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Statement of Treasury Secretary Timothy F. Geithner
Committee on the Budget
U.S. House of Representatives
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Chairman Ryan, Ranking Member Van Hollen and members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2012 Budget.

I. Introduction

When the President took office two years ago, the U.S. economy was in the middle of its deepest recession in more than 50 years. The economy was contracting at a rate of 5 percent per year, and private businesses were cutting more than 700,000 jobs per month.

In the face of this crisis, this Administration and Congress put in place policies that helped pull the economy back from the brink and established the basis for the ongoing recovery. Today the economy has grown for six straight quarters. Businesses have started to hire again and have added more than 1.3 million jobs since the labor market began to recover. Economic activity has accelerated over the last few months, supported by strong private demand.

This past December, the Administration and Congress agreed to a bipartisan tax package that will help ensure that the recovery continues. This agreement prevented a tax increase on middle class Americans, and also included crucial Administration initiatives – such as a temporary payroll tax cut, an extension of unemployment insurance benefits, and immediate expensing for certain business investments – that will provide a substantial boost to economic activity.

Consumers and businesses are now expressing more optimism about the future, suggesting momentum that will sustain growth in the coming months. At the same time, private sector analysts have issued more optimistic near-term forecasts and are projecting stronger growth in 2011 and 2012.

However, we still face very substantial economic challenges. Millions of Americans remain out of work, and families across the country are still struggling to make up for losses in their savings and in the value of their homes.

The President has outlined a broad strategy to help strengthen economic growth with investments in education, innovation, and the nation's infrastructure. Alongside those investments, we must reform the nation's finances to restore fiscal responsibility. Our deficits are too high and they are unsustainable. Left unaddressed, these deficits will hurt economic growth and make us weaker as a nation. We must go back to living within our means.

The Budget presents a detailed plan to cut spending and reduce deficits. The President's Budget cuts the inherited deficit in half as a share of the economy over his first term; includes proposals that will reduce deficits by more than $1 trillion over the next 10 years; and cuts non-security discretionary spending to its lowest level as a share of the economy since Dwight Eisenhower was President. These cuts are phased in over time to protect the recovery.

In addition, the Budget sets priorities by balancing spending cuts with the need to protect investments in education, innovation and infrastructure. Under-investing in these areas would compromise our competitiveness. Finally, the Budget reaffirms our commitment to reduce tax expenditures and reform entitlement programs.

II. A Credible Commitment to Fiscal Responsibility

The President's Budget meets the following five imperatives, all of which are necessary components of a credible commitment to fiscal responsibility:

- First, we must lower deficits over a multi-year period to stabilize or reduce the national debt as a share of the economy. Deficit reduction needs to be gradual to avoid endangering the recovery.

- Second, we need to reduce overall spending as a share of the economy, with spending cuts targeted at programs we cannot afford.

- Third, we need to protect and expand investments in targeted areas crucial for future economic growth.

- Fourth, we must develop tax policies that promote growth and investment while maintaining fairness and fiscal responsibility.

- Fifth, we must restore fiscal responsibility over the long term by reducing the rate of growth in health care expenditures and by strengthening and extending the solvency of Social Security.

The following sections outline in detail how the President's Budget meets each of these imperatives.

A multi-year commitment to stabilize the national debt

While our deficits will decline in coming years as the economy continues to recover, economic growth alone will not be enough to stabilize our finances. In the absence of further action, the deficit is projected to remain near 4.5 percent of GDP for the rest of the decade, even after the economy is fully recovered. Under this scenario, the national debt held by the public will grow from 62 percent of GDP in 2010 to nearly 85 percent of GDP by 2021, the highest share since 1948. Without reform, debt will continue to grow after 2021, as mandatory spending and interest payments on the debt grow faster than revenues.

Roughly speaking, stabilizing the debt as a share of the economy requires that outlays, excluding interest payments on the national debt, must equal revenues. This requires us to cut the deficit to approximately 3 percent of GDP and maintain deficits at about this level into the future.

The President's Budget accomplishes this over the medium term. Our proposals cut the deficit in half by 2013, reduce it to 3.2 percent of GDP by 2015, and maintain deficits around 3 percent of GDP for the second half of this decade. Under our proposal, the national debt held by the public as a share of the economy stabilizes around 76 percent starting in 2013, although it rises slightly at the end of the 10-year budget window. Excluding the financial assets held by the government, such as student loans and other investments, our proposals stabilize the national debt held by the public as a share of the economy at around 68 percent.

