common-sense type of legislation. So I just would caution right now that we shouldn't just open it up, go further faster and end up losing 1 year.

We saw some wonderful testimony this morning. Obviously, these people found what they needed. But I think we should be awfully careful about some of the things we have learned over the last few years. We should just say this is all wonderful. I would like to ask Mr. Banks, your company is a subsidiary of CNA—

Why did you decide to be a subsidiary rather than a part of CNA? Why did CNA decide to make it a subsidiary? Can I ask the question without appearing that I am negative on this, that they didn't want to have the State of Illinois regulate. There is a history here.

Mr. BANKS. We are a wholly owned company of CNA Financial, which is an investment arm of CNA that also owns CNA Life Insurance Companies. I imagine that CNA Financial can buy any kind of company they wish, including cinemas or gas stations. I think the important thing to realize here is that the NAIC has been aware of viatical settlement companies since 1989, and as well as pushing to have ADBs extended with the insurance companies, they have also incorporated the fact that viatical settlement companies are a reality, and have enacted model acts and regulation to control them. We really welcome that. We really feel that the industry needs that.

[The NAIC Model Act and regulations are being retained in the committee files.]

Mrs. KENNELLY. Thank you.

Mr. Mica, would you comment on my thought that maybe we better move on, and you have been very good about working with us with the 1 year certified by the doctor, and then possibly go into this whole new field that we are in?

Mr. MICA. Well, first, let me say, obviously, we have indeed been working with your office and with a number of members of this committee for at least 5 years that I am aware of. Indeed, you raise some questions that have been nagging this entire committee all the time I have been involved in the issue. Obviously, our association, the Life Insurance Association, would love to have approved the tax clarification discussed by the committee here today.

With regard to viaticals, we do not have official policy as to whether or not they should move at the same time or separately.

We have said, as you may recall, that we don't think there should be favored treatment for viaticals versus life insurance companies, but, obviously, we would be very pleased to have action as soon as possible.

Mrs. KENNELLY. That is my caution to the committee, that we move as the Contract so says and get something done and then maybe we will expand this further in the future. Maybe I am wrong. Maybe we can do it all at once, but I do caution the committee from getting mired down in trying to rewrite and go further and then end up with nothing.

Mr. BUNNING. Mr. Ensign will inquire. No questions?

Mr. Christensen.

Mr. CHRISTENSEN. Just a couple questions. I am a new member on this committee, and prior to coming to this committee I was a life insurance salesman and worked with Connecticut Mutual Life Insurance Co., one of Mrs. Kennelly's constituents, and always lost the sale to someone who was selling an accelerated death benefit policy also, so I have to tell you that I am glad to see that there are a number of companies that are now selling these kind of policies. Not always lost, but a few times.

I guess I would encourage this industry to really—there are 400 companies or so out there that don't have ADB benefits right now. My one question that Mr. Banks sparked was the fact that maybe viaticals pay more than insurance companies, and that wasn't my understanding of it in the past.

I thought maybe Mr. Mica could clarify that. I just thought it would be good to hear if there is a difference in payment and also wanted to ask Mr. Pardo a question about whether or not if all companies some day sell ADB benefits, wouldn't that almost put a squeeze on the viatical association and eliminate your industry?

Mr. MICA. Well, first, Mr. Christensen, with regard to your first question, we pay full value on policies. That is the standard in our industry. Now, I guess I couldn't say that you might find someone who didn't pay full value out there, but as far as we know, that is the standard, and the full value means this; that whatever the face value is, there is an actuarial adjustment for the fact that the benefit is paid earlier, a small administrative fee, and the full value is paid. In terms of financial services, full value means that you are getting every dollar.

I don't know how the viaticals pay, but that has never been a question. I have heard, a little bit to my surprise here, that they pay more. That has not been my experience. I don't want to get into a debate with the gentlemen at the table, but our experience has been, and it is highly regulated, as you know, by every one of the 50 States, that the only way they will approve such a rider or a policy is that it must pay full value.

Mr. CHRISTENSEN. Mr. Pardo.

Mr. PARDO. Mr. Christensen, with regard to the pay issue, I can tell you unequivocally that at this point in time viatical companies on the average pay much, much more, and that is why the vast majority of accelerated benefits of any sort are done through the viatical process.

I would say that today less than 10 percent of all policies viaticated in the United States occur through an insurance com-

pany accelerated benefit program simply because they restrict the time, they restrict the amount, and they also restrict by policy, usually only whole life policies.

Mr. MICA. Are we talking volume?

Mr. CHRISTENSEN. I am not criticizing the—you say much, much more. Maybe I could get a clarification on that.

Mr. PARDO. Yes, in cases of over 12 months, most of the people who are viaticating policies, well, say half of them at least have group policies. Most group policies can't be accelerated at all. Policies less than 12 months and particularly less than 6 months, I would say that the accelerated benefits programs of the insurance industry generally are higher in that area.

Mr. CHRISTENSEN. I want this clarification for the record because probably Mr. Mica wouldn't say anything like this, but I understand that CNA owns your company, and I understand that CNA is also one of the American Council for Life Insurance companies, and so I understand that you have to be careful here, and I don't have to because I don't sell life insurance anymore. Is that true, Mr. Mica?

Mr. MICA. Is CNA a member? Yes. But let me tell you what my understanding is from our staff professionals.

We pay 95-plus percent on these policies. When they are saying much, much more, I am not sure how it can be much, much more unless you are talking volume. In other words, per policy we may pay 95, 97, 98 percent, 99 percent, but there may be more settlements. I don't understand that.

Mr. CHRISTENSEN. The viaticals are doing a whole lot more, but the amount paid is nearly the same, if not the same.

Mr. PERPER. If I may draw the distinction, while the ADBs are often 90 or 95 percent, it is on a portion of the policy. It might be on a $100,000 policy, they will offer 90 percent on $50,000 and the other $50,000 remains as the traditional death benefit.

For a viatical company, such as Dignity Partners, we on average pay 70 percent, and we often do that on the remaining portion of the ADB after someone has accelerated the other half, so that is the difference.

Mr. CHRISTENSEN. My time has expired. Maybe if someone else wants to follow up on this, Mr. Chairman, but thank you.

Mr. BUNNING. Mr. Kleczka will inquire.

Mr. KLECZKA. I do want to follow up on it because I am not very knowledgeable about this whole viatical settlement business. In fact, this is the first I heard of it, not being in the insurance business. I thought I heard the payout on the settlements on average is 70 percent?

Mr. PARDO. No, what I think he is saying is that is the average payout for a viatical settlement. It is not a matter that the accelerated benefits programs pay more or less or viaticals pay more or less. The matter is, how many people can be affected by the program?

Mr. KLECZKA. I am not trying to compare the accelerated benefit with you. I am trying to ascertain what your business is all about here. Maybe you can walk me through an example.

Let's say I am terminally ill, the medical experts indicate I have 2 years to live, and I have a policy, and we will use the same exam-

ple for two types of policies. I have a $100,000 whole life, and I go to you for a settlement. In that situation with those bare facts, what type of settlement would I get on my $100,000 whole life policy?

Mr. PARDO. In that situation you would not qualify at all for an accelerated benefit program. That is point No. 1.

Mr. KLECZKA. No, I am talking about—that's not——

Mr. PARDO. Point No. 2 is that you would probably——

Mr. KLECZKA. If my policy had provisions for it, I would.

Mr. PARDO. You would receive between 65 and 70 percent if you decided to sell your policy, say, with a 2-year outlook. I would say that would be a fairly consistent average.

Mr. NEAL. Would the gentleman yield?

Mr. KLECZKA. Sure.

Mr. NEAL. Just to follow up on that, what about the inside cash buildup on the policy, how would that be impacted?

Mr. PARDO. That would be added, but usually that is used up already. Another factor here to consider is that people that sell their policies, many times if they don't, will lose them for lack of being able to pay for the premiums long before they ever get to the point where they could qualify for an accelerated benefit.

Mr. KLECZKA. Let's go back to my example, using my example. The $100,000 whole life, I would get 65 to 70 percent of the face value?

Mr. PARDO. Yes, that is right.

Mr. KLECZKA. One lump?

Mr. PARDO. Yes, lump sum payment.

Mr. KLECZKA. If I die the next day instead of 2 weeks.

Mr. PARDO. It is still the same. You sold the policy. You got the money.

Mr. KLECZKA. OK. If I live for 2 years instead of 2 weeks?

Mr. PARDO. Yes, or if you live for 4 years. You see, it is an estimate, but we find that people generally live longer once they have viaticated.

Mr. KLECZKA. But it doesn't cost you any more? Your profit is the same?

Mr. PARDO. Not really, because the profit of the investor in a viatical transaction is the time value calculation. It is not just the spread between the amount of the policy and the face value. It is the amount of time that that is held, so if the individual lives for 2 years, for example, he might receive a 12- or 14-percent return, but if he lives for 4 years, he might only receive a 6-percent return.

Mr. KLECZKA. What type of return would I get using my example, with a term policy through my employer?

Mr. PARDO. What would the return be?

Mr. KLECZKA. Yes.

Mr. PARDO. It would depend on how long the individual actually did live.

Mr. KLECZKA. OK. That is totally based on longevity at that point?

Mr. PARDO. That is right, because that is the holding period.

Mr. KLECZKA. Like a ballpark, is it 50 percent or less or more?

Mr. BANKS. The important thing to remember here is that there are State regs in place that have pricing guidelines and disclosure

within them, and that even if we give 80 percent, the Federal Government is going to come in as the law now stands and take another 30 percent, and that is what we would like to see changed so that we get more money in the consumer's pocket.

Mr. KLECZKA. But the whole tax issue does not affect your bottom line at all?

Mr. PARDO. Oh, yes it does.

Mr. BANKS. How they tax——

Mr. PARDO. Excuse me a second.

Mr. BUNNING. One at a time, please. Mr. Banks.

Mr. BANKS. No, the tax issue doesn't affect our bottom line at all. All it impacts is how much money goes into the consumer's pocket.

Mr. KLECZKA. I appreciate that interest on your part. OK. Jon, do you want time to finish up on yours?

Mr. CHRISTENSEN. Would the gentleman yield?

Mr. BUNNING. Go right ahead, Mr. Kleczka. It is your time. I am going to yield to Jon. I think he had some followup.

Mr. CHRISTENSEN. A question for Mr. Mica. On the inside cash buildup within a policy, was what Mr. Pardo was saying correct on that or not within the payout system?

Mr. MICA. If I understood him, he was correct. You could borrow that cash buildup up front, and it would be considered a loan on the policy.

If I may continue to answer the question that was asked by Mr. Kleczka, the gentleman is right the way he has calculated that they pay more if in the example that you used, if you have a $100,000 policy and they pay 70 percent, you get $70,000, and what he was referring to is that some life insurance companies, many do not let you accelerate the entire amount. Therefore, they may say you have a $100,000 policy. We have found that through our experience that the widow or widower or the costs after you are gone still need to be covered, so we restrict 25 percent or whatever. There are different percentages, so you cannot accelerate the entire policy and hold some in reserve for when you pass on, so then when you do that you only get a percentage of the $75,000, but it would be, by our experience, far in excess of 95 percent, so we are talking kind of apples and oranges here, but there is a rationale to that.

Mr. KLECZKA. Thank you very much.

Mr. BUNNING. Mr. Neal will inquire.

Mr. NEAL. Thank you. As a followup to that, would you advise—the individual people that work for you—advise the individual on how best to apply the inside cash buildup?

Mr. PARDO. We would advise the individuals to look at all options. I think this is standard in the industry both with insurance companies and viatical companies to look at all options, including accelerated benefits, use of cash buildup, and also a viatical option to yield to them the greatest amount of net cash at any particular time in the course of their disease that they are applying for this benefit.

Mr. BANKS. The State regs do address that. They call for excruciating disclosure, and we really support that.

Mr. NEAL. My followup to that is, it would seem to me that despite the fact that you present a good product here today of good

reputation, that there are opportunities for enormous abuse if the regulatory framework breaks down. I mean, somebody who is in desperate need of cash may well be tempted for a significantly fewer dollar settlement than you are offering to provide the mob or somebody else with that avenue of opportunity as well.

Mr. BANKS. The State regs do address that with minimum payout ratios.

Mr. PERPER. In California not all viatical settlements or accelerated death benefits are tax free. On the viatical settlement side, it is only limited, the tax-free treatment, that is, is only limited to proceeds received pursuant to a viatical settlement contract entered into pursuant to the insurance code, so that is an important distinction.

Mr. NEAL. I believe that during the Carter years at one point the prime interest rate hit about 15 percent. I think the mob was even embarrassed by the rates the banks were charging in those days, and it does present a relatively complex issue.

Mr. PARDO. For 5 years, Mr. Neal, this process has gone along without abuse or significant misconduct or any incident of that sort, and also it is a competitive process. Most viators, as you could tell by the earlier panel, are aware of the fact, due to support groups and various means of communication dealing with their particular kind of problem, that there are numerous companies out there, 50 or 60, as you have already heard, that are willing to buy and, in fact, compete to buy these policies, and so the process is essentially a bidding process. They are able to use the free market system very much to their advantage.

Mr. NEAL. But do you think there is legitimacy to the example I cited, that that individual who is desperate for cash——

Mr. PARDO. Not in today's atmosphere I do not. I think that it was possible 4 or 5 or 6 years ago when the process first began, very quickly more sophisticated financial sources and support groups such as the National Association of People With AIDS, and industry associations and others got into the act, and the knowledge that an individual could viaticate their policy among the people that are affected in that way is very broad, and so I think it is very unlikely in this climate.

Mr. NEAL. Mr. Mica, do you want to comment?

Mr. MICA. No. I would only say that we are, the life insurance industry is heavily regulated in all 50 States right now, and there has been a long record of dealing with the States, particularly on this issue, and as I indicated earlier, essentially every one of the 50 States insists on full value in order to approve the policy.

Mr. NEAL. Thank you.

Mr. BUNNING. I would like to ask Mr. Mica one other question. If the provisions of H.R. 8 are passed, can you give us an estimate on how many insurance companies would make the accelerated death benefit a standard option or do you have any idea?

Mr. MICA. We do. We have discussed this. We don't have—you cannot predict the future on something like this, but based on our past data, there has been a sixteenfold increase from 1991 to 1994.

Mr. BUNNING. Even though it is taxable?

Mr. MICA. Even though it is taxable. The main reason given to us for companies who are not doing it is the taxation of this benefit

has not been clarified at this time. We have every reason to believe this would become virtually universal on all future group and individual policies, and, in fact, there is strong indication that even now companies, because the public is so interested in this, are stepping further in the water while they are waiting for you.

Mr. BUNNING. I want to thank the panel.

Go ahead, Mrs. Johnson.

Mrs. JOHNSON. Do any of the insurance policies allow AIDS settlements?

Mr. MICA. Yes, I am glad you asked that. When they talk about—they don't specify AIDS, but they specify terminal illness. As soon as that comes within the timeframe that is specified in the policy, 6 months or 1 year, and that can be certified, the policy covers it.

Mrs. JOHNSON. Apparently, at one time insurance policies, though, tended to be disease-specific or exclude specific diseases. Is that no longer the case in general?

Mr. MICA. Well, not for accelerated death benefits. I might just tell you by way of history, although this product was introduced heavily and primarily in 1989 in the United States, it was specifically introduced in Canada to assist with some AIDS patients. That was the genesis.

Mrs. JOHNSON. But early on didn't many of the insurance policies exclude AIDS patients or exclude certain diseases?

Mr. MICA. For accelerated death benefits? Not that I know of, no.

Mrs. JOHNSON. Because that is the statement in the testimony here by Mr. Pardo. Would you comment on that?

Mr. PARDO. I believe I can substantiate that. AIDS is not specifically listed to this day as a defined illness in the accelerated death benefits of the insurance industry, to this day.

Mr. MICA. Again, let me just say, it says terminal illness. The policies indicate terminal illness. When AIDS or any other illness is determined to be terminal within the period specified, in most policies it is 6 months or 1 year, you become eligible for the death benefit, and indeed there are numbers of claims that have been made on that basis.

Mr. LARSON. Mr. Chairman——

Mr. PARDO. I just want to add that in most cases illnesses, terminal illnesses are listed by line item within those riders, and so they are this, this, this, and this, this is what qualifies for that. AIDS is not included in that.

Mrs. JOHNSON. So in other words the terminal illnesses are defined.

Mr. PARDO. I think that is correct.

Mrs. JOHNSON. I think we need to get this point very clear before us. If you could help us with that after the hearing, I think it is important for us to show how the private insurance industry has evolved and therefore what the role——

Mr. BANKS. I think if I could point out that viaticals——

Mr. BUNNING. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman. Because I work with the terminally ill directly, and very specifically conduct competitive bidding with viatical settlement companies and effect accelerated

death benefits, I would just like to add a note of caution to what Mr. Mica said.

I would like to put the emphasis back on the fact that this is supposed to be a Contract With America and not a contract with insurance companies, because I experience with my clients continually a deep frustration at the lack of accelerated death benefits available today, especially on group life insurance.

My experience indicates that the primary problem with this lies with the insurance companies as much as it does with State regulators. For example, I cite a 14-month regulatory process to approve an ADB, which I experienced recently with a client in New York and primarily with employers.

Now, what I would like to do is just urge the committee to look at this as a continuum, all diseases, all people with terminally ill diseases. They are the ones who are concerned here, not one provision versus another. Especially because of this problem with group life insurance, I think the best thing that will encourage accelerated death benefits will be, in fact, to grant tax-free treatment to viatical settlements which will put pressure on insurance companies and employers to offer ADBs and provide Americans with a complete spectrum of funds available if terminal illness strikes.

Mr. BUNNING. Mr. Banks, go ahead.

Mr. BANKS. Yes, I was just going to point out what Per mentioned, that viaticals do cover everyone, and it really is a real advantage in that they are presently covered by NAIC regulations at the State level.

Mr. BUNNING. Mrs. Johnson, do you have anything else?

Mrs. JOHNSON. To that issue of whether they are currently covered by the NAIC regulations at the State level, is that only true in the States that have adopted the NAIC regulations?

Mr. BANKS. Yes, that is correct. NAIC regulations have just been approved.

Mrs. JOHNSON. Only two States have adopted them and several more are in the process?

Mr. BANKS. The two States that adopted them actually developed their own regulations. The model regulation that was just approved by the NAIC was done so, I think, within the last month or so, and 14 States are looking at it already, so we would anticipate it becoming national.

Mrs. JOHNSON. Generally accepted over a period of a year or two?

Mr. BANKS. Again, the goal here is to remember that what we are trying to do is no matter what the pricing is, as long as it is well-regulated, which we support, the goal is to not have to share one-third of it with the Federal Government. This is—we can't tie this into some national health plan because this money also goes to keeping food on the table, making car payments, obviating a policy lapse; this is desperate.

Mr. KLECZKA. Will the gentlelady yield for a moment.

Mrs. JOHNSON. I would be glad to.

Mr. KLECZKA. I want you to respond, Mr. Banks, that you think it is ill advice to share one third of it with the Federal Government, although you have no problems of sharing one-third of it with your corporation.

Mr. BANKS. What was that again? It depends a little bit. If it is a 6-month policy, 10 percent of it is coming to our company to cover costs and profit. We do have to make a profit. In that scenario 33 percent is going to the government.

Mr. KLECZKA. Well, based on the example I was told before, the average on, say, a whole life is 65, 70 percent. That seems to me to be about 35 percent or one-third.

Mr. BUNNING. Thank you, panel, for your appearance here and thank you for your testimony.

The next panel, if they would come forward, Robert Shreve, Stephen Entin, Marilyn Moon, and John Goodman.

If we could take our conversations either out of the committee room so we can proceed, I would appreciate that. Mr. Shreve, if you would begin your testimony.

STATEMENT OF ROBERT SHREVE, CHAIRMAN OF THE BOARD, AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. SHREVE. Good afternoon, my name is Robert Shreve. I am chairman of the board of directors of AARP (American Association of Retired Persons). Mr. Chairman, the association thanks you for the opportunity to present its views regarding a phased-in repeal of the 1993 increase in the percentage of Social Security benefits subject to Federal taxation.

The association opposed the Social Security tax increase enacted in OBRA 1993 primarily for two reasons. First, the disproportionate tax burden that fell on middle-income older persons. Let me stress that people with taxable incomes of $34,000 or $44,000 a year are not wealthy.

Second, we were opposed because of the diversion of Social Security money for non-Social Security purposes. Given that older, middle-income taxpayers are the only nonwealthy group of taxpayers to experience large tax increases under OBRA 1993, it is easy to see why many older Americans do not perceive that tax as fair, and they support its repeal.

Nonetheless, the increased tax has become law, and the revenue raised is credited to the Hospital Insurance Trust Fund or Medicare part A. Now, we are faced with a dilemma, how to provide tax relief, but do so in a manner that does not increase the Federal deficit or leave the Hospital Insurance Trust Fund with a nearly $15 billion gap over 5 years.

Providing tax relief to older Americans is a legitimate goal. The increased tax was especially burdensome on middle-income older people. In fact, even though the thresholds were increased from those originally proposed by the administration, still approximately 1 million of the 5½ million affected beneficiaries are in the 15-percent tax bracket.

While many debate the precise meaning of middle income, surely those people in the 15-percent marginal tax bracket are not wealthy, yet they and other older taxpayers near the thresholds have been targeted for additional tax on their Social Security because they have been deemed wealthy.

Since middle-income taxpayers count on Social Security as a major, if not the largest source of income, the increased tax hits them hardest. This group has little ability to make up the lost in-

come. Additional work is often not a viable option. This group is already feeling the squeeze from skyrocketing medical costs and declining income, particularly interest rates.

Add to that income and property tax increases, and the normal costs of maintaining a household, and the loss of several hundred to a thousand dollars is significant. Indeed, an older person with $10,000 of Social Security and $35,000 in other income faced a tax increase of just under $1,000 in 1994, which is 3½ times the size of the 1994 COLA, which was 2.7 percent.

These losses are permanent and will accelerate what for most is already a time of declining income levels. This group also will feel the effect of higher Medicare premiums and other tax increases borne by all taxpayers under OBRA 1993.

AARP wants to work with this committee, as we have done in many instances in the past, to find a fiscally responsible way of providing tax relief that is fully paid for, that maintains the integrity of the Hospital Insurance Trust Fund, and that achieves those goals without placing additional burdens on Medicare beneficiaries.

We urge this committee to find a solution to pay for this and other provisions of the Contract With America that does not single out Medicare. The program has been reduced over $200 billion over the last decade, including $56 billion in cuts in OBRA 1993. Large Medicare reductions translate into real, substantial out-of-pocket costs for 36 million disabled and aged beneficiaries. These fiscally shortsighted cuts lead to a shifting of costs not only to individuals, but also to employers. In effect, the cost shift is a tax on business. Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

STATEMENT OF ROBERT SHREVE
CHAIRMAN OF THE BOARD
AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP) appreciates the opportunity to present its views regarding the provision in the Senior Citizens Equity Act to repeal the 1993 increase in the percentage of Social Security subject to federal taxation from 50 to 85 percent. AARP opposed this tax increase in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) because of the disproportionate impact it imposed on middle-income beneficiaries and the diversion of Social Security dollars from Social Security purposes. The Association commends the chairman for holding today's hearing and hopes it will lead to some tax relief for affected older Americans, while also providing the financing so as not to increase the deficit or jeopardize the Medicare HI trust fund.

I. BACKGROUND

Prior to 1983, Social Security benefits were not taxed. The Social Security Amendments of 1983 provided for taxation of some benefits for the first time effective in 1984. This change was an important component of a carefully crafted compromise in which current workers and employers (through increased payroll taxes) and retirees all contributed to maintaining Social Security's long-term solvency. Since the taxation of benefits provision was enacted to help restore Social Security's long-term solvency, the revenue has been credited to the Old Age, Survivors and Disability Insurance (OASDI) trust funds.

The 1983 Social Security legislation specified that single taxpayers with modified adjusted gross incomes (MAGI) over $25,000 (including tax exempt interest and half of their Social Security benefits), and joint filers with incomes in excess of $32,000, were to be taxed on the lesser of half of their benefits or half the amount of income above these thresholds. The maximum percentage of benefits subject to federal taxation was set at fifty percent of benefits because employees pay half of the Social Security (FICA) taxes and the employer pays the other half.

The 1983 thresholds deliberately were not indexed in order to provide the Social Security trust funds with increasing revenue in the future when the number of beneficiaries would rise dramatically and the ratio of workers to retirees would decline. Initially, about eight percent of

beneficiaries were taxed on up to 50 percent of their Social Security. Today, almost one in four beneficiaries are affected, and by the turn of the century, almost one in three beneficiaries will pay tax on their Social Security benefits.

In its FY 94 budget, the Administration proposed raising the percentage of benefits subject to taxation from a maximum of 50 percent to a maximum of 85 percent for beneficiaries whose incomes exceeded the 1983 thresholds ($25,000 for individuals and $32,000 for couples). From the beginning, the Association expressed its opposition to this provision. Social Security currently takes in substantially more revenue annually than is needed to pay benefits and does not contribute to the deficit elsewhere in the budget. Thus, dedicated Social Security money should not be diverted to a deficit it did not cause. The Association was also concerned about the impact of the change on middle-income beneficiaries who would face a large tax increase not faced by other taxpayers with similar incomes.

The Administration's proposal was modified during the budget and reconciliation processes. As the proposal moved through Congress, AARP continued to emphasize its concerns and worked to raise the proposed thresholds for increased taxation. After the House adopted the Administration's proposed thresholds, the Senate recommended income levels of $32,000 for individuals and $40,000 for couples. (It narrowly rejected an amendment to raise the thresholds even further). Ultimately, the conference committee agreement further increased the thresholds for taxing 85 percent of benefits from the originally proposed $25,000 to $34,000 for individuals and from $32,000 to $44,000 for couples. The Association did not support the 1993 budget reconciliation legislation -- the first time we had not supported a deficit reduction bill in a decade -- and expressed its disappointment at the disproportionate tax hike on middle income seniors.

Unlike the revenue from taxing 50 percent of benefits, which is credited to the Social Security (OASDI) trust funds, the revenue from taxing the additional 35 percent of benefits is directed to the Hospital Insurance (HI) trust fund (Medicare Part A). While it was suggested that this was directed to HI in response to its solvency problem, it was apparently more in response to the need

to avoid a point of order in the Senate that barred consideration of any legislation affecting Title II of the Social Security Act in any reconciliation bill or resolution.

II. THE EFFECT OF TAXING 85 PERCENT OF BENEFITS

A. The Tax Impact

The tax increase affects about 5.5 million persons including about 1 million people in the 15 percent tax bracket in the 1994 tax year. The impact of the added taxation falls hardest on middle income beneficiaries. For example, an individual with $10,000 in Social Security benefits and $35,000 in other income experienced a tax increase of $980, or an over 15 percent tax increase.

