S. HRG. 113–228

CONCURRENT RESOLUTION ON THE BUDGET FISCAL YEAR 2014

HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

February 12, 2013–The Budget and Economic Outlook Fiscal Years 2013–2023
April 16, 2013–The President's Fiscal Year 2014 Budget and Revenue Proposal
April 23, 2013–The President's Fiscal Year 2014 Budget Proposal and Veterans' Program Proposal
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June 18, 2013–The President's Fiscal Year 2014 Education Budget Request

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THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2013–23

TUESDAY, FEBRUARY 12, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 10:24 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Nelson, Sanders, Whitehouse, Warner, Merkley, Coons, Baldwin, Sessions, Grassley, Enzi, Crapo, Portman, Toomey, Johnson, Ayotte, and Wicker.

Staff Present: Evan T. Schatz, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing is coming to order, and I want to apologize to members. We are starting a few minutes early because we have a number of votes coming up on the Senate floor.

In the beginning, I want to start by just welcoming everybody to this first Senate Budget Committee hearing of the 113th Congress. We have a number of new members. We welcome all of them. Senator Baldwin is here; Senator Kaine, Senator King, and Senator Wicker are joining us as well. Good to have you all on the Committee. I want to thank our witness, Dr. Doug Elmendorf, for being here, as well as my Ranking Member, Senator Sessions, and all of our colleagues who are joining us today.

As we begin the budget process here in the Senate, I am hopeful that this Committee can be a place where we can come together to tackle our fiscal and economic challenges in a balanced way that works for the families and communities that we all represent.

Budget issues have received a lot of attention over the past few years, but the conversation is too often focused on abstract numbers and the partisan back-and-forth. Budgets, however, are about a lot more than this. They are reflections of our values and our priorities and our vision for what our Government and our country and our economy should look like now and into the future.

Budgets are not about us here on this Budget Committee. They are not about our colleagues across Congress or in the administration. They are about the families across America whose lives will be impacted by the decisions that we make. They are about their jobs and their children and their future, and we owe it to them to make sure they have a voice in this process and that their values and perspectives are heard.

So I see today's hearing as the first part of a two-part opening examination of our Nation's fiscal and economic challenges. Today we will hear from Dr. Elmendorf about the budget and economic outlook for fiscal years 2013–23. Tomorrow we will hear from members of the public and experts to learn more about the impact of budget decisions on families and communities.

Over the coming weeks and months, as we put together a pro-growth, pro-middle-class budget resolution, I am going to continue making sure the voices of the American people are heard loud and clear throughout this process and that their values and priorities are being represented.

As we start this hearing on the budget and economic outlook, I think it would be helpful to do a quick review of how we got to where we are today, because a look ahead is only valuable in the context of where we have come.

I have served on this Committee now for 20 years, and in the time since I arrived our country went from having a serious deficit and debt problem to running surpluses and being on track to pay down the debt, to 8 years later being in an even worse position than we were before, to today when we are starting to turn the corner but still have a very long way to go.

All of us remember the early 1990s. In 1992, the year before President Clinton came into office, the same year I was making my first run for the U.S. Senate, the Federal Government was taking in revenue equaling 17.5 percent of GDP while spending 22.1 percent of GDP. That was a deficit of 4.7 percent. When he was sworn in, President Clinton promised to tackle the deficit while continuing to invest in jobs and the middle class.

I bought into that vision, and I was proud to help make it a reality. When his bill to raise the tax rate on the highest-earning Americans passed the Senate and House without a single Republican vote, the top Republican on the Senate Budget Committee at the time said it would "devastate the economy." Others predicted calamity along similar lines.

But as we all know now, it did not work out that way. The unemployment rate went from 7.3 percent at the beginning of 1993 to 3.9 percent at the end of 2000. Over the course of those 8 years, 22 million jobs were created, and the economy grew at an average rate of 4 percent. And the deficit? Well, revenue increased from 17.5 percent of GDP to 20.6 percent, and responsible spending cuts brought Federal spending down from 22.1 percent of GDP to 18.2 percent. So a 4.7-percent deficit was turned into a 2.4-percent surplus in 8 years, and our Nation was on track to completely eliminate the Federal debt by 2010.

Now, I do not think the revenue increase under President Clinton was the sole cause of economic growth, but I do think our responsible fiscal and economic stewardship played a role in keeping interest rates low and giving markets and small businesses the confidence they needed to expand and create jobs.

Our work in the 1990s proved that calling on the wealthy to pay their fair share is not incompatible with strong economic growth. In fact, it is strongly associated with the kind of broad-based growth that helps the middle class prosper and expand.

In 2001, many of us Democrats saw the surplus as an opportunity for our country to free ourselves from debt and invest in national priorities. But President Bush and his administration had other ideas. They saw it as a blank check to cut taxes and increase spending. President Bush and Republicans in Congress immediately worked to pass two sets of tax cuts that were heavily skewed towards the rich. When his first Treasury Secretary, Paul O'Neill, tried to warn that the second round of tax cuts would blast a hole in the deficit, Vice President Cheney informed him that, "Deficits don't matter." Not too long after, O'Neill was fired.

When Federal Reserve Chairman Alan Greenspan testified in front of this very Committee in support of the 2001 tax cuts, my colleague Senator Sarbanes predicted these tax cuts would "put us on the glide path to dissipate this hard-earned fiscal restraint." He, like many of us at the time, was ignored.

President Bush took us into two wars without paying for them. He enacted Medicare Part D, a program that is estimated to cost taxpayers $60 billion this year alone without paying for that either. While he was President, more Americans lost jobs than got new ones. Inequality grew as the wealthiest Americans benefitted from the tax cuts while the middle class stagnated. By 2008, Federal revenues had plummeted back down to 17.6 percent of GDP. Spending had shot up to 20.8 percent. We were back to a deficit of 3.2 percent. And all those projections about the national debt being eliminated were tossed out the window.

When President Obama came into office, our country was losing over 700,000 jobs a month. He was desperately working to staunch the bleeding from the Wall Street collapse that threatened to push our country into a depression. Federal revenue plummeted even further. Middle-class families and the most vulnerable Americans were losing their homes, struggling to put food on the table, and worrying about what the future would be like for their children. But at the very time when we needed to be investing in our families and in our economy and focusing on growth, many of my colleagues went back to their file cabinets and dug out those talking points that they used back in the early 1990s. All of a sudden, they were telling us deficits were the most important issue to address and cutting spending was once again a new priority—not jobs, not the middle class, not economic growth, but deficits—forgetting what we did in the 1990s to get our country back on track, ignoring what happened during the Bush administration, and acting like the world was created on the day President Obama was sworn in. This narrow and short-sighted approach was wrong back in the early 1990s. It is just as wrong today, and it is not just Democrats who say so.

Right now, the economy is still struggling. Millions of workers are looking for too few jobs. Aggregate demand is still far below its potential, and at the moment, the Federal Government is borrowing at historically low rates. Experts and economists across the political spectrum agree it makes sense to invest in job creation in the short term, while putting ourselves on a strong path to responsible and sustainable deficit and debt reduction over the medium and long term. And poll after poll shows that is what the American people support as well.

Federal Reserve Chairman Ben Bernanke put this idea well in a speech he gave in August of 2011 when he said, “Although the issue of fiscal sustainability must urgently be addressed, fiscal policymakers should not as a consequence disregard the fragility of the current economic recovery.” And he said, “Fortunately, the two goals of achieving fiscal sustainability, which is the result of responsible policies set in place for the longer term and avoiding the creation of fiscal headwinds for the current recovery, are not incompatible. Acting now to put in place a credible plan for reducing future deficits over the longer term while being attentive to the implications of fiscal choices for the recovery in the near term can help serve both objectives.”

I think that is exactly right. I will work with anyone to tackle our debt and deficit responsibly. But as I have told my Ranking Member, Senator Sessions, and others, I feel very strongly that it does not make sense to replace our budget deficits with deficits in education and infrastructure and research and development. If we cut our budget deficit by giving up on the investments we need to compete globally in the 21st century economy, then we will not have done right by our economy today and certainly not for generations to come.

So we absolutely need to tackle our debt and deficit in a responsible and sustainable way, but our top priority needs to be jobs and economic growth. And as we saw in the 1990s, those two go hand in hand.

Which brings me to our witness today, and I am pleased to welcome back to the Committee the Director of the Congressional Budget Office, Dr. Douglas Elmendorf. The members of this Committee know Dr. Elmendorf well. He has appeared before us on numerous occasions and, of course, I want to thank you and your staff on behalf of this Committee for all the hard work and professionalism you provide to us and to Congress. I think it is fair to say the report you delivered to us last week on the state of the budget and economy over the next 10 years is a mixed bag, as it contains some hopeful signs but also highlights some real challenges for our Nation.

In terms of the economy, on the one hand, we are starting to see the effects of the housing and financial crisis fade following the work we did in Congress to support the recovery. We are clearly not out of the woods, and far too many workers are still struggling to get back on the job. But housing prices and the stock market are rising, and that is certainly some welcome news.

On the other hand, your report makes clear the economy still faces significant headwinds in the short term, particularly from the tightening of Federal fiscal policy. The sequester that is set to occur on March 1st is not the only policy action that is contributing to this fiscal drag, but it is a major factor. And in total, the impact of the fiscal tightening, including the March 1st sequester, is to depress economic growth by about 1–1/2 percentage points. That translates into about 2 million jobs by the end of this fiscal year. Leaving the sequester in place would lead to massive, self-inflicted damage that would hurt middle-class families, those already struggling in this economy, as well as our national security and future global competitiveness. But replacing it the way House Republicans have proposed with even more cuts to programs families and seniors depend on and without calling on the wealthy to pay even a penny more would be more damaging in the long run. That is why I believe very strongly that we should replace the sequester with a balanced package of responsible spending cuts and revenue from the wealthiest Americans. That approach makes sense for the Federal budget, and it makes sense for American families, particularly when we are talking about so many jobs and an unemployment rate that remains stubbornly high at near 8 percent.

In terms of the budget outlook, we see some slight improvement. The deficit is expected to total $845 billion this year, the first time it will be below $1 trillion in 5 years. To put that number in perspective, relative to the total size of the economy, it is expected to equal 5.3 percent in 2013. Now, that remains too high, but it is progress. And, in fact, in 2009 the deficit was almost twice as large at just over 10 percent of the economy. Unfortunately, CBO expects this downward trend in the deficit as a share of the economy to continue over the next few years, falling and remaining below 3 percent through 2018, and this is even with the end-of-the-year budget deal.

We also got what I believe is some good news in the area of health spending. As I was reading through the report, one section really got my attention, which was the discussion of the change in health spending in recent years. In fact, I stopped and underlined one statistic because I found it so surprising. The statistic is that CBO has lowered its estimate of Federal spending for Medicare and Medicaid to such a degree that spending for 2020, one year, just one year, is now $200 billion lower than CBO thought back in 2010. That is an improvement of 15 percent. And let us be clear. That improvement has occurred since the enactment of the Affordable Health Care Act.

Dr. Elmendorf, I know you have heard a lot from Senator Whitehouse and other Senators regarding their belief that current budget conventions and estimates miss the mark in the area of innovation and delivery reforms, and I will be interested in hearing your thoughts on what has led to this downward trend in health care spending.

Of course, as with the economy, the news on the budget is by no means all good. As I mentioned earlier, we got hit at the end of the last administration with the confluence of a financial crisis, housing crisis, and deep recession. Largely as a result of those conditions, the debt skyrocketed in a very short period of time. The debt was equal to roughly 36 percent of the economy in 2007. It will soon be at about 76 percent. And if we do not tackle that responsibly, it will begin rising again by the end of this decade, particularly with the retirement of the baby-boom generation and increasing health care costs.

So even with some good news, we have our work cut out for us as a Committee and as a Congress. This is a tough Committee with a tough mandate, and I look forward to working with all of my colleagues on both sides of the aisle to meet the challenge and address the budget in a way that is fair, works for the middle class and most vulnerable families, and invests in long-term and broad-based economic growth. We did it in the 1990s. I am confident we can do it again.

And, with that, let me turn it over to Senator Sessions for his opening comments, and then we will hear from Dr. Elmendorf. Senator Sessions.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Madam Chair, and thank you, Mr. Elmendorf, for appearing before the Committee today. We value what you do. It is important to us to help us have honest numbers that we can work with, and honesty in our financial situation is absolutely critical at this point in history.

I would also like to welcome the new members to the Committee, and I look forward to a productive year. We absolutely face some very serious challenges. And, of course, the reason Chairman Murray indicated that deficits have become the topic of the day is because we have never had such systemic deficits as we have today. They exceed anything the Nation has ever had, and we are on a systemic course that continues those deficits. And as the report that was given to us shows, they get worse in the out-years. We cannot continue on this course. Bowles and Simpson told us in this very room that this Nation has never faced a more predictable financial crisis.

So that is why we have to talk about this, and we have to ask some fundamental questions. The Chair has set forth the President's, the Democratic majority's narrative. We reject that narrative. We have serious differences with that narrative. We will not go quietly on that because we believe some of the real problems that are being caused today are because of this kind of incorrect economic thinking.

So it has been now 4 years since the Democratic-led Senate produced a budget. As the law requires, the Senate not only has a legal but a moral duty to present the taxpayers with a plan on how they will spend the Nation's money. So it is a tragedy that under Senator Reid's leadership we have not engaged in that kind of open public financial discussion that the American people deserve. Majority Leader Reid even said it would be foolish to have a budget.

By contrast, the GOP House, in accordance with law, has laid out a budget plan each year. That plan will change the debt course of America. We may not all like everything that is in it, but it would put us on a positive path. And they will do another budget this year.

So I am glad that we have had a relenting and are going to have a budget this year, else I wonder what our Committee might find itself having to do without a budget and whether we even need the Committee.

So we look forward to meeting the Committee deadline of April 1st to publicly produce a resolution and then April 15th on the Senate floor, including the statutorily mandated 50 hours of debate and a guaranteed vote.

Madam Chairman, I stand ready to work with you and the staff to produce a budget that we can talk with the American people about. I believe that budget should balance. We should balance it at least within 10 years. It is something that we can do, and I think the report Mr. Elmendorf has given us shows us some of the ways that we can get there, and it is not a hopeless situation, but it is a very dire situation.

The picture CBO paints of the next 10 years is immensely disturbing. Our gross Federal debt after rising $6 trillion in the last 4 years will rise another $9 trillion by 2023. CBO's report also suggests that then things only get worse outside that 10-year window, remain continuing up on an unsustainable financial path. And if it is unsustainable, that means we have to change it. Now this, despite the fact that CBO is projecting revenues to be well above the average of the last 40 years. Revenue will be up, according to CBO's numbers.

The top economists agree, including a recent study from the International Monetary Fund, that total debt over 90 percent of GDP weakens economic growth. Federal Government debt is now—gross debt—is 103 percent. In other words, our job-crushing debt not only threatens to collapse the economy through a financial crisis, as Simpson-Bowles predicted, but it is already destroying jobs and growth today. We are not receiving the growth today we should have as a result of the drag of this debt.

CBO also projects that we are entering a future in which our debt is so great that our fastest-growing item in the budget will be interest payments. According to CBO, annual interest costs will quadruple, totaling $5.4 trillion over the next 10 years—$5.4 trillion. By 2020, just 7 years from now, interest costs are expected to exceed the cost of national defense. And I just left the Defense Committee hearing talking about the sequester and how damaging that will be to the Defense Department because half of the cuts fall on one-sixth of the budget, the Defense Department. And that is too severe for them. It needs to be spread out across the entire spending panoply.

Interest payments, which help no one, build nothing, will crowd spending on the rest of the budget, and I think it will damage our economy in the meantime right now.

And while we talk of cuts and frugality, total spending is expected to go up 67 percent over the next 10 years. No one is proposing a real cut in the actual amount of money spent. It is the growth in spending that we have to confront.

Primarily alarming is the finding in an additional CBO report prepared at my request. Spending on just the ten largest welfare programs, means-tested and poverty programs, will increase even more—76 percent over 10 years. There are roughly 80 welfare programs that overall comprise the single largest item in the Federal budget, larger than Medicare, Social Security, or defense. Improving these things would do a lot more than just saving money. Like 1996 that helped put us on a path to a balanced budget, smart reforms of welfare will help more Americans rise out of poverty—that is what I want to see; I want to see more people out of poverty—and will strengthen the institutions of family, charity, and community. We must talk honestly and with compassion about these issues.

In that vein, I would also like to take a moment to address some comments, Senator Murray, that you made recently, that Republicans are committed to "protecting the rich above all else" and are only interested in "starving programs"—I am quoting now—"that help middle-class families and the most vulnerable Americans." So that hurts my feelings. That is not what I believe in. I believe we have to have an economy that is growing, creating prosperity, that we need to help poor people get jobs and move forward in their lives, not be dependent, ever dependent on more and more Government checks, handouts, and programs. That would be the way to save this country, in my opinion. That is the way to help poor people, and I resent the fact that people suggest that those of us who have a different view of how to help poor people somehow do not care about them. Compassion and help for the poor and struggling amounts to more than just borrowing money and sending out more money in the form of checks.

So my goal is to help working Americans from the social and economic harm that is caused by policies, I think, of this President and the Senate majority. These programs have not worked. In places like Baltimore, a great city, they are producing poverty, dependency, crime, and joblessness. That is what those programs are producing. One in three residents in Baltimore are on food stamps. One in three youth in Baltimore are living in poverty. There are solutions to these problems, and we can do better. We have to do better. We cannot continue on this course.

So compassion demands change. Our goal must be to help more Americans find gainful employment and the opportunity to financially support themselves and their family and to prosper.

Before closing my remarks, I would like to address the serious challenge we will be facing in the coming days. We are going to have to consider the immigration question. Studies show that the proposals for amnesty and legalization could add another $2.5 trillion to the national debt, or more, and we have to watch carefully that program.

So I look forward to addressing these and other issues during today's hearing. We have no higher obligation as lawmakers than to protect the financial security of the Republic. And with regard to our present posture and state of the economy, the last big systemic challenge I think maybe our Nation faced was when Volcker and Reagan dealt with a continually surging inflation rate. They broke that rise and put us on a path to 20 years of growth. We are now on a systemically dangerous path of debt. It threatens our future. We are going to have to confront that with the same clarity and courage that they did at that time.

And I came in 16 years ago, and I remember that Bush did spend more money than he should, and I was a critic of that. But I have to say that hardly a bill that came up that President Bush maybe proposed more spending that our Democratic colleagues did not complain because he did not spend enough, and I had to cast vote after vote after vote to try to contain the growth of spending, and it was usually every single Democratic colleague was voting to spend more and Republicans were taking the lonely position of trying to be responsible.

So those are the issues that we face. Our debt course is one that we have to confront. But looking at it, Madam Chair, I do think based on the numbers in this report, which include the Budget Control Act control and the $650 billion tax increase that just passed, if we do some other things in a responsible, effective way, we can put this Nation on a sound course. We can remove the debt cloud, the drag that this debt has over us, and put us on the path to prosperity. That is what we have to do. We have no choice.

I thank you.

Chairman MURRAY. Thank you very much.

With that, I will turn it over to Dr. Elmendorf for his opening statement, and for the Committee members, we are going to have a series of votes called. We will work our way through 5 minutes each, and hopefully people can come back and forth between votes as much as we can so that we can allow everybody who would like to ask questions to be able to do that.

Dr. Elmendorf, thank you.

STATEMENT OF DOUGLAS W. ELMENDORF, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. ELMENDORF. Thank you, Senator Murray and Senator Sessions. To all the members of the Committee, I appreciate the opportunity to be with you today and to discuss CBO's look for the budget and the economy over the next 10 years.

Our analysis shows that the country continues to face very large economic and budget challenges. Let me discuss the economy first, and then I will turn to the budget.

We anticipate that economic growth will remain slow this year because the gradual improvement that we see in underlying economic factors will be offset by a tightening of Federal fiscal policy scheduled under current law.

The good news is that the effects of the housing and financial crisis appear to be finally gradually fading. We expect that an upswing in housing construction, rising real estate and stock prices, and increasing availability of credit will help to spur a virtuous cycle of faster growth in employment, income, consumer spending, and business investment during the next few years.

However, several policies that will help to bring down the budget deficit will represent a drag on economic activity this year. The expiration of the 2-percentage- point cut in the Social Security payroll tax, the increase in tax rates on income above certain thresholds, and the cuts in Federal spending scheduled to take effect next month will mean reduced spending by both households and the Government. We project that inflation-adjusted GDP will increase about 1–1/2 percent this year, but that it would increase roughly 1–1/2 percentage points faster were it not for the fiscal tightening.

Under current law, then, we expect the unemployment rate will stay above 7–1/2 percent through next year. That would make 2014 the sixth consecutive year with unemployment so high, the longest such period in 70 years.

We expect that growth in real GDP will pick up after this year to about 3–1/2 percent in 2014 and the following few years. But the gap between the Nation's GDP and what it is capable of producing on a sustainable basis, what we call "potential GDP," still will not close quickly. Under current law, we expect output to remain below its potential level until 2017, almost a decade after the recession started in December 2007.

The Nation has paid and will continue to pay a very high price for the recession and slow recovery. We estimate that the total loss of output relative to the economy's potential between 2007 and 2017 will be equivalent to nearly half of the output produced in the country last year.

Let me turn now to the budget. Under current laws, the Federal budget deficit will shrink in 2013 for the fourth year in a row. At an estimated $845 billion, the deficit would be the first in 5 years below $1 trillion, and at 5-1/4 percent of GDP, it would be only about half as large, relative to the size of the economy, as the deficit was in 2009.

Our projections based on current laws show deficits continuing to fall over the next few years before turning up again by the end of the decade and totaling nearly $7 trillion for the decade as a whole.

Federal revenues are projected to reach 19 percent of GDP in 2015 and beyond because of both the expanding economy and scheduled changes in tax rules. That 19-percent figure compares to an average of about 18 percent over the past 40 years.

At the same time, Federal spending will fall relative to the size of the economy over the next several years and then rise again. The decline can be traced to the caps on discretionary funding and the drop-off in spending that goes up when the economy is weak, such as unemployment benefits.

But later in the decade, the return of interest rates to more normal levels will push up interest payments to nearly their highest share of GDP in 50 years. And throughout the decade, the aging of the population, a significant expansion of Federal health care programs, and rising health care costs per person will push up spending on the largest Federal programs. By 2023, spending reaches about 23 percent of GDP in our projection compared with a 40-year average of 21 percent.

What does this mean for Federal debt? We project that debt held by the public will reach 76 percent of GDP this year, the largest percentage since 1950. And under current laws, we project that debt in 2023 will be 77 percent of GDP, far higher than the 39-percent average seen over the past 40 years; and it will be on an upward path. Such high and rising debt relative to the size of the economy is a significant concern for several reasons.

First, high debt means that the crowding out of capital investment will be greater; that lawmakers will have less flexibility to use tax and spending policies to respond to unexpected challenges like a recession or a war; and that there will be a heightened risk of a fiscal crisis in which the Government would be unable to borrow at affordable interest rates.

Second, debt would be even larger if current laws were modified to delay or undo certain scheduled changes in policies. For example, if lawmakers eliminated the automatic spending cuts scheduled to take effect in March but left in place the original caps, prevented the sharp reduction in Medicare's payment rates for physicians scheduled for next January, and extended the tax provisions that are scheduled to expire, without making any other offsetting changes in budget policy, then budget deficits would be substantially larger than in our baseline projections. And debt held by the public would rise to 87 percent of GDP by 2023 rather than the 77 percent under current law.

Third, debt might also be larger than in our projections because even the original caps on discretionary funding in the Budget Control Act would reduce such spending to just 5.8 percent of GDP in 2023, a smaller share than for any year in at least the past 50. Because the allocation of discretionary funding is determined, as you know, by annual appropriation acts, lawmakers have not yet decided which specific Government services and benefits will be constrained or cut to satisfy those caps, and doing so might be quite difficult.

Fourth, projections for the 10-year period covered in this report do not fully reflect long-term budget pressures. Because of the aging of the people and rising health care costs, a wide gap exists between the future costs of the benefits and services that people are accustomed to receiving from the Federal Government, especially in the form of benefits for older Americans, and the tax revenues that people have been sending to the Government. It is possible to keep tax revenues at their historical average share of GDP, but only by making substantial cuts relative to current policies in the large benefit programs that benefit a broad group of Americans at some point in their lives.

Alternatively, it is possible to keep the policies for those large benefit programs unchanged, but only by raising taxes substantially for a broad segment of the population. Deciding now what combination of policy changes to make to resolve the budget imbalance would allow for gradual implementation, which would give households and businesses time to adjust their behavior.

Thank you.

[The prepared statement of Douglas Elmendorf follows:]

Congressional Budget Office

Testimony

The Budget and Economic Outlook: Fiscal Years 2013 to 2023

Douglas W. Elmendorf
Director

Before the
Committee on the Budget
United States Senate

February 12, 2013

Chairman Murray, Senator Sessions, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover fiscal years 2013 to 2023. Those estimates were released last week in the report titled *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*.

Economic growth will remain slow this year, CBO anticipates, as gradual improvement in many of the forces that drive the economy is offset by the effects of budgetary changes that are scheduled to occur under current law. After this year, economic growth will speed up, CBO projects, causing the unemployment rate to decline and inflation and interest rates to eventually rise from their current low levels. Nevertheless, the unemployment rate is expected to remain above 7½ percent through next year; if that happens, 2014 will be the sixth consecutive year with unemployment exceeding 7½ percent of the labor force—the longest such period in the past 70 years.

If the current laws that govern federal taxes and spending do not change, the budget deficit will shrink this year to $845 billion, or 5.3 percent of gross domestic product (GDP), its smallest size since 2008. In CBO's baseline projections, deficits continue to shrink over the next few years, falling to 2.4 percent of GDP by 2015. Deficits are projected to increase later in the coming decade, however, because of the pressures of an aging population, rising health care costs, an expansion of federal subsidies for health insurance, and growing interest payments on federal debt. As a result, federal debt held by the public is projected to remain historically high relative to the size of the economy for the next decade. By 2023, if current laws remain in place, debt will equal 77 percent of GDP and be on an upward path, CBO projects (see Figure 1).

Such high and rising debt would have serious negative consequences: When interest rates rose to more normal levels, federal spending on interest payments would increase substantially. Moreover, because federal borrowing reduces national saving, the capital stock would be smaller and total wages would be lower than they would be if the debt was reduced. In addition, lawmakers would have less flexibility than they might ordinarily to use tax and spending policies to respond to unexpected challenges. Finally, such a large debt would increase the risk of a fiscal crisis, during which investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow at affordable rates.

Under Current Law, Federal Debt Will Stay at Historically High Levels Relative to GDP

The federal budget deficit, which shrank as a percentage of GDP for the third year in a row in 2012, will fall again in 2013, if current laws remain the same. At an estimated $845 billion, the 2013 imbalance would be the first deficit in five years below $1 trillion; and at 5.3 percent of GDP, it would be only about half as large, relative to the size of the economy, as the deficit was in 2009. Nevertheless, if the laws that govern taxes and spending do not change, federal debt held by the public will reach 76 percent of GDP by the end of this fiscal year, the largest percentage since 1950.

With revenues expected to rise more rapidly than spending in the next few years under current law, the deficit is projected to dip as low as 2.4 percent of GDP by 2015 (see Table 1). In later years, however, projected deficits rise steadily, reaching almost 4 percent of GDP in 2023. For the 2014–2023 period, deficits in CBO's baseline projections total $7.0 trillion. With such deficits, federal debt would remain above 73 percent of GDP—far higher than the 39 percent average seen over the past four decades. (As recently as the end of 2007, federal debt equaled just 36 percent of GDP.) Moreover, debt would be increasing relative to the size of the economy in the second half of the decade.

Those projections are not CBO's predictions of future outcomes. As specified in law, CBO's baseline projections are constructed under the assumption that current laws generally remain unchanged, so that they can serve as a benchmark against which potential changes in law can be measured.

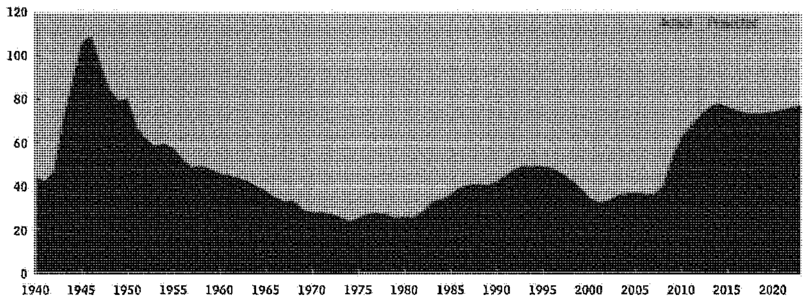
Revenues

Federal revenues will increase by roughly 25 percent between 2013 and 2015 under current law, CBO projects. That increase is expected to result from a rise in income because of the growing economy, from policy changes that are scheduled to take effect during that

Figure 1.

Federal Debt Held by the Public

(Percentage of gross domestic product)



Source: Congressional Budget Office.

period, and from policy changes that have already taken effect but whose full impact on revenues will not be felt until after this year (such as the recent increase in tax rates on income above certain thresholds).

As a result of those factors, revenues are projected to grow from 15.8 percent of GDP in 2012 to 19.1 percent of GDP in 2015—compared with an average of 17.9 percent of GDP over the past 40 years. Under current law, revenues will remain at roughly 19 percent of GDP from 2015 through 2023, CBO estimates.

Outlays

In CBO's baseline projections, federal spending rises over the next few years in dollar terms but falls relative to the size of the economy. During those years, the growth of spending will be restrained both by the strengthening economy (as spending for programs such as unemployment compensation drops) and by provisions of the Budget Control Act of 2011 (Public Law 112-25). Although outlays are projected to decline from 22.8 percent of GDP in 2012 to 21.5 percent by 2017, they will still exceed their 40-year average of 21.0 percent. (Outlays peaked at 25.2 percent of GDP in 2009 but have fallen relative to GDP in the past few years.)

After 2017, if current laws remain in place, outlays will start growing again as a percentage of GDP. The aging of the population, increasing health care costs, and a significant expansion of eligibility for federal subsidies for health insurance will substantially boost spending for Social Security and for major health care programs relative to the size of the economy. At the same time, rising interest rates will significantly increase the government's debt-service costs. In CBO's baseline, outlays reach about 23 percent of GDP in 2023 and are on an upward trajectory.

Changes from CBO's Previous Projections

The deficits projected in CBO's current baseline are significantly larger than the ones in CBO's baseline of August 2012. At that time, CBO projected deficits totaling $2.3 trillion for the 2013–2022 period; in the current baseline, the total deficit for that period has risen by $4.6 trillion. That increase stems chiefly from the enactment of the American Taxpayer Relief Act of 2012 (P.L. 112-240), which made changes to tax and spending laws that will boost deficits by a total of $4.0 trillion (excluding debt-service costs) between 2013 and 2022, according to estimates by CBO and the staff of the Joint Committee on Taxation. CBO's updated baseline also takes into account other legislative actions since August, as well as a new economic forecast and some technical revisions to its projections.

Table 1.

CBO's Baseline Budget Projections

	Actual, 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total 2014-2018	Total 2014-2023
							In Billions of Dollars							
Revenues	2,449	2,708	3,003	3,373	3,591	3,765	3,937	4,101	4,279	4,496	4,734	4,961	17,669	40,241
Outlays	3,538	3,553	3,618	3,803	4,067	4,300	4,542	4,811	5,078	5,350	5,691	5,939	20,330	47,199
Deficit (-) or Surplus	**-1,089**	**-845**	**-616**	**-430**	**-476**	**-535**	**-605**	**-710**	**-798**	**-854**	**-957**	**-978**	**-2,661**	**-6,958**
On-budget	-1,151	-872	-630	-433	-476	-533	-598	-693	-763	-799	-878	-872	-2,670	-6,675
Off-budget[a]	62	27	14	3	*	-2	-6	-17	-35	-55	-79	-106	9	-283
Debt Held by the Public at the End of the Year	11,280	12,229	12,937	13,462	14,025	14,642	15,316	16,092	16,957	17,876	18,902	19,944	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Revenues	15.8	16.9	18.0	19.1	19.1	18.9	18.8	18.7	18.7	18.9	19.0	19.1	18.8	18.9
Outlays	22.8	22.2	21.7	21.6	21.6	21.5	21.7	22.0	22.2	22.4	22.9	22.9	21.6	22.1
Deficit	**-7.0**	**-5.3**	**-3.7**	**-2.4**	**-2.5**	**-2.7**	**-2.9**	**-3.2**	**-3.5**	**-3.6**	**-3.8**	**-3.8**	**-2.8**	**-3.3**
Debt Held by the Public at the End of the Year	72.5	76.3	77.7	76.3	74.6	73.4	73.1	73.5	74.2	75.0	76.0	77.0	n.a.	n.a.

Source: Congressional Budget Office.

Note: * = between -$500 million and zero; n.a. = not applicable.

a. Off-budget surpluses or deficits comprise surpluses or deficits in the Social Security trust funds and the net cash flow of the Postal Service.

Looming Policy Decisions May Have a Substantial Effect on the Budget Outlook

Current law leaves many key budget issues unresolved, and this year, lawmakers will face three significant budgetary deadlines:

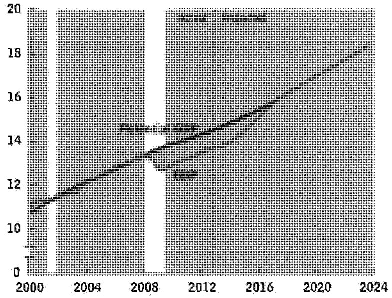
- Automatic reductions in spending are scheduled to be implemented at the beginning of March; when that happens, funding for many government activities will be reduced by 5 percent or more.
- The continuing resolution that currently provides operational funding for much of the government will expire in late March. If no additional appropriations are provided by then, nonessential functions of the government will have to cease operations.
- A statutory limit on federal debt, which was temporarily removed, will take effect again in mid-May. The Treasury will be able to continue borrowing for a short time after that by using what are known as extraordinary measures. But to avoid a default on the government's obligations, the debt limit will need to be adjusted before those measures are exhausted later in the year.

Budgetary outcomes will also be affected by decisions about whether to continue certain policies that have been in effect in recent years. Such policies could be continued, for example, by extending some tax provisions that are scheduled to expire (and that have routinely been extended in the past) or by preventing the 25 percent cut in Medicare's payment rates for physicians that is due to occur in 2014. If, for instance, lawmakers eliminated the automatic spending cuts scheduled to take effect in March (but left in place the original caps on discretionary funding set by the Budget Control Act), prevented the sharp reduction in Medicare's payment rates for physicians, and extended the tax provisions that are scheduled to expire at the end of calendar year 2013 (or, in some

Figure 2.

GDP and Potential GDP

(Trillions of 2005 dollars)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Notes: Potential gross domestic product (GDP) is CBO's estimate of the maximum sustainable level of output of the economy.

Data are quarterly. Actual data are plotted through the third quarter of 2012. Projections are plotted through the fourth quarter of 2023.

cases, in later years), budget deficits would be substantially larger over the coming decade than in CBO's baseline projections. With those changes, and no offsetting reductions in deficits, debt held by the public would rise to 87 percent of GDP by the end of 2023 rather than to 77 percent.

In addition to those decisions, lawmakers will continue to face the longer-term budgetary issues posed by the substantial federal debt and by the implications of rising health care costs and the aging of the population.

Economic Growth Is Likely to Be Slow in 2013 and Pick Up in Later Years

The U.S. economy expanded modestly in calendar year 2012, continuing the slow recovery seen since the recession ended in mid-2009. Although economic growth is expected to remain slow again this year, CBO anticipates that underlying factors in the economy will spur a more rapid expansion beginning next year.

Even so, under the fiscal policies embodied in current law, output is expected to remain below its potential (or maximum sustainable) level until 2017. By CBO's estimates, in the fourth quarter of 2012, real (inflation-adjusted) GDP was about 5½ percent below its potential level. That gap was only modestly smaller than the gap between actual and potential GDP that existed at the end of the recession (see Figure 2) because the growth of output since then has been only slightly greater than the growth of potential output. With such a large gap between actual and potential GDP persisting for so long, CBO projects that the total loss of output, relative to the economy's potential, between 2007 and 2017 will be equivalent to nearly half of the output that the United States produced last year.

The Economic Outlook for 2013

CBO expects that economic activity will expand slowly this year, with real GDP growing by just 1.4 percent (see Table 2). That slow growth reflects a combination of ongoing improvement in underlying economic factors and fiscal tightening that has already begun or is scheduled to occur—including the expiration of a 2 percentage-point cut in the Social Security payroll tax, an increase in tax rates on income above certain thresholds, and scheduled automatic reductions in federal spending. That subdued economic growth will limit businesses' need to hire additional workers, thereby causing the unemployment rate to stay near 8 percent this year, CBO projects. The rate of inflation and interest rates are projected to remain low.

The Economic Outlook for 2014 to 2018

After the economy adjusts this year to the fiscal tightening inherent in current law, underlying economic factors will lead to more rapid growth, CBO projects—3.4 percent in 2014 and an average of 3.6 percent a year from 2015 through 2018. In particular, CBO expects that the effects of the housing and financial crisis will continue to fade and that an upswing in housing construction (though from a very low level), rising real estate and stock prices, and increasing availability of credit will help to spur a virtuous cycle of faster growth in employment, income, consumer spending, and business investment over the next few years.

Nevertheless, under current law, CBO expects the unemployment rate to remain high—above 7½ percent through 2014—before falling to 5½ percent at the end of 2017. The rate of inflation is projected to rise slowly after

Table 2.

CBO's Economic Projections for Calendar Years 2012 to 2023

	Estimated,	Forecast		Projected Annual Average	
	2012	2013	2014	2015–2018	2019–2023
	Fourth Quarter to Fourth Quarter (Percentage change)				
Real Gross Domestic Product	1.9	1.4	3.4	3.6	2.2
Inflation					
PCE price index	1.5	1.3	1.8	1.9	2.0
Core PCE price index[a]	1.5	1.5	1.9	2.0	2.0
Consumer price index[b]	1.9 [c]	1.5	2.0	2.2	2.3
Core consumer price index[a]	1.9 [c]	1.8	2.0	2.2	2.3
	Fourth Quarter Level (Percent)				
Unemployment Rate	7.8 [c]	8.0	7.6	5.5 [d]	5.2 [e]
	Calendar Year Average (Percent)				
Interest Rates					
Three-month Treasury bills	0.1 [c]	0.1	0.2	2.2	4.0
Ten-year Treasury notes	1.8 [c]	2.1	2.7	4.5	5.2

Source: Congressional Budget Office. (Actual values for 2012 are from Department of Labor, Bureau of Labor Statistics; Federal Reserve.)

Notes: The numbers shown here do not reflect the values for GDP and related series released by the Commerce Department's Bureau of Economic Analysis on January 30.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2012.

d. Value for 2018.

e. Value for 2023.

this year: CBO estimates that the annual increase in the price index for personal consumption expenditures will reach about 2 percent in 2015. The interest rate on 3-month Treasury bills—which has hovered near zero for the past several years—is expected to climb to 4 percent by the end of 2017, and the rate on 10-year Treasury notes is projected to rise from 2.1 percent in 2013 to 5.2 percent in 2017.

The Economic Outlook for 2019 to 2023

For the second half of the coming decade, CBO does not attempt to predict the cyclical ups and downs of the economy; rather, CBO assumes that GDP will stay at its maximum sustainable level. On that basis, CBO projects that both actual and potential real GDP will grow at an average rate of 2¼ percent a year between 2019 and 2023. That pace is much slower than the average growth rate of potential GDP since 1950. The main reason is that the growth of the labor force will slow down because of the retirement of the baby boomers and an end to the long-standing increase in women's participation in the labor force. CBO also projects that the unemployment rate will fall to 5.2 percent by 2023 and that inflation and interest rates will stay at about their 2018 levels throughout the 2019–2023 period.

Chairman MURRAY. Thank you very much.

We will now do rounds of questions, and I am going to do my best to keep everybody at 5 minutes here so somebody has a chance.

Mr. Elmendorf, I really want to begin with the question of sequester. I believe our focus should be on jobs and the economy, not on arbitrarily creating pain for American families. In your report and in comments you have made since, two things got my attention. The first is that, even with Congress having eliminated some of the so-called fiscal cliff, we still have in place enough fiscal tightening that growth this year will only be about half of what it should be. And the second is that the loss in economic growth translates into about 2 million jobs.

Now, to be clear, the fiscal tightening is more than just the sequester, as we all know, but the sequester is a major part of it, and it is a piece that both sides I think agree is harmful to our economy, to our families, and our national security.

It seems obvious to me that the answer is to replace the sequester with a phased-in approach that includes an equal amount or more of smart and sustainable spending cuts and additional revenue.

So my question for you this morning is: Given that CBO notes that it expects a substantial slowdown in economic growth this year because of fiscal tightening, would it not be preferable to replace the sequester with a package of savings that is better targeted, that is programmatic rather than across the board, and that is phased in so it occurs when the economy is on a stronger footing?

Mr. ELMENDORF. Yes, Senator. If the sequester were replaced with a comparable amount of deficit reduction that was phased in more gradually, that would be better for the economy in the near term.

The matter of what the composition of that fiscal tightening is I think can affect the economy, as we have done analyses over the past few years of different ways of spurring economic growth and jobs. We talked about the different sorts of effects the different components of taxes and spending policies can have on the economy. But, of course, the composition also bears very importantly on what you and your colleagues think the Government should and should not be doing and where our public resources should and should not be devoted. So as you know, there are important issues in the budgetary choices in addition to the economic effects.

Chairman MURRAY. Okay. And, for the record, it is my recollection that you, like many people, have advised Congress that there are better and smarter ways to deficit reduction than through arbitrary, across-the-board cuts that are going to occur under sequester, correct?

Mr. ELMENDORF. Well, Senator, we do not make recommendations about policy. I think we have noted, as others have, that an across-the-board cut does not give you and your colleagues the chance to choose where you think the Government should be spending money on behalf of your constituents. I think that is a matter of—that is not a matter of economic analysis. It is a matter of allowing you and your colleagues to set the course of the Federal budget.

Chairman MURRAY. Okay. In my opening comments, I talked about the improvement in health spending in CBO's projections, and I noted that since March 2010, lower health spending has resulted in revisions that lowered estimates of Federal spending for Medicare and Medicaid by $200 billion, about 15 percent, in 2020. The Centers for Medicare & Medicaid Services have reached somewhat similar conclusions showing national health care expenditure growth rates at recent historic lows below 4 percent, levels well below those seen prior to 2009. Those are really encouraging signs, and we are hearing from providers and even your predecessor, Dr. Orszag, that significant innovation is already underway.

I alluded in my opening statement I would give you a chance to comment on this improvement, and I was wondering if you could explain what led CBO to make those revisions.

Mr. ELMENDORF. Yes, Senator. There has been a marked slowdown in the rate of growth of health care spending across the health care system. We see this in private insurance costs. We see this in Medicaid; we see this in Medicare. And within Medicare, we see it in Part A, which basically pays for hospital services, and Part B, which basically pays for doctors' services, and in Part D, which pays for prescription drugs.

So it is a very broad-based slowdown. It has been underway now for several years. We are working intensively, as are many other people, to try to understand better the sources of that slowdown, the causes of that slowdown.

Our current assessment is that a part of that comes from the financial crisis and recession, which reduced the income and wealth that people have to spend on health care. But we think that a significant part is more structural in nature and involves underlying changes in the way that health care is practiced and delivered.

The challenge for us and for others is to understand how much of those structural factors represent a transient phenomenon and how many represent a more enduring phenomenon, and we really do not know at this point. So what we have seen is that the spending in Medicare and in Medicaid in 2012 was about 5 percent below what we thought it would be in early 2010. We have extrapolated some of those slower growth rates over the coming years so that we have, as you noted, Senator, marked down Medicare and Medicaid spending by about 15 percent in 2020 because of these reasons. Of course, there are other factors, legislative factors and economic changes, that matter for our projections as well. But because of what we see happening in the health care sector, we have marked down growth—marked down the level of spending by about 15 percent. We have also over the past 2 years—

Chairman MURRAY. I am going to have to cut you off because I am going to have to limit everybody to 5 minutes. So I appreciate that response very much, and I will turn it over to Senator Sessions.

Senator SESSIONS. Thank you.

Thank you for your insightful report and comments. They are very important to us. I know CBO has worked hard in projecting growth rates. That is a big part of how you try to evaluate the impact of a budget and what we will be able to do financially over the next several years. We accept that as a reasonable way to do business, not perfect but reasonable, and I guess it is fair to say that you worked very hard to create an accurate picture.

Mr. ELMENDORF. My colleagues and I do, Senator.

Senator SESSIONS. We just had a $616 billion tax increase, averaging about $60 billion a year extra income, and we are having recovery from the recession, the slowest in a decade but some recovery, and that results in a lower deficit, as you have reported to us. By 2015, the deficit is projected to be $430 billion, the lowest you project over 10 years. That is slightly below the highest deficit President Bush ever had in his 8 years. And you have GDP growth projected at 3.9 percent. Last year, we were at 2.2 percent, I believe. So that gives us some perspective.

But after 2015, 3 years from now, the deficit starts a relentless rise again, increasing every single year almost 10 percent a year and would more than double over the following 8 years to $978 billion—is that correct?

Mr. ELMENDORF. Yes, Senator, that is right.

Senator SESSIONS. And you do not see, unless something changes, any improvement in the out-years, but your report would indicate that the upward trajectory, as you said, we would still be on that upward trajectory?

Mr. ELMENDORF. Yes, Senator, that is right.

Senator SESSIONS. And would you say that is an unsustainable path?

Mr. ELMENDORF. Yes, Senator. As we and many others have said, the debt cannot rise indefinitely as a share of GDP, and our projections under current law show debt rising relative to GDP in the back half of this coming decade.

Senator SESSIONS. And it also increases the risk, as Erskine Bowles and Alan Simpson told us, of a fiscal crisis that might occur.

Mr. ELMENDORF. Yes, Senator.

Senator SESSIONS. They said it was inevitable if we do not change this unsustainable path. Would you agree with that?

Mr. ELMENDORF. Well, in the longer-term projections that we have done, in the past years, we have shown debt rising relative to GDP under what had been current policies. We have not updated those projections, but, yes, if one extrapolates what we show at the end of the decade, then debt would continue to rise as a share of GDP.

Senator SESSIONS. Well, under your analysis, you conclude that the revenues are growing each year. You show solid increases. And your growth rate of revenues for the Government basically runs in harmony with the GDP increase. As the economy increases, people pay more taxes and revenue increases. If it declines, revenue would decline. Is that fundamentally correct?

Mr. ELMENDORF. Yes, Senator.

Senator SESSIONS. So even if tax increases were enacted—let me just ask this. I think this is important for us to understand. If tax increases were enacted that were large enough to balance the budget by 2015, not just leave us with a $430 billion deficit, is it not a fact that under your analysis and assumptions, a deficit would begin to return that year or the next year, and it would increase each year over that 10-year budget?

Mr. ELMENDORF. I think it depends, Senator, on the trajectory of the tax increase that you have in mind. So if the tax increase is a fixed number of billions of dollars per year, then, yes, the other factors will continue to push up—

Senator SESSIONS. Right, well, fundamentally, is it not true that the deficits continue to rise and rise steadily because they are increasing faster than economic growth?

Mr. ELMENDORF. Yes, Senator. In our projections, spending is above—

Senator SESSIONS. Excuse me. Spending is increasing at a rate higher than you project the economy to increase. Spending would be increasing around 6 or so percent; whereas, growth—and I will use your average, about 2 or so. And it is substantially less.

Mr. ELMENDORF. Yes, Senator. So we show spending continuing to rise—after the middle of this coming decade, we show spending continuing to rise as a share of GDP. Although we have not updated the longer-term projections, there is no reason to expect that to turn around because the fundamental drivers are the rising number of Americans collecting through these large benefit programs and the rising costs of health care per beneficiary.

Senator SESSIONS. So, to my colleagues, this is the reason I think it is accurate to say we have fundamentally a spending problem rather than a tax problem, because if your revenue is not going to keep up with the spending because we are on an automatic course through entitlements and other programs and all our desires to spend more, then you are not going to get the country on a sound path.

Mr. Elmendorf, debt, I believe, can slow the economy. Back in 2009, you wrote Senator Gregg stating that $850 billion stimulus would have an economic boost in the short term, this pushing out of stimulus money, but the cost of borrowing that money would inevitably become a drag on the economy, you told us. In fact, you said that by even next year—2014 I believe is what you projected back then—the benefits of the stimulus spending would be completely gone and there would be left a drag permanently on the economy. And so since there is no prospect of paying down that debt, we will have some drag—how much, we could dispute— permanently as a result simply of that debt. Is that not correct?

Mr. ELMENDORF. Yes, Senator. If cuts in taxes or boosts in spending that stimulate the economy in the short run are not offset by some later tightening of fiscal policy, then the extra debt that is accumulated will be a drag in the long run.

Senator SESSIONS. Thank you, Madam Chair. I have gone over my time limit. And the other debt we are adding also becomes a permanent drag on our growth, threatening the future of employment for millions of Americans.

Chairman MURRAY. I would like to inform the Committee members that the way we are going to work in this Committee on recognizing Senators is, as in past traditions, by seniority before the gavel is hammered and order of arrival after the gavel, so we will begin with Senator Sanders.

Senator SANDERS. Thanks very much, Madam Chair, and, Mr. Elmendorf, Dr. Elmendorf, thanks very much for being with us.

Just a few questions, and if you can give me some brief answers. Is it fair to say that one of the reasons we have the deficit today has to do with two wars that were not paid for; huge tax breaks, much of which went to the wealthiest people in this country; the Medicare Part D program that was not paid for; and a Wall Street-caused recession which resulted in significant declines of revenue? Would you say that that is one of the reasons we went from a surplus at the end of Clinton's administration to where we are today?

Mr. ELMENDORF. Yes, Senator.

Senator SANDERS. All right. The second question is: In terms of unemployment, the number roughly 7.8 percent is often thrown out, but would you agree that if you looked at real unemployment, people who have given up looking for work, people who are working part-time when they want to work full-time, that we are really looking at maybe 14 percent? Is that a fair statement?

Mr. ELMENDORF. Yes, Senator.

Senator SANDERS. All right, the point being that we are in the midst of a major, major recession.

Now, the debate that is taking place in the Congress right now is many of my Republican friends believe that the answer to the deficit problem, which all of us agree is a serious problem, is to cut Social Security, is to cut Medicare, is to cut Medicaid, is to cut programs for children. And that is true. That is one way you can go forward. But some of us believe that we have to take a look at revenue and the fact that at 15.8 percent of GDP, revenue today is the lowest point that it has been almost in 60 years.

Some of us also believe that we have to take a hard look at huge corporate loopholes, that before you cut a woman in Vermont who is living on $15,000 a year Social Security, you may want to end some of the loopholes that enabled the Bank of America to stash their money in the Cayman Islands and not pay any taxes at all. And that is kind of what the debate is about.

So let me ask you this, just confirm if my information is right. In 1952, 32 percent of all revenue generated in this country came from large corporations. Today that number is 9 percent. Does that sound accurate?

Mr. ELMENDORF. I am sorry, Senator. I just do not know that fact.

Senator SANDERS. Okay. In 2011, corporate revenue as a percentage of GDP was just 1.2 percent. Madam Chair, you remember many of our corporate friends coming here and how they were overtaxes. 1.2 percent of GDP happens to be, as I understand it, lower than any other major country in the OECD. So when people come in and say, "Oh, we are paying 35 percent," everybody here knows there is no corporation that pays 35 percent. If they do, they have to get rid of their accountants, that, in fact, the number on profits is 12 percent. Is that true?

Mr. ELMENDORF. So, Senator, certainly right that the statutory tax rate in the corporate tax code and the average share of profits paid in tax by companies are quite different, but I do not know the numbers, and I do not know the—

Senator SANDERS. Okay. Let me see if you know this one.

Mr. ELMENDORF. —OECD countries.

Senator SANDERS. In 2011, my understanding is that corporations paid just 12 percent of their profits in taxes, the lowest since 1972. How is that?

Mr. ELMENDORF. I think that sounds about right, Senator.

Senator SANDERS. So, again, the choice that we face, do you really in the middle of a recession want to cut Social Security benefits and Medicare benefits when corporations today are paying 12 percent of their profits in taxes, the lowest since 1972? Or do we think it might make more sense to ask our friends in the corporate world to pay a little bit more?

Another question. My understanding is that one out of four major corporations, profitable corporations in this country, in 2005, the last statistics I have seen—I am sorry I do not have closer ones—paid zero in taxes. Does that sound right to you?

Mr. ELMENDORF. I am sorry, Senator. I just do not know offhand. We can look these things up, but I do not carry them around in my head.

Senator SANDERS. All right. My understanding is that we are losing—and we have introduced legislation to remedy this—about $100 billion a year in revenue, a year, by companies' offshoring their profits in the Cayman Islands, Bermuda, and paying zero in taxes.

Mr. ELMENDORF. Again, Senator, I do not—

Senator SANDERS. All right. I know that, but do you think it is a legitimate area to pursue, the fact that we have companies like Bank of America and virtually every major corporation stashing their money in the Cayman Islands, paying zero in Federal taxes? Is that something that you think would be a worthwhile pursuit?

Mr. ELMENDORF. Well, I think that it is certainly a legitimate issue for the Congress, and we released a report last month that reviewed the pros and cons of alternative ways of changing the tax system applying to multinational corporations.

Senator SANDERS. Okay. Madam Chair, I would just conclude by saying we have a great philosophical difference in this room, and some of us think that when the wealthiest people are doing phenomenally well, when corporate profits are at an all-time high, we might want to ask those folks for more revenue rather than cutting back on the needs of some of the most vulnerable people in this country.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator ENZI.

Senator ENZI. Thank you, Madam Chairman.

I want to thank you for this great book. As an accountant, it has a lot of numbers in it; I love that. It does lead to a lot of technical questions, though, and I would rather submit those than ask them here.

Mr. ELMENDORF. Yes, Senator. We are happy to respond that way.

Senator ENZI. I still have a few questions, though, and Senator Sanders brings up one. Are we paying out more in Medicare than we are taking in at the moment?

Mr. ELMENDORF. Well, as you know, Senator, the dedicated taxes for Medicare cover the Part A, or are designed to cover Part A, the hospital spending, and the Hospital Insurance Trust Fund is, in fact, losing money every year. The other parts of Medicare have no dedicated financing. They are funded by beneficiary premiums and by general revenue transfers.

Senator ENZI. How are we doing on the difference between what is paid in for Social Security and what is going out monthly or annually?

Mr. ELMENDORF. So the dedicated taxes collected for Social Security are less than the benefits that are being paid out for Social Security.

Senator ENZI. Is there anything in sight where that is going to change?

Mr. ELMENDORF. No, Senator. That will continue under current law.

Senator ENZI. Thank you.

Now, in the CBO report, you indicate that revenues are projected to increase by roughly 25 percent between 2013 and 2015, and, in addition, growth of the economy is expected to be just one and four-tenths percent in 2013 but accelerate to three and four-tenths percent in 2014. I want to ensure that we all do not leave this hearing thinking that there is a direct link between increased revenues through tax hikes and increased economic growth.

In that regard, to what extent do the increased taxes that were recently enacted and that pull money out of the hands of both employers and employees have a negative impact on your economic growth projections?

Mr. ELMENDORF. So, Senator, we think the increases in taxes is part of the fiscal tightening that is slowing the economy this year, just as the planned reductions in spending are slowing the economy this year. That and other sorts of deficit reduction are good for the economy in the medium run and long run, and that is one of the difficult trade-offs that you and your colleagues face.

Senator ENZI. Thank you.

The CBO report also indicates that after the economy adjusts this year to the fiscal tightening inherent in current law, underlying economic factors will lead to more rapid growth— you project three and four-tenths percent in 2014 and an average of three and six-tenths percent a year from 2015 through 2018. Can you walk us through your analysis leading to the conclusion that the economy will adjust this year and not over a longer period of time due specifically to the tax increases that were enacted earlier this year?

Mr. ELMENDORF. Yes, Senator. So there are two factors here. There is a growth of the underlying potential of the economy, and then there is some catch-up from the current level of output, which is below that potential, which amounts to putting unemployed workers back to work making better use of the factors and offices that we have. And both those factors are at work in the growth we see over the next half-dozen years.

We think that the underlying forces driving the economy are finally—after long, lingering effects of the financial crisis and the housing bubble, we think those underlying forces are strengthening. We think those are going to help to pull the economy back up toward its potential output to put people back to work, but only gradually over the next 4 or 5 years.

The tightening of fiscal policy is reducing deficits, and the lowered debt that will result will be good for the economy later on. It is also true that the higher tax rates that will be in place because of the expiration of tax cuts on higher-income people, those higher tax rates will represent some drag on the economy, and we incorporate those factors in our baseline projections and in our analysis of the effects of alternative policies. We look at the effects of both debt on the economy and the effects of tax rates in distorting incentives to work and to save.

Senator ENZI. Well, I will have a few more follow-ups on that one, but, slightly different, the President recently said that in the absence of a larger budget deal, Congress should pass a smaller package of spending cuts and tax reforms that would delay for a few months the sequester slated to go into effect. It is anticipated those tax reforms mean closing what the President perceives as loopholes. And it would have the effect of simply raising taxes.

To what extent would raising taxes to offset a portion of the sequester have a negative impact on economic growth?

Mr. ELMENDORF. So I think the biggest issue to think about in terms of the effects of this fiscal policy on the economy in the near term is how quickly deficit reduction occurs, how much tightening occurs this year. But it is also true that the composition of the fiscal tightening, how much comes through certain sorts of spending cuts or certain sorts of tax increases can matter for economic outcomes, but the effect depends a lot on the specifics. When we have looked at different ways to boost the economy, we have found very different effects of different sorts of spending increases and very different effects of different sorts of tax cuts.

So I do not want to make any very general statements because it really depends on what provisions of the Tax Code would be changed.

Senator ENZI. I will follow up on that.

Senator ENZI. My time has expired. Thank you.

Chairman MURRAY. Thank you.

Senator WHITEHOUSE.

Senator WHITEHOUSE. Thank you, Madam Chair.

Welcome back, Dr. Elmendorf.

Mr. ELMENDORF. Senator.

Senator WHITEHOUSE. Two quick things. The first is that—I think it is relevant to the topic you were just discussing. Europe has gone on an experiment in austerity as a solution to the recession, and it does not seem to be working very well. Spain's economy shrank 1.4 percent in 2012 and is projected to contract another 1.4 percent in 2013. Greece's economy shrank 6 percent in 2012 and is projected to contract another 4.2 percent in 2013. Italy's economy shrank 2.3 percent in 2012 and is projected to contract another 0.3 percent in 2013. Portugal's economy shrank 2.3 percent in 2012 and is projected to contract another 0.3 percent in 2013. Unemployment is in double digits in all of those countries. So although we are not recovering well, we are certainly recovering, and we see GDP growth. And if you look at some of the people who are close to this and looking at it, the conservative Daily Telegraph, Jeremy Warner, who supported this austerity program, has recently written about Britain that they are in a "truly desperate state of affairs that demands swift and decisive action. We seem to have the worst of all possible worlds, with nil growth, some very obvious cuts in the quantity and quality of public services, but pretty much zero progress in getting on top of the country's debts."

The IMF, which had argued for austerity, now has corrected itself and says—the chief economist Olivier Blanchard said, "We find that forecasters significantly underestimated the increase in unemployment and the decline in domestic demand associated with austerity."

The Wall Street Journal, recently discussing Spain and its austerity program, said that it "threatens to create a vicious cycle as mass layoffs to meet budget targets spark a deeper contraction, reducing tax revenue and increasing welfare costs, as well as damping consumption."

Now, Robert Frank, who is a well-regarded American economist at Cornell, has said, "The cuts that are scheduled in the sequester are not a way to run a rational government. Cuts of any kind at this time are not a good idea. It is recessionary. It would slow growth for sure and put people out of work."

In that regard, the more conservative American Enterprise Institute, John Makin and Daniel Hanson said, "An abrupt spending sequester scheduled to begin March 1st could cause a U.S. recession."

Do you recommend an austerity path at this point? What should we be doing that is different than the European austerity experiment that appears to have ended so badly for them?

Mr. ELMENDORF. So, Senator, we have not studied each of those European countries carefully, and as you know, there are many factors that affect their economic performance. But I think that the recessions and economic contractions that have occurred in countries that have pushed for very rapid contractions of fiscal policy are entirely consistent with the analysis that we have been offering to the Congress for many years now that raising taxes and cutting spending at a time when the economy is already weak and the Federal Reserve is limited in its further options to support the economy will tend to reduce output and reduce jobs relative to what would occur if fiscal policy were not tightened in those ways. And—

Senator WHITEHOUSE. And you are predicting a more than 1-percent difference in GDP as a result of that if we do not manage the sequester properly, correct?

Mr. ELMENDORF. So we say that without any of the fiscal tightening that is occurring this year, GDP growth would be 1–1/2 percentage points faster. The sequester itself we think represents about six-tenths of one percent of GDP growth this year and would mean a difference of roughly 750,000 jobs by the fourth quarter of this year.

Senator WHITEHOUSE. Okay. And one last point, a different point. I make it virtually every time we have a hearing, and so I now will give the abbreviated version here, and the Chairman was kind enough to mention my interest in this. But when we have a health care system that is spending 50 percent more than our least efficient international competitor, when everybody from the President's Council of Economic Advisers to the Institutes of Medicine say that there is over $700 billion every year to be saved in the American health care system, when companies like, in Senator

Johnson's home State, Gundersen Lutheran, in Senator Toomey's home State, Geisinger, are actually showing the ways to reduce costs by providing better health care, I look forward to being able to work with my colleagues on the other side of the aisle to focus on that. I think when we look at Medicare benefits as the solution to our health care cost problem, we are fundamentally misdiagnosing the problem. When we misdiagnose a problem, we put the wrong cure on it. It will do harm, not good. And we really, I think, as a Congress can focus in bipartisan fashion on trying to make the American health care system at least as efficient as our least efficient international competitor rather than paying a 50-percent inefficiency penalty on that compared to the rest of the world.

Chairman MURRAY. Thank you.

Senator JOHNSON.

Senator JOHNSON. Thank you, Madam Chairwoman, Director Elmendorf. Let me first agree with Senator Sessions. I actually think we all share the same goal here. We all want a prosperous America. We want every American to be able to have the opportunity to build a good life for themselves and their family. It is a matter of, you know, how do we go about doing it, and it is really through economic growth.

Director Elmendorf, in general, don't tax increases harm economic growth?

Mr. ELMENDORF. I think it depends what the alternative is, Senator. I am not trying to—

Senator JOHNSON. I am just talking about—

Mr. ELMENDORF. —be difficult here.

Senator JOHNSON. I am just talking about—

Mr. ELMENDORF. If the alternative is to run large deficits indefinitely, if the only available policy lever were a change in tax rates or some other change in the Tax Code, I am not sure what the answer to that question is.

Senator JOHNSON. Let me point out a couple facts about economic growth. Even with the meager growth we have had since 2009, Federal revenue has increased by $388 billion per year since that time period, correct?

Mr. ELMENDORF. I will take your word for that, yes, Senator.

