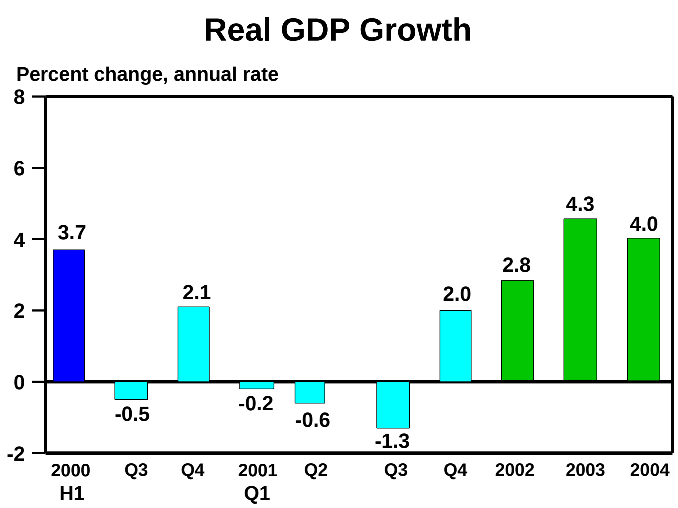
PROMOTING PROSPERITY, EXPANDING OPPORTUNITY

From the outset of his Administration, President Bush has promoted economic and job growth, just as he has acted to secure our national defense and protect the homeland. We are now seeing the fruits of these economic policies in strong output and income growth, in a rising stock market, and more recently, in resumed job growth.

As is now well established, the economy was entering a recession as President Bush took office. Industrial production peaked months before, as did the various stock market indices. Economic activity actually contracted in the summer of 2000 at a 0.5 percent annual rate, rose again in the fourth quarter, and by March of 2001 was shrinking steadily.



Following a recession and slow recovery, the economy takes off again.

The President's 2001 tax relief program of tax rate reductions, an increase in the child tax credit, and a reduction in the marriage tax penalty, among other provisions, proved to be extraordinarily well-timed to address an economy already in trouble when the President took office. In early summer 2001, the Congress passed and the President signed the bipartisan Economic Growth and Tax Relief Reconciliation Act, providing much needed tax relief for millions of families and small businesses. The family tax relief in particular, distributed in part through checks mailed in July, August, and September, helped families meet their needs, kept cash registers ringing, and allowed merchants to avoid the buildup in unwanted inventories that typically accompanies and exacerbates a recession. By continuing to provide tax relief, this legislation extends important support for families, consumption, and the economy in 2004 and beyond.

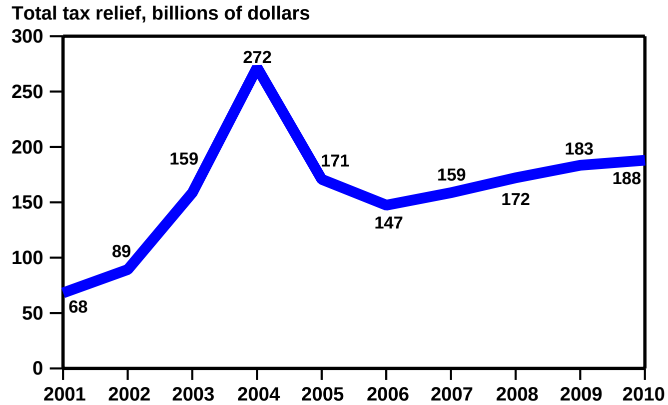
INITIAL RECOVERY, CONTINUED SHOCKS

Just as the President's tax relief plan began to take effect, terrorists attacked on September 11, 2001. The President responded quickly to the new terrorist threat to our economy by proposing another stimulus bill directed at sustaining business investment and reinvigorating manufacturing and other capital-intensive sectors of the economy. The centerpiece proposal was to allow businesses to deduct more of their investment sooner, thereby reducing the tax burden on new investments.

The overall economy was expanding again in the fourth quarter, yet employment and industrial production continued to decline and international terrorism raised new uncertainties about the future. Congress responded to the President's call for action by enacting the Job Creation and Worker Assistance Act in March 2002. This legislation provided stimulus precisely where the economy needed it most—by encouraging business investments to spur job creation.