For older middle income beneficiaries the impact is particularly onerous because the lost income is significant and difficult (if not impossible) to replace. Work may not be a realistic option, and shifting assets into potentially more profitable investments carries greater risk. Beneficiaries have limited flexibility to adjust their income because so much of it is fixed. Indeed, Social Security is generally their largest income source, averaging around 25 percent of gross income. Pensions, which generally are not fully indexed for inflation, are about 22 percent of income. Wages (of a beneficiary or a spouse) represent around 18 percent of income, and taxable interest is around 19 percent.

Those beneficiaries in the middle income group who derive a greater share of their income from Social Security will be hit hardest because a greater percentage of their overall income will be subject to new taxation. After federal and state taxes, local property taxes, higher out-of-pocket costs for health care and the normal costs of maintaining a household are accounted for, another several hundred to a thousand dollars in new tax liability represents a significant burden.

The tax increase is particularly onerous to those just above certain thresholds. Table A illustrates how the taxation in essence creates "cliffs". For example, if you compare single filers with $10,000 in Social Security benefits and $35,000 in other income to those with the same amount of

Social Security and $50,000 in other income, the tax increase is the same even though their total income is substantially different.

Other tax consequences result from the increased tax on Social Security. For older taxpayers living in the many states that directly tax Social Security or piggyback on the federal income tax system, state tax liability rises. Also, by including a greater percentage of Social Security in adjusted gross income (AGI), other deductions based on AGI (such as the medical deduction) will be reduced. The compounding effect results in an even greater tax bite.

B. The Tax Burden

In addition to the actual dollar increase, the increased taxation of Social Security raises marginal tax rates to excessive levels, particularly for older workers. It is actually possible -- taking into account income taxes, payroll taxes, and the Social Security earnings limit -- to lose money by earning extra income. The high marginal tax rates that are created by the interaction of the taxation of benefits provision and the earnings limit discourage additional earnings and act as a hurdle to those desiring additional employment income.

Some may argue that because of the existing partial exclusion of Social Security benefits from taxation, the tax burden of older Americans is too low. AARP believes that this is not the case. A reduced tax burden at retirement (of which an important component is the partial exclusion of Social Security) is wholly appropriate to maintain income adequacy as income declines. (See Charts 1 & 2) The average 62 year old retiree has a life expectancy of about 20 more years. Without wages, even a middle income retiree will have an uphill fight to remain middle income because incomes can erode significantly over time, and this tax increase accelerates that trend. Indeed, the Social Security cost-of-living adjustment (COLA), which helps older persons keep up with inflation, is effectively nullified for these middle income taxpayers by the increased taxation of Social Security. The increased taxation of Social Security means that some middle income older persons could pay in taxes an amount that far exceeds the value of the annual COLAs. For example, in 1994, an individual with $10,000 of Social Security and $35,000 in other income

received an annual COLA of $270 but faced a tax increase of $980. These middle-income older persons are not likely to see their incomes grow in the future and will experience an erosion of assets and buying power over time.

Although a reduced overall tax burden at retirement has been a long-time feature of the tax code, recent changes in the tax code have led to increased taxation of middle income older Americans. The Tax Reform Act of 1986 eliminated the extra exemption for persons over the age of 65 (replacing it with a smaller increased standard deduction for non-itemizers), and also cut back on one of the most important deductions for older persons, the medical deduction (raising the threshold from 5 percent of AGI to 7 1/2 percent of AGI). In addition, the Social Security Amendments of 1983 not only taxed Social Security, but also required that tax-exempt interest income be included in calculating the amount of Social Security benefits subject to tax. This provision, which may push beneficiaries over the tax thresholds, essentially requires (albeit indirectly) these taxpayers to pay tax on their tax exempt income. Given these recent changes, and the need for older persons to maintain an adequate income stream over their remaining lifetimes, the current tax burden at retirement is not "too low".

C. The Disproportionate Burden of Deficit Reduction

Throughout consideration of the OBRA 93 Social Security tax increase, AARP repeatedly pointed out to Congress and the Administration that elderly taxpayers, particularly those currently in the 15 percent tax bracket, would face a tax increase not borne by younger taxpayers with comparable income. In fact, under OBRA 93 middle income older taxpayers were asked to bear a much greater tax burden than non-elderly taxpayers with considerably more income.

In addition to the Social Security tax increase, OBRA 93 reduced the Medicare program by $56 billion, and increased other taxes that are also paid by older Americans. In short, older Americans were asked to make a disproportionately large contribution to deficit reduction in OBRA 93.

III. THE RATE FOR TAXING SOCIAL SECURITY BENEFITS

When the National Commission on Social Security Reform (the Greenspan Commission) originally analyzed proposals to tax Social Security benefits in the early 1980s, considerable attention was devoted to the appropriate percentage of benefits that should be subject to taxation. The level was set at up to 50 percent because the employee paid one half of the OASDI payroll tax with after-tax contributions. Beneficiaries understand this rationale even if they do not always agree with it.

The Greenspan Commission reviewed proposals to tax 85 percent of benefits. The higher taxation level was advanced because it would bring the tax treatment of Social Security benefits into closer conformity with the taxation principles that apply to private pensions. However, Social Security is fundamentally different from a private pension. Social Security is an almost universal social insurance program established by the government to provide income protection to workers and their families if the wage earner retires, becomes disabled or dies. The program has complete portability and a progressive benefit formula. In contrast, private pensions cover less than half of the workforce, lack portability, and benefits generally favor those with higher incomes. Given these distinctions it is not necessary for Social Security to have parallel tax treatment to private pensions.

Some analyses suggest that the 85 percent level may be too high. The Congressional Budget Office (CBO) has pointed out that the 85 percent level reflects the nominal value of payroll tax contributions and fails to adjust them for inflation. CBO suggests that a 60 percent rate would take inflation into account. An analysis by Social Security's former chief actuary, Robert Myers, notes that the 85 percent rate represents double taxation. He recommends an initial 80 percent rate (for nominal, not inflation adjusted dollars), followed by a declining percentage until it reaches 72 percent in the next century.

The 85 percent level is thus still subject to debate as the appropriate level for full taxation of benefits. Even so, parallel treatment with pension income is not necessarily desirable. In any

event, raising the percentage of benefits taxed represents a benefit reduction for 5.5 million current beneficiaries and many more approaching retirement. It heightens the anxiety of today's workers about the availability and value of their Social Security retirement benefits. While the "value" of Social Security for current workers is often understated because disability and survivor benefits are omitted from most analyses, workers' concerns about the impact of these proposals upon their retirement income security are understandable.

IV. ASSOCIATION POSITION

A. Cost of Repeal

AARP opposed the increase in the level for taxing Social Security from 50 to 85 percent. In addition, the Association believes that any revenue from taxation should have been used, as it had been in 1983, only to improve Social Security's long-term solvency.

Despite our concerns, the taxation of up to 85 percent of benefits became law, and the revenue raised was credited to the Medicare Hospital Insurance (HI) trust fund. The diversion of the revenue raised from taxing the additional 35 percent of benefits to the Medicare Part A trust fund, while enacted largely as a way to avoid a budget procedural point of order, currently improves the long-term balance of that trust fund.

Revenue from current law will infuse about $24 billion over 5 years into the HI trust fund -- money that will shore up the trust fund's declining financial health. A phased-out repeal would produce a $14.9 billion shortfall over 5 years. The HI trust fund is currently projected to be insolvent in 2002. If the provision is repealed without an offset, the HI trust fund would face a shortfall of needed revenue, and

insolvency would be moved up for the HI trust fund. Although the Budget Enforcement Act already requires that revenue reductions be paid for, it is also critical that any offsetting revenues maintain or improve the current condition of the HI trust fund.

B. Impact on the Medicare Program

AARP urges the Committee -- in its consideration of how to pay for the provisions in the Senior Citizens Equity Act as well as other provisions of the Contract with America -- not to single out the Medicare program. Medicare has been reduced substantially over the last several years -- by nearly $200 billion since 1980. Moreover, the program and its beneficiaries are only now beginning to feel the impact of the $56 billion in Medicare reductions recently made as part of OBRA 93. Medicare cannot continue to sustain cuts of this magnitude.

While some contend that cuts in Medicare spending would simply be reductions in the program's rate of growth, large reductions would translate into substantial out-of-pocket cost increases for the 36 million disabled and aged beneficiaries who depend on Medicare as their primary source of health insurance. Older Americans already have the highest out-of-pocket expenditures for health care of any age group (National Medical Expenditure Survey). Health care expenses currently account for 23 percent of the average older person's household income as compared with 8 percent for the non-elderly. Additional reductions would create a barrier to care for many beneficiaries or would limit their choices of health plans, providers and coverage.

Deep cuts in Medicare are also fiscally short-sighted. Cutting Medicare means that costs will simply be shifted to businesses and individuals -- driving up the costs of private health insurance. For businesses, this added expense means that employers will scale back coverage for their workers, require workers to pay more, or eliminate health insurance coverage for their workers all together.

The Association therefore supports tax relief for those affected by the Social Security tax increase, particularly for middle income taxpayers. However, the tax relief must be fully paid for. In addition, since the tax revenue now is directed to the Medicare Part A trust fund, the trust fund must be kept whole. Finally, any financing should not place further burdens on Medicare beneficiaries or the Medicare program. To do so would in effect be to replace a tax increase on one group of beneficiaries with another tax on a larger, more vulnerable group of beneficiaries.

V. ACCELERATED DEATH BENEFITS UNDER LIFE INSURANCE CONTRACTS

The Association has a deep, long-standing interest in the issue of long-term care. We appreciate the fact that the Contract with America recognizes the very serious nature of our nation's long-term care crisis and includes provisions that attempt to ease the substantial financial burden families face when the need for long-term care arises. While Social Security helps to provide some peace of mind for millions of retirees, it does not address their needs when a long-term disability strikes; not uncommon for the fastest growing segment of our population, persons over 75 years of age. One such proposal would allow tax-free accelerated death benefits under life insurance contracts.

In general, AARP supports granting tax favored treatment to a life insurance terminal illness benefit. In our view, prepayment of life insurance benefits could provide valuable financial assistance to terminally ill individuals. In limited circumstances, a morbidity benefit also should receive tax favored treatment. In both cases, adequate safeguards for consumers must be a condition for obtaining favorable tax treatment. Our primary concern is that certain beneficiaries -- spouses in particular--should be protected by requiring their consent to acceleration of the benefits. Such spousal consent could be similar to the requirement in the pension laws that spouses sign a written consent form in order to waive their right to benefits. The Association also urges that an individual considering purchasing or exercising a right to accelerated benefits receive disclosure and counseling from the insurer on a number of subjects, in particular on the implications for eligibility for low-income program benefits, such as those available under Medicaid.

VI. CONCLUSION

The Association supports tax relief for accelerated death benefits with appropriate consumer safeguards and for those affected by the Social Security tax increase, particularly for those middle income taxpayers who were hardest hit. AARP believes, however, that this tax relief must be paid for responsibly. Phasing out the Social Security tax, while likely to be confusing, will be less costly than an immediate repeal. We stand ready to work with this Committee to find a responsible solution that reduces the tax burden of those affected by the OBRA 93 provision, that is fully paid for, that maintains the integrity of the HI trust fund, and that achieves these goals without placing additional burdens on Medicare beneficiaries.

CHART A

ADDITIONAL FEDERAL INCOME TAX LIABILITY IN 1994 UNDER P.L. 103-66

Annual Social Security Benefit					
$5,000		$10,000	$15,000	$20,000	$25,000
Other income	Additional tax liability				
Single					
$20,000	--	--	--	c	c
25,000	--	--	--	c	c
30,000	--	98.00	343.00	c	c
35,000	490.00	980.00	1,183.00	c	c
40,000	490.00	980.00	1,470.00	c	c
50,000	490.00	980.00	1,483.50	c	c
75,000	542.50	1,085.00	1,627.50	c	c
100,000	542.50	1,085.00	1,627.50	c	c
Joint					
$20,000	--	--	--	--	--
25,000	--	--	--	--	--
30,000	--	--	--	--	--
35,000	--	--	--	52.50	183.75
40,000	--	127.50	221.25	360.50	768.00
50,000	490.00	980.00	1,470.00	1,960.00	2,450.00
75,000	490.00	980.00	1,470.00	1,960.00	2,450.00
100,000	490.00	1,085.00	1,627.50	2,170.00	2,712.50

a. AGI excluding social security, and assuming no tax-free interest is received.
b. Individuals are assumed to be age 65 or older and use the standard deduction.
c. Virtually no single individual currently received this level of benefits. Very few receive $15,000 in yearly benefits.

Source: Congressional Research Service, December 27, 1994

CHART 1

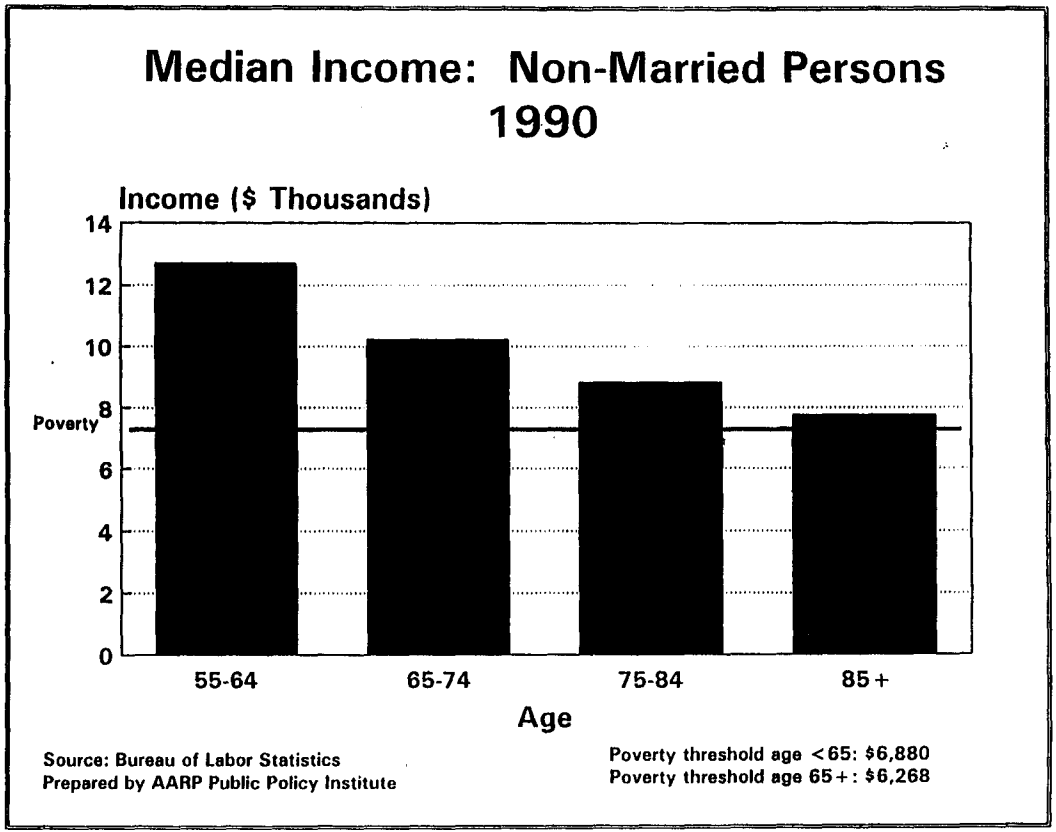
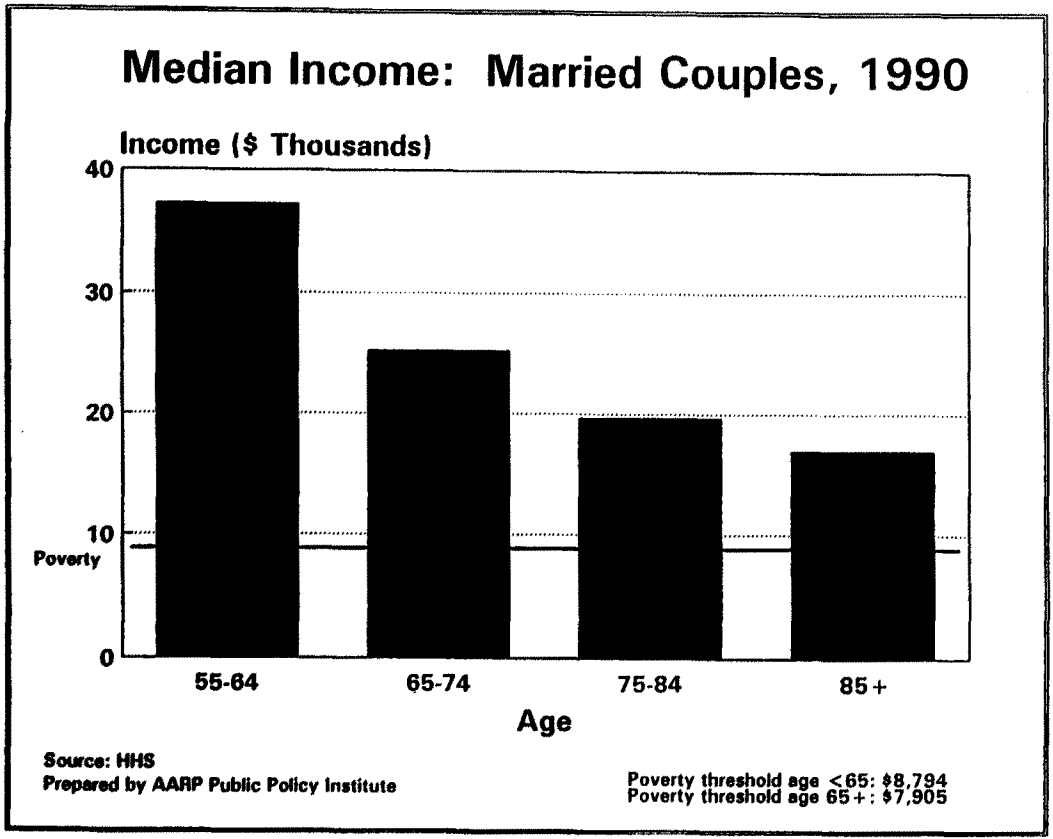

Median Income: Non-Married Persons
1990
Income ($ Thousands)
14
12
10
8
6
4
2
0
Poverty
55-64
65-74
75-84
85+
Age
Source: Bureau of Labor Statistics
Prepared by AARP Public Policy Institute
Poverty threshold age <65: $6,880
Poverty threshold age 65+: $6,268

CHART 2


Median Income: Married Couples, 1990
Income ($ Thousands)
40
30
20
10
Poverty
0
55-64
65-74
75-84
85+
Age
Source: HHS
Prepared by AARP Public Policy Institute
Poverty threshold age <65: $8,794
Poverty threshold age 65+: $7,905

Mr. BUNNING. Mr. Entin.

STATEMENT OF STEPHEN J. ENTIN, RESIDENT SCHOLAR, INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

Mr. ENTIN. Thank you, Mr. Chairman, and members of the committee. My name is Steve Entin. I work at the Institute for Research on the Economics of Taxation. Thank you for hearing me out on the subject of taxation of benefits.

The major provision of the Senior Citizens' Equity Act in the Contract With America would roll back the increase in the taxation of Social Security benefits enacted in the 1993 Budget Act (OBRA 1993).

Repealing the OBRA 1993 increase from 50 percent to 85 percent in the amount of Social Security benefits subject to tax would be a good step, but in my opinion, it does not go far enough.

A more sweeping reform of the taxation of benefits, as well as the Social Security earnings test which you covered in a hearing on January 9, is needed to reduce unconscionable disincentives created by the current system. What I want to focus on today is the disincentive effects of these provisions.

Since the 1983 Social Security amendments, which I must say were enacted in great haste and confusion, Social Security benefits are added to taxable income when the beneficiary's income exceeds certain thresholds. It is the threshold concept which causes the trouble.

Single beneficiaries with incomes above $25,000 and married beneficiaries with incomes above $32,000 must add 50 cents in benefits to their taxable incomes for each dollar over the threshold until half their benefits are taxed. OBRA 1993 increased the amount of benefits to be included in taxable income to 85 cents per dollar of income over $34,000 for single beneficiaries and over $44,000 for couples until 85 percent of benefits are included.

Now, here is the key point. The taxation of benefits is triggered by earning other retirement income that pushes total income over the threshold. Consequently, it is the other retirement income, including interest, even tax-exempt interest, dividends, pensions, and wages that is really bearing the tax, and at super-normal rates.

Over these thresholds, earning an extra dollar of retirement income can add $1.50 to taxable income, and up to $1.85 since OBRA 1993. For example, for someone in the 28-percent bracket, if you earn one extra dollar of interest there is a tax of 42 cents, if you are in the 50-percent tier, or a tax of 52 cents if you are in the 85-percent tier, on that added dollar of interest.

On wages, with the payroll tax added in, the marginal tax rate reaches 56 or 65 percent. If the taxpayer's wages are also subject to the Social Security earnings test, the tax rate can reach 103 percent to 109 percent, not even counting State income taxes. You even get 14 cents in tax imposed on $1 of tax-exempt interest if you are in the 28-percent bracket and you have to add 50 cents of benefits to taxable income because of the an added dollar of tax-exempt interest. If you are in the 85-percent tier, the tax is 24 cents.

Now, the Contract With America would eliminate the 85-percent provision in OBRA 1993, but it would leave up to 50 percent of benefits subject to tax. Just rolling back these punitive tax rates,

for example, from 52 percent to 42 percent, is not enough. A total overhaul of benefit taxation and the earnings test is needed.

The tax poisoning of private retirement saving that might push you over the threshold sends a terrible message to savers at all ages. It says "Congress does not want you to save for retirement." The super-normal tax rates on wages tells older workers, "We don't want your brains, skills, or experience in the work force." In time, because the thresholds for benefit taxation are not adjusted for inflation, more and more taxpayers will be pushed over the thresholds as incomes rise with inflation.

At 3 percent inflation, by 2010 when the baby boom is beginning to retire, the thresholds for married and single taxpayers will have fallen to roughly $19,000 and $15,000 in today's money. The tax spikes also poison pension and IRA withdrawals, penalizing the incentive to save.

Congress should remove both the 50-percent and 85-percent phase-ins by decoupling the taxation of benefits from other income. It is the only way to eliminate the resulting tax spikes. Instead of current methods, you might take some exempt amount, let's say $6,000 for a single beneficiary, $9,000 for a one-worker couple, and $12,000 for a two-worker couple, and require that benefits above those amounts simply be added to taxable income. That would create an income threshold below which you would not be taxing people on their benefits, which is the whole idea behind the thresholds in current law, but it would not have the side effect of driving marginal tax rates through the roof.

If you wanted to increase revenues, you could have lower thresholds. If you wanted to have fewer people subject to the taxation of benefits, you could have higher thresholds. That kind of approach or the other approach I put into the testimony would give you some flexibility in this matter. Thank you very much.

[The prepared statement and attachment follow:]

HEARING ON THE SENIOR CITIZENS' EQUITY ACT: REFORMING TAXATION OF SOCIAL SECURITY BENEFITS

Statement of Stephen J. Entin, Resident Scholar
Institute for Research on the Economics of Taxation

before the

Committee on Ways and Means

January 19, 1995

Repealing the OBRA93 increase, from 50 percent to 85 percent, in the amount of social security benefits subject to tax is a good step. Nonetheless, a more sweeping reform of the taxation of benefits, as well as the social security earnings test, is called for to reduce unconscionable disincentives created by the current system.

Before OBRA93, the tax treatment of up to 50 percent of social security benefits (tier 1) imposed marginal income tax rates of up to 42% on earnings of private saving for persons in the statutory 28% federal income tax bracket, a powerful disincentive to work and save. OBRA93 raised the rate as high as 51.8% by phasing in up to 85 percent of benefits into taxable income (tier 2). Beneficiaries who earn modest amounts of wages, not subject to the social security earnings test, can now face combined marginal federal income and payroll taxes as high as 65% (up from 56% before OBRA93), making working and saving for retirement or disability even less attractive. These rates would be several percentage points higher after adding typical state income tax rates.

Beneficiaries subject to the social security earnings limitation and taxation of up to 50 percent of benefits can face marginal tax rates of roughly 68% to 103% percent on additional wages (and about 72% to 109% when state income taxes are added). Beneficiaries subject to the earnings limitation and taxation of up to 85 percent of benefits can face tax rates of 71% to 109% on additional wages (and about 75% to 115% when typical state income taxes are added).

Clearly, strong action is needed to reduce these prohibitive tax rates. Repealing the OBRA93 increase in the amount of social security benefits subject to tax would only reduce the tax spikes described above from outrageous to merely horrible. A real correction requires completely restructuring the taxation of social security benefits and easing or repealing the earnings test.

How the tax works.

The so-called tax on social security retirement and disability benefits is really a tax on other, private income — interest, dividends, pensions, and wages — received by individuals collecting social security benefits. The taxation of benefits is triggered as other retirement income exceeds a set of thresholds, not by any change in one's social security benefits, which are set by a formula beyond an individual's control. Consequently, it is the other retirement income that bears the additional tax, not the benefits. The result is a tax on other income at super-statutory rates, resulting in a sharp disincentive for private retirement saving or continued work. The tax poisoning of private retirement saving sends a terrible message to savers of all ages: "Congress does not want you to save for retirement." The super-normal tax rates on wages sends a terrible message to older workers: "We don't want your brains, skills, or experience in the work force."

Under current law, benefits start to be taxed when modified adjusted gross income (MAGI) — the sum of a beneficiary's ordinary AGI (wages, interest, pensions, dividends, etc.), tax exempt bond income, and half of social security benefits — exceeds $32,000 for a married couple filing jointly and $25,000 for a single taxpayer (tier 1). For each dollar by which MAGI

exceeds the exempt amounts, $0.50 of the taxpayer's social security benefits becomes taxable income, up to half of benefits.

As benefits become taxable, earning another dollar of taxable interest, dividends, pensions, or wages increases taxable income by $1.50, effectively raising the marginal tax rate on the added dollar of income to 1.5 times the statutory rate, e.g., from 15% to 22.5% or from 28% to 42%. An added dollar of tax exempt interest raises taxable income by $0.50, subjecting the otherwise untaxed interest to de facto marginal tax rates of 7.5% for taxpayers in the 15% bracket, and 14% for taxpayers in the 28% bracket. Once half of benefits have become taxable, additional earnings again face normal marginal tax rates. (The 31% rate is not affected. Half of benefits become taxable before a taxpayer's income exceeds the 28% tax bracket.)

OBRA93 increased the amount of social security retirement and disability benefits subject to income tax to 85 percent for married couples with MAGI above $44,000 and for single beneficiaries with income above $34,000 (tier 2). Affected beneficiaries have to add $0.85 of benefits to taxable income for each dollar of MAGI over these thresholds until 85 percent of benefits become taxable. This increases the marginal tax rate spike to 1.85 times normal rates. The 15% marginal income tax rate becomes 27.8%, and the 28% marginal income tax rate jumps to 51.8%.

