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PRESIDENT'S BUDGET FOR FISCAL YEAR 2012

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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COMMITTEE ON FINANCE

MAX BAUCUS, Montana, *Chairman*

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PRESIDENT'S BUDGET FOR FISCAL YEAR 2012

WEDNESDAY, FEBRUARY 16, 2011

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

The hearing was convened, pursuant to notice, at 10:06 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

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

Also present: Democratic Staff: Russ Sullivan, Staff Director; Lily Batchelder, Chief Tax Counsel; Alan Cohen, Senior Budget Analyst; Hun Quach, International Trade Analyst; Tom Klouda, Professional Staff Member, Social Security; Diedra Henry-Spires, Professional Staff; and Claire Green, Detailee. Republican Staff: Chris Campbell, Republican Staff Director; Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; and Tony Coughlan, Tax Counsel.

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

The CHAIRMAN. The committee will come to order.

President John F. Kennedy said, "Anyone who is honestly seeking a job and can't find it deserves the attention of the U.S. Government and the people." Unfortunately, today too many Americans are seeking jobs and having little success. That is why our number-one priority must remain creating as many new well-paying jobs as possible.

We have already made real progress in our efforts to save jobs and to create new ones. During 2010, our economy created more than 1 million new jobs in the private sector. It was the best year for private sector job growth since 2006.

But we have a long way to go. The work to create jobs must continue as we examine the budget of the coming year, and it must continue as the economy continues to recover and return to deficit reduction.

For starters, the health care law we enacted last year dramatically reduced the deficit. The nonpartisan Congressional Budget Office projected that this legislation would reduce deficits by $230 billion in the first 10 years and by more than $1 trillion in the 10 years thereafter.

Despite that significant step, we need to continue the deficit reduction work with the administration and our colleagues on both sides of the aisle. So today we are joined by Treasury Secretary Tim Geithner, who will discuss the President's budget. He will examine the ways tax, trade, and health care policy can create the jobs we need, reduce our deficit, and ensure our long-term prosperity.

The President's budget proposal includes a number of tax incentives to encourage job creation. It makes permanent the tremendously successful Build America bonds program. In 2009 and 2010, the Build America bonds program led to over $180 billion in financing for new projects pursued by State and local governments.

Build America bonds come at a lower cost per dollar financed than tax-exempt bonds. These construction projects created new jobs all across the country. Last year, we also enacted a number of successful job-creation tax packages, including the HIRE Act and the Small Business Jobs Act. It is my hope that we can build on those successes.

Our ability to create jobs also depends on a smart, thoughtful, aggressive trade policy. The administration's goal of doubling exports by 2015 is one important way to create jobs here at home. Another certain way to create jobs and boost the sale of American goods around the world is to resolve the outstanding issues and approve the pending free trade agreements with Korea, Panama, and Colombia. I urge the administration to resolve these issues promptly, including concerns about access to the Korean market for U.S. beef.

We have to work to implement a trade policy focused on job creation. I am concerned that the President's proposal to consolidate Federal export agencies could impede export growth. Agencies such as the Office of the U.S. Trade Representative have long had great success promoting U.S. exports. This success is precisely because they are small, nimble, and non-bureaucratic. Any potential reorganization must preserve what works, create new jobs, and expand our economy.

And the administration must work together with Congress on this. The President's budget also ensures the successful implementation of the Nation's new health care law. Giving the law a chance to work reduces rising health care costs for families and businesses. It reduces the deficit by more than $1 trillion. It strengthens our economy and creates more than 250,000 new jobs. Repealing the new law would eliminate this job growth. Repealing the law would move our economy backwards.

The new health care law makes significant progress in creating the jobs our economy needs, but it cannot stop there. This year I plan to look closely at ways we can make America's tax code more competitive. We will continue our series of Finance Committee hearings on tax reform. We will look at ways to make our tax system as simple, efficient, and well-targeted as possible, and we will look at every deduction and every credit with an eye toward job creation and economic growth.

As we consider the President's budget today, let us resolve to do all we can to create the jobs our economy needs. Let us work to improve our long-term prosperity. The country is counting on us.

Secretary Geithner, thank you for being here today. We look forward to your testimony.

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

The CHAIRMAN. Senator Hatch?

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

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

I do not know how you get job increases here when Mr. Elmendorf said there would be 800,000 jobs lost. I know that Mr. Elmendorf is an honest man, trying to do the best job he can. The Build America bonds thing, my gosh, why do we have the rest of the country paying for the profligacy of a couple of States that just will not get their spending under control?

The American public is going to have to pay 28 percent of those Build America bonds. That means the other States that have their spending under control have to pay for States that do not, and that is not right. I do not care what anybody says. But I want to thank you for scheduling this hearing.

I welcome you, Mr. Secretary.

In thinking about our hearing today, a couple of humorous comments came to mind. The first comment comes from the famous poet, Ogden Nash. One of Mr. Nash's light verses was about the potential of omnipotent taxation. Here is what he said: "The more you earn, the less you keep, and now I lay me down to sleep. I pray the Lord my soul to take, if the tax collector hasn't got it before I wake." I think Ogden Nash was pretty prescient for our day.

The second comment comes from a constituent of the Senator from Wyoming, Senator Enzi. Mr. Bruce L. Hargraves, U.S. Navy, Retired, of Worland, WY, wrote a letter to the editor of the *Northern Wyoming Daily News*. His letter was entitled, "Objection from a Former Sailor."

Now, here is what Mr. Hargraves wrote: "I object and take exception to everyone saying that Obama and Congress are spending money like a drunken sailor. As a former drunken sailor, I quit when I ran out of money." [Laughter.]

Now, Mr. Hargraves's letter and Mr. Nash's poem are very relevant to the topic of today's hearing. The official topic is the revenue proposals in President Obama's budget, but there is a much bigger issue before us. Mr. Hargraves's letter was instructive. Over the last couple of years, the President and Congress have been spending like drunken sailors. Spending as a percentage of our economy is at levels we have not seen since World War II. The last time I saw it, it was 25.3 percent of GDP. The last time we did that was 1945.

Overall, it is up by 20 percent as a percentage of our economy. Non-defense discretionary spending by itself has ballooned in the last couple of years. It is up by—according to what I read the other day—25.3 percent, some say 24 percent. But that is still a whopping number. If you count the stimulus spending, it is up by 84 percent.

The President's budget proposes a freeze on that 24-percent ramp-up, but that is kind of like telling a drunken sailor that it is prudent that he continue his spending spree. Mr. Hargraves is also correct that drunken sailors run out of money to spend. Not so here in Congress, and not so in the White House.

Now, Mr. Chairman and Mr. Secretary, maybe we do owe those drunken sailors an apology. Unlike the drunken sailor's budget, the President's budget does not cut the government off from its spending spree. What does the budget tell us? The trend line for spending means all government spending will take 10 percent more of the economy than the historical average. From a fiscal discipline perspective, that number is surely viewed with skepticism. It will likely be much worse. We shall see what CBO says in a few weeks.

Viewed in the light most favorable to its proponents, this number must be disappointing. It basically concedes the point that we cannot restrain the growth of government to some reasonable measure. In that concession we have squandered an opportunity, Mr. Secretary. It is an opportunity because the will of the people, it seems to me, is clear. They want us to come together to restrain spending. A budget that at best means all government growing by 10 percent as a percentage of the economy is not restraint.

The poet Mr. Nash's verses bear on the consequences of the fiscal behavior enabled in this budget, and staggering levels of debt will be built up. By 2019, it will triple from where it was when the President took office. Now, this huge debt will have to, at a minimum, be serviced.

Recently CBO, with conservative baseline assumptions, pegged debt service as high as $1 trillion per year in the out-years. If Ogden Nash were alive today, he would be rightly concerned. With the spending-driven fiscal holes, mounting debt, who among us does not believe there is a monstrous tax hike coming? Could it be so monstrous that Mr. Nash might be worried that his soul would eventually be the subject of confiscatory taxation?

I am trying to help you, Mr. Secretary. I intend to help you. I happen to like you, and I happen to appreciate how hard you work. But we see the steps to that monstrous tax hike in the budget before us. By our calculation, a tax hike of $1.6 trillion is proposed. It comes in many forms, and it hits a lot of different taxpayers.

If the taxpayer is an entrepreneur with a growing small business, he or she may be facing marginal rate hikes of 17 to 24 percent; you know it, I know it. Investors can look forward to a top capital gains rate hike of almost 60 percent in 2013.

Some taxpayers may see their mortgage interest deductions, charitable deductions, and State and local tax deductions cut back. Families and businesses may see a doubling of the gas taxes they pay at the pump, and that does not even include how rapidly gas at the pump is going to go up just naturally. Business may face general tax increases.

Mr. Secretary, again, I want to thank you for appearing today. I am pulling for you. I would like to see you go down in history as a good Secretary. I know how hard you work, and I appreciate it, personally. I look forward to a full, frank, and constructive discussion of the revenue proposals in the President's budget.

I can only stay for a short period today because I have a number of things that I also have to do, but please do not consider that any element of disrespect, because I do have a lot of respect for you. I do think we have to weigh in heavier, and you are in a position right now where you can do it. You passed the first 2 years, and now they ought to be listening to you, and you ought to be helping them to get real about spending, and about taxing, and about government.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

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

The CHAIRMAN. Thank you, Secretary Geithner, for coming before us today to discuss the President's budget proposal, certainly with respect to your jurisdiction. You know the drill. Your statement is automatically included. Speak for as long as you wish.

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. It is a privilege to be before you today to talk about the choices ahead of us to help strengthen the economy and reduce our long-term deficits.

The President's budget presents a comprehensive strategy to strengthen economic growth and expand exports with investments in education, innovation, and the Nation's infrastructure. Alongside these investments, the budget presents a detailed, multi-year, comprehensive plan to cut spending and reduce deficits.

Our deficits are too high. They are unsustainable. Left unaddressed, these deficits will hurt economic growth and make us weaker as a Nation. We must restore fiscal responsibility and go back to living within our means as a country.

The President's budget cuts the deficit he inherited in half as a share of the economy by the end of this first term. These cuts are phased in over time to protect the recovery. In order to make it possible for us to invest in future growth and to restore fiscal sustainability, the President proposes to reduce non-security discretionary spending to its lowest level as a share of the economy since Dwight Eisenhower was President.

To achieve this, the President proposes a 5-year freeze of annual non-security discretionary spending at its 2010 nominal level, which will reduce the deficit by more than $400 billion over the next 10 years. The President also proposes to reduce the request for defense spending, to freeze civil service salaries, and improve efficiency in government through a range of program eliminations and reductions.

These savings create the room necessary for us to make targeted investments in support of reforms that will help strengthen future economic growth. The most important things we can do to promote our long-term growth are to improve the quality of our education system, to invest in innovation, and to rebuild our infrastructure. Without these investments, America will be weaker and less competitive.

As part of the strategy for growth, the President proposes reforms to our tax system designed to encourage investment. We propose to put in place a permanent and expanded tax credit for research and development in the United States, to eliminate capital gains on investments in small businesses, to encourage advanced manufacturing in clean energy technologies, to keep taxes on investment income—dividends and capital gains—low, and to make college more affordable for middle-class Americans.

These tax incentives are accompanied by reforms that would reduce the incentive to shift income and investment outside the

United States and to close loopholes and tax preferences that we cannot afford.

Now, in addition we propose to pursue comprehensive reform of the corporate tax system that would lower the corporate rate. Our present corporate tax system, as you know, combines a very high rate with a very broad range of very expensive tax preferences for specific industries and activities.

We need a more competitive system that allows the market, not tax planners and lobbyists, to allocate investment, a system in which businesses across industries pay a roughly similar share of earnings in tax, a system which provides more stability and certainty and is more simple to comply with, and we need to do all this without adding to our future deficits. We have begun the process of building support for comprehensive reform. I welcome the support many members of this committee have given to this exercise, and I think we have an opportunity now to try to do this.

The President's budget also outlines some responsible reforms on the individual side. We proposed, as we have in the past, to allow the 2001 and 2003 tax cuts for the wealthiest Americans to expire on schedule, to limit certain deductions for those same high-income Americans, to restore the estate tax to 2009 levels, and to close the carried interest loophole.

These proposals—and I want to emphasize this—will help ensure that the savings we achieve together through spending cuts are devoted to deficit reduction, not to sustaining lower tax rates for the most fortunate 2 percent of Americans.

This budget would achieve the dramatic reductions in our deficits over the next decade that are necessary to stop the national debt from expanding as a share of the economy and to stabilize the debt burden at a level that will not threaten future economic growth.

These are only a first step, however, a down payment on the longer-term reforms necessary to address the long-run deficits. To address the deficits we face over the next century, not just those over the next decade, we have to build on the progress that was achieved in the Affordable Care Act to reduce health care costs. Although it is not a contributor to our short- and medium-run deficits, we should work together across party lines to strengthen Social Security for future generations.

We cannot grow our way out of these deficits. They will not go away on their own. They will not be solved by cutting deeply into programs that are critical to future growth and competitiveness. We need to find consensus on a multi-year plan that cuts where we can so we can invest where we need to and that reduces our deficits. Making a multi-year commitment will allow us to make sure that the changes are phased in as the economy recovers, and making a multi-year commitment will give businesses and individuals adequate time to adjust and prepare for future changes in economic policy.

The President's proposal represents an important starting point for the discussion. Now, we recognize there are many ideas on both sides of the aisle, and we know, as you do, that we need both parties and both Houses of Congress to come together to enact solutions that are going to work.

Now, in December we were able to find bipartisan consensus, due to the hard work of a lot of people in this room, on a very strong package of tax incentives to help sustain the recovery and restore confidence. We need to bring that same commitment to the challenge of fiscal responsibility.

Thank you.

The CHAIRMAN. Thank you, Mr. Secretary.

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

The CHAIRMAN. I would like to follow up a little bit on jobs. You mentioned investment and future jobs. What can you tell people today who do not have a job? What is there here in the budget that gives them a little comfort that we are going to create jobs now, not only in the future?

Secretary GEITHNER. Well, Mr. Chairman, I will start with this. The economy is gradually getting stronger. With growth, you are going to see employment start to increase, as it already has. As you have said, we have created more than a million private sector jobs in the last three quarters—more jobs, more quickly—than was true in the last two recoveries. But of course, it is not happening fast enough, and we need to work to make sure we are reinforcing the strength of recovery so more people get back to work.

The budget has a series of very powerful proposals that will help that objective. We propose a very, very substantial multi-year plan to strengthen infrastructure. We propose, as you referred to in your opening comments, a broad strategy to double our export growth, pass trade agreements that will help expand market access for U.S. companies around the world. We propose a series of tax incentives to encourage investment in the United States so that the major U.S. companies, small and large, will build their next plant here, not outside of the United States. We propose a series of tax cuts for small businesses.

I referred in my opening statement to zero capital gains tax on investments in small businesses that will, again, help reinforce that broad objective of helping accelerate job creation. We propose a series of targeted investments in clean energy technology. We proposed, as you said, to reform, but extend, the Build America bond programs that can help States make sure that they are financing school construction, for example, in a sustainable way.

So those sets of proposals, we think, go a long way to building a foundation for better growth not just in the near term, but over the next several decades. We live in a much more competitive world. The world is not standing still. We need to make sure we frame a strategy as we think about these fiscal choices that is designed to support future growth.

The CHAIRMAN. I wonder if you could expand a little more on incentives to keep jobs here, not overseas. As you know, there are many who point out, roughly, American companies have about $2 trillion in cash reserves, cash on hand, and about half of that is overseas—a little less than half. Some suggest repatriation, let companies bring that money home under our deferral system at lower rates, much lower rates, to “create jobs.” I would like your thoughts on that suggestion, repatriation. Second, what other incentives are you referring to that would help bring jobs home instead of overseas?

Secretary GEITHNER. Well, in the President's budget we propose a series of specific changes to the existing tax structure for corporations that would advance those objectives: permanent expanded R&D tax credit; some changes to the treatment of foreign income that will, again, reduce the incentives and the opportunities in the current tax code to shift income and investments outside of the United States; and a series of tax preferences for small businesses, that all help work in that basic direction.

But we also say that that is working within the current system. I think the best thing we can do is look beyond the current system and legislate comprehensive corporate tax reform that would substantially lower the corporate rate and pay for that by substantially reducing a set of very expensive, broad-based tax expenditures and special interest tax expenditures that, again, are very expensive. They distort the allocation investment, they hurt economic growth.

The world, as you know, while we have been standing still, has moved to dramatically lower their corporate rates. I think in that more competitive environment globally, it makes sense for the country for us to move in that direction. So we will support working with Congress to build support for comprehensive reform that would lower the rate, broaden the base, improve the incentives for investing in the United States, but do so in a way that does not add to our long-term deficits.

The CHAIRMAN. Repatriation?

Secretary GEITHNER. Repatriation, we would be happy to consider in the context of overall corporate reform. If we can do corporate reform right, we will have a chance to help on that front, but we would not support it outside the context of comprehensive reform.

The CHAIRMAN. As you know, the biggest tax preference is a deferral. The corporate world suggests moving to a territorial system, which is even more than deferral on the surface. Your thoughts on that?

Secretary GEITHNER. Well, there is a range of ideas out there. Again, the basic principles that have to guide us are how to make sure that we are encouraging, not reducing, incentives to invest in the United States and that we are reducing, not enhancing, incentives to shift investment income outside of the United States.

So when we look at territorial tax systems, we have to make sure that the ultimate outcome supports that basic objective. There are lots of ways to do this, but again, to make a difference on that front you have to do a comprehensive reform that lowers the corporate rate quite significantly.

The CHAIRMAN. Some suggest that the United States has either the highest, or second-highest statutory corporate rate in the world, but the effective rate is competitive with other countries. The counter to that is, well, to some degree that may be true, but CEOs and people who look at the statutory headline rate, psychologically that has an adverse effect.

Second, even the CFOs may say, gee, our company's effective rate is not that bad. A lot of CEOs say, well, I am less concerned about that. They are looking at the statutory headline rate. Your comments on that. Your comments on the degree to which this top statutory rate is an impediment.

Secretary GEITHNER. I think you are right to emphasize the fact that our average effective corporate tax rate is about the average of our major trading partners. Some are below, but we are about the average. But I think the high statutory rate is a problem. Again, that rate is so high because we are paying for a set of special and broad-based tax expenditures that distort the allocation of investment, and the costs of complying with that are substantial.

I agree with what you said, which is that a lot of people who look at this who run businesses say, I would like the certainty of knowing what my tax burden is going to be over time, and I would like a lower corporate statutory rate even if my effective tax rate at the margin may go up a little bit. I think they would say that tradeoff is good for them. It makes them more competitive. I think that is what has to drive the interest in reform.

The CHAIRMAN. My time has expired. But you made a very good point which I did not have a chance to get into, and that is the uncertainty that exists in the American business world, and also among consumers. Some people think it is caused by big bills, health care reform, et cetera. It is also that all the extenders expire, and these tax preferences you talk about may or may not still be around.

I was very happy to hear you talking about making the R&D tax credit permanent. Senator Hatch and I have advocated that together for some time now, and I think that is one way of many, many ways we can address this question of uncertainty, by making very key, very important provisions permanent. Thank you very much.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman. Likewise, I think that is a very good step because then companies can plan on having that. A lot of other nations do it the right way. We do not do it the right way.

Also, even though you say we are pretty equal with other nations, they have tax expenditures too that have made them, what, the G–7, down around 28 percent, the G–20 somewhere down around 23 percent. They have tax expenditures. So we have to get those corporate rates down.

The CHAIRMAN. Good.

Senator HATCH. Mr. Geithner, when you appeared before this committee as Treasury Secretary nominee over the last couple of years, Senator Grassley referred to an op-ed in an August 14, 2008 edition of the *Wall Street Journal*. That op-ed was written by then-Senator Obama's senior economic advisors, Drs. Furman and Goolsby.

Now, they indicated that the Obama administration would seek to keep the revenue base at close to historic levels or averages of GDP. At that point, CBO reported that over the past 40 years taxes as a percentage of GDP averaged 18.3 percent. The budget before us stays very close to that average in the first 5 years, but the trend is about one-half point above that average in the last 5 years, though it peaks at 20 percent in the last year.

Is the only path to fiscal discipline to maintain record levels of Federal taxation as a percentage of the economy, and are there negative consequences to future economic growth if we return to record levels of Federal taxation?

Secretary GEITHNER. Senator, I think I would approach it this way: there is no way to bring our deficits down to a sustainable level, no strategy that could be achieved, by focusing just on discretionary spending cuts. It is, I think, completely unrealistic politically for that to be possible, and I think it would be very damaging to try to achieve that.

Senator HATCH. We all agree with that.

Secretary GEITHNER. Right. So I think that requires you to look at revenues. It is very hard to do. Most people say, I do not want to hear about revenues until you demonstrate as a country you can restrain spending more directly.

Senator HATCH. But does it not require us to look at entitlements?

Secretary GEITHNER. Right.

Senator HATCH. My position is this: just in the paper today, it said that the President leaves it up to Congress to work on these entitlements. You cannot make any changes without presidential leadership. Why is he not leading in this area, when we know that that is where the major problems are?

Secretary GEITHNER. Senator——

Senator HATCH. I am sorry to interrupt you.

Secretary GEITHNER. No, that is an exellent point. You are right. I think, again, the way I think you should think about the fiscal challenge is, it comes in two phases. We do have a real problem in the next 10 years. That problem has nothing to do with entitlements; it is about a huge imbalance between commitments and resources, partly a legacy of decisions made in the last decade, partly the cost of the recession.

It is very important—nothing is possible unless we can demonstrate we can bring that down much closer to balance. That is what the President's budget proposes doing. That is not enough because, even if we achieve that, over time you are going to see our commitments on entitlements slowly eat away a much more dramatic share of GDP over time. That is untenable and unsustainable.

Now, the President did show a lot of leadership in the last 2 years, working with the Congress, to pass comprehensive health care reform that does reduce substantially those costs to the taxpayer of health care over the next couple decades. The chairman referred to that in his opening remarks. That is absolutely right. The President is prepared to build on those changes with other reforms—he mentioned several in the State of the Union address, including medical malpractice reform—that allow us to go further. But it is important to emphasize, and you are right to say that entitlements matter.

Senator HATCH. Can I interrupt you here?

Secretary GEITHNER. Yes.

Senator HATCH. Is he going to submit something on medical liability reform? I know quite a bit about that, having tried some of those cases. It is nice to say he is for medical liability reform, but if that means just tinkering around the edges, we are not going to solve that problem.

Second, you know darn well that our revenue flow right now is a little less than 15 percent. I mean, it is nowhere near the 18–20 percent that we hope it would be.

Thirdly, I do not see how the administration can keep saying that we are going to save money in this health care bill when Mr. Elmendorf says we are going to lose about 800,000 jobs over time.

Secretary GEITHNER. Well, again, our budget system is not doing a very good job.

Senator HATCH. It is a lousy system.

Secretary GEITHNER. It is a lousy system. But——

Senator HATCH. Can you come up with a better one? I would like to see that.

Secretary GEITHNER. I think it is a very lousy system. It is completely untenable.

Senator HATCH. Then let us change it.

Secretary GEITHNER. But, Mr. Senator, the one great thing is we have a nonpartisan arbiter of costs and savings, and CBO has said consistently over time that these health care reforms will dramatically reduce the cost to the taxpayer of Medicare/Medicaid over the next two decades—substantially in the first decade, as you know, roughly $230 billion, but $1 trillion over the next decade beyond that. We have to make sure we safeguard that. Now, we can go beyond that, and we would like to work with you on that, but we have to make sure we lock those in.

Senator HATCH. Well, look. Nobody that I know really believes that. Frankly——

The CHAIRMAN. Whoa. Whoa. Whoa.

Senator HATCH. No, I do not believe it.

The CHAIRMAN. You know me.

Senator HATCH. Do I know you? [Laughter.]

You believe that?

The CHAIRMAN. Yes, I do.

Senator HATCH. I am worried. Usually Montanans are pretty tough on belief. But let me just say this, one other thing. There are a lot of things I would like to chat with you about. But look, one of the things that would help you a great deal, would help our country a great deal, is to expand the H1B and allow these Ph.D.s who are educated here, who want to stay here, who are brilliant and who could help us in the high-tech world and other worlds, to stay here. I mean, it is ridiculous that the administration does not weigh in on that. And I know why they do not, but it is ridiculous not to.

We have now created real competitors in India, in China, just to mention two places, but others as well. Even in health care, we have competitors in Thailand and all over those areas that are much more competitive than we are. We are not doing the things that really we ought to do to get competitive. Look, I want to help you, so weigh in on this H1B thing. That would help us a great deal. There are so many other things I wish I had time to chat with you about.

Secretary GEITHNER. I agree with you on H1B, by the way. It is just a question of how best to do it. But the great——

Senator HATCH. Expand it. Allow more people who qualify——

Secretary GEITHNER. I agree. That is the way you have to do it.

Senator HATCH. Yes. All right.

The CHAIRMAN. Thank you very much, Senator.

Senator Snowe?

Senator HATCH. I am giving you all these good ideas.

The CHAIRMAN. Oh, yes. Actually, Senator Wyden is ahead of you, but he is not here at the moment.

Senator SNOWE. Thank you.

The CHAIRMAN. You are next, and then Senator Nelson is after you.

Senator SNOWE. Thank you.

Thank you, Mr. Secretary, for being here today. One of the critical issues that I want to focus on, which I think has to be our Nation's ultimate priority, is job creation. Frankly, it is dismaying that we are where we are at this point in our Nation with respect to creating jobs. If you look at just what has happened over the last 2 years, we have lost 7.3 million jobs during this last recession.

So, when you are mentioning that you created 1 million jobs, it pales by comparison in terms of what we have lost, and with the extended numbers with respect to the unemployed, which is probably upwards of 14, 15, perhaps as high as 20 million people who are unemployed. If you look at the stagnation in the job creation market, we have only created 70,000 jobs between June of 2009 and December of 2010, which is a .06 increase over that period of time.

I have a couple of charts here that I think are illustrative of the point where we stand. The first chart demonstrates the severity and the intransigence of the unemployment number. It has been above 9 percent for 21 consecutive months. The only other period that was even close to approximating that was back in 1982, where there were 19 consecutive months. So that is where we stand today.

The second chart, I think, illustrates the point as well, even with the stimulus plan. I mean, looking at the administration's estimates with the recovery plan, we were supposed to be, at this point, 6.9-percent unemployment. Well, that is not where we were. As we look at the second line that indicates the fact that with this stimulus, with the White House estimates, we would be at 6.9 percent. Obviously, we were at 8 percent. Now we are 9 percent. In reality, we should be at 8 percent, according to your estimates, at this point in time, at least by virtue of the fact of the estimates that you had given with respect to the stimulus plan.

So that is $814 billion later, not to mention the extraordinary increase in spending in other parts of the category and what the Federal Reserve is doing, with the top related expenditures of more than $700 billion. So what is the plan for creating jobs? I mean, because obviously the stimulus has not worked to the degree that you indicated, just by virtue of those different lines between what you estimated would happen and what ultimately happened, which is where we stand today with an intractable 9-percent unemployment rate for 21 consecutive months.

Now, Chairman Bernanke indicated recently at a hearing that it is going to take a long time. It is going to be a slow process to rebuild. We need a plan. For all that we talk about all these different programs, more spending, that is what I am hearing even in the budget—more infrastructure spending.

That all was supposed to have occurred in the stimulus plan, and all that has happened since. People want to know, where are the jobs? If you look down the road, what is it going to take to get back to, let us just say 5 percent, by 2016? We require 285,000 jobs a month for 60 consecutive months. That is 5 years.

So, clearly, we have a long ways to go. I think we have to focus on this issue like a laser. We have to have a master plan. We have to get everybody together. We have to point in that direction. What I am hearing is more and more of the same. I mean, even on small business, you had the small business plan last fall. That became law, but now we are talking about small business initiatives and more spending. Yet, we are not seeing any turnaround.

I think there is a reason for that. I think it is the uncertainty that exists out there. Even with the $7 trillion that is sitting on the sidelines with small businesses and with large businesses, it is because they are unwilling because of the risk of the policies coming out of Washington. So where is the plan? We need a plan on job creation.

Secretary GEITHNER. Senator, you are exactly right to emphasize we still have a lot of challenges. Unemployment is very high. Even under the best of circumstances it is going to come down only slowly, and that is because of the cause of this crisis and the deficit crisis.

But we have laid out a very comprehensive set of proposals to make sure that we are investing in infrastructure, we are creating better incentives for investment in the United States, we are helping small businesses, and we are helping to expand exports. Those are things that, as you know, the executive branch cannot do, cannot compel Congress to do. It requires Congress to legislate to put those changes in place.

I think as part of that, as we are discussing today, it is important that Congress lay out a clear, multi-year, long-run plan to reduce these deficits, because part of the uncertainty that you are referring to out there is uncertainty among families and businesses about how we are going to go back to living within our means. You cannot provide that confidence if you leave us with a year-by-year huge uncertainty about what the basic rules of the game are going to be on tax and spending.

That is why, as part of anything we do to help reinforce recovery and strengthen employment, we have to have a multi-year, clear set of commitments to bring those deficits down over time. That will help businesses and families to plan and invest. But again, these basic changes that we have to confront as a country to help strengthen investment, strengthen innovation, improve education, improve competitiveness, those are things that Congress has to legislate.