Senator JOHNSON. If we would just return to a normal economy, which we had in 2007, when revenue generation was 18.5 percent of our economy, that would add an additional $435 billion per year.

Mr. ELMENDORF. Again, we certainly think that when the economy is—the growth we have in the economy is an important factor pulling up tax receipts.

Senator JOHNSON. Now, the tax increase, the punishing of success in the fiscal cliff piece of legislation, that in

2014, according to the Joint Committee on Taxation, would raise, I believe, $41 billion in 2014. Is that about right?

Mr. ELMENDORF. That sounds plausible, Senator, yes.

Senator JOHNSON. So increasing taxes on the rich is a tenth as effective if we would actually just return our economy to a normal economy. Is that about correct?

Mr. ELMENDORF. That particular policy, yes, Senator.

Senator JOHNSON. Now, in your projections, you are taking us—and you pointed out that the 40-year average is 18 percent of revenue compared to GDP, and your projections now are saying you are going to somehow get 19 percent out of the economy. I would like to point out over the last 62 years, we have only had 13 instances where revenue actually hit 19 percent. Three of those, it actually peaked 20 percent. But I would like to just quickly show a chart here. We have had a wide variety of top marginal tax rates, I mean the attempt to punish success, which I think is the wrong way to go, of as high as 91 percent, 70 percent, 50 percent, 28 percent under Ronald Reagan, I would like to point out. For a brief moment in time, we were actually 72 percent free, then 35, 39.6 percent, we are pushing that top marginal tax rate up to 40 percent. But it is amazing how incredibly tight the average around that, in my case, 18.1 percent over 50 year averages, what makes you think that we can actually extract over the next 10 years about 19 percent of revenue when we have not been able to do it regardless of how we have tried to punish success?

Mr. ELMENDORF. Well, Senator, as you know, there are a lot of other features of the Tax Code besides the top marginal rate, and one could draw pictures like that that showed the rates that applied to people at other points on the income distribution. There are a set of changes that have been made to what sort of income is taxed, what deductions and credits are available. So our projection is that under current tax law revenue will reach roughly 19 percent of GDP. That is not really hard for us to imagine given the way current tax law works.

One factor, of course, is—another factor you know is that at points where tax receipts have moved up to be a higher share of GDP, Congress has often stepped in and made some change in the tax law to bring them back down. And you may do that again, but that is not what our baseline projections are—

Senator JOHNSON. Okay. Let me quick answer Senator Enzi's question about how much more we are going to be paying out in benefits, and these are according to your schedules here. Between 2014 and 2023, we will pay out $5 trillion more in benefits to Social Security recipients and Medicare than we are taking in in terms of tax revenue and premiums on Medicare. Now, that $5 trillion compares to $9 trillion of total additional debt, it is almost 60 percent. If you are going to actually try and address the debt and deficit issue, wouldn't you actually have to try and propose a plan to save those programs for future generations? Wouldn't that be one of the first places you would look?

Mr. ELMENDORF. I think it is very difficult, Senator, if you look at our projections, to see how one can put the budget ultimately on a sustainable path without making significant changes in either of those large benefit programs or in the taxes paid by a broad cross-section of Americans.

Senator JOHNSON. Okay. Well, let me also ask just about interest payments, because we will be paying about $5.4 trillion in interest expense, and by the end of the period, we are about 5.2 percent of a 10-year Treasury note. I just want to put another chart up here. Over 30 years from 1970 to 1999, the average interest rate the Federal Government paid on its debt was 5.3 percent. We have been keeping that artificially low, 1.5 percent, to accommodate all this deficit spending. If we just reverted to that mean, that would be more than $600 billion per year for increasing our interest rates by 3.8. Isn't that largely correct?

Mr. ELMENDORF. So as you noticed, Senator, our own projection has the 10-year Treasury note rate going to 5.2 percent in the second half of the coming decade, and that is the reason why we show such a large increase in Federal interest payments.

Senator JOHNSON. That is something we really need to be concerned about. What makes you think that we will not hit that 5.2 percent a little bit quicker?

Mr. ELMENDORF. Because the weakness of the economy has kept down the private demand for credit and has led the Federal Reserve to keep interest rates low. In addition, there are serious economic and financial problems in Europe that have led people to put money in this country, and I think in general an aversion to taking financial risk given the events of the last half dozen years. We think those factors will persist for a while and then wane.

Senator JOHNSON. Aren't seniors on fixed incomes the biggest victims of these artificially low held interest rate?

Mr. ELMENDORF. I do not know, Senator. We have not analyzed that. It is true that the people who are dependent on receiving interest payments are receiving lower payments because interest rates are low.

Senator JOHNSON. Thank you.

Chairman MURRAY. Senator Baldwin.

Senator BALDWIN. Thank you, Madam Chairwoman, and I have to tell you, it is a delight to have my first budget meeting. I am delighted to have Director Elmendorf here. And since you only get your first hearing once, I wanted to say a couple of things.

I appreciated your opening remarks, Chairman Murray, about the fact that budgets truly are a statement of our values and our priorities as Americans. And for me, that means developing a budget that strengthens the essential pillars of our economy and economic security, especially for the middle class. Quality education, affordable health care, a good-paying job, retirement security are things that we really on to have a strong middle class. So I want to see us develop a budget that truly holds true to the belief that in America everybody gets a fair shot and everyone does their fair share.

I believe—and many have echoed this sentiment—that our country faces twin challenges: the challenges of getting our economy or economic recovery, seeing it through, job creation, and particularly in the private sector, and confronting our debt and deficit. And I believe that we have to face both of these challenges head on and address them in a bold yet balanced way.

In the past 2 years, we have made significant strides in achieving a $2.5 trillion bipartisan deficit reduction, but we obviously need to do more. But that is the trick, that is the challenge, that is the hardest task, is how do we forward a set of policies that helps us achieve both of those twin challenges without frustrating the other.

So, Mr. Elmendorf, I would like to begin by asking you how we approach these twin challenges, these parallel challenges of job growth and deficit reduction. You highlighted in your testimony that there is a large gap between potential GDP and actual GDP, and that gap is almost as large as it was during the worst of our recession. This means that there is a shortfall in consumption, in Government spending and/or investment. Additionally, we have record low financing costs right now and unemployment levels of above 16 percent in the construction sector.

In terms of economic multipliers, isn't it true that one of the best ways to increase growth in the future is to invest in infrastructure today?

Mr. ELMENDORF. Yes, Senator. Investments in infrastructure, if done in an intelligent manner, can provide a real boost to economic activity, not just today when the investment is occurring but over time as the investment yields returns.

Senator BALDWIN. And along those lines, what do you view as the other best economic multipliers strategies at this point? What gives us the most leverage?

Mr. ELMENDORF. Well, Senator, the most effective way that we know for the Congress to boost economic growth this year is to defer some of the fiscal tightening that is scheduled in current law. But I want to be clear that if that deferral occurs without some offsetting tightening of fiscal policy later, then that will make economic outcomes worse in the medium term and long term.

Senator BALDWIN. The dual twin challenges. You want to attack one without frustrating progress on the other.

You stated in your testimony that this fiscal tightening that we are talking about would restrict GDP growth by 1.5 percent and cost us 2 million jobs. In your testimony, you also stated that our unemployment rate would remain above 7.5 percent for the foreseeable future through 2014. I have a chicken-versus-egg question for you. I know they are challenging. But in your view, to what extent is high unemployment a cause of weak economic growth as opposed to the effect of weak economic growth? And if high unemployment is, in fact, a cause of slower growth, what effect would direct Government action to lower our unemployment rate have on our overall fiscal situation?

Mr. ELMENDORF. So, Senator, we think that the high unemployment rate is primarily the effect of businesses not hiring, which is primarily an effect of their not seeing the demand for their products, and that policies that would boost the demand for business services would encourage businesses to hire more, and that would tend to bring down the unemployment rate.

There are also policies that could be directed specifically at unemployed workers. We wrote a report last year on ways of responding to persistently high unemployment, and we talked in that report about some of the broad macroeconomic policies, but also about more targeted policies to help train workers, help connect workers to available jobs. Our view in that report was that those policies could be very helpful for certain people in certain circumstances but would be very difficult to implement on a national scale quickly enough to change, significantly change the trajectory of the overall unemployment rate over the next few years.

Senator BALDWIN. Thank you.

Chairman MURRAY. Thank you.

Senator WICKER.

Senator WICKER. Thank you, Madam Chair, and thank you, Mr. Budget Director.

The President a few days ago proposed a balanced approach to pay for sequestration in another way involving revenue increases and a different approach to making the budget savings. What would be the score of the President's proposal in this regard?

Mr. ELMENDORF. So, Senator, we have not seen a specific proposal, so I do not know what it—

Senator WICKER. You know, I have not seen a specific proposal either, so it is hard to score that speech that the President made, isn't it?

Mr. ELMENDORF. Yes, Senator.

Senator WICKER. Now, on the other hand, the House last year actually proposed legislation and passed legislation to deal with the sequestration. Is that correct?

Mr. ELMENDORF. Yes, Senator, that is right.

Senator WICKER. Okay. Did you have an opportunity to score that?

Mr. ELMENDORF. We did, Senator, but I do not remember the estimate that we provided. But we provided the cost estimate.

Senator WICKER. All right. And the Chair suggested earlier in this hearing that we avoid sequestration by restructuring the cuts to let them take effect a little more gradually that involve revenue there. Have you had an opportunity to score that proposal by the Democrats on this Committee?

Mr. ELMENDORF. No, Senator. We have not received a specific proposal of the sort that you are describing, and if we received— if such a proposal were made public and we were to do an estimate of it, then you and all of your colleagues would see it.

Senator WICKER. Okay. Well, I think that would be very helpful because it is frustrating to me because, on the one hand, our brothers and sisters at the other end of the building, at least if they have taken the hit, proposed specific solutions to sequestration. They have been scored. They have been passed. They sat over here in the U.S. Senate all last year with no action, and yet we have suggestions by the President, suggestions by our friends on the other side of the aisle, but they cannot be scored, and we cannot have any idea what CBO would think about those.

Let me just say this: There is a lot of revisionist history when it comes to this period that I participated in as a Member of the House of Representatives where we actually had budget surpluses at the Federal level. You would think from the Chair's opening statement that President Clinton came into office in 1993, proposed balanced budgets, got those balanced budgets, and we had 8 years of relative fiscal sense here in the Federal Government. The fact is, is it not, that President Clinton in 1993, in 1994, and in 1995 proposed in all of those years deficit spending as far as the eye can see? Is that correct?

Mr. ELMENDORF. I think that is right, Senator, but my recollection of the specifics of those budgets is not perfect.

Senator WICKER. That is my recollection, too. As a matter of fact, in the 1995 budget proposed by President Clinton, who takes credit for the surpluses later on, it proposed over $200 billion in budget deficits as far as the eye could see. And then what happened is in the 1994 election the people of the United States elected a Republican majority in the House and a Republican majority in the Senate. And I know you do not get involved in politics, but let me just observe that Chairman Kasich was directed by the Speaker of the House to come up with a very tough budget bill, and, in fact, the Republican majorities in the House and in the Senate got the President of the United States to buy into reconciliation, to buy into welfare reform, and on a bipartisan basis after Republicans took control of the House and Senate majorities, that is when we had budget surpluses. That is when the budget surpluses began. They were never proposed before then by President Clinton.

Now, also, I do not recall President Bush getting us into a war in 2001. I recall Osama bin Laden and al Qaeda getting us into a war in 2001. And as I recall, it was

passed unanimously in the United States Senate that we would retaliate in Afghanistan and go into war. It was not a Bush war. It was something that we all did and all Americans supported it—one dissenting vote in the House of Representatives. So I think it is disingenuous to have revisionist history when, in fact, we did have this war. We were in an economic recession in 2001. What would a tax increase have done to us in 2001 to pay for that war in Afghanistan? It would have been a huge drag on an already tenuous economy, would it not have?

Chairman MURRAY. Dr. Elmendorf, I am going to ask you to sum that up really quickly, or there are several of us who are going to miss a vote.

Mr. ELMENDORF. An increase in 2001 would have had that effect, yes, Senator.

Senator WICKER. Thank you very much, Doctor.

Chairman MURRAY. I am going to recess and go over and vote at the end of this vote and the top of the next one and come back. If any members want to come back and ask questions of Dr. Elmendorf, I will do it between the third and fourth vote, and I will be here.

We will take a quick break.

[Recess.]

Senator MERKLEY. [Presiding.] The Committee will come back to order, please. And as soon as my colleagues return, we will return to the regular order of questioning, but for now I am the only one here, so I will take advantage of that moment.

Thank you. Good to have you here.

Mr. ELMENDORF. Thank you.

Senator MERKLEY. And I appreciate so much the third-party, bipartisan analysis the CBO brings to our discussions. It helps if we have a common set of analyses to base our discussion and analysis on here in the Committee, and thank you for providing that.

I wanted to start by asking you a question that may not be reflected in the numbers and maybe it cannot be, but that is for you to respond to, and that is, we have had a series of fiscal cliffs, if you will, not only the fiscal cliff December 31st, but we have the upcoming concern over the debt ceiling, the continuing resolution, and so forth.

It seems like we have been lurching from budget crisis to budget crisis. Is there any way of measuring that or do you make an attempt to measure the impact on decisions made within the economy and perhaps within your models regarding investments and so forth that might drive economic outcomes?

Mr. ELMENDORF. Senator, we do think that the ongoing uncertainty about Federal budget policy represents a drag on spending and, thus, on incomes and jobs. But we do not know how to quantify that effect. There is economic research—we have had some of this presented at our meetings of our panel of Economic Advisers—that tries to, is starting to build some evidence about the effects of policy uncertainty on the economy. But that is, I would say, still in a preliminary stage, and we do not know how important those effects are.

We think the primary source of uncertainty that is holding back household spending and business investment and hiring is uncertainty about the income that households will have and the demand for the products that firms will face. But policy uncertainty is probably also playing some additional negative role.

Senator MERKLEY. It was interesting to see a series of reports in December and on into January regarding retail sales, everything from clothing to other consumer goods, that seemed to show a significant change, and one possible explanation was related to the fiscal cliff and the recognition of what is going to happen in March. Another was that the payroll tax got changed, and folks had 2 percent less money in their paychecks. Do you have any sense of how that—was that expected, that turndown? If not, what is the best explanation or culmination of explanations?

Mr. ELMENDORF. So it is difficult to read too much into the very preliminary data we have for the beginning of this year. Our expectation had been and remains that the expiration of the payroll tax cut represents an important piece of fiscal tightening that is good for the deficit over time but is a negative factor for consumer spending in the first part of this year. But that is a judgment based on decades of evidence of other changes in income and how it affects spending, not really derived from what we have seen over the past month, but we just do not know enough of what is going on.

Senator MERKLEY. So we are looking at another set of decisions, and right now we are on a course to have a significant drop in defense and non-defense discretionary programs. And one idea that has been put out there is, well, instead of reducing spending, let us reduce the spending on appropriated programs, if you will, let us reduce spending on tax loopholes. And for some, that is reducing spending; for others, increasing revenue. But largely, if you spend money on a tax loophole, it has a corollary in the real world, so it is fair to frame it that way.

Have you all looked at the different impact of whether, say, shutting loopholes that give special payouts to oil companies versus cutting food stamps, just an imaginary comparison, has in terms of how it reverberates in the economy and affects working people?

Mr. ELMENDORF. So, Senator, we have not looked at particular—we have not formally analyzed the macroeconomic effects of closing particular tax loopholes. But we have said many times that the sorts of spending or tax changes that matter most for the economy in the short run are those that directly affect the spending by the Government or by households or by businesses.

So food stamps are received by people who, as you know, have very little other income. They will tend to spend a very large share of any change, spend more if their food stamps go up or spend less if the food stamps go down. So changes in that way will tend to be passed through to changes in spending on a nearly one-for-one basis; whereas, most of the tax revenue is collected from people who are not living so close to the economic edge and thus will tend to respond less sharply in their spending for every dollar change in their after-tax income.

So, in general, changes in food stamps will tend to have larger effects on the economy in the short term than changes in other spending programs or tax provisions, but we have not looked at the specific example you raised.

Senator MERKLEY. Now that we are back in the world in which Social Security premiums are being paid for directly out of paychecks completely, the argument is often made that Social Security, the premiums go into the trust fund, the trust fund lends money out to earn a modest return, comes back, and they proceed to disburse it when folks become eligible. And in that sense, is it fair to say that Social Security does not contribute to the national debt?

Mr. ELMENDORF. I think that is not right, Senator, actually. The payroll tax receipts, as you know, that are going into Social Security are less than the benefits that are being paid out. And the interest payments that Social Security receives are a receipt to that part of the Government and a payment from some other part of the Government.

In the work that we do, we tend to look at the Government as a whole, and on that basis, the dedicated Social Security taxes are less than Social Security benefits. So on that basis, the program is actually a drain on the budget today. But even if one includes the interest payments and looks at the overall Social Security balance, that is positive today, so the tax receipts and interest payments together are larger than benefit payments. But that will actually turn around within the coming decade, by about 5 or 6 years from now, I think. In our projections, the Social Security Trust Fund, even counting interest payments, will be running a year-to-year deficit, that is, it will be starting to draw down on the accumulated balances in the trust fund.

Senator MERKLEY. It really does depend on how you view that trust fund, because if you view it as the equivalent of a semi-private entity which is truly separate, it would be no more than my saving money and my spending money out of that account in the future, and it would be separate from the overall debt analysis. But I understand that ongoing, eternal question of how you frame that.

Mr. ELMENDORF. Again, sir, I would say that even taking the interest on board, we think that in 2017 the combined OASI and DI trust funds will be running a deficit, even including the interest payments that they are receiving. So it is not very far off before even on that basis the program will be in deficit.

Senator MERKLEY. About roughly 20 years before the trust fund itself is depleted.

Mr. ELMENDORF. More than that, Senator, yes.

Senator MERKLEY. Let me turn a little bit to the impact of health care. I believe your summary said that if you look at the current deficits, which have dropped significantly over the past couple years, but they are going to double over the next roughly 10 years, from $400-plus billion to $800-plus billion, and that health care costs are the biggest driver as a result of the pressures of an aging population, one of the things that is common in the Medicare system is fee-for-service.

Now, fee-for-service basically says the more services you provide, the more profit you make. So whether you are building a piece of military equipment or running health care, it is an incentive to spend a lot, not necessarily to spend wisely.

Has CBO done an analysis of the impact of fee-for-service on the cost of health care and the savings that might result from changing that structure?

Mr. ELMENDORF. So, Senator, I think there is a widespread view among analysts that moving away from fee-for-service to paying providers for handling an overall medical condition rather than for each individual service they provide, by paying them for providing that overall bundle of care in a high-quality way, that sort of movement would be a great boon to our efficient use of health care dollars.

In the work that we have done, I think the crucial question is what the movement is to, is what alternative method is put in place. So as you know, in the Affordable Care Act there were a lot of changes made in the fee-for-service part of Medicare, including a number of changes in how providers are paid, that represent moves away from a traditional fee-for-service approach. And we estimated that some of those changes would indeed save the Federal Government significant amounts of money. But I think the challenge now that you and your colleagues face is what other specific changes in Medicare you might make. And as we work with the staff of this Committee and others on potential changes in Medicare, we and your staffs are looking at different ways of changing the fee-for-service system. But just what the Federal changes should be to induce the sort of changes in the delivery of health care that people have in mind is not so straightforward, and I think that is a real—that is a fundamental challenge.

Senator MERKLEY. Thank you very much. I think that given your analysis and that of everyone else, these are going to be the big drivers. I am sure members will be looking to the details that you all produce to try to understand the policy options.

With that, our Chair has returned, so I will return the Committee to Chairman Murray.

Chairman MURRAY. [Presiding.] Well, thank you very much, Senator Merkley. And we apologize to everybody. There are votes ongoing. Some members I believe are coming back. We are trying to get an assessment as quickly as possible on which ones are returning, so if you would not mind being flexible.

I believe that Senator Portman will be arriving shortly. We are checking right now, and I will turn it over to him the minute he gets here. I believe Senator Warner also was going to return. If there are any offices that know whether their Senator is returning, it would be really helpful to us so that we can conclude this fairly quickly. Again, we do have votes ongoing.

While none of my members are here, I will take this opportunity to ask you several questions, but, again, I will relinquish the minute someone walks in.

Dr. Elmendorf, a lot of my colleagues attempt to claim that after the fiscal cliff deal, which raised about $600 billion from the wealthiest taxpayers, the tax discussion is somehow finished, and some point to CBO's new budget outlook, noting that projected revenues will rise above the 40-year historical average of 18 percent of GDP.

But this argument really ignores some really important facts. It is true CBO expects revenues to average 18.9 percent of GDP over the next decade. It is also true that the last five times we have balanced the budget, revenues have been much higher, between 19.5 and 20.6 percent of GDP. Correct?

Mr. ELMENDORF. Yes, Senator, I think that is right.

Chairman MURRAY. Okay. And their argument also actually fails to take into account for the reality that the baby-boom generation is entering its retirement years, and I want to paraphrase you, but you have noted that the past combination of policies regarding Federal spending and revenue cannot be repeated when it comes to the Federal budget going forward, which I take to mean that we are entering a new phase with respect to our fiscal pressures. That reality was recognized by bipartisan budget groups— Simpson-Bowles and the Senate Gang of Six both did—and they proposed substantially more in revenue than will be generated by the 2012 fiscal cliff.

So my question to you is this: If we were to hold revenues at an average of 18.9 percent of GDP, as you estimate, not to ask for a penny more of contribution from either the wealthiest of Americans or from some of the most egregiously wasteful loopholes in the Tax Code, if you could, lay out for this Committee some of the policy choices that Congress will have to face within a relatively short period of time.

Mr. ELMENDORF. Yes, Senator. If tax revenues are maintained at their historical average share of GDP, or even at the roughly 19 percent that we project for the end of this coming decade, then putting the Federal debt on a sustainable long-run path would require substantial cutbacks in the benefits and services that people receive from the Government relative to what would happen under current law or current policies. The numbers for the increase in beneficiaries of Social Security and Medicare are just striking. We estimate that by 2023 there will be about 40 percent more people receiving Social Security and Medicare benefits than received them last year. With a 40-percent increase in the number of people receiving benefits, the total costs will be much higher or the benefits per person will have to be much lower.

When we look out even over the next 25 years, as we did in our long-term budget outlook last year, we were clear that the biggest factor pushing up spending was the aging of the population and the growing number of people who would be eligible for these benefits under current law. The rise in health care costs per person in excess of GDP growth per person is a smaller factor, not an insignificant one but a smaller factor, actually, than the aging of the population.

So over the past 40 or so years, leaving aside the developments of the past few because of the recession and financial crisis, but over the 40 years leading up to that, this country had an expansion of Social Security and health care programs that was essentially financed by a reduction in military spending as a share of GDP. There was no direct flow of money, but if you looked at the overall Government budget, the decline in defense spending as a share of GDP turned out to be essentially the mirror image of the increase in Federal spending on Social Security and the big health care programs between about 1970, say, and 2007.

But that is the pattern that cannot be repeated, and it cannot be repeated because we now have a much sharper increase in the number of people who are beneficiaries of these programs, so the underlying forces pushing them up are stronger. We have also reduced defense spending to a much smaller share of the economy than it had been before. So that method essentially of dealing with the rising costs of these programs is not available at that order of magnitude. And this is not to say that changes cannot be made, of course, in defense spending or other things. But something different will have to happen going forward. And under current law, all Federal spending apart from that for Social Security and the big health care programs and interest payments, but everything else the Government does is already on track to become a much smaller share of the economy than it has been in the past. So even as things stand in these projections, the role of the Federal Government over the next decade relative to the past decade is sharply different, much more spending on these benefit programs, particularly for older Americans, and relative to the size of the economy on a track to have less spending on defense but also non-defense discretionary spending and the mandatory programs apart from Social Security and the big health care programs.

So the share of GDP that we represented by in particular non-defense discretionary spending, and defense discretionary spending at the end of the coming decade, will be lower than they have been at any point in my lifetime, which is the period for which the Government has been collecting data on that basis.

So there is a really profound shift underway, even under the current law, which is not enough to put the debt ultimately on a sustainable path. So if you and your colleagues want to put the debt on a sustainable path, and also if you want to undo some of the things that are in current law like the sequester, then you will need to make substantial changes either in those large benefit programs or in the share of GDP taken up by tax revenue.

Chairman MURRAY. Okay. Let me check with our staff. Do we know if any members are returning?

[Pause.]

Chairman MURRAY. All right. I will ask one more question, and I would just like to notify all Senators, you have about 3 minutes to let me know if you are returning, or your staffs. Otherwise, I am going to ask one more question and adjourn.

Dr. Elmendorf, I did want to ask about the issue of sustainability as well as the second report you released last week on macroeconomic effects of alternative budgetary paths. I want to make sure that this Committee aggressively addresses the fiscal challenges we face, but to do it in a way that protects the recovery, puts in place sensible deficit reduction, and ensures the middle class get a fair deal.

The groups like Simpson-Bowles and the Senate Gang of Six prioritized protecting the economic recovery. They proposed to put our debt on a stable downward path without making immediate drastic cuts, and that approach would really allow us to make smart cuts, smart investments, and ask that everybody pay their fair share.

Your report suggests that in the near term large spending cuts would have a negative impact on growth, an effect that would be concerning given the relatively weak state of our economy today.

How might we avoid that negative impact while still achieving the benefit to the economy of deficit reduction?

Mr. ELMENDORF. I think, Senator, to provide more support for the economy in the near term without damping long-term economic prospects, you and your colleagues could pursue a path of less fiscal tightening this year and next, accompanied by greater tightening later in the coming decade. And there are many different combinations of policies that could be used to achieve that, but I think that sort of path that had less fiscal tightening now and more later could be good for the economy in the short term and also could strengthen the economy in the medium term and long term.

Chairman MURRAY. Okay. Well, CBO's analysis of alternative budgetary paths suggests that budget savings of about $4 trillion over the next decade on top of the sequester and the savings already achieved in the last Congress would be necessary to come close to eliminating the deficit by 2023. What would be the consequences of implementing an additional $4 trillion in deficit reduction, particularly if certain parts of the budget were to be excluded by defense or revenue?

Mr. ELMENDORF. Achieving that amount of deficit reduction would involve fundamental changes in some significant pieces of the budget, and the more pieces that were taken off the table, the more significant the changes would need to be in the remaining pieces. But the precise consequences, of course, on the benefits and services provided around the economy would depend on the nature of those cutbacks.

Chairman MURRAY. All right. Let me check with my staff to see if there are any Senators returning.

Okay. I think the votes contracted everybody's schedule this morning, and, Dr. Elmendorf, I know that you will answer any questions that are given to you in writing.

I do want to thank all of our Committee members for participating today, and thank you, Dr. Elmendorf, for being here, as well as all the staff of the Congressional Budget Office. I know the hard work you put into preparing the budget outlook and helping our Committee.

For all of our Committee members, I want to remind all of you that we do have our next meeting tomorrow at 10:30 to hear from members of the public and experts to learn more about the impact of budget decisions on families and communities, and as I said earlier, I am committed to making sure that families and communities have a voice in this process and that their values and perspectives are heard.

Finally, for the information of all my colleagues, additional statements and/or questions to Dr. Elmendorf for this hearing record are due by 6:00 p.m. today to be submitted to the chief clerk in Room 624.

With that, again, Dr. Elmendorf, thank you very much, and I will adjourn this hearing.

Mr. ELMENDORF. Thank you, Senator.

[Whereupon, at 12:19 p.m., the Committee was adjourned.]

CBO's Responses to Questions for the Record, Senate Budget Committee Hearing, February 12, 2013

__Senator Grassley__

Question 1: The CBO baseline shows that federal revenues, under current law, will rise to about 19 percent of GDP and stay there for most of the next ten years—higher than the historical average of about 18 to 18.5 percent. The baseline also shows that spending will average above 22 percent of GDP over the next ten years—higher than the historic average of 21 percent. This disparity leads to deficits totaling $7 trillion over the ten years.

Is it correct to state, that based on historical trends of revenue and spending, the primary driver of deficits over the next ten years is historically high spending?

Answer: Under current law, deficits during the 2014–2023 projection period will average 3.3 percent of GDP, CBO projects, similar to the 40-year average of 3.1 percent. In those projections, the deficit initially declines from 5.3 percent this year to a low of 2.4 percent in 2015 and follows an upward trend thereafter, reaching 3.8 percent by the end of the projection period.

CBO projects that revenues will average about 19 percent of GDP during the coming decade under current law, above their 18 percent average of the past 40 years. CBO also projects that outlays will average 22 percent of GDP over the next 10 years under current law, above their 21 percent average of the past 40 years. Thus, both outlays and revenues are projected to be higher than their historical average shares of the economy's total output.

CBO expects that, under current law, outlays will be above their historical average primarily because the aging of the population, rising health care costs, and a significant expansion in eligibility for federal subsidies for health insurance will push up spending for Social Security and the major federal health care programs (Medicare, Medicaid, and the subsidies to be provided through insurance exchanges). Such spending is projected to equal 10.9 percent of GDP during the coming decade, compared with a 40-year average of 7.2 percent. In addition, with federal debt held by the public much larger relative to GDP than it has been in the past, net interest payments are projected to equal 2.5 percent of GDP, compared with a 40-year average of 2.2 percent.

Other broad categories of spending are expected to represent smaller shares of GDP than they have been in the past: Mandatory spending other than for Social Security and the major health care programs is projected to average 2.6 percent of GDP, compared with a 40-year average of 3.0 percent; defense spending is projected to average 3.0 percent of GDP, compared with a 40-year average of 4.7 percent; and nondefense discretionary spending is projected to average 3.0 percent of GDP, compared with a 40-year average of 4.0 percent.

Question 2: Some have argued that to close the deficit over the next decade, we should simply bring revenue up to about 21% of GDP, from the present level of around 18.5%. An increase in effective tax rates to collect revenues at 21% of GDP would result in a tax increase over the next ten years of about $3-4 trillion. And, that's on top of the $600 billion tax increase enacted as part of the fiscal cliff deal.

Do you think raising taxes by $3-4 trillion is the right approach to reduce deficits and balance the budget over the next ten years? What would a tax increase of that size do to economic growth? Finally, what's better for our fiscal stability long-term – a $4 trillion tax increase or increased revenue as a result of economic growth?

Answer: Choices about public policy inevitably involve certain sorts of value judgments that CBO does not and should not make. To ensure that CBO's analysis is objective, impartial, and nonpartisan, the agency does not make recommendations about what policies the Congress should enact.

The economic effects of a tax increase would depend on how taxes were raised—including, in particular, the extent to which statutory tax rates were raised versus the extent to which the tax base was broadened. In the short run, a tax increase is likely to reduce economic output below what it would be otherwise by reducing after-tax income and therefore demand for goods and services. In the longer run, a tax increase would have competing effects on the economy: The policies that raise tax revenues might decrease people's incentives to work and save, but the smaller budget deficits and lower federal debt would boost national saving, investment, and income. The net effect on output would depend on the details of the policies underlying the tax increase.

Question 3: Following the enactment of legislation to cut spending and increase taxes, some of our colleagues and outside commentators, including Paul Krugman, have argued that we're essentially on the cusp of victory regarding our debt problem. He stated in a column recently that the budget deficit isn't our biggest problem, and it's a problem that is already, to a large degree, solved. He argues that an economic recovery will stabilize deficits.

Do you agree with this assessment, or is it important to put the debt-to-GDP ratio on a downward path? Is simply stabilizing it at the historically high level of 77 percent of GDP enough? What are the economic consequences of such high and rising debt?

Answer: By 2023, if current laws remain in place, debt will equal 77 percent of GDP and be on an upward path, CBO projects. Such high and rising debt will eventually have serious negative consequences:

- When interest rates rise to more-normal levels, federal spending on interest payments will increase substantially (as shown in CBO's baseline projections).

- Because federal borrowing reduces national saving, the capital stock will be smaller and income will be lower than they would be if the debt was smaller.

- Lawmakers will have less flexibility than they would otherwise to use tax and spending policies to respond to unexpected challenges.

- Such a large debt will increase the risk of a fiscal crisis, during which investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow at affordable rates. It is impossible to predict with any confidence whether or when a fiscal crisis might occur in the United States; in particular, there is no identifiable level of debt relative to GDP that indicates that a crisis is likely or imminent. At any given time, the risk of such a crisis depends not only on the debt levels and economic conditions in the United States and other countries at the time but also on expectations about budgetary and economic developments in the future. All else being equal, however, the greater the amount of federal debt, the greater the risk of a fiscal crisis.

Question 4: Your report indicates that interest rates will be higher in the second half of the decade due to the high debt-to-GDP ratio. I presume there is a negative consequence to economic growth of higher interest rates and lower private investment.

Will higher interest rates, caused by high debt levels, reduce long-term economic output?

Can you characterize the impact of higher interest payments and federal borrowing on national saving and wage growth?

And, what does this mean for America's poor and most vulnerable?

Answer: CBO forecasts that interest rates will average 4.0 percent on 3-month Treasury bills and 5.2 percent on 10-year Treasury notes over the period from 2018 to 2023. Those rates are consistent with the historical relationships among interest rates, inflation, federal borrowing, and the factors that underlie the growth of potential GDP. In particular, the rate on 10-year Treasury notes, adjusted for inflation, is projected to equal about 3 percent from 2019 to 2023—higher than its long-run historical average, primarily because CBO forecasts a higher-than-average ratio of federal debt to GDP during that period. With increases in federal debt and interest rates over the next decade, the federal government's net interest costs are projected to increase from 1.4 percent of GDP in 2013 to 3.3 percent of GDP in 2023, contributing to the increase in federal debt. The rise in debt is projected to crowd out investment, reducing the nation's output and wages for Americans in all income categories.

Question 5: It is my understanding from the work of the Congressional Budget Office that health care will become the single largest spending provision of the federal government, exceeding Social Security, as of 2015. I further understand from your work that over the next 25 years health care entitlements will nearly double as a share of GDP growing to 10% of GDP.

Given those two facts, if we are serious about spending, we have to be talking about health care. If we are going to reduce spending in health care, we have very few options. We can either increase the amount beneficiaries pay or reduce what we pay providers. If we want our health care system to be more efficient, we are going to have to make structural, delivery system reforms to our health care system.

Do you disagree with any of this statement?

Answer: Under current law, the aging of the population, rising health care costs, and a significant expansion in eligibility for federal subsidies for health insurance will substantially boost federal spending on Social Security and the government's major health care programs, relative to GDP, for the next 10 years and in decades thereafter. In particular, in CBO's baseline, outlays for the federal government's major health care programs—Medicare (net of receipts from premiums), Medicaid, the Children's Health Insurance Program, and subsidies offered through new health insurance exchanges and related spending—are projected to rise from 4.7 percent of GDP in 2012 to 6.2 percent in 2023. Spending for Social Security will also be rising as a share of GDP. In total, outlays for the major health care programs will exceed spending for Social Security by 2015 and will be 13 percent greater by 2023, CBO projects.

Unless the laws governing Social Security and the major health care programs are changed—or the increased spending is accompanied by corresponding reductions in other spending, sufficiently higher tax revenues, or a combination of the two—debt will rise sharply relative to GDP after 2023.

Major changes to current tax or spending policies will be necessary to put the budget on a more sustainable path, but such changes will require significant trade-offs between deficit reduction and other policy goals. If lawmakers want to reduce federal spending for health care relative to what it would be under current law, then increasing the share of health care costs borne by beneficiaries and reducing payments to providers are among the key alternative approaches. Some versions of those approaches—as well as other possible changes in federal programs—might also lead to changes in the delivery of health care that would increase the efficiency of the health care system. Policy changes that align the interests of patients, providers, and payers may have the greatest potential to control costs, although they may be complex to design and can have uncertain effects.

Senator Warner

Question 1: Starting with the Simpson-Bowles report, over the last couple years expert groups on solving long-term deficits have told us that in order to get our debt to GDP ratio to a sustainable level we need about $4 trillion in deficit reduction over 10 years to get our debt-to-GDP ratio to a sustainable level. How much deficit reduction would we need over 10 years to have the same effect that a $4 trillion package (constructed line in Simpson-Bowles) would have had in 2011?

Answer: The National Commission on Fiscal Responsibility and Reform (often called the Simpson-Bowles Commission) estimated that, under its plan (released in December 2010 and covering the years between 2012 and 2020), debt held by the public at the end of that period would stand at about 65 percent of GDP and be on a slightly downward trajectory. By contrast, under CBO's most recent baseline (which covers the years between 2013 and 2023), debt held by the public would equal 77 percent of GDP at the end of the period and be on a slightly upward trajectory. Under an illustrative path developed by CBO in which baseline deficits would be reduced by a total of $2.4 trillion (including the effects on debt service and on the economy), debt would decline to 67 percent of GDP in 2023, in the vicinity of the debt that the Commission projected for 2020 under its plan (although its plan did not take potential economic effects into account). A second illustrative path developed by CBO in which deficits would be reduced by a total of $4.8 trillion over 10 years (relative to CBO's current baseline) would put debt held by the public on a steeper downward trajectory and bring it to 59 percent of GDP in 2023.

The amount of debt considered "sustainable" is unclear. Achieving relative stability in the debt —as would occur in CBO's projections under current law—would be a welcome development after the sharp upward surge in debt during the past several years, but such debt would still equal a greater percentage of GDP than in any year between 1952 and 2010. Even stabilizing debt closer to 60 percent of GDP would still be a higher level than in nearly all years during that period. Debt that was high by historical standards would have significant consequences, including higher net interest costs and lower national saving, leading to less domestic investment and income relative to what they would be otherwise. In addition, policymakers' ability to use tax and spending policies to respond to unexpected challenges could be constrained, and the likelihood of a fiscal crisis would be higher.

Question 2: Are there benchmarks in terms of unemployment and GDP growth where allowing deficit reduction to take place will have a less dramatic effect on unemployment and GDP?

Answer: Deficit reduction would tend to have a smaller negative impact on GDP in the short run when the economy was stronger and monetary policy was less constrained in its ability to confront economic headwinds. Ordinarily, the Federal Reserve can seek to offset a tightening of fiscal policy by lowering short-term interest rates. But in the current economic environment, with output so far below its potential (maximum sustainable) level, the Federal Reserve has kept short-term interest rates near zero. As a result, the Federal Reserve would be unable to further reduce short-term interest rates to offset the negative short-run effects on GDP of tax increases or spending cuts. CBO currently projects that after output moves closer to its potential, the Federal

Reserve will begin to raise short-term interest rates above zero in 2016. As we near that time, CBO expects that fiscal tightening would have a smaller effect on unemployment and GDP than it would have this year or next year.

Question 3: Today, looking at what we have done in terms of new revenue for the next ten years and making an apples to apples comparison with baselines—how much revenue has the Congress raised compared to what Simpson-Bowles, which had bipartisan support, proposed that Congress raise in order to address our fiscal challenges?

Answer: The National Commission on Fiscal Responsibility and Reform proposed that federal revenues total 19.3 percent of GDP in 2015, 20.0 percent in 2017, and 20.6 percent in 2020. Under the assumption that the laws governing taxes do not change, CBO projects that federal revenues will equal 19.1 percent of GDP in 2015, 18.9 percent in 2017, and 18.7 percent in 2020. Thus, under current law, federal revenues would be below the commission's proposed amounts by about 1 percent of GDP in 2017 and about 2 percent of GDP in 2020.

Question 4: Sequester is scheduled to hit in just 17 days. These cuts were made to be so stupid that nobody would want them to happen. But, as the days go by, and we do nothing, it is seems more likely it will go into effect. What is immensely frustrating is that it seems like under the guise of trying to save money through sequester, we are going to end up paying more on many contracts due to termination fees and other associated costs. For example, with many pentagon multi-year contracts, we get cost savings by "buying in bulk". The problem is, if we miss a payment due to sequester, the contract will be cancelled and the taxpayer will be hit with huge charges for termination costs, and then end up paying more at the single quantity price. One tangible example is the USS Abraham Lincoln was scheduled to begin a 44 month overhaul on this month, but the Navy doesn't have funding for that project due to the CR, so it's tied the Lincoln up to a pier and it's going to cost the taxpayers $1OM/month to sit there (with a 1,000 person overhaul crew ready to go-but no funding), not to mention derailing the Navy's tightly coordinated carrier overhaul schedule.

Is CBO accounting for these types of potential cost increase, and how are you measuring them?

Answer: When departments and agencies cannot plan and execute their budgets because of sharp changes in funding or uncertainties about funding, their operations will often be less efficient. For example, uncertain budgets have led some federal agencies to lease buildings rather than purchase them outright, which may have resulted in higher total costs over the long term. Uncertain budgets have also led federal agencies to postpone updating computer and communications systems, which may have reduced the productivity of their employees.

However, the efficiency of the operations of federal departments and agencies does not affect CBO's baseline (current-law) projections for discretionary spending. With caps on discretionary spending in place, CBO's projections of overall defense and nondefense discretionary funding are equal to the cap amounts. Hence, the inefficiencies that may result from sharp changes in funding or uncertainties about funding do not affect the amount of discretionary spending that CBO projects. Rather, such inefficiencies reduce the quantity or value of the goods and services that the government can acquire and produce with that spending, and they may make it more difficult to constrain spending in the future.

Senator King

Question 1: Federal tax expenditures have grown substantially over the last decade, almost doubling from $508 billion in 1988 to $1.025 trillion (in 2010 dollars). In a 2012 report from the Joint Committee on Taxation, the committee lists tax expenditures at over $1 trillion dollars, constituting a larger part of the budget than Medicare, Medicaid, Social Security, or National Defense. Given this Congress' responsibility to address our fiscal challenges in a balanced way, reforming tax expenditures in order to achieve credible deficit reduction should be prioritized before cutting federal discretionary spending.

Could you provide insight on the sustainability of the growth of federal tax expenditures as a share of the federal budget?

Answer: Under current law, tax expenditures will continue to grow in coming years. For example, the staff of the Joint Committee of Taxation recently estimated that, under current law, total tax expenditures in the individual income tax will increase from about $1.0 trillion in 2012 to about $1.4 trillion in 2017, a rise of about 40 percent.[1] Some tax expenditures (such as ones related to health care) will grow at a faster pace, and some (such as the tax expenditure for the child tax credit) will grow more slowly. By way of comparison, CBO projects that, under current law, receipts from individual and corporate income taxes combined will increase by about 70 percent between 2012 and 2017.

Question 2: A series of bipartisan deals enacted in 2011 will cut federal discretionary spending by approximately $1.5 trillion for Fiscal Years 2013-2022. In the Budget and Economic Outlook: FY 2012-2023 report, the Congressional Budget Office projects that with the original caps on discretionary budget authority from just one of the deals – the Budget Control Act – discretionary spending will equal 5.8% of GDP in 2023. This would be the lowest level for discretionary spending as a share of the economy in more than fifty years, sinking discretionary spending to a new historic low.

Could you provide insight on the following: How have cuts in federal discretionary spending enacted under the 2011 series of Continuing Resolutions and the 2011 Budget Control Act affected the economy; and, as this Committee seeks to address upcoming fiscal challenges, such as the sequester, the budget, and the debt limit, how would further cuts in federal discretionary spending affect the U.S. economy?

Answer: CBO has not separately analyzed the economic effects of the limits on discretionary spending imposed by the Budget Control Act of 2011 and the various continuing resolutions enacted by lawmakers in recent years. In general, reductions in federal spending tend to lead to lower output and income in the short run because they subtract from the economy's demand for goods and services; but they tend to lead to greater output and income in the longer run because the resulting smaller budget deficits and lower federal debt boost national saving and investment. That positive long-run effect on output would be offset to some extent if the reductions in federal

[1] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), www.jct.gov/publications.html.

spending came from cuts in spending on productive government investment, such as carefully chosen infrastructure projects.

Question 3: It is undeniable that America's infrastructure is in decay. The American Society of Civil Engineers estimated in 2011 that we must invest $1.7 trillion between now and 2020 to rebuild roads, bridges, water lines, sewage systems, and dams that are reaching the ends of their planned life cycles. In Maine, the Federal Highway Administration estimates that 342 Maine bridges are structurally deficient (14.24 percent of the 2402 total) and in need of repair. We need to reinvest in and rebuild America's infrastructure system.

Could you provide insight on the following: How do targeted infrastructure investments effect economic growth? Are there investments Congress could make that would have greater economic impact than rebuilding our nation's public infrastructure?

Answer: In the current economic environment, with significant unused capacity, additional federal spending on infrastructure could increase employment and output. In addition, evidence suggests that spending on carefully selected infrastructure projects can contribute to long-term economic growth by increasing the nation's capital stock and raising productivity. If that spending on infrastructure resulted in greater federal debt, the negative effects on private investment and output from that higher debt would be offset to some extent by the positive contributions of the additional infrastructure itself. CBO has discussed infrastructure investments in a number of reports and testimonies, including *Spending and Funding for Highways* (January 2011), www.cbo.gov/publication/22003; *Public Spending on Transportation and Water Infrastructure* (November 2010), www.cbo.gov/publication/21902; and *Issues and Options in Infrastructure Investment* (May 2008), www.cbo.gov/publication/19633.

Other government investments that could enhance productivity in the long run include increases in the quality and quantity of public education and increases in research and development. However, the effectiveness of investments in those areas is very difficult to project, and outcomes would depend critically on the specifics of the policies.

Senator Enzi

Question 1: The CBO report indicates that revenues are projected to increase by roughly 25 percent between 2013 and 2015. In addition, growth of the economy is expected to be just 1.4 percent in 2013 but accelerate to 3.4 percent in 2014.

To what extent do increased taxes that were recently enacted and that pull money out of the hands of both employers and employees have a negative effect on your economic growth projections? Would you please quantify the amount?

Answer: CBO estimates that economic growth in 2013 would be roughly 1½ percentage points faster than the agency now projects if not for the fiscal tightening projected for this year. About 1¼ percentage points of that effect come from automatic reductions in federal spending established by the Budget Control Act of 2011, the expiration of the cut in payroll tax rates, and the increase in tax rates on income above certain thresholds; the spending changes and the combined tax changes account for about equal portions of that amount. (The remaining ¼ percentage point comes from other, smaller changes in spending and taxes.)

Question 2: The CBO report indicates that "after the economy adjusts this year to the fiscal tightening inherent in current law, underlying economic factors will lead to more rapid growth, CBO projects—3.4 percent in 2014 and an average of 3.6 percent a year from 2015 through 2018."

Would you walk us through your analysis leading to the conclusion that the economy will "adjust" this year, and not over a longer period of time, due specifically to the tax increases enacted earlier this year.

Answer: CBO's analysis indicates that the economy gained momentum in 2012, and will continue to do so in 2013, but that GDP growth will be constrained this year by the tightening of fiscal policy that is now under way. Were it not for that tightening, CBO's forecast for real GDP growth in 2013 would be about 3 percent, or about 1½ percentage points faster than our forecast under current law.

CBO expects that the effect of the fiscal tightening on the rate of growth of output will occur primarily in 2013 because the tax increases and spending cuts will reduce private and government purchases of goods and services fairly quickly. After that occurs, the underlying momentum of the economy appears to be strong enough to return growth to more than 3 percent in 2014. Nevertheless, output will remain lower than it otherwise would have been for several years, CBO estimates. In the longer run, the impact of the fiscal tightening on output will reflect the balance between two forces: People's incentives to work and save will be reduced because of higher marginal tax rates, but smaller budget deficits and lower federal debt will boost national saving and investment.

Question 3: In each of the past four years, the CBO has projected that a rapid recovery was only two years away, but that has not yet occurred. Your report indicated that the effects of

the housing and financial crisis will continue to fade and that an upswing in housing construction, rising real estate and stock prices, and increasing availability of credit will help spur economic growth.

Would you explain to us why these past projections were incorrect and how the estimations of economic growth in this year's report took those previous inaccuracies into account?

Answer: CBO regularly evaluates the quality of its economic forecasts by comparing them with the economy's actual performance and with forecasts by the Administration and the *Blue Chip* consensus—an average of about 50 private-sector forecasts. The most recent comparison, *CBO's Economic Forecasting Record: 2013 Update*, www.cbo.gov/publication/43846, was published in January 2013.

The economy has been weaker for a longer period of time than we and most other forecasters had anticipated. CBO recently published a report on the factors behind the slow recovery—*What Accounts for the Slow Growth of the Economy After the Recession*? (November 2012), www.cbo.gov/publication/43707—which includes a discussion of the performance of different sectors of the economy. Compared with past recoveries, this recovery has seen especially slow growth in four components of demand for goods and services: purchases of goods and services by state and local governments, purchases of goods and services by the federal government, residential investment, and consumer spending.

In 2009 and 2010, we marked down our forecast as we reassessed the effect that the financial crisis and recession were having on the economy. More recently, our forecast has been affected by such factors as weakness in Europe's economies and financial markets, and uncertainty about and anticipation of changes in fiscal policy. CBO's current forecast for the economy over the next few years reflects strengthening momentum as well as restraint from significant fiscal tightening that is projected to hold down growth this year. If not for that fiscal tightening, CBO's forecast for GDP growth in 2013 would be considerably stronger.

Question 4: Compared to the report issued last August by the CBO, the report issued last week shows that current law no longer puts our debt on a downward path. Would taking action sooner rather than later to reduce our $16 trillion (and growing) debt impose less pain, both financially and economically, on the nation and the taxpayers? For example, if we were to enact legislation like the Penny Plan (S. 1316, the One Percent Spending Reduction Act of 2011, introduced in the 112th Congress) that cuts spending by one percent across the board each year for several years to achieve a balanced budget, could the long-term benefits (in terms of economic growth and fiscal sustainability) of such a plan outweigh any potential short-term consequences?

Answer: Reductions in federal spending tend to lead to lower output in the short run because they subtract from aggregate demand for goods and services, and they tend to lead to higher output in the longer run because smaller budget deficits and lower federal debt boost national saving and investment.

How much the deficit is cut in the next few years will have a number of consequences. The longer that significant deficit reduction is deferred, the larger the government's accumulated debt will be (with its associated costs and risks), the greater people's doubts might be about whether long-term deficit reduction will actually take place, and the greater the policy changes will need to be when deficit reduction begins. Conversely, the sooner that the deficit is cut, the less time that households, businesses, and state and local governments will have to plan and adjust their behavior. In addition, the timing of the steps taken to put fiscal policy on a sustainable course will affect different generations differently and will have a substantial impact on the economy. CBO analyzed the economic effects of waiting to implement policies that would stabilize the ratio of federal debt to output in *Economic Impacts of Waiting to Resolve the Long-Term Budget Imbalance* (December 2010), www.cbo.gov/publication/21959.

Lawmakers could enact a wide range of policy changes with a wide range of timing for implementing those changes. Households, businesses, state and local governments, and participants in the financial markets would be more likely to believe that the deficit reduction would truly take effect in the future if the future policy changes were specific and widely supported.

Question 5: Would you please explain why the number of individuals projected to lose their employer-based or non-group insurance coverage has increased by more than 4 million since your previous estimate in August? Would you please explain what the effects of this increased loss of private insurance coverage will be on the federal government spending?

Answer: Appendix A of CBO's report *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013), www.cbo.gov/publication/43907, includes a section explaining the changes related to projected insurance coverage under the Affordable Care Act (ACA). As the report notes, reduced marginal tax rates are one of the main factors that explain the increase of 4 million people shifting out of employment-based coverage. The American Taxpayer Relief Act lowered marginal tax rates (compared with the rates that were scheduled to be in effect under prior law), thus reducing the subsidy for health insurance provided by the tax exclusion for employment-based coverage. (The value of that subsidy is equal to the amount that a firm pays for health insurance premiums multiplied by the marginal tax rate of the employee.) CBO anticipates that with a smaller government subsidy for employer-based coverage, less of that coverage will be provided and more people will enroll in the new insurance exchanges than CBO and the staff of the Joint Committee on Taxation (JCT) had previously estimated. That effect accounts for 2 million to 3 million additional people shifting out of employment-based coverage in the February 2013 baseline compared with prior estimates.

CBO also made a technical improvement to its models regarding how people's income is projected. As CBO stated in a March 2012 report on employment-based health insurance coverage under the ACA—*CBO and JCT's Estimates of the Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance*, www.cbo.gov/publication/43082—employers' decisions about whether to offer health insurance will depend in part on how many of their workers are eligible for Medicaid or exchange subsidies. In the February 2013 baseline, as a result of modeling improvements, slightly more people are now projected to have income that will make them eligible for Medicaid or significant subsidies in the insurance exchanges. That increases the likelihood that some of those workers or their employers may make decisions that move those workers out of employment-based coverage.

Another technical change incorporated in the February 2013 baseline is an improvement in CBO's projections of insurance coverage in the absence of the ACA (shown as "prior law" coverage in CBO's tables). That change has made employment-based health insurance coverage slightly more sensitive to the amount of unemployment and slightly less sensitive to growth in health insurance premiums. As a result, CBO now estimates that there would have been 166 million people enrolled in employment-based coverage in 2020 in the absence of the ACA, compared with 161 million in the August 2012 baseline. With more people estimated to have had such coverage in the absence of the ACA, there will be a slightly greater reduction in employment-based coverage due to the ACA. Nevertheless, because of that higher starting point, CBO and JCT now project that, after the reduction stemming from the ACA, about 158 million people will obtain coverage through their employers in 2020, compared with the estimate of 157 million in the August 2012 baseline.

Question 6: CBO has projected that 7 million people will lose their employer-sponsored health insurance coverage over the next ten years. However, other actuarial estimates have placed the number at twice that amount or higher. Would you please explain how CBO arrived at this estimate, and what sources you consulted in estimating the number of employees who will lose their employer-sponsored health insurance?

Answer: In March 2012, CBO and the staff of the Joint Committee on Taxation (JCT) published a lengthy report titled *CBO and JCT's Estimates of The Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance*, www.cbo.gov/publication/43082. That report explained in detail how CBO and JCT estimate changes in employment-based coverage stemming from the Affordable Care Act (ACA). As the report notes:

> Some observers have expressed surprise that CBO and JCT have not expected a much larger reduction in the number of people receiving employment-based health insurance in light of the expanded availability of subsidized health insurance coverage that will result from the ACA. CBO and JCT's estimates take account of that expansion, but they also recognize that the legislation leaves in place some financial incentives and also creates new financial incentives for firms to offer and for many people to obtain health insurance coverage through their employers. CBO and JCT have estimated that many workers and their families will not be eligible for Medicaid, the Children's Health Insurance Program . . . , or substantial subsidies for the purchase of health insurance through the exchanges and that most employers will continue to have an economic incentive to offer health insurance to their employees. . . . Other analysts who have carefully modeled the nation's existing health insurance system and the changes in incentives for employers to offer insurance coverage created by the ACA have reached conclusions similar to those of CBO and JCT or have predicted smaller declines (or even gains) in employment-based coverage owing to the law. Surveys

> of employers regarding their plans for offering health insurance coverage in the future have uncertain value and offer conflicting findings. One piece of evidence that may be relevant is the experience in Massachusetts, where employment-based health insurance coverage appeared to increase after that state's reforms, which are similar but not identical to those in the ACA, were implemented. (pp. 1-2)

CBO and JCT's current estimates reflect our assessment of employers' and employees' responses to the set of opportunities and incentives under the ACA. In particular, the estimates reflect the view that workers generally want to obtain health insurance coverage at the lowest possible cost, taking into account both the price charged and any changes in tax payments or government subsidies that apply. CBO and JCT continue to expect that the ACA will lead to a small reduction in employment-based health insurance. That projection arises from the agencies' modeling of the many changes in opportunities and incentives facing employers and employees under the ACA and is consistent with the findings of other analysts who have carefully modeled the nation's health insurance system.

Senator Johnson

Question: In the Budget and Economic Outlook: Fiscal Years 2013 to 2023, CBO projects slower growth in health care spending than has historically been the case. Please provide detailed information about the assumptions used by CBO in the adjustment of its current projections for Medicaid and Medicare, including the details on actual spending for 2012. Please provide specifics about what the Affordable Care Act's policy changes do to either achieve savings or increase costs, as well as the technical changes made to the CBO's assumptions pertaining to Medicaid expenditures.

Answer: In recent years, health care spending has grown much more slowly, both nationally and for federal programs, than historical rates would have indicated. For fiscal year 2012, federal spending for Medicaid was $251 billion, and federal spending for Medicare (net of beneficiaries' premiums and other offsetting receipts related to the program) was $466 billion. Those amounts are about 5 percent below the amounts that CBO had projected in March 2010. In response to that slowdown, over the past several years CBO has made a series of downward technical adjustments to its projections of spending for Medicaid and Medicare. For example, from the March 2010 baseline to the current baseline, technical revisions (mostly reflecting the slower growth in the programs' spending in recent years) have lowered CBO's estimates of federal spending for the two programs in 2020 by a total about $200 billion—by $126 billion for Medicare and by $78 billion for Medicaid, or by roughly 15 percent for each program.

For the 2013–2022 period, CBO's latest projection of Medicaid spending is nearly $240 billion (or about 5½ percent) lower than its estimate in August 2012. That revision reflects both lower anticipated enrollment in Medicaid and lower expected costs per person.

CBO now estimates that enrollment in 2022, for example, will be about 84 million, compared with the 85 million it projected last August. Although CBO has increased its estimate of the number of people who will enroll in Medicaid for the first time because of the Affordable Care Act's expansion of the program, the agency's projection of the number of people who would have been covered by Medicaid in the absence of that law has declined by a greater amount. Lower estimated Medicaid enrollment among those other groups is, in part, the result of improvements in CBO's methods for forecasting the number of people with insurance. More people are now expected to obtain insurance through other sources (primarily employers), resulting in lower projected enrollment in Medicaid. In addition, fewer people are now expected to enroll in the Supplemental Security Income program, and because people who are enrolled in that program automatically qualify for Medicaid, that change in turn reduces the projected number of Medicaid enrollees.

CBO's current baseline also shows lower spending per person in the Medicaid program than was shown in August, primarily because of adjustments to account for the slowed growth in Medicaid spending. The agency also expects that per-person costs will be lower than it anticipated in August because a larger share of the people who will be covered under the Medicaid program will be children and healthier adults, whose medical costs tend to be lower than those of less healthy adults. Because of those and other factors, CBO now estimates that

Medicaid spending per person in 2020 will be about 6 percent lower than it projected in August.

For the 2013–2022 period, CBO has reduced its 10-year projections of outlays for Medicare by about $140 billion (or about 2 percent) mostly for technical reasons—in particular, because of data on actual spending for 2012, the third consecutive year in which spending was significantly lower than CBO had projected. In past baselines, CBO had begun to reflect the slowing growth in spending for Medicare's Part A (Hospital Insurance) and Part B (Medical Insurance); the largest downward revision in the current baseline is for spending for Medicare's Part D (prescription drugs).

You also asked for specifics about what the Affordable Care Act's policy changes do to either achieve savings or increase costs. For the most recent estimate we have completed for the budgetary effects of the changes made by the Affordable Care Act, see Congressional Budget Office, letter to the Honorable John Boehner providing an estimate for H.R. 6079, the Repeal of Obamacare Act (July 24, 2012), www.cbo.gov/publication/43471.

<u>**Senator Whitehouse**</u>

Question: In CBO's review of the causes of slowing growth in health care spending, what types of evidence will you consider? How will you determine whether changes in health care spending are temporary or structural?

Answer: CBO continually reviews patterns of growth in health care spending to inform our projections. Whenever changes in those patterns are observed, we try to determine—through our own analysis and through discussions with outside analysts and practitioners—the extent to which the changes result from government policies, economic circumstances, demographic shifts, or changes in the nature of health care and the delivery of that care.

We are currently analyzing data on Medicare spending, Medicare beneficiaries, economic conditions, and other factors to determine what portion of the slowdown in Medicare spending can be attributed to changes in the prices paid for health care services under current law and changes in the composition and health of the Medicare population. In addition, we are examining which types of medical care experienced sharper slowdowns in growth than other types.
To help assess the extent to which changes in Medicare spending might be the temporary consequence of the weak economy, we are also exploring whether the use of health care services by beneficiaries who were affected the most by the financial crisis and recession grew at a slower rate than the use of services by beneficiaries who were less affected.

Senator Crapo

Question 1: It is my understanding that the Social Security Disability Insurance (SSDI) program is currently projected to be insolvent by 2016, that the Medicare program is projected to be insolvent by 2024 (just one year beyond the current 10-year budget window), and the Social Security program is projected to be insolvent by 2033. Is this all correct?

Answer: CBO projects that the Social Security Disability Insurance Trust Fund will exhaust its balances sometime in fiscal year 2016. Based on current law in 2012, CBO estimated that the Old-Age and Survivors Insurance Trust Fund would be exhausted in 2038 and that the combined balances of those two trust funds would be exhausted in 2034. (The trust funds are legally separate but are often combined for estimating convenience.) CBO has not yet updated its long-term baseline to reflect changes in law since 2012. For Medicare, CBO projects that the trust fund for Part A (the Hospital Insurance Trust Fund) will exhaust its balances sometime in fiscal year 2023.

Question 2: There has been much recent discussion about the composition and effects of recent deficit reduction efforts, particularly the Continuing Resolution, the Budget Control Act and the recent Fiscal Cliff agreement. I know there are some modest Medicare savings currently projected to be a part of the sequester. Outside of those modest savings, which have yet to actually take effect, is it not correct that, regardless of the significance that one may apply to the overall deficit-reduction effects of those pieces of legislation, those measures have not had any measurable effect on improving the solvency of any of these important programs?

Answer: The Budget Control Act provided adjustments to the discretionary spending caps for increased activities related to program integrity in the Disability Insurance program. Even if the Congress had provided the maximum amount allowed under the adjustment (it provided less than the maximum in 2012), CBO does not expect that the decrease in benefit outlays resulting from those activities—less than $2 billion cumulatively through 2016—would have a significant effect on the balances in the Disability Insurance Trust Fund, which will have a shortfall of about $15 billion in 2016.

None of that recent legislation significantly affected the solvency of the Hospital Insurance Trust Fund.

Question 3: I have spent much of the last 3 years focusing on ways to contain our ever-expanding deficit and entitlement problem. Sitting on the President's Fiscal Commission, the Gang of 6 and Gang of 8, my colleagues and I continued to go back to the same old reform ideas because we couldn't get any new ideas to save money. While we have heard about many different ideas from my colleagues on both sides of the aisle to reform our nation's Medicare program, CBO hasn't always been able to put a dollar amount to how much money these ideas would save.

Donald Berwick, a Center of American Progress senior fellow and former administrator of CMS recently stated that CBO's scoring rules are "much too much embed in the status quo. They require levels of certainty about the costs and benefits that defy many forms of innovation. They don't invite the kind of ambitious thinking that the country really needs right now, and unfortunately it does increase the risk of cuts."

We all know that CBO has previously acknowledged certain policies in Medicare reform that get away from the status quo are difficult to score—this includes those that will impact consumer or business behavior, prevention and care coordination.

Does CBO plan to make any changes to its current scoring rules to account for the innovation that is needed to reform the antiquated Medicare program to sustain it in the long run? And to sustain it without making blanketed cuts that will do nothing to bend the cost curve or address solvency?

