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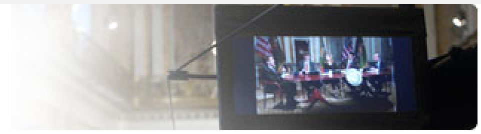

Remarks by Secretary Tim Geithner

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The Joan Shorenstein Center on Press, Politics and Public Policy
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As Prepared for Delivery

Thank you, Alex, for that kind introduction.

I know that the discussions and debates going on in Washington right now are something you care about. And I want to talk today about the question of how we deal with our fiscal challenges: to explain why this is important, what should be done, the politics and the economics of a credible solution, and the perils and the promise of the negotiations now underway in Washington.

I chose this subject not because it is the only challenge that we face in economic policy. With unemployment still around 9 percent and millions of Americans at risk of losing their homes, seeing the value of their savings eroded, and feeling uncertain about their future economic security, we face formidable economic challenges. But our ability to deal with all those challenges will now be determined by our ability to restore long-run fiscal sustainability.

We spent the last decade piling on debt to pay for expensive tax cuts, a large prescription drug benefit, and two wars.

On top of this legacy of choices, we had to clean up the worst financial crisis since the Great Depression.

And we face unsustainable future fiscal deficits, caused, in part, by the dramatic rise in the number of Americans who will turn 65 in the next decade, combined with the fact that we now live longer and will spend more on health care.

Now we have to find a way to return to living within our means.

Our economy is very resilient and very dynamic. And as we continue to repair the damage caused by this recession, you can see encouraging signs of future economic strength in the pace of innovation by American companies in advanced technology, the improvement in the personal savings rate, and the breadth of strength in export growth.

But our fiscal problems are so pressing that they threaten to undermine the foundations of our future economic strength, our ability to protect our national security interests, and our capacity to sustain the commitments made by 13 presidents over 75 years to provide economic security to the poor and the elderly.

We now borrow 40 cents for every dollar we spend, and under current policies, our total federal debt burden will be almost as large as the entire American economy within the next decade.

We do not have the option of leaving this problem to another day, another Congress, another President.

It is true that we are now able to fund these deficits at very low interest rates, less than 3.5 percent now for a 10 year Treasury bond. But these rates are a reflection of confidence that we will act, not a justification for inaction. And they are unusually low now also because of the relative lack of other investment alternatives in a world still recovering from crisis and with the other major economies facing comparatively tougher problems than even ours here in the United States.

There is no way of knowing how long financial markets will give the American political system to get ahead of this problem. But it makes no sense for us to wait until they force action upon us.

As we saw in the fall of 2008, when confidence turns, it can turn with brutal force and with a momentum that is very difficult and costly to arrest. This is a threat we should pre-empt. If we don’t, the economic damage and the human cost will be much greater. Confidence is much more expensive to recover than to keep.

If we leave our debt problems unaddressed, those who lend us the resources to fund our past and future commitments will eventually demand higher interest rates. Government borrowing in the future will crowd out private investment. With so much capital being required to finance government debt, interest rates are likely to increase for other types of borrowing. Higher borrowing costs for American households and businesses will discourage future private investment, lowering our capital stock, reducing our economic growth and depressing our standard of living.

The costs of paying higher interest rates will make us poorer. Every dollar in interest payments means a dollar in higher future taxes or a dollar we can't spend on more productive investments like education, our national security, or programs for the poor, the elderly or those with disabilities.

For all these reasons, the choice we face is not whether we start to get our fiscal house in order, but how we do it.

And to provide some context for the choices we must make now to preserve room for important investments in our future, consider the following facts:

- In the United States of America today, 40 percent of children born each year are covered by Medicaid. If you are born today in hard-pressed communities in many American cities, like St. Louis or Baltimore, you are more likely to die before your first birthday than if you were born in Sri Lanka or Belarus.
- In education, we're losing ground. For example, in Los Angeles, only about half the kids graduate from high school.
- Over the next 25 years, the number of Americans eligible for Medicare and Social Security will nearly double, while the number of working age Americans will only increase by about 10 percent, putting substantial new burdens on working Americans.
- We live in a dangerous world, with our young men and women fighting and dying to protect our freedom. We spend $700 billion a year on national security, and this is only about two-thirds of what we spent as a share of our economy during the Cold War.
- The effective income tax rate for the wealthiest Americans—those earning more than $250,000 a year—is at its lowest level in 50 years. And the effective rate for the very rich—those earning over $10 million per year— has declined much further and is now around 21 percent.

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Clearly, we have some tough choices to make. To put us on a path to living within our means, we have to bring our deficits down, gradually but dramatically, over the next three to five years.

We need to cut the annual deficits, now roughly 10 percent of GDP, to the point where the overall debt burden begins to fall as a share of the economy.

This requires that we achieve and maintain what economists call primary surplus, which means that we cut what we spend, on everything except interest payments, to less than we raise in revenues.

For the United States, this means a deficit below 3 percent of GDP.