The pace of deficit reduction has to be calibrated to the path of recovery. Under the path envisioned in the Budget, significant deficit reduction starts in 2012 and accelerates in 2013 and 2014, due mainly to economic recovery and the expiration of support measures, and also due to Budget proposals that reduce the deficit. Starting in 2015, when the economy is projected to be closer to operating at full capacity, the Budget proposals will reduce the deficit by more than $150 billion each year on average through 2021.

The tension between the need for fiscal responsibility in the medium term and supporting the recovery in the short term creates a difficult challenge for policy makers. Because changes made one year can easily be altered the next, the best way to resolve this tension is for Congress and the Administration to commit to a multi-year plan of fiscal responsibility, phased in over an appropriate time horizon.

Committing to a multi-year deficit reduction plan would give businesses and individuals more certainty about the impact of future government policy. This can improve confidence today and help keep borrowing rates low. Moreover, committing to a multi-year plan would give businesses and individuals adequate time to adjust and prepare for future changes.

Cut spending and eliminate programs we cannot afford

Meaningful deficit reduction requires serious cuts to government spending. The Budget proposes a five-year freeze of non-security discretionary spending at its 2010 nominal level, reducing the deficit by more than $400 billion over the next decade, and bringing the level of non-security discretionary spending to its lowest share of our economy since the Eisenhower Administration.

This will not be easy. The President has asked each agency to make tough choices, and the Budget includes more than 200 terminations, reductions and savings proposals. The President has also asked civilian government employees to share responsibility for reducing deficits and has proposed freezing their salaries for two years, which will save more than $60 billion over the next 10 years. Finally, we are continuing to make government more efficient by reducing administrative overhead costs, reforming the government purchasing process, and embracing competitive grant programs.

In addition to cutting current non-security discretionary spending, the President is asking departments and programs outside of the spending freeze to reduce their future spending. Specifically, the Department of Defense is pursuing a variety of strategies to reduce defense spending; as a result, the Budget reduces defense spending by $78 billion over the next five years, relative to last year's Budget proposal. Secretary Gates believes these savings can be realized through reducing overhead costs, improving business practices, and cutting excess or troubled programs, and will not weaken our national security.

In addition to cutting spending, the Budget includes two proposals that will reduce our future obligations. The Budget proposes giving the Board of the Pension Benefit Guaranty Corporation (PBGC) the authority to adjust gradually the premiums it charges pension plan sponsors. This will encourage companies to fund their pension benefits fully while improving the PBGC's long-term financial position. Premium increases would be phased in, starting in 2014. The Budget also includes a proposal that would provide short-term relief to states and employers, while encouraging states to put their unemployment insurance programs on firmer financial footing. Together these two proposals would reduce the federal deficit by $60 billion over 10 years.

Increase investment in areas important to economic growth

It is not enough to spend less; government must also spend more wisely. The President's Budget sharply restrains overall spending, but it also invests in important areas where the government has a clear role to provide public goods that promote future economic growth and competitiveness: education, innovation and infrastructure.

- Education: An educated and skilled workforce is critical for the United States to compete in the global economy. Workers with a college education not only earn higher wages for themselves, but increase the productivity of those who work with them and of the economy overall. The need for additional investment in education is striking: America has fallen to ninth among advanced countries in the proportion of young people with a college degree. The Budget proposes targeted investments in education to help us regain our competitive edge.

  We propose to strengthen investments in programs across every stage of a child's education. The Budget includes $350 million for the Early Learning Challenge Fund, a program that would apply the lessons learned from the successful Race to the Top program to early education, and dedicates $100 million to help prepare 100,000 new teachers in science, technology, engineering and math over the next 10 years. The Budget also recommits to maintaining the maximum Pell grant award and to making permanent the American Opportunity Tax Credit, which provides up to $10,000 for a student for four years of college. These two programs help make college affordable for millions of students and their families.

- Innovation: Investments in research and development (R&D) produce the technological advancements that contribute to productivity growth and improvements in U.S. living standards. However, businesses may under-invest in R&D because they do not capture the full social returns on their investments. The President believes that government has an important role to play in promoting technological progress, and the Budget includes $148 billion in R&D investments for this year to support basic research and clean energy.

  These include maintaining the Administration's commitment to doubling the investment in basic research conducted at the National Science Foundation, the Department of Energy's Office of Science, and the National Institute of Standards and Technology labs. The Budget's proposal to increase the federal investment in the National Institutes of Health to a total of $32 billion will support innovations in biomedical research, improving future health care outcomes and economic growth.

