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PRESIDENT'S BUDGET FOR FISCAL YEAR 2013

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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PRESIDENT'S BUDGET FOR FISCAL YEAR 2013

TUESDAY, FEBRUARY 14, 2012

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Kerry, Wyden, Schumer, Cantwell, Nelson, Menendez, Carper, Cardin, Hatch, Grassley, Snowe, Kyl, Crapo, Coburn, and Thune.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Lily Batchelder, Chief Tax Counsel; Alan Cohen, Senior Budget Analyst; Jeff VanderWolk, International Tax Counsel; and Tom Klouda, Professional Staff Member, Social Security. Republican Staff: Chris Campbell, Staff Director; Jeff Wrase, Chief Economist; and Nick Wyatt, Tax and Nomination Professional Staff Member.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Thomas Jefferson once said, "The value of an idea lies in the using of it." Yesterday, President Obama issued his budget proposals for the next 10 years. Treasury Secretary Tim Geithner is here to discuss them. We need to determine how to best use these ideas to create jobs, reduce the deficit, and create economic growth.

The top issue facing our country and the number-one priority of this budget is job creation. We have made real progress in our job creation efforts. The jobs picture is improving, and the economy is showing positive signs. We have added 3.7 million jobs in the last 23 months. The number of people applying for jobless benefits each week has fallen steadily. Yet there are still far too many people out of work: 12.8 million Americans are unemployed. We need to do more to spur economic growth and help businesses create jobs.

The President's budget contains critical policies to do just that, starting with the payroll tax cut. Extending this tax cut through the end of the year will save families real money, an average of $1,000. These families will spend this extra money at local businesses, pumping it through our economy. The budget also renews unemployment benefits for workers who have lost their jobs through no fault of their own. These workers are sure to spend these benefits, which will help support and create more jobs.

According to our nonpartisan scorekeeper, the Congressional Budget Office, every $1 in unemployment benefits can create nearly $2 in economic growth. Failure to extend the payroll tax cut in unemployment insurance would cost up to half a million jobs. We cannot let that happen to working families or our economy.

Continuing our smart, aggressive trade policy to open new markets to America's world-class goods is also key to our competitiveness and jobs here at home. Last year we passed three free trade agreements with Colombia, Panama, and South Korea. These agreements will generate $12 billion in new U.S. exports and create tens of thousands of new jobs here at home. We also extended a critical worker assistance and training program to ensure American workers have the tools they need to compete and take advantage of new trade opportunities.

This year I am working with my colleagues and the administration to grant permanent normal trade relations to Russia. Once we do, U.S. exports to Russia could double over the next 5 years. This will create more American jobs, particularly in the services, agriculture, manufacturing, and high-tech sectors.

This budget would extend tax provisions that expired at the end of 2011, known as the traditional extenders. These included deductions for college tuition and for State and local sales taxes. And they include a tax credit for research and development to encourage innovation. We should extend these tax breaks for families, individuals, and businesses, and do so now.

We also need to end the cycle of year-to-year extension and uncertainty for families and businesses. We should work together to enact comprehensive tax reform. We must make the tax code fairer and more predictable. This budget takes a step in this direction by making the 2001 and 2003 tax cuts for middle-class Americans permanent, providing permanent estate tax relief and solving the problem of the Alternative Minimum Tax.

We cannot stop there. Uncertainty is not the only problem with our tax system. The tax code and regulations are now as thick as a stack of a dozen Bibles. We need to simplify it and close loopholes. We must ensure that it helps businesses compete in the global economy and create jobs. I look forward to working with my colleagues and the administration to create a better tax system that meets our 21st-century needs.

The President's budget also makes much-needed investment in America's infrastructure, which is sorely needed at a time when unemployment in the construction industry is hovering around 15 percent. The Senate's highway bill has passed out of several committees, including this one, with bipartisan majorities. It will provide nearly $110 billion over 2 years to support road safety, mobility, interstate commerce, and jobs. It is time to enact this into law.

In addition to creating jobs, the President's budget takes important steps to bring the deficit and Federal debt held by the public under control. We have already reduced Federal deficits significantly. Earlier this year we enacted the Budget Control Act of 2011, which reduced spending by $900 billion, and the health reform law provided the biggest deficit reduction in more than a decade.

Nevertheless, Federal budget deficits and debt are still too large. We must adopt policies that will stabilize debt as a percent of GDP by the latter part of the next 10 years. This budget meets that test.

I look forward to continuing our work on deficit reduction and job creation in the coming years.

There is another reason that we must continue to focus on deficit reduction along with job creation this year: a perfect fiscal storm is waiting at the end of this year. First, the 2001, 2003, and 2010 tax cuts expire. Two days later, an automatic sequester of many Federal programs will take place. The debt limit will need to be raised at about the same time. This is what we will face if we do nothing to reduce deficits and control Federal debt in the coming year.

Any deficit reduction we develop must be balanced and it must be fair. Everyone must contribute, but no one should have to make undue sacrifices. Unfortunately, one area of the budget falls short of this standard. The cuts to rural assistance programs I believe are too deep. But we all must work together to achieve meaningful deficit reduction. We cannot do this at the expense of job creation and protecting programs that folks in rural areas depend on.

Deep cuts to agriculture programs will pull the rug out from under our hardworking producers and unjustly target rural States like Montana. Rural development programs provide important economic development, infrastructure, and housing resources. Cuts to these programs have a devastating effect on the economies of rural communities and paralyze our ongoing economic recovery. We need to enact deficit reduction in a smart way. I look forward to working with my colleagues and the administration to do so.

So let us work together to enact significant deficit reduction in a way that preserves and enhances our job creation efforts. Let us take these ideas and find the best way to use them.

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. I will now turn to my good friend, Senator Hatch.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Well, thank you. Thank you, Senator Baucus, Mr. Chairman. I want to thank you for holding today's hearing. We welcome you, Secretary Geithner, to the committee.

Let us begin by noting that total public debt outstanding is over $15.3 trillion, larger than the size of our Gross Domestic Product. A debt-to-GDP ratio above 100 percent is clearly unsustainable and puts us in the ranks of the many European countries currently in a severe debt crisis and unable to borrow at sustainable interest rates.

The Nation deserves a budget that responsibly addresses this debt crisis, yet last year the President delivered a budget that was unanimously rejected on the Senate floor. It did not receive a single yes vote, even from Senate Democrats. I will be interested to see if my colleagues are going to vote for this one.

Yesterday, the President laid out his most recent budget plan. Unfortunately, it similarly fails to address the Nation's glaring fiscal crisis, and it will probably never be brought to a vote. We have not seen a budget resolution from the Senate Budget Committee in years, despite it being legally required.

Last year, the President's budget did eventually get a vote, and there is only room for improvement on that result. But the Senate Majority Leader seems to have no inclination to debate a budget on the Senate floor, having stated that the Budget Control Act means that we do not have to debate fiscal year 2013 spending totals since they have already been determined.

If so, then we do not need to discuss a large part of what the President unveiled yesterday, which should make for a quick hearing today. Still, we have to do our due diligence. In reviewing the budget released yesterday by the President, it is clear that his plan would only make our fiscal problems worse and harm our economy by imposing around $1.9 trillion of stifling tax hikes.

Earlier this month the President suggested at the National Prayer Breakfast that these tax hikes are divinely inspired. That certainly was an interesting take on the Bible, as far as I am concerned. In the President's interpretation, "Render unto Caesar the things which are Caesar's and unto God the things that are God's" becomes "just give it all to Caesar."

Who knew that cosmic justice would be rendered by the Department of Education and HUD? Who knew that the separation of the wheat from the chaff would in fact be performed by the Obama administration, picking winners and losers in the name of fairness?

Perhaps churchgoing citizens should just cut to the President's chase and, instead of tithing or putting an envelope in the basket at church, they can just send their money directly to the divinely ordained Treasury. The fact is, this budget is politically, not divinely, inspired.

This budget is a plan for a permanently larger, European-style government. It does not send our country down a sustainable fiscal path. It does nothing to change the President's unwavering devotion to tax-and-spend policies and failed stimulus schemes that have and will continue to generate historic deficits and levels of debt.

It does nothing to wind down the mortgage giants Fannie and Freddie, to restore private flows of capital into our Nation's system of mortgage finance, or to remove the government's effective takeover of our housing markets. It does nothing to address our entitlement spending crisis, whistling past the graveyard as Social Security, health care, and disability trust funds are in death spirals towards bankruptcy.

The President presents this budget with its accelerated spending and class warfare as one of fairness and compassion. But is it fair to American workers to jeopardize economic growth through higher taxes? Is it fair to taxpayers to ignore the mortgage giants Fannie and Freddie, which continue to drain their wallets? Is it fair to the disabled to pretend that the looming bankruptcy of the disability trust fund will not happen in 2016? It is going to if we do not do something about it.

Is it fair to look at Social Security and turn the other way in the interest of avoiding hard choices that might make a reelection campaign uncomfortable? Secretary Geithner, I look forward to your testimony today on the President's plan and what it might do to the economy.

I have to say though that I wish you would be careful in your public economic pronouncements. It is disturbing and unwarranted when you claim, for example, that Republicans' resistance to the President's stimulus proposals for more taxing, spending, and borrowing—as in his so-called jobs bill—means that Republicans do not want to do anything to help the economy or that Republicans' resistance to wasteful stimulus somehow increases the risk of recession.

These claims are simply not true, and they are certainly not productive. Putting aside these discouraging political statements, perhaps we could be given an explanation of why the administration appears to believe that the economic recovery is vibrant enough to be hit with more taxes, despite clear warnings from the Congressional Budget Office of significant negative effects on growth, yet at the same time it is not vibrant enough to stop the runaway spending of the current administration.

It seems that for President Obama the recipe always calls for more taxes to fund more government. The result is this budget, which ignores the source of our Nation's fiscal challenges—a spending problem that is only getting worse. No matter what budget baseline you choose to consider, the CBO projects that Federal revenues as a share of GDP will rise above the long-run average as the economy recovers, even with a continuation of current tax rates. But spending as a share of GDP is projected to indefinitely stay above historic norms, pushing our economy and the size of our government further and further down the path that several major European countries have followed to fiscal ruin.

We also know that our fiscal outlook is very sensitive to future developments, including what might happen to interest rates or inflation. CBO tells us that, if interest rates run just 1 percent higher than assumed in their baseline budget projection, interest outlays over the next 10 years will increase by over $1 trillion. That is for just a 1-percent increase. If rates spike up precipitously once our creditors lose patience with the administration's unwillingness to chart a sustainable fiscal course, we could easily face deeply painful adjustments like those currently being experienced in Europe.

On the other hand, according to CBO, if inflation turns out to be 1 percentage point higher each year than under its baseline, then the deficit would actually fall over the next 10 years. While the economy would suffer, the government would benefit from higher inflation, and it would be up to the Fed to avoid the temptation to inflate for budgetary gain. I certainly hope that the Fed's recent appetite for mixing monetary and fiscal policies comes to an end and that we do not have to worry about the temptation to inflate our way out of our debt.

Our unsustainable fiscal path poses great and growing risks to the economy, and the President's budget does nothing to diminish these risks. In fact, given the riskiness of our fiscal path and the temptation to inflate away some of our debt, Warren Buffett, whom the administration appears to turn to for its formulation of tax policy, weighed in with advice for investors to steer clear of currency-based investments like U.S. Treasury securities. As Mr. Buffett said, "'In God We Trust' may be imprinted on our currency, but the hand that activates our government's printing press has been all too human." On bonds like Treasuries, the Oracle advises, "Right now, bonds should come with a warning label."

Secretary Geithner, Mr. Buffett is advising investors to shy away from investments such as Treasury securities, and it will be interesting to know if you agree with this advice. My hope is that his recent musings do not become a new Buffett rule for investors not to buy Treasuries, because, if investors heed that advice in large numbers, the spikes in interest rates that I worry about will materialize and the low-cost financing of our $15.3-trillion debt that the U.S. temporarily enjoys will evaporate in a hurry.

We need to resist the siren song of cheap financing, partly brought on by the Federal Reserve's massive purchases of Treasury securities to help push rates down. Unfortunately, the administration remains lulled in by the siren song and takes current low rates as a reason to spend more and pile up even more debt to finance a bloated European-sized government.

Secretary Geithner, I look forward to your testimony on the President's budget—testimony that I only received late yesterday, after the deadline you were supposed to honor for submission. Again, Mr. Chairman, I want to thank you for holding today's hearing, but I am really concerned. I do not see any real resolution to the problems that this country is currently facing.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator, very much.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. I am now pleased to welcome our witness, Treasury Secretary Tim Geithner. As you know, Mr. Secretary, your statement will be automatically included in the record, and I would urge you to summarize and just take your time.

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Hatch, and members of the committee. Thanks for the chance to come before you today and talk about the President's budget.

Our economy today is gradually getting stronger, but we have a lot of tough work still ahead of us as a country. Over the last 2½ years, despite the financial headwinds from the crisis, despite the severe cutbacks by State and local governments, despite the crisis in Europe, despite the increase in oil prices we saw last spring, despite the tragedy in Japan, despite all those shocks and headwinds, the economy has grown at an average annual rate of 2.5 percent.

Private employers have added 3.7 million jobs over the past 23 months. Private investment in equipment and software is up more than 30 percent. Productivity has improved. Exports across the American economy, from agriculture to manufacturing, are expanding rapidly. Americans are saving more and bringing down debt levels. The financial sector is in much stronger shape, helping meet the growing demand for capital and for credit.

Now, these improvements are signs of the underlying resilience of our economy, the resourcefulness of American workers and companies, and the importance of the swift and forceful actions we took to stabilize the financial system and to pull the economy out of the worst economic crisis since the Great Depression.

But I want to emphasize this: we still face very significant economic challenges, particularly for households and families across the country. Americans are still living with the acute damage caused by the crisis.

The unemployment rate is still very high. Millions of Americans are living in poverty, still looking for work, suffering from a fall in the value of their homes, or struggling to save for retirement, or to pay for college. We face, as you both said, unsustainable fiscal deficits. In the face of these challenges, the President's budget calls for substantial additional support for economic growth and job creation alongside longer-term reforms to improve economic opportunity and to restore fiscal responsibility.

Most urgently, I want to start with this as the chairman did. Congress must extend the payroll tax cut and emergency unemployment insurance by the end of this month. If Congress fails to act, 160 million Americans will immediately pay more in payroll taxes, and 5 million people looking for work will lose or be denied Unemployment Insurance benefits over the rest of the year.

We will continue to encourage Congress to support additional actions to cut taxes for workers and businesses, to preserve the jobs of teachers and first responders, to put construction workers back to work, and to help more Americans refinance their mortgages to take advantage of lower interest rates. Beyond these immediate steps, the President's budget outlines a longer-term strategy to strengthen economic growth and improve economic opportunity while reducing our fiscal deficits to more sustainable levels.

Now, I know the conventional wisdom in Washington is that this debate we begin today does not matter because Congress is too divided to legislate in this election year. But this debate is a very important debate. It matters because this is a fundamental debate about economic priorities, about how to increase growth and opportunity, how to strengthen health care and retirement security, how to reform our tax system, how to live within our means.

It is important also because of the stark array of choices we face at the end of this year with the expiration of the Bush tax cuts and the sequester. We govern with limited resources, and we have to make choices about how to use those resources more wisely. Any strategy to address these economic challenges has to answer a few key questions: how much do we have to cut; which program should be cut, expanded, or protected; how should we share the burdens of deficit reduction?

The President's budget reduces projected deficits over the next 10 years by $4 trillion, $3 trillion on top of the caps and cuts in the Budget Control Act. Overall, the President's plan would lower the deficit from just under 9 percent of GDP in 2011 to around 3 percent of GDP in 2018.

A deficit at that level will stabilize the overall level of debt-to-GDP in the second half of the decade, putting us back on the path of fiscal sustainability and better positioned to confront the remaining challenges we would still face that come from the rise in Medicare, Medicaid, and Social Security costs as more Americans retire.

Under the President's budget, non-defense discretionary spending is projected to fall to its lowest level as a share of the economy since Dwight Eisenhower was President, and the President's plan would significantly slow the rate of growth in spending in Medicaid and Medicare, both through the Affordable Care Act and the additional Medicare and Medicaid reforms proposed in the budget.

But, as we reduce spending, we also have to protect investments that are critical to expanding economic growth and opportunity. That is why the budget proposes a series of targeted investments in education, innovation, manufacturing, and in infrastructure.

Now, in order to achieve this balance—significant savings but some important investments—we are proposing to raise a modest amount of additional revenues through tax reform. We propose tax reforms that raise revenues because we do not believe it is possible to meet our national security needs to preserve a basic level of health care and retirement security or to compete effectively in the global economy without some increase in revenues as part of a balanced deficit reduction plan.

The President's plan includes $2.50 of spending cuts for every dollar of revenue increases. These revenue increases are focused on the top 2 percent of American taxpayers, not the remaining 98 percent. Although we illustrate in our budget a range of specific tax changes that could be added onto the present tax system to generate those increases in revenue, we think the best approach to get there is through comprehensive tax reform. We have outlined a broad set of principles for tax reform to make the system more simple and more fair and do a better job of encouraging investment in the United States.

The increases in revenue we propose, which are roughly 1 percent—I say 1 percent—of GDP, if structured as we propose, we do not believe would have a material adverse impact on economic growth, particularly if compared to a comparable reduction in, for example, Medicare benefits or spending on infrastructure.

Now, I know there are members of Congress who are critical of these proposals and would prefer a different strategy, and the President's plan should be judged against those alternatives. There are some who have suggested we should cut deeper and faster, with more severe austerity now. That approach, though, would damage economic growth, it would reverse the gains we have achieved in getting more Americans back to work and healing the damage caused by the financial crisis, and it would push more Americans into poverty.

Some have suggested that we try to restore fiscal balance without raising any additional revenue from anyone, or even by cutting taxes further. To do so, though, would entail deep cuts in benefits for retirees and low-income Americans, cuts in investments and education and innovation that would hurt growth and opportunity, and cuts in defense spending that would damage our national security interests. We do not support, and we will not support, those alternative strategies.

Now, the President's plan includes some very tough reforms, but with a balanced mix of spending cuts and tax reforms. It preserves some room—modest room—for us to make investments that would improve opportunity for Americans and help make growth stronger in the future.

It protects the basic commitment we make to retirement security and health care for the elderly and the poor, and it provides substantial immediate help for the average American alongside these long-term reforms to restore fiscal responsibility. This plan will not solve all the Nation's challenges, but it will put us in a much stronger position to deal with those challenges.

Thank you. I would be happy to answer your questions.

The CHAIRMAN. Thank you, Mr. Secretary.

[The prepared statement of Secretary Geithner appears in the appendix.]

The CHAIRMAN. I would like to focus a little on infrastructure. I personally believe this country is behind in building roads, streets, highways, bridges, and airports, and just modernizing our infrastructure. At the same time, that will all cost money. So, if you could just address a little bit that sort of trade-off on what is spending, what is investment, and how you see us moving in the future with needed expenditures on infrastructure——

Secretary GEITHNER. Of course, we agree. If you look at the state of American infrastructure today—roads, highways, rail, airports—by any measure, we will require very substantial investments over a very long period of time to get those into shape.

The absence of investment acts like a tax on business and makes business more expensive—harder to get your goods to market competitively. So we think it is good economic policy and good fiscal policy to recognize that imperative and to plan now for a sustained, substantial investment in infrastructure.

Now, we propose to pay for that through a mix of the traditional means we use today as well as a relatively small portion of the savings we gain from winding down the costs of the wars in Iraq and Afghanistan. We have laid out in the budget a substantial multiyear program for doing that. There are some people who think we can afford to do more than that, but it is tough because you have to find the resources to do it. But this is the approach we think is prudent.

The CHAIRMAN. How do you answer the question, you are just adding to the deficit by allocating money to just spend on infrastructure?

Secretary GEITHNER. In this case, as well as all the additional investments we propose in education, in innovation, in basic science and research, we are meeting the basic test of fiscal responsibility. We are showing how to not just pay for them, but to pay for them in the context of a plan that brings our deficits down over a sustained period of time to a level that is more sustainable. So, we meet that basic test of responsibility.

Now, these investments we think have pretty high economic return. I think most economists would agree with that. They do not just get people back to work very quickly and help bring the unemployment rate down, but they have higher long-term returns in terms of the efficiency, the competitiveness of the economy. Again, it is like a tax on business today when you leave infrastructure in the poor position it is in today.

The CHAIRMAN. The multiplier effect is pretty significant?

Secretary GEITHNER. We think it is, yes.

The CHAIRMAN. All right.

Second, with respect to tax reform, is the administration going to send up a fairly specific set of proposals on tax reform? If so, will it tend to focus on corporate taxes? If you could just give us a little flavor of what you plan to send up.

Secretary GEITHNER. We have laid out some general principles to guide individual and corporate tax reform. We think that process is going to take, realistically, some time. When we have done it in the past, it has taken years. We want to start laying the foundation for those reforms.

We are, within the next couple of weeks—I think by the end of this month—going to lay out a framework of elements that we think should guide the discussion on corporate tax reform to produce a system that does a better job of improving incentives for creating and building things in the United States.

So, there will be a little bit more to come in the next couple of weeks on corporate taxes. It is not going to be comprehensive, complete, in the form of a legislative language detailed proposal, but we are going to lay out a core set of elements in a sort of framework to begin that discussion.

Again, we view these things—the proposal on individual and on corporate—as foundation laying for the necessary debate we have to have as a country on how to fix this tax system and make it do a better job of creating growth in a way that is more simple, more fair.

The CHAIRMAN. But the proposals will be more in the nature of corporate tax reform as opposed to individual?

Secretary GEITHNER. Yes. In the next couple of weeks, we will do a framework on elements for corporate reform. We are not going to go beyond where we are on the individual for the foreseeable future. On the individual side we have been pretty specific about the basic elements we think should guide individual reform.

And, as you know—and I know there is a lot of opposition to that up here—we have suggested that the burden for the revenues that would have to come on the individual side should fall on the most fortunate 2 percent of Americans through an increase in the effective tax rate on those individuals.

The CHAIRMAN. But you are not going to just, as was the case in 1986, have a Treasury I or a Treasury II?

Secretary GEITHNER. No.

The CHAIRMAN. You are more specific. You are more on your principles.

Secretary GEITHNER. We are going to try—on the corporate side, we are going to be more specific than principles, but not as detailed as legislative language. We are going to take that approach because we actually think—this may not be true—that there is a lot of common ground in the broad elements of what we heard from the Hill on the corporate side, and so we want to maximize the chance we can take advantage of that to build consensus on something that is going to work.

Now, we are going to start in a different place than, for example, your colleague in the House started. We are going to start a little tougher in different ways. But there is going to be a fair amount of common elements in the basic strategy.

I think we are both guided by the important objective of saying, what can we do to make it more likely that you are seeing more things created, designed, and built in the United States with more investment in the United States?

The CHAIRMAN. Thank you very much.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Mr. Secretary, an op-ed which was written by then-Senator Obama's senior economic advisors, Drs. Furman and Goolsbee, in the August 14, 2008 edition of the *Wall Street Journal*—I would ask unanimous consent that that be put in the record.

The CHAIRMAN. Without objection.

[The article appears in the appendix on p. 131.]

Senator HATCH. In that op-ed, Drs. Furman and Goolsbee stated that then-Senator Obama's tax proposal would reduce revenues to less than 18.2 percent of GDP. However, the President's 2013 budget has revenues headed up to 20.1 percent of GDP by 2022. According to CBO, revenues have averaged 17.9 percent of GDP over the last 40 years and are projected to rise to 18 percent by 2017, even if we extend all of the bipartisan tax relief of 2001 and 2003.

In other words, even if we extend all of the 2001 and 2003 tax relief, revenues are already headed higher than their historical average, according to CBO. OMB puts revenues even higher as a share of GDP from 2014 onward.

Now, I have three questions, if you could answer them. First, considering that taxes are already heading higher than where they have been historically, should we really be raising them even more as the President proposes in his budget? Secondly, has the President abandoned his position that revenues should be less than 18.2 percent of GDP in his budget? And third, is he committed to keeping the size of government permanently higher, given that spending as a share of GDP has averaged over 24 percent during the President's term, a share the size of which we have not seen since 1946, at the end of the 2nd World War, and which is projected to remain above 22 percent, which is 4 percentage points higher than when President Clinton left office?

Secretary GEITHNER. Let me start by just noting for comparison that I think, in what people refer to as the Ryan budget, the Republican budget from last year, in that budget, revenues as a share of GDP are projected to average 19 percent over the budget window.

It is not clear how they get there, but even in that context there is a recognition that revenues are going to need to be higher than their historic average, and that is principally because, Senator Hatch, of the costs produced by the fact that more Americans are retiring and becoming eligible for Medicare and Social Security.

Now, you are right, and I say it over and over again, that we believe the only way to get to a more sustainable fiscal position is to raise revenues through tax reform. We proposed, through tax reform, raising about 1 percent of GDP in additional revenues. That is just 1 percent of GDP.

Now, we do not do that because we want to do it, we do it because we see no other way to restore fiscal sustainability. One way to think about the choice is this: that is about $1.5 trillion over 10 years, 1 percent of GDP. If you do not do that and you cannot borrow the money, because we cannot go out and borrow $1.5 trillion to avoid that, then you have to find $1.5 trillion in cuts to Medicare or low-income programs or national security to achieve that.

We have looked very hard at that, as many people have, and we do not see the basis of doing that. That is why not just the Simpson-Bowles Commission, but the bipartisan Senate group, or Domenici-Rivlin, all looked at this basic challenge and said, we do not see how you get to fiscal responsibility without this balanced plan with a modest increase in revenues.

Now, you can ask the question which is, what is the best way for that to happen? Of course, we all want to make sure that happens in a way that is fair and does not hurt economic growth or incentives for investment. Again, we believe that the modest increases in the effective tax rate that would come from these reforms, they would only fall in the top 2 percent of Americans.

We think it would be better for economic growth long-term and for fairness than if those tax increases were replaced by cuts in, let us say, Medicare benefits or cuts in infrastructure investment or in education. That is the judgment we are making. Now, I know that is not universally shared, but we think the economics are quite good, quite sound, and it is a more responsible approach.

Senator HATCH. Mr. Secretary, if there are no actions by the end of this year, ordinary income and dividends will face a top tax rate of 39.6 percent, and the capital gains rate will rise to 20 percent. An additional 3.8-percent tax on unearned income of top earners is also scheduled to take effect in 2013 as part of Obamacare.

According to a recent study, if Congress does not act, the integrated tax rate on dividends would rise to 68.6 percent, and the rate on capital gains would rise to 56.7 percent. The result would be that the dividend rate would be the highest among major economies, and the capital gains rate would be the second-highest.

With the scheduled increases in taxes on capital income, with the U.S. headed towards some of the highest taxes on such income in the developed world, and with the Congressional Budget Office telling us that such taxes will prove to be a significant drag on growth, could you explain whether you believe that those high tax rates are good for the economy and our international competitiveness?

And could you also explain how the President's budget proposal, which would also significantly increase tax rates on capital income, is consistent with his objective of not returning the economy to one overly financed with debt, as his tax hikes on capital would exacerbate distortions in the tax code that favor debt financing over equity financing?

Secretary GEITHNER. That is a good and thoughtful, complicated question, so let me try to be responsive to those concerns.

Senator HATCH. All right.

Secretary GEITHNER. I think the basic choice we face is, can we restore fiscal responsibility without raising revenues through tax reform? Now, the statistics you cited are a good argument for tax reform. And, although you are right that we have proposed some specific changes you could do on top of the current tax system to raise more revenues, we think a better way to get there is though comprehensive tax reform that would lower rates and broaden the base. We think you can do that in a way that would be balanced well, these basic objectives of growth and fairness longer-term. But your concerns I understand, but they are a good argument for doing this through tax reform.

Again, I think the basic divide between us though is not really this. The basic divide between us is, can you restore fiscal responsibility and still meet our commitments to retirees and seniors, still preserve some capacity to invest in education and infrastructure and meet our national security needs, can you meet those objectives without adding any revenues, without getting any revenues out of our current tax system? We do not think you can do that. That is why we are drawn to this position reluctantly, and we think that the burden of those increased revenues can be most fairly borne by the most fortunate 2 percent of Americans.

You can say you should spread the pain more broadly, but the average American is going to bear most of the brunt of the burden of the deficit that is going to come through spending restraint.

So again, we face constraints on our resources we have not faced in generations. It is going to require us making very tough choices. But I do not see how you get there if you are unable to counter, to contemplate, and to embrace modest increases in revenues through tax reform. I just do not think it is possible.

The CHAIRMAN. Senator Bingaman?

Senator BINGAMAN. Thank you very much. Thank you for being here.

I am just trying to get my mind around the various things that you anticipate happening or are proposing ought to happen with regard to the Federal budget over the next year or two. As I understand it, the President's budget calls for a portion of the Bush tax cuts being allowed to expire, that is, the expiration of high-income tax cuts. That raises $1.433 trillion, as I understand it, over the 10-year period.

In addition to that, you are proposing—as you pointed out, that represents about 1 percent of the deficit reduction that this budget contemplates—$1 of deficit reduction for every $2.50 of spending cuts. Of the spending cuts that you are proposing, how much of that is contemplated in the sequester that has already been enacted by the Congress?

Secretary GEITHNER. What Congress did last summer was, really, two important things. They put in place very tight caps on discretionary spending, defense and non-defense, for 10 years which produced savings—CBO measured it at roughly over $1 trillion.

But then it also put in place this sequester which would provide automatic cuts of another roughly $1 trillion as a device to frankly motivate Congress, to encourage Congress to embrace a more comprehensive, balanced package of reforms.

If Congress does not act to put in place a deficit reduction plan of comparable magnitude or greater—we would propose greater—then that sequester will force deep cuts in defense and the rest of the government—very deep cuts, and really very damaging cuts. There is no reason why we should face that prospect. But the sequester was designed to encourage Congress to replace those automatic cuts with a more carefully designed substantial additional down-payment on deficit reduction.

Senator BINGAMAN. So your budget has put forward an alternative to allowing the sequester to take place, as you see it?

Secretary GEITHNER. That is right. We propose a $4-trillion plan. One trillion is already in place in the caps that were enacted last August.

Senator BINGAMAN. Right.

Secretary GEITHNER. We propose an additional $3 trillion in other reforms. Those $3 trillion, if embraced by Congress, will allow Congress to avoid the more damaging effects of the sequester.

Senator BINGAMAN. Now, you say that we are going to need to raise revenue as part of tax reform. Tax reform is not going to happen by the end of this year. It is going to happen in the next Congress, or a future Congress. So you are saying that, even after Congress does what you are suggesting on the revenue side in this budget, it should then contemplate a tax reform package that will raise revenue of about 1 percent of GDP. Is that my understanding?

Secretary GEITHNER. That is one way to think about it. There are two ways to do this. One is to say, if we are left with the current tax system, we have to find a way to generate more revenue in a way that is fair. We lay out in the budget how we would propose to do that.

We propose to do that by letting the Bush tax cuts for the top 2 percent of Americans, those marginal tax rates, go back to where they were at the end of the Clinton administration and to limit the value of deductions and exclusions for the top 2 percent of Americans. The combined effect of those two proposals would generate the roughly 1 percent of GDP in revenue.

A better way to do that is through comprehensive tax reform that would lower rates and broaden the base. If you meet the other tests we have laid out in the President's principles, you could generate a reasonable amount of revenue, allow a fair and balanced deficit reduction plan, and leave yourself with a better tax system, a more fair tax system, a more efficient tax system, probably something better for broader economic growth.

You can do it either of those two ways. But, as you point out, we have a bit of a problem now because we do not have that much time. That is why we need to have this debate now, because we have to start to do the foundation laying, the tough decision we have to make in the lame duck and beyond.

Senator BINGAMAN. One of the sort of frameworks that we all seem to have bought into around here is the notion that, at the end of this year, we ought to have the payroll tax go back to where it used to be, 6.2 percent. It seems to me that, if we are concerned about reforming the tax code, it would make a lot of sense to find a way to continue in the future, in future years, with a lower payroll tax as an incentive for more people to be hired in jobs.

I know we got ourselves into this by saying we are going to fund Social Security through a payroll tax, but, if we had another way to fund Social Security, that would allow us to cut the payroll tax permanently. I know when the President proposed his temporary cut in the payroll tax as a stimulus to the economy, a lot of the criticism was, the problem with this is not that he is proposing to cut the payroll tax, it is that it is not a permanent cut. Do you think it would make sense for us to contemplate a permanent cut in the payroll tax as part of tax reform?

Secretary GEITHNER. I do not at this point. It is an interesting idea, though. I guess it is possible, conceivably, that as part of comprehensive tax reform you could find a different mix of what we call payroll taxes today and other types of income taxes. It is possible. But I do not think that is realistic, given the other constraints we face.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Mr. Secretary, the first question I am going to ask you to respond to in writing because I want it to be longer, or whatever it takes for you to answer it. But it comes from the President's proposal for a fiscal responsibility fee. The President has been asking for this in his budget for 3 straight years, imposing a fee on TARP recipients to help recoup the cost of TARP.

When the President first proposed this in 2010 for fiscal year 2011, I asked CBO and Joint Tax to analyze who would bear the brunt of this new fee. CBO responded, "The cost of the proposed fee would ultimately be borne to varying degrees by an institution's customers and employees and investors."

So he is proposing the same thing this year, and so I would like to include in the record, Mr. Chairman, the questions I asked CBO and their responses.

The CHAIRMAN. Without objection.

[The information appears in the appendix on p. 121.]

Senator GRASSLEY. So what I would like to have you do is read that and indicate if you agree or disagree with CBO's analysis, and, particularly, if you disagree with any of CBO's responses, I would ask that you provide a detailed explanation of why you disagree. Thank you.

I would like to ask you my first question about the economic impact of tax increases. As you know, on January 1, 2013, when the tax decreases of 2001 and 2003 sunset, our Nation is going to see a $3.5-trillion tax increase. CBO estimated the economic effect of this tax increase along with a few other policies. CBO estimates that the unemployment rate at the end of 2013 could be as much as 2 percentage points higher and that growth of GDP could be 3 percentage points lower.

Mr. Bernanke came before the committee last week, and I asked him about this, and I would like to quote him: "If no action is taken on January 1, 2013, between expiration of tax cuts, sequestration, and a number of other measures, there will be a very sharp change in the fiscal stance of the Federal Government, which by itself with no compensating action would indeed slow the recovery. CBO predicts a 1.1-percent growth and an increase in unemployment in that year, and that is based entirely on their current law assumptions, so they are assuming that contraction will take place."

Mr. Secretary, do you agree with Chairman Bernanke's and CBO's assessment that the failure to prevent this tax increase will have serious negative impacts on our economy in terms of GDP growth and unemployment?

Secretary GEITHNER. Absolutely. But just one short qualification. What the President is proposing is to extend the bulk of those tax cuts that go to 98 percent of taxpayers and to let expire those that affect only the top 2 percent of Americans; in addition to that, to limit the value of deductions and exclusions they get.

The impact of that mix of tax reforms and spending would be very, very modest on growth. But you are right to point out, as the Chairman has and the CBO has, if you let all the Bush tax cuts expire and add on to that the impact of the sequester, that would be a very damaging blow to the economy.

Senator GRASSLEY. You are right to say that a modified version of the sunset would maybe help to some extent, but I think you have to take into consideration—this is my rebuttal to you—that where most of those tax increases would impact would affect small business, which creates 70 percent of the new jobs in America and about 25 percent of our employment.

My last question. The President's budget includes a number of tax increases, some of which I understand are being labeled as tax reforms. However, the President's budget does not include a comprehensive tax reform proposal. It seems that the tax increases included in the President's budget are being used to pay for more of the President's spending priorities. Could you explain how these tax increases can then also be used to offset the cost of comprehensive tax reform?

Secretary GEITHNER. I am happy to do that. Just one quick qualification. The tax proposals that are in the President's budget that would affect the top 2 percent of American taxpayers affect only a very small portion of small businesses.

Senator GRASSLEY. Yes. Three percent. But they provide 25 percent of the jobs in America.

Secretary GEITHNER. And of those small businesses that are affected, most of them, roughly half of them, earn more than a million dollars in basic taxable income. So we are not talking about tax changes that we think would have a material affect on what most people would judge as small businesses.

On your question about the President's tax proposal and the spending plans, let me put this in broader context. The President's budget proposes to save substantial amounts of money across the government. It proposes to cut spending on national security quite substantially. It proposes hundreds of billions of dollars of cuts in Medicare and Medicaid.