When wages are involved, one must factor in the payroll tax. The self-employed and employers get to deduct half of the 15.3% payroll tax. In the case of the self-employed, the deduction reduces adjusted gross income by $0.0765 for each dollar of wage income subject to the payroll tax, slightly reducing the marginal income tax spike created by the phase-in of benefits into taxable income. The combined marginal income tax and payroll tax rates range from 37% to 66% before state income taxes (see table). (Similar result obtain in the case of employee/beneficiaries if one factors in the combined employee/employer payroll tax after allowing for the deduction of the employer's half.)

Interaction with income taxation of social security benefits.

Even higher tax rates occur when a beneficiary is subject to the social security earnings limit on wage and salary income (in 1995, $8,160 for beneficiaries ages 62-64, and $11,280 for those ages 65-69) as well as the phase-in of benefit taxation. Beneficiaries lose $1 in benefits for every $2 by which wages exceed the limit for people ages 62-64 or $1 for every $3 by which wages exceed the limit for people ages 65-69, producing effective tax rates of 50% and 33-1/3%, respectively, on the wages. These implicit tax rates due to the earnings test are not strictly additive to the income tax effects of benefit taxation, because the benefit reductions slightly reduce the income tax spike.[1] Nonetheless, together with the payroll tax on the added earnings, the federal marginal tax rate on beneficiaries' wages can reach confiscatory levels of 68% to 103% in tier one and 71% to 109% in tier two before state income taxes, and roughly 70% to 115% over the two tiers when typical state income tax rates are added (see table). Benefits lost to the earnings test may be recovered later in life if excess earnings cease, but only if the retiree lives long enough. The tax disincentive is surely daunting, and was made more so by OBRA93.

Not just an upper income penalty.

The tax spikes due to the taxation of benefits currently fall on the top 20 percent or less of social security beneficiaries. Ultimately, however, over 60 percent of beneficiaries will pay some tax on their benefits, because the income thresholds for benefit taxation are not adjusted for inflation. At three percent inflation, by 2010, when the baby boom is beginning to retire, the thresholds for married and single taxpayers will have fallen to roughly $19,000 and $15,000 in today's dollars. Children now in kindergarten will face thresholds of roughly $5,900 to $4,600 in 2050 in today's dollars, and will avoid tax on their benefits only by being too poor to owe any income tax at all.

Impact on saving incentives.

The tax spikes in current law are a trap for unwary users of pension plans and IRAs. Normally, people face higher tax rates during their working years, and lower rates after retirement. By using pensions or deductible IRAs, they can shift taxable income from a high tax rate period to a low tax rate period. However, if their retirement income falls within the phase-in range of their social security benefits, they may face a higher tax rate after retirement than when they were working. If the savers are young, the tax deferred inside build-up in the retirement plans is enough to compensate, but past a certain age, they would be better off not using such accounts. Such savers would be better off with a "back-ended" IRA, as proposed in the Contract with America, in which no deduction is allowed for contributions, but withdrawals are tax exempt. But beware: the taxation of social security benefits would poison even a back-ended IRA, just as it imposes a tax on other tax exempt income at 50% or 85% of the taxpayer's statutory tax rate, unless the IRA withdrawals were explicitly excluded from the calculation of modified adjusted gross income used to determine the amount of social security benefits subject to tax. If a back-ended IRA is enacted, that exclusion must be part of the provision, or the incentive to save provided by the back-ended IRA will be cut sharply.

Better ways to tax benefits.

Congress should do more than repeal the OBRA93 increase in the amount of social security benefits subject to tax. Congress should remove both the 50 percent and 85 percent phase-ins by decoupling the taxation of social security benefits from the amount of a taxpayer's other income. That is the only way to eliminate the resulting spike in marginal tax rates on interest, dividends, pensions, wages, and other privately provided retirement income. I offer two methods of decoupling for consideration.

Method 1: Benefits above some exempt amounts, up to half of total benefits, would simply be added to ordinary taxable income. The exempt amounts, say, $6,000 for a single retiree, $9,000 for a couple using the 50 percent spousal benefit, and up to $12,000 for a two-worker couple each receiving his or her own benefits, could be adjusted to produce the same, higher, or lower revenue than current law, as desired. (Including no more than half of total benefits is suggested because, in the future, it will roughly correspond to the half of the payroll tax paid by the employee, for which no income tax deduction was allowed, and which was, therefore, already taxed.)

Method 2: An alternative approach would be to tax social security benefits in the same manner as pension income used to be taxed. Individuals would pay no tax on social security benefits until their benefits exceed their lifetime employee payroll tax "contributions". Any benefits in excess of lifetime contributions would simply be added to taxable income. (Employer taxes, which were deductible when paid, would not be exempt.)

The thresholds in current law are designed to exempt, at least temporarily, low and middle income people from paying tax on benefits. Alternative method one, above, is designed to shelter roughly the same group of low and middle income beneficiaries without the tax spike created by the current method. This method effectively shelters lower income retirees because there is a strong relationship between having high social security benefits and having high levels of other retirement income. People have high social security benefits because they had high earnings during their working lives. Such persons also tend to have high private pension benefits, high levels of accumulated savings and earnings from savings, and a greater ability to continue to earn high levels of wages when semi-retired. It is conceivable that some people who had high levels of income during their working lives saved little or none of it, and so have little private retirement income, but they are the exception, and their situation should not drive tax policy into creating enormous disincentives against normal saving behavior.

Alternative method two would tax more people and more benefits than method one, and, initially, more than under current law. However, both alternatives would subject fewer benefits to taxation over time than current law, as more and more people exceed current law's unindexed thresholds.

Conclusion.

Reform of social security benefit taxation (and the earnings test) is urgent. The current tax treatment imposes mindless disincentives to work and save. The OBRA93 changes exaggerated the flaws. The Committee should do more than repeal the 1983 changes; it should completely overhaul the method of taxing benefits. The social security earnings limitation should also be raised or, better yet, eliminated entirely. (On January, 9, 1995, the Subcommittee on Social Security held a very informative hearing on raising the limit to $30,000.)

Current tax treatment of social security benefits fails every test of sensible policy. If the objective is fairness, or similarity to the tax treatment of private pensions, it cannot be achieved with tax rates approaching or exceeding 100%. If the objective is to turn Social Security into a means-tested welfare program, there are surely more efficient ways to do it.

Effective Federal* Marginal Tax Rates for Social Security Recipients				
Statutory income tax rate	Marginal tax rates as social security benefits become taxable, in tier 1 (50% phase-in range) or tier 2 (85% phase-in range)			
	Income from savings, pensions		Wage income below earnings test threshold	
	Tier 1 (150% of statutory income tax rate)	Tier 2 (185% of statutory income tax rate)	Tier 1 (adjusted income plus payroll tax rate**)	Tier 2 (adjusted income plus payroll tax rate**)
15%	22.5%	27.8%	37.2%	42.1%
28%	42%	51.8%	56.2%	65.3%
	Wages subject to the social security earnings test, payroll and income taxes**			
	Ages 65-69		Ages 62-64	
	Tier 1	Tier 2	Tier 1	Tier 2
15%	68.1%	71.2%	85.4%	88.9%
28%	84.9%	90.7%	102.7%	109.3%

* Add 4 to 6 percentage points for typical state income tax rates.
**Assumes self-employed payroll tax, allowing for income-tax deductibility of "employer's" half of payroll tax and effect of deduction on modified adjusted gross income used to determine amount of social security benefits subject to income taxation. Figures would be very similar for employee beneficiaries after adding the employee and employer payroll tax after deduction of employer's half at employer's tax rate.

Endnotes

1. When an employee/beneficiary is subject to both the Social Security earnings test and the phase-in of benefit taxation at the 50 percent rate, the interaction of the two provisions produces an effective increase of either 37.5 percent (for beneficiaries ages 62-64) or 41.67 percent (for beneficiaries ages 65-69) in the marginal tax rate on wage and salary income, rather than one-half. The added dollar of wages costs the beneficiary $0.50 in benefits if age 62-64, $0.3333 if age 65-69. Since half of Social Security benefits are counted in determining whether a taxpayer's income exceeds the threshold for taxation of benefits, that measure of income falls by half of these benefit losses, or by $0.25 or $0.1667. Thus, the net result of an added $1 in wages is an additional $0.75 or $0.8333 in the income measure used to determine benefit taxation, and an increase of half that amount -- $0.375 or $0.4167 -- in taxable benefits. Thus, the consequence of the added dollar of wages is to raise taxable income by $1.375 or $1.4167. This effectively raises the 15 percent tax rate to 20.625 percent or 21.25 percent, and the 28 percent tax rate to 38.5 percent or 39.67 percent, for those in the 62-64 and 65-69 age groups, respectively. For people subject to taxation of up to 85 percent of benefits, the corresponding increases in taxable income are $1.6375 or $1.7085, raising the 28 percent marginal income tax rate to 45.85 percent or 47.84 percent, for those in the 62-64 and 65-69 age groups, respectively. Adding in the 50% or 33-1/3% implicit tax rates due to the earnings test, plus payroll tax (adjusted for the employer's deduction) and state income taxes, marginal tax rates under these conditions can reach 75 percent to 115 percent.

The calculation is a bit trickier for the self-employed. The added dollar of wages raises adjusted gross income by $0.9235 (=$1-$0.0765). Subtracting half of the lost Social Security benefits ($0.25 or $0.1667) results in a net increase of modified adjusted gross income of $0.6735 (ages 62-64) or $0.5902 (ages 65-69), an addition to taxable income of 50% or 85% of those amounts, and implicit marginal income tax rates that are 1.337, 1.572, 1.295, or 1.502 times the statutory levels. One must then add the payroll and state and local income tax rates, arriving at similar results as in the employee/beneficiary example.

Mr. BUNNING. Ms. Moon, please.

STATEMENT OF MARILYN MOON, SENIOR FELLOW, URBAN INSTITUTE

Ms. MOON. Thank you. I appreciate the opportunity to be here to testify, but I must start out by apologizing. My formal statement has an error in it of a simple calculation done late at night on a holiday weekend, and I apologize. I would be happy to correct that for the record.

I would like to focus my oral remarks on my conclusion that it is undesirable for those who support Social Security and Medicare, our two important social insurance programs, to make changes that will benefit only a minority of elderly persons in the short run and potentially cause more harm in the long run.

I believe that it is irresponsible to consider this change in taxation in a vacuum, that the consequences of its rollback would be more harmful to the elderly, and that it is only wishful thinking, for example, to assume that Medicare would be spared any further changes after this rollback.

In my remaining testimony, I would like to focus just on two of the points that I raise in the written part. First, the issue of economic incentives that Mr. Entin raised is not the only principle to use in considering these changes. Although I don't agree with his analysis on the efficiency side, I want to focus on issues of fairness. Second, it is essential to understand the likely impact on the Medicare program of eliminating the revenues from Social Security taxation in an environment in which we are facing a financing crisis in Medicare in the near future.

First, let me talk about fairness of the actual tax itself. In judging the advisability of taxation of Social Security, there are two principle issues of fairness. One is the question of equal treatment of equals, where it is appropriate to look at how we treat younger families versus how we treat older families in the United States.

Since older Americans have long benefited from the exclusion of Social Security benefits from their incomes for purposes of calculating taxes, they do not pay as much as younger families in taxes. For example, if you consider two couples with $80,000 of income in 1995, one of which is over 65 and the other under 65, after accounting for payroll and income taxes, the Federal tax burden would be nearly twice as high on young working families as it would be on elderly families. Therefore, the expansion of the taxation of Social Security actually improves the principle of horizontal equity.

I think rather than thinking about this taxation as adding additional burdens, we need to think about the fact that we have provided this tax benefit in the beginning for these individuals, and we are now reducing that tax benefit to some extent.

A second equity principle is the issue of progressivity, of whether those who have a higher ability to pay, as measured by their incomes, pay a greater share of their incomes in taxes. Again, I conclude that taxation of Social Security benefits is a reasonable way to make Social Security benefits more progressive over time because it takes into account other income sources that individuals have.

It is very difficult to make that formula much more progressive than it is now, I believe, without recognizing the role that other income plays on individuals. Taxation of Social Security benefits essentially does that, and I believe, therefore, it is a reasonable tool to have in the arsenal of good social policy options for older Americans.

Now, let me also discuss the impact on Medicare of the likely repeal of this taxation. Even if the rollback of this legislation would find other ways of financing that revenue change under the budget rules, the important question is what will happen to Medicare because these dollars now flow into the Hospital Insurance Trust Fund. Medicare is going to face a number of problems in the future, and if you look at the arsenal of possible changes that could be used to cut Medicare, none of them are nearly as attractive as this particular way of helping to finance the Medicare benefit package.

For example, an income-related premium tries in a more cumbersome way than taxation of Social Security benefits to replace lost revenues. Such a premium would add considerable additional administrative burdens, making it undesirable from that perspective. Other changes such as a higher coinsurance on home health, which is a favorite of many people who propose changes in Medicare, would be particularly harmful to older Americans; that is, persons over age 85 who are heavy users of home health services.

This would mean, for example, an increase of about $700 in additional copayments to an average user of home health services, and an even greater amount for an extraordinary user of home health services. So on balance, while I don't think it is pleasant to talk about taxation of anything, the Social Security taxation provision being discussed here today is not an unfair approach in an environment in which the resulting revenues are being used to help older persons by dedicating them to the Hospital Insurance Trust Fund. Thank you.

[The prepared statement follows:]

TAXATION OF SOCIAL SECURITY BENEFITS

Statement by Marilyn Moon[1]
before the
Committee on Ways and Means
U.S. House of Representatives
January 19, 1995

I appreciate the opportunity to testify today on the issue of the taxation of Social Security benefits. The Contract with America proposes to roll back changes in the taxation of Social Security benefits that were made in 1993. My testimony today offers four issues that ought to be examined in considering such a proposal:

- The challenges that will face the financing of Social Security over the next 50 years;
- The history and rationale for the taxation of Social Security benefits;
- The impact of the taxation of Social Security on beneficiaries and Medicare; and
- The impact of the new burdens that would need to be added to replace revenue lost to Medicare.

My interest in this issue stems from my work on aging issues for most of my career as an economic researcher and policy analyst. I am currently a senior fellow at the Urban Institute, a nonprofit, nonpartisan research organization here in Washington, where I work mainly on health issues and measures of economic status for the elderly.

The Challenges Facing Social Security and Medicare in the Future

As I am sure you are well aware, both Social Security and Medicare will face unprecedented challenges as the Baby Boom generation approaches retirement age. And, for Medicare, the problems are projected to come even sooner because of the additional burdens of rapidly rising health care costs. Current projections by the actuaries suggest that the trust fund for Part A of Medicare will be depleted by the year 2001. This problem needs to be seriously addressed within the next two or three years.

Solvency for Social Security will also become a major issue but not as soon, meaning that adjustments to the Social Security program can be put off for a longer period. But here too the earlier we begin to tackle the problem, the less pain will likely be inflicted on anyone. Moreover, Social Security and Medicare are linked, so that problems in one part of our social insurance system will inevitably affect the other parts.

Any proposal that affects Social Security or Medicare needs to be viewed in the context of this looming financing crisis. Making tough decisions to protect the future of Social Security and Medicare will be difficult, so it makes little sense to propose changes that exacerbate these challenges. Consequently, changes that raise spending on these programs or that reduce revenues that flow into them are irresponsible unless fully offset by other changes that bolster the financial health of these two programs.

The History and Rationale for Social Security Taxation

Taxation of Social Security benefits was introduced in 1983 as part of a broader set of amendments to restore actuarial balance to the program. Other changes lowered future

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[1]Senior Fellow, The Urban Institute, Washington, D.C. This statement presents the views of the author and does not necessarily represent the views of the Urban Institute, its trustees or sponsors.

benefits, raised the retirement age for future generations of retirees, and increased contributions into the system--thus spreading the burdens of the change among Americans of all ages. Taxation of benefits is one of the few progressive changes that can be made to generate savings for the program from current beneficiaries. That is, by establishing an income threshold before taxation of Social Security begins (at $25,000 for single persons and $32,000 for couples), those with the lowest incomes were protected. And even then no more than 50 percent of all Social Security benefits were ever subjected to taxation. Even the highest income beneficiaries were still allowed to keep at least half of Social Security benefits from counting as income for purposes of taxation.

In judging the advisability of taxation of Social Security, a number of principles of taxation can be examined. One major principle is the equal treatment of equals--that is, people with the same incomes should pay the same level of taxes. Since older Americans have long benefitted from the exclusion of this very important part of their incomes from taxation, they do not pay as much as younger families in taxes.[2] The expansion of the taxation of Social Security thus actually improves this tax principle of horizontal equity.

Another principle relates to the issue of progressivity--of whether those who have higher ability to pay (usually measured by their incomes) pay a greater share of their incomes in taxes. Again, taxation of Social Security meets this principle of fairness. Moreover, it is a more progressive way to reduce benefits than changing the Social Security benefit formula, for example, because it takes into account all sources of income in determining who should be liable for higher taxes. In that sense, it is a better gauge of ability to pay than if adjustments were simply made on the basis of Social Security benefits alone. And it is certainly more progressive than across-the-board cuts in cost of living adjustments which constitute one of the other major proposals for Social Security savings.

Taxation of benefits is also fully consistent with the philosophy of Social Security to supplement retirement income for Americans, and to supplement it more generously for those with lower incomes. Finally, the original legislation on Social Security was silent about whether or not it would count as income for purposes of taxation. An IRS ruling--and not legislative intent--is what gave us the exclusion of this source of income from taxation.

Since 1983, proposals to further modify Social Security to assure its availability for future generations have often included extension of the taxation of benefits. When searching for ways to spread the burdens of these changes across present and future generations of beneficiaries, this has been viewed by many as one of the fairest ways for current beneficiaries to contribute to the solution. Thus, if the 1993 Social Security change had not been instituted as part of deficit reduction legislation, such a provision would very likely be included in any Social Security reform plan in the future.

Further, the additional taxation enacted in 1993 had another important element: these new revenues were dedicated to the Medicare Hospital Insurance trust fund to help improve its financial health. Thus, every dollar that higher income beneficiaries pay goes to help pay benefits to Medicare beneficiaries. Effectively, this is a way to make the Medicare program more progressive as well without generating new administrative structures to do so.

Elimination of the 1993 legislation that expands taxation of Social Security will deprive the Medicare trust fund of needed revenues and help to accelerate its fiscal crisis. Thus, any assessment of the value of rescinding this legislation must also consider the impact on the Medicare program because of this direct linkage between the two programs.

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[2]And coupled with other tax benefits they receive, the elderly, on average, paid 16.3 percent of their incomes in federal taxes as compared to 24.7 percent for families headed by someone under age 65 in 1991, for example.

The Impact of Taxation on Beneficiaries and Medicare

The taxation provision that the Contract with America proposes to rescind would only affect beneficiaries with incomes above $34,000 (singles) or $44,000 (couples), or about 13 percent of all elderly beneficiaries. Since many beneficiaries have relatively low incomes, more than seven out of every eight elderly beneficiaries are unaffected by this provision.

For those who are affected, the share of Social Security that counts as income gradually rises from 50 percent to 85 percent above that threshold. Thus, even the highest income beneficiaries are allowed to shelter 15 percent of their benefits from taxation--still giving them an advantage over younger families with similar levels of income.

Consider the example of a couple with an income of $80,000 per year, including $12,000 of Social Security benefits. Before the imposition of the tax change of 1993, this couple would have paid income taxes on one-half of their Social Security benefits, so that their adjusted gross income (AGI--that is, income before deductions and exemptions) would have been $74,000. After the new law, they would have to pay taxes on $10,200 of their benefits, bringing their AGI to $78,200. If they were in the 28 percent tax bracket, this would increase their taxes by $1,176. As compared to a younger family with the same income and deductions, however, they still would pay $504 less in income taxes.

And families with lower incomes, closer to the thresholds would pay less in additional taxes. For example, a single person with an income of $40,000 including $8000 in Social Security would have to report $4700 of that as income for tax purposes, bringing her AGI to $36,700. She would pay $196 more in federal income taxes (again assuming that she is in the 28 percent income tax bracket).

As noted above, the revenues raised from this provision go directly to the Medicare Hospital Insurance (Part A) trust fund. The Department of the Treasury estimates that this provision will add $15 billion to the Medicare trust fund over the next 5 years, and $48.5 billion between 1995 and 2005. While the $15 billion represents only about 13 percent of what Medicare Part A will spend this year, it does help to extend the life of the trust fund. And since other changes will still be needed to keep Medicare solvent, even this relatively small contribution is critical.

Alternatives for Replacing the Lost Revenue

Budget rules require that revenue lost by eliminating the 1993 expansion of taxation of Social Security benefits would have to be replaced by some other set of changes in spending or revenues. Moreover, even if other means were found to replace the revenue that did not affect Social Security or Medicare, it would still be necessary to make an equivalent amount of higher revenues or lower spending in Medicare to protect the trust fund. How might that be done? Medicare changes for Part A offer only a limited range of options, some of which will need to be tapped in the next few years even without losses from this income tax contribution. Part A covers hospital services, skilled nursing care and home health services, and so it is in these areas that reductions would need to be found.

One set of changes might be to reduce payments to health care providers for Medicare. This would mean, for example, cutting payments to hospitals, nursing homes, and/or home health agencies. Since hospital services make up the bulk of Part A spending, many of the cuts would have to take place there. Hospitals, however, are already objecting strongly to the levels of payment they receive under Medicare, arguing that they often do not even cover the costs of such care. To the extent that they are able, hospitals will attempt to shift any shortfall in payments onto other payers of care, such as private insurance patients. And if there are major shortfalls that cannot be shifted, hospitals and other health care providers may be force to close their doors or stop treating Medicare patients. Both of these effects create problems for our health care system. Since the early 1980s, Medicare has relied heavily on this type of savings. At some point, once the gap between costs and what Medicare will pay

widens enough, this option will cease to be a viable source of new savings, however.

A number of proposals for cutting Medicare thus look elsewhere to changes that would affect beneficiaries directly. These include a new Part A premium or higher cost sharing for the services received.

Medicare has never charged a premium for the Hospital Insurance portion of the program, so this would mean a major change in the philosophy of the program. Moreover, if applied to all beneficiaries, we would trade a progressive benefit for one that put heavier relative burdens on those beneficiaries with modest incomes. It is difficult to argue fairness when asking a widow making $10,000 per year to pay a new premium in lieu of an elderly couple with $80,000 of income paying more income taxes.

Some of the proposals for a higher hospital deductible or a new premium would be income-related (such as that proposed by Congressman Kasich last year). Those with higher incomes would pay more. While this would be fairer than a flat increase and would make higher premiums or deductibles possible since lower income beneficiaries would not have to bear the full burden, this would require either setting up a whole new administrative structure or using the IRS. Ironically, this would be equivalent to taxing Social Security benefits--but with more complicated adjustments. Thus, it makes little sense to trade taxation of Social Security for a similar, but more convoluted tax on Medicare.

Finally, one of the more likely options for helping the Part A trust fund would be to institute a new coinsurance payment for home health services. The coinsurance on this service was eliminated in 1972 and a number of health care proposals and deficit reduction plans have called for reinstituting the coinsurance. Indeed, the Congressional Budget Office has estimated that a 20 percent coinsurance could raise about $20 billion over 5 years. However, this option has particularly undesirable effects on low and moderate income beneficiaries. Because the very old are most likely to use this benefit--and to use it extensively--they would bear the greatest burden from this change. The average user of home health services would face a new coinsurance charge of over $700 per year under this proposal. And because the incomes of these older, frail Medicare beneficiaries tend to be quite low, this would be a particularly regressive change. For example, beneficiaries aged 85 and over would pay coinsurance rates about five times higher than those aged 65 to 69.

Conclusion

While it may be tempting to roll back the tax increase enacted in 1993 that subjected more of Social Security to taxation, there are strong reasons to resist that temptation. This expanded taxation of benefits is consistent with the types of sacrifices that Americans need to be asked to make in the future to ensure that Social Security will be able to fulfill its promises over time. Although the decisions will not be easy ones, needed changes in Social Security and Medicare should not be postponed. Moreover, repeal of this provision would send exactly the wrong signal to Americans about making tough but fair decisions regarding government spending.

The 1993 expansion of the taxation of Social Security represents a progressive change that not only helps in reducing the federal deficit but also in funding the Hospital Insurance portion of the Medicare program. Without this provision, changes in Medicare that would be required in the next few years would be less likely to protect the most vulnerable beneficiaries. Rescinding that provision would be a step backward, not forward in putting these two critical programs of the federal government on a firmer footing.

Mr. BUNNING. Dr. Goodman, please.

STATEMENT OF JOHN C. GOODMAN, PH.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CENTER FOR POLICY ANALYSIS, DALLAS, TEX.

Mr. GOODMAN. Thank you, Mr. Chairman. My name is John Goodman. I am president of the NCPA (National Center for Policy Analysis). Now, Marilyn Moon just told us that for tax purposes we should treat Social Security benefits the way we treat any other type of income, and if that is what we were doing, then I wouldn't be here today, but that is precisely what we aren't doing.

Although we call this tax a Social Security benefit tax, it is not really a tax on Social Security benefits. If you don't have any other income, you don't pay any tax at all. You only pay the tax to the extent that you have other income.

Now, as we have already learned, the way this tax works is that when you earn $1 of income, you pay taxes, theoretically, on 85 cents of Social Security benefits. What that means is you earn $1, you pay taxes on $1.85, and as Mr. Entin says, what that means is you increase your marginal tax rate by 85 percentage points.

Now, what this means is that we aren't treating people with equal incomes equally. This chart compares a young person with an elderly person earning exactly the same income. They are both in the 28-percent Federal income tax bracket, but because of this very pernicious Social Security benefit tax, the elderly person is in the 52-percent tax bracket paying almost twice the marginal tax rate of a young person.

Now, on what does this tax fall? If it is not falling on Social Security, what does it fall on? It falls on mainly investment income, capital income. Although the elderly represent only 12 percent of the population, they are holding 40 percent of all the capital assets, so this tax falls on dividend income, interest, capital gains, withdrawals from IRAs, and pensions, and although we were told just a few moments ago it affects only a small percent of the elderly population, that is not true.

This is also a tax on young people. Because of this tax, the vast majority of the working population suddenly discovers that its IRA is less valuable, its pension plan is less valuable. A 20-year-old worker today earning, say, an average wage of anywhere from $23,000 to $26,000, this worker might put money in an IRA or his employer may put money in a pension fund thinking they are taking advantage of the principle of tax-deferred savings, but in fact that worker's IRA is worth half as much as it would have been precisely because of this Social Security benefit tax.

Now, if I could have the next chart. For those elderly people who depend on wage income as well as investment income, in their retirement years this tax is even worse. As Mr. Entin just told us, when you combine the Social Security earnings penalty with the Social Security benefit tax and the Federal income tax and the Social Security FICA tax, you get enormously high marginal tax rates.

My numbers are a little different from Mr. Entin's numbers because we have only put in half the FICA tax in these calculations. If you put in the full FICA tax, you get even higher numbers. For

the elderly, between 62 and 65, they have to give up $1 of benefits for every $2 of earnings. That is a 50-percent tax added to all these other taxes.