  The Budget also provides $8.7 billion for clean energy technology, including more than doubling investments in energy efficiency research, development, and deployment; increasing renewable energy investments by over 70 percent; and expanding investments in the Advanced Research Projects Agency – Energy (ARPA-E).

- Infrastructure: Infrastructure is critical to economic growth and competitiveness, and yet our current investments in infrastructure are insufficient and often inefficiently allocated. In addition to a $50 billion up-front investment in transportation infrastructure to create jobs in occupations that have been hit hard by the recession, the Budget lays out a long-term plan for sustained, targeted investments in the most effective infrastructure programs and projects.

  The Budget proposes a six-year surface transportation reauthorization that increases average annual investment by $35 billion per year, in real terms, over the previous six-year authorization plus passenger rail funding appropriated in those years. This proposal includes $30 billion to create a National Infrastructure Bank, which will attract private capital to infrastructure projects while improving the process of allocating infrastructure funds. The proposal also includes $32 billion in competitive funding to encourage states and cities to reform their transportation programs to focus on more efficient and effective investments. We are committed to working with Congress on a bipartisan basis to ensure that there is sufficient revenue to keep the underlying Transportation Trust Fund solvent, because these investments must be fully paid-for.

Taken together, the Budget balances two priorities that guide our approach to government spending. First, spending cuts are necessary to lower the deficit. At the same time, we must protect targeted, responsible investments that allocate limited government resources towards programs that will boost economic growth and promote job creation over the long run.

A tax system that supports growth, fairness and fiscal responsibility

Strengthening our competitiveness and restoring fiscal responsibility will require reforms to our tax system.

Starting with revenue provisions that promote investment in innovation and clean energy, the President's Budget includes a series of specific tax policy changes that help us move towards a more efficient, fair and competitive tax system that will support economic growth.

Specifically, the Budget proposes making an expanded research and experimentation tax credit permanent, thereby increasing certainty for businesses making crucial long-term investments that will lead to more innovation. In addition, in order to support investment in clean energy technology, the Budget proposes tax credits for advanced manufacturing facilities, energy-efficient commercial buildings and an improved credit for plug-in vehicles.

The Budget proposals also reduce the incentives for multinational firms to shift income and assets to their foreign subsidiaries. Finally, the Budget proposes a fee on financial firms to recoup the costs of the extraordinary financial assistance the government put in place to resolve the crisis.

In addition to these proposals, we must pursue comprehensive corporate tax reform to create a competitive tax system that raises sufficient revenue in the most efficient, simple and fair way. The current system for taxing corporations and business hurts economic growth by placing burdens on U.S. businesses that negatively affect their investment and employment choices. Because of various loopholes and carve-outs, some industries pay an average rate that is four or five times higher than others, and although our statutory corporate tax rate is one of the highest in the world, we raise about the same amount of corporate tax revenue as our major trading partners.

Moreover, because of the high rate and because of the various loopholes and carve-outs, too many businesses end up making investments based on what their tax planners recommend, instead of what sound business judgment would suggest. This puts our entire economy at a disadvantage. As the President has announced, in consultation with the business community and other stakeholders, the Administration is examining ways to lower the corporate tax rate and to eliminate provisions that negatively affect investment. By pursuing these two objectives together, we can enact reform that does not add to current or future deficits. I look forward to working with you on this important endeavor.

Balancing the budget requires sacrifice from all Americans, but should also promote fairness for the middle class.

The Budget proposes reducing the value of certain tax expenditures on the wealthiest Americans by limiting the value of itemized deductions to 28 percent for high income households. This is a down payment on reform of the individual income tax system.

This provision alone will generate enough revenue to fully protect the middle class from a dramatic expansion of the Alternative Minimum Tax (AMT) for three years. The Budget calls on Congress to find additional ways to pay for permanent AMT relief, because if left unaddressed, the AMT will inappropriately sweep up tens of millions of families into this parallel tax system. Working with Congress to fully pay for AMT relief after 2014 would lead to an additional one percent of GDP in deficit reduction by the end of the decade.

In addition, the Budget proposes to reform the taxation of carried interests in financial partnerships, to close the loophole that allows some to pay tax at lower capital gains rates on what is effectively compensation.

We must also allow the 2001 and 2003 tax cuts for married couples with household incomes above $250,000 (and $200,000 for single filers) to expire and return the tax on large estates to 2009 levels. The President has been clear that we cannot afford these tax cuts for the wealthiest Americans, which do very little to support economic growth. Allowing these temporary tax cuts to continue indefinitely would increase the deficit by nearly $1 trillion over the next 10 years.