It proposes to shrink what people call the discretionary part of the government, meaning the whole part of the government—it is not about defense, national security, Medicare, Medicaid, or Social Security—to cut that to the smallest share of GDP since Eisenhower was President.

Now, alongside that, because we want to get our deficits down to a sustainable level, we are proposing some tax reforms that would raise revenue, that is correct. If you do not embrace those tax reforms that raise revenue, then you have to find another $1.5 trillion in cuts. You are not going to be able to find them without going right to Medicare, Medicaid, or national security.

So we do not propose this with anything but a basic view of the nature of the constraints we face and the responsibility we bear to put these deficits on a path to more sustainable—we do not do it because we think revenue increases are terrific, are great. It is best to always avoid them. It is just, we face some choices, and we do not see how you get an economy that is going to grow in the future consistent with our basic commitments on national security or to retirement health care security without this modest amount of additional revenues.

The CHAIRMAN. Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. First of all, I think that one of the critical issues facing this economy, and it has persistently, is the lack of confidence about the future and the lack of direction and certainty about various policies that are emanating from government or not emanating from Congress and the administration.

My biggest concern is that we have not created an environment of confidence, as represented in this budget here today. By all accounts, this is the worst post-recession recovery in the history of our country. We have the longest term of unemployment.

We have already increased the national debt by 44, 45 percent under this administration, and we are going on to the fourth consecutive year of historic annual deficits. So we have seen action on the spending side, yet we still have a sub-par, anemic, weak recovery. If you look to the future, as Senator Grassley indicated about the CBO projections, the fourth quarter of 2013 is a 1.1-percent economic growth projection, with 9.1 percent unemployment.

So it is not only the concerns about the facts today that are eroding the confidence of the private sector to invest and take the risk and to hire people, and hence we have this poor recovery, but it is also concerns about the future. I just do not see any certainty in the President's budget.

There is no certainty on the tax reform side, that is for sure, or on the tax code, on regulatory reform, no sustainable, credible debt reduction plan, because debt also affects the confidence of the private sector. I mean, 84 percent of small businesses have indicated the size of the national debt affects their feelings and their confidence about the future of their own business. We know what this current tax code is doing to affect the ability to create jobs.

So where is it in this budget that you would suggest that it creates certainty for the future so that the private sector would be willing to take the risk and get the kind of robust recovery that the American people deserve? In fact, I just read a study that was issued by three academics last fall, and they talked precisely about this point. They said, "A major factor behind the weak recovery and gloomy outlook is a climate of policy-induced economic uncertainty, and that U.S. policy uncertainty is at historically high levels." They went on to say, "If we had the 2006 levels of policy uncertainty, it would have yielded 2.2 million jobs over 18 months." I think the point is, there are not any policy prescriptions here, as I see it, in this budget, so uncertainty continues to reign. If there is anything that is certain about the budget, it is that there will be more uncertainty, in my view.

Secretary GEITHNER. Thank you, Senator Snowe. You will not be surprised that I disagree with your diagnosis of the problems facing the American economy. I think we disagree fundamentally on how best to solve them.

But let me cite a few things in evidence and support of the contrary argument. I know people say on your side of the aisle that what is hurting the American economy now is a set of policies from Washington—from Congress, the administration—that is hurting business and hurting business confidence.

That is a centerpiece of concerns we hear about the challenges facing the American economy. And yet, profits as a share of GDP are above the levels they were before the crisis. The profitability of industries that are in the public eye in terms of reform and regulation, like energy and health care, are very high. Levels of productivity growth have been improving through the recovery.

Investment, private investment in equipment and software, is up 30 percent. If you look at any measure of basic health of the business sector outside of construction, which is still weighed down by the crisis, the basic balance sheets of American business, levels of profitability and expected profitability are very, very strong.

The economy, though, is still suffering badly from all the aftereffects of the crisis. You can see it in the high unemployment rates, and you can see it in the high levels of poverty and the weakness in construction. Now, we have laid out—I know they are tough and they are going to be controversial, and I know you guys do not like the tax stuff in there—but we have laid out a very responsible, very tough set of fiscal reform plans. If those were embraced by the Congress tomorrow, there would be substantially more confidence around the world in the capacity of this political system in Washington, in our ability to go back to living within our means.

It would be embraced and welcomed, and you would leave people much more confident about the future of this country in terms of growth and opportunity. You were also right to emphasize, and I think Senator Hatch did this very well, if we sit here and do nothing about these long-term fiscal problems, even though interest rates are 2 percent today, over time, over the long run, that will hurt us. It will starve key things we have to do. It will hurt confidence in the country. That is a problem we are going to have to deal with. We cannot ignore that. It is why we want to start the debate now about how we lay a foundation for consensus on broader reforms.

But I do not believe there is a credible argument to make that uncertainty about our fiscal deficits or uncertainty about the design of regulation in Washington today is having a material adverse effect on the American economy today. The American economy is suffering from lots of different things. It is not suffering from that.

Again, if it were to be the case, then you would see very, very different numbers in profitability, things we can measure. This is in terms of how much they are investing. You see it in interest rates, you see it in equity prices, you see all sorts of things we can measure today.

Having said that, I agree with you that it would be better for the country for Congress to provide some certainty about how we are going to address these long-term fiscal problems, and we should begin that sooner, not later.

The CHAIRMAN. Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Secretary, thank you. Thank you for your service to our country. I just want to ask—I have heard some of my colleagues ask questions about the long range. Does anyone believe or would you say that the budget that is presented would be different if we were not facing a decade of tax cuts, largely unpaid for; two wars raging abroad in Iraq and Afghanistan, totally unpaid for; a new entitlement program in the Medicare Part D that is unpaid for; and the reality of, instead of a free market—which I am a huge supporter of—a free-for-all market in which the excesses of some entities became the collective risk of all of us as Americans? Would the budget be different if that had not been the preface which this administration was working on?

Secretary GEITHNER. Of course. When President Clinton left office in 2001, CBO projected 10 years of trillions of dollars of surpluses. When President Bush left office, CBO projected trillions and trillions of dollars of deficits. Those deficits were the result of two factors. The first factor is the one you referred to, a decision by the President and the Congress not to pay for two wars, very expensive tax cuts, and a very substantial expansion in Medicare. The deficits are also the product, though, of two recessions, a milder recession in the early part of President Bush's first term, and a terribly severe recession that began in 2007.

Now, a modest portion of our future deficit is the result of policies we proposed. Somewhere between 10 and 15 percent of the projected deficits are the result of the factors of budget proposals we have made.

Now, you are right that we would be in a much stronger position today—we would not face anything like the changes we face today on the tax side or the spending side—if we had not made those choices as a country under the previous administration on fiscal policy. We took a remarkably strong fiscal position and we jeopardized future generations of Americans by eroding those huge gains on fiscal discipline, and absolutely that puts us in a weaker position today.

Senator MENENDEZ. And one of the concerns I have, or things I applaud in listening to, certainly, the President's State of the Union speech—and I see some elements in this budget—is the effort to in-source. Now, I would like to bring your attention to something that I and members of this committee, some of the members of this committee, have that we believe can be helpful to us in this time.

A critical element of our economy is the severe downturn in the real estate market that our country faced and is still reeling from. Studies have shown that more than $1 trillion of commercial real estate loans will be maturing in just the next few years.

So some of us are concerned, just as we saw with home mortgages, if these borrowers cannot secure other funding options, equity, to replace debt, then, when the loans come due, commercial properties around the country could be in serious trouble.

In 2007, the IRS issued a ruling called Notice 2007–55 that further compounded the problem at a critical time, right when we were in the midst of this, which is why Senator Enzi and I introduced the Real Estate Investment and Jobs Act.

It is a common-sense approach that takes some modest steps to reform the Foreign Investment in Real Property Tax Act in order to reduce barriers to foreign investment that we can no longer afford. I mean, I do not think in the global economy which we live in, this makes sense in the national interests of the United States and our economy.

Can we work with you to ensure that our tax laws are not posing unnecessary barriers to much-needed investment during these challenging times, and does Treasury have any thoughts on whether the FIRPTA law may cause foreign capital to go to similar investments in other countries instead of the United States?

Secretary GEITHNER. Thank you, Senator. Let me just respond briefly, and I would be happy to respond in more detail separately. We have two objectives we have to bear in mind as we look at these kind of proposals and reforms. One is, we want to make sure that U.S. and foreign investors are really on an even playing field, are really treated equally. We do not want the system to favor foreign investors at the expense of U.S. investors, for obvious reasons.

We have to be careful, as you know, when we look at any reform, of how we are going to pay for it. If it is going to cost money, we have to figure out how we are going to pay for it. So with those two constraints, of course, we will look at any proposal and are happy to talk about it with you in more detail.

Senator MENENDEZ. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Kyl?

Senator KYL. Thank you, Mr. Chairman.

Because time is short here, let me do what some of the media people call a lightning round, if I could. I think these questions—at least some of them—can be answered yes or no.

The first has to do with fairness, which the budget talks some about. Do you think it is fair that the top 1 percent of earners in the United States pay just about 40 percent of the income taxes?

Secretary GEITHNER. I do, because I do not see how the alternatives are fair, are more fair.

Senator KYL. All right.

Do you think it is fair that—now, this was the *Wall Street Journal*'s figure in an editorial this morning, which you probably saw—the top 3 percent pay as much as the other 97 percent of taxpayers in income tax?

Secretary GEITHNER. Well, again, I do, because, again, life is about choices and alternatives. If they are not going to pay it, then you have to find the resources elsewhere in asking middle-class families to pay more or cutting the benefits to middle-class retirees.

Senator KYL. All right.

And that brings me to the third one. Is it fair that the bottom almost 50 percent pay no Federal income tax?

Secretary GEITHNER. As you know, Senator, because we talk about this a lot, I do not think that is a fair description of our current tax system. Those millions of Americans pay payroll taxes.

Senator KYL. Yes. And the payroll taxes are supposed to pay for Social Security, are they not? So there is a specific benefit allegedly resulting from the payment into the system. But the President proposes that we reduce the amount of payroll taxes paid into the system with the payroll tax holiday extension, is that not correct?

Secretary GEITHNER. Well, only temporarily. Of course, that temporary shortfall is made up by transfers which automatically happen.

Senator KYL. Right. And the 50 percent of the people who do not pay Federal income tax then are not contributing to the general revenues that are making up for the lost payroll taxes, right?

Secretary GEITHNER. Well, maybe another way to think about this is, some people say we are a large insurance company attached to an army. The biggest drivers of spending are Medicare, Social Security, Medicaid, too.

Senator KYL. That is all true. That is beside the point of my question.

Secretary GEITHNER. All Americans——

Senator KYL. I am trying to talk about fairness here. If you are going to get off on Medicare and Medicaid, maybe you could help persuade some on the other side of the aisle that addressing those entitlements would be a good way for us to help reduce our budget deficit.

Secretary GEITHNER. I agree with you that we have made unsustainable commitments in Medicare and Medicaid. We are going to have to slow the rate of growth in those commitments. The alternatives——

Senator KYL. One of the proposals in the budget, was it not, was that there be somewhat of a premium increase means-tested for Medicare Part B, and I think D. Is that correct?

Secretary GEITHNER. I think you are right. You have a modest set of changes that would in effect increase the share of those benefits paid for by the most fortunate Americans. That is correct.

Senator KYL. Right.

Let me ask you a couple of other questions to get to this question of how you do tax reform. You talked about lowering rates, broadening the base, eliminating the special privileges, and so on. The President had a good statement in the State of the Union Address. He talked about an economy where everyone gets a fair shot, does their fair share, and everyone plays by the same set of rules. That is the basic premise here.

So how does the proposal in the budget meet this test when it eliminates the manufacturing deduction for certain taxpayers, but then doubles it for certain other taxpayers but not for other manufacturing?

Secretary GEITHNER. Good question. I will be talking about this in more detail——

Senator KYL. I mean, obviously not everybody is going to be playing by the same set of rules here in terms of tax charges.

Secretary GEITHNER. A good question and a fair question. Let me say that the basic framework that we think should guide corporate tax reform—although we will say some more in the next couple of weeks—we are going to propose a broad reform that will lower rates, broaden the base, and eliminate and wipe out a very substantial fraction, dozens and dozens and dozens, of special tax preferences for businesses.

Senator KYL. While creating a whole bunch of new ones.

Secretary GEITHNER. No, no, no. While preserving a very limited number that are targeted against really one core objective, which is to make sure that we are improving incentives for designing, creating, and building stuff in the United States.

Senator KYL. All right. Now, let me just stop you there. We are talking about picking winners and losers. You would increase or create tax incentives for building advanced technology vehicles at the expense of other kinds of vehicles. I should not say at the expense of, but not for other kind of vehicles. Is that correct?

Secretary GEITHNER. Well, you are putting me in a slightly difficult position because I have said that, in the next 2 weeks, we will lay out a more comprehensive set of proposals here, and I know I will have a chance to debate those then.

But you are right to say that we are proposing to preserve a very limited number of core incentives for investment in the United States. We are doing that because we think there is a compelling economic case for doing that, and we are going to eliminate dozens and dozens of specific corporate tax preferences. We think that trade-off is a pretty good trade-off for the——

Senator KYL. We will look forward to seeing—excuse me. I just have 5 seconds left. The Treasury Department is where I get the statistic or the citation for the proposition that the people who would be hit by the so-called millionaire's surtax, according to your definition, 80 percent of them are business owners. Is that a correct statement?

Secretary GEITHNER. I will have to go back and look, but again, I want to emphasize the following. It is roughly 2 percent of taxpaying individuals and slightly higher—only a slightly higher portion of taxpaying small businesses. Now, again, if we do not do that, though, whom are you going to ask to bear the burden?

Senator KYL. All right. Are these job creators or not? Are these the people who hire other people?

Secretary GEITHNER. Another way to think about this is, look at the——

Senator KYL. Well, yes or no?

Secretary GEITHNER. Well, yes, they will apply to a small fraction of American businesses.

Senator KYL. Can I just ask you one last thing? My time is up.

Secretary GEITHNER. A small fraction.

Senator KYL. Is it true that the majority of jobs, especially coming out of a recession, are created by small businesses?

Secretary GEITHNER. You are right that small businesses create a substantial fraction of jobs. But again, we are proposing changes that affect a tiny fraction of small businesses. And look at the record of job creation by small businesses during the period. We have a recent experience with this, which is the period in the second half of the 1990s when they faced similar tax rates to what we are proposing, and the record of job creation was very, very good.

The CHAIRMAN. Senator Coburn?

Senator COBURN. Mr. Secretary, thank you for your service.

A couple of questions on your opening statement. According to the things that I have read, in your statement you talked about productivity gains and increased savings. However, the most recent data show that the productivity gains are declining, and we actually went, not negative, but we had a marked decline in the savings rate over the last 2 months. So the trend now is not as you described in terms of productivity or savings. Is that correct?

Secretary GEITHNER. You are right about the last few months. But I think if you look at the broad pattern since the recovery began, both those statements are true. That is very important because, again, we were living beyond our means, not saving enough, borrowing too much. Productivity growth in the United States throughout this recovery, in contrast to what we see in Germany, for example, has really been pretty strong, encouragingly strong.

Senator COBURN. The other thing is the assumption that you have made a couple of times in answering questions that, if we were to not get the revenue from raising rates on this 2 percent that you describe, we had no other option but to cut Medicare or those programs that benefit our retirement programs and our safety net programs. I want to challenge you on that for a minute.

The GAO, last February, released a report outlining duplication. They will issue a report at the end of this month on the second third of the Federal Government. According to my calculations for both of those, we could save $100 billion a year eliminating duplication in the Federal Government. There are no proposals in this budget to actually do that.

I am very complimentary of what now OMB Director-designate Jeff Zients has done. But there is also $100 billion in fraud in Medicare and Medicaid. That is $200 billion a year. That is $2.4 trillion. So it is not right to assume that we could not run the Federal Government more efficiently and that the only option is to raise revenues. The size of the Federal Government is twice the size it was 10 years ago.

The question that I would have for you is, does the administration not truly think, in all areas of operating the Federal Government, that we could become much more efficient, especially for example in fraud or in duplication, that we could not achieve significant savings that would go a long ways towards eliminating or lessening our budget deficit and eliminating the amount of money we are going to have to borrow to cover that?

Secretary GEITHNER. I completely agree with you, Senator, and you have shown great leadership in this area, that there is substantial unexploited room across the Federal Government to use the taxpayers' resources more wisely. I completely agree with that.

The President agrees with that. We are committed to that, and we are happy and would like nothing better to define better ways to achieve those savings, and we will keep doing that. But the reason I said what I did is partly because of the choices we saw made in what we call the Ryan budget, the budget that Republicans embraced last year, because that was a budget that showed what you have to do if you are not going to raise revenues or taxes. What that budget showed is, if you are going to reduce deficits to a level you need to without raising revenues, then you have to do very, very deep cuts in benefits in those programs.

Now, you are right, there may be more savings we can get, but I think the judgment I made is generally correct that, if you are not going to find this 1 percent of GDP in revenues, you are going to have to find it in cuts across national security, Medicare benefits, Medicaid benefits, low-income programs, and infrastructure and education type things. That will force us to contemplate cuts that we think go beyond what makes sense for the country.

Senator COBURN. Well, you are talking $150 billion a year. I am telling you, I think if you and I sat down we could find $150 billion a year that do not produce an economic multiplier greater than one, that we in fact could find efficiencies and effectiveness changes in the Federal Government that would not require us to do this.

Now, I am on record as saying we need to have tax reform, so my next and final question to you is, most people agree that if we were to lower the rates and broaden the base and significantly eliminate the $30 billion a year that the very wealthy in this country get through tax credits and breaks, that we could in fact markedly improve our economy.

So my question is, you are saying you want to build a base. Why have you not come out and said, here is what we did? Simpson-Bowles outlined that, the Gang of Six outlined that. There have been several proposals. Why not put something on the table and say, let us do this before the end of the year? Let us do major tax reform and let us make it fairer, flatter, and more effective.

Secretary GEITHNER. Good question. Maybe the most honest way to answer that is that we took a run at trying to negotiate a framework like that with the Republican leadership in the House over the course of the summer, as you know, at substantial political cost, and we found no basis for agreement on even the broad framework you said correctly was embraced by Simpson-Bowles and by the Senate bipartisan committee of Rivlin-Domenici.

Without that willingness, without that indication by Republican leadership, we are just trying to be realistic. What we are trying to do is to help make the case why reform is so important, why reform is a better way to get there than just adding more and more tax increases on the current system.

But just realistically, given the experience we had over the last year, we do not see the basis yet. Maybe it will come. I would say, without it we are not going to get the changes in health care spending that we all know are necessary because we just do not see realistically, politically, how we are going to get meaningful progress on that front without the kind of balance we need on the revenue side.

The CHAIRMAN. Senator Carper?

Senator CARPER. Thanks.

Let me just start off—Senator Coburn has raised again the idea of a grand compromise, where Democrats agree to some reforms with respect to entitlements and Republicans agree to some additional new net revenues.

I think that is—I have thought this for 18 months—what we ought to do. I think there are a number of us here, Democrat and Republican, who believe that is the right path to take and I hope we can get back on that path later, maybe later this year.

I want to thank you for your service and for the work that you are doing, not just here, but abroad and in Europe as they work through their difficulties, and hopefully towards a good end.

The administration—we had a chance to chat just a little bit before the hearing began, and I mentioned the President, under current law, has rescission powers. When the President signs an appropriations bill into law, he or she can then send a rescission message to propose to rescind or reduce spending in certain line items. Under current law, the Congress can or cannot vote on that. If they choose to ignore it, it goes away. What, historically, we have done is ignore it and those proposed rescissions go away.

In 1996, the Congress passed, and President Clinton signed, as you will recall, legislation that said the President could not only line item veto appropriations, but also entitlements and also tax measures, and that those would become effective unless two-thirds of the House and two-thirds of the Senate were to override those actions by the President.

That power is made permanent for the President in the 1996 legislation. What a number of us—Senator McCain and I, and others, including people sitting here to my right—have authored and cosponsored and have now passed in the House is legislation to say, let us try for 4 years, a 4-year test drive, to give the President the authority to go through an appropriations bill or an omnibus bill and to pick out certain line items that we would have to vote up or down on. We could vote it down with a simple majority in the Senate, 51 votes, or vote it down with a simple majority in the House, 218 votes, but we would have to vote on it. If it is defeated, then it goes away.

So we think it provides some extra accountability for the President and, frankly, for the Congress. We can try it for 4 years, see how it works. If it helps, good. Maybe we can make it better. If it does not work, then we stop doing it. So I appreciate the administration's support for this, and I just wanted to go on record for that.

I do not know if there has been any discussion here on clean energy tax policy, but I just want to mention one thing. A lot of other countries in the world derive a considerable amount of electricity from the wind. Some of that is on land, some of it is off their shores. We do not derive any electricity from the wind off of our shores, but there is a great opportunity for us to do that.

So there are some people who think that all we need to do is to extend a production tax credit, wind production tax credit, and that will help incentivize the deployment of offshore windmill farms off of Maryland, or Delaware, New Jersey, or North Carolina, all the way up to Maine. What we have learned is that the wind production tax credit does not get the job done. Nobody is going to build a windmill farm off of any of our coasts in the United States until there is an investment tax credit that will help out.

Senator Snowe and I have offered legislation that provides for an investment tax credit, a 30-percent investment tax credit, and it would inure to whomever deploys the first 3,000 megawatts of electricity that are generated off of our shores. So it is not 1 year, 2 years, 3 years, 4 years, but it would basically be first-come, first-served. If you get your windmill farm out there and producing electricity, whoever comes up with the first 3,000 megawatts, you get the tax credit.

Would you just give us some reaction to that in terms of whether that seems to make any sense, whether that is consistent with where the administration wants to go? As it turns out, the cost of that is just, I think, a couple of billion dollars a year over 10 years. It is not a heck of a lot of money because it goes away.

Secretary GEITHNER. Senator, I would be happy to talk to you in more detail about that and look at that carefully. There are different ways to do these things. But we agree that we want to make sure that we are preserving, even after comprehensive tax reform, a set of well-designed special incentives for improving, not just energy efficiency, but our use of renewable energy resources. We are absolutely supportive of that and happy to work with you on the most effective way to do that.

Senator CARPER. All right. Thanks very much.

Can you give us, lastly, just a quick update on TARP? How are we doing in terms of getting our money back with interest, without interest? Where are we losing, where are we gaining? Thank you.

Secretary GEITHNER. We are doing really exceptionally well by any measure. The CBO estimates the total costs of TARP are in the $25-billion range. My suspicion is, over time that will prove high.

Senator CARPER. It will prove what?

Secretary GEITHNER. High. I think the bank part of the program—banks have already yielded about a $20-billion return to the taxpayer, positive return to the taxpayer. We have a lot of risk still, a lot of losses in the investments we made in the automobile industry to help facilitate that restructuring, and other pockets of the programs.

But the costs are vastly lower than what people thought, hundreds and hundreds of billions of dollars lower than what people thought. We have most of that money back already, and we are on a very good path to show a very high return.

I think if you look at it across all the programs, the Feds, the FDICs, even with the cost in the GSEs alongside TARP, most independent forecasters think that the overall cost of this will be very small, a tiny fraction, for example, of what the country paid to resolve a much smaller crisis, the S&L crisis, which cost us 3.5 percent of GDP.

Senator CARPER. All right. Thanks very much.

The CHAIRMAN. Senator Kerry? Excuse me. Senator Cardin, you are next, then Senator Kerry.

Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman.

First, Secretary Geithner, let me thank you, and thank you for your presentation, thank you for your service. I agree that we need to have a balanced approach, whether it is dealing with our budget deficit, as the administration's budget deals with revenues, or spending, both of which we will have to do. It also deals with deficit reduction, but recognizing that we are in a recovery and that we need to make investments in education, job training, and infrastructure, which I agree with.

I want to concentrate, if I might, on the middle class and how important it is to grow the middle class. I look at the numbers and see a shrinking middle class and wonder where the consumers are going to be who buy the products that we want to produce.

I take a look at the administration's budget, and on the revenue side everyone talks about the revenues that it generates. Well, that is using a baseline that is current policy rather than current law. If we used current law, the revenues actually would be a lot different.

With current law, if we do not change it, the middle class is going to get socked. I mean, the tax rates will go up, and the Alternative Minimum Tax is liable to come back in. So part of the administration's budget is to concentrate, as I see it, on helping the middle class grow by using the tax code to provide some basically additional revenues in the hands of the consumers of America.

Second, we have mentioned several times education. Education is the ticket for being able to participate in the opportunities of America. Colleges are becoming out of reach, and the administration's policy, as I understand it in this budget, is not only to protect Pell grants but also to deal with the cost of college education for American families.

Could you just comment for a moment, from the administration's point of view, how important it is to help the middle class and to grow the middle class?

Secretary GEITHNER. Absolutely. I think you said it very well. Let me just highlight a few things. The basic tax framework we laid out is a very strong framework for the middle class. It protects the existing tax benefits they enjoy. It expands some for higher education, for example, to make it easier to afford a college education.

The President's budget protects and preserves basic health care retirement security for middle-class Americans. That is critically important. We are asking Americans across the economy to bear much more risk and uncertainty living in this global economy today. Providing that guarantee of protection for health care and retirement security is critically important.

The budget proposes a series of very important investments with reforms to improve the quality of education, access to training opportunities so Americans come out of college or community college with better skills, with the skills the economy most needs today. As you know, there are millions of jobs that go unfilled today because employers cannot find Americans with those skills, in engineering, for example. It is very important for us to fix that.

The infrastructure investments the President proposes are good economic strategy because they improve the competitiveness of American business, but they also have the benefit of creating substantial employment opportunities for Americans in construction who are still bearing most of the burden for the cost of the crisis.

So those are just some examples. And I think you are right, that is a good prism though which you should view all these proposals, through which you should look at these against the alternatives. This package of things is a very strong framework of programs to help improve, not just retirement security and health care security, but opportunity for middle-class Americans.

Senator CARDIN. I just want to underscore this point. If we do not help the middle-class families, the recovery is going to be much longer than we want it to be. We look at the current housing issues, which still are burdens to middle-class families. A lot have not been able to get over the fact that they now have negative value in their homes and how they are going to deal with that.

Then we look at gasoline prices that are increasing, which is having a major impact on confidence right now. Every time we go to the gasoline station, we pay another couple of dollars to fill up our tank. So all that, I think, is putting pressure on middle-class families. I would hope, as we evaluate the budget, that we use the prism of middle-income families to judge. If we do nothing, it is going to be bad for middle-income families. We need to get together and come forward with the type of framework that the President has laid out.

So, thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kerry?

Senator KERRY. Thanks, Mr. Chairman.

Mr. Secretary, thank you for the terrific job that you are doing, an important job, and particularly with respect to some of our interests in other markets on a global basis: Europe, China, elsewhere.

I think Senator Kyl was questioning you, going after the question of the impact of the tax increase on the upper-income people and small business. I would like to just give you an opportunity to be able to speak to that for a minute. What is the sort of downstream impact on small business, and what would be the impact on small business, obviously, of getting a deficit deal of reducing the cost of capital and putting America on a stronger economic track.

Secretary GEITHNER. Well, I should say by introduction, just in the category of "stay tuned," in the framework of corporate tax reform proposals that we will lay out next week, we will be very specific about what we think we can do to help protect small businesses from bearing an undue burden as we go forward.

But the tax changes we proposed, we believe, would fall appropriately and overwhelmingly on those limited number of Americans who are in the best position to bear that burden. So as I said—and we have said many, many times before, and I think Senator Grassley even used this number—it is true that they will affect a portion of small businesses, but a very, very small portion of small businesses, 2 to 3 percent, roughly, depending on how you measure it.

Many of those businesses are not small businesses in any way most humans would think about it. They include in that definition partners in a law firm or principals in a private equity or hedge fund business.

Many of those businesses may be small by some definition, but earn very substantial amounts of money. So again, we believe that we have designed these carefully to make sure the burden falls on those few people in the American economy who are in the best position to bear that burden, have benefitted most from the boom in the financial sector.

Again, we think you have to judge these by the alternative. If you do not do those proposals, do not embrace those proposals, then you are going to have to find some way to raise resources or cut benefits or spending on the rest of the American people, and we do not see any need to do that.

Senator KERRY. Now, Mr. Secretary, besides our own budget choices, and particularly the payroll tax in the next days, probably the next largest looming impact, apart from our macro deal that we need to make before the end of this year, the biggest looming question mark on our economy may well be Europe and other people.

I would like to ask you to speak to that, and specifically it is my understanding that there is something like $760 or $770 trillion worth of derivatives out there in the market. What kind of risk does that pose to us in terms of the lack of knowledge of what is out there, particularly given what is happening in Europe, in Greece, Italy, and so forth?

Secretary GEITHNER. An excellent question. So let me just start with this. Senator Snowe referred to the fact that the recovery has been moderate. Growth is only moderate, slower than the average of post-war recessions, recoveries from recessions. It is very important to understand why that is the case. Growth has averaged 2.5 percent since growth began.

Growth following a financial crisis produced by too much debt, too much building of houses, is always going to be weaker than following a typical recovery. There was no possibility that the American economy, digging out of the worst financial crisis since the Great Depression, was going to grow like we did in the average of past recoveries because, as individuals bring down their debt burdens and as you work through the huge imbalances we saw in construction, growth by definition is going to be slower than anybody would like.

But on top of those headwinds and the additional headwinds of State and local governments cutting back, we have had the combined effects on growth of higher oil prices produced by the Arab Spring, the catastrophe in Japan and Thailand later on, and the crisis in Europe.

The crisis in Europe so far has had a pretty substantial negative impact on growth here and around the world. European leaders, though, are making some progress. They have a ways to go, but they are starting to build more confidence around the world that they have a plan in place that will at least avoid the prospects of financial catastrophe in Europe.

Even though growth may be weaker and they still face years and years of difficult reforms, they seem more committed now to avoiding a catastrophe, an implosion, a blow-up in Europe that would have a very adverse impact in the United States. That is a very good thing for us because it means, even if growth in Europe is weaker than any of us would like, we are less likely to face the after-shocks of a sustained period of Europe living on the edge of crisis.

Now, the derivatives markets are still a substantial source of risk. Even with all the benefits they bring to people's capacity to hedge risk, they come with significant risk. But because we have forced U.S. financial institutions to hold much more capital against those risks, not just in derivatives but more generally, we think the American financial institution is in a much better position to withstand, not just the pressures we have seen in Europe so far, but could see from other shocks down the road.

But the risk out there still in derivatives is one reason why we want to see the reforms that Congress enacted, in Wall Street reform, allowed to take effect, and we are working very, very closely with the other regulators to bring much more transparency to those markets. Senator Cantwell has been a leader in this context, pushing for much more transparency to force much more of those markets onto standardized exchanges and clearinghouses so there is more transparency, better risk mitigation. We are making substantial progress in that direction, but we have some work to do.

Senator KERRY. Thank you very much, sir. Thanks.

The CHAIRMAN. Thank you, Senator.

Senator Schumer, do you want to——

Senator SCHUMER. I will defer. I just want to get settled.

The CHAIRMAN. Right.

Senator Wyden?

Senator WYDEN. I think Senator Cantwell is next.

The CHAIRMAN. Oh, Cantwell. I am all mixed up here.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman.

Mr. Secretary, I appreciate that the budget has tax provisions in it for the new market tax credit, the energy tax credit, and the low-income housing tax credit, all things that I think are stimulative to the economy and important for economic development.

I am curious about two aspects of that. One: things that need to be done now—I am assuming you are probably still a New York filer, but States that have income tax——

Senator SCHUMER. I hope so. [Laughter.]

Senator CANTWELL [continuing]. Have the ability to deduct their income tax from their Federal liability. States that rely primarily on a sales tax, do you believe they should have the same benefit, and do you think they should have certainty to that benefit?

Secretary GEITHNER. I understand your concern about that question; I fully understand it. I guess it is possible when Congress gets around to thinking about comprehensive individual corporate tax reform, we would have to look carefully at that stuff. But we do not have any plans to change that now, but of course we would be sensitive to your concerns and are happy to work with you on that.

Senator CANTWELL. So do you think States like Washington, Florida, and Texas deserve certainty on whether they get to deduct their sales tax from their Federal income tax? Do they deserve that certainty now?

Secretary GEITHNER. I think it would be good for Congress across the board to give not just States, but businesses and individuals, much more certainty about their tax treatment. That is one example of where certainty is good, but there are lots of others too.

Senator CANTWELL. All right. Because right now we do not have that certainty. The fact that these States basically watch other States get a deduction that is about $236 billion on the tax rolls as far as deduction, and we are talking about $16 billion here, and we cannot get certainty—it is a fairness issue.

The fact that every year we have to go through this, States like Florida, Washington, Nevada, and many others, is just—this is about tax fairness and certainty. So when you do not give the certainty as we do now, that means people are not buying automobiles, they are not making those—we have thousands, tens of thousands of people who itemize on our tax returns in the State.

Secretary GEITHNER. You make your case very well. I totally understand your concerns. I am happy to spend more time with you in digging through those.

Senator CANTWELL. Well, if the administration would just advocate for certainty on this now, that would be a huge help.

Secretary GEITHNER. I am a big fan of certainty.

Senator CANTWELL. All right.

And then on the other extenders, they have lapsed, so we are still in this period. So what is the administration doing to help us get these done now as opposed to waiting till a lame duck or next year?

Secretary GEITHNER. We are consulting very, very closely with your chairman of this committee, the ranking member, and their counterparts in the House, on how Congress is going to deal with this. Again, you are highlighting a very important question, which is, we have a tax system where we have, really, a tremendous number of temporary tax provisions, and many of them have a lot of value, a lot of justification for them, many may not anymore.

But the value of all of them is undermined by the fact that there is so much uncertainty about whether they are going to exist and be preserved, and really it is no way to run a country, to leave a country like the United States with this degree of uncertainty year by year, month by month.

It is already February 14, and, again, I think this is another good example of where it is important for Congress to—Congress may not be able to solve every problem facing the country now, but this is a pretty easy problem to solve.

Senator CANTWELL. Now?

Secretary GEITHNER. Now.

Senator CANTWELL. All right. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

First, I agree with Senator Cantwell's position on extenders. I think to let them wait means a lot of things will not happen. We know that people will not invest in, for instance, clean energy and windmills and things if they say, well, maybe in the lame duck they will do it retroactively.

I have something of great importance to New York, the mass transit deduction, which you cannot do. People are losing out on their monthly deductions right now. They have lost them for January, they will lose them for February if we cannot get it done and not have it done by March. It is only $240 million, but it equalizes.

So I hope you will heed Senator Cantwell's advice on that. I want to say first, I think the budget the President proposed is a very good budget on both the tax side and the spending side. I know there are many who say, just cut everything. That is not going to make America number one.

Deficit reduction is important, we all know that, but so is getting the economy going. To me, the number-one thing that will keep our economy number one is having the best schools in the world. If we do not have the best schools in the world, we could have a zero deficit and we will not stay number one.

So the President's much more measured approach, particularly by using some of the money returning because of Iraq and Afghanistan and putting that into the places where we need to bolster the country—infrastructure, research, education—makes eminent sense, and I think it makes eminent sense to the American people.

Many of our colleagues, they talk about, let us cut everything. But they say, when they are asked about infrastructure—some of the Tea Party people, to their credit—I have Tea Party people in New York who say to me, infrastructure is not a government function; the government should not do it. Then I ask them, so you think every highway and every bridge and every water project should be private? No, I do not mean that. But I think that debate is a good thing.

I would like to focus a little on the tax side here. Again, imposing the Buffett rule, which is the President's moniker, I guess, or he created the moniker—it is Warren Buffett's moniker—using the revenue to repeal the AMT, which is an existential threat to the middle class, is a very good thing.

It allows Warren Buffett to pay a little more in taxes and allows his secretary to get a permanent tax cut. It is a good principle; it works. We have to work the math out to see that it has some degree of balance. But there are a few misgivings I have, as you might imagine, knowing me as well as you do.

First, I think you are being a little too patient. By that, I mean the administration is characterizing many of the ideas as long-range principles for a tax code revamp that probably will not happen until the President's second term.

My view is, why wait? Why should we not be debating these issues now? I want to tell my Republican colleagues, it is my view that the Buffett rule is going to be on the floor of this Senate and we are going to debate it this year. Now, maybe the same thing will happen on the Buffett rule as happened on payroll tax: there will be such public outcry that some of our colleagues will say, well, maybe we should go along, as they just did even on the payroll tax not being paid for.

I think we should debate the issue of a surtax on the highest income people this year. We are going to put those on the floor and debate them and let our colleagues and let the American people see where our colleagues are. I am not so sure that nothing happens. So, that is one.

