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DEPARTMENT OF THE TREASURY FISCAL YEAR 2012 BUDGET

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 16, 2011

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DEPARTMENT OF THE TREASURY FISCAL YEAR 2012 BUDGET

WEDNESDAY, FEBRUARY 16, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 2:54 p.m., in room 210, Cannon House Office Building, Hon. Paul Ryan [chairman of the committee] presiding.

Present: Representatives Ryan, Garrett, Akin, Stutzman, Lankford, Ribble, Flores, Mulvaney, Huelskamp, Young, Rokita, Woodall, Van Hollen, Schwartz, Kaptur, Blumenauer, Yarmuth, Pascrell, Honda, Ryan of Ohio, and Wasserman Schultz.

Chairman RYAN. The hearing will come to order.

Sorry about the delay. We understand that everybody here is under a time crunch. I am going to, in the interest of time, make my opening remarks, as prepared, into the record instead of sharing the full text of my remarks now.

But, briefly, I just wanted to say how disappointed we are that the President has failed to lead on the most important fiscal challenges of our time. There has been a lot of talk about the politics of taking on these challenges, and the conventional wisdom is that the politically safe thing to do, I suppose, is to do nothing. But I sincerely wonder about that.

I wonder how long Americans are going to tolerate empty promises about their retirement security. I wonder how long they will put up with leaders who fail to lead us when we are staring a debt crisis in the face. Yes, we are running up to a statutory debt limit, but we are also running up to a real debt limit called the credit markets.

We feel that it is our responsibility to do things differently, to lead where the President has fallen short. And that is exactly what we intend on doing in the days, months ahead.

With that, I will submit the rest of my statement in the record, and I will yield to Ranking Member Van Hollen for some brief opening remarks.

[The prepared statement of Chairman Ryan follows:]

Prepared Statement of Hon. Paul Ryan, Chairman, Committee on the Budget

Thank you, Secretary Geithner, for coming before our Committee today to discuss the President's budget.

The President has disappointed us by presenting us with another budget that spends too much, borrows too much and taxes too much. It is a budget that will stifle job growth today and leave a diminished future for the next generation.

Last year, the long-term fiscal trajectory in the President's budget was so bad that it came with a warning label, like a cigarette pack: Warning: Must appoint fiscal commission to fix this problem.

But then, when his own commission put forward a set of fundamental entitlement and tax reforms, he ignored them.

Despite the urgent need to rein in our runaway debt, the President's budget would add $13 trillion to debt—an unconscionable burden we're imposing on our economy today and our children tomorrow.

To be sure, both parties share the blame for the unsustainable trajectory we're on.

Nevertheless, this President has made our spending problems much worse with policies such as the failed stimulus and the new health care entitlement.

To listen to my colleagues on the other side of the aisle, you would think these massive new spending programs have nothing to do with it. They blame the Bush tax cuts—even though they agree that most of these tax cuts should be made permanent.

In fact, one of the President's own economic advisers, Austan Goolsbee, recently defended the Administration's use of rosy economic forecasts to make its deficits look smaller by saying that the forecasts actually understated near-term growth, because the estimates hadn't factored in recent tax relief for all Americans.

So the Administration is admitting that low tax rates are good for growth, even as their budget is calling for $1.6 trillion in higher taxes on American families, businesses and entrepreneurs just two years from now.

Ironically, that's when the Administration's forecasts predict that economic growth will really take off. Must be all those tax increases.

On our nation's most pressing fiscal challenges, the President has failed to lead. Former Clinton Chief of Staff and co-chair of the fiscal commission, Erskine Bowles, said the White House budget request goes "nowhere near where they will have to go to resolve our fiscal nightmare."

The policies contained in this budget would commit us to the bankruptcy of our entitlement programs and the managed decline of our economy.

The President has asked us to raise the debt limit. But the experience of Europe teaches us that we cannot keep making unaffordable promises without eventually hitting a real debt limit—a limit on our borrowing imposed by credit markets in a state of panic.

The politically safe response, I suppose, would be to do nothing. But I wonder about that.

I wonder how long Americans will tolerate empty promises about their retirement security. I wonder how long they will put up with leaders who fail to lead us—when we are staring a debt crisis in the face.

We feel that it's our responsibility to do things differently—to lead where the President has fallen short. And that's exactly what we plan to do.

With that, I will yield to Ranking Member Van Hollen for an opening statement.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. And I will also work to shorten this up.

Welcome, Mr. Secretary.

I think that the President has laid out a proposal that is tough but responsible—tough because it cuts nonsecurity discretionary spending by $400 billion over the next decade to the lowest share of the economy since the Eisenhower administration; responsible because it steadily reduces the deficit, while making targeted investments in areas like education, clean energy, infrastructure, and scientific information—investments that the Chairman of the Federal Reserve, Ben Bernanke, said would help strengthen the economy in his testimony here last week.

That approach, the President's balanced and responsible approach, stands in stark contrast, I believe, to the Republican majority's reckless approach that they are taking on the floor of the House as we speak. That proposal will put more Americans out of work when too many families are still struggling to make ends meet and do virtually nothing to address our Nation's long-term deficit problem.

That is one of the reasons that the bipartisan commission on deficit reduction recommended against taking deep and immediate cuts, because they recognize the economy remains fragile.

Now, one other point here, because yesterday, in this committee, we heard a lot of our Republican colleagues criticize the President's budget for it not reaching primary balance—in other words, no longer spending more than we have—by the year 2017. In fact, many ridiculed the notion that reaching primary balance over the next 10 years was an important milestone.

I would point out first that the bipartisan commission did not reach full balance in that 10-year window. And yesterday, in the spirit of recognizing that achieving full balance in the short term is difficult, I pointed to the one Republican plan that has been put forth and scored by CBO. And that is the plan that the chairman of the committee has put forth. And he has put it forth in good faith.

But I had hoped that my comments in that regard would have been somewhat cautionary, because, as I indicated, CBO has looked at that plan, and it doesn't reach primary balance by the year 2020, and—in fact, I misspoke yesterday—it doesn't reach primary balance by the year 2040. It doesn't reach balance until sometime between 2040 and 2060—until after 2060, actual balance.

So I would just caution my colleagues that, to the extent that you are going to be criticizing the President and the administration for not reaching balance fast enough and ridiculing the notion of primary balance in the next 10 years, you are also criticizing the one proposal that has been put forward to date, and you are doing it more so, because the President's budget gets to that balance——

Chairman RYAN. Would the gentleman yield?

Mr. VAN HOLLEN. I am happy to yield.

Chairman RYAN. This proves how tough this is. This proves what kind of a hole we are in. And it is not your fault; both parties are responsible for where we are. It proves how difficult this is.

And the reason we are so disappointed in this current budget is because it does nothing to address the drivers of the debt. And when you even do address the drivers of the debt, you can see how tough it is to get out of the hole we dug ourselves into.

Mr. VAN HOLLEN. Yeah. If I could just say, I agree it is difficult. In fact, I am offering this caution in the spirit of a common recognition that it is difficult.

But I had hoped that, just by making that remark, sort of in the spirit of recognizing how difficult it is, that we wouldn't have heard so much from some of your Members criticizing the President's budget on that particular point. Because it is an important milestone, to reach primary balance in this 10-year period. And, as Jack Lew pointed out, by definition, you have to go through primary balance before you get to full balance.

So I only say this, Mr. Chairman, to say how hard it is, but we spent the rest of the day listening to your Members criticize the President for reaching primary balance in 2017 rather than full balance. So I think it is only fair play to say that the one good-faith effort on the Republican side that has been scored to date doesn't get close to that in 2020 and doesn't do it until after 2040.

But I hope that—obviously, you are going to be presenting a budget this year. That will be the next effort. And let me just close with this: We look forward to working with you wherever possible to find common ground in that effort.

Thank you.

[The prepared statement of Mr. Van Hollen follows:]

PREPARED STATEMENT OF HON. CHRIS VAN HOLLEN, RANKING MINORITY MEMBER, COMMITTEE ON THE BUDGET

Thank you very much, Chairman Ryan. Welcome, Secretary Geithner and thank you for joining us today.

President Obama has laid out a budget proposal that is tough but responsible. Tough because it cuts non-security discretionary spending by $400 billion over the next decade to the lowest share of the economy since the Eisenhower Administration. Responsible because it steadily reduces the deficit while making targeted investments in areas like education, clean energy, infrastructure, and scientific innovation—investments that Federal Reserve Chairman Ben Bernanke said would strengthen our economy when he testified here last week.

One key area of investment that the President has proposed is in our nation's infrastructure. The American Society of Civil Engineers—hardly a left wing group—issued a report card on the state of America's deteriorating infrastructure. They give us practically failing grades, mostly Ds and D-minuses for the state of our roads, schools, transit, and drinking water—not grades that we'd want our kids to bring home from school. I'm very pleased that the President has announced he wants to make investments in this area. As reported yesterday in USA Today, using the analysis of the Associated General Contractors—again, not a liberal group, his plan could create about 5.4 million construction jobs and 10 million more jobs in related industries and the broader economy. At a time when the construction industry is facing over 20 percent unemployment, these are exactly the kind of smart investments that will help grow our economy.

The President's balanced and responsible approach stands in stark contrast to the Republican majority's reckless plan for this year, which is being debated on the House floor today. That proposal will put more Americans out of work at a time when too many families are still struggling to make ends meet, and do virtually nothing to address our nation's long-term structural deficit. The Economic Policy Institute found that the Republican proposal would likely put 800,000 Americans out of work. Indeed, that's why the Bipartisan Commission charged with reducing the deficit warned against making deep, immediate cuts when the economic recovery is still fragile. And why would Republicans cut essential investments in kids, cops, cancer research, and consumers rather than eliminate huge taxpayer subsidies to the oil industry?

House Republicans have also taken a reckless approach to the debate on the debt ceiling—an issue that you, Mr. Secretary, have raised serious concerns about. In fact, you have said that "even a very short-term or limited default would have catastrophic economic consequences that would last for decades. Failure to increase the limit would be deeply irresponsible." Chairman Bernanke stated that defaulting would be "catastrophic." We simply cannot play games with the full faith and credit of the United States. Nor should we provide payments to foreign creditors—including China—before payments to American contractors, Social Security and Medicare recipients, and the salaries of our Armed Forces, as various Republican proposals would do. This is reckless and wrong.

Yesterday, we heard many of our Republican colleagues criticize the President's budget for not reaching primary balance—no longer spending more than we have—by 2017. In fact, many ridiculed the notion that reaching primary balance over the next 10 years was an important milestone. I would point out that the Bipartisan Commission did not reach full balance in the 10-year window. Yesterday, in the spirit of recognizing that achieving full balance in the short-term is difficult, I pointed to the one Republican plan that has been put on the table and scored by CBO—that of the Chairman. That good faith effort does not get to primary balance in 2020. In fact, it doesn't get to primary balance until sometime between 2040 and 2060. And it doesn't reach full balance until sometime after 2060. So today, as we speak with Secretary Geithner, I would caution our colleagues that criticizing the President's budget on that score also applies—but to a much greater extent—to the one Republican proposal that has been made to date. We look forward to seeing the next budget effort that House Republicans put forward, and we stand ready to work with you to find common ground whenever possible.

On another note, it is interesting that our Republican colleagues have criticized the President for not including more of the Bipartisan Commission's recommendations in his budget when every single House Republican serving on the Commission voted against their final report.

That being said, in order to tackle our longer-term fiscal challenges—beyond the 10-year period of this budget—it is important that the White House and the Congress, Republicans and Democrats, come together to seriously discuss and consider the ideas in the Commission's proposal. Compromise is not a dirty word. Getting things done requires give and take. We should begin that conversation now.

Thank you, Mr. Chairman, and we look forward to Secretary Geithner's testimony.

Chairman RYAN. Great. Great. We will stick with all our other criticisms of the President's budget then.

Secretary Geithner, the floor is yours.

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman and Ranking Member Van Hollen and members of the committee. It is a pleasure to be before you today to talk about these important questions.

I should say at the beginning, Mr. Chairman, that I agree that you deserve a lot of credit for laying out a comprehensive plan. I don't agree with a lot of the content of that, but I agree that you deserve a lot of credit for laying out something comprehensive. And you will have the chance, now that you are in the leadership, to put together a resolution that lays out a 10-year path for dealing with these challenges. And, of course, we look forward to working with you on how best to get there.

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. And we do that by presenting a detailed, comprehensive, multiyear plan to cut spending and to reduce deficits.

Our deficits are too high, and they are unsustainable. Left unaddressed, they will hurt economic growth and leave us weaker as a nation. We have to restore fiscal responsibility and go back to living within our means.

The President's budget cuts the deficits he inherited in half, as a share of the economy, by the end of his 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 sustainability, the President proposes to reduce nonsecurity discretionary spending to its lowest level, as a share of the economy, since Dwight Eisenhower was President.

To achieve this, the budget proposes a 5-year freeze of nonsecurity discretionary spending at its 2010 nominal level, which will reduce the deficit by more than $400 billion over the next 10 years. As you know, the President also proposes to reduce the request for defense, to freeze civil service salaries, to improve efficiency in government by reducing and eliminating a range of programs.

These savings create the necessary room for us to make targeted investments in support of reforms that will help strengthen future economic growth.

And the most important thing we can do to help promote long-term growth is to improve the quality of our education system, to invest in innovation, and to rebuild our Nation's infrastructure. Without these investments, we will be weaker and less competitive.

As part of this 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; to eliminate capital gains taxes on investments in small businesses; to encourage advanced manufacturing in clean energy; to keep taxes on investment income—this means 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 incentives to shift income and investment outside the United States and to close loopholes and tax preferences that we cannot afford.

Now, in addition to these changes, we propose to pursue comprehensive corporate tax reform that would lower the corporate tax rate. Our present system, as you know, combines a very high statutory rate with a very broad range of 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, a system that provides more stability and certainty, that is more simple to comply with. And we have to do all of this without adding to our future deficits.

We have begun the process of building support for comprehensive tax reform on the corporate side. I think we have a chance to do that now, and I hope we can work with this committee to help make that possible.

The President's budget also outlines some responsible reforms on the individual side. We propose, as we have in the past, to allow the 2001 and 2003 tax cuts for the wealthiest 3 percent—2 percent of Americans to expire; limiting certain deductions for those same high-income Americans; restoring the estate tax to 2009 levels; and closing the carried-interest loophole.

These proposals 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 reforms and reductions in our deficit over the next decade that are necessary to stop the national debt from growing as a share of the economy and to stabilize the debt burden at a level that will not threaten future growth. But these are only a first step, a down payment on the longer-term reforms necessary to address those long-term deficits.

To deal with those longer-term deficits, as you all know, the deficits we face over the next century, not just the next decade, we are going to have to build on the cost-reduction reforms that are achieved in the Affordable Care Act. And although it is not a contributor to our short- and medium-run deficits, we need to work together across the aisle to strengthen Social Security for future generations.

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

This is a starting point for the discussion, and 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 work best for the country.

Now, in December, we were able to find bipartisan consensus on a very strong package of tax incentives to help sustain the recovery and restore confidence. We want to bring that same commitment, that same spirit of bipartisanship to the challenge of restoring fiscal responsibility.