Fiscal sustainability over the long run

While stabilizing the debt-to-GDP ratio over the medium term is an important down payment on long-term fiscal stability, we must also reform entitlement programs, as entitlement spending is projected to increase more quickly than revenues due to an aging population and growing health care costs.

We made important progress on entitlement reform last year by passing the Affordable Care Act (ACA). Independent analysts have estimated that the ACA will significantly slow the growth of medical costs, relieving both government and businesses of some of the pressure of rising medical expenditures. According to the most recent analysis from the Congressional Budget Office, the ACA is estimated to reduce the deficit by more than $200 billion from 2012 to 2021, and by more than $1 trillion in the following decade. The most important step we can take right now for long-term deficit reduction is to implement the ACA fully and effectively.

Still, we know that more is needed, which is why the Budget includes additional provisions that address our rising medical expenditures. The Budget proposes $62 billion in specific savings in health programs that will fully pay for two years of relief from physician payment rate cuts called for by the Sustainable Growth Rate formula. The Budget calls for a long-term, fiscally responsible reform of physician payments that provides incentives to improve quality and efficiency while ensuring that payments will be predictable. A long-term solution will build on the fully paid-for, one-year relief for physicians enacted this past December. In addition, the Budget includes $250 million in grants to encourage progress on medical malpractice reform, which can reduce over-utilization of some expensive procedures without compromising patient outcomes.

Finally, the President is committed to strengthening Social Security. Together with Congress, we will consider ideas that put Social Security on more sound financial footing over the long term. However, we will reject plans that slash benefits; that fail to protect current retirees, people with disabilities and the most vulnerable; or that subject Americans' retirement savings to the whims of the stock market.

III. Conclusion

America is at a fiscal crossroads. We cannot pretend that our budget problems are merely the result of the financial crisis, nor can we pretend that we can restore fiscal responsibility without real sacrifice that affects all Americans.

Unless we act today, the national debt will continue to grow as a share of the economy over the medium run, even after the economy is fully recovered. Without reform, an aging population and rising health care costs will cause entitlement spending to grow more quickly than revenues in the long run, putting increasing strain on the budget and causing deficits to remain elevated far into the future.

If the debt were to continue to grow as a share of the economy, an ever-increasing share of revenues would have to be devoted just to paying the interest on the national debt, so that in 2020 interest payments would be nearly as large as all defense spending. Such escalating interest payments would create an unsustainable cycle that would eventually force dramatic adjustments. Without appropriate reforms, this path would have consequential effects on the U.S. economy.

While it is apparent that adjustments are necessary, we need to choose our path wisely. Cutting services and programs too much, too soon would jeopardize the recovery and destroy tens of thousands of jobs. Cutting the deficit today without making a long-term commitment to fiscal responsibility could enable a return to profligacy in the future. Cutting spending indiscriminately would force us to cut investments in vital public goods, and focusing reform solely on spending would impose an undue burden on those most in need while ignoring the opportunity to make our tax system more simple, fair, and efficient.

The President's plan navigates these challenges. The Budget lays the foundation for long-term growth while cutting spending in order to reduce the deficit. Making a multi-year commitment to the principles embodied in the President's Budget will reduce the risk of future crises, reassure investors and provide certainty about the future path of spending and taxes. In addition, a multi-year commitment will help ensure that borrowing costs remain low, making home ownership and higher education more accessible for Americans and making long-term investments more attractive for American businesses. Together the increased certainty and improved confidence will contribute immediately to economic growth and job creation.

History provides many examples of how past Congresses have made similar multi-year commitments. In some cases, Congress made permanent changes to policy that lowered the deficit over many years. For example, the 1983 amendments to Social Security extended the solvency of the Social Security Trust Fund for several generations. In other cases, Congress adopted budget rules that locked in a path of deficit reduction, limiting future deficit spending. For example, discretionary spending caps and PAYGO rules for mandatory spending and revenue legislation adopted in 1990 and 1993 contributed to reductions in the budget deficit, and eventually to budget surpluses.

Restoring fiscal sustainability will require courage from both the Administration and Congress, as we cannot move forward without compromise. We know compromise is possible. The December tax agreement proves that we are capable of forging agreements that move our economy forward.

There is no doubt that Members of this Congress – in both parties and both houses – have many good ideas of their own for promoting fiscal sustainability. While we believe the President's Budget is appropriately balanced in its priorities, we look forward to working with you to make a commitment that reflects our common ground – creating American jobs and promoting long-term economic growth.

Thank you, and I look forward to taking your questions.