Step two. Your budget does not provide any specific—do you agree that it is a good idea to debate these earlier?

Secretary GEITHNER. I do. As I said before you came in, a lot of people think these debates do not matter because Congress has not been doing them this year, and I think that is not a great approach to take. We have to have this debate. We are not going to be able to delay these choices indefinitely. We have some very tough choices at the end of the year in a lame duck session. Better to debate them now.

Senator SCHUMER. Good. I agree. We might be surprised—pleasantly—about progress that we might make, and particularly as the Republican primaries end and there is a nominee. Instead of that nominee moving as far to the right as possible, they have to try to move as far to the center as possible. There is a different political climate as well.

So, the Buffett rule. You did not mention anything specific in your budget. You did not outline what kind of specific Buffett rule you would like. Do you have concerns if the Senate presses ahead with the Buffett rule? We have one person who has dropped in such a bill—I co-sponsored it—Senator Whitehouse. I am sure the chairman would have a great deal of wisdom on what to do here in the committee. Would you have any problems with us putting some specifics on the table?

Secretary GEITHNER. Well, it always depends on the specifics. But we are broadly comfortable with the approach Senator Whitehouse laid out in his proposal. Now, you can do it different ways, but we have no concerns about Congress going ahead with something in that broad neighborhood.

Senator SCHUMER. Good. All right. One final—well, my time is up. All right. Thank you. Is it all right?

The CHAIRMAN. Go ahead. Yes, go ahead.

Senator SCHUMER. All right. Just one final point. This is a place the administration and I have disagreed, and that is on $250,000 versus a million. I know the revenue concerns with $250,000. The problem is, in my State, I imagine in some others—certainly in Senator Menendez's, Senator Kerry's, Senator Cantwell's States—there are a lot of people who make above $250,000 who are not rich. Property is much more expensive, taxes higher, et cetera, et cetera, et cetera.

So, if the administration believes $250,000 is the right cut-off for capping deductions and extending the Bush tax cuts, why is it not also proposing a Buffett rule that hits on the same rung of the ladder? Why do we not just all move to the nice $1 million Buffett rule?

Secretary GEITHNER. Excellent question, well phrased. Of course, I am familiar with your views on this issue; we have talked about it a lot. But again, we are trying to balance a lot of different competing considerations, and we are trying to figure out, what is the most fair way, given the fiscal realities we face, to make sure that we can support the types of investments, benefits, we think we need. That is why we are making this choice, but of course we understand and respect your proposal.

Senator SCHUMER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator SCHUMER. And thanks to Senator Wyden for letting me go.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. It has been a long morning. I have tried to listen carefully on this comprehensive tax reform issue, and see if you can sort a little bit of this out for me, if you will. You mentioned 3 times that we ought to have comprehensive tax reform. That is a good thing.

Yet, when you look at the budget, its corporate reform is, in effect, going to come now—that is what has been announced—and individual reform would come sometime later. So corporate reform is not comprehensive, it is in effect piecemeal. If you would, start with me in terms of how your view would get the country to comprehensive tax reform, because we both agree that is what is needed, and there is bipartisan support for it.

Secretary GEITHNER. A good question. You are right to say, why not do it all at once? I think realistically that is how it is going to happen. But what we are saying is that we want to provide a little bit more detail in terms of framework for core elements of corporate at this stage.

We think that is the best way to start to get the debate going. I think you are right that, ultimately maybe, these things have to happen together. You cannot do corporate ahead of individual. There are lots of good reasons for that. You have spoken a lot about that, and you have been a big champion of comprehensive reform.

But part of what we are trying to do is to get people to think about a comprehensive approach to improving incentives for investment in the United States. We think one way to do that is to try to get discussion earlier on how to redesign the corporate tax system to support that objective. But I understand your point that, ultimately, these things have to go together.

Senator WYDEN. Let me ask one other point and then kind of get a sense of what will come next. You also talk about—I think the way you described it was—foundational principles. The foundational principles in 1986, I think, still have a lot of support up here in the Congress, bipartisan support.

The idea was to cut breaks on businesses and individuals, keep a simpler code for both individuals and businesses, and retain progressivity. What I am concerned about is that, if we are not careful, we could end up with a different foundation. In effect, you would see changes on the business side. You have correctly described, you are going to clean out these business breaks in order to reform the corporate side, but we could end up with more complexity as well.

So like the last question, how do you see us getting to the foundational principles, as you describe, that are so key and keeping them within that 1986 approach with how we are going along the lines you have described?

Secretary GEITHNER. Those are the right principles. We would very much support those. In general, you want to clean up and eliminate—reduce, scale back—a bunch of the special preferences/tax expenditures across the tax code and use those to make affordable a reduction in the overall marginal tax rates, to preserve a basic level of progressivity for obvious reasons, and to leave yourself a system that is more simple, more efficient, better for growth, easier for people to comply with. Those are the constraints we should all live with in this context.

I do not think we are going to put those at risk by showing—we have shown a lot of elements of what we think should guide the individual tax discussion, even though we have not done a comprehensive proposal. We are going to provide a comparable level of additional elements of what we think should guide the corporate proposal, but that will be guided by the nice way you framed the core objectives parameters.

Senator WYDEN. The only point I would make in terms of summing up is, the key in 1986 was of course the presidential bully pulpit, and that the executive branch, every single time out, talked about how you had to fit the pieces together. I am glad you said what you did. In the end, it is probably all going to have to come together.

But we have to get that message about 2 hours earlier, because we have been sitting here for 2 hours and hashing through all of the specifics in terms of corporate reform and how you would clean it out, and what would go first and the like. Absent somebody—particularly at 1600 Pennsylvania Avenue—with all of you who are out and about the country, it is going to be very hard to build it here.

I think we have a lot to work with. Chairman Baucus and Chairman Camp clearly want to move in this direction. But 2 hours in we finally got to a key point, which is, we are going to have to bring this together. We are going to have to bring it together around 1986 principles. I hope you and everyone in the administration will start using that bully pulpit, because that was the key in 1986.

Secretary GEITHNER. I agree with that, and I think you made the point right.

Can I just say one thing, Mr. Chairman, on this?

The CHAIRMAN. Absolutely.

Secretary GEITHNER. You know this very well, Senator, better than I do. Our challenge here is much greater than it was in 1986 because the scale of our fiscal problems is much greater, and we do not have the luxury of offering people a substantial net tax cut to individuals, or to do something that does not raise revenues overall so we can contribute to deficit reduction. We do not have that luxury now. We do not have the ability—even with all the unpleasant features of our tax code today, it is in many ways a cleaner, less—I guess I do not really want to go there.

Senator WYDEN. I do not think you would want to call this system cleaner than anything.

Secretary GEITHNER. I was going to make a point, which is that in the 1986 Act, as you know, it was possible at that point to provide individuals, at least at the first stage of that reform, a very substantial net tax cut.

Now, President Reagan, to his credit, 2 years later took back about two-thirds of that tax cut because it proved unsustainable, unaffordable. The country today, even though there is a lot of support for the President's proposals, we face I think a much more difficult political environment in the current context.

But I completely support you on the principles. These are going to have to happen together. We recognize that. I agree with you also that, when Congress is ready to move on this, we are going to have to get to looking at a much more comprehensive framework of reform.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for coming today. I appreciate your statements about support for tax reform. I think everybody here wants to get on with that issue and hopefully do something that will lower rates and broaden the base. But I just am still waiting for the White House to put forward a proposal on that.

I think that it has been said here earlier, but I think the proposals in the budget this year actually sort of take us backwards when it comes to the issue of tax reform. You have all kinds of new tax rates coming in, the proposed Buffett rule, raising dividend and capital gains tax rates. It strikes me at least that, if we are serious about tax reform, that the administration ought to put forward a plan that would actually accomplish tax reform that would allow us to move forward.

Now, there is one thing that I did want to ask you about, and that has to do with the proposal that qualified dividends be taxed at the same low rate as capital gains. That was in last year's budget. And in fact, last year I think in the 2012 budget, word-for-word, the quote was something to the effect that "taxing qualified dividends at the same low rate as capital gains for all taxpayers reduces the tax bias against equity investment and promotes a more efficient allocation of capital."

The budget this year, however, proposes to tax dividends as ordinary income, which, if you have your way, will be at a top rate of 39.6 percent. So, if you include the new 3.8-percent surtax included in the health reform, that means the top rate on dividends would be over 43 percent before you even consider that the income was already taxed at the 35-percent rate at the corporate level. The question is, is it not true that such a high tax burden on dividends is actually going to promote an inefficient allocation of capital?

Secretary GEITHNER. I do not think so. But, Senator, I would say that one way to think about this is, it helps explain why ultimately we need tax reform. As I said earlier, what we did is, we have done this to say, if you try to do a balanced deficit reduction plan and do that with a mix of spending and tax reforms and you are raising revenue on top of the current tax system, then you have to embrace a mix of things like what we proposed.

But it is a good reason to think about why it is good to do this for tax reform. Again, we expect we will get an opportunity to work with you on tax reform, particularly given the looming expiration of the Bush tax cuts at the end of this year. I think that the reason why we proposed this in the budget is just for the crude reality that we face unsustainable deficits, and we are proposing those changes in the tax treatment of dividend income for the top 2 percent of Americans.

Again, just for the top 2 percent of Americans we are proposing those, because we are also proposing very substantial cuts in defense spending, in non-defense discretionary, in Medicare and Medicaid, and other mandatory programs. To balance that out and make sure there is a bit more shared sacrifice in this context, we felt, in order to achieve a more sustainable deficit, we had to find some initial revenue.

Again, this is a very limited proposal; it affects only the top 2 percent of taxpaying Americans. We think they can handle it and the economy can afford it. But you are right to point out, the better way to get to a more sensible tax system as part of a deficit reduction plan overall is through a comprehensive tax reform process.

Senator THUNE. I mean, are you going to propose a tax reform plan at some point? Because when this was done last time in 1986, there was a proposal put forward by, at that time, the Reagan administration to reform the tax code, and it was the starting point. Congress picked that up, worked from it, and came up with the 2-rate structure that we ended up with, at least for a while.

I mean, we all say we are going to do this, but the clock is ticking. If we punt this down the road to the next Congress, who knows what the excuse will be next year for not moving forward with this? I mean, is there something that is going to be forthcoming?

Secretary GEITHNER. I agree with you. I said this earlier: better sooner than later. We cannot defer indefinitely. Even if we did not have the incentive of the expiration of the tax cuts at the end of this year, it would be a good thing to try to get moving on this now. But as you know, we spent a substantial amount of time this summer working in particular with the House Republican leadership on how to set out broad parameters for tax reform.

As you know, we were unsuccessful in that effort, and we feel like, frankly, we need to see a better, clearer recognition on the Republican side you would be willing to consider tax reform to raise revenues as part of a balanced deficit reduction plan before we think there is going to be the basis for a more serious negotiation. It is because of what we tried this summer that we decided to do some more foundation laying for tax reform rather than putting out a comprehensive tax reform plan now.

Senator THUNE. The tax rates, when they go up at the end of the year—if that happens; hopefully it will not—what does that do to economic growth?

Secretary GEITHNER. Well, as I said earlier today, and one of your colleagues said this, if you were to allow all the Bush tax cuts to expire and this sequester to hit, that would be a very damaging, adverse blow to the economy. Of course, no one is proposing that. We are proposing to extend the Bush tax cuts that go to 98 percent of Americans, to let expire those that affect only the top 2 percent of Americans.

We are proposing to limit deductions for those Americans, too. Those are pretty modest in terms of their impact on the economy, and it is because of that concern for the middle class and for the overall economy that we are not proposing to allow to expire what we call the middle-class tax cuts.

Senator THUNE. The same discussion was held 2 years ago, and at that time I think the administration concluded that raising taxes on people above $200,000 would be harmful to the economy.

Secretary GEITHNER. That is not quite——

Senator THUNE. That is why the extension was made at the time.

Secretary GEITHNER. That is not——

Senator THUNE. We are facing the same circumstances now.

Secretary GEITHNER. We may, but that is a very good point. Thank you for asking that question this way. As you know, at that point our view was, we should protect the vast bulk of Americans, 98 percent of Americans, from any increase in their tax burden. But we could afford, and the prudent thing was to allow, the tax cuts for the top 2 percent to expire.

Now, as you know, your side of the aisle would not support that. You were not willing to allow the tax cuts for the top 2 percent to expire, and the only way we were able to prevent a tax increase on 98 percent of Americans was to agree temporarily with the position you took. But the economy absolutely could have absorbed the impact of letting the tax cuts for the top 2 percent expire. It would have been a very, very modest change. Even then, with growth as modest as it is, we could have afforded the impact then.

Senator THUNE. I would just, in closing, Mr. Chairman—I see my time has expired—point out, however, that 4 out of 5 people who pay at that higher rate above the $200,000 income threshold are small business owners. I mean, people who have businesses and they have flow-through income, they are people who create jobs. I think that was a calculation that was made, not only by those of us in Congress, but also by the administration when the decision was made 2 years ago to extend all the rates.

Secretary GEITHNER. We should probably agree to a moratorium on this debate, because we do it every time I am in this room, over and over and over again. You say small businesses, and we say 2 to 3 percent. You acknowledge 2 to 3 percent. We say it is only 2 to 3 percent.

In any case, we can allow the independent arbiters to judge the impact on small business, but there is no credible argument that exists to suggest that those tax proposals we are making would affect more than that very, very small fraction of small businesses.

As you know, a large number of those firms you call small businesses are lawyers in law firms, partners in hedge funds, private equity. But we have had this debate many times, and we probably should agree to——

Senator THUNE. There are probably a lot of people up here who would not mind taxing lawyers. I am just kidding. [Laughter.]

But, no. I mean, I do think that you can argue that it is 2 to 3 percent, but it is also the people who do own the businesses and the people who are creating the jobs. Right now it strikes me, at least, that we want to have policies that encourage job creation and economic growth. I think it would be counterproductive to raise taxes on the people who are creating the jobs.

Secretary GEITHNER. Again, we share that general objective with you. The only disagreement we have is that we do not believe there is a feasible way or a fair way to restore fiscal sustainability without asking a very small fraction of the most fortunate Americans to bear a modestly higher burden for the privilege of being Americans.

The only reason we propose that is because the alternative to that, since we cannot go out and borrow $1.5 trillion to afford continuing those tax cuts, is to cut deeply into defense spending, Medicare benefits, programs for the poor, or investments in education and infrastructure.

If we thought there was a way to avoid that, we would join you in embracing that, but we just do not think the basic fiscal realities of the country give us an alternative.

Senator THUNE. And reforming entitlement programs might be a solution to that.

Secretary GEITHNER. And we are going to take a different approach to you on that, as you know. But again, I remind you that the President's budget proposes $350 billion, roughly, of savings from Medicare and Medicaid over the budget window.

Senator THUNE. Out of providers?

Secretary GEITHNER. No—substantially out of providers but not only out of providers.

Senator THUNE. Mostly.

Secretary GEITHNER. And again, not to compare or go back to history, but you could ask your staff to make the following comparison to you. Can I just make one more point? Which is, compare the level of savings from Medicare—since you guys want to be for courage on entitlements—in the President's budget over the next 10 years to those in the Republican alternative from last spring.

We are proposing tough, difficult reforms in Medicare and Medicaid in the hundreds of billions of dollars range, alongside these other cuts across government. We think to go significantly deeper than that would be unfair to middle-class retirees.

The CHAIRMAN. Thank you, Mr. Secretary, very much.

I think Senator Hatch has a follow-up question. I am going to have to leave. But I very much hope—and it will probably happen when you send up your corporate reform idea—that we have this debate that we are all talking about during the year so we do not wait until the end of the year. If we have it now, the result is going to be a lot more constructive and make a lot more sense.

But thank you very much for your testimony, and thank you very much for being so helpful and so constructive today.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

I will not keep you much longer, Mr. Secretary. I know you want to go. You wanted to go when you first got here, and I would not blame you.

Secretary GEITHNER. I would be happy to continue it.

Senator HATCH. No. Let me just say this. On Senator Kyl's question, the Joint Committee on Taxation did say that the bottom 51 percent of all households do not pay any income taxes at all. You raised the issue that they pay payroll taxes. Yes, but that is Social Security. We all do that. But about 23 million of them, according to Joint Tax, receive refundable tax credits that are more than they pay in payroll taxes. So in essence they are not really paying anything. Another 15.5 million people get refundable tax credits that are more than both what they and their employer pay in payroll taxes.

Now, I am not suggesting that we should tax the truly poor. I do not think anybody wants to do that. We want to help them. I have spent 36 years here trying to help people. But I am suggesting that we have to lift people out of the current situation where they are paying taxes, and that base needs to be spread, and there is no way we will ever get there, it seems to me, with this administration's approach. Because you want to raise taxes on the upper 2 percent, but I do not see any of that money going for deficit reduction.

Now, maybe you think it is, but I do not see any of it going for deficit reduction. I do not see us making real headway. I see us as at 100 percent of GDP in national debt. I see our spending has now gone up to over 24 percent, or something like that, of GDP, from around 18. We all know that we are spending too much. These are some of the things that are driving me bats up here.

Tell me how you are going to get the deficit down when the President comes up with all kinds of more programs to spend money on, and in the process we are not lifting the economy at all, we are making it a worse economy. I have also added to that that it is based upon low interest rates that we know are going to go up. Now, I think those are fair questions.

Secretary GEITHNER. Totally fair questions. Could I respond to those questions?

Senator HATCH. Sure. Sure.

Secretary GEITHNER. Let me just try to go through those questions. Let me just first start with the magnitude of our debt problems, because you used a bunch of numbers I want to put in perspective.

Senator HATCH. Well, tell me they are wrong.

Secretary GEITHNER. You are absolutely right that we have unsustainable deficits, and if we do not figure out a way to restore——

Senator HATCH. But where does this budget make a difference in deficits?

Secretary GEITHNER. One of the great things about our country, Senator Hatch, is that we use a neutral, independent arbiter of our policies and yours to judge their impact on the deficit. Our policies, which CBO will evaluate for you, will show, if Congress were to enact them, they would bring our deficits down from their current unsustainable levels to a level that is sustainable. We define sustainable, as most economists would, as the level—and this is the minimum you have to do—where the debt stops growing as a share of our economy.

If the Congress were to adopt these proposals, even under reasonably conservative assumptions, then our debt burden as a share of the economy—this is debt held by the public and debt net of financial assets, which is the appropriate way to measure it—will stabilize in the 70s as a percent of GDP. Now, that would be good if we were lower over time.

Senator HATCH. Are you telling me the deficit is going to go down? I do not believe that.

Secretary GEITHNER. Oh, absolutely.

Senator HATCH. You are going to have to prove that to me, because I do not believe it one bit.

Secretary GEITHNER. It depends on what Congress does, of course. In the Constitution, we can only propose and Congress has to enact. But if Congress were to enact the President's proposals——

Senator HATCH. I am talking about the President's proposals.

Secretary GEITHNER. Then they will bring the deficit down from the current level of just above 8.5 percent of GDP.

Senator HATCH. I have a lot of respect for you. I think you are a very bright man, and you have had one of the toughest jobs in history, and I acknowledge that. But I do not believe you can make that case.

Secretary GEITHNER. Oh, absolutely.

Senator HATCH. You will have to make it in writing to me.

Secretary GEITHNER. You do not have to trust our judgment because, again, the great strength of our country is that CBO can show you.

Senator HATCH. I will trust your judgment. You write it to me. You can write it——

Secretary GEITHNER. All right.

Senator HATCH [continuing]. How you think we are going to knock the deficit down with the current budget that this President has offered to us.

Secretary GEITHNER. Oh, absolutely. Absolutely it will come down dramatically over time. In fact, it will come down much faster than you think. I think what we disagree on really is whether we should cut much more quickly than we propose to cut—as I said in my opening remarks, our judgment is, that would hurt the economy quite badly——

Senator HATCH. No, I think——

Secretary GEITHNER [continuing]. Or how we do it, and the composition of it.

Senator HATCH. I would just like to lift our workers and our economy by providing more opportunity.

Secretary GEITHNER. We share that goal.

Senator HATCH. I know we do.

Secretary GEITHNER. Yes. I just want to point out one thing. You are right to say that rates are low today. Interest rates are low today.

Senator HATCH. They are not only low, they are almost nonexistent.

Secretary GEITHNER. Well, the 10-year yield of treasuries is about 2 percent.

Senator HATCH. Yes.

Secretary GEITHNER. And you are right that that is a reflection of lots of different things. But it is——

Senator HATCH. Have you factored in, if they start going up to normal rates——

Secretary GEITHNER. I am going to embrace——

Senator HATCH. Sorry. Sorry to interrupt.

Secretary GEITHNER. I am going to explain it to you. They are low in part because of the concern in Europe and because growth is not that strong anywhere. But they are also low because investors around the world judge those securities, those Treasury securities, as a relatively safe bet.

They believe that the Congress of the United States ultimately will act to restore fiscal responsibility soon enough so we can avoid the risks you and I both would worry about a lot, which is that, if Congress does not act, that over time those interest rates would rise and hurt growth. There is no risk of that. I do not see any risk of that now, but we would be better positioned to avoid that risk if Congress were to enact a sensible set of deficit reduction proposals over time.

Right now, by almost any measure you can look at about how people judge the relative security of U.S. financial assets, including Treasuries, they judge us as in a very strong position to meet our long-term fiscal challenges because they have a lot of confidence ultimately this Congress will act and come together and do some sensible things in that context. But that requires action by the Congress.

Senator HATCH. Mr. Secretary, I just have to ask a couple of other questions because of what I have heard here today. I do not agree with you on your analysis, but you have all kinds of economists working with you, and I cannot ignore the fact that you are in a position to be able to make that statement.

But why does the President want to raise taxes in any way on small businesses with unemployment at 8.3 percent? I mean, do small businesses with taxable income over $200,000 not help the unemployment situation by creating and retaining jobs?

I mean, we all know that businesses would get hit with the President's tax hikes even if their owners do not take one penny out of the business and instead plow it all back into worker salaries or into building the business. The President says small business create two-thirds of the new jobs in this country. My worry is, why does he want to take more of their money that they could use to hire more workers and retain the ones that they have?

Now, I know you are aware that 50 percent of all flow-through business income is subject to the President's proposed rate hikes. That is a fact. You seem to dismiss concerns about increasing taxes on businesses with incomes over $200,000 in taxable income, whether their owners take out any of their income at all. Now, why are you not more concerned about increasing taxes on these small businesses with jobs still as scarce as they are? And remember, this President promised unemployment would not go above 8 percent if this stimulus was enacted. It has been over 8 percent for 32 straight months now.

And let me make one last comment about this, and then of course I am glad to hear your response. I think I have been very fair to you over your tenure.

I think you are a very bright guy, and I think that you are a very smart guy and a very hard worker. I think you are very wrong on a lot of things, to be honest with you. But let me just say this. Why hammer millionaires and small business owners, who are the job creators, especially in rural America? According to CRS, 75 percent of those making $1 million or more in income are small business owners. Seventy-five percent.

Now, that group already pays plenty. Their effective tax rate is 29 percent. So they are already paying the Buffett rule, there is no doubt about it. I just have a real rough time with this. We have to keep increasing taxes, but we cannot provide any incentives to the economy, especially small businesses, that really create 70 percent of the jobs, and get us so we pull out of this so that it is more than 49 percent paying the whole freight in this country.

Secretary GEITHNER. Senator, I of course respect your views on this, and we have had a lot of conversation about this, so let me just say a few things in response. But I do not think I am going to change your mind.

Senator HATCH. We have not had too many on this one. I mean, you and I have not, I will put it that way.

Secretary GEITHNER. We have significantly reduced taxes on small businesses in the first 3 years of the President's first term. We propose in the budget additional reductions in taxes on small businesses. For example, zero capital gains on new investments in small businesses, extending very generous expensing provisions. We think those are good economic policy, given the challenges we face as a country.

Senator HATCH. I agree with that.

Secretary GEITHNER. Now, I am not a politician, but I have never met anybody in public office who ever wants to be in favor of raising any taxes on anybody. But as you know and as you have said eloquently, we face unsustainable fiscal deficits. We have to find a way to figure out how to dig our way out of that and restore some balance.

As you have heard us discuss all morning, we do not see a way to do that that is fair and consistent with our other obligations as officials without some modest increase in revenues, and we want to make sure that those revenues come from the people who are in the best position to bear that burden. These proposals will affect a very, very, very small, tiny fraction of small businesses.

Now, it does affect some small businesses, but most of those small businesses, a very substantial fraction of them, are not small by any definition, and they make substantial amounts of earnings. I think more than half make more than $1 million in taxable income after expenses.

So we do not do this with any enthusiasm. We just do it out of the recognition that we face terribly difficult fiscal challenges. We are adding substantial burdens on average Americans because of the broader cuts in spending happening across the government, across the economy.

We think, to avoid putting additional burdens on middle-class Americans, on retirees, on a defense budget that is already being cut substantially, we have to find some ways to raise some revenues sensibly through tax reform. That is why we are taking this approach. We do not do it with any enthusiasm, we just think it is better than the alternatives.

Senator HATCH. All right. I have only been here 36 years, but I have gone through it over and over where a Democratic administration has come in and said, we just need more taxes and we will cut spending. We have given them the more taxes, and the spending has never been cut.

Secretary GEITHNER. Well, again, I think this is a good debate to have. I think, again, if you look at any independent evaluation of what we have proposed on the spending side, you will see that we are proposing to cut spending by between $2.5 and $3 trillion, depending on if you include interest. Between $2.5 and $3 trillion over 10 years in spending cuts across the government, all parts of the government, including defense, with substantial savings for Medicare and Medicaid.

Now again, it is only in that context—$2.5 in spending cuts for every $1 of revenue increases—that we think a modest amount of revenue makes some sense. Again, we have to make choices. Governing is about choices, about alternatives. If we do not do that modest amount of revenues, where are we going to find the savings to make sure we can live within our means?

Now, if you are going to not find 1 percent of GDP in revenues, you are going to have to figure out a way to cut benefits, cut education, cut Medicare and Medicaid, or cut defense further.

Senator HATCH. Yes. There are no entitlement reforms being offered by this administration.

Secretary GEITHNER. But Senator——

Senator HATCH. Not a dime of it.

Secretary GEITHNER. That is not true. The budget includes $360 billion——

Senator HATCH. No restraint of growth.

Secretary GEITHNER [continuing]. In savings and reforms to Medicare and Medicaid. Compare the Medicare ones to the alternatives we have seen from your side of the aisle. You guys go much, much deeper in transforming changes to Medicare over time that we would never support, but we are trying to find responsible, sensible ways to get more savings out of the Medicare and Medicaid system because, as we all recognize, we have made unsustainable commitments in those programs.

Senator HATCH. And also in the budget you are taking credit for war reductions and a lot of other things that may or may not be real.

Secretary GEITHNER. Well, I am glad you raised that question. We are treating the overseas contingency operations—which is the budget that pays for foreign wars—more carefully and more responsibly even than the Republican budget of last year. We are treating it, like the Republicans last year, we are proposing to count those savings and allocate a substantial fraction. But we allocate the savings differently.

We are proposing to put most of it to deficit reduction, part of it to a substantial infrastructure investment program. But in general, we are being consistent with the way those things have been treated, not just in the Republican budget more recently, but in the past.

Senator HATCH. Well, let me just say this. You have a tough job, and I do not want to make it any tougher than it is. But I am really concerned because I do not think anybody up here wants to cut entitlement programs if they can avoid it. But we also know that is where we have to find savings if our kids, grandkids, and great-grandkids, in our case, want to have a future. I just do not see it in this particular budget, in the President's budget.

Look, you have a very difficult job. You work very, very hard. I do not think you get as much credit as you deserve. On the other hand, I do not agree with you. I actually think that this administration is putting us into real jeopardy. I do not blame you for that, completely. [Laughter.]

But we are going to have to get real about this.

Secretary GEITHNER. I think, Senator, we recognize that we are going to have to have pretty significant changes to the trajectory of growth in Medicare and Medicaid.

Senator HATCH. I do not see it in this budget.

Secretary GEITHNER. Well, you can ask for more. But then you have to decide how you are going to get more and how deep you are going to go in benefits.

Senator HATCH. That is what we are talking about. You are our guy.

Secretary GEITHNER. But I was going to make a slightly different point, which is that, as you know, we do not think it is realistic or fair to consider even those changes we propose on entitlement reform without changes to the tax system.

Senator HATCH. All right. Now, I agree with that.

Secretary GEITHNER. You have to do entitlement reform——

Senator HATCH. I think we do need to modify our tax system. I do not think there is any question about it. But we ought to make it so that we can create jobs and opportunities——

Secretary GEITHNER. Right.

Senator HATCH [continuing]. And magnify the small business community, which I do not think your budget does.

Secretary GEITHNER. Well, we are going to have to raise some revenues from the tax system. We cannot do it without raising revenues. So, when we talk about entitlement reform alongside tax reform, we are talking about entitlement reform that saves real money and tax reform that helps contribute to deficit reduction. We think you need both those things. We are not going to move forward on either one without the other.

Senator HATCH. Well, I think we are over-taxed now. I do not want to raise revenues. I would rather have us make the tough decisions and see what we can do to get things under control.

Now, I know you want to get down to the dinner. I have so many more questions. Very seldom am I all by myself so I can ask anything I want.

Secretary GEITHNER. Well, I will come see you. Invite me to come see you, and I will come talk to you.

Senator HATCH. All right. I will invite you to come see me. I just want you to know that you have inherited a very difficult job in one of the toughest times in history. I have respect for how hard you work. I know that you are trying to do the best you can. I would like to see you convince this President of some of the things that you and I both know he ought to be convinced of.

But in any event, I always respect people who work hard, and you are one of the hardest workers I have seen. I wish you would work a little less hard on some of these crazy ideas that this administration has. But I just want you to know that I really appreciated your testimony today. I have appreciated the amount of time you have given to this committee, and I appreciate how hard you really work.

So with that, we will let you go. I do not see anybody else. We will let you go, and thank you for taking the time. You are going to come see me, though.

Secretary GEITHNER. Thank you, sir.

Senator HATCH. And you are going to convince me about some of these things.

Secretary GEITHNER. Thank you. Thank you.

Senator HATCH. All right. Thanks so much.

With that, we will recess until further notice. Thank you.

[Whereupon, at 12:28 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Jobs, the Economy and the President's Fiscal Year 2013 Budget Proposal

Thomas Edison once said, "The value of an idea lies in the using of it."

Yesterday, President Obama issued his budget proposals for the next ten years. Treasury Secretary Tim Geithner is here to discuss them. We need to determine how to best use these ideas to create jobs, reduce the deficit and create economic growth.

The top issue facing our country – and the number one priority of this budget – is job creation. We have made real progress in our job creation efforts, the jobs picture is improving and the economy is showing promising signs of recovery.

We've added 3.7 million jobs in the last 23 months. The number of people applying for jobless benefits each week has fallen steadily. Yet there are still far too many people out of work; 12.8 million Americans are unemployed.

We need to do more to spur economic growth and help businesses create jobs. The President's budget contains critical policies to do just that, starting with the payroll tax cut.

Extending this tax cut through the end of the year will save families real money – an average of one thousand dollars. These families will spend this extra money at local businesses, pumping it through our economy.

The budget also renews unemployment benefits for workers who've lost their jobs through no fault of their own. These workers are sure to spend these benefits, which will help support and create more jobs. According to our nonpartisan scorekeeper, the Congressional Budget Office, every one dollar in unemployment benefits can generate nearly two dollars in economic growth.

Failure to extend the payroll tax cut and unemployment insurance would cost up to half a million jobs. We can't let that happen to working families or our economy.

Continuing our smart, aggressive trade policy to open new markets to America's world-class goods is also key to our competitiveness and jobs here at home. Last year, we passed three free trade agreements with Colombia, Panama and South Korea. These agreements will generate $12 billion in new U.S. exports and create tens of thousands new jobs here at home. We also extended a critical worker assistance and training program to ensure American workers have the tools they need to compete and take advantage of new trade opportunities.

This year, I am working with my colleagues and the Administration to grant permanent normal trade relations with Russia. Once we do, U.S. exports to Russia could double over the next five years. This will create more American jobs, particularly in the services, agriculture, manufacturing and high-tech sectors.

This budget would extend tax provisions that expired at the end of 2011, known as the "traditional extenders." These include deductions for college tuition and for state and local sales taxes, and they include a tax credit for research and development to encourage innovation. We should extend these tax breaks for families, individuals and businesses and do so now.

But we also need to end the cycle of year-to-year extension and uncertainty for families and businesses. We should work together to enact comprehensive tax reform. We must make our tax code fairer and more predictable.

This budget takes a step in this direction by making the 2001 and 2003 tax cuts for the middle class permanent, providing permanent estate tax relief and solving the problem of the alternative minimum tax.

We cannot stop there. Uncertainty is not the only problem with our tax system. The tax code and regulations are now as thick as a stack of a dozen bibles. We need to simplify it and close loopholes, and we must ensure that it helps businesses compete in the global economy and create jobs. I look forward to working with my colleagues and the Administration to create a better tax system that meets our 21st-century needs.

The President's budget also makes much-needed investments in America's infrastructure, which is sorely needed at a time when unemployment in the construction industry is hovering around 15 percent.

The Senate's Highway Bill has passed out of several committees – including this one – with bipartisan majorities. It will provide nearly $110 billion over two years to support road safety, mobility, interstate commerce and jobs. It's time to enact it into law.

In addition to creating jobs, the President's budget takes important steps to bring the deficit and Federal debt held by the public under control. We have already reduced Federal deficits significantly. Earlier this year we enacted the Budget Control Act of 2011, which reduced spending by $900 billion, and the health reform law provided the biggest deficit reduction in more than a decade.

Nonetheless, Federal budget deficits and debt are still too large. We must adopt policies that will stabilize debt as a percent of GDP by the latter part of the next ten years. This budget meets that test.

I look forward to continuing our work on deficit reduction and job creation in the coming years.

There is another reason that we must continue to focus on deficit reduction, along with job creation, this year: A perfect fiscal storm is waiting at the end of the year. First, the 2001, 2003 and 2010 tax cuts expire. Two days later, an automatic sequester of many Federal programs will take place, and the debt limit will need to be raised at about the same time. This is what we'll face if we do nothing to reduce deficits and control Federal debt in the coming year.

Any deficit reduction we develop must be balanced and fair. Everyone must contribute, but no one should have to make undue sacrifices. Unfortunately, one area of the budget falls short of this standard. The cuts to rural assistance programs are too deep. While we all must work together to achieve meaningful deficit reduction, we can't do this at the expense of job creation and protecting programs that folks in rural areas depend upon.

Deep cuts to agricultural programs will pull the rug out from our hard-working producers and unjustly target rural states like Montana. Rural development programs provide important economic development, infrastructure and housing resources. Cuts to these programs have a devastating effect on the economies of rural communities and paralyze our ongoing economic recovery.

We need to enact deficit reduction in a smart way. I look forward to working with my colleagues and the Administration to do so.

So let us work together to enact significant deficit reduction. Let us do so in a way that preserves and enhances our job creation efforts. Let us take these ideas and find the best way to use them.

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Statement of Secretary Timothy F. Geithner
Committee on Finance
U.S. Senate
February 14, 2012

Chairman Baucus, Ranking Member Hatch and members of the Committee, thank you for giving me 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.

Corporate Tax Reform

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.

III. 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.

SENATE COMMITTEE ON FINANCE
"The President's Fiscal Year 2013 Budget Proposal"
Hearing - February 14, 2012
Witness: Timothy Geithner, Secretary of the Treasury

QUESTIONS FOR THE RECORD

Senator Baucus

1. **Last year, I worked with Ways and Means Chairman Camp and the Administration to reauthorize Trade Adjustment Assistance (TAA). TAA helps workers, firms, ranchers, and farmers by providing the assistance they need to better compete in the global economy. I was pleased that both the TAA for Workers and the TAA for Firms programs were funded at the authorized level in the President's fiscal year 2013 budget. However, I was disappointed to see that the TAA for Farmers program was not funded. In addition, I was surprised to see a new proposal for a Universal Dislocated Worker Program, which is intended to replace TAA for Workers during fiscal year 2014. What is the Universal Dislocated Worker Program and what benefits and services will be provided to America's workers? Will these services and benefits water down what TAA-eligible workers can receive today or will this provide more workers access to TAA-level services and benefits, which have helped hundreds of thousands of American, get retrained and back into good-paying jobs? And will this be a discretionary or mandatory program?**

   A streamlined re-employment system for workers who have lost their job through no fault of their own, the Universal Displaced Worker (UDW) program would integrate the current Trade Adjustment Assistance (TAA) for workers and Workforce Investment Act (WIA) Dislocated Worker programs. UDW will provide better assistance to more people, regardless of why they became displaced.