Achieving this is the essential test of fiscal sustainability.

But we can't do this too quickly. It has to be a multi-year process, with cuts phased in over time, that doesn't put at risk an economy coming out of crisis. With interest rates very low, we cannot count on the Federal Reserve to be able to offset the contractionary effects on economic growth of a lurch to excessive austerity.

If we put our deficits on a path to get them below 3 percent of GDP by 2015 and hold them there, with reforms that politicians commit to sustain, then the federal debt held by the public will peak in the range of 70 to 80 percent of GDP, and then start to fall.

The economic and political question is not whether but how best to achieve this objective. The debate we now confront is how to cut these deficits while strengthening our ability to grow and compete, protecting our national security interests, and preserving health care and retirement security for the elderly, the poor and people with disabilities.

Let me describe how the President proposes to restore fiscal responsibility.

First, the President proposes to reduce spending across the government while at the same time protecting the investments we need to strengthen the economy.

Toward this objective, the President has proposed cutting spending on government functions outside of national security, health care, and Social Security by more than $1 trillion over the next 12 years. These cuts will bring non-security discretionary spending to its lowest level since Eisenhower and will involve savings in other mandatory programs, including agricultural subsidies.

And on top of this, the President proposes to cut $400 billion in security spending, while making sure we maintain our capacity to meet our national security responsibilities.

The President's framework cuts government spending while at the same time financing productive investments in areas critical to future economic growth, such as education, research and innovation, infrastructure, and clean energy.

These investments meet two key tests: they have very high returns in terms of future growth and the private markets will not finance these things at an adequate level without the catalyst of government.

Alongside these investments, the President proposes to remake the corporate tax system so that it does a better job of promoting business investment in the United States.

Together, these reforms reflect the reality that the composition of spending cuts is hugely consequential to whether deficit reduction hurts or helps future economic growth.

Second, the President proposes substantial savings from Medicare and Medicaid, on top of the reforms in the Affordable Care Act. Together, these programs are about one-fifth of our budget, and because of the aging of the population, the increase in life expectancy and rising cost of new medical treatments, they are the main source of long-term deficits.

For Medicaid, the President proposes at least $100 billion in savings over the next 10 years, while making it easier for the states to administer the program.

For Medicare, the President proposes at least another $200 billion in savings over the next 10 years by harnessing the purchasing power of Medicare to control spending on medicine, doctors and hospitals. In addition, he would build on the fundamental reforms in the Affordable Care Act that were praised by independent health experts from across the political spectrum, including by requiring the Independent Payment Advisory Board to target cost growth in Medicare to GDP plus 0.5 percent.

And while Social Security is not the cause of our current deficits, the President has said that Republicans and Democrats need to come together to make changes to the program that will put it on solid footing well into the future.

Finally, the President's budget framework proposes changes to the tax code that will reduce the deficit while moving toward a more fair and simpler system.

By restoring the tax rates on individuals earning more than $250,000 to their level during the Clinton years; returning the estate tax to 2009 rates; and scaling back tax expenditures, the President's plan would generate additional revenue, without putting at risk future incentives for investment or growth.

The changes must be grounded in realistic assumptions about the path of future policies, the impact of legislative changes, and economic assumptions. Neither Congress nor the Administration should be able to use unrealistic assumptions about future economic growth or future political courage, or other forms of magical thinking, to minimize the magnitude of the reforms that will be necessary.

These changes will be difficult, but in this balanced framework, with the burden of adjustment shared broadly and over an appropriate time frame, then the overall economic impact will be manageable.

To make this framework credible, we need a mechanism that forces reform. So the President has proposed that Congress impose on itself a debt cap that would lock in the necessary reductions in deficits over the next several years and, as a failsafe, would automatically cut spending, including in the tax code, if the targets aren't met.

This is the fiscal policy equivalent of taking politics out of monetary policy, as we and most countries did some time ago by making central banks independent with a mandate to keep inflation low.

We need a debt cap so that politicians cannot choose to live with unsustainable deficits because they cannot or choose not to agree on how to spend within their means. It reduces the legitimate area for political debate on how to achieve a sustainable fiscal position, not whether to achieve a sustainable fiscal position.

Now, you can tell from the debate underway in Washington that there are big differences among Republicans and Democrats on how to achieve the reductions in future deficits we all know are necessary.

The divisions are greatest in three areas: how to best promote future economic growth, how to reform the tax code, and how to protect health care and retirement security for the elderly and the poor.

We believe the most realistic approach is to design a framework that forces the necessary political agreement on reforms.

To do this, we are working to negotiate a multiyear framework of debt caps and targets, with a substantial downpayment of specific cuts and policy reforms.

In order to be meaningful, the down-payment should be substantial relative to the total amount of deficit reduction needed. The fiscal plans that are on the table include roughly $4 trillion in total deficit reduction over the next 10 to 12 years so there is broad agreement on the ultimate goal and timeline.