Between 65 and 70 years of age, they are giving up $1 of benefits for every $3 of earnings. That is a 33-percent tax, add them all together, take account of all the interactions, and you get tremendously high marginal tax rates, which really penalize and discourage the elderly from bringing their valuable skills to the labor market.

Finally, if I could have the third chart, many people have never stopped to look at the formula that people have to use in order to calculate how much tax they owe, but it is a very, very complicated formula. It turns out it gets in very subtle ways to income that people don't even realize is being taxed.

I have already mentioned that withdrawals from pensions and IRAs are taxed at a 52-percent rate; capital gains, the highest rate is 28 percent for everybody else in the population. It hits 52 percent for some of the elderly; tax-exempt income.

Most people think when they buy tax-exempt bonds that they are not paying taxes on this income, but if they are elderly, that gets included in the calculation of their tax, and the marginal tax rate on that income can be as high as 24 percent. Social Security COLA increases, if you are young and disabled, you don't pay tax on that kind of income, but if you are elderly, that is also included in the calculation of this tax, and the tax rate can be 12 percent.

Now, these are very, very pernicious marginal tax rates. They fall on capital. They do harm to the economy. What do we get in return? Well, in 1989, the NCPA, my organization, made a forecast of what we would gain and what we would lose by increasing the Social Security benefits tax from 50 percent to 85 percent of benefits.

We discovered the revenue gain would be small, only about $4 billion a year in the short run, but in the long run the revenue loss would be much larger, about $14 billion, certainly by the end of the decade, and the reason for the revenue loss is that when you tax capital income this heavily, you really discourage investment. You really reduce the Nation's capital stock, and the country pays a price for doing that. Thank you very much.

[The prepared statement and attachment follow:]

Rolling Back Taxes on Social Security Benefits

By John C. Goodman

When the portion of Social Security benefits that is subject to taxation was increased from 50 percent to 85 percent in 1993, the Clinton administration called it an "entitlement spending reduction." In fact, it was a tax increase on investment income and wages of elderly Americans. This increase in the amount of benefits subject to tax has increased marginal tax rates faced by the middle-income elderly to a record high, resulting in less capital and labor, a slower rate of economic growth and a lower income for all Americans.[1]

The portion of a person's Social Security benefits that is taxable is determined by a complex formula. The elderly pay income taxes on 50 percent of their Social Security benefits if their total income (calculated by including all tax exempt income and one-half of their benefits) is between $25,000 and $34,000 for an individual or between $32,000 and $44,000 for a couple. If their total income (measured the same way) exceeds $34,000 for an individual or $44,000 for a couple, they pay taxes on 85 percent of their Social Security benefits.

Here is an example of how the formula works: Suppose an elderly couple receives $12,000 in Social Security benefits and $26,000 in other income. Their total income is $32,000 as measured by the formula — $26,000 plus one-half of the benefits ($6,000). Thus, the income tax would apply only to the $26,000 in non-Social Security income. If this couple earn $1 more, however, the income tax applies to that $1 *plus* 50 cents of Social Security benefits. If they earn $12,000 of additional income, an additional $6,000 (one-half of their Social Security benefits) is taxed. This puts the couple at $44,000 as measured by the formula. If they earn $1 more at that point, the income tax applies to that $1 plus *85* cents of Social Security benefits. And so on until 85 percent of their total Social Security benefits are included in taxable income.

The Social Security benefit tax usually is described as a tax on *benefits*, but in fact, it is a tax on other *income*. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 85 cents of benefits is taxed for each additional $1 of income, when elderly taxpayers earn $1 they pay taxes on $1.85. The effective tax rate on income is 85 percent higher than otherwise.

The High Tax Rate on Savings. About 60 percent of the income of elderly taxpayers comes from investments (including pensions).[2] For most younger people, the tax rates on investment income are 15 percent and 28 percent. Yet, because of the Social Security benefit tax, the rates for the elderly on income from savings can be up to 85 percent greater than the rates for the younger people.[3] As Table I shows:

- Elderly taxpayers in the 15 percent income tax bracket pay an effective rate of 27.8 percent (15% x 1.85).
- Elderly taxpayers in the 28 percent tax bracket pay an effective rate of 51.8 percent (28% x 1.85).

The Higher Tax Rate on Workers. Many elderly people continue to work — their marginal tax rates are higher still. When the Social Security (FICA) tax (7.65 percent) is added to the income tax rates of 15 and 28 percent, marginal tax rates for younger workers are 23 and 36 percent.[4] For the elderly between 65 and 70 who earn more than $11,280 in wages per wage earner, there is an additional penalty. They lose $1 of Social Security benefits for each additional $3 of earnings. For those under age 65, the

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[1] This subject is discussed in detail in Aldona Robbins, Gary Robbins and John Goodman, "Should 85 Percent of Social Security Benefits Be Taxed?" National Center for Policy Analysis, NCPA Policy Backgrounder No. 126, June 10, 1993.

[2] See Aldona Robbins and Gary Robbins, "Elderly Taxpayers and the Capital Gains Debate," National Center for Policy Analysis, NCPA Policy Report No. 153, July 1990.

[3] Assumes taxpayer is below the maximum Social Security benefit tax.

[4] We have counted only the employee's share of the FICA tax because that is directly deducted from the paychecks of workers. Most economists, however, would agree that workers pay the employer's share (also 7.65 percent) as well in the form of reduced wages. Our calculations of marginal tax rates, therefore, are conservative.

TABLE I

How the Social Security Benefit Tax Affects Marginal Tax Rates on Income from Savings

Income Tax Bracket	Social Security Benefit Tax	Total Tax
15%	12.8%	27.8%
28%	23.8%	51.8%

TABLE II

Marginal Tax Rates on the Wages of Elderly Workers[1]

Ages 65-70

Tax	15% Bracket	28% Bracket
Income Tax	15.00%	28.00%
FICA Tax	7.65%	7.65%
Social Security Earnings Penalty	33.33%	33.33%
Social Security Benefit Tax[2]	10.63%	19.83%
Total Federal Tax	66.61%	88.81%

Ages 62-64

Tax	15% Bracket	28% Bracket
Income Tax	15.00%	28.00%
FICA Tax	7.65%	7.65%
Social Security Earnings Penalty	50.00%	50.00%
Social Security Benefit Tax[2]	9.56%	17.85%
Total Federal Tax	82.21%	103.50%

[1] Workers are assumed to be below the caps on the FICA tax, the Social Security benefit tax and the Social Security earnings penalty (which becomes zero once all benefits are lost).

2 The Social Security benefit tax rate is lower than the rate shown in Table I because of the loss of benefits due to the earnings penalty.

penalty is even more severe: if they earn more than $8,160 in wages, they lose $1 of benefits for each additional $2 of earnings. Add these penalties to the FICA tax, the income tax and the Social Security benefit tax, and as Table II shows:

- Workers between 65 and 70 years of age face a marginal tax rate as high as 88.81 percent.
- For workers ages 62 through 64, the marginal rate can be as high as 103.5 percent.
- This means that workers pay as much as $1.04 in taxes when they earn an additional $1.00 of income.

For some workers the rates can be even higher. For example:

- If workers face a state and local income tax rate of 5 percent, the highest marginal tax rate on wages climbs to 112.5 percent.
- For workers who are also self-employed — and thus are paying a 15.3 percent FICA (Social Security payroll) tax — the marginal rate climbs to 120.4 percent.
- To cite an extreme example, there are circumstances under which elderly workers who are self-employed and living in Montana can face a 130 percent marginal tax rate.[5]

The Long Reach of the Benefit Tax. Because of the way income tax returns are organized, many elderly taxpayers do not realize that the Social Security benefit tax actually taxes income. Many also are unaware of how far-reaching it is. The Social Security benefit tax reaches capital gains income, tax-exempt income and Social Security COLA increases. And because many states accept the federal definition of taxable income, it increases some state and local income tax rates by 50 percent.[6]

- Capital gains income is subject to the 52 percent top rate for persons receiving Social Security benefits versus 28 percent for others.
- Tax-exempt income can be taxed at a rate of 24 percent versus a zero rate for younger taxpayers.
- Social Security cost-of-living adjustments (COLA) increases are taxed at a rate as high as 12 percent.
- And state and local income taxes can be increased as much as 9 percentage points.

A Tax on Middle-Income Families. These high marginal tax rates affect the incentives of middle-income families, not of the wealthy elderly. Once a taxpayer reaches an income level at which fully 85 percent of Social Security benefits are taxed (about $30,000 of other income for an individual and about $42,000 for a couple), additional income is taxed at ordinary tax rates.[7] The wealthy elderly, who face a marginal tax rate of 31 percent, 36 percent or even 39.2 percent, are made worse off by the Social Security benefit tax. But the tax does not affect their economic decisions. The middle-income elderly, on the other hand, are affected directly. High marginal tax rates affect their decisions to work additional hours, invest in or sell assets and realize other types of income.

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[5] Based on a 14 percent state income tax rate that applies to Social Security benefits.

[6] At least 15 states tax Social Security benefits: Colorado, Connecticut, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Rhode Island, Utah, Vermont, West Virginia and Wisconsin. See David Baer, "State Taxation of Social Security and Pensions," American Association of Retired People (AARP), Public Policy Institute, Issue Brief No. 13, June 1992.

[7] Assumes the individual receives a benefit of $10,000 and the couple receives a $20,000 benefit. Someone who always earned the average wage retiring at age 65 in 1993 would be entitled to a benefit of $9,853. *1993 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC, April 1993, Table II.F.12, p. 112.

The argument for taxing Social Security benefits is that the beneficiaries paid for only a small portion of their benefits through payroll taxes.[8] Even if the argument is accepted, beneficiaries should be taxed at the same marginal tax rate as all other taxpayers. For example, a portion of Social Security benefits could be included in the ordinary income of elderly beneficiaries — taxable at ordinary income tax rates. Then the elderly would face the same marginal tax rates as younger taxpayers. Exemptions could be raised to prevent undue hardship for the low-income elderly without increasing marginal tax rates.

Encouraging the elderly to work and to save is important to the economic well-being of the nation. The withdrawal of elderly workers from the labor market is costly for the nation as a whole. In addition to their talents, they contribute to the nation's output of goods and services, and to both tax revenue and Social Security revenue, when they work. The Labor Department warns that in the long run we face labor shortages and elderly workers will be needed to help fill the gap.[9]

Although the elderly constitute only 12 percent of the population, they hold about 40 percent of all capital assets in the United States.[10] The driving force behind the American economy is its ability to combine labor with larger and larger amounts of capital. More capital per worker leads to more output per worker. These productivity gains result in higher wages and a higher standard of living for all Americans. To the degree that government discourages saving for the retirement years everyone is worse off — old and young.

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[8] Note that the argument can easily be reversed for young workers. Many of today's young people will pay more in Social Security taxes than they will ever receive in benefits. So, if the goal is to make taxes equal benefits, we should lower the payroll tax for the current generation.

[9] *Labor Market Shortages*, U.S. Department of Labor, 1989.

[10] Aldona Robbins and Gary Robbins, "Taxing the Savings of Elderly Americans," Appendix B.

Mr. BUNNING. Thank you. Mrs. Johnson will inquire.

Mrs. JOHNSON. Thank you. That was a very interesting exchange amongst you on a difficult issue. I think pretty much you covered my questions. Thank you.

Mr. BUNNING. Mr. Herger.

Mr. HERGER. No questions.

Mr. BUNNING. Mr. Jacobs.

Mr. JACOBS. Mr. Chairman, I just have an observation for the record. I think what we need here is a primer between taxes and benefits. Taxes are something citizens pay to the government. Benefits are something the government pays to citizens.

For example, if you had somebody on welfare and he or she found a job, took it, and performed it, we don't say that that person had a marginal tax increase because he or she could no longer receive welfare benefits. Yet I hear now and then people indicate that if the government will not pay Social Security benefits to someone who is not retired by the kind of definition that has been a part of the act since the thirties, that that person somehow or another, because of the denial of benefits, had a marginal tax increase. I might add that much of the Social Security benefit could be classified as welfare since it hasn't been paid for by the recipient. We don't call that a marginal tax. We say that that person no longer is eligible for the taxpayers to help him or her. Now, the next thing I want to say is nothing.

Mr. GOODMAN. May I respond to that?

Mr. KLECZKA. The nothing or——

Mr. GOODMAN. I have great respect for Congressman Jacobs.

Mr. JACOBS. I return that respect, sir. Obviously, you are a scholar. We have a difference of opinion. I have no disrespect for you, I assure you.

Mr. GOODMAN. But just real quickly——

Mr. BUNNING. No. Mr. McCrery will inquire.

Mr. MCCRERY. Dr. Goodman, if you would like to expound upon your objection to that statement.

Mr. GOODMAN. It really doesn't matter whether we call a withdrawal of welfare benefits a tax or a withdrawal of benefits. Economists can calculate an implied marginal tax rate, so that from the point of view of the welfare recipient, the question is if you go out and earn $1, what do you lose.

The same analysis can be applied to the elderly. That is what is going to determine behavior, not whether we call it a tax or whether we call it a benefit. What does the person get at the end of the day if he goes out and earns $1, that is the critical question.

Mr. MCCRERY. Thank you, Dr. Goodman.

In fact, you have precisely laid out why the explanation Mr. Jacobs gave us is of little import. In fact, some economists do talk in terms of marginal tax rates with respect to the welfare system, and the incentives in that system, so I don't think it is particularly important whether it is a benefit or whether it is income.

The fact is, as you pointed out, the penalties imposed—whether it is a tax or a withdrawal of benefits—by the government has an effect on that person's behavior, and that is what we are talking about here today. That is what most of you have talked about today, and I agree that the current system has the effect of discour-

aging work on the part of seniors in this country, and therefore we lose a good bit of productivity.

We lose some of our most productive workers, and I think that is a shame, so I am glad to hear your testimony today, glad to know that most of you, at least, agree that the increase in taxes imposed upon senior citizens in the 1993 bill was ill advised. I am glad you agree with us that we ought to put it back to the State that it was in prior to the 1993 tax bill. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Levin.

Mr. LEVIN. Thank you very much. Let me just ask a couple of questions to those of you who favor the repeal of this. Do you have any ideas as to how we would make up the difference for the Medicare fund? Dr. Goodman, do you?

Mr. GOODMAN. I don't have an opinion. Do you have an opinion?

Mr. LEVIN. You don't have any suggestion as to how we do that?

Mr. GOODMAN. No particular suggestion.

Mr. LEVIN. How about a general one? I mean seriously, because I don't think this should be judged, I want to make it clear, solely on that basis. If something is basically inequitable, we should try to take action to remedy it, but it is relevant to the issue where we make up the difference.

Mr. GOODMAN. Well, I think there are a lot of problems in the Medicare program, and the program needs very careful and serious attention from the Congress and from this committee. One of the things it needs to change is we can't keep giving first dollar coverage and lavish health care benefits to elderly Americans who, after all, have more after-tax income and more assets than the younger population, and expect the younger population to keep bearing that burden. We are going to have to do something that involves the elderly taking more financial responsibility for their medical bills. That is my general comment.

Mr. LEVIN. So your proposal would be to give back, to return some of the money that we tax, but then to assess them as they obtain health care?

Mr. GOODMAN. No, I don't have a specific proposal, but generally the elderly population as a group are going to have to take, it seems to me, more responsibility for medical bills, and that is the general way in which we should seek to solve the problems of Medicare.

Mr. LEVIN. But isn't that what this does in part? What this does is to say to seniors somewhat on an income level basis, you are going to pay more for your health care because this goes into the Medicare fund, so I am not quite sure——

Mr. GOODMAN. You don't have to solve the problem that way. As Mr. Entin pointed out, there are other ways to solve this problem. You could take Social Security benefits and make them part of taxable income, period, and then you wouldn't have these real high marginal tax rates or you could take half the benefits or 85 percent of benefits. There are different ways to solve the problem without having the severe high marginal tax rates apply to elderly investment income and wage income.

Mr. LEVIN. So if we did that, making—if we came up with this same amount of money from taxing Social Security benefits, it would change the impact of the tax, right? It would shift the tax

burden more from higher income to middle income and lower income seniors, would it not?

Mr. ENTIN. Not necessarily, sir. If you pick your thresholds carefully, you can hit roughly the same group of people you are hitting now, and to roughly the same extent you are hitting them now, but you don't have the interaction with the other income.

It is a change in method to get roughly the same money from roughly the same group without the side effect. If you are chopping wood and you have the choice between a dull axe and a sharp axe, and the dull axe is going to bounce off the log and hit you in the foot and the sharp axe is going to cleave the wood properly, you may get the same splitting of the wood, but you are going to get it more safely with fewer side effects because you take the sharp axe—in this case, the alternative tax mechanism.

Mr. LEVIN. I understand that. Let me ask you this, though, if you don't relate it to other income, how do you relate it so that——

Mr. ENTIN. I can explain that if I have 30 seconds.

Mr. BUNNING. You have 1 minute.

Mr. ENTIN. A person with high Social Security benefits had a high earnings history, otherwise the formula would not have given him a high benefit.

Mr. LEVIN. But wait 1 minute, high but nothing compared to—you can have people who——

Mr. ENTIN. Follow me for just a moment. If you have had high earnings—suppose you are getting maximum benefits because you have had maximum covered earnings all your working life. Contrast that with someone whose benefits are below average because his earnings were quite low all his working life.

You will find an enormous correlation between the high beneficiary and high pensions and high saving and high alternative income versus the below average beneficiary who, because he had very little to save with all his life, probably has a small pension and very small savings. So the groups of people who have high benefits also tend to be the groups of people who are over these thresholds, whether it is the 50-percent or the 85-percent threshold.

So if you simply have an exempt amount of benefits, people below that tend to be lower income, and people above that tend to be higher income with the higher pensions, with the higher interest, with the higher dividends. It is true, you may find somebody who has very high Social Security benefits, but very little other income. However, that would have to be a person who was quite well to do all of his working life, but frittered it all away and did no saving at all, and is falling back on these high Social Security benefits in his old age. I don't feel sorry for that person when you look at the damage you are doing to the national economy with these high tax rates.

There are very few people who have very little other income who would be taxed under this alternative system.

Mr. LEVIN. Mr. Chairman, thanks for your indulgence, we went a bit beyond. I hope someone else will pick up that line of questioning because, as I understand the Social Security system, you may be calling people high income who are very much in middle-income ranges, and I think there would be a substantial shift in burden if we followed yours from high income to middle income.

Mr. BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Mr. Goodman, I want to go back to the $1 and $3 that you mentioned about the benefits for those 65 to 69. There is really not a reduction in benefits that are received by those individuals. I mean the benefit level stays the same, 65 to 69 based on previous earnings and contributions, whether they work or they don't work.

The $1 out of $3 is actually a penalty that is assessed on those who work and earn beyond the limit; is that not true?

Mr. GOODMAN. That is correct.

Mr. COLLINS. Ms. Moon, you are apparently the only one on the panel to really argue against tax—that argued that taxing benefits for seniors just ensures that they pay a more fair share. How do you—what do you mean, pay more fair share? These people have worked for years and are retired. Do you not consider that their previous history was participating and fair?

Ms. MOON. I believe that social insurance benefits are very important to Americans. But, I also believe that it is very important to maintain the actuarial balance in the program, and over time we are going to have to face some changes in both Social Security and Medicare. My support for this particular piece of tax policy is not because I think it is the ideal tax policy if I were going to redesign our whole system of taxes and government programs, but when I look at the range of options, particularly in terms of what will happen if we roll back this tax, I don't see any of them as improvements.

I could agree with my colleagues about ways to change the taxation of Social Security so that it is done in a slightly fairer manner, but I think that these specific proposals would pass additional burdens onto lower income individuals. I understand why the thresholds were put in place which lead to the spikes in marginal tax rates. They are there to protect low-income senior citizens, and I think that that is a very important principle to retain.

If what we are talking about here is changing taxation of Social Security to make it fairer, I don't have an objection. But I don't think that that is what the Contract With America is saying. I think it is saying let's roll taxation of Social Security benefits back, and get rid of it, and then it is silent in terms of what the next step will be. The likely next steps are the reason why I am here talking about this proposal, which I oppose but not because I think that senior citizens are undeserving.

Mr. COLLINS. Does anyone else care to comment on that?

Mr. SHREVE. Just to this whole issue that we are talking about right now that Mr. Levin opened, and I guess I am the resident oldtimer on this panel, and I can speak from a little different perspective. This whole problem is complicated and now is interwoven because of the fact that the additional moneys that were raised when the level went from 50 to 85 percent went into the Hospital Insurance Trust Fund.

If that is stopped, then as I mentioned, there becomes a $15 billion or so shortfall in a 5-year period. That has to be made up somehow, and the whole thing started not because Social Security was in trouble and the hospital insurance thing was added as something to do to avoid a point of order on the Senate side dealing

with the Social Security trust fund, and so what we have is a complicated situation that has implications for the Hospital Insurance Trust Fund.

It has implications for the recipients of Social Security, and it also has implications on the budget deficit, and I think all of these are going to have to be addressed together. I don't think we can tinker with one part of it and tinker with another part and tinker another part and have it all come out. I think we have to look at what the serious problem is, that there is a budget deficit, that we do have an unfair system of taxation at this point, and that we have a Hospital Insurance Trust Fund that has a drop-dead date of 6 or 7 years hence.

Mr. COLLINS. In other words, what I hear you saying is that in order to put—the manner in which the funds were put into the Hospital Insurance Trust Fund was just a means of raising revenue, even though it went into a trust fund as the Social Security is supposed to go into a trust fund. Those trust funds are income, and they do help offset and hide a true deficit; is that not what I understood you to say?

Mr. SHREVE. That money goes into the Hospital Insurance Trust Fund, but that was not the original intent of the increase in the tax. The benefits went from a taxation level of 50 percent to 85 percent in order to reduce the deficit, not to help the insurance trust fund, but because of a procedural thing on the Senate floor, it wound up going into the Hospital Insurance Trust Fund.

Mr. COLLINS. That is right. Thank you, sir.

Mr. BUNNING. The gentleman's time has expired. Mr. English will inquire.

Mr. ENGLISH. Thank you, Mr. Chairman. I simply want to thank the witnesses for taking the time to appear and provide their individual perspectives on this issue.

As the chairman knows, we have already had hearings which Mr. Entin has participated in on this issue before the subcommittee. I am grateful for your appearance here today, and I will simply yield back my time.

Mr. BUNNING. Mr. Kleczka will inquire.

Mr. KLECZKA. Thank you, Mr. Chairman. Let me follow up on the line of questioning that Mr. Shreve was responding to. Even though the dollars from the 85-percent taxation of benefits went into the Medicare Trust Fund, is it not true that those $15 billion would be available to fund programs coming out of that trust fund?

Mr. SHREVE. Yes, the $15 billion is for the Medicare part A.

Mr. KLECZKA. Right, so it had the effect of not only helping out on the deficit because it was a balance in the trust fund, but when those funds were needed for Medicare part A expenses, they would be used?

Mr. SHREVE. That is right.

Mr. KLECZKA. Now, with you advocating repeal of that tax revenue, know full well that the Medicare Trust Fund will now be broke. In fact, it had an ending surplus of $3 billion, which is not much to speak of. Now, could you help this committee in indicating how best to replace those needed revenues?

Mr. SHREVE. As I indicated, I think that is a very complex problem which we are not going to settle in——

Mr. KLECZKA. But wait 1 minute, it is easy to come before the committee and advocate tax decreases, but know full well for your constituent group, which is a major constituent group of mine, it is going to provide a very big hardship.

This committee and the Republican contract are looking at some very gigantic cuts in Medicare, OK? This will exacerbate that problem.

Mr. SHREVE. Exactly.

Mr. KLECZKA. What we are doing by your advocating repeal of this actual taxation is to take some dollars and put it in this pocket for the senior citizen, knowing full well that under the Contract we are going to take it out plus the wallet, OK? So I would be very—I would be extremely careful of your position on this because I think you are going to do more harm than good for the people that you represent.

Know full well that once this tax is repealed, 80 percent of the benefits are going to go to families, senior families with incomes over $75,000 a year, OK? But when it comes to cutting Medicare, that distribution will not be the same because the cuts are going to go to the poorest and the least able to afford them, sir.

Mr. SHREVE. Exactly, and that is why in the past we have worked with this committee in helping to——

Mr. KLECZKA. Well, then work with me today and indicate how we can make up those lost revenues, which will total $15 billion.

Mr. SHREVE. I can't come up with $15 billion.

Mr. KLECZKA. You know what? I got the same problem because I can't, either. Now we have a real dilemma.

Mr. SHREVE. As I say, we are willing to continue to work with the committee in that respect.

Mr. KLECZKA. Well, swell. Mr. Entin, do you have any response or any recommendation for the committee?

Mr. ENTIN. I recommended a revenue neutral change.

Mr. KLECZKA. I'm sorry, could I finish the question unless you know the question before I ask it. Do you have any possible solutions as to replace $15 billion in the Medicare Trust Fund?

Mr. ENTIN. I don't have to. I recommended a revenue-neutral change in the testimony.

Mr. KLECZKA. You don't have to, OK, good. Thank you.

Mr. BUNNING. Mr. Christensen will inquire.

Mr. CHRISTENSEN. I wanted to ask Dr. Goodman if he had any input on the question that was asked Mr. Shreve, and whether or not taking the moneys into the Hospital Insurance Trust Fund maybe didn't set a bad precedent. Mrs. Moon said that she might have an idea for going along with fairness in terms of the tax policy. Mr. Entin, Dr. Goodman, would you identify a better tax policy for seniors and Social Security benefits if there is one. Do you have any suggestions?

Mr. GOODMAN. Well, I agree with a couple of the principles that Marilyn Moon laid out in her testimony, and one of them is if people earn the same income, they should be taxed at the same rate, and if we regard Social Security income as income, then we should put Social Security income into the taxable income of the elderly, or at least some portion of it. That would be a fair way to treat

Social Security income. Then an elderly person and a young person earning the same income would pay the same tax rate.

Mr. CHRISTENSEN. So there could be an argument made for dropping the tax altogether?

Mr. GOODMAN. Yes, but what I am saying is you could take Social Security benefits or some portion of Social Security benefits and make it part of every elderly person's taxable income. If the person only had Social Security benefits, they wouldn't pay any income taxes, but if they have a lot of income, they would be paying taxes on their Social Security benefits along with other income. You would still have a very modest—modest is the wrong word, you would still have the elderly facing the same marginal tax rates as young people.

Mr. ENTIN. I think either of the approaches in my testimony would accomplish what I think you are trying to get at. If you were to try to raise roughly the same revenue with some exempt amount of benefits, you would have an enormous overlap of something like 80 percent of the same people being subject to taxation of benefits as are under current law, but you wouldn't have the tax spikes. You wouldn't have that much of a revenue differential you would have to make up for.

If you really were trying to tax Social Security benefits the same way everybody else's income is taxed, you would probably simply have to say, "You have contributed a certain amount over your lifetime to Social Security. We won't tax you on your benefits until they have exceeded that amount, and then anything else you receive must be added into taxable income." That is the way we used to treat pensions.