Thank you.

[The prepared statement of Secretary Geithner follows:]

PREPARED STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

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

I. INTRODUCTION

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

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

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

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

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

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

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

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

II. A CREDIBLE COMMITMENT TO FISCAL RESPONSIBILITY

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

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

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

A multi-year commitment to stabilize the national debt

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

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

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

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

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

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

Cut spending and eliminate programs we cannot afford

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

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

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

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

Increase investment in areas important to economic growth

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

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

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

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

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

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

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

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

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

A tax system that supports growth, fairness and fiscal responsibility

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

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

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

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

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

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

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

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

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

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

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

Fiscal sustainability over the long run

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

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

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

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

III. CONCLUSION

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

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

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

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

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

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

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

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

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

Chairman RYAN. Thank you, Secretary.

A couple of questions, but first I want to get into credit ratings.

Would you agree with me that if we stay in the current fiscal trajectory indefinitely, that we are not going to be able to maintain a AAA credit rating?

Secretary GEITHNER. Let me say the positive way of saying it: that I am very confident that this body will make the changes necessary for us to preserve that status. It is very important we do that.

You know, I think if you look at markets today, there is a lot of confidence in the political will of this country to get ahead of this problem, but we have to earn that confidence over time.

Chairman RYAN. Agreed. So, last month, Moody's gave us a—they laid out a debt trajectory in which the U.S. Could face a credit rating downgrade by mid-decade. Obviously, you take that risk seriously, and confidence matters a lot.

So if the administration continues to punt, using The Washington Post's words, on entitlement reform, aren't we inviting a credit downgrade and market turmoil? I mean, how does that inspire confidence?

Secretary GEITHNER. Well, I would like to come back to where you—this is the central choice in strategy. I think as you know better than anybody, we face two different types of deficit problems, drivers to the deficit. Over the next 5 to 10 years, we have an unsustainable fiscal position. We have to get that down to a level where the debt is not growing as a share of the economy.

Without that, nothing else is possible, and we will do a lot of damage to future growth and confidence. That is very important. That is why you need to bring the deficits down over the next 3 to 5 years to something that achieves primary balance. That is a minimum necessary.

Now, the entitlement programs we have in place today are not contributing significantly at all to those near-term deficits, but they are the substantial driver of the deficits that come in the next decades. As you know better than anybody——

Chairman RYAN. Which is the long-term trajectory.

Secretary GEITHNER [continuing]. Without addressing those, we are left with commitments that will eat away too large a share of income—completely unsustainable.

Now, the Affordable Care Act, although I know it is not popular on your side of the aisle, does make a very substantial contribution to reducing the rate of growth in costs and will reduce our deficits over the next two decades by $1.2 trillion.

Now, we would like to build on that with you. The President has laid out some additional suggestions we think we can do with you on that, but we need to build on those thing. But that is a pretty good first step towards entitlement reform.

Chairman RYAN. The way we want to build on it is repeal it and then go in a different direction. That is, I guess, what we would call building.

I am not going to get into the claim. I would definitely—I could throw some charts up—I could definitely go at the claim of the savings from the Affordable Care Act. That is not the path I want to go down.

Secretary GEITHNER. Luckily, you and I don't get to decide that. The CBO gets to decide.

Chairman RYAN. That is right. That is right. And if you want to go down that rabbit hole, we can. When they say that this law is going to increase the debt, I don't know how you get there without increasing the deficit.

But putting that aside, the assertion on primary balance is an important one. And the assertion in the budget on the primary balance assumes we are going to have, you know, in 2013, 4.4 percent growth rate; blue chip is at 3 percent; CBO is at 3.1. In 2014, your budget assumes 4.3 percent growth; blue chip is at 2.8 percent; CBO is at 3.5 percent. You don't get to primary balance if those projections by CBO or blue chip materialize.

And so the question I have is, in 2013, the top income tax rate goes to 44.8 percent. That is the Federal. You throw in all the States that have income taxes, and it is above 50 percent in most States. The top income tax rate will be higher—because international competition obviously matters here—it will be higher than France, than Britain, than Italy. Our capital gains tax will be higher than China. Our capital gains tax goes to 23.8, and the top rate on dividends in that year alone goes to 45.4 percent.

Are we going to have this boom of economic growth that you are predicting, which is how your budget achieves primary balance, if we are hitting small businesses, entrepreneurs, successful investors, or job creators with huge tax increases in that very year? How can you claim all this growth in the year of 2013 when you have this massive tax increase on job creation and then get primary balance?

Secretary GEITHNER. Let me just say a couple things in response.

The growth assumptions in the President's budget imply a level of growth, on average, that is lower than what occurred in the last two recoveries. It is a reasonably conservative assumption.

Now, CBO's is lower because CBO was forced to make the assumption that all those tax cuts on every American expire at the end of 2012. And that would hurt growth, absolutely. But we are proposing, of course, to maintain and extend those tax cuts for 98 percent of Americans. And so, these proposals would not result in that damage to growth that CBO has to build into their estimates.

Now, one other point on this——

Chairman RYAN. But tax increases affect economic vitality and affect behavior and growth.

Secretary GEITHNER. Well, you know this debate, you know this debate. And I will give you two responses, because you are comparing us to the other major economies in Europe.

The best way to compare the tax burden that is projected in this budget to those economies is to look at what happens to revenues as a share of GDP over the budget horizon. And they will leave us slightly above the long-term average but way below—way below—the amount of revenues those countries collect from their citizens and their businesses. So that will leave us with a much more competitive tax system than any of those countries are contemplating facing in this context.

Now, one other thing about these forecasts, or two other things. One is, OMB estimates this year's budget much higher than CBO——

Chairman RYAN. The deficit, you mean.

Secretary GEITHNER. Yeah, sorry, the deficit—much higher, much more conservatively estimated. It is probably too high.

So there are some things in this forecast that are more conservative than CBO, some things perhaps a little more optimistic, a little more confident than CBO. But, in the end, CBO will rule, in this case. That is a good strength of our system.

And you are right to say, if CBO—when CBO——

Chairman RYAN. About 3 weeks.

Secretary GEITHNER [continuing]. Scores the impact of our projected policies on their projected economy, they will show a somewhat larger budget deficit than we estimate in this deficit.

And, again, one strength of our country is, CBO is independent, nonpartisan, and they govern in this context. So you and I don't need to debate these assumptions, because they will choose for us.

Chairman RYAN. Yeah. So the point I am trying to make here is, I question the assertion of primary balance, given that the final arbiter, CBO, on this is using a different set of projections. And you are not going to get there with what I think is a deeply inadequate budget.

Secretary GEITHNER. No, but you are—I would distinguish a couple things. And, again, you are going to have the chance to propose a 10-year budget——

Chairman RYAN. Right.

Secretary GEITHNER [continuing]. That does better, and you will make different choices than we did. But I think we can all agree that it is necessary but not sufficient. Achieving primary balance doesn't go far enough. We will have to do better than that over time.

Chairman RYAN. Okay. Because I don't want to chew up too much time, on debt limit you sent us a letter saying you want a clean debt limit because you think it ought to be done standalone.

I simply just want to point out—and I don't want to get into it, because I want to get to these other Members—last time the debt limit occurred, in the last session, PAYGO was attached to it. It was the engine that, sort of, drove the train off, you know, through Congress. And the President was perfectly complicit with this. He was obviously in favor of it; he signed it. The fiscal commission, itself, was attached and passed through Executive order in exchange for the debt limit.

So let's not say that we are only for clean debt limits when, just a year ago, the President was fine with attaching things on debt limit. That is just a point I want to make.

Last thing, the corporate tax reform. It is a little vague in corporate tax reform in the budget. What do you mean exactly?

And then I assume you are talking about deferral, I assume you are talking about foreign tax credits as one of your revenue-raising or base-broadening provisions. Wouldn't just going to a territorial system, kind of, fix those problems? And what is your position on going to a territorial system?

And then I want to turn it over to Mr. Van Hollen.

Secretary GEITHNER. Okay. Just one quick thing on the debt limit. We are suggesting it is best and easiest and cleanest and most responsible to do a clean debt limit extension for reasons you understand. You know, this is not a popular thing for people to do, and if you let people negotiate over the terms, the risk is you leave people with expectations you can't meet. And it is just that that suggestion leads us to suggest you should do it clean.

Now, we recognize that we are going to have a big debate about how to bring down these deficits over time. And we are looking forward to having that debate. And I believe, as I think you do, it would be good for the country now for us to come together and agree on a multiyear plan that would lay out enforceable commitments. Because then the markets would have more confidence in our political system's willingness to deal with this. So we are for doing that.

But one last thing on the debt limit. I would just encourage you not to do anything that will call into question the commitment of this country—we are the United States of America; we don't play around with this stuff—to make sure we meet our obligations. And don't allow the markets to build in any concern about our willingness or ability to do that, because that would put at risk this recovery and set us back substantially. We can't afford that risk.

Now, on the question about corporate tax reform, you are right that, in the budget, we did not propose a comprehensive plan for corporate tax reform. But we are beginning the process of trying to lay out the foundations of that.

And what we would like to try to do is do a comprehensive reform that would lower the statutory rate significantly, bring it much closer to the range of our trading partners, do that by broadening the base substantially, eliminating these expensive expenditures and special preferences, do that in a way that is revenue-neutral and strengthens incentives for investing in the United States.

As part of that, we are going to have to examine how we tax the worldwide income, foreign income of U.S. corporations.

Chairman RYAN. Right.

Secretary GEITHNER. But as we look at that and we look at all forms of territorial, we have to be careful, again, not to be increasing opportunities or incentives to shift income and investment outside the United States. That will hurt jobs in this country. That is a difficult thing to do, but we will look at all ideas in that context.

Chairman RYAN. You have no explicit position on worldwide versus territorial——

Secretary GEITHNER. No, because, again, I think this—you would want us to take this approach. We have to be careful, again. Overwhelmingly, why would we do this? We do it because we want to improve incentives for investment——

Chairman RYAN. We want jobs and competitiveness.

Secretary GEITHNER. Exactly. That is why. So, as you look at that test, you have to make sure everything meets that test.

And when you look at a lot of the proposals for territorial, they usually fail on two grounds. They either lose a huge amount of income, because they make it easier to shift investment income outside the United States, or they hurt jobs by, again, magnifying the incentives to shift investment outside the United States. And so, for those reasons, you have to be careful, looking at those.

But, again, we will look at everything——

Chairman RYAN. Yeah.

Secretary GEITHNER [continuing]. But we will be governed by those tests: lower the rate, broaden the base, revenue-neutral, and more competitive, stronger incentives for investment.

Chairman RYAN. We will pick this up at Ways and Means, I think.

Mr. Van Hollen?

Mr. VAN HOLLEN. Thank you, Mr. Chairman.

Mr. Secretary, thank you, again, for your testimony.

I want to pick up on a couple points that the chairman raised, first with respect to the debt ceiling. We had the chairman of the Federal Reserve, Ben Bernanke, here, who has said that a failure of the United States to meet its debt obligations and to make sure that we protect the full faith and credit of the United States would be, quote, "catastrophic." You have said similar things.

There have been proposals introduced in the Senate and the House by Republican Members which take the position that we should pay our bondholders, like foreign governments, like China, first before we would pay Medicare recipients, Social Security recipients, members of the armed services, U.S. Government contractors.

Could you just talk briefly about two things: One is what the impact would be of that on the credit markets; and, two, what you think about the fairness of that proposal.

Secretary GEITHNER. Well, you know, I have written and spoken publicly on this before, and you know the arguments very well. But let me try and do as an example—I think this is the most simple example you can use.

If you think about a family sitting around the table, if they decide they are going to not pay their utility bill, not pay their credit card, not pay their mortgage, so they can pay their car loan, they will be judged in default by their creditors.

So this idea that somehow you can minimize the pain to the country, minimize the damage to our credit and our credibility by, in effect, not meeting your obligations, some obligations, while you meet others is, I think, mistaken.

And it won't buy us any time, and it won't deprive this Congress of the responsibility of raising the limit. So I wouldn't go there and don't think it helps at all.

And, again, we will be, every month, letting economists know what our latest estimate is of when we will run out of room. And we will be very open with the Congress of where we have some flexibility to buy a little time. But the important thing to recognize is, because our deficits are so large, the traditional forms we have do not buy that much time.

So, again, I know this is a challenge to do and not a very fun thing to do. You are going to have the privilege a lot of your predecessors have had of doing this. And my suggestion is, do it in a way that makes sure the markets understand that we, the United States of America, will meet our obligations. We will never cast doubt on our commitment to meet our obligations. We are a serious country.

And we will do that while we have a debate about how we figure out how to bring these deficits down to a sustainable level. And we recognize, as you do, that that is going to require, again, both houses, both parties working together.

Mr. VAN HOLLEN. Well, the chairman of the Federal Reserve warned not only about the catastrophic consequences of it, but he urged the Congress not to use the debt ceiling as a, quote, "bargaining chip." And I hope that we won't play politics with the full faith and credit of the United States.

Let me pick up on some of the other questions raised by the chairman regarding tax policies. You indicated the President's budget assumes that we will continue the current tax rates for 98 percent of the American people but that we can no longer afford to provide a tax break to the folks at the very top.

By our rough calculation, over a 10-year period that saves close to a trillion dollars if you include the debt service. Does that square with your calculations, approximately?

Secretary GEITHNER. That is right. Another way to say it is, the cost for extending those tax cuts for the top 2 percent of Americans and the more generous estate tax exemptions and rates would be roughly a trillion dollars over 10 years.

Mr. VAN HOLLEN. Now, during the Clinton administration——

Secretary GEITHNER. Another way to say that is that, to make that affordable and still reduce deficits, you have to find another trillion of spending cuts to make that possible. That is another way to think about it.

Mr. VAN HOLLEN. That is right.

Now, during the Clinton administration, of course, we had higher tax rates in effect for the 98 percent of Americans we are talking about, and we also had it, obviously, at the top income. Do you remember what the GDP growth during that period was? We had Jack Lew here, who served during that period.

Secretary GEITHNER. Well, it is true that, to allow those rates to revert to their level—they do without extension—would restore them to the level that prevailed in the 1990s. And that was a period when you had probably the best record of small-business expansion we had seen in decades, best record of private investment growth, productivity growth, broad-based income growth, employment growth. So it was a very good time for the American economy at rates similar to those.

Now, as the chairman might remind us, it is a little different because that doesn't capture some of the provisions of the Affordable Care Act. But, again, you are talking about rates that, in broad magnitude, prevailed in the 1990s. And that was an excellent period of remarkable growth in employment investment, led by small businesses in this country.

Mr. VAN HOLLEN. While we are on the Affordable Care Act, just a couple things, because the director of the CBO was right where you are last week on this question of their deficit and essentially said very flatly and clearly on the record that the CBO did not engage in, quote, "double counting" in coming up with the $230 billion savings.