Tax relief combined with a stimulative monetary policy helped give the economy impetus to grow in 2002, but two additional obstacles emerged to slow the recovery's progress. First, America's confidence in the business sector suffered yet another setback when substantial corporate fraud—dating in most cases from years before—was uncovered. Second, the prospect of military operations to liberate Iraq, though essential to our national security and the prosecution of the War on Terror, injected further uncertainty into the economy.

Combined Effects of Three Tax Bills Passed Since 2001*

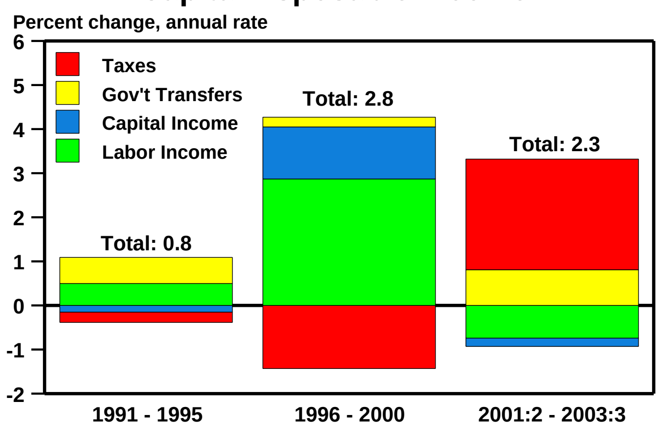


*Includes proposed permanent extensions.

Powerful and timely tax stimulus helped to turn the economy around.

Faced with continued weakness in the economy and especially a lagging recovery in employment, in January 2003 the President proposed a third set of tax relief measures. These included the acceleration of some elements from the 2001 tax cut and a new initiative to spur investment further through a reduction in the tax on corporate dividends. Five months later the Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003.

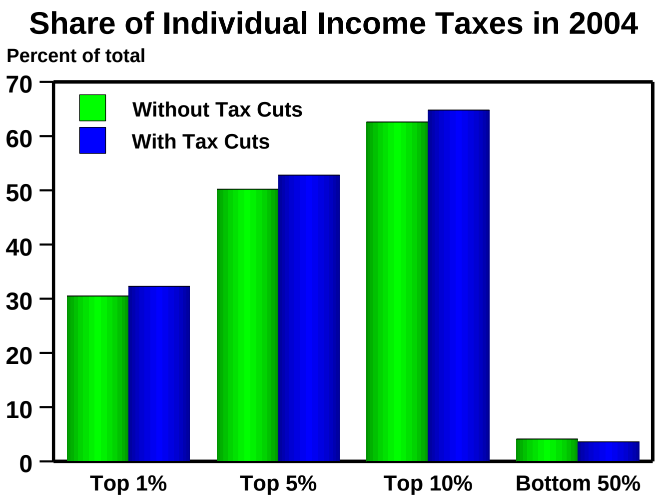
Contributions to Growth in Real Per Capita Disposable Income



Taxes went from an extra drag on the economy to a powerful stimulus through the President's program.

Consumers have sustained the economy through the recent period, and tax cuts have been the key to maintaining consumer purchases. Taxes ate away almost half of the growth in real per capita disposable income in the late 1990s, but provided nearly all of the growth in disposable income since 2001. (Real per capita disposable income is a measure of the net income individuals have available for consumption or saving, after taxes, and adjusted for inflation to allow for comparisons across different time periods. When taxes rise, real disposable income falls; and when taxes fall, income rises.) Had the tax cuts not been enacted, real per capita disposable income would have stagnated, personal consumption would have been much lower, inventories would have accumulated, business activity and employment would have fallen further, and the recession would have certainly been much longer and much deeper. According to the Council of Economic Advisers, the combined effects of the President's three tax measures helped preserve over two million jobs by the end of 2003.

The Tax Burden: Upper Income Pay a Greater Share With Tax Cuts than Without



Upper income taxpayers pay most, and now pay even a larger share of the tax burden.

The individual income tax accounts for nearly half of all Federal receipts each year. (Most of the remainder comes from payroll taxes that finance the Medicare and Social Security programs.) The overwhelming share of the individual income tax burden is paid by upper-income taxpayers.