I think that would gain you quite a bit of revenue. If you really want to keep sheltering some of the middle-income people from the taxation of benefits, you could give them an exempt amount on top of that, and I think you could still roughly break even.

Again, the overlap wouldn't be perfect, but it would be enormous, and you wouldn't be making that radical a change. But if you go that route, you would have to eliminate the 50-percent taxation of benefits, and the 85 percent, getting rid of both thresholds, and go to an exempt amount instead. You need to be bolder to have less trouble.

Ms. MOON. One thing we should be very clear about here is that, with the exception of the American Association of Retired Persons, all the members of this panel are not saying roll back taxes on seniors. My two colleagues on the panel are simply saying do it in a different way.

I am satisfied to leave the taxation where it is in terms of fairness. I think it does a pretty good job of meeting the test of fairness. It is a little awkward, but this results from good intentions to protect lower income seniors. I would not be opposed if the proposal of this committee was to accept the changes others on this panel have discussed, if the exempt amount was set at a high enough level so it achieved the protection of low-income individuals.

I think it is unrealistic to talk about rolling back this tax and not talking about what will happen in place of it. Something will

happen in place of it, and my fear is that the response in Medicare will be less desirable than the tax that we have now.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Shreve, let me ask you directly, would you support this proposal if it was your understanding that it was going to be financed directly by cuts in the Medicare program?

Mr. SHREVE. I don't think we could support anything at this point that is going to produce more cuts in the Medicare program because they sustained a very great number of cuts in recent years.

Mr. NEAL. I am on your side on that entirely. In a followup question, would you oppose the Contract With America if you determined that it was going to be financed by cuts in Medicare? Would you urge your members to do that?

Mr. SHREVE. I don't know, all I can say about the Contract With America, it is a document. It is not a piece of legislation, and until we have legislation that we are looking at specifically, and we know what the tradeoffs are, I don't think we can take a position until we know precisely what the gives and the takes are.

Mr. NEAL. Well, the other side is purporting that this document will leave very little room for any sort of negotiation. It will leave very little room for modification, and as a result, I guess the question that we are trying to pose on this side is where will you be once you determine that it is going to be financed by huge cuts in Medicare.

Mr. SHREVE. We are going to have very serious reservations because, as I say, there is only so much that can be cut out of Medicare and still have a Medicare program because access then becomes a problem.

Mr. NEAL. OK. I think that is fair enough, and let me ask Mr. Goodman; Mr. Goodman, in your testimony you seem fairly flexible about what you were laying out in front of us. How would you propose that we make up the $15 billion cut and avoid touching Medicare?

Mr. GOODMAN. OK, No. 1, I think on a dynamic scoring basis, this tax cut pays for itself.

No. 2, put that aside, the right way to tax Social Security benefits is to make Social Security benefits part of everyone's taxable income, and that way if you are poor you won't pay any more taxes, but if you are wealthy, you will. That is the right way to do it. You don't have to put them all into taxable income. You could put some portion of it, but that way you hit wealthier—the wealthier elderly will pay more taxes, but their marginal tax rates will still be comparable to young people's marginal tax rates.

Mr. NEAL. How would you—the dynamic scoring piece, now you have intrigued me by offering that reference. How would you suggest or how would you counter the argument that has been offered by Alan Greenspan and other leading economists, including many think tank people who are not given to partisan political activity? That dynamic scoring under careful scrutiny and being put under the magnifying glass really doesn't make it?

Mr. GOODMAN. Well, with all due respect to Alan Greenspan, it was his committee that proposed this tax, and the original proposal

was even worse than what we have now, and I don't think that committee ever considered what this tax does to marginal tax rates and I don't think it ever considered that this tax is really a tax on the pension plans and deferred savings accounts of young people, and if you take into account that this is a tax on capital, including all deferred savings and that those taxes affect behavior, then it seems to me you have to recognize that this can't be good for the economy.

Mr. NEAL. Are you a supporter of Mr. Greenspan?

Mr. GOODMAN. I am not a supporter, I am not a detractor. I think he has done, until very recently, a reasonably good job at the Federal Reserve.

Ms. MOON. Could I say something about dynamic scoring?

Mr. NEAL. Please do.

Ms. MOON. Even if dynamic scoring were used, this rollback of the taxes would still leave a $15 billion deficit in the Hospital Insurance Trust Fund. It wouldn't make any difference if there were dynamic scoring or not because those dollars would not be dedicated to the Hospital Insurance Trust Fund.

Mr. NEAL. OK.

Mr. ENTIN. A small portion would be, if you did get a larger labor force, and they were paying more payroll taxes, a portion of that payroll tax would be dedicated to the Hospital Insurance Trust Fund. Part of the problem is you have all of these firewalls in the tax system, this tax goes here, that goes there, this other one goes into the highway trust fund, etc. Then there is Medicare part A, and Medicare part B that are separate from the Social Security retirement program.

When you are dealing with the total budget, you really need to leave yourselves a little bit more flexibility to take a little bit from over here and put it over there in case you don't want to take it out of the hospital insurance program. You may want to take it out of some other program or sell off some government assets somewhere to tide you over until you have time to actually fix hospital insurance.

Right now you have tied yourself up in knots. I appreciate your difficulties, but I am sorry, you were the ones who passed that large knot-tying exercise.

Mr. NEAL. Do you think Mr. Greenspan ought to be reappointed?

Mr. ENTIN. I was referring to Mr. Greenspan's chairmanship of the National Commission on Social Security Reform back in 1982 and 1983 that led up to the 1983 Social Security amendments. I don't think anyone here is upset with his performance at the Federal Reserve Board. It was the National Commission exercise that led to this particular problem.

Mr. BUNNING. The gentleman's time has expired.

Mr. NEAL. Thank you, Mr. Bunning.

Mr. BUNNING. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. I want to thank all of our witnesses for being here and helping us on this issue of taxation related to Social Security income.

I can appreciate the fact that many Americans believe that we should reduce taxes or that the marginal tax rates are too high. I

would like to focus on the fairness of the relative treatment of income.

I would like to think that there is some rational basis for our Tax Code giving tax preference to some income. Social Security, for example, is not subject to the normal income taxation for certain people at certain income levels and certain percentages.

I would like to know why there should be a tax preference for Social Security income vis-a-vis private pension plans or other types of income that people invest in or receive which is subject to normal taxation.

In private pensions, there is a tax provision that states that any contributions that one makes with dollars, that that person has already paid taxes on, can be taken back out without that person paying a double tax. That makes sense and so does the provision which states that the other incomes that you receive from your pension plans should be subject to the normal tax rules.

For Social Security the Tax Code is very different. In the 1993 tax provisions, we used, for people of incomes over the $40,000 threshold, rough justice to say that 85 percent was approximately what the Social Security recipient did not contribute on after-tax dollars. This 85 percent mark was used to try to give some parity between Social Security and private pension returns. I would just like your justification for the repeal of the 1993 tax provisions on the Social Security income. Why should there be a tax preference for those who receive Social Security versus those who receive a private pension fund?

Mr. GOODMAN. My position is that this is the worst, most harmful way that I can think of to raise $4 or $5 billion a year.

Mr. CARDIN. You are missing my point. What is the differential? I am trying to take two taxpayers in the same situation, one receiving a private pension, the other is receiving Social Security; one paying taxes, the other not.

In the exact same economic circumstances, what is the justification for giving tax preference for income received by the Social Security recipient when that recipient never paid any taxes on that income?

Mr. GOODMAN. I don't believe there is any justification and therefore as I have said and Mr. Entin has said, the fair and right way to do it is to make Social Security income part of everyone's taxable income, so that the elderly pay taxes on their benefits and face the same rates as younger people.

Now, I recognize that if you promise people for a long, long time that it is not going to be done that way, you have a political problem and maybe also an economic problem in making that change, but you are right. There isn't an argument for treating the two kinds of income differently.

Mr. ENTIN. I agree. We didn't recommend that you not tax the benefits. We just simply highly protested the way it was tied in with other income and led to these peculiar tax spikes. As for the 85-percent figure, you raise a very good point. These are arbitrary percentages. They may or may not accurately reflect what the individual paid in contributions versus what the individual gets back in benefits, and what part of the contribution (the employee's half) has not yet been taxed.

Furthermore, over time, the relationships are going to change wildly. You know about the very large impending deficit of the system. Either you are going to have to raise the taxes or trim the benefits, and fairly soon. But when you do that, 85 percent, if it is the right number now, will certainly not be the right number down the road. I would not quite know how to tell you what is the right number.

Ms. MOON. The rationale for continuing some preference for Social Security income is that taxing the incomes that older persons have will lower their standards of living. In that case, Social Security might not be sufficient.

If so, then you would want to readjust Social Security to make it higher to return the net impact to a more desirable level. I believe that older Americans with low incomes need that additional protection. Those at higher levels don't need nearly as much protection, and, thus, while I think this is rough justice at best, it is a reasonable tax policy in a world in which we seldom have the ideal tax policy on the table.

[The following was subsequently received:]

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January 20, 1995

The Honorable Bill Archer
Chairman, Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Archer:

In the interest of time, I did not respond to Representative Cardin's question at the January 19th hearing regarding a rationale for taxing Social Security income differently from private pension income. I would appreciate your inserting my written response in the appropriate place in the hearing record.

Some maintain that Social Security is like a private pension, and therefore should be taxed more like a pension. While both programs provide income in retirement, the simple fact is that Social Security is not a private pension. Social Security is a mandatory, government-sponsored, portable program with almost universal coverage. The private pension system is a voluntary, employer-established program that is rarely portable and covers less than fifty percent of the workforce. Social Security is based on a progressive benefit formula that provides a greater rate of return for low-wage earners. The private pension system is based on myriad plan designs that more often favor the relatively higher income earner. Social Security is partially pre-funded with generally no access to contributions before retirement (or disability). Private pensions are generally advance-funded, and access to money pre-retirement is common. Social Security is social insurance and is the base of retirement security. Private pensions represent a privately sponsored, tax-subsidized income supplement.

Those who argue that Social Security should be taxed as a pension fail to fully recognize these substantial policy differences. In fact, policy goals often have led to different tax treatment where fundamental differences exist. For example, the tax code treats mortgage interest payments different than rental payments (even though both are for housing), and employer provided health benefits different than wages (even though both are forms of compensation). Similarly, Social Security is appropriately taxed differently than a pension.

The 1993 tax may serve to undermine the program. By adding additional taxes to an already progressive Social Security benefit formula, these changes risk undermining the widespread public support the system enjoys. Dramatic changes that substantially erode net benefits will further undermine public confidence that the Social Security system will provide a fair return on contributions.

Once again, thank you for letting the American Association of Retired Persons testify at the January 19th hearing.

Sincerely,

Robert D. Shreve

Robert Shreve, Chairman
AARP Board of Directors

Mr. CARDIN. Thank you.

Mr. BUNNING. The gentleman's time has expired. Let me try to clarify a couple things that I have heard since I have not had a chance to question anyway. We talked about cuts in Medicare.

In the 1993 reconciliation bill there were no real spending cuts if you want to talk about cuts, I call them reduction of increase because they weren't actually cuts. They were a reduction in increase of about $56 billion in that reconciliation bill, and Mr. Neal has left, but he also talked about cutting Medicare to pay for these benefits.

If he is talking about reducing the increase that is projected for the next 5 years in the budget that will be coming down, there was approximately an 11-percent increase projected in Medicare increases, and if you are talking about reducing the increase from 11 to 6 percent, it seems to me that is still a 6-percent increase in funding for Medicare, not a reduction, so I am having trouble with the word "cuts."

The fact of the matter is if we are talking about low-income seniors, another portion of the Contract is aimed at raising the earnings limit, I am talking about people who go to work, not passive income. I am talking about actual wage earners. We are penalizing that senior who is dependent on Social Security income to pay their bills with a Social Security earnings limit now, and I think it is very important that we look at the consequences of that social policy that we now have in effect in our Tax Code because it is a social policy.

It is bad policy to say to a working senior that if you earn over this amount of money, we are going to penalize you, and you are going to have to give back part of your Social Security benefit. The senior that needs to work is the person that we have to really look out for, the senior who—is collecting Social Security on top of other unearned income, savings, pensions. We don't want to make a social policy in this country that penalizes savings, either, and those are people we are talking about penalizing with raising this tax up.

So I want to make sure that it is understood that part of the Contract addresses the working senior, the person who has to work to pay their bills. By increasing the earnings limit over a period of 5 years to $30,000, I think we are going to do and accomplish that goal. When seniors cannot pay their bills on Social Security income, we have to address that, and we are going to do that.

I would like to see us adopt dynamic scoring. I heard Chairman Greenspan's testimony at the Budget Committee and I dramatically disagree with Chairman Greenspan. That is my privilege. He said that we don't have enough data to do it. I hate to tell you this, but Great Britain has been doing it in their budget scoring for quite a long time, and so we ought to have the same skills in the United States of America that they have in Great Britain. We can estimate a little better through a different scoring method how many dollars we are going to receive, and I am sure with all the data that the Federal Reserve gets in trying to project what to do as far as interest rates are concerned, fiscal policy, we ought to have the ability to score better than we do now. If necessary, let's go to Great Britain and England and find out how they do it.

I want to thank you all because your testimony was very good, and it is very important that we understand the social policies and the political reality of reducing taxes. These policies have a very dramatic effect on what we are going to do here, and it also has consequences on our senior citizens. Again, thank you for your testimony.

Mr. BUNNING. The last panel of the day, Beau Boulter, former Member of Congress, Robert Ball, former Commissioner of Social Security, and Martha McSteen, the president of the National Committee to Preserve Social Security and Medicare, and for the record we will accept Arthur Flemming, former Secretary of Health and Human Services. We will accept his statement for the record, and Mr. Boulter, if you will begin, thank you.

STATEMENT OF HON. BEAU BOULTER, MEMBER, NATIONAL ADVISORY BOARD, UNITED SENIORS ASSOCIATION

Mr. BOULTER. Thank you, Mr. Chairman. Beginning in 1984 when we started or when Congress started taxing Social Security in order to resolve the Social Security crisis which existed at that time, and to make sure that the moneys were used for that purpose, Congress required that all tax receipts would be credited to the Social Security trust funds, thus it is clear that that tax was to make Social Security solvent again, and then because of the high economic growth and long sustained economic recovery coupled with low inflation, the Social Security taxes greatly outpaced the payments, and that still is true today, so that the Social Security trust funds are running a huge surplus.

There is a common perception that this surplus is squirreled away somewhere, but, of course, the truth is that the Social Security receipts are deposited in the general treasury. The payments are paid out of the general treasury, and the surplus is credited to the Social Security trust funds in the form of U.S. Government securities. But there is, as we all know, there is no separate pool of money anywhere, and as often has been said, even by many Members of Congress, this surplus is used for everything under the sun from paper clips to battleships, so clearly the 1993 tax increase on Social Security is not for Social Security.

What about hospital insurance? I know that question has been asked several times, hospital insurance. It is my view, as a member of the National Advisory Board of United Seniors Association that the hospital insurance program is going to have to be dealt with separately, that the several billion-plus dollars a year that we get from this tax increase is not going to be adequate to deal with that problem, and beyond that I agree much with what has been said before by the earlier panel, that we don't take care of structural deficit problems by continually raising marginal tax rates, which is what is being done with the 1993 tax increase.

What about using the tax increase for deficit reduction? Well, I used to serve in Congress and when I was here at least we used to say that for every dollar of new taxes, spending increased by about $1.50. I suppose that that probably is still somewhat accurate today, but in any event, we are not going to solve the deficit with this 1993 middle-income tax increase, which is what it is.

We are going to have to solve the deficit simply by, I think, two ways, and that is economic growth and cutting spending, and that is what United Seniors Association is for. We are a little bit different of a group than you have heard from earlier in the day. We are a seniors group.

I am not an economist like Dr. Goodman or some of these others have been. We do represent seniors, but we are a very conservative seniors group. As some of you know, we are growing very fast.

I was visiting with the executive director of the President's White House Conference on Aging, a gentleman doing very, very good work, in my view, and he said, well, look, we look at United Seniors Association and we see a group that is very, very active and a group that takes some very firm positions, and we do.

The group that I represent and most of our members, which are somewhere around 400,000, oppose tax increases of any kind, and we strongly believe in less government and less spending, and I am, frankly, very pleased that our grassroots views are the majority views today in the House. So I identify with all the remarks that have been made about marginal tax rates. That is not the way to solve the problem, and we strongly support the repeal of the 1993 tax increase, not only as an issue of fairness for seniors, but also as part of the congressional agenda, to spur economic growth and to make our country competitive again.

[The prepared statement follows:]

Testimony of The Honorable Beau Boulter
on behalf of United Seniors Association, Inc.

Before the
House Committee on Ways and Means

Thursday, January 19, 1995

Mr. Chairman and Members of the Committee:

My name is Beau Boulter and I had the privilege of serving with many of you during the four years I represented the thirteenth district of Texas in this House. It is indeed a pleasure to see my former colleagues here.

Today, I appear before you on behalf of United Seniors Association.

United Seniors Association is a non-partisan, non-profit grassroots educational and lobbying organization with more than 400,000 members nationwide. We are essentially a conservative seniors' organization, advocating lower taxes and less government. We opposed all of President Clinton's 1993 tax increases, especially the increased taxation of Social Security benefits which was included in the Omnibus Reconciliation Act of 1993, or OBRA '93.

We worked hard, with then-Congressman Jon Kyl and Senator Trent Lott, to repeal that provision of OBRA '93, and I appear before you today in support of Title II of the Senior Citizens' Equity Act.

It is the position of United Seniors Association that the tax increase on Social Security benefits — the Senior Citizens' tax — is a tax hike on middle-class Americans. It is, effectively, a reduction in Social Security benefits based on presumed wealth; that is, the benefits tax results in means-testing of Social Security.

The Senior Citizens' tax results in double taxation for many, and by increasing seniors' marginal tax rates, discourages some of this nation's most productive and experienced workers from re-entering the labor force.

The Senior Citizens' tax undermines middle- and upper-income seniors' faith in the Social Security system, and provides future retirees with a disincentive to participate in the Social Security system.

The History of the Taxation of Social Security Benefits

As you know, for nearly half a century Social Security benefits were not taxed as income. Then, in 1983, a bipartisan majority of Congress agreed that for some households up to one-half of Social Security benefits could be treated as taxable income.

Under the 1983 Social Security amendments, when a retiree's adjusted gross income (AGI), tax-free interest income and one-half of OASDI benefits exceeds a threshold — $25,000 for single taxpayers, $32,000 for married couples — some portion of OASDI benefits are subject to taxation. For every dollar by which retirees' incomes exceed one of these thresholds, 50 cents worth of OASDI benefits are treated as taxable income.

As a result of the so-called deficit reduction legislation enacted a decade later, in OBRA '93, a second set of thresholds was introduced. For every dollar single taxpayers earn over $34,000 and for every dollar married couples earn over $44,000, 85 cents worth of OASDI benefits are now subject to taxation.

Who is Affected by the Benefits Tax, and How?

Nearly one in every four Social Security beneficiaries — about eight million retirees — are subject to some taxation of benefits. Those on the high-end of the income scale lose up to one-third of

their benefits due to the tax, and for some semi-retired seniors, working can mean a marginal tax rate of more than 100 percent.

Because the thresholds are not indexed to inflation, they effectively move lower each year, and more and more seniors each year will find their OASDI benefits subject to taxation.

The Social Security Administration has projected that, under the old law, by the year 2030 income taxation of benefits would recapture about 4.3 percent of total benefits outlays. Estimates reported by C. Eugene Steuerle and Jon M. Bakija in their book *Retooling Social Security for the Twenty-First Century* suggest that by raising the maximum taxable income to 85 percent, Social Security would recapture an additional three percent of benefits outlays.

In dollars and cents, we're talking about roughly $4.6 billion this year. That's a lot of money to you and me, Mr. Chairman. But it's not that much when we're talking about an earned entitlement program which now posts an annual surplus of — and reduces the federal budget deficit by — more than $50 billion.

Indeed, one of the problems with Congress' expansion of the tax on benefits is that under the 1993 formula, the revenues raised do not even go into the Social Security surplus, as is the case under the 1983 law. Instead, the revenues go to help pay for the troubled HI program and to reduce the deficit.

Even if every penny did go into the OASDI trust funds, the revenues still would not be helping to pay for benefits. Rather, because the federal government loans the Social Security surplus to itself, the revenues would go to pay for everything from "battleships to paper clips," as has been pointed out before.

The Tax on Benefits is a Tax on Middle-Class Americans

When President Clinton proposed and Congress passed the Senior Citizens' Tax, they raised the taxes of middle class Americans — something the President, at least, promised not to do.

President Clinton's claim that his tax increases soaked only the "rich" is completely false. The thresholds the President and Congress established are, as noted before, $34,000 for singles and $44,000 for couples. As you know, Mr. Chairman, that's middle class in the real world.

The increased taxation of Social Security benefits raised taxes for 6.1 million middle income senior citizens. The tax increase is projected to take $26 billion away from seniors over the first five years. The middle class of senior citizens, earning $50,000 to $75,000, will pay the largest portion of the new tax — $1.4 billion in 1994 alone.

Middle class seniors have fewer options to make up lost income, while their expenses — medical and otherwise — are often as great or greater than those of their younger counterparts.

And, because the thresholds for this middle-class tax are not indexed, it will bite deeper and deeper into the ranks of middle-class seniors as the years go by.

The Tax on Benefits Results in Double-Taxation for Many

The Senior Citizens' tax represents a tax on after-tax dollars for many. Setting aside the fact that under the scheme used to determine taxable income "tax-free" interest is added to outside earnings and one-half of Social Security benefits, some retirees above the higher thresholds find their contributions — taken from after-tax earnings — taxed again.

This double taxation will become even more prevalent as future retirees begin crossing the income thresholds at lower real levels.

United Seniors Association opposes all double taxation of savings, and supports efforts by Majority Leader Armey and others to end that confiscatory practice.

The Tax on Benefits Stifles Productivity, Minimizes Government Revenue

The Senior Citizen's tax provides some retirees with a paralyzing antidote to any desire they might have had to continue working. The high marginal tax rates they would pay on additional income could actually make earning more money a losing proposition.

Many middle-class seniors already face marginal tax rates of more than 50 percent. Under the current income tax code, a millionaire faces a 39.6 percent federal income tax rate, as well as state and local income taxes. A senior in the 28 percent tax bracket can potentially face a higher marginal tax rate when the earnings test and the taxation of Social Security benefits are added to the federal income tax burden.

Once a single senior reaches the income level of $34,000, not only is the next $1 of earnings subject to the 28 percent income tax, but an additional 85 cents in Social Security benefits become subject to the income tax.

When the earnings test is taken into consideration, this senior in effect loses 33 cents in Social Security income and at the same time faces additional income taxes of 35 cents, so that the $1 earned translates into only 32 cents. And that's before paying state income taxes and FICA taxes.

Economists Gary and Aldona Robbins, in a study for TaxAction Analysis, calculate that repealing the 1993 Social Security taxes would reduce the economy-wide marginal tax rate on capital, and thus increase investment, by $332 billion in the year 2000, creating 91,000 jobs. The additional economic growth would add $97 billion to the GDP between 1995 and 2000, and higher economic growth would generate an extra $17 billion to federal payroll, corporate and personal income, and excise taxes, bringing the net revenue loss from the repeal to only $9 billion over five years.

The Tax on Benefits Undermines Faith in the System

The keystone to Social Security is the popular perception that it is a sort of contributory pension plan — that one's contributions over the years determine what one gets back. It was originally designed to be just that, but was changed to a pay-as-you-go social insurance plan before the first benefits were ever paid out.

But in order to maintain public support for the program, the federal government has continued to foster the mistaken belief that workers' contributions are squirreled away somewhere, earning interest, and will one day be returned to the workers when they retire.

As an investment, Social Security performs rather poorly — and the rate of return will only diminish in the future.

But Social Security works, and it works because taxpayers across all income levels have historically felt they have a stake in the program. No matter how successful you eventually become, we have told workers, you will get the same rate of return on your contributions as anyone else.

Start means-testing Social Security — and the tax on benefits is a means test — and soon, those who are more successful, and thus will see more of their benefits confiscated, begin to resent having to hand over to Uncle Sam 15.3 percent of their earnings.

Take away that keystone of fairness, and those who contribute more to the system and receive less will no longer want to participate. We can already see how this breach of trust is affecting the attitudes of the so-called Generation X — their resentment is growing, and soon, younger workers could revolt entirely against a program they see purely as an income transfer from their pockets to the pockets of their parents and grandparents.

Proponents of the Senior Citizens' tax point out that seniors generally face a much lower federal tax burden than younger families at similar income levels. They say that by including some portion of Social Security benefits as taxable income, this gap is closed.

But I say everyone is paying too much in taxes. Our government is trying to do too much, and it is taxing middle-class Americans to death to do it.

We all know that federal budget deficits arise from too much spending, not from too few taxes. The Joint Economic Committee a few years back released a study showing that for every new $1 the federal government collected in revenues since 1949, it had spent $1.49. Clearly, new taxes are not the answer to our deficit problem.

In fact, since 1981 Congress has raised taxes six times for the stated purpose of "deficit reduction." Each time, the deficit increased rather than decreased.

It is true that we need to fundamentally reform the Social Security system; in fact, United Seniors Association will soon release a major proposal for doing just that. But the portion of the Senior Citizens' tax that goes into the OASDI trust funds is today spent on anything but Social Security, which is more than paying for itself. As for the portion of the tax that goes toward reducing the deficit, a better solution would be, as I suggested a moment ago, to cut spending.

The bottom line is this: eliminating the 1993 Social Security taxes isn't just about fairness to seniors or maintaining public support for Social Security -- though these are reasons enough for repeal. Eliminating the increased taxation of Social Security benefits is also an important part of the overall congressional agenda of creating jobs and spurring economic growth.

It is our pleasure to support your repeal of the 1993 tax increase, Mr. Chairman. But I urge you to go further and remove the 1983 tax as well. It would be good for the seniors who suffer reduced benefits; it would be good for the labor market and the economy; and it would be a first step toward keeping the faith with tomorrow's retirees.

I look forward to working with you in the future on behalf of United Seniors Association.

Thank you.

Mr. HOUGHTON [presiding]. Thank you very much, Mr. Boulter. Maybe, Mr. Ball, you would allow me to introduce Mrs. McSteen first. Would you like to proceed with your testimony, Mrs. McSteen.

STATEMENT OF MARTHA MCSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

Ms. MCSTEEN. Thank you very much. I am pleased on behalf of the national committee to support both the repealing of the 1993 increase in the taxation of Social Security benefits and allowing tax-free accelerated death benefits under life insurance contracts. There are five reasons why the proposal to repeal the increased tax on Social Security benefits makes sound public policy.

The increased taxation affected about 13 percent of Social Security beneficiaries in 1994, and it is estimated that it will affect about 17 percent in 1998, unless it is repealed. The national committee estimates that affected beneficiaries will save an average of $158 in 1996, increasing to about $662 in the year 2000.