Now, there has been a lot of conversation in the last couple days about the need to bring some of the long-term health-care costs under control. And I think it is worth reminding people that the Affordable Care Act included some changes. For example, we got rid of the large subsidy for Medicare managed care plans. We made some other reductions. In fact, I think a lot of our Members are well aware of it, because they were on the receiving end of a lot of ads against them in the last campaign for some of the decisions they made in terms of reforming Medicare.

Could you speak to that? Because I think that has been a little bit lost in the discussion over the last couple days.

Secretary GEITHNER. Well, again, you guys have been talking about this for a long time, and I think you know everything there is to be known about this, but I would be happy to repeat the core tenets of this.

Again, in our system, CBO scores for us savings and costs. In CBO's judgment—and, traditionally, they have been very conservative about estimating the savings that you get from health-care reform—health-care reform will save, over the next two decades, $1.23 trillion.

Now, that is very substantial entitlement reform. It doesn't solve the problem completely. We recognize that we want to go beyond that. But if you put that in jeopardy, you will end up adding very substantially to our long-term deficits, and that will hurt our credibility in the markets more generally and undermine the market's confidence in our ability to get a hold of these basic deficits.

Social Security, in contrast, is not a meaningful contribution to our long-term deficits. And there is a very good case to try to figure out how to lock in reforms in Social Security now that would help secure those benefits for future generations, but they are not a material contributor to our long-term deficits in any foreseeable time frame.

Chairman RYAN. Because we started quite a bit late from the votes, we are doing 4 minutes. I think that gives everybody ample time so everybody can talk. It is not our intention to keep doing this. It is only because we want to make sure that people at the ends of the dais have a shot to ask.

So, Mr. Garrett?

Mr. GARRETT. So I will say thank you and keep my remarks fast, and just a couple questions.

But just, to the gentleman from Maryland, with regard to playing politics with the debt limit and what have you, I don't think anyone up here honestly wants to play politics with it. I think we want to all take a look at it seriously. But I think we also understand that no one in America believes that we can simply borrow our way into prosperity. And that would be the result if we simply take no action, as far as addressing our debt circumstance.

To use your little example of sitting at the kitchen table paying your mortgage first, you pay your mortgage first, you don't go out and take another mortgage on top of that if you are in those dire circumstances.

Turning to——

Secretary GEITHNER. And I agree with you on that. We want to work together——

Mr. GARRETT. Right.

Secretary GEITHNER [continuing]. To put in place multiyear commitments that reduce our deficits over a period of time in ways that don't kill future growth. We want to do that with you, and we don't want to wait to do that. We would like to do that. We just want to make sure that we don't call into question our basic credibility as a country on our obligations.

Mr. GARRETT. And one of those areas that I look forward to working with you on and I appreciate that the administration has come out with publicly with their position with regard to the GSEs, Fannie Mae and Freddie Mac, with regard to dismantling that, trying to get the private sector back into that sector. Better late than never, as far as your report, but I do appreciate it. Unfortunately, of course, your report, as you know, did not specify specifically one plan. It gave us various options.

But one thing it did specifically say in there is that the Federal Government will stand behind the debt of these obligations, right? It says, "Our commitment to ensuring Fannie and Freddie have sufficient capital to honor any guarantees issued now or in the future and meet any of their debt obligations remain unchanged." That means the Federal Government is behind it. And, "Ensuring these institutions have the financial capacity to meet their obligations is essential to their continued stability."

So this is pretty explicit. Even though you and I have had the discussion as to whether this is sovereign debt or not, that off the table, that is still pretty explicit.

The interesting thing here, just as an aside, is, we have been asking private sector, right, if they have these off-budget things, to bring them back on the budget. Wouldn't that be good here? And I will just give you two examples. One, I have a legislation to do that. I would appreciate your comment on that.

And, secondly, at a hearing just this week at Capital Markets, someone came up with an idea on this and how it actually may help save money to the taxpayers. That is, if you bring these things on line and put it on budget, both the portfolio, which would be the assets, and the outstanding debt, which would be the liabilities, on your own balance sheet, with the idea of assuming the debt, there would be basically a negligible impact upon the budget.

And because of the spreads—then if you had the Treasury actually reissue the debt from these—and there is a spread of around 25 basis points difference between them, over the long term the amount of money that the taxpayers will actually pay out on these, as opposed to the way we are doing it now, if you brought it on budget, would be a cost savings to the taxpayers.

Your comment on either one of those proposals?

Secretary GEITHNER. First, I appreciate your comments on this reform plan and look forward to working with you on how best to put them in place. And you are right, we have to craft an ultimate solution in legislation.

The two most important things of this are the following. One is, the markets have to understand that we will make sure these institutions have the resources they need to meet their commitments over time. And we are going to make sure we do that. And you know why that is so important.

The second thing I would say is that you are right, there are lots of different ways to account for this stuff. But we do the necessary thing, which is we put on the budget, in a fully transparent way, the full costs of providing this support over——

Mr. GARRETT. You know that the CBO treats these things different than the way the OMB does. And that is why we are suggesting that we have commonality in treatment. And this would not be—we were basically suggesting that the Treasury would have to do it the same way the rest of America would have to do it.

Secretary GEITHNER. Yeah. But, again, I think we are meeting the best test of credibility, which is we show transparently the full cost on our budget of the mistakes these guys made in the past and what that means in the future on our budget. And we are going to continue to do that.

But I know we will have a chance to talk about this more. I would be happy to do so.

Mr. GARRETT. Okay. And I am looking at the little clock in front of you that continues to go all over the board.

Secretary GEITHNER. Yeah, exactly.

Chairman RYAN. Jose, we have to buy a new clock.

Ms. Schwartz?

Ms. SCHWARTZ. Well, I can't see the clock, so someone is going to have to let me know when it gets close so I can figure it out.

Mr. Secretary, I want to thank you for your comments, and I appreciate what is really sounding like a pretty complex set of questions and answers. And I just want to do a couple of things quickly, if I could.

First, I want to acknowledge that the President has put forward a very serious and very timely budget that does reduce the deficit in a way that doesn't hurt our fragile recovery—we are grateful for that recovery; we want to see it stronger—and then invests in our future. We appreciate that. In terms of the focus on reducing the deficit by $1.1 trillion, that is really important, bringing financial stability to the Nation, and the focus on spending cuts. It is all there. Tough cuts—I mean, $400 billion—getting to a trillion dollars is a lot of money.

So what I wanted to ask you about—just before I get there, I want to just say that I appreciate the comment about the cuts that we did under the health law. We have neglected to talk about that, for the last week or so. I believe it was every Republican who was here at the time voted against what is essentially $1.2 trillion, almost $1.3 trillion, in deficit reduction. That is what it does. I believe it could do more. But we have to implement it, and we have to get about the business of making sure that we can bring down the cost of health care under Medicare, for Medicaid, for our government, and of course for the private sector, as well. So we need to talk more about that. And the President's leadership on that is to be acknowledged, in bringing down the deficit.

The President's leadership also—and it has been mentioned here, as well—is also about the fact that tax expenditures also, if they are not paid for, add to the deficit. Just "yes" or "no," I mean, does a trillion dollars' worth of tax expenditures, if we don't pay for it, does it add to the deficit?

Secretary GEITHNER. Yes, absolutely.

Ms. SCHWARTZ. All right. The other side of the aisle seems to not count that. In fact, their rules say that they don't count tax expenditures as spending.

I think the President has taken real leadership on this, in acknowledging that and in wanting to follow through on the budget deficit commission. And I want you to talk about that.

I can't see the clock, but hold on to that notion. I want you to answer that, but I also want you to, if you would just very briefly, address an issue that came up in Ways and Means, I understand, around the trade adjustment assistance. And I did want to give you the opportunity to clarify your statement about how important it is to do trade adjustment assistance on its own as soon as possible. That has expired. And I did want to just give you an opportunity to say something about that.

Secretary GEITHNER. Yes, thank you for giving me that chance. I will start with trade, and I will come back to the question about tax policy.

It is very important we move ahead on trade adjustments. This is for reasons you all know. We would like to do that as quickly as possible. We expect to bring a Korea deal, a very strong Korea deal, to the Congress to consider relatively soon. We are working to strengthen the Colombia and Panama trade agreements.

Ms. SCHWARTZ. Uh-huh.

Secretary GEITHNER. And if we achieve the improvements we seek, then we will consult with Congress on how best to move those forward.

But a critical part of our strategy for growing this economy is going to rely on getting exports to grow more rapidly. They are growing pretty rapidly now, but we want to build on that. And it is very important that we move trade adjustments as quickly as we can.

Ms. SCHWARTZ. Even before that. Thank you.

And if you have anything——

Secretary GEITHNER. On the tax—you know, again, I think the commission did a great service in pointing out to people how expensive these tax expenditures are. It is not just that they cost a huge amount of money, but if you look at who benefits from them, they are not particularly targeted to things that are that helpful for growth, and they go substantially to relatively fortunate Americans.

So our view, as the commission suggested, is a critical test of reform of fiscal restraint, of fiscal responsibility is going to be to start to dial back some of those that are the most expensive, the least targeted, have less basic benefits for growth or for middle-class Americans.

Ms. SCHWARTZ. And if we did that, we might be able to lower the corporate tax rate, for example, and——

Secretary GEITHNER. Well, on the corporate side——

Ms. SCHWARTZ [continuing]. On the individual side we might be able to make some changes, too.

Secretary GEITHNER. Yeah. Thank you.

Ms. SCHWARTZ. I think my time is up, but my guess is we are going to be talking a good bit about that, as well. Thank you.

Chairman RYAN. Thank you.

Mr. Akin?

Mr. AKIN. Thank you.

Mr. Secretary, a couple of questions. A lot of us have a number of questions. This is pretty straightforward. It appears, from a Wall Street Journal article, that we are going to increase the IRS budget by 9.4 percent, hiring an additional 5,000 or 5,100 agents, at the cost of $460 billion.

I suppose some of the reason that some of the tax money that the IRS thinks could be collected is not coming in could be because those tax manuals, when you stack them up on a little wagon, you know, they are about a yard high.

Don't you think that perhaps we could save money and do things a lot more simply if we were just to simplify the Tax Code and skip the 5,100 IRS agents, not to mention the fact that it would make us all look better if we don't have a goon squad of 5,000 more IRS agents tromping around the country with the economy the way it is?

Secretary GEITHNER. You are absolutely right. If we were able to simplify the Tax Code, not just corporate but individual, it would be easier for citizens to meet their obligations, easier to enforce, and that might save us some enforcement resources over time.

But, you know, just a couple of comments in response to what you said. All the people that look at the way the IRS works say that, if you put a dollar carefully into enforcement, customer services, things like that, you get more than $4 back.

Why is that fair? It is because, by helping people meet their obligations, you make sure that other people aren't bearing too large a cost of being citizens of the country. So it is just part of the test of a democracy and part of the test of fairness.

And what we are proposing is a set of modest improvements in resources for customer service, for technology designed to make it easier for people to meet their objections. But, of course, you are right, if we were to dramatically simplify the code, that would help save some resources, too.

Mr. AKIN. I appreciate that. Somehow, rather the 9.4 percent and the 5,000 IRS agents, I thought, oh, my——

Secretary GEITHNER. Just one clarification. It is not 5,000 IRS agents. A relatively small fraction of that is people you might call involved in the process of enforcement. A substantial fraction of those are customer service people and technology people, again, designed to make it easier for people who want to meet their obligations to meet their obligations. There are some people who don't want to meet their obligations——

Mr. AKIN. I appreciate your trying to make that distinction. "I am from the IRS, I am here to help you." That is hard to sell in the State of Missouri. But let me——

Secretary GEITHNER. Remember, the IRS doesn't set what your tax obligations are. That is set by the Congress, by you in this room.

Mr. AKIN. I wanted to just mention that, you know, we have talked about the debt limit several different times, with different people asking you questions. And it has been pointed out that the PAYGO and some things were attached to it.

If nothing else from sheer politics, it is helpful to put something with the debt limit, because you want people to vote for that silly thing. That is like swallowing a radioactive pill, and particularly for some of us that have just gotten a message from taxpayers.

But I guess my concern is, if you submit a budget, the way you have, that has not really dealt with the entitlements and the massive problem there, and then you put in these assumptions about a tremendous level of growth while you are increasing taxes—I mean, I could understand it, looking at May of 2003, and you take a look at capital gains, dividends, and death tax. In flat-line scoring, it looks like, by golly, we are going to lose more money. And yet, when you take a look at it, the employment goes up, the GDP goes up, and, by the way, Federal revenues go up substantially year after year.

But you are trying to make the same magic happen by increasing taxes. So I don't know, somehow, to me, it is hard for me to see the budget that you have submitted as really being politically willing to step up to a very, very hard challenge.

And that being the case, how can you then say to us, we want you to swallow this debt limit thing and don't put anything on it at all? I mean, the people back where I come from, they want fiscal responsibility, they want it now, and they don't want any excuses. And we are the ones that have to listen to them when they call us on the phone.

And so, I don't know how you can say, well, the debt limit is just going to be a straight vote. There are going to have to be some guarantees, or it is just not going to get through.

Thank you.

[The Wall Street Journal article referred to follows:]

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REVIEW & OUTLOOK | FEBRUARY 16, 2011

5,100 More IRS Agents

The White House plan to close the mythical "tax gap."

President Obama's fiscal 2012 budget doesn't cut much of anything (see above), and certainly not the Internal Revenue Service. The White House is requesting that the most beloved of all government agencies get an additional 5,100 agents next year, no doubt to wring further tax revenue from Americans. The White House wants to give the IRS a 9.4% raise in fiscal 2012, to $13.28 billion. Reuters reports this would allow for a roughly 5% increase in agency manpower to 100,537, including $460 million more for tax enforcement than in 2010.

We doubt this is the kind of fiscal discipline that voters had in mind in November, but it does reflect the mentality of an Administration that assumes it could go a long way to balancing the budget if only fewer Americans shirked their tax bills. The 5,100 extra IRS gumshoes are supposed to chase the $300 billion "tax gap," the Beltway's version of the Loch Ness monster that is the difference between what the IRS collects and what Congress thinks Americans owe. It's about as real as Nessie, though at least with the monster some Scots claim photographic evidence.

This is the same mentality that gave us the IRS Form 1099 small business harassment as part of ObamaCare, a provision that 81 Senators voted last week to repeal. Federal revenues are still below normal, although individual tax receipts are up 23% through January as the recovery gains steam. Revenues will rise as growth does, no thanks to the IRS.

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Chairman RYAN. His time is up. We will just put him down as a supply-sider for IRS agents but not on tax policy, I guess.

So, who was next?

Secretary GEITHNER. Can I say that I have been a consistent supporter of, and there are in the budget, a variety of well-designed incentives to encourage investment and low rates on investment income, because we recognize that that is important to future growth.

And, as you know, Mr. Chairman, in the tax package we agreed to at the end of last year, we included some very powerful incentives for business investment, I think the most powerful we had ever seen—100 percent expensing for capital investment for 1 year for all businesses across this country.

So we are——

Chairman RYAN. That is one thing we liked, actually.

Secretary GEITHNER [continuing]. We are earning some—we are demonstrating that we think that matters to growth.