Answer: The procedures that CBO follows in producing baseline projections and cost estimates for legislative proposals are procedures that the budget committees and others in the Congress have found most useful over time. CBO aims to provide estimates of the budgetary impact of proposals that reflect its best judgment, based on available data and information, about what would occur if those proposals were implemented. Because the budgetary effects of proposed policies are almost always uncertain, however, those estimates should be viewed as CBO's assessment of the middle of a distribution of possible outcomes.

Such estimates are particularly challenging for proposals that are more innovative, which tend to have effects—on the federal budget, on beneficiaries of federal programs, and on providers of services—that are more uncertain. For innovative health care proposals, the distribution of possible outcomes often includes both a possibility of large savings and a possibility of small savings or even costs. Indeed, assessments of numerous demonstration projects in Medicare—which CBO reviewed in *Lessons from Medicare's Demonstration Projects on Disease Management, Care Coordination, and Value-Based Payment* (January 2012), www.cbo.gov/publication/42859 —show that certain changes in Medicare have led to a wide range of budgetary and other effects for different providers of care who have participated in those projects.

A key issue in many proposals that we have analyzed is not whether efficiencies can be achieved in principle, but the extent to which a particular legislative proposal will result in efficiencies in practice. For example, in many cases, our estimate of the budgetary effects of a proposal depends on how well the proposal targets a specific population or behavior. In the case of prevention activities, the costs of a new screening program for a specific disease that is made broadly available to Medicare beneficiaries often outweigh the savings generated from detecting that disease at an early stage in a small share of those benefi ;aries. If the screening policy could effectively target the narrower population, the budgetary costs would be smaller relative to the budgetary benefits. The fact that a policy might lead to improved health outcomes does not necessarily mean that it would save the government money. Of course, even if such screening cost the government money, on balance, it might well represent an appropriate use of government funds, but that is not CBO's judgment to make.

To estimate the effects of legislative proposals generally, CBO reviews studies by outside analysts, examines historical data for federal programs and any relevant data available from states, and conducts its own research using administrative records and survey data. The agency also consults with people in research organizations; relevant federal, state, and local government agencies; and businesses and national associations representing various groups. In the case of innovative strategies in health care, we are continually and very actively engaged in assessing new information as it becomes available. We are also engaged in several in-depth analytic efforts to improve our ability to model significant structural changes in Medicare, such as a premium-support approach.

Question 4: Along those lines, the Bowles-Simpson Commission recognized that, while it would not be appropriate to seek savings from Social Security to reduce the overall national debt, it is a fact that Social Security will be insolvent within a generation if we do not act. Therefore, we felt it appropriate to include policies that would meet the goal of ensuring that Social Security remains solvent for the next 75 years, and beyond. And we were told by experts that various policy proposals can be measured on how they improve the solvency of Social Security, and that the goal of overall solvency is measurable.

However, when it comes to Medicare, we are told by experts that it is not as clear cut to be able to determine the precise type or magnitude of policies that would need to be enacted to pull the program from the brink and ensure the program remains solvent for at least the next 75 years. We know that the entitlement programs are by far the major driver of our long-term budget pressures. As such, rather than trying to focus on policies that would achieve a certain targeted amount of overall deficit reduction, if policymakers instead focused on enacting policies that would achieve 75-year sustainable solvency for Social Security, Medicare and Medicaid (with the secondary effect being a dramatic improvement in the long-term budget outlook), do we currently have the scoring/ estimating measurements available in your office and elsewhere that would allow us to make the necessary decisions to try to achieve those long-term solvency goals?

Answer: Federal trust funds, such as those for Social Security and Medicare's Hospital Insurance, are essentially accounting mechanisms within the government's overall financial flows. They have important legal meaning but little economic or budgetary meaning. The dates on which the balances of those trust funds are projected to be exhausted do not provide useful information about the resources that will be needed in future years from taxes, other government income, or government borrowing to pay for benefits to be provided in that year.

The Social Security and Medicare trust funds are part of the federal government, so transactions between them and the Treasury are intragovernmental and have no net impact on the unified budget or on federal borrowing from the public. For each year, the sum of a trust fund's receipts and the interest that is credited on the trust fund balance, minus spending for benefits, represents the surplus (or deficit, if benefit spending is greater) in the trust fund for that year. Any cash generated when receipts exceed spending is not retained by the trust fund; rather, it is turned over to the Treasury, which provides government bonds to the trust fund in exchange and uses the cash to finance the government's ongoing activities. Thus, from a unified-budget perspective, any increase in revenues or decrease in outlays for the trust funds represents cash that can be used to finance other government activities without requiring new government borrowing from the public. Similarly, any increase in outlays or decrease in revenues for the trust funds in some future year represents a draw on the government's cash in that year. Thus, the resources to redeem government bonds in the trust funds and thereby pay for benefits in some future year will have to be generated from taxes, other government income, or government borrowing in that year.

The financial pressures that will be generated by Social Security and Medicare in future years can best be assessed not by the projected exhaustion date of the trust funds but by the difference between projected spending for those programs and other activities and projected federal revenues. Such projections (as well as projections of balances in the trust funds) are particularly difficult to make for health care programs over very long time periods because a wide range of changes could occur in people's health, in the sources and extent of their insurance coverage, and in the delivery of medical care—and those changes could have a significant impact on federal health care spending. Those potential changes make long-run estimates of the effects of proposals to alter federal health care programs much more uncertain than estimates of the effects of proposals to alter the Social Security program, which is affected primarily by demographic changes that are somewhat less difficult to predict.

Although the trust funds have little budgetary meaning, maintaining the solvency of such funds can be a goal that contributes to accomplishing the overall deficit reduction necessary to put the nation on a sustainable fiscal course. However, the solvency concept is more applicable to Social Security, which has a dedicated revenue source, than to Medicare, only part of which (Hospital Insurance) has a dedicated revenue source, or to Medicaid, which does not have a dedicated revenue source. As illustrated by our report *Social Security Policy Options* (July 2010), www.cbo.gov/publication/21547, CBO has the capacity to analyze many different types of changes in Social Security's program rules that affect benefits or taxes. The report shows not only effects on Social Security's solvency over the 75-year horizon for 30 different options but also likely effects on different types of people over time.

The Medicare trust funds are different. In the case of the Part B and Part D accounts in the Supplementary Medical Insurance Trust Fund, the amounts credited to the trust fund—and therefore, the amounts that come from taxes, other government income, or government borrowing—are automatically adjusted to cover the expenditures of the Part B and Part D components of the Medicare program. For those trust fund accounts, solvency is automatic.

THE PRESIDENT'S FISCAL YEAR 2014 BUDGET PROPOSAL

THURSDAY, APRIL 11, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 2:07 p.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Sanders, Whitehouse, Warner, Merkley, Coons, King, Sessions, Portman, Johnson, and Wicker.

Staff Present: Evan T. Schatz, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing will now come to order, and I want to thank again my Ranking Member, Senator Sessions, and all of our colleagues for joining us here today, as well as members of the public who are here in person or watching online.

Today's hearing is on the President's fiscal year 2014 budget proposal. Our witness is Acting Director of OMB Jeff Zients, who is here to talk about the proposal and answer our questions.

Jeff, I just want to start by thanking you once again for being here today and for all of your hard work at OMB during some really tough times. Your skilled leadership has really been instrumental in helping our Nation work through a number of budget crises, any of which could been devastating to our fragile economic recovery had we been unable to work our way through them.

And we especially appreciate your willingness to serve as Acting Director the past 15 months, including your work on the past two budgets. I know that you and your family have sacrificed a lot in order to provide continuity to this agency and the dedicated employees who work there.

Mr. ZIENTS. Thank you.

Chairman MURRAY. It is sometimes pretty thankless work, but you have done a great job, and I want the record to reflect the thanks from me and from all of our Budget Committee. So thank you very much.

Mr. ZIENTS. Thank you.

Chairman MURRAY. I imagine we are going to hear some questions about the timing of this budget today, but everyone really should keep in mind why our budget process has been operating so far outside of regular order.

The uncertainty surrounding the fiscal cliff had major ripple effects on budget writing in Congress, as well as, I am sure, at OMB. The policy changes coming out of the year-end deal added to the challenges, and then sequestration, which we all hoped would be replaced, went into effect and shuffled that dynamic even further.

So I am hopeful we can return to regular order in the budget process, but we should be clear. There has been nothing regular about the lurching from crisis to crisis over the past year.

As I am sure Jeff will talk a bit more about, the fact that the President's budget timing has shifted, along with other considerations, has changed the way they have now approached their proposal.

Normally, during times when we are not dealing with fiscal cliff uncertainty and devastating automatic cuts, the President lays out his budget proposal, the House and Senate hold their hearings on it, and it influences our work as we write our respective budgets in Congress.

This year, of course, is different. The House has already passed their budget, the Senate has passed our budget, and now we are trying to move forward towards the next step in the process and find a way to get to a balanced and bipartisan deal.

So President Obama has made it very clear that the proposal we are discussing today does not reflect his thoughts on the ideal policy, and it certainly does not represent any kind of new starting point for negotiations.

It is not the budget I would write on my own, and it includes several policies that I do not think are the best ways to tackle the deficit and debt.

While I was glad to hear some Republicans in the past few days express interest in finally putting an end to governing by crisis, I was disappointed to see members of leadership come out and seemingly reject any compromise at all. I hope Republicans are now prepared to tell us their ideas for a bipartisan path forward. And I know that the American people are expecting us to work together now to come to a deal. I know I am ready to do that, and I think the onus is on Republicans to now show us that they are as well.

While this proposal reflects President Obama's compromise offer, I was very glad to see the President maintained his commitment to putting jobs and broad-based economic growth first. I know Democrats here in the Senate feel very strongly that protecting our fragile economic recovery is paramount. The budget we passed reflects that, and any deal we come to would have to work for middle-class families and the economy as well.

One of the most important ways that both the Senate budget and the President's proposal puts the economy first is by replacing sequestration in a fair and responsible way.

I know that when I went home to Washington state over the recess, my constituents were telling me about the negative impact that sequestration was already having on their families and communities. I am sure my colleagues heard similar stories back in their home States. And the problem is it is only going to get worse.

We all know sequestration was never intended to take effect. It was supposed to motivate both sides to reach a compromise. That is why the Senate budget replaces those automatic cuts with an equal mix of responsible spending cuts and new revenue.

And while the House budget refused to include any compromise in this area and replaces only the defense cuts while making even deeper cuts to programs families and seniors depend on, I am hopeful that we can work together on a fair and responsible replacement.

In addition to replacing sequestration, the President's proposal, like the Senate budget, also prioritizes creating jobs and laying down a strong foundation for long-term economic growth through investments in early childhood education, college affordability, transportation infrastructure, and other key programs that we include in the Senate budget as well.

I was also very glad to see that the President's proposal maintains the key principle in the Senate budget that is supported by bipartisan groups and the vast majority of the American people, that deficit reduction needs to be done in a balanced way, and includes a responsible mix of spending cuts and new revenue from those who can afford it the most.

Since the Simpson-Bowles report was released in 2010, which recommended $4 trillion in deficit reduction, Congress and the administration have worked together to reduce the deficit by $2.4 trillion, with $1.8 trillion coming from spending cuts and $600 billion from allowing tax rates to rise on the wealthiest Americans.

The Senate budget as well as the President's proposal builds on that work to exceed the bipartisan goal of $4 trillion in a way that reduces the deficit to below 3 percent of GDP and that pushes our debt as a percentage of the economy down and moving in the right direction.

If the Senate budget was enacted, the total deficit reduction since the Simpson-Bowles report would consist of 64 percent from spending cuts, 14 percent from tax rates on the rich, and 22 percent from new revenue from closing loopholes and cutting wasteful spending in the Tax Code that benefits the wealthiest Americans and biggest corporations.

The ratios under the President's compromise proposal would be slightly different, but the fact that it includes a mix of spending cuts and new revenue reflects the values and principles of balance and fairness that the vast majority of Americans have clearly stated they support.

In addition to responsible spending cuts, a critical component of a balanced approach is ensuring that the burden of deficit reduction is not borne solely by the middle class, seniors, and most vulnerable families. And that means making sure that the wealthiest Americans and biggest corporations pay their fair share.

Although our budget leaves the specifics to the Finance Committee and the President's proposal lays out a particular path, both put revenue on the table and specifically cite the need to close loopholes and wasteful deductions that benefit the rich.

This should not be controversial.

In 2012, on average, the top 1 percent of income earners saw their after-tax income increase by nearly $250,000 as a result of special tax provisions; the middle class only received an average of about $3,500. Those heavily skewed tax breaks do little for our economy; they just make it harder for middle-class Americans to get ahead. Especially at a time when we are looking everywhere for savings, we just cannot afford them.

Even many Republicans agree there is waste to be found in the Tax Code. Speaker Boehner proposed raising $800 billion for deficit reduction by closing what he called “special interest loopholes and deductions.” Chairman Ryan has noted that, “The Tax Code is patently unfair.” And he has said that many of the deductions and preferences in our Tax Code are, and I quote, “mainly used by a relatively small group of mostly higher income individuals.”

In fact, to keep the House Republican budget’s tax reforms revenue neutral, as they have committed to doing, they would have to identify $5.7 trillion in savings from the Tax Code to pay for the tax rate cuts they want to give to the rich. That is almost six times what the Senate budget proposes.

So House Republicans clearly know there are savings to be found in the Tax Code. The difference is that Democrats believe that instead of that savings going toward more tax cuts for the rich, we should use it to reduce the deficit and invest in our middle class.

I was very glad to see that although some of the details differed, the President’s budget reflects that critical idea as well. So I am looking forward to hearing more about the proposal today and asking some questions.

The Senate budget that we passed last month reflects where I think our country needs to be, as well as the pro-growth, pro-middle-class values and priorities of Senate Democrats and the vast majority of the American people as we now move into negotiations with the House. I am hopeful that Republicans will come to the table and show they are willing to compromise to get to a deal.

I have been talking to Chairman Ryan about my desire to move to the next step in this process under regular order and do everything possible in a conference committee to bring the House and Senate budgets together. I know it will be difficult, but it is what the American people expect, and I think we owe it to them to make it work.

So with that, before we ask our witness to deliver his testimony and move to questions, I will turn to my Ranking Member, Senator Sessions, for his opening remarks.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Director Zients. We thank you for your work and for your appearing before the Committee today to present the President’s 2014 10-year budget. You have been placed in a difficult, unenviable position of defending a policy in terms of budgets that is indefensible. The administration has not indicated willingness to compromise, but as they have released with this budget, they slam the door on compromise, in effect, saying that this is not a compromise position. And Gene Sperling made that clear in other statements he has made. So this was not well received by those who thought that there may be some possibility of progress.

Now, the Chair is correct that things can break, and we would hope that there is a possibility we will have some improvement. But the President’s statement was very strong.

His budget message in this document he submits uses the word "balance" seven times, and, of course, it does not produce a balanced budget. Our colleagues in the Senate used that word "balance" 230 times in the 15, 18 hours that they used to debate. This budget, like the Senate budget, is not a balanced budget, nowhere close to being a balanced budget, does not intend to be a balanced budget. Spending never equals revenues. Spending always goes up, and substantially so.

Now, our colleagues in the House understand what balance means to the American people. You do not spend more money than you take in. That is what it means. The budget plan passed by the House achieves an actual balance of revenue and expenditures. Yours does not.

The administration says this simple understanding of balance is not a correct one. They say in their arrogance that the more sophisticated and erudite and correct understanding of the word "balance" is that tax increases equals spending cuts and, therefore, you have a balanced plan.

Tax increases equals spending cuts, and you have a balanced plan.

But this budget does not achieve even that twisted definition of "balance." In comparison with current law, the law we are operating under since August of 2011, the law the President signed, the budget increases spending and increases taxes.

Commentators hoping for real progress have taken your numbers at face value and taken them as a cause for some optimism. A careful examination of the budget numbers, however, reveals little basis for optimism. In fact, this budget fails in every important category needed to put the Nation on a sound financial path.

Using OMB's own numbers, your numbers, this budget will increase spending by one thousand twenty-five billion dollars relative to current law. Increases spending. That includes $61 billion in spending proposed in this budget for this fiscal year, which ends less than 6 months from now. Taxes are increased by one thousand eighty-three billion. The deficit is largely unchanged, a meager $59 billion reduction in the deficit path we are on today.

Total debt will continue to climb, increasing by $8.3 trillion and reaching $25.4 trillion over 10 years. Stunningly, interest payments on that debt reach $763 billion in the last year of your budget, larger than the spending we have for national defense.

So this plan is not balanced, even under the sophisticated understanding of balance propounded by the President, and that you have used, I believe. Mr. Lew certainly did. What this budget provides is the old-time Democratic religion of tax and spend. Under this budget, spending by the Federal Government will reach $4,200 per household in 2023.

Democrats say the Government needs more money to finance the continued expansion of the State. They say the American people are at fault, they have not sent enough money here, we need to extract more from them and not reduce spending that we now have.

So this President has already cajoled Congress into giving him some $1.6 trillion in tax increases—$600 billion in January of this year and $1 trillion as part of the health care law.

The President is now asking for an additional $1 trillion in tax increases, and he wants more spending increases. Many Americans will pay for these tax increases, not just the mythical rich. We know that. These tax increases will weaken the economy, coming on the heels of tax increases that just took effect on January 1st of this year: higher income tax rates on income and capital gains, a new 3.8 percent tax on investment income, and a 0.9 percent Medicare tax surcharge.

This budget amazingly creates new Federal entitlement programs. For example, rather than confronting abuses in existing public welfare programs, which are expected to grow by 83 percent over the next decade, the budget creates a new educational entitlement for universal preschool financed by tax increases. It provides mandatory spending for neighborhood revitalization and subsidizes taxable bonds issued by State and local government.

The tendency of this Government is to use tax increases to pay for new spending, and it has caught the attention of the fiscal watchdogs. "The President's many new expensive spending initiatives, paid for in large part with additional tax increases, could detract attention from the need to come up with a bipartisan solution to the Nation's significant fiscal challenges." That is Maya MacGuineas at the Committee for a Responsible Federal Budget, a very respected commentator on the fiscal scene.

So this budget has no real proposal for reforming ineffective and outmoded welfare programs that comprise in total the largest spending in the budget. And, sadly, there are no serious reforms for saving our endangered Social Security and Medicare programs—reforms that are essential.

Will this budget get us out of a high-debt, slow-growth economy we currently find ourselves in? Again, the budget fails in that.

After spinning the numbers in unjustified ways, the President claims that the debt-to-GDP ratio goes down starting in 2016 as the President will be prepared to leave office. And so the Republic is saved. There is no need to worry about entitlements or the specter of higher interest rates. Nothing really could be further from the truth.

By your own numbers, this budget leaves us above the 90 percent total of debt-to-GDP ratio that academic studies have shown tends to slow economic growth.

In the last year of your budget, the gross debt is 97 percent of GDP, leaving each American household with $189,000 in debt. And in the out-years the entitlement avalanche is even more pronounced. You do nothing to help the United States avoid what Simpson and Bowles called "the most predictable economic crisis in our history."

It is possible that the 2.9 percent real economic growth projected in this budget will prove optimistic given the high levels of debt and Federal taxation that are called for in the budget, and this is without any expectation, no projection that we might have a recession or a real spike in interest rates.

So the world is a fragile place. The world economy is fragile. The budget leaves us vulnerable. There is no room for error. It chooses to grow the Government at the expense of the economy, and this is the wrong course.

So I look forward to discussing some of these issues, and I would note, Madam Chairman, that, yes, the sequestration was hoped to be avoided, but the cuts in that sequestration were not to be avoided. They were in law and all agreed to by the President. So proposals to alter where the cuts fall rather than so disproportionately on the Defense Department are legitimate discussions, but not to alter that.

And with regard to the Tax Code, the Democratic witness a few weeks ago told us that the deduction closings and loophole closings in the corporate tax rate should be used to reduce that corporate rate and not to spend on new programs. That is certainly what the Chairman of the Finance Committee, Senator Baucus, believes.

So we have a lot of disagreement. I am disappointed in this budget. I look forward to discussing it with you and I will reflect that we are disappointed also that it was so late in coming.

Thank you, Madam Chair.

Chairman MURRAY. Director Zients, thank you very much again for being here. We will turn to you for your testimony.

STATEMENT OF THE HONORABLE JEFFREY ZIENTS, ACTING DIRECTOR AND DEPUTY DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Mr. ZIENTS. Thank you Chairman Murray, Ranking Member Sessions, and members of the Committee.

I want to begin by thanking the Committee for holding the hearing yesterday for Sylvia to be the next OMB Director. If confirmed, we all believe she will do a great job, and we would encourage the Committee and the full Senate to move as fast as possible on her confirmation.

I am pleased to be here today to present the President's fiscal year 2014 budget. The main message—and I am going to use a couple of slides—of the President's budget is that we can make critical investments to strengthen the middle class, create jobs, and grow the economy while continuing to reduce the deficit in a balanced way. We can do both balanced deficit reduction and jobs investments.

On the left-hand side, in terms of balanced deficit reduction, the budget builds off the deficit reduction achieved to date. It includes the President's fiscal cliff compromise offer to Speaker Boehner from December. Importantly, the budget turns off the sequester by replacing the sequester cuts with balanced deficit reduction.

At the same time, the budget proposes important jobs investments to enhance economic growth through skills and competitiveness with investments in education, R&D, and infrastructure. Each of these new investments are fully offset. They are fully paid for, and they do not add to the deficit.

On deficit reduction, as the Chairman said, over the past couple years Democrats and Republicans have worked together to cut the deficit by more than $2.5 trillion. Here is a rack-up of the deficit reduction to date. The BCA capped discretionary spending, saving over $1 trillion; another $370 billion in savings to the 2011 appropriations; the end of last year's fiscal cliff agreement reduced the deficit by more than $600 billion. Together, the deficit reduction lowered interest payments, saving an additional $480 billion. In total, more than $2.5 trillion in deficit reduction has been achieved.

The President is committed to achieving a total of $4 trillion in deficit reduction. As the Chairman cited, $4 trillion is the benchmark set by Bowles-Simpson and other independent economists that puts us on a sustainable fiscal path. The good news is we are more than halfway there, more than halfway there on the $4 trillion target.

The President's budget finishes the job with an additional $1.8 trillion of deficit reduction. The $1.8 trillion is from the compromise offer the President made to Speaker Boehner during fiscal cliff negotiations in December. By including this offer in the budget, the President is showing his willingness to compromise and make tough choices and his commitment to putting the country on a sustainable fiscal path.

Here are the components of the deficit reduction, the $1.8 trillion. Let us start on the left side with the $2.5 trillion we have already achieved. The first bar, $400 billion in health savings that strengthen Medicare by squeezing out waste and incentivizing delivery of high-quality and efficient health care.

Next, $200 billion in savings from other mandatory programs, including reductions to farm subsidies, reforms to Federal retirement, and selling unneeded Federal real estate.

Next, $230 billion by indexing annual inflation adjustments to the chained CPI.

Another $200 billion in discretionary savings beyond the $1 trillion that I mentioned earlier from the BCA caps.

Next, $580 billion in revenues from tax reform, not by raising rates but by closing loopholes and reducing tax benefits for families with more than $250,000 in income.

As a result of this, we have $190 billion in savings from reduced interest payments on the debt. At the same time, we invest $50 billion immediately in infrastructure to repair our roads and bridges and create jobs. In total, this achieves $1.8 trillion in additional deficit reduction over the next 10 years, bringing our total deficit reduction to $4.3 trillion, with more than $2 in spending cuts for every $1 in revenue.

To be clear, this offer includes difficult cuts that the President would not propose on their own, including CPI, which the President is only willing to do with protections for the vulnerable and as part of this whole balanced plan. However, by including the compromise offer in the budget, the President is showing his willingness to make tough choices and his commitment to reducing deficits and putting the country on a sustainable fiscal path.

Here are the annual deficits from 2012 through 2023. As you can see on the left-hand side, in 2012 the deficit was 7 percent as a percent of the economy. The budget phases in deficit reduction to support the ongoing recovery, and by 2016, the deficit is below 3 percent. By 2023, it is below 2 percent, at 1.7 percent.

As a result of this deficit reduction, debt as a percent of our economy is also on a declining path. With declining deficits and declining debt, the President's budget achieves important milestones of fiscal sustainability.

This budget reaches those milestones of fiscal sustainability while investing in the drivers of economic growth. In doing so, it demonstrates that we do not have to choose between deficit reduction and economic growth. It shows that we can, and indeed we must, do both. The country will not prosper if we have unsustainable deficits. But it also will not prosper if our infrastructure is crumbling and our workers lack the skills to compete.

Through paid-for initiatives like Pre-K for All, job training, and accelerated infrastructure investments, this budget will enhance our Nation's competitiveness. And through balanced deficit reduction, this budget will enhance confidence and lay the foundation for more durable economic growth. It is the right strategy for our economy, for creating jobs, and for building prosperity.

I am happy to take your questions.

[The prepared statement of Mr. Zients follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
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TESTIMONY OF JEFF ZIENTS
ACTING DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE
SENATE COMMITTEE ON THE BUDGET

April 11, 2013

Chairman Murray, Ranking Member Sessions, members of the Committee, thank you for welcoming me here today, and giving me the opportunity to present the President's 2014 Budget. It is good to be with you again.

I want to begin by thanking the Committee for holding a hearing yesterday on the President's nomination of Sylvia Mathews Burwell to be the next OMB Director. If confirmed, we believe Ms. Burwell will be an outstanding OMB Director and hope the Committee and full Senate will move to a vote on her confirmation as soon as possible.

I also want to congratulate the Chairman and Committee for passing the Senate Budget Resolution. The Resolution is a concrete plan that will grow our economy and shrink our deficits in a balanced way. It also makes investments critical to our middle-class security.

The President's 2014 Budget demonstrates that we can make critical investments to strengthen the middle class, create jobs, and grow the economy while reducing the deficit in a balanced way. The Budget addresses three core questions the President raised in his State of the Union address: How do we attract more jobs to our shores? How do we equip our people with the skills needed to do the jobs of the 21st Century? How do we make sure hard work leads to a decent living? The Budget addresses these questions as part of a comprehensive plan that reduces the deficit and puts the Nation on a sound fiscal course.

Every new initiative in this plan is fully paid for, so they do not add a single dime to the deficit. At the same time, the Budget includes the President's offer made as a part of the 'fiscal cliff' negotiations to build on the more than $2.5 trillion in deficit reduction already enacted with another $1.8 trillion, comprised of additional entitlement reforms, spending cuts, and tax reform that promotes growth, while reducing tax benefits for the wealthiest Americans. The Budget would result in:

- **$4.3 trillion in total deficit reduction**, with over $2 in spending cuts for every $1 in increased revenue.

- **Debt as a share of GDP on a downward trajectory by 2016**, reducing it from 78.2 % of GDP in 2014 to 73.0% by 2023.

- **Deficit under 2% of GDP in the 10-year window**, and below 3% of GDP by 2016.

This strategy will build on our country's economic recovery. It is the right budget and economic plan for this period in our economy.

Since I was last with you, we have continued to make significant progress in the recovery from the worst financial crisis since the Great Depression. The economy is now on the mend. We have seen positive economic growth for 14 consecutive quarters, and 37 months of private sector job growth. Our businesses have created nearly 6.5 million jobs. The housing market is recovering. America's auto industry is once again resurgent. And we have successfully ended the war in Iraq and are bringing our troops home from Afghanistan.

But as the President has indicated, our work is not done. The economy is adding jobs, but too many Americans are still unemployed. Businesses are hiring again, but too many are still struggling to compete and find workers with the right skills to meet their needs. Home prices are rising at the fastest pace in six years and construction is expanding, but too many families with solid credit are still finding it difficult to buy a home or refinance.

At the same time, we face significant near- and long-term fiscal challenges. In the near-term, deficits are coming down, but they remain too high– primarily as a legacy of the recession, and unpaid for policies enacted over the decade before this President took office. Over the long-term, although the Affordable Care Act reduced the deficit and is helping to slow the growth in health care costs, along with an aging population, rising health costs continue to be one of the largest threats to our long term fiscal sustainability.

The right prescription to address these challenges is to combine smart, targeted investments in areas critical for economic growth and competitiveness, with deficit reduction that will boost confidence and certainty by putting the nation on a sound long-term fiscal trajectory. The Budget does just that – offering a plan for deficit reduction that is phased in to avoid harming the economic recovery, and includes protections for the most vulnerable. At the same time, it preserves high priority investments that will enhance economic growth and private sector job creation.

Let me briefly give an overview of how this Budget invests for growth, and then how it reduces the deficit in a balanced way.

INVESTING FOR GROWTH AND STRENGTHENING THE MIDDLE CLASS

Making America a Magnet for Jobs

Over the last four years, we have begun the hard work of rebuilding our Nation's infrastructure, but to compete in the 21st Century economy and become a magnet for jobs, we must do more. The Budget includes $50 billion for up-front infrastructure investments, including a "Fix-It-First" program that makes an immediate investment to put people to work as soon as possible on our most urgent repairs. And to make sure taxpayers do not shoulder the whole burden, the Budget creates a Rebuild America Partnership to attract private capital to upgrade what our businesses need most: modern ports to move our goods, modern pipelines to withstand a storm, and modern schools worthy of our children.

If we want to make the best products, we must also invest in the best ideas. That is why the Budget maintains a world-class commitment to science and research, increasing non-defense research and development (R&D) investment by 9 percent over 2012 levels. Furthermore, we are targeting resources to those areas most likely to directly contribute to the creation of transformational technologies that can create the businesses and jobs of the future— like Advanced Manufacturing R&D, where the Budget proposes to increase R&D investments by over 80%.

No area holds more promise than our investments in American energy. The Budget continues to advance the President's "all-of-the-above" strategy on energy, investing in clean energy research and development; promoting energy efficiency in our cars, homes, and businesses; encouraging responsible domestic energy production; and launching new efforts to combat the threat of climate change.

A top priority is making America a magnet for new jobs and manufacturing. After shedding jobs for more than 10 years, our manufacturers have added more than 500,000 jobs over the past three years. To accelerate this trend, the Budget builds on the success of the manufacturing innovation institute we created in Youngstown, Ohio last year, and calls for the creation of a network of up to 15 of these institutes across the Nation. Each manufacturing innovation institute will bring together companies, universities and community colleges, and government to invest in cutting-edge manufacturing technologies and turn regions around our country into global centers of high-tech jobs.

The Budget also supports efforts the President announced earlier this year to modernize and improve the efficiency of the Federal permitting process, cutting through the red tape that has been holding back even some of the most carefully planned infrastructure projects. These efforts will help cut timelines in half for infrastructure projects, while creating new incentives for better outcomes for communities and the environment.

Educating a Skilled Workforce

All of these initiatives in manufacturing, energy, and infrastructure will help set the stage for entrepreneurs and small business owners to expand and create new jobs. But these investments won't matter unless we also equip our workforce with the education, skills, and training to fill those jobs.

And that has to start at the earliest possible age. The Budget includes a proposal that invests in America's future by ensuring that four-year-olds across the country have access to high-quality preschool education through a landmark new initiative in partnership with the States. Research confirms that investments in quality pre-school are among the highest return in improving educational outcomes and better preparing our workforce for the demands of the global economy. This investment in preschool is fully paid for in this Budget by increasing the tax on tobacco products, which is also an effective measure to improve health outcomes for our communities.

But it's not just preschool that we need to invest in. We also need to ensure access to higher education for our country's young people. Skyrocketing college costs are still pricing too many young people out of a higher education, or saddling them with unsustainable debt. To encourage colleges to do their part to keep costs down, the Budget includes reforms that will ensure affordability and value are considered in determining which colleges receive certain types of Federal aid.

To further ensure our educational system is preparing students for careers in the 21st Century economy, the Budget includes additional measures to improve and promote science, technology, engineering and mathematics (STEM) education. This includes a comprehensive reorganization and consolidation of STEM education programs to make better use of resources and improve outcomes, and a new STEM Master Teacher Corps, to leverage the expertise of some of America's best and brightest teachers in science and mathematics, and to elevate the teaching of these subjects nationwide.

Making Sure Hard Work Leads to a Decent Living

The Budget also builds on the progress made over the last four years to expand opportunity for every American and every community willing to do the work to lift themselves up. The Budget creates new ladders of opportunity to ensure that hard work leads to a decent living.

The Budget proposes partnerships with communities to identify Promise Zones that will help them thrive and rebuild from the recession. The Promise Zones initiative will revitalize high-poverty communities across the country by attracting private investment, improving affordable housing, expanding educational opportunities, reducing crime, and providing tax incentives for hiring workers and investing in the Zones.

The Budget makes it easier for the long-term unemployed and youth who have been hardest hit by the downturn to remain connected to the workforce and gain new skills with a Pathways Back to Work fund. This initiative will support summer and year round jobs for low-income youth, subsidized employment opportunities for unemployed and low income adults, and other promising strategies designed to lead to employment.

The Budget supports the President's call to reward hard work by raising the Federal minimum wage to $9.00 an hour. Raising the minimum wage would directly boost wages for 15 million workers and would help our growing economy. Furthermore, the Budget permanently extends expansions of the Child Tax Credit, the American Opportunity Tax Credit and the Earned Income Tax Credit.

Economic growth is best sustained from the middle class out. Everyone who works hard and plays by the rules should have a fair shake at opportunity, including going to college and getting a well-paying job to support their family. As the President said in the State of the Union, "America is not a place where the chance of birth or circumstance should decide our destiny. And that's why we need to build new ladders of opportunity into the middle class for all who are willing to climb them."

Keeping America Safe

Finally, we know that economic growth can only be achieved and sustained if America is safe and secure, both at home and abroad. At home, the Budget supports the President's initiative to help protect our children, reduce gun violence, and expand access to mental health services. To confront threats outside our borders, the Budget ensures our military remains the finest and best-equipped military force the world has ever known, even as we wind down more than a decade of war.

Importantly, the Budget upholds our solemn obligation to take care of our service members and veterans, and to protect our diplomats and civilians in the field. It keeps faith with our veterans, investing in world-class care, including mental health care for our wounded warriors; supporting our military families; and giving our veterans the benefits, education, and job opportunities that they have earned.

REDUCING THE DEFICIT IN A BALANCED WAY

The Budget does all of these things as part of a comprehensive plan that reduces the deficit. All of these initiatives and ideas are fully paid for, to ensure they do not increase the deficit by a single dime. As a result, we do not have to choose between investing in our economy and reducing the deficit—we have to do both.

We have already made important progress in reducing the deficit. Over the past few years, President Obama has worked with Democrats and Republicans in Congress to cut the deficit by more than $2.5 trillion through a mix of spending cuts and new revenue from raising income tax rates on the highest income Americans. This deficit reduction puts us more than halfway toward the goal of $4 trillion in deficit reduction that independent economists say is needed to put us on a fiscally sustainable path.

Now we need to finish the job. That is why the President stands by the compromise offer he made during "fiscal cliff" negotiations this past December. That offer is still on the table. And this Budget includes the proposals in that offer. These proposals would achieve $1.8 trillion in additional balanced deficit reduction over the next 10 years, bringing total deficit reduction to $4.3 trillion, with more than $2 in spending cuts for every $1 in revenue. The Budget brings deficits to below 3 percent by 2016, to below 2 percent of GDP by the end of the budget window, and puts debt on a declining path.

This represents more than enough deficit reduction to replace the damaging cuts required by the Joint Committee sequestration. We should reduce the deficit in a balanced, targeted and thoughtful way, not by making harsh and arbitrary cuts that jeopardize our military readiness, devastate priorities like education and energy, and cost jobs. As the President has said, sequestration is not smart policy—it can and should be replaced.

By including this compromise offer in the Budget, the President is demonstrating his willingness to make tough choices to find common ground to further reduce the deficit. This offer includes some difficult cuts that the President would not propose on their own. But both sides are going to have to be willing to compromise if we hope to move the country forward.

Deficit reduction is not an end in and of itself. But reducing the deficit in a way that protects our core priorities is a critical step toward ensuring that we have a solid foundation on which to build a strong economy and a thriving middle class for years to come.

The key elements of the President's compromise offer include:

- **Tax Reform:** $580 billion in additional revenue from tax reform that closes tax loopholes and reduces tax benefits for those who need them least.

- **Health Savings:** $400 billion in health savings that build on the health reform law and strengthen Medicare.
- **Other Mandatory Savings:** $200 billion in savings from other mandatory programs, such as reductions to farm subsidies and reforms to Federal retirement contributions.
- **Discretionary Savings:** $200 billion in additional discretionary savings, with equal amounts from defense and non-defense programs – that is $200 billion below the Budget Control Act spending caps that were lowered even further by the American Taxpayer Relief Act.
- **Inflation Indexing:** $230 billion in savings from switching to the use of chained-CPI.
- **Reduced Interest Payments:** Almost $200 billion in savings from reduced interest payments on the debt and other adjustments.

Reforming the Tax Code

First, the Budget proposes pro-growth tax reform that closes loopholes and addresses deductions and exclusions that allow the wealthy to pay less in taxes than many middle-class families. The President believes that today's tax code has become increasingly complicated and unfair. There is no better time to pursue tax reform that reduces the deficit, maintains progressivity, simplifies the tax system, and supports job creation and economic growth.

As a first step towards comprehensive tax reform, the Budget proposes two measures that would raise $580 billion by broadening the tax base and reducing tax benefits. First, by limiting the tax rate at which high-income taxpayers can reduce their tax liability to a maximum of 28 percent, the President's Budget will reduce the tax benefits for the top two percent of families to levels closer to what middle-class families get. Second, by requiring those individuals with incomes over $1 million to pay no less than 30 percent of their income after charitable giving in taxes – the so-called Buffet rule – the President's Budget will further reduce wasteful and inefficient tax expenditures.

The Budget also supports the President's plan for corporate tax reform. Now more than ever, we cannot afford a tax code burdened with costly special-interest tax breaks. In an increasingly competitive global economy, we need to ensure that our tax code contributes to making the United States an attractive location for entrepreneurship and business growth. For this reason, the President is calling on the Congress to immediately begin work on corporate tax reform that will close loopholes, lower the corporate tax rate, encourage investment here at home, and not add a dime to the deficit.

Health Savings

Along with an aging population, rising health costs continue to be one of the largest contributors to the deficit, and any sustainable fiscal path forward must include further reforms to our country's health care systems.

The Affordable Care Act (ACA) was a significant step toward controlling health care spending. The law reduced the deficit by over $100 billion in the first 10 years and $1 trillion in the 10 years after that, and it includes some of the best ideas on how to make our health system more efficient and change payment systems to incentivize higher quality and lower cost care. One of the most important steps we can take right now for long-term deficit reduction is to implement the ACA fully and efficiently. Still, more needs to be done.

The President is proposing to build on the achievements of the Affordable Care Act by offering additional health savings that will reduce the deficit by another $400 billion over the next 10 years. These savings will be primarily achieved through smart reforms that address long term cost growth, reduce wasteful spending, improve efficiency, and ask beneficiaries who are able to contribute a little more.

Specifically, the Budget includes several reforms, encouraging delivery of high-quality and efficient services by skilled nursing facilities, long-term care hospitals, inpatient rehabilitation facilities and home health agencies. We are squeezing out waste by making sure we get the same rebates for drugs, regardless of whether people are participating in Medicare or Medicaid. Finally, the Budget calls for the wealthiest Medicare beneficiaries to cover more of the costs. We can reform Medicare without breaking the fundamental compact we have with our nation's seniors. Together, these reforms illustrate that we can achieve significant savings to improve the long-term fiscal outlook of our healthcare programs without sacrificing quality care.

Other Mandatory Savings

Third, the Budget includes $200 billion in other mandatory savings, coming from smart reforms and tough choices in programs outside of mandatory health care programs. This includes reforms to agriculture subsidies, Federal employee retirement programs, and disposing of excess Federal property.

Combined with the economy's continued recovery, over time these savings will reduce mandatory spending as a share of the economy outside of the major entitlement programs by 15 percent.

Discretionary Savings

Fourth, the President's plan proposes additional cuts to discretionary spending without jeopardizing our need to maintain the investments in education, research and development, clean energy and infrastructure that are necessary to continue to rebuild our economy in the short-term and build a foundation for long-term growth. Total discretionary spending has already been cut by over $1 trillion since January 2011, and is currently on a path to its lowest level as a share of the economy since the Eisenhower Administration.

In the interest of reaching bipartisan agreement on a balanced deficit reduction package, the Budget proposes to lower the discretionary caps even further, reducing discretionary spending by an additional $200 billion over the next decade. The proposed cuts are evenly distributed between defense and non-defense spending, and are timed to take effect beginning in 2017, after the economy is projected to have fully recovered.

It is important to note that discretionary spending only represents about a third of the budget this year and is projected to drop to less than a quarter of the budget by 2023. While we can work to eliminate inefficiencies, we cannot put the country on a sustainable path forward with cuts to discretionary spending alone.

Inflation Indexing

Fifth, in the interest of achieving a bipartisan deficit reduction agreement, the President is also standing by his compromise offer to use the chained Consumer Price Index (CPI) to compute cost-of-living adjustments in major federal programs and the tax code. This is not the President's preferred approach, but it is an idea that both House Speaker Boehner and Senate Minority Leader McConnell have pushed for and that the President is willing to accept. However, he is only willing to do so in the context of a major fiscal agreement that is balanced, includes revenue contributing to deficit reduction, and protects vulnerable populations, as the Budget does.

The switch to chained CPI, like the additional domestic discretionary spending cuts in the Budget, is a clear example of the President's willingness to make tough choices in order to reach a bipartisan agreement. The President has made it clear that he is willing to make these compromises as part of a deal that calls for shared sacrifice, and will put the country on a sustainable long-term fiscal path.

Rooting Out Waste and Inefficiency

In addition to making tough trade-offs to reduce the deficit in a balanced way, the Budget continues the President's efforts to ensure we are getting the biggest bang for our buck when it comes to spending taxpayer dollars. It includes a series of new proposals to root out waste as well as reform and streamline government for the 21st Century.

In total, the Budget includes 215 cuts, consolidations, and savings proposals, which are projected to save more than $25 billion in 2014. These measures include closing a loophole in current law that allows people to collect full disability benefits and unemployment benefits that cover the same period of time; major food aid reforms that would assist up to two million additional people, while reducing mandatory spending by $500 million over the next decade; and ensuring that the government pays the lowest price for drugs, regardless of the program that makes the purchase, saving $123 billion over 10 years.

The Budget also builds on the Administration's successful efforts to root out wasteful improper payments, which have prevented over $47 billion in payment errors over the past three years. The Budget dedicates a dependable source of funding to root out fraud and abuse, producing deficit savings of roughly $40 billion over 11 years.

CONCLUSION

Building on the economic recovery we have seen over the past couple years, the Budget is the right plan for this moment in our country's economy. This is the plan it will take to make sure America remains strong in the years ahead and that we leave behind something better for future generations.

I look forward to working with both houses of Congress in the coming months as we work to make the tough decisions needed to both grow our economy and put our country on a sustainable fiscal course.

CHAINED CPI: A BENEFIT CUT FOR SENIORS

The chain-weighted consumer price index – "chained CPI" – would erode seniors' Social Security benefits by reducing annual cost of living adjustments (COLAs). With lower COLAs, seniors will see their limited incomes cover less and less of their everyday expenses, putting them at higher risk of poverty.

IMPACT ON SENIORS

- While effects of chained CPI would be small each year, they would become significant over time. For seniors retiring over the next few years, this means that chained CPI would cut benefits by about:
  - 3.7% at age 75;
  - 6.5% at age 85; and
  - 9.2% at age 95. [Social Security Chief Actuary, 6/21/11].
- These percentages translate to significant annual benefit cuts of:
  - $658 at age 75;
  - $1,147 at age 85; and
  - $1,622 at age 95. [SSA].
- Nearly one in six seniors currently lives in poverty. [AARP, 12/2012].
- One third (33.9%) of all beneficiaries are 80 years old or older – a group that relies on Social Security for nearly all of its income (90% or more), and which would suffer more from chained CPI. [AARP, 10/2012].
- The existing CPI formula – based on a basket of goods not geared to the needs of the elderly – shortchanges seniors, and chained CPI would make it worse. In 2010 and 2011, seniors did not receive a COLA. According to the Bureau of Labor Statistics, however, seniors saw prices on the following necessities increase substantially during those two years:

Item	Percent Increase Dec. 2009-Dec. 2010	Percent Increase Dec. 2010-Dec. 2011
Food and Beverages	1.5%	4.5%
Medical Care	3.3%	3.5%
Gasoline	13.8%	9.9%
Fuel Oil (household use)	13.5%	14.3%

- The President has proposed a complex and inadequate "benefit enhancement" to compensate the very elderly for the damage of chained CPI. Only those 85 and over (fewer than 15% of seniors) would get the full 5% enhancement, and that amount would not fully compensate them. Even seniors retiring in the near future would see a 6.5% cut from chained CPI by age 85. Since the effects of chained CPI compound over time, future generations would be hurt even more. A 35-year-old today would see a 15% cut when she turns 85.

SENATOR SHELDON WHITEHOUSE 4/11/13

Chairman MURRAY. Thank you very much, Mr. Director.

For the information of all of our Senators here, in deference to those Senators who have to wait a long time, I am going to be, to Senators on my left and on my right, very strict on time limits on the 5-minute time, so know that as you are going to into it, I am going to make sure that everybody gets a chance to ask their questions in a timely fashion.

Senator SESSIONS. Well, 5 minutes is a pretty short time, Madam Chairman, I got to tell you. I know you want to get this through, and I know Mr. Zients does not want to be questioned hard about some of these numbers—

Chairman MURRAY. I would object—

Senator SESSIONS. —his numbers that are incorrect and his statement that is disappointingly incorrect. But—

Chairman MURRAY. Senator—

Senator SESSIONS. —you are the Chairman, we will try to cooperate. But I just want to be on record as saying I am disappointed that we are constricted. And presumably we will not have a second round either?

Chairman MURRAY. I am willing to sit here as long as we need to. I am just trying to—I was trying to make a ruling to allow the Senators who are at the end of our aisle—

Senator SESSIONS. If we could have a second round—

Chairman MURRAY. If anybody wants to come back for a second—

Senator SESSIONS. You are very—

Chairman MURRAY. I will be happy to do it—

Senator SESSIONS. That is good. That would be fair.

Chairman MURRAY. —take an extra 5 minutes. I am not trying to be unfair to anybody's questions, and I assure you Director Zients has not asked me for relief. I am simply, in deference to a number of our Senators who have told me they need to leave early this afternoon, I want to have everybody gets a chance to ask. That is all.

Senator SESSIONS. Fair enough.

Chairman MURRAY. And I will restrict myself too.

Director, since enactment of the fiscal cliff deal, which made most of the Bush tax cuts permanent but will raise about $600 billion from the highest-income Americans, some of my Republican colleagues have said that the tax discussion is finished and claim that because revenues as a share of the economy are now projected to rise slightly above their 40-year average of 18 percent of GDP, any additional revenue, even if generated by closing tax loopholes, is off the table.

The last five times we have had a balanced budget, revenues were considerably higher than we are projected to experience going forward, even after the fiscal cliff. And now, unlike in past years, we also have to consider the retirement of the baby boomers and the critical need to invest in our people and our infrastructure to make sure we can compete on an international basis.

The revenue policy in the budget that this Committee wrote and the Senate passed a few weeks ago was shaped by those unavoidable realities, and I believe that is what every bipartisan group that has examined our budget situation—Simpson-Bowles, Gang of

Six—has also recommended several times more revenue than the year-end deal will generate.

So I wanted to ask you today whether or not you agree that raising additional revenue, if we are going to reduce deficits, has to be a part of it in a fair and balanced and sustainable manner. And, additionally, can you comment on the extent to which structural factors like demographics led the administration to propose additional revenue?

Mr. ZIENTS. Absolutely. You are right in that we do believe that we need to have additional revenues. In the $1.8 trillion compromise offer, there is $580 billion of revenue, all through tax reform so not raising rates.

I think it is important to note that in December Speaker Boehner said that there was potentially $800 billion or more available through tax reform. So I think we all believe we can make our Tax Code simpler, fairer, and get rid of wasteful spending in the Tax Code.

You are right also on demographics. Thirty million people are part of the baby boomers joining retirement, starting back a decade or so ago, going forward to the next decade. We have 30 million new folks who will be recipients of Social Security and on Medicare. Those demographics are undeniable. So in the context of those demographics, and when you study historically, the proportion that is revenue, GDP, you are right that we absolutely need additional revenue. The President is proposing $580 billion, all through tax reform, not through raising rates. And, again, Speaker Boehner as recently as December said that $800 billion or more would be available through tax reform.

Chairman MURRAY. Okay. President Obama made it very clear that his proposal is not the budget he would write on his own. It is not the budget I would write on my own. And there are some policies in there that I personally do not think are the best way to tackle the deficit and debt. But the President did say he wanted to lay out a path to a bipartisan deal that included some key Republican demands in return for significant revenue being put on the table.

So I wanted to ask you, Mr. Zients, this budget includes the offer that the President made to Speaker Boehner in December. Some of the choices I believe are really quite stark. However, I do understand the President's determination to reach a bipartisan accord.

Can you tell us why the President chose to submit a budget that represents last year's compromise offer rather than pursuing a fresh one?

Mr. ZIENTS. The President is very committed to getting the country on a sustainable fiscal course, and his commitment to that is reflected in his willingness to put forward what is a compromise offer. You know, whether it is in budget negotiations or my time in the private sector, if you are in the middle of a negotiation, then everybody retreats to their extremes, very little gets done. The President is very committed to getting something done, getting these manufactured crises behind us so businesses can grow and invest and hire. This is not his ideal way of doing deficit reduction. The chained CPI is in interest rate because Leader McConnell and Speaker Boehner asked for it. They also asked for age 67, which is not good policy, which the President is not willing to do. But as part of a balanced plan that does the $1.8 trillion, the President is willing to do CPI as part of that plan, while having one other condition on it—that it has provisions to protect the most vulnerable and older recipients of Social Security.

Chairman MURRAY. In my last 15 seconds, what do you see as the path forward?

Mr. ZIENTS. I think you hit the nail on the head up front: regular order.

Chairman MURRAY. Thank you very much.

Mr. Sessions? Senator Sessions?

Senator SESSIONS. You indicate that new spending is paid for, but that is exactly what this budget does. It increases spending almost $1 trillion and increases taxes a similar amount. It does not reduce the deficit in any significant way, almost a minuscule amount.

You indicate in your statement and the President has said that the compromise includes $580 billion in additional revenue from taxes. Looking at your own table on page— Table S.4, page 187 of your budget, it indicates that over the next 10 years, in the absence of adopting the President's policies, revenue would be $40.089 trillion. Then you go to the next page, Table S.5 on page 189, it shows the revenue after adopting the President's policies, and it is $41.231 trillion, equaling an increase in projected revenue of $1.14 trillion.

Isn't your compromise hiding over a half trillion dollars in tax increases over the current baseline?

Mr. ZIENTS. No. And I think this is a very important point to make because my guess is the structure is going to be important for our conversation throughout. If you remember the first slide, it has two sides. It had a compromise offer for $1.8 trillion of deficit reduction. The President stands by that—

Senator SESSIONS. Are you saying this budget has $1.8 trillion in deficit reduction over the current baseline, over the current law?

Mr. ZIENTS. The structure is important. On the other side are investments, each of which is paid for. Pre-K is an example. There is a tobacco tax.

Senator SESSIONS. Yes, it is paid for. With what?

Mr. ZIENTS. With a tobacco tax.

Senator SESSIONS. Is that included in the $580 billion—

Mr. ZIENTS. Senator—

Senator SESSIONS. —in new taxes you say is there?

Mr. ZIENTS. Let me—

Senator SESSIONS. Yes or no. Is it in the 580—

Mr. ZIENTS. The President—this will answer your question. The President is willing to do that deal on the left-hand side. He is willing to—

Senator SESSIONS. I am looking at—

Mr. ZIENTS. He believes it should be—

Senator SESSIONS. —not a chart, Mr. Zients.

Mr. ZIENTS. Let me be clear. The President stands by the $1.8 trillion compromise offer. The President also believes that we should be investing in Pre-K and other areas that will help grow the economy, help our competitiveness, but that offer, that $1.8 trillion offer—

Senator SESSIONS. Well, let me just conclude. I appreciate that. I will conclude that you did not count the $70 billion in tax increases to pay for the children, so that is up over $580 billion, another 70-some-odd billion. And there is a series of those in there that total up $1.142 trillion in new taxes. Is it not?

Mr. ZIENTS. Let us—I think you are on the same page—

Senator SESSIONS. Is it not—

Mr. ZIENTS. —that we are willing to do, the President is willing to do the $1.8 trillion deficit reduction package, which includes $580 billion through tax reform. He believes that additional investments should be made to improve our competitiveness—

Senator SESSIONS. Did you count increasing the unemployment surcharge by $15 billion as new taxes?

Mr. ZIENTS. There is no increase in the unemployment insurance during the next few years across time.

Senator SESSIONS. What about the Superfund tax increase of $20 billion? Was that scored in your $580 billion—

Mr. ZIENTS. The $580 billion is all through tax reform, and the President has two specific policies to back that up: a 28-percent maximum on deductions and the Buffett Rule. But I want to be clear that that offer stands. We believe, the President believes that are worthy investments that should be made to improve our competitiveness, put people back to work, each of which is offset.

Senator SESSIONS. Mr. Zients, all I am going to tell you is I read your budget, it increases taxes in plain numbers by over $1 trillion, and it increases spending by almost that same amount, virtually having no deficit reduction. So your statement, repeated statement that your budget raises taxes and reduces spending is utterly inaccurate.

Mr. ZIENTS. Senator—

Senator SESSIONS. Yes, it is.

Mr. ZIENTS. Senator, it is time that we come together, get something done, get these manufactured crises behind us. In that spirit, the President has put forward $1.8 trillion. The investments are sound investments that should be made, each of which is offset. But the President will do the compromise deal.

Senator SESSIONS. Well, Ms. Maya MacGuineas feels that the increase in spending jeopardizes the progress that could be made, and I totally agree. This is not a compromise plan. It is a tax-and-spend plan that does not alter the debt course of America, and that debt course, as Mr. Bowles told us, is unsustainable at this point.

Mr. ZIENTS. So two things. One, I think it is very important that one understand that the primary driver of spending increase is that the President's plan turns off the sequester with balanced deficit reduction. Maya MacGuineas—you have mentioned her a couple of times now—

Senator SESSIONS. If you turn off the sequester—

Mr. ZIENTS. —she does not have—

Senator SESSIONS. —have you not increased spending by about $1.1 trillion?

Mr. ZIENTS. Maya MacGuineas, the person you have quoted several times, does not have the sequester in her baseline. We replaced the sequester with balanced deficit reduction. And at the end of the day, when you are in business, you look at a bottom line. It is your profits. It is your sales growth. The bottom line here is that we have deficits on a declining path below 2 percent in 2023 at 1.7 percent, and debt as a percent of the economy is on a declining path. So we can spend lots of time looking at big numbers and different baselines. Let us make sure we focus on the bottom line.

Senator SESSIONS. Well, your budget increases the deficit by $8.2 trillion over 10 years? Yes or no.

Mr. ZIENTS. The deficit—the deficit—

Senator SESSIONS. In your own number—

Mr. ZIENTS. The deficit as a percent of the economy is at—

Senator SESSIONS. No. I asked you the dollars.

Mr. ZIENTS. —1.7 percent.

Senator SESSIONS. Did it increase the deficit by $8.2 trillion?

Mr. ZIENTS. I need to check—

Senator SESSIONS. You do not know what is in your numbers, how much you increase the deficit?

Mr. ZIENTS. There are a lot of numbers there. What I can tell you is what we should focus on, and this is exactly what Bowles-Simpson does, and other groups. What is debt as a percent of our—what is the deficit—

Chairman MURRAY. I am sorry.

Mr. ZIENTS. —as a percent of our economy? We are less than 2 percent at the end of the window at 1.7 percent.

Senator SESSIONS. Chairman Murray increases the deficit $7.3 trillion, considerably better than yours.

Senator WICKER. Hear, hear.

Chairman MURRAY. Senator Sanders.

Senator SANDERS. Very nice of you, Senator Sessions, to compliment Senator Murray.

Chairman MURRAY. I will take it.

Senator SANDERS. it is unusual.

Mr. Zients, thanks very much for being with us.

Mr. ZIENTS. Thank you.

Senator SANDERS. Let me begin. I am Chairman of the Budget Committee, and I have the misfortune of trying to follow in the footsteps of Patty Murray, who did a wonderful job.

Chairman MURRAY. Veterans Committee.

Senator SANDERS. Veterans Committee. I am sorry. I am not trying—Veterans Committee. And I want to ask you a question about veterans' benefits. Right now in our country, as I think you know, we have more income and wealth inequality than at any time since the 1920s. In fact, between 2009 and 2011, as you well know, all of the new income created in America went to the top 1 percent. In the midst of that growing inequality where the wealthy are doing phenomenally well while the middle class in many ways disappears, we are looking in the President's budget at very significant cuts to the benefits of disabled veterans. In fact, the chained CPI would impact the benefits of 3.2 million veterans with war-related disabilities. The largest cuts in benefits would impact young, permanently disabled vets who were seriously wounded in combat, and these are really significant cuts.

Our veterans who started receiving VA disability benefits at age 30 would have their benefits reduced by $1,425 a year at age 45, $2,300 at age 55, and $3,231 at age 65. Spouses, widows of soldiers who were killed in action, would also see cuts.

In the midst of enormous income and wealth inequality, Mr. Zients, do you really think we should move toward deficit reduction on the backs of men and women who have lost arms and legs defending this country.

Mr. ZIENTS. Clearly veterans, Wounded Warriors, are a top, top, top priority for this President and this First Lady and for this country. All means-tested veterans programs would be exempt from CPI, as would be the case with means-tested programs—

Senator SANDERS. I am familiar with the so-called superlative CPI. But you will not disagree with me that the overwhelming majority of disabled vets would suffer cuts?

Mr. ZIENTS. The annual increase that they would have, their inflation increase, would be indexed to chained CPI.

Senator SANDERS. Right. And do you disagree with the numbers that I said. I believe they are accurate.

Mr. ZIENTS. I have no basis for—

Senator SANDERS. Okay. So I am just asking you, when you one out of four corporations in America that pay zero in taxes, when the effective corporate tax rate today is 12 percent, the lowest that it has been since 1972, do you not think that there are ways to move toward deficit reduction in a way that is fairer than on the backs of disabled veterans?

Mr. ZIENTS. Well, clearly we share passion for taking care of our veterans. As we move forward in deficit reduction, we should work together to make sure that what we—

Senator SANDERS. But we are not doing that, Mr. Zients. We are talking about significant cuts on people who have given, you know, more than—

Mr. ZIENTS. I want to be clear that the benefit would be calculated the same way. The annual increase would be index—

Senator SANDERS. And the figures that I—

Mr. ZIENTS. The most vulnerable veterans—

Senator SANDERS. All right. But those are a small—I understand. That is a good talking point. But the vast majority of disabled vets would see significant cuts as opposed to the current chained CPI.

Let me ask you another question, and that is the issue of revenue. In 2012, as I recall, revenue was about 15.8 percent of GDP, the lowest in about 60 years. And it is going to go up a bit. My understanding is that the President's proposal for corporate tax reform is to try to do away with loopholes without bringing in—in a deficit-neutral way, without bringing in any new revenue.

When you have major corporation after major corporation paying zero in taxes, when we are losing about $100 billion a year through offshore tax havens, why are we not talking about bringing in substantial sums of new revenue rather than cutting Social Security or benefits for disabled vets?

Mr. ZIENTS. The President's position on corporation tax reform has remained the same, which is, first of all, it has to pay for the $40 billion or so of so-called annual extenders, so that is $400 billion across a 10-year period of time. Those have to—either those annual extenders have to go away or they have to be paid for as part of corporate tax reform.

What is corporate tax reform all about. It is about growing the economy and creating jobs. So companies that get tax breaks for moving jobs overseas, those will go away. R&D—

Senator SANDERS. But isn't it also—we are here to—I apologize for interrupting. I do not mean to be rude, but we do not have a lot of time.

Mr. ZIENTS. Please. Please.

Senator SANDERS. But here we are struggling to deal with deficit reduction. Do you not see, when the corporate tax rate today is at 12 percent, the lowest that it has been since 1972, do you not see the opportunity to bring in substantial sums of revenue through tax reform?

Mr. ZIENTS. We see the opportunity, as I mentioned before, to get rid of those annual extenders which cost $40 billion a year. We see the opportunity to reward companies through things like the R&E tax credit, which only applies to R&E done here in America, extending that permanently while getting rid of tax havens and other loopholes to grow the economy and create jobs. If—

Chairman MURRAY. Senator Sanders—

Mr. ZIENTS. I will just finish my statement. If there is not going to be a corporate tax reform process that does what we just talked about, then those closing of loopholes and getting rid of wasteful tax expenditures should go to deficit reduction, I agree.

Chairman MURRAY. Thank you very much.

Senator SANDERS. Thank you.

Chairman MURRAY. Senator Johnson?

Senator JOHNSON. Thank you, Madam Chair.

Director Zients, welcome back.

Mr. ZIENTS. How are you?

Senator JOHNSON. You are going to miss this, right?

My assumption was the reason that you were 2 months late in presenting your budget really was the CBO score, CBO baseline under the fiscal cliff deal, trying to get that all in order.

Mr. ZIENTS. Yes, it was the fiscal cliff deal, which, you know, impacted—ended up impacting obviously the revenue side and discretionary side, November and December, as Senator Portman—sorry, November and December as Senator Portman knows are the prime budget times. We really had to put things on pause during that period of time.

Senator JOHNSON. Okay. So, again, we are comparing all of your numbers really against the CBO baseline. Getting back to Senator Sessions' question on revenue, your budget now is going to raise revenue by 42.1—let me see here. It is always difficult to follow this stuff—$41.2 billion over 10 years, $41.2, and the CBO baseline is $40.2, so that is $1 trillion, correct? So revenue is up a trillion, but you are saying you are going to increase taxes $580 billion.

Mr. ZIENTS. Yes.

Senator JOHNSON. So what is the other revenue?

Mr. ZIENTS. Well, as I said before, there are paid-for investments, also like the tobacco tax for Pre-K. Those are investments that the President believes we should make. But the $1.8 trillion of deficit reduction, that package, that compromise deal, is not conditioned—is not conditioned on making those other investments.

Senator JOHNSON. Okay, but you are increasing revenue by $1 trillion. How likely do you think it is that we are actually going to achieve deficit reduction outside your administration's time frame here? What I am looking at is, again, comparing the CBO baseline, it is claiming about $1.7 trillion of deficit reduction. But the fact is you actually increase the deficit over the first 4 years, the 4 years of your administration, by $540 billion. So the deficit actually increases over the CBO baseline by $450 billion, and then the last 6 years of the budget window, when you are out of office, then you reduce the deficit by about $2 trillion.

How likely is it that you will actually increase the deficit by $450 billion during your administration but then will actually realize that $1 trillion of deficit reduction in the last 6 years—

Mr. ZIENTS. Well, I think we see with the BCA that when we sign something into law, we live by the caps.

Senator JOHNSON. Aren't you getting out of—aren't you canceling half the BCA, the sequester part?