The executive can propose, and we have proposed, but it is really up to this body, up to both Houses, to find a consensus on concrete things that will help work. Now again, we do not have a monopoly of wisdom on this stuff. There are lots of other ideas out there. We are willing to take any idea, but we have to find some way like we did in the tax package. I think that is a very good example of bipartisan cooperation. We have to find a way to get people to come together and work on practical things that will help.

Senator SNOWE. Well, I think it requires presidential leadership on this question.

Secretary GEITHNER. But we met that test in the sense that—again, you can debate the proposals, but they are proposals. They are comprehensive plans. We would welcome a debate about how to achieve the same amount of deficit reduction with a better mix of incentives for job creation because, if there are better ideas out there, we would be happy to take them.

Senator SNOWE. But what I am saying is, the stimulus occurred 2 years ago, and this is where we stand today on unemployment. That is the bottom line.

Secretary GEITHNER. But Senator, I——

Senator SNOWE. And you can sit here and say it, but all the proposals you are talking about are way down the line. We need to be working on it now. It requires presidential leadership. Let us get together here. We can get together. I think we are just sort of deferring.

Secretary GEITHNER. But Senator, I——

Senator SNOWE. Everybody can get together. The President can call it and let us just all sit down and work it out.

Secretary GEITHNER. But Senator, can I just say, I think you are a little dark and pessimistic about what is actually happening in the economy. The tax package. To give you an example, in the tax package there is a $100-billion tax cut for payroll taxes that goes to 155 million working Americans today, and the most powerful incentive for businesses' expensing that we have ever passed: 100-percent expensing for investment in capital expenditures this year, available to any business across the country.

Those two things are helping contribute to a little acceleration in the economy as a whole. We want to reinforce that and should not put that at risk. Again, the worst thing we could do now as a country is to call into question our commitment to bring these deficits down, to meet our obligations as a country. We want to make sure that we are reinforcing that, but that requires Congress fixing how it does budgets so we can lay out a multi-year plan that will bring these down and people can plan for that.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Thank you, Mr. Chairman.

Mr. Secretary, we have heard a lot of commentary that has been critical. I personally think that the President's budget is a step in the right direction, but we have a long way to go. We have heard a lot of commentary that is critical about, well, you are not doing anything about entitlements. In fact, in the health care bill, $400 billion is being squeezed out of the Medicare system over the course of the next 10 years. Now, I am assuming that your budget takes that into account. Is that right?

Secretary GEITHNER. It does.

Senator NELSON. All right. Well, given the fact of that $400 billion, how does that then project into keeping Medicare in a solvent position for the future? How long does that extend the life of Medicare solvency?

Secretary GEITHNER. Well, it extends it very substantially. But again, I think the right thing to emphasize is that, using the non-partisan, independent CBO estimates, the Affordable Care Act reduces the deficit over the next 10 years in health care by $230 billion, and by $1 trillion over the next decade.

Now, a lot of experts will point out that CBO is traditionally very conservative in estimating cost savings—often understates those estimates—so we could do better, but only if the law is allowed to be implemented over time. Unless those reforms can get some traction now, we will not realize those savings.

Senator NELSON. For example, CBO cannot estimate the cost savings for Accountable Care Organizations, and yet that is a basic underpinning of the health care bill, that it is going to increase efficiency, increase quality, and lower cost. So, is it that we are going to actually have to get into it with these Accountable Care Organizations that—by the way, hospitals that are buying up all these doctors' practices are now forming their own Accountable Care Organizations. Is it basically that we are going to have to get into it and see what the cost savings are in order to realize——

Secretary GEITHNER. Well, I think that, again, there are specific changes in the law that CBO is willing to score in terms of their savings and costs, and, if Congress allows those to remain in place and to be implemented, they would deliver those savings maybe even better. But there is a whole range of other reforms in the bill that CBO will not score. You will note over time how much savings they will produce, but they are likely to surprise on the positive side over time. But again, only if we allow those reforms to take effect.

But I think you are right to say that the Congress did pass the most sweeping entitlement reform considered in a long time with the largest impact on reducing cost growth that Congress has considered, much less passed, in decades and decades.

Senator NELSON. I do not know how you go about something that is politically acceptable for squeezing any more out of Medicare in the immediate future. Do you have any suggestions?

Senator NELSON. I think the President's view is, again, we are happy to build on the framework laid out in the Affordable Care Act. He has identified some specific areas—I mentioned medical malpractice reforms—where we think we can do better. But I think, realistically, our best hope is to make sure we let those reforms start to work. As we explore other ideas, we can do them on top of those.

Senator NELSON. All right. Now, let us shift subjects. Why has the HAMP program not worked? It has only helped some 700,000 folks, when in fact we were looking at it helping 3 million.

Secretary GEITHNER. The HAMP, the President's mortgage modification program, has helped more than 2.5 million Americans take advantage of a mortgage modification that lowered their monthly payments very substantially, on average, $500 or $600 a month, for a sustained period of time, and thereby helped them have a chance to stay in their homes.

Now, it cannot reach everyone, because a lot of the people at risk of foreclosure today are people where it is an investor-owned property, it is a second home, or was a very expensive home supported by a jumbo mortgage, or frankly are people who can afford to meet those payments. It can help people who really just got too overextended, bought a house they just could not afford, and have lost the capacity to meet those commitments.

But we want to make sure these programs reach as many people as possible. But they made a very substantial difference for millions of Americans, and without those programs you would have seen much, much higher rates of foreclosure and much, much more damage to the communities where those foreclosures in the States were concentrated.

We are going to try to make sure, again, those programs reach as many people as we can, but we cannot reach everybody caught up in this crisis. This crisis has a lot of innocent victims. A lot of people saw their home values decline who were very careful and prudent. A lot of people lost their home through no fault of their own. I think we have an obligation still to make sure we are not just strengthening this recovery, but reaching as many Americans as we can.

Senator NELSON. Are you optimistic that the small business lending program that we passed last fall that is still yet to be implemented, that it is going to help put $300 billion of loans out there for small business?

Secretary GEITHNER. I think it is going to make a big difference. I think it is better than all of the alternative ideas out there. I will tell you where we are on implementation. We have about 250 applications from banks for capital under this program. Those applications, if they were granted, would result in about $4 billion in capital provided by the government to those banks for a fee. Of course, the way that program works, the more they increase lending, the more the fee is reduced. So it is a well-designed program with good incentives.

We are also approving programs for States to help give them more financial support for their small business credit programs. I think that will help. It is coming just at the right time now because you are seeing loan demands start to pick up. We want to make sure small banks across the country are able to help support that rising demand for credit.

The CHAIRMAN. Senator Crapo?

Senator NELSON. Mr. Chairman, I have taken less time than everybody else. I would just say, in conclusion, that I want you to work with me on saving the citrus industry of this country with the citrus trust fund. Thank you.

The CHAIRMAN. Thank you. Thank you very much.

Senator Crapo?

Senator CRAPO. Thank you, Mr. Chairman.

Secretary Geithner, we welcome you here. I want to talk with you a little bit about the tax reform issue because, frankly, as I evaluate this budget, I do not find what I call tax reform in it. Now, there are some positive provisions. For example, the provision you referred to earlier about the R&D tax credit, and so forth.

But as I look at the budget, we have about $1.6 trillion of new taxes in the proposed budget over 10 years, but no real change in our tax system. Frankly, depending on whether the economic assumptions of this proposal are accurate—and I think they are significantly overstated—maybe at most, with the most aggressive economic projections, you have a $1-trillion reduction in the rate of growth of our debt over 10 years, which I think is far lower than what we need to be focusing on.

My question is this: as you know, Senator Coburn, Senator Conrad, and I served on the Fiscal Commission that made recommendations for tax reform. Although the budget that you are proposing contains, I think, over $300 billion of reduction of tax expenditures, and it is said that you are following the pattern of the Fiscal Commission, that is very different from what the Fiscal Commission did, because the Fiscal Commission did much more than that.

But the tax expenditure reduction that the Fiscal Commission proposed was utilized for rate reduction and for major reform of our tax system. The tax expenditure reductions that I see in the budget are being used to offset more spending, as I see it. Could you comment on that?

Secretary GEITHNER. Yes. Let me just compliment you, first, for the work you did in the committee, because I think you helped highlight the cost of existing tax expenditures, and you laid a path for bringing sensible changes to our tax system that involve lowering rates significantly, a broadened base, and raising revenue. The proposals you endorsed do raise substantial revenue over time, but in a way that, frankly, makes a lot of sense.

Look, if you are going to make changes around the margin in the current tax system, you have less scope for fixing the broad set of problems our tax system presents the economy today. What the budget does, as you said, is it makes a set of changes around the edges of the current tax system. I agree with many who say that realistically it may make more sense to do comprehensive reform on the individual side and the corporate side rather than making these changes at the basic margin.

If you do comprehensive reform, then you can lower rates, you can broaden the base, you can probably raise some revenues too in a way that is more acceptable to people, and you can clean up a system that is very complicated, very unfair now, and probably bad for economic growth. So that has a lot of merits.

We did not propose comprehensive reform on the individual side in this budget, but the President said in the State of the Union address that we think that is something we are going to have to come to. What we need to do is try to build the foundation in the Congress on alternative strategies to achieve that. But I admire the path you laid out in the Commission, and I think that is obviously a model. There are other models out there; I know Senator Wyden has one.

Senator CRAPO. Well, let me just interrupt and say it seems to me to use $320 billion-plus of tax expenditures and end up with zero reform of the tax code, no rate reduction, and in fact in my opinion, as I read the budget, no real spending restraint, is a huge mistake. It uses up a huge portion of our opportunity for true tax reform.

Secretary GEITHNER. Senator, could I just clarify one thing? In the proposals we set in the budget, we are proposing, as you said, to reduce this one tax expenditure that goes to the top 2 percent of Americans. We suggest to devote that to helping pay for extending the AMT. So that is like using a tax expenditure reform to make possible lower rates for a substantial number of Americans, but I will not disagree with you that there is a lot of merit in taking a comprehensive approach, because you can do a lot of good things for simplicity, fairness, for growth, for efficiency, by looking at this comprehensively and trying to lower rates as you broaden the base.

Senator CRAPO. Thank you. I want to get into that further with you, but I am running out of time, and I have one other question I really want to get out to you.

That is on the corporate side. Again, I do not see the kind of reform that I think we should have seen coming from the President. But one question I have is, as you know, the Commission recommended in our corporate reform, when we get to it, that, in addition to rate reduction, we adopt a territorial system for our country in our tax code, which most other nations are moving to now. Nothing from the White House has been said on this yet. I would like you to share your opinion with us as to whether we should make that move.

Secretary GEITHNER. Well, as I tried to say, as the President said in the State of the Union address, we would like to work towards comprehensive corporate tax reform that lowers the rate, broadens the base, and is revenue-neutral. As part of that, we will examine a range of options on the territorial side. The test for us is going to be, how do we make sure our system encourages, rather than discourages, investment in the United States?

When you look at territorial systems, you have to be very careful, not just so you are not losing hundreds of billions of dollars in revenue, but you do not want to be reinforcing incentives and opportunities for companies to shift income and shift investment outside of the United States. We could not justify it, cannot defend it. But we will look at a whole range of those options in the context of comprehensive reform.

Can I just say one quick thing about what you said about deficit reduction? The Commission laid out a comprehensive approach that would reduce the deficits, as the Commission estimated, to somewhat below 3 percent of GDP over the next 5 years or so. That was the task we gave the Commission, and you guys met that, and slightly over-achieved on that task, though it has not been scored formally.

This budget does achieve reduction, as it brings us down to 3 percent over the same time frame. You go a little further, which I commend you for. That is at a minimum necessary. I mean, we need to go beyond that over time, but that is a good place to start. What the President does is lay out a comprehensive set of changes that achieves not just spending reduction, but a set of reforms that will help bring the deficits down, too.

Again, I emphasize this because, as you said, I think you do not want those spending savings that we are going to have to deliver to go to sustained, unaffordable tax expenditures, tax rates, tax preferences that only benefit a very small fraction of the economy and have other costs for everybody else. Everybody else pays higher taxes because of those expenditures. It is not a good way to make fiscal policy.

The CHAIRMAN. Thank you very much.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman. Thank you, Secretary Geithner. I think you know, I am very interested in working with you and the administration on this tax reform issue. Picking up on Senator Crapo's point, tax reform is not like health care. I mean, we have done it before, number one. Nobody is going to go out and say, I want you to keep the tax code I love, and that kind of thing.

I just want to get your thoughts about 1986, because there you had an instance where Democrats and Ronald Reagan got together, and in the 2 years after they passed the bill, 6.3 million non-farm jobs were created in America, which is twice as many—twice as many—as were created between 2001 and 2008 when tax policy was partisan.

So tell me your thoughts about why we cannot pick up, again, in a bipartisan way with the 1986 model, because many witnesses have sat in your seat. Chairman Baucus, to his credit, has had a ton of hearings, and we are going to have a lot more. I am asking them all about 1986, and most people think that that model is still valid today. What are your thoughts on that?

Secretary GEITHNER. I do think it is. I mean, another thing from that experience is that it took 3 years, I believe. It requires the President, but also leadership on both sides of the aisle, both Houses. I do not think this is a tax system that is going to suit the needs of the country looking forward, and I think it is going to be very hard for us to achieve the kind of fiscal sustainability we need working within the current tax system.

Now, we do not have the advantage we had in 1986 of being able to eliminate a bunch of very, very expensive tax preferences and raise the corporate tax burden to pay for lower individual rates. We do not have that opportunity available to us now. That will make it a little bit harder for us. The remaining tax expenditures in both the individual and the corporate side that are expensive are very, very broad-based. Your own work has highlighted this.

So I think it will be harder to do politically, but as the President said, I think we are going to have to get there. One of the virtues of—I do not think of this as a virtue really, but one of the realities presented by the deadlines imposed by the expiry of the Bush tax cuts 2 years from now is, it will force us to decide not just what to do with those tax cuts, but whether we can, whether we should use that as an opportunity to force comprehensive reform.

Senator WYDEN. It will if we move quickly to get real tax reform on the agenda. My concern is, in the lame duck session of the 2012 Congress, we will have exactly the same debate that we had in the 2010 session. The only point I would make with respect to what is different between 1986 and now, as Chairman Baucus has pointed out, we have added more than 15,000 tax breaks. It is now taking the American people 6 billion hours annually to just fill out all these forms, so there is plenty of stuff that we can look to in terms of these narrow breaks that give away a lot of money, to use them to hold down rates.

A question on the corporate reform issue. First, I am glad you are looking at it. I particularly would like to see us take away the tax breaks for shipping jobs overseas and use that money to substantially lower the rate for people who do business in this country. I think we can get it into the middle 20s and do it in a bipartisan way.

But here is my concern. If all we do is the corporate rate, the first thing we are going to see is, we are leaving out 80 percent of the businesses. We are leaving out the sole proprietorships and the partnerships, scores of these small businesses. Dr. Bernanke and others have pointed out that we actually may end up with a bit more distortion because of the interaction between the individual provisions of the code and the corporate provisions. So you have the businesses all paying, for the most part, as individuals because they are pass-throughs. We have Dr. Bernanke on record saying it is important to do this together because of the interactions. How are we going to do that if we just go the corporate route alone?

Secretary GEITHNER. I understand that challenge. I will tell you, my view is that you can do corporate without doing individual at the same time. But to do corporate, you probably have to look at the broader classes of income that are out there. I think fundamentally, Congress has to revisit this basic question about whether it makes sense for us as a country to allow certain businesses to choose whether they are treated as corporations for tax purposes or not. It is not a fundamentally sustainable balance now.

But I think you could do corporate ahead of individual, and I think we have a chance to do it now. Although I agree with you, you cannot wait until the lame duck session in 2012 if you are going to have a chance of getting this done, so we have to begin the process now.

Senator WYDEN. Mr. Chairman, a lot of hearings to have to examine all this.

The CHAIRMAN. Right.

Senator Coburn?

Senator COBURN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here. Let me just start by saying, do you feel it is all right or safe for us, over the next few years, to run trillion-dollar deficits?

Secretary GEITHNER. Speaking as the Secretary of Treasury, I would say that it is absolutely critical to us that we find a way to lock in a set of fiscal reforms over a multi-year period of time that the world will look at as offering a credible path to bring down these deficits over time. I do not believe that is something we can defer, and it is not something you can do year by year.

Again, it is not something you can achieve if you just look at one year or one piece of the budget. One of the virtues of what you did in the Commission was say it has to be comprehensive, it has to be multi-year, you have to lock people in to changes that they can start to plan for. But I think that we will weaken the country and we will impede, impair, and weaken the recovery, put it at risk, if we do not demonstrate to the world that we have the political will to lock in some reforms now.

Senator COBURN. Do you have plans to lengthen the maturity of our debt?

Secretary GEITHNER. I would be happy to report to you in writing in more detail on this stuff, but we have substantially lengthened maturity over the last 18 months.

Senator COBURN. You are at 59 months, right?

Secretary GEITHNER. We are. That is somewhat lower than the average of other countries, but we are a little special as a country in this context, for a variety of reasons. But I think our view is that we have an opportunity to go further, and we are going to do that.

Senator COBURN. And your worry behind that is because you are worried about a possible liquidity crisis?

Secretary GEITHNER. I am actually not worried about that. I am very confident that we can avoid that. Again, one of the great things about the United States, we saw this in the crisis, is that, even at a time when we were at the verge of catastrophic financial failure, facing the risk of a Great Depression, people still believe in the end that the U.S. will get its act together and do the right thing. We have to earn that confidence over time. So, I am not worried about that. It is just a prudent way to proceed.

Senator COBURN. That is why it is important for us not to run trillion-dollar deficits, and send a signal to the international financial community that we are going to fix this.

Secretary GEITHNER. That is right. If we cannot, then interest rates will go up. Private assets will be crowded out, and the recovery will be weaker.

Senator COBURN. Let me ask one more question about the budget. I looked at the budget, and it is $1.1 trillion savings over 10 years. If you take the projected deficit over the next 3 years and apply your present rates that you are paying, we are going to go in the hole $400 billion. Correct?

Secretary GEITHNER. Well——

Senator COBURN. Well, the interest cost is going to be $1.4 trillion over the next 3 years on the deficits, just for those first 3 years. We know we are still going to run deficits at the end of your budget.

Secretary GEITHNER. Right.

Senator COBURN. And there is a savings of $1.1 trillion over 10 years, but our additional interest costs are going to be $1.4 trillion over just the first 3 years. So in essence, we are actually going in the hole. I am not making a commentary on the efforts that you are putting forward on the budget. Just the plain fact is, we are still swimming backwards when you consider interest costs.

Secretary GEITHNER. Deficits matter. They are expensive, they are unsustainable, and they will hurt the economy over time. You have to bring them down very substantially over the next 3 to 5 years. But again, it requires a multi-year plan with a set of commitments people can plan on.

Senator COBURN. I am with you. I was on the Deficit Commission. I am there. I am wanting, as my colleagues have said, the President to lead more than he has. I think the only way we get out of it is if he does so.

Let me just talk about one other thing. Are you really very comfortable with the assumptions in this budget in terms of GDP growth, and would you tell us why you feel we are going to have this kind of GDP growth, also the kind of revenue growth that you are projecting? It has been a long time since we have had 3 years in a row of double-digit revenue gains for the Federal Government. Would you comment on that, please?

Secretary GEITHNER. Yes. I should say, I am never, ever comfortable with any assumption, any forecast about the economy's—there is too much uncertainty about these things, but you have to make a basic judgment for planning. These assumptions in this budget are, in my view, reasonable and quite conservative.

I will give you one example. I will give you two examples. The growth rate assumed over the 10-year period of time is substantially lower than the average of the past several recoveries. That is one example of a realistically conservative assumption. That is, again, because this is a recovery following a financial recession.

Another example is, the deficit estimate for this year is way above CBO's estimate, very conservative estimate, almost certainly too high. But it will not be perfect. What is good about our country, about our system in this context, is that CBO will make its judgments, and CBO will be nonpartisan, and they will be careful, too, and their judgments will bind.

Senator COBURN. Let me ask one follow-up question. When you look at this, do you do inside-the-Treasury dynamic scoring on what you believe is going to happen versus static scoring so you can get comfortable with where we are going?

Secretary GEITHNER. We look at, as does CBO, the impact of these policies on behavior and growth rates.

Senator COBURN. I think that is a yes, then.

Secretary GEITHNER. No, I am not sure. Dynamic scoring has a special sensitivity for people in how they talk about it, but of course we look at the impact of policies on growth rates and behavior.

Senator COBURN. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman.

Secretary Geithner, it is a pleasure to have you before the committee. I think we all agree that we need a credible plan to deal with the deficit. To have a credible plan, the Congress needs to work with the administration, come together on a plan. Democrats and Republicans need to come together. One thing is also clear, that we cannot do it on the discretionary spending side. Senator Nelson pointed out how the health savings are likely to be more than what CBO has projected. I just want to concur in that, just the intuitive nature of getting people out of emergency rooms, getting them into preventive care.

Yesterday, I pointed out to the committee with the Secretary of Health, I went to a community health center close by that is expanding. It is doing prenatal care. It is going to end up having healthier babies and help save us money. None of that has really been scored by the CBO.

So I think we can be pretty confident that we are going to produce greater savings, provided that we implement the health care bill and allow America to get in step with the rest of the world in the amount of its economy it spends on health care. We are out of step on that. There are a lot of areas where we can make significant improvement.

But we also need to deal with it on tax reform. We have to have tax reform as part of this package, and we could talk about a lot of different reasons why. But let me tell you one of the challenges I see as we talk about tax reform. That is, when you look at the American economy before we went into this recession, in almost every indicator we were doing very well, except one. That was our national savings rates were very, very low. We all warned that this would be a problem. Our personal savings were low, our retirement savings were low. We knew that for retirement security we rely not just on Social Security, but private savings and private retirement. They were low during the best of economic times.

I remember at hearings talking about this, and the answer you usually got was, well, Americans are saving through their values in their home, the equity in their home. Well, that is gone. So now that we are about ready to talk about serious tax reform—and we get to this about every 25 years, if my math is right—I want to make sure that, as we look at tax reform, we are not overly influenced by the current situation we are in where we need revenue and we have to get Americans more confident to spend, to help our economy. I just want to make sure that we are going to also focus on a tax code that will reward savings, help us with national savings, as well as retirement savings.

Secretary GEITHNER. Senator, I agree with that. I think that you are right. When you think about tax reform, you have to look at the long-term incentives you are creating, not just for investment but for savings. I think you are right that any credible reform would have to look carefully at how you preserve, design, and reform incentives for savings and for things like investments in education, college savings. I think those things are important.

I think you are right to emphasize that. We have to again make sure that you are looking at the long-term requirements of the economy, not just the immediate challenges we face in helping the economy recover as a whole. It is encouraging that in the early stage of the crisis you are seeing the private savings rate improve so much. Private savings rates were about a negative 2 percent before the crisis, and now they come up to between 4 and 6 percent or so. That is a big improvement in our current account imbalance.

Now our borrowing from the rest of the world has come down to about half its peak as a share of the economy. So we are saving more as a country. Consumers are reducing debt burdens. That is helpful today. But I agree with you that, when you look at tax reform as a whole, you have to look at ways to make sure you have better incentives for savings and investment.

Senator CARDIN. I would point out, the reasons why we are saving more today is credit is more difficult, and Americans are concerned about the future. But when our economy starts to grow, the optimism of Americans is such that we could fall back into the same type of economic issues. So we need to develop policies that encourage more savings, particularly retirement savings, which are not only secure long-term savings, but also help us deal with retirement security without putting additional pressure on governmental programs. So, I would encourage you to do that.

I was just going to ask another question quickly on a different subject. That is, our trade deficit continues to worry me. This is an issue we had before the recession. You have jurisdiction over currency issues with China. I just want you to know that many of us are very concerned, and remain concerned that, if we are going to be able to deal with our trade imbalance, we need to continue to get reform in China to allow their currency to fluctuate.

Secretary GEITHNER. I completely agree with that, as you know. I welcome very much the attention and support many of you on both sides are bringing to this issue, because I think it is important that China understand that this matters a lot to the basic health not just of our economy, but the world economy as a whole. China is letting their currency gradually appreciate, but it is only moving at about 0.5 percent a month now against the dollar.

But because their inflation rates are much higher than ours, if you look at the actual competitive balance now, it is appreciating substantially more rapidly than that. That is very good because it means that companies now, as they are choosing where they build their next plant, where they lock in long-term contracts, they have to plan for the reality that the competitive playing field is going to be shifting in our direction. But we have to make sure that happens.

Senator CARDIN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Kyl?

Senator KYL. Thank you, Mr. Chairman.

Mr. Secretary, in a colloquy with Senator Baucus, I heard you say that you thought that the effective tax rate for the United States was about the same as the effective tax rate of our major trading partners. That is actually not true, at least according to World Bank statistics.

The last year for which we have those statistics is 2009, and the difference is dramatic. For the United States, the effective tax rate for corporations is 27.6 percent; for the other countries, 15.9 percent—a dramatic difference. If you are going to lower the effective tax rate and do this in a budget-neutral way, the effect is that you are not changing the effective rate. What have you actually accomplished for American competitiveness if you attempt to do it that way?

Secretary GEITHNER. Well, Senator, I think that when we say that the average effective rate of our major competitors is around the high 20s, it is——

Senator KYL. It is 15.9.

Secretary GEITHNER. It depends on the mix you look at. Again, if you include——

Senator KYL. All of the OECD countries.

Secretary GEITHNER. Well, if you include the very small countries that have very low tax rates, like Ireland, or include Singapore, things like that, it would be much lower. But for the large, major economies, it is sort of the high 20s. Now, you raise a very important question, which is, if you are going to just lower the statutory rate to the average effective rate now——

Senator KYL. May I just interrupt you? Your statement is false. There is only one country that is higher than the United States, and that is New Zealand. If you look at major European countries—well, Canada, 9.8; France, 8.2; even Greece, 13.9, nowhere near our 27.6.

Secretary GEITHNER. Well, again, that is a factual matter. I will be happy to show you what we believe the——

Senator KYL. All right. Well, these are World Bank numbers.

Secretary GEITHNER. We are major shareholders in the bank.

Senator KYL. Yes. Right. I know you respect their numbers.

Secretary GEITHNER. They are not perfect, but generally they are very good. But again, I think the point you are raising is, how low do you need to go to make a difference. Is that your question?

Senator KYL. Sure. How do you help American competitiveness if all you do is affect the statutory rate, but not the effective rate?

Secretary GEITHNER. I think I make the argument I think people on your side would normally make in this case. If you have a tax code where fundamentally people in this room are deciding where investment should go, you are going to have lower growth rates as a country. Right now, we have a system where certain industries, certain activities are very favored. That means overall tax burdens are higher than they need to be, and it distorts the allocation of investment and makes us less competitive. So you can make a big difference by cleaning up the system, lowering the rate, broadening the base.

Senator KYL. Sure. In fact, the President's statement was, "The tax system has been loaded up with revenue-side spending such as special deductions credits and other tax expenditures that will help well-connected special interests but do little for middle-class families or our Nation's economic growth." I totally agree. A bipartisan agreement here.

So how does the President's proposed tax expenditures for clean industry—why are they not part of the problem here?

Secretary GEITHNER. A very fair point. As you are right to point out, we make an exception for certain types of investments we think we want to favor. For example, we propose to favor a permanent R&D tax credit. We propose to favor tax benefits to help people get their kids through college. We propose to favor investments in clean energy technology because it helps shift us to less carbon-intensive forms of energy. But you are right that we are not pure.

Senator KYL. Yes. And you understand the criticism? Each one of us here has our favorites, too.

Secretary GEITHNER. Sure.

Senator KYL. And that is what is wrong. I think the President is right on to say that a tax code which has politicians picking and choosing, because we all have different ideas about who should be favored here, is the least best and that a flatter, more general code would be better.

Let me just ask you, in the spirit of bipartisanship here, if you agree with the following statements about tax reform: we should have a pro-growth tax code. Now, I know there will be some difference about exactly what that means.

Secretary GEITHNER. I would use the same phrase.

Senator KYL. Right. On balance, tax rates should be permanent.

Secretary GEITHNER. I agree with that, too.

Senator KYL. Tax spending, what we were just talking about, is a poor way to raise revenue.

Secretary GEITHNER. Well, it reduces revenue, I think.

Senator KYL. Yes.

Secretary GEITHNER. Tax spending.

Senator KYL. Yes. I mean——

Secretary GEITHNER. It reduces revenue.

Senator KYL. Right. You may be promoting various causes, but it is not a good way to raise revenue.

A simplified tax code is better than complex tax code. You already made that point.

Secretary GEITHNER. I agree with that, too.

Senator KYL. And finally, American businesses should have tax rates that are better than our competitors'.

Secretary GEITHNER. No, I wouldn't say quite that.

Senator KYL. Are at least competitive with our competitors?

Secretary GEITHNER. More competitive with. Yes.

Senator KYL. All right. That is true whether or not the businesses are structured as C corporations, S corporations, or other flow-through entities.

Secretary GEITHNER. I would tread carefully in that direction, but I agree with you, as I said earlier, that you have to look at business tax that is outside the corporate sector if you are going to do something sensible here.

Senator KYL. Yes. And I think the reason for that is, and I think you may have said this or inferred it, because you do not want the tax code to be the driving force for the form that the entity organizes under. Is that correct?

Secretary GEITHNER. That would be ideal. I agree with that, and you said it better than I did.

Senator KYL. Well, on that high note, Mr. Secretary, thank you.