The President's tax cuts have raised upper-income taxpayers' share of the tax burden even higher. For example, the Department of Treasury estimates that as a result of the President's 2001 and 2003 tax cuts, the top five percent of filers will see their share of the tax burden rise to 52.8 percent with the tax cuts versus 50.3 percent without the tax cuts. The President's tax policy has delivered tax relief for all income tax payers through reductions in the tax rates, but the benefits of the $1,000 child credit and marriage penalty relief are greatest for middle- and lower-income taxpayers.

As important as the tax cuts have been in stimulating and sustaining the economy through three difficult years, the powerful impetus they will provide for job growth and international competitiveness will continue into the future. By reducing tax rates, improving incentives to save, phasing out the estate tax, and reducing taxes on investment income, their combined effect will be to reduce dramatically the distortions imposed on our economy by the Federal income tax. Our manufacturing sector and other capital-intensive businesses, for example, will find it less expensive to raise the equity capital they need to finance research and development and new plant and equipment. Corporations will rebalance their financing to put more emphasis on equity over debt. Entrepreneurs with the energy and ideas to start new businesses will find it much easier to raise venture capital to bring those ideas to the marketplace. In short, the tax cuts have materially improved prospects for sustained, strong growth in jobs and wages long after our economy has fully recovered from the recent recession.

THE FULL SCOPE OF A PRO-GROWTH PROGRAM

Tax relief has been at the center of the President's economic program, yet it is just one element in a comprehensive set of pro-growth policies that he has advocated over the past three years. The President has been active on many other fronts to strengthen the economy, create jobs, and raise wages.

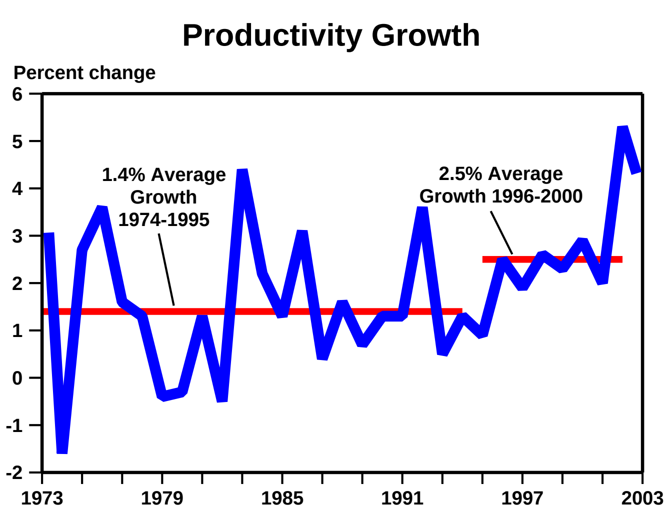
The President has led on free trade, obtaining from the Congress for the first time since 1994 the trade promotion authority necessary to negotiate market-opening trade agreements, and then launching a multi-pronged effort to bring down trade barriers through multilateral, regional, and bilateral trade agreements. American companies and workers can compete effectively in the global marketplace, but will do so with much greater success if they have increased access to foreign markets. The bilateral efforts have begun to show results, for example, through trade agreements with

Singapore and Chile; regional talks have begun to bear fruit as evidenced by the agreement between the United States and four Central American nations announced on December 17th of last year; and multilateral talks also continue to make progress.

To respond to revelations of corporate malfeasance, in many cases stretching back many years, President Bush called for reforms in corporate governance to protect the rights of investors and to ensure the proper functioning of our capital markets. The Congress passed and the President signed the Sarbanes-Oxley corporate governance reform bill, the most far-reaching reform of American business practices since the 1930s. The President has also called for the vigorous prosecution of those who broke the law, and to this end in July 2002 he established by Executive Order the multi-agency Corporate Fraud Task Force. The Task Force obtained over 250 corporate fraud convictions in its first year. To strengthen the government's enforcement efforts, the budget of the Securities and Exchange Commission has more than doubled since passage of the Sarbanes-Oxley legislation, providing funding for almost 1,000 additional accountants, attorneys, and examiners. The Securities and Exchange Commission, the Department of Justice, and local law enforcement authorities have responded with a wide-ranging and on-going effort to detect and prosecute these crimes. These actions have provided investors the basis for renewed confidence in the quality of the information available to them, as well as reassurance that the Administration will act quickly and effectively as needed to address future problems of corporate malfeasance.