Mr. ZIENTS. No. We are—

Senator JOHNSON. You are canceling that. You are—

Mr. ZIENTS. We are placing the sequester—the sequester was never intended to be implemented. The sequester was meant to be such bad policy that it would force balanced deficit reduction. It was never intended to be implemented. I think we can all agree to that.

Senator JOHNSON. It was intended to reduce spending by another $1.2 trillion, which now you are canceling.

Mr. ZIENTS. No. It was intended—

Senator JOHNSON. Yes.

Mr. ZIENTS. —to create $1.2 trillion of balanced deficit reduction.

Senator JOHNSON. Listen. No, in your budget you have canceled the $1.2 trillion—

Mr. ZIENTS. And replaced it with balanced deficit reduction.

Senator JOHNSON. —with $1 trillion of increased revenue, taxes.

Mr. ZIENTS. No, with $1.8 trillion of deficit reduction where there is $580 billion of revenue.

Senator JOHNSON. Well, again—

Mr. ZIENTS. That was always the intention—

Senator JOHNSON. The point being is the serious part of your budget is the first couple years, and you are actually increasing the deficit by about $250 billion in the first 2 years. That is really the direction of your budget.

Mr. ZIENTS. This might be—

Senator JOHNSON. You are increasing deficits.

Mr. ZIENTS. This might be a fundamental difference between us. We believe that deficit reduction is important, putting the country on a sustainable—

Senator JOHNSON. But something kind of like Wimpy, though: "I will gladly pay you Tuesday for a hamburger today."

Mr. ZIENTS. But in and of itself, not an economic policy. We have to get people back to work. We have to create jobs. We have to grow this economy. We have to compete globally. The deficit reduction alone is not—

Senator JOHNSON. Anyway, so you are increasing—you are increasing the deficit in the first 4 years by $450 billion, are you not?

Mr. ZIENTS. We have—

Senator JOHNSON. Compared to the CBO, that is a correct figure, is—

Mr. ZIENTS. We have deficit on a declining path—

Senator JOHNSON. You are increasing the deficit over the CBO baseline in the first 4 years by $450 billion, are you not? That is—

Mr. ZIENTS. I think the important thing to do is by 2016—

Senator JOHNSON. Can you say yes or not? That is correct, isn't it?

Mr. ZIENTS. —you are below—

Senator JOHNSON. Okay. Let us move over to what I was talking to Sylvia Burwell about yesterday. Just in terms of agreeing on numbers, you can never solve a problem unless you can start agreeing on numbers. According to OMB's analysis, the trust fund has no value to the Federal Government. Would you agree with that?

Mr. ZIENTS. Which trust fund?

Senator JOHNSON. The Social Security Trust Fund has no valued because you have the trust fund holding about $2.6 trillion worth of assets in Social Security and then you have a $2.6 trillion liability to the Treasury. When you consolidate that, that has no value in terms of making payments on Social Security. Isn't that correct?

Mr. ZIENTS. No. The trust fund has value.

Senator JOHNSON. To who?

Mr. ZIENTS. The trust fund has value to Social Security.

Senator JOHNSON. So where is the liability? Do you disavow the fact that Treasury has the liability of $2.6 trillion that offsets in a consolidated statement—

Mr. ZIENTS. I think what you are talking about is the difference between gross debt and debt held by the public. If you—

Senator JOHNSON. I am talking about having some—I am talking about having some value to actually make payments on the $1.3 trillion of deficit spending of Social Security over the next 10 years.

Mr. ZIENTS. That has the full faith—

Senator JOHNSON. There is no value—

Mr. ZIENTS. That has the full faith and credit of the U.S. government.

Senator JOHNSON. Your OMB says that nets to zero. Isn't that correct?

Mr. ZIENTS. Social Security is not the driver of our near-term fiscal issues.

Senator JOHNSON. I was just asking—

Mr. ZIENTS. Social Security—Social Security—

Senator JOHNSON. I was not asking that question—

Mr. ZIENTS. —is solvent to 2033.

Senator JOHNSON. Does the Social Security Trust Fund have any value to pay off those benefits?

Mr. ZIENTS. The Social Security Trust Fund is solvent through 2033. Those assets are backed by the full faith and credit of the U.S. Government.

Senator JOHNSON. Okay. Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you very much, Madam Chair. And welcome, Mr. Zients.

Mr. ZIENTS. Thank you.

Senator WHITEHOUSE. I am afraid this is your last time before us, which is probably a mixed blessing from your point of view. But thank you for your service.

Mr. ZIENTS. Thank you.

Senator WHITEHOUSE. Two topics and then a question.

The first is on health care delivery system reform. Bipartisan, nonpartisan, very expert groups have said that there are savings available in the health care system between $700 billion and $1 trillion a year. And the administration in many ways has deployed quite a lot of resources to try to implement delivery system reform, and we gave you 45 different provisions in the Affordable Care Act to try to help you do it.

What frustrates me is that, to date, the administration has yet to put a savings target on this effort. The talk is still about bending the health care cost curve. I would urge OMB to urge the administration to be accountable and set a target, because an organization as big as the United States Government is not going to respond as effectively to a meaningless and unaccountable standard like bend the health care cost curve as it will to this much dollar savings by this date from these mechanisms.

Now, you have built some health care cost savings into this. Some of it requires political changes that are going to be difficult. But there has yet to be a hard number that is the administration's target on what it is going to do for delivery system reform. So I would urge you to please reconsider that. We are left completely at sea when the administration that has the implementation power for this will not even set a target for itself.

The second thing is on chained CPI. I would like to put into the record a summary sheet that we have done, if I may do so, without objection.

Chairman MURRAY. Without objection.

Senator WHITEHOUSE. It shows, I think, that it is just as wrong as it can be to have made that choice. I do not care where it came from. I do not care if it was Speaker Boehner's idea. It is wrong. Social Security, as you just said, has not contributed to the deficit problem. And seniors, at least the ones that I deliver Meals on Wheels to in senior high-rises, are not living so high off the hog that they are great people to go after. And the protection of vulnerable seniors, as I read your plan, is actually less than the hit to them. They end up still negative, even at 85 years old, because by the time they get the 5-percent hit—5-percent benefit, they are getting a 6.5-percent hit.

So I just want to let you know, anything I can do to be a foe of that, I intend to do. The $15 billion that comes back to seniors through the benefit against the $230 billion overall cut to me is a fig leaf.

Mr. ZIENTS. A couple of comments?

Senator WHITEHOUSE. Yes.

Mr. ZIENTS. First—

Senator WHITEHOUSE. Leave me time

Mr. ZIENTS. I will go fast. Let me just go to bottom-line results on health care. Total health care spending grew by 3.9 percent in 2011—

Senator WHITEHOUSE. I know. I know all that. I know all that.

Mr. ZIENTS. That is the third year in a row—

Senator WHITEHOUSE. Let me go to my—

Mr. ZIENTS. Let me go to Medicare spending, though. Medicare spending per beneficiary grew only 0.4 per beneficiary—

Senator WHITEHOUSE. I know all that.

Mr. ZIENTS. —in fiscal year 2012.

Senator WHITEHOUSE. I know all that.

Mr. ZIENTS. Okay. On CPI—

Senator WHITEHOUSE. Do not tell me things I have not asked you about that I already know.

Mr. ZIENTS. The protection for the older beneficiaries—

Senator WHITEHOUSE. Yes.

Mr. ZIENTS. —for the most vulnerable, i.e., the lowest income, they will actually not at age 85, as you suggested, be behind. They will actually be ahead, because it is a 5-percent adjustment based on the median.

Senator WHITEHOUSE. We will take a look at that because that is not what we are looking at.

Mr. ZIENTS. Okay.

Senator WHITEHOUSE. Do you know what a fiscal multiplier is?

Mr. ZIENTS. Sure.

Senator WHITEHOUSE. Okay. There is an ideology around here that all cuts help grow the economy—all cuts help grow the economy—and that all Federal spending is a burden on the economy, and that here endeth the lesson. That is all there is to it. It is that simple. That is ideology.

There is also economics. Economics says that the impact of cutting and spending by the Federal Government on the economy varies depending on the condition of the economy. And right now we have a whole raft of reports coming out showing that the fiscal multiplier is actually above 1, which means that every dollar cut out of the economy in terms of Federal spending does more damage to the economy than it saves. You have Oxford Economics saying that the fiscal multiplier is 1.4; Goldman Sachs, that famous left-wing institution, 1.5; IMF, 1.7; UC Berkley, 2.5; and a group out of Northwestern University shows it actually at 3.7. If it is 3.7, that means that every dollar you cut in spending, you reduce GDP by $3.7. You are creating actual damage in the economy by cutting spending.

Is that something that we should be considering in the Budget Committee as we hear this repeated ideology that all cuts help and all spending is bad?

Mr. ZIENTS. I think we have an immediate task, which is the sequester. So the sequester is $85 billion taken out of the economy, hundreds of thousands of jobs. Goldman, CBO, and others say it is a half to 1 percent of GDP. We need to immediately turn off the sequester, which was never intended to be implemented, and replace it with balance deficit reduction that phases in as the economy improves.

Senator WHITEHOUSE. Thank you.

Chairman MURRAY. Thank you.

Senator Portman?

Senator PORTMAN. Thank you, Madam Chair. And, Director Zients, welcome back for your last visit, which is probably a happy thing for you. But thanks for your service.

I must tell you, I feel like I am living in a separate universe when I hear the discussion about the budget and what we just heard about ideology. We are in a deep fiscal hole. We have never experienced this as a country, so very few economists can tell us exactly what is going to happen. But the best economists out there all agree that we are in danger, and Rogoff and Reinhart, of course, have told us that when you hit 90 percent of GDP, you end up having an impact of 1 or 2 percent to the Nation's growth, which means about a million jobs this year alone. So the notion that we can continue careening down this path of record debt, now over $17 trillion, gross debt over 100 percent of our economy, and an annual deficit again this year of $1 trillion—we have never had a deficit of $1 trillion until 3 years ago. Now we have had—we will have had 4 years of it. This is dangerous. And we have already had one downgrade. We are on a negative watch for the others. And what happened in Southern Europe could happen to us.

And so I know you probably do not disagree with anything I just said, but you might disagree with whether your budget proposal is adequate to it. But this notion that we should just go ahead and spend and do not worry about it, that the chickens will not come home to roost, is really dangerous. I mean, who gets hurt the worst? The folks who are on the first or second rung of the ladder trying to get on the third or fourth rung.

And so I applaud some things in this budget. One is the fact that you are willing to take one small step and talk about the entitlement programs. As you know, CBO has told us in this Committee that these incredibly important programs that are a safety net, that must be preserved, are going to increase 95 percent in spending over the next 10 years, almost 100-percent growth, almost doubling spending. And 100-percent growth in those programs and you all do propose something, would is to have an accurate measure of inflation for CPI. It is not a cut. The question is how much the inflation adjuster ought to be, and you use what you think most economists agree with, and so that is a measure that I think is fair. It also affects taxes, of course, so it raises revenue as well, because taxes are indexed, and the brackets being indexed are affected by what the measure of inflation is. So it is about $100 billion in taxes, too. So I think that is good.

I think on the corporate reform side, I will say I read the corporate reform part a little differently than some of my colleagues on my side and the other side. I do think that this is all about growth and all about jobs and all about revenue, ultimately. And we have the most competitive—a non-competitive, antiquated corporate tax system in the world, the highest rate, of course, among all developed countries. Even when you include the effective rate, it is still way above the average of these other countries. And so I am glad you said in your budget for the first time that you ought to not use these preference reductions or loophole closures for the budget deficit generally but for revenue-neutral tax reform. So I want to give you credit for that, and it is consistent, as you said, and which the President has said, over the years, in fact, and what most people believe has to be done if we are going to become competitive.

By the way, CBO has told us 70 percent of that benefit of the lower rate goes to who? Workers. And this is about those workers, again, middle-class Americans who are trying to keep their job or get a job and have decent pay when their pay has gone down almost 4,500 bucks over the past several years on average. So I thank you for that.

What I am concerned about is this just does not seem to be nearly up to the task that we identified, and let me ask you a couple questions, if I could. One, what is the debt-to-GDP in the tenth year in terms of the gross debt? We have your chart as to the public debt. What is your gross debt number?

Mr. ZIENTS. I can get that for you while I also would say that CBO and others all agree that gross debt is not a terribly meaningful metric.

Senator PORTMAN. Well, you just said the trust fund is an asset. If you believe that, you must think gross debt is important.

Mr. ZIENTS. And so, you know, when you—

Senator PORTMAN. You cannot have it both ways.

Mr. ZIENTS. I think the right way to look at it is debt held by the public, and debt held by the public is 73 percent—

Senator PORTMAN. Because you do not think that the trust fund should be made whole in Social Security?

Mr. ZIENTS. I am saying when you are benchmarking, you are using the R&R study and benchmarking and worried about our economic growth—

Senator PORTMAN. Well, and R&R talks about—

Mr. ZIENTS. —versus other countries. If I can—

Senator PORTMAN. I do not have a whole lot of time left, but let us just stipulate that you do not have a gross debt in your figure, but it is about 100 percent of the economy. It is between 95 and 100 percent—

Mr. ZIENTS. And, again, I do not—we join CBO in not thinking that is the right way to look at it.

Senator PORTMAN. Well, it is the right way to look at it if you consider the trust fund to be something that we ought to replenish and it ought to be made whole. In terms of Social Security, again, telling you you are doing the right thing, a small step admittedly because it does not solve the problem, but with regard to Social Security, what is the shortfall this year in Social Security, payroll taxes being paid versus benefits being paid out.

Mr. ZIENTS. Social Security is working how it was intended to work.

Senator PORTMAN. What is the shortfall——

Mr. ZIENTS. It is solvent through—

Senator PORTMAN. What is the shortfall this year?

Mr. ZIENTS. I do not have that number handy.

Senator PORTMAN. $77 billion. A $77 billion shortfall this year.

Mr. ZIENTS. Again, while Social Security is not a driver of our immediate fiscal situation, we should talk about reforming Social Security across time.

Senator PORTMAN. We should, of course.

Mr. ZIENTS. And the President—

Senator PORTMAN. And where does that $77 billion come from? It comes from general revenue. So here is my bigger point. When you look apples-to-apples comparison to what you all have in the CBO baseline—and baseline, by the way, for those listening who might not understand all this jargon, it just means if we do not do anything, just like, you know, what is the autopilot? If we do not have this budget, given the crisis that we face, your debt to GDP—public debt, not gross debt; and let us use your numbers, public debt—is actually higher than CBO's because they use different economic assumptions than you do. You have higher GDP. Yours is actually above the Blue Chips as well, and that is fine. But I am just saying we are not getting at the problem if it actually is an increase in the deficit over the next few years—

Mr. ZIENTS. Well, we all know that we could spend the next 2 weeks discussing baselines and—

Senator PORTMAN. Well, no. That is fine. Let us just—

Chairman MURRAY. Senator, I hate to—

Mr. ZIENTS. —bottom line. The bottom line—

Chairman MURRAY. Senator Portman, if I can interrupt—

Mr. ZIENTS. —is the President's budget—

Senator PORTMAN. The bottom line is if we do not do anything, the situation would be better than—

Mr. ZIENTS. If I could just say one more sentence, the bottom line is the President's budget has deficits below 2 percent in 2023, and debt as a percent of the economy on a declining—

Chairman MURRAY. Senator Portman, I hate interrupting, but I have Senators at the end of the line here who are—

Senator PORTMAN. Thank you.

Mr. ZIENTS. Thank you, Senator.

Chairman MURRAY. —pressing me to allow them a chance.

Senator Warner?

Senator WARNER. Thank you, Madam Chairman. And, Mr. Zients. great to see you. I think you are seeing one of the reasons why it is hard to get a grand bargain. But, candidly, the fact that you are getting as much grief from both sides of the aisle shows me that you are probably in the zone where things are going to get talked about, because if there is not some angst on both sides, we are not going to get things done.

I would point out to all my colleagues that actually the President's budget is the only one of the three budgets between the Senate budget or the House budget that at least starts to take on the challenges around Social Security. The Senate chose not to; the House chose not to. And chained CPI, which examples that were used earlier, your COLA increase might go from $36 a month to $33 a month based on historic norms, I think quite honestly, which solves about 22 percent of the Social Security problem, does not solve it all but it takes about a fifth of it out of the way. I actually think the overwhelming majority of Americans would believe, if rather than looking at the dramatic fall off the cliff that Social Security is going to hit—and I actually believe earlier than 2033—you know, I commend you for taking an appropriate stand.

I also would agree that, as some of my colleagues have said, you know, we cannot, no matter how—we cannot cut our way or we cannot tax our way simply to prosperity. We also have to have a growth agenda. And I would point out that there was a lot of talk made here of Simpson-Bowles. I think I would argue—I have spent as much time with that report as most on this Committee. Simpson-Bowles, Domenici-Rivlin, all laid out in their agendas, one, that our problem on debt and deficit—and I am particularly on this side of the aisle was probably one of the more obsessed members about that issue—that this is not as much an immediate problem, but an intermediate problem and needs to have phase-ins. And both Simpson-Bowles and Domenici-Rivlin said as part of a growth agenda on items like infrastructure, which your budget has included and paid for, those are things that will actually help grow the economy, which will at the end of the day generate additional revenue—

Mr. ZIENTS. Yes.

Senator WARNER. —as well and be part of a longer-term solution. And as we have continued to see the markets— actually, I have been a little bit surprised—continuing to buy our debt at interest rates of record lows, and as Chairman Bernanke and others at the Fed have said, this is an intermediate problem, not one that needs to be solved tomorrow but does need to be acted upon, I do believe an investment component in a budget is a responsible and reasonable thing, and as well as something that both Simpson-Bowles and Domenici-Rivlin did.

I would also point out on Maya MacGuineas, again, somebody who I have spent an enormous amount of time on and worked closely with her organization, in her statement she does point out that public debt would fall from 77 percent in 2013 to 73 percent by 2023. I think the goal was closer to 70. I would rather it get lower than that, but it is in the right direction.

Her quote as well is, “pleased to see the President’s continued support of deficit reduction,” and “he is still serious about fiscal reform.”

So while, again, this may not be the budget any of us would have individually written, it is a budget that I think starts us down towards structural reform of our entitlements, which I would say to some folks on my side of the aisle, the math is pretty persuasive. On average, the person pays in about $115,000 in Medicare taxes and takes out about $320,000 in Medicare taxes. That is not sustainable.

When I was a younger, 16 people were working for every 1 person on Social Security. Now it is three. In 15 years it will be two. It is the most successful program ever put in place, but the math is not sustainable. And nothing is self-correcting about this unless we act, and I commend you and the President for making some of the—starting down some of the hard choices that need to be made.

On the revenue item, I tell you, I would just simply say, you know, I think with the demographic bulge and with even no matter what kind of structural reform of entitlements we would have, the idea that we are ever going to go back to a sustainable fiscal circumstance with anything around the 18.6 or even 19 percent is just not in the realm of reality, that if we are not between 20 and 21 percent of revenue on an ongoing basis, we will just—we are never going to get close.

Now, that does not mean as well that we do not need to drive down our costs, and I want to in my last 17 seconds commend you on one other item, finally, on GPRA, a little important bill that nobody has ever heard of that actually Senator Sessions helped get through, and I appreciate that. You have finally identified some of the underperforming programs, and of the 215-odd programs you have identified for either substantial cutback or elimination, 56 of those are programs that were in the process of being eliminated because of GPRA. And I have done over my time, but I would look forward to working with you and your successor, Sylvia Burwell, on making sure that on some of these programs we actually end up making the hard choice of finally eliminating them. We are going to be under tight fiscal constraints for as far as the eye can see, and we just do not have room for inefficient programs in this Federal Government.

Mr. ZIENTS. Thank you, Senator Warner.

Chairman MURRAY. Thank you.

Senator Wicker?

Senator WARNER. There was no question there.

Chairman MURRAY. But you filled your time.

Senator Wicker?

Senator WICKER. Madam Chair, first a matter of housekeeping. Mr. Zients said the path forward is regular order. The Senate has passed a budget. The House has passed a budget. Has a conference committee been appointed and have conference meetings been scheduled?

Chairman MURRAY. No, we have not done that yet, and the Senate is—I have had a chance to talk to my counterpart in the House, and we are looking to move forward on that. I believe that we need to get to a conference committee and am working to get to that.

Senator WICKER. Well, I certainly support regular order there.

Mr. Zients, this budget does not balance at any point within 10 years, does it?

Mr. ZIENTS. No. The President—

Senator WICKER. Okay. That is fine. You do not need to explain. Is there a glide path for it to balance later on in the century after the 10-year period?

Mr. ZIENTS. This budget makes significant progress. As Senator Warner said, it brings the deficit to below 2 percent, debt as a percent of the economy down significantly. It is a big step forward, but the important thing—

Senator WICKER. Okay. Well—

Mr. ZIENTS. The important thing, I want to make this point, if you would give me one minute, is that we need to get this economy ramped further up. We have added 6.5 million jobs across the last 37 months, 14 straight quarters of GDP growth—

Senator WICKER. You know, I do not mean to be rude, Mr. Zients. I just asked if it gave us a glide path to balance at any point, and you are free to explain on someone else's time.

Mr. ZIENTS. Significant progress consistent with Bowles-Simpson. Most importantly, we need to focus on jobs and growing this economy.

Senator WICKER. I think I understand the answer to that is no.

Let me ask you about the estate tax. You know, the President signed only 4 months ago the bipartisan vote, passed the Senate by 89–8, to permanently set the estate tax rate at a top rate of 40 percent with an exemption of $5.12 million indexed for inflation. He just signed that 4 months ago. Now, for some reason the President proposes to return that back to the old rate 4 months later. Surely you do not—well, let me ask you this: How much theoretically does this raise in revenue?

Mr. ZIENTS. Well, he is not suggesting that we do this 4 months later. He is suggesting that in his budget he is proposing in 2018—

Senator WICKER. Okay. Four months later, he proposes to—

Mr. ZIENTS. In 2018, and that is to return to the 2009 parameters.

Senator WICKER. Right.

Mr. ZIENTS. The 45 percent rather than 40 percent. Still a $3.5 million exemption per individual. I think the figure is three out of 1,000 estates would be impacted by this. I think that in the context of the fiscal situation that we have all talked about, the need to put the country on a sustainable fiscal path, the President believes that that is fair and good policy.

Senator WICKER. Okay. And yet he signed a bill on a permanent basis to put it at 40 percent and 5.12 inflation adjusted. I would have to say this, Madam Chair. I think the President cannot realistically believe that this has a prayer of passing. And so the $79 billion—I never got my answer there, but the book says it is supposed to raise $79 billion—is just totally false.

But let me move on to my last question. I appreciate what Senator Warner said about the Consumer Price Index. You know, the President told a group of us last night that chained CPI has a bad connotation. Maybe we need to give it another name. I have come up with one, Madam Chair. Let us call it "TRICOLA"—truth in cost of living adjustments.

Now, isn't it a fact that the President's proposal is a more accurate measure of the inflation adjuster than the current CPI we have?

Mr. ZIENTS. Well, I think that—I am not an economist, and, again, the President would not do chained CPI or superlative CPI on his own as part of balanced deficit reduction.

Senator WICKER. Is he suggesting a more or less accurate inflation adjuster?

Mr. ZIENTS. I think he uses it as a technical rationale for chained CPI.

Senator WICKER. Is that it is more accurate?

Mr. ZIENTS. As a technical rationale for using chained CPI. At the same time, it is very important to protect the most vulnerable and to have a bump for older Social Security recipients.

Senator WICKER. Well, let me just say this: Mr. Warner has left the room, but I think he put it correctly. You are talking about $3 a month, and with protections in there for the bottom tier of benefit recipients. If we cannot do that to save the system and to save a successful program, then we are pretty well not going to be able to save Medicare and Social Security in the future.

Would you agree also that it is a balanced approach— and we have heard this ad nauseam—in that chained CPI or the new TRICOLA not only saves us in the spending side of it, but also it does amount to a significant revenue raiser?

Mr. ZIENTS. It does have a component of changing how the annual increase in tax brackets are calculated. It does result in more revenue.

Senator WICKER. It results in a substantial amount of new revenue. So in that sense, Madam Chair, we have the answer to our President's request for a balanced approach. Thank you.

Chairman MURRAY. Thank you.

Senator Merkley?

Senator MERKLEY. Thank you, Madam Chair, and thank you for your testimony, Mr. Zients. I applaud the President's attention to manufacturing in this budget. I applaud his investment in education, early education and STEM, his understanding of the importance of investing in infrastructure, and of the goal of laying out a plan that lowers the debt as a ratio to GDP. All these are good things.

I am going to expand on the conversation we have been having about CPI, and I noticed you were careful not to say it was not more accurate, as my colleague asked you to say. And, of course, there is a good reason for that. I think you are aware that the CPI index as applied to Social Security is not based on a basket of goods faced by our senior citizens. You are aware of that? Just yes or no is fine.

Mr. ZIENTS. It is based on a certain measure of cost of living and the chained CPI.

Senator MERKLEY. Please tell me you know that it is not based upon a basket of goods seniors face. This is the most fundamental fact in CPI.

Mr. ZIENTS. It is an annual inflation adjustment—

Senator MERKLEY. It is based on a basket of goods that all Americans face, not that seniors face. Am I right or wrong?

Mr. ZIENTS. It sounds like that is the case, yes. It is used across—

Senator MERKLEY. Please, simple answers are fine in this room. We do not—

Mr. ZIENTS. It is used across many Government programs, and as we talked about—

Senator MERKLEY. Great.

Mr. ZIENTS. —it is also used across the Tax Code.

Senator MERKLEY. Because it does not track what seniors face, there is a separate CPI for what seniors face. It is called "CPI–E." I assume you are familiar with that.

Mr. ZIENTS. What I know about CPI–E is that it is very early stage index that is not terribly well developed at this stage.

Senator MERKLEY. Thank you. It is developed to track what seniors face. It goes the opposite direction of what you are proposing in a chained CPI, which is less accurate about what seniors face in their basket of goods. And I think that is very important because at the heart of this is an issue of fairness.

Now, there are many ideas that have been put forward about how to make sure that we have a trust fund that is not only solvent for 20 years but solvent for 75 years. Those include, for example, a sliding-scale means testing the 25 percent most affluent retired Americans. So they get a little bit less. They still get Social Security, but they get a little bit less. Has the President and his team carefully looked at such measures and tried to evaluate them in terms of fairness to our seniors?

Mr. ZIENTS. So let me just comment a little more on CPI–E. My understanding is that it is not proven. It is only experimental. I want to emphasize the chained CPI would apply across all Government programs, excluding means-tested Government programs. I also want to emphasize that we have talked about that there will be a bump-up for older Social Security beneficiaries.

As to Social Security overall, the President has put forward principles for Social Security reform and would engage in a Social Security reform process.

Senator MERKLEY. Thank you. I do not think you answered my question. Should I repeat it for you? Has the President's team looked at other strategies for reducing the costs of Social Security that might be fairer such as means testing the 25 percent richest seniors in a sliding scale, a modest reduction in their benefits?

Mr. ZIENTS. Social Security is not the driver on near-term fiscal issues. Social Security is a reform process that the President has laid out principles for. The reason that chained CPI is in the compromise offer is that Speaker Boehner and Leader McConnell asked for it to be in. They also asked for us to consider moving the age for Medicare eligibility to 67. We are not willing to do that. We are willing to do chained CPI under two conditions: one, it is part of balanced deficit reduction—

Senator MERKLEY. Thank you. I am going to cut you off because you have chosen not to answer the question I asked you, if you had looked at other strategies affecting Social Security. I will take that your avoidance of answering is simply no. I would like to encourage the administration, as I have on multiple occasions, to look at many other strategies that have been suggested that are fundamentally fairer, that protect the solvency of Social Security for 75 years, go much further in that sense than this 20 percent improvement we have before us, but do not reduce Social Security for hard-working, middle-income Americans.

I want to close by noting that under the charts that Senator Sessions referred to, I see under the outlay section a 0.3 reduction, a $0.3 trillion reduction, and I see under receipts a 1.1 increase. That totals 1.4. I am not seeing where—and this is compared to the baseline that you have on the previous chart.

Mr. ZIENTS. What page or table are you referring to?

Senator MERKLEY. Yes, 186 is the baseline. That is the adjusted baseline, S.4 on 187. And on 189 is the proposed budget, and if you compare the outlays and the baseline, those are 46.8 versus 46.5 in the President's budget. That is a 0.3 reduction in outlays. And if you compare receipts, there is a 1.1 increase. So 0.3 and 1.1 is 1.4. Where is the other $400 billion?

Mr. ZIENTS. Well, I think actually the easiest way to see the deficit reduction is to use Table S.3. As I explained before, we have in the baseline sequester— because, unfortunately, that has been implemented. We replace sequester with balanced deficit reduction, which I think most people believe is a much better path for this country. And in doing so you have that discrepancy.

If you look at Table S.3, you will see—

Senator MERKLEY. Okay. But if we simply compare the baseline to the President's budget, it would be 1.4.

Mr. ZIENTS. So the President's—the baseline has the sequester in as all spending cuts, which was never the intended policy. We are replacing that with balanced deficit reduction—

Senator MERKLEY. I understand

Mr. ZIENTS. —which is laid out on S.3.

Senator MERKLEY. Thank you for that clarification.

Chairman MURRAY. Senator Coons.

Senator COONS. Thank you, Chairman Murray.

Thank you, Acting Director Zients, for your testimony and for coming here today. As I am sure has been said before, a budget is a statement of priorities and values, and in my view, the President's budget is an important contribution to our ongoing conversation. It does the right thing by prioritized job growth and investing in our economy in the short run. There are a number of things in here that I am very interested in, find appealing, as others of my colleagues have commented, focus on STEM education, on manufacturing, on investing in R&D and infrastructure. But there are other things that are part of any rough-hewn compromise that are objectionable to some, as you have heard today.

Last month, when we passed the Senate budget resolution, I think we also struck a balanced compromise that was a mix of tough spending cuts with revenue increases. This budget, as I have understood it so far, builds on the very real progress we have made, the $2.4 trillion in progress towards the broadly agreed roughly $4 trillion objective. It does about another $1.8 trillion.

I wanted at the outset to say I was thankful to see there was some continued investment in a project near and dear to my region, the Delaware River dredging, as well as a variety of programs that I have long championed and believe in, the Manufacturing Extension Partnership and a broad range of other manufacturing-related initiatives I would like to ask about.

But the President also included difficult choices on entitlement reform, and I would like to drill down a little bit further if I could to follow on some questions you haveten from the previous two Senators. In my view, when it comes to any conversation about entitlement reform, we have to be clear about maintaining a circle of protection around our most vulnerable that is both rooted in our most fundamental values and in what I hear from the people of Delaware. I have consistently voted against proposals that would dismantle Medicare, Medicaid, and Social Security, turn them into voucher or block grant programs. These are vital programs seniors have worked for their entire lives and I think need and deserve protection.

So in the conversations you have been having today, there has been some dialogue, some discussion about what is chained CPI and what are the provisions. If I understand correctly, the budget as proposed, as you have just recently said, includes some protections for the most vulnerable. Would you explain those in a little bit more detail for me?

Mr. ZIENTS. Any Government program that is means-tested would not be subject to the chained CPI.

Senator COONS. So what would the principal exclusion— what would that mean for veterans' benefits or SSI or—

Mr. ZIENTS. The means-tested veterans' programs—we had a discussion on veterans before you came in—would be excluded. SSI is excluded. Pell is excluded. Social Security, as we have talked about, chained CPI applies. Chained CPI applies to Federal retirement programs. We could get you a more complete list, but that is a representative sample.

Senator COONS. And a reference to an additional payment for those who have been on Social Security for a long time—

Mr. ZIENTS. That is right. At 76 there is a bump-up, which is based off of the average benefit, 5 percent of the average benefit, and that phases in across the following 10 years.

Senator COONS. And the rationale for—

Mr. ZIENTS. As I said, anyone who is on SSI, that is means-tested. That is not—that would not be subject to chained CPI.

Senator COONS. You had an exchange, a conversation with Senator Merkley about the different versions of CPI: CPI–U, CPI–W, CPI–E, chained CPI. And you were asked previously about whether chained CPI was more accurate. My understanding is for a long time it has been viewed by economists as being a more accurate predictor broadly, not for the specific population of seniors or the most vulnerable.

Mr. ZIENTS. Yes.

Senator COONS. Help me understand—

Mr. ZIENTS. That is my understanding. Again, I am not an economist, but my understanding is it has to do with the substitution effect, that when something is priced higher, if there is an opportunity to buy a like good or a similar good that is less expensive, you know, chicken versus another type of meat, that you need to take into account the substitute effect. But, again, in terms of real technical expertise, I do not pretend to have that, and we can certainly follow up and give you more—

Senator COONS. My sense was the name "chained" comes from chaining the effects from quarter to quarter or month to month. The substitution effect you are talking about is if the price of apples goes up very quickly, folks will substitute oranges for apples.

Mr. ZIENTS. That is right.

Senator COONS. If the price of beef goes up, they will buy chicken. But I think the specific question Senator Merkley was trying to drill down on was for those of us who share a concern about its potential impact on seniors and the most vulnerable, is it an accurate predictor of the basket of costs, whether housing or medical or food, that would be relevant? Or is there a more accurate predictor?

Mr. ZIENTS. Well, again, for the most vulnerable, the chained CPI will not apply. There will be the increases we talked about for the older beneficiaries. My understanding is there is a technical rationale for chained CPI being a better indicator or tracker, if you will, of annual inflation.

Senator COONS. You said earlier that the President rejected a request and asked for consideration of raising the age of Medicare, but was willing to move forward with chained CPI, and one of its benefits was it raised revenue as well as reducing costs. Could you talk about that a little further?

Mr. ZIENTS. Well, I think, importantly, on the age 67, that is just cost shifting.

Senator COONS. Right.

Mr. ZIENTS. It is cost shifting to the private sector. It is cost shifting to our seniors. It could leave people uninsured. That is not good policy. The President is not willing to do it. Chained CPI the President has been clear he will not do on its own. It has to be part of balanced deficit reduction that includes revenue. The $1.8 trillion package has $580 billion of revenue in it, and he will only do chained CPI with the protections that we just talked about, protections for the most vulnerable and protections for older recipients of Social Security.

Chairman MURRAY. Thank you very much. I will—

Senator COONS. I see I am out of time. I apologize. Thank you.

Chairman MURRAY. Thank you, Senator.

Senator Sessions?

Senator SESSIONS. Mr. Zients, on Table S.13, Federal Government financing and debt, the gross debt of the United States in 2013 is $17.2 trillion, and in 2023, it is $25.4 trillion, a net increase of $8.2 trillion in the gross debt of the United States, according to your own numbers in your budget that you have submitted to the Senate and the Congress of the United States. Is that not correct?

Mr. ZIENTS. Well, let me just catch up to you. I think that you are citing gross debt, and we have spent some time talking through how gross debt is not the right metric. I think the right—

Senator SESSIONS. Well, but if you are wrong about that question—let us talk about the gross debt. So you agree that it is an $8.2 trillion increase in the gross debt.

Mr. ZIENTS. Yes, that—

Senator SESSIONS. By your own numbers.

Mr. ZIENTS. Right. I do not think the gross debt is the right metric here—

Senator SESSIONS. Now, you say you are not an economist, but you say the gross debt is not the right metric.

Mr. ZIENTS. I will join CBO—

Senator SESSIONS. Let me put up a chart—

Mr. ZIENTS. —in saying that gross debt is not the right metric.

Senator SESSIONS. All right. You join with CBO, but I think there has been a serious misunderstanding about that. The Rogoff-Reinhart study and their work that considered the debt crises in countries all over the world for over 100 years, they say in this paper, public debt refers to the gross central government debt. And they say that is the number that they had when they calculated that debt over 90 percent of GDP slows growth.

So I would ask you, if you are wrong in that estimation, that the important figure is the gross debt, would that not mean the United States is at risk for slow growth right now, a fact that you said is most important for—

Mr. ZIENTS. First, let us go someplace that we both agree on. We need to reduce our deficits, and we—

Senator SESSIONS. I know, but this is really important.

Mr. ZIENTS. —need to reduce that as a percent—okay. In terms of—

Senator SESSIONS. This is really important.

Mr. ZIENTS. In terms of that study, it is benchmarking versus other countries, and other countries have different financing systems. If the U.S. measured the same way as other countries, our debt would be well below that 90 percent. It would be much closer to the debt held by the public, which is in the mid-seventies.

Senator SESSIONS. Well, let me point out that three other studies in recent years have been done in Europe. The European Central Bank, the International Monetary Fund, and the Bank for International Settlements, they have all done independent analysis. They showed that high government debt weakens the economy, slows growth, and our growth is well below what CBO was predicting just a few years ago.

Last year, they predicted—2 years ago, they predicted 2012 would be 4.4 percent growth. It came in at 2.2 percent growth, well below what CBO was projecting.

Mr. ZIENTS. One thing I would agree on—

Senator SESSIONS. I would say, just to follow up—and this is a serious matter. We need to address it. Those three studies—European Central Bank, IMF, and the Bank for International Settlements—also used gross debt, and each one of those analyses that they have produced, the United States is at a level where our growth is being slowed by the existing level of debt. And to me that gives us a great imperative to get off this track and begin to place our country back into a debt level that is sustainable.

Mr. ZIENTS. So I am sure you spend a lot of time with businesspeople around the country. I do the same. I think that we also agree that we need to decrease our debt as a percent of our economy.

I will tell you something that is holding back growth right now. It is the manufactured crisis after manufactured crisis coming out of Washington. We need to turn off the sequester. We need to do balanced deficit reduction and let our job creators create jobs without worrying about what Washington is going to—

Senator SESSIONS. Well, we certainly need to avoid crises everywhere we can. However, the August 2011 debt ceiling increase resulted in the only real reduction in the growth of spending, $2.1 trillion, and it was a firm commitment and law to reduce spending by $2.1 trillion. And that was not—

Mr. ZIENTS. That crisis also led to a severe drop in consumer confidence, a rating decrease, and tremendous reaction across the economy.

Senator SESSIONS. So it was—

Mr. ZIENTS. We cannot repeat that. We owe it to this country, to our job creators, to people who are seeking jobs, to avoid that type of crisis. The President—

Senator SESSIONS. We need to avoid that crisis and we need more help from this administration to get our debt level down. And you are raising taxes substantially in this budget that you produced. You raise taxes. But, Mr. Zients, unlike what Senator Warner suggested, we are not using those taxes to reduce the debt. They are being used to fund new spending above the spending level we are on. The CBO baseline, the law that we passed in August of 2011 increases spending about 5 percent plus a year.

Mr. ZIENTS. Senator—

Senator SESSIONS. So this would not reduce spending. It would just reduce the growth of spending—

Mr. ZIENTS. The President's budget—

Senator SESSIONS. —under current law, and you increase that. You increase spending over the steadily increasing CBO baseline. That is what you do.

Mr. ZIENTS. The President's budget puts this country on a sustainable fiscal path, invests in jobs and competitiveness, and gets this economy growing again.

Chairman MURRAY. Okay.

Senator SESSIONS. And makes it worse than the current situation.

Chairman MURRAY. Director Zients, I just have a couple more questions. I was really pleased to see the President's budget included a strong focus on early childhood education. As you know, that is an area of particular interest to me. I have long believed that early childhood education is one of the best investments the Federal Government can make. We know the research that shows that a child's early years are a critical development stage, and early childhood education really is a great benefit to that child, their family, their community, and our country.

So I wanted you to speak to that issue for a minute. Your budget proposes expansions in several areas of childhood education. Can you speak to how many children currently have access to pre-kindergarten and other early childhood education programs and how the proposals that you are presenting would expand those?

Mr. ZIENTS. Yes, I do not have those exact statistics with me, but my team will definitely follow up. I share your passion around early childhood and the importance of it for our competitiveness, the return on investment that we will get from that. The tobacco tax will fund the Pre-K initiative. It also at the same time will reduce smoking. It will discourage teenagers from smoking, and it will hopefully encourage folks to quit. So it has great public health benefit, and at the same time I share your passion about the Pre-K initiative.

Chairman MURRAY. Okay. I appreciate that, and I really would like to see those numbers.

Mr. ZIENTS. We will get those to you.

Chairman MURRAY. I also wanted to ask you about an area really important to me at home, and that is the Pacific salmon issue. There are many species of Pacific salmon and steelhead. They are really central to the cultural identity of my home State and really the west coast, and they support commercial fisheries, recreation, tourism, and economic activities, and they are very sacred to many of our Native American tribes, and, really, we have an obligation on treaty requirements that we have to meet.

So I was really dismayed to once again see how drastically underfunded the Pacific Coastal Salmon Recovery Fund is. Even in today's austere times, which we all recognize, and with sequestration, the cuts that are called for in this program are much greater as a percentage of total funding than for a lot of the other programs in the discretionary funding.

I just want to remind the administration this program leverages State, local, and private dollars to recover these species that are vital to so many areas of our economy and to our treaty obligations in the Pacific Northwest. So I am disappointed again in the funding, and I will work with your replacement, as well as this administration, because this is something critical to all of us at home.

Mr. ZIENTS. I will take that feedback. Obviously, it is difficult times, particularly on the discretionary side with the caps.

Chairman MURRAY. Thank you very much.

We have two more questioners for you, and then we are going to call the hearing to a close. Senator Johnson and then Senator Whitehouse.

Senator JOHNSON. Thank you again, Madam Chair.

Mr. Zients, let us go at the Social Security Trust Fund another way here. Let us just go through the transactions. what happens when the Social Security Trust Fund basically starts paying for benefits using U.S. Government bonds? What happens?

Mr. ZIENTS. It will sell those bonds.

Senator JOHNSON. To who?

Mr. ZIENTS. To the public, and it will be reflected in our public debt, the metric that I keep turning to.

Senator JOHNSON. So we are going to have to, again, float those bonds, and somebody is going to have to give us money for that again.

Mr. ZIENTS. That is all reflected in the President's budget.

Senator JOHNSON. Which is just very similar to when the U.S. Treasury floats a bond to finance the deficit.

Mr. ZIENTS. Yes. At the end of the day, the Social Security Trust Fund is working the way it was intended to work, which is that it is—

Senator JOHNSON. But, again, it is going to have to—

Mr. ZIENTS. And it is solvent through 2033. At that point, if we do nothing—which I do not think would be any of our strategies—the benefit would go down to 75 percent. Clearly, we need to reform Social Security. It is not an immediate driver of our issues, but it is an issue we need to tackle.

Senator JOHNSON. But it is doing the exact same thing as U.S. Treasury has to print a bond and then sell that to the public. And as we continue to grow our debt, it is going to more and more difficult to sell those—

Mr. ZIENTS. Well, I think we are—

Senator JOHNSON. —U.S. Government-backed bonds. Correct?

Mr. ZIENTS. —all in passionate agreement that we need to get our fiscal house in order, and we need to bring down our deficits. We need to bring down our debt as a percent of GDP. The metric that I keep coming back to is debt held by the public. That is reflective of the dynamic you just described.

Senator JOHNSON. But, again, there is no difference whether it is the Social Security Trust Fund selling a bond to the creditors or the U.S. Treasury selling a bond.

Mr. ZIENTS. And that ends up—when they do that—

Senator JOHNSON. It is the exact—

Mr. ZIENTS. —that is reflected in debt held by the public.

Senator JOHNSON. It is the exact same—

Mr. ZIENTS. But they are not—

Senator JOHNSON. —thing.

Mr. ZIENTS. That bond is not being sold today. it is being reflected across time, and when you have debt on a declining path, it includes the dynamic that you just described.

Senator JOHNSON. So, again, in your—

Mr. ZIENTS. So we are driving down—

Senator JOHNSON. In OMB's own publication—and I do not have the graphic up here, but it basically is talking about that, you know, when you consider the asset of the Social Security Trust Fund offset against a liability of the U.S. Treasury, it nets to zero. In terms of the value to the Federal Government, the Social Security Trust Fund has zero value. Do you agree with your own agency's publication?

Mr. ZIENTS. I agree with the conversation we are having here. I cannot take a quote out of context and not understand the whole thing.

Senator JOHNSON. Okay.

Mr. ZIENTS. So what I said is that when Social Security sells those bonds to the public, that is reflected in the debt path that we have been talking about, which is on a declining path starting in 2016. And that is why the debt held by the public I believe is the right metric for us all to be using.

Senator JOHNSON. The reason I am making such a big point of this is I do not see any way we start solving these problems until we are honest with the American people in terms of the depth of the problem. And for anybody to say that Social Security is solvent to the year 2035 is just—I just think that is a false statement, because you have a cash deficit—

Mr. ZIENTS. Well, that is the Social—

Senator JOHNSON. You have a cash deficit of $5.1 trillion that we are going to incur between now and 2032, quite honestly.

Mr. ZIENTS. Well—

Senator JOHNSON. And, we have—again, all we are going to have to do is we are going to float those bonds.

Mr. ZIENTS. But this is the Social Security Actuary. It is 2033, not 2035, I think you just said. And I think we all agree that we do need to tackle our Social Security set of issues across time. It is not an immediate driver, but it is something that we should move on.

Senator JOHNSON. Okay. Within the next 10 years, the cash deficit in Social Security will be about $1.3 trillion. That is according to the Social Security Administration. The chained CPI that the President has included in his budget reduces benefits by a more accurate inflation calculation, by about $130 billion. Correct?

Mr. ZIENTS. Well, I think across time that compounds quite a bit, so—

Senator JOHNSON. In the first 10 years, that is—

Mr. ZIENTS. Right, but be careful about the compounding effect of it. So it is more significant across time because of the compounding effect.

Senator JOHNSON. What would it be in the second decade?

Mr. ZIENTS. I do not know that exact number. We can follow up.

Senator JOHNSON. Okay.

Mr. ZIENTS. But a multiple of that.

Senator JOHNSON. But it is fair to say that in terms of solving—

Mr. ZIENTS. And I think you heard Senator Warner—

Senator JOHNSON. Unfortunately, I was at a different hearing. Sorry.

But in terms of just the magnitude of the problem, what the President is proposing here with the chained CPI would solve about 10 percent of the 10-year deficit in Social Security benefits exceeding the revenue generated. Correct?

Mr. ZIENTS. I think that is about right. Again, I think we are in passionate agreement that we should be tackling Social Security reform in a way that is balanced, that protects the most vulnerable, and it is not a crisis but it is something that we should do.

Senator JOHNSON. Okay. Well, thank you, Madam Chair. Thank you, Director Zients.

Mr. ZIENTS. Thank you.

Chairman MURRAY. Senator Whitehouse, last 5 minutes.

Senator WHITEHOUSE. Thank you, Madam Chair.

Director Zients, I was a little bit out of time last time, so I want to go back to my fiscal multipliers again, and we had described how the fiscal multiplier is basically the measurement of the effect of Government spending or Government cuts on gross domestic product on the economy. And if the number is over 1, we pointed out that actually you are doing more damage to the economy by cutting. And I used the example that hypothetically the Northwestern University and National Bureau of Economic Research recent number suggests that the fiscal multiplier might be 3.7, and that that means that if you cut $1 in Federal spending, if that number is accurate, you are causing $3.7 in reduced economic activity.

And what I want to add to that is that the reverse is true as well, that if, in fact, the fiscal multiplier is at 3.7, as the National Bureau of Economic Research suggests, $1 of additional Federal spending will create $3.7 in additional activity. So the $3.7, as I understand it, applies both to the magnifying effect of a cut, also the magnifying effect of Federal spending, while the fiscal multiplier is in that position. Is that your understanding as well?

Mr. ZIENTS. Yes.

Senator WHITEHOUSE. So the other thing I wanted to touch base and ask—I was running out of time, and I did not want to hear a speech from you about health care, about stuff that I already knew. But I do want to give you the chance to answer that question now that we do have the time. There was a point that you were trying to make, and I wanted to get to the fiscal multiplier, so why don't we spool back to where we were when I was explaining my concern that the Obama administration has not set a specific target with a dollar target amount and a date for its delivery system reform efforts and my view that that is an impediment to the successful accomplishment of those efforts. The example I use is I do not think we would have put a man on the moon when we did if President Kennedy's goal had been to bend the curve of space exploration. It was because we had a hard target, accountability metric that the agencies of the Federal Government and the private sector all came together around that.

So that was my point, and you wanted to respond. Go for it.

Mr. ZIENTS. No, I think as someone who spent 29 years in the private sector, I could not agree more in terms of having a handful of metrics to drive performance. You know, right now, standing up ACA is a very high priority. Implementing the—hopefully passing the budget and implementing these reforms to Medicare is important. But I think a conversation with Secretary Sebelius and getting advice from you on the metrics and how her metrics compare to what you are thinking would be a healthy conversation. We definitely need—in order to manage health care costs toward high-quality care delivered at a lower cost—that is a hard thing to do. There is a lot of variation, as you know, in care across the country, and there is not a good correlation between how much people spend and the quality of that care. Figuring out those best practices and how we implement them across the system and what metrics we use to drive toward high-quality, lower-cost care is central. And I would encourage that conversation, and I will absolutely let Secretary Sebelius know that you have specific thoughts on it.

Senator WHITEHOUSE. And I think the other point that you are making is that the growth rate in our health care cost has come down significantly since the passage of the Affordable Care Act—

Mr. ZIENTS. You have had 3 years in a row now where— this is not Federal costs. This is health care costs for our country.

Senator WHITEHOUSE. For the country.

Mr. ZIENTS. Which, you know, in my old life trying to run a business, a significant part of your cost structure is your health care cost. So this is important for our competitiveness. We have had 3 years of below 4 percent. That is the first time that has happened in 50 years.

So there is more work to be done, but we are making progress. CBO actually cites ACA as one of the drivers of that progress.

Senator WHITEHOUSE. The two main drivers that are cited, as I understand it, are that the economic troubles we are having have probably reduced it somewhat, and the Affordable Care Act have—

Mr. ZIENTS. Absolutely, which is doing a better job of aligning incentives and getting providers to work together and finding those best practices and implementing those and incenting those.

And then the other figure I cited was Medicare on a per capita basis cost growth has come in quite a bit. Now, we do have the demographic challenge that we talked about, that we will have many more participants in the Medicare program.

Senator WHITEHOUSE. So last point. To the extent that our colleagues want to reduce the cost of so-called entitlements like Medicare, we are actually already doing it, and it is built into the projections going forward because those numbers have come down. Correct.

Mr. ZIENTS. Absolutely.

Senator WHITEHOUSE. Thank you.

Chairman MURRAY. Thank you very much. I really want to thank the participation and cooperation of all of our colleagues today. And, Mr. Zients, I especially want to thank you for coming to testify and, again, for serving as Acting Director of OMB.

As a reminder to all of our colleagues, statements and/or questions for the record for today's hearing are due in by 12:00 p.m. tomorrow, and we are meeting against next Tuesday, April 16th, to consider the President's fiscal year 2014 budget proposal, and Secretary of Treasury Jacob Lew will be here to testify on behalf of the administration.

Again, Mr. Zients, thank you very much.

Mr. ZIENTS. Thank you for having me.

Chairman MURRAY. The hearing is adjourned.

[Whereupon, at 3:55 p.m., the Committee was adjourned.]

FY 2014 Budget QFRs

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Sen. Crapo

Acting Director Zients, in the President's FY14 budget, it is projected that the Federal Housing Administration (FHA) will require $943 million from the U.S. Treasury this year to meet its obligations. Understanding that at this point we are only discussing a projection, please walk the Committee through the process by which this would occur, if it does, and how the public would be notified of the action.

The actual need for a mandatory appropriation from the general fund to FHA's Mutual Mortgage Insurance (MMI) fund will not be determined until September 2013, and will be based on FHA's realized revenues through the end of the fiscal year. In the event that FHA's capital reserve does not have sufficient balances at the end of the year to satisfy the $22.4 billion net reestimate obligation, FHA will receive a mandatory appropriation using the permanent indefinite authority for reestimates provided under the Federal Credit Reform Act of 1990—standing authority available to all Federal loan programs.

If a mandatory appropriation is required, it will be presented in detail in FHA's financial statement for fiscal year 2013. The financial statement is typically published in early November.

Sen. Johnson

When you were asked to describe what happens when the Social Security trust funds (the combined OASI and DI trust funds need to cash in Treasury bonds they hold to pay for current benefits, you seemed to say bonds would be sold to the public. Which entity would sell bonds to the public?

When trust fund holdings are redeemed to fund the payment of benefits, the Department of the Treasury finances those benefits out of current revenues, or by borrowing from the public.

Sen. Johnson

Describe the transaction that takes place when the Social Security trust funds redeem Treasury bonds: Which entity pays and which receives payment? If it is a government entity that must pay, describe where the funding comes from.

When the Social Security trust funds redeem trust fund securities from the Department of the Treasury, the Department of the Treasury credits the Social Security trust funds with cash balances. The redemption of the securities is an intragovernmental transaction.

Sen. Johnson

You seemed to refer several times to the Social Security trust funds selling bonds to the public. Do you believe that the Social Security trust funds sell bonds?

The Social Security trust funds invest revenue in excess of benefit payments in Treasury bonds. When the Social Security trust funds need to redeem those securities in order to pay benefits, they redeem the securities from the Department of the Treasury. The Department of the Treasury finances the redemption of securities to pay benefits out of current revenues or by borrowing from the public.

Sen. Johnson

In the Analytical Perspectives section of President Obama's Fiscal Year 2010 budget, the OMB described the Social Security trust funds in this way: "These balances are available for future benefit payments and other trust fund expenditures, but only in a bookkeeping sense. The holdings of the trust funds are not assets of the Government as a whole that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury." It went on to write, "The existence of large trust fund balances, therefore, does not, by itself, increase the Government's ability to pay benefits. Put differently, these trust fund balances are assets of the program agencies and corresponding liabilities of the Treasury, netting to zero for the Government as a whole." Do you agree with OMB's assessment? Do you believe these statements are true?

Trust fund balances represent the value of past surpluses of the trust funds that are reserved for future payments from the funds. For Social Security, for example, the trust fund balances represent the value of past payroll taxes and other income in excess of past benefits. These balances are committed toward the payment of future benefits for existing and future beneficiaries.

The quoted statements accurately describe the nature of trust fund balances from the perspective of Treasury's cash management. When a trust fund redeems its balances to pay benefits, the Treasury Department must finance those benefit payments in the same way that it finances other Government payments—from current revenues or from borrowing.

Sen. Johnson

The above description by the OMB in President Obama's 2010 budget indicate that the assets of the Social Security trust funds are liabilities of the Treasury, which is to say debt that must be paid by American taxpayers. This would seem to differ in no substantial way from any federal debt held by the public, which also must be paid by the American taxpayers. What is your basis for distinguishing the two kinds of debt in saying that one is important for Budget Committee members to consider and the other is not?

There is an important distinction between debt held by the public and debt held by the trust funds in economic terms, because debt held by the public requires borrowing on the capital markets, absorbing funds that could otherwise be invested in the private sector.

While the balances of the trust funds provide the program with authority to draw upon the U.S. Treasury in later years to make future payments to the public, issuing debt to the trust funds does not have any of the credit market effects of borrowing from the public. The issuance of debt to the trust funds is an internal transaction of the Government, is not financed by private saving, and does not compete with the private sector for available funds in the credit market. The assets provided to the trust fund are fully offset by the increased liability of the Treasury to pay the claims, which will ultimately be covered by the collection of revenues or by borrowing from the public.

The current interest earned by the trust funds on their Treasury securities does not need to be financed by other resources. In contrast, interest on debt held by the public contributes to the unified budget deficit and must be financed through revenues or borrowing from the public.

Some observers point to the debt held by trust funds as a measure of the future payments to be made by these programs and therefore of future demands on the capital markets. However, it is important to note that debt held by trust funds does not accurately represent the actuarial present value of projected payments to beneficiaries. Those future payments are better captured by the projections in the annual trustees' reports.

Sen. Sessions

Carmen Reinhart and Ken Rogoff produced a seminal book, This Time Is Different, showing that when gross debt approaches and exceeds 90% of GDP, growth is reduced by 1 percentage point or more. On February 17, 2011, then Treasury Secretary Geithner said the following: "It's an excellent study. And you could say in some ways what you summarize from it, understates the risks, because it's not just that governments or countries that live with very high debt-to-GDP ratios are consigned to weaker growth. They're consigned to the damage that comes from periodic financial crises as well." Do you agree with this assessment?

I do agree that Reinhart and Rogoff's research is valuable. They updated the research in This Time is Different, most recently in a 2012 article, and other authors have published related research. One needs to be careful not to exaggerate or distort the findings of this research when we draw lessons from it, and recognize that no one study is definitive or infallible. Researchers in this field are quick to point out that a statistical association between higher debt and lower growth is in itself not evidence that higher debt causes lower growth. Nevertheless, this area of research suggests that we must not be complacent about the high debt-to-GDP levels that resulted from the economic and financial crisis of 2008, and argues for a fiscal policy that reduces debt as share of the economy. The President's FY 2014 Budget proposal accomplishes that goal.

Reinhart and Rogoff made clear that their research does not support austerity. Their 2012 paper said that their research "should not be interpreted as a manifesto for rapid public debt deleveraging exclusively via fiscal austerity in an environment of high unemployment." The President's Budget addresses the risks pointed about by economists such as Reinhart and Rogoff, but without unnecessary austerity measures that would cost the economy jobs and sacrifice critical investments in areas such as education and infrastructure.

Sen. Sessions

The President's Budget proposes a 56 percent total spending increase over the next 10 years. Mandatory spending alone will grow by 5.2 percent per year. Over the same period, OMB estimates that inflation will be about 2.2 percent per year. Do you believe that 5.2 percent annual spending growth in mandatory programs is sustainable?

The 2014 Budget includes reforms that strengthen Social Security and Medicare and preserve our fundamental compact with America's seniors. Despite these cost saving reforms, demographics will continue to drive mandatory spending as the baby boom generation retires. Over the next two decades, over 30 million new people will participate in Social Security and Medicare. Over the next 10 years, mandatory spending for programs other than Social Security, Medicare, and Medicaid will fall as a share of GDP.

The most relevant metric for assessing fiscal sustainability is the path of the deficit and the debt as a share of GDP. By proposing $1.8 trillion in additional deficit reduction, bringing cumulative deficit reduction since January 2011 to more than $4 trillion, the President's Budget reduces the deficit below two percent of GDP by the end of the budget window and brings down debt as a share of the economy.

Sen. Sessions

Total receipts under the President's "adjusted baseline" in Table S-4 total $40.089 trillion over the next ten years. Total receipts under the President's Budget in Table S-5 total $41.231 trillion over the next ten years. The difference between those two figures is $1.142 trillion. Please provide me with a table that shows the specific revenue policies that reconcile the difference between the two figures.

The Administration's revenue proposals reduce the deficit and make the tax system fairer by reducing tax benefits for higher-income taxpayers and eliminating a number of tax loopholes, while providing support for job creation, incentives for investment in infrastructure, and help to families saving for retirement and paying for college and child care. The Budget includes the President's offer to Speaker Boehner during the fiscal cliff negotiations that raises $580 billion from upper income tax provisions. The upper income tax provisions include a limitation on the value of tax deductions and preferences for the highest-income families and compliance with the Buffett rule so that the wealthiest American families pay no less than 30 percent of their income in taxes. The offer also includes a switch to the chained CPI for indexing tax provisions for inflation which generates $100 billion in additional revenue.

In addition to the offer to Speaker Boehner, the Budget includes other revenue changes and loophole closers to offset tax cuts and job creating initiatives and investments, which account for $199 billion of the proposed tax increases and include proposed increases in unemployment insurance taxes and an increase in tobacco excise taxes. An additional $20 billion in increases is attributable to the Administration's proposals to increase employee contributions to Federal defined benefit retirement plans. Finally, several of the mandatory savings proposals include receipt effects which, on net, increase government receipts. The specific tax increases, loophole closers, and reforms proposed by the Administration are summarized in the table below. Descriptions and estimates of the receipt effect of each proposal are presented in Chapter 14 of the Analytical Perspectives volume of the FY 2014 Budget; estimates of the proposals are also provided in Summary Table S-9 of the main Budget volume.

Effect of Revenue Proposals on Receipts
(in billions of dollars)

	2014-23
Adjusted baseline receipts	40,089
Tax simplification, incentives and relief:	
Tax relief to create jobs and jumpstart growth 1/	-32
Incentives for investment in infrastructure 1/	72
Tax cuts for families and individuals 1/	-24
Simplify the tax system 1/	-4
Trade initiative	-1
Total tax simplification, incentives and relief	11
Tax increases, loophole closers and reforms:	
Upper-income tax provisions	583
Modify estate and gift tax provisions	79
Reform treatment of financial industry institutions and products	63
Other revenue changes and loophole closers	199
Reduce the tax gap and make reforms 1/	78
User fees	11
Other initiatives	120
Total tax increases, loophole closers and reforms	1,131
Net effect of revenue proposals on receipts 2/	1,142
Policy receipts	41,231

1/ The provision affects both receipts and outlays; only the receipt effect is presented here.
2/ Total effect of the Administration's receipt proposals with outlay effects presented as though they were receipts is as follows:

	2014-23
Total tax simplification, incentives and relief	-89
Total tax increases, loophole closers and reforms	1,132
Net effect of revenue proposals (total budget effect)	1,043

Sen. Sessions

The President's Budget cuts defense discretionary spending by $120 billion, compared to the initial Budget Control Act caps. Has the new national security strategy been modified to accommodate this reduction? Would it need to be?

The President's Budget proposes a total of $5,996 billion in national defense (050) function discretionary budget authority over the FY 2014 – FY 2023 period. This is approximately $120 billion, or two percent, less than current law would allow, assuming an extension of the caps in current law to FY 2023. This reduction, along with a roughly equal reduction in non-defense budget authority, is part of a balanced deficit reduction package that would allow Congress to replace and repeal the much larger cuts to both defense and non-defense programs required under current law.

This Budget supports implementation of the defense strategy announced last year. The senior leaders of the Department of Defense (DOD) were fully consulted in the development of the Budget, and no reductions to the defense caps in current law are proposed until FY 2017. That gives the Department time to carefully assess a variety of approaches to accommodate the reductions. DOD has begun a Strategic Choices and Management Review to develop options to ensure that the Department is prepared to defend the Nation and our strategic interests, whether a balanced deficit reduction proposal is enacted or the deeper cuts associated with sequestration are allowed to continue.

Sen. Sessions

The President's Budget proposes an immediate $50 billion surface transportation stimulus and $166 billion in additional stimulus, including an Infrastructure Bank and billions of dollars for high-speed rail. No state has been able to secure enough funding to complete and operate high-speed rail in the U.S. In fact, Florida, Ohio, and Wisconsin all rejected federal high-speed rail funds from the 2009 stimulus bill because such projects were too costly. Are states better able to undertake such projects now? What is the federal share of high-speed rail projects assumed to be in the President's budget?

The President first laid out his vision for high-speed rail in America over four years ago and since that time the High-Speed Intercity Passenger Rail (HSIPR) has funded improvements and upgrades in major corridors around the country, including the Northeast Corridor. To date the Federal Railroad Administration has obligated more than $10 billion in grant funding provided by Congress through the American Recovery and Reinvestment Act of 2009 (ARRA) along with additional funding provided in FY 2010.