Chairman RYAN. Mr. Blumenauer?

Mr. BLUMENAUER. Thank you.

Mr. Secretary, appreciate you clarifying about the dedicated people who work for the IRS. To label these people as a goon squad, I think, is offensive on so many levels, and it might be the sort of thing that inspired that maniac to crash a plane into the towers. It was Congress that gave the IRS this mess to interpret.

And, with all due respect, looking at the last time Republicans were in charge of the Tax Code, look at—I think it was a million extra words that were added to it. So let's—I welcome your call to tax simplification. It is Congress that made their job a nightmare.

And any of you can try what I have done. I have met with accountants and attorneys in my community who wonder why in the heck we are not auditing anymore; why don't we invest strategically to collect money? But they do appreciate the work on customer service.

And I hope we are not being reckless about talking about the people who work for you as being part of a goon squad. That is reprehensible.

Secretary GEITHNER. Thank you for saying that. Of course, I completely agree. There is somebody——

Mr. BLUMENAUER. But I want to get to my questions.

Secretary GEITHNER. I am sorry. Go ahead.

Mr. BLUMENAUER. I wanted to thank you. But we have had a lot of talk around here about the administration punting on entitlement reform. And I appreciate your reference to the fact that the single most important element of entitlement reform, the entitlement that is out of control, is Medicare. And you are committed in this budget to actually administrator that health-care reform, which has in it every single proven potential cost-bending effort——

Secretary GEITHNER. Almost every one.

Mr. BLUMENAUER. We didn't lay many of them out. They are not as strong as they could have been because people were a little nervous. What we should be doing is taking the newfound backbone and accelerating and strengthening them.

These elements used to be bipartisan. In fact, they used to be nonpartisan. And so, we can battle all this other stuff, but zero in on the cost containment that is there.

We had Dr. Berwick testify—I forget whether it was before our committee here or Ways and Means—pointed out that areas like Medicare Advantage, we have actually a reduction in premium. We have 12 million more beneficiaries. And there is a 5 percent increase in the highly rated programs.

This, to me, is a success story. And we ought to, as a Congress, be focusing on the facts and make it work better. Because if we don't do that, if we repeal the reform with nothing in place, we are going to have higher deficits, no matter how much we cut.

But I want to get to the tax reform. I think Chairman Camp is very interested in working with you, as, actually, the last two administrations have been, to try to fix this corporate mess.

I want to just point to one specific item. In fact, I will be offering an amendment on the floor in a while to implement what the administration called for, closing some of these tax benefits to the oil industry, some dating back to 1916, that most people think makes no difference on the production of oil.

But I want to just zero in, because you have been in the middle of this debate. In a $2 trillion to $3 trillion global oil market, would the loss of $5 billion to $8 billion a year of tax benefits to oil companies make any difference on the price of oil?

Secretary GEITHNER. No, it would have no effect on price, no effect on price.

They are expensive, though. And, again, the more you sustain tax preferences like that for individual companies, industries, activities, all businesses across the country pay higher taxes to make that possible. So it is not good policy, it is not fair, it is not consistent with the kind of things we want to do to make the country stronger. So getting rid of those things is better for our competitiveness.

Mr. BLUMENAUER. Thank you very much, sir.

Chairman RYAN. Mr. Ribble?

Mr. RIBBLE. Thank you, Chairman Ryan.

And thank you, Secretary, for coming. I have enjoyed the conversation so far, and I have especially appreciated your tone. I think this country, more than anything, needs to really have an adult conversation among ourselves about what we want to see for the future, particularly entitlements. And I think you brought a bit of that adult tone today to this hearing, and I wanted you to know how much I appreciate that.

Before I ask one other question, yesterday I heard from the President that this budget would stop adding to the national debt. Do you concur with that?

Secretary GEITHNER. Well, what this budget does, again, on our assumptions for what Congress—if Congress enacts this, it will reduce the deficit to a level that achieves what we call primary balance, meaning it is balanced except for interest payments. And for an economy like ours, growing at the rates we expect over time, meaning our economy normally grows somewhere between 2½ and 3 percent over the long run, that means you have to get the deficit to around 3 or slightly below to achieve primary balance.

And if you achieve that in the time frame we are suggesting, then you will stabilize our debt burden, net held by the public, net of financial assets, in the about 60, high 60, 70 percent of GDP range. And that is a level that does not threaten future growth. That is a level that is sustainable over time.

Now, we don't hold that over time because, without doing a better job on health-care costs, without building on the Affordable Care Act, those deficits will start to grow again, and the debt will start to rise again as a share of GDP. And that is why, again, it is so important to move.

Mr. RIBBLE. Because wasn't the debt actually——

Chairman RYAN. Will the gentleman yield for a second on that?

Mr. RIBBLE. Yeah.

Chairman RYAN. I don't see how you can square Mr. Carney—is that your new press secretary's name—Mr. Carney, Mr. Lew, and the President's comment that we are not adding to the debt. Your own Table S-14, the debt goes from $13 trillion to $26 trillion, debt subject to the limit.

How can you say you are not adding to debt?

Secretary GEITHNER. No, no. The——

Chairman RYAN. The statement wasn't deficits. It was debt.

Secretary GEITHNER. I am just making a point about math and economics.

Chairman RYAN. What? I am looking at your own chart.

Secretary GEITHNER. If you get the deficit down to that range—you need to get it slightly below 3 percent of GDP——

Mr. RIBBLE. The deficit?

Secretary GEITHNER. The deficit. When you get it to that point, if you can hold it at that level, then the debt stops growing as a share of the economy. And the question is, is it still going to be too big at that point? And it will be—again, net of financial assets, the assets we hold, net held by the public, will stabilize roughly around 70 percent of GDP.

That is a level we can sustain, but not—it doesn't hold for a long period of time because, again, the health-care costs start to eat away at that over a longer period of time. So you have to go beyond that.

Mr. RIBBLE. Yeah, because it looked like——

Secretary GEITHNER. It is a necessary but not sufficient condition. That is a way to think about it.

Mr. RIBBLE. Yeah. The numbers I saw yesterday added about $9 trillion to the debt in the next decade.

Secretary GEITHNER. Well, the period between now—you know, again, our deficits are unsustainably high. The period before you get them down to 3, absolutely, you are adding to debt, absolutely. And the debt is growing as a share of the economy. That is why you want to move as quickly as you can. You can't put it off indefinitely.

In that period when you are trying to get it from 10 to 3, the deficits are so large that they will keep adding to the debt, and the debt will be growing as a share of the—more rapidly in the economy as a whole, and that is what makes them unsustainable.

But once you get it down to 3, you will stabilize them at a level that is more acceptable.

Mr. RIBBLE. Do the assumptions, though, take into consideration that if the economy begins to recover like it is proposed, don't interest rates typically go up, as well?

Secretary GEITHNER. Well, you are right, the economic assumptions that matter most for this are, how fast does the economy grow, what happens to interest rates, what happens to inflation. And, as I said before, you know, there is no certainty around these things. It is a matter of judgment.

And, ultimately—and this is a great strength of our system—CBO's judgments will govern the choices you make. And, as the chairman said, when CBO estimates the impact of our proposed policies on the economy over time, they are going to show slightly higher deficits than we have shown in the budget.

Mr. RIBBLE. Just changing gears a little bit, do you know what percent of mortgages are currently held by Fannie Mae and Freddie Mac, U.S. Household mortgages? Is it in the high 80s or 90 percent?

Secretary GEITHNER. No, it is not that high. If you look at, on an ongoing basis, the share of mortgages financed today in the market, a very substantial fraction of those are by a combination of Fannie, Freddie, FHA, VA. Their combined share of new mortgages today is well north of 80 percent.

Mr. RIBBLE. Okay, north of 80 percent. Well, what assurances can we give the American people that we are not going to have another housing crisis as a result of that high risk? It is not spread out across the economy anymore; it is kind of held in the GSEs.

Secretary GEITHNER. Well, two points on that. One is, as we said last week, you know, we need to wind them down and bring capital back into the mortgage market. And we proposed a series of graduated reforms that will make that possible over time. And that is absolutely essential to fixing what was broken in the system. And we are not prepared to live with the mess that helped create this crisis.

Now, it is important to recognize that you want to do that in a way that is careful, because you don't want to be adding to mortgage costs, hurting home values as we start to recover. So you have to do it carefully.

But one point about Fannie and Freddie: The losses that they face today are the result of the mistakes they made during the boom. On an ongoing basis, looking forward, the guarantees they are making today are on much more conservative terms—more equity in homes, better underwriting standards—and there are more expensive guarantee fees. So that is why the independent estimates that have looked at this suggest that we are at the peak of losses, likely, and those will start to come down and we will start to get more of the government's, the taxpayers' investments back.

Mr. RIBBLE. Okay. Thank you, Mr. Secretary.

Thank you, Chairman Ryan.

Mr. PASCRELL. Good afternoon, Mr. Secretary.

I like when we look at alternatives and options. And obviously, with all due respect to a gentleman I have great respect for, Mr. Ryan, he has presented the alternative and the option as he did in 2010 before the election, what his alternative was and what kind of an effect it would have on the budget. The alternative was very specific. He did deal with the entitlements, some of them. In fact, he dematerialized one of them. He basically started the process of looking at Medicare, and it does not exist.

Chairman RYAN. Will the gentleman yield for a moment?

Mr. PASCRELL. Sure.

Chairman RYAN. If you want to talk about budgets, why don't you look at our 2009 budget, which was the last budget we as a conference actually did, instead of an individual piece of legislation that I introduced?

Mr. PASCRELL. May I respond? Because this was presented to us in September of 2010 as a legitimate—I thought it was a legitimate alternative before we got to the 2011 budget, and before we got to the massacre of the CR. So I thought it was a legitimate presentation, and I said so at the time, Mr. Ryan. I didn't have to wait to look at the results of the election. But it is an alternative.

And I was going to ask the Secretary, with your permission, whether or not the Secretary thinks that this option—Mr. Ryan's option, the Republican option to what we are talking about as a budget and what we are talking about in terms of health care in much of this, what does it do to the budget, in your eyes?

Secretary GEITHNER. Well, in some ways the chairman is best positioned to speak to his proposal. But I would make the following suggestion, which is that as the chairman of this committee, he is going to have a responsibility of putting out a 10-year budget resolution in the next several weeks, and that is going to have to provide a comprehensive plan for how you get these deficits down and what you should do to revenues, spending, discretionary, defense, entitlements in that time frame. And that will give us a chance to see a different strategy for doing deficit reduction, and then you will be able to compare two different comprehensive plans. And I guess I would reserve judgment to see what he proposes then.

Mr. PASCRELL. But is that the center—the budget proposal, whatever that proposal is, it is quite obvious in terms of the money we are talking about in this entitlement, it is the centerpiece of the entire budget. Would you not agree with that?

Secretary GEITHNER. In the chairman's road map, as I understand it, he does propose very, very, very substantial cuts in the basic level of health benefits we provide in Medicare and Medicaid and Social Security over a long period of time, and the deficit reduction that plan achieves is substantial, although, as Mr. Van Hollen says, it comes in over decades, not over months or years. It achieves that through, again, very substantial reductions in those basic benefits.

Now, again, the test of credibility should be what comprehensive plan achieves the amount of deficit reduction we need, and what does it do for growth and for fairness? And again, we are going to have a good debate, important debate, about what is the best way to get these deficits down over time.

Mr. PASCRELL. I think we could both agree with that, right, Mr. Chairman?

Chairman RYAN. Yes. I would only put a caveat: My plan does not reduce. It just slows the rate of growth. These benefits continue increasing year after year after year throughout the century.

Secretary GEITHNER. That is an important reminder, because the approach we are bringing to the budget on the discretionary side is a similar approach. We are saying we want to stop the rate of growth, and in real terms what that means is very substantial reductions over a period of time, but it happens in a way that is gradual.

Mr. PASCRELL. Can I finish with one quick question?

Chairman RYAN. Yes.

Mr. PASCRELL. Mr. Secretary, can you explain why it is so important for the deficit that cuts not be made to CMS in order for them to be able to fully implement the health reform law?

Secretary GEITHNER. Well, you know the answer to that question. If you don't allow these reforms to get traction, to be implemented, then you will not get the savings these reforms provide. If you delay them by slowing down the pace of it, you will delay and reduce the savings. It is just a simple proposition.

Mr. PASCRELL. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Flores.

Mr. FLORES. Thank you, Secretary Geithner, for your testimony today. Earlier in the conversation you talked about one of the bases in the budget is simplification of corporate tax rates, and the reason for that was competitiveness and more jobs, lower rate, broader base. That way you create more investment and more jobs.

Now, on the other hand, you say with respect to high-income individuals that those same rules don't apply, and so that when you raise taxes on the highest tax brackets of Americans, the group of people that creates 50 to 60 percent of the small business jobs in this country, that it is okay, you can do it there and still create jobs. But that you use exactly the reverse logic for corporations. Can you explain the obvious problem in that logic?

Secretary GEITHNER. Absolutely, and, again, I am happy to talk about it. It is a very important question, because, again, the test of everything we do should be measured through the prism of not just how are we reducing deficits, but what are we doing to growth, job creation, and investment centers in the United States. That is the critical test.

Now, what we propose in this budget is a series of very narrowly targeted, modest changes in taxation that only affect 2 percent of the richest individuals in the country——

Mr. FLORES. Where 50 percent of the small business jobs are created.

Secretary GEITHNER [continuing]. And less than 3 percent of small businesses. And those small businesses that will be affected by this are those structured where their income gets treated—they are flow-through entities. Those are overwhelmingly businesses that are earning very substantial money. The median earnings annually of the businesses affected, those 3 percent, are north of $700,000. They are not small businesses in that definition. And a substantial number of those businesses are what we would call—look more like law firms or investment partnerships or hedge funds, not like the hardware store on Main Street.

Now, again, those are the rates that prevailed in the 1990s, which was the best period for small business growth, job creation, investment that we have seen in generations. And so we think that at a time when we have to make choices, we don't have unlimited resources, that is a prudent and responsible step. And again, as we cut spending, we want to make sure that those spending reductions go to reduce the deficits, not to sustain tax preferences, tax subsidies that are very narrowly targeted and don't help growth, that we can't afford.

Mr. FLORES. The next direction I would like to go is talk about the President's position on the debt ceiling increase. The President has said he wants a clean debt ceiling increase. One of the issues he has got is there is a credibility gap. On this committee alone on the other side of this room, we have got 39 votes against debt ceiling increases. The last time the President voted against one, he said there was failure of leadership to vote for that ceiling increase.

Help us out on this side of the aisle. We came in on a group of American voters that said, enough is enough. No more debt ceiling increases. Help us walk down that path and show why it is not a failure of leadership today to vote yes.

Secretary GEITHNER. I did not create this system, and you did not either, and it is not a way to run a country.

Mr. FLORES. I would concur.

Secretary GEITHNER. Congress decides the obligations we have as a country. We have to meet those obligations. That is our responsibility. But you set the obligations. You set that through a process. It is not a terrific process, but you set that through a process every year. And the debt we have taken on is a function of the choices all of your predecessors made over time, Republicans and Democrats over time.

