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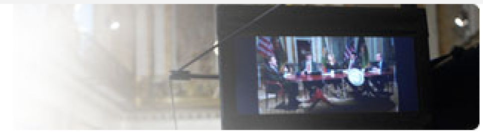

Written Testimony of Secretary Geithner Before the Senate Finance Committee on the President's FY2013 Budget

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As Prepared for Delivery

Chairman Baucus, Ranking Member Hatch and members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2013 Budget.

I. INTRODUCTION

Three years after the worst financial crisis since the Great Depression, our economy is gradually getting stronger. The decisive actions we took to combat the financial crisis, combined with the President's policies to restart job growth and support the economy, have helped lay the foundations for continuing growth. Over the last two and a half years, the economy has grown at an average annual rate of 2.5 percent, exceeding growth in the year prior to the recession. Private employers have added 3.7 million jobs over the past 23 months, including more than 400,000 manufacturing jobs. Growth has been led by exports, which have grown 25 percent in real terms over the last 2 ½ years, and by business investment in equipment and software, which has risen by 33 percent during the same period.

While the economy is regaining strength, we still face significant economic challenges. Unemployment, at 8.3 percent, is still far too high, and the housing market remains weak. The damage inflicted by the crisis presents continued difficulties for consumers and businesses alike. In addition, the debt crisis in Europe and the slowing of major economies elsewhere in the world present potential impediments to our economic growth.

The harm caused by the crisis came on top of a set of deep, preexisting economic difficulties. In the years leading up to the crisis, the average middle-class family saw few gains in income, productivity growth slowed, and the fiscal policies of the previous Administration turned record budget surpluses into substantial deficits.

In my testimony, I want to outline the President's strategy for addressing these immediate and underlying challenges. This strategy entails a carefully designed set of investments and reforms to improve opportunity for middle-class Americans and strengthen our capacity to grow, combined with reforms to restore a sustainable fiscal position.

The Budget proposes three specific steps to boost growth and secure the United States' position as the most competitive economy in the world.

- Improving access to education and job training, so that our workers are the best prepared in the world for the jobs of the 21st century.
- Promoting manufacturing and innovation, with a particular focus on research and development and jumpstarting advanced manufacturing, so that the United States remains the world's most competitive economy and firms create well-paying jobs here at home.
- Investing in infrastructure, in order to create job opportunities now and enhance productivity in the long run.

Under the President's plan, these critical investments are combined with a balanced plan for deficit reduction. The Budget reduces projected deficits by a total of more than $4 trillion over the next 10 years by adding more than $3 trillion in deficit reduction to the approximately $1 trillion in savings already enacted through the discretionary caps included in the Budget Control Act (BCA). These savings are sufficient to stabilize our debt as a share of the economy by 2015 and begin placing our debt on a downward path.

More than two-thirds of the total deficit reduction is achieved through savings in entitlements and other spending programs, and discretionary spending is projected to fall to its lowest level as a share of the economy since Dwight Eisenhower was President.

These significant cuts are phased in over time to protect the economic recovery. Cutting spending too deeply or too soon would damage the economy in the short-term, impede our ability to make necessary investments for long-term growth, and achieve deficit reduction at the expense of the most vulnerable Americans, including seniors and the poor.

In order to achieve a sustainable fiscal position, we must combine these cuts with savings achieved through reforms to our tax code that make it simpler, fairer, and more efficient.

Sustainable deficit reduction requires the right combination of policies: we must have a tax system that collects revenue fairly and supports growth and investment, but does not place undue burdens on families and businesses; spending cuts and entitlement reforms that reduce expenditures but do not harm the economy or the most vulnerable Americans; and investments that give us the ability to grow but do not misallocate valuable government resources.

The central challenges addressed in the President's Budget—strengthening growth now, investing in our future, and putting our nation on a sound fiscal footing—complement and depend on each other. Investing in our economy will help us grow and make our fiscal challenges more manageable. Locking in credible deficit reduction, in turn, will make room for investments that enhance our long-term growth.

II. INVESTING IN OUR COMPETITIVENESS

Education and Training

An educated and skilled workforce is critical for the United States to compete in the global economy. We once led all advanced economies in the percentage of our population that graduated from high school and college, but today we are not providing enough Americans with the educational skills they need. America has fallen to 16th among advanced countries in the proportion of young people with a college degree, and many Americans of all ages need further education and training in order to succeed in today's economy.