The CHAIRMAN. Thank you, Senator Kyl.

I might say that I did, earlier, say that it is my understanding that the average effective rate in the United States for United States corporations is about in the middle. I got my information from the OECD. I asked what I regard is a very objective, reputable group to say to me, what is the fact, what is not the fact. You cite totally different figures. I do not know which figures are accurate, but that is the whole point of our hearings.

We are going to have tax reform hearings, and we are going to find out just what is actually, as near as possible, the U.S. effective rate. I am guessing it depends on various factors, that is, what is in the numerator, what is in the denominator. That is, what income do American companies report compared with what income they actually get or report? I mean, some of them might be in tax havens, et cetera. So it may be a bit difficult to get the correct answer. My information was from OECD. I asked OECD what the effective rate is, and I wanted to be honest about it. I wanted to get an authoritative source for it, and that is the data they gave to us. But we will find the right answer when we do the hearings.

Secretary GEITHNER. Mr. Chairman, can I just make one more point? Not to take the glow of bipartisanship out of the room, but I think the issue where we are going to have a challenge is that we think this has to be revenue-neutral. We do not want to add to the burden on corporations in America because they exist in a more competitive world, but we also do not think we can ask other businesses, other individuals to pay a higher rate so we can lower the effective rate on the business community as a whole. So revenue neutrality will be a necessary test for us for a credible reform effort, because again we do not have unlimited resources, we have unsustainable deficits, and that will be a challenge for us.

The CHAIRMAN. There is also another challenge we have just lightly touched on, and that is pass-throughs.

Secretary GEITHNER. That is right.

The CHAIRMAN. In this respect, but in many respects—not too many years ago there were 7,000 companies listed on stock exchanges. Today there are only 4,000 worldwide, which means companies are not reporting. Business entities are not reporting as much today as they were then, and the trend is for fewer companies to be listed on stock exchanges. They organize as partnerships and LLCs, and all those kinds of things. So, that is something we are going to have to address. Thank you very much.

Next, Senator Carper. Oh. Senator Thune. Sorry, he just walked in. Senator Thune, you are next.

Senator THUNE. Sorry about that, Tom. Thank you, Mr. Chairman.

Mr. Secretary, thank you for being here. I want to ask, and this is talking about sort of a difficult question to answer. But the administration has talked about, when they are defending the individual mandate, talked about it in terms of being a penalty when answering questions about whether or not the President, through the individual mandate, raised taxes. But it has alternatively described it—alternately described it, I should say—as a tax when defending its constitutionality in the courts. So you are the head of the Treasury Department. What do you believe it is? Is it a tax or a penalty?

Secretary GEITHNER. You know what I believe. But unfortunately, I do not get to decide in the end. The lawyers will decide this, and the lawyers and financial people, economists, disagree on lots of things.

Senator THUNE. All right.

The budget, many of us had hoped would be, I think, more bold in terms of entitlement reform, tax reform, other things—and that has been touched on a little bit by some of my colleagues, and there is a lot of rhetoric about reducing the corporate tax rate—but nothing in here addresses that. There are a number of other tax provisions, changes in tax law that they have proposed, some of which were proposed last year. One has to do with the issue of limiting deductions for charitable contributions.

Now, that is something that the Senate, last year, weighed in on. We had a vote on that on the floor. It was 94–3. Given the importance of the organizations we are talking about who do so much to aid those in our country who need help, do you believe now is the time to decrease the incentive to give to these organizations?

Secretary GEITHNER. I do. I think it is the reasonable thing to do. Again, let us just clarify what we are proposing. Not to make an example of the two of us, but let us say that we live in the same community and we give to the same church. We each give $100 a year, or $1,000 a year. Let us do $1,000 a year. Let us say we were generous. Let us say you make a million dollars a year and I make $100,000 a year. You get back $35 in the current system on that, I get back somewhere in the 20s. Why does that make sense? Why is that fair? So what we are proposing is a very simple thing, to say that we suggest that you should still get a tax expenditure, a tax break for that, but only 28 cents on the dollar.

Now, there are lots of other ways to think about how to bring our deficits down over time, but we think that is a reasonably practical, concrete step. It only affects 2 percent of the wealthiest Americans. We would be happy to try to do comprehensive reform too, but that is a start. Again, we do not like doing this. The only reason we are doing it is because, as many people have recognized in this room, we have unsustainable deficits. We have to bring them down over time. That is going to force us to do things we would otherwise not like to do.

Senator THUNE. And I do not disagree. I think that people who give to charities, they do not give because of tax policy. But I do think it impacts how much they give. I think you could see a significant drop-off in charitable giving if a change like that is proposed, because the people on the higher end to whom you are referring are, in many cases, the people who are contributing to a lot of these organizations.

I have a question that deals with an issue we are going to be facing here in the not-too-distant future, and you have referred to it. You sent Congress a letter regarding the debt limit, a warning letter. I notice that you referred to several "extraordinary measures"—spending the investment of the government securities investment funds, spending reinvestment of the Exchange Stabilization Fund, those types of things.

If you go back historically, these are tools that have been used rather frequently. I mean, since 1984, Treasury has called back Treasury deposits held by commercial banks, has drawn down the emergency reserve fund at the Federal Reserve, prematurely redeemed debt held by government pensions and trust funds to pay cash benefits.

If you look at exchanged debt instruments with the Federal Financing Bank in three different years, redeemed debt in the Exchange Stabilization Fund six different times, suspended new investments in the Civil Service Retirement Disability Fund, or prematurely redeemed securities held by that fund 9 different years, and suspended reinvestment in the G fund in 11 different years.

So is it not reasonable to conclude then that these are not necessarily extraordinary measures, but relatively routine accounting mechanisms that have been used by several administrations?

Secretary GEITHNER. It does not matter really what you call them. The question is, how much time do they buy us? The problem is, because the deficits are so high and our debt is so high, they do not buy us as much time as they did in the past. So they buy us between 6 and 8 weeks or so, maybe a little longer, but not that much. They will not remove the obligation Congress faces of raising the debt limit.

Senator THUNE. And I do not disagree that at some point you face that ultimate decision, but these are things that I think have been used in the past, could be used to buy some amount of time. You say 6 to 8 weeks is what you can——

Secretary GEITHNER. Well, we will be very open with the Congress about how much time that buys us. It is a question of math, it is not a question of discretion. We want to make sure everybody understands what this flexibility gives us, what it does not. But again, they will not relieve the Congress of the obligation of raising the debt limit. I want to say, I welcome the comments made by many people on both sides, recognizing that we are a country that meets its obligations. Of course, we would never contemplate leaving the markets with any uncertainty about our commitment to meet those obligations.

Senator THUNE. Mr. Chairman, my time has expired. Thank you. Thank you, Mr. Secretary.

The CHAIRMAN. Thank you, Senator.

Senator Carper?

Senator CARPER. Mr. Secretary, good to see you. Always good to see you. Thanks for your service. I want to preface my question by just making a comment. We have a couple of people in this room, certainly Senator Crapo and Senator Baucus, who have spent a lot of time with respect to this Deficit Commission headed up by Erskine Bowles and Alan Simpson. I am grateful for those efforts and hope that their proposal and your proposal will actually have legs—my sense is that it will—as we look for ways to begin to trim the sails on the deficit and get it under control.

One of the things I am urging you to consider is, a lot of people think we operate here in Washington as, I call it, the culture of spend-thrift. What I have been pushing for is for us to change that. Tom Coburn has been working on this with me, and I have been working with him, trying to change the culture to a culture of thrift. Everything I do, I know I can do better. I think that is probably true for all of us. Virtually every Federal program that we run, we could probably find ways to get better results for less money. What we need to do is to look in every nook and cranny of the Federal Government to see if that is indeed the case.

The question—I am going to bounce back over to the Environment and Public Works Committee too, but I do want to ask at least one question before I do that. Here is my question: when you look at manufacturing jobs, we are actually seeing an economic recovery that is actually being led by manufacturing. We do not always see that. Sometimes it is housing, sometimes it is consumer demand. But it is manufacturing. The job numbers for January were not hugely encouraging, but for manufacturing they were some of the best numbers I think we have seen in, gosh, a dozen years or so.

When you look at what you all are proposing in the President's budget on either the spending side or the revenue side, would you talk specifically to helping us to continue to encourage that recovery in manufacturing?

Secretary GEITHNER. Maybe I could step back a little bit and think about the broad strategic imperative we face. We have about one-fifth the global economy, about one-twentieth, 5 percent, of the population of the world. The world of Brazil, India, China, emerging markets, is going to be growing much, much more rapidly for a long period of time. They are at the early stage of that boom. What we want to make sure of is that—and they need things that we are uniquely good at as a country.

We want to make sure that, as much as possible, the investment necessary around the world to meet that demand for goods and services is met by investment in the United States, by things we are creating and building in this country. To make that possible, we have to do a better job at certain basic fundamental things: education, innovation, infrastructure, promoting exports, trade agreements that expand market access. Those are simple things to say and hard things to do, but that is where you have to start.

Again, when we think about these fiscal choices we face, which are very difficult, we have to recognize the fact that we have to be driven by what is going to be good for long-term growth, what is going to make sure that we raise the chance that we meet a larger share of that demand in the world with investment in the United States—jobs we create here, things we create here, ideas generated here. Again, that requires those fundamental improvements and reforms. And we can afford those things. They are not unaffordable to us. We can meet those challenges at the same time we are trying to restore gravity to our fiscal situation.

Senator CARPER. All right. Thank you. I do not know if this issue has already been raised, but as we think about how to trim spending on the domestic discretionary side—and I look across the dais here, and I see Senator Coburn. I mentioned some of the folks who have spent a lot of time on supporting and helping to mold the recommendations of the Deficit Commission. He has done yeoman's labor, and I want to commend him for that and thank him.

But we are trying to figure out how we restrain the growth of spending on the discretionary defense and non-defense side. How do we do it with respect to entitlements? How do we collect additional revenues? As you know, the tax gap has been out there, has been haunting us for a long time. I think the last time I saw a report on it, it was 2001. IRS was saying there was about a $300-billion tax gap. I do not know if it has been updated. I am told it is probably greater today than before. You all are doing some things in your budget to help us go after a piece of that. Could you just talk about a couple of those ideas that you think ought to generate bipartisan support?

Secretary GEITHNER. Well, it is true we do list a number of them, but to be honest, they are not dramatic proposals for reform. They will help, at the margin, reduce that tax gap. But to make a meaningful difference in the tax gap you have to do much more difficult, much more fundamental changes to, frankly, how we treat small business income in particular. It is very hard to do.

You can make much more progress, and this committee has done very important things in this area, to try to close loopholes, close tax shelters, things like that. But the largest part of that tax gap comes from the way we treat or do not treat small business income today. That has proven, as you know and this committee knows, very, very difficult to do politically.

Senator CARPER. Yes, it has. I would just say, my understanding is that, when income tax is actually withheld and there is a W–2 submitted for income, that there is about a 99-percent compliance. I am told that when income is reported through like a 1099, that there is a compliance of over 90 percent. When neither of those occurs, the compliance in these cash businesses can be as low as 50 percent. I think you are right. If we want to be serious about it, that is where we need to do our work. What did Willie Sutton say, why did he rob those banks? He said, "That's where the money is."

Thank you.

The CHAIRMAN. Thank you, Senator Carper.

It is just interesting, the tax gap. I do not know it is so much small business as it is cash accounting, which is just under-reporting, over-expensing generally in the cash economy. I do think information returns help, but we have to figure out how to make information return reporting not unnecessarily burdensome on small businesses. I do not think there has been enough thought to that, because a lot of small businesses thought, my gosh, $600 per transaction, each one reported, some companies just are not set up for that. That has to be thought through more carefully.

Could you give us your current thinking about the free trade agreements? I personally favor the Colombia agreement, I favor the Panama agreement. TAA has to be extended. I, frankly, favor the Korean agreement, so long as Korea opens up its market on beef a little. I am not asking for the moon. Could you just tell me—tell us—a little bit how the administration intends to handle that and set them up and get them passed?

Secretary GEITHNER. We would like to pass all of them alongside Trade Adjustment Assistance, and we want to do it this year. We are close to submitting an agreement with Korea that is a very strong agreement, much stronger than it was. Each of these agreements has the virtue of substantially expanding exports and adding substantially to job creation in the United States.

I mean, it is important for people to recognize in these agreements that the countries we are doing these agreements with have higher trade barriers than the United States. These agreements bring those barriers down. We benefit when that happens. They are overwhelmingly in our favor economically. If we do not do it, what it means is that business just goes to other countries. It just makes no sense as a country, so we need to find a way to pass them.

We are working very closely with you and with your colleagues in the House to try to figure out, what is a strategy that is going to get enough votes to get these through. But of course, we want them to be strong agreements. They are not going to pass unless they are strong agreements. We look forward to working with you on how to do that.

The world is watching to see whether we find a way to rebuild a political consensus in the United States on agreements like these, and our hand strategically in Asia and in emerging markets will be much stronger if we can demonstrate through these agreements that we found a way to rebuild that consensus on trade.

The CHAIRMAN. I appreciate that. In fact, with respect to Colombia, it is our information that, because we do not have any barriers to Colombian exports in the United States, but Colombia does in ours, it is a $1-billion annual net gain if we could get that agreement with Colombia. And I might say to a lot of people in my State, in Montana, our grain producers are very concerned. They want that agreement, because the Canadians are now starting to sell much more aggressively into Colombia at the expense of American producers.

Secretary GEITHNER. I agree with you. I think you make the case well.

The CHAIRMAN. And I do not think it is well-known that these, on net, are very much in the United States' best interests. That is not well-known at all to people.

Secretary GEITHNER. So we are going to work to try to strengthen these and make sure that we can maximize a chance to get them passed, and of course look forward to working with you on how best to do that.

The CHAIRMAN. Including beef.

Secretary GEITHNER. Obviously we want to make sure that we are expanding opportunities for American beef producers around the world, not just in east Asia. Of course, I look forward to working with you on that as well and know how important that is to you.

The CHAIRMAN. But this is a Korean agreement, it is not an around-the-world agreement.

Secretary GEITHNER. No, it is not just in Korea. But I am saying that we want to look beyond Korea too, because the world is a lot bigger than Korea.

The CHAIRMAN. I understand. But I am very serious about better access of American beef into Korea.

Secretary GEITHNER. Yes. Again, the President shares that commitment, and we know how important it is to you, and we are working on it.

The CHAIRMAN. Let us solve it.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

The Secretary said that tax reform must be revenue-neutral. Now, the question is, how do you measure revenue?

Secretary GEITHNER. On the corporate side. Yes.

Senator HATCH. Yes. How do you measure the revenue neutrality? You can measure it against current law. If that is the measure, then in terms of comprehensive reform it means an across-the-board increase of 10 percent. I think you can count me and others on this side out if that is the case.

Now, another measure would be against current policy, and that is much more workable. It is a distinction, in my opinion, that matters. I just want you to be aware of our feelings on that.

Let me ask you this, Mr. Geithner. In your prepared testimony you discuss an administration proposal to put State employment insurance programs, in your words, "on a firmer financial footing." When you say "firmer financial footing" you are referring to the administration's proposal to raise unemployment taxes by nearly $46 billion.

The proposal would increase the taxable wage base from $7,000 to $15,000, but the proposal also states that the Federal unemployment tax rate would be cut by more than half, leaving the impression that the proposal is revenue-neutral. But the revenue tables reveal that the proposal will raise nearly $46 billion. Now, please explain to us how the proposal raises nearly $46 billion when the Federal tax rate would be reduced by half, at the same time that the wage base is doubled.

Secretary GEITHNER. Well, Senator, you said it mostly right. The reason why, according to some estimates, it will raise revenue over time is based on estimates of what the States would do. But at the Federal level, what we are proposing to do is to broaden the base, which is more fair, and lower the rate.

And again, we are doing this because we think it makes sense to buy time for the States and for employers to adjust to this burden more gradually over time and to put in place a reform system that is, again, more fair. We think this is a more fair system over time, but we recognize that there is a lot of concern about this proposal, and we would be happy to work with you and your colleagues on how best to try to get the same kind of balance, which is more time for States and for employers to adjust to this burden as we dig out of this crisis, a better reform system that is more fair for everybody.

Senator HATCH. Well, your prepared testimony describes the administration's budget proposal to save $16 billion by giving the Pension Benefit Guaranty Corporation the authority to raise pension insurance premiums for companies. I am concerned about that because the PBGC insures payments to retirees and under-funded pension plans of companies that have failed, much like the FDIC insures bank accounts when a bank fails. I am concerned about that.

The PBGC protects retiree pensions with an insurance fund, paid for with insurance premiums, not taxpayer dollars. But your testimony says that the PBGC insurance premium proposal will reduce the deficit. Now, I would like to submit this in writing for you to answer, because it is a little more detailed than that, and I am very concerned about it.

Let me just ask this last question. The Treasury Department, just on Friday, released a report called, "Reforming America's Housing Finance Market." Now, the report states that, "The housing market remains fragile, and it will take years to fully recover," and the "home prices remain weak."

Presumably, those are conditions the Treasury Department finds uncomfortable or undesirable. However, the Treasury Department's Green Book might lead one to think that the Treasury Department wants to exacerbate the problems of a fragile housing market and of weak home prices.

Specifically, I am referring to the proposal which proposes a 28-percent cap on the itemized deduction for home mortgage interest. Now, is limiting the benefit of the home mortgage deduction consistent with the Treasury Department's goal of protecting the fragile housing market, or is that not actually the Treasury's goal?

Secretary GEITHNER. It is consistent, in my view. In my judgment, if Congress were to enact that proposal, we could withstand the impact, if any, of that on the broader housing market. Again, what that proposal does is limit modestly the existing deductions enjoyed by the most fortunate 2 percent of Americans. It is a very modest change, and I think the economy can handle it.

Senator HATCH. Well, given that the most common mortgage in the United States is a 30-year mortgage, if there were to be any limiting of the mortgage deduction, should such a limitation not have a long lead-in time to give those who take advantage of the deduction plenty of opportunity to prepare? After all, a homeowner may think that he or she will get this benefit for the next 30 years, and then to give them only a few months' notice that the deduction will be limited may be inadequate and unfair. That is assuming that there were to be any limiting of the deduction at all, which I am certainly not proposing.

Secretary GEITHNER. Well, in general, and we were very careful in our report to make clear on this, for all these reforms to the housing finance system—which of course we have to do—we have to make sure we phase them in gradually over time, because we have to recognize that we have a long way to go in repairing the damage done by the crisis to the housing market. So we agree that you want to lay out a path with gradual reforms people can adjust to.

Senator HATCH. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Thank you, Secretary Geithner, for the outstanding job you are doing.

I would first like to ask you a couple of questions about an issue on my mind as of late, which is the New York Stock Exchange merger. As you know, I think generally this is a good deal for New York and for U.S. financial markets, but I have one concern that I feel very strongly about, which is the name.

I believe that NYSE should be part of, and come first, in the name of the new parent for three reasons: first, it is a symbol of New York's continued status as the financial capital of the world. Second, it is the most trusted and respected brand worldwide, and it would benefit the new entity to be called NYSE. There is no better brand when it comes to exchanges, so it is the right thing to do from the business' perspective. Third, because there are still many details of this merger that have to be implemented, and if Deutsche Boerse should force a different name, it would be an indication that politics may trump substance when those decisions are made, that they are using geopolitical muscle.

So I want to ask you, do you agree that the NYSE name should be a part of, and come first, in the new company?

Secretary GEITHNER. As you know, Senator, I do not make that judgment, ultimately.

Senator SCHUMER. Of course.

Secretary GEITHNER. But I think you made the arguments very well. I agree very much that this is in some ways the world's iconic stock exchange. That happened in part because we had the best property rights, best disclosure, best investor protection regime in the world, and were the envy of the world for a long period of time. I want to underscore again our commitment to make sure that we are building—rebuilding—a financial system that is the envy of the world. I think New York will remain at the center of that system for a long time to come.

Senator SCHUMER. So again, to reiterate, even though you do not make the decision, and neither do I, you think it would be best for the NYSE name to be first?

Secretary GEITHNER. I think you made the argument well. Again, that is a decision the companies are going to have to make. I think there is a good chance that they will decide, as you suggested, that that would be good for business.

Senator SCHUMER. You agree with that? Yes, you do. Come on. [Laughter.]

Secretary GEITHNER. As I said, how could I say it more strongly?

Senator SCHUMER. All right. Good. I will take that as a yes.

Senator HATCH. Would you quit badgering the witness? [Laughter.]

Senator SCHUMER. Thank you. He is my friend.

Secretary GEITHNER. I think we are in agreement.

Senator SCHUMER. Yes. All right.

Do you think the overall merger is a good thing?

Secretary GEITHNER. You know, Senator, I have not looked at it that carefully yet. It is really not my authority, it is the SEC's authority. But I have heard many people who have looked at it express the same sentiment you did, which is it looks like good business, good for New York, good for the system, good for both exchanges.

Senator SCHUMER. Fine. Thanks.

Second, on China currency. The bottom line is that we have seen some movement in the yuan upward. Not enough for my satisfaction, not enough for most Americans' satisfaction, but some. Do you feel this upward movement will continue? Do you feel that those in the Chinese government who want to see it continue have the upper hand against those who do not?

Third, do you think China can really survive as an economic power if it does not allow the renminbi to actually revalue? They are having huge inflation problems, in part caused by their currency problems. They are having all kinds of discombobulations. It hurts America, but it is now hurting them.

I guess my question is, have we reached a changing point in China where they have no choice? They should have done this a long time ago; they have no choice now. I do not want to give the impression I do not think our legislation is necessary; I have seen too many fits and starts. But I want to know your view of the conditions in China and what they will lead to.

Secretary GEITHNER. I think you have it exactly right. It is moving, but very gradually in nominal terms against the dollar. But because their inflation rates are so much higher than ours, it is actually appreciating in real terms against the United States at a rate, if continued—roughly 10 percent a year, a little more, and if that were sustained—that would bring about a major shift in the competitive balance in our favor over time, which is necessary and important not just to us, but for all of China's trading partners.

I think they have reached the judgment themselves internally that they have no choice but to let that process happen over time, because again, if they were not to, they would be left with the risk of much more inflation, much more risk of the type of financial crisis we went through, and they want to make sure they avoid that outcome.

But again, right now what you are seeing is very important, which is that companies make decisions with a long fuse. They have to look forward in the future. It is like a quarterback has to pass to where the receiver is going, and they look at the competitive landscape today and they see inflation in China rising, the currency rising, wage rates rising, and they are going to change their decisions about where they build their next plant, where they buy from in the future. That will help, again, reinforce this recovery we are seeing here in the United States.

Senator SCHUMER. Clearly, any of us on this side, bipartisan, do not think it is quick enough, and we intend to move them along.

Secretary GEITHNER. And I share that view.

Senator SCHUMER. But I think the balance is beginning to change.

Secretary GEITHNER. Right.

Senator SCHUMER. Thank you, Mr. Chairman.

Senator HATCH. Thanks.

Senator Crapo?

Senator CRAPO. Thank you, Senator Hatch.

Mr. Secretary, I would like to go back to an issue that I think Senator Coburn covered with you. I had to step out of the room for a minute then, but it deals with the economic assumptions behind the President's budget.

We are still working through all of this, but my understanding from the information I have seen at this point is that the economic assumptions used in developing this budget are about 10 or 12 percent higher than CBO's economic assumptions and about 20 percent higher than blue chip assumptions in the private sector. Is that your understanding as well?

Secretary GEITHNER. No, but I think it is very important to discuss. I would like to come at it this way. We are assuming growth over the next 5 to 10 years that is significantly lower than the average recoveries of past recessions, so we are trying to be realistic and conservative.

Senator CRAPO. But is comparing it to past recessions going to give you a real feel for what is going to happen in reality?

Secretary GEITHNER. Well, I will give you a bunch of other comparisons. If you look at the average of the members of the Federal Open Market Committee, their forecasts, we are sort of at the middle of those. Now, we are a little higher than CBO's, but that is in part because of the way CBO has to make assumptions. They have to assume all the Bush tax cuts expire on schedule all at once together, and that would hurt growth in that period of time.

So we do not make that assumption because we want to extend the middle-class tax cuts. So, I think it is a little more balanced than you suggested. We think they are actually quite realistic and quite conservative. But in the end, of course, it is CBO's estimates which will govern.

Senator CRAPO. Well, let us just take CBO's. Would you agree that, if we used the same assumptions that CBO put out in January as they evaluated the economy, if we just assume that their opinion has not changed since January and those assumptions were used, would $1.1 trillion of debt reduction that you see in this budget still exist?

Secretary GEITHNER. Well, I agree with you. You will see this when CBO puts out their estimates. If CBO was to estimate the economic effect of our proposed policies, if enacted by Congress, on their assumptions about the underlying dynamics of the economy, they will show somewhat higher deficits than what we are estimating in the President's budget. Somewhat higher. Not dramatically higher, but somewhat higher.

Senator CRAPO. Let me come at this from a little different perspective. Would you agree that there are approximately $1.6 trillion in tax increases in the proposed budget over 10 years?

Secretary GEITHNER. I would, but I would draw your attention to the more than $3 trillion in tax cuts that are in the budget, because, if you add up what we are doing for middle-class Americans on the business side, small businesses, they substantially outweigh those more modest tax changes that apply to just a limited number of the most fortunate Americans.

Senator CRAPO. I think that might get us into a discussion as to whether a payment of the Federal Government to an individual is a tax cut. But I understand the way——

Secretary GEITHNER. The big difference really is just what assumptions you make about what we call the middle-class tax cuts. Again, we propose to extend them. You can call that a tax cut or you can call it a tax change, but the changes you refer to are a combination of limiting tax expenditures for the top 2 percent and allowing the rates for the top 2 percent to expire.

Senator CRAPO. All right. So, back to the question then. Regardless of how we debate the definition of tax cuts and tax increases, if there are approximately $1.6 trillion of tax increases and the debt over 10 years is only being retired by $1.1 trillion, then it seems to me that the approach of the budget is to try to deal with the debt with revenue increases rather than spending restraint.

Secretary GEITHNER. No. I think I would disagree with that. We propose a balance of spending restraint and tax changes to achieve that deficit reduction, much like the Commission did as a whole. In fact, I think if you look at the Commission recommendations on the tax side, they raise somewhat more revenue than we do, but not significantly more revenue than we do, just a little bit more revenue than we do in this context. But again, as you did in the Commission, we are proposing a comprehensive approach that looks at all the key drivers of these near-term deficits, the 5- or 10-year deficit.

Senator CRAPO. Well, let me go back to the question I started out with you in my first round of questioning, and that is the notion of utilizing tax expenditures in this budget the way they are being utilized without achieving, in my opinion, much if any reform of either the corporate or the individual tax system.

I am very concerned about that, frankly, because it seems to me that we do need to have major tax reform on both the individual and corporate side. If we utilize the revenue from tax expenditures in the way the budget proposes, we take away significant potential for tax reform. I would just like you to address that question again.

Secretary GEITHNER. I think you are exactly right. There are two different strategy choices we can make about how we think about tax reform. One is to change individual features, specific features of the current system, corporate and individual, to get a better balance of incentives, help bring down our deficits as a whole. The other is to do comprehensive reform that lowers rates, broadens the base, and in that context make sure we are meeting our long-term fiscal commitments. There are merits to both approaches.

What we did in the budget is, we did not propose comprehensive reform in a detailed way on corporations or individuals in the budget. Absolutely. We did not claim we were going to do that. What we did say is, if we have to work within the current system, here are a set of changes which we think get the incentives better for investment, are more fair, and are consistent with our fiscal obligations.

But I understand the case, as you made in the past, for coming at this question through the path of comprehensive reform, because in that context you can maybe have a better chance to make more substantial fundamental shifts in the tax code that would be better for incentives, better for growth, and more fair, more simple. If we can find a way to do that, we would welcome that.

Senator CRAPO. Well, I see my time is running out, or has run out. But let me just say, I believe the choice you have made in the budget significantly undercuts the opportunity for meaningful tax reform on both the corporate and the individual side, and I would just encourage you to evaluate that.

Also, the President has said a number of times that he believes we need tax reform. I want to state again to you publicly that I think that the President needs to get engaged and get out and lead on this issue. That is not to say that Congress does not need to be a part of that leadership as well, but we need the President engaged.

Secretary GEITHNER. Senator, could I just respond on this one question?

Senator HATCH. Sure.

Secretary GEITHNER. I agree with you. As I said before, there is no effective, no credible path to tax reform that does not require the executive and Congress working together, and ultimately requires usually somebody in my job to lay out a set of proposals in this context. I suspect that we are going to get to that point sooner on corporate than we will on individual, but we will meet that challenge. Again, we are trying to figure out how to build consensus now before we take that next step so that we maximize the chance we get it done.

But just one quick point. I think the virtue of what we did in the budget is to help people face more clearly what you can do in the current system or you cannot. In many ways, for the reasons you are saying, showing people what you can do if you are constrained to operate within the current system might make people more interested in doing something comprehensive. Certainly on the corporate side I think that is the case.

Senator CRAPO. Well, I hope so. As you know, it is my strong encouragement that we do move toward meaningful and comprehensive tax reform.

Thank you.

Senator HATCH. Mr. Secretary, it is not just on the corporate side. You have all kinds of pass-through companies that have to be considered here as well. I know you know that.