No Social Security benefits were taxed during Social Security's first 44 years, and up to 50 percent have been taxed only for the last 10 years. The national committee is concerned that the increase in the taxation of Social Security benefits could undermine future public support for Social Security. That is because the support for the higher tax is built on two flawed assumptions.

First, that most low- and middle-income beneficiaries will not be affected by the increased taxation; and second, that Social Security should be taxed like a private pension. Third, the bracket creep has been eliminated for every taxpayer except Social Security beneficiaries.

Over time many moderate- and low-income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed. Fourth, some defend the increased tax as fair because they believe that Social Security is not progressive, yet the benefit formula already is progressive.

Support for taxing benefits grows out of the belief that all beneficiaries receive huge windfalls, windfalls that upper income beneficiaries don't need. The so-called windfalls that earlier generations received under Social Security, typical of all pay-as-you-go pension plans in the early years, are no longer true for Social Security benefits.

For the average earner who retired at 65, taking into account COLAs and continued accrual of interest, it takes about 16 years to receive back the combined employer-employee OASI payroll taxes plus interest.

Last, one assumption underlying taxing up to 85 percent of benefits is that this is similar to the tax treatment of private pensions. However, private pensions with an employee contribution are currently overtaxed. This has not been a major controversy because most private pensions, unlike Social Security, do not require direct employee contributions.

The second subject of today's hearing concerns the tax treatment of accelerated death benefits. Another positive aspect of the Contract would permit tax-free distributions from life insurance policies to pay medical bills and living expenses of chronically or termi-

nally ill individuals. Life insurance companies developed this alternative in response to the needs of its clients.

Permitting payments to the insured for expenses of a terminal illness is sound public policy. Additionally, more than 80 percent of long-term care is provided in the home by family and friends. This assistance enables chronically ill individuals to remain at home rather than be institutionalized. It also saves the government money for Medicaid nursing home care it might otherwise have to pay.

The $500 tax credit proposed in the Contract provides some assistance for these families. The national committee looks forward to the passage of the provisions in the Contract With America which would repeal the 1993 tax increase on Social Security benefits and would provide favorable tax treatment for accelerated death benefits and home care expenses. Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

TESTIMONY OF MARTHA McSTEEN
NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

I am Martha McSteen, President of the National Committee to Preserve Social Security and Medicare, a grassroots, education and advocacy organization representing millions of senior Americans. I am pleased to appear before the Ways and Means Committee to express the National Committee's support both for repealing the 1993 increase in the taxation of Social Security benefits and allowing tax free accelerated death benefits under life insurance contracts.

There are five reasons why the proposal to repeal the increased tax on Social Securitybenefits makes sound public policy.

One, the 1993 budget bill increased the amount of Social Security benefits subject to tax from 50 percent to 85 percent for individual beneficiaries with income above $34,000 or for couples with income above $44,000. The Administration consistently claimed that the 1993 budget package would only increase taxes for the upper one percent of Americans and while that was true for American taxpayers under age 65 it was not true for senior taxpayers.

The increased taxation did affect about 13 percent of Social Security beneficiaries in 1994 and it is estimated that it will affect about 17 percent in 1998—unless it is repealed. Therefore, National Committee members strongly endorse the proposal in the Contract with America to repeal the tax increase.

Under the proposal in the Contract with America, the amount of benefits taxable will decline gradually from 85 percent to 50 percent. The National Committee estimates (see Table 1) that affected beneficiaries will save an average of $158 in 1996 increasing to $662 in the year 2000.

Table 1. Impact of Contract with America Repeal of 85 Percent Taxation of Benefits on Social Security Beneficiaries

Year	Percent of Benefits Taxed	Revenue Reduction	Number of Beneficiaries Affected	Average Tax Savings for Beneficiaries Affected
1996	75%	$0.9 billion	5.7 million	$158
1997	65%	$2.2 billion	6.2 million	$355
1998	60%	$3.1 billion	6.7 million	$463
1999	55%	$4.1 billion	7.2 million	$569
2000	50%	$5.1 billion	7.7 million	$662

Source: SSA. National Committee estimated number of beneficiaries affected in 1997, 1998 and 1999 and average tax savings. Revenue estimates and average tax savings are for fiscal years.

Secondly, no Social Security benefits were taxed during Social Security's first 44 years and up to 50 percent have been taxed only for the last ten years. The National Committee is concerned that the increase in the taxation of Social Security benefits could undermine future public support for Social Security. That is because support for the higher tax is built on two flawed assumptions—first, that most low and middle income beneficiaries will not be affected by the increased taxation of Social Security benefits, and, second, that Social Security should be taxed like a private pension.

Bracket Creep

Third, "bracket creep" has been eliminated for every taxpayer except Social Security beneficiaries. Individuals have paid tax on 50 percent of Social Security benefits with income above $25,000 ($32,000 for a couple) since 1984 when benefits were first taxed. Over time, many moderate and low income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed. In 1984, these thresholds were high enough so that only ten percent of beneficiaries paid tax on benefits. By 1998, 26 percent of beneficiaries will pay tax on benefits according to the Social Security Administration. While the income thresholds for paying tax on 85 percent of benefits are higher, they are also not indexed. As a result, most middle income and even some low income beneficiaries will be affected over time.

And since the threshold for married couples is only 29 percent higher than for individuals, married couples are more likely to pay tax on 85 percent of benefits than individuals especially if the individual is still in the work force.

And, the increased tax is a heavier burden on middle income seniors with income between $40,000 and $80,000 than it is on upper income seniors whose taxable Social Security benefits are capped at no more than 85 percent of Social Security benefits.

Excessive Progressivity

Fourth, some defend the increased tax as fair, because they believe that Social Security is not progressive. Yet the benefit formula already is progressive. Taxing up to 85 percent of benefits is excessive and discourages retirement savings.

Although frequently not acknowledged, the Social Security benefit formula favors low income workers at the expense of upper income workers. Benefits for a low earner are approximately 58 percent of average earnings, 43 percent for an average earner and only 24 percent for the maximum earner. If a maximum earner with a benefit of $1,195 in 1995 would receive 43 percent of average earnings, his or her benefit would be $946 a month higher. This $946, which the maximum earner does not receive, is in effect a "tax" to provide more adequate benefits for a low income worker.

Support for taxing benefits grows out of the belief that all beneficiaries receive huge windfalls, windfalls that upper income beneficiaries don't need. But the so-called windfalls that earlier generations received under Social Security, typical of all pay-as-you-go pension plans in the early years, are no longer true for Social Security benefits today. For the average earner who retired at age 65 in 1994, taking into account COLAs and continued accrual of interest, it takes 16 years to receive back the combined employer-employee OASI payroll taxes plus interest. It takes a maximum earner 22 years. With the average male life expectancy at age 65 of 15 years, the average earner breaks even and the high earner subsidizes the low earner.[1] Factoring in the reduction in benefits due to the taxation of benefits could add three or more years to the number of years it takes to receive back contributions.

False Private Pension Analogy

And lastly, one assumption underlying taxing up to 85 percent of benefits is that this is similar to the tax treatment of private pensions. However, private pensions with an employee contribution are currently overtaxed. This has not been a major controversy, because most private pensions, unlike Social Security, do not require direct employee contributions.

The government fully taxes private pensions except for the nominal value of the original employee contribution. It does so even though inflation means the original contribution is worth a lot more in today's dollars. In order to correct this inequity, the Department of the Treasury in 1984 proposed to exclude from taxable income not only the nominal employee contribution to a private pension but also the inflation adjusted value. While the proposal was not adopted, the reasoning behind it is still valid. Just because some private pensions are overtaxed now doesn't mean that Social Security benefits should also be overtaxed.

If Social Security contributions were indexed so that beneficiaries were not paying tax on inflation, the taxable portion of Social Security benefits for a single high wage earner who will be 65 in 1995 would be around 60 percent of Social Security benefits, much lower than the current 85 percent. The taxable portion would be even less than the current level of 50 percent for many younger individuals.

Favorable Tax Treatment for Accelerated Death Benefits and Home Care Expenses

The second subject of today's hearing concerns the tax treatment of accelerated death benefits. We would also like to comment on a related issue on the tax treatment of home care expenses, one of the subjects of yesterday's hearing.

Another positive aspect of the Contract with America would permit tax-free distributions from life insurance policies to pay medical bills and living expenses of chronically or terminally ill individuals. Life insurance companies developed this alternative in response to the needs of its clients. Permitting payments to the insured for expenses of a terminal illness is sound public policy. Individuals currently are reluctant to accept accelerated death benefits, however, because of the high taxes imposed.

More than 80 percent of long-term care is provided in the home by family and friends. This assistance enables chronically ill individuals to remain at home rather than be institutionalized. It also saves the government money for Medicaid nursing home care it might otherwise have to pay. Many families perform great sacrifice in providing home care assistance with little or no support from the government up to now. The $500 tax credit proposed in the Contract with America provides some assistance for these families. Unlike a tax

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[1] Geoffrey Kollman, "How Long Does It Take New Retirees to Recover the Value of Their Social Security Taxes?" Congressional Research Service (94-5 EPW), updated January 3, 1994, p. 9, illustration 10.

deduction, it is more valuable to those with low taxable income than those with high taxable income.

Conclusion

The National Committee looks forward to the passage of the provisions in the Contract with America which would repeal the 1993 tax increase on Social Security benefits and would provide favorable tax treatment for accelerated death benefits and home care expenses.

Mr. HOUGHTON. Thank you very much, Ms. McSteen.
Mr. Ball, we would like to have your testimony.

STATEMENT OF HON. ROBERT M. BALL, WASHINGTON, D.C., FORMER COMMISSIONER OF SOCIAL SECURITY

Mr. BALL. Mr. Chairman and members of the committee, on this issue of how to tax Social Security benefits, my own view is somewhat different from either rescinding the 1993 increase in the tax or just keeping the present law at 85 percent. All other retirement income, IRAs, Keoghs, 401(k) plans, individually bought private annuities, government career plans, pension plans, particularly the ones that are contributory, are all treated the same. Any income that has not previously been taxed is taxed on receipt.

I see absolutely no reason why Social Security shouldn't be treated just the same. Social Security is not just a poor people's program. It is not just aimed at getting rid of poverty. Social Security goes to people at all income levels, and there is no reason why the tax treatment shouldn't be like other types of retirement income.

Now, I would make one differentiation in Social Security tax policy from the general rule that I spoke of earlier, and that is I think at least temporarily, and temporarily may be quite a long time, that the exemption at the bottom should be continued.

I don't take that position on theoretical grounds. I think it would be better if we didn't have those exemptions and let the income tax work its will in terms of protecting low-income elderly people, like all other people are in the country. We have a progressive income tax and low-income people don't have to pay it, and I think that ultimately the same rules should apply to older people as to everyone else, but the problem is the practical one of arriving at this situation gradually without the disruption of sudden change.

I have been for taxing Social Security benefits for at least the last 30 years, maybe longer, and treating it just like other retirement income, but when Stanley Surrey, Assistant Secretary for Tax Policy, and I tried to do this some 30 years ago, the opponents of taxing Social Security got everybody stirred up by making it seem that what we were proposing was to tax everybody's Social Security as if it were an excise tax on Social Security benefits. To make absolutely clear that low-income people would not be taxed— and if you didn't have these exemptions—40 percent of Social Security beneficiaries wouldn't have to pay a tax anyway—in the last couple of decades, I have been for having an explicit exemption for low-income people.

It does create some problems, as you heard earlier. I don't think it is the ultimate good policy, but as long as it is unindexed, it is a way of gradually working around to what I think is a correct policy, and that is to in every respect treat the taxation of Social Security benefits just like all other retirement income. Social Security is the only exception. I see no reason whatsoever for this exception.

[The prepared statement follows:]

TESTIMONY OF ROBERT M. BALL, WASHINGTON, D.C.
FORMER COMMISSIONER OF SOCIAL SECURITY

Mr. Chairman and Members of the Committee:

My name is Robert Ball. I was Commissioner of Social Security from 1962 to 1973. Prior to my appointment by President Kennedy, I was the top civil servant at Social Security for about 10 years, and have had a total of some 30 years of service at the Social Security Administration. Since leaving the Government, I have continued to write and speak about Social Security, health insurance, and related programs.

I was Staff Director of an Advisory Council on Social Security to the Senate Finance Committee in 1948, a council which recommended the major changes that became the Social Security Amendments of 1950. I have also been a member of the statutory Advisory Councils on Social Security in 1965, 1979, and 1991, and am now a member of the Advisory Council currently studying the program. I was also a member of the small negotiating group from the National Commission on Social Security Reform in 1982-1982, the Greenspan Commission, which reached an agreement with the White House on a series of recommendations that became the basis for the important 1983 amendments. I am currently Chair of the Board of the National Academy of Social Insurance.

I have long believed that the same tax policy that applies to other types of retirement income should apply to Social Security. I see no reason for any special treatment of Social Security income. Social Security is not a poor people's program (although it does prevent poverty for some 15 million beneficiaries and prevents millions more from falling into near poverty); it is a universal retirement, life insurance, and disability insurance program. Benefits go to people at all income levels and fairness requires that the same taxation rules should be applied to their Social Security income as to IRAs, Keogh plans, 401(k) plans, private pension plans, whether they are contributory or not, and Government-career plans.

Although in detail the taxation of income from these various plans appear to be somewhat different, the taxing principle is the same: Any income that has not previously been taxed is taxed on receipt. Thus, in non-contributory private pension plans, since none of the benefit has been previously taxed, all is taxable to the retiree as received. In the case of contributory Government-career plans, such as Civil Service or the Congressional Retirement System, benefits are taxed to the extent that they exceed what the retiree paid in.

In other types of retirement plans, too, if a payment into the plan was not taxed when made, the entire income is taxed on receipt, and if the payment was from after-tax income, as in a privately bought annuity, only the interest accumulation is taxed when the annuity is paid out.

The application of this policy to Social Security would be to make Social Security benefits taxable to the extent that they exceed the employee's contributions. Present law differs from this policy in two respects:

(1) The taxation of benefits applies only to those with total incomes above specified thresholds: $25,000 a year for a single person and $32,000 a year for couples. Those with incomes above these thresholds have at least 50 percent of their Social Security benefits included in gross income for income tax purposes, and those whose incomes are above $34,000 if single and $44,000 for couples, have 85 percent of the Social Security benefit included in gross income.

And, (2) The proportion of the benefit taxed after the higher threshold is exceeded, 85 percent, is an approximation of the amount that would be taxed under the general rule, rather than the exact amount. The approximation is used to save administrative work for the Social Security Administration, which thus avoids figuring out individual-by-individual the exact excess of benefit over contributions. The 85 percent figure was selected to protect retirees from paying more than the taxation principle would require. In most instances the 85 percent is less than if the amount were exactly calculated.

On the first exception, (1) above, from the general application of the taxing principle, one might well ask, "Why this exemption for lower income people?" The answer is, "Experience." Even without the specific low income exemptions, about 40 percent of beneficiaries wouldn't pay taxes anyway because the progressive features of the income tax protect those with low incomes, but it might not be clear that this was the case. When I and the then Assistant Secretary for Tax Legislation of the Treasury, Stanley Surrey, first proposed taxing Social Security benefits some 30 years ago, the opposition got everyone excited, regardless of their income, because they presented their case as if the proposal was to tax everyone's Social Security benefit, sort of an excise tax on Social Security! So in recent years, as a practical matter, I have favored an explicit income exemption to make it absolutely clear that the tax wouldn't apply to those with low income. I believe that from a policy point of view, it would be preferable not to have these special income exemptions, but I think we have to get to that position gradually. Keeping these thresholds unindexed will gradually require more people to pay the tax, and finally only the general provisions of the income tax will protect low income people, as is the case for other types of income.

On point (2), the substitution of a presumptive figure, 85 percent of the benefits for individual calculations, now seems to me undesirable. I believe that the taxation of Social Security benefits ought to be calculated individually and that the beneficiaries should pay on the amount by which their benefits exceed what they have paid in. In total, this will result in more income from benefit taxation than the 85 percent rule. Modern technology makes it possible to do the calculations, and it would be fairer to apply exactly the same rules as with other retirement income. I would favor having this rule apply to benefits going to individuals above the thresholds of $25,000 for singles, and $32,000 for couples, thus dropping the higher exemption in present law before the 85 percent rule is applied.

What I am proposing, of course, goes in the opposite direction from the legislation you are currently considering. But I see no basis for returning to the 50 percent rule for Social Security when all other retirement income is taxed to the extent it has not been taxed previously. Of course, it is important not to tax income twice, but beneficiaries of Social Security now, and in the future, will have paid in much less than 50 percent of their benefits. It is not just the employer contribution that needs to be taxed on receipt in order for the treatment to be comparable to other retirement income, but also taxes should be paid on all of the benefits that exceed the employee contribution.

On first glance it may seem difficult to reconcile the statement that beneficiaries will get back much more than what they and their employer pay in with recent calculations which show that those now young, with their employers, will pay in over a lifetime just about enough to get their money's worth. But there is no conflict. In a calculation to determine the extent to which Social Security beneficiaries get their "money's worth," it is proper to take the employer and employee contribution, and to add interest on the combined contribution to compare with the benefits paid out. However, in applying the general tax rule to Social Security only the employee contribution has been taxed and all benefits that exceed these contributions should be taxed as received.

One might also ask, "Why in the 1983 amendments, which first taxed Social Security, was only 50 percent of the benefit included in gross income?" The answer is that it was simply the most that those of us who favored taxation could get, and it had, at least, the superficial appeal of the employer having paid 50 percent of the total contribution (which had not been taxed), and the employee paying 50 percent (which had been taxed). There was no attempt to rationalize the policy in terms of bringing the treatment into line with the way other retirement income was treated. That came later with the 85 percent proposal that became law in 1993.

When one considers the history of the taxation of Social Security benefits, or rather the lack of it before 1983, it is not surprising that the initial step was only a partial step. Up until 1983 Social Security benefits had not been taxed at all and whenever the issue had been raised, Congress reacted in no uncertain terms that they thought it a bad idea. When the 1979 Advisory Council on Social Security proposed taxing Social Security benefits, the Senate immediately passed a resolution, practically unanimously, stating that they would never do such a thing. It was possible to begin taxing Social Security at all, only because the income from the tax was to be returned to the Social Security Trust Funds and because in 1983 Social Security very much needed more income. It was a compromise driven by the desperate financial situation of the program at that time. The fact that some of us believed it was good policy probably did not have a great deal to do with its acceptance.

But why weren't Social Security benefits taxed from the beginning of the program? There is no law on this, only early Treasury rulings. These rulings were apparently based on what I consider the mistaken notion that Social Security was similar to other payments that had been exempted in previous rulings because they were considered gratuities rather than earned rights. Since gratuities are not taxable to the recipient, Social Security was ruled exempt. This original interpretation had some basis in the way the law was set up. In 1935, when the Social Security Act was first drafted, the Supreme Court had been invalidating a high proportion of new social legislation that came before it. There was concern that the Court might also invalidate Social Security. To reduce the possibility of constitutional challenge, the titles in the Social Security Act granting benefits were kept entirely separate from the titles imposing taxes. There was clearly no constitutional prohibition against Congress granting benefits, and there was no doubt that Congress could levy taxes, but there was concern, at that time, that connecting the two in a social insurance system -- a new concept in the United States of 1935 -- might be overturned by a majority of the Supreme Court.

When Treasury later considered the question of taxation, they apparently reasoned that if the benefits weren't connected to the taxes paid, there was a basis for thinking of them as a Government grant, a gratuity, and not taxable. In the early Treasury rulings, the Treasury referred to previous rulings on other unearned income as precedents. It seems clear now that Social Security benefits are paid for by earmarked deductions from workers' earnings matched by their employers, and that even though the amount of the benefit is not strictly related to what individual workers have paid in, few people today would see it as a gratuity. The Treasury ruling, however, had governed for so many years that it was clear in 1983 that legislative action was desirable if the policy was to be changed.

Today the taxation of Social Security benefits is a relatively small but nevertheless significant part of the long-range financing of the program. Under present law, in the long-run, these taxes will represent about one percent of annual covered payrolls for Social Security, more than one percent if what is going into the Hospital Insurance program is added in. If the provision for taxing benefits and putting the proceeds into one of the Social Security Trust Funds were eliminated, the loss would have to be made up for in some other way. Even reducing the income from taxation of benefits, as proposed in the legislation you are considering, would make the long-range actuarial balance of these programs worse by a total of 0.36 percent of taxable payrolls. On the other hand, extending the taxation of benefits further for those above the thresholds of $25,000 and $32,000, by following the rules applied to other retirement income, as I propose, would further reduce the long-range actuarial balance by 0.14 percent, a swing of a half percent of payroll.

The short-run effect of the change under consideration is also important. Returning to the law in effect before the 1993 amendments is estimated to reduce the income to the Hospital Insurance Trust Fund by $15 billion over five years. (It is a peculiarity of the present law that the proceeds from those taxes on Social Security benefits which were imposed by the 1993 amendments go into the Hospital Insurance fund rather than the OASDI fund. This came about because it would have required 60 votes in the Senate to increase the income of the Social Security fund, but this was not the case for hospital insurance. At some point this anomaly needs to be cleared up. Clearly the proceeds of taxes on OASDI benefits should go to the OASDI funds.) Moreover, cutting back on the amount of taxation increases the deficit in the unified budget of the United States. Any such increase should be offset elsewhere.

For me, the most important question for long-run policy is the application to Social Security of the tax policy applied to other retirement income. I favor treating Social Security income above the first threshold just like other retirement income. I have not attempted to evaluate whether the tax policy applied to retirement income generally is the best possible policy. My whole point is to treat Social Security in the same way other retirement income is treated. If the treatment of other retirement income is changed, then Social Security should also follow the new rules. This is a matter, not only of equity, but of what is good for Social Security.

Some people have asked why I oppose benefit cuts and yet support the taxation of benefits. Isn't the tax equivalent to a benefit cut, they ask? It is at any particular time, but the development of tax policy may take a very different direction from the development of Social Security policy so that they are not necessarily equivalent over time. If income taxes are increased because of a set of circumstances that has nothing to do with Social Security, Social Security beneficiaries should get less income, and if, on the other hand, taxes are reduced, the income of Social Security beneficiaries should be increased like that of other taxpayers. This is what changes in the policy call for and when the new policy is applied to other income, what possible reason is there for treating Social Security differently?

I see taxing Social Security benefits, not only as fair, but as a way of identifying the program with all other earned retirement income, and thus making clear that Social Security is not welfare, but similar to all other earned pension and retirement income rights. Treating Social Security just like all other benefits paid as a right, rather than giving it special tax treatment, emphasizes its character as a contributory system paying its own way. Thus, I believe, it is important that the tax treatment follow the same principles, not just follow them half-way.

I am interested in the money, too. Social Security needs it for the long run, although it is well financed for the next 20 to 25 years. The unified budget needs the income now. But the principle of treating Social Security like all other retirement income is equally important.

Mr. HOUGHTON. Thank you very much, Mr. Ball.

Mr. Christensen will inquire.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I have two questions. One, I wanted to get your views, Mr. Boulter, from what you felt the sense of your membership is toward the flat tax proposal. I want to ask Mr. Ball a question first.

According to the Congressional Research Service, it currently takes average workers who retire at age 65, 17.9 years to get back all that they and their employers paid into Social Security. High earners it takes 24 years.

In other words, they would have to live until 82 and 89 before they get back their entire investment. That is before you factor in the tax increase from the 50 percent to 85 percent. After you figure in the tax increase that the Clinton administration heaped upon the backs of senior citizens, that goes up to, I believe, the average earner is 36 years and for higher income earners, age 101 for high wage earners to get back their investment.

Isn't it true that more and more workers will never live long enough to get back what they paid into Social Security, especially when you figure in the tax that was recently imposed upon the seniors?

Mr. BALL. I don't think that is a valid way of figuring how taxes operate. In any other type of retirement income, if you figure in the tax on that income which varies, of course, depending on how high your total income is, you will have instances where if you take the tax into account, people would not be getting back fully what they had paid in.

Those numbers that you are using from the Congressional Research Service are higher than I have seen before, and I would like to examine them. They seem high to me, and more than I have ever heard from Social Security actuaries.

Mr. CHRISTENSEN. OK. Mr. Boulter.

Mr. BOULTER. Congressman, our group is supporting the flat tax. I am sure that our membership would, by a big majority, be in favor of that. We are polling them. I better be right on this, but our members pretty much know how we believe, and that is why they join, and we oppose these high marginal tax rates and tax increases. We think a flat tax or something like the majority leader has proposed is good for the economy and is fair to all.

Mr. CHRISTENSEN. Would the majority of your members be under the exemption of, say, the Armey proposal of say the $38,000, $38,000 or less in income? Do you know whether they would fall in that or not? Do you think a lot of them would not have to pay any of the income flat tax?

Mr. BOULTER. I think a lot of them would be under that exemption.

Mr. CHRISTENSEN. How about you, Ms. McSteen?

Ms. MCSTEEN. Our average age member is 68, and the annual income is around $30,000.

Mr. CHRISTENSEN. OK.

Mr. BALL. Mr. Christensen, could I ask you if you know what interest rates the CRS was using in the examples you referred to and whether they used the entire OASDI rate or just that part devoted to retirement benefits?

Mr. CHRISTENSEN. I don't have that figure, Mr. Ball. Thank you, Mr. Chairman.

Mr. HOUGHTON. Thank you very much. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Boulter, can you tell us the most recent time the Federal accounts were in balance for a fiscal year?

Mr. BOULTER. Not since I have been running for Congress or been serving or been interested in the political process as an active adult, I don't believe. When we had a balanced budget?

Mr. JACOBS. I think it was fiscal year 1969?

Mr. BOULTER. 1960 something.

Mr. JACOBS. 1969, I think. Didn't that follow the 10-percent surcharge tax increase in fairly rapid order?

Mr. BOULTER. I do not know, Mr. Jacobs.

Mr. JACOBS. It was passed in 1968. You say that the 1963 act had no effect on the deficit. Did I understand that to be your——

Mr. BOULTER. You mean the 1983?

Mr. JACOBS. 1993, I beg your pardon.

Mr. BOULTER. My point there is that Social Security should not be used for deficit reduction.

Mr. JACOBS. No, I thought you simply——

Mr. BOULTER. But, in fact, that it is being used for lots of purposes, including financing the deficit.

Mr. JACOBS. That is not correct. The 1993 tax on Social Security benefits, the increased amount of your free Social Security benefits that you have to include in your taxable income does not relate to the Federal funds budget at all, does it?

Mr. BOULTER. It goes into hospital insurance and deficit reduction.

Mr. JACOBS. How do you get deficit reduction by its going into hospital insurance? It is a trust fund.

Mr. BOULTER. Because you are borrowing money from the trust funds for all government purposes.

Mr. JACOBS. Regardless of where you borrow the money, if you borrowed it at the bank, would you say that the bank was financing the Federal funds budget or would they have just lent the money, it was an obligation to pay?

Mr. BOULTER. I would say if the income into the Social Security trust funds on the books is about, what, $65 billion more than outgo last year, and that money is being used for other purposes, that it is being used for other purposes, including deficit reduction.