The Budget takes a number of steps to make sure that higher education is attainable and affordable. The President has increased the maximum Pell Grant by 20 percent to $5,635, and in academic year 2010-2011, Pell grants supported the educational aspirations of 9.3 million low- and moderate-income students, who received $35.6 billion in grants, an average of $3,831 for each student. This year's Budget maintains the expanded maximum Pell grant of $5,635 through FY 2013.

Moreover, as part of the bipartisan December 2010 tax compromise, the President extended through 2012 the American Opportunity Tax Credit (AOTC) he created as part of the Recovery Act. The AOTC is projected to provide nearly $19 billion in credits to over 9 million families this year. This year's Budget proposes to make the American Opportunity Tax Credit permanent, so it can offer up to $10,000 in tax credits over a four-year college career.

In addition, the Budget provides $8 billion for the Community College to Career Fund in the Departments of Labor and Education to support State and community college partnerships with businesses to build the skills of American workers. A $12.5 billion Pathways Back to Work Fund will also help jump-start America's economy by putting thousands of long-term unemployed and low-income Americans back to work and helping them gain skills for the jobs of the future. The Budget also provides support for a new initiative designed to improve access to job training across the nation and make it easier for those looking for work to access help in their communities and online.

Innovation and Manufacturing

As the global economy becomes more and more advanced, it is crucial that U.S. firms and workers remain on the cutting edge. Investment in research and development (R&D) creates good jobs for American workers, raises living standards, and keeps our economy competitive.

Private businesses are likely to underinvest in R&D, because they cannot capture all of the gains from their investment. A substantial portion of the benefits, however, accrues to the broader business community or the public at large. Federal investments in research and development have played an important role in spurring the internet, global positioning systems, and clean energy.

Though private sector investment in R&D has continued to grow, when the President took office, public investment in R&D was near its lowest levels in half a century as a share of the economy. The FY 2013 Budget proposes a number of important investments in R&D:

- The Budget includes $141 billion for Federal R&D – investments that will promote the development of a variety of high-priority technologies, from next generation robotics to nanotechnology to improved cybersecurity. The budget also keeps spending on the National Institutes of Health steady at $31 billion.
- Of this, the Budget provides $2.2 billion for Federal advanced manufacturing R&D, a 19 percent increase over 2012.
- The Budget proposes simplifying, expanding, and making permanent the Research and Experimentation Tax Credit, to provide a crucial incentive for businesses to invest in R&D.

Another key part of creating good-paying jobs for American workers is to make sure that our manufacturing sector remains on the cutting edge. The Budget includes several key investments to support manufacturing:

- The Budget sets aside $149 million in the National Science Foundation, an increase of $39 million above the 2012 enacted level, for basic research targeted at developing revolutionary new manufacturing technologies in partnership with the private sector.
- The President's Advanced Manufacturing Partnership invests in a national effort to develop the emerging technologies that will create high-quality manufacturing jobs. For example, the Budget includes $21 million for the Advanced Manufacturing Technology Consortia program, a new public-private partnership that will develop road maps for long-term industrial research needs and fund research at universities and government laboratories directed at meeting those needs.
- The Administration also supports a range of investments and initiatives to bring about a clean energy economy and create jobs for the future, especially manufacturing jobs. For example, the Budget provides $290 million to help meet the goal of doubling the pace of energy intensity improvements across America's industries over the next decade, as well as funding to double the share of electricity that comes from renewable energy sources by 2035.

Infrastructure

Our nation's aging infrastructure is a drag on growth and productivity. In order to compete in the global economy, American businesses require a world-class infrastructure. In the long-run, a modern infrastructure lowers costs for both businesses and individuals. And there is tremendous short-term value as well—according to the Congressional Budget Office, infrastructure investment is one of the most efficient job-creation programs available. With more than 2.2 million fewer construction workers on the job than at the pre-crisis peak, and with interest rates at historically low levels, now is the right time for greater public investment in infrastructure.