Finally, the War on Terror itself is an integral component of a sound national economic policy. The economic damage done on September 11th was obvious in New York City, and it was manifest in a number of industries across America including tourism, airlines, and the travel industry generally. But the specter of terrorism also had a profound effect on consumer and business confidence. Winning the War on Terror is vital to national security, and it is essential economic policy that will strengthen the confidence Americans have in their future.

FIRST FRUITS OF SOUND POLICIES

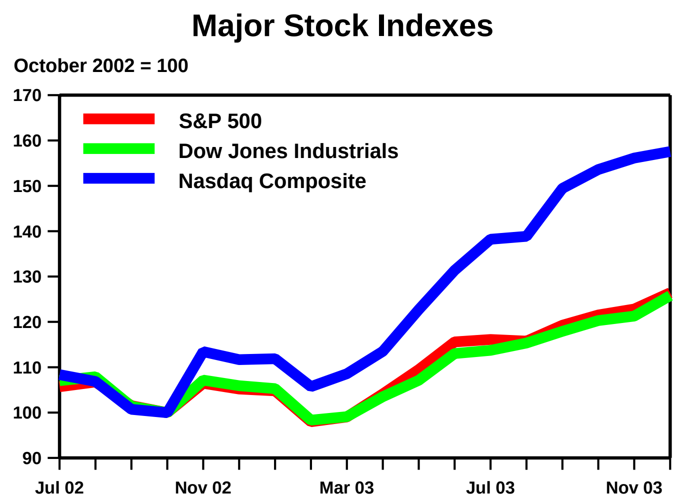


Strong productivity growth means more competitive companies and higher paid workers.

Thanks to the President's leadership, the Congress' support, and the fundamental strengths of our economic institutions, the economy is now showing signs of a strong and sustained, job-creating expansion. Economic output as measured by Gross Domestic Product grew at an 8.2 percent annual rate in the third quarter of 2003, the eighth consecutive quarterly increase and the fastest rate of growth in almost 20 years. The Administration is currently forecasting 4.4 percent real growth in 2004, in line with private sector forecasts such as the Blue Chip Consensus.

Productivity growth has been remarkable in recent years. After growing at just 1.4 percent a year from 1974 to 1995, productivity accelerated to 2.5 percent in the latter half of the 1990s, and has grown at a 4.4 percent rate since the fourth quarter of 2000. This extraordinary productivity growth has meant that many companies were able to ride out the economic downturn with a healthy cash flow, but it also meant businesses have increased their output without increasing employment. As job growth recovers and labor markets strengthen, the stronger underlying productivity growth should lead to strong growth of wages and salaries.

The strengthening economy is also apparent in the equity markets. As seen in the accompanying chart, each of the major stock market indices is up sharply from its trough, indicating that investors have renewed confidence in the future. Increases in the equity markets have added almost $3 trillion to household wealth since March. Combined with the gains from the growth in housing values, households' wealth has risen by $4 trillion since the third quarter of 2001. These gains have further supported consumer spending, and they have also helped to replenish households' pool of saving for retirement.



Rising equity values signal economic strength ahead and reinforce economic growth today.

Labor markets have also shown clear signs of strengthening since the summer of 2003. Initial unemployment claims have fallen, as has the unemployment rate. The economy created over 250,000 new jobs from August through December, and most forecasters agree with the Administration that job growth should accelerate into 2004. Consistent with most other forecasters, the Administration's economic forecast reflects the expectation that the unemployment rate will drop from 5.7 percent at the end of 2003 to 5.5 percent by the end of 2004, and to 5.3 percent by the end of 2005.