Mr. JACOBS. But don't you ignore the interest that it has accrued on the loan? I mean, if the bank lends you $1,000 to go on vacation, can you say the bank is squandering my deposit by financing a vacation, or can you say the bank has a contract that earns interest for me and the real question is whether you will pay it back, not what you did with it?

Mr. BOULTER. I am not sure of what——

Mr. JACOBS. I am not accusing you of doing that, I think that would be stupid but——

Mr. BOULTER. I am not sure I understand your question. I know I have heard you say today that this money, that the tax increase is used for hospital insurance, and is used for deficit reduction.

Mr. JACOBS. You are entirely right on the first. You kind of lose me on that second corner, though. That is almost like saying all

cottage cheese is made in cottages. You could say, then, that every Social Security tax paid is used for deficit reduction.

Mr. BOULTER. Let me ask, do I understand correctly that the tax receipts for Social Security go into the general treasury? Do I understand that correctly? Am I correct in that? That is what I stated on my testimony. Am I correct?

Mr. JACOBS. I don't usually answer questions from witnesses, but I think the answer is it goes in a trust fund of which the Treasury Department is custodian.

Mr. BOULTER. Benefits are paid out of that same fund.

Mr. JACOBS. I am sure you would agree with that.

Mr. BOULTER. The surplus is credited on the books to the Social Security trust fund, but in the form of government securities. That is my testimony. So that money is being used for other purposes. That is widely acknowledged.

Mr. JACOBS. Why is it my life savings, the bulk of them, are invested in U.S. securities? Because people like Jane Bryant Quinn tell us that is the safest investment you can make for obvious reasons, that the Federal Government would be the last institution to go down after the banks and S&Ls, but you can say that we are financing the Pentagon or helping finance social programs or something like that, but what we are interested in is that our account is credited each 90 days with the interest. So, no, I don't think that is correct to say that it is used for deficit reduction until it is borrowed. You could say the Japanese are reducing our deficit, too, because we borrow money from them.

Mr. BOULTER. It has been borrowed. It has been borrowed. I am simply saying it should not be used for deficit reduction. It should not be used for other governmental purposes. I don't even think it should be used for hospital insurance.

Mr. JACOBS. That was one of the big arguments at the time, would it be used for deficit reduction, deposited into the Federal funds budget, or would it be plowed back into the Social Security. I am sure Ms. McSteen remembers that, and ultimately it passed the House doing what you said. It was for deficit reduction, but in the conference it was redirected to the trust funds, but we may be arguing about semantics. We are definitely arguing after our time has expired.

Mr. HOUGHTON. Without being accused of choking off debate here, I would like to thank the witnesses, thank the members of the panel, and I would assume that Dr. Flemming's remarks will be put into the record.

Mr. BALL. Mr. Chairman, I took the red light very seriously in my summary statement. Could I say about two sentences more?

Mr. HOUGHTON. Sure.

Mr. BALL. I think the bottom line is that we just can't afford this cut in taxes for the hospital insurance program nor if it were made part of the social security program. Both of those funds are going to need more money. Social Security is well financed for the next 20–25 years, but not for the really long run. For these social programs with their dedicated taxes, we can't afford this cut.

Mr. HOUGHTON. Thank you very much, sir.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

AFFORDING CARE
611 G Street, SW
Washington, DC 20024
(202) 479-2543

January 19, 1995

Honorable Bill Archer
Chairman
Ways and Means Committee
House of Representatives
1102 Longworth Building
Washington, DC 20515

Re: Senior Citizens' Equity Act - Accelerated Death Benefits

Dear Mr. Chairman:

We are writing to offer comments and suggestions regarding the accelerated death benefit tax exemption provisions of the Senior Citizens' Equity Act.

Affording Care is a national, non-profit, all-volunteer organization which conducts workshops, issues newsletters, dispenses information and provides counseling to seriously ill persons and those who assist them about insurance, financial planning and public entitlements, drawing upon our volunteers' wide career backgrounds in these areas. We have taken the lead in "consumer" education and advocacy in the issues revolving around "living benefits" and related mechanisms for terminally ill persons' raising desperately needed cash from their life insurance policies before death. As such, we are probably close to unique among those commenting upon this particular sub-provision of the Contract in that we have no business or financial stake in the insurance, viatication or related enterprises in the field--our only concern is the provision of wider options, along with useful information, to seriously ill persons so that they can make wise and beneficial decisions about money in what may be their last months of life. To this end, we work with patients with all serious diagnoses (for example, cancer, AIDS, heart disease) without regard to personal background, financial status, political belief or age. Where possible, we favor private financial solutions for those we work with, although we do also advise on such matters as SSDI, SSI, Medicare and Medicaid as well. We accept no commercial funding other than a few small advertisements in our occasionally-produced, free newsletter; our costs are largely met by donations from volunteers' own funds.

As you know, accelerated death benefits are paid out by insurance companies to verifiably terminally ill insured policyholders with life expectancies of six to twelve months, and the payout amount ranges from only a portion to nearly all of the death benefit amount, depending upon

policy provisions. The Contract provision before the Committee would exempt from the presently-applicable taxation accelerated benefits received by a taxpayer during the last year of life. This change is both logical and compassionate inasmuch as death payments received by an insured's life insurance beneficiaries after his death are and have been traditionally tax-free (unless estate assets, together with the insurance payouts, total over the $600,000 threshold for estate taxation--an event covering only a tiny minority of cases). This change in tax law will not only ease the plight of terminally ill persons whose incomes have been cut because of medical inability to work, it will also prevent the bizarre and indefensible result of our present tax laws: terminally ill persons deterred by taxes from realizing desperately-needed cash on their life insurance policies who literally die destitute (and what's worse, often forced thereby on publicly-funded welfare programs like SSI and Medicaid) whose beneficiaries, after their deaths, are often enriched--usually tax free!

But only a small percentage of terminally ill people can use accelerated benefits to meet their living expenses and medical costs. This is because only a minority of life insurance policies have accelerated death benefit clauses; the six month or one year life expectancy limitation closes out most terminally ill persons who need money earlier in the course of illness; and many insurance firms with acceleration riders available on their product lines choose to medically underwrite (i.e., exclude from the option) even present policyholders or those who can qualify for the underlying life policy (this is true, for example in conversions from employer group term life policies, where departing, fatally ill employees do have the right under the group contract to convert the same amount of coverage into an individual policy without medical exclusions--but not the right to add on an otherwise-available acceleration clause).

As a result, accelerated benefits meet the needs of only a minority of insured, fatally ill persons who seek to avoid poverty and becoming public charges in their final days. What has filled the gap has been viatication: the sale of policy ownership or control rights to a business investor which verifies policy provisions and the insured's medical prognosis, pays any remaining lifetime premiums and collects the full policy face amount at death. Because viatical investors are classic free enterprise entrepreneurs, they offer selling patients less than the full amount due at death--not only to take some profits but also to meet high overhead costs associated with policy and medical verifications, future premium payments, the cost of financing sale prices and extensive customer service personnel costs. Thus, policy sale prices can range from 55% of face value to over 80%, depending on the innumerable variations present in a given policy upon the life of a given individual patient.

Viatication has been questioned for having a somehow "improper" profit motive. But this motive is basic to our economy and our society. After all, who would question the **bona fides** of insurance companies, physicians and even hospitals, all of which operate for "profit"? Viatication serves a desperately-needed function in our society, and its emergence in recent years has made the final days of thousands of terminally ill people more bearable--and simultaneously lessened resort to government welfare programs for those in genuine need. Any abuse can and will be rooted out by state regulation (already in effect in California,Kansas, New Mexico and New York) initiated pursuant to the Model Code recently promulgated by the National Association of Insurance Commissioners. These issues can be, should be and will be appropriately addressed at the state level--they certainly don't belong at the federal level, and in particular have no place in considering the pre-death taxation of insurance money.

In light of the above, we strongly recommend that proceeds of life insurance policy viatication be treated identically with accelerated death benefits in being made exempt from federal taxation--a step already taken by the California and New York income taxation codes. We believe that this exemption should be available to all terminally ill taxpayers whatever their age, and not just to those over age 65.Finally, to make this exemption fully meaningful, we strongly urge that the life expectancy horizon be set at two or three years. A one year limit that matches the niggardly limits life insurance firms offer in their acceleration riders effectively denies the tax benefit to the bulk of financially needy, no-longer-able-to-work, gravely ill but still-ambulatory persons while conferring protection only upon those who are nearing or are already in a bedbound, hospice-level quality of life where financial concerns have telescoped solely into coverage for deathbed care (which, curiously enough, will almost always be available without much fuss from Medicare and Medicaid).

We thank you for hearing our concerns with strengthening this thoughtful and comprehensive piece of legislation. If we can be helpful to you and your staff on this question, please do call us at (202) 479-2543.

Yours truly,

Thomas P. McCormack
Washington Representative

STATEMENT OF CAROL PECK
PROGRAM DIRECTOR FOR FAMILY SUPPORT
CATHOLIC CHARITIES USA

Thank you for the opportunity to provide written testimony regarding the proposed Family Reinforcement Act refundable tax credits as they relate to adoption expenses.

Catholic Charities USA is the nation's largest, private, social service organization. The network of 1,400 agencies and institutions and thousands of concerned individuals works to reduce poverty, support families, and empower communities in the United States.

Catholic Charities agencies and institutions, with more than 266,000 staff members and volunteers, provide social services ranging from adoption and counseling to food and housing. People of all religious, national, racial, social, and economic backgrounds receive services from Catholic Charities.

Catholic Charities USA promotes public policies and strategies that address human needs and social injustices. More than 3.8 million people turned to Catholic Charities for help in 1993. 1.3 million of those individuals were children and adolescents who were 17 years of age or younger.

Catholic Charities agencies have a long and proud history of making permanent placement plans for children in need of families. Even before 1910 when the National Catholic Conference (now Catholic Charities USA) was founded, our agencies were providing quality permanent placement plans for children available for adoption.

In 1993, Catholic Charities agencies served 38,915 individuals involved in adoption placements. Adoptive homes were found for 3,100 children including 1,377 special-needs children and 241 children from other countries. Other services included services to adult adoptees, pre-adoption foster care, and post adoption services.

Although Catholic Charities USA would support an increase for qualified expenses for legal child adoption, we have concerns about the proposed legislation supplanting the current reimbursements available under the nonrecurring adoption expenses available under Tax Reform Act of 1986. On December 14, 1988, the Department of Health and Human Services published a final rule to implement nonrecurring adoption expenses throughout Title IVE under the Social Security Act. That rule asks that states share in the cost of nonrecurring expenses for special needs adoptions.

With limited resources available for qualified adoption expenses, we question legislation which would cost over $900 million dollars over the next five years which would not specifically address special needs adoptions. There are currently 30,000 children who are waiting for families but are hard to place because of their ethnic heritage, because they are older children, because they belong to sibling groups, or because they have a physical or mental disability. In 1995, the Child Welfare League of America

anticipates that 70,000 to 85,000 of these children are likely to be waiting for adoptive families.

Under current law, families can be reimbursed through Title IVE with matching state funds up to $2,000 once a special needs adoption has been finalized. The current legislation permits families to adopt special needs children who are waiting in foster care for permanent placement.

Although we agree that the $5,000 tax credit would certainly help families to pay for qualifying legal adoption expenses and help promote adoptions, it is aimed primarily toward those parents with incomes that are high enough to pay qualifying fees up front. The proposed tax credit will not benefit parents who do not have the money to spend before they can get it back in the form of a tax credit.

We additionally have concerns that a tax credit rather than a cash reimbursement, could encourage a rise in both agency and legal fees. For example, agencies and attorneys that currently charge a $5,000 fee will be tempted to raise their fees once they are aware that adoptive parents will receive a tax credit after the money has already been spent on the placement. $5,000 would currently cover only about half the costs for the adoption of a healthy infant. For a special needs child, the costs are far greater.

Our agencies are able to defer their fees under current law for special needs placements. They are able to carry the bill over until the family is reimbursed. If the adoptive family does not have the money to pay for one time agency expenses, our agencies can bill for service and hold the balance of that bill until post finalization of the adoption.

With a tax credit, adoptive families pay these one time fees up front. Many families who adopt special needs children do not have the out of pocket money necessary for one time expenses. Under current law, the family is able to pay the vender (in our case the agency handling the placement) once the adoption is completed. There is a partnership between the federal government and the states so that costs can go directly to an agency when the adoption is completed.

Under tax credit the family would have to pay the actual costs up front. Agencies would not be able to recover these costs under the proposed legislation. Private adoption agencies would not be able to collect and would have to waive or reduce their fees because they are committed to finding homes for handicapped children, children of color, and older children waiting for families. From an agency perspective, the proposed legislation would not help.

Under current law our agencies are able to at least recoup $2,000 for special needs adoptions within three to six months of the finalized. The question that begs to be asked if the proposed legislation is passed is what place will a private agency have in finding homes for hard to place children? We believe that the public and private system should be encouraging agencies to help find homes for these children. We ask that any new legislation assist private agencies to participate in adoption, not put them out of business because they can no longer afford to pay for all the costs associated with adoption placements.

We also have concerns about how "qualifying expenses" would be defined. We recommend that the guidelines for expenses be clearly defined to include:

- Home study expenses that would include necessary physical and psychological exams;
- Legal fees and court costs;
- Supervision of the placement prior to adoption
- Reasonable and necessary adoption fees by the placement agency;
- Reasonable travel, transportation, food, and lodging costs for the child and parents when necessary to complete the adoption placement.

Finally, Catholic Charities USA would like to take this opportunity to express our appreciation that the Contract with America recognizes the importance of adoption. We do feel however, that the proposed legislation would disproportionately help one group that is already able to afford adoption expenses at the expense of another group that may not be wealthy but are willing to lovingly accept children who are hard to place. With the limited resources available for adoption, is this the direction we want to take?

Thank you for the opportunity of offering this written testimony.

STATEMENT OF DAVID S. LIEDERMAN, EXECUTIVE DIRECTOR THE CHILD WELFARE LEAGUE OF AMERICA

The Child Welfare League of America (CWLA) appreciates the opportunity to submit testimony on Title I of H.R. 11, the Family Reinforcement Act, which proposes a refundable tax credit for adoption expenses. CWLA encourages the federal government to extend its commitment to help children with "special needs" to find loving adoptive homes. CWLA is a membership organization representing 800 public and voluntary child-serving agencies that assist some 2.5 million vulnerable children and their families each year. More than 300 of these agencies provide adoption services.

CWLA commends this Committee for considering the needs of adopted children and their families. Helping children find families who can care for them through adoption is an important commitment on the part of the federal government. CWLA supports federal efforts to defray the costs related to adoption and to help children secure loving homes. CWLA particularly supports those federal efforts that assist children with "special needs" find adoptive families who can care for them such as the current entitlement (IV-E of the Social Security Act) which reimburses states for a portion of their expenses for foster care and adoption assistance for children with special needs.

CWLA strongly urges members of this Committee to maintain full support for the Title IV-E Foster Care and Adoption Assistance Program as you review new child welfare proposals. It would be misdirected federal policy to reduce or trade support of the IV-E Adoption Assistance subsidies to families who adopt "waiting" children with special needs in order to fund a new tax credit as proposed in H.R. 11.

CWLA also suggests that the proposed tax credit be limited to those taxpayer families who adopt children with special needs. In this time of scarce resources, it seems important to provide funds in a way that will enable the majority of children awaiting adoption to find loving homes.

WHO ARE THE CHILDREN AWAITING ADOPTION?

Seventy-two percent of children awaiting adoption have one or more "special needs." "Special needs" refers to those children who may be school age, part of a sibling group, children of color, or children with special physical, emotional, or developmental needs. Children with special needs include the rising number of children who are HIV affected or infected, and those who are drug exposed. An estimated 30,000 abused, neglected, abandoned children with special needs are legally free and awaiting permanent adoptive families, and another 70,000 to 85,000 are likely to need adoption in the near future. As homelessness, substance abuse, and HIV/AIDS compromise and destroy more and more families, their children suffer complex health, mental health, and developmental problems and the families who adopt them often need special training and assistance.

WHO ARE POTENTIAL ADOPTIVE FAMILIES?

The type of families who adopt special needs children varies dramatically: childless couples, older parents who have already raised a family; single parents, two-parent working families; and families from a wide range of ethnic and cultural backgrounds. Families nationwide adopt from all educational backgrounds, all income levels, and all types of religious backgrounds. The number of some families seeking to adopt has increased dramatically as couples marry later and frequently delay their attempts to have children until their mid-thirties to early forties and experience difficulites. At the same time, the majority of young women who have babies are choosing to keep their infants and raise them within the context of their extended families. This has led to a dramatic decline in the number of infants available for adoption.

The opposite is true for the thousands of children in foster care who are waiting for adoptive families. Far fewer families than needed have been recruited for the large numbers of school age children; children with brothers and sisters who need to be adopted together; children of color; and children with serious physical, emotional, or developmental needs.

HOW MANY CHILDREN ARE ADOPTED EACH YEAR?

The data available indicate that approximately 118,800 adoptions were completed in 1990 (the most recent year for which information is available). Of these, approximately 51% are relative adoptions, including stepparent and other kinship adoptions, and approximately 49% are non-relative adoptions. The U.S. Department of Health and Human Services'(HHS) newly implemented Adoption and Foster Care Analysis and Reporting System (AFCARS), began in 1994 to collect more reliable data on foster care and adoption nationwide. HHS expects to have initial data available later this year.

H.R. 11 TAX CREDIT PROPOSAL

H.R. 11 proposes a dollar-for-dollar tax credit of up to $5,000 for adoption expenses including adoption fees, court costs, attorney fees, and other expenses directly related to the legal adoption of a child. For individuals with incomes over $60,000, the credit would be reduced. The proposed credit would not be available for taxpayers whose income exceeds $100,000. The Congressional Budget Office estimates that the proposed tax credit would cost $900 million over five years.

The federal government has been historically, and we believe appropriately, most concerned with removing the obstacles to the adoption of children who have special needs. It is more difficult to find adoptive families who are able to care for these children. These children often may require extra emotional, physical, or medical care. Accordingly, the Economic Recovery Tax Act of 1981 (P.L. 97-34) put into place a deduction of $1,500 for qualified adoption expenses to help reduce the financial burdens for taxpayers who adopt children with special needs. This initiative, which was repealed by the Tax Reform Act of 1986 (P.L. 99-514), cost the federal government between $9 million to $12 million per year. The tax deduction was repealed because Congress found that it had provided relatively greater benefits to higher-income taxpayers, who presumably had relatively less need for assistance, and no benefits to nonitemizers or to individuals whose income was so low that they had no tax liability. The tax credit proposal contained in H.R. 11 is substantially higher than the tax benefit provided by this previous tax law and it would benefit primarily infant adoptions for which no incentive is needed.

COST EFFECTIVENESS OF ENCOURAGING SPECIAL NEEDS ADOPTION

Adoption assistance is an investment in children which results in significant economic savings to the taxpayer. By providing federal subsidies to 40,700 children during 1983 - 1987, federal and state governments saved $1.6 billion in foster care costs according to a 1993 study by Westat Incorporated. Targeting resources to help children who need adoptive families leave foster care not only makes good economic sense, it has been shown to provide these children with the best opportunity to develop into useful, productive adults who become taxpayers rather than becoming dependent upon government subsidies as adults. Adoption makes good sense for a humane society, and it makes good economic sense as well. The availability of federal financial assistance is often the critical difference between a child in foster care becoming part of an adoptive family or remaining in foster care indefintely.

CWLA urges this Committee to maintain its current efforts by providing subsidies to reduce the financial burdens for families who legally adopt these children with special needs. The Adoption subsidies currently provided through the Foster Care and Adoption Assistance Program, Title IV-E of the Social Security Act must continue. This program provided adoption assistance for an estimated 90,800 children in FY 1994. Without this assistance, many of those children otherwise would still be awaiting permanent adoptive families. A tax credit provided to families who adopt children with special needs would complement this federal effort.

THE CONCORD COALITION

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STATEMENT OF MARTHA PHILLIPS
Executive Director
THE CONCORD COALITION

February 3, 1995

Before the Committee on Ways and Means
U.S. House of Representatives

On behalf of the Concord Coalition and its 150,000 members in state and local chapters across the country, thank you for the opportunity to present our views on the tax provisions of the Contract With America.

Mr. Chairman and Members, The Concord Coalition believes that this is the wrong time for tax cuts. We strongly urge the Committee to set aside tax cuts for another day when the nation has a balanced budget and our children enjoy a greater measure of economic prosperity. We stand ready to help this committee and others reduce spending and bring about that day.

Public opinion polls indicate that the American people are deeply concerned about the huge deficits that are being incurred needlessly year after year. When President Clinton was sworn into office, the public debt stood at about $4 trillion. By the end of this calendar year, it will exceed $5 trillion -- about $20,000 for every living American man, woman, and child. By the end of fiscal year 1998, yet another trillion dollars of debt will have been incurred if the government stays on its present path.

Americans are properly anxious about a federal government that loads on a trillion dollars of borrowing in three short years. Their concern generated momentum for the recent House passage of the Balanced Budget Amendment to the Constitution. The Concord Coalition strongly supports the Balanced Budget Amendment and hopes for speedy Senate consideration and quick ratification by the States.

Passing the Constitutional amendment, however, is only a preliminary step. Achieving a balanced budget will be far more difficult. The Congressional Budget Office estimates that upwards of $1.2 trillion of deficit reduction between now and 2002 will be required in order to reach balance by the effective date of the Constitutional amendment. This means that Congress cannot wait for several years to determine whether or not the amendment will be ratified. It must begin this year to put into place a coherent set of policies that will assure compliance with the balanced budget requirement for the year 2002.

The first step toward a balanced budget is NOT a package of tax cuts. Enacting tax cuts now would only make the already daunting task of balancing the budget even more difficult. The cuts under discussion are large. The Treasury Department's initial estimates peg the Contract tax cuts at $97.7 billion in fiscal year 2002, the year we are supposed to balance the budget. President Clinton's proposed tax cuts reduce revenues by about one-quarter that amount, but still a large one-year figure. To pay for the tax cuts, in compliance with pay-as-you-go budget enforcement rules, a number of tough spending-cut decisions will have to be made.

The Concord Coalition is willing to support tough spending-cut choices -- but for deficit reduction, not for tax cuts. If these tough choices are squandered on paying for tax cuts, it will be all the harder to find additional spending cuts to reach a balanced budget by the deadline. Some people gloss over that difficulty by talking about "gliding to balance" or "slowing the rate of spending growth." But glide paths and spending slowdowns do not happen automatically or painlessly. Congress must review existing programs and enact specific policy changes to reduce benefit payouts to specific groups, individuals, business entities or state or local governments.

Using up these hard won spending cuts to pay for tax cuts only uses up political capital to stay in place. Any savings that can be found should be used first to reduce the deficit. Once that goal has been accomplished, there will be plenty of time to talk about tax cuts.

It is argued that the proposed tax cuts would revitalize the economy, increase savings, and lead to greater prosperity. However, our economy is hardly crippled. Gross domestic product grew last year at a four percent rate, about as fast as most economists think is sustainable, and faster than some think is wise. Unemployment is relatively low. As to increasing savings, it is hard to see how any policy that discourages deficit reduction would increase savings. The Federal Government is using for current consumption most of the funds that individuals and businesses in our nation are able save each year. Reducing the budget deficit would reduce this dissaving. This, in turn, would leave more funds available for investment in the physical, human, intellectual and technological capital required to sustain economic growth and lead to improved standards of living. Thus, The Concord Coalition believes that balancing the budget would do far more than tax cuts to strengthen the economy over the long run.

Could Concord Coalition members use the promised tax cuts right now? Sure. Who couldn't?

Are the tax cuts -- which, after all, wouldn't amount to much on a per family basis -- worth the long term price? Are they worth jeopardizing the opportunity to balance the budget? We don't think so.

Testimony

of

William & Patricia Condit

on

H.R. 11 - the Family Reinforcement Act

before the

Committee on Ways and Means

U.S. House of Representatives

January 18, 1995

Mr. Chairman, and Members of the Committee, thank you for the opportunity to testify today on behalf of the Family Reinforcement Act of 1995 sponsored by Congresswoman Vucanovich and many others. We are Bill and Pat Condit, the proud adoptive parents of two foreign-born children, Maya and Tom. Our family now resides in Burke, Virginia.

Our story is not unlike that of many - perhaps most- adoptive couples. We sought to have children in the "conventional" manner but without success. Pat went through the tests administered to women with fertility problems and Bill was checked out as well. In our case, we both had fertility problems sufficiently daunting for us to say to each other after a year of questioning further extraordinary medical measures, "Let's look into adoption." And so we did.

By then (1980) we lived in Duluth, Minnesota, where Bill worked for the Department of the Interior. The local social services people informed us the typical wait for infants born in St. Louis County was about seven years! That being much too long, we elected to write to several agencies around the country that aid in adoption of foreign kids and discovered the Children's Home Society of Minnesota in St. Paul could help us.

After the usual battery of counseling, home visits by a social worker, gathering of letters of reference, etc., the orphanage in Guatemala that we chose to work with (AGAND, a Spanish language acronym for Guatemalan Association for the Assistance of Abandoned Children) sent us a tiny picture of a then six-weeks old girl with some very sketchy information about her birth mother's plight and why she was placing her daughter for adoption. Based solely on this information, we were given the choice of adopting this child, or waiting for another referral. We said "yes" and Bill

carried her picture in his wallet like some prospective parents carry sonograms of *in utero* babies. After what seemed like months of paperwork delays, we found ourselves flying to Guatemala City to pick up our daughter, who we named "Maya" after the indigenous people of that beautiful country. A State Department glitch delayed our return to the U.S. for a week, but all in all, we had a relatively easy encounter with the difficulty which adoption of foreign-born children can bring to couples.

That must have been the case, because only a year later we set about finding a boy child for our family. Again, the Children's Home Society and AGAND fulfilled our needs. In 1982 we adopted our son, Tomas, who like his adoptive sister is a descendant of the "indigena de Guatemala." Maya and Tom are now naturalized citizens of the United States and "teenagers!" Like children everywhere, they bring their parents much happiness with occasional sorrow. Are we glad to have chosen adoption as an option? Yes, without question, but it was not easy financially.

In fact, at Bill's salary as a federal employee at the GS-9 grade level supplemented with Pat's earnings as a part-time respiratory therapist, the cost of adopting our children may have been prohibitive had not Bill's maternal grandfather died a year earlier leaving his grandchildren each a small inheritance. In contrast, had we been able to have kids "biologically" the costs of prenatal visits, labor and delivery, and post-natal care would have been covered by the health insurance policy we had through the Federal Employees Health Benefits Act, subject only to deductibles and co-payments (and even the out-of-pocket medical expenses are deductible on one's income taxes).