Let me just say this. If we are ever going to do anything about entitlements, it is going to take presidential leadership. There is no way that Congress is going to do that without being led. I think the President, sooner or later, cannot just say, let Congress do what it wants to do. My experience is that, if you go that route—Congress can foul up a three-car funeral, as far as I am concerned. It is going to take executive leadership, and it is going to take both parties.

So the President should take into consideration how some of us feel, and it is going to take sacrifice by both parties, but it still cannot happen without presidential leadership. You and I both know, without doing some entitlement reform, we are never going to get where we need to get.

Secretary GEITHNER. I think that is good advice, Senator. I agree with you. I think the President agrees with you, too.

Senator HATCH. Well, but the reports in the paper, today's headline is that he is not going to get involved.

Secretary GEITHNER. No, no. I would not interpret it that way. But again, I want to underscore what we said at the beginning, which is that the deficits we face over the next 5 to 10 years are not driven by our entitlement commitments, they are driven by other sets of challenges. We have to fix those.

Senator HATCH. Well, they are driven by both, both sets of challenges, or a multiplicity of challenges. I think entitlements are part of it. I do not think there is any question about that.

Secretary GEITHNER. I am not in favor of deferring those things. I just feel like it is important for people to recognize, unless we put in place a multi-year commitment to bring down those deficits over the next 3 to 5 years, then we are going to put at risk future growth and expansion. What we are suggesting is that we try to lock that in as we try to build better consensus for dealing with the long-term entitlement reform so we can build on the savings in the health care bill.

But I understand your perspective. Of course, this is just fundamentally a political challenge. It is not beyond our capacity as a country. We are going to be able to figure out how to get our way through this, we just should move now so we do not let the cost build more over time.

Senator HATCH. Well, thank you. You have been here a long time, and I do not want to keep you any longer. So we just want to thank you for your testimony and hope that we can—we are going to submit questions for you, and we hope that you will return the answers a lot quicker than they have been in the past. Some of the responses have taken months to get.

Secretary GEITHNER. I am confident we can do that. And of course, we will respond as quickly as we can.

Senator HATCH. Well, thanks so much. We appreciate you, and appreciate you taking the time here today.

With that, we will recess until further notice.

[Whereupon, at 12:05 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus
Regarding the President's Fiscal Year 2012 Budget Proposal

President John F. Kennedy said: "Anyone who is honestly seeking a job and can't find it deserves the attention of the United States government and the people."

Unfortunately, today too many Americans are seeking jobs and having little success. That's why our number one priority must remain creating as many new well-paying jobs as possible.

We have already made real progress in our efforts to save jobs – and create new ones.

During 2010, our economy created more than one million new jobs in the private sector. It was the best year for private-sector job growth since 2006, but we still have a long way to go.

The work to create jobs must continue as we examine the budget for the coming year, and it must continue as the economy continues to recover and we turn to deficit reduction.

For starters, the health care law we enacted last year dramatically reduced the deficit. The non-partisan Congressional Budget Office projected that this legislation will reduce deficits by $230 billion in the first ten years and by more than $1 trillion in the ten years thereafter.

Despite that significant step, we need to continue that deficit reduction work with the Administration and our colleagues on both sides of the aisle.

And so today we are joined by Treasury Secretary Tim Geithner who will discuss the President's budget.

We will examine the ways tax, trade and health care policy can create the jobs we need, reduce our deficit and ensure our long-term prosperity.

The President's budget proposal includes a number of tax incentives to encourage job creation.

It makes permanent the tremendously successful Build America Bonds program. In 2009 and 2010, the Build America Bonds program led to over $180 billion in financing for new projects pursued by state and local governments. And Build America Bonds come at a lower cost per dollar financed than tax-exempt bonds.

These construction projects created new jobs all across the country.

Last year we enacted a number of successful job-creation tax packages, including the HIRE Act and the Small Business Jobs Act. It is my hope that we can build on those successes.

Our ability to create jobs also depends on a smart, thoughtful and aggressive trade policy. The Administration's goal of doubling American exports by 2015 is one important way to create jobs here at home.

Another certain way to create jobs and boost the sale of American goods around the world is to resolve the outstanding issues and approve the pending free trade agreements with Korea, Panama and Colombia. I urge the Administration to resolve these issues promptly, including concerns about access to the Korean market for U.S. beef.

But as we work to implement a trade policy focused on job-creation, I am concerned that the President's proposal to consolidate federal export agencies could impede export growth.

Agencies such as the Office of the U.S. Trade Representative have had great success promoting U.S. exports. This success is precisely because they are small, nimble, and non-bureaucratic. Any potential reorganization must preserve what works, create new jobs, and expand our economy. And the Administration must work together with Congress on this important issue.

The President's budget also ensures the successful implementation of the nation's new health care law.

Giving the law a chance to work reduces rising health care costs for families and businesses. It reduces the deficit by more than a trillion dollars. It strengthens our economy and creates more than 250,000 new jobs. Repealing the new law would eliminate this job growth. Repealing the law would move our economy backwards.

The health care law makes significant progress in creating the jobs our economy needs. But we cannot stop there.

This year, I plan to look closely at ways we can make America's tax code more competitive.

We will continue our series of Finance Committee hearings on tax reform.

We will look at ways to make our tax system as simple, efficient and well targeted as possible. We will look at every deduction and every credit with an eye toward job creation and economic growth.

So as we consider the President's budget today, let us resolve to do all we can to create the jobs our economy needs. Let us work to improve our long-term prosperity. The country is counting on us.

Secretary Geithner, thank you for being here today. We look forward to your testimony.

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Statement of Treasury Secretary Timothy F. Geithner
Committee on Finance
U.S. Senate
February 16, 2011

Chairman Camp, Ranking Member Levin and members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2012 Budget.

I. Introduction

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

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

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

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

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

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

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

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

II. A Credible Commitment to Fiscal Responsibility

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

- First, we must lower deficits over a multi-year period to stabilize or reduce the national debt as a share of the economy. Deficit reduction needs to be gradual to avoid endangering the recovery.
- Second, we need to reduce overall spending as a share of the economy, with spending cuts targeted at programs we cannot afford.
- Third, we need to protect and expand investments in targeted areas crucial for future economic growth.
- Fourth, we must develop tax policies that promote growth and investment while maintaining fairness and fiscal responsibility.
- Fifth, we must restore fiscal responsibility over the long term by reducing the rate of growth in health care expenditures and by strengthening and extending the solvency of Social Security.

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

A multi-year commitment to stabilize the national debt

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

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

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

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

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

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

Cut spending and eliminate programs we cannot afford

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

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

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

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

Increase investment in areas important to economic growth

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

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

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

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

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

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

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

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

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

A tax system that supports growth, fairness and fiscal responsibility

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

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

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

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

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

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

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

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

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

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

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

Fiscal sustainability over the long run

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

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

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

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

III. Conclusion

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

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

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

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

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

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

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

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

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

Questions for the Record
Treasury Secretary Timothy F. Geithner
Senate Finance Committee hearing on the
President's FY2012 Budget and Revenue Proposals
February 16, 2011

<u>Questions from Senator Max Baucus</u>

1. **Trade Adjustment Assistance (TAA) has helped thousands of American workers, small businesses, farmers and ranchers, as well as communities. TAA has helped them recover and thrive. These programs, however, expired on February 12, 2011. While I am pleased to see the President's fiscal year 2012 budget support extending the TAA for Workers program under the 2009 law, this budget falls short in the other programs – in particular, the TAA for Firms, TAA for Farmers and TAA for Communities programs. What steps will the Administration take to ensure all TAA programs are extended?**

   The Administration strongly supports the goals of the 2009 TAA expansion and looks forward to working with Congress to renew TAA as quickly as possible. We are particularly disappointed that Congress did not renew TAA, resulting in Americans losing access to the job training they need. We also support renewal of both the Andean Trade Preference Act (ATPA) and the Generalized Systems of Preferences (GSP) so as not to disrupt supply chains important to American companies and consumers.

2. **The three pending U.S. FTAs with Korea, Colombia, and Panama will play a critical role in expanding U.S. exports and creating jobs here at home. I am concerned that the Administration has failed to negotiate a process by which Korea will address its remaining barriers to U.S. beef exports. I have made it clear that I do not need to see full market access now. But we need to put a roadmap in place for getting there. I urge the Administration to resolve this issue quickly. And I also urge the Administration to resolve outstanding issues with the Colombia and Panama FTAs quickly so that all three of these agreements can be submitted to Congress for our approval as soon as possible. Secretary Geithner, can you commit that the Administration will work to resolve the outstanding issues with all three of the pending FTAs and submit them to Congress as soon as possible this year?**

   The beef issue remains a top priority for the Administration, and we will continue to urge South Korea to open its market to the full range of U.S. beef and beef products, consistent with science and international standards. At this time, the biggest barrier to U.S. beef sales in South Korea is the 40% tariff levied against U.S. beef imports. The U.S.-South Korea trade agreement would bring that tariff to zero over 15 years, enabling America's beef producers to build on the significant growth of exports to

South Korea – which reached $518 million in 2010, and a one-year increase of 140 percent in value.

The Administration has intensified engagement with Colombia and Panama with the goal of resolving the outstanding issues as quickly as possible and submitting the agreements to Congress immediately thereafter. Our intensive work with Colombia has resulted in agreement on an Action Plan Related to Labor Rights that significantly expands the protection of labor leaders and organizers, bolsters efforts to punish those who perpetrate violence against such persons, and strengthens labor laws and their enforcement. President Obama and President Santos endorsed this plan when they met in April. The Action Plan contains specific, detailed actions that Colombia will take to advance each of these goals. Some of these actions will be taken before we move the agreement forward, while others will be taken before Congress votes on the U.S.-Colombia trade agreement or prior to entry into force. At each step, we will work closely with the Colombian Government on implementation and to jointly assess progress.

In February, Ambassador Kirk met with Panamanian Vice President Juan Carlos Varela to obtain an update on issues related to the Panama agreement, following which the government of Panama sent a technical team to the United States to discuss outstanding labor and pending tax transparency legislation. On April 18, the Administration announced that that the Government of Panama had taken the necessary actions to address these concerns and that the Administration is ready to work with Congress to prepare the U.S.-Panama trade agreement for submission.

3. **I support the administration's efforts to double U.S. exports by 2015. To accomplish this, we need to ensure that our trade-related agencies can make decisions quickly and efficiently. Consolidating our trade agencies, such as USTR and the Export-Import Bank, will have the opposite effect. It will add layers of bureaucracy and it will slow down the decision-making processes. Will you commit to consulting closely with me and my staff before making any decisions regarding your proposed reorganization?**

   President Obama announced in his State of the Union address that he has requested a review of the export promotion functions of the U.S. Government. That effort is being led by Jeff Zients, Deputy Director of the Office of Management and Budget. I am happy to consult with the Committee and its staff, especially as the reorganization or reform relates to the functions of the Treasury Department.

<u>Questions from Senator Robert Menendez</u>

1. **Mr. Secretary, I want to commend the Administration's $148 billion dollar commitment to innovation in its budget; a commitment that is important to jobs in my home state of New Jersey and the economic competitiveness of our**

country. I am committed to working with you to enact proposals such as the permanent expanded R&D credit and increases in basic research at places such as NIH and the National Science Foundation. Clearly, this administration understands that investing today in our nation's intellectual infrastructure – our researchers, our scientists, our technicians and our entrepreneurial small business talent - is the best way to guarantee that the high-paying jobs of tomorrow are created here in America. Working to foster an innovation economy is something I care deeply about and it was for this reason that I pushed to have included in health reform $1 billion dollar in tax credits for research done at nearly 3,000 small innovative American life sciences companies.

Unfortunately, the U.S. has slipped out of the top ten countries for incentivizing innovation. Recent studies have noted that optimal levels of R&D investment in America are at least 4 times larger than current investment levels. As we begin the discussions about corporate tax reform, will you continue to work with me and other members of the committee to ensure that any corporate tax reform package will promote American-based innovation that enhances our competitiveness in the world?

Yes. The overall goal of corporate tax reform is to put the United States in a more competitive position internationally. Corporate tax reform should lower the corporate tax rate and make corporations headquartered in the United States and their workers more competitive in the global economy. As you note, the President's FY 2012 Budget demonstrates our deep commitment to supporting innovation with measures including our proposal to expand and make permanent the research and experimentation tax credit. We look forward to working with you and the Committee on Finance on this important issue.

2. **I believe one thing everybody can agree on is the need for a fundamental reform of our tax code, to simplify what has become a nightmare for millions of Americans, to get rid of so much preferential treatment for special interests currently in the code, and to lower income tax rates permanently and responsibly. I believe we could make significant progress in simplifying the tax code by consolidating the tuition tax incentives into one universal credit and making the credit fully refundable. Taking these basic steps would eliminate the complexity for middle class families who have to fill out multiple formulas to figure out which incentive is best for them and which ones they may or may not be eligible for, allow these families to have certainty in how much tuition tax relief they will get to put their kids through school, and provide a simple tool for unemployed and underemployed workers so they can learn new skills.**

   Would you consider supporting the consolidation and reform of tuition tax incentives so that American families can have simple and predictable tuition tax relief that they can use when making their education spending decisions?

Making college more affordable and simplifying the process of applying for and receiving financial aid has been a priority for the Administration. The American Recovery and Reinvestment Act of 2009 signed into law by President Obama in February 2009 created the American Opportunity Tax Credit (AOTC). The AOTC provides a tax credit of up to $2,500 per year for students and their families. For an undergraduate student attending college for four years, the AOTC offers a total of up to $10,000 in tax savings. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the AOTC to 2011 and 2012, and the President's FY 2012 Budget calls on Congress to make the AOTC permanent.

For many students, the AOTC has simplified the choice among education credits. Unlike the prior law Hope credit, the AOTC is always the largest credit for students who are eligible for more than one tuition tax incentive. The Lifetime Learning Credit and tuition deduction remain in the tax code for those students who do not qualify for the AOTC, including those attending school less than half-time, those attending for more than four years, and graduate students. Further simplification of education provisions would need to account for the needs of students who currently receive the Lifetime Learning Credit or tuition deduction.

The Administration also has simplified the process of applying for financial aid by implementing a simplified web-based version of the Free Application for Federal Student Aid (FAFSA). The new FAFSA no longer requires low-income students to provide asset information, which was not used to determine their eligibility in the first place. The new application also uses skip logic, text pop-ups, and an IRS Data Match—a capability that automatically pre-populates, transfers, and verifies applicant tax data with the IRS in real time—further reducing the amount of time and paperwork required.

The Administration welcomes further ideas for making the process of applying for and receiving aid simpler for all students.

3. **The Tax Policy Center recently wrote this about the American Opportunity Tax Credit: "the proposal deserves extra credit for making it easier for unemployed or underemployed workers to enhance their skills."**

   Do you agree that the American Opportunity Tax Credit is a jobs and competitiveness issue both for now and the future? And would you agree that making a consolidated credit fully refundable would not just help working families but could offer a ray of hope to the millions of long-term unemployed by providing simple to understand universal financial assistance so they would have the resources to learn new skills that can get them back in the workforce?

   Yes, we agree that the American Opportunity Tax Credit makes it easier for unemployed and underemployed workers to increase their skills. The credit is partially refundable and therefore available to all low- and middle-income students and their families, not just those with individual income tax liability. In 2009, an estimated 4.5 million families received $3.6 billion in refunds because the AOTC exceeded their tax liability. In addition, the maximum Pell grant rose to a historic high of $5,550 for the 2010-2011 academic year and will remain there for 2011-2012. The combination of Pell grants and refundable AOTCs provides valuable assistance to the unemployed, the underemployed, and working Americans who wish to increase their skills.

4. **Commercial real estate properties in communities across the country are facing a severe equity crisis. We need to be proactive in dealing with this issue, because if left unchecked, the flood of commercial real estate loans coming due could result in significant economic damage to our communities and could become a significant liability for our nation's economic recovery.**

   One of the factors inhibiting equity coming into this sector is the Foreign Investment in Real Property Tax Act (FIRPTA), a law that economists from all perspectives believe makes foreign investment in U.S. real estate less attractive. Simply put, FIRPTA is a barrier to raising equity at a time that the commercial real estate industry has an equity problem too large for domestic investment alone to solve.

   As you know, the Treasury in 2007—before your time in office-- made a very controversial ruling (IRS Notice 2007-55) to tax the proceeds of a liquidating REIT, if distributed to foreign shareholders, as a sale of real property rather than as stock, thus subjecting them to FIRPTA. This ruling helped dry up foreign investment in real property in the U.S.. In June 2008, the Tax Section of the American Bar Association submitted a detailed discussion of this issue and recommended a series of changes to the 2007 policy.

   Will you reexamine this ruling as you move forward with your review of rules and regulations that inhibit economic activity and job creation?

   The Foreign Investment in Real Property Tax Act of 1980, or FIRPTA, generally subjects foreign investors' gains from the sale of U.S. real property to the same net-basis taxation that is imposed on U.S. taxpayers. IRS Notice 2007-55 was issued in response to a perceived abuse of the FIRPTA rules, and clarifies that foreign investment in U.S. real property that would otherwise be subject to tax under FIRPTA cannot avoid tax simply by placing the U.S. real property in a REIT.

   We are always willing to consider improvements to our rules and regulations, including Notice 2007-55. We do not, however, see a sound tax policy reason to favor investment through REITs over direct investment in U.S. real property or investment through other structures, nor are we aware of any evidence that suggests that changing the result of IRS Notice 2007-55 would significantly increase foreign investment in U.S. real property. In fact, in the years since the issuance of Notice 2007-55, foreign investment has continued to increase as a percentage of U.S. net real estate investment.

5. **Over the past decade, the top 5 oil companies have had combined profits of just under $1 trillion and yet we have a system that provides them billions in subsidies. I applaud the President for his efforts to end these subsidies and I am working alongside him to pass legislation in the Senate to accomplish this aim. In 2009, Exxon Mobil made $45 billion in profits. That year Exxon Mobil actually got a $156 million refund from the federal government. That is simply outrageous.**

   To make matters worse, Shell's former CEO recently said oil companies do not need subsidies when oil is over $70 a barrel. The price of oil right now is roughly $85 a barrel and rising.

   Given the fact that we are currently padding oil profits with subsidies they do not need, would you consider these subsidies to be a textbook example of government waste?

   The Administration strongly supports your effort to repeal the tax subsidies for the oil industry. These subsidies create a market distortion is detrimental to long-term energy security and is inconsistent with the Administration's policy of supporting a clean energy economy, reducing our reliance on oil, and cutting carbon pollution. Moreover, the subsidies must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.

6. **We hear time and again from our friends on the other side of the aisle, no need to pay for tax cuts because they pay for themselves. Now, if tax cuts really did pay for themselves I think we would all find serving on the Finance Committee, and you would find being Secretary of the Treasury to be dramatically easier. Unfortunately the reality doesn't match the rhetoric. Even President Bush's Treasury found that "A permanent reduction in taxes would lead to an unsustainable accumulation of debt."**

   Would you agree with this assessment and could you briefly discuss the flaws associated with the myth that tax cuts raise revenues?

   At current income tax rates, cutting taxes loses revenue. That is the consensus of most tax experts, including the Treasury and the Congressional Budget Office, and it is borne out by history. In the early 1980s, large tax cuts produced large deficits, and, in the early 2000s, that happened again.

   If tax rates are sufficiently high, it is theoretically possible that cutting tax rates could produce additional revenues. Some have argued that there is a revenue-maximizing tax rate beyond which further increases in the tax rate will reduce tax revenue because they will induce large reductions in the earnings of taxpayers seeking the tax base as taxpayers seek to avoid the increasingly heavy tax burden. The claim that tax cuts raise tax revenues implies that we are currently beyond this revenue-maximizing tax rate so that reductions in tax rates would lead to increased revenues through increased taxable economic activity. There is little evidence that this is the case and much evidence to the contrary.

7. **Mr. Secretary, I am pleased that the budget this year reinforces and strengthens the Administration's efforts to end the affiliate reinsurance loophole that allows foreign-based insurers to strip their U.S. earnings overseas and avoid paying U.S. tax.**

   What can you and I do working together to ensure that this loophole is effectively closed this year to put our companies on a level playing field with their foreign competitors in writing business here?

   The Administration is committed to restoring competitive balance in the U.S. insurance market by addressing the tax advantage that foreign-owned insurance companies currently gain by reinsuring U.S. risks with offshore affiliates.

   The FY 2012 budget proposal was revised relative to the FY 2011 proposal both to more effectively achieve a level playing field for U.S. and foreign insurance companies, and to maintain consistency with international agreements by taking into account loss recovery, maintaining treaty benefits, and applying to all reinsurance premiums.

   We look forward to working closely with you and other members of the Finance Committee to further refine this proposal and achieve these policy objectives.

Questions from Senator John D. Rockefeller IV

1. **Secretary Geithner, I am concerned about the Administration's proposal to allow the successful Empowerment Zone program to expire. This program has benefitted Huntington, West Virginia, and I am curious how the proposed Growth Zones would treat Huntington and other Empowerment Zone cities? Limiting the Growth Zone program to twenty cities would seem to leave dozens of other cities out at a time when they most need help.**

   The Administration wants to build on the success of the existing empowerment zone initiative, which as you note is due to expire. The Growth Zone proposal shares many features with existing empowerment zone provisions, but the capital tax incentive in our Growth Zone proposals is broader and simpler, and the employment tax incentive is more expansive since it applies to zone residents working both inside and outside the zone. Both these features should lead to greater utilization by businesses.

Having a new national competition would help to identify the areas where these incentives could be most beneficial. Any area in the United States that meets the minimum eligibility requirements, including existing empowerment zones, would be eligible to apply for Growth Zone status.

2. **Secretary Geithner, I appreciate the administration's efforts to improve the Low-Income Housing Tax Credit program. Affordable housing is something I care deeply about. Unfortunately, this program has little impact in rural states like West Virginia. What efforts if any are you making to try and expand the reach of these credits to rural communities?**

   The Administration's Budget includes an important proposal that will expand the reach of the Low Income Housing Tax Credit (LIHTC) to rural communities.

   Under current law, every household that occupies a unit that earns LIHTCs must have income that is at or below 60 percent of area median income. (Some projects elect to be bound by a maximum of 50 percent of area median income.) Given economic incentives outside the tax system, most qualifying units are occupied by tenants whose income falls in a relatively narrow band just below the maximum. In sparsely populated rural areas, therefore, developers may be concerned that there will not be sufficient households in this income band to fill a new building with qualifying tenants.

   The Administration has proposed to allow units to be counted toward the low income housing tax credit if their occupants have an average percent of area median income that is no more than 60, and if no unit is occupied by a household above 80 percent of area median income.

   The proposal would enable developers in rural areas to be confident that they will be able to fill their buildings with qualifying households because the population of eligible tenants would be expanded to include households between 60 and 80 percent of area median income; it also would provide affordable housing for families most in need because a project with some tenants above 60 percent would have to include lower-income tenants to counterbalance them.

3. **Secretary Geithner, does the Administration's proposal for the Pension Benefit Guaranty Corporation (PBGC) guarantee the PBGC's future solvency or is it just one step of what will need to be a broader effort to safeguard the PBGC?**

   The President's FY 2012 Budget proposes to give the PBGC Board the authority to adjust premiums and directs them to take into account the risks that different sponsors pose to their retirees and PBGC as the federal insurer of private sector defined benefit plans. This proposal will incentivize companies to adequately fund the pension benefits promised to their employees; it also will help ensure PBGC's continued financial soundness. It is one component of the Administration's ongoing strategy to strengthen the PBGC, while also strengthening the defined benefit pension system for the millions of American workers who rely on it for retirement security.

Does the Administration's proposal take into account funding challenges down the road like the precarious position of the Central States plan and other similarly situated plans such as some in the coal industry?

The Administration's proposal acknowledges that PBGC's future funding challenges require legislative action that allows PBGC over time to charge an appropriate risk-based premium for the insurance it provides to private-sector defined benefit plans. There is broad consensus that the current PBGC statutory premium levels are not commensurate with the financial risk to which PBGC is exposed, and that they do not incentivize companies adequately to fund the pension benefit promises they make to their employees.

Would it cost the federal government more to assist troubled multi-employer plans, or let them fall further into decline and be taken over by the PBGC?

We recognize the financial hardship facing workers and retirees who could experience lower pension benefits as result of a failed multiemployer plan. Unlike the single-employer program, multiemployer plans (MEPs) are not taken over by the PBGC. PBGC provides financial assistance when a MEP does not have plan assets to pay guaranteed benefits.

There have been various proposals to provide MEPs further assistance. However, we need to ensure that any solution would protect PBGC's ability to continue to pay guaranteed benefits to all of the workers and retirees whose defined benefit plans it is responsible for insuring.

4. **Secretary Geithner, I have heard from several retirees in my state who were troubled by an increase in withholding on their pension checks. I am told this increased withholding is in response to the expiration of the Making Work Pay Credit and its subsequent effect on tax tables. What effort, if any, did the Administration make to warn retirees about this change to their pension checks and what steps can they take to make up for this inconvenience?**

The withholding changes to which you refer are mainly the result of the expiration of the Making Work Pay (MWP) credit. The MWP credit was based on the earned income of employees and the self-employed in 2009 and 2010. It did not apply to the pension income of retirees. The legislation that created the MWP credit also required the adjustment of withholding rates to reflect the MWP credit. Because preexisting law requires the same withholding tables to be used for pension income as for wages and salaries, the adjustment of the tables could have resulted in underwithholding on the pensions income of some retirees for 2009 and 2010.

Because of this concern, the Treasury Department developed and issued an optional adjustment for pension withholding that generally backed out the MWP withholding reduction and made the withholding on pensions as accurate as prior to enactment of the MWP credit.

At the beginning of 2011 when the MWP credit expired, retirees whose payors had used the optional withholding adjustment for retirees did not see a substantial change in withholding. In fact, many had small withholding reductions. In contrast, retirees whose payors did not use the optional withholding adjustment for retirees generally did have a withholding increase on their pensions in January 2011. However, it is important to note that this was an increase in withholding, not an increase in tax. The 2011 withholding increases for retirees whose payors had not used the optional withholding adjustment for pensions during 2009 and 2010 made their withholding more accurate.

Whenever withholding is changed and at other appropriate times, the IRS encourages taxpayers to review and, if necessary, adjust their withholding periodically to minimize overwithholding or underwithholding. That type of notice was included when the 2011 withholding tables were announced on December 17, 2010. Also, on February 10, 2011 IRS issued a "Tax Tip" that explained the effect of recent tax law changes on withholding and reemphasized that IRS encourages taxpayers to review their withholding annually.

5. **Like you, I care about cutting our $14 trillion debt. I am curious how deficit neutral corporate tax reform would help in this endeavor. Does the Administration believe the debt should be reduced through Social Security and Medicare reforms while cutting corporate tax rates and not asking these businesses to contribute any extra to the debt reduction effort?**

   The President has laid out a framework for cutting $4 trillion from the deficit over the next 12 years, based on the values of shared responsibility and shared prosperity. That framework includes a call for reforming the tax code, while asking the wealthiest Americans to pay more. At the same time, the President has made clear that we cannot shortchange the areas critical to our country's competitiveness and growth– such as investments in education and innovation and reforming the corporate tax code.

   The overall goal of the corporate tax reform effort is to put American workers and companies in a more competitive position internationally by getting rid of corporate loopholes and tax expenditures and lowering the tax rate. This should be accomplished without adding to the deficit.

6. **Secretary Geithner, the President says that developing carbon capture and sequestration technology is a priority of his, but this budget cuts funding for carbon capture programs. How do you explain this discrepancy?**

In FY 2012 and through the Recovery Act, the Department of Energy's coal program continues aggressive funding for carbon capture and storage (CCS) activities, including large-scale demonstration of injection and storage of CO_2 in geologic formations through the Regional Carbon Sequestration Partnerships and large-scale demonstration of carbon capture technologies through selected Clean Coal Power Initiative (CCPI) and Industrial CCS demonstration projects.

The Carbon Capture & Storage and Power Systems program is leading efforts to develop technologies to enhance the clean use of domestic fossil fuels and to reduce emissions from fossil-fueled electricity generation plants to achieve near-zero atmospheric emissions from power production. Funding for this program will support research activities specific to CCS and Power Systems in Carbon Capture, Carbon Storage, Advanced Energy Systems and cross-cutting research. Areas within the fossil energy budget where funding has been reduced reflect a shift in focus toward technologies that have potential benefits to both existing and new fossil-fueled power plants, and in those areas unrelated to CCS reflect the Administration's policy of phasing out inefficient fossil fuel subsidies. The 2012 Budget request does not provide any demonstration funds because these projects are already strongly supported through the 2009 American Recovery and Reinvestment Act (ARRA). ARRA provided $3.4 billion for CCS, of which $800 million supported CCPI demonstration projects.

In FY 2012, the Department of Energy's Basic Energy Sciences program will expand basic research efforts in focused areas that underpin advances in areas such as carbon capture and sequestration. For example, the Budget requests increased funding for predictive modeling of carbon capture, and for new research to improve our understanding of geologic processes and rates relevant to subsurface sequestration sites. Increased funding for Materials Sciences and Engineering Research will support research on novel materials and chemistries for carbon capture.

7. **Secretary Geithner, I am deeply concerned that eliminating tax incentives for coal production will lead to higher electricity prices for consumers and increased costs of production. How will eliminating coal tax incentives effect coal production? Will the effects on coal production vary in different coal producing regions of the country?**

Over the long term, reducing tax preferences will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our overall economy stronger over time.