   The UDW program would infuse $28 billion over 10 years into the workforce system, on top of the funding that would be available for TAA and the WIA Dislocated Worker program, to provide displaced workers in America with access to the training and re-employment services they need for success. Beginning in 2014, the new, streamlined program would serve as many as 1 million workers per year – more than doubling the number served through TAA and the WIA-Dislocated Worker program in the last non-recessionary year.

   Benefits available to displaced workers through UDW will include:

   - $8,000 over two years for training — significantly more than is available under the WIA Dislocated Worker program.
   - Income support of about $150-$300 for up to 78 weeks beyond Unemployment Insurance (UI) benefits — income support beyond UI is not available under the

WIA Dislocated Worker program, while TAA for Workers offers income support within the first 104 weeks of layoff and an additional period of up to 78 weeks to complete training.

- Additional services not currently available to all WIA Dislocated Worker participants:
  - Job search and relocation allowances of up to $1,250 per worker.
  - Wage insurance for up to two years for workers over 50 who have re-employment earnings of less than $50,000.
  - Guaranteed employment and case management services, to direct trainees to the most effective and proven training programs.

Under the Administration's proposal, UDW will be a *mandatory* program; it will provide a universal suite of services to a substantially larger number of unemployed workers. The UDW program design is broadly comparable to the well-regarded TAA and WIA programs. These programs have been evaluated rigorously over the years.

- Longer-term technical training programs at community colleges have been found to be cost-effective when undertaken by displaced workers who opt in at their own initiative.

Other components of the current TAA program will also be included in the UDW program, including income support for those in training (except that UDW will provide additional stipends for credit-constrained low-income workers), wage insurance for older workers who accept a new job at a lower wage, and access to One-Stop Centers providing a range of services for the unemployed and under-employed.

2. In a period of economic growth, tax revenues and decreased spending on benefits help replenish the State and Federal UI trust funds. In a recession, the UI tax revenues fall and benefit spending increases, which may lead to State UI Trust Fund insolvency. The taxable wage base currently being used has remained at $7,000 since 1983. In 1983 it represented 40 percent of the average annual wage, but today represents less than 20 percent of the average wage. 16 states index their wage bases, but currently 33 state programs have a tax base between $7,000 and $15,000. Many State Unemployment Insurance Trust Funds are insolvent because they were not adequately prepared for the most recent economic downturn. What ideas does the President's budget lay out for policies that could better prepare State Trust Funds in the future?

The President's 2013 Budget Proposal would increase the Federal Unemployment Tax Act (FUTA) taxable wage base from $7,000 to $15,000 of taxable payroll earnings in 2015, while decreasing the effective FUTA tax rate from 0.8 percent (after a proposed reenactment and extension of the FUTA surtax) to 0.37 percent. In real dollars, a Federal UI taxable wage base of $15,000 in 2015 (which would be indexed to wage growth for subsequent years) is projected to be slightly less than the $7,000 FUTA tax base established by President Reagan in 1983. The proposed reduction in the FUTA tax rate would offset the taxable wage base increase, holding Federal UI tax revenues constant. The President also proposes offering UI tax relief to employers in indebted states.[1]

These changes, if enacted, would have three important effects.

1. The UI tax burden would be more equitably distributed.
   - Currently, because the FUTA tax base is capped at a relatively low level, the Federal UI tax rate is applied to a relatively large share of low-wage workers' earnings while the share of high-wage workers' earnings subject to the FUTA tax is relatively small.
   - By law, no state may have a taxable wage base that falls below the FUTA taxable wage base without adversely affecting the availability to many employers in the State of credits against FUTA taxes for State UI tax paid by the employer. Assuming states with a low tax base did raise their UI taxable wage base, the burden of state UI tax rates would be distributed more equitably as well.
   - States would be free to offset the tax base increase in whole or in part by lowering state tax rates. However, a majority of the states need to increase state UI tax revenues in order to restore their own trust fund accounts to a positive balance and greater solvency.

2. By law, most employers in states that chose not to raise their taxable wage base to at least equal the Federal level would not be able to take full advantage of the FUTA tax credit for the employers' state UI tax payments.
   - Provided that Federal advances (loans) to a state are repaid on a timely basis, employers receive the full FUTA credits.
   - When balances in state accounts in the unemployment trust fund (UTF) are negative for an extended period, the FUTA credit is reduced, thereby increasing employer tax rates. Part of the FUTA credit goes instead toward paying down outstanding state unemployment trust fund account loans, following formulas established in law.

3. Importantly, for indebted states, the President's proposal would suspend for two years (2012 and 2013) the FUTA credit reductions that would result in employer tax rate increases, and would also suspend interest payments on state debt to the Federal UI trust fund.

   These are reasonable, sound measures designed to restore balances in state accounts in the UTF. Partly because of extremely low state account balances just prior to the recession, as of May 2, 2012, state trust funds in 25 states had outstanding loan balances from the Federal UI trust fund totaling almost $36 billion. The President's Budget includes the following projections from the Department of Labor:
   - Revenues and interest income for state UI trust fund accounts are projected to exceed outlays in FY2012 *for the first time since 2007.*

[1] *Fiscal Year 2013 Budget of the U.S.Government*, p. 146.

- State trust fund account balances, net of loans, are projected to increase by $2.9 billion in FY2012 and $4.7 billion in FY2013. Net balances are not projected to become positive again until FY2016.

States have been understandably reluctant to raise UI tax rates until recovery is firmly established. Now that confidence is returning, the President's Budget proposes appropriate measures to help put state trust fund balances on a firm footing. The UI system is widely recognized to be an important macroeconomic stabilizer. A strong UI program is in the best interests of the country. The President's Budget proposes much-needed changes that will strengthen this system.

Senator Bingaman

1. **Under current law, the Treasury Secretary is empowered to make a systemic risk determination, which then allows certain additional actions to be taken, such as the orderly liquidation of a failing financial institution. The law authorizes the Federal Reserve and FDIC to recommend to the Secretary that he make such a determination. If the Secretary makes a systemic risk determination, the law requires him to document his decision, and a GAO review of the determination is automatically triggered. (See 12 U.S.C. 5383(c)(1) and 12 U.S.C. 1823(c)(4)(G)(iii); see also 12 USC 5611(c)(1).)**

   But if the Secretary declines to make a systemic risk determination, there is no documentation requirement and no GAO review is triggered. A 2010 GAO report noted that on two occasions in 2009, the Federal Reserve and the FDIC recommended the Treasury Secretary make a systemic risk determination, but the Secretary did not do so (GAO-10-100). GAO wrote, "When a determination is not made ... Congress cannot be assured that Treasury's reasoning would be open to the same scrutiny required in connection with a formal systemic risk determination because Treasury does not have to act upon the [law's] documentation and accountability measures."

   I am concerned that there is no documentation requirement if the Secretary declines to make a systemic risk determination after receiving a recommendation from the Federal Reserve and FDIC. An event that creates systemic risk is by definition a serious matter for the economy. If the Treasury Secretary disagrees with the Board of Governors of the Federal Reserve about something this significant, it would seem sensible to require the Treasury Secretary to document why he disagrees, and to require GAO to review the decision.

   Do you agree that the Treasury Secretary should document those instances when he declines to make a systemic risk determination after receiving a recommendation from the Federal Reserve and FDIC that he make such a determination? Do you

agree that GAO should review those instances and have access to those documents? I would be interested in hearing your thoughts about this matter.

The Treasury Department is committed to principles of transparency and accountability. Accordingly, the Treasury Department, in the normal course of business, would document any decision made by the Treasury Secretary to make a systemic risk determination (or other similar determination) after receiving relevant recommendations from the Federal Reserve Board and the FDIC. These documents were provided to GAO for its 2010 report.

It is important to note that any statutorily required GAO review and report may be more informative when the Treasury Secretary makes a systemic risk determination than when the Secretary declines to do so. Documentation of an affirmative determination would provide substantial information supporting a decision to resolve a financial firm under the orderly liquidation authority of Title II of the Wall Street Reform Act, consenting to the creation of a debt guarantee program under section 1105 of the Wall Street Reform Act, or making a systemic risk determination under section 13(c)(4)(G) of the Federal Deposit Insurance Act. Nevertheless, we would anticipate that any final documents regarding a decision by the Treasury Secretary not to make a systemic risk determination would be made available to GAO at the appropriate time and in connection with a GAO review.

Senator Thune

1. **Mr. Secretary, there are reports that the Treasury Department is considering allowing Argentina to restructure its official debt through the Paris Club. As you know, the portion of this debt owed to the US government, approximately $300 million, is relatively small compared to the over $3.5 billion Argentina owes private US creditors. Indeed, studies have shown that if Argentina were to pay what it owes private Americans, the US Treasury would receive far more revenue from the taxes on those payments than it would from settling the government-to-government debt.**

   Given these facts, can you provide assurance that the Treasury Department will withhold approval of a Paris Club deal for Argentina until Argentina has satisfied all awards under the US-Argentine bilateral investment treaty and the outstanding US court judgments against it? Additionally, there are reports that Treasury appears willing to break with longstanding Paris Club practice to allow a restructuring without requiring a separate monitoring agreement with the IMF. Can you provide assurance that this is not the case and that Argentina will be held to the same standard as other nations that have restructured their debt?

   Argentina's arrears to U.S. government agencies total about $550 million, and U.S. government efforts, including in the Paris Club, are appropriately focused on recovering full payment on these loans extended on behalf of American taxpayers. Imposing additional conditions that are unrelated to the government's claims could undermine the government's recoveries, which would not be in the taxpayers' interest. Any arrangement we conclude will be in accordance with Paris Club principles and in the direct interest of U.S. taxpayers.

We are not aware of any studies that show that more than the $550 million Argentina owes the U.S. government would be collected in taxes were Argentina to pay other creditors. In any case, Administration efforts to recover on loans extended on behalf of our taxpayers in no way diminishes our urging of Argentina to resolve the claims of private American investors.

2. **In your testimony, you argued that the President's FY13 budget is more aggressive on entitlement reform in the next ten years than Representative Paul Ryan's budget is in the next ten years. As you may know, the Ryan budget focused on ensuring that individuals closest to retirement would not be affected. Do you have an estimate of how your budget curbs growth in entitlements in the second ten years compared to a similar time-window in the Ryan budget?**

   The Administration displays projections of the budgetary effects of Social Security, Medicare, and Medicaid over the next 75 years in Table 5-1 of the FY 2013 Analytical Perspectives Long Term Budget Outlook chapter. These long-turn projections come from a model that is separate from the one used to produce detailed programmatic estimates and results are not shown as effects relative to the baseline. For this reason, and because of different underlying economic assumptions, the published projections of entitlement programs in the President's Budget cannot be directly compared to those produced for Representative Ryan's plan.

<u>Senator Carper</u>

1. **Many of our energy tax incentives that need to be extended every year, or every other year, are heavily focused on renewable energy. For example, the investment tax credit (ITC) that is in place now for wind is crucial for a fledgling offshore wind industry. The ITC expires at the end of this year — well before any offshore wind project can start construction in this country. Without an ITC offshore wind extension, we may not see any offshore wind projects developed in this country for the foreseeable future.**

   However, our permanent energy tax incentives seem to be more focused on fossil fuel incentives. For example, we have several permanent tax incentives for drilling for oil — at a time when oil companies are seeing record profits and increased global demand for oil production.

   Should we prioritize our energy tax incentives to focus on start-up industries — such as offshore wind — that need the greatest investment assistance in the short-term, but will give our country energy security in the long-term? Should we consider removing some of our permanent tax credits and make some of our

renewable tax credits (like what Senator Snowe and I are trying to do for offshore wind) for a longer time?

The Administration shares your concerns regarding fossil fuel subsidies and the need for permanent incentives for renewable energy. The President's FY 2013 budget proposes to eliminate tax subsidies for fossil fuel production which would raise about $41 billion over the next ten years. In addition, the President's Framework for Business Tax Reform proposes to make the tax credit for the production of renewable electricity permanent and to make it refundable so it can benefit all businesses that qualify. This will provide a strong, consistent incentive to encourage all investments in renewable energy technologies like wind and solar.

2. **Senator Olympia Snowe and I introduced the Incentivizing Offshore Wind Power Act (S.1397) last year, which extends investment tax credits for the first 3,000 MW of offshore wind facilities placed into service. We have been told by numerous stakeholders that offshore wind investment tax credits are vital for this new clean energy technology because there is a much longer lead time for the permitting and construction of offshore wind turbines, compared to onshore wind energy. Evidently, traditional wind production tax credits will not help the offshore wind industry because of the long-term investment time. Nor will a short-term extension of the investment tax credit, as is in the President's budget, because no project in this country will be completed by 2014. I request technical assistance from your staff to review S.1397 and provide any comments on how to improve the legislation or how best incentivize this brand new industry.**

Although the credit proposed in S. 1397 is not part of the President's budget proposals, the staff of the Office of Tax Policy would be happy to provide technical assistance in the development of your tax legislation. Please have your staff contact Sandra Salstrom in our Office of Legislative Affairs at 202-622-1900 determine how that assistance can be provided.

3. **The U.S. has been a global leader in clean energy technology innovation. Unfortunately, our innovations are being mass-produced somewhere else besides this country. We design it and China builds it costing us jobs and billions in trade deficits. According to a recent Economic Policy Institute study, we import 10 clean energy technology products from China for every one product we export to China.**

In the President's budget, there is a $5 billion extension of a tax credit for qualified manufactures that wanted to refurbish, expand, or establish a facility that makes clean energy technology – commonly known as the 48C tax credit. This seems to me a smart way to continue to grow our clean energy manufacturing base so we can compete in the global clean energy market – would you agree? What else can we do to expand our clean energy manufacturing?

We agree that the section 48C program should be renewed and expanded. The $2.3 billion cap on the credit resulted in the funding of less than one-third of the technically acceptable applications that were received. Rather than turning down worthy projects that could be deployed quickly to create jobs and support economic activity, the program – which has proven successful in leveraging private investment in building and equipping factories that manufacture clean energy products in America – should be expanded. An additional $5 billion in credits would support nearly $17 billion in total capital investment, creating tens of thousands of new construction and manufacturing jobs. Because there is already an existing pipeline of potentially eligible projects and substantial interest in this area, the additional credit can be deployed quickly to create jobs and support economic activity.

The President's FY 2013 Budget includes a number of other tax proposals to expand our clean energy manufacturing sector. These include a proposal to approximately double the domestic activities production deduction for manufacturers of advanced energy property and a proposal to enhance and make permanent the research and experimentation credit. The President has also proposed to provide $2.2 billion in funding for advanced manufacturing research and development at the National Science Foundation, the Department of Defense, the Department of Energy, the Department of Commerce, and other Federal agencies.

4. **I strongly believe that our country needs to move off of foreign oil, and continue to grow our domestic sources of fuel. I have especially been interested in advanced biofuels fuels that could be "dropped-in" our current infrastructure – such as biodiesel and biobutonal. And very interested in advanced biofuels that are made from renewable sources other than the food we feed ourselves or our livestock – such as cellulosic and algae.**

   Over the past few years, the federal government has taken some encouraging steps to incentivize these types of fuels. However, I also understand the current incentives to encourage the growth of these types of advanced biofuels has not been enough. How should we structure our tax incentives so that they maximally encourage growth in the advanced biofuels industry? How could we better encourage drop-in renewable fuels like biobutonal, biodiesel and advanced fuels like algae and cellulosic?

   The President's FY 2013 budget proposes an extension of the existing tax credits for biodiesel, but the Administration also recognizes the importance of taking promising cellulosic and advanced biofuels technologies to scale. To help advance the commercialization process, the Administration has set a goal of breaking ground on at least four commercial-scale cellulosic or advanced biorefineries before the end of 2013. We have already met this goal, one year early. In addition, the President has challenged the Secretaries of Agriculture, Energy, and the Navy to investigate how they can work together to speed the development of drop-in biofuels. Competitively priced drop-in biofuels could help meet the fuel needs of the Navy, as well as the commercial aviation and shipping sectors.

<u>Senator Enzi</u>

1. **The FY 2013 budget includes a variety of proposals to eliminate any tax preferences for the oil, gas, and coal industries. Repealing those tax preferences will cost jobs in states like Wyoming where American energy is produced. Further, increasing taxes on those industries will lead to higher prices for consumers on their electricity bills and at the pump. With a weak economy and rising oil prices, does it really make sense to propose a tax increase that will make energy more expensive for all Americans?**

   The fossil fuel tax preferences the Administration proposes to repeal distort markets by encouraging inefficient investment. To the extent these subsidies crowd out investments in other energy sources, they are detrimental to long-term energy security and are also inconsistent with the Administration's policy of reducing greenhouse gas emissions and encouraging the use of renewable energy sources. And since these subsidies promote inefficient investment, they result in underinvestment in other, potentially more productive, areas of the economy.

   When considering the elimination of these subsidies the Administration carefully considered the impact that these subsidies would have on the overall economy. Our analysis indicates that changes in domestic fossil fuel production costs resulting from loss of these subsidies would have little effect on U.S. fuel prices. Regarding oil, the domestic price of oil is determined by global supply and demand because oil is an internationally traded commodity. The U.S. contribution to world oil supply is relatively small and thus any changes likely will not significantly change the world oil price, and U.S. consumers would see little impact from the removal of oil tax preferences. The subsidies for the coal and natural gas industries amount about one percent of average total revenues in these industries. As a result, the final market impact on consumption and production is likely to be very small.

2. **This is the 4th budget in which you proposed repealing incentives from the oil, natural gas, and coal industries. Since Congress has not enacted this same proposal in any other year, isn't it disingenuous to continue claiming the savings from the repeal of these incentives?**

   For the reasons set forth above, we continue to believe that the repeal of these subsidies is the correct policy approach.

3. **Does the FY 2013 budget proposed by President Obama spend more money in actual dollars in 2022 versus 2013 or does it anticipate real spending cuts?**

As a share of GDP, outlays are expected to decline from 23.3 percent in 2013 to 22.8 percent in 2022. To accomplish this, the President's FY2013 budget proposes significant spending cuts across the Budget in both discretionary and mandatory programs.

The Administration's Budget proposals bring discretionary spending as a share of the economy down from 8.7 percent in FY2011 to 5.0 percent in FY2022, the lowest level in more than 50 years. In inflation-adjusted and population-adjusted terms, this represents a drop from $1.3 trillion in 2013 to just under $0.98 trillion in 2022. The Budget Control Act, which the President signed into law in August 2011, placed caps on discretionary spending that achieves nearly $1 trillion in deficit reduction over the next 10 years. In order to meet these spending caps, the Administration combed through the Budget to identify programs that were ineffective, duplicative outdated, or of lower priority and needed to be cut or consolidated.

The Administration recognizes that savings in mandatory spending programs are also necessary to achieve fiscal sustainability in the long term. The Budget proposes $278 billion in savings over the next 10 years in mandatory programs outside of health care. Additionally, the Budget puts forth $360 billion in savings to Medicare, Medicaid, and other health programs over the next decade to make these programs more effective and efficient.

4. **Currently, the Pension Benefit Guaranty Corporation (PBGC) has a number of trust funds under the Corporation's administration. The two largest are the Trust Fund for Single Employer Plans (Single Fund) which receives assets from plans taken over by the PBGC and the Revolving Trust Fund (Revolving Fund) which receives premium monies from companies and which sends out benefit payments to beneficiaries. These trusts were created when the PBGC was a much different agency and had much less capital to invest and fewer benefits to pay out to beneficiaries. Accordingly, the Revolving Fund is backed by the Department of Treasury's General Fund to help facilitate the smooth receipt of premiums and the smooth delivery of benefits as well as to help cover any shortfall in the Revolving Trust assets to pay benefits. As a result, the PBGC's Revolving Trust is scored on the Federal Government's balance sheet. In addition, any increase in premiums paid by companies to the PBGC end up as being as scored as a "savings" to the balance sheet even though these monies are intended to pay for PBGC costs and to reduce its deficit.**

Now that the PBGC is nearly a $100 billion financial institution, should the Trust Fund structure be changed so that the Department of Treasury's General Fund is no longer the backup for the PBGC's Revolving Trust?

PBGC is a government corporation created by the Employee Retirement Income Security Act ("ERISA"). ERISA specifies that the U.S. Government does not stand behind the obligations of PBGC.

- There is no specific Treasury backup provision, general fund or otherwise, for the revolving funds or PBGC.
- Under section 4005(c) of ERISA, PBGC is authorized to issue notes or debt instruments to the Secretary of the Treasury not to exceed in aggregate $100 million.

For the past ten years PBGC has had no capital; in fact, it has more annuity liabilities than assets. PBGC single-employer and multiemployer insurance programs had a combined negative net position "deficit" of $26 billion, as of September 30, 2011. PBGC's investment assets consist of premium revenues, which are accounted for in the revolving funds and assets from trusted plans and their sponsors, which are accounted for in the trust fund.

PBGC Investments (includes cash & investment income receivables)

(Dollars in Millions)	As of September 30, 2011		
	Single-Employer Program	Multemployer Program	Total
Revolving funds (premiums)	$17,278	$1,732	$19,010
Trust fund (trusteed plans)	54,480	not applicable	54,480
Total	$71,758	$1,732	$73,490

Since 1981, the PBGC revolving funds have been "on-budget" (i.e., premium receipts into the revolving fund and disbursements for pension benefits out of the revolving funds are included in the federal budget as Federal revenue and Federal expenditures, respectively). Cash and other investments that PBGC obtains when failed DB plans are trusteed to PBGC are not scored as Federal Revenue because they are considered non-appropriated funds. Accordingly, disbursements for pension benefits out of the trust fund are not treated as Federal expenditures.

Premiums are collected by the government, for a government purpose, investments in the revolving funds are restricted to Treasury securities.

PBGC currently faces a significant negative net position "deficit" in its combined single-employer and multiemployer programs, with the expectation that its current assets will not cover expected future liabilities. The PBGC Board recognizes that the deficit of the PBGC cannot be addressed primarily through the investment policy.

In its FY 2012 and FY 2013 budget proposals, the Administration proposed a way to set premiums that would improve PBGC's ability to meet current and future commitments to retirees while at the same time encourage the preservation of better funded defined benefit pension plans. Without such action, the PBGC's deficit will increase and we may face, for the first time, the need for taxpayer funds. To avoid this outcome and to strengthen retirement security for American workers, we strongly encourage Congress to support this proposal

5. **Should increases in PBGC's premiums intended to pay down PBGC's deficit be sequestered in Federal Government's balance sheet so that these "savings" cannot be used for other purposes?**

   The Administration proposes that the increases in PBGC premiums reduce the deficit and not be used for other purposes. As noted earlier, the increase would increase the PBGC's capacity to meet its commitments without taxpayer funds.

6. **What changes can the Department of Treasury make to ensure that increased PBGC premiums be used solely to pay down PBGC's deficit or to administer benefits?**

   The Administration's PBGC premium proposal would reduce the PBGC deficit. The Secretaries of Labor (Chair), Commerce, and Treasury make up the PBGC Board of Directors (Board). The Board is responsible for establishing and overseeing the policies of PBGC. The statutory role of the PBGC Director is to manage and administer PBGC subject to policy established by the Board. The Board supports PBGC's commitments to preserve plans and protect pensioners, pay pension benefits on time and accurately to retirees and beneficiaries, and maintain high standards of stewardship and accountability. To ensure this, it is essential that PBGC does its work professionally. The Board is committed to improving PBGC management.

   The actual reduction of the PBGC deficit is independent of how premiums are scored for budget purposes. The failure of PBGC to satisfy its statutory obligations would expose $2 trillion in retirement benefits owed to 44 million workers and retirees to the risk of loss. The PBGC Board and PBGC look forward to working with Congress to strengthen the PBGC and preserve the defined benefit pension system on which so many Americans depend.

7. **In September of 2011, the Internal Revenue Service (IRS) announced a New Voluntary Worker Classification Settlement Program intended to allow companies and small businesses to reclassify independent contractors as workers without incurring penalties and fees.**

   How many businesses have gone through this settlement program?

   As of February 29, 2012, the IRS had received 395 applications: 159 had been completed (closing agreement executed and payment received), 111 were in the process of being completed (closing agreement out for signature), 112 were being processed, and 13 had been rejected or withdrawn. (The majority, if not all, of those rejected were due to the taxpayer requesting to reclassify for prior periods while the settlement program is prospective only.)

8. What information is disclosed to businesses prior to the settlement programs?

The Voluntary Worker Classification Program (VCSP) is voluntary, so businesses must opt to come in under the program. Businesses can learn more about VCSP in Announcement 2011-64, which provides information about the program, and by going to IRS.gov, which contains further information including Form 8952, Application for Voluntary Classification Settlement Program (which tracks the VCSP closing agreement) and its instructions, FAQs, and a news release.

9. Does the IRS provide information on the ramifications of reclassification of independent contractor status with respect to state tax and labor laws, federal labor laws and/or employee retirement/health laws?

Under the VCSP, the IRS does not comment on or make determinations about past periods or about other laws or issues that are outside its employment tax jurisdiction. The VCSP deals only with Federal employment taxes and is prospective only. The IRS does not share VCSP information with the states or the Department of Labor, and there are no referrals or other coordination with employee benefits issues. Under the VCSP, no determination or representations are made with respect to past periods, and coming in under the VCSP is not an admission of wrongdoing or misclassification for past periods. Under the VCSP, a taxpayer will not be audited for employment tax purposes for prior years with respect to the classification of workers. If a taxpayer's application for the VCSP is rejected, it will not automatically trigger initiation of an audit for prior periods; the taxpayer could be audited for another reason, but not as a result of applying to the VCSP.

10. If a company completes the settlement program, will the company be responsible for back pay, overtime, and/or retirement benefits for the time the new employee previously spent as an independent contractor for the company?

As noted in response to Question 9 above, there is no direct relationship between VCSP and whether a company will be responsible for back pay, overtime, and/or retirement benefits. Under the VCSP no determination or representations are made with respect to past periods, and coming in under the VCSP is not an admission of wrongdoing or misclassification for past periods.

11. If a company completes the settlement program, is the company protected from civil litigation or criminal prosecution for any labor laws or employee benefit laws for the time the new employee previously spent as an independent contractor for the company?

Under the VCSP no determination or representations are made with respect to past periods, and coming in under the VCSP is not an admission of wrongdoing or misclassification for past periods. The VCSP deals only with Federal employment taxes and is prospective only. While the IRS will not disclose information to the states or the Department of Labor , the legal exposure, if any, that a company may have under other laws is not covered by the VCSP.

12. The President's budget proposes to scale back the exclusion for deductions including monies placed into a 401(k) account to 28 percent. However, an individual who places money into a 401(k) account would be subject to immediate taxation for the monies above the 28 percent level. Then when the individual makes a distribution after age 70.5 all monies distributed are subject to pay tax. Therefore, the individual would be subject to paying taxes twice for the same monies – the first time for the amounts over the 28 percent limit and the second time for the retirement distribution.

Is it the Administration's intent to have this double taxation go into effect?

Under the proposal, the value of deductions and exclusions of the amounts that high-income individuals elect to contribute to retirement plans would, like most other deductions and exclusions, be limited. The deduction or exclusion at a 28-percent rate that would be allowed at the time of the contribution in combination with the deferral of tax on earnings, however, remains valuable to high-income taxpayers, even with no explicit adjustment for the limitation in determining the amount of tax due on distributions. For the small group of taxpayers who are affected at all by the limit, the proposed limitation generally would reduce, but not eliminate, the tax benefits received for these elective retirement savings. However, I understand your concern, and the Administration would welcome the opportunity to work with you to specify the details of how a limitation on this exclusion for high-income taxpayers should be structured.

13. Has the Administration's budget score for this provision include the double taxation of these retirement monies?

Our estimate does not assume any adjustment to basis to account for the limitation in determining the tax liability on distributions from retirement accounts funded in part by elective contributions by high-income taxpayers.

14. What would be the score without the double taxation?

We have not estimated the cost of providing an adjustment to basis to account for the limitation on the tax value of elective contributions in determining the tax liability on distributions from these accounts.

From: Senator Hatch

1. **According to a recent study, if Congress doesn't act, the integrated tax rate on dividends would rise to 68.6 percent and the rate on capital gains would rise to 56.7 percent. The result would be that the dividend rate would be the highest among major economies and the capital gains rate would be the second highest.**

   With the scheduled increases in taxes on capital income, with the U.S. headed toward some of the highest taxes on such income in the developed world, and with the Congressional Budget Office telling us that such taxes will prove to be a significant drag on growth, could you explain whether you believe that those high tax rates are good for the economy and our international competitiveness?

   Could you also explain how the President's budget proposal, which would also significantly increase tax rates on capital income, is consistent with his objective of not returning the economy to one overly-financed with debt, as his tax hikes on capital would exacerbate distortions in the tax code that favor debt financing over equity financing?

   The revenue proposals put forth by the Administration fund necessary investments in our economy and help put our fiscal situation onto a sustainable path. The benefits from these actions outweigh any modest incentive effects from reducing the preferential tax rates on capital gains and dividend income for higher income households. Similar individual tax rates on capital income were in place for much of the 1990s, a time of strong and balanced economic growth. It is also important to note that for the purpose of making international comparisons of investment incentives, it is the corporate tax rate (and other provisions in the corporate tax system that are most relevant because they affect a corporation's investment decisions (e.g., the allocation of investment across borders) and its financing decisions. The importance of investor-level taxes is less clear, because the investor may be tax exempt (such as a college endowment fund) or a foreigner subject to source-base taxation.

   That being said, these particular revenue proposals do not reduce the bias towards debt financing in the tax code. The Administration believes it is better to handle this issue in the context of overall reform of the tax system. As discussed in the recently released "Framework for Business Tax Reform," the Administration supports reform of the corporate tax system that would broaden the base and lower the statutory rate, which would directly reduce the bias towards debt financing. In addition, further steps could be taken, such as potentially placing limits on the full deductibility of interest for corporations. We look forward to working with you and your colleagues in Congress to reform our tax system in a manner that raises revenues in a fair manner and in a way that reduces the economic distortions caused by our current tax system.

2. **Housing and mortgage markets remain broken, after a full three years during which the administration had opportunities to act. Treasury and other agencies**

have instituted several housing relief programs, including HAMP; HAMP 2; HAMP 2.5; PRA; 2MP; HARP; UP; HAFA; and more.

Most of those programs have been widely seen as ineffective. And the Special Inspector General for TARP (SIGTAPR) has told Treasury several times that Treasury has not seemed to be trying very hard to achieve permanent mortgage modifications, and you often didn't even set targets to hit. It appears that you have had funds available for years to provide mortgage relief, but have not put the funds to use. One target that you did set was that HAMP would have led to up to four million mortgage modifications, but to date you are more than 75% below that target.

After three years of reportedly not trying very hard to help struggling homeowners, now, at the beginning of an election year, the administration is making fresh claims that it is serious about mortgage relief. New possibilities are being raised of thousands of dollars of mortgage relief for homeowners with FICO scores as low as 580 and loan-to-value ratios of up to 140%. The administration's recent proposals for additional mortgage relief would push even more risk into FHA, which already stands a high chance of needing a bailout in the near future (even if you account for any possible funds streaming into FHA from the recent "settlement" between major financial firms and State Attorneys General).

Please identify all of the existing federal mortgage relief programs, how long each has been in place, how much is already available in funding for each program, and what the results have been relative to targets, if any, which were set?

Please explain how existing mortgage relief programs at Treasury and those proposed by the President on page 21 of "Fiscal Year 2013: Budget of the U.S. Government" have or will identify and exclude outright speculators in housing to ensure that innocent taxpayers who played by all the rules and borrowed prudently are not bailing out those who borrowed irresponsibly to buy more house than they could afford absent upside realizations on their speculation the house price increases would persist?

Please explain why fully three years into an administration which recently adopted a "We Can't Wait" slogan there have been three years during which, according to SIGTARP reports, administration officials have waited and have not devoted adequate attention to using available resources to attain permanent mortgage modifications and to setting goals.

When the Obama Administration took office in January 2009, millions of American families could not make their monthly mortgage payments – having lost jobs or income – and were unable to sell, refinance, or find meaningful modification assistance due to a housing crisis that had been building for nearly a decade. The Administration took immediate steps to help responsible homeowners and began to establish a broad set of programs designed to stabilize the housing market and keep millions of Americans in their homes, including:

- Treasury's Mortgage-Backed Securities Purchase Program, initiated in 2008, which along with mortgage-backed securities purchases by the Federal Reserve, has helped to keep mortgage interest rates at historic lows and helped over 12 million homeowners to refinance since April 2009. This program was unwound with the sale of these securities over the year ending March 2012, resulting in total cash returns to the taxpayer of $25 billion more than the initial investment;
- The extension of the Homebuyer Tax Credit Program in November 2009 – a program originally created when Congress passed Housing Economic Recovery Act in 2008 that President Obama also expanded to assist homeowners who sought relocation after having been in their first homes for at least five years – helped over 2 million homeowners purchase homes, bolstering macroeconomic demand;
- The Home Affordable Refinance Program (HARP), initiated in March 2009, which helps underwater homeowners in Fannie Mae or Freddie Mac loans to take advantage of lower interest rates by refinancing into a more affordable mortgage – to date, more than 1 million borrowers have refinanced through HARP and in December 2011, recent changes were announced that will allow for many thousands of additional families to begin the process of refinancing;
- The Making Home Affordable (MHA) program, initiated in March 2009, which includes the Home Affordable Modification Program (HAMP) for first lien modifications and provides eligible, responsible borrowers with mortgage assistance and other alternatives to foreclosure – to date, over one million homeowners have been assisted by HAMP and the broader suite of related MHA programs; and
- HUD's Loss Mitigation Program – which includes FHA's Loss Mitigation Interventions -- that have led to more than 1.3 million FHA loss mitigation interventions since April 2009.

Before Treasury launched MHA, the mortgage industry was ill-equipped to respond to the foreclosure crisis. Their operations were focused on collecting payments on performing loans, and they did not have the systems, procedures or people to modify mortgages or otherwise help large numbers of delinquent borrowers. Borrowers had little meaningful assistance available and in fact before HAMP, borrowers who received private modifications saw a reduction in their monthly mortgage payment only 36 percent of the time.

HAMP set a new standard for homeowners struggling with underwater mortgage payments, and required servicers to establish modification programs at a time when little meaningful assistance was available. By contrast to private modifications, almost 100 percent of HAMP loan modifications have led to payment reductions and have helped increase the proportion of private modifications that reduce monthly payments to 83 percent. In addition to the more than 1.1 million families helped by HAMP modifications and other MHA assistance, the standards set by HAMP as to how to achieve sustainable modifications, as well as standards for consumer protection, have transformed the industry and helped to cause an additional 4.1 million modifications that have occurred since the program was launched. As a result, there have been more than twice as many public and proprietary modifications performed as there have been foreclosures completed.

Treasury developed standards for HAMP to ensure that responsible homeowners who meet the eligibility criteria are properly evaluated and offered meaningful modifications, or where appropriate, other alternatives to foreclosure. Treasury required servicers to increase staffing and to improve customer service through its extensive compliance program. Treasury developed a defined process for escalating homeowner complaints to be resolved promptly and fairly. And Treasury provided the most detailed public reporting on what mortgage servicers are performing, including through its quarterly Servicer Assessments for the largest servicers participating in MHA.

HAMP was designed as a "pay for success" program. Funds are only expended if homeowners receive permanent modifications and only if they continue to make their payments. Treasury developed prudent criteria and strong compliance measures to ensure that taxpayer funds are used wisely.

Treasury has given careful consideration to all of the recommendations from its oversight bodies, such as the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), of Treasury's various housing programs. We have implemented most of the recommendations made by the oversight bodies regarding our housing programs.

Over the course of the mortgage crisis, Treasury has complemented HAMP with additional programs under MHA to meet the changing economic landscape, including the Second Lien Modification Program, which provides matching second lien modifications on eligible loans where the first lien was modified under HAMP; the Home Affordable Foreclosure Alternatives Program, which supports short sales and deeds-in-lieu of foreclosures; and the Unemployment Program, which provides up to 12 months of forbearance for unemployed homeowners otherwise eligible for HAMP.

Treasury further enhanced HAMP with the Principal Reduction Alternative Program, which provides incentives to participating servicers and investors to reduce the principal for underwater borrowers who have a hardship. Treasury also agreed to support the Federal Housing Administration's (FHA) Short Refinance Program, designed to help underwater homeowners refinance into a FHA loan and reduce their negative equity.