There is no country on the planet that puts its members through this kind of torture. You have to vote occasionally around increasing a limit that has already been locked in over time. It is not a sensible way to run a country.

Mr. FLORES. I would concur with that.

Secretary GEITHNER. Again, I think Mr. Hoyer has spoken to this question the best way. Mr. Hoyer said it is a mistake—when I voted against, it was a mistake. It is not a responsible thing to do. And I don't think you want to put the country through the position of having to have too much politics around something that goes so to the core of our credibility as a country.

And again, I don't envy the position you are in, and I wouldn't want to be in your position. There is nothing good to say about it except to say that you have to do it. There is no choice.

Mr. FLORES. We have to vote.

Chairman RYAN. That is inspiring. Thank you.

Secretary GEITHNER. I want to compliment what the chairman has said and what your leadership has said. They recognize right away that we have obligations as a country, and we don't play around with these things. We have to do it. And again, we completely recognize and agree with you, and we owe it to the citizens of the country that we have demonstrate to them that we have to find a way to bring the deficits down over time.

But we are just making the pragmatic judgment that if you make it complicated and hard, something that is already very hard, there is greater risk that you are going to mess up the expansion because of that. The world looks to us and they say, gee, is politics going to overwhelm common sense? Then they are going to start to be worried, and you will see rates rise, and we cannot afford that.

Your leadership has done a very good job of saying this, that there is no risk that the United States of America will not meet its commitments in a timely manner. But again, we recognize the position that you are in, and that is why it is good for us to find a way to lock in a medium-term plan, multiyear plan that brings down the deficits in a way that are going to be reasonably good for growth and investments.

Chairman RYAN. Mr. Honda.

Mr. HONDA. Thank you, Mr. Chairman. And I welcome Secretary Geithner.

As these budget hearings are unfolding against the backdrop of the slash-and-burn continuing resolution on the floor, it is clear that this is a debate between two competing visions of this country: the Democratic vision of helping America's small businesses and working families forging a 21st century economy, and a Republican vision that is cold-hearted, foolhardy and actually dangerous.

Secretary Geithner, the Republicans are trying to build a straw man out of entitlement reform, but we know that for the next decade our budget deficits are driven by an endless war in Afghanistan and tax breaks for the wealthy.

Your budget does not continue all of the tax cuts that expire at the end of 2012. The budget documents indicate that this would save 953 billion compared to extending all of the tax cuts, including interest savings. So if you wish to make all the tax cuts permanent, you would have to find nearly a trillion dollars in additional deficit reduction in order to match the deficits in the President's budget. Is that a correct statement?

Secretary GEITHNER. Absolutely. And again, I think it is important to recognize that tax cuts are not free. They don't pay for themselves. We have to go borrow money to finance them. And I know we are having a big debate about what the appropriate role of government is. The country is a divided country on that question at the moment, but there is no credible argument that the role of government is to go out and borrow a trillion dollars to finance tax cuts for the top 2 percent of Americans.

I think there is no—it is not good for growth. It is not necessary for growth. It is deeply irresponsible and will deeply magnify the challenge of restoring fiscal sustainability. If you don't make those modest reforms in tax provisions, very limited targeted reforms, you will have to find another trillion dollars in benefit cuts or in spending cuts, and that is going to be a very hard thing to do.

Mr. HONDA. Thank you.

And also the President made it clear that we need to invest in education. Today you mentioned three critical areas for investment: early childhood, teacher preparation, and financial support for higher education. In contrast, Republicans believe that cutting our investments in education is critical to creating jobs and growing the economy.

These are vastly different approaches, and only one can be correct. Can you explain why the President is investing in these three areas of education? And also can you hazard a guess as to what the effect the Republican alternative of cutting education investments would be on job creation and economic growth?

Secretary GEITHNER. Again, I think there is an overwhelmingly strong, compelling case to recognize that we have been experiencing a very damaging erosion in the relative quality of education in the United States. You talk to any company in the United States and ask them how hard it is to find the people with the skills they need to be competitive in high-end manufacturing, it is overwhelming and compelling. The world is not standing still, the world is getting much better at these kind of things.

So if you—remember, businesses have a choice about where they build their plant. And if they don't find the talents here in the United States, they will have greater incentives to go build that plant where they can find the engineers to do that.

So whether you care about opportunities for all Americans, whether you care about our children having a chance to earn a better living, whether you care about inequality or the competitiveness of the American economy, you have to care about reforms with investments that are going to do a better job of improving education outcomes in the United States. And I don't think that there is any argument that you can help make growth stronger if you are cutting into those kinds of investments that are so obviously critical to our competitiveness.

Chairman RYAN. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

Very briefly, I am one of the new folks, and I can tell you that after having been here only 5 weeks, my patience with the level of rhetoric, and probably better described as doublespeak, is probably already worn out. If you paid attention, you heard the ranking member today move very easily between the terms "primary balance" on one hand and "full balance" on another, which we both know are entirely different things. You heard folks talk about not playing politics with the debt ceiling, yet with the exception of Mr. Yarmuth, there is not a single person on the other side of the aisle that has not voted against one.

Mr. VAN HOLLEN. Will the gentleman yield?

Mr. MULVANEY. No, sir. I have only got 4 minutes remaining.

Mr. VAN HOLLEN. Well, you should look the at record before you distort the statement.

Mr. MULVANEY. And we have a situation where the President has done the same thing. Just yesterday this is what he said about his budget: What the budget does is put forward some tough choices, some significant spending cuts so that by the middle of this decade our annual spending will match our revenues. We will not be adding more to the national debt. So to use a sort of analogy that families are familiar, with we are not going to be running up the credit card anymore.

And that is just not true, is it? That is not accurate.

Secretary GEITHNER. No, it is true, because, again, you said this in your opening remarks, this is just a matter of numbers and math and economics. Not disputable. Primary balance is not balance. Balance is balance. Primary balance means you are balanced except for interest costs. For a country like ours, we need to be at or below 3 percent of GDP to stabilize the debt burden and stop it from growing. That is necessary, but not sufficient. We get there in this budget over a 3-year time frame. It is very hard to do, but it is not as hard as doing it in a way that is going to not kill future growth prospects for the country.

And the challenge is a political challenge in trying to make sure you bring those deficits down without, again, hurting investments that are important to our capacity to grow, and doing it in a way that is just and fair to people.

But I do not do rhetoric——

Mr. MULVANEY. I appreciate it, and I have not accused you of it. But to suggest that we are not running up our credit card, we will be adding to our debt as we go on. And I would suggest to you, for the American family, that is not balanced.

Secretary GEITHNER. Just one clarification, which is we said this. Again, we are very clear about this. We want to stabilize the level of debt as a share of the economy. The economy is going to be growing. So you are right, the debt is growing in that case, but what matters economically is it stable at a rate that is not going to hurt growth.

Mr. MULVANEY. Mr. Secretary, I am not here to pick a fight with you today, despite what a lot of folks think. I would simply put to you that I am not the only person who interprets it differently. The IMF has recently released a report that concluded that the United States is falling behind on a promise it made to other top economic countries to halve its budget deficit by 2013.

But let us get to the bigger issue, which is I have heard you today talk about the importance of lowering the tax rate, broadening the base. This budget does not do this. I have heard you today talk about the importance of entitlement reform, and I agree with you on these things, but the budget does not do these things.

Until we can have a debate that is removed from this rhetoric, it is going to be very difficult to discuss policy issues with you. It is the exact point I made to the OMB Director yesterday, that we have to be able to move past the rhetoric in order to do what the folks want us to do, which is have a discussion on policy.

Let me ask you a specific question on math. I have heard this term "sustainable deficit." I have heard you talk about trying to stabilize it at 3 percent of GDP. That 3 percent of GDP is not the critical number. It is the ratio that is more important, which is the ratio between the size of the debt—excuse me—the size of the deficit on an annual rate and the growth of the GDP.

I am concerned that over all of this budget, with the exception of 2014 and 2015, even though you do manage to get the deficit to around 3 percent on an annual basis, that you are only at GDP growth of roughly 2.5, 2.6, 2.9; that in every year except two, the budget deficit is larger than the growth in the overall economy, which to me means that as a percentage of our GDP, our deficit will continue to grow. I know I am out of time, but I would be curious to know your thoughts on that.

Secretary GEITHNER. I am not sure that is right, but I don't think it is worth debating, because, as I said, CBO in our country makes these judgments for us. They will estimate for you what the consequence of our policies will be if they were enacted on the economy. You will be able to look at those. As I said, they are going to conclude that we need to go further. We are going to agree with that.

But a phrase that I use which is not rhetoric is "a plan beats no plan." We lay out a comprehensive plan. You are not going to like features of that plan. You might want to go further or do it differently. The chairman is going to lay out a competing vision for growth and fairness. And we should have a debate then on what makes most sense for the country.

But one thing in our Constitution, the executive has to propose, but Congress has to legislate. And in our country now, given how divided the country is, it is going to take both Houses and both parties to legislate. And it is not something we can put off. We have to do it not just because people expect it from us, but because our overall confidence in our Nation will depend on you all being able to demonstrate that we can find a way to bring these down over time. But remember as you look at how to cut, make sure you are worried about stuff that is important for growth.

Chairman RYAN. Mr. Ryan.

Mr. RYAN OF OHIO. Thank you, Mr. Chairman.

Thank you, Mr. Geithner, and I appreciate it. I think it is important as we have this long-term discussion as we—a lot of times we hear questions asked of you and the last couple of visitors we have had here where there has been a complete disregard for the economic crisis that we just went through. And I think this budget, as much as I don't like a lot of it, does make the kind of investments that we need to be competitive. That tax rates, as you stated earlier, are not the only indicator for growth. It is quality of workforce, it is infrastructure, it is all of these other things. And I just want to say that I think you guys have done—with a horrible economic situation over the past couple of years—have done a pretty good job. And I can't imagine having to do this without dealing with the politics that the President and you and the administration has to consistently deal with.

And I think if we look back to the number of jobs that were being lost in January of—the month the President got sworn in, if we look the at direction of the country and look what the stimulus bill has done—although it has not—I mean, I am from Ohio. Clearly unemployment has not gone down quick enough, but we have stabilized. You guys have saved the auto industry. I just had some folks in my office from Ford, where they have now 850 people working in the Parma plant. Lordstown General Motors now has a third shift. They are making the Cruze. They are selling like hotcakes. That would not have happened if it were not for the courage of this administration.

So talk about rhetoric in Washington, D.C., let us be fair to each other who are trying to make some pretty difficult decisions here. I just wanted to say that. You know, I wanted to get in my questions, but if we are going to change the tone, if we are going to have adult conversations that everybody in the Capitol wants to start having, I think it starts by saying—do you remember when Paulson came here, and everybody was running around the Capitol with their hair on fire because we were going to go into a global depression in a matter of days? And if you contrast that with, I think, some very difficult and mature decisions that you guys have made—and I am not here to blow smoke, but we have to appreciate the difficult decisions that were made under President Bush, then President Obama, then the stimulus package and all of these other things, and now to propose a budget as we start to turn the corner and move in another direction where we made these critical investments, continue to say this is a priority for our country, I think this is important, and I think you guys are showing some leadership in spite of what some of the critics are saying.

Two quick questions. One—and we talked about this a million times—China currency. I think it is a major issue. I think it could be a major stimulus for the United States if we do it. Where are we at with currency? Are you continuing to push this? I feel like this could be a major, major stimulus. It does not cost us any money.

Secretary GEITHNER. It is very important to us and very important to a lot of people up here. They are moving, and moving very gradually. But what you can see in the exchange rate understates the pace of appreciation, because, as you know, they have moved about 3.5 percent over the last 6 or 7 months.

But inflation in China is much higher than in the United States, in part because of their exchange rate policy. What that means in real terms is they are moving about 10 percent a year at an annual rate. If they continue that, that would make a big change, and it is already having a much bigger effect than just what that 3.5 percent would imply.

Businesses have to look forward, and what they see is a sustained increase in wages in China, sustained loss in competitiveness for China, so they are less likely to build the next plant there, more likely to look to other places to buy the goods they need and services they need, and that will help reinforce this recovery. But they are just at the beginning of that process. We want to it continue, and we are going to continue to encourage them to move.

Mr. RYAN OF OHIO. Well, we are going to continue to push. I want to remind my new Members who are here, we passed that China currency bill last year with 380 votes, bipartisan support. We need to continue to give you that hammer.

Please advocate for the health care tax credit as well. A lot of these auto jobs and people in Ohio have lost it, and the increase up to 80 percent. We need the help of the administration for that and the trade adjustment benefits.

Secretary GEITHNER. Thank you. Thank you for what you said.

Chairman RYAN. Mr. Huelscamp.

Mr. HUELSCAMP. Thank you, Mr. Chairman.

Mr. Secretary, it is a pleasure to have you here today.

I want to make a comment. I made a comment with Mr. Lew yesterday, but I just wanted to point out again that the President's claim—and you echoed the claim here, Mr. Lew echoed the claim as well, that the President has met his pledge to cut the deficit in half. And, of course, when he made that pledge, he said nothing about tying it to economic growth. It was a flat pledge to cut it in half, and it is still $175 billion short.

With that said, even with that in mind, and restating that, exactly how does the President plan on helping this Congress to make sure—for instance, the freeze on discretionary nonsecurity spending. He made the comment, the President proposes and the Congress disposes, and I have a third grader, and that is the way they understand it. That is not the way it works. In 1997, President Clinton stepped up when we had the debate over the debt ceiling and said, let us talk about balanced budgets.

My question is does the President have any desire to make some concrete proposals in this time period other than simply presenting this budget, which we all agree is unsustainable? Is there anything concrete?

Secretary GEITHNER. As part of the debt limit or reducing deficits?

Mr. HUELSCAMP. I think when we talk about the debt limit, a vote on the debt limit is a referendum on past spending by your administration and previous Congresses. That is what we are doing. But what about going forward in the future? I understand the President would like to not have to face a discussion about the future in the debt limit, but, frankly, that is why I think the discussion should be——

Secretary GEITHNER. We absolutely want to have a discussion about the future. Again, the important thing we face is to try to figure out how we come together on a credible, comprehensive plan to reduce those deficits. That is what our citizens except of us. That is what the world is going to require. That is what is important to recovery going forward.

But it is more complicated, of course, than just trying to figure out how to get them down. You have to get them down in a way that is going to be acceptable, pass the Congress. Of course, you are right. We can't leave it to you. We will be an active part of trying to shape consensus, and the President will help play an active role in that process.

But again, the budget is the beginning of that process. It does not solve all the Nation's problems. There are other things we have to do, and we recognize that you are going to have different ideas on how to do it. And what we look forward to is hearing your alternative suggestions for how we get there; how quickly we get there, and how we get there. And then we will have two contrasting visions, and we will figure out what makes the most sense.

Mr. HUELSCAMP. And I appreciate that. I believe your timetable is maybe April or May for the debt ceiling vote. But we will not anticipate anything from the administration before we have that vote as far as serious discussion on the deficits?