In addition, changes in domestic coal production costs resulting from loss of these subsidies are unlikely to have a noticeable impact on U.S. prices. The tax subsidies for the coal industry amount to less than one percent of average total revenues from coal production. The overall market impact on consumption and production is likely to be very small. Regional production impacts may vary based on the relative size of the subsidies received by the industry in each region.

The Administration supports research, development and deployment of clean coal technologies. The Treasury Department has allocated nearly $2.5 billion in credits under Internal Revenue Code (Code) sections 48A and 48B for advanced coal technology and coal gasification technology, and has authority to allocate an additional $632 million in credits under these provisions. In addition, taxpayers may claim up to $1.5 billion in carbon sequestration credits under section 45Q of the Code. The section 45Q credit supports the development of carbon sequestration technology for use at coal-burning utilities and other industrial sources.

The President's Budget includes an additional $5 billion in Code section 48C advanced energy manufacturing credits which may be used for, among other things, technologies that reduce greenhouse gas emissions, including technologies for carbon capture and storage.

8. **Secretary Geithner, in 2008, Congress enacted a new tax credit for carbon capture and sequestration. This new credit was designed to be available in addition to other, existing tax incentives, such as for clean coal. However without any clear basis in the statute, the Treasury and IRS have concluded that these incentives are mutually exclusive. Ironically, this position has become a serious impediment to the White House and DOE's goal of building new CCS facilities in the next few years. The affected companies have met with Treasury. In addition, various members of Congress and high ranking officials at DOE have all contacted Treasury about this, so far without effect. Please explain what steps you are taking to address this issue and when you expect a resolution. In addition, will you reach out to your counterpart, Secretary Chu, and work with him to ensure that Treasury is doing everything it can to support the DOE's deployment goals for CCS?**

We appreciate your comments on this issue. Treasury's Office of Tax Policy and the Internal Revenue Service have re-examined the issue in the light of arguments made by taxpayers, you and other members of Congress, and the Department of Energy. As a result of this review, we have revised the guidance to permit advanced coal facilities and gasification facilities to qualify for the carbon dioxide sequestration credit with respect to carbon dioxide that is required to be captured as a condition of claiming the investment tax credit for the facility. The revised guidance was posted on the IRS website on March 23, 2011 (http://www.irs.gov/pub/irs-drop/n-11-25.pdf), and will be published as Notice 2011-25 in I.R.B. 2011-14, dated April 4, 2011.

<u>Questions from Senator Debbie Stabenow</u>

1. **First, I want to thank you for your response to my question on the retroactivity of LIFO repeal, which I submitted for the record for last year's budget hearing before this committee.**

   My concern is that if LIFO is repealed it would force both large and small companies to report their LIFO reserves as income, resulting in a massive retroactive tax increase on the LIFO reserves that have been building up for years. This means that companies would be required to pay off their increased tax obligation rather than create new jobs or maybe even retain current jobs.

   I understand that you believe that by spreading the recapture over the next 10 years this should lessen the burden on these companies, however, it appears to me that if the increased tax payments are at the dimensions that many expect, the payments resulting from the recapture of LIFO reserves would, in some cases, exceed the net worth of the companies involved -- that result would be excessively burdensome for many companies even if it were spread over 10 years of tax returns. In fact, in many instances I would expect that such tax liabilities could render the taxpayer insolvent.

   I would appreciate your reaction to this observation. I would also appreciate your assessment of the fairness of the retroactive LIFO repeal. Some have advised me that the proposed repeal would constitute the most retroactive reach by the government in the history of the Internal Revenue Code. Would you agree with that assessment?

   The tax deferral provided under the LIFO method is inconsistent with general income tax principles, which require gains be taxed when realized and recognized. The LIFO method allows these gains to be deferred indefinitely, despite the fact that inventory sales are realized and recognized annually. Recognition of accumulated LIFO reserves would put LIFO taxpayers on a more even playing field with other taxpayers that have paid and continue to pay tax on their inventory sales without being able to take advantage of the tax deferral that the LIFO method provides. Eliminating this tax deferral benefit will result in a more fair and equal treatment among taxpayers.

   The tax law has long-standing rules governing the consequences of changes in accounting methods. Under these rules, when a taxpayer ceases to use LIFO, it must write-up the value of its inventory from its LIFO value to the value of the inventory under the new accounting method. If this results in taxable income, that income is taken into account over a four-year period. Consistent with these long-standing rules, the Budget proposal for eliminating LIFO as an accounting method requires LIFO taxpayers to write-up their inventories. As you point out, under the Budget proposal, the tax due from LIFO repeal can be spread over a ten-year period, which is more generous than current law's four year period, lessening any immediate effect.

The requirement that a taxpayer must recognize the tax consequences resulting from a change in accounting method is not a retroactive tax increase. Rather, such a requirement properly reflects the accounting for previously deferred income and puts taxpayers that cease to use LIFO on equal ground with those that have not used it in the past.

2. **Economist Robert Scott has estimated that, in 2010, Chinese currency manipulation cost the United States over 500,000 jobs. Scott estimates that these job losses and the corresponding reduction in GDP cause an increase in the federal budget deficit of $55 to $82 billion per year. Do you believe an appreciation in the Chinese RMB would increase U.S. economic growth and lower federal budget deficits?**

The U.S.-China economic relationship offers great promise and potential, and we are committed to securing the best outcomes for American workers and businesses. We are now exporting more than $100 billion a year in goods and services to China, which supports more than half a million American jobs. The $45 billion in contracts finalized during President Hu's recent visit to Washington offer a concrete illustration of that growth.

China's economic policies, including its exchange rate policy, are important to all of China's trading partners, not just the United States. To support global recovery and ensure strong, sustained, and more balanced global growth into the future, the United States, China, and the other members of the G-20 group of nations have committed to policy measures that will strengthen domestic demand-led growth in major economies, including China. Stronger growth of domestic demand in China, particularly household consumption that reduces China's trade surplus will be a powerful impetus to global growth, creating new opportunities for U.S. firms and workers. A stronger RMB is an indispensible part of this process of reorienting Chinese growth.

China has begun to adjust its nominal exchange rate in recent months, and we welcome this progress. Since June 2010, China's authorities have allowed their currency to appreciate against the dollar at a pace of about 6 percent a year in nominal terms, and over 10 percent a year in real terms, given higher inflation in China than in the United States. Despite this, progress thus far is insufficient. China's currency remains substantially undervalued and more rapid progress is needed. China's leaders recognize increasingly that exchange rate flexibility needs to be part of China's efforts to rely more on its own domestic demand to generate growth, which will in turn mean more opportunities for U.S. firms and workers to do business with China.

But in any discussion of China, it is important for Americans – including the Administration and Congress – to understand that the solutions to our challenges in the United States rest first and foremost in the policies of Washington, not of Beijing.

Fundamentally, how many jobs and how much wealth we create will be the result of the choices we make in the United States – not the choices of others.

That includes restoring fiscal responsibility. This will require the government to spend less and spend more wisely, so that we can afford to make the investments that are critical to future growth.

Questions from Senator Orrin G. Hatch

1. **The U.S. Department of Labor ("DOL") has proposed a regulation that will change the pension law definition of pension plan "fiduciary" to expand the number of investment advisors treated as pension plan fiduciaries. The regulation's reach extends beyond pension plans and the Employee Retirement Security Act ("ERISA") to include the definition of fiduciary with respect to IRAs under the Internal Revenue Code (the "Code"). Although the DOL has authority to promulgate regulations with respect to some aspects of IRAs, violations of the new DOL rules would also result in violations of the Code resulting in liability relating to prohibited transaction excise taxes. Prohibited transaction excise taxes are enforced by the Internal Revenue Service ("IRS"), not the DOL.**

    a. **Has the DOL consulted with Treasury and the IRS and coordinated this regulatory expansion with Treasury and the IRS?**
    b. **Has Treasury estimated the additional resources the IRS will need to enforce the DOL's new rule and has Treasury determined that the IRS has the necessary resources?**
    c. **Protecting IRA owners is very important of course, but if adequate coordination between the DOL and the IRS has not taken place, wouldn't it be prudent to ask the DOL to delay the publication of their regulation until the proper coordination with the IRS occurs?**

On October 22, 2010, the Department of Labor (DOL) published in the Federal Register a proposed regulation that would protect participants in and beneficiaries of employee benefit plans and individual retirement accounts by revising its definition of the circumstances under which a person is considered to be a "fiduciary" by reason of giving investment advice for a fee to an employee benefit plan or to individuals covered by the plan or IRA. DOL solicited comments on the regulation and proposed that the new definition would only become be effective 180 days after a final regulation is published. We understand that DOL has received comments and held two days of public hearings in early March with respect to the proposed regulation.

The term "fiduciary" is defined in section 3(21)(A) of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Section 4975(e)(3) of the Internal Revenue Code (Code) provides a similar fiduciary definition for purposes of the imposition of an excise tax on certain prohibited transactions involving plans (including employer plans and IRAs) and certain disqualified persons (including fiduciaries). As noted in the preamble to the proposed regulation, section 102 of Reorganization Plan No. 4 of 1978 transferred to the DOL the Treasury Department's authority to interpret section 4975 of the Code. Accordingly, DOL, rather than the Treasury Department, has authority to define who is a fiduciary.

Some commenters have asked that the proposed regulation not apply to IRAs. We have held meetings with industry representatives concerning this and other issues related to the regulation. Additionally, Treasury staff and staff from DOL have met and will continue to meet to discuss issues related to the application of the proposal to IRA's. As DOL reviews and considers comments, the Treasury Department and IRS will be available as a resource to DOL in evaluating excise tax enforcement issues that could affect DOL's decisions in finalizing the proposed regulations.

2. **The Administration's budget proposal would increase the FUTA taxable wage base from $7,000 to $15,000 but decrease the net Federal tax rate by more than half, from 0.8% to 0.38%. This leaves the impression that the proposal is revenue neutral. But Table 1 of the Tables of Revenue Estimates in the General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals reveals that the proposal will raise nearly $46 billion over 10 years in Federal revenues. At the hearing I asked you to explain how the proposal raises nearly $46 billion when the Federal tax rate would be reduced by half at the same time that the wage base is doubled. According to the CQ Congressional Transcript of the hearing, you said the following: "Well, the reason why, according to some estimates, it will raise revenue over time is based on what estimates of what the states would do."**

    a. **Please explain how the actions of the states are expected to result in raising $46 billion in Federal revenues over ten years.**
    b. **If the actions of the states are not the source of the $46 billion increase in Federal revenues, what is the source of the increase?**

(Responds to questions #2 and #3)

The $46 billion in tax revenue is a net amount that mostly reflects revenue raised by State UI taxes. Federal UI taxes are held roughly neutral since we proposed to decrease the federal tax rate (from 0.8 percent to 0.38 percent), even as the wage base increases.

States UI revenues are placed in the federally administered Unemployment Trust Fund (UTF) and counted as Federal tax revenue for purposes of determining the Federal deficit. States with taxable wage bases of less than $15,000 have a strong incentive via the Federal unemployment tax credit system to increase their wage bases by 2014. Ultimately states decide how to address the solvency of their system by setting tax rates. This plan retains the local control features of the existing U.S.

system. States may offset the base increase with reductions in State UI tax rates. However, since states currently owe more than $47 billion dollars to the Federal Unemployment Account in the UTF, we expect that some states will take this opportunity to replenish their accounts in the UTF. The proposal also includes a provision to index the taxable wage base to wage growth. This will allow the tax revenues used for paying benefits to keep pace with wage growth.

3. **Mr. Geithner, in your prepared testimony you discuss an Administration budget proposal to put state unemployment insurance programs, in your words, "on firmer financial footing." When you say "firmer financial footing," you are referring to the Administration's proposal to raise unemployment taxes by nearly $46 billion. The proposal would increase the taxable wage base from $7,000 to $15,000. But the proposal also states that the Federal unemployment tax rate would be cut by more than half, leaving the impression that the proposal is revenue neutral. But the revenue tables reveal that the proposal will raise nearly $46 billion. Please explain how the proposal raises nearly $46 billion when the Federal tax rate would be reduced by half at the same time that the wage base is doubled.**

   Please see the previous answer for an explanation of the $46 billion revenue gain.

4. **Mr. Geithner, in March 2009, the President said "My interest over time is potentially lowering corporate rates in exchange for closing a lot of the loopholes that make the tax system so complex. That's a very appealing conversation to me, and I'd like to pursue it." Well, I agree with him, that is appealing, and I would like to pursue that as well, although I do not think such a conversation can happen in a vacuum, separate from discussion of reforming the individual income tax.**

   In the President's most recent State of the Union Address, he said: "Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate for the first time in 25 years."

   That is quite commendable. However, where is the follow-through?

   One major section of the Treasury Department's Green Book is called "loophole closers." That was the first part of the President's formula during his State of the Union Address, but the second part, lowering the corporate tax rate, is nowhere to be found in the Green Book. When will the Congress receive the follow-through on a proposal from the President to lower the corporate tax rate? You were there at the State of the Union Address, as was I – don't you want to follow-through on his suggestion to lower the corporate tax rate?

   Again, I want to make clear that I believe tax reform needs to be comprehensive – we need to talk about corporate reform and individual reform at the same time, given that both are intertwined with each other.

Anyway – what do all of us need to be doing differently so that the President will formally propose reduction of the corporate tax rate, and not merely talk about it?

The Administration is committed to working with Congress and the business community to reform the corporate tax system, and we hope we can find consensus on this important issue.

At the Department of the Treasury, we have already begun to meet with members of the business community and other stakeholders and outside tax policy experts. These conversations and meetings are ongoing. We have also begun consulting with Congress, and look forward to engaging with you and your staff on this issue. Reform can be achieved only if it is bipartisan.

We hope that those discussions will produce the necessary consensus that meets the goals and principles we have outlined, including especially making the United States more competitive in the global business environment.

5. **Mr. Geithner, with this budget, and the accompanying Greenbook, you have asked Congress to enact provisions, especially in the tax area. All of the tax provisions, if acted upon, will pass through this Committee. You want us to be timely responsive to your requests. I would like you to return the favor.**

   In at least some occasions in the past, however, you have not been timely responsive to this Committee. Specifically, I would like to remind you about the following:

   > **On May 4, 2010, you testified before this Committee in a hearing entitled "The President's Proposed Fee on Financial Institutions Regarding TARP."**
   >
   > **May 7, 2010 was the deadline for members of the Committee to submit written Questions for the Record to you as a follow-up to the May 4 hearing.**
   >
   > **On January 18, 2011, the members of this Committee received your written responses to the May 7 questions. That is, it took you 8 ½ months to respond to this Committee. I find that unacceptable.**

   I realize that my colleagues and I don't ask easy questions. I realize some of the questions may take some time to respond to. But 8 ½ months is simply too long.

   So, my question for you here and now is this: Today is February 16. Assuming the members of this Committee have additional questions for you in writing, and that you get those questions by this Friday, February 18, when do you think you can reasonably commit to answering such questions? Can you get those answers to us by April 1, 2011, just over six weeks from now?

The Treasury Department is committed to providing thoughtful and detailed answers to questions for the record that are sent by the Finance Committee, or by any Congressional Committee. I apologize for the delays that have occurred in the past, and we are committed to improving the timeliness of our responses.

6. **Mr. Geithner, the Administration's 2012 Budget, in discussing Surface Transportation Reauthorization, notes that $435 billion in additional receipts would be sufficient to liquidate all outlays from transportation programs over a 10-year window. The "Analytical Perspectives" volume of the budget helpfully notes that surface transportation, as specified on the budget reauthorization, would cost $328 billion net income offsets. Does the Administration have any suggestion as to where additional revenue for surface transportation reauthorization would come from?**

   Mr. Secretary, though one part of the "Analytical Perspectives" states that the Administration "does not endorse or imply any specific revenue proposal," at another place in the same volume I read that, regarding proceeds to the Transportation Trust Fund it is assumed, "that a bipartisan agreement on financing produces new revenues that have the general characteristics of an excise tax, for which net proceeds are 75 percent of gross proceeds." Mr. Secretary, what meaning do you take from what I've just read you? To me it sounds like the Administration is contemplating an increase in the gas tax. I understand that it could take a gas tax increase of 25 cents per gallon in order to meet the Administrations funding target. Do you support a gas tax increase of 25 cents per gallon? If you do not, please explain the meaning of the tax offset language in the Analytical Perspectives volume, and please tell us what excise tax you do support increasing.

   The budget seems to indicate that the Administration would prefer a solvent Highway Trust Fund as opposed to the insolvent trust fund we now have. However, the budget does not include any means of restraining spending from the trust fund, and seems to assume that trust fund solvency is a matter of raising taxes. In fact the budget proposes an increase in the scope of the Highway Trust Fund and renaming it the Transportation Trust Fund. Last week this Committee reported a revenue title for the FAA bill currently being debated by the Senate. That revenue title includes a proposal put forward by Senator Coburn that only allows 90 percent for forecasted Aviation and Airway Trust Fund revenues to be appropriated. This builds in a 10 percent buffer to prepare for the frequent occurrence that actual revenues fall short of projected revenues. Does the Secretary believe that forecasted dollars that are not actually collected are able to be spent? Are you willing to implement a similar provision for the Highway Trust Fund? Do you think spending from the Highway Trust Fund should be limited to money actually within the Highway Trust Fund?

Current revenue from the Highway Trust Fund is inadequate to support current spending levels. The Administration is committed to working with Congress on a bipartisan basis to bring solvency to the Transportation Trust Fund while ensuring that funding increases for surface transportation do not increase the deficit. The Administration believes that the proceeds from existing Highway Trust Fund excise taxes should be dedicated solely to the highway and transit accounts of the Highway Trust Fund. The Administration intends to work with Congress on a bipartisan basis to develop the specific revenues to be included in the reauthorization and the date on which they would become effective.

7. **My colleague from the state of Iowa, Senator Chuck Grassley, asked you a question on May 7, 2010 which you responded to January 18, 2011. I would like to ask you about that exchange.**

Senator Grassley wrote:

> **The current General Counsel of the Treasury Department, George W. Madison, wrote: "Notice 2010-2 does not have a prospective effective date. Therefore, a taxpayer theoretically could rely on the Notice with respect to transactions that occurred prior to its date of issuance." Letter to Chuck Grassley from George W. Madison (April 28, 2010).**
>
> **How is this consistent with 5 USC § 801, which states that "Before a rule can take effect, the Federal agency promulgating such rule shall submit to each House of the Congress and to the Comptroller General a report containing ... a copy of the rule ..." and various other items? That is, the earliest that section 801 was complied with regarding Notice 2010-2 was December 18, 2009 – so, how could it have been effective prior to that date?**

You responded:

> **The effective date and applicability of a rule are two distinct concepts. The CRA does not foreclose retroactive application of a rule (as permitted by law), once that rule becomes effective. For example, a regulation relating to a recently-enacted statute may apply retroactively under section 7805(b)(2), but the regulation will "take effect" – meaning it will begin to apply both prospectively and retroactively – only once the CRA requirements have been met.**

- **Is it your position that the CRA *allows* retroactive *applicability* of a rule?**
- **Is it your position that the CRA *bars* retroactive *effect* of a rule?**
- **If your answer to both of the immediately preceding questions is "yes," then wouldn't it be your position that Notice 2010-2 has a prospective effective date, but not a prospective applicability date? That is, if the CRA bars the retroactive effect of a rule, then how could Notice 2010-2**

have anything other than a prospective effective date? (General Counsel – Weideman – in conjunction with TP and IRS Chief Counsel)

If a final rule does not specify its effective date, then it "takes effect" once all applicable Congressional Review Act ("CRA") requirements have been met. In this case, Notice 2010-2 does not have an express effective date; therefore, it took effect on its date of issuance. As we previously have noted, however, the effective date and applicability of a rule are two distinct concepts. Once Notice 2010-2 took effect, it could apply both prospectively and retroactively.

8. You wrote: "IRS rules generally have not been submitted to OIRA for a determination of whether they are 'major' under the CRA, because ... IRS rules generally are not 'major' within the meaning of the CRA." [1]

Are IRS rules not major because the IRS and Treasury have determined none of the three substantive criteria of 5 USC section 804(2) are met? Or is it because OIRA has not deemed any of those three substantive criteria to have been met? If it is the former reason, isn't that a determination for OIRA exclusively to make,[2] and thus it would be inappropriate for IRS and Treasury to make that determination? If it is the latter reason, isn't your statement rather circular? That is, aren't you effectively stating "IRS doesn't submit a rule to OIRA for major rule determination because OIRA has not determined such rule to be major"? (General Counsel – Weideman – in conjunction with TP and IRS Chief Counsel)

The CRA defines the term "major rule" to mean any rule that the Administrator of the Office of Information and Regulatory Affairs ("OIRA") finds has resulted (or is likely to result) in one of three specified criteria being satisfied. We respectfully disagree with your suggestion, however, that agencies are required to submit every rule to OIRA for this determination. The CRA does not include any such requirement.

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[1] Senate Finance Committee Hearing, "The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2" (May 4, 2010), Responses to Questions for the Record, the Honorable Timothy F. Geithner, Secretary, United States Department of the Treasury (Jan. 18, 2011), p. 13 (Response to question from Senator Chuck Grassley).

[2] "The CRA defines the term 'major rule' to mean any rule that the Administrator of OIRA finds has resulted (or is likely to result) in one of three specified criteria being satisfied." *Id.* This statement certainly suggests that the Administrator of OIRA exclusively makes the major-rule determination.

<u>**Questions from Senator Olympia J. Snowe**</u>

1. **Secretary Geithner, it is the Treasury Department's mission to "maintain a strong economy and create economic and job opportunities by promoting the conditions that enable economic growth and stability at home and abroad." Yet, according to the non-partisan Congressional Budget Office, payroll employment declined by 7.3 million during the recent recession and we gained a net of 70,000 jobs between June 2009 and December 2010 – a mere 0.06 percent growth in 18 months.**

   January marked the 21st consecutive month that the unemployment rate has been at or above 9 percent – the next longest time the unemployment rate was that high was for 19 months beginning in 1982. The Chairman of the Federal Reserve, Ben Bernanke, stated that it will take several years for unemployment to become "more normal" as the job market is improving "only slowly." Consider that we must create approximately 285,000 jobs per month for 60 months – five straight years – to bring the economy back to 5 percent unemployment by 2016. Now consider that last month, the Labor Department reported that in January we created only 36,000 private-sector jobs.

   What specific steps and initiatives is the Treasury Department prepared to take to revitalize the economy and stimulate job growth, to regain the confidence of the American people?

   I agree with you that our primary challenge is to create the conditions that will strengthen the economy and help more Americans get back to work. You are right to remind us of the responsibility we have to address this challenge, and I appreciate you raising this concern in the hearing.

   The economy is currently recovering from its deepest recession in fifty years, and the recovery is being driven by strong private demand, not by government spending. Strong private-sector demand is the essential precondition for a sustained period of job creation.

   It is also important to remember that in all recessions, job growth does not return immediately at the recessions end. In this recession job growth returned 8 months after the economy hit the bottom—a quicker return to private sector job growth than was experienced in either of the past two recessions.

   Since job growth has returned we have added 1.8 million private sector jobs.

   While this is encouraging, there are still more than 7 million fewer private-sector jobs than there were prior to the beginning of the recession, and the national unemployment rate is still very high. The economic challenges we face require a comprehensive approach to increasing investment in the United States, to making

American workers and businesses more competitive, and to expanding demand for American products in foreign markets.

In December, we took an important step in coming together to help support the recovery by passing a bipartisan measure that included a payroll tax cut that provides $1,000 to the typical family making $50,000 a year, an extension of unemployment insurance, expansions of key tax credits for working families, and a provision to allow businesses, big and small, to expense 100 percent of key investments this year. This measure is helping to boost growth and employment this year, with outside economists increasing their estimates of GDP growth by 0.5% or more and some projecting it would create over 1 million jobs.

But the President has also put forward an ambitious agenda that is intended to support growth both now and over the long-term.

First, we need to improve incentives for investment in the United States. The President has proposed expanding and making permanent the tax credit for research and experimentation (R&E), eliminating capital gains taxes on investments in small businesses, and keeping taxes on investment income low.

Second, we must improve our education system for American workers to remain competitive. The President's proposals are designed to strengthen investments in programs across every stage of a child's education and to reform and improve training and skills programs for workers. For example, the President has proposed extending the American Opportunity Tax Credit – a credit that Treasury estimates will provide nearly 10 million students and their families with assistance in 2011 alone.

Third, maintaining America's global leadership in innovation requires investments in basic scientific research and in new technologies, including clean energy and health care. The President's strategy includes $148 billion in R&E investments for this year, in addition to enhanced tax incentives for R&E and for advanced manufacturing in clean energy.

Fourth, America's competiveness depends on having high quality infrastructure. This requires continued, targeted investment in critical projects. For example, the President has called for an immediate $50 billion investment in transportation infrastructure, a sector where the current unemployment rate is more than 15 percent.

Fifth, and finally, boosting demand for our products abroad requires us to open new markets and to expand existing export opportunities.

These sets of proposals, and others in the Budget, will go a long way to building a foundation for job creation and better growth, not just in the near term, but over the next several decades.

2. **Both the Congressional Budget Office (CBO) and the Government Accountability Office (GAO) have repeatedly warned that the United States is on an unsustainable fiscal course. The CBO currently projects that gross federal debt will be 100 percent of GDP by the end of 2011, rising to 105.23 percent by 2021. Although these levels are lower than in Greece, they are well within the levels of other countries facing debt crisis, such as Ireland, Spain, and Portugal.**

While it is feasible that interest rates will rise gradually as investors' confidence declines, other countries' experiences demonstrate that it is also plausible that investors could lose confidence abruptly and interest rates on government debt would rise sharply.

CBO has reported that if interest rates were just one percentage point higher per year – over ten years, the deficit would be $1.3 trillion larger from increased interest costs. As a result, a sudden loss of investor confidence could inflict a considerable negative impact on the federal budget.

Treasury is in a unique position to monitor the Treasury bond market. Given the United States is already on an unsustainable fiscal course, any sudden increase outlays to cover net interest payments could force extremely difficult policy decisions. As such, familiarity and in depth understanding of the bond markets and their effect on the overall economy is critical.

What can we expect from the financial markets in response to our mounting deficit and debt condition, and what effect might it have on our economic situation?

The Federal Government issues debt for two main reasons: (1) to borrow from the public to finance the Federal deficit (the "public" includes foreigners); and (2) to invest the surpluses of trust funds and other Federal Government accounts. Generally, trust fund surpluses must, by law, be invested in Federal securities. Gross Federal debt is defined as both the debt held by the public and the debt held by Government accounts.

Since gross Federal debt includes the transfer from a surplus account to the general fund, many analysts believe that debt held by the public is a more relevant measure of debt. This is because only borrowing from the public directly affects the size and composition of assets held by the private sector and the amount of saving imported from abroad. It also influences the amount of future resources required to pay interest to the public. Debt held by the public is therefore an important concern of Federal fiscal policy.

There are no hard and fast rules about the appropriate ratio of debt held by the public to GDP. Debt held by the public was at 40.3 percent of GDP in 2008, prior to the financial crisis. It rose to 62.2 percent of GDP in 2010. The historical average over the years 1955-2008, which excludes the Korean War, is close to 40 percent; it peaked at 108.7 percent in 1946.

The FY 2012 Budget projects debt held by the public as a share of GDP will rise over the next few years to 76.3 percent in FY 2013 and FY2014 and then stabilize at around 76 to 77 percent in 2016-2021. This stabilization is an important first step in getting our fiscal house in order.

It is important to consider that interest rate increases are built into the forecast as the economy recovers and the demand for money increases. Ten-year Treasury bond rates are currently at relatively low levels. This indicates that financial markets are confident that the U.S. government will address the growing debt burden. However, if we do not get an agreement on how to achieve long-term sustainability within a reasonable time frame, our borrowing costs may increase due to investors losing confidence. This would have an adverse impact on the economy in both the short term and over the longer term.

We feel strongly that the best way to achieve long-term fiscal sustainability is through a multi-year commitment that addresses the difficult issue of reducing all spending – including containing growth in non-security non-discretionary spending. We share the concern that delay in coming to an agreement over how to reach this goal may ultimately induce interest rate increases. It is better to make deliberate choices about fiscal responsibility than to have choices imposed more bluntly by markets.

3. **By its own estimation, the White House calculates that $7 billion remains in unspent stimulus funds (from the ARRA) and that there is a further unspent $161 billion in project-targeted funds, despite claims that these funds were for "shovel-ready" projects. The Administration argues that the $168 billion in total funds cannot be rescinded because it has been committed. Nonetheless, after two years and in light of other serious budgetary constraints, it is vital to redirect these funds to a greater good to reduce the deficit and prevent further tax increases.**

   CBO projects that for 2011, the federal budget will show a deficit of close to $1.5 trillion, or 9.8 percent of GDP. I have long held that we must reexamine unspent stimulus funds to determine who they can be redirected to deficit reduction, to more effective job-creating programs, and to tax incentives in a way that maximizes each dollar spent, and these extraordinary budgetary problems only reinforce my resolve. Indeed, a year ago I introduced legislation with Senator Thune that would redirect unspent stimulus funds in precisely this manner (S. 2981, Reevaluate and Redirect the Stimulus Act), but the Majority refused to take up this issue.

   Like me my constituents are appalled by the deficit and insisting that we spend each of their dollars at our disposal with the same care that they spend their own.