Treasury recently announced further changes to MHA, expanding the reach of the program and providing modifications for rental properties and homeowners with reduced incomes or higher levels of secondary debt. Expanding the reach of MHA to prevent avoidable foreclosure of both owner-occupied and rental properties supports Treasury's initial goal of stabilizing the housing market. Foreclosures – regardless of property ownership – have a negative impact on neighborhoods and communities.

Vacant properties cause home prices and property tax revenues to decline at the same time that law enforcement, fire protection and neighborhood stabilization costs to local governments increase. Additionally, single family homes are an important source of affordable rental housing and foreclosure of investor-owned homes disproportionately hurts low-and moderate-income renters.

To continue providing protection against the potential misuse of taxpayer resources in light of this recent expansion, Treasury has limited the pool of additional eligible borrowers in a manner that excludes corporate investors or persons that own more than five properties. Treasury has also instituted a requirement that participating borrowers make three trial period payments before the modification becomes permanent to demonstrate that the borrower is committed to sustaining the modified mortgage.

In addition, in 2010, Treasury launched the Housing Finance Agency Innovation Fund for the Hardest Hit Markets (HHF), in February 2010, for state housing finance agencies in the nation's hardest hit markets to design innovative, locally targeted foreclosure prevention programs tailored to their local needs. States are experimenting with a number of different programs to help homeowners, including principal reduction, reinstatement, short sale/transition assistance, modification assistance, loan purchase and mortgage payment programs. Approximately 70 percent of total program funds are being targeted to help unemployed borrowers, primarily through reinstatement and programs that help homeowners pay their mortgage while looking for work.

The total number of homeowners that will be helped by all these programs is difficult to predict but we continue to see a need for assistance through the steady pace of permanent modifications, unemployment forbearance plans, refinances and short sale agreements every month.

In total, Treasury has allocated $29.9 billion to provide relief through MHA; $7.6 billion to the HHF; and $8.1 billion to the FHA's Short Refinance Program. As of January 2012, Treasury has set aside approximately $8.7 billion out of the $29.9 billion in MHA available funds for non-GSE modifications already executed, of which approximately $2.7 billion has been paid. The pay-for-success model of HAMP requires Treasury to set aside all future potential incentive payments assuming that every borrower is current for the life of their modification.

The amount of funds ultimately spent depends on the number of homeowners that receive assistance. Therefore, keeping funds available through the end of the program will allow more homeowners to be assisted. While these programs have been vital to the recovery of our economy, the Administration believes that continued relief is needed and we welcome any suggestions Congress may have to improve or expand the reach of our mortgage assistance efforts.

3. **The Disability Insurance Trust Fund, one of the funds in the Social Security System, is projected to go bankrupt in 2016. The President's budget proposes around $1 billion of additional so-called "program integrity" funds for the Disability Insurance**

program, but does not propose reforms that would ensure that disabled Americans won't face a bankrupt program in just a few years. More broadly, we know that many of our entitlement programs, including Social Security generally, are actuarially unsound and will go bankrupt without reform.

We also know that it is always best to reform unsustainable entitlement promises as soon as possible, to give those affected adequate time to adjust in terms of their lifetime savings and consumption patterns.

Why are there no proposed fundamental reforms to entitlements in the budget, including reforms to the Disability Insurance program and the Old Age and Survivors Insurance program and the Medicare Hospital Insurance Program, when we know that Trust Funds backing entitlement promises will go broke starting as early as 2016? To be clear, I do not view the President's Budget proposals to achieve $360 billion of savings in Medicare, Medicaid, and other health programs over a 10-year period to be fundamental reforms to programs that involve trillions of dollars annually.

To begin, the Administration proposes significant savings for Medicare and Medicaid in the Budget . Those savings would build on the work we have done to reduce health care costs through the Affordable Care Act.

The President's Budget acknowledges that more must be done to address entitlement spending beyond ten years; page 57 of Analytical Perspectives states:

> "Nonetheless, the Administration recognizes that there is considerable uncertainty in its long-term projections and that future challenges will require policy responses that have yet to be formulated. The projections in this chapter reflect the fact that, until these reforms are enacted, simply extending current laws and policies leaves the country with a large and growing publicly held debt. Reforms are needed to make sure that overall budgetary resources are sufficient to support future spending and that programs like Medicare Part A and Social Security, which are expected to be financed from dedicated revenue sources, remain self-sustaining. The Administration intends to work with the Congress to develop additional policies that will assure fiscal sustainability in the future."

The Administration is committed to making our entitlement programs sustainable into the foreseeable future in a way that fairly shares the sacrifice and gives Americans ample time to prepare.

As you note, to help protect the Social Security trust funds, the President's 2013 Budget requested $1 billion for SSA program integrity, including to complete over 650,000 medical Continuing Disability Reviews that make sure that DI and SSI recipients continue to meet the medical criteria for those programs. In addition, the Administration has called for Congress to reauthorize SSA's demonstration authority for the DI program. Reauthorization of this authority is overdue and would let SSA build the evidence base for future program improvements. More substantial measures will be needed to safeguard both the DI and OASI programs for the long run, however. The Administration has put forward a series of principles to guide Social Security reform and stands ready to work on a bipartisan basis to make that happen.

4. **The President wants to institute a so-called "Buffett Rule," though he doesn't spell out details. The objective, we are told, is greater equality. And we have seen repeated attempts in Congress sold under the same guise of equality to institute surtaxes on the so-called "rich" of 5.6%, or 0.5%, or 0.7%, or 3.25%, or 1.9%, or whatever tax rate it would take to implement whatever is the spending proposal of the day. None of these proposals had to do with generating equality directly through the tax code. Rather, they are tax hike proposals to fund more government spending, or permanent tax hikes to fund supposedly temporary payroll tax cuts.**

   If the administration really wants to engineer greater equality through the tax code, then any revenue from whatever is a Buffett Tax or upper-income surtax would be redistributed by lowering taxes on some other classes of taxpayers, though that is not what the proposals made thus far have sought to achieve.

   How do the President's proposed tax hikes redistribute income directly through the tax code?

   What is the ultimate objective—that is, according to whatever is your preferred measure of income equality (e.g., Gini index), what is the point at which we can say that we have attained an optimal level of fairness and equality, and who decides what the ultimate amount of fairness is?

   The "Buffett Rule" is a principle that should be observed in reforming the tax code in a comprehensive manner. It is not a specific legislative proposal and therefore we have not estimated the effect that implementing the principle would have on revenue and on the after-tax distribution of income. As you know, those impacts will depend on the other features of the reformed tax system.

   The Administration has not set a specific metric for after-tax income equality that reform must achieve. However, high-income families should not pay effective tax rates that are lower than those faced by middle-income families (which is the essence of the Buffett Rule). In addition, the reformed tax system should be at least as progressive as the tax system would be under the President's Budget proposals.

5. **The Treasury Department is responsible for U.S. currency policy. I wrote you and Ambassador Kirk last year asking for your views on S. 1619, the Currency Exchange Rate Oversight Reform Act, before the Senate debated and voted on that legislation. I am disappointed that you did not provide those views. The Administration remained silent while the Senate acted on legislation which could have a profound impact on our relationship with our second largest trading partner.**

On January 18th I wrote you again, asking a number of questions, which I hope you will answer in response to this question for the record.

First, what are the Administration's views on S. 1619?

The President has been clear that we strongly share Congress's objective of providing a level playing field with China for our workers and companies. Aspects of the pending legislation do, however, raise concerns with our international obligations; if legislation were to advance, those concerns should be addressed. For any approach to be effective, it must be consistent with our international obligations.

Second, what is the position the Obama Administration will take at an upcoming WTO seminar on the relationship between trade and currency in Geneva next month?

At the World Trade Organization seminar on March 27-28, the United States emphasized the importance of market-determined exchange rate systems, enhancing flexibility to reflect underlying economic fundamentals, and avoiding persistent exchange rate misalignments and refraining from competitive currency devaluation – which in turn will facilitate balanced international trade. When trading partners believe others are allowing their exchange rates to adjust in line with fundamentals, there is less pressure for protectionism and more support for trade liberalization. The United States also underscored that the IMF has a core mandate to exercise rigorous surveillance over its members' exchange rate policies and it must carry out this vital core mission.

Third, what are your views on proposals to include currency provisions in the Trans-Pacific Partnership negotiations and future trade agreements?

We appreciate your interest and views on potentially developing new trade disciplines in the Trans-Pacific Partnership negotiations and future trade agreements. We also have taken note of considerable stakeholder interest in this issue, and we will want to be in close contact with you as we consider possible approaches to address persistent exchange rate misalignments.

6. **In both the recent State of the Union and in the 2013 Budget, the President requests fast track authority to reorganize the government. In the 2011 State of the Union the President identified 12 agencies that deal with exports as candidates for a major government reorganization. This year's plan, apparently, combines 6 trade agencies, including USTR, into one super-trade agency.**

   I am not sure these changing reorganization plans are well thought out. Both the Chairman and I voiced serious concerns with absorbing USTR when this process began – and we were ignored. At the same time, other critical agencies seem to be left out.

   According to your own website, Treasury's Office of Trade and Investment Policy is responsible for the negotiation of trade and investment agreements, including free trade agreements and bilateral investment treaties, with the office taking either a

lead or supporting role in various facets of these negotiations; reviewing and addressing contemporary trade and financial services issues, as well as participation in the World Trade Organization.

Why should such a critical trade policy office not be part of the President's trade reorganization plan?

President Obama is committed to rethinking and reforming our government and has called on Congress to reinstate the authority that past Presidents had, for decades, to propose reorganizations of the government for expedited consideration by Congress. If Congress reinstates Presidential reorganization authority, his first focus would be to make it easier for America's businesses - which are America's job creators - to compete, export, and grow through a proposed consolidation of several agencies into one department. Treasury would work with the President's team to help develop and implement the new department with an integrated, strategic, government-wide focus to help businesses grow and thrive.

Treasury's Office of Trade and Investment Policy works to promote open trade and investment policies internationally and for the United States, functions integrally tied to the other work of the Department. Under the Trade Expansion Act of 1962, Congress established an interagency trade policy mechanism, chaired by USTR, to assist with the implementation of these responsibilities, and mandated Treasury participation in that mechanism. Treasury's Office of International Trade and Investment represents Treasury in this interagency process, works with other agencies to develop U.S. trade and investment policy, including in various bilateral and multilateral negotiations, and co-leads negotiations on financial services. Under the President's reorganization plan, USTR would continue to chair the interagency trade policy process and Treasury's Office of International Trade and Investment would continue to represent Treasury in the interagency process.

7. **The President writes in his budget that "we need an economy that is no longer burdened by years of debt." However, his budget would set in place significant and possibly world-record high, tax rates on income from capital investments. Of course, the President's proposed tax hikes would exacerbate a system already distorted by providing significant favor through the tax code for debt financing over equity financing.**

   If the President really wishes to see an economy that is no longer burdened by debt, why does he propose tax policies that would give even more favor to debt finance over equity finance, which would place many sectors of the economy even more at risk during periods of economic weakness?

   This quote by the President is in reference to the debt of the federal government. The President's revenue proposals fund necessary investments in our economy to enhance current and future growth, while setting our overall fiscal situation onto a sustainable path. This requires a balanced approach that includes increasing tax revenues above levels reflected by current policy and making significant cuts to Federal spending to put our fiscal house in order.

8. **Your testimony identifies that as a share of GDP, tax revenues from 2009 to 2011 were at their lowest since 1950. Of course, given the depth of the recession and given that government revenues come from the economy, revenues did fall, but are projected by CBO to return soon to above the historic norm as a share of GDP, even with extension of current tax rates. What you failed to identify in your testimony, though, is that federal spending as a share of GDP during that same period averaged 24.5%, a share that has not been surpassed since 1946 after the resource-intensive Second World War. Moreover, spending as a share of GDP is projected to remain elevated above historic post-war norms by over 2.5% of GDP under the President's fiscal proposals. Even well after projected recovery of the economy, fully five years from now, the President envisions a large federal spending footprint.**

   I often hear from my friends on the other side of the aisle that now is not the time to stop spending. We need to wait until later, and then we will pivot, I hear. But I see no pivot in the President's budget toward spending levels consistent with historic norms relative to GDP. Does the administration continue to believe that the federal government spending will and should forever account for over 22% of our entire GDP? If it is believed that spending should be over 22% of GDP in the long run because of aging of the baby boom generation, then: why does the budget not address other drivers of the long-term fiscal outlook like Social Security and Medicare and Medicaid by making new policy proposals (aside from the relatively small $362 billion [over a 10 year period] or so of so-called "reforms" contained in the budget); what analysis by the administration shows that the difference between the administration's desired, over 22%, spending-to-GDP ratio and the post-World War II average spending-to-GDP ratio is the difference needed to account for impending demographic dynamics?

   Outlays as a share of GDP averaged 20.2 percent from FY1960 to FY2008 (before the Great Recession hit). In the President's FY2013 Budget, outlays are scheduled to decline from a peak of 25.2 percent of GDP in FY2009 (at the height of the recession) to 22.8 percent in FY2022. Cutting spending too deeply would endanger the economy as it recovers from the worst recession since the Great Depression of the 1930s, and impede our ability to make the investments necessary for strong growth over the longer term.

   These cuts in spending, along with an increase in tax receipts moves the Budget into primary balance – the point at which the deficit is no longer adding to the national debt – in FY2018. According to the recent score of the President's Budget by the Congressional Budget Office, primary balance would be achieved two years earlier in FY2016. Primary balance is an important yardstick with which to measure to budget progress.

   In order to accomplish more on the spending side, it is necessary to find balance in the growth of mandatory/entitlement spending programs. Given demographics of an aging population, certain mandatory spending categories are projected to grow rapidly. For example, under the President's FY 2013 Budget, Social Security is projected to increase from 4.8 percent of GDP in FY 2011 to 5.3 percent by FY2022; Medicare from 3.2 percent to 3.8 percent of GDP; and Medicaid from 1.8 percent to 2.3 percent over the same interval.

The Administration also acknowledges that mandatory programs are an important area to find savings. We propose significant reductions in Medicare and Medicaid spending in the Budget. Those savings would build on the work we have done to reduce health care costs through the Affordable Care Act.

The President's Budget acknowledges that more must be done to reduce entitlement programs such as Medicare, Medicaid, and Social Security form a significant and growing portion of the Budget, increasing from 44 percent in 2011 to more than 60 percent in 2035, and that a balanced approach is critical to ensuring their long-term sustainability.

> "Reforms are needed to make sure that overall budgetary resources are sufficient to support future spending so that programs like Medicare Part A and Social Security, which are expected to be financed from dedicated revenue sources, remain self-sustaining. The Administration intends to work with the Congress to develop additional policies that will assure fiscal sustainability in the future." (Analytical Perspectives, page 57.)

9. **Moving into the President's fourth year in office, many parts of our housing and mortgage-finance sectors remain broken. The federal government has essentially taken over mortgages and housing, and there are no detailed plans from the administration of its preferred approach for how to resurrect private-sector activity. A year ago, Treasury put out a required white paper laying out three already-known possible ways to reform the mortgage giants Fannie and Freddie to begin to replace government with private flows of mortgage finance.**

   That paper has been sitting idle for a year, and the only efforts I see from the administration are efforts to further enmesh government into housing and housing finance. I see no effort and nothing in the President's budget, to plan a return of the private sector to the housing and housing finance markets. If anything, unfortunately, the President wishes to double down on the GSE model by proposing, again, an infrastructure bank that has been rejected repeatedly by Congress and would place innocent taxpayers, again, at risk of loss.

   The administration has had three years to devise a GSE reform plan. Yet there is no plan, even though you and the President know that the mortgage finance system is essentially all government and is broken. I hope that simply because it is an election year, the administration does not want to kick the can further down the road in the interest of political expedience. I also hope that the administration is very careful

about loading up the Federal Housing Administration with more risk, given that the FHA is already at high risk of needing a federal bailout given that its reserves are just a tiny fraction of the obligations that it may face.

Given the importance of the housing sector and the administration's identification of it as a sector that is holding back a stronger economic recovery, in the interest of greater certainty please identify what is the administration's specific plan to reform our mortgage finance system?

We will continue to make progress this year building the foundation for reforms to the mortgage market in the United States, including a path for winding down the GSEs. In our white paper released last February, the Administration outlined a broad strategy with several options for reforming the housing finance system. We expect to lay out more detail around approaches to reform soon.

As we made clear last year, our immediate obligation is to repair the damage caused by the crisis to homeowners, neighborhoods and the broader housing market. In early February, the President spoke about the range of tools we're utilizing to this end, including broad-based refinancing for responsible homeowners; putting forward a single set of standards to fix the mortgage servicing system; and, in conjunction with the FHFA, the conversion of foreclosed homes into rental properties.

Our plan for a more sustainable housing finance system calls for winding down the GSEs and bringing private capital back into the market to reduce the government's direct role in the housing market. We will better target our support for first-time homebuyers and low- and moderate-income Americans, including the development of affordable rental options, stronger and clearer consumer protections, and a level playing field for all institutions participating in the housing finance system. For this to happen without hurting the broader economic recovery and adding further damage to those parts of the country hardest hit by the crisis, we need to get banks and private investors to come back into the market on a larger scale. This cannot happen without more clarity on the rules that will apply. We will continue to work to provide that clarity and pull forward the prospects for broader reform.

10. **The President proposes higher taxes on domestic energy producers or, more specifically, on domestic fossil fuel production. You and others have argued that those tax hikes would do nothing to energy prices, because energy markets are vast globally. Yet, if energy prices are unaffected, it would have to be the case that any decline in domestic production of energy would be accompanied by a like increase in foreign production. How does this lead to the President's stated goal of reducing U.S. reliance on foreign sources of energy?**

When considering the elimination of these subsidies, the Administration carefully considered the impacts on the economy. The fossil fuel tax preferences the Administration proposes to repeal distort markets by encouraging inefficient investment.

To the extent these subsidies crowd out investments in other energy sources, they are detrimental to long-term energy security and are also inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy. Moreover, these inefficient subsidies also direct investment away from other, more productive, investment opportunities, putting a damper on future economic growth.

The Administration also encourages the safe development of domestic oil and gas resources. The President directed the Department of Interior to finalize a national offshore energy plan that makes 75 percent of our potential offshore resources available for development by opening new areas for drilling in the Gulf of Mexico and Alaska. Over the past few years, the United States has increased overall production of oil, reducing our dependence on foreign energy sources. The United States is the world's leading producer of natural gas. To find ways to harness this abundant supply of natural gas once it's out of the ground, the Administration has proposed new incentives for medium- and heavy-duty trucks that run on natural gas or other alternative fuels in addition to other policies such as developing transportation corridors that allow trucks fueled by liquefied natural gas to transport goods.

To further reduce our reliance on foreign oil it is also important to reduce our nation's demand for oil. The Environmental Protection Agency and the Department of Transportation have formally announced their joint proposal to set stronger fuel economy and greenhouse gas pollution standards for model year 2017-2025 passenger cars and light-duty trucks. When combined with other actions the Administration has taken to increase efficiency in the transportation sector, this announcement will save Americans $1.7 trillion, reduce oil consumption by 2.2 million barrels per day by 2025, and slash greenhouse gas emissions by 6 billion metric tons.

The President identifies his continued goal of eliminating "unwarranted tax breaks for oil companies" and argues that current law provides a number of credits and deductions that are targeted toward certain oil and gas activities. Are any of the credits or deductions that the President wishes to eliminate or curtain that are targeted toward certain oil and gas activities credits and deductions available to firms producing in any other sector of the economy? If so, which ones?

The domestic production deduction is available to manufacturers and certain other producers. The deduction for percentage depletion is available for natural resource deposits generally, and expensing of intangible drilling costs (IDCs) is also available for geothermal wells. The remaining subsidies the Administration proposes to repeal (the enhanced oil recovery credit, the marginal well credit, the deduction for tertiary injectants, and the working interest exception to the passive loss limitation) are unique to oil and gas activities.

11. Federal outlays in fiscal years 2010 and 2011 were 24.1% of GDP, and are estimated to rise to 24.3% for fiscal year 2012 by OMB, and then edge down to 23.3% in fiscal

2013. In contrast, receipts as a share of GDP are estimated by OMB to reach 17.8% by 2013, just below the long-run average, after which they rise relative to historic standards. The message is that, as the recovery progresses, federal receipts are on a path to surpass the historical average relative to GDP, while the President wishes to keep a bloated sized government above 22% of the economy in the long run.

Some people look to budget outcomes attained during the Clinton years and cite that the budget improved despite taxes having been increased. What they often fail to also observe is that while receipts as a share of GDP increased from 18% in fiscal year 1994 to 19.5% by fiscal year 2001, federal outlays as a percent of GDP fell from 21% to 18.2%. Revenues rose by 1.5% of GDP, but spending was cut by 2.8% of GDP.

President Obama's plan would put spending as a share of GDP at 4% of GDP or more above where it was at the end of the Clinton years. And, it would put receipts at around 1% higher as a percent of GDP than under Clinton.

Many of my friends on the other side of the aisle argue that we do not have a revenue problem. But all projections show revenue climbing above historic norms as the economy eventually recovers. On the spending side, however, recovery will not significantly reduce government outlays, and the President seems content to keep spending at amounts significantly above historic norms. Administration officials sometimes argue that increased outlays relative to GDP will be required given absorption of the baby boom generation into retirement.

Do you believe that the President's budget adequately acknowledges that the Nation has a spending problem and not a revenue problem over the long run? And do you believe that absorption into retirement of the baby boom generation will necessitate a federal government permanently sized at over 22% of GDP?

Comparison with Clinton era spending is, as noted in the preamble to your question, complicated by changing demographics, particularly the retirement of the baby boom generation. This cohort was in its prime productive years in the 1990s and early 2000s, contributing significantly to revenue, while using mandatory programs, which include Medicare, Medicaid, and Social Security, much less intensively than older age groups. Now that the baby boom generation is retiring, they will increasingly draw upon these mandatory programs. It is no secret that the key drivers of the long-term deficit are Medicare, Medicaid and to a lesser extent Social Security.

Table 5-1 of Analytical Perspectives for the FY2013 Budget provides evidence of this trend. It shows that overall mandatory spending was just 9.9 percent of GDP in 1990, just prior to the Clinton era; in 2010 it was 13.6 percent and by 2040 it is projected to reach 16.4 percent. Even with the Affordable Care Act (ACA) and the Budget Control Act (BCA) in place, which will help constrain deficits over the next ten years and beyond including in the area of mandatory spending, more will need to be done to address the long-term budget issues related to mandatory spending.

That said, we have already made significant progress in reducing the deficit in the medium-term. In addition to the ACA and BCA, the President's FY2013 Budget includes an additional $3 trillion in deficit reduction over the next ten years. One important yardstick in measuring progress on the deficit is the primary balance – the point at which the deficit is no longer adding to the national debt. The FY2013 Budget shows that primary balance will be achieved by 2018 (where aggregate spending less interest payments is exceeded by revenues). From FY2018 -2022, the Budget is projected to show a primary surplus equivalent to 0.4 percent of GDP.

Despite these important achievements, the Administration recognizes that more will need to be done over the long term to keep entitlement spending in balance with the economy. However, our ability to bolster economic growth and control our deficits in the long term depends in large part on the actions we take in the near term to support our economy as it continues to recover from the deepest recession since the Great Depression. The Administration's Budget includes measures to shore up the economy and provides a credible plan for long-term fiscal responsibility. The Administration looks forward to working with Congress to keep mandatory and total spending at acceptable shares of GDP.

12. Investor Warren Buffett, who the administration turns to for its formulation of tax and policy and social equality evaluation, weighed in recently with advice for investors to steer clear of currency-based investments, like U.S. Treasury securities. As Mr. Buffett says: In God We Trust may be imprinted on our currency, but the hand that activates our government's printing press has been all too human. On bonds like Treasuries, Mr. Buffett advises: Right now bonds should come with a warning label.

Mr. Buffett is advising investors to shy away from investments such as Treasury securities. Do you agree with Buffett's advice to investors not to buy what he calls "currency-based investments," like U.S. Treasury securities?

Investors purchase Treasury securities because they safe and highly liquid. As a nation, we benefit from the value that investors place on our securities, as we are able to fund ourselves at very low interest rates. This is evidenced by the fact that our interest expense as a percentage of GDP has fallen over the past several years, despite a significant increase in our borrowing needs.

As the economy improves, interest rates will likely increase. This would be a healthy development, as Treasury yields have been depressed because of concerns about the U.S. economy and financial market stress emanating from Europe. But going forward, it is important that we maintain the trust of investors, and that is why the President has put forth a balanced plan for deficit reduction.

13. Prior to last year's Strategic and Economic Dialogue, you said: The renminbi remains substantially undervalued. China needs to let the exchange rate adjust at a faster pace to correct that undervaluation.

The Financial Services Forum, a non-partisan financial and economic policy organization comprising the CEOs of 20 of the largest and most diversified financial services institutions doing business in the United States, argues that reform and modernization of China's financial system – including greater foreign participation – must remain a key area of focus if genuine progress is to be made on reducing the trade imbalance and achieving a more market-determined Chinese currency.

Unfortunately, despite your work, China still controls its closed banking system, its currency remains substantially undervalued, and China prohibits American financial services and products from competing openly and fairly.

Liberalization of China's financial and banking system is key to China adopting a free-floating Chinese currency.

What are you doing to open China's closed banking system to U.S. firms and spur financial liberalization?

We agree that financial sector reform has a critical role to play in China's economic transformation – both to support rebalancing of the economy more toward consumption, provide Chinese policymakers more tools to manage monetary policy, and create opportunities for American firms and workers. This is a common theme in our discussions with our Chinese counterparts.

As our own financial sector has stabilized since the financial crisis and since our regulatory reform path has been set with enactment of the Wall Street Reform Act, we have re-invigorated discussions with China on financial sector liberalization. This includes pressing China to fully comply with its WTO commitments on financial services, pressing China to undertake continued financial sector liberalization beyond its WTO commitments, and pushing for the dismantling of administrative barriers in China that have the effect of disadvantaging foreign financial firms.

While negotiations between two sovereign nations with diverse interests are always challenging, we have made meaningful progress on our financial reform agenda with China and will continue to push for further progress. We have engaged WTO dispute mechanisms when necessary. Under the auspices of the Strategic and Economic Dialogue, China has committed to financial sector liberalization that extends beyond its WTO agreement and we continue to push China to fully open up its financial sector to foreign competition. For example, at the most recent Strategic and Economic Dialogue, China agreed to allow a higher level of foreign investment in securities joint ventures, which goes beyond China's WTO commitments, and to also allow higher levels of investment in futures joint ventures. Finally, through our bilateral efforts our Chinese counterparts have resolved certain administrative barriers that create an un-level playing field for U.S. and other foreign financial firms. We will continue to focus on these issues..

14. In both the recent State of the Union and in the 2013 Budget, the President requests fast track authority to reorganize the government. In the 2011 State of the Union, the President identified 12 agencies that deal with exports as candidates for a major government reorganization. This year's plan, apparently, combines 6 trade agencies, including USTR, into one super-trade agency. I am not sure these changing reorganization plans are well thought out. Both the Chairman and I voiced serious concerns with absorbing USTR into a large federal bureaucracy when the Administration launched its review of possible government reorganization approaches – and we were ignored. Moreover, the fact sheet that the White House has distributed regarding its trade reorganization plan appears to leave critical trade agencies and offices out of the new super-agency.

According to Treasury Department's website, Treasury's Office of Trade and Investment Policy is responsible for the negotiation of trade and investment agreements, including free trade agreements and bilateral investment treaties, with the office taking either a lead or supporting role in various facets of these negotiations; reviewing and addressing contemporary trade and financial services issues, as well as participation in the World Trade Organization (see http://www.treasury.gov/about/organizational-structure/offices/Pages/-Trade-and-Investment-Policy.aspx). Why should such a critical trade policy office not be part of the President's trade reorganization plan and the new super-trade agency?

President Obama is committed to rethinking and reforming our government and has called on Congress to reinstate the authority that past Presidents had, for decades, to propose reorganizations of the government for expedited consideration by Congress. If Congress reinstates Presidential reorganization authority, his first focus would be to make it easier for America's businesses - which are America's job creators - to compete, export, and grow through a proposed consolidation of several agencies into one department. Treasury would work with the President's team to help develop and implement the new department with an integrated, strategic, government-wide focus to help businesses grow and thrive.

Treasury's Office of Trade and Investment Policy works to promote open trade and investment policies internationally and for the United States, functions integrally tied to the other work of the Department. Under the Trade Expansion Act of 1962, Congress established an interagency trade policy mechanism, chaired by USTR, to assist with the implementation of these responsibilities, and mandated Treasury participation in that mechanism. Treasury's Office of International Trade and Investment represents Treasury in this interagency process, works with other agencies to develop U.S. trade and investment policy, including in various bilateral and multilateral negotiations, and co-leads negotiations on financial services. Under the President's reorganization plan, USTR would continue to chair the interagency trade policy process and Treasury's Office of International Trade and Investment would continue to represent Treasury in the interagency process.

The Administration's fact sheet does, however, indicate that Treasury's Community Development Financial Institutions Fund (CDFIF) program will be absorbed into the new super-trade agency. But the mission of the CDFIF program is, according to Treasury's website, "...to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States." (see http://www.cdfifund.gov/who_we_are/about_us.asp). There does not appear to be much the CDFIF does that impacts U.S. trade policy. What is the nexus between the CDFIF program and U.S. trade or export policy? Why did the Office of Management and Budget absorb the CDFIF from Treasury into the new super-trade agency but ignore Treasury's Office of Trade and Investment?

President Obama is committed to rethinking and reforming our government and has called on Congress to reinstate the authority that past Presidents had, for decades, to propose reorganization of the government for expedited consideration by Congress. If Congress reinstates this Presidential authority, his first focus would be to make it easier for America's businesses - which are America's job creators - to compete, export and grow through a proposed consolidation of several agencies into one department.

The President's team would work with affected departments to develop and implement the new department with an integrated, strategic, government-wide focus to help businesses grow and thrive. The proposed consolidation of small business and community economic development programs, including Treasury's Community Development Financial Institutions Fund (CDFI), would enable the new Department to provide a comprehensive set of services to support small business growth. By integrating small business and economic development programs that are currently scattered across the Federal Government, customers would be better served and program effectiveness enhanced. The CDFI's mission, to promote economic growth in underserved communities and markets by supporting entrepreneurship and investment, would make it a natural fit for the new department.

Treasury's Office of Trade and Investment Policy works to promote open trade and investment policies internationally and for the United States, functions integrally tied to the other work of the Department. Under the Trade Expansion Act of 1962, Congress established an interagency trade policy mechanism, chaired by USTR, to assist with the implementation of these responsibilities, and mandated Treasury participation in that mechanism. Treasury's Office of International Trade and Investment represents Treasury in this interagency process, works with other agencies to develop U.S. trade and investment policy, including in various bilateral and multilateral negotiations, and co-leads negotiations on financial services. Under the President's reorganization plan, USTR would continue to chair the interagency trade policy process and Treasury's Office of International Trade and Investment would continue to represent Treasury in the interagency process.

15. A series of disturbing developments continue to unfold in Argentina harming American business and economic interests. Many commentators and companies have noted that Argentina has taken a variety of WTO-illegal measures designed to block U.S. imports, and that Argentina is the first country ever to ignore international arbitral awards against it. The Administration must not allow such flagrant violations of Argentina's commitments and international obligations to continue without a sufficient response. Otherwise, the Administration's repeated promises regarding its commitment to trade enforcement account for little more than empty rhetoric.

I understand that the Treasury Department is considering agreeing to a restructuring of Argentina's debt in the Paris Club. In particular, there are rumors that Treasury appears willing to break with the longstanding Paris Club practice of requiring a separate monitoring agreement with the IMF before moving forward with a debt restructuring for a country. Please clarify Treasury's position on this matter regarding Argentina. Will Treasury agree to restructure Argentina's debt without an IMF agreement in the face of Argentina refusal to live up to its commitments to the detriment of American business and economic interests? What steps has Treasury and the Administration taken to ensure that Argentina lives up to its trade and investment commitments?

Treasury and the Administration are very concerned about Argentina's actions. We have made clear to the Argentines that we expect them to uphold their international obligations.

Argentina's arrears to U.S. government agencies total about $550 million, and U.S. government efforts, including in the Paris Club, are appropriately focused on recovering full payment on these loans extended on behalf of American taxpayers. Imposing additional conditions that are unrelated to the government's claims could undermine the government's recoveries, which would not be in the taxpayers' interest. Any arrangement we conclude will be in accordance with Paris Club principles and in the direct interest of U.S. taxpayers.

We are not aware of any studies that show that more than the $550 million Argentina owes the U.S. government would be collected in taxes were Argentina to pay other creditors. In any case, Administration efforts to recover on loans extended on behalf of our taxpayers in no way diminishes our urging of Argentina to resolve the claims of private American investors.

The United States also has raised the issue of non-payment of final arbitral awards with Argentina at high levels on many occasions over the past several years. On March 26, 2012, the President announced that he was suspending Argentina's eligibility for Generalized System of Preferences (GSP) benefits, in light of the Argentine Government's failure to act in good faith in recognizing and enforcing final arbitral awards to U.S. companies. In addition, USTR on many occasions has raised U.S. concerns in the World Trade Organization (WTO) regarding the nature and application of trade-restrictive measures taken by Argentina, which are adversely affecting imports into Argentina from the United States and a growing number of WTO Members. These measures include the overly broad use of non-automatic import licensing, trade balancing requirements, and pre-registration and pre-approval of all imports to Argentina. On behalf of the United States, USTR has asked Argentina to take immediate steps to address these concerns. At the March 30 meeting of the WTO Council for Trade in Goods, the United States and 13 other WTO Members (including both developed and developing countries) co-sponsored a joint statement to demonstrate the seriousness with which WTO Members view Argentina's import restrictions.

16. As you may be aware, the Committee on Finance was actively involved in crafting the language that Chairman Levin and Ranking Member McCain inserted into the National Defense Authorization Act (NDAA) clarifying Custom and Border Protection's (CBP) authority to disclose information to rights holders whose trademarks appear on suspected counterfeit imports. In particular, I am aware that counterfeit chips have made their way into sensitive defense department systems as well as critical civilian products like defibrillators, automobile air bags and antilock breaking systems.

In the NDAA, Congress clearly intended for CBP to immediately return to its prior practice of sharing compete photographs or samples of potentially dangerous counterfeit imports with rights holders in order to ensure that counterfeit goods do not enter the stream of U.S. commerce to protect national security, health, and commercial harm to the U.S. economy and its citizens. Some of us felt that stronger language may be necessary to ensure that CBP shared Congress' commitment to stopping counterfeit goods from entering the United States. But even under the NDAA language as passed, it was our understanding that once enacted, nothing more than an email to CBP Port Officers would be required in order to implement the law.

A month and a half have now passed since the enactment of the NDAA and CBP's authority was reaffirmed. I am very disturbed to learn that to date CBP has not reinstituted its prior practice now that CBP's erroneous interpretation of its authority has been clarified. I also understand that the Treasury Department is preventing CBP from adhering to the clear provisions and intent behind the NDAA on this matter until accommodations can be made to protect certain grey market interests. Can you please explain Treasury's position on the NDAA law and why it has not been fully implemented yet? When will Treasury fully implement these provisions in the NDAA? In the Lanham Act and the Tariff Act, Congress has clearly instructed Treasury and CBP to stop dangerous counterfeits from entering the United States. Please explain why Treasury is forestalling timely identification and seizure of counterfeits and what other economic or policy interest, such as protecting grey market goods, Treasury believes justifies its position? If the information I have received is incorrect, then please make that clear and please explain what steps Treasury is taking to ensure full implementation of the NDAA as

soon as possible. If Treasury believes that policy or economic interests, including protecting the grey market, trump combatting counterfeit goods and trump the NDAA, please provide your policy justification and the legal basis for that determination.

I share your interest in expanding Customs and Border Protection's ability to share information about and samples of imported goods suspected of being counterfeit with rightholders of the trademarks on those goods suspected of being counterfeited for purposes of determining whether the imports are counterfeit. To that end the Treasury and the Department of Homeland Security published a rule on April 23, 2012 that will enable information sharing. This matter is important both to our national security and to the strength of our Nation's economy.

The Administration fully supports the information sharing goal of the National Defense Authorization Act for fiscal year 2012 (NDAA), and had itself proposed legislation last July consistent with this goal.