ENSURING GOOD HARVESTS TO COME

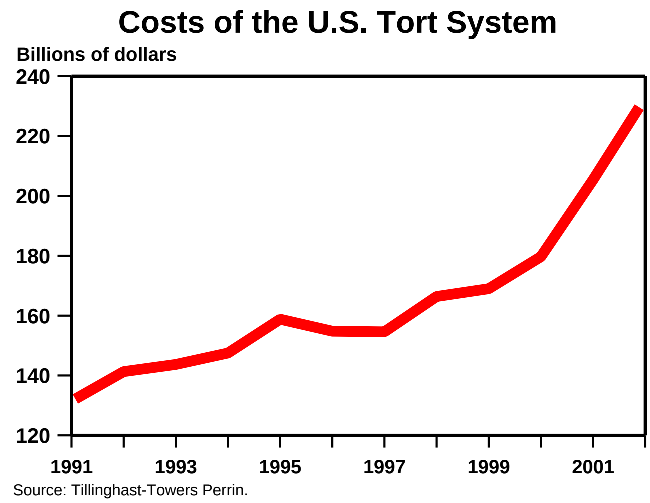
Despite a recession, revelations of corporate scandals, the September 11th terrorist attacks, and the inevitable strains created by the War on Terror, America has demonstrated tremendous resolve to recover and grow stronger.

The President recognizes much remains to be done to ensure a strong and competitive economy, and he continues to push aggressively for policies to strengthen job and wage growth. To this end, the President has called for a dramatic slowdown in non-security related Federal spending. The times require significant increases in defense and homeland security spending, and there have been especially large temporary increases in spending associated with the September 11th attacks, homeland defense, and the War on Terror. The President has also worked to increase spending in the highest priority domestic programs, for example in the education area with core No Child Left Behind programs and Pell Grants. For the rest of Government, he has reduced dramatically the growth in annual discretionary spending, as discussed in detail in the Ensuring Fiscal Responsibility chapter.

There is much more that Government can do to improve economic performance. The President has identified six specific initiatives that will improve job and economic growth for years to come.

Making Health Care Costs More Affordable and Predictable. Health insurance costs for employers have been rising 10 percent per year since 2000, causing businesses to hire fewer workers and families to go without insurance. The recently enacted Medicare reform bill created new Health Savings Accounts (HSA) that allow individuals to buy less expensive high-deductible health plans and to save pre-tax dollars for out-of-pocket medical expenses. By shifting individuals' health care buying incentives, HSAs will provide an important market-based constraint on rising health care costs. HSAs are just one of several proposals the President has put forward to address rising health care costs. For example, President Bush also proposes to allow small business to pool together to purchase health coverage for workers at lower rates; to create a refundable tax credit for the purchase of health insurance to ease the financial burden and improve the incentives for uninsured low-income individuals and families to buy health insurance; to allow individuals with HSAs and high-deductible policies to take an above-the-line deduction for their health insurance premiums; and to reduce frivolous lawsuits and time-consuming legal proceedings against doctors and hospitals that drive up health care costs for all.

Ensuring an Affordable, Reliable Energy Supply. Businesses depend on affordable and reliable energy supplies. Energy shortages, price spikes, and blackouts disrupt the economy and discourage businesses from investing and adding new workers. President Bush has proposed a comprehensive national energy plan to upgrade the Nation's electrical grid, the need for which was made all too clear during last summer's blackout in the Northeast. The President's plan also would promote energy efficiency, increase domestic energy production, and provide enhanced energy security, all while protecting the environment. The Congress has made great strides toward enacting an energy bill that meets the President's goals. It is time for Congress to finish its work and pass legislation based on the President's energy plan.



Soaring tort costs primarily benefit a small group of lawyers at the expense of consumers, workers, and investors.

Reducing the Lawsuit Burden on Our Economy. The direct costs of our tort law system have skyrocketed in recent years as shown in the accompanying chart, affecting health care costs and the manufacturing sector in particular, but also touching most other sectors of our economy. When the tort system functions properly, these lawsuits play a vital role in our economy by allowing individuals and businesses to enforce property rights and to discipline inappropriate actions. The system today, however, is clearly out of control, and it is costing American jobs. President Bush has proposed, and the House of Representatives has approved, measures that would move more class action and mass tort lawsuits into Federal courts—so that lawyers will have a harder time shopping for a favorable court. The President's proposed reforms would also ensure that in a class action lawsuit most of the benefits of a settlement will actually go to the people who were injured. These reforms will help those who have been injured while allowing businesses to focus on creating jobs and becoming more competitive, rather than fighting junk lawsuits and outrageous judgments. The President has called on the Senate to join the House in enacting these reforms as quickly as possible.