Do you agree with me that we should find offsets to the deficit or to other programs by reevaluating the stimulus given that $168 billion remains on the table? Will you commit to an examination of what can be done to rescind these billions in available funding for budget-reducing and tax-increase-preventing efforts?

The President and I, share your concern about growing and unsustainable budget deficits. The Administration is committed to working with Congress to identify and implement cost-saving reforms and eliminate redundant and unnecessary spending.

The Recovery Act was an unprecedented effort to stabilize a faltering economy and prevent a second Great Depression, and that effort is ongoing. Abruptly, cancelling these ongoing initiatives would cost tens of thousands of jobs in the short term, harm progress toward vital national priorities in the long term, and hurt the neediest among us that are in need of the economic assistance promised to them under the Recovery Act.

Many Recovery Act projects and programs are already at or near the completion stage, as the Administration placed strong emphasis on starting work immediately and quickly reinvesting funds back into the economy.

Some programs and projects were designed to operate on a longer timeline, to keep a steady stream of Recovery Act assistance flowing into the economy. These remaining programs include funding for major clean energy, transit, and other infrastructure projects that are critical to long-term economic growth, as well as longer-term awards to support state and local government programs such as Community Oriented Policing Services, or COPS. In many cases, these funds have already been awarded to projects and are just in the process of being formally put under contract. In the case of the COPS program in particular, we are now in the second year of a three-year commitment to fund the salaries of law enforcement officers in local communities across the country; to renege on that promise now would strain local law enforcement budgets already stretched thin and put at risk those positions funded with Recovery Act resources.

4. **Several proposals have been offered to freeze portions of government spending at various levels. These proposals include various ideas put forth by the President's Deficit Commission, the Administration's FY 2012 budget proposal, the House Republican leadership, the House Republican Study Committee, and others.**

   Given that mounting government spending without equal tax increases leads to increases in the national debt, reducing spending before a European-style debt crisis occurs seems prudent.

As a person in charge of America's balance sheet, do you believe freezing non-defense discretionary spending at the levels specified - or implied by either Republicans or Democrats - is sufficient to address budget gaps? If not, what specific budget cuts do you propose to remedy the budget situation and send the right kind of signal to the bond markets?

President Obama has proposed a balanced approach to achieve $4 trillion in deficit reduction over the next 12 years, based on the values of shared responsibility and shared prosperity. This approach borrows from the recommendations of the Bipartisan Fiscal Commission and builds on the $1 trillion in deficit reduction in the President's 2012 budget.

The framework reduces annual domestic spending as a share of the economy to the lowest level since Eisenhower, calls for additional savings from security agencies, and asks the wealthiest among us to pay more. At the same time, it will protect the middle-class, defend our commitments to seniors, and make the smart investments we need to create good jobs and grow our economy.

This framework would bring the deficit to 2.5 percent of GDP by 2015 and reduce it to nearly 2.0 percent by the end of the decade—putting the debt on a declining path as a share of the economy.

The President is also calling for a "debt failsafe" trigger to ensure a decline in the debt as a share of the economy. The President is confident that, with continued economic growth and a bipartisan agreement on deficit reduction, we will reduce the debt as a share of the economy. However, as a strong incentive for Congress to act on deficit reduction and to ensure we hit this goal, the President is proposing a trigger that would require that, by the second half of the decade, our nation's debt is on a declining path as a share of our economy. If that target isn't met by 2014, there would be automatic spending cuts (including cuts to spending through the tax code).

5. **In December 2010, the President's Deficit Commission proposed a six-part plan that would:**

   a. **Achieve nearly *$4 trillion in deficit reduction through 2020.***
   b. ***Reduce the deficit to 2.3 percent of GDP by 2015* (2.4 percent excluding Social Security reform), exceeding President's goal of primary balance (about 3 percent of GDP).**
   c. ***Sharply reduce tax rates, abolish the AMT, and cut backdoor spending in the tax code.***
   d. ***Cap revenue at 21 percent of GDP and get spending below 22 percent* and eventually to 21 percent.**
   e. ***Ensure lasting Social Security solvency*, prevent the projected 22 percent cuts to come in 2037, reduce elderly poverty, and distribute the burden fairly.**

f. ***Stabilize debt by 2014 and reduce debt to 60 percent of GDP by 2023 and 40 percent by 2035.***

While the President's Deficit Commission failed to garner the necessary votes to force a floor vote, many ideas and proposals generated by the Commission members appear sound.

Are there any proposed measures in the Deficit Commission's report that you believe would return the nation to a sustainable fiscal course?

The Administration recognizes that the only way to return our nation to a sustainable fiscal path is to come together around a balanced approach to deficit reduction. The Fiscal Commission was useful in pointing out the seriousness of the challenge we face, and by putting on the table a set of proposals designed to address it.

The President's deficit framework builds on several recommendations in the Fiscal Commission:

- It takes an approach to deficit reduction that seeks significant savings across all parts of the Budget—with $4 trillion in deficit reduction through non-security discretionary spending, security spending, health care, other mandatory spending, and spending through the tax code

- This includes cutting non-security discretionary spending to levels consistent with the Fiscal Commission—for total deficit reduction of $200 billion more than the $400 billion in savings under the President's Budget and $770 billion in savings over 12 years

- It seeks comprehensive tax reform that both lowers rates and the deficit by closing loopholes

- It seeks savings in Medicare and Medicaid in line with Commission recommendations. For example, the President proposed to find Medicare savings by limiting excessive payments for prescription drugs. These build on other ideas the President proposed in his Budget that the Commission has endorsed to *reduce health care spending*, for example by increasing government authority to fight Medicare fraud and phasing down the Medicaid provider tax threshold.

The President's framework builds on other Fiscal Commission recommendations that were already in the President's Budget:

- The President also already *implemented a two-year freeze on federal civilian pay* in line with the Commission's recommendation.

- The President's Budget calls for the *medical malpractice reforms* proposed by the Commission.

- The President has called for *corporate tax reform – as the Commission propo*sed – to lower rates without adding to the deficit, by closing loopholes.

- The President has asked for the *authority to reorganize government for the 21st century*, in line with the Commission's recommendations.

- The Budget included an *elimination of in-school subsidies in federal student loan programs for graduate students*, as the Commission recommended, which allows us to maintain historic increases in Pell Grants in a fiscally responsible way.

The Commission also recommended reforming the budget process to ensure the debt remains on a stable path, spending stays under control, inflation is measured accurately, and taxpayer dollars go where they belong. What changes can be made to the budget process that would fulfill Commission's proposed objective?

The President is calling for a "debt failsafe" trigger to ensure a decline in the debt as a share of the economy. The President is confident that, with continued economic growth and a bipartisan agreement on deficit reduction, we will reduce the debt as a share of the economy. However, as a strong incentive for Congress to act on deficit reduction and to ensure we hit this goal, the President is proposing a trigger that would require that, by the second half of the decade, our nation's debt is on a declining path as a share of our economy. If that target isn't met by 2014, there would be automatic spending cuts (both including cuts to spending through the tax code).

Debt interest payments

6. **CBO projects that spending on net interest will more than double in the next ten years, increasing from 1.5 percent of GDP in 2011 to 3.3 percent in 2021. If interest rates are one percentage point higher than the CBO forecast, the deficit for Fiscal Years 2011-2021 would be $1.3 trillion larger than projected (from additional interest costs alone). Our staggering national debt is projected to rise even further and forcing us to utilize an increasing percentage of the budget to cover net interest expenses.**

   At what point in time will interest payments on our debt become fiscally unbearable (i.e., the point of no-return)?

   The FY 2012 Budget projects interest spending will be 1.5 percent of GDP in FY 2012, rising to 3.4 percent of GDP by FY2021. Interest payments as a share of GDP increase only minimally after FY2018. This is because after FY2017 debt held by the public as a share of GDP remains relatively steady at 76 to 77 percent. The issuance of new net debt is limited after FY2016, and the primary deficit (the deficit not including interest payments) is zero after FY2017, and goes negative (i.e. shifts to a small surplus) through 2021.

Over the past 40 years, interest payments as a percentage of GDP have averaged 2.2 percent. In the past, interest payments have reached the levels projected for the end of the budget window: in 1991, 1992, and 1995, interest payments as share of GDP reached 3.2 percent.

We agree that a budget compromise that drives interest payments closer to long-term historical proportions of GDP would be desirable. The FY 2012 Budget is a first step towards restoring sustainability. We look forward to working with Congress in enacting a multi-year plan for fiscal responsibility.

7. **In your January 6th letter to Senator Reid, you estimated that the debt limit would be reached sometime between March 31st and May 16th. Just a month later that prediction was revised back and the Treasury Department is now reporting that the debt limit will be reached sometime between April 5th and May 31st. There is historical precedent for disregarding the Treasury predictions, as occurred in 1995 – 1996 when President Bill Clinton and the new Republican majority deadlocked over spending levels. At that time the Treasury Department was able to manage funds to keep the government going even after the debt limit was reached and not increased.**

   How would the Treasury Department handle U.S.'s financial obligations if the debt ceiling is not increased and all accounting games have been exhausted?

   If the Congress does not increase the debt limit and all of the extraordinary measures that past Treasury Secretaries have used to postpone the date when the debt limit must be increased have been exhausted, Treasury would have no remaining borrowing authority. When Treasury's remaining cash balances are exhausted, the United States Government would be forced to default on its legal obligations. This is an unthinkable outcome that could provoke a financial crisis potentially more severe than the crisis of 2008-2009, reverse the current economic recovery, and impact U.S sovereign credit ratings. It is critically important that Congress increase the debt limit before it is reached.

   I welcome the comments made by the Republican leadership, both in the House and the Senate, that recognize America must meet its obligations.

   Assuming that we reach the debt ceiling and that Congress fails to increase it yet again, what happens after the Treasury makes the payments to cover the interest on debt, i.e., how would Treasury determine what bills gets paid after that and in what amount? Would the Treasury halt payments of unemployment benefits,

Social Security benefits, military expenses, other non-discretionary and/or discretionary spending?

I will not consider hypothetical or countenance the possibility that Congress does not raise the debt limit. It would be unthinkable.

8. **Treasury can take several actions to raise funds to meet federal obligations without exceeding the debt ceiling, such as by not issuing Treasury securities for trust fund receipts or reinvesting maturing Treasury securities.**

   During the debt ceiling crisis in 1985, Treasury was unable to follow its normal trust fund investment and redemption policies and procedures. Specifically, it suspended investing certain trust fund receipts and redeemed some Treasury securities issued to one trust fund earlier than normal to pay fund benefits.

   The period beginning on November 15, 1995 when the Secretary of the Treasury declared a debt issuance suspension period became known as the 1995-1996 debt ceiling crisis. The Congress provided the Secretary of the Treasury authority to issue securities that did not count toward the debt ceiling.

   How do the debt ceiling crises of 1985 and 1995-1996 compare to what we are facing today? Would actions taken in those situations work under the current debt burden of nearly 100 percent of GDP?

The rate of debt accumulation today is significantly greater than it was in either 1985 or 1995-96 debt limit impasses, particularly in relation to the size of extraordinary measures that may be invoked to postpone the time by which the debt limit needs to be increased. This means that the currently available extraordinary measures that were described in my January 6 and April 4 letters will provide far less time before the debt limit needs to be increased than in the prior debt ceiling crises you mentioned.

In addition, there are fewer current extraordinary measures available to Treasury than those that were available during the 1995-96 debt limit impasse.

- In 1996, in order to enable Treasury to pay the March 1996 Social Security benefits, Congress passed legislation that permitted Treasury to issue a limited amount of Treasury securities that were temporarily excluded from being counted against the debt limit. In addition, Congress passed legislation that temporarily excluded from being counted against the debt limit the new Treasury securities that Treasury issued to federal trust funds in March 1996 to invest new trust fund receipts and to reinvest the proceeds of maturing trust fund investments. Those exclusions from the debt limit expired on March 30, 1996.

- In the past, Treasury had an ability to increase its cash balance without increasing debt by calling in the non-interest-bearing balances that Treasury formerly kept on deposit at banks to compensate them for fiscal services they provided to Treasury. That option is no longer available because Treasury discontinued keeping those "compensating balances" after Congress appropriated funding to Treasury in 2004 to pay directly for fiscal services.

- In the past, Treasury was able to free up headroom under the debt limit by entering into multi-step exchange transactions with FFB and the CSRDF, swapping obligations that do not count against the debt limit for an equal amount of Treasury securities held by the CSRDF that do count against the debt limit. In each case, FFB used the Treasury securities that it received from the CSRDF to pay down its borrowings from Treasury. When Treasury received from FFB the Treasury securities, they were extinguished, creating the headroom. The potential to use such an exchange transaction is of limited use at this time because FFB has a limited amount of obligations available to exchange.

Do you worry that such accounting maneuvers might send a dangerous signal to financial markets that the U.S. is reaching a breaking point?

Financial market participants are familiar with the debt limit and the use of the extraordinary measures used by previous Secretaries of the Treasury. That said, it should be stressed that these actions by their very nature are "extraordinary" and Treasury is concerned whenever we have to take extraordinary actions to fund the government.

9. **Our tax code is so horribly complex that according to the August 2010 report from the President's Economic Recovery Advisory Board, taxpayers and businesses spend 7.6 billion hours and shell out about $140 billion trying to comply with tax-filing requirements in 2008, which is roughly equivalent to 1 percent of the GDP.**

   While undertaking fundamental tax reform is not necessarily going to solve all of these problems, it must be undertaken to address these issues and provide a stable economic platform on which growth can be fostered.

   I am committed to six basic principles for tax reform that would:

   1. **Establish a pro-growth tax code with the fewest number of economic distortions that raises sufficient revenue to finance our nation's spending priorities.**
   2. **Simplify the tax code to reduce the burden of compliance.**
   3. **End the fiscal "shell game" where we extend tax cuts for only a year or two at a time or make them temporary.**

4. **Promote savings and investment in the tax code, which are the drivers of long-term growth.**
5. **Remove a barrier to American business competitiveness in the global economy. We have the second highest corporate tax burden in the industrialized world today.**
6. **Ensure that the tax code remains progressive and distributes the tax burden fairly.**

What steps and initiatives does the Treasury Department intend to take to provide the tools to Congress to address fundamental tax reform as we approach the 25th anniversary of the Tax Reform Act of 1986? Should Congress then proceed with such reform without Treasury's input?

As part of the President's Framework for Shared Prosperity and Shared Fiscal Responsibility, which he announced on April 13, 2011, the President called on Congress to undertake comprehensive tax reform that produces a system which is fairer, simpler and has fewer loopholes. The President supports efforts to build on the Fiscal Commission's goal of reducing tax expenditures so that there is enough savings to both lower rates and lower the deficit

In addition, as he explained in the State of the Union address, the President is continuing his effort to reform our outdated corporate tax code to enhance our economic competitiveness and encourage investment in the United States. Savings from eliminating loopholes, reducing distortions and leveling the playing field in our corporate tax code can be used to lower the corporate tax rate for the first time in 25 years without adding to the deficit.

We at the Treasury Department have already met with many members of the business community, other stakeholders and outside tax policy experts to discuss corporate tax reform and we have begun consultations with Congress. These conversations and meetings are ongoing. The Administration is committed to continuing our work with Congress, the business community and other stakeholders to move ahead on the President's priorities.

Regarding simplification, the Budget includes over 10 simplification proposals, and we look forward to working with Congress to enact those and any other sound proposals that simplify our tax system and thereby reduce the burden on taxpayers and tax administrators.

10. **The President expressed unequivocal support in his State of the Union Address for the nation's almost 30 million small businesses, which are the engine of our nation's economy.**

I repeatedly hear from Main Street business owners that we need smarter government and sensible, bipartisan solutions that work. A broad theme of the concerns raised by Mainers is the unstable economic climate whether that is due

to upheaval of major components of the tax code, massive new mandates in health care benefits, unstable energy prices or the lack of credit available for cash flow or investment.

What specific steps will the Administration will take to provide small business owners with the certainty they are looking for, so they can feel more confident about the future and that their cost of business will not increase, which in turn would enable small businesses to create new jobs and aid the economic recovery?

The Administration has taken many measures to improve the business climate and provide greater certainty for small businesses, including the following:

- The Recovery Act encouraged investment in small businesses by excluding from taxation 75 percent of the capital gains for investors in small businesses who hold their investments for five years. The Small Business Jobs Act and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 expanded this exclusion to 100 percent of qualified capital gains for stock acquired after September 27, 2010 and before the end of 2011. The Budget proposes to make this 100 percent exclusion permanent, saving small business owners $5.4 billion over 10 years.

- Building on provisions in the Recovery Act and HIRE Act, the Small Business Jobs Act increased the amount of qualified investment small businesses could immediately write off in 2010 and 2011 to $500,000 for qualifying investments and raised the total phase out limit to $2 million — providing an immediate tax incentive for smaller businesses to expand and create new jobs.

- The President proposed to temporarily allow all businesses, large and small, to expense 100 percent of their investments made from September, 2010 through December 2011, potentially generating more than $50 billion in additional investment in 2011, which will fuel job creation. This proposal was enacted in the Tax Relief and Unemployment Insurance Reauthorization and Job Creation Act of 2010.

- The President's Budget would make permanent the policy of allowing small businesses to immediately write off up to $125,000 of qualified investment, providing a continued tax incentive to invest in plant and equipment and create jobs while cutting small business taxes by $44 billion over the next 10 years. Without this measure, the cap on eligible investments would drop to just $25,000 in 2013.

- In conjunction with the automatic IRA proposal, the Budget also proposes to increase the maximum credit for small employers' start-up expenses for establishing a new retirement plan from $500 a year to $1,000 per year.

11. **Dr. Winslow Sargeant, the Chief Counsel for the Small Business Administration's Office of Advocacy has recently issued a report which states that from 2008 to 2010, small business lending has dropped from $712 billion to $652 billion. This represents a drop of $60 billion or over 8 percent. The study also provides evidence showing that the credit crunch is pervasive across all sectors of the economy. The Office of Advocacy's report also noted that commercial loans to large businesses dropped by a similar amount, 8.9 percent, between 2009 and 2010. These large decreases in lending can be partly explained by drops in demand, with businesses no longer looking to borrow funds to expand or hire.**

    For the American economy to grow and create jobs though, businesses must start to re-enter the capital markets and use those funds to expand and hire employees. The information provided in Chief Counsel Sargeant's report paints a chilling picture of the credit markets for all businesses.

    What efforts is the Treasury Department making to restore credit to *all* businesses?

    In the fall of 2008, the economy experienced the most severe credit freeze since the Great Depression. Along with critical actions by the Federal Reserve, FDIC, and other agencies, Treasury launched two programs to help revive credit markets – the Term Asset Backed Securities Loan Facility, and the Public-Private Investment Program. The first helped restart the asset-backed securitization markets that provide credit to consumers and small businesses; the latter was designed to restart the market for legacy mortgage-backed securities and assist with price discovery.

    Today, as a result of these and other emergency programs, financial markets are far more stable than in the fall of 2008. Interbank lending spreads, which exceeded 450 basis points in the fall of 2008, returned to pre-crisis levels by mid-2009. LIBOR-OIS spreads followed the same trajectory – after spreads rose dramatically after Lehman Brothers's collapse, they returned to pre-crisis levels within roughly six months of Obama's inauguration and the implementation of the Administration's Financial Stability Plan.

    Treasury continues to focus on the comprehensive reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act to address flaws in the financial system and help ensure that, going forward, the problems that contributed to the credit freeze and financial crisis do not recur.

    Treasury is also focused on generating new ideas and carrying out initiatives that will improve access to credit for small businesses to help them expand and create jobs. In March, the Treasury hosted a conference to convene policymakers and market participants to share new and innovative ideas on addressing access to capital challenges that small companies are currently facing. Over the past two years, the President has signed into law 17 different tax cuts for small businesses, including eliminating capital gains taxes on key small business investments and raising the amount small businesses can expense to $500,000. The 2010 Small Business Jobs Act also included two landmark initiatives designed to spur needed lending to America's small businesses: the Small Business Lending Fund and the State Small Business Credit Initiative.

The Small Business Lending Fund (SBLF) is a $30 billion initiative that encourages lending to small businesses by providing low cost capital to community banks and Community Development Financial Institution Fund (CDFI) loan funds with assets of $10 billion or less. Through the SBLF, community banks and small businesses can work together to help create jobs and promote economic growth in local communities across the nation. The program provides eligible institutions with an incentive to expand loans to small businesses. The largest incentives will go to banks that do the most to increase their lending to reward performance. Treasury recently began accepting applications and all SBLF investments will be completed by September 27, 2011. As of April 15, Treasury has received 600 applications for SBLF funding from institutions across the country.

Also passed as part of the Small Business Jobs Act, the State Small Business Credit Initiative (SSBCI) will provide almost $1.5 billion to support state programs that provide access to credit for small businesses. The SSBCI is expected to help spur $15 billion or more in lending to small businesses. Under the SSBCI, participating states will use the federal funds for programs that leverage private lending to help finance small businesses and manufacturers that are creditworthy, but are not getting the loans they need to expand and create jobs. The SSBCI will allow states to build on successful models for state small business programs, including collateral support programs, Capital Access Programs (CAPs), loan participation programs, credit guarantee programs and other innovative programs such as state-run venture capital fund programs. Existing and new state programs are eligible for support under the State Small Business Credit Initiative. States are currently applying for program funds. To date, the SSBCI has approved allocations to North Carolina ($46 million), California ($169 million), Vermont ($13 million), Connecticut ($13 million) and Missouri ($27 million). These allocations represent 17 percent of the total funds appropriated for the SSBCI and are expected to eventually spur up to $2.68 billion in new private financing for small business. Three additional state applications for allocations totaling an amount of over $83 million are pending.

With the efforts to stimulate lending and access to capital made through the Recovery Act and the Federal Reserve's qualitative easing, how will the market for businesses seeking capital look one year from now?

While it is impossible to predict the future, Treasury is focused on the approaches described in the previous answer to improve access to capital of business. Treasury continues to focus on the comprehensive reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act to address flaws in the financial system and help ensure that, going forward, the problems that contributed to the credit freeze and financial crisis do not recur. The Administration is optimistic that by this time next year, the various provisions of the Small Business Jobs Act will have taken hold such that additional low-cost capital is flowing into the economy so that our nation's small businesses can access the credit they need to expand and create jobs.

12. The most recent Federal Reserve Senior Loan Officer Opinion Survey shows a net loosening of 1.9 percent in the climate for small business loans. This statistic comes shortly after the Small Business Administration set a one week volume record backing nearly $2 billion in 7(a) loans from December 18th to December 24th.

As a strong supporter of fee reductions for SBA lending and the expansion of 7(a) and 504 loan limits to $5 million and $5.5 million respectively, I have labored to implement policies that would speed access to capital to our nation's job generators.

In your capacity as Secretary of the Treasury, you too are responsible for ensuring that our nation's small firms are able to acquire the necessary funding to start, operate, and expand their businesses.

What actions have you taken to expand access to capital for small businesses?

Since the beginning of this Administration, the President and his entire economic team have worked together to take steps to make credit more available to small businesses and help them lead an economic recovery. These steps have included provisions to spur SBA lending, providing 17 tax cuts to small businesses, and – as described earlier – implement two Treasury programs, the State Small Business Credit Initiative (SSBCI) and the Small Business Lending Fund (SBLF), to boost lending to small businesses. The SBLF is authorized to provide up to $30 billion in low cost capital for small banks with strong incentives to lend to America's small businesses. We expect the SSBCI to increase small business lending by $15 billion or more and have already begun funding innovative state small business credit programs. These initiatives should have a meaningful impact on the ability of small businesses all across the country to access badly needed capital as the recovery continues.

In what ways, if any, do the elements of the President's FY 2012 budget create an environment conducive to increased lending for small businesses?

We believe the President's FY 2012 Budget will help create an environment conducive for small business lending based on the following:

- The President proposes subsidies to support more than $15 billion in additional 7(a) loan guarantees that will help small businesses operate and expand in the coming year. The President's Budget also supports measures to strengthen financing programs for small business owner-occupied commercial real estate and equipment through Certified Development Companies (CDCs); leverage early-stage mezzanine investment financing through Small Business Investment Companies; and provides Microloan funding to emerging entrepreneurs through non-profit intermediaries.

- The Budget also proposes expanding the New Markets Tax Credit to encourage private sector investment in startups and small businesses operating in lower-income communities.

- The Recovery Act encouraged investment in small businesses by excluding from taxation 75 percent of the capital gains for investors in small businesses who hold their investments for five years. The Small Business Jobs Act and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 expanded this exclusion to 100 percent of qualified capital gains for stock acquired after September 27, 2010 and before the end of 2011. The Budget proposes to make this 100 percent exclusion permanent, saving small business owners $5.4 billion over 10 years.

13. The Obama Administration established the Home Affordable Modification Program (HAMP), which commits $75 billion, including $50 billion from TARP, to keep up to 3 to 4 million Americans in their homes by preventing avoidable foreclosures.

In my discussions of the HAMP program with various stakeholders, two reasons indicating HAMP's failure emerge: (i) borrowers are having tremendous difficulty working with lenders to determine whether or not they qualify for a loan modification, and (ii) some borrowers are not providing required paperwork to lenders, or lenders are repeatedly "losing" borrowers' paperwork, putting borrowers at risk for being denied a final modification.

One in five U.S. homeowners whose loans were modified under a federal government program to help reduce foreclosures were at least 60 days late in their payments a year after their mortgages were reworked. The re-default rate for HAMP averaged 20.4 percent after 12 months, 15.9 percent after nine months, 10.7 percent after six months and 4.6 percent after three months, according to a report released by the Treasury Department.

A healthy housing market is essential to our economic recovery. HAMP is simply not working quickly enough to keep people in their homes and large numbers of foreclosures are eroding neighborhoods and the very fiber of America's homeownership tradition.

I sent letters on November 9th to the leaders of the Department of the Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the Department of Housing and Urban Development, the Federal Housing Administration, the Office of the Comptroller of the Currency,

the Office of Thrift Supervision, the Securities and Exchange Commission, and the Department of Justice asking them to specify how they will coordinate and leverage each agency's role within the government's overall response to the foreclosure crisis.

Please outline the successes and failures of HAMP and other Treasury efforts to aid homeowners facing foreclosures.

What progress (or lack thereof) has Treasury made in its effort to coordinate with other federal government agencies to address foreclosure servicing abuses? Could you please cite a few specific numbers and examples?

So far, more than 600,000 homeowners have received a permanent HAMP modification and the immediate monthly payment reduction in these modifications is a median of over $520 per month, or 37 percent of their previous monthly mortgage payment. The programs only pay for successful modifications, and they pay over time as a loan remains current.

Homeowners in HAMP permanent modifications continue to perform well over time, with re-default rates lower than industry norms. December 2010 data for HAMP shows that after 12 months, nearly 85 percent of homeowners remain in a permanent modification. The OCC recently stated that "HAMP modifications were performing better than other modifications implemented during the same periods at the end of the third quarter of 2010. These lower post-modification delinquency rates reflect HAMP's emphasis on the affordability of monthly payments relative to the homeowner's income, verification of income, and completion of a successful trial payment period."

In addition, HAMP has spurred the mortgage industry to adopt similar programs that have helped millions more at no cost to the taxpayer. Mortgage assistance to homeowners provided through HAMP, the Federal Housing Administration (FHA) and private sector participation in the HOPE NOW Alliance, has outpaced foreclosure sales by more than two-to-one.

Due to the changing nature of the economic crisis, sustained unemployment challenges and negative equity mortgages became main causes of mortgage defaults and required greater attention. As a result, Treasury created new programs and designed the next phase of HAMP, with input from various constituencies, to better address these challenges. These programs, detailed below, are still in their early stages of implementation, and reporting on them should begin in the next few months.

The **Unemployment Program (UP)** requires servicers to grant qualified unemployed homeowners of non-GSE mortgage loans a forbearance period to have their mortgage payments temporarily reduced for a minimum of three months, and up to six months or longer when permitted by regulatory or investor guidelines, while they look for new jobs. Servicers are not reimbursed by TARP for any costs associated with UP, and there is no cost to government or taxpayers from the forbearance plans.

Under the **Principal Reduction Alternative (PRA)**, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. Incentives are based on the dollar value of the principal reduced. The principal reduction and the incentives are earned by the homeowner and investor based on a pay-for-success structure.

Treasury has worked with the FHA to establish the **FHA Short Refinance Program.** It requires that the mortgage investor write off the unpaid principal balance of the original first lien mortgage by at least ten percent. The new FHA loan must have a balance less than the current value of the home, and total mortgage debt for the homeowner after the refinancing, including both first and any other mortgages, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and an affordable monthly payment.

Finally, the Administration has allocated $7.6 billion to the **Hardest Hit Fund (HHF)**, to allow State Housing Finance Agencies (HFAs) in the nation's hardest hit housing markets to design locally-targeted foreclosure prevention programs. The HHF has been rolled out to 18 states and the District of Columbia. Most states are using the funds to help unemployed homeowners make their mortgage payments, as well as to offer principal reduction for homeowners with high negative equity.

We recognize that across the board, homeowners' experience with servicers has been frustrating. Homeowners have faced a range of communication challenges during the modification process, from receiving contradictory information to simply failing to reach someone knowledgeable about their case. We are currently developing guidance to be released within the next few weeks that would require all MHA-participating servicers to assign a single point of contact to each homeowner requesting a HAMP modification. We also believe that the mortgage industry should move expeditiously to establish a single point of contact for homeowners seeking assistance from their mortgage companies and those national servicing standards should include single point of contact as a requirement.