As for implementation of the information sharing language of the national Defense Authorization Act, the following background is relevant:

The Trade Secrets Act (TSA), a criminal statute, prohibits the unauthorized release by a Federal employee or officer of certain types of information received by the government.[2] The twin goals of the statute are protecting competition and encouraging business to share information with the government. The Act "cover(s) practically any commercial or financial data collected by any Federal employee from any source" and that the "comprehensive catalogue of items" listed in the Act "accomplishes essentially the same thing as if it had simply referred to 'all officially collected commercial information' or 'all business and financial data received.'"[3]

The TSA does not, however, preclude the disclosure of information "otherwise protected" by the statute if the disclosure is "authorized by law." Section 818(g) of the NDAA creates authorizes the Secretary of the Treasury to make such disclosures.

[2] The TSA provides in relevant part:

> Whoever, being an officer or employee of the United States or of any department or agency thereof, ... publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information coming to him [or her] in the course of his [or her] employment or official duties or by reason of any examination or investigation made by, or return, report or record made to or filed with such department ... , which information concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association...; shall be fined under this title, or imprisoned not more than one year, or both; and shall be removed from office or employment.

18 U.S.C. 1905.

[3] CNA Financial Corp. v. Donovan, 830 F.2d at 1140.

Current CBP regulations, promulgated in 1998 (63 FR 11996), and specifically taking into account the strictures and operation of the TSA, allow the sharing of certain information to facilitate border enforcement counterfeit trademarks (19 CFR 133.21). The regulations provide, in the case of suspected counterfeit trademarks, for sharing information and samples of seized counterfeit goods. Under the regulations, sharing certain TSA-protected information was authorized for counterfeit goods that are seized. However, under current regulations, prior to seizure, for goods that may be counterfeit, Customs may disclose only certain limited information to third parties regarding the importation of the merchandise. The procedures for this limited sharing were further elaborated in Customs Directive 2310-008A, April 7, 2000.

At no time in the past has CBP changed this official position on such information sharing and at no time has Treasury directed it to do so. The draft regulations noted above, however, would amend the existing regulations and allow CBP to share information with trademark right holders prior to the seizure of goods.

As you know, CBP has faced challenges identifying counterfeit semiconductor chips. Chips are very small and have highly technical features that may distinguish a legitimate chip from a counterfeit. Apparently even manufacturers can only identify some counterfeits by examining the lot or code number on the chip, but manufacturers have declined to share lists of legitimate codes, or their meanings, with CBP. We seek the most rapid implementation possible in order to implement changes that will help CBP to overcome these obstacles.

17. The President is, again, proposing something that he calls a "Financial Crisis Responsibility Fee." However gently labeled, the "fee" is a tax targeting "financial firms with assets over $50 billion. In your testimony, Mr. Secretary, you tout gains made on the Troubled Asset Relief Program, citing your estimate that "investments made through TARP bank programs, for example, will return more than $20 billion in gains to taxpayers."

To date, what are the costs or gains associated with Troubled Assets Relief Program "investments" in American International Group, General Motors Corporation, and Ally Financial Inc.?

The President's Budget states that: "...shared responsibility requires that the largest financial firms pay back the taxpayer for the extraordinary support they received as well as to discourage excessive risk taking."

What amount of financial resources will "financial firms with assets over $50 billion" have to pay back to the taxpayer in order for those firms to have fully paid back to the point of having fully shared their responsibility, or is the responsibility perpetual?

Does the President intend to levy his fee on Ally Financial Inc.? If not, why not?

Does the President intend to levy his fee on General Motors and Chrysler? If not, why not?

Does the President intend to levy fees on money market mutual funds and participants in the tri-party repo market, segments of the financial system at the very heart of the recent financial crisis and segments that received extraordinary taxpayer support? If so, how will the fee be structured? If not, why not?

While we know that the incidence of a tax does not necessarily fall on the person who writes a check to the government to pay the tax, please provide any analysis that the administration has performed on what the effect of the proposed responsibility "fee" would be on costs of financial services for American consumers and on returns that American investors, including pension funds and retirees, would receive on deposits and investments in "the largest financial firms."

Does the administration believe that there will be no effects, if a "Financial Crisis Responsibility Fee" were to be levied on financial institutions with assets over $50 billion, on fees, returns on financial assets, or costs of financial services for American consumers and investors such as pension funds and retirees?

In the event of any cost associated with the Troubled Asset Relief Program (TARP), Congress required in the Emergency Economic Stabilization Act that the President put forward a plan "that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt." The proposed Financial Crisis Responsibility Fee is intended to address this requirement.

The Financial Crisis Responsibility Fee would be assessed on U.S.-based bank holding companies, thrift holding companies, certain broker-dealers, and companies that control such institutions as of January 14, 2010, with world-wide consolidated assets of more than $50 billion. U.S. subsidiaries of foreign firms that fall into these categories and have assets in excess of $50 billion also would be covered. The fee is designed so that it would fall most heavily on firms that fund riskier activities with less stable, short-term forms of funding. Under the Administration's proposal, firms would pay a fee based upon their covered liabilities, which are generally the consolidated risk-weighted assets of a financial firm, less its capital, insured deposits, and certain loans to small businesses.

Firms that take on more risk and fund those activities with less-stable sources of financing (e.g. through commercial paper or "repo" markets) would pay larger fees. Firms that fund activities with more stable sources of funding through a traditional banking model (e.g., funded using equity and insured deposits) would pay smaller fees. The fee proposal specifically excludes small business lending.

The fee is designed to limit the risk of any adverse impact on the large majority of financial institutions in the United States. By assessing the fee only on institutions with over $50 billion in assets, the fee excludes more than 99 percent of U.S. banks, which currently provide the majority of small loans to businesses and farms across the country. If covered firms try to pass on the cost of the fee to their borrowers, they will likely lose market share to other institutions. The Congressional Budget Office, in its review of our proposal, highlighted these advantages by noting that the proposal "would improve the competitive position of small- and medium-size banks, probably leading to some increase in their share of the loan market."

As of April 30, 2012, Treasury has recovered $264 billion from TARP's bank programs through repayments, dividends, interest, and other income, compared to the $245 billion initially invested. Treasury continues to recover additional funds and estimates that the bank programs will result in a lifetime positive return for taxpayers of more than $20 billion.

Treasury's estimated lifetime cost figures for TARP are currently updated quarterly in conjunction with the Office of Management and Budget, which for outstanding investments in publicly-traded securities such as AIG and GM, are based on the aggregate value of the investments at market prices as of the date of the estimate (in this case February 29, 2012).

As of February 29, 2012, the estimated lifetime cost of Treasury's investment in the American International Group (AIG) was $17.62 billion. Treasury holds additional AIG common shares that are projected to yield a positive return of $16.43 billion for the benefit of the Treasury, which means that the projected net AIG cost is approximately $1.19 billion. The Automotive Industry Financing Program (AIFP)—which includes Treasury's investments in General Motors, Ally Financial, and Chrysler—has an estimated lifetime cost of $21.7 billion.

As of March 31, 2012, the combined market values of AIG and GM common stock had increased by approximately $1.78 billion, which has a corresponding decrease on the estimated cost of AIG and AIFP. However, cost changes associated with these common stock holdings are sensitive to conditions in the overall equity markets and should be expected to adjust.

18. The President's Budget estimates that the Office of Financial Research (OFR) will incur $11 million in expenses in 2013 associated with implementation of the Federal Deposit Insurance Corporation (FDIC) implementation.

What are those expenses?

Section 210(n)(10) of the Wall Street Reform Act provides that certain reasonable implementation expenses of the FDIC incurred after the date of enactment of the Wall Street Reform Act shall be treated as expenses of the Financial Stability Oversight Council (Council). The FDIC must periodically submit requests for reimbursement for implementation expenses to the Chairperson of the Council, who shall arrange for prompt reimbursement to the FDIC of reasonable implementation expenses. The expenses are for rule writing and resolution planning consistent with the FDIC's implementation of its responsibilities under Title II of the Wall Street Reform Act. For further details on these expenses, please contact the FDIC.

The Budget also notes that after July 21, 2012, funding of the OFR and the Financial Stability Oversight Council (and thus for these FDIC expenses) will be obtained through "assessments on bank holding companies with total consolidated assets of $50 billion or more and non-bank financial companies supervised by the [Federal Reserve's] Board of Governors."

The Budget also notes that after July 21, 2012, funding of the OFR and the Financial Stability Oversight Council will be obtained through "assessments on bank holding companies with total consolidated assets of $50 billion or more and non-bank financial companies supervised by the [Federal Reserve's] Board of Governors."

Are there any legal limits on what those assessments can be?

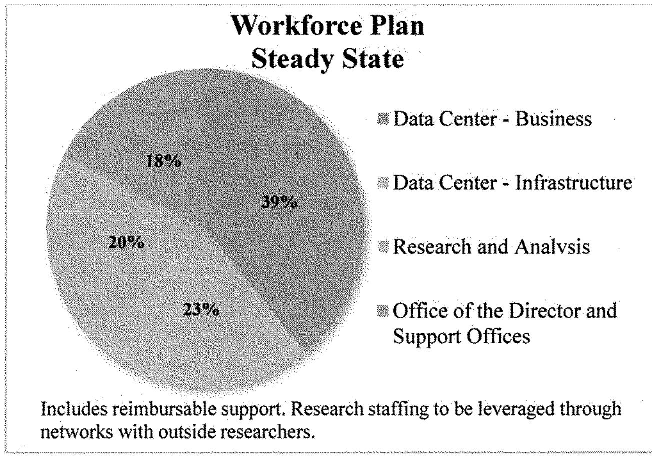
Under section 155(d) of Wall Street Reform, assessments are limited to bank holding companies with total consolidated assets of $50 billion or greater and nonbank financial companies supervised by the Board of Governors.

The budget for the OFR is determined by the Director of the OFR in consultation with the Chair of the Council. The Director of the OFR is a presidentially-appointed, Senate-confirmed position.

The Council budget is determined by and approved by the members of the Council.

The Budget also identifies an estimated increase, on page 1065 of the Appendix, in OFR full-time equivalent employment from 179 in 2012 to 312 in 2013. Please provide information about the positions that the OFR expects to fill during fiscal years 2012 and 2013.

The OFR plans to build to steady state staffing levels of 275-300 within the next twenty-four to thirty-six months. Below is a breakdown of the positions by department.



19. The President's Budget frequently mentions fairness, fair shares, and what is fair with respect to tax obligations and after-tax incomes of Americans. Your testimony on the President's Budget talks of a need for individual tax reform, and identifies that: "The key to these reforms is fairness." Of course, such pronouncements raise questions of defining what is fair and what is the ultimate objective of using tax policy to generate greater equality of after-tax incomes and, perhaps, wealth levels. Too much inequality in after-tax income can be socially corrosive and too little removes important incentives for productive activities.

In terms of the objective, using a Gini index or whatever is your preferred measure of inequality of after-tax incomes, what is the administration's desired after-tax income distribution which would correspond to a situation in which the tax system and after-tax income distribution can be considered fair and equitable?

In terms of the objective and historical experience, using a Gini index or whatever is your preferred measure of inequality of after-tax incomes, during what past year does the administration believe that the United States has generated the fairest and most equitable distribution of those incomes?

In terms of the objective, using a Gini index or whatever is your preferred measure of inequality of after-tax incomes, how far do the President's tax proposals in his budget, some of which are motivated by the interest of attaining greater fairness, move the after-tax distribution in the direction of greater fairness?

The President's Budget also frequently refers to "middle-class families" and their tax obligations relative to others. In terms of a measure of income, precisely what

(e.g., what range of such income) is the administration's definition of "middle class?"

We understand that equity and efficiency must be balanced in designing a tax code that meets our revenue needs. The Administration has not set a specific metric for after-tax income equality that tax reform must achieve. However, high-income families should not pay effective tax rates that are lower than those faced by middle-income families (which is the essence of the Buffett Rule). In addition, the reformed tax system should be at least as progressive as the tax system would be under the President's budget proposals.

In response to your question, about what past year the administration believes that the United States has generated the fairest and most equitable distribution of those incomes.

The Administration has not made such a determination, and doing so would be very difficult. However, the Congressional Budget Office maintains an excellent time series of pre-tax income, tax burdens, and after-tax income that clearly demonstrates that income inequality has grown in recent decades. Similar data sets have also been generated for longer time periods by academic researchers.

20. Secretary Geithner, you and others in the administration have claimed that the President's Budget contains $2.50 of spending cuts for every $1 of increased revenue. This number appears to rely partly on a calculation of deficit reduction over the next 10 years resulting from a combination of the President's new proposals in his Budget and laws that were enacted last year. If we consider only future policy proposals of the President's Budget, and ignore spending cuts and tax increases that have already been enacted into law, what is the resulting ratio of spending cuts to increased revenues associated with the President's future policy proposals over the next 10 years? What would that ratio be if you do not count interest savings as spending cuts?

The ratio of $2.50 in spending cuts for every $1 of increased revenue does indeed take into account previously enacted deficit reduction measures. As shown in Summary Table S-3 of the Budget, enacted outlay reductions in 2013 plus Budget spending proposals total $3.77 trillion. Enacted receipt increases plus Budget revenue proposals total $1.510 trillion. The ratio of spending cuts to revenue increases is 2.5.

Excluding deficit-reduction measures enacted with 2011 and 2012 full-year appropriations as well as the savings achieved by the Budget Control Act, the ratio of spending cuts to revenue gains is 1.34. However, this calculation ignores the significant achievements embodied by these earlier deficit reduction measures. Moreover, it ignores the substantial role already played by spending cuts in achieving deficit reduction, and therefore the need to now add revenues to the mix in order to achieve a balanced approach.

It is absolutely appropriate to include the interest savings generated by deficit reduction proposals. To exclude them from either calculation would provide an incomplete picture of the savings achieved through spending cuts.

21. The President's Budget calls for tax hikes, some of which are motivated in the interest of greater fairness. Administration officials have cited what one official calls "mindboggling" shifts in the income distribution from 1979 to 2007. A recent Congressional Budget Office analysis has identified as one step to take to arrest decades of growth in income inequality adherence to "principles like the Buffett Rule, which states that those making more than $1 million should not pay a lower share of their income in taxes then middle class families."

Please provide details of exactly how the administration would implement the Buffett idea in the tax code in terms of changes in tax rates or allowable credits and deductions, and not merely in terms of establishing a vague "principle."

Given those details, if the administration's desired Buffett idea were enacted, how much revenue per year do you estimate will be raised?

Given the projected revenue that would be raised by the Buffett idea, please quantify what the effect would be on whatever is your preferred measure of after-tax income inequality.

In the administration's desired implementation of the Buffett idea, will it be the case that increases in revenue from upper-income taxpayers will be coupled with changes in tax rates for other taxpayers such that redistribution occurs through the Buffet permutation of our tax code, or is the intention to use the revenue to fund more spending or other things?

The "Buffet Rule" is a principal that should be observed in reforming the tax code in a comprehensive manner. It is not a specific legislative proposal and, therefore, we have not estimated the effect that implementing this principle would have on revenue or the after-tax distribution of income. As you know, the overall impact will depend on the other features of the reformed tax system.

The Administration has not set a specific metric for after-tax income equality that tax reform must achieve. However, high-income families should not pay effective tax rates that are lower than those faced by middle-income families (which is the essence of the Buffett Rule). In addition, the reformed tax system should be at least as progressive as the tax system would be under the President's budget proposals.

We look forward to working with this Committee to develop and implement comprehensive tax reform that is fiscally responsible, that leads to a Tax Code that is simpler and that has lower rates, that has a broader tax base that cuts inefficient and unfair tax breaks, that promotes jobs and growth, and that ensures that high-income families do not pay effective tax rates that are lower than those faced by middle-income families.

22. The President, in his Budget, states that last year there was "...the willingness of Republicans in Congress to risk the first default in our Nation's history..." Aside from being factually incorrect, it is not clear why Republicans in Congress have been singled out. An impasse in a debate over an issue typically involves more than one group of people.

Given that there was a long-lived debt limit impasse among many engaged in the debate, does the administration agree that in symmetry to what the President wrote in his budget it was also the case that there was a willingness of Democrats in Congress to risk the first default in our Nation's history and a willingness of the administration to risk the first default in our Nation's history?

During the debt limit impasse there was a willingness of the administration to inject uncertainty into the finances of American seniors and our troops when the President in July of last year identified, for example, that he could not guarantee that Social Security payments would be made on August 3 if a debt deal was not reached. However, the Treasury Department was projecting late in July and early in August that it would have sufficient cash and liquid assets to make the payments. There were assets that could have been liquidated, had the projections been too low, Social Security payments could have been made, thereby extinguishing a like amount of debt owed by Treasury to the Social Security Trust Funds. That would have opened up a corresponding like amount of additional headroom under the statutory debt limit which, in turn, would have allowed Treasury to issue a like amount of fresh debt to recapture the funds spent to make Social Security payments and, in the end, would have had no effect on where debt subject to the debt limit stood relative to the limit. Why did Treasury and the administration not respond during the debt limit impasse to my inquiries about Social Security payments and questions about how much in cash and liquid assets were available and projected to be available at the Treasury in late July and early August of last year?

I also inquired of Treasury and voting members of the Financial Stability Oversight Council during the impasse concerning what contingency plans were being made for the possibility of default on U.S. obligations or a downgrade of the sovereign rating of the U.S., which unfortunately materialized after the impasse. I have to date not received adequate responses. Statement by Federal Reserve (Fed) officials and an entry in the minutes of a meeting of the Fed's Federal Open Market Committee clearly identify that contingency plans were developed, at least with input from the Fed and Treasury. Yet I have not received information about such plans that I requested, even after the impasse when the information is no longer "market sensitive." Reports in the press identify that the Treasury Secretary provided some assurances to an executive of a major Wall Street financial firm with respect to

contingency plans for dealing with functioning of the payments system. The Treasury Secretary's telephone log shows communications between the Secretary, on August 1, 2011, and Mr. Larry Fink, Mr. Lloyd Blankfein, Mr. Jamie Dimon, and Mr. Warren Buffett. Please provide me with any contingency plans developed by Treasury, alone or in conjunction with the Federal Reserve or other regulators. Please also identify information provided to executives of major financial firms or investors prior to resolution of the debt limit impasse concerning contingency plans of the federal government for what were then possibilities of a U.S. government default or a downgrade of the U.S. sovereign credit rating.

Beginning in January of last year, and continuing until the debt limit was raised on August 2, 2011, Treasury repeatedly stated that there was no alternative to an increase in the debt limit. During this period, Secretary Geithner wrote at least ten letters to Members of Congress stressing the importance of raising the debt limit. Secretary Geithner made it clear that it would be irresponsible for "either party" to use the full faith and credit of the United States as a bargaining chip.[4]

Treasury attempted to provide as much transparency as possible during the debt limit impasse, including providing monthly updates. Secretary Geithner received a letter from Senator Hatch on July 27, 2011, requesting additional information regarding the debt limit. Secretary Geithner sent a response three business days later, on August 1, 2011. Treasury has responded to a number of follow-up inquiries from Senator Hatch over the ensuing months, including providing projections from July 29, 2011 and August 1, 2011 regarding the projected cash balance on August 2, 2011. The most accurate and up-to-date source of information on Treasury's cash position is the Daily Treasury Statement, which is made public every day and is available on Treasury's website.

In the event that the debt limit had not been not raised by August 2, Treasury was prepared to alter its normal auction schedule for the sale of Treasury securities, and at a regularly scheduled meeting with primary dealers on July 29, 2011, Treasury notified them that such alterations were possible. Treasury did not provide information regarding contingency plans to Wall Street that was not made available to Congress and the public.

With respect to how Treasury would have operated if the debt limit had not been raised: In the period prior to August 2, 2011, Treasury considered a range of options, many of which had also been considered by previous Republican and Democratic Administrations. These options included gold and other asset sales; delaying payments; across-the-board payment reductions; and various ways of attempting to prioritize payments. However, after careful consideration of all of these ideas, we reached the same conclusion reached by previous Administrations: that these options could neither protect America's creditworthiness from irreparable harm, nor shield citizens from the severe economic effects of a default crisis. This is why Secretary Geithner maintained, as did previous Treasury Secretaries who faced debt limit impasses, that there was no viable alternative to a timely increase in the nation's borrowing authority.

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[4] Letter from Sec. Geithner to Sen. Reid (May 2, 2011).

The decision of how we would operate if the United States exhausted its borrowing authority, if inaction by Congress had made it necessary, would have been made by the Secretary of the Treasury and the President of the United States. No such decision was made. Fortunately, Congress acted to increase the statutory debt limit and prevent a default crisis before such a decision became necessary.

23. The President's Budget proposes a new $100-per-flight mandatory surcharge for air traffic services, with certain exemptions. I would like more information on this proposal. Given that this new surcharge is identified in the budget as a user fee, I presume that proceeds would be deposited in the Airport and Airway Trust Fund. Is this the case?

The President recently signed the FAA Modernization and Reform Act of 2012, which reauthorizes FAA appropriations through FY 2015. Neither the Senate nor House passed FAA bills that were considered in a conference committee contained a $100 surcharge. I did not hear from the administration any advocacy to include this surcharge in the FAA bill during conference deliberations.

Given that FAA reauthorization has been considered by Congress for the last several years, why wasn't this surcharge proposed in the context of FAA reauthorization?
How was the administration's proposal developed, and what stakeholders did the administration meet with as the proposal was formulated? Why was $100 set as the amount of the surcharge?

The most recently available Congressional Budget Office estimates of receipts and outlays for the Airport and Airway Trust Fund show a Trust Fund surplus going forward. Given this, how did the administration reach the conclusion that it was necessary for the aviation community to more equitably share the costs of air traffic services?

If the costs of air traffic services really are not equitably distributed, how does imposing an additional $100 surcharge on commercial and general aviation correct the deficiency in equitability?

The "Analytical Perspectives" volume of the Budget notes that "...commercial and general aviation can pay very different aviation fees for those same air traffic services." If the President's proposal is enacted, wouldn't commercial and general aviation still pay different fees, if current fees were increased by $100 for both groups?

For details on how the proposal was developed and with whom the proposal was discussed, I would direct you to the Department of Transportation which was the lead Administration agency in dealing with the FAA reauthorization legislation.

This fee would not eliminate the disparate fee treatment commercial and general aviation face. As you know, there are both fixed and variable costs imposed on the air traffic system by both general and commercial aviation. However, this fee does increase the percentage of total fees borne by general aviation, thus reducing the relative disparity in the treatment of the two sectors.

Revenues would be deposited in the Airport and Airway Trust Fund.

24. The President's Budget suggests newfound urgency to use funds for mortgage relief, including funds already available in the Troubled Asset Relief Program (TARP). Continued vigilant oversight of TARP is, of course, necessary and, I am sure, welcomed by you.

On February 1, 2012, Christy Romero was nominated to be the Special Inspector General for the TARP (SIGTARP). Given that Mr. Barofsky left the position nearly a year ago, why has it taken so long for his Deputy, Ms. Romero, to be nominated?

It is my understanding that Ms. Romero served as acting SIGTARP. Because of the Federal Vacancies Reform Act, however, she reverted back to her previous position as Deputy Special Inspector General after 210 days. Given that the administration spent nearly a year searching for someone who was essentially already doing the job, what did the Administration do to fill the office of SIGTARP for the past year?

Do you pledge to fully cooperate with the office of the SIGTARP at all times and to direct all Treasury employees to do the same?

Oversight has played an important and welcomed role in the Troubled Asset Relief Program (TARP). Since the program's inception, Treasury has maintained an active dialogue with SIGTARP, as well as the other bodies with oversight responsibility over the TARP, including Congress, the Financial Stability Oversight Board, and the Government Accountability Office.

We were pleased that Christy Romero was sworn in as the next Special Inspector General for the TARP on April 9 after being confirmed by the United States Senate. Treasury has had a productive working relationship with Ms. Romero and the many professionals who work for SIGTARP since Mr. Barofsky's departure. Assistant Secretary Massad is scheduled to meet weekly with Ms. Romero to discuss Treasury's current activities and to address any concerns of SIGTARP. In addition, the Office of Financial Stability (OFS) interacts daily with Ms. Romero's team to ensure SIGTARP has the information necessary to conduct oversight of TARP.

25. The President's Budget proposes a six-year, $476 billion surface transportation reauthorization paid for in part with funds made available from ramping down

military operations overseas. It is my understanding that these funds will only exist in the current Congressional Budget Office baseline until they are not reflected in a current year's appropriations. After that, this spending as proposed by the President's budget would be scored as new spending.

Currently, receipts into the Highway Trust Fund are less than outlays from the Trust Fund. Given that the President's budget does not alter this dynamic, how does the administration propose that Surface Transportation Reauthorization would be funded in six years, if the proposal contained in the FY 2013 budget were to be enacted into law?

The President has always been on record as supporting enactment of a surface transportation bill that invests in our future in a fiscally responsible manner. The 2013 Budget does exactly that – providing needed resources to rebuild America without adding to the deficit, fully offsetting the cost by reducing overseas military operations.

The Administration looks forward to working with Congress to reauthorize surface transportation programs over both the short and long term. The Administration's Surface Transportation Reauthorization proposal treats all surface transportation spending (outlays) as mandatory and funding will be subject to "PAYGO" provisions. This is consistent with a fully paid for surface transportation bill that the Administration has consistently advocated. Moving the program from the current hybrid trust fund model into a fully mandatory program, consistent with how other trust funds are treated, will help enhance fiscal discipline in the future.

26. Implementing aspects of the President's Budget would require increased staffing at the Treasury Department and filing of positions that require nominations from the President and, typically and Constitutionally, advice and consent of the U.S. Senate. Confusingly, the President, in responses to press inquiries on December 8 of last year, stated: "But part of what's happened over on Capitol Hill -- not just on this issue, but on every issue -- is they will hold up nominations, well-qualified judges aren't getting a vote -- I've got assistant secretaries to the Treasury who get held up for no reason, just because they're trying to see if they can use that to reverse some sort of law that's already been passed. And that's part of what gets the American people so frustrated -- because they don't feel like this thing is on the level." (http://www.whitehouse.gov/the-press-office/2011/12/08/statement-president). No one on my side of the aisle in Congress wishes to generate frustration, but the sense in which nominated Treasury officials are being held up by Republicans or that Republicans are holding up anyone in order to reverse a law leaves me confused. Perhaps I could receive clarification from the administration. Of course, Congress has a Constitutional obligation to exercise oversight responsibilities, and I would hope that our responsibilities are not viewed as hold ups.

Which assistant secretaries of the Treasury are being held up and precisely what is the nature of the hold up?

I can't speak for the President, but my impression from reading the transcript of his remarks is that he was not referring to any pending nominations or placing responsibility on one party or another.

Does anyone in the administration know which "law that's already been passed" was the subject of the President's remark, and can you identify the manner in which anyone in Congress could reverse an existing law by in some sense holding up the nomination of assistant Treasury Secretaries?

No. I can't speak for the President, but my impression from reading the transcript is that he was referring to the concerns he raised earlier in his remarks relating to the changes being sought to the Wall Street Reform Act regarding the Consumer Financial Protection Bureau.

27. In discussing tax reform in your testimony on February 14, you mentioned that it was important to "retain progressivity." Please identify:

- **a. What you mean by retaining progressivity?**
- **b. Whether you believe the tax code is sufficiently progressive?**
- **c. Whether you believe the tax code should be more or less progressive than it currently is and, if so, how much and by what measure?**
- **d. Do you believe the tax laws should have as a goal wealth redistribution on equal par with a goal of revenue collection?**
- **e. If it could be proven that making the Code more progressive would harm GDP growth, would you believe it a mistake to make the Code more progressive?**

Regarding items (a) through (c), the Administration has not set a specific metric for after-tax income equality that reform must achieve. However, high-income families should not pay effective tax rates that are lower than those faced by middle-income families (which is the essence of the Buffett Rule). In addition, the reformed tax system should be at least as progressive as the tax system would be under the President's budget proposals.

Regarding items (d) and (e), we know that equity and efficiency must be balanced in designing a tax code that meets our revenue needs. Our current Budget proposal does this. We look forward to working with this Committee on comprehensive tax reform that is fiscally responsible, and that leads to a Tax Code that is simpler with lower rates, that has a broader tax base that cuts inefficient and unfair tax breaks, that promotes jobs and growth, and that ensures that high-income families do not pay effective tax rates that are lower than those faced by middle-income families.

28. You support an extension of the Social Security Tax cut by two percentage points for the remainder of 2012. As I understand it, one of your reasons for that support is the persistently high rate of unemployment. I agree that unemployment remains persistently high and remains above projected rates promised by the President's stimulus. Do you anticipate supporting such a cut for 2013 or thereafter? What level of unemployment would indicate to administration officials a need for further extension of the payroll tax holiday beyond 2012?

The extension of the payroll tax cut through the end of this year was signed into law on February 23, 2012. The payroll tax cut extension is expected to help 160 million American workers at a time they need it most and also helps support the broader economy.

The Administration in the FY2013 Budget currently assumes the payroll tax cut will expire as planned at the end of 2012.

29. In 2009, you and the President proposed limiting the tax benefit from itemized deductions to 28%. At that time, you estimated that this would raise $267 billion over ten years for the federal government. In 2011, you and the President expanded this proposal to include limiting the tax benefit from the section 911 foreign earned income exclusion, from the employer-provided health insurance exclusion, and from the exclusion for interest paid on state/local bonds. It appears that you and President Obama have added to the list and now propose limiting the tax-benefit to 28% for retirement contributions as well. You now estimate that this 28% cap would raise $584 billion over ten years for the federal government. Can you explain whether the retirement limitation:

a. Would apply to 401(k), TSP, 403(b), and 457 plans?

Yes, the proposal would limit the tax value of exclusions for employee contributions to these defined contribution plans to 28 percent for high-income taxpayers.

b. Would include IRAs?

Yes, the proposal would limit the tax value for contributions to IRAs to 28 percent for high-income households.

c. Would apply to both employee deferrals and to employer matches?

No, the limitation would not apply to employer matches.

Would be taxed yet again when money is withdrawn from the account in retirement (or would the account somehow have a tax basis, or somehow be considered to be a hybrid, part-Roth and part-traditional, retirement account?

Our estimate does not assume any adjustment to basis to account for the limitation on the value of contributions in determining the tax liability due on distributions. Note that for the small group of taxpayers who are affected at all by the limit, the proposed limitation generally would reduce, but not eliminate, the tax benefit received for these elective retirement savings because the account value grows tax-free over time. However, I understand your concern, and the Administration would welcome the opportunity to work with you to specify the details of how a limit on this exclusion for retirement contributions made by high-income taxpayers should be structured.

Please, also, break down the $584 billion figure and explain how much of this comes from the application of the proposal to itemized deductions, how much from limiting the tax benefit for retirement contributions, and how much from limiting the exclusions for foreign-earned income, employer-provided health insurance, and state and local bond interest.

We have not estimated the components of the proposal separately and so this breakdown is unavailable.

30. The administration has proposed that the Internal Revenue Code "provide tax incentives for locating jobs and business activity in the United States and remove tax deductions for shipping jobs overseas." The administration has estimated that this would reduce revenue to the federal government by $90 million over 10 years. However, providing "tax incentives for locating jobs and business activity in the United States" presumably reduces revenue to the federal government, while removing "tax deductions for shipping jobs overseas" presumably raises revenue for the federal government. So, the $90 million figure is a net figure of these two provisions. Please identify the separate revenue estimate for each of these two provisions. That is, please identify, separately, the revenue estimate for "tax incentives for locating jobs and business activity in the United States" and the revenue estimate for removing "tax deductions for shipping jobs overseas."

The proposed general business credit for expenses connected with insourcing is estimated to reduce tax revenue by $241 million over the FY 2013 –FY 2022 10-year budget window. The disallowance of deductions connected with outsourcing is estimated to increase tax revenue by $151 million over the FY 2013 – FY 2022 10-year budget window.

31. I was contacted last year by the Utah Retirement Systems (URS), which collectively cover approximately 175,000 retired and active workers in Utah. The letter outlines a serious issue in connection with Section 457A of the Internal Revenue Code and its effect on the method by which URS compensates investment advisors.

Specifically, the statutory language of Section 457A appears to be unclear as to the treatment of stock options, even though the legislative history contemplates, and guidance published by Treasury and the Internal Revenue Service allows, the use of certain stock options as permissible compensation. Section 457A(d)(3)(A) defines a "nonqualified deferred compensation plan" subject to the application of Section 457A to have the same meaning given under Section 409A(d), except to also include in the definition any "plan that provides a right to compensation based on the appreciation in value of a specified number of equity units of the service recipient." However, the legislative history contemplates, and current IRS guidance allows, the use of certain stock options as permissible compensation. URS wants to use the types of stock based compensation permitted in the IRS guidance.

It is my understanding that other state pension administrators are also concerned with this issue. Stock option-based compensation plans are beneficial for U.S. public pension plan investors because they better align the interests of fund managers to investor interests over time and provide investors the ability to clawback compensation for poor performance by the fund manager or investment advisor. However, despite the legislative history and guidance by Treasury and the IRS, fund managers are hesitant to engage in these transactions due to the lack of clarity in the statute.

A technical correction to Section 457A codifying the IRS guidance would clarify the statutory language, resolve the uncertainty surrounding this issue, and provide consistency between the statute and the legislative history and administrative guidance.

a. Would you support a technical correction to Section 457A that adopts the Treasury and IRS guidance?

b. If not, in light of the fact that the technical correction would follow the current interpretation of Section 457A published by Treasury and the IRS, please explain in detail why you would not support such a technical correction?

Early in 2009, the Treasury Department and IRS issued Notice 2009-8, which addresses the treatment of stock options under section 457A. Notice 2009-8 states that certain types of nonqualified stock options and stock-settled stock appreciation rights, as described in the Notice, are excluded from the section 457A definition of nonqualified deferred compensation and, therefore, are not subject to section 457A. With this guidance, which may be relied upon by taxpayers, we believe that we have addressed the issue raised in your question. Before determining whether a technical correction to section 457A to address stock options is necessary, we would need to better understand the reason that a technical correction is being requested.

32. Internal Revenue Code section 132(f) allows employers to provide certain "qualified transportation fringe" benefits that are not taxable to employees. A transit pass is stated expressly in the Code as a qualifying transportation fringe. A qualified transportation fringe includes a cash reimbursement only if a voucher or similar item that may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee. The Code defines a transit pass to mean "any pass, token, farecard, voucher or similar item entitling a person to transportation (or transportation at a reduced price)" on mass transit or in a commuter highway vehicle. IRS regulations determined that a debit card that can be used to purchase items other than transit fare media is equivalent to cash and is not a voucher. There is no public information available that indicates whether the DOT TRANServe debit card can be programmed to restrict its use to only fare media purchases.

The Department of Transportation (DOT) recently announced that all DOT TRANServe customers with participants who ride VRE, MARC and MTA commuter buses must migrate to the use of the TRANServe Debit Card immediately in order to continue to receive transit benefits. The DOT further stated that "TRANServe's Counsel has been working closely with Counsel from the U.S. Treasury Department, Financial Management Service and Internal Revenue Service regarding the relevant statutory and regulatory authorities. This is to ensure our debit card meets the requirements of IRS Revenue Ruling 2006-57 and does not create a taxable event or place a tax burden on the federal employee." DOT currently has contracts with three providers of paper transit vouchers for many transit services in several cities, including the VRE and MARC, so transit vouchers clearly are readily available for those services. The DOT mandate to use debit cards instead of transit vouchers when vouchers remain readily available appears to violate the non-taxable transportation fringe benefit rules, potentially putting thousands of federal employees at risk of unwittingly receiving taxable income when they use the debit cards to purchase transit fares. Also, using debit cards that could buy general merchandise as well as transit fares can be expected to increase waste, fraud and abuse at the expense of American taxpayers.

Neither Treasury, IRS nor DOT have explained how the law was applied to the facts in order to reach the conclusion that switching to debit cards when vouchers were readily available meets the tax-free fringe benefits requirements and does not trigger taxable income to federal employees. Without knowing the rationale that was used and what the IRS told the DOT, it is impossible to determine whether the DOT's move to debit cards comports with the law and regulations so that workers will not be caught by surprise at tax time. This lack of transparency and accountability is unacceptable.

a. State the IRS and Treasury's current policy regarding qualified transportation fringe benefits, including, but not limited to, when transit passes are considered not readily available, when debit cards are considered as vouchers and when they are considered as cash, and the circumstances under which cash or cash equivalents do not trigger taxable income for employees.

The current interpretations relevant to your questions are set out in the regulations under Internal Revenue Code section 132(f) and in Revenue Ruling 2006-57.