But adoption expenses are not so covered by any health insurance of which we are aware, nor are the costs deductible against income on any 1040 form or schedule that we can find. This seems inequitable to us, and to most adoptive parents with whom we have spoken. We believe Title I of H.R. 11 would at least begin to correct this unfairness for middle-class adoptive parents. In our case, the costs associated with the adoption of each of our children was approximately the $5,000 limit, albeit in 1980 and 1982 nominal dollars. We have heard stories of domestic adoptions costing significantly more, and we know the fee that the orphanage in Guatemala imposes on prospective adoptive parents to help feed and clothe the children waiting there has risen sharply since then.

Nonetheless, we believe the cap on the tax credit seems to us to reasonably balance fairness to adoptive couples with tax revenue concerns. We hasten to add that Bill and Pat Condit will see none of the tax benefit proposed in H.R. 11, nor are we asking for a retroactive credit. Those costs were "sunk" a long time ago, as economists are wont to say. We simply wish to

add our voices to those who argue the current tax code discriminates against adoption thereby reducing the likelihood this option will be considered.

By all accounts, there are tens of thousands of kids in need of parents and no dearth of prospective parents unable to conceive their own children. Why shouldn't the government "reinforce" these potential families by removing - or at least lowering - the financial barrier to bringing them together. Our social worker fourteen years ago told us this poem to an adopted child:

"Not flesh of my flesh,
nor bone of my bone,
but nevertheless my own.

Never forget,
for a single minute,
you didn't grow under my heart...
but in it."

We think that this advice remains sound today. Help make adoption a more readily available option to middle-class families. Please enact H.R. 11 into law.

TESTIMONY OF THE HUMAN RIGHTS CAMPAIGN FUND
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
REGARDING THE FAMILY REINFORCEMENT ACT (H.R. 11)
FEBRUARY 3, 1995

A provision in the Family Reinforcement Act--part of the Republican "Contract With America"--would provide a $500 tax credit for people providing home care for seriously ill or severely disabled parents, stepparents, and grandparents. Encouraging home care would keep families together, save on the costs of nursing homes and hospitals, and relieve pressures on Medicare and Medicaid. This is a good idea, but it could be better.

Consider two families. Alan and Alice, a married couple in their 40's, both have full-time jobs. They live with Alice's mother, Ann, who is 75. Ann suffers from Alzheimer's Disease. She cannot wash, dress, or feed herself, and needs substantial help with all three activities.

Ben and Betty are a retired married couple in their 60's. Their son, Bob, 40, suffers from AIDS and has returned home to spend the last few months of his life with his parents. Like Alice's mom Ann, Bob needs substantial help to perform the ordinary activities of daily life.

As it currently stands, the Family Reinforcement Act would give a tax break to Alan and Alice, the two-income couple with the sick mother, but not to Ben and Betty, the retired couple with the sick son. The proposal provides a tax credit for those who live with a "qualified person" who needs "substantial assistance" to perform "at least 2 activities of daily living," such as bathing, dressing, and eating. But "qualified person" under the proposal includes only parents, stepparents, and grandparents.

Encouraging both families to care for their sick loved ones at home makes sense. Not only does home health care keep families together, it is also much cheaper than hospitalization, which can cost $4000 per day.

Home health care can cost as little as $70 per day. Home care also beats the cost of nursing-home care and hospital care. With Medicaid and Medicare the fastest growing portions of the federal budget, encouraging home care can help ease federal budget pressures and make a major contribution to a more competitive economy.

In addition, home health care, because it "protects the patients from hospital-borne infections," can actually be healthier than hospitalization, according to Dr. Greg Haessler,

medical director for the Princeton Financial Group, a Des Moines, Iowa insurer.

Finally, in many cases--Alan and Alice and Ben and Betty are typical examples--home health care is provided by family members rather than hired help. Granting these family health-care providers a tax credit recognizes the traditional family value of caring for one's own.

But if encouraging home care of sick relatives is such a good idea, why limit the tax credit to parents, stepparents and grandparents? Families caring for other loved ones, including children like Bob, have the same needs. Home Health care is beneficial regardless of the patient's precise relationship with the caregiver.

The case of families with adult children with AIDS illustrates this point. With AIDS already the leading killer of young adult Americans, caring for AIDS patients will take an increasing toll on our economy, making savings in AIDS-care expenses even more crucial in the years ahead. End-stage AIDS patients are already among the major users of home care, and a growing number of providers are developing specialized home-care programs for patients with AIDS.

Moreover, AIDS leaves the patient subject to numerous "opportunistic" infections that kill AIDS patients. Home health care can help avoid many of these infections, by keeping the patient out of an environment rife with infection: the hospital.

Finally, AIDS in an adult child introduces tensions into the family at least as grave as those introduced by other diseases. Few parents can easily accept that their child will die before them. Surely families with a critically ill adult child need support and strengthening as much as families with seriously ill parents or grandparents.

In testifying on the tax credit proposal, Assistant Treasury Secretary Leslie Samuels described a "basic principle of tax policy": fairness, including the "equal treatment of equals." There's an old saying that the law should be just before it is generous.

"Pro-family" should include all families. The Contract With America must be a contract with all Americans. In enacting a tax credit to support families with a severely disabled or seriously ill member, Congress should include those who care for sick children and other loved ones, not just parents.

STATEMENT OF LINCOLN NATIONAL CORPORATION, LINCOLN NATIONAL LIFE INSURANCE COMPANY, AND FIRST PENN-PACIFIC LIFE INSURANCE COMPANY ON THE SENIOR CITIZENS EQUITY ACT, H.R. 8

For hearings held before
The Committee on Ways and Means
on January 19, 1995

Lincoln National Corporation and Lincoln National Life Insurance Company, of Fort Wayne, Indiana, and First Penn-Pacific Life Insurance Company, of Oakbrook Terrace, Illinois (the "Lincoln National Companies") submit this statement for inclusion in the record of the hearings held by the Committee on Ways and Means on January 19, 1995 concerning the Senior Citizens Equity Act, H.R. 8. The Lincoln National Companies are pleased to express their strong support for the provisions of the Senior Citizens Equity Act that provide clarifications for the tax treatment of accelerated death benefits and long-term care insurance.

We consider the Senior Citizens Equity Act well framed in providing tax clarifications for accelerated death benefits and long-term care insurance, and we compliment the drafters on both their willingness to step forward in this area and their foresight in so doing. H.R. 8 makes much-needed clarifications in the tax law, and is quite timely in view of the substantial and rising interest in "living benefits" provided through life insurance contracts. This fact, coupled with the importance of facilitating efficient funding for the often great costs of long-term care and terminal illness, make enactment of these tax clarifications both important and necessary.

There are two types of "living benefits" addressed by H.R. 8 that are increasingly offered in connection with life insurance contracts: (1) accelerated death benefits, usually provided by a rider on a life insurance contract which accelerates payment of the contract's death benefit when the insured becomes chronically ill (including the "long-term care acceleration rider") or when he or she becomes terminally ill (the "terminal illness rider"), and (2) so-called "non-acceleration" long-term care benefits, provided under a rider which pays long-term care benefits when the insured becomes chronically ill but which does not affect the values, including the death benefit, of a related life insurance contract (sometimes referred to as a "stand-alone" long-term care rider).

H.R. 8 addresses accelerated death benefits in section 306 of the bill, while non-acceleration long-term care benefits offered in connection with life insurance contracts are addressed in section 301 of the bill (specifically in proposed section 818A(d) of the Internal Revenue Code). H.R. 8 also addresses long-term care insurance offered independent of any life insurance contract in sections 301-303 of the bill. This statement focuses on the tax clarifications made for life insurance rider products, although we support the tax clarifications which H.R. 8 provides for long-term care insurance generally.

Accelerated Death Benefits

In General. Since the late-1980s, many life insurance companies have begun offering accelerated death benefits in connection with their life insurance contracts. The purpose of accelerated death benefits is to allow chronically and terminally ill policyholders to receive the full value of their contracts prior to death, not just their cash surrender values, to help them manage the added financial burdens occasioned by their illness.

People primarily purchase life insurance for income protection, to provide for a surviving spouse or children in the event of the insured's premature death. As individuals reach older ages, their need for income protection becomes less important. But, at such times, the built-up value of the life insur-

ance contract may be used to address other insurance needs that are then arising -- the risk that an illness will place substantial financial burdens on the family. Accelerated death benefit riders provide access to the "entire" value of a life insurance contract (including its pure insurance element) to pay long-term care or terminal illness costs. These riders thus substantially complement an individual's insurance protection after retirement, recognizing that one of the greatest risks, or emergencies, that individuals can face at this time is the financial crisis that arises upon an insured's chronic or final illness.

Accelerated death benefits constitute an important addition to the benefits offered under life insurance contracts. If they were not available, a chronically or terminally ill individual would likely be faced with poor financial options -- either avoiding life-time expenses to the extent possible or cashing in his or her life insurance contract to cover expenses. If forced to surrender the contract, the individual would lose the pure insurance element of the contract (the excess of the contract's death benefit over the cash surrender value). Under an accelerated death benefit rider, however, both the pure insurance element and the cash surrender value are available to provide benefits.

Long-Term Care Acceleration Riders. Under a long-term care acceleration rider, accelerated death benefits are paid to chronically ill individuals in the same circumstances as under stand-alone long-term care insurance contracts. When benefits are paid under the rider, however, there is a dollar-for-dollar reduction in the death benefit of the related life insurance contract -- the rider "accelerates" payment of the death benefit. Benefit payments under such a rider are made periodically, either in reimbursement of actual long-term care expenses incurred (subject to limits set forth in the rider) or as a stated percentage of the life insurance death benefit.

Terminal Illness Riders. Under a terminal illness accelerated death benefit rider, benefits are paid upon establishment of the insured's terminal illness (when the insured's life expectancy is 12 months or less). Most riders pay the benefits in a lump sum rather than on a periodic basis, although it is not uncommon for some portion of the life insurance death benefit to remain after the accelerated death benefit payment. For example, a rider might provide that 50 percent of the death benefit may be paid out as an accelerated death benefit, with the remainder to be paid out to the beneficiary when the insured dies.

Methods of Purchase for Long-Term Care Acceleration Riders and Terminal Illness Riders. There are several methods by which insurance companies are compensated in connection with accelerated death benefits, but, in all cases, the cost is only the time value of money cost associated with paying the death benefit prior to death. In the case of long-term care acceleration riders, the cost is typically assessed through stated charges imposed prior to the chronic illness, e.g., through a monthly rider charge. Therefore, in contrast with terminal illness riders, discussed next, the full undiscounted death benefit can be paid out as benefits under a long-term care acceleration rider.

In the case of accelerated death benefits payable under terminal illness riders, there are two mechanisms by which the cost is typically assessed: (1) through the so-called "lien method" or (2) in the form of a "back-end" discount. Under the lien method, the accelerated death benefit is paid out in the form of a loan: the loan is secured by a lien against the death benefit payable under the related life insurance contract, and interest accrues on this loan. Insurers generally require that some portion of the death benefit remain unencumbered by the lien after the accelerated death benefit payment is made, so that interest can be offset against this amount upon death. When

terminal illness accelerated death benefits are paid out through the discount method, the accelerated death benefit payment typically will represent 85 percent to 90 percent of the death benefit extinguished by the payment. The 10 percent to 15 percent difference represents the interest cost of paying the death benefit early.

As indicated above, for all accelerated death benefits, the insurance company need only charge for the time value of money cost associated with paying the death benefit prior to death. As a result, accelerated death benefits represent an inexpensive way for policyholders to acquire insurance protection against the costs associated with chronic or terminal illness. The low incremental cost of these benefits, together with the wide-spread current ownership of cash value life insurance, provides a large number of people with the ability to acquire these beneficial insurance coverages.

"Non-Acceleration" Long-Term Care Insurance Riders

We also strongly support the tax clarifications provided by the Senior Citizens Equity Act for "stand-alone" long-term care insurance. These tax clarifications are provided in sections 301-303 of the bill, and address both long-term care insurance benefits offered in connection with a life insurance contract and those offered independent of any life insurance contract. In the former case, it is our understanding that proposed section 818A(d), which addresses long-term care benefits offered under life insurance contracts, was included in the long-term care portion of H.R. 8 to address "non-acceleration" long-term care rider benefits, i.e., long-term care insurance riders which do not accelerate payment of the underlying life insurance contract's death benefit.

An example of a non-acceleration long-term care rider is the so-called "extension rider," which pays long-term care benefits only after a long-term care acceleration rider has paid out the entirety of the underlying life insurance contract's death benefit. Another example of a non-acceleration long-term care rider would be one similar to that described in IRS Private Letter Ruling 9106050 (November 16, 1990) which operated as an independent long-term care insurance contract attached to a life insurance contract.

The Proposed Legislation

We are very pleased that the Senior Citizens Equity Act contains provisions which clarify the tax treatment of accelerated death benefits and long-term care insurance. These clarifications are especially timely given that use of living benefits under life insurance contracts has flourished in recent years. With these clarifications, life insurance policyholders will be able to utilize their contracts in an efficient manner to assist them in dealing with the potentially devastating costs associated with chronic and terminal illness.

There are several minor technical changes, however, that we would recommend for improvement of the bill. We believe that the recommendations, set forth in the attached appendix, will help assure that the bill achieves its goals.

Conclusion

Accelerated death benefits and long-term care insurance provide an efficient and effective way for individuals to achieve some "piece of mind" in regards to the potentially devastating cost of chronic or terminal illness. Thus, it is entirely appropriate that favorable clarifications in the tax status of such benefits be provided at this time, to remove any unintended disincentive that may exist because of the current tax uncertainty.

APPENDIX

SUGGESTED TECHNICAL MODIFICATIONS TO THE ACCELERATED DEATH BENEFIT AND LONG-TERM CARE PROVISIONS OF H.R. 8

Matters Relating to the Section 7702 Definition of Life Insurance

Treatment of Rider Charges. When accelerated death benefit or long-term care rider charges are made against a life insurance contract's cash value to fund the rider, there may not be a corresponding reduction in "premiums paid" for the life insurance contract, within the meaning of section 7702(f)(1) of the Code, and this may prevent the life insurance contract from being able to mature on its promised benefits. This problem has been addressed in prior bills by providing for an increase in the guideline premium limitation under section 7702(c)(2) in any case where such charges do not reduce "premiums paid." (See proposed section 7702B(d)(3) in section 7402 of S. 2357, 103d Cong., 2d Sess.)

As an alternative to legislative language, we note that a specific grant of regulatory authority exists in section 7702(f)(1), under which "premiums paid" can be reduced by "amounts received with respect to [a life insurance contract] which are specified in regulations." If this approach is to be taken, it would be very helpful for this Committee's report to indicate that the Treasury Department should exercise its regulatory authority under section 7702(f)(1) in respect of accelerated death benefit and long-term care rider charges.

Application of the Section 7702(f)(7) Adjustment Rule. A related problem regarding "premiums paid" arises when payments of accelerated death benefits result in the application of the section 7702(f)(7) adjustment rule. Long-term care acceleration riders generally make periodic payments, so that the death benefit may be reduced by a relatively modest amount each month. In addition, while terminal illness riders can pay out all of the death benefit, many pay out only a portion of the death benefit, leaving some life insurance so that the beneficiary will receive a death benefit on the insured's death. Thus, under either type of rider, the life insurance contract, with a reduced death benefit, may remain after accelerated death benefits are paid, and this necessitates application of the section 7702(f)(7) adjustment rule under current law. This adjustment rule will often produce extremely harsh results in such circumstances -- adjustments may cause a life insurance contract to collapse either when or within a short time after accelerated death benefits commence. This is because the adjustment rule will reduce the guideline premium limitation, but the payment of accelerated death benefits (and any consequent reduction of the life insurance contract's cash value) apparently will not reduce "premiums paid."

We believe it would be appropriate to create a statutory rule to address how the section 7702(f)(7) adjustment rule should apply upon the payment of accelerated death benefits, and we would be pleased to provide any technical assistance that the Committee may require in this regard. Alternatively, this problem could be substantially ameliorated if the Treasury Department were to issue regulations indicating that "premiums paid" is reduced by any payments of accelerated death benefits, to the extent such payments reduce the cash value of the life insurance contract. If this approach is to be taken, it would be very helpful for this Committee's report to indicate that the Treasury Department should exercise its existing regulatory authority under section 7702(f)(1) to this effect.

Modification of "No Material Change" Transition Rule

The transition rule in section 307(d) of H.R. 8 is intended to prevent the addition of a long-term care or accelerated death benefit rider to a life insurance contract from constituting a modification or material change of the contract. Under this rule, adding such a rider would not disrupt any "grandfathering" that exists with respect to a life insurance contract, nor would it

subject the contract to a change in its limitations under the technical rules of sections 101(f)(2)(E), 7702(f)(7), and 7702A(c)(3). Thus, if a life insurance contract is currently governed by a set of rules under prior law, e.g., it is a section 101(f) flexible premium life insurance contract, the addition of a rider would not, in and of itself, cause the contract to become subject to a new set of rules. Further, if the contract is already governed by current law, e.g., section 7702A, the addition of a rider would not trigger a section 7702A(c)(3) material change.

As currently drafted, however, the rule does not appear to accomplish this purpose fully and unambiguously. We therefore recommend that the following changes be made:

- The rule currently appears to be limited to "determining whether section 7702 or section 7702A" of the Code "applies to any contract." This might be interpreted as limiting application of the rule to older, grandfathered contracts, denying its relief to recently or newly issued contracts. To clarify that this is not intended, the phrases "determining whether" and "applies to any contract" should be deleted.

- The rule currently has no application to terminal illness riders -- only long-term care riders are expressly covered -- and fails to mention section 101(f) contracts. The rule should be changed to cover the omitted riders and contracts.

- The rule currently appears only to address the addition of riders. The rule should be expanded to include the conformance of an existing rider to any of the Act's requirements, e.g., those of proposed section 818A(b) or (c).

Thus, we respectfully suggest that the transition rule be modified to read as follows (deleted language is stricken, new language is underscored):

> (d) Issuance of Certain Riders Permitted.-- For purposes of ~~determining whether~~ sections 101(f), 7702 or 7702A of the Internal Revenue Code of 1986 ~~applies to any contract~~, the issuance, whether before, on, or after December 31, 1995, of a rider on a life insurance contract providing long-term care insurance or accelerated death benefit coverage, or the conformance of such a rider to the requirements of this Act, shall not be treated as a modification or material change of such contract.

Long-Term Care Acceleration and "Non-Acceleration" Riders

It is our understanding that the treatment of long-term care benefits under H.R. 8 has been bifurcated, so that benefits from "non-acceleration" long-term care riders are addressed in section 301 of the bill (in proposed section 818A(d) of the Code) and benefits from long-term care acceleration riders are addressed in section 306 of the bill (in proposed section 101(g)(1)(B) of the Code). We believe it is entirely appropriate to address these benefits in the manner done in H.R. 8, given the operation of long-term care acceleration riders. Also, proposed section 818A(d) is necessary given the existence of products such as the extension rider. To alleviate any potential confusion arising from this bifurcated treatment, it would be helpful if this Committee's report, in addressing the accelerated death benefit provisions of H.R. 8, included the following language:

> The treatment of benefits from long-term care insurance riders to life insurance contracts that accelerate the life insurance death benefit is addressed in the accelerated death benefit provisions of the Act. In contrast, the treatment of benefits from other long-term care insurance riders is addressed in the long-term care insurance provisions of the Act.

STATEMENT TO THE WAYS AND MEANS COMMITTEE OF THE UNITED STATES HOUSE OF REPRESENTATIVES BY THE NATIONAL ASSOCIATION OF PEOPLE WITH AIDS

THE GRANTING OF TAX-FREE STATUS FOR ACCELERATED BENEFITS AND VIATICAL SETTLEMENTS

JANUARY 19, 1995

William J. Freeman
Executive Director

The National Association of People With AIDS (NAPWA) wishes to express its strong support for those sections in H.R. 8, the "Senior Citizens Equity Act" (the "Act"), that propose granting tax-free status to accelerated benefits received by terminally ill people as a subsidiary benefit of their life insurance policies. NAPWA believes, however, that people who are eligible for such payments would be better served if the Act were amended to extend the grant of tax-free status to the proceeds of viatical settlements of life insurance policies.

While the purely mechanical elements of the two types of transactions differ -- accelerated benefits clauses provide the insured with some percentage of the face value of their life insurance policy as an element of the life insurance contract while viatical settlements provide the payment of a mutually agreed upon percentage of the face value of life insurance policies by an investor in exchange for the naming of that investor as beneficiary -- the practical results of the two transactions are the same: a terminally ill person receives cash to provide for crucial needs created by their illness.

We believe that this expansion of tax-free status, in addition to providing equity for those terminally ill people whose lives are insured, but whose insurance policies do not include an accelerated benefits clause or who, due to the stringent requirements of many of the clauses, don't qualify, will help to create a more free and equitable market for life-insurance policies. Previous to the creation of the viatical settlement industry and the proliferation of viatical companies, no life insurance policies included accelerated benefits clauses. Now, however, market forces have created competition that gives people living with HIV real choices when they plan for their futures.

In 1992, NAPWA published *HIV in America: A Profile of the Challenges Facing Americans Living With HIV*. Among the findings of this landmark needs assessment was documentation of the long-held but heretofore anecdotal belief of the degree to which AIDS is financially devastating for nearly all people living with HIV, including a significant number of people who remain employed. Over half of the survey respondents reported significant difficulties in providing for basic personal needs such as rent, food and medicines. Of course, many people with expensive, chronic disease can no longer afford to work, whether or not they remain physically able to do so. It is ironic that a society that places such a high value on self-reliance has formulated public policies that effectively force individuals to stop working in order to qualify for vital benefits. Since a great many people living with HIV or other chronic illness find themselves unable to afford private health insurance or are excluded from coverage due to spending caps or preexisting condition clauses, they are forced to impoverish themselves in order to qualify for Medicaid benefits. This forced poverty leads to an unconscionable waste of both public and private resources.

Unfortunately, little organized research has been conducted on the non-medical repercussions of HIV disease status on factors such as income, housing, food and other nutritional supports, etc. Medical costs and related support programs have been analyzed, however, and the results of that analysis clearly indicate the depth of financial need among this population. Only 31.4% of Americans with asymptomatic HIV disease, 29% with symptomatic disease and 25.9% of people with AIDS are covered by private health insurance. And while 37.3% of people with asymptomatic infection are covered by some form of public insurance -- primarily Medicaid -- that figure rises to 62.3% for people with an AIDS diagnosis.

Meanwhile, the cost of care for people living with HIV disease continues to rise. In 1992, the last year for which such figures are available, the cost of treating an individual with asymptomatic HIV disease was approximately $6,400 per year. That cost jumps to more than $13,500 per year when the patient develops symptoms, and to over $40,000 annually when AIDS-defining conditions appear. At the same time, many private health plans that remain available to people living with HIV require the insured to pay large deductibles -- often over $2,000 a year -- and co-payments of 20% or more. In addition, treatment for HIV disease is heavily reliant on prohibitively expensive prescription drugs which remain uncovered under many medical plans. People living with HIV also pay out many thousands of dollars for nutritional supplements, large doses of vitamins and experimental treatments in order to stay as healthy as possible for as long as possible.

Complicating these difficulties is the scarcity of work opportunities for people living with HIV disease. Among the people surveyed for NAPWA's needs assessment, 30.9% were fully employed, 10.5% were employed part-time, and 58.5% were unemployed. Since 89% of the cases of AIDS in American males and 83% in females that were diagnosed through June of 1994 were among people between the ages of 20 and 49, the prime working years, any financial benefit provided by private sources -- such as private employer funded benefits -- as versus to public resources such as Medicaid or Social Security Disability -- provides important relief for strained government programs.

For all the above reasons, we believe that it is vital to people living with HIV and with other terminal or "dread diseases" that Congress act to exempt from taxes both viatical settlements and accelerated benefits under the conditions outlined above. This would involve the following modifications to H.R. 8:

- Amend Section 306 to include all types of accelerated benefits mechanisms specifically including viatical settlements. Tax-free status should be granted to any individual who is either terminally ill or suffering from a dread disease who decides to accelerate their benefits.

- Further amend Section 306 to set out definitions of "terminal disease" (less than 24 or 36 months to live), and "chronic illness" and "dread disease" (to allow the benefit for those whose condition is debilitating and who have no hope of recovery but whose prognosis is not terminal). This amendment is particularly important to our constituents because, while typical accelerated benefits provisions allow the insured to "cash in" their policies only when their medical condition suggests that they are likely to die within six months, typical viatical agreements allow the viator to cash in their policy when they are within two years of death. Because the average survival time after an AIDS diagnosis is between 18 and 24 months, and since many people cannot continue to work full-time after their diagnosis with an AIDS defining opportunistic infection, this two year window better meets the needs of people with HIV disease.

- Amend Section 306 to include a provision which protects individuals from having to include the potential value of accelerating their benefits as an element in means testing for Social Security Disability, Medicaid or other public benefit programs. This should remain an option for people who are ill, not a prerequisite.

We hope that you will give due weight to these suggestions in continuing your work on the Contract With America.

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The National Association of People with AIDS (NAPWA) is dedicated to improving the lives of the more than one million people in the United States living with HIV/AIDS at home, in the community and in the workplace. Founded in 1983 by a coalition of people with AIDS, NAPWA serves as a national information center and voice for the needs and concerns of all people infected and affected by HIV.

STATEMENT OF ARTHUR S. FLEMMING
CHAIRMAN, SAVE OUR SECURITY COALITION

I. Introduction

A. Soon after the Social Security Act was passed the Commissioner of Internal Revenue was asked if the benefits under social insurance for retirees were taxable.

1. The Commissioner ruled that they were gratuities and as such were not subject to taxation.
2. This ruling prevailed until 1983 when Congress decided that a portion of social security benefits should be taxed and the existing revenue designated for the Social Security Trust Fund.
3. The Congress had never before addressed, pro or con, the subject of taxation of social security benefits.
4. The exclusion of social security benefits from taxation was not a part of the initial commitment.
5. Private pension or income from private retirement funds are subject to taxation.

II. Body

A. Under present law, people with income and social security benefits above the threshold of $34,000 for unmarried individuals and $44,000 for married individuals, must include up to 85 per cent of social security benefits in their adjusted gross income.

B. The Contract With America would provide that not more than 50 per cent of social security benefits would be subject to income tax, regardless of the level of the beneficiary's total income.

1. The phase out would occur between 1996 and 2000.
2. The proposal would reduce tax receipts deposited by law in the Hospital Insurance Trust Fund by $15 billion over the five year period 1996-2000 and by $48.5 billion over the ten-year period--1996-2005.

III. Conclusion

A. This proposal is opposed because it would mean that Government would be taxing private pensions and private retirement income at much higher rates than they would be taxing social security benefits.

1. It is opposed also because it would reduce the revenues needed for the Hospital Insurance Trust Fund.

2. Furthermore, the increase from taxation of benefits of 50 per cent to 85 per cent over the threshold of $34,000 and $44,000 affected only 13 per cent of taxpayers reporting social security benefits in 1994--those at the high end of income affecting beneficiaries.

B. It is believed that it is wise Government policy to reduce the gap between taxes paid on private pensions and the receivers of income from private retirement income plans and taxes paid by social security beneficiaries, and to use the income from social security taxes for the strengthening of the social security trust funds.