- The President's Budget provides funding for crucial infrastructure investments. Specifically, the Budget proposes investing $476 billion over the next six years in our nation's surface transportation system, which builds upon our proposal to immediately invest $50 billion to help workers get back on the job. The savings achieved through our orderly drawdown of forces in Iraq and Afghanistan will pay for these investments, with the other half of those savings used to reduce projected deficits.
- The Budget also calls for the creation of a National Infrastructure Bank, a bipartisan idea that will leverage private capital with more flexible financing so that we can build worthwhile projects efficiently and effectively, based on their merits.
- The Budget also provides significant new investments for the modernization of public schools and community colleges so that those who attend have access to a safe environment with modern technology.
- Finally, the President has proposed a national effort through the $15 billion Project Rebuild to put construction workers back to work rehabilitating and refurbishing hundreds of thousands of vacant and foreclosed homes and businesses, which will also help counteract the effects of blight on home prices in affected neighborhoods.

III. CONTINUING TO BUILD FISCAL SUSTAINABILITY

When President Obama came into office he inherited an annual budget deficit equal to 9.2 percent of GDP. Moreover, there was a need for additional steps to stop the economy's free fall, and so Congress and the President enacted the American Recovery and Reinvestment Act and other short-term programs, which temporarily added to the deficit. The expiration of this recession-related spending, economic growth, and the spending cuts mandated by the BCA, including both the approximately $1 trillion in spending caps and the $1.2 trillion that is to occur through sequestration, by themselves are projected to reduce the deficit to 3.7 percent of GDP by 2018.

However, between 2018 and 2022 the deficit under this baseline budget would actually start rising again, reaching 4.7 percent of GDP in 2022. The President's Budget therefore goes beyond the additional $1.2 trillion in deficit reduction required by the BCA, identifying additional spending cuts and revenue raisers that reduce the deficit by over $3 trillion over the next 10 years, while paying for the policies to strengthen growth and invest in our future.

By identifying savings far greater than the BCA, the Budget allows us to meet the BCA's goals while replacing the sequester's $1.2 trillion in damaging, arbitrary cuts with more responsible—and more substantial—reductions. We believe this is the right approach. As the President has made clear, it is not acceptable to simply repeal the sequester without a responsible combination of policies to replace it—policies such as the ones outlined in this Budget.

Overall, the President’s plan lowers the deficit from just under nine percent of GDP in 2011 to around three percent of GDP in 2018, after which it stabilizes through 2022.

Our fiscal situation is improved by the fact that taxpayers are being repaid for many of the investments made in banks under the Troubled Asset Relief Program (TARP). We estimate that investments made through TARP bank programs, for example, will return more than $20 billion in gains to taxpayers.

Spending Cuts

Meaningful deficit reduction requires serious cuts to government spending. This will not be easy, but the President’s Budget identifies areas where cuts are necessary, while protecting the most vulnerable Americans and investments in our future. As described below, President Obama proposes to reduce spending by reorganizing the government, cutting discretionary spending consistent with targets set forth in the bipartisan BCA, and reforming entitlements.

Non-security Discretionary Spending

The $1 trillion in savings from the discretionary spending caps mandated by the BCA, which the President signed into law, reflect the hard choices that need to be made in order to meet our obligation to building a fiscally sustainable foundation. Achieving these cuts will not be easy and will require us to continue to make tough choices.

The President’s Budget meets this challenge, identifying more than 200 cuts, consolidations, and savings proposals. This is on top of the ongoing effort by the Administration to make government more efficient by reducing administrative overhead costs, reforming the government purchasing process, and embracing competitive grant programs. The Budget makes these cuts in a way that asks all to shoulder their fair share.

The President has also asked for the power to reorganize the executive branch to cut out needless duplication, enhance the efficiency and effectiveness of government programs, and improve service delivery. The President has already proposed consolidating into one department the business and trade components of the Department of Commerce, the Small Business Administration, and several additional agencies to better support our nation’s economic growth through trade, entrepreneurship, and innovation.

As a result of these cuts, non-security discretionary spending will fall to just 1.7 percent of GDP in the final year of the Budget horizon, as compared to approximately 3 percent this year.

Discretionary Defense Spending

Just as we must reprioritize our non-security spending to meet the challenges of the new economy, we must also rethink our defense spending in light of the evolving global environment. The conflicts our military confronted over the past decade are winding down: our troops have exited Iraq, operations in Afghanistan are increasingly being turned over to the Afghan people, and we have dealt a devastating blow to al Qaeda by eliminating Osama bin Laden and other leaders. This provides us with the opportunity not simply to cut spending, but rather to take the hard lessons learned from the past decade of conflict to create a military that secures the safety of the United States while taking into account the more fiscally constrained environment in which we are operating.