Streamlining Regulations and Reporting Requirements. Government regulations and reporting requirements, although in many cases providing important public benefits, also impose enormous costs on the economy. To an extent, those costs are unavoidable, but they cost jobs as well as money, and so Government has a responsibility to ensure that its regulatory actions are reasonable and affordable. Too often, government regulations and compliance burdens unnecessarily discourage, rather than promote, job creation. The Administration will continue to work to simplify and streamline regulations, along with ensuring that well-intentioned compliance requirements do not have the unintended effect of eliminating jobs. For example, the Administration streamlined tax reporting requirements for small businesses, helping 2.6 million small businesses save an estimated 61 million hours of unproductive work.

Opening New Markets for American Products. American workers can compete with anyone in the world when given a chance to compete on a level playing field. Foreign taxes and tariffs drive up the costs of American products in too many countries, making our products less competitive than those produced elsewhere. History has shown that countries engaging in free and fair trade prosper most. President Bush will continue to work hard to open foreign markets to American products.

Enabling Families and Businesses to Plan for the Future with Confidence. America's families and businesses need certainty to plan effectively for the future. And while the future holds many uncertainties, Government policies should not needlessly add to them. Right now, key elements of the tax relief passed by the Congress and signed into law by President Bush—including the increase in the child tax credit, the marriage penalty relief, and the increased incentives for small business investing—will expire in a few years. For example, a married couple with two children and an annual income of $40,000 would face a $922 tax increase in 2005 if the provisions of the Jobs and Growth Act are not made permanent. This family needs to know today that it will have that $922 in 2005 for its own needs, not the Government's. President Bush urges the Congress to make these vital tax reductions permanent.

Increasing Private Saving

In addition to the President's six-point program to strengthen our economy and improve job creation, the President has four specific proposals to increase private saving, thereby expanding the amount of investment owned by Americans and building the pool of savings Americans will need as they retire. First, the President has proposed Retirement Savings Accounts that would greatly simplify the tax treatment of individual tax-preferred savings opportunities. Recognizing the importance of retirement saving, the Congress has enacted a bewildering array of savings alternatives. Retirement Savings Accounts cut through the complexity to create a simplified, generous option for individuals to save.

Second, the President has proposed consolidating the various employer-based defined-contribution saving plans into one simple plan called Employer Retirement Savings Accounts. The tax code contains a great many employer-based saving options including 401(k) plans, Simple 401(k) plans, 403(b) plans, Thrift plans, and many more. The resulting complexity discourages companies from offering these saving opportunities to their employees, and discourages employees from signing up when their employer does offer. The President's proposal vastly simplifies the landscape of employer-based defined-contribution savings options and thereby encourages more employers, and employees, to participate.

Third, to help all taxpayers save for emergencies and large purchases, the President has proposed Lifetime Savings Accounts, which allow an individual to earn a tax-free return on deposit amounts and withdraw the funds as needed without paying further taxes and without facing a withdrawal penalty. Individuals need to save for retirement, but they also need to save for other needs, such as emergencies and unexpected expenses, as well as large, expected purchases like a home, a car, or a child's education. Lifetime Savings Accounts are a new concept that will give individuals a whole new opportunity for tax-deferred saving.

Finally, to help low-income taxpayers build a financial cushion, the President has proposed Individual Development Accounts which use tax credits to leverage amounts saved by low-income taxpayers. Low-income taxpayers, in particular, often face real hardship because they have little financial cushion with which to save for a child's college education or to build up a downpayment on a house. Individual Development Accounts create an extra opportunity for low-income individuals to take the first steps in accumulating wealth. Taken together, these four saving proposals will simplify the tax code while significantly reducing the existing tax disincentives to saving.

The economy has faced a series of challenges over the past three years, but the President's policies are now taking full effect, the economy is again growing at a strong pace, and job growth has resumed. These policies will continue to strengthen the economy in the months and years ahead, but much remains to be done to ensure that every American who wants a job can find a job, and to ensure that economic opportunity expands to every corner of our society. Holding the line on non-security related spending, implementing the President's six-point plan for economic growth, and improving savings incentives are the right policies for the economy and for the Nation.