As of the end of 2012, 27 individual projects were under construction or completed and California is set to break ground this year. When grants were made available through the HSIPR program, the Department of Transportation (DOT) received applications from 39 States and the District of Columbia totaling more than $75 billion. While States like Florida, Ohio, and Wisconsin ultimately returned Federal funds, DOT received bipartisan letters submitted by delegations from 24 States seeking a portion of the $2.4 billion that Florida returned to the Department. The Administration proposes to include rail within the broader surface transportation framework so that projects to expand and improve rail surface can proceed with greater certainty with regard to long-term funding.

Generally speaking, programs to expand rail service, such as High Speed Rail, assume an 80 percent Federal share and a 20 percent non-Federal share.

Sen. Sessions

The President's Budget calls for an increase in funding for surface transportation programs beyond the current surface transportation authorization (MAP-21, which expires at the end of FY 2014) of $88.5 billion over 2015-2020 period. How much of that amount will be devoted to highways? At the same time, the President's Budget also calls for the creation of an expanded Transportation Trust Fund to replace the Highway Trust Fund, and would move several General Fund programs (including Amtrak) to the new Trust Fund. The Transportation Trust Fund would also provide dedicated funding for a National High-Performance Rail System, among other rail programs, through a new Rail Account (in addition to the existing Highway and Transit accounts). Can you provide a table that shows the allocations to the various programs that will be covered by the proposed Transportation Trust Fund?

The 2014 Budget includes $469 billion in total transportation funding across the proposed surface and rail reauthorization periods. Funding for the reauthorization proposals would be derived from the Transportation Trust Fund. Funding for the two reauthorizations is distributed as follows:

(1) For rail, beginning in 2014, $40 billion is proposed over five years, an authorization length in line with the Passenger Rail and Improvement Act (PRIIA).

(2) For other surface transportation programs, the budget reserves $429 billion over six years beginning in 2015. The start of the authorization coincides with the expiration of MAP-21. This amount covers baseline funding levels, including general fund transfers to keep the transportation trust fund solvent, and includes programmatic increases for highway, transit, highway safety, and multi-modal programs.

Because the rail proposal begins in the budget year, the budget includes year-by-year amounts over the reauthorization period. The surface transportation funding is reserved in an outyear allowance without modal splits.

Though this detail is not included in the outyear estimates due to the allowance, the Administration envisions that allocations for surface transportation programs will generally be consistent with the 2013 Budget proposal, when surface and rail were proposed for a concurrent six-year period, with the allocations proposed in the attached table.

FY 2013 Surface Reauthorization Proposal Average Annual Modal Allocations	
Mode	**Percentage Share**
Highways (FHWA)	66%
Highway Safety (NHTSA, FMCSA)	2%
Transit (FTA)	23%
Rail (FRA)	9%
Total	**100%**

Sen. Sessions

The President's budget proposes universal access to pre-kindergarten programs for all four-year-olds, financed by new tobacco taxes- a tax increase of 94 cents per pack (from $1.01 to $1.95). According to the Centers for Disease Control, tobacco usage in the U.S. has been declining nearly 2 percent every year since 1965, so, other thing being equal, tobacco taxes likely will not keep up with future costs of the new pre-kindergarten programs. Do you think it is smart to initiate a new entitlement program - that will grow larger over time - but pay for it with a declining revenue source? Would the administration advocate scaling back the new spending if the new taxes did not keep pace with spending growth?

The President's pre-kindergarten proposal, Preschool for All, is a financial incentive to States to provide access to high-quality preschool to all children, not an entitlement that will grow over time. The program establishes Federal-State cost-sharing partnerships to provide all low- and moderate-income four-year-olds with high-quality, publicly-funded preschool. The ten-year Federal cost of the program is fully paid for through new tobacco taxes, which also would result in 230,000 fewer youths smoking. Funding for Preschool for All is based on a model where the Federal government would assume a significant share of the program costs in the first years of the program with states gradually assuming more responsibility over time. For example, in the first year of the program, Federal funds would support approximately 90 percent of the cost in a typical State and this funding would decrease to approximately 25 percent of the cost in the tenth year. Under this program, the Federal government provides critical support for the creation and expansion of State preschool while encouraging states to eventually incorporate preschool into their K-12 education system. This model ensures the Federal cost does not exceed declining tobacco tax revenue.

Sen. Sessions

In the prepared testimony, you applaud the creation of 6.5 million new jobs since the Great Recession ended, but in that time nearly the same number of individuals - 5.5 million people - have left the workforce. Many of those folks now receive (some simultaneously) federally-funded food stamps, federally-funded unemployment insurance, federally-funded disability insurance, and federally-funded health care. As previous testimony in this committee has shown, many of these people are trapped by federal policies that discourage work and perpetuate poverty. How does the President's Budget change these federal programs to incentivize financial independence?

The programs you mention provide a critical safety net to those who have lost their jobs or are unable to work, and the Administration is committed to making sure they are available for those who need them. At the same time, the President's Budget builds on the significant progress made over the last four years to create ladders of opportunity into the middle class. The President's 2014 Budget contains a variety of initiatives and reforms designed to help unemployed Americans find jobs more quickly. Specifically, the Budget includes:

- A $4 billion Reemployment NOW proposal, which incorporates a number of reforms to help UI claimants and other long-term unemployed individuals get back to work more quickly.
- $25 million to facilitate State take-up of the demonstration authority that was included in the Middle Class Tax Relief and Job Creation Act of 2012, to help States test new and better strategies for getting UI beneficiaries back to work.
- $30 million for reemployment services targeted at UI claimants who are identified as most likely to exhaust their benefits.
- A reformed Universal Displaced Workers program to provide a core set of support and reemployment services to all workers who lose their jobs.

In addition, the Budget includes reforms to ensure that these programs provide benefits only to those who are eligible. The Budget includes additional funding for:

- Medical eligibility reviews for Social Security Disability Insurance. While most Disability Insurance beneficiaries have permanent disabilities, these reviews ensure that those who do medically improve and are able to work leave the program. The Budget proposes to fund a historic number of medical eligibility reviews to make certain that only those who remain eligible for benefits continue to receive them.
- Unemployment Insurance Reemployment and Eligibility Assessments (REAs), a proven strategy whereby States review the continued eligibility of UI claimants and refer them to additional reemployment services. The Budget's proposed investment of $80 million is expected to provide benefit savings of $315 million.

The Budget also includes a legislative proposal to reduce an individual's Social Security Disability Insurance benefit in any month in which the person also receives unemployment benefits. This proposal would eliminate duplicative payments for the same period out of the workforce, while still providing a base level of income support.

The Administration also strongly supports changes to ensure that hard work leads to a decent living. The President has long championed the Earned Income Tax Credit (EITC), enacting substantial expansions as part of the Recovery Act, which were subsequently extended. The EITC reduces poverty by encouraging work and supplementing the wages of low-income workers. The EITC is particularly effective at increasing the work and earnings of female-headed families. By boosting employment among single mothers, the EITC also reduces the number of families that receive cash welfare assistance. The Budget proposes to permanently extend recent EITC and Child Tax Credit expansions. The President has also called for an increase in the minimum wage to $9 per hour, which would raise wages for 15 million wage earners. Along with refundable tax credits, this would ensure that a minimum wage earner with children no longer falls below the poverty line.

Sen. Sessions

Under current law, Social Security benefits would be reduced 25 percent by 2034. If chained CPI were implemented as envisioned in the President's Budget, in what year would a reduction in benefits start?

The Social Security actuaries estimate that adopting the chained CPI immediately would extend the ability of the Social Security trust funds to make full scheduled benefit payments by about two years. Building in protections for the elderly and long-term disabled would likely reduce that estimate.

Sen. Sessions

The President's Budget again proposes placing caps on Overseas Contingency Operations. In the absence of caps, would funding for Overseas Contingency Operations decrease on its own due to the realities on the ground in Afghanistan and policy decisions already in place? Are there other options available to the Congress to reduce spending beyond the proposed caps if Congress believed national security was at risk?

The Budget proposes a $450 billion multi-year cap, from FY 2013 to FY 2021, on Government-wide Overseas Contingency Operations (OCO) funding. This proposal generates an estimated $675 billion in deficit savings relative to OMB's adjusted baseline.

This Administration brought a responsible end to the war in Iraq, with all American forces out by December 2011. We are steadily drawing down our presence in Afghanistan, as well. The President announced in this year's State of the Union address that we will bring half our 68,000 troops in Afghanistan home within one year. By the end of calendar year 2014, our war in Afghanistan will be over. As a result of these policies, war spending has begun to decline.

We expect that OCO funding will continue to decline over the next few years, and capping OCO funding will ensure that the OCO budget cannot be used to evade the discipline required by the Budget Control Act in other parts of the discretionary budget.

As required by law, the Congressional Budget Office (CBO) estimate of the baseline deficit assumes that we will be spending as much as we are today on OCO for years into the future. OMB's adjusted baseline makes a similar assumption. In reality, responsibly ending the war in Afghanistan in 2014 and capping OCO will mean that we spend much less, and the projected deficit will come down as a result.

In case of a national emergency requiring OCO funding above the proposed cap level, Congress could designate such funding as an emergency requirement. This is also the case with regular discretionary funding subject to caps under current law.

Sen. Sessions

The Administration claims that most of the tax increases in the President's Budget fall on upper income taxpayers. However, adopting the chained CPI-U would affect taxes paid by taxpayers in lower tax brackets as well, such as taxpayers that are now on the edge between the 10 and 15, 15 and 25, and 25 and 28 percent tax brackets. These tax brackets are those that contain the middle income taxpaying households. How many of these middle income taxpayers will face tax increases under the Administration's budget plan?

No middle income taxpayers will face tax rate increases. When tax brackets are indexed to inflation, tax rates stay constant for taxpayers of any given real income level. The chained CPI proposal would use an alternative measure of inflation to index tax brackets, and therefore make it more certain that tax rates would stay the same for each real income level.

Sen. Sessions

During the hearing, you spoke of a list of programs that would be affected by the President's chained CPI proposal. Could OMB provide a list of those programs, as well as programs that currently receive an inflation adjustment that would not be covered by the President's proposal?

In the interest of achieving a bipartisan deficit reduction agreement, the Budget proposes to use the chained CPI to compute cost-of-living adjustments in major Federal programs, such as Social Security and federal employee retirement, as well as the tax code. However, this change must be paired with protections for the elderly and those who rely on Social Security for long periods of time and it would not be applied to any means-tested programs.

Sen. Sessions

Under the President's proposal, interest payments more than triple from $220 billion today to $760 billion in 2023. These payments go to foreign and domestic creditors to pay for our growing national debt. Will higher interest payments in the future prevent the government from fully funding worthwhile goals like defense? Does interest on the debt pose a risk to this country's fiscal future?

We all agree that we must take steps to put our country on a sustainable fiscal path. That is why the President has proposed an additional $1.8 trillion in deficit reduction, bringing our deficit below 2 percent of GDP and putting debt as a share of the economy on a declining path. Including previously enacted deficit reduction, this will lower interest payments over the next decade by almost $700 billion.

Under our projections, interest payments do rise from where they are today—in large part because we expect interest rates to eventually increase from their historic lows as the economy continues to recover. The President's plan takes this into account and puts the budget on a sustainable path. To be clear—we need to take action, and the President has a plan to do so.

Sen. Sessions

As OMB Director, you are the Administration official responsible for submitting legislation to Congress in response to Medicare funding warnings issued by the program's trustees. Last year (2012) was the sixth consecutive year that the trustees were required to issue a Medicare funding warning. The Administration has never submitted legislation in response to these warnings. Will the Administration submit Medicare legislation to Congress this year? If not, why not?

The Administration takes very seriously both Medicare costs and the program's financing gap and has worked relentlessly to enact legislation that strengthens the program's benefits and financing for seniors. The President's FY 2014 Budget proposes specific actions to strengthen Medicare that would produce roughly $370 billion in Medicare savings over the next decade and would extend the program's solvency about four years by promoting high-quality, efficient care, while encouraging beneficiaries to seek high-value services.

Moreover, the most recent Medicare Trustees Report shows that the funding warning threshold was last exceeded in 2012, and not during any other subsequent year during the applicable 2012-2018 time frame. Therefore, legislation is not necessary to bring general revenue financing below the funding warning threshold for 2013 through the remainder of the seven-year funding warning window.

Additionally, as noted in prior years during this Administration as well as during the previous Administration, the Executive Branch considers the provision requiring the submission of legislation in response to the Medicare funding warning to be advisory and not binding, in accordance with the Recommendations Clause of the Constitution.

Sen. Sessions

The President's Budget proposal calls for increasing receipts from offshore and onshore oil and gas development by $2.5 billion over 10 years through royalty reform, encouraging development of existing leases, and improved revenue collection. How many additional (fewer) barrels of oil and cubic feet of natural gas are estimated to be produced if the President's proposals are enacted? What percentage increase (decrease) in production does that represent? What general geographic regions represent the bulk of this increase (decrease)? What proportion of the increase (decrease) comes from offshore production in federal waters and from onshore production on Federal lands?

The Budget includes a package of legislative and administrative reforms to improve the management of Federal oil and gas resources both onshore and offshore. These reforms serve three purposes:

(1) improving the return to taxpayers from development of publicly-owned oil and gas resources;

(2) encouraging diligent development of both new and existing oil and gas leases; and

(3) streamlining revenue collection processes.

Collectively, these reforms will generate roughly $2.5 billion in net revenue to the Treasury over 10 years, of which about $1.7 billion would result from statutory changes. Many States will also benefit from higher Federal revenue sharing payments. The details of some reforms are still under development, so it is too early to estimate the net aggregate impact of these reforms on Federal oil and gas production or speculate on impacts by geographic region. However, in total, these reforms are not expected to have a significant negative impact on near-term production, and the impact may ultimately be positive.

It is worth noting that the FY 2014 Budget also includes permitting reforms and increased resources for Department of the Interior agencies to support the responsible development of our Federal oil and gas resources. The Budget provides robust support for onshore energy permitting and oversight on Federal lands, with a more than 20 percent increase over the 2012 enacted level in total discretionary funding for the oil and gas program of the Bureau of Land Management (BLM). We are also proposing an extended and revamped BLM permitting pilot office authority and we continue to implement administrative changes that will facilitate improved responsiveness to industry permit requests.

The Budget proposes $169 million and $222 million, respectively, to fund the Bureau of Ocean Energy Management and Bureau of Safety and Environmental Enforcement, which share responsibility for overseeing development of oil and gas resources on the Outer Continental Shelf (OCS). The current OCS five-year leasing program will make more than 75 percent of estimated undiscovered technically recoverable oil and gas resources on the OCS available for development.

Sen. Sessions

The President's Budget calls for an Energy Security Trust, provided $200 million annually. Is this increase in spending tied to receipts from new production from federal onshore or offshore areas? The Trust is intended to "transition our cars and trucks off of oil." In what form will this money be spent (e.g., on advanced research at DOE facilities)? What technologies are expected to receive funding through this program? What will be the level of market penetration achieved by cars and trucks not powered by oil in 10 years without the Energy Security Trust? In 20 years? What will be the level of market penetration achieved with the Energy Security Trust in place in 10 years? In 20 years?

The Administration is calling on Congress to establish an Energy Security Trust, setting aside $2 billion over 10 years (or $200 million annually) that would support breakthrough research into a range of cost-effective technologies like advanced vehicles that run on electricity, homegrown biofuels, fuel cells, and domestically produced natural gas. The mandatory funds would be set aside from royalty revenues generated by oil and gas development in Federal waters of the Outer Continental Shelf (OCS), already included in the Administration's five year plan. The Energy Security Trust would be administered by the Department of Energy (DOE), supplementing DOE programs funded on an annual basis with discretionary appropriations. This R&D investment would accelerate cost reduction and improve performance, presenting consumers with cleaner transportation alternatives and enabling increased market penetration within the next 10 to 20 years.

The intent of this Trust is to support efforts to reduce our reliance on oil. In furtherance of that objective, it will support the highest-priority research designed to accelerate the transformation of our transportation system from one that relies nearly exclusively on oil to one in which alternative fuels play an increasingly important role. We expect that it will fund R&D in support of alternative fuel vehicles, such as advanced battery chemistries for electric vehicles; stronger, lighter, and cheaper containers for compressed natural gas; and advanced liquid biofuels. It also could support limited deployment related R&D in areas where such support could help facilitate the adoption of vehicles that do not use oil.

The Energy Security Trust will continue to increase momentum towards a cleaner, more efficient fleet that is good for consumers, increases energy security, and cuts carbon pollution. And it will help set us on a course to meet the President's goal to cut net oil imports in half by the end of the decade, relative to 2008 levels.

Sen. Sessions

The President's Budget calls for increasing the receipts that fund the inland waterways trust fund by $1.1 billion over 10 years. Under the President's proposal, when does the Army Corps of Engineers estimate the Olmsted Lock and Dam will be completed and no longer consume resources from the inland waterways trust fund?

Olmsted Locks and Dam would replace two aging dams on a key segment of the inland waterways on the Ohio River, near the point where it flows into the Mississippi. For the Army Corps of Engineers (Corps) civil works program, this project is a high priority.

The Corps is in the process of developing a revised detailed schedule for completing this project. Under the President's legislative proposal and the current Corps construction schedule:

- the Olmsted Locks and Dam would become operational in FY 2019, based on the minimal project features required for the dam to safely hold the pool and pass commercial tows and barges through the new locks;
- the Corps would complete the other physical work associated with the dam contract in FY 2020, including contractor de-mobilization and equipment salvage; and
- the Corps would complete the remainder of the project in FY 2023, including work on miscellaneous other facilities (e.g., buildings and grounds), permanent operating equipment, river dikes, and the demolition of Locks and Dams 52 and 53.

Due to the low level of receipts now in the inland waterways trust fund, the ongoing cost of the Olmsted Locks and Dam project accounts for roughly 66 percent ($163 million) of the total Corps budget authority proposed for inland waterways capital investments in FY 2014, and roughly 87 percent ($81.5 million) of the amount financed through this trust fund.

The Administration recognizes the need for additional capital investment on the inland waterways. The President's legislative proposal is an equitable way to finance the non-Federal share of this investment, which is the responsibility of the commercial users of these waterways under current law. The proposal would create a workable balance of funds in the inland waterways trust fund, based on an assessment of the likely capital investment needs. With the additional revenue collected from the users and matching funds from the general fund, the Corps would be able to complete the Olmsted Locks and Dam project sooner, without consuming such a large percentage of the receipts in this trust fund, and would therefore be able to undertake and complete other inland waterways capital investments sooner as well.

Sen. Sessions

The President's Budget calls for a strategic review of the Tennessee Valley Authority, potentially including divestiture. Will the President keep Members of Congress from states serviced by the Tennessee Valley Authority informed at the start of the strategic review, during the review, and at the conclusion of the review? Will the President commit to seeking Congressional input during the strategic review? What factors will govern the Administration's consideration of this issue? Does the Administration expect to make a determination for proposal to Congress? If so, when?

The Administration's primary consideration is how to best position TVA to address its capital financing constraints within the current fiscal environment. The possible TVA divestiture option referenced in the President's Budget was not intended to suggest a specific course of action but rather to provide a basis for discussion. The Administration will evaluate various options for addressing this issue, including potentially some of those outlined in the September 2011 TVA Office of Inspector General's (OIG) report entitled "History, Status, and Alternatives: TVA Financial Flexibility."

Administration officials will work with TVA over the next few months to develop a plan for the review which will address its financing issues to meet future capacity needs, fulfill its environmental responsibilities, and modernize its aging generation system. The review will include discussions with appropriate stakeholders, including the Congress, customers, State and local governments, and employees, contractors and labor organizations to ensure that all issues are taken into consideration—including electricity prices, environmental obligations, employment issues, and the safe and reliable delivery of electricity.

Should the Administration determine actions which require legislative changes may be appropriate, the Administration will work with the Congress on them.

Sen. Sessions

The President's Budget proposal calls for savings of nearly $38 billion in a new Farm Bill, including reductions in Crop Insurance of nearly $12 billion. $7.4 billion of this is would come from lower premium support rates. How many farmers do you estimate will forego crop insurance under your proposal? How many will seek lower levels of coverage? If these reductions have minimal impact on farmers' coverage decisions, at what reduction level would you expect to see more than negligible impact?

The Administration does not currently have an estimate of how much the government paid premium would have to decrease before farmers would leave the crop insurance program. However, the reduction would have to be larger and more broadly applied before farmers would be likely to forego crop insurance.

The Administration assumes that no farmers currently participating will forego crop insurance because of the Budget proposal.

The savings estimate reflects a change in growers' insurance coverage choices based on the decrease in government subsidy. The Budget assumes that a small proportion of growers (from 2 percent to 5 percent of policies) would opt out of buy-up crop insurance program, especially those who purchased the lowest levels of coverage. These farmers are expected to participate in catastrophic (CAT) coverage, for which the premium would continue to be subsidized at 100 percent of the premium. Within the buy-up coverage, the Budget assumes that a larger portion of growers would drop a coverage level or so, depending on the degree to which the decrease in subsidy increased out-of-pocket costs. Current estimates are that the effect on the out-of-pocket cost per farmer will average 12.5 percent or about $500 annually.

Sen. Sessions

The President's Budget calls for increasing the Department of Energy's Budget by $1.7 billion over FY 2012 levels. At the same time, it calls for reducing spending on coal research and development by more than $80 million, a cut of nearly 25 percent. Does the President have an estimate on when carbon capture technology will be commercially available? What impact will this reduction in spending have on that when that milestone will occur?

The President's Budget is consistent with the Administration's plan, as outlined in *The Report of the Interagency Task Force on Carbon Capture and Storage*, to overcome the barriers to the widespread, cost-effective deployment of carbon capture and storage (CCS) with a goal of bringing 5 to 10 commercial demonstration projects online by 2016. With over $4 billion of support from prior year appropriations and the American Reinvestment and Recovery Act, the Department of Energy is managing a portfolio of eight commercial-scale demonstration projects that are progressing toward meeting this goal. In fact, one of these projects is already operating while two more are under construction. These projects will demonstrate a range of currently available CCS technologies integrated at scale with power plants and industrial facilities. The research and development activities in the President's Budget focus on second generation CCS technologies--those that are not currently in commercial application at any scale or level of integration, but have potential to improve the efficiency or reliability of CCS processes.

As stated in *The Report of the Interagency Task Force on Carbon Capture and Storage*, there are no insurmountable technological, legal, institutional, or other barriers that prevent CCS from playing a role in reducing greenhouse gas (GHG) emissions. The technologies exist and the President's Budget continues to invest in improving their performance and reliability. However, widespread, cost-effective deployment of CCS will occur only when driven by a policy designed to reduce GHG emissions. Ultimately, comprehensive energy and climate legislation will provide the largest incentive for CCS deployment as an option for climate change mitigation, because it will create a stable, long-term, market-based framework to channel private investment into low-carbon technologies.

Sen. Sessions

Recently, acting EPA Administrator Bob Perciasepe indicated that EPA's FY 2014 appropriations would fund an effort to curb greenhouse gases from existing coal-fired power plants. 1. Does the President's Budget envision the incremental shutdown of more than 5% of the nation's coal-fired power plants that are currently not slated for closure as a result of this rule? 10%? 2. How much of EPA's budget will be dedicated to all stages of development and promulgation of this rule? Does that estimate include funding for performing economy-wide modeling of the rule?

EPA will continue to collaborate with Federal and State agencies, the private sector, and other stakeholders, to explore cost-effective strategies to reduce greenhouse gas emissions. As such, the Budget requests an increase of $2 million to support climate-related emissions reduction efforts in the stationary source program. In FY 2014 EPA will work to address whether New Source Performance Standards for new and existing sources of greenhouse gases are warranted. The additional resources will improve the agency's ability to perform analyses of prioritized sectors, including power plants.

Sen. Sessions

During testimony, you asserted that debt held by the public relative to Gross Domestic Product (GDP)-not gross debt, which includes the bonds held by the Social Security trust funds-was the "relevant" measure of our indebtedness. When asked why the debt held by the Social Security trust funds was not relevant, you responded that the federal government would simply "sell the trust funds ' bonds to the public," therefore debt held by the public relative to GDP was still the best measure. However, neither the Social Security Administration nor the US Treasury are permitted to sell the bonds held by the trust funds to the public. By law, these bonds are non-marketable (see section 201(d) of the Social Security Act). Therefore, your statement that the federal government would simply "sell the trust funds' bonds to the public" appears to be incorrect. Moreover, it seems fiscally irresponsible to ignore the debt burden imposed by the Social Security trust funds. Treasury's obligations to Social Security will have to be financed with higher taxes or new (marketable) debt-a fact conceded by the Clinton Administration: "These [trust fund] balances are available to finance future benefit payments and other trust fund expenditures-but only in a bookkeeping sense. Unlike the assets of private pension plans, they do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, make it easier for the Government to pay benefits." (Fiscal Year 1999 Budget of the United States Government, Analytical Perspectives, p. 328.) The bonds issued to the Social Security trust funds also count towards the debt ceiling. During the debt crisis of 2011 , obligations held by the trust funds comprised over 30 percent of the debt subject to limit. Between 1997 and 2002, the federal government raised the debt limit twice even though debt held by the public was declining. It seems clear, the debt issued to the Social Security trust funds, and hence gross federal debt, is certainly not irrelevant. Given this, how do you justify the Administration's position that gross debt relative to GDP, which includes debt held by the Social Security trust funds, is not a superlative measure of our nation's indebtedness? How do you explain to the US taxpayers who will have to finance our gross debt that debt held by the public relative to GDP (which excludes the promises to Social Security), is "the best measure" of our debt burden?

Debt held by the public is more important than gross Federal debt in economic terms, because debt held by the public requires borrowing on the capital markets, absorbing funds that could otherwise be invested in the private sector.

While the balances of the trust funds provide the fund with authority to draw upon the U.S. Treasury in later years to make future payments to the public, issuing debt to Government accounts does not have any of the credit market effects of borrowing from the public. The issuance of debt to Government accounts is an internal transaction of the Government, is not financed by private saving, and does not compete with the private sector for available funds in the credit market. The assets provided to the account are fully offset by the increased liability of the Treasury to pay the claims, which will ultimately be covered by the collection of revenues or by borrowing.

The current interest earned by the Government account on its Treasury securities does not need to be financed by other resources. In contrast, interest on debt held by the public contributes to the unified Budget deficit and must be financed through revenues or borrowing.

Some observers point to the debt held by trust funds as a measure of the future payments to be made by these programs and therefore of future demands on the capital markets. However, it is important to note that debt held by trust funds does not accurately represent the actuarial present value of projected payments to beneficiaries. Those future payments are better captured by the projections in the annual trustees' reports.

Sen. Warner

The GPRA Modernization Act required OMB and the agencies to develop an inventory of federal programs - can you tell us when we can expect that inventory and what will it include?

Over the past year, OMB has worked with agencies to develop a comprehensive list of government programs, as required by the GPRA Modernization Act. The initial list of programs for the major agencies will be available online at the end of May. The initial inventory will describe each program and show how it supports the agency's strategic goals and objectives, and show three years of funding at a summary level. Once this initial inventory is established, and we have collected feedback, we plan to continue to build out additional information in the coming year. We look forward to hearing feedback on the initial inventory as we continue to improve this effort over time.

Sen. Warner

OMB expanded the performance.gov website last year to include quarterly performance updates for the priority goals across government, but unfortunately, the website developed is difficult to navigate and the data is not presented in a consistent way with trend data for all the goals. What are your plans to improve this website to make it easier for Congress and the taxpayers to track the performance of our government? Do you have plans for a citizen scorecard/report card to communicate the results on key priorities?

OMB is continuously improving Performance.gov to provide a clear, concise picture of Federal performance—both on mission-oriented goals and government-wide management priorities—and meet the requirements of the GPRA Modernization Act. OMB's first priority has been to develop the capacity to collect the information from Federal agencies required by the Act and present this information in a useful way on Performance.gov. In December 2012, Performance.gov was updated to provide the public with the first-ever quarterly performance reporting on Priority Goals. For each Priority Goal, users can see the Goal Leader, progress summary, key performance indicators, major milestones, and contributing programs. In total, agencies have identified 241 quantitative performance indicators, which are displayed in graphs to allow an easy view of the trends; in other cases milestones may be more appropriate. For the first time, agencies are reporting results for most of their indicators on a quarterly basis, not just through annual reports.

As you mention, work remains to be done. This includes the addition of new content to fulfill the requirements of the Act, as well as enhancements to the site to improve usability. OMB is working closely with GSA, agencies and the Performance Improvement Council (PIC) to further develop Performance.gov, including refining the presentation and streamlining the back-end data collection capabilities. Constraints on available funding and agency capacity, and the need to learn what works before we scale up government-wide, have necessitated a phased development path. We've requested additional funds in the FY2014 budget to enhance Performance.gov, including adding more citizen-focused presentations. Within resource and capacity constraints, we will continue to develop Performance.gov to provide more useful and timely performance information.

THE PRESIDENT'S FISCAL YEAR 2014 BUDGET AND REVENUE PROPOSALS

TUESDAY, APRIL 16, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 3:01 p.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Nelson, Sanders, Whitehouse, Coons, Kaine, Sessions, Enzi, Portman, Johnson, and Ayotte.

Staff Present: Evan T. Schatz, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing will come to order, and I want to thank all of my colleagues, and in particular our Ranking Member Senator Sessions, for joining me today, as well as all the members of the public who are watching, whether it is here in person or from home.

Before we begin, I do just want to take a quick moment to express my dismay and heartache at the tragedy that took place at the Boston Marathon yesterday. Secretary Lew, I know you have a strong connection to Boston. And I know I join with all of our colleagues here, and all Americans, in saying that my thoughts are with the athletes and the spectators, their families, and everyone who has been impacted from around the world. And I echo President Obama, who said last night that all Americans stand with the people of Boston, and that we will bring those people responsible to justice.

We are here today to continue our discussion of the President's fiscal year 2014 budget proposal and, particularly, its approach to reducing the deficit through a combination of spending cuts and new revenue from those who can most afford it.

Secretary Lew, it is nice to welcome you back to this Committee in your new role as Secretary of the Treasury, and congratulations and thank you so much for your doing that and for appearing, of course, before us today, and for all of your work, really, to help strengthen our economy and our middle class.

As we all know, yesterday was Tax Day. Americans across the country sat down at their kitchen tables or at a computer and filled out a lot of complicated forms. It is a common experience but, unfortunately, one that some workers and families experience very differently than others. This year, for example, it will be very possible for a hedge fund manager to pay a lower tax rate on his income than a soldier or a police officer or a teacher.

Taxpayers will subsidize millionaires more when they purchase a second home or a yacht than they will middle-class families who are purchasing their very first home. American families will continue to subsidize billions of dollars in tax incentives for companies reporting record-breaking profits. And the complicated forms that I just mentioned, a lot of that complication is due to tax expenditures, which a member of President George W. Bush's Council of Economic Advisers called "spending in disguise."

The majority of these tax expenditures, about 70 percent of them, are structured so they are more valuable as your income increases. In 2012, middle-class families received an average benefit from tax expenditures of about $3,500. But the top 1 percent of income earners received an average benefit of nearly $250,000. In other words, the less you needed, the more you got.

And tax expenditures are estimated to cost us $1.3 trillion this year. We have heard testimony in this Committee that too many of those expenditures are not doing much to support our economy, although they have helped to drive the effective tax rates of the wealthiest Americans to historic lows.

At a time when we are looking for savings everywhere to address our debt and deficit, finding ways to both make our tax code fairer and help reduce our deficit makes sense. And addressing tax earmarks for special interests, like tax subsidies for the fossil fuel industry and the special tax rates applicable to hedge fund managers' income, should be at the top of our list. We should also address the tens of billions of dollars lost each year to offshore tax abuse and the nearly $400 billion the IRS has told us we lose each year to the tax gap.

These are the kinds of goals a bipartisan budget deal could accomplish, which is one of the reasons why it is so important that we take advantage of the opportunity we have right now.

The Senate has passed our budget, the House has passed their budget, and the President weighed in with a bipartisan path forward, and now we need to do everything we can to get to a balanced and fair agreement. And an essential part of any agreement will be asking the wealthiest Americans and biggest corporations to pay their fair share.

That is why I am pleased the President's budget proposal maintains the key principle in the Senate budget, which is supported by bipartisan groups and the vast majority of the American people: we need to tackle our deficits and debt in a balanced way, with a mix of spending cuts and new revenue from those who can afford it most.

If the Senate budget were enacted, 64 percent of total deficit reduction since the original Simpson-Bowles report would come from spending cuts—64 percent—14 percent would come from rate increases on the wealthiest, and 22 percent would come from new revenue raised by closing tax loopholes and cutting wasteful spending in the Tax Code that benefit the wealthiest Americans and biggest corporations.

The ratios under the President's compromise proposal would be slightly different, but the fact that it includes a mix of spending cuts and new revenue reflects the principles of balance and fairness that the vast majority of Americans support.

It is disappointing that, given the clear need for fairness in our tax code and the need for a balanced approach to deficit reduction, the budget passed in the House last month represents the opposite values and principles. The House budget doubles down on protecting tax cuts for the wealthiest Americans.

According to the Center on Budget and Policy Priorities, to avoid increasing the deficit while achieving its tax reform goals, the House budget would provide filers with incomes of $1 million or more an average net tax cut of $245,000, while families with children who make less than $200,000 would see their taxes increase by $3,000 on average.

The House budget pursues an extreme, cuts-only approach, slashing our investments in education and infrastructure and research that help ensure our country can create good middle-class jobs in the future. All in all, the House budget is an extreme plan that makes it harder for the middle class, and those aiming to reach the middle class, to get ahead.

It just will not work for American families or for our economy and it certainly does not suggest the willingness to compromise, or work across the aisle, that we will need to see from Republicans in the next few months.

We have reached a unique point in the last 2 years of discussions about our country's economic and fiscal future, one that both Democrats and Republicans have pursued. We have the opportunity now to go to conference through regular order, debate our different approaches, and hopefully come to a fair, bipartisan deal.

This process, which I would think my Republican colleagues would want to begin as soon as possible, will require tough choices on both sides. Democrats have consistently shown we are willing to do so, and now it is up to Republicans to join us at the table ready to compromise.

Secretary Lew, as you know from your history of bipartisan budget deals, including the year-end deal to avert the fiscal cliff, revenue will have to be a focal point of our debate and any solution.

Republican leaders, who are seemingly rejecting any effort at compromise, will need to put our families and our economy above partisan ideology. This should be doable, especially because some leading voices in the Republican Party have expressed a willingness to look at new revenue.

Speaker Boehner himself has proposed raising $800 billion in deficit reduction by closing special interest loopholes and deductions, likely including many of the ones I just talked about. In the House budget, Chairman Ryan's tax plan implicitly assumes he can find $5.7 trillion in savings from our Tax Code. He, of course, puts every dollar of these savings to rate reduction and puts nothing toward addressing our debt and deficit.

But the majority of the Senate has made it clear that when it comes to eliminating spending in the Tax Code or moving forward with tax reform, we must identify savings to address our debt and our deficit. Doing so would be consistent with the approach supported by the vast majority of Americans and with bipartisan recommendations and would help us reach the fair and comprehensive agreement that American families and businesses deserve.

I hope that our hearing today can be a productive part of this conversation, and I want to again thank everyone for being here. Secretary Lew, I look forward to hearing more from you about the President's proposal today and why new revenue from the wealthiest has to be part of any fair and responsible budget plan.

With that, I will turn it over to Senator Sessions for his opening remarks.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Madam Chairman. The budget of the United States is indisputably in terrible shape, and we remain on an unsustainable path.

I would note, however, in defense of the House budget, that it balances in 10 years. It does not just use the word "balance." Its revenue equals its outflow. That is what a real balance means, although we are in "Through the Looking Glass" sometimes in this place, and we do not understand what a balanced budget is.

It is a balanced budget, and it allows spending to increase 3.4 percent each year. That is the kind of budget we ought to be doing here, not another one that increases taxes but increases spending almost as much.

The President has now sent us his budget. It came after the Senate and House had passed their budgets. But we do have—Madam Chairman, you mentioned tax expenditures, but I do recall so vividly the witness you called, a Democratic witness who told us there are tax expenditures, deductions that can be eliminated and loopholes that can be confronted in corporate tax policy, but that all of that should be utilized to reduce our rates because we have the highest corporate tax rate in the world, and we should be using that to reduce the corporate rate rather than increasing spending, and that is the view shared by the Democratic Chairman of the Finance Committee, Max Baucus, also.

I have examined this budget. I did not really intend to talk about it too much, but you have talked about, and I know Mr. Lew will talk about it also. We have disagreed over these things before, and I do not really want to prolong it. But I do think it is important that I share a few thoughts about it.

The President says this budget raises taxes $580 billion over 10 years, but the budget actually calls for $1.1 trillion in tax increases. It is easy for anyone to figure this out. If you subtract the total taxes in OMB's baseline shown on Table S.5 from the total revenues OMB proposes in Table S.4, the difference is $1.1 trillion. That is just a fact. The House Budget Committee independently analyzed the budget. They reached the same number. It is easy to see.

The President uses the term "balanced" seven times in his cover letter on the budget in his message, but it does not balance. It does not pretend to balance. And not once does he reveal that he raises taxes $1.1 trillion.

Your budget would require people to send $1.1 trillion more to Washington at a time when the economy is already weak. But this does not go to reduce the debt. It is not even used to reduce the debt.

You also increase spending $1.1 trillion over current law that the President signed into law August almost 2 years ago. The budget hides this by using a number of gimmicks. For instance, it claims $675 billion in savings from war costs—costs that are not going to happen because we are drawing down. And that was virtually basically emergency spending.

It hides another $250 billion in spending by just asserting that Congress will eventually find offsets to the so-called doc fix, but CBO will not score that as an offset, paid-for expenditure, and it should not be.

You then claim the budget will reduce deficits by $1.8 trillion. That is just not accurate. Compared to current law, the law we are on, the baseline we are on, apples to apples, excluding the war cost gimmick, the deficit reduction in this budget is no more than about $100 billion over 10 years, not $1,800 billion.

The administration claims that the increased spending and debt will grow the economy, however. We are not to worry, it is going to grow the economy. The Government has tried to boost the economy through stimulus spending for several years. That has not worked. It has failed. Instead, we have the weakest recovery since the end of World War II, and this has meant that Federal tax revenues have failed to recover as we would like to see them recover from a growing economy, and that has contributed to our debt problem, leaving us more debt than projected.

How weak has this recovery been? After 63 months from the beginning of the recession, the total number of people who have jobs remains far below the number that were working when the recession began. Total employment is 2,847,000 below the level of employment in December of 2007, and wages are not up either. Wages are down.

At no time since the end of World War II have we had such a high percentage of working-age Americans simply give up trying to find work. Over 5.5 million workers have left the labor force since the recovery began. An additional 485,000 left just last month, with only 88,000 new jobs being created. One might think that this is due to people retiring, but the data show that only a fifth of the people who have dropped out of the labor market retired. So people are just giving up.

Why are they dropping out? The likely truth is unsettling. The four-fifths who have not retired are working-age Americans who may be forced to live on food stamps or housing assistance or Government programs in a netherworld of no work and dependency on the Government. This budget does nothing to effectively help them, but continues a tax-and-spend policy that has not worked.

The fact is spending continues out of control. I believe that spending and debt is affecting our economic growth adversely right now. Entitlement spending would continue to grow at 5.2 percent, much faster than OMB expects the economy to grow. Yet the administration refuses to reform the broken welfare and retirement programs that are driving the spending surge. You did propose a CPI change that helps somewhat, but is not in any way a systemic fix of a program out of control.

Later in the 10-year budget window, these surging programs overwhelm the rest of the budget. But let us focus today on a danger here. I will not argue with you anymore in my questions, Mr. Lew, about the budget numbers. I know what you will talk about in your talk, though I disagree with your analysis. This budget increases our debt over $8 trillion over 10 years. That is a fact. That is in your own tables that you have given us. That is an increase of $61,000 for every household—$61,000 in additional debt per household over the next 10 years. This is more debt than the budget that our Chairperson has produced for us and the Senate passed.

Based on your own numbers, gross debt never gets lower than 96 percent of GDP. Erskine Bowles sat in the chair you are in now and said we face the most predictable economic crisis in our Nation's history. This budget does not avert that crisis. It increases deficits over current law over the next few years. It increases deficits more than current law over the time that President Obama remains in office and adds more debt than the Senate budget.

We are in a danger zone, and there are many ways for us to get out of it, but this budget does not get us out of it.

Mr. Lew, congratulations on your confirmation. You got a strong vote. I gave you a hard time. We disagreed on a lot of issues. But you are our Secretary of the Treasury. You are an individual that I think has the ability to help us get out of this fix and get us on a path to sound economic growth. I will be asking some questions about our current financial situation, where we will be going in the future, and I appreciate having a discussion with you on those issues.

Chairman MURRAY. Thank you very much.

With that, we will turn to you, Secretary Lew, for your opening statement.

STATEMENT OF THE HONORABLE JACOB J. LEW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary Lew. Thank you, Chairman Murray and Ranking Member Sessions, and I, too, would like to begin by just saying that our hearts go out to the people of Boston today. It is a second home to me. It is very personal thinking about that place and those people. And they are in our thoughts and prayers today, and we are going to do everything we can to find out who did this.

I appreciate the opportunity to testify today on the President's budget. I would like to begin by taking a quick look at our economy. Our economy is much stronger today than it was 4 years ago, but we must continue to pursue policies that will continue to grow the economy and create jobs.

Since 2009, the economy has expanded for 14 consecutive quarters. Private employers have added nearly 6.5 million jobs over the past 37 months. The housing market has improved, consumer spending and business investment have been solid, and exports have expanded.

But we have very tough challenges still. We have removed much of the wreckage from the worst economic crisis since the Great Depression, but the damage left in its wake is not fully repaired. Families across the country are still struggling. Unemployment remains high. Economic growth needs to be faster. And while we have made progress, we need to do more to put our fiscal house in order.

At the same time, political gridlock in Washington continues to generate a separate set of head winds, including harsh, indiscriminate spending cuts from the sequester that will be a drag on the economy in the months ahead if they are not replaced with sensible deficit reduction policies like the ones in the President's budget.

This budget is animated by the simple notion that we can and must do two things at once: we must strengthen the recovery in the near term, while reducing the deficit and debt over the medium and long term.

This has been the President's longstanding approach to fiscal policy, and when you compare the trajectory of our recovery with those of other developed economies in recent years, it is clear why the President remains so committed to this path.

It is important to bear in mind that our deficits are already falling. In the last few years, the President and Congress working together have come to hammer out historic agreements that substantially cut spending and modestly raise revenue. When you combine these changes with savings from interest, we have locked in more than $2.5 trillion of deficit reduction over the next 10 years. And now we are putting forward policies that will lower the deficit to below 2 percent of GDP and bring down the national debt relative to the size of the economy over 10 years.

We restore the Nation's long-term fiscal health by cutting spending and closing tax loopholes, taking a fair and balanced approach. At the same time, the budget incorporates all the elements in the President's offer to Speaker Boehner last December, demonstrating his readiness to stay at the table and make very difficult choices to find common ground.

Consistent with that offer, the budget includes things the President would not normally put forward, such as means-testing Medicare through income-related premiums and adopting a more accurate but less generous measure of inflation known as "chained CPI."

It includes these proposals only so we can come together around a complete and comprehensive package to shrink the deficit by an additional $1.8 trillion over 10 years and to remove fiscal uncertainty that hampers economic growth and job creation.

This framework does not represent the starting point for negotiations. It represents a fair balance between tough entitlement savings and additional revenues from those with the greatest incomes. The two cannot be separated and were not separated last December when we were close to a bipartisan agreement.

This budget provides achievable solutions to our fiscal problems, but as crucial as these solutions are, we have to do more than just focus on our deficit and debt.

Now, the significance of balancing the budget is something I know well. Under President Clinton, I helped negotiate the groundbreaking agreement with Congress to do just that. And as Budget Director in that administration, I oversaw three budget surpluses in a row and worked with many on the left and the right on a plan to pay down the debt.

But that does not mean we should make deficit reduction our one and only priority. So, in addition to ensuring that we have a sound fiscal footing, this budget lays out initiatives to fuel our economy now and well into the future. Every one of these initiatives is paid for in our deficit reduction package, meaning they do not add a dime to the deficit.

As the President explained in his State of the Union address, the surest path to long-term prosperity is to strengthen the middle class. This budget does that by zeroing in on three things: bringing more jobs to our shores, equipping American workers with the skills they need to make the United States more competitive, and making sure hard work amounts to a decent living.

We will strengthen manufacturing and domestic energy production, invest in infrastructure and worker training, and expand opportunities for children and those hardest hit by the recession.

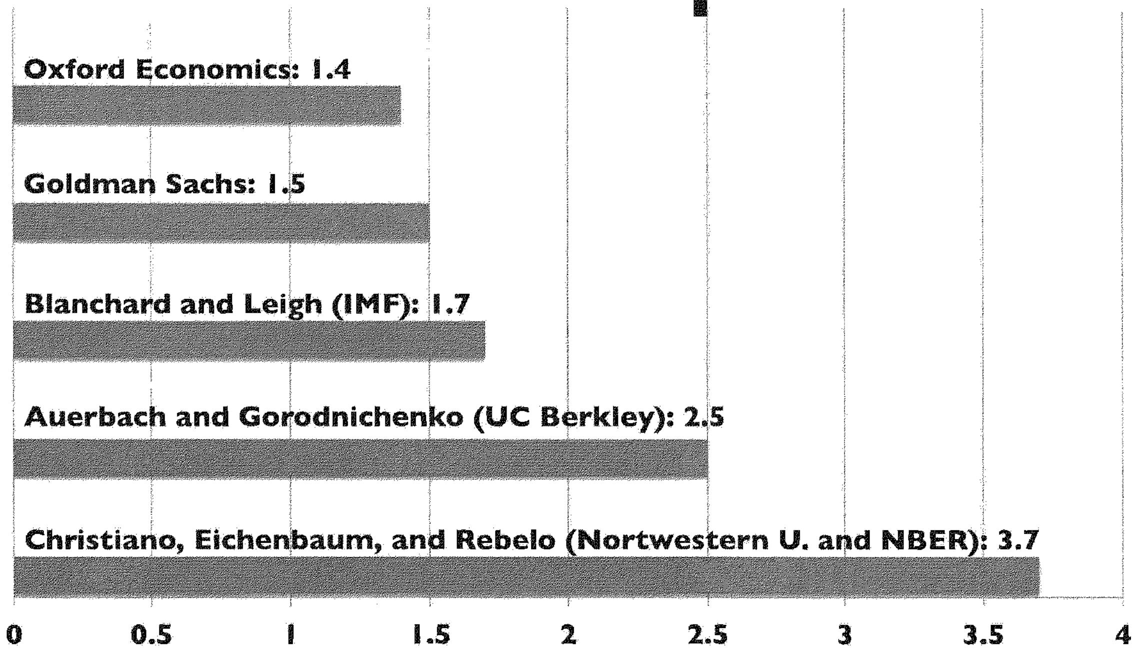
The President has provided a detailed blueprint for growing our economy and cutting our deficits, and as this budget shows, we do not have to choose between the two and, indeed, we must not. We can adopt a powerful jobs and growth plan even as we embrace tough reforms to stabilize our finances.

The debate we are engaged in is very important. It is part of a complex sorting-out process that will determine our Nation's future. But as everyone on this Committee knows, the path before us is going to be a struggle. It is going to require difficult decisions that will directly affect the daily lives of millions of Americans, and it really matters that we get it right.

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

[The prepared statement of Secretary Lew follows:]

Recent Estimates of Fiscal Multipliers*



*Figures represent possible fiscal multipliers for economies in recession or recovery.

"These balances are available for future benefit payments and other trust fund expenditures, **but only in a bookkeeping sense.** The holdings of the trust funds **are not assets of the Government as a whole that can be drawn down in the future to fund benefits.** Instead, they are claims on the Treasury."

—**Office of Management and Budget**, 2010 Analytical Perspectives, page 345

"The existence of large trust fund balances, therefore, does not, by itself, increase the Government's ability to pay benefits.

Put differently, these trust fund balances are assets of the program agencies and corresponding liabilities of the Treasury, **netting to zero.**"

— **Office of Management and Budget**, 2010 Analytical Perspectives, page 345

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UNTIL 3:00 PM ET, APRIL 16, 2013

Statement of Secretary Jacob J. Lew
Committee on The Budget
U.S. Senate
April 16, 2013

Chairman Murray, Ranking Member Sessions, and members of the committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2014 Budget.

The President's Budget is based on a belief that an agreement to achieve balanced deficit reduction is consistent with making – and fully paying for – targeted investments critical to continued economic growth and job creation. The Budget includes the President's compromise offer to Speaker Boehner to reduce the deficit by an additional $1.8 trillion, in addition to the more than $2.5 trillion already enacted, and fully pays for all new initiatives to ensure that they do not add to our deficit burden.

I. Introduction

The United States economy has made substantial progress toward recovering from the worst financial crisis since the Great Depression. Despite significant headwinds – both as a result of the crisis and from other temporary shocks – the economy has grown at an average annual rate of just over 2 percent over the last three and a half years. We have seen steady improvement in the labor market, where private sector employers have added nearly 6.5 million jobs since the trough of the labor market in February 2010. The housing market, which had been a significant drag on economic growth throughout the recession and into the early stages of the recovery, is now gaining upward momentum.

While our economy is stronger today, more work must be done to help create jobs and accelerate growth. Even though the unemployment rate, at 7.6 percent, is at its lowest level in four years, it is still too high. Too many Americans are still struggling to find work. Despite recent improvements in the housing market, many families remain underwater on their mortgages and credit-worthy borrowers continue to have trouble getting the financing they need to buy a home or refinance existing mortgages. Although corporate profits are at an all-time high, America's middle class continues to struggle.

The President's Budget addresses these challenges in a way that builds on the momentum of the economic recovery. It takes a credible approach to bringing our deficits down to a sustainable level; at the same time, it makes important investments to help build a foundation for sustainable economic growth. These proposals are based on the conviction that an agreement is within our reach, and that it is also possible to achieve *both* our fiscal goals and our long-term priorities.

While deficit reduction is necessary to put our nation on a sound fiscal course, we have to bear in mind that the recovery remains fragile. Cutting spending too deeply or too soon would harm the recovery in the near term, undermining our shared fiscal goals and our ability to make necessary investments for growth over the long term.

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The proposals in the Budget are *targeted* at growth and opportunity – cutting where we can and investing where we will see the strongest return, both now and into the future. Specifically, the Budget calls for increased investment in innovation and infrastructure to make the United States a more attractive place for job creation. It introduces initiatives to bolster education and worker training so Americans have the necessary skills to compete in a global economy. And it puts forward policies that are designed to give all Americans the opportunity to share in the benefits of economic growth. These measures will help grow and strengthen the middle class, which has been the key engine of prosperity in the United States. Additionally, they are fully paid for, so they will not add to the deficit.

Ultimately, the central challenges addressed in the President's Budget – strengthening growth now, investing in our future, and putting our nation on a sound fiscal footing – complement and depend on each other. Investing in our economy today will help us grow in the future and that, in turn, makes our fiscal challenges considerably more manageable. Committing to a credible path for deficit reduction today allows for investments that enhance our long-term growth.

II. Balanced Deficit Reduction

When the President came into office four years ago, he inherited a large fiscal deficit – projected to be more than 9 percent measured as a share of the economy before any of his policies were enacted. As the economy has been healing, both the expiration of cyclical spending and a pickup in economic growth have contributed to a more sustainable path for the country's finances.

Over the past two and a half years, we have made considerable progress in reducing the size of the deficit, which fell to about 7 percent of GDP in FY 2012 – the fastest pace of deficit reduction over a similar time frame since just after WWII. Moreover, following current policy, the deficit will continue to decline over the next 10 years, owing to a mix of spending cuts and tax reforms including $1.4 trillion in spending cuts to discretionary programs (as a result of both the Budget Control Act of 2011 and other appropriations bills enacted since 2011), as well as over $600 billion in revenue from the American Taxpayer Relief Act of 2012. Taking into account interest savings, this amounts to more than $2.5 trillion in deficit reduction over the 10-year window, not including savings from winding down the wars in Iraq and Afghanistan. But we need to do more to ensure that our long-term fiscal outlook continues to improve.

We must continue to achieve deficit reduction in a balanced way. It must include entitlement reform and spending reductions. We must also pursue tax reform that closes loopholes and addresses deductions and exclusions that allow the wealthy to pay less in taxes as a percentage of income than many middle-class families. Individual tax reform must be coupled with reform of the U.S. business tax system to enhance American competitiveness, lower rates, broaden the tax base, and level the playing field for companies without losing any revenue. All told, these initiatives constitute a balanced approach to deficit reduction. Such a balanced approach does not force unnecessary cuts to education, energy, and medical research and does not endanger Medicare and Social Security.

The President's Budget takes this balanced approach with additional spending cuts and increased revenues through tax reform. These policies will reduce the deficit to roughly 1.7 percent of GDP by the end of the budget window and put the nation's debt on a declining path, reaching 73.0 percent of GDP by 2023.

The additional $1.8 trillion in deficit reduction proposed in this Budget comes from closing tax loopholes and reducing tax benefits for those who need them least; continued health care reform; savings from mandatory programs; additional cuts to discretionary spending; and savings from using a more accurate measure of inflation, plus the reduced interest payments resulting from lower borrowing.

The most important pieces of the compromise offer made by the President include:

- **Tax Reform:** $580 billion in additional revenue from tax reform that closes tax loopholes and reduces tax benefits for those who need them least and that will support the creation and retention of high-quality jobs.
- **Health Savings:** $400 billion in health savings that build on the health reform law and strengthen Medicare.
- **Other Mandatory Savings:** $200 billion in savings from other mandatory programs, such as reductions to farm subsidies and reforms to federal retirement contributions.
- **Discretionary Savings:** $200 billion in additional discretionary savings, with equal amounts from defense and non-defense programs– that is $200 billion below the Budget Control Act spending caps that were lowered even further by the American Taxpayer Relief Act of 2012.
- **Consumer Price Index**: $230 billion in savings from switching to the use of chained-CPI.
- **Interest Payments:** Almost $200 billion in savings from reduced interest payments on the debt and other adjustments.

I will address each of the key elements of the President's compromise offer, all of which are in the Budget.

Components of Balanced Deficit Reduction

Tax Reform

As a first step toward balanced deficit reduction and tax reform, the President proposes enacting two individual tax reform measures that would raise $580 billion by broadening the tax base for high-income taxpayers, and ensuring that the very wealthy pay federal tax rates at least equal to those paid by middle-class Americans. The first measure sets a 28 percent maximum rate at which upper-income taxpayers could benefit from itemized deductions and certain other tax preferences to reduce their tax liability. The second puts in place the Buffet rule, which requires those individuals with incomes over $1 million to pay no less than 30 percent of income after charitable contributions in taxes. At the same time, the Budget includes business tax reform that will provide greater certainty and improve global competitiveness while preserving the revenue collected today.

Health Care Reform Savings

The President's Budget builds on the health care cost savings driven by the Affordable Care Act by reducing excess payments for health care services and supporting reforms that boost the quality of care. The Budget also includes structural changes that will help encourage Medicare beneficiaries to seek high-value health care services, while preserving the basic structure and promise of the program. These actions would save an additional $400 billion.

Other Spending Cuts and Savings

The Budget calls for a total of $400 billion in additional discretionary and non-health mandatory spending cuts over the next 10 years. Savings in mandatory programs outside of health care include reforms to agricultural subsidies and federal retirement benefits as well as from a variety of smaller savings initiatives across the agencies.

The budget includes an additional $200 billion in spending cuts, split evenly between defense and nondefense spending. On its current trajectory, discretionary spending is projected to decline to its lowest level as a share of the economy since the end of the 1950s; the discretionary cuts included in the President's offer to Speaker Boehner would push discretionary spending even lower. The President's cuts are coupled with targeted investments that are imperative to growth and opportunity, such as early childhood education.

In addition, the Budget includes additional savings of $230 billion by changing the standard measure of inflation used to adjust spending programs and the tax code from the standard CPI to a chained CPI, coupled with protections for the most vulnerable. The chained CPI is a more accurate measure of inflation in that it does a better job of reflecting the substitution of goods in response to relative price changes.

III. Strengthening the Middle Class by Investing in the U.S. Economy

In addition to the proposals to stabilize our finances, the President's Budget offers a number of policies aimed at making targeted investments to promote long term growth. These policies make domestic job creation more attractive by increasing investment in innovation, infrastructure, and manufacturing. The Budget also offers policies to increase access to and the affordability of education and job training programs. At the same time, it includes proposals so that the gains from these policies can be shared by all Americans.

Promote Greater Competitiveness in Global Markets

A number of proposed initiatives are designed to enhance our ability to sell American-made goods and services to the rest of the world. The Budget increases funding for agencies involved in trade promotion and trade financing so that these agencies can help the United States achieve the goal set in 2010 by the National Export Initiative (NEI) to double U.S. exports over a five-year period. In addition to the NEI, the Budget prioritizes completing ongoing trade negotiations – such as the Trans-Pacific Partnership – and opening new negotiations – like the Transatlantic

Trade and Investment Partnership with the European Union – to help strengthen trade ties with the Asia-Pacific region and the European Union, respectively. In addition, more resources for trade enforcement will help make sure that our workers and businesses exporting their products and services overseas are operating on a level playing field.

Currently, the U.S. corporate tax system provides incentives for companies to relocate operations abroad by allowing them to reduce their tax liability. The President's Budget changes that by reforming the corporate tax system to encourage domestic job creation without losing any revenue. Part of that effort will include removing deductions for moving production overseas and providing a new tax credit for firms that bring foreign operations back to U.S. soil.

Investing in Innovation, Infrastructure, and Manufacturing

As global markets become more open and as economic activity abroad continues to strengthen, it is crucial that U.S. firms and workers remain on the technological frontier. That is why we need to invest in Research and Development (R&D), infrastructure, and our manufacturing base. These investments will help foster job creation, raise living standards, and keep our nation competitive in a global economy.

The President's Budget increases funding for non-defense R&D investment to $70 billion, a roughly 9 percent increase over its 2012 level of $64 billion. These investments are targeted to areas most likely to unleash transformational technologies that will create the businesses and jobs of the future. History has shown that federal support for R&D has helped spur new technologies, including the internet, global positioning systems, and clean energy.

Similarly, federal investments in public infrastructure projects, such as the national highway system, have led to significant gains in our nation's productive capacity. In recent years, however, work to maintain and improve public infrastructure has failed to keep pace with the rate of deterioration and obsolescence. As CEOs tell me every time we meet, our aging infrastructure has become a detriment to our future growth prospects, and modernizing infrastructure must be a national priority.

The President meets this obligation by directing $50 billion toward infrastructure upgrades and repairs. And to get started on the most urgent projects as quickly as possible, the Budget would create a "Fix it First" program that puts people on the job right away to clear out the backlog of deferred work on highways, roads, bridges, transit systems, and airports. But taxpayers need not shoulder the entire cost of these projects: the President's Budget calls for a Partnership to Rebuild America. This program helps leverage private investment in infrastructure by starting a National Infrastructure Bank as well as by enacting America Fast Forward bonds, which help facilitate and reduce the cost of financing new projects. These initiatives will help lay the foundation for long-term economic growth and also help generate new high-quality middle-class jobs today.

Growing our manufacturing sector also generates new, high-quality middle-class jobs. The Budget makes a one-time down payment of $1 billion to establish manufacturing innovation hubs in various regions around the country. The Budget also includes funding to launch

Manufacturing Technology Acceleration Centers oriented toward improving supply-chain efficiency. Finally, the Budget prioritizes investments and initiatives to make the United States a world leader in clean energy.

Investing in the American Workforce

If we want to make America more competitive in the global economy, we must equip America's workers with the high-tech skills that the 21st century requires.

The Budget takes a number of steps to help Americans acquire these skills. It proposes to work together with states to make high-quality preschool available to every four-year old in America. It rewards school districts that develop new partnerships with colleges and employers, and focus on science, technology, engineering, and mathematics (STEM) so that high school students are better prepared for the jobs of tomorrow. And it expands access to higher education by making college more affordable. The Budget makes the American Opportunity Tax Credit – which helps students pay for college expenses – permanent. At the same time, it reaffirms the Administration's strong commitment to the Pell Grant program, which provides grant assistance to low- and moderate-income students and provides a mechanism to keep interest rates for student loans from rising – at a time when market rates are low.

In addition to investing in education, the Budget strongly supports training and employment programs to help workers gain skills and find new jobs or careers. One specific focus is on modernizing, streamlining, and strengthening government delivery of job training services. The Budget proposes a Universal Displaced Worker program that would reach over 1 million workers per year with a set of core services, combining the best elements of two more narrowly targeted programs. In addition, starting in fiscal year 2015, the Budget provides $8 billion for the Community College to Career Fund; this Fund supports state and community college partnerships with businesses, thereby enhancing the skills of American workers.

Strengthening the Middle Class

Investing in U.S. firms and workers is critical to maintaining competitiveness, but it is also important to make sure that all Americans have an opportunity to benefit from the resulting economic gains.

To this end, the President's Budget includes tax proposals that are geared toward rebalancing the tax code in a way that eases the burden on the middle class, including closing specific loopholes that benefit only a small group of the wealthiest Americans. The Budget also contains a number of proposals designed to build ladders of opportunity so that hard work is rewarded and inequality and poverty are reduced.

The Budget creates a Pathways Back to Work fund to make it easier for workers, particularly the long-term unemployed, to remain connected to the workforce and gain new skills for sustained employment. The Budget would also increase the minimum wage to $9.00 an hour by the end of 2015 and index it to inflation thereafter.

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UNTIL 3:00 PM ET, APRIL 16, 2013

Taken as whole, the policies put forth in the President's Budget enhance America's competitiveness and, in doing so, create a healthy environment for fostering a strong, growing middle class – a key engine for sustainable economic growth in which hard work is rewarded and every American has an opportunity to advance and succeed. At the same time, we maintain our commitment to our most vulnerable citizens and to our seniors.

Moreover, these new policy initiatives are fully funded, so that the Budget is able to make essential investments in the nation's future while also reducing the deficit.

IV. Conclusion

In summary, the U.S. economy has made significant progress toward recovering from the worst financial crisis since the Great Depression. However, it is important to recognize that we should be doing more to secure the recovery, create jobs, and improve the future prospects of the nation.

We have made significant gains in the labor market, but unemployment remains unacceptably high at 7.6 percent and too many Americans are still looking for work. Congress has already passed some parts of the American Jobs Act. We can further support the recovery in the private sector by passing the rest. Similarly, activity in the housing market appears to be gaining momentum, but we need to do more to support credit-constrained families who want to buy a house or refinance their existing mortgage.

The President's FY 2014 Budget, by including the components of the President's December compromise offer to Speaker Boehner, reiterates a commitment to coming together around a balanced plan to reach more than $4 trillion in total deficit reduction over the 10-year budget window. At the same time, it prioritizes growth-oriented policies that are designed to enhance U.S. competitiveness and strengthen the middle class, ensuring that the resulting economic gains can be shared broadly among all Americans.

In conclusion, it is important to note that this framework does not represent the starting point for negotiations. It represents a fair balance between tough entitlement savings and additional revenues from those with the greatest incomes. The two cannot be separated, and were not separated last December when we were close to a bipartisan agreement.