Over the next year, the overall defense budget, including overseas contingency operations reductions, will be down by 5 percent from the 2012 enacted level. On January 5, the President announced the Defense Strategic Review (DSR), which will set priorities for our national defense over a longer period. The review is designed to provide us with a leaner, more technically advanced fighting force, better designed to address the threats of today’s world. In particular, the strategy calls for strengthening our presence in the Asia-Pacific region, along with continued vigilance in the Middle East and North Africa. We will also continue to invest in our critical partnerships and alliances, including NATO.

The DSR is designed to reduce defense spending over the next 10 years by $487 billion relative to last year’s Budget, which will slow the growth of defense spending. The President’s Budget will allow us to make significant and thoughtful reductions in defense spending without implementing the damaging path of the BCA sequester.

Mandatory Spending

Achieving fiscal sustainability in the long term will require changes to mandatory spending programs. The President is proposing $270 billion in savings over 10 years in mandatory programs outside of health care. This includes the modernization of the pay and benefits of federal workers and the military, and increasing the efficiency of our agricultural support programs. The Budget also proposes increasing the retirement security of American workers by giving the Board of the Pension Benefit Guaranty Corporation (PBGC) the authority to gradually adjust the premiums it charges pension plan sponsors, as well as a proposal to restore solvency to the unemployment insurance program. Together, these latter two proposals would reduce the federal deficit by more than $60 billion over 10 years.

However, as the population ages and health care costs continue to rise, one of the biggest challenges in addressing our long-term fiscal sustainability results from projected spending on health programs due to aging of the population and excess health care cost growth.

The Affordable Care Act (ACA) was a significant step toward controlling health care spending. According to analysis from the Congressional Budget Office, the ACA is estimated to reduce the deficit by more than $100 billion from 2012 to 2021 and by more than $1 trillion in the second decade. It is projected to reduce Medicare’s average annual growth by 1.5 percentage points. One of the most important steps we can take right now for long-term deficit reduction is to implement the ACA fully and effectively.

Still, more needs to be done. The Budget therefore proposes an additional $362 billion in health care savings over the next 10 years, through better administration and innovation, strengthening program integrity, aligning payments with costs of care, and strengthening provider payment incentives to improve quality of care. The Budget also includes structural changes that will help encourage Medicare beneficiaries to seek high-value health care services.

Tax Reform

While the proposed spending cuts are an important component of reducing our deficit, the President has recognized that we cannot responsibly address our fiscal situation without raising additional revenue. As a share of GDP, tax revenues from 2009 to 2011 were at their lowest level as a share of the economy since 1950. Our current tax code is inefficient and filled with loopholes. We need a tax system that is simpler and more efficient, one where businesses and individuals play by the rules and pay their fair share. Comprehensive tax reform will strengthen our competitiveness, promote fiscal sustainability, and restore fairness.

As the President has emphasized, these reforms should follow a set of key principles. They should be fiscally responsible, so that the tax code promotes jobs and growth while collecting appropriate levels of revenue. The code should be simpler, combining lower tax rates for individuals and corporations with fewer loopholes and carve-outs—which will increase efficiency so that businesses compete based on the products and services they provide, not the tax breaks they are able to collect. And finally, it should be fair, so that middle-class Americans are not carrying more than their fair share of the tax burden.

Individual Tax Reform

As with corporate tax reform, for individual reform the best path would be to enact comprehensive tax reform that meets the principles the President laid out last September and revisited as part of the State of the Union. The key to these reforms is fairness.

The individual income tax cuts of the last decade were tilted toward the wealthy and have contributed to tax revenues falling to near their lowest level as a share of GDP in 60 years. As we consider individual reforms, families with incomes under $250,000 should not see a tax increase. But the most fortunate Americans, the wealthiest 2 percent, must contribute a greater share of their income in order to correct the imbalance in our system. And in keeping with the Buffett Rule, high-income families should not face tax rates that are lower than those faced by middle-income families.