Secretary GEITHNER. No, we are beginning a serious discussion on the deficit right now. That is what the budget starts. And again, we laid out a comprehensive plan.

Mr. HUELSCAMP. But there is nothing about entitlement reform in there.

Secretary GEITHNER. Again, I don't think that is really a fair way to look at the record of what this President has done. The Affordable Care Act, parts of it, delivers very, very substantial entitlement reform that delivers very, very substantial deficit reduction over time.

Mr. HUELSCAMP. I understand that. But you also agree that it is unsustainable to have a $768 billion deficit. In 2 years we will still be at $768 billion.

Secretary GEITHNER. Yes, as I said, we propose to bring it down to roughly 3 percent of GDP over a 3- to 5-year period. We phase it in because we do not kill growth.

Mr. HUELSCAMP. I understand that. I am just about out of time. I just want to note that Mr. Obama may not be here in 3 to 5 years. He promised by the end of his administration. We have 2 years, and actually I think we have a couple of months' window here, and I encourage the President to step up and provide an opportunity before April to provide a real proposal to help reach an agreement. But I appreciate it.

Secretary GEITHNER. Again, I just want to make this one point again. Again, we have got a lot of strengths as a country and a lot of strengths in our budget process, although it is not working very well for the country right now. But please consider this as you consider how to help us fix this problem. We need a multiyear plan that brings them down over time that you can lock yourself into, because if you do it year by year, nobody will have any confidence you will deliver on it. So it has to be a multiyear plan. Other countries have found a way to do this. We need to find a way, too.

Mr. HUELSCAMP. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Yarmuth.

Mr. YARMUTH. Thank you, Mr. Chairman.

Mr. Secretary, nice to see you again. Thank you for being here.

I would like to echo Mr. Ryan's and others' comments that I think the administration has done a terrific job of trying to strike a balance of trying to get our house in order, and also respecting the need to make the kind of long-term investments that will keep this country competitive a generation and two generations down the road.

Secretary GEITHNER. You are referring to both Ryans in the room?

Chairman RYAN. I was going to make the same clarification. The gentleman from Ohio?

Mr. YARMUTH. Mr. Ryan from Ohio.

Obviously not everybody is going to agree with every provision in this budget, and there is something that causes me a great deal of concern—you and I have had this conversation in public before—and that is the repeal of the LIFO accounting method, which will have a devastating impact on one of Kentucky's primary industries, the bourbon industry.

In my district alone, Brown-Forman Distillers, which employs about 1,300 people in my district, would effectively have its taxes raised by hundreds of millions of dollars, they estimate, when they have, in fact, relied on an accounting method which was approved in 1939. But not only would this budget anticipate repealing it prospectively, it recaptures their reserve. And, to me, that is like saying you bought a house 30 years ago, you took advantage of the mortgage deduction, not only do you lose the mortgage deduction going forward, you are going to have to pay back all of that money that you saved, which seems to me to be incredibly unfair.

So I would like to get—other than the fact it is a lot of money sitting there that you could go after to balance the revenue side of the ledger, what is the rationale for that kind of essentially retroactive penalty?

Secretary GEITHNER. Congressman, let me start by saying I understand your concerns, and these changes, like many, are painful changes. And we do propose ways to make sure that we try to minimize the burden by giving people time to meet that change in tax treatment.

But the basic rationale for this is one of fairness. We want to put industries on a level playing field and not favor—not create favors or create preferences that disadvantage other industries in favor of one industry. And it is a complicated thing to do. Our Tax Code is ridden with all sorts of other examples of unfairnesses like that. We think this just puts people on a level playing field. But I understand your concerns, and we are happy to talk to you in more detail about how to address those. And I understand why it would be a challenge for you.

Mr. YARMUTH. And not just for my industry, but for the wine industry. There are many industries that are faced by this problem, and particularly the bourbon industry, which the law requires them to age their product. In many cases these products sit on the shelf 15, 18, 20 years. And just as we provide depreciation benefits for some companies that gives them an advantage over others, I just want to raise that point.

Thank you. I look forward to working with you on that.

I yield back.

Chairman RYAN. Mr. Rokita. Did he not come first before he did? All right. Mr. Young.

Mr. YOUNG. Mr. Secretary, thanks so much for being with us here today.

I wanted to pivot to the housing market. As we know, it has been lethargic for some period of time. That, in turn, is impacting consumer consumption. It is having some effects on our labor market and the ability to match up jobs with a mobile workforce.

And I did not see it in the budget. I am thoroughly new here. So I looked in, and I thought it was a glaring absence. And I did some digging here and found out that CBO actually scores Fannie Mae and Freddie Mac differently. CBO says that Fannie Mae and Freddie Mac are entities of the government because they are under the control and ownership of Treasury. The President's budget, on the other hand, as you know, says Fannie Mae and Freddie Mac are nongovernmental entities, and therefore leaves them out of the budget.

As a Member, my colleagues and I, it is our job to oversee such matters. How can Treasury assure us that the President and the administration is fully accounting for the risks associated with their management of Fannie Mae and Freddie Mac?

Secretary GEITHNER. Excellent question. And again, I would be happy to talk to you in more detail about this or explain exactly how we do this.

What we do is we show—and CBO does a similar thing—they show on a rolling basis the estimate of likely losses over time, what the ultimate cost might be to the taxpayer as a whole. And we try to explain how we are trying to minimize those costs.

And what FHFA does, which is the responsible authority as conservator, is they provide a range of different estimates under different scenarios, a stress test, a base case scenario about what losses might actually be. And what we lay out for people is how, through a strategy of more conservative underwriting standards, requiring homeowners to hold more equity in their homes, more conservative eligibility requirements and higher guarantee fees—we lay out the clean economics of why we think the guarantee business going forward is much more conservatively managed. And because of this, both OMB and CBO show those losses coming down now over time.

Mr. YOUNG. You are still estimating losses. And why isn't your most likely scenario, or an average of certain scenarios, included in the budget itself?

Secretary GEITHNER. No, we do build into the budget the estimated cost of this to the taxpayers over time, and those estimates change over time. Again, they are likely to come down a little bit. They are still significant, but they will come down over time because, again, these companies pay us dividends, and that helps offset some of those costs.

We are very transparent and open about this. We account for it in the budget. It is there for everybody to see. And people can come to their own estimates what it might cost. But ultimately, as in many cases, CBO will determine for you what the right way to account for this is.

Mr. YOUNG. I know the administration is in the process of reforming in various ways Fannie and Freddie and its operations. I didn't see that included in the budget either.

Secretary GEITHNER. We proposed last Friday—before the budget came out, we put in a white paper, a comprehensive plan for winding them down over time, reforming the market, fixing what was broken. Doing that in a gradual way doesn't hurt the housing market. And we will begin the process of consultation on the Hill about how to translate those reforms into legislation that would fix what is broken in the system. But the details are not in the budget. We did those separately ahead of the budget release.

Mr. YOUNG. I have got 30 seconds left. Should there be a government guarantee in the housing market? And if so, to what extent?

Secretary GEITHNER. A very important question. I think what we laid out in this proposal was three different options for the future. One option leaves the government's role to a limited role through the Federal Housing Administration so that low- and moderate-income Americans would have the ability to take advantage of a guaranteed mortgage. Two other options might complement that, one that would provide you might call it emergency assistance in a recession, deployed only in an emergency, to help cushion the effects of the housing market collapse. The third option would be a much more targeted, narrower guarantee that the market would pay for. And if the government was exposed to any losses, we have to make those up by a fee on the market like we do with deposit insurance.

We are going to begin debate on those options. Ultimately you could choose a mix of those options, but that is a judgment that we will have to reach with Congress. And we can go through that process carefully because we already have the authority now to begin to put in place reforms that will wind down those institutions and bring the private markets back into the mortgage finance business as we try to figure out what the best ultimate choice is about the future.

Chairman RYAN. Thank you.

Ms. Kaptur.

Ms. KAPTUR. Thank you very much.

Welcome, Mr. Secretary.

As you know, America is enduring a housing crisis of monumental proportions, and it is amazing to me that you have not addressed that in your testimony today. President Obama did not mention it in his State of the Union Address, nor did President Bush in the recent book that he published on his career here as President.

Just in 2010, more than 1 million more homes were repossessed. Since 2007, 3 million homes were taken back. Almost one in five American homes remain under water, worth less than what families owe on their mortgage. And the Wall Street Journal reported that home prices are declining in all 28 major metropolitan areas as of the fourth quarter of 2010.

Back in the 1980s and 1990s, the costs of the savings and loan crisis precipitated by reckless bankers were placed on the American people; $170 billion placed squarely on the backs of our taxpayers to pay for their misdeeds. Now the costs of this housing crisis caused by Wall Street abuses through the creation of asset-backed securities made a few very, very greedy bankers quite wealthy at the expense of millions of ordinary citizens and doing great harm to our Republic.

This cost is also being placed on the backs of U.S. taxpayers. Reports show that the true direct costs involve trillions of dollars, and according to numbers I have, these include 12 Treasury programs thus far have cost taxpayers over $700 billion of which the TARP is nearly $380 billion; 24 Federal Reserve programs have cost $1.738 trillion; and for the next 3 years, Treasury has engineered unending support, regardless of the dollar amount, to Fannie Mae and Freddie Mac. So far we have spent 61 billion on Freddie Mac and 83 billion on Fannie Mae.

All of this debt is being financed by foreign borrowing, with China now number one financier to our country, followed by Japan and the Middle East oil-exporting countries. But snug up against them is the major role of the Cayman Islands. And I would like to ask unanimous consent to place in the record a report on foreign portfolio holdings of U.S. Securities.

Chairman RYAN. Without objection.

[The report, "Foreign Portfolio Holdings of U.S. Securities," as of June 30, 2008, may be accessed at the following Internet address:]

http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/shla2008r.pdf

Ms. KAPTUR. I thank the chairman.

My question, I have three, is there a transparent—I will read all three—is there a transparent list of which Cayman Island financial institutions hold the lion's share of the debt that they are financing? Number two, who exactly will lose money if Freddie and Fannie default on their obligations? And number three, how much interest will our government pay this year to foreign interests who finance our debt?

Secretary GEITHNER. The first I would like to respond in writing. On the second——

Ms. KAPTUR. So you don't know, sir, if there is a transparent list of which Cayman Island institutions hold the lion's share of U.S. Debt in asset-backed securities? It is quite striking when you read the report that almost all of the what are called corporate debt securities are held in the Cayman Islands, more than any other country in the world. Very interesting. Who would that be, from everything that you know at the moment?

Secretary GEITHNER. I have not seen that report, but I would be happy to look at it and happy to respond in writing.

Ms. KAPTUR. It is actually a Department of the Treasury report along with the Federal Reserve of New York, which you used to chair, sir, I think; am I correct?

Secretary GEITHNER. Was the CEO of that. Right.

Ms. KAPTUR. And the Board of Governors of the Federal Reserve System.

Secretary GEITHNER. I am not sure what you are getting at, but I would be happy to respond in writing.

On your second question, Fannie and Freddie will not default on their obligations. It is not going to happen.

Ms. KAPTUR. But if they did, who would lose money?

Secretary GEITHNER. I will not contemplate it.

Ms. KAPTUR. But theoretically, who holds the paper?

Secretary GEITHNER. The American people would lose on that because you would cause devastating damage to the housing market, and you would cause a huge increase in the losses for the taxpayer that came from the mistakes of entities made before the crisis.

Ms. KAPTUR. How much interest will we pay this year for foreign interests?

Secretary GEITHNER. I will be happy to respond. I don't know that number myself.

Ms. KAPTUR. It is sizable, is it not, Mr. Secretary, and it is growing?

Secretary GEITHNER. Yes, it is, because our deficits are very large, which is why we have to bring them down.

Ms. KAPTUR. I think the American people are deeply worried that this country is in hock to foreign interests. This Member is worried.

Secretary GEITHNER. Well, I think what the American people should be worried about is that we have unsustainable deficits, and we need to bring them down. But you cited a bunch of numbers earlier in your remarks that were not correct about our financial investments, and I would happy to respond in writing on that.

You raise the S&L crisis. The S&L crisis cost the U.S. Taxpayers about 3 percent of GDP. This crisis all in, looking at the direct costs of our programs under TARP, the GSEs, meaning Fannie and Freddie, what the Fed did, what the FDIC did, what the Treasury did directly, will cost almost certainly less than 1 percent of GDP. The investments we made in the banking sector will earn a substantial positive return to taxpayers. The FDIC's programs, the Fed program will earn billions and billions of dollars for the taxpayers because they were incredibly carefully managed. I would be happy to report in detail.

Ms. KAPTUR. I thank you, Mr. Secretary. My time is up, but I would just say back in the early 1990s and late 1980s, foreign interests were not financing the majority of our debt securities, and they are today.

Chairman RYAN. Thank you.

Mr. Rokita.

Mr. ROKITA. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for your time today.

I just went and looked back at the record, asked the staff to do it, because I could not believe what I was hearing when you said that—when we asked about whether or not the President was really getting to entitlement reform as a driver of this budget, and you pointed to Obamacare. Mr. Elmendorf, who was here, I believe, last week, said, and I quote: Rising health costs will put tremendous pressure on the Federal budget during the next few decades and beyond. In CBO's judgment, the health legislation—he was talking about Obamacare—enacted earlier this year does not substantially diminish that pressure.

Do you want to respond to that?

Secretary GEITHNER. Again, I can only quote his estimates, and those are the ones that, again, govern what Congress does in this area. And what CBO's estimates are, and he reaffirmed them, are that the reforms that we refer to as the Affordable Care Act will reduce our deficits by $1.23 trillion over the next two decades, $230 billion in the next decade, a trillion in the subsequent decade, and that is because they substantially reduce the rate of growth in health care costs to the taxpayer. They still leave us—even with those reforms, they still leave us with unsustainable commitments, obligations in Medicare, Medicaid and Social Security. So they are a beginning, but they are unsustainable——

Mr. ROKITA. Okay. We are talking about the things that are going to drive deficit and debt reduction into the future are what you just mentioned, and we are not touching it in the President's proposed budget.

Secretary GEITHNER. No, no, again, that is not quite accurate. The first obligation we all have is to make sure over the next 5 to 10 years we take an unsustainable deficit that is not a result of entitlement commitments and bring that down to Earth. That is absolutely essential to maintain confidence in our recovery, keep interest rates low.

Now, you are right, even with the Affordable Care Act, if you look at over the next several decades beyond that, we have an unsustainable set of obligations, and we need to try to build on those reductions to try to do that. But what the Affordable Care Act did was the most important cost-saving entitlement reform this country has done in decades, not just paid for fully, but deficit reducing on a dramatic scale.

Now, we are happy to work with you on how best to go beyond that, and the President laid out some initial suggestions, like malpractice reform, to try to do that. But we have to figure out how to build on that commitment. But don't look past—I know you won't—don't look past the next 5 or 10 years, because that still presents an enormous challenge.

Mr. ROKITA. Okay. I will try not to. Thank you for the answer, Secretary.

I still don't—when you talk about covering 40 million more people in a government-controlled system and plan, you can't tell me that you are actually going to get deficit reduction.