This is my first opportunity to appear before you as Treasury Secretary, but this is far from the first budget that I have worked on. There is no doubt that this is a serious proposal at a serious time. There is a path to a bipartisan agreement that moves the country forward. This budget deals with the world as it is now and as it will be in the future. It makes difficult choices. It includes a powerful jobs and growth plan. And it is the right course of action for our nation and our economy, and a path for bipartisan agreement to move the country forward.

Thank you. I look forward to taking your questions.

Economist and social insurance expert statement on Social Security COLA

No empirical basis for reducing the Social Security COLA

November 20, 2012 *— 250 Ph.D. economists and more than 50 social insurance experts with doctorates in related fields oppose proposals to reduce the Social Security cost-of-living adjustment by tying it to an index (the chained CPI-U) that does not reflect the spending patterns of beneficiaries.*

As economists and social insurance experts, we agree that the annual Social Security cost-of-living adjustment (COLA) should be based on the most accurate measure possible of the impact of inflation on beneficiaries. For this reason, we oppose proposals to reduce the Social Security COLA by tying it to a chained consumer price index that does not directly measure the actual expenditures of beneficiaries. Such a move would lower the COLA by an estimated 0.3 percentage points per year, translating into a 3 percent benefit cut after 10 years and a 6 percent cut after 20 years. The oldest beneficiaries, who are often the poorest beneficiaries, and persons receiving disability benefits for more than 20 years would see even larger cuts over time.

Arguments in favor of reducing the COLA are premised on the assumption that the current COLA overcorrects for inflation. However, it is just as likely that the current COLA fails to keep up with rising costs confronting elderly and disabled beneficiaries. For historical reasons, the current COLA is based on a consumer price index for workers, excluding retirees and other Social Security recipients who are not in the labor force. It and other indices based on the spending patterns of workers or the general population likely understate the impact of cost increases faced by Social Security beneficiaries because seniors and disabled people spend a greater share of their incomes on out-of-pocket medical expenses than do other consumers, and health costs have risen faster than overall inflation in recent decades.

A chained price index is supposed to more fully reflect the ability of consumers to substitute cheaper goods and services in response to price changes. Whether or not such substitution preserves consumers' standards of living, different consumers have varying ability to make such adjustments. Since elderly and disabled people spend a greater share of their incomes on necessities such as health care, rent, and utilities, and since this population is also less mobile, a chained COLA based on the spending patterns of workers or the general population may overestimate the ability of Social Security beneficiaries to take advantage of cheaper substitutes.

The actual spending patterns of Social Security beneficiaries have not been comprehensively studied. However, an experimental index computed by the Bureau of Labor Statistics suggests that the current COLA may not keep up with seniors' costs of living. Until direct evidence is gathered, there is no empirical basis for reducing the Social Security COLA, which could exacerbate, rather than correct, an existing problem.

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Structure of the President's Budget

BALANCED DEFICIT REDUCTION

- Builds off deficit reduction to date
- Includes Fiscal Cliff compromise offer
- Replaces the sequester

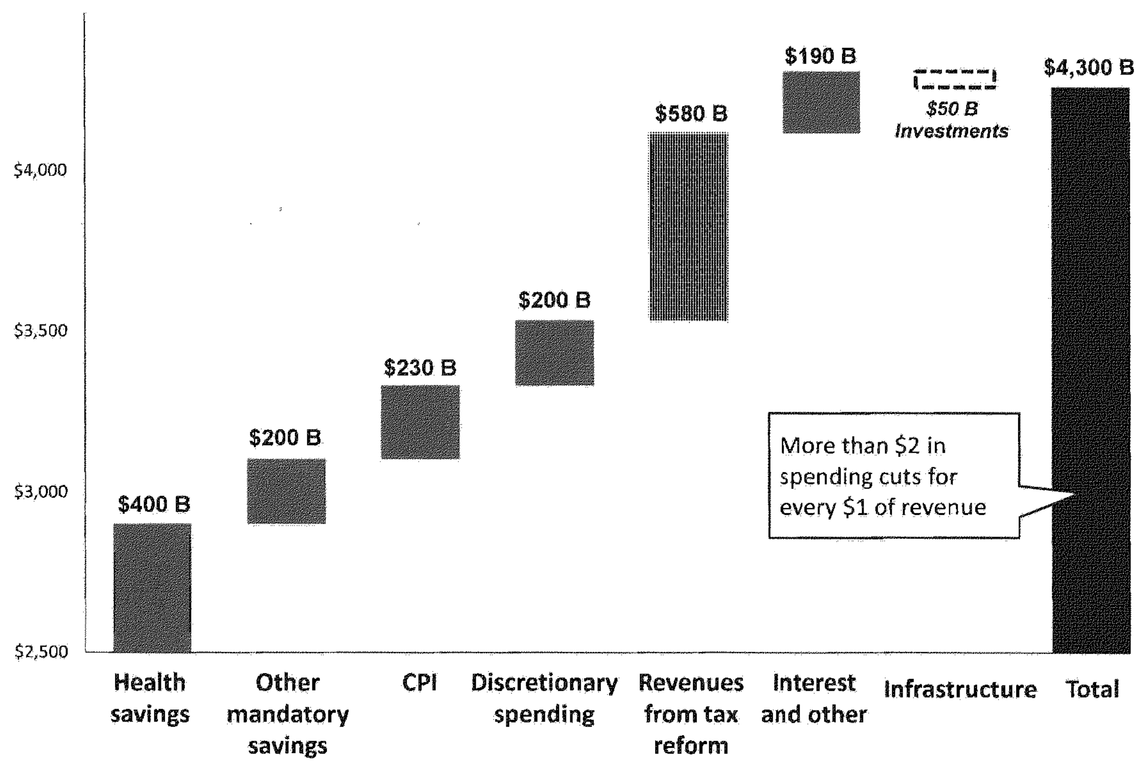
JOBS INVESTMENTS

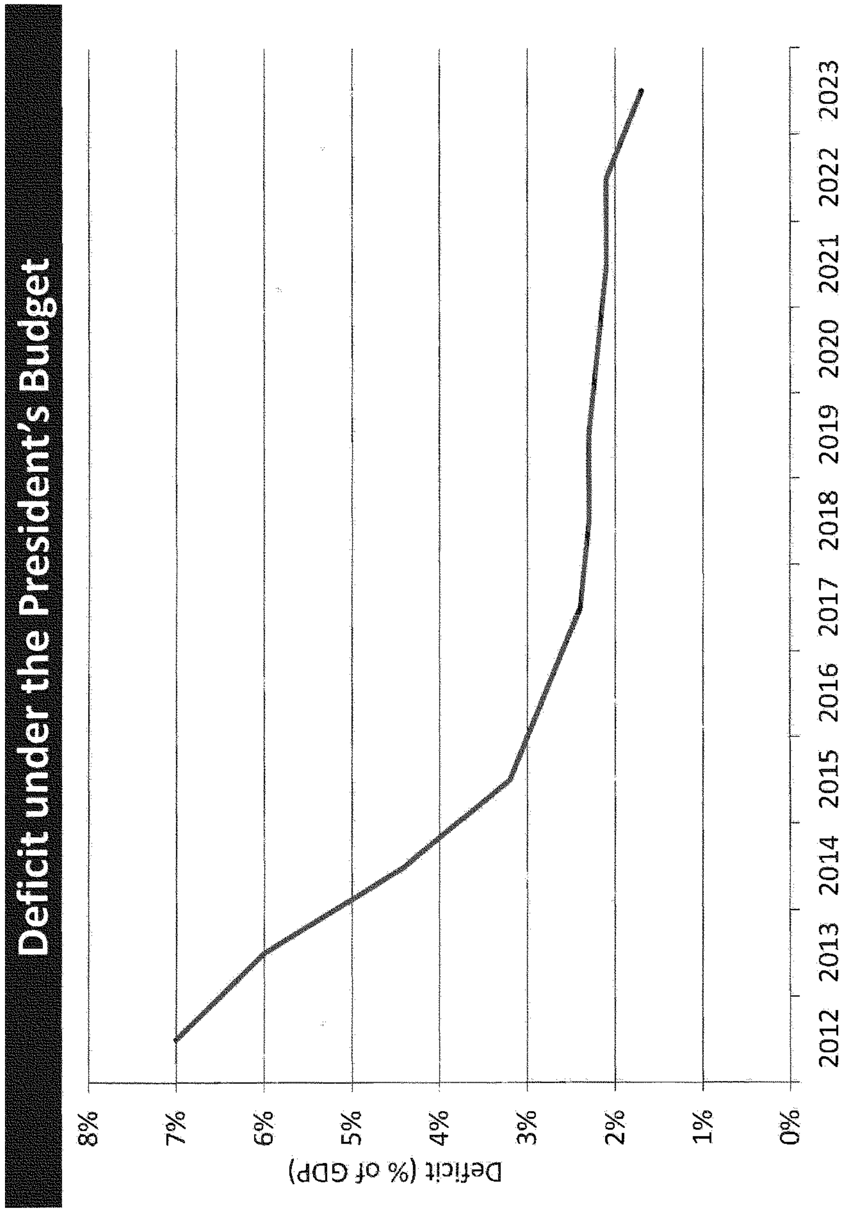
- Skills and Competitiveness
- Education and R&D
- All fully paid for

Deficit Reduction to Date

Budget Control Act	**$1,090 B**
2011 Appropriations	**$370 B**
Fiscal Cliff Agreement	**$660 B**
Reduced Interest Payments	**$480 B**
Total	**> $2.5 T**

The President's Commitment to Deficit Reduction





Deficit under the President's Budget
Deficit (% of GDP)
8%
7%
6%
5%
4%
3%
2%
1%
0%
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023

Chairman MURRAY. Thank you very much, and, Secretary Lew, let me start. I want to ask you a question that I also asked Acting Director Zients last week, because I feel the topic really does cut to the heart of the current budget debate.

Since enactment of the fiscal cliff deal, which made most of the Bush tax cuts permanent but does raise $600 billion from the highest-income Americans, we hear Republicans now claiming that the tax discussion is finished because revenues as a share of the economy are now projected to rise slightly above their 40-year average of 18 percent of GDP. They are saying that any additional revenue, even if it is generated by closing unfair tax loopholes, is off the table.

But as you well know from your time as OMB Director during the late 1990s, every time we have had a balanced budget in recent memory, revenues have been higher than we are projected to experience going forward, even after the fiscal cliff deal. And now, unlike in past years, we have to consider the retirement of the baby boomers and the need to invest in our people and in our infrastructure so that we can compete internationally.

The revenue policy in the budget that this Committee wrote and the Senate passed a few weeks ago was shaped by those unavoidable realities, and I believe that is why every bipartisan group—Simpson-Bowles, Gang of Six—has also recommended several times more revenue than the year-end deal brought us.

So, Secretary Lew, I would like you to respond to that and what you would say in response to the notion that somehow the revenue discussion is finished.

Secretary Lew. Madam Chair, I totally agree with the notion that, in order for us to reduce the deficit and ultimately close the gap so that we can have a conversation about balancing the budget in the future, revenue is going to have to be higher than it is in the baseline.

In December, there was a broad understanding that if there was going to be a deal, a real deal, something that covered everything, there would be more revenue than the $600 billion that was enacted in January. There was a debate as to whether it should be $1 trillion, $1.2 trillion, or more, but it was clear that $600 billion was not going to close the gap.

I think if you look at the next 10 years, the next 20 years, the baby boom is retiring, and that is a fact. We have known that fact, you know, for a very long time, and that means more people, 30 million more people, are becoming eligible for Medicare and for Social Security. So the thing that is going to drive up spending is not decisions that we are making today. It is decisions that were made a long time ago, and I think we have a real obligation to keep the commitments behind that.

So if we are going to talk about closing the deficit or if there is going to be a discussion about balancing the budget, if you do not honor—if you honor those commitments, you are going to need more revenue. There is no way to cut your way out of that alone.

Now, it does not take the kind of revenue that puts us into a place that should create the kind of partisan gridlock that we have seen over revenues. It just takes a fair mix. The President's plan is $2 of spending cuts for every $1 of revenue. That is something he has been saying. He said it all fall, all summer. And I think the American people accept that.

Chairman MURRAY. Okay. During February 2012, the White House released a framework for business tax reform that supported lowering the top corporate rate to 28 percent in a revenue-neutral fashion by eliminating loopholes and taking other steps to broaden the tax base. The administration's most recent budget for the first time also embraces revenue-neutral business tax reform.

Now, I am sure you are aware that there are many Democrats in Congress who do not agree with the idea that corporate taxpayers should not have to contribute to deficit reduction. Not only are corporate revenues as a share of the economy at historic lows, but at the same time, in recent years middle-class taxpayers have been asked to bail out and subsidize large corporations who are making record profits.

In your testimony before the Ways and Means Committee last week, you noted that the White House supports revenue-neutral corporate tax reform, but only in the context of comprehensive tax reform—I assume meaning individual and corporate reform together—that raises revenue for deficit reduction.

So can you elaborate a little bit on that and explain where you are?

Secretary Lew. Sure, I would be happy to.

I think that when we look at the fiscal challenges, the only way we are going to get to the kind of balanced and fair solution is if there are additional revenues. The President's budget calls for $580 billion of additional revenues to hit the deficit target.

In terms of where those revenues come from, we have been clear. We think they should come from those at the high end of the income scale. Now, that is a pretty clear overlap with individuals who benefit a lot from corporate profits, so I do not think it is fair to say that we have shielded high-income or big investors from potential tax increases.

On the business side, our view is that one of the real benefits of business tax reform is to make it more competitive to do business in the United States than overseas. And we have a challenge that our statutory tax rate on the business side is very high. Our average tax rate is not as high as our statutory rate because we have so many loopholes and deductions and special provisions.

So the goal is to bring down the statutory rate by closing loopholes, and we have a number of things that are offsets for specific things in our budget as well, but do not net out to any new taxes.

So we think it is fair. We think it puts a burden on those who are able to pay and where the income is in the current distribution of income in this country.

Chairman MURRAY. I assume that you are talking about moving both of those at the same time. Correct?

Secretary Lew. Well, it certainly would be our notion that it should be part of an overall fiscal frame. Obviously, Congress will choose how to move pieces of legislation. But I think even if you just look at the decisions businesses make to organize either as a corporation or as a partnership, I think you need to know what the world is going to look like in both the individual Tax Code and the business Tax Code in order to make a sensible decision. So we need the deficit reduction, and it also makes more sense to do tax policy that way.

Chairman MURRAY. All right. Senator Sessions?

Senator SESSIONS. Mr. Lew, I do agree that economic growth is so important for us. If we can get that, it will help our situation. I am generally of the view that we cannot grow our way out of this. I think we need to have some belt tightening. You say we should have some more tax increases.

Carmen Reinhart and Ken Rogoff published a best-selling book that concluded that when gross debt as a percentage of GDP approaches or exceeds 90 percent, it hurts economic growth. I think you and I have talked about that before.

When Senator Conrad asked Secretary Geithner, your predecessor, about this study, he said it was an excellent study and in some ways understated the danger. We are now at 106 percent of GDP gross debt. There has been a disagreement about whether we were talking about public or gross debt, but it is clear from our review of the Rogoff-Reinhart study their numbers were based on 90 percent of gross debt, it is the numbers they have.

But in February of this year, importantly, the Federal Reserve sponsored a conference in New York dedicated to looking at the question of how high debt impacts economic growth and can slow job creation. The participants looked at all the studies on debt and growth.

For instance, a study published by the International Monetary Fund concluded that levels of debt above 90 percent of GDP have a significant negative impact on growth.

A study by the Bank of International Settlements concluded, "The results support the view that, beyond a certain level, debt is bad for growth. For government debt, the number is about 85 percent of GDP."

The European Central Bank published a report called "Debt and Growth: New Evidence for the Euro Area" that found, "For high debt-to-GDP ratios above 95 percent, additional debt has a negative impact on economic activity."

Well, I guess my first comment would be—and I would make one more observation. As I understand the Federal Reserve's discussion about this, the presenters concluded that the correct figure is gross debt, not public debt, in their discussion. And these studies that I have just read are all talking about gross debt, not public debt.

So I guess I would ask you, first and foremost, do you think that high debt can slow economic growth? And do you think our debt level is at such a level that it could be impacting our growth right now?

Secretary Lew. Senator, I do think that it is important for us to make sure that debt does not grow beyond a danger point. I would disagree in terms of whether the metric should be the debt held by the public or the gross debt.

I think when you look at the United States and the way we have our public finance structured and other countries', for most countries there is no big difference between gross debt and what we call "debt held by the public," because they do not fund their insurance programs like Social Security with trust funds.

I think it is a difference that makes a difference. I think if you look at the presence of the Federal Government in the marketplace, it is debt held by the public that represents our borrowing in the marketplace.

Senator SESSIONS. Well, can I just interrupt you briefly? Because time does go by. But I know a lot of people have assumed that to be the figure, but our research indicates otherwise. Do you have any studies that have actually stated that the better figure is gross debt—or public debt rather than gross debt?

Secretary Lew. Well, I would be happy to go back afterwards and, you know, give you the basis for the thought. But in the few minutes that we have, I would just make a couple of other points, if I could, Senator.

You know, our treatment of the unified budget, as had the surpluses that were in the trust funds for many years, contributing to smaller deficits. For many years, when the Social Security and Medicare Trust Funds were, you know, more flush, it made it easier to avoid making the tough decisions in the rest of the budget, and it made it possible to do things like pass tax cuts that we could not afford and to put wars on the credit card.

I think that we are going to have to pay those bills. I do not disagree with you. And I also do not disagree that we still have to do some belt tightening. The President's budget has a lot of belt tightening in it. So we agree that there needs to be some belt tightening. Where we disagree is there has to be a balance between revenue and spending cuts.

I would argue that debt held by the public is the right measure. That is what the financial markets have looked at for a very long time, and I would be happy to follow up on it with you.

Senator SESSIONS. We will have to look at that some more. I will just quote from the Rogoff-Reinhart report recently: "In this paper, 'public debt' refers to gross central government debt." And I think the other studies do, too.

So I would suggest that 2 years ago, in 2010, the Congressional Budget Office projected that we would have growth in 2012 of 4.4 percent of GDP, and we came in at 2.2 percent of GDP. And we had a very slow fourth quarter, and we got a real bad jobs number this last week, which indicates to me that our debt may be the precipitating factor that is not being properly calculated. And I thank the Chair for giving me time to study that. If you are in error about that, then I think it gives greater credence to our need to change our debt course.

Chairman MURRAY. Thank you.

Senator Sanders?

Senator SANDERS. Thank you, Madam Chair. And congratulations, Mr. Secretary. You managed to squeeze to squeak in without my vote. But you did it.

[Laughter.]

Secretary Lew. Someday I will get it.

Senator SANDERS. Someday. I am going to give you the opportunity right now to get you to change my mind.

[Laughter.]

Senator SANDERS. Mr. Secretary, in your prepared remarks, you stated that, "The chained CPI is a more accurate measure of inflation..."

Madam Chair, I want to introduce and put into the record with unanimous consent a letter signed by 250 Ph.D. economists and 50 social insurance experts that states that the chained CPI is not the most accurate measure of inflation for seniors. And, in fact, as you know, Mr. Lew, many economists will tell you, including people from the AARP and quite knowledgeable people on senior issues, that the current formulation underestimates inflation for seniors because it does not fully take into account what seniors spend money on, which is prescription drugs, health care, heating, food—which is going up faster than general inflation.

So, Madam Chair, I would ask unanimous—

Chairman MURRAY. Without objection.

Senator SANDERS. Mr. Secretary, according to the Social Security Administration, under the administration's chained CPI proposal, average 65-year-old retirees would lose about $658 a year in Social Security benefits by their 75th birthday, a cumulative loss of more than $4,600.

I understand the theory of the chained CPI is that if you do not want steak, you can eat chicken. In my State, the weather gets 20 below zero, and a lot of elderly people spend a lot of money on heat. Your budget, the President's budget, is going to make significant cuts in LIHEAP for a start. But on top of that, I want you to tell the people, the elderly people in Vermont, what substitute they might use for heating oil when the weather gets 20 below zero. Do you have any good ideas for them on that one?

Secretary Lew. Senator, I do not disagree that heat is a big issue in Vermont. It is a big issue in the Northeast. And in all the years that I worked on the LIHEAP program— which I do not right now, but for many years I did—I worked to make sure that the assistance went to the states that were hard hit by things like heating oil.

Senator SANDERS. But this budget, as you know, makes over $400 million in cuts.

Secretary Lew. Yes, I actually am less familiar with some of the details on the spending side of this budget than I have been when I did—

Senator SANDERS. My point that I just wanted to make— and forgive me, I do not mean to be rude. We just do not have a whole lot of time.

The second point that I want to ask you is that White House spokesman Jay Carney said—and I think, by the way, you said something fairly systemic risk, but this is what Carney said, November 26, 2012: "We should address the drivers of the deficit, and Social Security currently is not a driver of the deficit." Adding that Social Security should be addressed on a "separate track."

I think a number of administration people have acknowledged—Mr. Zients was here last week—that Social Security has a significant surplus, and its trust fund could pay out benefits for the next 20 years. If Social Security is not a cause of the deficit, why are you proposing in your budget to cut Social Security?

Secretary Lew. Senator, I think the President made clear in the budget, I tried to make clear in my opening remarks, that the President would not normally choose to put a proposal like this forward. We have been in 2–1/2 years of budget discussions of one form or another where it has been made crystal clear that there is no path to a bipartisan agreement, something that Republicans will sign on to with revenue, that does not include fixing the chained CPI—changing the chained—adopting the chained CPI.

I tried to make the case, as I did in my remarks, and I believe that it is overall a more accurate measure. CPI is used for many purposes in the Government—

Senator SANDERS. I do not want to argue that point. I disagree with you, not for seniors.

But let me ask you this question. I think essentially your political point of view is you want to make a compromise. Republicans wanted to privatize Social Security for years. They wanted to cut access for years. And you are giving them a little bit of something. They will want more.

In your compromise efforts, what have you gotten from my Republican friends? Will any of them stand here and tell me that they are prepared to support more revenue now?

Secretary Lew. Well, Senator, I can tell you, the President has made clear that he is not proposing chained CPI on its own. It is something he is proposing as part of a package that would resolve these budget issues for some time, that would have a balance of the kind of spending cuts and tax increases that would move the country in the right direction.

I know that there are many who are concerned that, even as part of a package like that, we should not do chained CPI. But the thing I would tell you very strongly is it is not something that can be pulled apart from the other elements.

Senator SANDERS. Let me ask you this, and now I speak as Chair of the Veterans Committee, inheriting that Committee from the wonderful job that Patty Murray did. You also know that it is not just cuts in Social Security. You know that it is significant cuts in benefits for disabled veterans. And these are fairly significant. We are talking about VA disability benefits at age 30. Folks would have their benefits reduced by $1,425 a year at age 45 and $3,200 a year at age 65.

At a time when one out of four major corporations pays zero in taxes, when we have growing wealth and income inequality in this country, by which the wealthiest people are doing phenomenally well, do you really think from a moral perspective it is appropriate to balance the budget or move to deficit reduction on the backs of men and women who have lost their arms and legs defending this country?

Secretary Lew. Senator, I think you have to look at this budget in its totality. There are billions of dollars in one year of spending initiatives for health care, for job training, for job search assistance. This administration takes very seriously its obligation to veterans, and we have put together a budget that represents that.

Senator SANDERS. If I could just—it does. Your VA budget was a decent budget. I said that just yesterday at a hearing. On the other hand, I do want you to really think about cutting benefits for men and women who have lost arms and legs defending this country.

Thank you.

Chairman MURRAY. Senator Enzi.

Senator ENZI. Thank you, Madam Chair, and thank you, Mr. Secretary, for being here, and I hope you will answer additional questions in writing—with the help of your staff, of course, because there are a lot of questions on a budget of this magnitude.

In your testimony, you said that the budget was closing the gap, and in your response to Senator Sessions, you said that there was a lot of belt tightening. It appears to me that most of the sequester was eliminated, and that is the first real cuts that we have made. But there is a proposal in there for $580 billion in additional taxes.

Now, the summary tables accompanying the President's budget show gross debt increasing from $17.2 trillion to $25.4 trillion by fiscal year 2023. So it is fair to say the President's proposed budget increases gross Federal debt by over $8 trillion.

Secretary Lew. Senator, it depends, obviously, how you measure in order to answer your question. Our budget reduces the debt from where it would be without our policies. Obviously, there is going to be additional debt as long as we have a national debt to service, and, you know, that is something we are going to work our way down.

But I do not think that, looking at the sequester the way you described it, is—well, it is not the way we look at it. The sequester was not meant to be policy. When it was enacted, it was not meant to be policy. It was meant to be so bad that we would avoid it, and the super committee, which the Chair knows well—

Senator ENZI. But it did wind up being passed and signed.

Secretary Lew. Well, it was signed into law with the super committee created, and the super committee did not hit the deadline—

Senator ENZI. If I had more time, I would go into that one in a lot more depth, but you did eliminate most of the sequester.

Secretary Lew. But that was the goal. That was the goal.

Senator ENZI. The gross debt increases $17.2 trillion to $25.4 trillion. That does not sound like a lot of belt tightening to me. And the Congressional Budget Office projects somewhat higher interest rates than the President's budget. Even using those lower interest rates in the budget, OMB expects that the cost of servicing our debt will exceed the costs of national defense by 2020.

What would be the effect on deficits if interest rates were, say, one percentage point higher than forecast?

Secretary Lew. Clearly, it is very sensitive in interest rates. I think that if the—the question, I think, is how quickly can we reduce the deficit while we are contributing to the kind of economic growth that we need to create jobs and have the economy moving in the right direction.

The sequester moves in the wrong direction. The sequester takes too much out of the economy in a ham-handed way that was designed to be bad policy and it is bad policy. It is bad for difference, it is bad for domestic programs.

So we intentionally replace it with more sensible policies. So that was not an accident. It was an intention. It was what the joint committee was hoped to do. I know the Chair tried very hard to get the joint committee to an agreement.

This is an attempt to get to that kind of an agreement on a bipartisan basis to make sensible policy that can balance the kind of growth in the short term and deficit reduction in the medium and long term. That was the goal when the sequester was created.

Senator ENZI. Well, I think the sequester could have been done a lot more diplomatically and a lot more beneficially. I did not appreciate the notice that went out that it should be made painful. Our State had a budget deficit. They knew a year ago they were going to have a budget deficit. I think with sequester we knew we were going to have a deficit. Our Governor said, "Every department, every agency, every program needs to give me a 2-percent reduction, a 4-percent reduction, a 6-percent reduction, and an 8-percent reduction." He looked through those to see how consistent the reductions were in each of those areas and wound up having to implement a 6-percent reduction. And you did not hear a whine from the people around Wyoming that they had been significantly hurt, because they cut the worst first. So there are ways of doing that, but not unless there is some leadership from the White House.

Along with the interest rates, of course, there is the near-term assumption that growth in gross domestic product is significantly rosier than what the CBO economic and budget outlook is and also what is contained in the Blue Chip Economic Indicators, which is an average of 50 private forecasts. So the administration projects GDP growth being one-half of a percentage point higher than the Blue Chip and 1.2 percentage points higher than CBO.

In 2014, this rosier outlook continues to be about seven-tenths percentage points higher than both CBO and Blue Chip. Over the entire 10-year window, the administration predicts higher growth than Blue Chip forecasts.

Why are your economic forecasts so much higher than the CBO and the private sector?

Secretary Lew. Senator, depending on which years you look at, we are a little higher in some years, lower in other years. I think in the short term we are already seeing the economy outperform the expectations that were originally used in the budget. So we are in the range of the mainstream assumptions. We are in the Fed's range of assumptions. We could go assumption by assumption. I do not think you are going to find overall that they are very inconsistent. There is never any two forecasts each year that are exactly the same. But ours are well within the band of mainstream forecasts.

Senator ENZI. I think the Government has a record of being phenomenally wrong. I yield my time.

Chairman MURRAY. Senator Kaine.

Senator KAINE. Thank you, Secretary Lew. Good to have you with us today. I want to begin by thanking you for producing a budget that tries to balance some very difficult—very, very difficult issues. I appreciate the elimination of the sequester because, as you pointed out, it was not Congress' intent that it should go into effect. No rational body would have designed cuts of this kind, across-the-board cuts that would have fallen equally on so many programs. There is not a single American who thinks we should be spending less money on cybersecurity, for example. And so the notion that because Congress designed this mechanism of pain that was never supposed to go into effect, that we should just accept it seems to me to be ridiculous. I was not here when it happened, so I guess I it is easier for me to criticize it. But my purpose of criticizing is just to find an alternative. And the Senate budget did that, and I am happy that the President's budget did that.

I do not fault you for laying out a series of compromises that might not be your opening gambit. I want to associate myself with some of Senator Sanders' points. I think that Social Security does not contribute to the deficit. I think the best way to deal with Social Security reform is to deal with it separately from the deficit. I think the best and first thing to do, to the extent that we are going to wrestle with Social Security solvency, is to consider the payroll tax cap and adjust it upward and possibly even adjust it upward without adjusting benefits as a form of means testing. And so in those senses, I think we are probably in the same place on a lot of the policy issues.

But where I would differ a little bit is I do not think by putting a good-faith discussion about is there a more accurate way to calculate the CPI on the table that you are trying to harm veterans or harm anyone.

There is either a more accurate way to calculate CPI or there is not. If it not a more accurate way to calculate CPI, especially as the CPI would affect seniors, you know, that is something that I would like to dig into. And if it is not more accurate, I would not support it. But I do not think you are making an attempt to harm folks. But I do credit your point that you are trying to do something that is big picture.

As I look at this budget, I see a whole series of things where you are attempting, the White House is attempting, the President is attempting, to find reasonable compromises to try to find that big deal.

You do not propose any increase in tax rates. You could have done that. My sense is Republican colleagues have often taken pledges that would render that a nonstarter from the very beginning, regardless of oath of office. And so as a way of compromising with those who have taken such pledges, you have avoided any increase in tax rates.

You have focused on tax expenditures, where the other side has often said that is a fair way to look at it. The tax expenditure adjustments that you put on the table are quite modest. The amount of tax expenditures in the budget every year is about $1.3 trillion; $583 billion over 10 years, if we just even it out across 10 years, $60 billion a year, you have reduced the size of the tax expenditures in the budget by about 5 percent a year, which strikes me as extremely reasonable in terms of compromising given the size of some of the cuts we have seen in sequester and otherwise.

You have proposed to do corporate tax reform and make it revenue neutral, which, again, does not make everybody on my side of the aisle happy. That seems to be clearly a compromise.

I do agree with also the question that Senator Sanders asked. For all these compromises, no comments have been made today to suggest you are getting any credit—any credit—for adjusting to try to compromise with the other side. But in another sense, I do not mind because your goal is not to try to impress or get comments. Your goal is to try to do what the American public want. And I think what the American public deeply want us to do is to take the two budgets, the House budget and the Senate budget, to take our different philosophies and to try to find some longer-term deal that would keep the economy strong while we are responsibly managing the debt and deficit as a percentage of GDP, and to do that in a way where we can do it, set it and forget it for a while, and then allow some positive market forces to move forward.

So as you will notice, I have not asked any questions, and my time is almost up. But what I just want to say is there are really two philosophies that are competing right now, and that is, what do we do to fix the American balance sheet? And I think one philosophy is you fix one side of the balance sheet. And the other philosophy is you fix both sides of the balance sheet. And I am going to associate myself with those who say you have to fix both sides of the balance sheet. And I appreciate the fact that your budget does just that and does it by offering a number of compromises that shows you have been listening to both Houses and both parties and you are trying to find a path forward where we can find that kind of a compromise. And I wish you the best in that work.

Secretary Lew. Well. thank you, Senator. I think that very much captures the intent and the spirit of the budget, and it reflects what I think is what the American people very much want us to do.

Chairman MURRAY. Senator Portman.

Senator PORTMAN. Thank you, Madam Chair. And I appreciate your being here, Secretary Lew, and I enjoyed talking to you in the Finance Committee about some of these issues.

I would like to associate myself with Senator Kaine's comments about the need for us to figure out how to deal with this debt and deficit, because I do think that is what the American people want us to do. They want to see this economy grow. And as Senator Sessions has made clear—and I think it is backed up by all kinds of studies, but also just common sense—having record deficits and debt—and this year's deficit is going to be over a trillion bucks, and the debt is at record levels—does have a negative impact on the economy, and it is tough for us to see the kind of robust economic recovery we all hope for until we deal with this issue. I think that is something that you have talked about. Your budget indicates how you would like to get there.

I do not think it is enough, as you know. I do not think it is adequate to the task before us. I will say, because my colleague has said that Republicans are not saying anything good about it, I do like the fact that the tax reform piece on the business side is revenue neutral. I will also say that when you ask, you know, who benefits from this, it is not the board room. CBO has a study, and, you know, they are the nonpartisan folks up here who tell us what the economic impact is. They say 70 percent of the benefit of a lower rate on the corporate side is going to go to who? The workers. Why? Because we are not competitive now. And I think you said that accurately.

I will say that you do not have enough money to do it in here because you have in your budget $335 billion and elimination of loopholes, tax preferences. But then you create another $241 billion of new loopholes. And I am not suggesting they are all bad. In fact, one of them I really like, which is making the R&D credit permanent. That is the research and development, or R&E credit, as some call it, and that is a good thing. But the net of that would be enough to finance about one-tenth of a 1-percent cut in the corporate rate. And we do have the highest rate among our trading partners, the highest in the industrialized world.

And, by the way, we are not only number one, even if you assume that the effective rate is what we ought to be talking about, the Tax Foundation tells us our effective rate is 26 percent, it is still above the average. And when you add State taxes, of course, which some countries have and some do not, then it is even higher.

So the fact is we are high, and that is one reason we are losing headquarters and we are losing jobs. And we see it every day.

But can you tell us, do you have additional thoughts on corporate reform to meet the standards you set up in your own budget?

Secretary Lew. Well, Senator, obviously our budget is not an exhaustive list of the things that could be done to broaden the base as we go through tax reform. Our goal would be to work together. It is going to be tough. I mean, we have had this conversation before, and every one of these deductions has fierce defenders. But if we are going to be able to succeed in substantially lowering the corporate tax rate, it is going to require that we go at a lot of things that are in the Code right now. We would look forward to working on a bipartisan basis to do that.

I do think that the point you were making about the deficit, record deficits not being good, I agree with that. That is why we are bringing the deficit down. It is why at the end of the budget window in this 10-year window our budget deficit would be 2 percent of GDP—less than 2 percent of GDP, which is tremendous progress. We have already cut in half the deficit as a percentage of GDP. We are now proposing to go down to 2 percent or under 2 percent—on the way to further policy discussions where, you know, it has rarely—this has never gotten done in just one piece of legislation.

Senator PORTMAN. Let us talk about that for a second. I, as you know, disagree with some of the economic assumptions, as Senator Enzi talked about, you know, because they are way above CBO and even above Blue CHIP, but sort of different numbers. But apples-to-apples comparison, we still have, unfortunately, a budget deficit as a percentage of GDP that is relatively high, but more importantly is the debt. And, by the way, in that tenth year you can always get that last number down to get, you know, under 3 percent, and that is fine, and we should—

Secretary Lew. It is under 2 percent.

Senator PORTMAN. Under 2 percent.

Secretary Lew. We cannot get it from 3 to 2 so easily.

Senator PORTMAN. But we are still talking about, based on, again, an apples-to-apples comparison with CBO, probably high 70s on public debt and 100 percent on gross debt. So, obviously, you are not satisfied with that, I know. And the reason is we really do not deal with this mandatory spending issue. And there is a lot of talk today about CPI. I would just remind my colleagues on this side who are complaining that there is no guarantee of tax increases if the administration supports anything on CPI—and, by the way, the CBO number is $340 billion a year, is about $230 billion because you do not do the full chained CPI. But I, you know, commend you for taking a step in the right direction in terms of an accurate measure of inflation at a time when we have these explosion in costs and we have to deal with it to save the programs.

But it is about $100 billion in taxes, so it is $130 billion under your numbers in savings, and then it is $100 billion in additional revenue. So just to remind folks, because of the fact that our income tax brackets are indexed to inflation, and inflation will be relatively less by this more accurate measure. So there are not a lot of tax increases.

But on chained CPI, I will give you a chance to respond generally to this, but we have been told by CBO that these incredibly important programs cannot be sustainable in their current form, and what they have said is Social Security, Medicare, and Medicaid alone increase by 95 percent over the next 10 years, a 100-percent increase almost. And so if you look at what you all have proposed on the mandatory spending side, we actually take mandatory spending from about 65 percent of the budget today to about 77 percent of the budget in 2023.

I know there is concern around this table about research and our military and about education and other things. My point is we are continuing to squeeze that part of the budget that is annually appropriated here, and we are putting more and more into mandatory.

So when I said earlier, you know, it is not adequate to the challenge that we face, it is in terms of the spending and it is specifically in terms of the mandatory side and the fact that, under your own numbers, your net interest goes from $220 billion today to $763 billion in 2023. And, again, you have substantial increases, and this mandatory part of the spending is going to crowd out other spending.

Do you have any thoughts on that?

Secretary Lew. Well, may I take a couple of minutes, Madam Chair?

Senator PORTMAN. I will not ask any more questions. Sorry, Madam Chair.

Chairman MURRAY. Okay. We will give you a few seconds here to answer that long question.

Secretary Lew. First, in terms of where our debt as a percent of GDP would be, publicly held debt would be at 73 percent at the end of this period, which is a lot of progress. I mean, we obviously need to keep bringing it down. But that is at a level that, you know, is enormously better than if it were at 100. I mean, we are making—which is where it was projected to go.

The full chained CPI—

Senator PORTMAN. By the way, it is not projected— well, never mind. It is not—under the CBO analysis, it is 76.

Chairman MURRAY. If we can let him answer the question.

Senator PORTMAN. Yes.

Chairman MURRAY. I do have to turn to Senator Whitehouse.

Secretary Lew. The full chained CPI, the reason we do not take credit for all the savings is we have from the very beginning, every time we have discussed doing chained CPI, it has been something that we said was essential that there be provisions that protect the most vulnerable. And I actually think there has been pretty broad bipartisan agreement that if we change the way we calculate the CPI, even if we can justify that it is a more accurate measure, for certain populations even small adjustments are something that cannot be absorbed.

So that is something we put in our proposal. You know, people can debate whether or not you have drawn the line in the right place. But I think everyone can agree that the very old—the "old-old," as they say—for whom $10 a month is a difference that makes a huge difference, is the kind of thing that has to be reflected, and that is why there is an offset. So we have not taken full credit for it because we have built in the ability to protect those who would be most adversely affected.

On the question is it sufficient, in all the negotiations that I have sat through on the budget, there were three things that we were told were critical if there was going to be a willingness on the part of Republicans to do more revenue. We have put two of those in this budget. We put in means testing Medicare through premiums, and we put in chained CPI.

Now, I think that that is going more than halfway. That is a way of saying we very much want this to come to closure in a way that can give some confidence that for the next number of years the budget is in a decent place, and you come back and you visit it.

I think the right way to do Social Security reform is outside of the context of a budget bill. That is how it was done in 1983. I think that it is going to be impossible to get the kind of bipartisan cooperation to deal with Social Security if it is intertwined with a budget bill.

Now, some of my friends say that chained CPI crosses that line. Chained CPI is something that affects many, many parts of the budget. So I think we have gone, you know, considerably more than halfway to try and elicit the kind of cooperation to put together a serious bipartisan effort.

Senator PORTMAN. Thank you.

Chairman MURRAY. Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Secretary Lew. I appreciate very much that cutting Social Security is sort of catnip for Republicans, and as a negotiating strategy, I can understand why you might want to advance that to sort of get things started.

But I really join my colleagues in disputing that it is a more accurate version of the CPI than—at least for seniors. Most seniors spend their money on food and drink, health care, gas, and heat. And if you look at 2010, food went up 1.5 percent, health care went up 3.3 percent, gasoline went up 13.8 percent, fuel oil went up 13.5 percent; and their existing COLA, the one that I guess you guys think is too high, went up 0 percent.

The following year, 2011, food and beverage went up 4.5 percent, medical care went up 3.5 percent, gasoline went up 9 percent, heating oil went up 14.3 percent. That is on top of the previous raises in the previous year. And the COLA again went up 0 percent.

So when that is the environment in which most seniors live, please, fine, make it your negotiating strategy. But I think to tell the public that it is actually more accurate where seniors are concerned is just factually a mistake. And so I would like to at least urge that on you.

I have a question about the so-called fiscal multiplier, which is, as you know, the ratio between Government spending and economic growth. And as I understand it, if the fiscal multiplier is below 1, that means that Government spending is not economically effective and that it does not create as much economic growth as the spending itself. And if it is over 1, that means that there is an amplifying effect in the economy.

We have seen I think as many as five recent reports that show in the circumstances that we are in right now, there is a way above 1.0 fiscal multiplier, which would mean that cuts in Federal spending have a much more dramatic negative effect on the economy, and Federal spending itself has a much more dramatic beneficial effect on the economy.

I think that that is a fact. Our friends on the other side believe that it is a matter of faith that all Federal spending is bad for the economy, all Federal spending cuts are good for the economy. I think that is ideology, not economics. Where do you think the fiscal multiplier—what signals should we be taking from the fiscal multiplier information that we are getting out of some pretty conservative institutions, like Goldman Sachs and Oxford Economics and the International Monetary Fund?

Secretary Lew. Senator, I have read probably a dozen different analyses of what the impact of the sequester will be on the economy, and all of them assume that if the sequester stays in effect, it will take in the neighborhood of a half a percent out of GDP, which supports very much the notion that there is a direct effect, that Government spending has an effect on the macro economy.

Now, I for one do not understand why this is a time when one would want to reduce GDP by half a percent. If we get into the high 2's or cross the line to 3, that is hundreds of thousands of jobs. And that is a world of difference to real people.

So I very much believe we need to reduce the deficit in the medium term and the long term. I think if you look at the history of the last 4 years, the experience of the United States versus the experience in countries where the move to fiscal consolidation has been more rapid and more abrupt, we have had better recovery from the recession, which also supports the theory that you are articulating.

I do not think we can put it off forever. The sooner we lock into place a plan that gives confidence to the whole economy that we are not going to either have gridlock or kicking the can down the road, it will probably have a very substantial beneficial effect in terms of decisions to invest and hire.

Senator WHITEHOUSE. A vicious circle is an economic possibility in which Government cuts lead to GDP shrinking, lead to lower revenues, lead to a worse deficit. And if you are following the ideology, you chase that with more cuts which drive the economy down further, which leads to less revenue, which creates bigger deficits, and down the spiral you go. Is there any example you can think of in the world right now where we might be actually seeing that take place?

Secretary LEW. Senator, I just spent 2 days meeting with European finance ministers, and you do not have to look very far to see examples of where the rapid reductions in public spending slowed the recovery or caused a double-dip recession. I urged many of our friends in Europe that it was a time for them to think more about balancing growth and jobs with the pace of fiscal consolidation. And I do not think it is a choice between the two. Just as our budget has to balance the two and accomplish both, that was the message that I carried to them. I would rather have our growth rate than theirs right now. But I am not happy with ours. Ours needs to be better, which is why I think we need to replace the sequester.

Senator WHITEHOUSE. Thank you, Chairman.

Chairman MURRAY. Thank you.

Senator Johnson?

Senator JOHNSON. Thank you, Madam Chair.

Mr. Lew, isn't it true that your budget actually increases the deficit over the CBO baseline in the first 3 years?

Secretary LEW. I do not believe—

Senator JOHNSON. It does by $326 billion. Actually, if you add in 2013, it is $450 billion. So—

Secretary LEW. Yes, I think it may just be the first year. I will go back and check.

Senator JOHNSON. No, it actually does the first 3 years. During the rest of President Obama's administration, the deficit increases over CBO baseline. Then, of course, after President Obama leaves office, then you supposedly claim about $2 trillion worth of deficit reduction. So I guess my question is, you know, how credible is that type of budget for actual deficit reduction?

Secretary LEW. I think if you look at the policies of this budget, they are very credible. You know, there might be small differences in terms of scoring. But you enact policies like the policies in the President's budget, and it is going to reduce the deficit.

Senator JOHNSON. We are already trying to cancel sequestration, so the promise of deficit reduction in the future is not particularly credible.

Secretary LEW. Well, if you enact it now—

Senator JOHNSON. Let me turn—let me turn to—

Secretary LEW. In the case of sequestration, Senator, we did not enact alternate policies. This is alternate policies that are being recommended.

Senator JOHNSON. Okay. Anyway, so the first 3 years, your budget actually increases the deficit by $326 billion. Let us talk about Social Security. It is true that in the next 10 years Social Security will run a cash deficit of $1.3 trillion. Isn't that correct?

Secretary LEW. Well, I think that you are defining the Social Security fund drawing down its trust fund—

Senator JOHNSON. Cash. No, I am talking about just cash right now.

Secretary LEW. I have a fundamental disagreement, Senator—

Senator JOHNSON. No. Hang on. In terms of the dedicated revenue coming in versus the amount that is being paid out will be $1.3 trillion, according to the Social Security Administration.

Secretary Lew. But that is not the measure of whether Social Security is running a deficit.

Senator JOHNSON. Then over the next—

Secretary Lew. From 1983 until now, we have been building up reserves to draw down when we need them. So those reserves are part of—

Senator JOHNSON. So let us talk—good. Let us talk about the Social Security Trust Fund. What assets does the trust fund hold?

Secretary Lew. Senator, there are special treasuries in the trust fund.

Senator JOHNSON. So let us go through the scenario when we are no longer adding to that trust fund with interest payments now, and the trust fund actually has to start redeeming those bonds. Who pays those things off?

Secretary Lew. It obviously comes back to the unified budget, just as the benefit of the surplus went to the unified budget while the surpluses were being built up.

Senator JOHNSON. Acting Director Zients said that you sell those bonds to the general public. That is not correct, is it?

Secretary Lew. Well, to finance whatever deficit we have at the Federal Government, you do go to the general public for bond—for—

Senator JOHNSON. The Treasury will do that, not the Social Security Trust Fund.

Secretary Lew. Correct.

Senator JOHNSON. So let us talk—

Secretary Lew. The special bonds are between Treasury and Social Security.

Senator JOHNSON. Okay. Let us put up on the screen here a report by the Office of Management and Budget that basically says what I have been trying to make the point, that the Social Security Trust Fund in total, on a consolidated basis, has no value to the Federal Government. Do you agree with this statement put out by the Office of Management and Budget that these balances are available for future benefit payments but only in a bookkeeping sense? The holdings of the trust fund are not assets of the Government as a whole that can be drawn down in the future to fund benefits. They are claims on the Treasury.

Let us go to the next slide here real quick. Basically what we are talking about is the Social Security Trust Fund, yes, has assets, Treasury bonds worth $2.7 trillion right now. But at the same time, the Treasury holds that liability. When you consolidate that—I mean, you are a financial guy. You consolidate that statement, those cancel out, it is worth zero—netting to zero. I mean, isn't that correct that the Social Security Trust Fund has no value to the Federal Government? Isn't that—

Secretary Lew. I do not agree with that, Senator. I am happy to answer the question—

Senator JOHNSON. So you do not agree with your own Office of Management and Budget?

Secretary Lew. If you read that whole chapter, that chapter says quite a number of things, and if you would permit me, I would be happy to answer the question.

Senator JOHNSON. Well, tell me how those have any value whatsoever and why those would not be included in total debt.

Secretary Lew. Senator, from 1983 until now, we have been building up surpluses in the Social Security Trust Fund. In years when there were balances that were positive, it went to the benefit of the unified budget, and it made it possible to do things like enact tax cuts and make it seem like we could afford—

Senator JOHNSON. Right, that money was spent. It is gone.

Secretary Lew. Okay, but, Senator—

Senator JOHNSON. It is gone.

Secretary Lew. —I do not believe that. I think—

Senator JOHNSON. It was not invested in a real asset that has value to the Federal Government.

Secretary Lew. See, that is where I fundamentally disagree with you. That is an asset that is backed by the full faith and credit of the United States, like every other bond.

Senator JOHNSON. That gets replenished how?

Secretary Lew. I do not believe—

Senator JOHNSON. Increasing taxes or by floating more bonds?

Secretary Lew. I do not believe that we will—

Senator JOHNSON. Increasing more debt.

Secretary Lew. I do not believe we will tell the American people that the full faith and credit matters in other cases but not in Social Security. It does put a burden on all of us to make balanced fiscal policy to reduce the deficit so that we can have a fiscal position where we can make—do the right thing and pay back the Social Security Trust Fund. But I think it is not right to say that it is meaningless. I just disagree with that.

Senator JOHNSON. It nets to zero. The value of the trust fund nets to zero to the Federal Government.

Secretary Lew. That is a—

Senator JOHNSON. Isn't it true the Federal Government is either going to have to tax the American public or the Treasury will have to float different bonds? You are going to have to do the same thing—

Secretary Lew. You will have to have a unified budget that can, at the bottom line, pay the bills, and either there will be revenues or spending cuts elsewhere or borrowing. I do not disagree with that. But what you are saying is different. You are saying that it is meaningless. And it is not meaningless. It is a bond backed by the full faith and credit of the United States.

Senator JOHNSON. It is a bookkeeping—it is a bookkeeping—

Secretary Lew. The fact that accountants describe something in one way does not give it the status you are giving it. I have made this case for many decades. I fundamentally disagree with the view you are taking.

Senator JOHNSON. Okay. Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Coons?

Senator COONS. Well, thank you, Mr. Secretary, for your testimony here today. Thank you, Madam Chair. Just a moment to breathe, if we could.

Secretary LEW. No, I am fine.

Senator COONS. I think the President's budget has a lot to commend it. There is obviously a lot to dislike and a lot to like, and I appreciate your coming and taking vigorous questions and challenges from both parties, from both sides of the dais here.

In general, as you know, budgets are a reflection of values and priorities. I think the President's budget, broadly speaking, does the right thing by prioritizing investment and growth in the short run, and then focusing on competitiveness in the longer run. And as previous questioners suggested, there is a counter-example in Europe to look at in terms of strict austerity and its impact in the short run.

I think we had comparable goals when we enacted the Senate budget last month focusing on the investments we need to make in order to help grow the economy while also engaging in responsible deficit reduction. In particular, I have been concerned about how we accomplish that, responsible deficit reduction, while still enacting a circle of protection around the most vulnerable in our society and ensuring that we do not undermine some of our most treasured programs.

We have made a lot of progress, $2.4 trillion together so far towards that $4 trillion deficit reduction objective, and it is my hope that we will find ways to work together towards that.

I wanted to talk with you about interest rates, if I could. I think further deficit reduction is absolutely critical. We do have to reduce our deficits, and we have to deal with our national debt. And a big reason for that is so that we do not have interest payments that crowd out other priorities, whether it is Head Start, affordable housing, cancer screening, R&D, infrastructure.

Interest rates are at an all-time low. Table S.12 of the budget says we had a 10-year note rate of 1.8 percent in 2012, but it forecasts that rate going to 5 percent by 2023, if I have that right.

In the long run, what is driving that increase in interest rates? It is obvious, I think, that higher debt can lead to higher debt service, but is there a connection between higher debt and higher interest rates in the market? And if—or I should probably say when—interest rates do rise, what is the impact of that on seniors, on students, on families, on businesses? Because I think to have a whole picture here, we need to also focus on those broader macroeconomic impacts on working people, students, and seniors.

Secretary LEW. Senator, the forecast shows that both growth goes up and interest rates go up. I think it is very different if interest rates go up while the economy is growing. And right now we have very low interest rates, in large part because we were in the deepest recession of a generation, and those low interest rates were a way to help get out of the recession.

So I think that the reason for interest rates going up makes a big difference. I do not think that where we are now is permanent and normal interest rates. And as long as the economy is growing and interest rates are going up in an orderly way, not spiking in a way that is out of line with economic growth, you know, from a

Federal perspective, obviously, we will see more robust revenue because a larger economy throws off more income. And that is why our budget shows that you can accommodate, you know, too large a national debt, but you can accommodate it in a growing economy. If you do not have a growing economy, I do not know how you can accommodate it, because if interest rates go up and the economy does not.

For individuals, you know, one of the things that we think is very important is that as many families as possible get a chance to refinance their mortgages while interest rates are low. You know, this is a time-limited opportunity. We are not going to be in a world of 3.5- to 4-percent mortgages forever. As many families as can should refinance, and we have done everything we can, and we hope to pass legislation making it possible to help more families.

I am not sure when you get to seniors how to answer your question. It tends to be less of a direct issue in the lives of seniors. They are not typically taking mortgages at the same rate that, you know, they did when they were younger. But, obviously, to the extent that seniors have debt and they have a fixed income, you know, it will be more pressure. I think there are other things we have talked about here that are probably more of a direct factor in the economic well-being of seniors, things like we were talking about earlier with fuel prices.

Senator COONS. If I could have just a brief follow-on, what fiscal policy tools do you propose in order to keep interest rates and interest payments in check, since I think there would be some really negative consequences if the interest rates rise but growth does not?

Secretary Lew. Well, you know, this budget incorporates, as you pointed out, a rising interest scenario. So I think the fact that we have built in the capacity to manage a debt service with interest rates getting back into what is a more normal range is one answer which is very important.

In our regular management of the national debt, we have been working to make sure that we do it in an orderly way. There has been some extension of maturities that gives you a little bit more adjustment space. But we do not market-time the purchases of the sale of Federal debt, and I do not think we should start now.

Senator COONS. Thank you, Mr. Secretary.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Ayotte?

Senator AYOTTE. Thank you, Madam Chairman. I appreciate it. Thank you, Secretary. I appreciate your being here today.

I wanted to ask you, within the Affordable Care Act there was, in order to pay for the Affordable Care Act, a tax that recently lawmakers from both sides of the aisle are concerned about, and I think there is a recognition that it taxes—that it will have the potential of stifling innovation and impacting American jobs in the area of the medical device industry.

Just looking at, you know, one State, the State that I represent, New Hampshire, certainly having visited many of these companies in our State, I have heard directly that this 2.3-percent tax on revenue is having a negative impact both on the cost of the devices that will be passed on to consumers, also on their hiring projections, and then finally many of them are taking it out of their research and development budget, which we, of course, want Americans to have the very best medical devices.

So the vote passed in the budget resolution 79–20 to repeal this tax. You know, there is not much around here that we get 79 votes for in the Senate, so I guess I would ask you, given the bipartisan support in the United States Senate for repealing this tax, what is the President's position on the medical device tax repeal? And will he commit—will I guess you as the Secretary of Treasury, if you have spoken to him about it—I hope that he would commit to working with both sides of the aisle to support bipartisan efforts to overturn this tax, which I think that there is agreement is harming an important industry within our country that also, of course, most of all helps the patients that want the very best medical devices?

Secretary Lew. Senator, I think we all agree that having the best technology available for our patients is a very high priority. I think it is also important, though, to note that there has been a dramatic increase in the costs associated with the reimbursement for these medical devices, and I am aware of the vote, you know, in the Senate on the budget resolution.

I think there were some misunderstandings at the time of the vote in terms of how it affected U.S. versus foreign manufactured devices. In fact, it does not distinguish, so a foreign device sold here would be covered by it just as much as a U.S. device. It has nothing to do with making U.S. industry less competitive against devices that are manufactured elsewhere.

It obviously is a piece of the funding that is in the Affordable Care Act. It is something that, you know, if it were to have to be replaced, there is—

Senator AYOTTE. Well, Mr. Secretary, I understand that it would treat foreign as well as American devices the same, but the reality is that on the ground what we are hearing from the medical device companies in this country is a 2.3-percent tax on revenue, if you couple that with the actions of the FDA, this is an industry that is becoming less competitive. It is an industry that is very vibrant, and so, you know, I would hope that the President would work with us to try to come up with a solution to repeal this tax, because it would be good for our economy.

Secretary Lew. I would only point out that it has been a very profitable business, so this is not a difference that is the difference between it being profitable to being in—

Senator AYOTTE. Except can I ask you, given that it is a 2.3-percent tax on revenue, even if I am a startup and I do not make a profit, don't I still have to pay the tax?

Secretary Lew. Well, if you have sales, you are—

Senator AYOTTE. I have sales, but I have no profit because I am a brand-new company, starting with a brand-new device in this country, a brand-new idea, the basis of innovation in this country, I still have to pay the tax, don't it?

Secretary Lew. I believe that is correct. I would have to—it is on the sale of the devices, yes.

Senator AYOTTE. So when you talk about these companies being profitable, the reason that the concerns are coming back on innovation is because the companies that it punishes the most, frankly, are the startups because it is a tax on revenue, not profit. So I think this is one of the issues that many of us on both sides of the aisle are hearing about.

Secretary Lew. I understand the concern, and maybe there is a way of looking at it differently than the way it was designed. It is always a dangerous business to reopen something when it is a critical funding element in a complicated piece of legislation. But the idea was not to target startups. It has a much broader effect than that, and many, if not most, of the sales are not of startups. But I would be happy to go back and take a look at that?

Senator AYOTTE. I appreciate it. I know my time is up. I have some questions I will submit for the record, including one on Iran sanctions. So I will submit those for the record. Thank you.

Secretary Lew. Yes, and I would be happy to answer them.

Senator AYOTTE. I appreciate it. Thank you.

Chairman MURRAY. Thank you.

Senator Nelson?

Senator NELSON. Do you feel a little chagrined, Mr. Secretary, that you put out what you consider a fair and balanced approach to a budget as your first offer and you are getting hit from both sides?

Secretary Lew. I think we are proud to defend the budget that we put out.

Senator NELSON. But, you know, from revenue versus cuts, you have just one to three, one part revenue to three parts of cuts. And the budget that came out of this Committee, it was bold. It was one to one, half revenues and half cuts to lower the deficit. So even your proposal, which is more modest, is getting all kinds of stuff.

Secretary Lew. Ours is two to one, not three to one.

Senator NELSON. Two to one.

Secretary Lew. Yes.

Senator NELSON. Well, my compliments to the Chairman. She was bold.

I would be curious, because I am in a State that does not have a State income tax. And what is deductible to our citizens is the State sales tax, which is sizable, 6 percent. Why is that something—what was your calculation that you wanted to eliminate that as a deduction?

Secretary Lew. Well, to be clear, we did not eliminate it as a deduction. We have a cap of 28 percent in our budget that essentially says for people who are in the very top bracket, they will get the same benefit of deductions as people in the 28-percent bracket. So that is different than eliminating deductions.

It is something we only do as part of a budget that overall is helping to pay for infrastructure and other important things that we need to do in this country. So, you know, it is like many other things in our budget. It is connected to an overall set of policies.

Senator NELSON. I would just point out for your folks sitting behind you that the sales tax deduction expires at the end of this year, and therefore, you would have the treatment differently of different States as to what would compromise that 28 percent.

Secretary Lew. Senator, I am sorry. I have to correct myself. I was talking about the deductibility of taxes generally which is covered by the 28-percent provision. Because the sales tax deduction is an expiring provision, it does expire unless it is extended. And what we said was we wanted to work with the Congress on expiring provisions, and we are obviously going to have to pay for the expiring provisions that are—if they are extended. And, you know, we would be open to working with you on that. I was talking about the general deduction of State and local taxes.

Senator NELSON. Do you want to comment on the territorial tax system?

Secretary Lew. The debate is often laid out in pretty stark terms of either territorial or worldwide. It actually is already something of a hybrid, and I think we will find a path, if we can accomplish business tax reform, to find the right balance of the hybrid where we can address the concerns about competitiveness without having the enormous revenue loss associated with the kind of black-and-white choices.

I think that we—you know, we put a worldwide minimum proposal—global minimum proposal in our white paper, and we would look forward to working with the Congress in the context of corporate and business tax reform to see if we can find that right balance.

Senator NELSON. Do you see any potential change of the sequester in the present fiscal year until September the 30th?

Secretary Lew. Senator, that is really a question of whether Congress is prepared to take action. We have made clear we think it would be advisable to act sooner rather than later. The cuts are not good. They are not good on the defense side; they are not good on the nondefense side.

In the macroeconomic sense, every month they are in place is costing us GDP growth. So I think the sooner, the better.

The President put this budget forward in, you know, large measure to try to jump-start the conversation, to get it to a place where we can see where the reasonable center is.

Getting back to your initial question about chagrin, obviously there is going to have to be some willingness to do business in that reasonable center if it is going to work in any timely way.

Senator NELSON. And I must say that I am concerned, because I do not see a lot of give. And the whole process of putting a budget together is a give-and-take, and especially in a country as big and as broad and as complicated as our country. And yet it is like there are two different worlds out there. And you have heard some of that questioning right here.

Thank you, Madam Chairman.

Chairman MURRAY. Thank you very much.

Secretary Lew, I just had one additional question. You know, over the past several decades, we have witnessed a dramatic rise in income inequality in this country. Over that time period, we have seen top tax rates on earned income, capital gains, and dividends fall considerably, and not only that, the number of so-called tax expenditures, which often primarily benefit the wealthiest Americans, has exploded. Due to the confluence of those factors, we now have a situation in which we see the wealthiest Americans are able to pay tax at a lower effective rate than a typical middle-class family.

Can you comment on what you see as the relationship between our country's tax policy and rising inequality?

Secretary Lew. Senator, there is no doubt that the trend over the last few decades is as you describe: a heavy concentration of income growth at the very high end and at the expense of the middle and the bottom. That has real implications for our tax system because we tax income, and if income is at the top, there is going to be more of a burden of taxation at the top as well.

I think it was very important in January to have the top rate go back to 39.6. I did not support lowering it in the first place. The economy was doing quite well with the 39.6-percent rate. I think it will continue to do well with the current rate where it is.

We have also put in our budget what we call the "Buffett rule" to make sure that, you know, people who earn a million dollars or more pay at least a minimum tax rate that puts them above where middle-class people are. Again, it is only fair. I mean, if through a complex set of tax deductions and forms of income people who make millions of dollars pay a lower percentage tax rate than people who work for $50,000 a year, it is just not right.

So I think our budget addresses that. I think it is something the Tax Code has to deal with, because the Tax Code and income tax is based on income. And I think we have made more progress in January than we had for a long time in terms of the Tax Code reflecting that, and I think if the Buffett rule were enacted, it would make further progress. And tax reform which takes away deductions that go disproportionately to people at the high end or that put a cap on deductions at the high end would have the same effect.

Chairman MURRAY. Okay. Thank you very much.

Senator Sessions?

Senator SESSIONS. Thank you, Madam Chair.

Well, this tax policy and income inequality is a problem for me. It seems to me quite clear that the President believes that you should just tax the upper-income people more and pass out benefits to other people with the money extracted from them. I do not believe that is the right approach.

We do have a growing income inequality. The average working person has not had his wages kept up with inflation for, I think, 15 years or more—maybe longer than that. Some say back to 1970. So it is a really worrisome thing. I just reject the idea that you solve it by raising more taxes.

And let me just say we have looked at the numbers, we have studied the Borjas report, three members of the Civil Rights Commission have written. This immigration bill will bring in a huge number of low-wage workers, and there is no doubt that it will impact adversely already hurting low-income workers in terms of their wages not advancing and in terms of higher unemployment. And that is going to be clear as we go through this debate, colleagues. You are going to have to look at those numbers. It is an absolute fact.