Section 132(f)(3) of the Code generally allows employers to use bona fide cash reimbursement arrangements to provide employees with qualified transportation fringe benefits. This section, however, prohibits use of such arrangements to provide transit benefits "if a voucher or similar item which may be exchanged only for a transit pass" is "readily available." Section 1.132-9, Q&A-16(b) of the Regulations specifies that a voucher or similar item is not readily available if the entity providing it imposes restrictions that effectively prevent the employer from obtaining vouchers appropriate for distribution to employees. A nonexclusive list of examples of such restrictions include:

(1) Excessive fare media charges: The term "fare media charges" refers to extra fees that the voucher-provider requires employers to incur to furnish employees with vouchers. Such fees are excessive if the average annual fare media charges that the employer incurs to provide its employees with transit benefits via vouchers are more than one percent of the average annual value of the vouchers for a transit system.

(2) Advance purchase requirements: A voucher-provider imposes an excessive advance purchase requirement if it "does not offer vouchers at regular intervals or fails to provide the voucher within a reasonable period after receiving payment for the voucher." The regulations clarify that a requirement that employers purchase vouchers only once per year is an excessive advance purchase requirement, but a requirement that an employer purchase vouchers on a monthly basis is not.

(3) Purchase quantity requirements: A voucher is not readily available if the voucher-provider requires the employer to purchase vouchers in quantities that are not reasonably appropriate to the number of employees who use public transit.

(4) Limitations on denominations of available vouchers: A voucher is not readily available if the voucher-provider requires the employer to purchase vouchers in denominations that are not appropriate for distribution to the employer's employees.

As discussed below, certain statutory restrictions applicable to Federal government agencies can result in vouchers not being readily available to those agencies although the vouchers would be available to a private employer in the same area whose employees are using the same transit system.

The position of the IRS has been that the administrative costs of distributing vouchers to employees would not prevent the vouchers from being readily available.

Revenue Ruling 2006-57, which became effective January 1, 2012, provides guidance on the use of smartcards, debit or credit cards, or other electronic media to provide qualified transportation fringes. This includes guidance on when a debit or credit card can qualify as a voucher, and when a debit or credit card can be used to administer a bona fide cash reimbursement system.

b. Describe the complete fact pattern on which the advice from the IRS/Treasury to the DOT was based.

DOT indicated that participants in the national capital region (NCR) who commute using transit systems that do not accept the Washington Metropolitan Area Transit Authority (WMATA) SmarTrip card would need to begin receiving their monthly transit benefits via debit card in December of 2011. As a result of changes in the SmarTrip card system, WMATA notified transit providers and transit authorities in the NCR, including VRE, MARC, and MTA, that it would no longer accept paper vouchers after November, 2011.

DOT further indicated that no other voucher or transit pass was available for use by Federal government employers to provide benefits on these non-WMTA transit systems because of restrictions placed on the use of Federal funds under 31 U.S.C. section 3302. Under 31 U.S.C. 3302, Federal agencies are prohibited from holding public money outside of Treasury, meaning that agencies may not have a private entity or financial institution hold such money. The only entities that may hold public money are depositaries and financial and fiscal agents of the United States, which are designated by the Secretary of the Treasury and required to collateralize any public money they hold. See 12 USC 90, 265, 332, 1767 and 391. Agency funds deposited in an account to provide or reimburse for transit benefits are public money. Thus, a Federal agency may not use a private contractor to hold and distribute transit benefit funds. DOT's delivery of transit benefits via debit card involves the depositing of transit benefit funds to an account with a designated fiscal agent where they are held on behalf of the agency until utilized by cardholders. Funds in the account belong to the agency and funds that have been deposited to the account but that are not spent by cardholders for transit are returned to the agency. Our understanding is that the return of unused amounts to the agency was intended a means of complying with Executive Order 13150, which was issued in 2000, and provides for Federal agencies in the national capital region to provide transit benefits for commuting to the extent possible, as permitted under section 132(f). DOT interprets the order as limiting monthly transit benefits to the amounts used for commuting and as thus requiring any unused benefits remaining at the end of the month to be returned to the agency. DOT indicated that other methods of providing transit benefits for the VRE, MARC and

MTA systems did not satisfy the requirement to return unused amounts in a way that would not violate the requirements on handling Federal funds.

Under these circumstances, the conclusion was that vouchers are no longer readily available and the use of debit cards (rather than cash, checks or electronic fund transfers to reimburse an employee for expenses incurred) is permitted as a means of implementing a cash reimbursement system.

c. **Explain the complete legal analysis developed by the IRS/Treasury that was provided to, or used to advise, the DOT, including, but not limited to, how the use of DOT TRANServe's debit cards when transit vouchers were readily available for VRE and MARC (and other transit services) does not constitute taxable income to federal employees.**

Please see the answer to "b." above.

d. **Provide any and all written comments, advice and guidance that were provided to the DOT by the IRS/Treasury regarding this matter, as well as a description of any oral comments, advice and guidance.**

On November 1, 2011, the IRS sent an email to DOT providing written advice. The text of that email was as follows:

> "Based on recent conversations between our offices and information provided by your office, we have concluded that your proposal to provide certain federal employees in "Service Area 1" (i.e., Maryland, the District of Columbia, and Virginia) with transit benefits via a merchant category code (MCC) restricted debit card complies with Code section 132(f). Specifically, and as more fully explained below, the information and preliminary testing data you have provided indicates that the debit card constitutes a "transit pass" in the Norfolk and Baltimore metropolitan regions, and its use in the National Capital Region (NCR) to purchase fare media on transit systems that do not accept the WMATA SmarTrip card satisfies the requirements for a bona fide cash reimbursement program (and is usable as such since a transit pass does not appear to be otherwise readily available for use by DOT as a federal agency for these limited systems to be required under the Code and regs). Therefore, as we discussed and as set forth below, the distribution of benefits via debit card to certain federal employees in Service Area 1 will not result in additional income and wages to those employees.
>
> <u>Participants in the NCR</u>
>
> WMATA is the main transit system provider in the NCR. We understand that WMATA is fully implementing a "purse" system auto load beginning on December 1, 2011. Under the purse system, funds stored on a participant's SmarTrip card will be separated into a Transit Benefit Purse, Personal Purse,

and Parking Benefit Purse. These funds will not be transferable from one purse to another. Funds in the Transit Benefit Purse can only be used to purchase fare media. Federal government employers will only fund a participant's Transit Benefit Purse, and unused monthly benefits will be credited back to the employer's account at the end of each month. Revenue Ruling 2006-57, which is effective January 1, 2012, provides that fare media stored on smartcards that is useable only as fare media for mass transit systems qualifies as a "transit system voucher." Once the purse system is implemented, the SmarTrip card will qualify fully as a transit pass as of the January 1, 2012 effective date of Revenue Ruling 2006-57, because employer funds will be confined to the Transit Benefit Purse where they can only be used to purchase fare media. However, we understand that transit benefits loaded onto the SmarTrip card directly by individual employees will not be placed into separate purses. Thus, employees using debit cards to load benefits onto their SmarTrip cards will be able to use the benefits on their cards for either parking or fare media. Under these circumstances, the SmarTrip card would not qualify as a "transit pass" because it can be used to purchase both parking and fare media. Moreover, we understand that SmarTrip cards with Transit Benefit Purses loaded directly by employers are readily available to federal government employers. Thus, as we have discussed, beginning on January 1, 2012, the law requires federal employers in the NCR to distribute transit benefits via the SmarTrip card Transit Benefit Purse to those employees who commute using transit systems that accept the SmarTrip card.

We understand that participants in the NCR who commute using transit systems that do not accept the SmarTrip card will begin receiving their monthly transit benefits via debit card in December of 2011. As a result of the new purse system, WMATA has notified transit providers and transit authorities in the NCR, including VRE, MARC, and MTA, that it will no longer accept paper vouchers after November, 2011. You have indicated that no other vouchers or transit pass is available for use by federal government employers to provide benefits on these transit systems as a result of the restrictions placed on the use of federal funds under 31 U.S.C. section 3302. For this reason, the federal government is effectively prohibited from continuing to use WMATA's SmarTrip program to indirectly provide federal employees with benefits on these transit systems through other providers. As we discussed, because transit passes are not readily available for distribution to participants who use transit systems that do not accept the SmarTrip card, the use of debit cards under these circumstances is permitted as a means of implementing a cash reimbursement system. Moreover, your debit card program qualifies as a bona fide reimbursement program because amounts are credited to the MCC-restricted debit cards equal to the employees' mass transit commuting expenses, debit card statements are subject to monthly review by federal agency employers to ensure that the cards are used only to purchase fare media, and excess amounts are returned to the employer at the end of each month.

Participants outside the NCR

For participants working in the Norfolk and Baltimore metropolitan regions, we have concluded that the debit cards qualify as "transit passes" under section 132(f). As tested thus far, the restrictions that are placed on the cards effectively permit employees to use them only to purchase fare media on mass transit systems. (You are working to address the few anomalies and will continue to track the use to ensure the anomalies don't continue or are addressed appropriately when they do occur.) Based on the facts you have provided regarding its operation in the Norfolk and Baltimore metropolitan areas, the debit card is consistent both with the statutory and regulatory standard for a transit pass for transit in these metropolitan areas. Moreover, the debit card is consistent with the intent behind the requirements of Revenue Ruling 2006-57 since the restrictions on the card appear to prevent recipients of the cards from using the cards for purposes other than purchasing fare media on mass transit systems. Accordingly, we consider the debit cards to qualify as transit passes in the Norfolk and Baltimore metropolitan areas, pending further testing of the cards."

Please see the answer to "b." above for a summary of oral discussions.

e. **Does the IRS intend to open a guidance project during 2012 to consider qualified transportation fringes? If so, when will a notice requesting comments be issued? If not, why not, since the issue is on the guidance priority list.**

The Treasury Department and the Internal Revenue Service, along with DOT, have become aware of changes in technology that may give rise to the need for additional guidance on the use of electronic media to provide transit benefits. We are currently working on a notice requesting comments relating to these issues that we expect to publish.

From: Senator Roberts

1. **Mr. Secretary, I'm struggling to understand the repeated rhetorical and policy attacks that this Administration has leveled against Business Aviation. These punitive messages have a chilling effect on the market and are making it more difficult for this critical industry to fully recover in this challenging economic environment. Mr. Secretary – can you go on the record and agree that Business Aviation is essential to our economy? That this industry would be a top contributor to your stated goals of doubling exports, retaining and building a robust manufacturing base in this country and ensuring that communities of all sizes can access and compete in markets across the state or across the world? Can you acknowledge that business aviation provides a large number of high paying manufacturing and services jobs across the country; helps companies to be efficient**

and competitive in this global marketplace; is a lifeline to communities with little or no airline service; and, plays a vital part in this country's emergency preparedness and disaster assistance?

I agree with you that the aviation industry is a vital part of the U.S. economy, and that it makes significant contributions to employment and to strengthening the nation's manufacturing base. The Aerospace Industries Association estimates that as of March 2011, aviation employment (in aircraft, engines and parts) exceeded 400,000,[5] while the Bureau of Economic Analysis indicates that 2010 investment in air transportation-related equipment and software totaled $10.5 billion. Besides these direct impacts, aviation stimulates other sectors of the economy, with one estimate suggesting that a $1 dollar increase in aviation manufacturing output can stimulate $2 worth of additional manufacturing activity.[6]

Certainly the Administration recognizes the importance of a well-functioning national aviation system, to all communities. The Administration has taken steps through its aviation-related policies to strengthen the nation's aviation system. For example, the FAA Modernization and Reform Act of 2012 will provide funds for the modernization of the air traffic control system which will help communities of all sizes throughout the country.

More broadly, continuing to improve our nation's air traffic control systems through the NextGen program will help American air travelers save time and money and will save billions of gallons of jet fuel annually. The Treasury Department, along with the Council of Economic Advisers recently released a report, "A New Economic Analysis of Infrastructure Investment" which cited a study that found: "Total projected savings from NextGen implementation would result in $29 billion of net benefits annually for the United States by 2026." The full report can be found at: http://www.treasury.gov/resource-center/economic-policy/Documents/20120323InfrastructureReport.pdf.

2. **Mr. Secretary, I have heard from people across Kansas and across the country who can't reconcile the President's strong support for building airplanes in this country, but clear distain for the people and companies who buy and use these US products. Do you understand that if you continue to say that we like manufacturing aircraft but will punish people who use them that we won't have a manufacturing base for long because you can't build products if there are no customers?**

We both agree that aircraft manufacturing in the United States creates and sustains jobs, stimulates investment, and helps strengthen the manufacturing sector more broadly. The Administration believes this sector is important to the nation's health and has taken

[5] Aerospace Industries Association, http://www.aia-aerospace.org/assets/stat12.pdf Including guided missiles, space vehicle parts, and search/navigation instruments raises the total to 621,000.

[6] The Economic Impact of Civil Aviation on the U.S. Economy, U.S. Department of Transportation - FAA August 2011 (FAA Report) Tables 4 and 5.
http://www.faa.gov/air_traffic/publications/media/FAA_Economic_Impact_Rpt_2011.pdf

decisive action to strengthen its performance. For example, The American Recovery and Reinvestment Act of 2009 provided funding to invest $200 million in FAA facilities and equipment and $1.1 billion in grants-in-aid for airports. Another example consists of the Export-Import (Ex-Im) bank financing programs that assist U.S. companies selling abroad. These programs have helped civilian aviation become an important contributor to our international trade position, with the U.S. civilian aviation industry supporting an $80 billion positive net trade balance in 2011. Not only does the Ex-Im Bank help industries such as aviation export more, it also does so in a fiscally prudent manner for the taxpayer. Since 2005, the Ex-Im Bank has returned almost $2 billion to the Treasury. To facilitate the important work that the Ex-Im bank accomplishes in aviation and other sectors, the Administration strongly urges Congress to enact reauthorizing legislation.

3. **Mr. Secretary, I see that LIFO repeal continues to be in your budget despite concern about the proposal that has increasingly been expressed from both sides of the aisle. One of the major problems I have with the proposal is the degree of retroactivity that is associated with it. As I understand the proposal, you would not simply terminate the LIFO method prospectively (which I would oppose in any event), but you would require all LIFO taxpayers, large and small, to pay over to the Treasury all of the tax benefits they have ever received from LIFO, even those benefits dating back 60 or 70 years -- the full period LIFO has been in existence. In other words, you would require that those taxpayers be treated as if they were never on LIFO in the first place. Quite apart from the harsh economic consequences to the companies that would therefore result from the proposal, do you really believe that a proposal so constructed is fair?**

The repeal of the last-in, first-out (LIFO) method would eliminate a tax deferral opportunity to taxpayers that hold inventories, the costs of which increase over time. In addition, LIFO repeal would simplify the Code by removing a complex and burdensome accounting method that has been the source of controversy between taxpayers and the IRS.

Eliminating LIFO prospectively without requiring taxpayers to write up their beginning LIFO inventory to its first-in, first-out (FIFO) value would result in a permanent exclusion of taxable income to taxpayers. A more appropriate approach is to require this write-up, which would be no different than the effect of most tax accounting method changes. Generally, taxpayers are required to recognize the difference in taxable income as if they had always been using the new method of accounting, whether that cumulative result is a reduction to income or an increase. The cumulative difference is generally recognized over one to four tax years for most accounting method changes. The President's LIFO proposal allows taxpayers to recognize the income over a period of 10 tax years to minimize the impact of additional tax liability.

4. **Mr. Secretary, recently the President held an event he called an "Insourcing Forum" at which businesses that operate in America were highlighted. A number of the companies that participated in the forum are global businesses headquartered elsewhere but with good jobs here in America. The tax proposals put forth in the President's budget would reward companies for bringing jobs to America but punish American headquartered companies that must also compete for business in locations around the world.**

   Mr. Secretary, do you understand that 95% of the world's consumers are outside of America and that just as the companies highlighted by the President must operate here to service customers in the United States, American headquartered companies must also operate in countries where 95% of the world's consumers live? Why do your proposals aim to punish American companies for trying to compete for business and win customers all around the world?

   The Administration believes that tax reform should properly balance the need to reduce tax incentives to locate overseas with the need for U.S. companies to be able to compete globally. The Administration understands that some overseas investments and operations are necessary to serve and expand into foreign markets in ways that benefit U.S. jobs and economic growth.

   However, as the President emphasized in his State of the Union address, it is important to end the tax deductions that U.S. companies now get for relocating operations overseas and instead provide tax credits for moving expenses when U.S. companies bring operations back home. The proposal to end deductions for relocating U.S. businesses overseas would not affect companies that are expanding into foreign markets, but, rather, would only affect companies that relocate an existing U.S. business activity overseas, resulting in a net loss of U.S. jobs.

   Moreover, there is strong evidence that corporations use accounting mechanisms and transfer pricing strategies to shift profits from where they are actually earned to tax havens and other low-tax jurisdictions. This problem has become so large that U.S. subsidiaries in Bermuda report earning profits there that are more than six times that country's entire actual output. U.S. companies do not need to locate profits in tax havens in order to be competitive in foreign markets.

   As part of the recently-released framework for business tax reform, the President is proposing a minimum tax on the foreign income that U.S. corporations earn abroad. This is a matter of fairness and a way to target tax havens and help prevent the global race to the bottom on corporate tax rates. The Administration's business tax reform plan is intended to lay the foundation for a dialogue with Congress and stakeholders on tax reform. We are committed to working with Congress to enact comprehensive tax reform, as well as working with Congress on the details of the minimum tax as part of that reform.

<u>From: Senator Stabenow</u>

1. **MF Global: The MF Global bankruptcy is a fresh reminder of the importance of effective market oversight. As Chairwoman of the Agriculture Committee, this bankruptcy has hit particularly close to home, affecting many farmers and ranchers from Michigan and the states of my fellow committee members. You made reference to your role in responding to the MF Global crisis in a speech on February 2, 2012. I have been active in soliciting policy responses to the bankruptcy and would like you to explain those comments further. As the investigations continue and we begin to discuss policy responses, what role do you envision Treasury or the Financial Stability Oversight Council playing in addressing the bankruptcy?**

   The failure of MF Global was handled in the United States primarily by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). The SEC and CFTC are investigating the events that led to MF Global's bankruptcy filing and analyzing the causes of the firm's failure. The lessons of the episode will then be considered for policy, supervision, and regulatory implications. At the time of MF Global's bankruptcy filing, the FSOC came together to discuss potential broader market impacts from the failure, and continues to consider how to address a similar situation in the future.

2. **International Harmonization: Last week, EU negotiators agreed to a final text of the European Market Infrastructure Regulation (EMIR). This long-awaited reform will soon shift responsibility to the European Securities and Market Authority (ESMA) to draft detailed rules that will aim to make our global derivatives market safer and more transparent. As Europe enters this crucial stage—they have set a goal to complete the rules by year-end in order to meet G-20 deadlines. What steps will you take, as Treasury Secretary and Chairman of the Financial Stability Oversight Council (FSOC), to ensure that the United States meets G-20 deadlines and that the rules are harmonized between both our regulators and European regulators so as not to create opportunities for regulatory arbitrage or put American companies at a competitive disadvantage?**

   The U.S. and EU have closely cooperated in designing the basic framework for regulation of OTC derivatives. We share a common approach to derivatives regulation, and our frameworks are largely aligned, even though we need to work through technical differences from time to time. This is a complicated area where we need a clearly articulated common approach across the U.S. regulatory agencies. Treasury is focused on creating a level playing field. Treasury's involvement in OTC derivatives issues helped to greater align U.S. and EU rules and led to a biweekly dialogue between the CFTC, the SEC, the European Commission, and the new European Securities Markets Authority (ESMA). Treasury has a regular dialogue with the European Commission and ESMA and closely monitors ESMA's implementing rules to strive for alignment between U.S. and EU rules."

SUBMITTED BY SENATOR GRASSLEY

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510–6200

January 15, 2010

Douglas W. Elmendorf
Director
Congressional Budget Office
Ford House Office Building, Fourth Floor
Washington, DC 20515

Thomas A. Barthold
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Dear Dr. Elmendorf and Dr. Barthold:

There is widespread agreement with the President among taxpayers and members of Congress that financial institutions should repay every dime of government money they have received for financial stability. Yesterday, the President proposed a "Financial Crisis Responsibility Fee" to help facilitate that repayment. I agree with the goals the President articulated. We in Congress have a responsibility to ensure the legislative product carries out the goals the President set. Before Congress is asked to vote on legislation imposing such a fee, it will be important to understand the potential impact on consumers, the criteria for applying the fee to some entities and not others, and the implications for the security and stability of these institutions. I am writing to request that the Congressional Budget Office and the Joint Committee on Taxation provide an analysis addressing the following questions about the Obama Administration's proposed "Financial Crisis Responsibility Fee":

1. Will the fee get passed on to consumers in any manner? If so, how will it get passed on to consumers?
2. Will the fee reduce the amount of bonuses paid by the financial institutions that are subject to the fee?
3. What impact will the fee have on the availability of credit generally?
4. What impact will the fee have on the availability of credit for small businesses?
5. Are the financial institutions that the fee is imposed upon the same ones that caused the estimated losses under TARP?
6. Are there entities that caused the estimated losses under TARP that are not subject to the fee? If so, which entities are they and what amount of the estimated TARP losses did each entity cause?
7. Are there entities that will be subject to the fee that did not cause the estimated losses under TARP? If so, which types of entities are these?

8. Does the fee account for any additional losses from TARP that the Administration may generate as a result of future disbursement of TARP funds?
9. The Administration has estimated that unrecouped losses from TARP could be, absent the proposed Financial Crisis Responsibility Fee, $117 billion. a) Does this amount include the cost of IRS Notices that alleviate the tax burden on TARP recipients that otherwise would have been imposed by Internal Revenue Code section 382 (i.e., Notices 2008-100, 2009-14, 2009-38, and 2010-2)? b) Should an accounting of TARP costs include the costs of these IRS Notices? c) What is the cost of these IRS Notices?
10. What impact will this fee have on the United States' Gross Domestic Product?
11. Will the fee increase the security of the affected financial institutions, thus diminishing the need for any future bailouts?
12. Are there currently any federal or state taxes based on asset value?
13. Does the Administration's cost estimate include the cost of administration?
14. What is your estimate of the cost of the TARP program to date, including the cost of administration?
15. Do you estimate that all TARP losses will be repaid by 2013?
16. What effect will this fee have on the administerability and complexity of the tax system?
17. What is your estimate of the value of the financial assistance provided by the Federal Reserve since the enactment of TARP and what is the potential amount of losses associated with this assistance?
18. Does the fee recoup any potential losses as a result of the Federal Reserve's assistance to various financial institutions?

Thank you in advance for your assistance. Please do not hesitate to contact Jim Lyons at (202) 224-4515 with any questions.

Sincerely,

Chuck Grassley

Charles E. Grassley
Ranking Member

CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

March 4, 2010

Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Senator:

This letter responds to questions you posed about the President's proposal for a "Financial Crisis Responsibility Fee":

- Who would pay the fee?
- What would be the impact of the fee on the stability of financial institutions and government outlays to cover future losses of those institutions?
- What would be the impact of the fee on the availability of credit in general and for small businesses in particular?
- What would be the impact of the fee on economic growth?
- What are the estimated costs to the federal government of the Troubled Asset Relief Program (TARP) and the Federal Reserve's activities related to the financial crisis?
- What is the overlap between firms that would pay the proposed fee and firms that generated losses for the TARP?

The Congressional Budget Office (CBO) is working with the staff of the Joint Committee on Taxation (JCT) to analyze the proposal. Although the Administration has laid out the broad outlines of the proposal, it has not specified how comprehensive the definitions of assets and liabilities would be for the purpose of assessing the fee. Those definitions would affect which institutions were covered, how institutions would react to the fee, and what its incidence would be.

The proposal

The President proposes to assess an annual fee on liabilities of banks, thrifts, bank and thrift holding companies, brokers, and security dealers, as well as U.S. holding companies controlling such entities. The fee, which would apply to firms with consolidated assets of more than $50 billion, would be approximately 0.15 percent of a firm's total liabilities—excluding deposits subject to assessments by the Federal Deposit Insurance Corporation (in the case of banks) and certain liabilities related to insurance policies (in the case of insurance companies).[1] The Administration estimates that the fee would generate revenues totaling about $90 billion from 2011 to 2020.

Who would pay the fee?

Preliminary estimates by JCT identified approximately 60 bank holding and insurance companies with assets in excess of the $50 billion threshold, which include most of the institutions that are likely to pay the fee. A small number of very large firms would account for most of the payments. However, the ultimate cost of a tax or fee is not necessarily borne by the entity that writes the check to the government. The cost of the proposed fee would ultimately be borne to varying degrees by an institution's customers, employees, and investors, but the precise incidence among those groups is uncertain. Customers would probably absorb some of the cost in the form of higher borrowing rates and other charges, although competition from financial institutions not subject to the fee would limit the extent to which the cost could be passed through to borrowers. Employees might bear some of the cost by accepting some reduction in their compensation, including income from bonuses, if they did not have better employment opportunities available to them. Investors could bear some of the cost in the form of lower prices of their stock if the fee reduced the institution's future profits.

What would be the impact of the fee on the stability of financial institutions and future government outlays to cover future losses?

In general, the effect of a 0.15 percent fee would be small because the fee is small—for instance, it represents a small fraction of the rate charged on an average bank loan to businesses, which currently is in excess of 3 percent. Because the proposed fee does not appear to be high enough to cause financial institutions to significantly change their financial structures or activities, it would not have a significant impact on the stability of financial institutions or

[1]Financial reporting done on a consolidated basis includes a wider range of assets and liabilities than that done on an unconsolidated basis; consolidated obligations of a parent company generally include the assets and liabilities of its subsidiaries. It is uncertain how comprehensive the definition of consolidation would be under the proposal—whether, for instance, the obligations of "special-purpose vehicles" controlled by the affected companies would be included. For some financial companies, assets and liabilities on a fully consolidated basis are many times larger than those carried on their balance sheets.

significantly alter the risk that government outlays will be needed to cover future losses.

The fee would provide incentives that might either increase or decrease institutions' risk taking, and CBO cannot predict whether the net impact would be to raise or lower the federal government's costs in the future. On the one hand, the fee could reduce the profitability of larger institutions, which might create an incentive for them to take greater risks in pursuit of higher returns to offset their higher costs.[2] On the other hand, the fee would provide an incentive for larger financial institutions to reduce their dependence on liabilities subject to the fee. To the extent that institutions increased their reliance on equity, the risk of future losses would be reduced. However, financial institutions consider equity capital to be expensive, and introducing a fee of this size would probably not induce much of a substitution of equity for debt.[3] More generally, whether a particular institution would have an incentive to change its investment or financing mix in a way that altered its risk profile would depend on a number of factors, including the relative cost of financing options and regulatory constraints.

Imposing a fee on the largest banks would improve the competitive position of small- and medium-size banks, probably leading to some increase in their share of the loan market. How that development would affect the government's costs and risk exposure is unclear. Smaller banks have experienced higher failure rates historically, but their failures are less costly to resolve and less likely to pose a systemic risk to the economy.[4]

What would be the impact of the fee on the availability of credit in general and for small businesses in particular?

The fee would probably lower the total supply of credit in the financial system to a slight degree. It would also probably slightly decrease the availability of credit for small businesses. Small businesses often rely on smaller financial institutions for their credit needs, and those institutions would not be affected by the fee.

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[2] Federally insured institutions have an incentive to take more risk than they otherwise would because their shareholders reap all of any gains but are partly protected from any losses. The expected gain from risk-taking is higher for less profitable institutions, which gain more from the downside protection of insurance. Because the fee could reduce profitability, it could increase the propensity to take risk. (The value of insurance accrues to equity holders rather than depositors because it allows banks to pay lower interest rates on deposits.)

[3] Large institutions might shift to funding sources not included among the liabilities covered by the fee—for example, by increasing their reliance on deposits. An increase in the total volume of insured deposits would increase the amount of liabilities bearing explicit federal insurance, but a substantial additional reliance on deposits would probably involve large uninsured deposits. Large institutions might also fund more loans by securitizing them—bundling them into securities and selling the securities to investors—if those securities would not be covered by the fee.

[4] The Federal Deposit Insurance Corporation is responsible for resolving bank failures. Under current law, its costs are covered by premiums charged to insured financial institutions and not by taxes or other federal revenues.

However, larger financial institutions also supply funding for small business loans, and that lending would probably be diminished a bit by the fee.

What would be the impact of the fee on the economic growth?
Because of its modest size, the fee would probably not have a measurable impact on the growth of gross domestic product.

What are the federal government's costs from the TARP and the activities of the Federal Reserve related to the financial crisis?
CBO estimates that the full cost of the TARP will be $99 billion (including realized losses and the present value of expected future losses on funds already disbursed and projected future disbursements), plus about $200 million a year for administrative costs.[5] In your letter, you asked whether receipts from the proposed fee would repay all of the TARP's losses by 2013. Although JCT does not yet have enough detail about the proposal to estimate expected revenues, the Administration's budget shows only $25 billion in receipts from the proposed fee through fiscal year 2013; moreover, CBO does not expect all of the TARP's transactions to be resolved by then.

The Federal Reserve has purchased a substantial amount of longer-term and riskier securities in support of the housing market and the broader economy. Those securities have a significantly higher expected return than the rate that the Federal Reserve pays on the reserves used to finance them. Consequently, CBO expects that, over the next several years, the Federal Reserve's remittances to the Treasury will be higher than previous levels.[6] A forthcoming report by CBO will provide an estimate of the cost of the Federal Reserve's activities in response to the financial crisis.

What is the overlap between firms that would pay the proposed fee and firms that generated losses for the TARP?
For the most part, the firms paying the fee would not be those that are directly responsible for losses realized by the TARP. Some firms subject to the fee are expected to generate such losses, including the American International Group, GMAC Financial Services, and CIT Group (which filed for bankruptcy protection on November 1, 2009). However, the fee would not apply to firms in the automotive industry, which account for $47 billion of the program's estimated total cost of $99 billion. Other firms that would be subject to the fee have either paid back all of the funds received from the TARP or are current on their repayment schedule and unlikely to generate losses from their participation in the program. However, all of the institutions that might be covered by the fee

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[5] See Congressional Budget Office, *The Budget* and *Economic Outlook: Fiscal Years 2010 to 2020* (January 2010), Box 1-2, pp. 12–13.

[6] See Congressional Budget Office, *The Budget* and *Economic Outlook: Fiscal Years 2010 to 2020*, Chapter 4.

benefited to varying degrees from the program's contribution toward stabilizing the nation's financial system and overall economy.

I hope that you find this information helpful. If you have any further questions, please contact me or my staff. The primary staff contact is Deborah Lucas.

Sincerely,

Douglas W. Elmendorf

Douglas W. Elmendorf
Director

cc: Honorable Max Baucus
Chairman

Honorable Christopher J. Dodd
Chairman, Senate Committee on
Banking, Housing, and Urban Affairs

Honorable Richard C. Shelby
Ranking Member, Senate Committee on
Banking, Housing, and Urban Affairs

Honorable Sander M. Levin
Acting Chairman, House Committee on
Ways and Means

Honorable Dave Camp
Ranking Member, House Committee on
Ways and Means

Honorable Barney Frank
Chairman, House Committee on
Financial Services

Honorable Spencer Bachus
Ranking Member, House Committee on
Financial Services

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF FEBRUARY 14, 2012
PRESIDENT'S BUDGET FOR FISCAL YEAR 2013

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Committee on Finance, delivered opening remarks at a committee hearing examining the President's budget proposal for FY 2013. Treasury Secretary Timothy Geithner testified before the Committee this morning.

A full copy of the remarks, as prepared for delivery, follows:

Thank you for holding today's hearing, Mr. Chairman, and welcome Secretary Geithner. Let's begin by noting that total public debt outstanding is over $15.3 trillion, larger than the size of our gross domestic product. A debt-to-GDP ratio above 100 percent is clearly unsustainable and puts us in the ranks of the many European countries currently in a severe debt crisis and unable to borrow at sustainable interest rates.

The nation deserves a budget that responsibly addresses this debt crisis. Yet last year, the President delivered a budget that was unanimously rejected on the Senate floor. It did not receive a single *yes* vote, even from Senate Democrats. Yesterday the President laid out his most recent budget plan. Unfortunately, it similarly fails to address this nation's glaring fiscal crisis, and it will probably never be brought to a vote.

We haven't seen a budget resolution from the Senate Budget Committee in years, despite it being legally required. Last year, the President's budget did eventually get a vote, and there is only room for improvement on that result. But the Senate Majority Leader seems to have no inclination to debate a budget on the Senate floor, having stated that the Budget Control Act means that we don't have to debate fiscal year 2013 spending totals since they have already been determined. If so, then we don't need to discuss a large part of what the President unveiled yesterday, which should make for a quick hearing today.

Still, we have to do our due diligence, and in reviewing the budget released yesterday by the President, it is clear that his plan would only make our fiscal problems worse and harm our economy by imposing around $1.9 trillion of stifling tax hikes. Earlier this month, the President suggested at the National Prayer Breakfast that these tax hikes are divinely inspired. That certainly was an interesting take on the Bible. In the President's interpretation, *render unto Caesar the things which are Caesar's, and unto God the things that are God's* becomes, *just give it all to Caesar!*

Who knew that cosmic justice would be rendered by the Department of Education and HUD? Who knew that the separation of the wheat from the chaff would in fact be performed by the Obama administration, picking winners and losers in the name of fairness? Perhaps church going citizens should just cut to the President's chase and instead of tithing or putting an envelope in the basket at church, they could just send their money directly to the divinely ordained Treasury.

The fact is, this budget is politically, not divinely, inspired. This budget is a plan for a permanently larger, European-style government. It does not set our country down a sustainable fiscal path. It does nothing to change the President's unwavering devotion to tax-and-spend policies and failed stimulus schemes that have and will continue to generate historic deficits and levels of debt. It does nothing to wind down the mortgage giants Fannie and Freddie, to restore private flows of capital into our Nation's system of mortgage finance, or to remove the government's effective takeover of our housing markets. It does nothing to address our entitlement spending crisis, whistling past the graveyard as Social Security, health care, and disability trust funds are in death spirals toward bankruptcy. The President presents his budget, with its accelerated spending and class warfare, as one of fairness and compassion.

But is it fair to American workers to jeopardize economic growth through higher taxes? Is it fair to taxpayers to ignore the mortgage giants, Fannie and Freddie, which continue to drain their wallets? Is it fair to the disabled to pretend that the looming bankruptcy of the disability trust fund will not happen in 2016? Is it fair to look at Social Security and turn the other way in the interest of avoiding hard choices that might make a reelection campaign uncomfortable?

Secretary Geithner, I look forward to your testimony today on the President's plan and what it might do to the economy. I have to say, though, that I wish you would be careful in your public economic pronouncements. It is disturbing and unwarranted when you claim, for example, that Republicans' resistance to the President's stimulus proposals for more taxing, spending, and borrowing — as in his so-called jobs bill — means that they do not want to do anything to help the economy or that Republicans' resistance to wasteful stimulus somehow increases the risk of recession.

These claims are simply not true, and they are certainly not productive. Putting aside these discouraging political statements, perhaps we could be given an explanation of why the administration appears to believe that the economic recovery is vibrant enough to be hit with more taxes, despite clear warnings from the Congressional Budget Office of significant negative effects on growth, yet at the same time is not vibrant enough to stop the runaway spending of the current administration. It seems that for President Obama the recipe always calls for more taxes to fund more government.

The result is this budget, which ignores the source of our nation's fiscal challenges — a spending problem that is only getting worse. No matter what budget baseline you choose to consider, the CBO projects that federal revenues as a share of GDP will rise above the long-run average as the economy recovers, even with a continuation of current tax rates. But spending as a share of GDP is projected to indefinitely stay above historic norms, pushing our economy and the size of our government further and further down the path that several major European countries have followed to fiscal ruin.

We also know that our fiscal outlook is very sensitive to future developments, including what might happen to interest rates or inflation. CBO tells us that if interest rates run just one percent higher than assumed in their baseline budget projection, interest outlays over the next 10 years will increase by over $1 trillion. That is for just a one-percent increase. If rates spike up precipitously once our creditors lose patience with the administration's unwillingness to chart a sustainable fiscal course, we could easily face deeply painful adjustments like those currently being experienced in Europe.

On the other hand, according to CBO, if inflation turns out to be one percentage point higher each year than under its baseline, then the deficit would actually fall over the next 10 years.

While the economy would suffer, the government would benefit from higher inflation, and it will be up to the Fed to avoid the temptation to inflate for budgetary gain. I certainly hope that the Fed's recent appetite for mixing monetary and fiscal policies comes to an end, and that we don't have to worry about this temptation to inflate our way out of our debt.