Secretary GEITHNER. You don't need to rely on my judgment. Use CBO's.

Mr. ROKITA. I did. I just quoted the man.

Anyway, let me ask unanimous consent to put this chart in the record.

Chairman RYAN. Without objection.

Mr. ROKITA. Thank you.

You used the word "torture" to talk about this debt ceiling vote that we are going to have to go through.

Secretary GEITHNER. Could I withdraw that?

Mr. ROKITA. I appreciate your empathy. And you are right. Politicians before us put us on this path, and here we are having to clean up. I take that responsibility. I don't use the word "torture;" I use the word "responsibility" and also use the word "leadership." And we will pick up if we have to where your budget proposal left off, and then we can work together and get some things done. I think that is important.

But I also don't understand—and let me give you 20 seconds to respond—why we couldn't attach—why it is politics to attach some things to it that would actually guarantee or help cure this situation so it does not have to happen again, whether it is balanced budget language, whether it is making sure that our interest payments are paid first, and all of them; not just the car payment, to your earlier analogy, but others? I don't see that as politics. I don't see that as irresponsible. I think that is what we ought to do to make sure that our kids don't have to pay for this.

Secretary GEITHNER. Again, I did not use those terms. I will say it this way. As you work with your colleagues on the other side of the aisle and work with us to figure out a way to put in place a credible deficit-reduction plan that allows us to go back to living within our means, make sure you don't call into the question the basic obligations of this country. And we are just making the pragmatic observation I know your leadership shares that this is a really hard thing to do. You are finding it really hard to do. People will disagree on the right path to do it. Do not complicate it up, because we can't afford to take any risk that people call into question our commitment to meet our obligations.

Chairman RYAN. Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

Mr. Secretary, it is great to be with you and see you again.

We have had a number of different individuals testify, Chairman Bernanke, CBO Director Elmendorf, Mr. Lew from OMB, and each of them affirmed—I have asked each of them this question, and I will ask it of you as well—related to the draconian cuts proposed in the continuing resolution that we are considering right now by the Republicans and the impact that they would potentially have on the recovery. Could you comment on that? Because each of the previous three individuals that I asked all confirmed that that was a significant concern.

Secretary GEITHNER. Well, I am a little reluctant to do so because we haven't seen how this comes out, and, of course, it has not passed the Congress. But as American people observed, by putting so much of the burden in cutting discretionary spending, which is a small share of our budget, in 1 year, and going down deeply into critical services that are important to future growth, in my judgment, if Congress were to pass those cuts, they would hurt our competitiveness, hurt our growth prospects, and in that way in some ways make the long-term deficit problem worse.

Ms. WASSERMAN SCHULTZ. So it is risky and potentially reckless to cut too deeply.

Secretary GEITHNER. Again, I would say be careful as you cut spending to make sure you are reducing deficits, too, but focus on doing it in a way that is not going to hurt our future growth prospects.

Ms. WASSERMAN SCHULTZ. Thank you.

Secretary GEITHNER. Again, can I just say one thing? These things that we all care about for competitiveness are things we can afford. You know, if you look at the costs of the reforms for the Department of Education, they are not expensive for a country like the United States. The suggestions we are making for incentives in innovation are not beyond our means as a country. And if you try to balance the budget on the strength of deep cuts on that relatively small share of the budget and not bring a comprehensive plan that helps future growth, then you are going to hurt growth.

Ms. WASSERMAN SCHULTZ. Just an extension of what Mr. Rokita referred to, would you say that it is not responsible for us to hold the lifting of the debt ceiling hostage with items that might warrant debate and that we might ultimately be able to find some common ground on, but that irresponsibly would tie to the lifting of the debt ceiling?

Secretary GEITHNER. I would, of course, say that. But every predecessor who has had my job would say that, as would every President faced with this basic choice. And you would expect us to say that because, again, the stakes are too high. We can't afford to take any risk with a recovery that is still in the early stage after a recession that was traumatic. We are still living with 9 percent unemployment, and we can't afford to take any risk of jeopardizing the process of repairing that damage.

Ms. WASSERMAN SCHULTZ. Thank you.

And just in the last minute, I am really pleased to see that the President has made a commitment to making sure that intellectual property rights are preserved in the budget, and glad to see that he has made a commitment to that. I think we all understand the obvious benefits to that.

But on closing tax loopholes specifically, we know that in terms of winning the future and the concepts that the President has pushed in allowing us to outinnovate and outeducate and beat our global competitors, what does the President's budget do specifically to close those corporate loopholes and shut off incentives to ship American jobs overseas?

Secretary GEITHNER. We proposed a series of reforms to reduce both the opportunities and the incentives in the current Tax Code to shift income to low-tax jurisdictions and to shift investment outside the United States. And we also propose, though, some very positive incentives for investment in this country. We propose to make permanent an expanded R&E tax credit. We propose very substantial cuts for small business, small businesses themselves. And if you look the at the combined impact of the reforms we are proposing, I think they would be very good for growth and very good for investment in the country.

Chairman RYAN. Mr. Woodall.

Mr. WOODALL. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here. I am the newest member to this subcommittee and have a steep learning curve as I have been trying to pore through the numbers in the President's budget and listening to what he has said when he it out talking about reducing the deficit and attacking the debt. Can you tell me in simple terms, true-or-false terms, this budget never, ever, ever reduces the debt; is that right?

Secretary GEITHNER. That is correct. It does not go far enough to bring down the debt, not just as a share of the economy overall, you are right.

Mr. WOODALL. It does not bring down the debt at all.

You have said a lot, which I very much appreciated, about preferences for industries. It started with Mr. Blumenauer, and Ms. Wasserman Schultz followed up on that. You said it is not good policy, that it is not fair, that preferences for even Mr. Yarmuth's folks were bad policy. But as I read your written testimony, you go right into we are going to start with revenue provisions that promote investment in clean energy; that we are going to go on and promote—to make revenue changes that make investments in manufacturing facilities with energy-efficient commercial buildings and plug-in vehicles, and on and on and on.

Can you tell me why it is that tax preferences for the bourbon industry are bad and for the oil industry are bad, but tax preferences for these other industries are good and procompetitive?

Secretary GEITHNER. Absolutely. Fair point. We do include in the budget a series of targeted tax incentives that go to support investments in clean energy. You know why we are doing that, because we think it is important for the country as a whole to move to less carbon-intensive energy as a whole.

Mr. WOODALL. I guess my question, Mr. Secretary, would be why you? If we want wanted to do it on the spending side of the ledger, I think that is absolutely right. But you have said over and over again that your job is to collect revenue. I will associate myself with Mr. Blumenauer's comments. It is not the IRS agent's fault; it is our fault. Here we have an opportunity, what seems like agreement on both sides of aisle, to move to lower rates, a simpler system, and yet even though we agree on that, here we are again using your agency, using your Department to continue to create these market distortions. If we want to distort the market, why don't we do it on the spending side of the ledger instead?

Secretary GEITHNER. You and I can agree on that more than you think. And as I said, we are in favor of trying to find a basis for doing comprehensive tax reform that will lower the rate and broaden the base. And where we preserve incentives for investment, we want to make sure they meet a very, very high bar; very powerful, very strong impact on investment incentives that we can all justify as a whole. We won't be perfect on cleaning them up completely, but we think it is worth doing.

And you are right to say that in this budget we are proposing a set of changes built on the current tax system on the corporate side that we think shifts the incentives in a positive direction for investment. But we also say that if we can, we would like to move to comprehensive reform that would clean it up more dramatically.

Mr. WOODALL. Would you agree with me that businesses don't pay taxes, that their consumers and their shareholders pay those taxes, but that there is no secret drawer at the business to pay those taxes?

Secretary GEITHNER. I am not an economist, but all economists would agree with you that those costs are borne by a mix of shareholders, employees, managers and customers.

Mr. WOODALL. What is the downside, then? We talk about reducing the corporate tax rate and simplifying the compliance process. What is the downside of eliminating the corporate tax rate altogether so that we are certain that we are a magnet for jobs, so that we are absolutely certain that we are not moving folks overseas, and since we are absolutely certain that the only taxpayers in the world are consumers, employees and shareholders?

Secretary GEITHNER. Sounds to me like you could do fine explaining the arguments against doing that.

Mr. WOODALL. I just need you on my team, Mr. Secretary.

Secretary GEITHNER. I will just make a pragmatic argument that if you do that, you are asking individuals to directly bear a much higher tax burden, and I think you are going to find that untenable politically.

Mr. WOODALL. I will have to bring you down to the Seventh District of Georgia, where folks are pleased to shoulder that personal responsibility.

Chairman RYAN. Mr. Lankford.

Mr. LANKFORD. I want to continue on this conversation on the corporate tax side as well. You mentioned earlier in your testimony in the conversation about territorial or global and how we want to land on that. And you mentioned you were looking for those ideas on how we handle that, and do we set our criteria and expectations on that.

What country do you look at that is doing global taxation that you say that is a good model in how they transitioned and what they have done? Is there another country out there that you say, gosh, they do global taxation well?

Secretary GEITHNER. Excellent question, but I don't see anything out there yet that we can fit to our particular circumstance as a country. You know, we are a little special in many ways. The countries in Europe are not really a good model.

Mr. LANKFORD. Like to keep it that way.

Secretary GEITHNER. Yes, we want to keep it that way, too. We would be happy to talk to you about it in more detail. We are beginning a very careful process of consultation to look at all alternatives out there, but, again, we want, like I think you would want, to make sure that we are not eroding the tax base substantially, and we want to create more incentives, more opportunities to move that stuff outside of the United States.

Mr. LANKFORD. As a general principle, though, and following up on Mr. Woodall's comments as well, as a general principle, if you subsidize something, you get more of it; if you tax something, you get less of it. Do you generally assume that?

Secretary GEITHNER. I am not an economist, but I think most economists would agree with you.

Mr. LANKFORD. The issue then comes back to the energy side. Obviously we are trying to subsidize heavily one side of it, this clean energy side, and traditional energy is about to get whacked based on the President's proposal on it.

Secretary GEITHNER. "Whacked" would be overstating it, but I would say the existing preference is somewhat diminished. Only some of them——

Mr. LANKFORD. Well, they would definitely have a pretty hard hit on it, on how they are going to handle it. So that would decrease our energy supply there to try to increase it on another side of energy. But it is not actually there.

My question is based on your statement you said earlier. You didn't feel like raising taxes on traditional energy sources. Your statement was it would have no effect on price. And I am kind of astounded by that to say, well, add a tax burden on them, which will cause them to drill less and to research less for things like IDCs and such. And so supply then goes down, your tax amount goes up, and you are saying that it will have no effect on price. It is almost astounding to me, I guess.

Secretary GEITHNER. Don't rely on my judgment. I am just saying economists would say that these prices in a market like oil are set by the global market, and modest changes in the tax preferences for where some production happens won't affect those prices.

Mr. LANKFORD. Well, I would say in the same vein, if that would have no effect on the price on that, then what if we stop subsidizing ethanol as much, for instance; would that have no price effect on ethanol, you think, as well?

Secretary GEITHNER. You know, I am a little reluctant to speak to that because that is a little different market in terms of size in that context.

Mr. LANKFORD. I am just saying on the energy side, we can't say that we subsidize things and we get more of it, and we tax it and we get less of it. The exception to that is in energy that we can kind of switch it. Because I get this feeling from reading speeches from the Carter administration, they tried this same experiment. I am sure you are very aware of that.

Jimmy Carter made the statement that by the year 2000, 20 percent of our electricity would be produced be solar power. And there was a heavy push towards all the clean-energy options, with the exception of coal. He was a big fan of coal. But then it didn't occur. We dumped a lot of money in that, and it didn't occur. You can't just flip it on and say, we are going to do that as a country.

Let me just make a couple of quick statements just as observations on it. I am also a new Member in this, and coming from central Oklahoma, some of the words and the phrases that are coming out don't ring true in just normal Americans that we are interacting with. The statements that you made earlier like, we are worried about more generous estate tax rates, gives the impression that the Federal Government owns the property of people who die, and we get to choose whether they are going to have more generous rates or not, which they have now, and whether they are going to have less rates. You mentioned fortunate Americans. The primary balance we have already talked about. It is a great frustration. Sustainable deficits.

I just don't hear anyone that I am interacting with saying, you know, if we just get to $26 trillion in debt, I think we will be fine. I just don't hear anyone saying that except for the administration. The administration continues to say, we will have sustainable debt, we will have $26 trillion in debt, and we will be just fine.

Secretary GEITHNER. You will never, never, ever hear me say that.

Mr. LANKFORD. Well, that is what is coming across in our budget, and we have got to serious about that. My fear is right now we are more worried about balancing the budget and what effect that will have on our economy than we are about dealing with our debt. And I just think more people are more worried about—let us get back to balance.

Chairman RYAN. Mr. Stutzman.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thank you, Mr. Secretary. I have enjoyed our conversation today.

Did you have any involvement in putting the budget together for the President?

Secretary GEITHNER. I did.

Mr. STUTZMAN. Okay. I guess what I am curious is, I would like to go to—off of page 202 and the economic assumptions in growth, especially in particular GDP; 6.1 percent is the high, and the low that I see there outside of 2010 is 4.0 in 2011, and I think I heard you say earlier that average growth of GDP is around 2 to 3 percent.

Secretary GEITHNER. I think you are quoting nominal GDP rates, not real GDP rates.

Mr. STUTZMAN. Even with real GDP rates, they are still very optimistic in the short—right after 2013—or right in 2013, 2014, what gives you the idea that we are going to see that type of growth? Because when I mention that to folks back home, they are trying to figure out what to buy.

Secretary GEITHNER. Again, I am repeating a conversation we have already had at some length.

Mr. STUTZMAN. I am sorry. I came in a little late.

Secretary GEITHNER. It is an important question. Again, you want to have realistic, conservative assumptions as you make budgets. In the end, of course, it is CBO's estimates that will govern what you do and how that affects—how we estimate the cost of these policies in the economy long term.

If you look at the full mix of these assumptions, I think they are actually reasonably conservative. Again, the growth rates we assume in the budget over time are lower, materially lower, than the average of past expansions. So they are conservative in that sense. The fiscal year 2011 budget estimate is substantially above CBO's estimate because it is very conservatively estimated. It will much—it will be lower than that almost certainly. But again, the way our system works, CBO will look at those independently, and you will be able to look at their judgments, too, about what is a prudent set of assumptions.

Mr. STUTZMAN. But why the big spike in 2013, 2014, and everything levels back off to—you have 2.9, 2.6 and then 2.5 the remaining 3 years.

Secretary GEITHNER. The way I think economists think about how recoveries happen is that in the early stages of recovery, you should grow above what they call the trend rate of growth. And ultimately you return to the trend rate of growth. Again, for our economy, trend growth is like 2½ percent of GDP in real terms over time. But as you are digging out of a hole like this, you put more people back to work, you start to absorb that excess capacity in factories across the country, you will grow more rapidly in the initial stages. But all economists who look at our economy now would agree that growth would be faster in the near term than it will be if you look out 5 to 10 years.