We have a surplus, as the Civil Rights Commission said—used the word "glut"—of low-wage workers, low-skilled workers. Businesses—I do not share the view that we have a shortage of low-wage workers. So I will wrestle with that, and we can figure out precisely what the impact is and how to create an immigration policy that does not hurt those who are already hurting, create an immigration policy and a social welfare policy that moves people from dependency and Government benefits to independence in the workforce. I know we can do better, and I hope we will on that.

Mr. Lew—

Secretary LEW. I was just going to respond, if I could, Senator. You know, I believe that it is considerably more than just a question of tax policy, so I did not mean in my response to the Chair to suggest that the entire answer to income disparity is on the tax side. The question was: What role does the Tax Code play?

Our fundamental challenge is to create good middle-class jobs, to have a growing economy so we create more and more good middle-class jobs with good wages, and that will actually put more people into the place where they are paying taxes because they are earning more income.

I think the minimum wage is part of it, also, because the minimum wage has eroded considerably in the last decades. And I think the benefit of immigration reform is, I think, greater than your comments suggest, because right now we have people who are in the shadows who are working without legal status, and if those people come out of the shadows, it becomes much less likely that they are going to drive down labor rates.

Senator SESSIONS. I would totally disagree with that, and I think that economic studies are going to prove that is wrong. It is going to pull down wages, and you also have a 50-percent increase in the future flow in addition to the large numbers that would be legalized. But we will go through that as the debate goes.

One thing I would say with regard to Senator Johnson's questions, if you believe there is a valid Social Security Trust Fund—and I do; I believe our trustees, I believe they have a Treasury bill note, an IOU from the U.S. Treasury. But Senator Johnson is correct. If you believe that it is a valid trust fund, it is owed money, we have saved no money to pay it back, and it should be part of the—and it is part of the gross debt of the United States of America, that unpaid internal debt, then you should count the gross debt as the most appropriate figure for ascertaining the true debt of the United States.

And with regard—and I will let you respond, but in the paper presented to the Fed conference in New York February 22nd, the title of it is "Crunch Time," Mr. Lew, "Crunch Time: The Fiscal Crises and the Role of Monetary Policy." And in their abstract, first page, they say, "We analyzed the experience of advanced economies using both econometric methods and case studies, and conclude that countries with debts above GDP and persistent current account deficits are vulnerable to rapid fiscal deterioration as a result of these tipping point dynamics. Such feedback is left out of current long-term U.S. budget projections and could make it more difficult for the U.S. to maintain a sustainable budget course."

And then a little further one, it makes the—answers our question about gross debt. After setting forth one of the most complex economic formulas I have ever seen, they say, "Note that gross debt regression has a better predictive power than net debt regression."

So we rail about those figures, and I think we are in a danger zone. You need to help us get out of it. Your budget does not. But I yield.

Secretary Lew. You know, I think that the—I appreciate that you agree that the Social Security Trust Fund is real. I think it is an important point.

Senator SESSIONS. It is a legal document. There are trustees who hold notes on the U.S. Treasury.

Secretary Lew. In my new role—

Senator SESSIONS. That is a fact.

Secretary Lew. In my new role as Chair, I consider them to be real obligations, and I am glad that you agree.

Senator SESSIONS. But there is no money to pay it with.

Secretary Lew. But at the point when the Social Security Trust Fund is being drawn down for, you know, the purpose it was intended, it has an impact on the unified budget, the bottom line of the unified budget. And if we look at our deficit and the unified budget year to year, that will incorporate the effect of paying back the Social Security Trust Fund. So I think that is actually a more accurate way of doing that than looking at gross debt.

Senator SESSIONS. That is not what the—

Chairman MURRAY. Senator Sessions—

Senator SESSIONS. —told the Fed.

Chairman MURRAY. Senator Sessions—Sanders. Senator Sanders.

[Laughter.]

Senator SANDERS. It has been a long hearing, right?

Senator SESSIONS. Making a habit of that.

Senator SANDERS. I knew, by the way, that if I listened to Jeff Sessions long enough, I would find areas where I agree with him. I knew it. And he made two good points.

Number one, obviously the Social Security Trust Fund is real. It is held by bond backed by the faith and credit of the United States of America. And if we stop paying that, we do not have to worry about anything else, Jeff. The entire world will be in a financial collapse. We do not have to worry about Social Security.

The second point, though, where you were right—and I think Secretary Lew is right—is on immigration. His point, taking people out of the shadows so that they are not exploited, is a good thing because it will raise the wage structure. On the other hand, your point is also a good point. If the Chamber of Commerce were to get its way and bring hundreds of thousands of low-wage workers into this country, there is no question in my mind it would drive wages up. I think that was your point.

But I want to go to another issue. Out of curiosity, Mr. Secretary, you mentioned earlier that you gave the Republicans two out of three. You gave them cuts in Social Security, and you gave them deficit-neutral tax reform. What was the third thing you have not yet given them?

Secretary Lew. Senator, the third item was eligibility age in Medicare. That has been the thing we have heard over and over again, and I think you and I have had private conversations about this.

Senator SANDERS. Yes.

Secretary Lew. We have come to the view, after looking at it very carefully, that it actually does not have any savings, it increases national health care spending.

Senator SANDERS. Right. Okay. Let me ask you this, getting back to one of your gives to our Republican friends. The GAO just came out with a report the other day—published by Reuters yesterday, I think—"Corporate tax breaks cost U.S. Government $180 billion per year." A huge amount of money.

Now, what I do not understand is at a time when one out of four corporations pay nothing, many major corporations, some of the most profitable corporations of the world, pay nothing—maybe they get a rebate from the IRS—why you think it is more preferable to cut benefits for disabled vets or cut Social Security on people making $15,000, $16,000 a year, rather than getting some revenue from these large corporations?

Secretary Lew. So, when, I guess I am not sure that is the way I would describe the trade-off. If we are saying we need $580 billion of revenue and we are saying that revenue has to come from closing tax loopholes that go to people in the top brackets, one could argue it is a different form. I mean, the beneficiaries of corporate profits are in those top brackets. So if we can increase the competitiveness of the United States and have job creation expand and we get the revenue on the individual side, that was the—

Senator SANDERS. Well, that is a big if, and I understand that many of the people who get their dividends from corporate stock are in the top 1 percent. But, on the other hand, as you know, while corporate profits today are at an all-time high, corporate income tax revenue as a percentage of GDP is near a record low. True? That is true. I mean, that is—and today, as opposed to, say, in 19—

Secretary Lew. I do not know if it is a record. It is low.

Senator SANDERS. Well, I will give you an example. Back in 1952, 32 percent of all the revenue generated in this country came from large corporations. Today that number is 9 percent.

Now, many of our friends here talk about how high corporate tax rates are. You know—and I think you have indicated—that is the nominal rate.

Secretary Lew. The statutory rate.

Senator SANDERS. Right. The effective tax rate is just 12 percent, and, in fact, in 2011—and this is an important point to make—corporate revenue as a percentage of GDP was just 1.2 percent lower than any other major country in the OECD.

So my question, again—I do understand your point. But are you really suggesting to me, when the GAO tells us we are losing $180 billion per year, there is no way to capture revenue from corporate tax loopholes to help us with deficit reduction that is preferable than cutting Social Security?

Secretary Lew. Senator, if the world were a binary choice between those two, it would be different than the world that, you know, the budget is in. If you add to that the choice of raising revenue from the top brackets, I think that is a better way to do it than to do something which might be something there is an argument about, but we believe is something that is a competitiveness issue for bringing jobs to the United States, which is lowering the business tax rate.

Senator SANDERS. But you can do both, and, again, I would argue that right now corporate revenue as a percentage of GDP today is the lowest among any OECD nations.

Secretary Lew. I would be happy to follow up on this, Senator. The effective bonus depreciation over the last number of years has been to reduce taxes now so that taxes will be higher in the future. The deductions have been accelerated and taken now. And I am not sure the extent to which that explains the phenomenon of the lower corporate tax share, but I would be happy to take a look at it.

Senator SANDERS. Thank you.

Chairman MURRAY. Senator Kaine, my understanding is you had no additional questions.

Senator Whitehouse, the last 5 minutes is yours.

Senator WHITEHOUSE. Thank you very much. Two things.

As you are considering lowering the corporate tax rate for the folks at the top, we might want to consider figuring out ways to raise the corporate tax rate for the folks at the bottom. Rhode Island has CVS located in it, which is a great chain of drug stores pretty much all across the country now, and being a retail store, they pay pretty much a 35-percent rate. And to see their rate go down I think would be very good for them and probably good for Rhode Island.

At the same time, a lot of Rhode Islanders take cruises, and a lot of them take cruises on Carnival Cruise Lines. Carnival Cruise Lines pays a 0.8 percent corporate tax rate. And it is hard for me to understand why even if you have adjusted CVS' rate from 35 to 25—let us just pick that as a hypothetical number—you still have Carnival Cruise Lines out there at 0.8, and they are not unique. You can look at tech companies, you can look at electric manufacturing companies, you can look at oil companies, and over and over again what they are paying to the United States in taxes is zero.

So I hope we will consider ways to try to prevent that kind of tax evasion on the corporate side as well as just lowering the top. We should lower both bands if we are going to go that way, in my view.

Secretary Lew. Well, I think there are two things that are at issue. One is, in some of the cases you mentioned, it is because of deductions and credits that are available that in broadening the base would go away. And that is why tax reform will be very hard, because it will be a tax increase on companies that take advantage of special provisions. There are other—

Senator WHITEHOUSE. But it is also sheltering offshore—

Secretary Lew. That is my second—the other issue is overseas shelters, and that falls into two categories. There are legal and illegal overseas transactions. We have worked very hard to try and create an environment of much greater transparency so that we can see and other countries can see when companies are illegally hiding income. And we are very open to exploring ways to close down legal means of creating tax havens.

Senator WHITEHOUSE. One thing that I would like to mention on that subject is that I think, at least in Rhode Island, when I talk to people about this, folks understand about spending and they are concerned. They understand about borrowing and they are concerned. They understand about revenues, and they know that we are at a more or less all-time low, at least in modern history, for tax revenues. And then there is that fourth piece that rarely gets discussed, and that is all the tax spending, all the tax earmarks, what goes out the back door of the Tax Code.

And what many Rhode Islanders do not understand—and I will ask you to check my numbers. I think they are roughly right. If we allow for no growth, then in the 10-year budget period we are looking forward to more than $11 trillion goes out the back door of the Tax Code. If you allow for reasonable expectations about growth, more than $14 trillion goes out the back door of the Tax Code. And if you count the amount of revenue that is hidden offshore and never even gets calculated in the Tax Code, guesstimates range on that pretty widely, but it could be $17, $18 trillion, out of which, to Senator Kaine's point, what you are looking for is a pretty small percentage. But it is also astounding to most people that actually if you count it that way, more money goes out the back door of the Tax Code than actually gets collected by the United States Government in revenues. So why would we not want to look at that part of the Tax Code other than it tends to go to people who can get deals into the Tax Code and it is biased towards higher-income and politically connected institutions? Correct?

Secretary Lew. We very much want to go at that base of $1 trillion a year of tax expenditures. It may be that we can accomplish more than others have been able to accomplish in the past and we can do better. And we look forward to working with you on that.

Senator WHITEHOUSE. And the last point, and as Monty Python said, "Now for something completely different," as Secretary of the Treasury, you oversee the Commissioner of the Internal Revenue Service. The Internal Revenue Service oversees the tax-exempt organizations. The tax-exempt organizations include 501(c)(4)s. 501(c)(4)s, some of them, are groups that are engaged in very aggressive political activity. One study showed 32 different 501(c)(4)s actively engaged in political activity, in fact, even reporting it to the Federal Election Commission, but they signed a form at the IRS that said they would do no political activity at all. And in a hearing I held on the Judiciary Committee last week, it turned out that zero cases had been referred by the IRS to the Department of Justice, not over complicated tax matters, not over peculiar calculations of Tax Code liability, but over whether these statements were false or not, which, as the woman from the DOJ said, "That is a plain-vanilla criminal case." But they are getting exactly zero referrals, and every witness said that the IRS was the wrong place for these cases to be made. They were ill suited, un- or understaffed, and unwilling.

So I would ask you to consider having a conversation with the Attorney General about changing the paradigm between the IRS and the Department of Justice so that it can make these plain-vanilla cases without the IRS giving a referral where the IRS has apparently fallen down pretty heavily in making those referrals.

I think this study took 72 501(c)(4)s and looked at them, and of them, 32 had made the apparently totally false statement that they would not engage in political activity. And I think in a country of laws, failing to enforce the law is a mistake.

Secretary Lew. I am happy to take a look at it, Senator.

Senator WHITEHOUSE. I appreciate it. We will look forward to working with you on it. Thank you.

Thank you very much, Madam Chair.

Chairman MURRAY. Thank you very much.

Let me thank all of our Senators for participating in this hearing today. Secretary Lew, thank you very much for coming here to testify and your incredibly important work on all this.

As a reminder to all my colleagues, additional statements and/or questions for the record are due by 12:00 p.m. tomorrow. And we will meet again next Tuesday, April 23rd, to consider the President's fiscal year 2014 budget and veterans programs. Secretary Shinseki will be here. This is going to be an important hearing, and I encourage our members to attend.

Thank you very much. Thank you, Secretary Lew.

Secretary Lew. Thank you, Madam Chair.

[Whereupon, at 4:54 p.m., the Committee was adjourned.]

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Senator Kelly Ayotte (R-NH)

Question 1:

Secretary Lew, as you know, the United States and European Union (EU) sanctions have taken a severe toll on Iran's economy as inflation rates have skyrocketed amid the Rial's substantial depreciation.

Despite increasing economic pressure, Tehran continues to pursue a nuclear weapons capability. American and European officials must continue to work together to further increase economic pressure to convince the regime in Tehran to honor its international obligations and halt its pursuit of a nuclear weapons capability.

I believe Iran's passenger airlines offer such an opportunity. Iran Air, the country's flagship airline, and its largest private airline, Mahan Air, have facilitated the illicit activities of Iran's Islamic Revolutionary Guard Corps (IRGC), the Iranian Ministry of Defense and Armed Forces Logistics (MODAFL), which oversees Iran's ballistic missile program, and Hezbollah. Additionally, the IRGC has used Iran Air's passenger jets to transport rocket and missile components to Syria disguised as medicine and spare parts.

Since 1995, Iran Air has been subject to U.S. sanctions that prevent it from buying spare parts from Boeing and Airbus.

As you know, in June 2011, the Department of the Treasury froze the assets of Iran Air and its affiliates to cut off their access to the U.S. financial system. In September 2011, the Treasury Department took similar action against Mahan Air for its links to Iran's support for terrorism.

In September 2012, the Treasury Department implemented another round of sanctions against both airlines for transporting military and crowd control equipment to the Assad regime.

I believe it is critical that the EU join the United States in applying tough sanctions against Iran Air and Mahan Air to prohibit their purchase of spare parts from European aerospace companies.

Secretary Lew, in order to increase the economic pressure on the regime in Tehran, will you urge your EU counterparts to go a step further and join the United States in fully sanctioning Iran Air and Mahan Air?

Treasury is actively engaged in isolating Iran Air and Mahan Air from the international financial and commercial system. In addition to designating Iran Air and Mahan Air under our weapons of mass destruction proliferation and terrorism authorities, we have also targeted their procurement and support networks. Most recently, in May 2013 Treasury took action pursuant to these authorities against thirteen additional entities and individuals as a result of their connection with Iran Air or Mahan Air, including some with a presence in Europe. We have urged our European partners to take parallel action. Our engagement with our European counterparts has led to the EU imposing restrictions on all Iranian airlines, including Iran Air and

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Mahan Air. The EU prohibits cargo flights operated by Iranian carriers from accessing EU airports and maintains export bans on a wide variety of dual use goods, including dual use avionic equipment. For safety and related humanitarian reasons, U.S. policy does not seek to deny all spare parts for aircraft in Iran.

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Senator Michael Enzi (R-WY)

Question 1:

I was glad to see the Administration included in its budget a proposal to exempt foreign pension funds from the application of the Foreign Investment in Real Property Tax Act (FIRPTA). As we have discussed previously, Senator Menendez and I have been working on legislation that would reform the FIRPTA rules to encourage greater foreign investment in U.S. real property. One of our requests has been that Treasury would review a Notice it issued back in 2007 (Notice 2007-55) that deals with certain liquidating distributions from real estate investment trusts (REITs). During your confirmation hearing back in February, you stated that you had not yet had an opportunity to fully develop a position regarding the Notice. Given the Administration's proposal to alleviate the burden of the FIRPTA tax, when will you be taking Administrative action to further lessen the burden by reversing the liquidating distribution guidance issued in the 2007 Notice?

Notice 2007-55 was intended to enforce a statutory rule that imposes U.S. tax on distributions by a real estate investment trust (REIT) that are attributable to the REIT's gain from the sale of U.S. real property. That statutory rule is intended to prevent foreign investors from taking advantage of the REIT provisions to achieve a more tax-advantaged position than those investors could achieve by investing in U.S. real property directly.

I have not yet had an opportunity to fully develop a position on Notice 2007-55, but I understand that it was intended to clarify that foreign investors in U.S. real property who would otherwise be subject to U.S. tax under FIRPTA cannot avoid that tax by holding the U.S. real property in a REIT and to support the basic notion underlying FIRPTA – to treat foreign investors in real estate in a similar fashion to domestic investors. In contrast, the budget proposal to exempt foreign pension funds from the application of FIRPTA promotes parity for foreign and domestic pension funds with respect to investments in U.S. real property.

Question 2:

The Administration's budget includes a number of proposals intended to be part of a "revenue-neutral business tax reform that would also cut the corporate rate and comprehensively reform tax subsidies," but does not identify a target statutory corporate tax rate. The revenue-neutral business tax reform reserve fund raises a net $95 billion over 10 years, which is only a fraction of the roughly $700 to $800 billion estimated cost of reducing the 35 percent statutory corporate tax rate to 28 percent, as the Administration targeted in its Framework for Business Tax Reform released in February 2012. Does the Administration really believe the corporate tax rate should be reduced only by 1 percent, from 35 percent to 34 percent? If not, why did the budget proposal not fully identify how to achieve a 28 percent tax rate? What other provisions do you recommend that Congress consider removing from the tax code in order to reduce the corporate tax rate to 28 percent?

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The *President's Framework for Business Tax Reform* provided a framework that would reduce the top corporate tax rate to 28 percent, broaden the business tax base, preserve key tax incentives, strengthen international taxation, and simplify and cut small business taxes, all without increasing the deficit. As a start on the process, the Administration's Fiscal Year 2014 Budget lists several specific business tax reform measures that would be consistent with that framework. As we discussed in the *President's Framework*, additional policy changes would be needed to lower the corporate rate to 28 percent, so this list is not exhaustive. The Administration looks forward to working with Members of Congress on tax reform.

Question 3:

In addition to lowering the corporate tax rate, we've got to reform the tax code to ensure we address the taxes paid by so-called "flow-through" businesses – these are the partnerships, S-corporations, and limited liability companies. Just fixing the corporate side doesn't help the millions of businesses that are structured as flow-through entities. I appreciate the President wanting to do revenue-neutral corporate tax reform. But that only addresses part of the problem.

I generally don't like to do things "comprehensively." We should do legislation in smaller parts so people can understand what's in them and can vote for and against the things they support and don't support. But given the interaction between the individual and corporate side of the tax code, we really need to look at them together and make sure changes we make in one area don't make things worse in another area.

Do you and the President agree that we need to reform both the corporate and the individual tax code at the same time?

The *President's Framework for Business Tax Reform* includes provisions affecting both traditional corporations taxed at the entity level and pass-through businesses taxed at the individual level. Many of the base-broadening provisions in the *Framework* would affect both corporations and pass-through entities. To prevent this base-broadening from leading to a tax increase for small businesses (and also to reduce complexity), the *Framework* would enhance the annual expensing of investments for small businesses and increase the threshold for which cash accounting is allowed.

The largest gains from tax reform could be achieved under a comprehensive reform of both the corporate and individual tax systems. Our view is that there is already a general consensus about the need to reform the business tax system, toward which our detailed proposals have been addressed. The Administration looks forward to working with Members of Congress on both business and individual tax reform.

Question 4:

The President's budget proposal would increase taxes as a percent of the nation's total output, or GDP, each year over the next 10 years, resulting in revenues as a percent of GDP

at 20 percent in fiscal year 2023. The average rate over the past 40 years has been approximately 18 percent of GDP. The U.S. has balanced the budget 12 times since World War II. The average revenue for those 12 years was 18 percent of GDP. These numbers tell the story - our problem is not that we tax too little but that we spend too much. Our nation owes over $16 trillion and no one is talking about reducing it. We've got to get to balance – the sooner the better – and start paying down the debt. How do you defend raising taxes by nearly $1 trillion and still not getting to balance and still adding to the deficit and the debt?

The key fiscal test of any deficit-reduction proposal is whether it stabilizes and then starts to reduce publicly held federal debt as a percent of GDP – the preferred metric of debt used by most public finance economists as well as by the Congressional Budget Office. The President's FY2014 Budget – as scored by both OMB and CBO – passes this test, reducing debt from 78.2 percent of GDP in FY2015 to 73 percent in FY2023 thanks to a balanced proposal that both cuts spending and raises revenues.

A long-term average of historic revenues does not necessarily inform us about the appropriate level of revenues in the future. We also note that the last four times the budget was balanced – Fiscal Years 1998, 1999, 2000, and 2001 – revenues averaged 20 percent of GDP.

Finally, note that earlier this year, the American Taxpayer Relief Act locked in marginal individual income tax rates at 1990s levels for high-income households, and at or below 1990s levels for the rest of Americans. Going forward, the President in his Budget has called for comprehensive tax reform that closes loopholes, lowers rates, and reduces deficits by raising revenue, an approach shared by virtually all bipartisan deficit reduction commissions over the past three years.

__Question 5:__

The President's budget did not include an extension of all the so-called "tax extenders." The Acting OMB director, Mr. Zients, indicated that tax extenders would be covered under the revenue-neutral business tax reform policy, saying "those either have to be gotten rid of or paid for through revenue-neutral tax reform." In an apparent reference to the extenders, the budget said the President's proposal for revenue-neutral corporate tax reform would "prevent hundreds of billions of dollars from being added to the deficit if the Congress continues to extend temporary business tax incentives without paying for them." Because the budget was silent on how to pay for permanent extensions of these provisions, would you tell us which spending cuts or other revenue provisions you suggest Congress consider as it potentially extends some or all of these provisions?

The baseline used in the President's Budget assumes that most temporary tax provisions expire as scheduled under current law. By not proposing to extend them, these provisions generally are assumed to expire. In contrast to the general approach, the Budget proposes permanent extension of a few expiring provisions that have substantial social benefits, such as the R&E credit. In the context of developing a fiscally responsible comprehensive tax reform proposal, the Administration is willing to discuss the pros and cons of permanent extension of other expiring provisions. We look forward to working with Members of Congress on this important matter.

Question 6:

The President's budget did not include an extension of all the so-called "tax extenders." Comments from the White House seem to suggest that "business" tax extenders might be addressed as part of revenue-neutral corporate tax reform. But how does the Administration propose addressing the individual tax extenders, like the deduction for state and local sales taxes, which is important to my constituents back in Wyoming?

Temporary provisions create uncertainty for taxpayers and for the state and federal government. Routinely extending temporary provisions, particularly without paying for them, is fiscally irresponsible. Thus, Congress and the Administration should work together to create a Tax Code that is permanent and that raises the revenue needed to pay for important national priorities. The Budget proposes to make permanent several of the most critical tax incentives. The President is not necessarily opposed to continuation of other tax extenders but believes they should be not addressed as part of comprehensive tax reform. Moreover, the President has articulated a set of broad principles dealing with revenue, efficiency, and equity that fundamental tax reform should meet. Any of the expiring provisions that are retained should be made permanent and should provide substantial social benefits. I look forward to working with you to create an individual income tax code that is fiscally responsible, fair, and provides long-term certainty.

Question 7:

You have previously been asked about the potential movement of the U.S. international tax system to a "territorial" system, where the offshore earnings of U.S. companies are largely exempt from U.S. tax. You commented that the U.S. has a "hybrid" system, i.e., a worldwide system that provides deferral that potentially serves as a de-facto territorial system. You also indicated that the Administration's proposal to implement a worldwide minimum tax on offshore earnings would make the U.S. international tax system even more of a hybrid system. Wouldn't implementing a minimum tax simply erode deferral and push the U.S. from being a hybrid system to more of a worldwide system with even-more limited deferral? Have you taken a look at my international tax proposal (S. 2091, introduced in the 112th Congress) which we discussed during your confirmation hearing two months ago? Would you commit to providing me your thoughts on my territorial proposal because I think you might see some things that you could support and we should focus on those things?

Under the *President's Framework for Business Tax Reform*, foreign income deferred in a low-tax jurisdiction would be subject to immediate U.S. taxation at a minimum tax rate with a foreign tax credit allowed for income taxes on that income paid to the host country. This minimum tax would be designed to balance the need to prevent a race to the bottom in corporate tax rates with the goal of keeping U.S. companies on a level playing field with competitors when engaged in activities which, by necessity, must occur in a foreign country. There is considerable debate as to how to reform the international tax system, but I believe that there is common ground on this subject, including a shared concern about preserving the U.S. tax base by reducing incentives that encourage the shifting of investment and income overseas, and making the United States more competitive globally. I look forward to working with Congress on a bipartisan basis to develop approaches to international taxation that will ensure the United States will retain and attract high-quality jobs.

Question 8:

Similar to previous Administration budgets, the President's budget contains a proposal to limit the value of itemized deductions to 28 percent for higher-income individuals. The proposal in the last couple of years has been expanded to limit income exclusions related to tax-exempt state and local bond interest, employer-sponsored health insurance, employee deferrals to 401(k) plans, contributions to IRAs, and contributions to health savings accounts and Archer MSAs, among others. The limitation would reduce the value to 28 percent of the specified exclusions and deductions that would otherwise reduce taxable income in the 33-percent, 35-percent, or 39.6-percent tax brackets. The 33 percent tax bracket starts at $183,250 of taxable income for singles and $223,050 of taxable income for married couples filing jointly. Doesn't applying the 28 percent limitation to this tax bracket represent a break from the President's pledge that those making under $200,000 (single) or $250,000 (married) would not have a tax increase? Isn't this clearly a violation of the President's pledge not to raise taxes on the middle class?

In virtually all cases, taxpayers affected by this provision will have adjusted gross incomes (AGI) above $250,000 ($200,000 in the case of a single filer). While the 33-percent bracket for married couples begins at taxable income slightly below that in 2014, nearly everyone with taxable income at this level would have AGI in excess of $250,000. For example, a couple with taxable income of $227,650 (the beginning of the 33-percent bracket in 2014) claiming just two personal exemptions and the standard deduction would have AGI of $247,950. Since most high-income taxpayers will have incentives that are excluded from taxation or claim itemized deductions in excess of the standard deduction, these households would have income above $250,000.

Question 9:

As we consider tax reform, one of the most important things I think we need to consider is transition – how we move from the current system to the new system. That might include delayed effective dates and phase-in's and phase-out's of certain provisions. Are there particular provisions that you think we should be particularly mindful of as we consider transition to a new system?

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It is difficult to find basic principles that can help to separate instances in which transition relief is appropriate from those in which it is not appropriate. This is because many unanticipated tax changes can have effects that appear to be inequitable to some. Nonetheless, certain types of transition relief are frequently provided or suggested. These sometimes seek to apply the tax change only prospectively. Another approach is to phase in or out over time certain provisions, such as an increase in a tax rate. A third approach would be to permit taxpayers to elect the new or old tax treatment. We look forward to working with you on transition rules and other issues that arise in the important task of enacting a reformed tax system.

Question 10:

The President's budget calls for reinstating on a permanent basis the 2009 estate tax regime, with a top tax rate of 45 percent and a $3.5 million per-person exemption. The so-called fiscal cliff deal made permanent a top tax rate of 40 percent and a $5 million per-person exemption. The change is proposed to take effect in 2018. Why is the Administration re-litigating the estate tax issue? The President got what he wanted out of the fiscal cliff deal – more money from hardworking Americans. Now he wants even more money from people like the ranchers back in my state of Wyoming.

The Administration believes that the $5 million exemption and the 40 percent federal tax rate for both estate and gift taxes was too generous to the very wealthy, and that we cannot afford to preserve these levels indefinitely. The Administration has consistently proposed making permanent the exemption and tax levels that were in effect in 2009, and continues to believe that the 2009 parameters would affect a small number of estates and generate an appropriate level of revenue from the estate and gift taxes.

Question 11:

The retirement plan account savings cap in the President's budget proposal is not tied to a hard dollar limit, but to the amount that would finance, in 2013, an annuity of $205,000 per year in retirement. Converting a $205,000/year annuity amount into an estimated lump sum equivalent depends on factors such as interest rates and annuity pricing. Would the cap be pegged to inflation? Would a higher interest rate environment result in an even lower cap threshold?

The proposal to limit the total accrual of tax-favored retirement savings in the President's budget is based on the accumulation necessary to provide an annuity of $205,000 per year beginning at age 62 and extending for the lifetime of the taxpayer and the taxpayer's spouse. The $205,000 annuity amount is based on the maximum permitted annuity under a tax-qualified defined benefit plan and would be adjusted for future inflation. When interest rates are higher, smaller tax-advantaged accumulations can generate an annuity of this size. However, the basic point would remain unchanged, that the tax system should not provide subsidies for people who have already accumulated sufficient savings to finance very large annuities.

Senate Budget Committee
Hearing on the Administration's FY 14 Budget Proposal
Questions for the Record for Secretary of the Treasury Jacob J. Lew
April 16, 2013

Senator Ron Johnson (R-WI)

Question 1:

According to the Social Security trustees, the combined OASDI trust funds are now running cash deficits that will continue to increase. When you were told, "in terms of dedicated revenue coming in versus the benefits being paid out, it'll be $1.3 trillion" of deficit, you replied that "that's not the measure of whether Social Security is running a deficit." If benefit payments exceeding dedicated revenue is not the measure of whether Social Security is running a deficit, what is?

According to the latest Social Security Trustees report, OASDI trust fund income (payroll tax revenue, general fund reimbursements, and taxation of benefits, and interest) is projected to exceed costs (benefits, administrative costs, and railroad retirement interchange) by $133 billion between 2013 and 2022. Interest on trust fund assets is projected to total $1,087 billion over the time same time period. Meanwhile, costs are projected to exceed non-interest income by $953 billion. The Administration is committed to protecting Social Security for our nation's current and future elderly population.

Question 2:

When Social Security's trustees redeem Treasury securities in the OASI and DI trust funds, where does the Treasury get the money to pay? Does Treasury have a reserve of money or wealth set aside on which it can draw? How will Treasury raise the revenue to make payments on the redeemed bonds?

Transfers are made from the general fund to execute the redemption of trust fund assets.

Question 3:

You said, in explaining the Social Security trust funds' value, that "from 1983 until now, we've been building up surpluses in the social security trust fund. In years when there were balances that were positive, it went to the benefit of the unified budget. And it made it possible to do things." Did the federal government set aside any of those surpluses in any asset that is not offset by a corresponding liability of the Treasury? If so, in what form precisely? Specify the nature and quantity of that store of wealth.

By law, the Department of the Treasury must invest trust fund reserves in interest-bearing securities of the U.S. Government.

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Question 4:

You testified, in explaining the value of the Treasury securities in the Social Security trust funds, that they are "an asset that's backed by the full faith and credit of the United States, like every other bond." If they are backed in the same way as every other bond, why wouldn't they have the same effect on the economy as debt held by the public would? If the two forms of debt should be distinguished and debt held by the public should be preferred as a metric over gross federal debt, please explain why. Does one form of debt constitute a lesser obligation or an obligation less binding on the government?

Both gross debt and publicly held debt are measures of government finances. Accounting for assets held in the Social Security trust fund allows us to measure the promises we have made to current and future workers and their dependents and survivors. The combined Old Age, Survivors, and Disability Insurance Trust Fund has $2.7 trillion in assets and has sufficient funds to pay full benefits until 2033.

Question 5:

You said that the obligation to pay off the Treasury debt owed to the Social Security trust fund "does put a burden on the rest of us to have a balanced fiscal policy." In the President's proposed fy2014 budget, does revenue ever equal or exceed outlays in any year? Can you project, based on the changes in outlays and revenue called for in the President's budget, what year we will have a balanced budget?

Revenue does not equal or exceed outlays in any year. The Administration and the CBO project publicly held debt as a share of GDP to stabilize and then fall through the budget window under the Administration's budget, but neither projects the budget to be balanced in any year in the budget window.

Senate Budget Committee
Hearing on the Administration's FY 14 Budget Proposal
Questions for the Record for Secretary of the Treasury Jacob J. Lew
April 16, 2013

Senator Bernard Sanders (I-VT)

Question 1:

I am very disappointed by the Administration's budget proposal to repeal a tax incentive to pay employee owners dividends on stock in their ESOP accounts, or used to have employees own more stock -- (Section 404(k) Employee Stock Ownership Plan Dividend Deduction for "large corporations").

On pages 96 and 97 of the "Green Book," the Administration justifies eliminating this incentive for ESOP creation and operation because employee stock ownership is "risky," and employees do not understand how their labor can benefit their company, and their stock value if the company's revenue is over $5 million a year, which would be a company with approximately 10 to 20 employees.

On what data, research, or surveys does the Administration base its claim that employee stock ownership provides no boost in productivity, profits, or job sustainability in companies with more than $5 million in gross revenue?

The reason that I ask this question is because all of the studies that I have seen on this subject have shown that broad-based employee ownership has been proven to increase employment, increase productivity, increase sales, and increase wages in the United States. Unlike large corporations that have been shipping jobs overseas, employee owned businesses, by and large, are not shutting down and moving their businesses to China or other low-wage countries where workers are paid as little as 25 or 30 cents an hour. Further, employee owned businesses boost morale because workers share in future profits and have greater control over their work-life.

According to a 2010 survey conducted by researchers at the University of Chicago, during the Great Recession, ESOP companies laid off employees at a rate of less than 3%, while conventionally owned companies laid off employees at a rate of more than 12%.

According to the National Center for Employee Ownership, for every $1 in tax expenditures to promote employee stock ownership, the Federal government collected $13 in taxes.

In my opinion, we need more employee-owned companies in America, not less.

By expanding employee ownership and participation, we can create stronger companies in my state of Vermont and throughout this country, prevent job loss, and improve working conditions for struggling employees.

When employees own their own companies, when they work for themselves, when they are involved in the decision-making that impacts their jobs, workers become more motivated, absenteeism goes down, worker productivity goes up, and people stay on the job for a longer period of time.

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Simply put, when employees have an ownership stake in their company, they will not ship their own jobs to China to increase their profits. They will be more productive. And, they will earn a better living.

Unfortunately, I believe that the Administration's budget proposal on ESOPs is a step backwards that will lead to fewer employee owned businesses, lower wages, and higher unemployment.

Adding insult to injury, the $6 billion in estimated savings over 10 years by ending this tax incentive for employee ownership wouldn't go into deficit reduction, but would be used to lower the tax rates and provide even more tax breaks to some of the largest corporations in America.

I would respectfully ask you to reconsider this proposal and work with me to expand broad-based employee ownership in this country.

I look forward to your response.

The deduction for certain dividends paid on ESOP-held stock is one of several special tax benefits afforded ESOPs under current tax law. It is important to note that the remaining special tax benefits afforded ESOPs under current law would not be affected by the proposal and would continue to provide incentives to expand broad-based employee ownership. Moreover, the proposal would retain the deduction for certain dividends paid on ESOP-held stock for those companies (smaller C corporations and S corporations) that are more likely to provide broad-based employee ownership through an ESOP. Employees of companies for which the special tax benefit for dividends paid on ESOP-held stock is proposed to be repealed are more likely to own a smaller percentage of the company through the ESOP (such as through a 401(k) plan that includes an ESOP component that may own a relatively small percentage of the company) and therefore the performance effects of the ESOP are more likely diluted.

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Senator Sheldon Whitehouse (D-RI)

Question 1:

I recently had the opportunity to travel to Cuba and Haiti on a Congressional Delegation led by Senator Patrick Leahy. While there, we met with American and Cuban scientists. These scientists are conducting research in many areas, including the state of fisheries, weather, and offshore drilling safety—issues that affect both of our nations. They explained to me that professional staff of their organizations sometimes has difficulty travelling to Cuba for scientific exchanges due to U.S. Treasury regulations that do not allow general licenses for U.S. individuals attending professional organization meetings sponsored by a U.S. organization. They also explained that their support staff has difficulty obtaining permission to travel with them.

Can Treasury revise its regulations to eliminate the exclusion against general licenses for individuals attending professional organization meetings in Cuba organized by U.S. organizations? Can Treasury also revise regulations to eliminate restrictions against support staff travelling to Cuba with U.S. researchers and U.S. individuals attending professional meetings?

Treasury's Office of Foreign Assets Control (OFAC) implements the Cuba sanctions program – including regulatory changes – consistent with current U.S. foreign policy and with statutory requirements. OFAC has issued a general license authorizing travel transactions for purposes of professional research of a noncommercial, academic nature and attendance at professional meetings organized by international professional organizations. OFAC also authorizes, via specific license, travel by individuals to attend conferences or meetings sponsored by a U.S. organization that is itself licensed, should the individuals meet the criteria set forth in the application guidelines. However, OFAC receives very few such applications from U.S. organizations.

THE PRESIDENT'S FISCAL YEAR 2014 BUDGET PROPOSAL AND VETERANS' PROGRAM PROPOSALS

TUESDAY, APRIL 23, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 10:33 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Nelson, Whitehouse, Merkley, Baldwin, Kaine, King, Sessions, and Ayotte.

Staff Present: Evan T. Schatz, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning, and welcome to this morning's hearing on the fiscal year 2014 budget and the fiscal year 2015 advance appropriation request for the Department of Veterans Affairs. Thank you to Secretary Shinseki and your team for being here this morning. I know you have been very busy over the past couple weeks as you worked to get this budget request out.

One month ago, the Senate passed our budget resolution. There was plenty of debate and plenty of disagreement, a long markup in this Committee, and extensive consideration on the floor. But there was never any question about the importance of providing for our Nation's veterans.

The budget resolution protected funding for veterans benefits and services. It also included deficit-neutral reserve funds to assist in several important policy areas, including eligibility and delivery of benefits, rural health care, education and training, veterans' families, and homeless veterans.

The Department's budget submission will help inform us as we move forward in discussions with the House on a compromise budget resolution.

The President's request is $152.7 billion for VA in fiscal year 2014 and $55.6 billion in advance appropriations for medical care in fiscal year 2015. Overall, this is a strong request, and it represents an increase of more than 10 percent over last year. It also makes important investments in some high priority areas.

As we have discussed in the past, it is important that the Department follows good financial management principles. This means being straightforward with Congress about what the Department's real needs are.

It also means accurately projecting costs and savings. And it goes without saying that we expect the Department to be good stewards of taxpayer dollars, especially in this difficult budget environment. There is no place for wasteful spending or inefficiency.

One of the newest developments is VA's recent announcement that it will focus on expediting claims that have been pending for more than a year by granting provisional ratings. This will allow veterans to receive benefits while their claims are finalized. I am pleased the Department is taking action and trying a new initiative to make a difference for our veterans.

But I still have a number of questions about how this will be implemented. Certainly we cannot maintain the status quo, where almost 70 percent of our veterans are waiting 125 days or more for their claims.

Secretary Shinseki, considering the steps you have taken to address this problem so far, I think you share my concern and dedication to solving this. So I look forward to exploring this new initiative with you today.

I was pleased to see the Department requested almost $7 billion in funding for mental health care. This is an increase of more than 7 percent.

During the last Congress, we took a hard look at mental health in VA and found some serious problems. VA was generally providing good mental health care. But understaffing and long wait times were plaguing the VA and keeping veterans from the care they needed.

Importantly, we also found that the Department did not have an accurate, reliable way of measuring the need for mental health care and of distributing its staff effectively. We asked the Department to undertake a number of reforms to improve access to care and bring down unacceptably long wait times. This included key changes that were part of the Mental Health ACCESS Act.

Today, I hope we will hear more about what progress the Department is making in implementing those changes.

As I have said before, not every veteran will be affected by these invisible wounds. But when a veteran has the courage to stand up and ask for help, the VA must be there every single time. VA must be there with not only timely access to care, but also the right type of care.

This is especially important at a time when 22 veterans every day are taking their own lives. The VA has a number of good initiatives, such as the Veterans Crisis Line and the Suicide Prevention Coordinators, but we clearly need to do more.

As you know, women are the fastest growing part of the veteran population. The VA has needed to make major changes to ensure there is a full range of health services for female veterans, that facilities are safe and privacy is protected, and support services are available. The requested $422 million for gender-specific care for women is a 13.7-percent increase over last year.

I will also continue working to end the terrible epidemic of military sexual assault in the services. In the coming days, I will be introducing legislation to help prevent sexual assault and protect the victims. And at the same time, the VA must continue to provide for those suffering from MST. Only a small fraction of sexual assaults in the military are reported, so the VA has to provide both the highest quality treatments, but also outreach and screening to help the victims get into care.

Developing a seamless transition is another challenge the VA and DOD continue to face, though we have made important progress.

The requirement in the VOW to Hire Heroes Act making the Transition Assistance Program mandatory, along with a major overhaul of the curriculum, has created a much more useful tool to assist servicemembers who are leaving the military. And the feedback I have received is that even colonels and sergeants major found the training invaluable. If even those senior leaders are benefitting from the help on resume writing and VA resources, we are doing something right.

Other requirements, to expand job opportunities and eliminate barriers to getting civilian licenses and credentials, are key to combating the unemployment rate for veterans which is still far too high. We have made a great deal of progress working with employers to encourage them to hire veterans. And I will continue to engage our private sector partners to help them understand the skills veterans bring to the table and why they make the best of employees.

Getting our veterans into education programs, good jobs, or starting small businesses does not just benefit the veteran; it helps us grow our economy and the middle class. It builds on the investments we have made in our veterans as they continue to help our communities, our businesses, and their fellow veterans.

While we are making these investments in our veterans, we must also continue to invest in VA infrastructure. I have concerns about the proposed cuts to major construction and non-recurring maintenance. The Department is proposing a 47-percent cut in non-recurring maintenance and only $342 million in major construction funding. This comes while the Department still estimates it has between $54 and $66 billion in infrastructure needs. I was pleased to see the request includes funds to complete work on the mental health building in my home State of Washington at the VA hospital in Seattle.

Information technology also provides a critical role in many of the Department's major initiatives, and it is a key part in giving our servicemembers a truly seamless transition from active duty to civilian life.

The President's budget request includes an overall 18-percent increase in IT funding for the VA. This request includes a number of important priorities, such as the continued development and implementation of the Veterans Benefits Management System.

The request would also fund further development of the Virtual Lifetime Electronic Record, which, while implemented regionally, has not been rolled out nationwide. However, the recent announcement by VA and DOD that the Departments will no longer pursue development of a single electronic health record has raised important questions about the future of the iEHR program.

The Departments must clearly define the path forward for this important project and address the underlying reasons for the program's abrupt change of course. VA and DOD have to make sure there is clear, strategic leadership to guide further development of the iEHR program.

So, Secretary Shinseki, I want to thank you for your dedication and leadership over the past several years. It is not easy to steer the Federal Government's second largest Department. And it is not easy to make the changes that are needed.

You have set some very ambitious goals, including ending veteran homelessness, breaking the claims backlog, and transforming the way the VA delivers health care.

Setting these high goals is a good thing. And I am confident you have set these goals because of your continuing demand for excellence on behalf of our Nation's veterans.

We recognize the good progress that has been made, but we will continue to push you to meet those goals. So I am looking forward today to a constructive discussion about the challenges ahead, the concerns that we have, and what we can do to provide the resources and authorities that you need.

I will now call on Senator Sessions, our Ranking Member, for his opening statement.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you very much, Chairman Murray, and thank you, Mr. Secretary, for being here today. I recall well our working together when you were Chairman, and you produced the Stryker vehicle that is so much a part of the military army today. I am real impressed with your performance and leadership on that, and you serve your country so well with integrity and courage.

Let me begin by saying that much of America's greatness comes from our veterans. I believe that supporting them, as we have committed to do, is one of the main priorities of the United States Government. This is a belief that goes well beyond party lines. It goes beyond State lines.

This budget request is one that, in a time where sequestration is affecting many programs, including our defense budget, the defense budget is getting cut significantly. It looks like another $480 billion or so, $490 billion, in cuts in addition to an almost equal number previously. But we do see a $2.5 billion increase from last year's levels in support of the commitment of the Nation to those who have served and sacrificed for our country. They served not because they had to but because they were willing and able to serve. It is undeniable we owe much to the courageous men and women who put their lives on the line for their country and their countrymen repeatedly.

So my concern today with the budget that is before us is whether or not we are truly serving our veterans effectively in the best way we can. Can we do it better? As we examine the VA budget more closely today and hear from Secretary Shinseki, it is my hope that the questions that I have and others have will be answered.

I hear from veterans in Alabama about the major concerns facing the veteran population, and the top-most concern I am hearing right now is about the very serious backlog of disability compensation claims. That is just a top concern for our veteran community.

Another thing I heard recently was a passionate call by former servicemember I believe in Vietnam who expressed concerns about the suicide situation in the military and among veterans. The Chair has raised that. I do think we need to focus on that and ask if there are other things that we can do to confront that problem.

Mr. Secretary, in last year's fiscal year 2013 budget, you requested an increase of $9.2 billion to decrease the backlog of disability claims. I have a press release that your Department issued in February of 2012 discussing the fiscal year 2013 VA budget. It states, and I quote: "By 2013, the budget projects no more than 40 percent of compensation and pension claims will be more than 125 days old."

It goes on to say that claims were at 60 percent in 2012. But as of last Monday, April 15th, disability compensation claims were at 70 percent, with nearly 900,000 claims pending for more than 125 days. So this is a problem that is not getting better, it would appear, but it hasten worse.

This budget for fiscal year 2014 includes an increase of $10 billion over the fiscal year 2013 levels for the Veterans Benefit Administration, which administers those disability claims. How do we know this money is being used to fix the backlog when the performance levels on the issue are worse than previously? So we will have to look at that.

Another issue that the Chair mentioned was the electronic records. We have a national discussion of those issues at the time of the concern at Walter Reed, and that was perceived to be a way to improve dramatically the seamlessness of our health care system. That it is not there may be justifiable, but it is a concern. We would like to see it get there so it is fully operational in serving like we think it can serve to benefit health care and avoid delays and paperwork problems.

The budget before us now states that the backlog problem will be under control by 2015. I look forward to greater detail on your plan to do this, and I am sure my colleagues do as well.

Mr. Secretary, thank you and your team for being with us today. I know you care about these issues, and we look forward to cooperating with you in a common concern.

Chairman MURRAY. Thank you very much, Senator Sessions.

Now let me introduce our witness today. Our panel consists of Veterans Affairs Secretary Shinseki. He is accompanied by Under Secretary for Health Robert Petzel and Under Secretary for Benefits Allison A. Hickey. Also accompanying the Secretary are Under Secretary for Memorial Affairs Steve L. Muro; Acting Assistant Secretary for the Office of Information and Technology Stephen W. Warren; and Executive Director for the Office of Management and Chief Financial Officer Todd Grams.

We look forward to hearing from you. All of the witnesses' statements will be in the record. Secretary Shinseki, we will hear from you verbally, and then we will go to questions and answers from all of us. So thank you very much for being here, Secretary Shinseki.

STATEMENT OF THE HONORABLE ERIC K. SHINSEKI, SECRETARY, U.S. DEPARTMENT OF VETERANS AFFAIRS;

ACCOMPANIED BY THE HONORABLE ROBERT A. PETZEL, MD, UNDER SECRETARY FOR HEALTH; THE HONORABLE ALLISON A. HICKEY, UNDER SECRETARY FOR BENEFITS; THE HONORABLE STEVE L. MURO, UNDER SECRETARY FOR MEMORIAL AFFAIRS; STEPHEN W. WARREN, ACTING ASSISTANT SECRETARY FOR THE OFFICE OF INFORMATION AND TECHNOLOGY; AND W. TODD GRAMS, EXECUTIVE DIRECTOR FOR THE OFFICE OF MANAGEMENT AND CHIEF FINANCIAL OFFICER

Secretary Shinseki. Well, thank you, Madam Chairman, Ranking Member Sessions, distinguished members of the Committee. Thank you for this opportunity to present the President's 2014 budget and 2015 advance appropriations requests for the VA. We deeply value your partnership and support in providing the resources needed to assure quality care and services for veterans.

Let me also acknowledge other partners who may be here today, our veteran service organizations with whom we work fairly closely and whose insights and support make us much better at our mission of caring for veterans, their families, and survivors.

Madam Chairman, thank you for introducing the members of the panel and also for accepting my written statement.

The 2014 budget and 2015 advance appropriations requests demonstrate the President's steadfast commitment to our Nation's veterans. I thank the members for your resolute commitment to veterans as well and seek your support on these requests.

The latest generation of veterans is enrolling in VA at a higher rate than previous generations. Sixty-two percent of those who deployed in support of operations in Afghanistan and Iraq have used at least one VA benefit or service.

VA's requirements are expected to continue growing for years to come, and our plans and resources must be robust enough to care for them all.

The President's 2014 budget for VA requests, as the Chairman outlined $152.7 billion—$66.5 billion in discretionary funds and $86.1 billion in mandatory funding— an increase of $2.7 billion in discretionary funds, 4.3 percent above the 2013 level.

This is a strong budget which enables us to continue building momentum for delivering three long-term goals we set for ourselves roughly 4 years ago, and the first is to increase veterans' access to VA benefits and services.

The second is to eliminate the disability claims backlog in 2015, understanding when we open access, we are adding to workload.

And then, finally, and thirdly, key for us is ending veteran homelessness in 2015.

These were bold and ambitious goals 4 years ago. They remain bold and ambitious today because veterans deserve a VA that is an advocate for them and one that puts resources behind its words.

Access. Of the roughly 22 million living veterans in this country today, more than 11 million now receive at least one benefit or service from VA, an increase of over 1 million veterans in the past 4 years. We have achieved this by opening new facilities, renovating others, increasing investments in telehealth and telemedicine, sending mobile clinics and vet centers to remote areas where veterans live, and then using every means available, including social media, to connect more veterans to VA. Increasing access has been a success story at VA.

Regarding the backlog, too many veterans wait too long to receive benefits they deserve. We know this, and it is unacceptable. And no one wants to turn this situation around more than this Secretary or Secretary Hickey or the workers at VBA, 52 percent of whom are veterans themselves.

We are resolved to eliminate the claims backlog in 2015, a goal we set a few years ago. And in 2015, the intent is that claims will be processed in 125 days or less at a 98-percent accuracy level.

Our efforts mandate investments in VBA's people, processes, and technology. In terms of our investments in people, more than 2,300 claims processors have completed training to improve the quality and productivity of their claims decisions. More are being trained each day, and this will be an ongoing effort. VBA's new employees now complete more claims per day than their predecessors.

Processes. Use of a disability benefits questionnaire, DBQ, an online form for submitting medical evidence, has dropped average processing times of medical exams and improved accuracy. We are now organized into three lanes for processing claims: an express lane for those that will predictably take less time; a special operations lane for unusual cases or those requiring special handling; and the core lane for the remainder, which will be the majority of claims.

Technology is critical to ending the backlog. Our paperless processing system, which we call VBMS, Veterans Benefits Management System, will be faster, improve access, drive automation, and reduce variance. Thirty-six regional offices now VBMS. All 56 will have it by the end of this year.

Finally, homelessness. The last of our three priority goals is to end veterans' homelessness, again, in 2015. Since 2009, we have reduce the estimated number of homeless veterans by more than 17 percent. The latest available estimate from January 2012 is 62,600. There is more work to be done here, but we have mobilized a national program that reaches into communities all across this country. Prevention of veterans' homelessness will be our follow-on main effort for the long term.

So, Madam Chairman, we are committed to the responsible use of the resources you and this Congress provide. Again, thank you for the opportunity to appear here today and for your support of veterans, and we look forward to questions.

[The prepared statement of Secretary Shinseki follows:]

STATEMENT OF THE HONORABLE ERIC K. SHINSEKI
SECRETARY OF VETERANS AFFAIRS

FOR PRESENTATION BEFORE THE
SENATE BUDGET COMMITTEE

BUDGET REQUEST FOR FISCAL YEAR 2014

APRIL 23, 2013

Chairman Murray, Ranking Member Sessions, Distinguished Members of the Senate Budget Committee:

Thank you for the opportunity to present the President's 2014 Budget and 2015 advance appropriations requests for the Department of Veterans Affairs (VA). This budget continues the President's historic initiatives and strong budgetary support and will have a positive impact on the lives of Veterans, their families, and survivors. We value the unwavering support of the Congress in providing the resources and legislative authorities needed to care for our Veterans and recognize the sacrifices they have made for our Nation.

The current generation of Veterans will help to grow our middle class and provide a return on the country's investments in them. The President believes in Veterans and their families, believes in providing them the care and benefits they've earned, and knows that by their service, they and their families add strength to our Nation.

Twenty-two million living Americans today have distinguished themselves by their service in uniform. After a decade of war, many Servicemembers are returning and making the transition to Veterans status. The President's 2014 Budget for VA requests \$152.7 billion – comprised of \$66.5 billion in discretionary funds, including medical care collections, and \$86.1 billion in mandatory funds. The discretionary request reflects an increase of \$2.7 billion, 4.3 percent above the 2013 level. Our 2014 budget will allow VA to operate the largest integrated healthcare system in the country, with more than 9.0 million Veterans enrolled to receive healthcare; the ninth largest life insurance provider, covering both active duty members as well as enrolled Veterans; an education assistance program serving over 1 million students; a home mortgage service that guarantees over 1.5 million Veterans' home loans with the lowest foreclosure rate in the Nation; and the largest national cemetery system that leads the Nation as a high-performing organization, with projections to inter about 121,000 Veterans and family members in 2014.

Priority Goals

Over the next few years, more than one million Veterans will leave military service and transition to civilian life. VA must be ready to care for them and their families. Our data shows that the newest of our country's Veterans are relying on VA at unprecedented levels. Through January 31, 2012, of the approximately 1.58 million Veterans who returned from Operations Enduring Freedom, Iraqi Freedom, and New Dawn, at least 62 percent have used some VA benefit or service.

VA's top three priorities – increase access to VA benefits and services; eliminate the disability compensation claims backlog in in 2015; and end Veterans homelessness, also in 2015 – anticipate these changes and identify the performance levels required to meet emerging needs. These ambitious goals will take steady focus and determination to see them through. As we enter the critical funding year for VA's priority goals, this 2014 budget builds upon our multi-year effort to position the Department through effective, efficient, and accountable programming and budget execution for delivering claims and homeless priority goals.

Stewardship of Resources

Safeguarding the resources – people, money, time – entrusted to us by the Congress, managing them effectively, and deploying them judiciously, is a fundamental duty. Effective stewardship requires an unflagging commitment to use resources efficiently with clear accounting rules and procedures, to safeguard, train, motivate, and hold our workforce accountable, and to assure the effective use of time in serving Veterans on behalf of the American people. Striving for excellence in stewardship of resources is a daily priority. At VA, we are ever attentive to areas in which we need to improve our operations, and are committed to taking swift corrective action to eliminate any financial management practice that does not deliver value for Veterans.

VA's stewardship of resources begins at headquarters. Recognizing the very difficult fiscal constraints facing our country, the 2014 request includes a 5.0 percent reduction in the Departmental Administration budget from the 2013 enacted level. This reduction follows a headquarters freeze in the 2013 President's Budget — a two-year commitment.

Recent audits of the Department's financial statements have certified VA's success in remediating all three of our remaining material weaknesses in financial management, which had been carried forward for over a decade. In terms of internal controls and fiscal integrity, this was a major accomplishment. In the past four years, we have also dramatically reduced the number of significant financial deficiencies from 16 to 1.

At VA, we believe that part of being responsible stewards is shutting down information technology (IT) projects that are no longer performing. Developed by our

Office of Information and Technology, the Project Management Accountability System (PMAS) requires IT projects to establish milestones to deliver new functionality to its customers every 6 months. Now entering its third year, PMAS continues to instill accountability and discipline in our IT organization. Through PMAS, the cumulative, on-time delivery of IT functionality since its inception is 82 percent, a rate unheard of in the industry where, by contrast, the average is 42 percent. By implementing PMAS, we have achieved at least $200 million in cost avoidance by shutting down or improving the management of 15 projects.

Through the effective management of our acquisition resources, VA has achieved savings of over $200 million by participating in Federal strategic sourcing programs and establishing innovative IT acquisition contracts. In 2012, VA led the civilian agencies in contracting with Service-Disabled Veteran-Owned Small Businesses, which, at $3.4 billion, accounted for 19.3 percent of all VA procurement awards. In addition, we have reduced interest penalties for late payments by 19 percent (from $47 to $38 per million) over the past four years.

Finally, VA's stewardship achieved savings in several other areas across the Department. The National Cemetery Administration (NCA) assumed responsibility in 2009 for processing First Notices of Death to terminate compensation benefits to deceased Veterans. Since taking on this responsibility, NCA has advised families of the burial benefits available to them, assisted in averting overpayments of some $142 million in benefit payments and, thereby, helped survivors avoid possible collections. In addition, we implemented the use of Medicare pricing methodologies at the Veterans Health Administration (VHA) to pay for fee-basis services, resulting in savings of over $528 million since 2012 without negatively impacting Veteran care and with improved consistency in billing and payment.

Technology

To serve Veterans as well as they have served us, we are working on delivering a 21st century VA that provides medical care, benefits, and services through a digital infrastructure. Technology is integrated with everything we do for Veterans. Our hospitals use information technology to properly and accurately distribute and deliver prescriptions/medications to patients, track lab tests, process MRI and X-ray imaging, coordinate consults, and store medical records. VA IT systems supported over 1,300 VA points of healthcare in 2012: 152 medical centers, 107 domiciliary rehabilitation treatment programs, 821 community-based outpatient clinics, 300 Vet Centers, 6 independent outpatient clinics, 11 mobile outpatient clinics, and 70 mobile Vet Centers. Technology supports Veterans' education and disability claims processing, claims payments, home loans, insurance, and memorial services. Our IT infrastructure consists of telephone lines, data networks, servers, workstations, printers, cell phones, and mobile applications.

No Veteran should have to wait months or years for the benefits that they have earned. We will eliminate the disability claims backlog in 2015; technology is the critical component for achieving our goal. VA is deploying technology solutions to improve access, drive automation, reduce variance, and enable faster and more efficient operations. Building on the resources Congress has provided in recent years to expand our claims processing capacity, the 2014 budget requests $291 million for technology to eliminate the claims backlog— $155 million in Veterans Benefits management System (VBMS) for our new paperless processing system, and $136 million in the Veterans Benefits Administration (VBA) to support a Veterans Claims Intake Program, our new online application system that will allow for the conversion of paper to digital images for our new paperless processing system, the Veterans Benefits Management System (VBMS). Without these resources, VA will be unable to meet its goal to eliminate the disability claims backlog in 2015.

Information Technology

At VA, advances in technology -- and the adoption of and reliance on IT in our daily commercial life -- have been dramatic. Technology is integral to providing high quality healthcare and benefits. The 2014 budget requests $3.683 billion for IT, an increase of $359 million from the President's 2013 Budget, reflecting the critical role technology plays in VA's daily work in serving and caring for Veterans and their families. Of the total request, $2.2 billion will support the operation and maintenance of our digital infrastructure and $495 million is for IT development modernization and enhancement projects.

The 2014 budget includes $32.8 million for development of VBMS, our new paperless processing system that enables VA to move from its current paper-based process to a digital operating environment that improves access, drives automation, reduces variance, and enables faster, more efficient operations. As we increase claims examiners' use of VBMS version 4.2 to process rating disability claims, our major focus is on system performance, as we tune the system to be responsive and effective. VA will complete the rollout of VBMS in June 2013.

In addition, the 2014 budget includes $120 million for development of the Veterans Relationship Management (VRM) initiative, which enhances Veterans' access to comprehensive VA services and benefits, especially in the delivery of compensation and pension claims processing. The program gives Veterans secure, personalized access to benefits and information and allows a timely response to their inquiries. Recently, VRM released Veterans Online Application Direct Connect (VDC), which enables Veterans to apply for VBA benefits by answering guided interview questions through the security of the eBenefits portal. Claims filed through eBenefits use VDC to load information and data directly into VBMS.

The Virtual Lifetime Electronic Record (VLER) is an overarching program which aims to share health, benefits, and administrative information, including personnel records and military history records, among DoD, VA, SSA, private healthcare providers, and other

Federal, State and local government partners. eBenefits is already reaching 2 million Veterans and Servicemembers and 1 million active users with BlueButton. The 2014 budget requests $15.4 million for VLER to develop and support these functions as well as the Warrior Support Veterans Tracking Application; the Disability Benefits Questionnaires; a VA/DoD joint health information sharing project known as Bidirectional Health Information Exchange; and a storage interface known as Clinical Data Repository/Health Data Repository. All of these efforts are designed to enable the sharing of health, military personnel and personal information among VA, other Federal agencies, Veteran Service Organizations and private health care providers to expedite the award and processing of disability claims and other services such as education, training and job placement.

Eliminating the Claims Backlog

Too many Veterans wait too long to receive benefits they have earned. This is unacceptable. Today's claims backlog is the result of several factors, including: increased demand; over a decade of war with many Veterans returning with more severe, complex injuries; decisions on Agent Orange, Gulf War, and combat PTSD presumptions; and, successful outreach to Veterans informing them of their benefits. These facts, in no way, diminish the urgency that we all feel at VA to fix this problem which has been decades in the making. VA remains focused on eliminating the disability claims backlog in 2015 and processing all claims within 125 days at a 98-percent accuracy level.

To deliver this goal, the Veterans Benefits Administration (VBA) is implementing a comprehensive transformation plan based on more than 40 targeted initiatives to boost productivity by over the next several years However, as VBA transforms its people, processes, and technologies, its claims demand is expected to exceed on million annually. From 2010 through 2012, for the first time in its history, VBA processed more than one million claims in three consecutive years. In 2013, VBA expects to receive another million claims and similar levels of demand are anticipated in 2014. This is driven by successful outreach, claims growth not previously captured in VBA's baseline, and new requirements. Included are mandatory Servicemember participation in VOW/VEI benefits briefings and an expected increase upon successful completion of a transition assistance program, revamped by the President as Transition: Goals, Plan, Success (GPS). As more than one million troops leave service over the next 5 years, we expect our claims workload to continue to rise. In addition, VBA is experiencing an unprecedented workload growth arising from the number and complexity of medical conditions in Veterans' compensation claims. The average number of claimed conditions for our recently separated Servicemembers is now in the 12 to 16 range – roughly 5 times the number of disabilities claimed by Veterans of earlier eras. While the increase in compensation applications presents challenges, it is also an indication that we are being successful in our efforts to expand access to VA benefits.

Investments in transformation of our people, processes, and technologies are already paying off in terms of improved performance. For example:

- ***People***: More than 2,100 claims processors have completed Challenge Training, which improves the quality and productivity of VBA compensation claims decision makers. As a result of Challenge Training, VBA's new employees complete more claims per day than their predecessors – with a 30 percent increase in accuracy.