We have faced many challenges in developing and implementing our programs and much work remains to ease the housing and foreclosure crisis. But that should not obscure the importance of what has been accomplished. Our housing programs have established key benchmarks and borrower protections that are now viewed as industry best practices. We will continue to reach out to as many eligible homeowners as possible before our programs' expiration in 2012, while safeguarding taxpayer resources every step of the way.

But the mortgage servicing system we have today is broken, and we should work together to establish a stronger set of standards and best practices. Last fall we launched an Administration-wide, coordinated federal agency Task Force on the mortgage foreclosure and servicing situation involving Treasury, HUD, the Department of Justice, and all the relevant federal regulators.

The Task Force is working collaboratively with the state Attorneys General to identify and fix the breakdowns in internal controls, documentation, and corporate governance practices associated with mortgage servicing and foreclosure processes. On-site reviews of major mortgage servicers and vendors revealed critical deficiencies in the foreclosure processing and mortgage servicing requirements under state and federal law.

On April 13, the federal banking agencies announced formal enforcement actions against certain servicers. Efforts to coordinate further corrective action among the Task Force members and the state Attorneys General are ongoing, but the core objective is clear: servicers that engaged in any wrongdoing must be held fully accountable for their actions.

Regarding Treasury programs specifically, as information regarding irregularities in servicer foreclosure practices arose, Treasury acted swiftly and instructed its Compliance Agent to review the ten largest servicers' internal policies and procedures for completing these pre-foreclosure certifications before initiating the foreclosure proceedings, and to assess a limited sample of foreclosure sales that have occurred since the effective date of the guidance. The results of the review are not yet available. However, if any incidents of non-compliance with HAMP guidelines are identified, Treasury will direct servicers to take appropriate corrective action, which may include suspending foreclosure proceedings and re-evaluating the affected homeowners for HAMP, as well as undertaking changes to servicing processes to help ensure that HAMP guidelines are followed prior to initiating the foreclosure process.

14. In a July 14, 2010 Congressional Oversight Panel (COP) for TARP report, "Small Banks in the Capital Purchase Program," COP found that the Capital Purchase Program's (CPP) "one-size-fits-all" repayment terms have served large banks much better than smaller institutions. Small banks may find it difficult or impossible to exit the program, particularly if the current distressed financial markets persist.

The report found that 17 of 19 American banks with more than $100 billion in assets participated in the CPP, receiving 81 percent of the total CPP funds. Money was made available to many of these large banks in only a matter of weeks, in some cases even before the banks applied for the funds. Of these large banks, 76 percent have already repaid taxpayers, and many are now reporting record profits.

By contrast, the report found that of the 7,891 banks with assets of less than $100 billion, only 690 received funds from CPP and less than 10 percent have repaid. Those banks experienced a longer and more stringent evaluation, and many are now struggling to meet their obligations to the taxpayers.

Moreover, according to the report, one in seven small banks in the CPP has already missed a dividend payment, and fewer than 10 percent of CPP-recipient small banks have repaid taxpayers. As of July 2010, Treasury had $24.9 billion in CPP funds outstanding at small banks, and the prospects for full recovery are uncertain.

What are the underlying reasons for TARP's mistreatment of small banks and what are the specific steps that the Administration intends to make to remedy the discrepancy in treatment between small and large financial institutions that are receiving TARP funds?

I respectfully disagree with the premise that TARP has resulted in a "mistreatment of small banks." First, as Timothy G. Massad, Acting Assistant Secretary for Financial Stability, noted in his March 4, 2011 testimony before the COP, Treasury under the Obama Administration has "made no further investments in the nation's largest banks" but rather has "invested $11 billion in more than 400 other banks and thrifts, most of which were small and community banks."

Indeed, while Treasury agrees with the Bush Administration's decision to invest CPP funds in the nation's largest banks, the fact remains that smaller financial institutions make up the vast majority of CPP participants. Today, there are 539 institutions with less than $10 billion in assets still participating in CPP. As Acting Assistant Secretary Massad explained during his March 4 testimony:

> *The Obama Administration focused on small banks not only because EESA required that assistance be made available to financial institutions regardless of size, but also because of the critical role small banks play in our nation's communities. Small banks finance small businesses, which generate a large percentage of our private sector jobs, as well as serve the needs of many families. While it may ultimately take longer for Treasury to recoup its investment in these small banks, the fact remains that without TARP, many more of these institutions (and the communities they serve) would have been in jeopardy.*

I agree with Acting Assistant Secretary Massad's statements and Treasury continues to implement programs to assist small banks and small businesses. I would also note that the amounts of TARP funds outstanding in small banks are considerably less today than they were in July 2010. For CPP participants with assets of $1 billion or less, a total of $3.28 billion remains outstanding. For CPP participants with assets of less than $10 billion, the figure is $9.84 billion.

TARP programs were designed and implemented to treat all banks fairly. The Obama Administration's commitment to fairness for small banks and small business has been and continues to remain strong.

As the Congressional Oversight Panel stated in its May 2010 report, there is very little evidence to suggest that the CPP led small banks to increase lending. What is your view on TARP's mandate to increase general credit availability, including to small banks?

By providing capital through CPP, Treasury has helped financial institutions absorb losses from bad assets so those institutions can continue to provide financial services to businesses and individuals. Most small banks extend the majority of their business loans to small businesses. Moreover, because most small businesses cannot directly access the capital markets, many have few other options for financing outside of bank loans, making community banks critical to the future of these businesses. These capital programs have been effective and our financial system is more stable because of them.

It is important to remember, however, that CPP was not the only TARP program designed to increase credit availability. As Acting Assistant Secretary Timothy G. Massad testified before the COP on March 4, 2011:

> *Through the Term Asset-Backed Securities Loan Facility ("TALF"), a joint program with the Federal Reserve, we helped to restart the asset-backed securitization markets that provide credit to consumers and small businesses. Since TALF was launched in March 2009, new issuances of asset-backed securities have averaged $10.5 billion per month, compared to less than $2 billion per month at the height of the financial crisis.*
>
> *In addition, through the Public-Private Investment Program ("PPIP") for legacy securities, we matched TARP funds with private capital to purchase legacy mortgage-related securities. This program returned liquidity to key markets for financial assets and helped to remove troubled assets from the balance sheets of major financial institutions. Since the announcement of PPIP in March 2009, prices for eligible residential and commercial mortgage-backed securities have increased by as much as 75 percent. Although the funds remain in their ramp-up phase, they have earned a positive return for taxpayers.*
>
> *Finally, through the SBA 7(a) Securities Purchase Program, we helped unlock credit for small business by purchasing securities backed by small business loans. Markets for these securities have since returned to healthy levels.*

15. The Congressional Oversight Panel's July 2010 oversight report, titled "Small Banks in the Capital Purchase Program" (CPP) makes the case that many small

banks are at a disadvantage, compared with larger banks, when it comes to repaying TARP funds.

In fact, the report states that of the $205 billion the CPP pumped into 707 banks, 81 percent of these funds went to banks larger than $100 billion. Small banks that were accepted into the program "experienced a much longer and more stringent evaluation" but according to this report, "these safeguards appear to have been insufficient."

According to the COP, "there is little evidence that the CPP has strengthened the small bank sector," one in seven of the 690 small banks within the CPP have already missed a payment and fewer than 10 percent of CPP-recipient small banks have fully repaid the Treasury. This points to a future crisis, as small banks that took these funds and cannot repay them are now facing the prospect of increasing their payments to the Treasury Department from 5 percent to 9 percent, which may drive otherwise profitable small banks out of business.

Community banks form the backbone of the financing system for small businesses and if community banks fail, there will be repercussions for small firms. With that in mind, how should the Treasury Department treat these CPP recipient banks?

As noted above, small banks finance small businesses, which generate a large percentage of our private sector jobs, as well as serve the needs of many families. Treasury thus shares your concern for the continued health of our nation's small banks. Under the Obama Administration, this concern has led Treasury to invest "$11 billion in more than 400 other banks and thrifts, most of which were small and community banks."

As Assistant Secretary Massad testified "[w]hile it may ultimately take longer for Treasury to recoup its investment in these small banks, the fact remains that without TARP, many more of these institutions (and the communities they serve) would have been in jeopardy." Additionally, the "track to recovery is longer because these institutions have less access to the capital markets and greater exposure to the commercial real estate ("CRE") market." I agree with Acting Assistant Secretary Massad's assessment. In addition, most of our outstanding investments are in perpetual preferred stock, which does not include an obligation to repay. And prior to repaying, banking institutions must obtain regulatory approvals.

Although these smaller banking institutions continue to face challenges, we have seen some positive signs. Over the past year, the CRE market and credit conditions have shown signs of stabilization and, in some areas, modest signs of improvement. With the launch of the Small Business Lending Fund (SBLF), which is outside of TARP, Treasury will provide capital to qualified small banks.

What effects could the failure of these banks have on the already depressed small business access to capital market?

Treasury is committed to helping ensure that we have a strong small bank sector. That is why Treasury is diligently dedicating resources to the implementation and deployment of the SBLF, which is outside of TARP. This new fund, created under the Small Business Jobs Act of 2010, is a $30 billion fund that encourages lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion.

Through the SBLF, small banks and small businesses can work together to help create jobs and promote economic growth in local communities across the nation.

16. **Last Congress I worked extensively with colleagues on both sides of the aisle to formulate the Small Business Jobs Act of 2010 (H.R. 5297). The bill included many of my priorities, like increasing the maximum loan limits on SBA 7(a) loans from $2 million to $5 million and raising 504 loan limits from $1.5 million to $5.5 million. Unfortunately, it also included the controversial Treasury Lending Fund that allocates Treasury $30 billion to provide to small banks, in an effort to increase small business lending.**

While the law directs that within 10 years of receiving the funds, the banks should repay them to the Treasury Department, and has interest rates that rise if the funds are not repaid, it also gives you the discretion to extend – even indefinitely – the period of time that banks have, to repay the government.

This is unacceptable. If the average taxpayer knew that their hard earned dollars were going from the Federal government to banks – at exceptionally low interest rates – and that there is no absolute requirement that those funds be repaid, they would rightfully be justifiably irate.

I intend to introduce legislation this Congress that would, among other things, require that the funds be repaid in 10 years – ample time for repayment. Would you support such a requirement?

Treasury shares your goal of ensuring the prompt repayment of funds made available through the Small Business Lending Fund (SBLF). For this reason, the investment terms Treasury has developed to implement the SBLF include strong incentives for banks to redeem Treasury's investment within ten years. For example, as you note, the Small Business Jobs Act of 2010 (Jobs Act) requires that the dividend rate payable to Treasury for SBLF funding increase to nine percent after four and one-half years. In addition, after ten years participating banks that are not publicly traded will be prohibited from repurchasing or declaring dividends on common stock and other equity shares that rank equivalent to or below Treasury's investment. Treasury has no intention of extending these deadlines. Moreover, the securities Treasury receives will not be subject to any contractual restrictions on transfer. If participating institutions do not repay Treasury quickly, Treasury will have the option to return funds to taxpayers by selling its investments to third parties in market transactions.

Your question observes that, despite these incentives, certainty of prompt repayment could be further enhanced by imposing a mandatory repayment date by statute. Under current banking law and regulations, a ten-year repayment deadline could be imposed only at the cost of adversely affecting the Tier 1 capital treatment of SBLF securities. Adverse regulatory capital treatment of SBLF securities could substantially deter participation in the SBLF by community banks, which are the backbone of the financing system for small businesses, and could hamper lending at the banks that do participate. In light of this result under current banking law, and because increasing the availability of credit for small businesses is the purpose of the SBLF, Treasury would not support an amendment to the Jobs Act that imposes a mandatory ten-year repayment deadline on SBLF funding.

17. **Manufacturers and workers in trade-sensitive industries – such as paper production in Maine – feel that the Yuan ("you-on") is significantly undervalued, making Chinese imports artificially cheaper compared to competing U.S. goods. As a result, according to the independent Economic Policy Institute, since China joined the WTO in 2001, 2.4 million jobs have been lost or displaced in the U.S. – including nearly 10,000 in my home state, which has been absolutely devastated. For years I have been concerned that the Treasury and Commerce Departments have refused to investigate the undervaluation of foreign currency.**

In 2006 and again in 2007, Federal Reserve Chairman Ben Bernanke stated that China's currency manipulation provides "an effective subsidy for Chinese exporters." Do you generally agree with this statement? (IA)

This is a critical question because to date the Commerce Department – which regularly investigates and imposes tariffs on imported products that benefit from foreign government subsidies in violation of our trade rules – has refused to even initiate an investigation into whether China's currency practices constitute an illegal export subsidy. Last week I introduced the "Currency Reform for Fair Trade Act" to require Commerce to at least initiate an investigation – on a case by case basis – into whether currency undervaluation constitutes a prohibited export subsidy. My bill mirrors legislation (H.R. 2378) that passed the House last September by broad, bipartisan margins. Does the Administration support this approach?

The Administration has not taken a position on any piece of currency legislation introduced in the House or Senate. We will carefully examine all proposals put forward by Congress; however, as I have said, it is important that any legislation be both consistent with our international obligations and effective in achieving our objectives. September's vote in the House of Representatives on H.R. 2378, and Congressman Levin's recent re-introduction of that same piece of legislation with over 100 Republican and Democratic co-sponsors, clearly show that lawmakers have serious concerns about China's exchange rate policy.

The President and I share those concerns. As Treasury concluded in our February 4, 2011, *Report to Congress on International Economic and Exchange Rate Policies*, China's continued rapid pace of foreign reserve accumulation and the huge flow of capital from the Chinese public to advanced countries that it implies, the essentially unchanged level of China's real effective exchange rate especially given rapid productivity growth in the traded goods sector, and widening of current account surpluses, all indicate that the RMB remains substantially undervalued.

China's exchange rate is an important factor in shifting China's economy towards greater reliance on, and production for, domestic demand. This is a critical part of the G-20 Framework for strong, sustained, and balanced global growth.

In June 2010, China resumed allowing its exchange rate to adjust, and the RMB has appreciated by 4.5 percent against the dollar since then. The rate of appreciation against the dollar in real terms – adjusting for the higher rate of inflation in China than in the United States – is even higher. While this progress is welcome, it is not sufficient. We have said repeatedly that China needs to allow a significant, sustained appreciation over time, and we continue to raise this issue at every opportunity.

18. I was pleased to see that the President's budget proposed that the New Markets Tax Credit (NMTC) be extended for one year with $5 billion in credit allocation authority for 2012. The $5 billion allocation requested for 2012 is an increase over the $3.5 billion available for 2010 and 2011 and I am interested in hearing your assessment of the NMTC and specifically how the Credit is generating private investment in business and economic development activity in low income communities.

Please elaborate on the annual demand for New Markets Tax Credits from community development entities (CDEs) applying for allocations and also from NMTC investors. Has there been an increase in NMTC investment activity over the last year?
Also, the President's Fiscal 2012 budget would permit any NMTC investments made after December 31, 2010 to offset AMT liability. Does Treasury believe that new investors, or new types of investors, might enter the NMTC markets if AMT relief were available? Are you aware of any NMTC investors that have run up against AMT and had to limit their NMTC investing?

Demand for New Markets Tax Credits

Since the inception of the New Markets Tax Credit Program (NMTC Program), demand has far outweighed the available allocation authority. Demand has been fairly consistent over the past several award rounds of the program. Since 2006, applicants have requested over five times the amount of allocation authority available.

In 2010 alone, NMTC Program applicants requested nearly seven times the available dollar amount in tax credit allocation authority. In addition, the number of awardees has always been far smaller than the number of applicants – in general, there have been between 2.5 and four times the number of applicants to the NMTC Program as there have been awardees every year.

Year	*Number of Applicants*	*Amount Requested*	*Number of Allocatees*	*Allocation Authority Available*
2010	250	$23.5 billion	99	$3.5 billion
2009	249	$22.5 billion	99	$5 billion*
2008	239	$21.3 billion	102	$5 billion*
2007	258	$27.9 billion	61	$3.9 billion**
2006	254	$28.3 billion	63	$4.1 billion***

*includes $1.5 billion in Recovery Act allocation authority
**includes $400 million authorized by the GO Zone Act of 2005
***includes $600 million authorized by the GO Zone Act of 2005

Investor Demand and Increased Investment Activity

The NMTC Program has been successful in attracting investment capital to distressed areas. To date, over $20 billion of investments have been made into qualified Community Development Entities (CDEs), with over two-thirds of these investments made in communities characterized by significantly higher indicia of distress than minimally required under program regulations. Close to half of these investments made in communities where minorities comprise the majority of the population. In 2010 investor demand was strong, with $4.5 billion of investments made in CDEs. This is a marked increase over the $3.4 billion and $2.7 billion raised in 2008 and 2009 respectively.

Through FY 2009, the most recent year for which the CDFI Fund has complete data, NMTC proceeds have financed nearly 3000 businesses and real estate projects in low-income communities, supporting over $40 billion in total project costs. These investments have financed a wide variety of projects, including charter schools, health care facilities, manufacturing companies, and alternative energy companies.

AMT Relief

AMT relief is important to ensure continued demand for the NMTC and attract new investors to the tax credit. While overall NMTC investments were strong in 2010, the number of different NMTC investors has fallen considerably. A few very large investors comprise most of the NMTC market. As a result, pricing on credit has fallen, which means fewer subsidies are available to support the projects that need financing. Allowing the NMTC to offset the AMT would expand the program to new investors such as individual investors and corporate investors already subject to the

AMT as well as those who may be unsure of their future AMT status. Furthermore, it brings NMTC in line with other tax credits, such as the Low Income Housing Tax Credit and Historical Rehabilitation Credit, which are allowed to offset the AMT. Many high-wealth individuals are potentially subject to the AMT, and therefore may be discouraged from participating in the NMTC Program.

19. **I appreciate the Administration's recent announcement to pursue a "Better Building Initiative" and as an author of the residential and commercial building energy efficiency tax credits, I have long argued that our energy tax policy should be more directed towards using existing technology to reduce the use of finite and expensive energy. According to the National Renewable Energy Laboratory (NREL) our existing building sector uses as much as 40 percent of all our energy consumed in our country and investing in insulation, and energy efficient lighting and HVAC systems can reduce energy bills by 20-40 percent.**

In 2005, I worked with then Chairman Grassley, Senator Bingaman, Senator Feinstein, and Senator Kerry on developing the 179D tax deduction, which established for the first time an incentive for commercial building contractors to build an energy efficient building that will save energy for generations. At the same time, I am concerned that the Treasury Department has not issued regulations for the deduction to allow commercial building owners a simple method to claim a partial deduction. On October 20th, 2009 I wrote the Administration requesting that final regulations be issued to ensure that this tax deduction could be used more effectively.

While I would like to work with the Administration on this initiative and understand your proposal to modify the deduction into a credit, present law 179D(d) directs the Secretary, after consultation with the Secretary of Energy, to establish regulations prescribing methods for calculating and verifying energy consumption and outline partial compliance pathway. Does the Administration intend to use existing authority to issue regulations that would allow the deduction to be more effectively utilized?

The Treasury Department, after consultation with the Department of Energy, has issued guidance prescribing procedures under which taxpayers may establish their eligibility for the deduction under section 179D. Although this guidance takes the form of an Internal Revenue Service Notice, rather than regulations, taxpayers may rely on the guidance in claiming the section 179D deduction.

Under section 179D, property qualifying for the deduction must be installed as part of a plan to reduce energy cost by 50 percent or more in comparison to a reference building. A partial deduction is allowed for systems that meet a lower energy-savings target specified by the Treasury Department. Based on consultation with the Department of Energy, the guidance establishes energy-savings targets of 10 percent for building envelope property and 20 percent for lighting systems and heating, cooling ventilation, and hot-water systems.

The guidance, again based on consultations with the Department of Energy, specifies the method under which energy savings are computed for purposes of determining whether the applicable target has been met. In addition, the Department of Energy maintains a list of approved software programs that may be used to calculate energy and power consumption for this purpose.

We share your belief that a simple method should be available for claiming the partial deduction although, rather than limiting the simplified method to the partial deduction, we would prefer to make it available for the full deduction as well. Accordingly, our Budget proposes to allow a credit for satisfying specified prescriptive efficiency standards based on building types and climate zones. This would enable taxpayers to avoid the complexity of the current-law standards, which require whole-building auditing, modeling, and simulation.

How does the Administration propose that the legislative proposal interact with existing authority to issue regulations?

We believe that determinations regarding the energy-savings targets of current law require whole-building auditing, modeling, and simulation. We would be happy to work with you and this Committee on this issue.

Although I understand the request for modifying the deduction into a credit are there also technical modifications to present law that would allow the Administration to advance this initiative expeditiously?

Any determination as to whether parts of our simplification initiative could be advanced through a technical correction would require consultations involving the Senate Finance Committee, the House Ways and Means Committee, the Joint Tax Committee, and the Treasury Department. We would be pleased to participate in that process.

20. **Residential energy efficiency improvements lead to lower energy bills, reduced pollution, and catalyze more employment in the fledgling construction sector. In the President's budget the Administration reiterates a commitment to enacting the Home Star, which would provide rebates for energy efficiency property as well as a long-term tax credit. As a cosponsor of the Home Star legislation in the 111th Congress, I appreciate the Administration's commitment to residential energy efficiency. At the same time I believe it is critical to create long-term tax policies to promote energy efficiency along with a short-term catalyst, which was included in Senate version of Home star (S.3434).**

    Does the Administration support enacting long-term performance-based residential energy efficiency tax credit for homeowners, comparable to what the Administration has proposed for commercial building owners?

The Administration has proposed a short-term extension through calendar year 2012 of the tax credit under section 25C of the Internal Revenue Code for energy efficiency improvements to residences. This is consistent in duration with what the Administration has proposed for commercial building owners (a credit of up to $1.80 per square foot for property placed in service in calendar year 2012). In addition, the Administration continues to urge Congress to pass the Homestar energy efficiency retrofit program. While the Budget does not propose any long-term tax incentives for homeowners and commercial building owners, we will continue to evaluate the need for the extension or improvement of current tax incentives for achieving increased energy efficiency in both commercial and residential buildings.

In the Administration's budget you propose an extension and modification of the 25C residential energy efficiency tax credit through 2012. What are the modifications that the Administration proposes?

The proposed modifications to the section 25C credit are the same as those made by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Thus, under the proposal, the section 25C credit would be determined under the rules in effect for 2011, rather than the rules in effect for 2009 and 2010.

Questions from Senator Michael B. Enzi

1. **Just a few weeks ago, an overwhelming majority in the Senate voted to approve an amendment to an aviation bill that would repeal the onerous Form 1099 reporting provisions that were included in the health care reform law. The Administration's budget suggests that this bipartisan agreement is not the right answer – that, in fact, a portion of the provision should remain in the law. More specifically, the Administration has proposed that a business be required to file an information return for payments for services or for gains aggregating to $600 or more in a calendar year *to a corporation* (except a tax-exempt corporation); information returns would not be required for payments for property. The amendment agreed to by the Senate would strike from the law both payments to corporations and payments for property. After hearing from small businesses in Wyoming and around the country about the negative impact of this provision, and after gaining bipartisan support in the Senate, why is the Administration rejecting the Senate amendment and offering a proposal that only gets half the job done?**

   Since this question was submitted, Congress enacted H.R. 4, which the President signed on April 14, 2011, repealing the expanded Form 1099 reporting requirements included in Section 6041 of the Internal Revenue Code, as modified by Section 9006 of the Affordable Care Act.

As indicated in our Budget proposal, the Administration strongly supported efforts to repeal the provision in the Affordable Care Act that established information reporting requirements for tax purposes that placed an unnecessary bookkeeping burden on small businesses. While the Administration is committed to reducing the gap between taxes legally owed and taxes paid, the burden imposed on businesses by the Affordable Care Act new information reporting requirement for purchases of goods that exceed $600 was too great.

The Budget also includes a second proposed information reporting change, which was included in our prior budgets as well as in budgets proposed by President Bush, which would expand the previously existing reporting requirements to apply to transactions with corporations. Under current law, as recently amended, payments to corporations are exempted from the reporting requirements. The Administration continues to believe that leveling the playing field between businesses with different organizational forms in the manner proposed is a responsible way to address the tax gap.

2. **I, along with Chairman Baucus, was one of the lead authors on a carefully constructed agreement that reauthorized the Abandoned Mine Lands (AML) Trust Fund in 2006. That trust fund continued the tax on coal companies for each ton of coal they mine. The compromise legislation included Democrats and Republicans. The coal industry and the United Mine Workers of America supported the bill. Members from certified states like Wyoming supported the compromise as did members from uncertified states like Pennsylvania and West Virginia. As a Senator, President Obama voted in favor of the legislation that included this compromise.**

   The Administration's budget proposal would target coal AML fee receipts at the most hazardous sites through a new competitive allocation process with State participation. Why is the Administration backtracking on the agreement between Democrats and Republicans and that was supported by then-Senator Obama?

   The Administration proposes to end mandatory payments from the Treasury general fund to States and Tribes that have been certified as completing reclamation of abandoned coal mine sites and, consequently, no longer need funds for that purpose. These payments to certified States and Tribes can currently be used for any purpose approved by the State legislatures or tribal councils and do not contribute to reclamation of abandoned coal mines. This proposal would not affect payments to States that have active reclamation programs, but would require non-certified States to focus their AML funding on only priority coal mine reclamation needs. This is similar to the 2010 budget proposal, except this new proposal reserves $10.0 million annually to address the highest priority coal projects, including Federal high-priority coal issues that develop or are discovered in certified States and Tribes. Budget savings of $115.0 million are anticipated in 2011 with savings of $1.2 billion over ten years.

3. **Once again, the Administration's FY 2012 budget calls for the expiration of the 2001 and 2003 tax cuts for so-called "high-income earners" upon their expiration in 2012. Based on the discussions that this administration had with business owners and executives over the past several months regarding tax reform, I am surprised that the administration has not recognized the impact of not allowing those tax rates to continue for small businesses that operate in pass-through form, the business income from which is taxed at individual income tax rates. Pursuant to this proposal, half of all small business income would be subject to higher taxes, and nearly 750,000 small businesses would face higher taxes. Is this proposal the Administration's idea of a good non-corporate tax reform effort – raise taxes on small businesses and small business owners in Wyoming and around the country? Does the Administration believe that it can separate tax reform into corporate and non-corporate tax reform? If so, why has the Administration not taken into account the proliferation of businesses in Wyoming and throughout the United States that operate as partnerships, limited liability companies, or S-corporations, all of whose business income is subject to individual income tax rates?**

The Administration recognizes the importance of small businesses to the health and growth of the U.S. economy. President Obama has signed into law at least 17 tax cuts for small business. In addition, his FY 2012 Budget proposes a large permanent increase in the amount of investment that small businesses can expense and proposes to eliminate permanently any capital gains on qualifying small business stock, providing entrepreneurs and small businesses further encouragement and reward for new investment.

The Administration believes that these types of targeted incentives are more cost-effective in helping small business contribute to economic growth than is extending the 2001 and 2003 tax cuts for those taxpayers with the highest incomes. It is also worth noting:

- Only about 3 percent of "small business owners" are subject to the top tax brackets. And even that figure and the others cited count not just owners of truly small businesses owners but recipients of any flow-through income.
    - Under that definition, every partner in a major law firm and every principal in a major financial institution would count as a separate small business.
    - A CEO who has board fees or speech fees would also count as a small business owner under this overly broad definition.
- Moreover, the cited figures include income received through both large businesses and small businesses and thus overstates the share of small business income received by high income taxpayers.

Regarding tax reform, the Administration is interested in and willing to work with Congress to reform and improve all of the components of the U.S. tax system. Our interest in beginning the tax reform dialogue with a discussion of corporate tax reform does not preclude other reforms. However, as a first step toward more comprehensive tax reform, we believe we can make progress now on corporate tax reform that repeals provisions that distort investment and uses the revenue raised to lower the corporate tax rate. We understand that given the significant amount of business income earned outside the corporate sector, we must consider the effects of corporate tax reform on non-corporate businesses.

4. **The Administration's budget again calls for the repeal of the last-in, first-out (LIFO) method of accounting for inventories, effective for taxable years beginning after December 31, 2012. Taxpayers required to change from the LIFO method would be required to report their beginning-of-year inventory at its first-in, first-out (FIFO) value in the year of change, causing a one-time increase in taxable income that would be recognized ratably over ten years. Some would argue that the revenue to be raised from LIFO repeal would come not from the elimination of its use going forward, but from the tax on accumulated LIFO reserves (defined as the difference between the LIFO cost of inventory and the cost of the inventory under the FIFO method). The tax on LIFO reserves would in many cases exceed a company's yearly revenues. Such a tax increase could prove devastating for many U.S. companies, even with the ability to pay over a number of years as described in the President's budget. Has the Administration considered the impact of such a change on small businesses, and whether a more targeted approach to any perceived abuse might be a better path forward?**

   The tax deferral provided under the LIFO method is inconsistent with general income tax principles, which require gains be taxed when realized and recognized. The LIFO method allows these gains to be deferred indefinitely, despite the fact that inventory sales are realized and recognized annually. Recognition of accumulated LIFO reserves would put LIFO taxpayers on a more even playing field with other taxpayers that have paid and continue to pay tax on their inventory sales without being able to take advantage of the tax deferral that the LIFO method provides. Eliminating this tax deferral benefit will result in a more fair and equal treatment among taxpayers.