As we move to consider these reforms, the Budget presents a path that raises the appropriate amount of revenue within the context of the current tax system. The President's Budget proposes a number of steps in line with his tax reform principles, including:

- Allowing the high-income 2001 and 2003 tax cuts to expire;
- Setting a maximum 28 percent rate at which upper-income taxpayers could benefit from itemized deductions and certain other tax preferences to reduce their tax liability; and
- Eliminating the carried interest loophole that allows some to pay capital gains tax rates on what is essentially compensation for services.

These steps in the direction of a reformed system would reduce the deficit by about $1.5 trillion over the next 10 years and would set in motion the process of broader reform.

<u>Corporate Tax Reform</u>

Right now, the United States has one of the highest statutory corporate tax rates in the world, but the large number of loopholes and special interest carve-outs means that effective tax rates vary widely by industry, even by company, and allow some corporations to avoid paying income taxes almost entirely. Even though our statutory corporate tax rate is among the world's highest, the corporate tax revenue we collect, as a percentage of GDP, is relatively low for advanced economies.

There are too many tax provisions that favor some industries and investments and benefit only those who receive them, rather than society as a whole. This creates problems beyond forgone revenue: it forces some businesses to carry a larger share of the tax burden than they would under a more equitable system, and it also hurts overall economic growth by distorting incentives for investment and job creation.

Soon, the Administration will release a framework for reforming the corporate tax system. This proposal will lower the maximum statutory rate, limit the ability of firms to shift profits to low-tax jurisdictions, eliminate tax expenditures that have no positive spillovers to society as a whole, and bring a sense of permanence to various provisions in the corporate income tax code. In short, it will help level the playing field for businesses and allow the government to collect needed revenue while promoting economic growth. The President's Budget proposals, if implemented, would move the existing corporate tax code in the direction of these principles but would not eliminate the need for deeper reforms.

IV. Conclusion

In today's testimony, I have outlined the President's plan for addressing our substantial economic challenges through the combination of targeted investments, spending cuts, and tax reform.

In closing, I want to emphasize that bolstering economic growth in the long run and controlling our deficits both depend a great deal on us taking strong steps to support the economy right now.

A common mistake in the wake of financial crises is for governments to withdraw support for the economy too soon. Though recent economic data has been somewhat promising, we have a long way to go to fully recover from the worst shock to our economy since the Great Depression. Failure to act in the face of these challenges is one of the biggest threats to our economy ahead in 2012 and 2013. There are two key areas where Congress can provide immediate, meaningful support:

First, Congress should extend the payroll tax cut and emergency unemployment compensation set to expire at the end of this month. These extensions will put more money in the pockets of American families at a time when they need it most and will help support the broader economy. Private sector economists estimate that if these programs are not extended through the end of 2012, it will shave about half a percentage point from our GDP this year. After a fourth quarter of 2011 in which government cutbacks took nearly 1 percentage point off of GDP growth, we cannot afford to further undermine our support for the economy. And the savings to families are significant: if extended, the tax cut alone will save $1,000 this year for the typical household earning $50,000, while the extension of emergency unemployment insurance will prevent 4.5 million UI claimants who are looking for work from losing benefits, helping them and 8.3 million people living with them over the next 10 months.

Second, we must continue to work together to support the housing market, whose weakness is a stress on millions of families and a drag on overall growth. To this end, the President recently announced new policies designed to aid the housing market, including broad-based refinancing for responsible homeowners that would save the typical family $3,000 a year. We are also working with the FHA and FHFA to take a range of steps to improve access to mortgage credit, and the FHFA also recently launched a pilot program to convert foreclosed homes into rental properties.

Finally, Congress should consider the plan set forth by the President, first in the American Jobs Act, and now in the Budget, to create jobs and strengthen our economy. The President's Budget cuts taxes for American workers. It cuts taxes for small businesses, so they can hire more people, and cuts taxes for businesses that add employees. It protects the jobs of teachers, police, and firefighters. And it puts construction workers back to work on much-needed projects. There are 13 million Americans looking for work. We have an obligation to them.

Implementation of these short-term steps will help strengthen the economy as we enter the next fiscal year. The President's Budget for FY 2013 provides a path forward that will help our nation grow now and in the future. These are important proposals. They are balanced proposals. And they will help make our economy and our nation stronger.

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