The components of the down-payment need to address all parts of the federal budget, from national security to Medicare and Medicaid, and should be balanced by changes in revenue. It should include a mix of specific savings from mandatory programs and lower future discretionary spending. The more specific, the more believable and credible the framework will be.

These savings would be complemented by an overall cap on future debt and deficits, with a strong enforcement mechanism to force action on the remaining savings.

Here's how this mechanism would work. At the beginning of 2013 and annually after that, we will assess the magnitude of the deficit reduction required needed to bring down the debt as a share of the economy over the following five years.

Congress would have roughly nine months to enact legislation to meet the fiscal target. If Congress cannot agree on legislation, then, automatic cuts in spending and tax expenditures would go into effect for the following year that would put us on the path to meet our fiscal target.

The size of the remaining cuts in spending will depend in part on the future of the Bush tax cuts, which without new legislation will expire at the end of 2012.

The President has proposed to extend tax cuts that benefit the middle class and allow the tax cuts that benefit just the top 2 percent of Americans to expire. Allowing the tax cuts for the wealthiest Americans to expire will reduce future deficits by roughly $1 trillion over the decade ahead.

Overall, this is a reasonable plan. It includes a balance of short-term spending cuts and long-term reforms, so that we do not just push all the tough choices into the future. It is achievable. And it is better than the alternatives.

In fact, in a joint op-ed published yesterday, all four co-chairs of the Bowles-Simpson and Rivlin-Domenici bipartisan commissions endorsed a comprehensive approach that includes cuts to national security, entitlements, and discretionary spending, reform of the tax code that limits tax expenditures to increase revenues, and a strong enforcement mechanism—an approach consistent with the President's framework I have just outlined.

A few points on the alternative strategies that have been proposed:

Some have suggested we set a global cap on spending as a share of the economy at the level of the decade before the crisis, or even decades before that. This sounds appealing but it has no practical value as a device for fiscal restraint.

We cannot cap or reverse the aging of the population. As the Baby Boom generation ages, the number of Americans turning 65 and retiring will increase dramatically. As a result, capping spending at historical levels would force deep cuts in benefits to seniors and the poor, as well as in core functions of government such as national security and education.

Spending caps would not provide the government with the flexibility it needs to respond to future national security threats or future recessions.

And spending caps, even if set at more realistic levels, would not be sufficient to achieve fiscal sustainability. Without overall caps on debt and deficits, spending measures alone would enable future Congresses and Presidents to still try to live with higher deficits by cutting tax rates or shifting more spending into the tax code. Already we now "spend" as much in special tax preferences as we collect in federal income tax revenue.

The Ho House House Republican budget has deep spending reductions but devotes a significant portion of those savings to keeping tax rates at current low levels for the wealthy, not just the middle class.

This approach will not pass the Congress, now or in the future. Not just because any legislation today will require votes from Republicans and Democrats, but also because this alternative would require implausibly deep cuts in benefits for the elderly and the poor, and would reduce the rest of U.S. government spending to what it was before the modern era, or to the level more typical of some countries in the developing world.

The fundamental reality of our fiscal situation is that we will need to generate more revenue, and we will need to reduce the rate of growth in spending on health care and retirement security. Both are necessary. Neither alone can carry the full burden.

The essential contribution of the House budget is to show that if you try to deliver fiscal sustainability with no contribution from tax reform, then you have to make drastic cuts to critical government functions. According to the CBO, these cuts would, by 2022, raise costs for an average Medicare beneficiary by $6,500 a year, and would eventually reduce the total amount the government spends as a share of the economy, aside from interest and Social Security, to a lower level than at any time since World War II.

America can do better. And if Republicans try to impose that plan on this country as a condition for raising the debt limit, then they will own the responsibility for the first default in our history, with devastating damage to the nation.

Yesterday, we reached the debt limit, and because Congress had not acted, we were forced to deploy a series of extraordinary measures to prevent default.

These measures will give us until August 2 before we will no longer be able to meet our obligations securely. As I have said before, Congress must meet its responsibility to protect the Nation's full faith and credit by increasing the debt limit.

The debt limit, of course, relates only to commitments we have made in the past. Rather than debating whether we should pay our past bills and whether default would in fact be so bad; rather than designing schemes to allow us to continue to make interest payments by breaking our commitments to seniors and veterans; we should be working together to narrow our differences on how to solve the causes of future deficits.

But I want to emphasize again that if a fiscal agreement is not reached in the coming weeks, in advance of August 2nd, then the debt limit must still be increased. It simply is not an option for Congress to evade the basic responsibility to protect America's creditworthiness.

Our objective is to seize this moment when Democrats and Republicans now agree that deficits matter, that living within our means is not just an option but a necessity, and that putting this off for another day is no longer possible.

Our objective is to build a bipartisan consensus on a comprehensive, and balanced fiscal reform plan.

This will help restore confidence that Washington is up to the many challenges we face. It will help give businesses and investors the confidence to make long term investments in the United States. It will help preserve the strong economic foundations necessary for protecting our national security. It will give us the room we need to invest in the future.

Thank you.