Mr. STUTZMAN. But my fear is if we are going to continue to grow the national debt—I mean, we are looking at interest in 2010 of 196 billion, expenditure to the Federal Government. In 2021, 844 billion in interest payments is what I see on page 176. When are we going to give people confidence that they can start investing money here, because a deficit just may take—potentially a tax increase is coming. I am going to take my money, and I am going to invest it somewhere else where the tax climate is better, where I see a government that is under control.

Secretary GEITHNER. Again, this is not rocket science. You are exactly right. What you need to give the American people is clarity of what it is going to take, what is going to happen to taxes and spending that bring those deficits down, and we can afford them over time. That is what our responsibility is. And it is very important to confidence that you start to put in place those sets of changes and let that happen. And again, you need to lock them in over time so people don't think you are going to change every year.

Mr. STUTZMAN. But do you really believe this budget—I mean, we have talked about it earlier. Some of the folks said that, you know, it is Congress that passes legislation, and I agree with that. But if Congress passed this bill, this budget, I mean, to me, I think it is irresponsible. And to send a message to the American economy that we are going to continue to grow deficits, we are going to continue to grow—not deficits—grow debt, where is the confidence going to come out of this budget?

Secretary GEITHNER. Let me take the slightly more optimistic side of it. If Congress were to legislate a set of tax polices and expenditure policies that achieved this level of deficit reduction, then two things would happen. One is the world would be much more confident than they are today that we have the political will to act, to live within our means. But people would also say that that is a pretty good step, pretty good start, but ultimately we are going to have to do better than that longer term.

But if you did that—I don't mean just a precise mix, because we are not suggesting you legislate exactly this mix of things, but if you legislated that deficit reduction, and it was clearly committed and locked in over that period of time, that would be an enormously positive first step towards restoring people's confidence that this will work.

Mr. STUTZMAN. I appreciate that, and I am looking forward to taking action with that. Thank you.

Chairman RYAN. Obviously, we dramatically disagree with your interpretation of your budget, but we will leave it at that.

One final housekeeping detail. I ask unanimous consent that Members be allowed 7 days in which to file questions for the record. So ordered.

[The information follows:]

QUESTIONS SUBMITTED FOR THE RECORD AND THEIR RESPONSES

QUESTIONS SUBMITTED BY CHAIRMAN RYAN

1. The President's Budget requests a 34% increase for U.S. contributions to the multilateral development banks reflecting recently concluded negotiations for the replenishment of the concessional lending facilities and general capital increases of several institutions. These replenishments and capital increases were negotiated by the Treasury Department while the U.S. was facing deficits in excess of $1 trillion each year.

For each institution for which replenishment is requested, please provide a table showing how much the U.S. pledged in the previous replenishment and how much the Treasury has pledged in this replenishment.

U.S. PLEDGES IN NEW REPLENISHMENTS (VS. PREVIOUS)

International Development Association: $4,075.5m ($3,705m)
African Development Fund: $585m ($468.05m)
Ongoing Replenishments (vs. Previous):
Asian Development Fund: $461m ($461m)
International Fund for Agricultural Development $30m ($18m)
Multilateral Investment Fund: $150m (This is the first replenishment of the MIF.)
Global Environment Facility: $575m ($320m)

2. The U.S. has for over a decade provided less actual funding than the Treasury Department had pledged in replenishment negotiations. Was this historical pattern considered during the most recent round of negotiations and what steps could be taken to better align the Treasury Department's pledges with the amounts likely to be appropriated by Congress?

As we approach any new pledging at the multilateral development banks, Treasury is mindful of only making pledges where we can deliver. As a result, we work closely with Congressional staff during the negotiation process to get their input and feedback. This process directly influenced what amounts we were willing to pledge in the replenishment negotiations last year.

3. For each institution for which a capital increase is request, would the U.S. voting share decline (and by how much) if the U.S. share of the capital increase is not fully funded?

The decline in the U.S.'s relative shareholding would depend on the extent to which U.S underfunds the pledge to purchase shares, the rate at which other countries purchase their shares and the governing rules of the institutions themselves. However the following consequences are clear:

- International Bank for Reconstruction and Development GCI and Selective Capital Increase (SCI): If the United States were to make no payment towards the IBRD's GCI and SCI, and if other shareholders were to obtain the shares that had been allocated to the United States for these capital increases, U.S. shareholding would fall from 16.8 percent to 11.6 percent. With this decline, the United States would no longer be able to veto changes to the Bank's Articles of Agreement. This could affect issues such as the role of the President of the World Bank, entities eligible to receive loans from the Bank, membership, and role and responsibilities of the Board of Executive Directors.
- African Development Bank GCI: The United States' present voting power in the AfDB is 6.616 percent. The United States is the second largest AfDB shareholder (after Nigeria), the largest non-regional shareholder, and the only member to have a single-country constituency in the Executive Board. If the United States were to make no payments to the AfDB's sixth general capital increase (GCI-6), U.S. voting power would decline to 2.197 percent once all GCI-6 shares were fully subscribed. This assumes other shareholders (e.g. China, South Africa) would take up the shares not subscribed by the United States. This could put the ability of the U.S.

to hold a single country chair in serious jeopardy—the U.S. has never shared a chair with any country at any MDB and it is unclear whether or how the voting mandates could be implemented in such a case. If the United States fails to pay its first installment of GCI-6 by mid-June 2012, when the grace period for payment of the first installment expires, the United States would forfeit its right to the full amount of shares designated to it under GCI-6, and these shares would be made available for subscription to other shareholders.

- Asian Development Bank GCI (First year in US budget request = FY2011): If the United States were to make no payments to the AsDB's GCI, U.S. shareholding would decline to 5.19% from the normal shareholding of 15.57%. A normal voting power under full GCI payment would put the U.S. at parity with Japan for leadership of the institution and retain the joint veto with Japan. However, because we have not yet made our payments, the United States has fallen to number 7 in shareholding at the AsDB, behind China, India, and Indonesia. Japan, Canada and Australia are also ahead of the U.S. because those countries have provided their entire capital contribution.
- Inter-American Development Bank General Capital Increase (GCI): Under the Bank's Articles of Agreement, no increase in the subscription of any member to capital stock can become effective if it would reduce the voting power of the largest member (the United States) to below 30 percent. Given that the current share of the United States is just above 30 percent, if the United States fails to provide its subscription, the GCI cannot go forward. The outcome would be that the capital base of the IDB would stay at $101 billion instead of increasing to $171 billion. Given that the IDB is the largest source of development finance in the Western Hemisphere, this would have considerable economic and political repercussions.

QUESTIONS SUBMITTED BY MR. HONDA

1. Thank you Secretary Geithner. As these budget hearings unfold against the backdrop of the slash and burn Continuing Resolution being debated on the floor, it has become clear that this is a debate between two competing visions of the country. The Democratic vision of helping America's small businesses and working families forge a 21st century economy; and a Republican vision that is coldhearted, foolhardy and dangerous.

Secretary Geithner, Republicans are trying to build a straw man out of entitlement reform. But we know that for the next decade our budget deficits are driven by an endless war in Afghanistan and tax breaks for the wealthy.

Your budget does not continue all of the tax cuts that expire at the end of 2012. The budget documents indicate that this would save $953 billion compared to extending all of the tax cuts, including interest savings. So if you wish to make all of the tax cuts permanent, you would have to find nearly $1 trillion in additional deficit reduction in order to match the deficits in the President's budget. Is that correct?

Yes, that statement is correct. The figures you cite refer to the cost over the ten year budget window of permanently extending the 2001 and 2003 income tax cuts for high-income taxpayers (those married filers with incomes over $250,000 and single taxpayers with incomes over $200,000) and the estate tax cut enacted by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which expire at the end of 2012. The total amount is comprised of $709 billion from extending the income tax cuts for high-income families, $98 billion from extending the estate tax cut, and $147 billion of debt service associated with the foregone revenue.

2. The President has made it clear that we need to invest in education. Today you mentioned three critical areas for investment: early childhood, teacher preparation, and financial support for higher education. In contrast, Republicans believe that cutting our investments in education is critical to creating jobs and growing the economy. These are vastly different approaches and only one can be correct.

Can you explain why the President is investing in these three areas of education—and also can you hazard a guess as to what the effect of the Republican alternative of cutting education investments would be on job creation and economic growth?

It is crucially important to invest in education. As the President noted in his State of the Union address, America has fallen to ninth in the proportion of young people with a college degree. Having an educated and skilled workforce is critical to competing in the global economy—workers with a college education not only earn higher wages for themselves, but also increase the productivity of those who work with them and of the economy overall.

The President's goal is to have the highest proportion of college graduates in the world by 2020, and as such, the Budget proposes targeted investments that address every stage of a child's education to help us reach that goal. Providing children with high-quality early learning programs before gaps in learning develop can reduce the need for more costly and difficult interventions later on. Research suggests that high-quality early learning programs can have a significant impact on participant outcomes as adults, including on earnings.

QUESTIONS SUBMITTED BY MR. CALVERT

One area that I believe has a major impact on our nation's economic recovery is the stability of the commercial real estate industry. A healthy commercial real estate market provides more than 9 million jobs and generates billions of dollars in federal, state and local tax revenue. However our commercial real estate market continues to suffer from reduced operating income, property values (down 43% across the board), and equity and this has a direct and lasting impact on the stability of tens of thousands of small businesses and small and mid-size banks.

An estimated $2.2 trillion worth of commercial real estate loans will be coming due over the next decade, with a very limited capacity to refinance. This has a potential to wreak havoc on the broader economy. As we've all seen falling commercial real estate values have forced many small regional and community banks to take steep write-downs, which has resulted in bank failures and a reduction in credit.

1. What specific policy prescriptions do you think are necessary to reverse this trend?

2. In terms of the banks, what can be done to minimize these write-downs and failures, without further constraining commercial real estate lending?

3. Is there something the U.S. Treasury can do to help mitigate this problem?

We share your concerns regarding commercial real estate, small businesses, small and mid-size banks, and, more generally, the broader economy. In order to promote robust small business activity, the Administration and Treasury have taken various measures to address the health of commercial real estate market, increase liquidity for small and mid-sized banks and incentivize small businesses to drive the economy forward.

To promote liquidity in the securitized commercial real estate sector, the Department of the Treasury launched, or partnered to launch, two liquidity initiatives, the Term Asset-Backed Securities Loan Facility (TALF), a joint Treasury and Federal Reserve program, and the Public Private Investment Program (PPIP). Both TALF and PPIP have played a significant role in supporting market functioning, facilitating price discovery and helping restart this $600+ billion market.

Since the announcement of PPIP in March 2009, prices for legacy CMBS securities eligible for PPIP have appreciated between 70% and 300% with many of these securities now trading at or above par value. With increased liquidity and tightening of spreads, holders of these securities, such as banks, have capital available from which new lending activities can be supported.

In addition, there have been 19 new CMBS transactions representing more than $16 billion in new issuance following an 18-month period in which there was no new issuance. Although smaller than the levels of annual issuance prior to the onset of the financial crisis, this level of new issuance represents a meaningful step in the recovery of the markets for CMBS and commercial real estate.

In addition to TALF and PPIP, in September of 2010, the President signed into law the Small Business Jobs Act. The Small Business Jobs Act established the Small Business Lending Fund (SBLF), an initiative that encourages lending to small businesses by providing capital to community banks and other eligible institutions. The SBLF incentivizes financial institutions to provide credit to small businesses by tying the cost of capital to the volume growth of the institutions' small business lending portfolio helping to get small businesses off the sidelines. To date, over 600 banks have applied to participate in the program. In addition to the SBLF, the Small Business Jobs Act includes eight small business tax cuts and extends Recovery Act provisions temporarily eliminating SBA fees. The Act also established the State Small Business Credit Initiative, which will provide $1.5 Billion to cash-strapped states to support innovative credit programs, supporting the creation of $10 of new private sector lending for every $1 of federal funding. These measures encourage small business hiring and investment and help creditworthy businesses secure the capital they need to restore our economic prosperity.

As you know, I remain concerned about the economic risks posed by commercial real estate and am curious about what your thoughts are on the need to restructure some $1.5 trillion of commercial real estate debt that remains on bank balance sheets.

Credit availability in the commercial real estate market today is scarce, and we need to be on the offensive to aid this sector. It may be that one of the factors inhibiting foreign capital coming into this sector is the Foreign Investment in Real Prop-

erty Act (FIRPTA), a law that penalizes foreign investment in real property versus other asset classes.

In 2007, the Treasury made a ruling to tax the proceeds of liquidating real estate investment trusts (REITs) as the 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 US.

1. Wouldn't this be a relatively cost-effective way to help fill the estimated $1 trillion equity gap in commercial real estate?

2. Do you have any plans to reexamine the 2007-55 ruling?

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 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 do not see a sound policy reason to favor investment through REITs over direct investment in U.S. real property or investment through other structures. In addition, we are not 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 investments.

QUESTIONS SUBMITTED BY MS. KAPTUR

1. The cost of this housing crisis caused by Wall Street abuses through the creation of asset-backed securities made a few very greedy bankers quite wealthy at the expense of millions of ordinary citizens and doing great harm to our republic.

This cost is also being placed on the backs of U.S. taxpayers. Reports show that the true direct costs involve trillions of dollars, and according to numbers I have, these include 12 Treasury programs thus far have cost taxpayers over $700 billion, of which the TARP is merely $380 billion; 24 Federal Reserve programs have cost $1.738 trillion. And for the next three years, Treasury has engineered unending support, regardless of the dollar amount, to Fannie Mae and Freddie Mac. So far, we've spent $61 billion on Freddie Mac and $83 billion on Fannie Mae.

All this debt is being financed by foreign borrowing with China now number one financier to our country, followed by Japan and the Middle East oil exporting countries. But snug up against them is the major role of the Cayman Islands, and I would like to ask unanimous consent to place in the record a report on foreign portfolio holdings of U.S. securities.

Is there a transparent list of which Cayman Island financial institutions hold the lion's share of the debt that they are financing?

The Department of the Treasury's reporting systems on foreign portfolio investment in the United States collects information annually on the holdings of U.S. securities held in the aggregate by all residents, both public and private, in a foreign country. The information is provided to Treasury by U.S.-resident custodians who hold in custody U.S. securities for the account of foreign residents. The information provided is the amount, in aggregate, for a country. It does not identify holdings by specific foreign entities in that country. This basic data is supplemented by data on net purchases, again collected on an aggregate basis, to make estimates of monthly holdings of U.S. Treasury securities.

As of December 2010, Treasury estimates that total holdings of U.S. Treasury securities by residents of Caribbean Banking Centers were $168.3 billion, or 1.2 percent of total Treasuries outstanding. Total holdings attributable to the Cayman Islands were $92.3 billion, or 0.7 percent of total Treasuries.

2. How much interest will our government pay this year to foreign interests who finance our debt?

Approximately half of the projected $250 billion in net interest payments on the debt for 2011 will be paid to foreign holders of Treasury securities.

Chairman RYAN. We have kept you a while, and we started late, so I thank you for your indulgence, Secretary. This hearing is adjourned.

[Whereupon, at 4:55 p.m., the committee was adjourned.]

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