   Moreover, our analysis indicates that the LIFO tax benefit is overwhelmingly concentrated among the larger taxpayers.

   The tax law has long-standing rules governing the consequences of changes in accounting methods. Under these rules, when a taxpayer ceases to use LIFO, it must write-up the value of its inventory from its LIFO value to the value of the inventory under the new accounting method. If this results in taxable income, that income is taken into account over a four-year period. Consistent with these long-standing rules, the budget proposal for eliminating LIFO as an accounting method requires LIFO taxpayers to write-up their inventories. As you point out, under the Budget proposal, the tax due from LIFO repeal can be spread over a ten-year period, which is more generous than current law's four year period, lessening any immediate effect.

5. **The FY 2012 budget includes a variety of proposals to eliminate tax preferences for the oil and gas industry and for the coal industry. 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? Why is the Administration not taking a page from its own Fiscal Commission and provide for reductions in tax rates by eliminating these types of tax expenditures, rather than spend on new initiatives?**

Tax subsidies for the oil, gas, and coal industries create a market distortion that is detrimental to long-term energy security and is inconsistent with the Administration's policy of supporting a clean energy economy, reducing our reliance on oil, and cutting carbon pollution.

The elimination of such subsidies makes sense both in the context of rate-lowering revenue neutral corporate tax reform and on its own. In a competitive market, a tax system free of subsidies will promote investment decisions that reflect an investment's economic returns rather than its tax benefits. Tax subsidies that are not designed to correct an existing distortion or market failure, like the existing preferences for fossil fuels, lead to an under allocation of resources to other industries. These distortions in resource allocation result in inefficiency and generally reduced economic growth. Over the long term, eliminating these tax preferences will result in a more efficient allocation of capital, which will tend to increase national output. Thus, eliminating these tax subsidies will make our overall economy stronger over time. In addition, these subsidies impede investments in clean energy sources and undermine efforts to address the threat of climate change.

Eliminating fossil fuel subsidies will not have significant effects on consumer prices. The domestic price of oil is determined by global supply and demand because oil is an internationally traded commodity. Because we expect elimination of the subsidies to have little effect on the world supply of oil, we believe effects on world or domestic oil prices will be insignificant.

Unlike oil, a large majority of the other fossil fuels consumed in the U.S. are domestically produced. However, the cost of these subsidies which we propose to eliminate is extremely small relative total revenues in these industries. Thus, the potential effect on prices from removing the tax subsidies would be small relative to normal price fluctuations.

6. Former Senator Alan Simpson said that anyone who proposes a budget that doesn't make major changes to our entitlement programs is not making a serious proposal. The Fiscal Commission, which included my fellow Finance Committee members Mike Crapo and Tom Coburn, worked hard on a proposal that seems to have been ignored by President Obama.

Why didn't the President use this leadership opportunity to propose much of what the Fiscal Commission suggested and make the really hard choices that this country needs and deserves?

The Administration is committed to restoring fiscal sustainability. The only way to return our nation to a sustainable fiscal path is to come together around a balanced approach to deficit reduction. The Fiscal Commission was useful in pointing out the seriousness of the challenge we face, and by putting on the table a set of proposals designed to address it.

The President's deficit framework builds on several recommendations in the Fiscal Commission:

- It takes an approach to deficit reduction that seeks significant savings across all parts of the Budget – with $4 trillion in deficit reduction through non-security discretionary spending, security spending, health care, other mandatory spending, and spending through the tax code.

- This includes cutting non-security discretionary spending to levels consistent with the Fiscal Commission—for total deficit reduction of $200 billion more than the $400 billion in savings under the President's Budget and $770 billion in savings over 12 years.

- It seeks comprehensive tax reform that both lowers rates and the deficit by closing loopholes.

- It seeks savings in Medicare and Medicaid in line with Commission recommendations. For example, the President proposed to find Medicare savings by limiting excessive payments for prescription drugs by leveraging Medicare's purchasing power – similar to what was called for by the Commission. These build on other ideas the President proposed in his Budget that the Commission has endorsed to reduce health care spending, for example by increasing government authority to fight Medicare fraud and ending state gaming of a Medicaid tax gimmick

The President's framework builds on other Fiscal Commission recommendations that were already in the President's Budget:

- The President also already *implemented a two-year freeze on federal civilian pay* in line with the Commission's recommendation.

- The President's Budget calls for the *medical malpractice reforms* proposed by the Commission.

- The President has called for *corporate tax reform* – as the Commission proposed – to lower rates without adding to the deficit, by closing loopholes.

- The President has asked for the *authority to reorganize government for the 21st century*, in line with the Commission's recommendations.

- The Budget included an *elimination of in-school subsidies in federal student loan programs for graduate students*, as the Commission recommended, which allows us to maintain historic increases in Pell Grants in a fiscally responsible way

7. **Mr. Secretary, you said in your testimony that "we still face very substantial economic challenges" and that "Millions of Americans remain out of work." Last week before the House Budget Committee, CBO Director Doug Elmendorf said because of the health reform law "there would be a reduction of 800,000 workers." Specifically, the health reform law imposes $52 billion in new taxes on employers that cannot afford to provide health insurance to their workers. According to CBO, this new employer tax will result in lower wages and lost jobs.**

   What impact do you believe the employer mandate will have on jobs and wages? Have you quantified how many jobs will be eliminated and how many employees will see their wages reduced as a result of this new tax on employers?

   As I understand it, Director Elmendorf was discussing labor supply effects, not the impact of the employer responsibility requirement. Some people work – or delay retirement – in order to have access to health insurance; with the Affordable Care Act (ACA), they will have access to affordable, high-quality health insurance even if an employer doesn't provide it. As a result, some people may choose to scale back their hours or leave the labor market.

   The ACA also will slow the rate of growth of health spending, which will lower health insurance costs, raise take-home wages, and increase labor supply by making work more remunerative. Ensuring access to affordable coverage will also increase the efficiency of the labor market by reducing job lock and increasing labor mobility as workers enjoy their new freedom to move to a more productive job or start their own small business.

   The large majority of employers that will be subject to the employer responsibility provision already offer health insurance. Smaller employees are already beginning to receive tax credits to help them offer insurance. Beginning in 2014, small firms will have the option of providing their workers with coverage though a state-based exchange, which will provide increased market power and reduced administrative costs, freeing small businesses to offer competitive wages to the best workers. Overall, the ACA is good for workers, businesses, and the labor market.

8. **Mr. Secretary, as you know, the Stimulus created tax credits to purchase vehicles that operate on clean energy. There was about a 20 percent error rate in the filing of these tax credits. CBO estimates from 2014 to 2019 the Treasury will issue nearly $500 billion in tax credits to purchase health insurance. A 20 percent error rate in credits to purchase insurance would result in $100 billion in erroneous credits.**

   How many IRS employees will be involved in issuing the health insurance credits? How many employees at IRS worked on issuing the credits to purchase clean energy vehicles? What steps are you taking to avoid the 20 percent error rate that occurred in the clean energy vehicle credit?

   IRS research has shown that the highest compliance rates are associated with provisions where taxpayer claims can be corroborated by third-party information reporting. For example, when taxpayers report wage, dividend, or interest income, the IRS can compare what the taxpayers report with what is reported by employers and financial institutions. Where there is third-party information, taxpayers tend to be more compliant to begin with, and where there is non-compliance the IRS can run highly efficient and risk-based enforcement programs.

   In contrast, the IRS faces substantial challenges where there is no third-party information reporting to confirm what taxpayers report on the return. This is true for the types of clean energy vehicle credits that you reference (where the IRS had no third-party information to confirm which individuals bought which cars), as well as for certain types of business income and deductions where the IRS has no independent information source. In these cases the IRS relies on other compliance approaches which are less precise and targeted.

   The premium assistance tax credit included in the Affordable Care Act is accompanied by other provisions of the Act that require exchanges and insurance companies to report to the IRS the fact of health coverage over the course of each year starting in 2014. This means that when taxpayers claim the premium assistance tax credit, the IRS can match that claim with records from the exchanges to confirm that the coverage was obtained by that taxpayer. The known presence of third-party information reporting should substantially reduce the likelihood that taxpayers attempt to claim the credit fraudulently. And, where there are individuals attempting to game the system, the IRS will have the information that it needs to run targeted compliance programs.

   With respect to your questions about IRS staffing, the President's 2012 Budget includes a request for 219 FTEs devoted to building the information technology infrastructure to support accurate delivery of the premium assistance tax credit.

The IRS does not have a dedicated function to administer the tax credits that provide incentives for purchasing plug-in electric, alternative fuel, and other related vehicles, and it does not otherwise track what portion of existing operational time is devoted to these credits in particular.

9. The new law limits how much can be recouped from an individual who receives a health care tax credit in excess of what they are eligible for. How much could be saved if this provision were eliminated and would you support requiring individuals who received federal payments in error being forced to refund these amounts to the treasury?

The Administration would have serious concerns about a proposal to eliminate the caps that protect middle-class families who receive advance health care tax credits. Eliminating the caps would result in tax increases on certain middle-class families, in some cases totaling thousands of dollars, notwithstanding that they followed the rules. It would also create substantial uncertainty about the cost of health care coverage obtained on an exchange, which would likely reduce participation in state-based exchanges, leaving more lower-income individuals without insurance.

10. Starting January 1, 2011, Americans with Flexible Spending Accounts and Health Savings Accounts are no longer allowed to use those accounts to purchase over the counter medicines without a doctor's prescription. Over the counter medicines allow Americans to address their health care needs in a cost effective manner. Requiring prescriptions that could potentially mean costly visits to a doctor seems to be at odds with the goal of reducing overall health care costs.

Shouldn't a health care consumer be incentivized to try an over the counter medicine to treat an everyday ailment first, rather than immediately enter the costly health care system? Has Treasury examined how this change could actually increase health care spending, by encouraging patients to switch from over the counter products to more expensive prescription medications?

The Affordable Care Act's requirement of a prescription in order to obtain non-taxable reimbursements of over-the-counter (OTC) drugs from flexible spending arrangements (FSAs) and tax-preferred health savings accounts (HSAs) helps bring the rules for what qualifies as a medical expense for purposes of these accounts more closely in line with the rules that apply for purposes of the itemized deduction for medical and dental expenses. This provision will also help to ensure that these accounts are used to purchase medically necessary health care items and services. That is why any drug that is prescribed – whether or not it's available over-the-counter – continues to qualify for purchase through the accounts.

We do not believe that this measure creates a significant incentive for individuals to switch to prescription medications, since OTC medications are generally less expensive than their prescription-only competitors.

11. In your testimony you note that independent analysts have estimated that the new health care law will significantly slow the growth in medical costs. This contradicts the finding made by the Administration's own chief Medicare actuary. Please identify who these independent analysts are and why you rely on their findings over those of senior actuaries within the Department of Health and Human Services.

The Office of the Actuary of CMS (Centers for Medicare & Medicaid Services) released an "illustrative alternative" to the current-law projections published by the Medicare Trustees to project what Medicare spending would be even if Congress overrides some of the current law provisions intended to slow the growth of the program. Even under the alternative projections (which assume that Medicare physician payments are not reduced as required by the Sustainable Growth Rate (SGR) formula under current law), the Actuary projected that Medicare spending will be lower over the next 75 years as a result of the ACA. Moreover, the Trustees Report indicates that many of the Medicare payment system reforms in the ACA, such as bundled payments and accountable care organizations, have the potential to lower costs and cost growth. Further, a number of experts have estimated the impact of payment system reforms. Harvard economist David Cutler estimated that health spending could be 1.5 percentage points lower as a result of the reforms. The Commonwealth Fund estimated that a package of reforms similar to those in the ACA would slow health spending growth by nearly one percentage point annually over 10 years. Finally, a New England Journal of Medicine article published in 2009 also estimated that bundled payment reforms could reduce national health spending by 5.4 percent between 2010 and 2019.

12. Please identify what specific actions Treasury is currently taking to implement the provisions in the new health care law regarding health insurance tax credits and how your department plans to coordinate with Health and Human Services as well as state based insurance exchanges.

The new tax credits under Code section 36B play an important role in achieving the Affordable Care Act's goal of increasing the number of middle-class Americans with access to affordable health insurance coverage. Starting in 2014, these advanceable and refundable credits will be available to individuals and families who purchase insurance through exchanges, who have incomes that are below 400 percent of the federal poverty line, and who are not eligible for other affordable coverage. (In 2010, 400 percent of the poverty line was about $43,000 for an individual or $88,000 for a family of four.)

Treasury and IRS are currently developing guidance on the health insurance tax credits. Because the tax credit is one that can be advanced to cover the cost of insurance purchased from a health insurance exchange, and initial eligibility will be determined when the taxpayer applies for coverage at the exchange, Treasury and IRS have been working closely with HHS to develop rules for eligibility determinations that are administrable at the exchange level and that result in the most accurate calculation of the advance credit.

13. **How many individuals will be enrolled in plans that are subject to the new Excise Tax on High Cost Employer-Sponsored Insurance in 2021 and 2031? What percentage of those individuals subject to this new tax will see their health benefits reduced as a result of the provision?**

    The excise tax is designed to reduce the growth in health care costs by discouraging insurers from providing high-cost health plans. It is a 40 percent tax on health insurers that provide the highest-cost health coverage; the tax only applies to the portion of the cost of coverage that exceeds certain thresholds. (For example, the threshold for family coverage in 2018 will generally be about $27,500.)

    To the extent that the excise tax succeeds in reducing the cost of health coverage, fewer insurance companies will pay the tax, and employers will spend less on health insurance for their workers, allowing them to increase taxable wages.

14. **The Community Living Assistance Services and Supports Act (CLASS Act) was passed as part of the Patient Protection and Affordable Care Act of 2010. On January 5, Secretary Sebelius sent a letter to Congress stating that the CLASS Act programs would be moved to the Administration on Aging (AoA). The following questions concern that move and the overall implementation of the CLASS Act.**

    - **The Administration is utilizing nearly $1 billion in funds authorized by Section 1005 of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152) to implement the Patient Protection and Affordable Care Act of 2010. Will the Department of Treasury be receiving any of these monies? Will you please provide a breakdown of how these monies are being spent and by the agencies with the Department of Treasury spending the money? How much money is being used and will be used to implement the CLASS Act?**

    - **The CLASS Act requires that the Secretary of Health and Human Services have three actuarial analyses prepared for the implementation of CLASS Act programs. Will the Department of Treasury provide any of the actuarial analyses? Which of the Department's actuaries will be part of this process?**

    - **The CLASS Act requires the Department of Treasury to develop and implement payroll deduction and enrollment mechanisms for both businesses and individuals seeking to enroll in the CLASS Act programs. What has been done to date regarding these payroll mechanisms? Will the payroll mechanisms be published for public comment? If so, when will the proposals be published in the Federal Register? Will small**

businesses be given the opportunity to comment and give input before the proposals are published in the Federal Register? Will these anticipated regulations be subject to a Small Business Regulatory Enforcement Fairness Act small business panel?

- **The CLASS Act requires the Secretary of the Treasury to invest and manage the CLASS Independence Fund in a similar as the Federal Supplementary Medical Insurance Trust Fund. What has the Department of Treasury done to date with respect to this mandate? Will the Department be establishing a process and procedure for investing and managing the CLASS Independence Fund and will these be published in the Federal Register for public comment? If so, when do you anticipate that these will be published?**

- **What will be the anticipated annual administrative costs to the Department to run the payroll deduction and enrollment mechanisms? What will be the anticipated annual administrative costs to invest and administer the CLASS Independence Fund?**

The Treasury Department plays a very limited role in the implementation of the CLASS Act provisions. The Department of Health and Human Services, not the Treasury Department, has primary responsibility for implementing the withholding mechanisms that you describe. The Treasury Department will not provide the actuarial analyses you describe. While the Treasury Department must establish and maintain the trust fund itself, this is not anticipated to be a substantial incremental expense over current operations. None of the funds authorized in Section 1005 of the Health Care and Education Reconciliation Act of 2010 will be allocated to the Treasury Department for this purpose.

Treasury has assigned responsibility for the CLASS Independence Fund investment management process to the Bureau of the Public Debt. Based on the legislative requirement to invest and manage the fund to the same manner and extent as the Federal Supplementary Medical Insurance Fund (FSMI), the existing system of practices and policies governing Treasury's management of the FSMI will be implemented for the CLASS Independence Fund. Treasury's management practices for the Social Security and Medicare (Including FSMI) trust funds are well documented and were the subject of Congressional hearings in 1981, 1982, and 1986. In addition, the practices were analyzed by the National Commission on Social Security Reform in 1983. In the Report of the National Commission on Social Security Reform, page 2-22 (1983), the Commission concluded "the investment procedures followed by the trust funds in the past have been proper and appropriate." As such, Treasury does not intend to publish the long-standing system of investment practices and policies that will be employed for the CLASS Independence Fund in the Federal Register for public comment.

15. Currently, the Department of Treasury's Questionable Employment Tax Practice (QETP) initiative enters into Memorandums of Understanding (MOU) with states to combat schemes that are to avoid federal and/or state employment taxes. One of the primary goals is to combat worker/independent contractor misclassification.

How many states are involved in QETP?

Thirty-nine agencies in 37 states now participate in QETP.

How many states that are not involved have signaled a willingness to become involved in the future?

Although IRS Governmental Liaison maintains a dialogue with the non-participating states, at this time, none of them has signaled a willingness to become involved.

Are there any other employment tax practices covered by the QETP?

Generally, worker classification is the primary issue involved.

How many states have entered into an MOU with the Department to share information on Form 1099 data?

At this time Form 1099 data is provided to 30 states under the Governmental Liaison Data Exchange Program.

Currently, is there any other effort that the Department is involved that targets the misclassification of workers/independent contractors?

The IRS and the U.S. Department of Labor are discussing an agreement for increased cooperation in addressing misclassification compliance issues.

16. Should Individual Retirement Accounts (IRA's) established in the Internal Revenue Code be subject to the proposed fiduciary duties as envisioned by the Department of Labor's proposed fiduciary regulations published in October 2010? (For example, if the Department of Labor's proposed regulations were to be finalized in its current form then a target date fund sold in an IRA would be subject to ERISA fiduciary duties but a target date fund sold on the retail market would be subject to securities law fiduciary duties. Should the same financial product be subject to different fiduciary duties? What will that do to market incentives?)

Under Reorganization Plan No. 4 of 1978, which allocated ERISA regulatory jurisdiction between the Treasury and the Department of Labor (DOL), DOL has authority to define the term fiduciary, including for purposes of the imposition of excise taxes under section 4975 of the Code. The Treasury Department and IRS have met with industry groups that have commented on the DOL proposed regulation and with DOL staff. We are available as a resource to DOL in evaluating any excise tax enforcement questions that may arise in finalizing the proposed DOL fiduciary regulations. We note that legal distinctions between investments in the IRA and retail markets pre-exist the proposed regulations. For example, the existing prohibited transaction excise tax rules under Code section 4975 apply to investments in IRAs, but not to retail investments. Similarly, various investment products sold to employee benefit plans, such as non-registered pooled separate accounts managed by insurance companies, are subject to rules under ERISA while essentially identical registered retail investment products are subject to regulation under the securities laws.

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF FEBRUARY 16, 2011
PRESIDENT'S BUDGET FOR FISCAL YEAR 2012

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 2012. Treasury Secretary Timothy Geithner testified before the Committee this morning.

A full copy of the remarks, as prepared for delivery, follows:

When thinking about our hearing today, a couple of humorous comments came to mind. The first comment comes from the famous poet, Ogden Nash. One of Mr. Nash's light verses was about the potential of omnipotent taxation.

Here's what he said: "The more you earn, the less you keep. And now I lay me down to sleep. I pray the Lord my soul to take, if the tax collector hasn't got it before I wake."

The second comment comes from a constituent of my friend from Wyoming, Senator Enzi. Mr. Bruce L. Hargraves, USN Retired, of Worland, Wyoming wrote a letter to the Editor of the Northern Wyoming Daily News. His letter was entitled "Objection from a former sailor." I ask unanimous consent to enter Mr. Hargraves' letter in the record.

Here's what Mr. Hargraves wrote. "I object and take exception to everyone saying that Obama and Congress are spending money like a drunken sailor. As a former drunken sailor, I quit when I ran out of money."

Mr. Hargraves' letter and Mr. Nash's poem are very relevant to the topic of today's hearing. The official topic is the revenue proposals in President Obama's budget. But, there's a much bigger issue before us.

Mr. Hargraves' letter is instructive. Over the last couple of years, the President and Congress have been spending like drunken sailors. Spending as a percentage of our economy is at levels that we haven't seen since World War II. Overall, it's up by 20% as a percentage of our economy. Non-defense discretionary spending, by itself, has ballooned in the last couple of years. It's up by 24%. If you count the stimulus spending, it's up by 84%.

The President's budget proposes a freeze on that 24% ramp-up. But that's kind of like telling a drunken sailor that it's prudent that he continue his spending spree. Mr. Hargraves is also correct that drunken sailors run out of money to spend. Not so here in Congress. Not so in the White House.

Mr. Chairman and Mr. Secretary, maybe we do owe those drunken sailors an apology. Unlike the drunken sailor's budget, the President's budget doesn't cut the government off from its spending spree.

What does the budget tell us? The trend line for spending means all government spending will take 10% more of the economy than the historical average.

From a fiscal discipline perspective, that number is surely viewed with skepticism. It will likely be much worse. We'll see what CBO says in a few weeks.

Viewed in a light most favorable to its proponents, this number must be disappointing. It basically concedes the point that we can't restrain the growth of government to some reasonable measure. And, in that concession, we've squandered an opportunity, Mr. Secretary. It's an opportunity because the will of the people is clear. They want us to come together to restrain spending. A budget that, at best, means all government growing by 10% as a percentage of the economy is not restraint.

Staggering levels of debt will be built up. By 2019, it will triple from where it was when the President took office. This huge debt will have to, at a minimum, be serviced. Recently, CBO, with conservative baseline assumptions, pegged debt service at as high as $1 trillion per year in the out years.

If Ogden Nash were alive today, he'd be rightfully concerned. With the spending-driven fiscal holes, mounting debt, who among us doesn't believe there's a monstrous tax hike coming? Could it be so monstrous that Mr. Nash might be worried that his soul would eventually be the subject of confiscatory taxation?

Mr. Secretary, we see the steps to that monstrous tax hike in the budget before us. By our calculations, a tax hike of $1.6 trillion is proposed. It comes in many forms. And it hits lots of different taxpayers.

If a taxpayer is an entrepreneur with a growing small business, he or she may be facing marginal rate hikes of 17%-24%.

Investors can look forward to a top capital gains rate hike of almost 60% in 2013. Some taxpayers may see their mortgage interest deductions, charitable deductions, and state and local tax deductions cutback. Families and businesses may see a doubling of the gas taxes they pay at the pump. Businesses may face general tax increases.

Mr. Secretary, again, thanks for appearing today. I look forward to a full, frank, but constructive discussion of the revenue proposals in the President's budget.

Thank you, Mr. Chairman.

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Senator John D. Rockefeller IV
Record Statement
Treasury Secretary Tim Geithner Hearing
February 16, 2011

Secretary Geithner, thank you for testifying before this committee today. I have studied the President's budget request carefully and have several comments I would like to share with you.

The President and I share a goal of job creation. I am a strong supporter of additional investment in infrastructure and education, and I am pleased to see some of the proposed funding increases in these areas. I support a permanent Research & Development Tax Credit and a stronger New Markets Tax Credit. These incentives will create jobs in West Virginia and I will fight to see these changes signed into law.

I applaud the President's efforts to expand the Earned Income Credit and the Child Care Tax Credit. These proposals can make it easier for families to make ends meet. The unemployment rate is beginning to drop, but the recovery is still a delicate one and every dollar is being stretched thin.

I am concerned that the President's proposed cuts to the coal industry would offset some of the good these other funding increases would do. Higher utility bills blunt the impact of an expanded Earned Income Credit and make it more difficult to afford child care or put food on the table. It is shortsighted to give with one hand and take away with the other. I do not doubt this Administration's commitment to the recovery effort, but I ask it to think long and hard about the unintended consequences of its actions. Higher energy prices will stunt the recovery's growth.

The President and I also share a goal of deficit reduction. I am not sure how deficit neutral corporate tax reform helps reduce the deficit, but I look forward to hearing more from the Administration about this idea. So far there have not been any specifics on how this is supposed to be accomplished, but despite my skepticism, I want you to know I will look with an open mind at any proposal you send to Congress.

By the same token, I hope this Administration will keep an open mind as well. A deficit reduction plan that involves Social Security and Medicare reforms while cutting corporate taxes is a tough sell in my book. Some critics might say that in that scenario retirees are paying for tax cuts for big corporations, and I would be inclined to agree with them.

I am not opposed to cutting corporate tax rates. There are too many tax loopholes clogging the system and eliminating them will allow rates to come down to a responsible level while still raising the revenue we need to pay off our country's bills.

I am pleased that this budget would wisely allow tax cuts for upper income earners to expire at the end of 2012 and re-instate a more sensible Estate Tax. Our debt burden is too serious to ignore while endlessly renewing tax cuts for individuals who do not need them.

I voted for an extension of these tax cuts in December because the middle class tax cuts and unemployment benefits they were tied too were too important to the people of West Virginia to let expire. 99% of the families in my state who filed tax returns last year made less than $200,000 annually, but their tax cuts were held hostage by the other 1%.

Now we have the time necessary to make a responsible decision. I hope this committee will have a great debate this year about the future of our nation's tax policy and avoid the need to make last-minute decisions about matters of such consequence.

Thank you again for your time today. I look forward to working with you on these and other issues of importance to West Virginia in the months ahead.

COMMUNICATION

Statement of the U.S. Chamber of Commerce

ON: **FY2012 ADMINISTRATION BUDGET PROPOSALS**

TO: **THE SENATE FINANCE COMMITTEE**

DATE: **FEBRUARY 16, 2011**

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 FY2012 budget (the "Greenbook"). The Chamber is immensely disappointed, both with the proposals included in the Greenbook and that the Greenbook makes no mention of tax reform. While we are disappointed with the included proposals, which largely are a rehash of prior year Greenbooks, we are even more so with the fact that none are coupled with true fundamental tax reform. Despite months of the Administration touting an interest in tax reform, they completely fail to mention the issue of fundamental tax reform, and, instead, seek to impose over a trillion dollars in new taxes on the business community.

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 piecemeal approach contained in the Greenbook and seek to undertake comprehensive tax reform to foster growth, competitiveness, innovation, 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 over a trillion dollars of new business taxes, while providing only $116 billion[2] of tax cuts, $106 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 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.

Our tax system is already highly progressive (in 2008, the top 1% of the income distribution controlled about 20% of income and paid almost 40% of federal income taxes). Yet, the Greenbook proposes an even more punitive system on those who save, invest, and create jobs. It proposes increasing the top marginal tax rates, reducing or

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[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.

eliminating itemized deductions, limiting the rate at which the remaining deductions could be taken, and raising the tax rate on capital gains and dividends.

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. Last year, 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, the backbone of the U.S. economy and America's jobs creators, would bear a substantial portion of these higher taxes.

Further, according to the nonpartisan Tax Foundation, about 39% of the tax increase on upper income taxpayers proposed in last year's Administration budget would have come from business income. It is fair to presume that this year's proposals would have similar adverse impacts on small business job creators.

The Chamber believes these burdensome tax increases represent poor policy, in both the short term and long term. Further, the lessons of such proposals should be two-fold as the Committee considers fundamental tax reform. First, it is critical to recognize the significant numbers of entities who remit taxes under the individual Code, and, 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 which 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 $357 billion, 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.

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 treatment of intangibles. Despite the fact that 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," the Greenbook contains these $129 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 transitioning to a territorial tax system. 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 suggests large and onerous tax increases on traditional energy producers, totaling over $46 billion. This represents not only continued, but increased, attacks on oil and gas companies as well as coal companies. Further, in addition to industry punitive taxes, 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. Further, the Greenbook justifies these increased taxes on traditional energy sources to pay for "clean" energy benefits. 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 policies that could benefit broader sections of the entire business community, such as more efficient cost recovery rules or increased research and development incentives.

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 $53 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 $8 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. Further, any recovery in the value of the inventory in a subsequent year is not lost; rather, the business will recognize a larger amount of taxable income in the year the inventory is sold.

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 which would be adversely impacted by these changes.

Changes to Investment Partnerships

To raise another $15 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 over one trillion dollars in new taxes businesses can expect to face, they would see only $116 billion of tax cuts.

Small Businesses and Individual Incentives

For small businesses, the Greenbook contains little in the way of broadly applicable incentives. Summing barely $10 billion in total small business tax cuts, the Greenbook proposes eliminating capital gains taxes on small businesses, providing only $5 billion in tax incentives. Further, it provides for small regional incentives, such as extending and expanding the new markets tax credit, which adds only another $1.8 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 which are of value to only one industry, sector, or geographic area. Instead, it should seek policies which broadly benefit the widest possible cross-sections of individuals and businesses, such as the full repeal of the onerous 1099 reporting requirements.

General Business Incentives

The Chamber supports the inclusion of the proposal to make permanent the research and experimentation (R&D) tax credit. Longstanding Chamber policy provides that research and development incentives should actually be more expansive, for example, that research and development expenses should be deductible in the year incurred and that a credit as high as 25% credit for increases in research expenditures should be allowed.

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 that the fact that the Administration proposes to use all of these tax increases in a piecemeal uncoordinated fashion will actually make it harder to do 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.