Our unsustainable fiscal path poses great and growing risks to the economy, and the President's budget does nothing to diminish those risks. In fact, given the riskiness of our fiscal path and the temptation to inflate away some of our debt, Warren Buffett, who the administration appears to turn to for its formulation of tax policy, weighed in with advice for investors to steer clear of currency-based investments, like U.S. Treasury securities. As Mr. Buffett says: *In God We Trust may be imprinted on our currency, but the hand that activates our government's printing press has been all too human.* On bonds like Treasuries, the Oracle advises: *Right now bonds should come with a warning label.*

Secretary Geithner, Mr. Buffett is advising investors to shy away from investments such as Treasury securities, and it will be interesting to know if you agree with this advice. My hope is that his recent musings don't become a new Buffet Rule for investors not to buy Treasuries, because if investors heed that advice in large numbers, the spikes in interest rates that I worry about will materialize, and the low-cost financing of our $15.3 trillion debt that the U.S. temporarily enjoys will evaporate in a hurry.

We need to resist the siren song of cheap financing, partly brought on by the Federal Reserve's massive purchases of Treasury securities to help push rates down. Unfortunately, the administration remains lulled in by the siren song and takes current low rates as a reason to spend more and pile up even more debt to finance a bloated, European-sized government. Secretary Geithner, I look forward to your testimony on the President's budget, which I only received late yesterday, after the deadline you were supposed to honor for submission. And, again Mr. Chairman, thank you for holding today's hearing.

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From *The Wall Street Journal*

August 14, 2008

Opinion

The Obama Tax Plan

By Jason Furman and Austan Goolsbee

Even as Barack Obama proposes fiscally responsible tax reform to strengthen our economy and restore the balance that has been lost in recent years, we hear the familiar protests and distortions from the guardians of the broken status quo.

Many of these very same critics made many of these same overheated predictions in previous elections. They said President Clinton's 1993 deficit-reduction plan would wreck the economy. Eight years and 23 million new jobs later, the economy proved them wrong. Now they are making the same claims about Sen. Obama's tax plan, which has even lower taxes than prevailed in the 1990s – including lower taxes on middle-class families, lower taxes for capital gains, and lower taxes for dividends.

Overall, Sen. Obama's middle-class tax cuts are larger than his partial rollbacks for families earning over $250,000, making the proposal as a whole a net tax cut and reducing revenues to less than 18.2% of GDP – the level of taxes that prevailed under President Reagan.

Both candidates for president have proposed tax plans. But they are starkly different in their approaches and their economic impact. Sen. Obama is focused on cutting taxes for middle-class families and small businesses, and investing in key areas like health, innovation and education. He would do this while cutting unnecessary spending, paying for his proposals and bringing down the budget deficit.

In contrast, John McCain offers what would essentially be a third Bush term, with his economic speeches outlining $3.4 trillion of tax cuts over 10 years beyond what President Bush has already proposed and geared even more to high-income earners. The McCain plan would lead to deficits the likes of which we have never seen in this country. It would take money from the middle class and from future generations so that the wealthy can live better today.

Sen. Obama believes a focus on the middle class is appropriate in the wake of the first economic expansion on record where the typical family's income fell by almost $1,000. The Obama plan would cut taxes for 95% of workers and their families with a tax cut of $500 for workers or $1,000 for working couples. In addition, Sen. Obama is proposing tax cuts for low- and middle-income seniors, homeowners, the uninsured, and families sending a child to college or looking to save and accumulate wealth.

The Obama plan would dramatically simplify taxes by consolidating existing tax credits, eliminating the need for millions of senior citizens to file tax forms, and enabling as many as 40 million middle-class filers to do their own taxes in less than five minutes and not have to hire an accountant.

Sen. Obama also recognizes that small businesses are the engine of job growth in the economy. That is why he is proposing additional tax cuts, including a tax credit for small businesses that provide health care, and the elimination of capital gains taxes for small businesses and start-ups. The vast majority of small businesses would face lower taxes under the Obama plan than under the McCain plan. In addition, Sen. Obama supports reforming corporate taxes in a manner that would help create jobs in America and simplify the tax code by eliminating distortions and special preferences.

Sen. Obama believes that responsible candidates must put forward specific ideas of how they would pay for their proposals. That is why he would repeal a portion of the tax cuts passed in the last eight years for families making over $250,000. But to be clear: He would leave their tax rates at or below where they were in the 1990s.

• The top two income-tax brackets would return to their 1990s levels of 36% and 39.6% (including the exemption and deduction phase-outs). All other brackets would remain as they are today.

• The top capital-gains rate for families making more than $250,000 would return to 20% – the lowest rate that existed in the 1990s and the rate President Bush proposed in his 2001 tax cut. A 20% rate is almost a third lower than the rate President Reagan set in 1986.

• The tax rate on dividends would also be 20% for families making more than $250,000, rather than returning to the ordinary income rate. This rate would be 39% lower than the rate President Bush proposed in his 2001 tax cut and would be lower than all but five of the last 92 years we have been taxing dividends.

• The estate tax would be effectively repealed for 99.7% of estates, and retained at a 45% rate for estates valued at over $7 million per couple. This would cut the number of estates covered by the tax by 84% relative to 2000.

Overall, in an Obama administration, the top 1% of households – people with an average income of $1.6 million per year – would see their average federal income and payroll tax rate increase from 21% today to 24%, less than the 25% these households would have paid under the tax laws of the late 1990s.

Sen. Obama believes that one of the principal problems facing the economy today is the lack of discretionary income for middle-class wage earners. That's why his plan would not raise any taxes on couples making less than $250,000 a year, nor on any single person with income under $200,000 – not income taxes, capital gains taxes, dividend or payroll taxes.

In contrast, Sen. McCain's tax plan largely leaves the middle class behind. His one and only middle-class tax cut – a slow phase-in of a bigger dependent exemption – would provide no benefit whatsoever to 101 million families who do not have children or other dependents, or who have a low income.

But Sen. McCain's plan does include one new proposal that would result in higher taxes on the middle class. As even Sen. McCain's advisers have acknowledged, his health-care plan would impose a $3.6 trillion tax increase over 10 years on workers. Sen. McCain's plan will count the health care you get from your employer as if it were taxable cash income. Even after accounting for Sen. McCain's proposed health-care tax credits, this plan would eventually leave tens of millions of middle-class families paying higher taxes. In addition, as the Congressional Budget Office has shown, this kind of plan would push people into higher tax brackets and increase the taxes people pay as their compensation rises, raising marginal tax rates by even more than if we let the entire Bush tax-cut plan expire tomorrow.

The McCain plan represents Bush economics on steroids. It has $3.4 trillion more in tax cuts than President Bush is proposing, largely directed at corporations and the most affluent. Sen. McCain would implement these cuts without proposing any meaningful steps to simplify taxes or eliminate distortions and loopholes. In addition, Sen. McCain has floated over $1 trillion in new spending increases but barely any specific spending cuts.

As previously mentioned, the Obama plan is a net tax cut – his middle-class tax cuts are larger than the rollbacks he has proposed for families making over $250,000. Sen. Obama would pay for this tax cut by cutting spending – including responsibly ending the war in Iraq, reducing excessive payments to private plans in Medicare, limiting payments for high-income farmers, reducing subsidies for banks that make student loans, reforming earmarks, ending no-bid contracts, and eliminating other wasteful and unnecessary programs.

While Sen. Obama would shrink the deficit from its current record levels, he recognizes that it is even more important to confront our long-term fiscal challenges, including the growth of health costs in the public and private sector. He also believes it is critical to work with members of Congress from both parties to strengthen Social Security while protecting middle-class families from tax increases or benefit cuts. He has done what few presidential candidates have been willing to do by making a politically risky proposal to strengthen solvency by asking those making over $250,000 to contribute a bit more to Social Security to keep it sound.

Sen. Obama does not support uncapping the full payroll tax of 12.4% rate. Instead, he is considering plans that would ask those making over $250,000 to pay in the range of 2% to 4% more in total (combined employer and employee). This change to Social Security would start a decade or more from now and is similar to the rate increases floated by Sen. McCain's close adviser Lindsey Graham, and that Sen. McCain has previously said he "could" support.

In contrast, Sen. McCain has put forward the most fiscally reckless presidential platform in modern memory. The likely results of his Bush-plus policies are clear. As Berkeley economist Brad Delong has estimated, the McCain plan, as compared to the Obama plan, would lower annual incomes by $300 billion or more in real terms by 2017, costing the typical worker $1,800 or more due to the effect of large deficits on national savings and thus capital formation. Sen. McCain's neglect of critical public investments would further impede economic growth for decades to come.

Do not take the critics' word for it. Go look at the plans for yourself at www.barackobama.com/taxes. Get the facts and you will see the real priorities at stake in this election. America cannot afford another eight years like these.

Messrs. Furman and Goolsbee are, respectively, economic policy director and senior economic adviser at Obama for America.

The President's Budget for Fiscal Year 2013
United States Senate Committee on Finance
Tuesday, February 14, 2012

Statement for the Record
Senator Pat Roberts

Chairman Baucus, Ranking Member Hatch, thank you for holding this hearing on the Fiscal Year 2013 Budget. I appreciate the opportunity to comment on the President's proposals. I wasn't surprised yesterday to again see the President attack a key Kansas industry. I wasn't surprised, but I am dismayed.

Once again, the Budget proposes to eliminate a depreciation method used by a key Kansas industry, general aviation. I find this particularly ironic, given the statements and descriptions of this budget purportedly being focused on boosting jobs, supporting growth, and improving opportunity for middle-class Americans.

It's frustrating to see a significant number of proposals designed to draw jobs and business activity back to the U.S. At the same time, this budget attacks an industry that has never left our shores. It has weathered the economic down turn and has, for decades, provided the exact type of business opportunity, job growth, and economic benefit that the Administration wishes to keep here in the country.

President Obama has on multiple occasions singled out the general aviation industry as an example of a "big" business that only serves the wealthy and should contribute more to lowering the deficit. The only problem with this claim is that it's completely devoid of reality.

General aviation aircraft actually serve as essential business tools for a multitude of U.S. businesses of all shapes and sizes that rely on them to access multiple offices and facilities spread across the nation. Understanding that managers, sales teams and technical experts are often required to visit numerous offices in a short amount of time, and in regions of the U.S. that aren't served by large airports, general aviation is sometimes their only option.

In fact, 90% of our country's airports aren't accessible by commercial aircraft. Beyond its essential use as a business tool, general aviation employs over 1.2 million workers, and annually contributes $150 billion to the U.S. economy. In 2010, general aviation delivered 1,334 planes valued at $7.9 billion, with well over half attributed to exports – a number that supports President Obama's goal of doubling U.S. exports over the next five years.

This industry is doing everything the President claims is a priority. So, it's confusing that the White House would again directly attack this industry with talks of repealing a tax provision that has contributed positively to job creation in a time of severe economic downturn.

COMMUNICATIONS

Comments for the Record

Senate Finance Committee

The President's Fiscal Year 2013 Budget Proposals

Tuesday, February 14, 2012, 10:00 AM

By Michael G. Bindner

Center for Fiscal Equity

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Alexandria, VA 22304

Chairman Baucus and Ranking Member Hatch, thank you for the opportunity to submit these comments for the record to the Senate Finance Committee. The beginning of the budget debate for a new year brings with it the opportunity to rethink proposals. The Center for Fiscal Equity is using this opportunity to change our proposed fix for Social Security, which we will address in due course in our comments, which outline how Congress can respond to the President's Budget submission. Congress has four options in pursuing fiscal policy this year. It can do nothing, it can play small, it can play medium or it can go big. Our comments will address each possibility.

Doing nothing is a possible solution to almost every issue. At the end of the calendar year, the tax cuts of 2001, 2003 and 2010 expire automatically, as do the recently extended payroll tax cut, extended unemployment insurance benefits and the suspension of the "Doc Fix" for doctors serving Medicare patients. Allowing these provisions to expire essentially solves the nation's fiscal problems in the long term.

If the economy is more robust in December than current forecasts suggest, which is possible if ambitious solutions are pursued by the Federal Reserve on the underwater mortgage issue, this may be the most realistic option -- although in our view it would be a lost opportunity for long term reform. This is not likely, however, as richest Americans (including doctors) who by and large fund the anti-tax movement, would be the hardest hit should permanent law come back into force, and would become the loudest voices for compromise to avoid this.

On the expenditure side, the Budget Control Act of 2011 contains within it spending caps which effectively serve as budget allocations for the purpose of enacting appropriations – making a concurrent budget resolution entirely unnecessary for the upcoming fiscal year. Voices who continue to claim that the Senate has not enacted a budget in 1000 days should be silent and if they continue to make this claim, held up to public ridicule because they should know better.

If the law included automatic enactment of the current service budget within these allocations, as we have suggested, then the only action required for this fiscal year would be extension of the debt limit, although some analysts, among them Bruce Bartlett, have suggested that the limit itself is unconstitutional and could be dispensed with, either in law or by Administration decree. Automatic enactment of the budget and dispensing with the debt limit would spur the Congress to enact timely compromise, which would end the impulse to gridlock.

There are two ways that Congress and the Administration can play small ball. Sadly, this is the most likely scenario given the state of the national economy. The most likely way is to delay action until after the election and, as a package, extend the debt limit through December 2013 in exchange for extending the expiring income, payroll, unemployment and medical payment provisions for an equal period of time, accepting the temporary pain of one year of sequestration.

A slightly more ambitious version of this scenario, which leaves less to chance as far as the impact of the election (as a lame duck President has no interest in any compromise at all) is to extend the debt limit, doc fix suspension, the payroll tax cut, extended unemployment and tax rates for middle class and wealthy taxpayers through July 2013 in exchange for making certain tax cuts for lower income Americans permanent, including the 10% tax rate and expanded Child Tax Credit – offsetting some or all of the spending cuts that have already been agreed to. This allows discourse on tax reform without holding our most vulnerable citizens hostage.

Should the President indicate that he is likely to let gridlock rule the day, a medium ball solution is more likely as opposition to a balanced solution evaporates as the likelihood of automatic tax cuts increases. The balanced solution is some combination of the cuts and tax reforms supported by the majority of the Fiscal Commission, also known as Bowles-Simpson, and the proposals of the Bipartisan Policy Center, also known as Rivlin-Domenici. Many of these proposals are similar and where they coincide seems like a fruitful place to start drafting legislation. Using the congressional budget process to begin enacting these provisions could occur in regular order, with the Department of the Treasury playing a supporting role in writing tax reform language.

The large ball game would be to actually balance the budget and enact radical reform in entitlement revenue and spending provisions, a shift from income taxes for most filers to consumption taxes and higher tax rates on those most ability to pay. The Center for Fiscal Equity proposes a large ball solution with four major provisions:

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25% in either 5% or 10% increments. Heirs would also pay taxes on distributions from estates, but not the assets themselves, with distributions from sales to a qualified ESOP continuing to be exempt.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

We have no proposals regarding environmental taxes, customs duties, excise taxes and other offsetting expenses, although increasing these taxes would result in a lower VAT. American competitiveness is enhanced by enacting a VAT, as exporters can shed some of the burden of taxation that is now carried as a hidden export tax in the cost of their products. The NBRT will also be zero rated at the border to the extent that it is not offset by deductions and credits for health care, family support and the private delivery of governmental services.

Some oppose VATs because they see it as a money machine, however this depends on whether they are visible or not. A receipt visible VAT is as susceptible to public pressure to reduce spending as the FairTax is designed to be, however unlike the FairTax, it is harder to game. Avoiding lawful taxes by gaming the system should not be considered a conservative principle, unless conservatism is in defense of entrenched corporate interests who have the money to game the tax code.

Our VAT rate estimates are designed to fully fund non-entitlement domestic spending not otherwise offset with dedicated revenues. This makes the burden of funding government very explicit to all taxpayers. Nothing else will reduce the demand for such spending, save perceived demands from bondholders to do so – a demand that does not seem evident given their continued purchase of U.S. Treasury Notes.

Value Added Taxes can be seen as regressive because wealthier people consume less, however when used in concert with a high-income personal income tax and with some form of tax benefit to families, as we suggest as part of the NBRT, this is not the case.

The shift from an income tax based system to a primarily consumption based system will dramatically decrease participation in the personal income tax system to only the top 20% of households in terms of income. Currently, only roughly half of households pay income taxes, which is by design, as the decision has been made to favor tax policy to redistribute income over the use of direct subsidies, which have the stink of welfare. This is entirely appropriate as a way to make work pay for families, as living wage requirements without such a tax subsidy could not be sustained by small employers.

The income surtax is earmarked for overseas military, naval sea and international spending because this spending is most often deficit financed in times of war. Earmarking repayment of trust funds for Social Security and Medicare, acknowledges the fact that the buildup of these trust funds was accomplished in order to fund the spending boom of the 1980s without reversing the tax cuts which largely benefited high income households.

Earmarking debt repayment and net interest in this way also makes explicit the fact that the ability to borrow is tied to the ability to tax income, primarily personal income. The personal or household liability for repayment of that debt is therefore a function of each household's personal income tax liability. Even under current tax law, most households that actually pay income taxes barely cover the services they receive from the government in terms of national defense and general government services. It is only the higher income households which are truly liable for repayment of the national debt, both governmental and public.

If the debt is to ever be paid back rather than simply monetized, both domestically and internationally (a situation that is less sustainable with time), the only way to do so without decreasing economic growth is to tax higher income earners more explicitly and at higher rates than under current policy, or even current law.

The decrease in economic class mobility experienced in recent decades, due to the collapse of the union movement and the rapid growth in the cost of higher education, means that the burden of this repayment does not fall on everyone in the next generation, but most likely on those who are living in high income households now.

Let us emphasize the point that when the donors who take their cues from Americans for Tax Reform bundle their contributions in support of the No Tax Pledge, they are effectively burdening their own children with future debt, rather than the entire populace. Unless that fact is explicitly acknowledged, gridlock over raising adequate revenue will continue.

Unlike other proposals, a graduated rate for the income surtax is suggested, as at the lower levels the burden of a higher tax rate would be more pronounced. More rates make the burden of higher rates easier to bear, while actually providing progressivity to the system rather than simply offsetting the reduced tax burden due to lower consumption and the capping of the payroll tax for Old Age and Survivors Insurance.

One of the most oft-cited reforms for dealing with the long term deficit in Social Security is increasing the income cap to cover more income while increasing bend points in the calculation of benefits, the taxability of Social Security benefits or even means testing all benefits, in order to actually increase revenue rather than simply making the program more generous to higher income earners. Lowering the income cap on employee contributions, while eliminating it from employer contributions and crediting the employer contribution equally removes the need for any kind of bend points at all, while the increased floor for filing the income surtax effectively removes this income from taxation. Means testing all payments is not advisable given the movement of retirement income to defined contribution programs, which may collapse with the stock market – making some basic benefit essential to everyone.

Moving the majority of Old Age and Survivors Tax collection to a consumption tax, such as the NBRT, effectively expands the tax base to collect both wage and non-wage income while removing the cap from that income. This allows for a lower tax rate than would otherwise be possible while also increasing the basic benefit so that Medicare Part B and Part D premiums may also be increased without decreasing the income to beneficiaries.

If personal accounts are added to the system, a higher rate could be collected, however recent economic history shows that such investments are better made in insured employer voting stock rather than in unaccountable index funds, which give the Wall Street Quants too much power over the economy while further insulating ownership from management. Too much separation gives CEOs a free hand to divert income from shareholders to their own compensation through cronyism in compensation committees, as well as giving them an incentive to cut labor costs more than the economy can sustain for purposes of consumption in order to realize even greater bonuses. Employee-ownership ends the incentive to enact job-killing tax cuts on dividends and capital gains, which leads to an unsustainable demand for credit and money supply growth and eventually to economic collapse similar to the one most recently experienced.

The NBRT base is similar to a Value Added Tax (VAT), but not identical. Unlike a VAT, an NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

In the long term, the explosion of the debt comes from the aging of society and the funding of their health care costs. Some thought should be given to ways to reverse a demographic imbalance that produces too few children while life expectancy of the elderly increases.

Unassisted labor markets work against population growth. Given a choice between hiring parents with children and recent college graduates, the smart decision will always be to hire the new graduates, as they will demand less money – especially in the technology area where recent training is often valued over experience.

Separating out pay for families allows society to reverse that trend, with a significant driver to that separation being a more generous tax credit for children. Such a credit could be "paid for" by ending the Mortgage Interest Deduction (MID) without hurting the housing sector, as housing is the biggest area of cost growth when children are added. While lobbyists for lenders and realtors would prefer gridlock on reducing the MID, if forced to chose between transferring this deduction to families and using it for deficit reduction (as both Bowles-Simpson and Rivlin-Domenici suggest), we suspect that they would chose the former over the latter if forced to make a choice. The religious community could also see such a development as a "pro-life" vote, especially among religious liberals.

Enactment of such a credit meets both our nation's short term needs for consumer liquidity and our long term need for population growth. Adding this issue to the pro-life agenda, at least in some quarters, makes this proposal a win for everyone.

The expansion of the Child Tax Credit is what makes tax reform worthwhile. Adding it to the employer levy rather than retaining it under personal income taxes saves families the cost of going to a tax preparer to fully take advantage of the credit and allows the credit to be distributed throughout the year with payroll. The only tax reconciliation required would be for the employer to send each beneficiary a statement of how much tax was paid, which would be shared with the government. The government would then transmit this information to each recipient family with the instruction to notify the IRS if their employer short-changes them. This also helps prevent payments to non-existent payees.

Assistance at this level, especially if matched by state governments may very well trigger another baby boom, especially since adding children will add the additional income now added by buying a bigger house. Such a baby boom is the only real long term solution to the demographic problems facing Social Security, Medicare and Medicaid, which are more demographic than fiscal. Fixing that problem in the right way definitely adds value to tax reform.

The NBRT should fund services to families, including education at all levels, mental health care, disability benefits, Temporary Aid to Needy Families, Supplemental Nutrition Assistance, Medicare and Medicaid. If society acts compassionately to prisoners and shifts from punishment to treatment for mentally ill and addicted offenders, funding for these services would be from the NBRT rather than the VAT.

The NBRT could also be used to shift governmental spending from public agencies to private providers without any involvement by the government – especially if the several states adopted an identical tax structure. Either employers as donors or workers as recipients could designate that revenues that would otherwise be collected for public schools would instead fund the public or private school of their choice. Private mental health providers could be preferred on the same basis over public mental health institutions. This is a feature that is impossible with the FairTax or a VAT alone.

To extract cost savings under the NBRT, allow companies to offer services privately to both employees and retirees in exchange for a substantial tax benefit, provided that services are at least as generous as the current programs. Employers who fund catastrophic care would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates, but not so much that the free market is destroyed. Increasing Part B and Part D premiums also makes it more likely that an employer-based system will be supported by retirees.

Enacting the NBRT is probably the most promising way to decrease health care costs from their current upward spiral – as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise. While not all employers would participate, those who do would dramatically alter the market. In addition, a kind of beneficiary exchange could be established so that participating employers might trade credits for the funding of former employees who retired elsewhere, so that no one must pay unduly for the medical costs of workers who spent the majority of their careers in the service of other employers.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

The Center calculates an NBRT rate of 27% before offsets for the Child Tax Credit and Health Insurance Exclusion, or 33% after the exclusions are included. This is a "balanced budget" rate. It could be set lower if the spending categories funded receive a supplement from income taxes. These calculations are, of course, subject to change based on better models.

In testimony before the Senate Budget Committee, Lawrence B. Lindsey explored the possibility of including high income taxation as a component of a Net Business Receipts Tax. The tax form could have a line on it to report income to highly paid employees and investors and pay surtaxes on that income.

The Center considered and rejected a similar option in a plan submitted to President Bush's Tax Reform Task Force, largely because you could not guarantee that the right people pay taxes. If only large dividend payments are reported, then diversified investment income might be under-taxed, as would employment income from individuals with high investment income. Under collection could, of course, be overcome by forcing high income individuals to disclose their income to their employers and investment sources – however this may make some inheritors unemployable if the employer is in charge of paying a higher tax rate. For the sake of privacy, it is preferable to leave filing responsibilities with high income individuals.

Dr. Lindsey also stated that the NBRT could be border adjustable. We agree that this is the case only to the extent that it is not a vehicle for the offsets described above, such as the child tax credit, employer sponsored health care for workers and retirees, state-level offsets for directly providing social services and personal retirement accounts. Any taxation in excess of these offsets could be made border adjustable and doing so allows the expansion of this tax to imports to the same extent as they are taxed under the VAT. Ideally, however, the NBRT will not be collected if all employers use all possible offsets and transition completely to employee ownership and employer provision of social, health and educational services.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement Of the U.S. Chamber Of Commerce

ON: **ADMINISTRATION TAX PROPOSALS IN FY2013 BUDGET**

TO: **THE SENATE FINANCE COMMITTEE**

DATE: **FEBRUARY 14, 2012**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

INTRODUCTION

The Chamber thanks Chairman Baucus and Ranking Member Hatch for the opportunity to comment on the tax proposals contained in the Administration's FY2013 budget (the "Greenbook"). The Chamber is disappointed with the proposals included in the Greenbook. These proposals are largely a rehash of prior year Greenbooks and once again offer no policies that make our tax code more competitive, fair, simpler, compliance-friendly or more pro-growth. Instead, we see the same policies of prior years and an even greater reliance on raising revenues through the tax code.

The Chamber believes that as the Committee considers policies to drive job creation and economic growth and considers fundamental federal tax reform, it should firmly reject the proposals contained in the Greenbook and seek to undertake comprehensive tax reform to foster growth, competitiveness, innovation, ease of compliance, and job creation. As other countries, and even individual states within our own borders, move to adopt tax policies that foster growth, competitiveness, and innovation, these proposals generally would move the federal tax code[1] in precisely the opposite, and wrong, direction.

IN GENERAL

The Greenbook, in large part, repeats prior year tax proposals of this Administration, levying onerous tax increases on businesses of all sizes and picking winners and losers, while omitting pro-growth tax policy. It levies almost $2 trillion in new taxes, while providing only $146 billion[2] of permanent tax cuts for business, $108 billion of which is comprised of one incentive – making the research and development (R&D) tax credit permanent – which generally is already renewed on an annual basis.

TAX INCREASES

Individual and Small Business Tax Hikes

As in prior years, the Greenbook includes significant tax increases on upper income individuals, totaling over $1.5 trillion. These proposals fail to recognize that these increases hit the most successful U.S. small businesses that pay taxes at individual tax rates, hindering their ability to grow and create jobs.

While this year's budget calls for implementation of a "Buffett" rule that results in a minimum effective tax rate of 30% on those making over $1 million, the rule appears nowhere in the Greenbook. Instead, the Greenbook once again targets those making over $200,000 or $250,000 jointly. The Greenbook ignores that our tax system is already highly progressive (in 2009, according to the IRS, the top 1% of the income distribution controlled about 17% of income and paid almost 37% of federal income taxes). It proposes an even more punitive system on those who save, invest, and create jobs. It proposes increasing the top marginal tax rates, reducing or eliminating itemized deductions, and limiting the rate at which the remaining

[1] All references to the "code" are to the Internal Revenue Code of 1986, as amended.
[2] All revenue estimates are for 10 year periods and are provided by OMB.

deductions can be taken. Further, it proposes raising taxes on investment – taxing long term capital gains at 20%, up from 15%, and dividends at marginal rates as high as 39.6%, up from 15%. These increased investment taxes are compounded by the Medicare hospital insurance (HI) tax of 3.8% that kicks in next year. Additionally, the failure to maintain lower, synchronized capital gains and dividends rates, a departure from prior year proposals, discourages efficient capital allocation and decreases fairness.

Quite simply, the Committee cannot ignore the negative impacts of these tax increases and must reject such policies in both the near and long term. Over the past 30 years, the number of pass-thru businesses – sole proprietorships, S-corporations, LLCs and partnerships – has nearly tripled. In 2010, the Joint Committee on Taxation determined that a substantial share of new revenue (50% for the increase in the top two rates) was directly attributable to the income reported for pass-thru businesses by their owners. In other words, small businesses would bear a substantial portion of these higher taxes.

Further, increased investment taxes have real and damaging ramifications.[3] Millions of Americans of all income levels would be adversely impacted by these tax hikes. Further, older Americans and those saving for retirement would be disproportionately hurt by investment tax hikes. Raising capital gains and dividends taxes has real adverse effects on the economy. Thus, the Chamber strongly opposes these tax hikes and the negative ramifications on investment, economic growth, and productivity that come with increased investment taxes.

As the Committee considers fundamental tax reform, it is critical to recognize the significant numbers of entities who remit taxes under the individual Code; thus, careful consideration must be given to any reform that addresses the corporate tax rate without properly considering individual rates. Second, given the significant and increasing numbers of these pass-thru entities, the Chamber believes proposals, such as these tax increases, must be rejected, as they thwart the growth of the very businesses that are the backbone of our economy.

Other Business Tax Increases

Also as in prior years, the Greenbook includes tax increases on larger business entities, totaling almost half a trillion dollars, achieved by, among other things, double taxing the profits American worldwide companies earn overseas, levying punitive new taxes on traditional energy producers and reinstating Superfund taxes, repealing longstanding accounting practices, and taxing the carried interest in partnerships as ordinary income.

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[3] For more detailed information on the damaging impact of raising investment taxes and the Chamber's opposition to increased investment taxes, please see our September 14, 2011 testimony to the Senate Finance Committee, available at http://www.uschamber.com/sites/default/files/110914testimonysenateFinance.pdf. For a recent detailed study on the international aspects of capital gains and dividends and the adverse economic consequences of high tax rates on this investment income, see E&Y, "Dividend and Capital Gains Taxation: A comparison of the US to other developed nations," (February 2012), available at http://www.theasi.org/assets/EY_ASI_Dividend_and_Capital_Gains_International_Comparison_Report_2012-02-03.pdf.

International Taxation

The Greenbook once again proposes to double tax the profits American worldwide companies earn abroad, by curtailing deferral, limiting foreign tax credits, and attacking the tax treatment of intangibles. The President's own fiscal commission report states that our system of taxing foreign source income is against the norm, and "[t]he current system puts U.S. corporations at a competitive disadvantage against their foreign competitors." His Export Council recommends creation of an international tax system "in which U.S. corporations can compete well with those in other OECD countries," going on to state that a "competitive territorial tax system for the United States should broadly follow the practice of our trading partners… to make the U.S. tax system more competitive with its major trading partners." Despite this, the Greenbook moves in the opposite direction with $148 billion of international tax increases that threaten to put American companies at even greater competitive disadvantage.

The Chamber urges the Committee to reject these proposals and, instead, as it considers fundamental reform, consider ways to level the playing field for American businesses, such as adopting a territorial tax system as recommended by the President's Deficit Commission and Export Council. The Chamber believes any changes to international tax policy should make American companies more competitive, drive job creation, and stimulate overall economic growth.

Punitive Energy Taxes

The Greenbook also repeats its attack on oil and gas companies and coal companies from prior years, proposing large and onerous tax increases, totaling over $41 billion on these traditional energy producers. This represents continued attacks on oil and gas companies as well as coal companies. In addition to industry-specific punitive taxes, many of these companies also face tax hikes in the form of last-in, first-out (LIFO) repeal and changes to the dual capacity rules. All of these tax increases result in increased energy costs and decreased energy security.

Once again, these proposals punish industries such as oil and gas, who already face some of the highest effective tax rates of any industry sector and who create millions of high-paying jobs. The Greenbook justifies these increased taxes on traditional energy sources to pay for "clean" energy and manufacturing incentives. The Chamber strongly urges the Committee to reject tax policies such as this, which preference one industry or sector to the detriment of another. Instead, the Chamber suggests the adoption of fundamental tax reform that would benefit the entire business community.

Changes to Longstanding Inventory Accounting Methods

In addition to the above tax increases, the Greenbook once again proposes repeal of longstanding accounting methods, solely to raise tax revenues. For example, the Greenbook, as in prior years, would repeal LIFO to raise $74 billion. The Chamber opposes the repeal of LIFO accounting as it would result in a punitive, retroactive tax increase for businesses, placing significant cash constraints on them and limiting their ability to manage inflation.

Companies would have to record illusory profits on their books, when no economic activity has occurred that would justify recording any profits.

In addition to the repeal of LIFO, the Greenbook once again proposes repeal of the lower-of-cost-or-market (LCM) and subnormal goods accounting methods to raise $13 billion. The Chamber opposes the repeal of these accounting methods as they provide an important cushion during economic downturns. Without these methods, businesses are precluded from recognizing real economic losses in the year of loss, and, rather, must wait until disposal of inventory.

The repeal of these accounting methods originally was proposed as revenue offsets for unrelated initiatives. As the Committee considers short term policies and fundamental reform, the Chamber urges it to reject changes solely sought to raise revenue without consideration for the wide range of industries and businesses of all sizes that would be adversely impacted by these changes.

Punitive Financial Service Sector Taxes

The Greenbook once again proposes a financial crisis responsibility fee.[4] This $61 billion tax will impede economic recovery by constraining commercial lending and capital investment, including much needed lending to small businesses. This tax also creates situations that may lead to double and excessive taxation. In short, this will be a tax borne by America's job creators and is simply the wrong tax at the wrong time.

The punitive financial service sector taxes do not stop there. To raise another $14 billion, the Greenbook would tax "carried interest" – capital gains paid to managers of investment partnerships – as ordinary income. The Chamber believes that taxing carried interest as ordinary income would deter economic activity, reduce credit flow, and stifle job creation. Further, changing this longstanding law ignores the fact that state pension funds, charitable nest eggs, and universities rely on these partnerships and could face funding shortfalls if this tax hike drove talented management capital into other fields.

Thus, as the Committee considers changes to tax policy, the Chamber urges it to seriously consider both the direct and indirect ramifications of these changes on the economy before adopting policies such as those described above.

PRO-GROWTH TAX INCENTIVES

While the Greenbook is full of tax increases, it provides little in the way of tax incentives to help businesses grow. As noted above, in contrast to the almost $2 trillion in new taxes businesses can expect to face, they would see only $146 billion of tax cuts, $108 billion of which is attributable to making permanent the research and development (R&D) tax credit. The long touted incentives for manufacturing are minute in comparison to the tax hikes.

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[4] For further information on the adverse impacts of the proposed financial crisis responsibility fee, please see the 2010 study conducted for the Chamber by Hal S. Scott, Nomura professor of international financial systems at Harvard Law School, "Financial Crisis Responsibility Fee: Issues for Policymakers," that demonstrates the adverse impacts this tax would have upon capital formation, available at http://www.uschamber.com/reports/financial-crisis-responsibility.

Small Businesses and Individual Incentives

For small businesses, the Greenbook contains little in the way of broadly applicable incentives. Summing barely $25 billion in total small business tax cuts, the Greenbook proposes eliminating capital gains taxes on small businesses, providing only $8 billion in tax incentives. Further, it provides for small regional incentives, which add only another $8 billion in incentives.

The Chamber believes that the impact of these provisions is extremely limited. For example, the small business capital gains incentive is diminutive, partially due to its applicability only to the limited number of small businesses operating in C corporation form. The Chamber believes that as the Committee considers proposals in the context of fundamental tax reform, it should avoid narrow incentives that are of value to only one industry, sector, or geographic area. Instead, it should seek policies that broadly benefit the widest possible cross-sections of individuals and businesses.

General Business Incentives

The Chamber supports the inclusion of the proposal to make permanent the R&D tax credit. Longstanding Chamber policy provides that research and development incentives should actually be more expansive, for example, by allowing research and development expenses to be deductible in the year incurred and providing a credit as high as 25% for increases in research expenditures.

As the Committee considers both short term policies and fundamental tax reform, the Chamber believes that it must pay close attention to how taxes impact innovation. The United States continues to lag behind other countries in its treatment of research and development costs. Thus, the Chamber recommends that the Committee seek policies that encourage businesses to conduct research and development within the United States and locate the intellectual property developed as a result of that research within our borders.

Conclusion

The Chamber appreciates the opportunity to comment on the tax proposals contained in the Greenbook. We believe the fact that the Administration proposes to use all of these tax increases in a piecemeal, uncoordinated fashion will actually make it harder to accomplish comprehensive, fundamental tax reform if and when Congress seeks to do so. This piecemeal approach will decrease competitiveness, hurt job creation, and quash economic growth; should Congress undertake fundamental reform it should be comprehensive and should seek to foster growth, competitiveness, innovation, and job growth. We look forward to working with Congress and the Committee to develop tax policies that promote growth and encourage investment in the United States.

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