  VBA's new standardized organizational model incorporates a case-management approach to claims processing that organizes its workforce into cross-functional teams that work together on one of three segmented lanes: express, special operations, or core. Claims that predictably can take less time will flow through an express lane (30 percent); those taking more time or requiring special handling will flow through a special operations lane (10 percent); and the rest of the claims flow through the core lane (60 percent). Initially planned for deployment throughout 2013, VBA accelerated the implementation of the new organizational model by nine months due to early indications of its positive impact on performance.

  VBA instituted Quality Review Teams (QRTs) in 2012 to improve employee training and accuracy while decreasing rework time. QRTs focus on improving performance on the most common sources of error in the claims processing cycle. Today, for example, QRTs are focused on the process by which proper physical examinations are ordered; incorrect or insufficient exams previously accounted for 30 percent of VBA's error rate. As a result of this focus, VBA has seen a 23 percent improvement in this area.

- ***Process***: Disability Benefits Questionnaires (DBQs) are online forms used by non-VA physicians to submit medical evidence. Use of DBQs has improved timeliness and accuracy of VHA-provided exams – average processing time improved by 6 days from June 2011 to October 2012 (from 32 to 26 days).

  Fully developed claims (FDCs) are critical to reducing "wait time" and "rework." FDCs include all DoD service medical and personnel records, including entrance and exit exams, applicable DBQs, any private medical records, and a fully completed claim form. Today, VBA receives 4.5 percent of claims in fully developed form and completes them in 117 days, while a regular claim takes 262 days to process. Fulfilling the Veterans Claims Assistance Act, to search for potential evidence, is the greatest portion of the current 262-day process. The Veterans Benefit Act of 2003 allows Veterans up to 365 days, from the date of VA notice for additional information or evidence, to provide documentation. Of the 262 days to complete a regular claim, approximately145 days are spent waiting for potential evidence to qualify the application as a fully developed claim.

  VBA built new decision-support tools to make our employees more efficient and their decisions more consistent and accurate. Rules-based calculators provide suggested evaluations for certain conditions using objective data and rules-based functionality. The Evaluation Builder uses a series of check boxes that are associated with the Veteran's symptoms to help determine the proper diagnostic code of over 800 codes, as well as the appropriate level of compensation based on the Veteran's symptoms.

- ***Technology***: The centerpiece of VBA's transformation plan is VBMS – a new paperless electronic claims processing system that employs rules-based technology to improve decision speed and accuracy. For our Veterans, VBMS will mean faster, higher-quality, and more consistent decisions on claims. Our strategy includes active stakeholder participation (Veterans Service Officers, State Departments of Veterans Affairs, County Veterans Service Officers, and Department of Defense) to provide digital electronic files and claims pre-scanned through online claims submission via the eBenefits Web portal.

- VBA recently established the Veterans Claims Intake Program (VCIP). This program will streamline processes for receiving records and data into VBMS and other VBA systems. Scanning operations and the transfer of Veteran data into VBMS are primary intake capabilities that are managed by VCIP. As VBMS is deployed to additional regional offices, document scanning becomes increasingly important as the main mechanism for transitioning from paper-based claim folders to the new electronic environment.

There are other ways that VA is working to eliminate the claims backlog. VHA has implemented multiple initiatives to expedite timely and efficient delivery of medical evidence needed to process a disability claim by VBA. As a result, timeliness improved by nearly one-third, from an average of 38 days in January 2011 to 26 days in October 2012. Recently, VA launched Acceptable Clinical Evidence (ACE), an initiative that allows clinicians to review existing medical evidence and determine whether they can use that evidence to complete a DBQ without requiring the Veteran to report for an in-person examination. This initiative was developed by both VHA and VBA in a joint effort to provide a Veteran-centric approach for disability examinations. Use of the ACE process opens the possibility of doing assessments without an in-person examination when there is sufficient information in the record.

Another way to eliminate the claims backlog is by working closely with the DoD. The Integrated Disability Evaluation System (IDES) is a collaborative system to make disability evaluations seamless, simple, fast and fair. If the Service member is found medically unfit for duty, the IDES gives them a proposed VA disability rating before they leave the service. These ratings are normally based on VA examinations that are conducted using required IDES examination templates. In FY 2012, IDES participants were notified of VA benefit entitlement in an average of 54 days after discharge. This reflects an improvement from 67 days in May 2012 to 49 days in September 2012.

The Benefits Delivery at Discharge (BDD) and Quick Start programs are two other collaborations for Servicemembers to file claims for service-connected disabilities.

This can be done from 180 to 60 days prior to separation or retirement. BDD claims are accepted at every VA Regional Office and at intake sites on military installations in the U.S., and at two intake site locations overseas. In 2012, BDD received more than 30,300 claims and completed 24,944 -- a 14% increase over 2011's productivity (21,657). During this same period of time Quick Start decreased their rating inventory by over 44 percent.

Expanding Access to Benefits and Services

VA remains committed to ensuring that Veterans are not only aware of the benefits and services that they are entitled to, but that they are able to access them. We are improving access to VA services by opening new or improved facilities closer to where Veterans live. Since 2009, we have added 57 community-based outpatient clinics (CBOCs), for a total of 840 CBOCs through 2013, and increased the number of mobile outpatient clinics and mobile Vet Centers, serving rural Veterans, to 81. Last August, we opened a state-of-the-art medical center in Las Vegas, the first new VAMC in 17 years. The 2014 medical care budget request includes $799 million to open new and renovated healthcare facilities and includes the authorization request for 28 new and replacement medical leases to increase Veteran access to services.

Today, access is much more than the ability to walk into a VA medical facility; it also includes technology, and programs, as well as, facilities. Expanding access includes taking the facility to the Veteran -- be it virtually through telehealth, by sending Mobile Vet Centers to rural areas where services are scarce, or by using social media sites like Facebook, Twitter, and YouTube to connect Veterans to VA benefits and facilities. Telehealth is a major breakthrough in healthcare delivery in 21st century medicine, and is particularly important for Veterans who live in rural and remote areas. The 2014 budget requests $460 million for telehealth, an increase of $388 million, or 542 percent, since 2009.

As more Veterans access our healthcare services, we recognize their unique needs and the needs of their families—many have been affected by multiple, lengthy deployments. VA provides a comprehensive system of high-quality mental health treatment and services to Veterans. We are using many tools to recruit and retain our large mental healthcare workforce to better serve Veterans by providing enhanced services, expanded access, longer clinic hours, and increased telemental health capabilities. In response to increased demand over the last four years, VA has enhanced its capacity to deliver needed mental health services and to improve the system of care so that Veterans can more readily access them. Since 2006, the number of Veterans receiving specialized mental health treatment has risen each year, from over 927,000 to more than 1.3 million in 2012, partly due to proactive screening. Outpatient visits have increased from 14 million in 2009 to over 17 million in 2012. VA believes that mental healthcare must constantly evolve and improve as new knowledge becomes available through research.

The 2014 budget includes $168.5 million for the Veterans Relationship Management (VRM) initiative, which is fundamentally transforming Veterans' access to VA benefits and services by empowering VA clients with new self-service tools. VA has already made major strides under this initiative. Most recently, in November 2012, VRM added new features to eBenefits, a Web application that allows Veterans to access their VA benefits and submit some claims online. Veterans can now enroll in and manage their insurance policies, select reserve retirement benefits, and browse the Veterans Benefits Handbook from the eBenefits Website. With the help of Google mapping services, the update also enables Veterans to find VA representatives in their area and where they are located. Since its inception in 2009, eBenefits has added more than 45 features allowing Veterans easier, quicker, and more convenient access to their VA benefits and personal information.

VBA has aggressively promoted eBenefits and the ease of enrolling into the system. We currently have over 2.5 million registered eBenefits users. Users can check the status of claims or appeals, review VA payment history, obtain military documents, and perform numerous other benefit actions through eBenefits. The Stakeholder Enterprise Portal (SEP) is a secure Web-based access point for VA's business partners. This electronic portal provides the ability for VSOs and other external VA business partners to represent Veterans quickly and efficiently.

VA also continues to increase access to burial services for Veterans and their families through the largest expansion of its national cemetery system since the Civil War. At present, approximately 90 percent of the Veteran population—about 20 million Veterans—has access to a burial option in a national, state, or tribal Veterans cemetery within 75 miles of their homes. In 2004, only 75 percent of Veterans had such access. This dramatic increase is the result of a comprehensive strategic planning process that results in the most efficient use of resources to reach the greatest number of Veterans.

Ending Veteran Homelessness

The last of our three priority goals is to end homelessness among Veterans in 2015. Since 2009, we have reduced the estimated number of homeless Veterans by more than 17 percent. The January 2012 Point-In-Time estimate, the latest available, is 62,619. We have also created a National Homeless Veterans Registry to track our known homeless and at-risk populations closely to ensure resources end up where they are needed. In 2012, over 240,000 homeless or at-risk Veterans accessed benefits or services through VA and 96,681 homeless or at –risk Veterans were assessed by VHA's homeless programs. Over 31,000 homeless and at-risk Veterans and their families obtained permanent housing through VA specialized homeless programs.

In the 2014 budget, VA is requesting $1.393 billion for programs to assist homeless Veterans, through programs such as Department of Housing and Urban Development-VASupportive Housing (HUD-VASH), Grant and Per Diem, Homeless Registry, and Health Care for Homeless Veterans. This represents an increase of $41 million, or 3 percent over the 2013 enacted level. This budget will support our long-range plan to end Veteran homelessness by emphasizing rescue and prevention -- rescue for those who are homeless today, and prevention for those at risk of homelessness.

Our prevention strategy includes close partnerships with some 150 community non-profits through the Supportive Services for Veteran Families (SSVF) program; SSVF grants promote housing stability among homeless and at-risk Veterans and their families. The grants can have an immediate impact, helping lift Veterans out of homelessness or providing aid in emergency situations that put Veterans and their families at risk of homelessness. In 2012, we awarded $100 million in Supportive Service grants to help Veterans and families avoid life on the streets. We are currently reviewing proposals for the $300 million in grants we will distribute later this year. In 2012, SSVF resources directly helped approximately 21,000 Veterans and over 35,000 household members, including nearly 9,000 children. This year's grants will help up to 70,000 Veterans and family members avoid homelessness. The 2014 budget includes $300 million for SSVF.

To increase homeless Veterans' access to benefits, care, and services, VA established the National Call Center for Homeless Veterans (NCCHV). The NCCHV provides homeless Veterans and Veterans at-risk for homelessness free, 24/7 access to trained counselors. The call center is intended to assist homeless Veterans and their families, VA medical centers, federal, state and local partners, community agencies, service providers, and others in the community. Family members and non-VA providers who call on behalf of homeless Veterans are provided with information on VA homeless programs and services. In 2012, the National Call Center for Homeless Veterans received 80,558 calls (123 percent increase) and the center made 50,608 referrals to VA medical centers (133 percent increase).

VA's Homeless Patient Aligned Care Teams (H-PACTs) program provides a coordinated "medical home" specifically tailored to the needs of homeless Veterans. The program integrates clinical care with delivery of social services and enhanced access and community coordination. Implementation of this model is expected to address health disparity and equity issues facing the homeless population. Expected program outcomes include reduced emergency department use and hospitalizations, improved chronic disease management, and improved "housing readiness" with fewer Veterans returning to homelessness once housed.

During 2012, 119,878 unique homeless Veterans were served by the Health Care for Homeless Veterans Program (HCHV), an increase of more than 21 percent from 2011. At more than 135 sites, HCHV offers outreach, exams, treatment, referrals, and case management to Veterans who are homeless and dealing with mental health issues, including substance use. Initially serving as a mechanism to contract with providers for community-based residential treatment for homeless Veterans, many HCHV programs now serve as the hub for myriad housing and other services that provide VA with a way to outreach and assist homeless Veterans by offering them entry to VA medical care.

VA's Homeless Veterans Apprenticeship Program was established in 2012--a 1-year paid employment training program for Veterans who are homeless or at risk of homelessness. This program created paid employment positions as Cemetery Caretakers at five of our 131 national cemeteries. The initial class of 21 homeless Veterans is simultaneously enrolled in VHA's Homeless Veterans Supported Employment program. Apprentices who successfully complete 12 months of competency-based training will be offered permanent full-time employment at a national cemetery. Successful participants will receive a Certificate of Competency which can also be used to support employment applications in the private sector.

Another avenue of assistance is through Veterans Treatment Courts, which were developed to avoid unnecessary incarceration of Veterans who have developed mental health problems. The goal of Veterans Treatment Courts is to divert those with mental health issues and homelessness from the traditional justice system and to give them treatment and tools for rehabilitation and readjustment. While each Veterans Treatment Court is part of the local community's justice system, they form close working partnerships with VA and Veterans' organizations. As of early 2012 there are 88 Courts.

The Veterans Justice Outreach (VJO) program exists to connect these justice-involved Veterans with the treatment and other services that can help prevent homelessness and facilitate recovery, whether or not they live in a community that has a Veterans Treatment Court. Each VA Medical Center has at least one designated justice outreach specialist who functions as a link between VA, Veterans, and the local justice system. Although VA cannot treat Veterans while they are incarcerated, these specialists provide outreach, assessment and linkage to VA and community treatment, and other services to both incarcerated Veterans and justice-involved Veterans who have not been incarcerated.

Multi-Year Plan for Medical Care Budget

Under the Veterans Health Care Budget Reform and Transparency Act of 2009, which we are grateful to Congress for passing; VA submits its medical care budget that includes an advance appropriations request in each budget submission. The legislation requires VA to plan its medical care budget using a multi-year approach. This policy ensures that VA requirements are reviewed and updated based on the most recent data available and actual program experience.

The 2014 budget request for VA medical care appropriations is $54.6 billion, an increase of 3.7 percent over the 2013 enacted level of $52.7 billion. The request is an increase of $157.5 million above the enacted 2014 advance appropriations level. Based on updated 2014 estimates largely derived from the Enrollee Health Care

Projection Model, the requested amount would allow VA to increase funding in programs to eliminate Veteran homelessness; continue implementation of the Caregivers and Veterans Omnibus Health Services Act; fulfill multiple responsibilities under the Affordable Care Act; provide for activation requirements for new or replacement medical facilities; and invest in strategic initiatives to improve the quality and accessibility of VA healthcare programs. Our multi-year budget plan assumes that VHA will carry over negligible unobligated balances from 2013 into 2014 – consistent with the 2013 budget submitted to Congress.

The 2015 request for medical care advance appropriations is $55.6 billion, an increase of $1.1 billion, or 1.9 percent, over the 2014 budget request. Medical care funding levels for 2015, including funding for activations, non-recurring maintenance, and initiatives, will be revisited during the 2015 budget process, and could be revised to reflect updated information on known funding requirements and unobligated balances.

Medical Care Program

The 2014 budget of $57.7 billion, including collections, provides for healthcare services to treat over 6.5 million unique patients, an increase of 1.3 percent over the 2013 estimate. Of those unique patients, 4.5 million Veterans are in Priority Groups 1-6, an increase of more than 71,000 or 1.6 percent. Additionally, VA anticipates treating over 674,000 Veterans from the conflicts in Iraq and Afghanistan, an increase of over 67,000 patients, or 11.1 percent, over the 2013 level. VA also provides medical care to non-Veterans through programs such the Civilian Health and Medical Program of the Department of Veterans Affairs (CHAMPVA) and the Spina Bifida Health Care Program; this population is expected to increase by over 17,000 patients, 2.6 percent, during the same time period.

The 2014 budget proposes to extend the Administration's current policy to freeze Veterans' pharmacy co-payments at the 2012 rates, until January 2015. Under this policy, which will be implemented in a future rulemaking, co-payments will continue at $8 for Veterans in Priority Groups 2 through 6 and at $9 for Priority Groups 7 through 8.

The 2014 budget requests $47 million to provide healthcare for Veterans who were potentially exposed to contaminated drinking water at Camp Lejeune as required by the Honoring America's Veterans and Caring for Camp Lejeune Families Act of 2012, enacted last August. Since VA began implementation of the law and in January 2013, 1,400 Veterans have contacted us concerning Camp Lejeune. Of these, roughly 1,100 were already enrolled in VA healthcare. Veterans who are eligible for care under the Camp Lejeune authority, regardless of current enrollment status with VA, will not be charged a co-payment for healthcare related to the 15 illnesses or conditions recognized, nor will a third-party insurance company be billed for these services. In 2015, VA expects to start treating family members as authorized under the law and has included $25 million for this purpose within the 2015 advance appropriations request.

VA continues a robust outreach campaign to these Veterans and family members while we press forward with implementing this complex new law.

Mental Healthcare and Suicide Prevention

At VA, we have the opportunity and the responsibility to anticipate the needs of returning Veterans. Mental healthcare at VA is a system of comprehensive treatments and services to meet the individual mental health needs of Veterans. VA is expanding mental health programs and is integrating mental health services with primary and specialty care to provide better coordinated care for our Veteran patients. Our 2014 budget provides nearly $7.0 billion for mental healthcare, an increase of $469 million, or 7.2 percent, over 2013. Since 2009, VA has increased funding for mental health services by 56.9 percent. VA provided mental health services to 1,391,523 patients in 2012, 58,000 more than in 2011.

To serve the growing number of Veterans seeking mental healthcare, VA has deployed significant resources and is increasing the number of staff in support of mental health services. Consistent with the President's August 31, 2012 Executive Order, VHA is on target to complete the goal of hiring 1,600 additional mental health clinical providers and 300 administrative support staff by June 30, 2013 to meet the growing demand for mental health services. In addition, as part of VA's efforts to implement the Caregivers and Veterans Omnibus Health Services Act of 2010, VA has hired over 100 Peer Specialists in recent months, and is hiring and training nearly 700 more. Additionally, VA has awarded a contract to the Depression and Bipolar Support Alliance to provide certification training for Peer Specialists. This peer staff is expected to be hired by December 31, 2013, and will work as members of mental health teams.

In addition to hiring more mental health workers, VA is developing electronic tools to help VA clinicians manage the mental health needs of their patients. Clinical Reminders give clinicians timely information about patient health maintenance schedules, and the High-Risk Mental Health National Reminder and Flag system allows VA clinicians to flag patients who are at-risk for suicide. When an at-risk patient does not keep an appointment, Clinical Reminders prompt the clinician to follow-up with the Veteran.

Since its inception in 2007, the Veterans Crisis Line in Canandaigua, New York, has answered over 725,000 calls and responded to more than 80,000 chats and 5,000 texts from Veterans in need. In the most serious calls, approximately 26,000 men and women have been rescued from a suicide in progress because of our intervention—the equivalent of two Army divisions.

We recently completed a 2012 VA suicide data report, a result of the most comprehensive review of Veteran suicide rates ever undertaken by VA. We are working hard to understand this issue — and VA and DoD have jointly funded a $100 million suicide research project. We will be better informed about suicides, but while research is ongoing, we are taking immediate action and are not waiting 10 years for final study outcomes. These actions include Veterans Chat on the Veterans Crisis Line, local Suicide Prevention Coordinators' for counseling and services, and availability of VA/DoD Suicide Outreach resources.

The Affordable Care Act

The Affordable Care Act (ACA) expands access to coverage, reins in health care costs, and improves the Nation's health care delivery system. The Act has important implications for VA. Beginning in 2014, many uninsured Americans, including Veterans, will have access to quality, affordable health insurance choices through Health Insurance Marketplaces, also known as Exchanges, and may be eligible for premium tax credits and cost-sharing reductions to make coverage more affordable. The 2014 budget requests $85 million within the Medical Care request and $3.4 million within the Information Technology request to fulfill multiple responsibilities as a provider of Minimum Essential Coverage under the Affordable Care Act, including: (1) providing outreach and communication on ACA to Veterans related to VA health care; (2) reporting to Treasury on individuals who are enrolled in the VA healthcare system; and (3) providing a written statement to each enrolled Veteran about their coverage by January 2015.

Medical Care in Rural Areas

VA remains committed to the delivery of medical care in rural areas of our country. For that reason, in 2012, we obligated $248 million to support the efforts of the Office of Rural Health to improve access and quality of care for enrolled Veterans who live in rural areas. Some 3.4 million Veterans enrolled in the VA healthcare system live in rural or highly rural areas of the country; this represents about 41 percent of all enrolled Veterans. For that reason, VA will continue to emphasize rural health in our budget planning, including addressing the needs of American Indian and Alaska Native (AI/AN) Veterans.

VA is committed to expanding access to the full range of VA programs to eligible AI/AN Veterans. Last year, VA signed a Memorandum of Agreement with the Indian Health Service (IHS), through which VA will reimburse IHS for direct care services provided to eligible American Indian and Alaska Native Veterans. While the national agreement applies only to VA and IHS, it will inform agreements negotiated between the VA and tribal health programs.

This follows the agreement already in place between VA and IHS whereby nearly 250,000 patients served by IHS have utilized a prescription program that allows IHS pharmacies to use VA's Consolidated Mail Outpatient Pharmacy (CMOP) to process and mail prescription refills for IHS patients. By accessing the service, IHS patients can now have their prescriptions mailed to them, in many cases eliminating the need to pick them up at an IHS pharmacy.

Women Veterans Medical Care

Changing demographics are also driving change at VA. Today, we have over 2.2 million women Veterans in our country; they are the fastest growing segment of our Veterans' population. Since 2009, the number of women Veterans enrolled in VA healthcare increased by almost 22 percent, to 591,500. However, by 2022 -- less than a decade from now -- their number is projected to spike to almost 2.5 million, and an estimated 900,000 will be enrolled in VA healthcare.

The 2014 budget requests $422 million, an increase of 134 percent since 2009, for gender-specific medical care for women Veterans. Since 2009, we have invested $25.5 million in improvements to women Veterans' clinics and opened 19 new ones. Today, nearly 50 percent of our facilities have comprehensive women's clinics, and every VA healthcare system has designated women's health primary care providers, and has a women Veteran's program manager on staff.

In 2012, VA awarded 32 grants totaling $2 million to VA facilities for projects that will improve emergency healthcare services for women Veterans, expand women's health education programs for VA staff, and offer telehealth programs to female Veterans in rural areas. These new projects will improve access and quality of critical healthcare services for women. This is the largest number of one-year grants VA has ever awarded for enhancing women's health services.

Medical Research

Medical Research is being supported with $586 million in direct appropriations in 2014, with an additional $1.3 billion in funding support from VA's medical care program and through Federal and non-Federal grants. VA Research and Development will support 2,224 projects during 2014.

Projects funded in 2014 will be focused on supporting development of New Models of Care, identifying or developing new treatments for Gulf War Veterans, improving social reintegration following traumatic brain injury, reducing suicide, evaluating the effectiveness of complementary and alternative medicine, developing blood tests to assist in the diagnosis of post-traumatic stress disorder and mild traumatic brain injury, and advancing genomic medicine.

The 2014 budget continues support for the Million Veteran Program (MVP), an unprecedented research program that advances the promises of genomic science. The MVP will establish a database, used only by authorized researchers in a secure manner, to conduct health and wellness studies to determine which genetic variations are associated with particular health issues – potentially helping the health of America's Veterans and the general public. MVP recently enrolled its 100,000th volunteer research participant, and by the end of 2013, the goal is to enroll at least 150,000 participants in the program.

Veterans Benefits Administration

The 2014 budget request of $2.455 billion for VBA, an increase of $294 million in discretionary funds from the 2013 enacted level, is vital to the transformation strategy that drives our performance improvements focused most squarely on the backlog.

Virtually all 860,000 claims in the VBA inventory, including the 600,000 claims that have been at VA for over 125 days and are considered backlogged, exist only in paper. Our transition to VBMS and electronic claims processing is a massive and crucial phase in VBA transformation. VA awarded two VCIP contracts in 2012 to provide document conversion services that will populate the electronic claims folder, or eFolder, in VBMS with images and data extracted from paper and other source material. Without VCIP, we cannot populate the eFolder on which the VBMS system relies. The 2014 request for $136 million for our scanning services contracts will ensure that we remain on track to reach this key goal. In addition, the budget request includes $4.9 million for help desk support for Veterans using the Veterans On-Line Application/eBenefits system.

VBA projects a beneficiary caseload of 4.6 million in 2014, with more than $70 billion in compensation and pension benefits obligations. We expect to process 1.2 million compensation claims in 2014, and we are pursuing improvements that will enable us to meet the emerging needs of Veterans and their families.

Veterans Employment

Under the leadership of President Obama, VA, DoD, the Department of Labor, and the entire Federal government have made Veterans employment one of their highest priorities. In August 2011, the President announced his comprehensive plan to address this issue and to ensure that all of America's Veterans have the support they need and deserve when they leave the military, look for a job, and enter the civilian workforce. He created a new DoD-VA Employment Initiative Task Force that would develop a new training and services delivery model to help strengthen the transition of our Veteran Servicemembers from military to civilian life. VA has worked closely with other partners in the Task Force to identify its responsibilities and ensure delivery of the President's vision. On November 21, 2012, the effective date of the VOW Act, VA began deployment of the enhanced VA benefits briefings under the revised Transition Assistance Program (TAP), called Transition GPS (Goals, Plans, Success). VA will also provide training for the optional Technical Training Track Curriculum and participate in the Capstone event, which will ensure that separating Servicemembers have the opportunity to verify that they have met Career Readiness Standards and are steered to the resources and benefits available to them as Veterans. Accordingly, the 2014 budget requests $104 million to support the implementation of Transition GPS and meet VA's responsibilities under the VOW Act and the President's Veterans Employment Initiative.

Veterans Job Corps

In his State of the Union address in 2012, President Obama called for a new *Veterans Job Corps* initiative to help our returning Veterans find pathways to civilian employment. The 2014 budget includes $1 billion in mandatory funding to develop a *Veterans Job Corps* conservation program that will put up to 20,000 Veterans back to work over the next five years protecting and rebuilding America. Jobs will include park maintenance projects, patrolling public lands, rehabilitating natural and recreational areas, and administrative, technical, and law enforcement-related activities. Additionally, Veterans will help make a significant dent in the deferred maintenance of our Federal, State, local, and tribal lands including jobs that will repair and rehabilitate trails, roads, levees, recreation facilities and other assets. The program will serve all Veterans, but will have a particular focus on post-9/11 Veterans.

Post 9-11 and other Education Programs

Since 2009, VA has provided over $25 billion in Post-9/11 GI Bill benefits to cover the education and training of more than 893,000 Servicemembers, Veterans, family members, and survivors. We are now working with Student Veterans of America to track graduation and training completion rates.

The Post-9/11 GI Bill continues to be a focus of VBA transformation as it implements the Long-Term Solution (LTS). At the end of February we had approximately 60,000 education claims pending, 70 percent lower than the total claims pending the same time last year. The average days to process Post-9/11 GI Bill supplemental claims has decreased by 17 days, from 23 days in September 2012 to 6 days in February 2013. The average time to process initial Post-9/11 GI Bill original education benefit claims in February was 24 days.

National Cemetery Administration

The 2014 budget includes $250 million in operations and maintenance funding for the National Cemetery Administration (NCA). As we move forward into the next fiscal year, NCA projects our workload numbers will continue to increase. For 2014, we anticipate conducting approximately 121,000 interments of Veterans or their family members, maintaining and providing perpetual care for approximately 3.4 million gravesites. NCA will also maintain 9,000 developed acres and process approximately 345,000 headstone and marker applications.

Review of National Cemeteries

For the first time in the 150-year history of national cemeteries, NCA has completed a self-initiated, comprehensive review of the entire inventory of 3.2 million headstones and markers within the 131 national cemeteries and 33 Soldiers' Lots it maintains. The information gained was invaluable in validating current operations and ensuring a sustainment plan is in place to enhance our management practices. The review was part of NCA's ongoing effort to ensure the full and accurate accounting of remains interred in VA national cemeteries. Families of those buried in our national shrines can be assured their loved ones will continue to be cared for into perpetuity.

Veterans Employment

NCA continues to maintain its commitment to hiring Veterans. Currently, Veterans comprise over 74 percent of its workforce. Since 2009, NCA has hired over 400 returning Iraq and Afghanistan Veterans. In addition, 82 percent of contracts in 2012 were awarded to Veteran-owned and service-disabled Veteran-owned small businesses. NCA's committed, Veteran-centric workforce is the main reason it is able to provide a world-class level of customer service. NCA received the highest score—94 out of 100 possible—in the 2010 American Customer Satisfaction Index (ACSI) sponsored by the University of Michigan. This was the fourth time NCA participated and the fourth time it received the top rating in the Nation.

Partnerships

NCA continues to leverage its partnerships to increase service for Veterans and their families. As a complement to the national cemetery system, NCA administers the Veterans Cemetery Grant Service (VCGS). There are currently 88 operational state and tribal cemeteries in 43 states, Guam, and Saipan, with 6 more under construction. Since 1978, VCGS has awarded grants totaling more than $500 million to establish, expand, or improve Veterans' cemeteries. In 2012, these cemeteries conducted over 31,000 burials for Veterans and family members.

NCA works closely with funeral directors and private cemeteries, two significant stakeholder groups, who assist with the coordination of committal services and interments. Funeral directors may also help families in applying for headstones, markers, and other memorial benefits. NCA partners with private cemeteries by furnishing headstones and markers for Veterans' gravesites in these private cemeteries. In January of this year, NCA announced the availability of a new online funeral directors resource kit that may be used by funeral directors nationwide when helping Veterans and their families make burial arrangements in VA national cemeteries.

Capital Infrastructure

A total of $1.1 billion is requested in 2014 for VA's major and minor construction programs. The capital asset budget reflects VA's commitment to provide safe, secure, sustainable, and accessible facilities for Veterans. The request also reflects the current fiscal climate and the great challenges VA faces in order to close the gap between our current status and the needs identified in our Strategic Capital Investment Planning (SCIP) process.

Major Construction

The major construction request in 2014 is $342 million for one medical facility project and three National Cemeteries. The request will fund the completion of a mental health building in Seattle, Washington, to replace the existing, seismically deficient building. It will also increase access to Veteran burial services by providing a National Cemetery in Central East Florida; Omaha, Nebraska; and Tallahassee, Florida.

The 2014 budget includes $5 million for NCA for advance planning activities. VA is in the process of establishing two additional national cemeteries in Western New York and Southern Colorado, according to the burial access policies included in the 2011 budget. These two new cemeteries, along with the three requested in 2014, will increase access to 550,000 Veterans. NCA has obligated approximately $16 million to acquire land in 2012 and 2013 for the planned new national cemeteries in Central East Florida; Tallahassee, Florida; and Omaha, Nebraska.

Minor Construction

In 2014, the minor construction request is $715 million, an increase of 17.8 percent from the 2013 enacted level. It would provide for constructing, renovating, expanding and improving VA facilities, including planning, assessment of needs, gravesite expansions, site acquisition, and disposition. VA is placing a funding priority on minor construction projects in 2014 for two reasons. First, our aging infrastructure requires a focus on maintenance and repair of existing facilities. Second, the minor construction program can be implemented more quickly than the long-term major construction program to enhance Veterans' services.

In light of the difficult fiscal outlook for our Nation, it's time to carefully consider VA's footprint and our real property portfolio. In 2012, VA spent approximately $23 million to maintain unneeded buildings. Achieving significant reduction in unneeded space is a priority for the Administration and VA. To support this priority, the President has proposed a Civilian Property Realignment Act (CPRA), which would allow agencies like VA to address the competing stakeholder interests, funding issues, and red tape that slows down or prevents the Federal Government from disposing of real estate. If enacted by Congress, this process would give VA more flexibility to dispose of property and improve the management of its inventory.

Legislation

Besides presenting VA's resource requirements to meet our commitment to the Nation's Veterans, the President's Budget also requests legislative action that we believe will benefit Veterans. There are many worthwhile proposals for your consideration, but let me highlight a few. For improvements to Veterans healthcare, our budget includes a measure to allow VA to provide Veterans with alternatives to long-stay nursing homes, and enhance VA's ability to provide transportation services to assist Veterans with accessing VA healthcare services. Our legislative proposals also request that Congress make numerous improvements to VA's critical homelessness programs, including allowing an increased focus on homeless Veterans with special needs, including women, those with minor dependents, the chronically mentally ill, and the terminally ill.

We also are putting forward proposals aimed squarely at the disability claims backlog – such as establishing standard claims application forms—that are reasonable and thoughtful changes that go hand-in-hand with the ongoing transformation and modernization of our disability claims system. We are offering reforms to our Specially Adaptive Housing program that will remove rules that in some circumstances can arbitrarily limit the benefit. The budget's legislative proposals also include ideas for expanding and improving services in our national cemeteries.

Finally, this budget includes provisions that will benefit Veterans and taxpayers by allowing for efficiencies and cost savings in VA's operations – for example, we are forwarding a proposal that would require that private health plans treat VA as a 'participating provider' – preventing those plans from limiting payments or excluding coverage for Veterans' non-service-connected conditions. VA merits having this status, and the additional revenue will fund medical care for Veterans. We are also requesting spending flexibility so that we can more effectively partner with other federal agencies, including DoD, in pursuit of collaborations that will benefit Veterans and Servicemembers and deliver healthcare more efficiently.

Summary

Veterans stand ready to help rebuild the American middle class and return every dollar invested in them by strengthening our Nation. And we, at VA, will continue to implement the President's vision of a 21st century VA, worthy of those who, by their service and sacrifice, have kept our Nation free. Thanks to the President's leadership and the solid support of Congress, we have made huge strides in our journey to provide all generations of Veterans the best possible care and benefits through improved technology that they earned through their selfless service. We are committed to continue that journey, even as the numbers of Veterans using VA services increase in the coming years, through the responsible use of the resources provided in the 2014 budget and 2015 advance appropriations requests. Again, thank you for the opportunity to appear before you today and for your steadfast support of our Nation's Veterans.

Chairman MURRAY. Thank you very much, Mr. Secretary.

Let me start. As I mentioned, you have a new announcement of a new initiative to expedite claims that have been waiting for over a year, and that is encouraging, and I am glad to see that the Department is taking action, but I do have some questions about how it is going to be implemented, and I wanted to ask you, if the VA determines the veteran's final rating is lower than the provisional rating, will the Department seek to recover money that has already been paid to that veteran?

Secretary Shinseki. Madam Chairman, you know, that is a question—what I would say is that, historically, when we have established a standard for a veteran, we have usually stayed with that. And let me call on Secretary Hickey here, but my intent is that the provisional rating that is provided will be on those issues for which we have clarity and documentation and we can render a decision. For issues where documentation is not provided, those are the issues that will remain open up to a year for veterans to locate, with our help even, documentation that would allow us to make a decision there.

Secretary Hickey?

Ms. HICKEY. Chairman Murray, thank you for the question and for your interest in this initiative, which we think is really important to ensure that we are taking care of those veterans who have waited the longest while we completed the more than 260,000 Agent Orange Nehmer claims to take care of our Vietnam veterans over the last 2–1/2 years.

We are using the provisions that allow us to make good decisions, so we will continue under this provisional criteria to use service treatment records, to use private medical records, to use the information available on our veterans in terms of the nature and character of their service. So all the similar evidence that we have used in previous decisions we will use again to ensure that we do not make any of those kinds of decisions. I do not expect to see any of those decisions where we overcompensate for a claim.

The other thing that we will do is we will keep—the reason for the provisional decision, that would put a really huge safety net under every one of our veterans. We are going to keep the record for a whole year, the ability for our veterans to come back with additional evidence. And we will keep asking if we do not have—

Chairman MURRAY. So the additional year will only be to provide information to have an additional claim, not to lower the claim?

Ms. HICKEY. The reason for the year is to allow additional evidence to increase the rating, if necessary. So I think in that, it advantages our veterans for that additional year. And then they still have, after that, the same appeal processes that they have had in the past. So we do not anticipate having conditions where we overpay a veteran under this initiative.

Chairman MURRAY. Mr. Secretary, are you going to need additional support from the Defense Department in order to meet the timelines you proposed?

Secretary Shinseki. For these particular claims?

Chairman MURRAY. Correct.

Secretary Shinseki. We are dealing with claims in our inventory right now, and so we are—I think we have as much control as we need. Of course, we work closely with the Defense Department on an ongoing basis because the sharing of data is something that goes on daily.

Chairman MURRAY. Okay. There are a number of different services that are contingent on a disability rating. Benefits from health care, home loans, designation as a disabled veteran-owned small business, they all rely on the rating that you are talking about. How will this provisional rating affect those other benefits?

Secretary Shinseki. Secretary Hickey?

Ms. HICKEY. Chairman, thanks for the question. I will tell you that in the same way that we provide those additional benefits today associated with a claims decision, we will continue that avenue.

I will say, though, that any veteran who is returning home today does not require a decision from us to seek the 5 years' worth of medical care that this Congress made provision for. They can still get that by just showing up to one of the VA medical hospitals or clinics and get that medical care for free without a decision even today associated with this new initiative. It does not have an impact there. They still can get health care.

Chairman MURRAY. Okay. Under this initiative, as you just described, there is the provisional rating that will be given to them, and then they can make continued claims. So are we looking at increasing the workload by requiring two ratings decisions instead of one?

Ms. HICKEY. Chairman, we are not. We are actually trying to benefit the veteran who has been waiting the longest in this case. We want to get a decision to them. If that veteran returns after the fact saying, "I have additional information," we will expedite that claim to the front of the line. We will re-rate it based on the additional information; then we will get them a final decision.

Chairman MURRAY. Okay. There are a number of efforts going on, programs like Benefits Delivery at Discharge and fully developed claims process. Both have been successful. They need to be maintained. A successful Integrated Disability Evaluation System, the IDES, is critically important to our injured servicemembers. There is a lot of work that still needs to be done from both DOD and VA on that, and we cannot lose sight of keeping making improvements to fundamental issues in the claims processing that we still have.

So are you going to be able to implement this new initiative and still support all those other efforts?

Secretary Shinseki. Chairman Murray, that is our intent, and as you implied earlier, this requires a level of continuous synchronization between DOD and VA.

As you know, BDD, Benefits Delivery at Discharge, Quick Start, IDES, Integrated Disability—these are DOD programs in which VA has provided our capability to support on medical exams. And so there is good collaboration there. We do this best when we have some indication of what the flow is, and then we match up.

About the only times we have run into difficulty here is when the flow exceeded what we thought it was going to be, and then there is a period in which we have to generate additional capability. But these are things we work on a daily basis.

Chairman MURRAY. Okay. I have a number of additional questions. I am going to let my Committee members go ahead. Senator Sessions had to leave for a few moments, so I will turn to Senator Ayotte first.

Senator AYOTTE. Thank you, Madam Chairman. I want to thank all the witnesses for being here, for what you do is so important to the country, and how we treat our veterans is incredibly important.

I wanted to ask you, Mr. Secretary, New Hampshire is a State that does not have a full-service veterans hospital. And, in fact, as you know, Alaska and Hawaii also do not, but they at least have an active-duty hospital there that New Hampshire does not have as well. So we have nearly 10 percent of our population—we are a State that serves—has served in the military, and many of our veterans are traveling long distances to get the care that they deserve and across State lines, and it is very difficult for many of them.

So I wanted to ask you, does the VA have a plan to ensure that all States have access to a full-service veterans hospital? Or in the absence of a hospital, you have, for example, instances where you have entered into a contract, for example, with the Concord Hospital. And so while our veterans are waiting, we would like a full-service hospital. But even access to health care that is already available to, for example, local hospitals would be very important to our veterans.

Could you help me with that?

Secretary Shinseki. Sure. Senator, I am going to call on Dr. Petzel here in a second, but let me just say up front, for 4 years now my commitment has been that veterans ought not to have to wait for access to health care, and so for Iraq and Afghanistan veterans, this discussion about 5 years of care under VA is important. It also increases our responsibilities. And it is not just access, but it is access to quality health care.

Senator AYOTTE. Right.

Secretary Shinseki. And it should not matter whether it is a veteran living in a rural area or a veteran in an urban environment. And so we have to create the opportunities to meet those requirements. Whether it is a full-service hospital or some combination of working with quality hospitals that are currently available to us, we arrange our relationships to provide what the veterans deserve.

And so with that, Dr.—

Senator AYOTTE. Mr. Secretary, I certainly want to hear from the doctor. I just wanted to follow up, though. Would you agree with me that New Hampshire is certainly in a unique position vis-a-vis other States, not having that full-service access for our veterans?

Secretary Shinseki. I would, Senator. But I would also say that in terms of the access criteria that I described, one of the things, for example, we do is provide fee basis for those veterans to quality medical facilities that are already there. And this is our fee-basis arrangement. I think we spend maybe $5 billion to provide that kind of access, and we are increasing it in the 2014 budget.

Senator AYOTTE. I appreciate that, and I will have a couple of specific follow-ups on certain areas of our State with regard to more access. Thank you.

I wanted to allow the doctor to answer.

Dr. PETZEL. Thank you, Senator. The Secretary described, I think, the situation quite well. Specifically in New Hampshire, we have a very extensive outpatient operation at Manchester and a number of community-based outpatient clinics around the State, as well as the access to telehealth.

In Manchester particularly, there is specialty services as an outpatient available, and probably more than 90 percent of the health care needs of people are met in those kinds of services. We have what I would deem to be an excellent contract with Concord for the immediate hospitalization right in that metropolitan area of Manchester. And then for quaternary and tertiary care, people are referred, as they had been previously even with inpatient beds, to the Boston VA Medical Center and also to the White River Junction VA Medical Center.

I think one of the most important indicators of the fact that this is working well is the satisfaction of the veterans that use health care in that area with the Concord contract. They are very satisfied. They have good access to really excellent inpatient care through that contract and through fee basis.

Senator AYOTTE. So, Doctor, that contract with Concord is only providing that type of access to a limited number of veterans in our State. And so many of them that have to, for example, live in the North Country of our State, they are in a position where—and I would love to have you all come up to the northern part of our State and see the geography up there and see the mountainous terrain and where they are having to drive to get to White River Junction, and many of them just to get from the north part of the State to Manchester, 150 miles. And the same thing with trying to go over to Massachusetts. Many of them are having very— difficulty with it.

So I wanted to ask you in particular, because the Concord contract, I agree, is a very positive thing, and it is my hope that you will expand that to other areas of the State that have many geographic challenges, including, for example, Berlin. I was up at Androscoggin Hospital recently, and they are very interested for the northern part of our State of having a similar contract that you already have in place with Concord. And I hope that that is something that you would consider, particularly in the northern part of New Hampshire.

Dr. PETZEL. Yes, we would.

Senator AYOTTE. I appreciate it. And as a follow-up to that, our delegation on a bipartisan basis, we appreciate, Mr. Secretary, that we have asked you in Colebrook, which is even farther north than Berlin that I just told you in New Hampshire, that you had written our delegation in July of 2012 saying that you were considering putting a telehealth technology partnership in that area. So I wanted to follow up on where that is.

And then we have also requested a view if you would consider putting a part-time CBOC in that area in conjunction with the telehealth initiative, because it is so far north for our folks to go from there over to White River Junction, that they are having a lot of difficulties. And our veterans in our North Country deserve the same kinds of access to other more populated areas of the state, I think you would agree.

Dr. PETZEL. Thank you, Senator. We can explore both of those that you mentioned. The telehealth clinic, as I understand it, is proceeding apace. I do not know exactly where it sits now. We can certainly get back to you about that. And the partial clinic that you described, we will look into that.

Senator AYOTTE. I really appreciate that, and this is something that my colleague Senator Shaheen and I have been working on together, and our entire delegation feels this is very important to our veterans, particularly in the northern part of our State. So thank you.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Madam Chair, and welcome, Secretary Shinseki and your team. There are two things I would like to raise.

The first is just to note my continuing objection to the President's decision to put the so-called chained CPI benefit cut in for Social Security recipients and for disabled veterans. The context for this is that a 100-percent disabled veteran who begins to receive benefits at age 30, which is not unheard of considering the young men and women who are sustaining very significant injuries overseas now, would see $1,425 less a year at age 45, $2,341 less a year at age 55, and $3,233 less a year at age 65. And as you know, we are not very profligate in our spending on these veterans. This is a pinch that they will really feel.

And my take is that, at least with respect to Social Security, the COLA is too low already. When you look at the kind of things that seniors and disabled veterans are likely to be spending their resources on, it is food, it is health care, it is heat, and to a degree, perhaps also gasoline. When you look at those things, you look at 2010, food was up 1.5 percent, medical care was up 3.3 percent, gas was up 13.5 percent, fuel oil was up 13.5 percent. The COLA went up zero percent. It strikes me that for that year the COLA was too low, not too high.

You go to the next year, food was up 4.5 percent, health care was up 3.5 percent, gas was up 9.5 percent, fuel oil was up 14.3 percent. That is on top of the increases in the previous year, not incorporating them, so you would actually have to sum those increases and add a little bit for the compounding. Again, zero in the cost-of-living adjustment.

So I think that this is a very misguided strategy, and I just want to serve notice to everybody in the administration who has a role in this that I intend to fight it with whatever means I have at my disposal.

The second piece that I want to—you can comment on that if you want, but let me get my question I have to you out, which is something specific to Rhode Island. You have been to Rhode Island a couple of times to visit Senator Reed and myself, and each time I have talked to you about the problem we have that the VA has a terrific electronic health record, but if a veteran gets hit by a bus in Kennedy Plaza and rushed to the Rhode Island Hospital emergency room, it does not do them any good because the VA record is enclosed within the VA system.

Rhode Island is one of the most advanced States in terms of developing electronic health records and providing true interoperability among different components. And we are working very hard to try to integrate the VA into that process. It is not easy. There are technical problems. There are funding problems and so forth. But what I would like to ask you to do is to convey your view, if it is your view, down to the folks in Rhode Island that this should be a priority for them. And to the extent that the so-called VLER Program, the Virtual Lifetime Electronic Record initiative, is extended, I would like to have Rhode Island become—I think you call them "VLER," "a VLER site."

I honestly do not think that there is a State that is further ahead than Rhode Island in terms of developing an interoperable electronic health record. There are individual companies that are where you can have a CEO direct here is what we are going to do, but in terms of a whole community of everybody, from the imagers to the laboratories to the hospitals to the providers, I really think that we are at the forefront. And I would ask that in the spirit that we should be doing what we can in this area to let the lead dogs move faster, to put an asterisk next to the effort in Rhode Island and try to give it some of your and your staff's direct personal attention, if you can do that.

You can respond to both of those if you wish.

Secretary Shinseki. Well, Senator, on the first issue, the chained CPI proposal, I would just say thanks for, you know, your statement here. I would also point out that the President has been very clear in his consistent desire to protect vulnerable populations. The proposal excludes means-testing veterans' pensions, which have provided to low-income wartime veterans who are age 65 and older or who are under 65 but remain totally permanently disabled as a result of conditions unrelated to military service. And I believe that addresses some of your concerns.

Senator WHITEHOUSE. Only a little bit, just because of the numbers involved. The President identifies $230 billion in savings from the so-called chained CPI benefit cut. And all those programs put together that you mentioned put back $15 billion. So there is still a huge whack that is taken out of the populations that are subject to chained CPI, and the amount that gets brought back is pretty small, less than 10 percent. It is whatever percentage $15 billion is of $230 billion.

Secretary Shinseki. I would also include that the budget proposal excludes certain veterans' education programs as well. Post 9/11 GI bill, Montgomery GI bill for active-duty, those inflationary adjustments are decided elsewhere, so they are not included under chained CPI.

Senator WHITEHOUSE. And on the VLER Program in Rhode Island?

Secretary Shinseki. On the VLER Program, I would say we have been very aggressive in our outreach between VA and DOD in terms of record sharing, and then a number of pilot test events, west coast and east coast, between VA, DOD, and the civilian community. And, you know, I regret that we have not made it up to your home State yet, but I do recall our discussion, and that is something I would be happy to explore with you.

Senator WHITEHOUSE. If you could review it and give it a moment of your personal attention, talk to your senior staff about it and see what we can do, that would be helpful to us.

Secretary Shinseki. Sure.

Senator WHITEHOUSE. I truly believe—there is actually, Madam Chair, quite an interesting report in the HELP Committee written by the minority criticizing the so-called high-tech bill that provides for meaningful use of electronic health records in the private sector that it did not focus enough on interoperability. And I think they are actually dead right about that. So I think you need to put your resources where the lead dogs are. The pack will never run faster than the lead dogs. Move out the lead dogs and let us get this done.

Thank you.

Chairman MURRAY. Senator Baldwin.

Senator BALDWIN. Thank you, Chairman Murray, and I appreciate the fact that you are holding this hearing today. And I also want to thank our panel, Secretary Shinseki and all of the panelists. Thank you for being here today and also thank you for your service to our country.

As we face our budget challenges, one of the most important things for me is ensuring that we are keeping our promises to our veterans and their families. When our servicemen and -women return from serving their country, they and their families deserve the peace of mind that they will have all the resources they need to thrive upon their return.

However, for many of our returning veterans, this is not the case. Too many are waiting far too long for the benefits that they have earned. In Milwaukee, Wisconsin, alone, veterans are waiting an average of more than 311 days for their claims to be processed. And I know that the VA has recently announced a new process to expedite claims that have been pending for over a year. However, while these reforms are positive steps, veterans do not want to hear about new programs or new processes. They really want results, and so do I. And in this regard, I look forward to working with you to make sure that we finally tackle in a comprehensive way this claims backlog.

Moving on to another area in which I have some very serious concerns, Secretary Shinseki, I want to start by asking you about the VA's response to the epidemic of military sexual trauma among our brave veterans. I have two specific areas that I want to delve into and ask you about.

First, we know that the high prevalence of military sexual trauma among female veterans requires a substantial degree of staff and provider sensitivity at VA health facilities. Yet we also know from a number of studies that the VA is still struggling to provide gender-specific let alone trauma-informed care.

We know that the VA is all but failing our women veterans in the screening process for military sexual trauma. A recent American Legion report found that 40 percent of female veterans were dissatisfied with the screening process.

And we know the VA struggles to hire experienced staff and provide guidance for those mental health providers who will work with victims.

The second area, I understand that legislation has been introduced to help assist survivors of military sexual assault in securing VA benefits. I have heard from veterans in the State of Wisconsin who are dealing with severe PTSD due to military sexual trauma, in some cases so severe that they are unable to work. But as these brave women have related to me, their dealings with the VA system and trying to secure adequate benefits can feel very traumatic in and off itself.

So I would like, Secretary Shinseki, for you to provide me with, for purposes here today, a brief update on these two issues—the gender-specific and gender-sensitive services, and then as well as the issue of accommodating benefits to serve the needs of those who have suffered military sexual trauma.

Secretary Shinseki. Well, Senator, I am going to call on two people who work with this issue daily, but let me just say, if you were to look at our budget over the past 4 years, five submissions now, I think in the case of women veterans funding, between 2009 and this year's budget, 2014, you would see a 134.4-percent increase in funding, which I hope suggests to you that women's issues are important to us. And we realize that today women veterans comprise about 6 percent of our veteran population, but we know out there in the active force, 15 percent in the active military and in the reserve component about 17 or 18 percent. So we understand there is a growth coming, and we are trying to get ahead of it.

I am going to call on Dr. Petzel to talk about the investments in health care, both in infrastructure, programs, and in research as well.

And let me just set up the second response to you, and I will ask Secretary Hickey to take that on from a benefits perspective.

The issue is sexual assault. We can call it, you know, MST, military sexual trauma, as though it were a condition, but this is assault. And I do know that in DOD they are taking great strides to address this.

On our side, I think in the past we may have been less discerning about these issues. But I can tell you, since her arrival, Secretary Hickey has gone back and relooked at previous cases and challenged ourselves that our instincts and our assumptions were correct.

For one thing, we know that these assaults are underreported, and then even at this stage of asking for benefits, it is difficult for people to come forward and say this happened. So I think Secretary Hickey will describe a fairly generous approach to reviewing these cases.

Let me start with Dr. Petzel and then Secretary Hickey.

Dr. PETZEL. Thank you, Mr. Secretary.

Senator Baldwin, over the past 15 years, the VA has invested, as the Secretary has indicated, in trying to provide for a safe, private, sensitive environment for women in our clinics and in our medical centers. And I think we have made great progress. We still have things that we need to do, but I think we have made great progress.

In terms of services specifically, we are developing a three-part program to provide gender-specific care to women. The first is the women veterans' clinic. In about 76 of our places where we have large numbers of women, we have clinics that basically have all the services one might need concentrated in one place.

Secondly, in those areas where there is a smaller population of women veterans, we have primary care women veterans' clinics where the primary care clinic is exclusively devoted to the needs of women veterans and the primary care providers are trained to provide gender-specific and -sensitive care.

And then in those remaining places, such as our community-based outpatient clinics, we have trained at least one primary care provider in each one of those clinics in gender-specific care again so that virtually at 100 percent of our places, primary care can be delivered in a gender-specific fashion.

In terms of military sexual trauma, we screen everybody. Everybody, male or female, that comes to the VA is screened for military sexual trauma. In 2012, 24 percent of the women that we screened indicated that they had been subjected to some form of sexual trauma or assault. And 1.2 percent of men also indicated they had been subjected to some sort of sexual assault.

We provide gender-specific military sexual trauma treatment at all of our medical centers. All primary care providers and all mental health providers have been trained in recognizing and in dealing with military sexual trauma—

Chairman MURRAY. I hate to interrupt, but we have gone way over time. If you can summarize really quickly, we can get to Senator Sessions.

Dr. PETZEL. All right. I am sorry.

We have special places where we can give specific, very special care for military sexual trauma. Not to say that we do not have more work to do, but I think we have made good progress in identifying the problem and providing the appropriate treatment.

Secretary Shinseki. Madam Chairman, may I ask Secretary Hickey to very quickly respond to the benefits?

Ms. HICKEY. Very quickly, we now have a woman, as requested by our people who suffer from military sexual trauma PTSD, in every single regional office. They are the only ones that are trained to do these claims. They are done down our special operations lane to handle them sensitively. No one else is allowed to touch them but that woman who is designated in every single regional office.

When I arrived in 2011, in June 2011, within 2 weeks I had them pull a statistically valid sample. I saw that we did have a problem. We had a 35-percent grant rate compared to about a 55-percent grant rate for PTSD due to the other conditions. I jumped on it fast. We drove new training, integrated training with the health folks, and within 6 months had that gap totally closed, and will remain closed. I check it every 3 to 4 months. And right now we are within 2 to 3 percentage points of every other grant for PTSD within MST right up next to it.

Chairman MURRAY. Thank you very much.

Senator Sessions?

Senator SESSIONS. [Presiding.] Thank you. One thing I would like to emphasize is that it is not a definition of good policy or concern just to spend more money. So we have been spending more money. Some of that is, I know, necessary. Maybe all of it is necessary. But we do, I believe, have a right to expect efficiency.

I was just looking at the job situation, the programs that we have for impacting jobs. According to the GAO, there are 40 job training programs in America, Federal job training programs. GAO's most recent duplication report made a specific recommendation for VA to "incorporate DOD's employment assistance initiatives into the agreements that guide interagency cooperation."

Do you agree with that, Secretary Shinseki? And have you made any progress toward that?

Secretary Shinseki. Senator, I am not particularly familiar, I would say, with this particular GAO report. Let me get into it and provide you a better answer.

But I would just say, if we were to look back over what this Department has tried to do for 4 years, efficiency, effectiveness, savings has been very much a priority.

Senator SESSIONS. Well, it is going to take strong leadership, there is no doubt about that, and you have to stay on it every day. But I think the point of this is should we be creating a more veteran-specific program and allocating more resources for that? Or can we somehow coordinate with many of these other existing programs that have training for carpenters or computer experts and that sort of thing? And I believe we can do a better job. The idea that this Government ought to have 40 job training programs—not in the VA you do not have 40, but throughout the whole Government—speaks to some of the inefficiencies and duplications we have.

Secretary Shinseki. Well, I would say, Senator, about the only area that we have a specific training program would be where we have a need and there is a population of veterans not being addressed elsewhere, for example, homeless veterans, and our opportunity to provide them work experience occurs in our National Cemetery System where they come in as entry-level folks, and then we give them a successful work experience. It is a modest payroll, but at the end of the year-long training program in which we invest the experience of other senior people into their development, they have a choice to come to work for us or to go out and do it elsewhere. So that is one example of where we meet a need, because, one, we have a requirement to backfill our retirements. And then we have the homeless population in need of an opportunity.

We do the same in our emergency rooms where we take medics and corpsmen from the military, and for a variety of reasons, they immediately are not able to be certified in the States where they are residing, and so we will take a number of them, put them in our ERs, and have them work for us and develop the credentials they need. Very modest.

Senator SESSIONS. Well, Mr. Secretary, I think those are some good, specific proposals that we should do more of in the Government, and I do think we can do a better job of having military people certified for State—according to State rules if they often have been operating at standards far above what the States require, but then they are unemployed until they can get their State certifications. There has been some good work done on that.

Can I just ask you this question, a bigger question? Where are we in terms of the next 10, 15 years with the number of veterans you serve? What will the trends look like as we go forward in terms of the number?

Secretary Shinseki. Senator, I think as we look back historically, after an operation ends, VA's requirements in terms of veteran support has generally grown for about 10 years. And so I would expect that in our case, we will continue to see a growth in requirements of veterans coming to us, and especially in this case. We are dealing with a very small professional force, but one that has been used repeatedly over 10 to 12 years. And with the advances in battlefield medicine, many of them are incurring serious and complex injuries.

So I think our requirements—my answer to your question is historically there has been continued growth. In our case, I do not see a need to change that. We will continue to see growth over the next 10 years, but the complexity of the cases we deal with will add a measure we probably have not seen before.

Senator SESSIONS. Thank you. Do you have any percentage numbers of growth? Have you made any estimates of what those numbers might be?

Secretary Shinseki. Well, Senator, we here rely on DOD's sort of flow of what they think it is going to be. At one point we were told a million veterans over the next 5 years, and so we are trying to understand what that flow rate will be.

Senator SESSIONS. Is that more or less than what we have seen in the last 5 years?

Secretary Shinseki. Generally what we have seen in the last 4 years.

Senator SESSIONS. Maybe you could give us a report on that. I am just curious about the total numbers.

And, you know, the disability backlog needs to be dealt with. Let me say this to you. When you get behind and people start rushing, we start throwing money at problems, sometimes it does not work very well, and we do not do it as well either. So I know you have to strike that balance. I encourage you to do so, both in terms of doing a full evaluation and getting people their disability promptly and making evaluations that are justified in the process. So speed can be a problem, but the growing backlog situation we have seen recently is not acceptable, and you probably have already discussed that while I had to step out. But if you have not, you might give us an insight.

I think I am over my time, so you can be brief, if you would.

Secretary Shinseki. Well, Senator, let me try to do this very quickly. Let me start by just telling you that I am sensitive to your concerns about, you know, ensuring that taxpayer dollars that are provided to us by the Congress are zealously guarded and executed in meaningful ways. And, therefore, we have taken a deliberate approach in this issue on resolving the claims backlog. It did not begin 4 years ago. It has been decades in the making.

But over the past 4 years, we have taken actions to generate savings for ourselves and reinvest them in our own budget, $528 million for fee basis at the medical care rates; $200 million savings in acquisition improvements, $200 million in a better way of fielding information technology projects. Four years ago, we were fielding less than 30 percent of them successfully. Today we are in excess of 80 percent. And then $142 million First Notice of Death. We go after these so that we can take those dollars and reinvest them in the next budget cycle so that while the top line may be established, we are buying down the requirement for new dollars, if we could.

Let me turn to the backlog. We sit astride a river of paper. We get paper, we process paper. That is the way it has been. It is not efficient. It is not effective from a management standpoint because you cannot see all of your variance. We need to go to an automation system.

We have been developing this automation system for 2 years now. It is being fielded. We started 6 months ago. It is called VBMS, Veterans Benefits Management System. It is in 36 of our 56 stations today. It will be in all 56 by the end of this year.

But having an automation system is one thing. Unless it is connected, it leads nowhere. So a part of this has also been connecting with DOD, who has agreed to provide us electrons by the end of this year. This will be an important connection, and this is an important partnership.

Part of this is we have 800,000 claims already in paper. Some of that already begun in paper we are going to allow to finish in paper. That is the most efficient way and the fairest way to get them through the system. The rest of that in paper, we are currently scanning into electrons to feed our electronic database.

And, finally, we have provided veterans an online capability to file claims electronically. So this is the year where all these connections come together. To do this, we have requested an increase in the budget of VBA, our Benefits Administration, by 13 percent and an increase in IT for 10 percent, crucial to making these connections sync up and have our promised delivery in 2015. We are ahead of 2015, and we intend to end the backlog then.

Chairman MURRAY. [Presiding]. Thank you very much.

Senator Kaine?

Senator KAINE. Thank you, Secretary Shinseki, and to your team. You know, three stats kind of occur to me as you talk that ought to cause us pause and tell us what our works is going to be like here in supporting your mission: the growing number of veterans that you just testified to in the aftermath in that million estimate, what we will see in the next few years will present additional challenges.

You indicated in your testimony, your written testimony, that 62 percent of veterans of IF, EF, and New Dawn are using at least one VA service, and you suggested that was higher than earlier norms. What would have been a norm in an earlier time period?

Secretary Shinseki. I would say something in the low 30 percent.

Senator KAINE. So a growing number of veterans, a higher percentage of them using at least one VA service, and then this aspect of your testimony: the average number of claim conditions for our recently separated servicemembers is now in the 12 to 16 range, roughly five times the number of disabilities claims by veterans of earlier eras. Growing numbers of vets, higher percentage accessing at least one service, and those filing disability claims claiming numbers of disabilities about five times earlier averages. This is a very significant challenge, obviously, and it is going to be with us for a long time.

And that moves into some follow-up questions I had to Senator Sessions on the backlog issue. You indicated that the VBMS management system has already been implemented across a number of your regions, and then will you just tell me, it will be in all regions by when?

Secretary Shinseki. Well, our plan laid out by December of this year, but our feeling, it is going well enough that I can anticipate that is going to be sooner. And I always hesitate to put the sooner date out there because you know one hiccup there, and—

Senator KAINE. Sure, right.

Secretary Shinseki. —we are having to revisit that.

Senator KAINE. But I understand you started to implement this system, the VBMS system, in 2011?

Secretary Shinseki. 2012.

Senator KAINE. 2012?

Secretary Shinseki. 2011 was testing and, you know, bringing folks that could help us. But we began in September of 2012, so we are 6 months into it.

Senator KAINE. And when was the system—when did you start to design the system? It was tested in 2011. When was the design started?

Secretary Shinseki. Probably 2 years ago, early 2011, late 2010. I do not have a specific date, but it is about then, and I will tell you the reason this occurred. In 2009, we were given the 9/11 GI bill, a brand-new program. We had no automation for it. We were a paper-driven exercise there. That fall of 2009, just to get 173,000 veterans into schools was a major effort because it was pen and paper.

Senator KAINE. And, Secretary, if I could just stop you right there, in 2009 when you got the new GI bill and it was paper driven, was everything else paper driven too pretty much at that time?

Secretary Shinseki. Everything else, yes.

Senator KAINE. So we went to war in 2002—well, 2002 immediately after—into Afghanistan or 2001, 2003 in Iraq. We did not have an electronic system for managing VA benefits until you started to try to work to design one in 2009?

Secretary Shinseki. Well, you know, I think there may have been several efforts that did not pan out.

Senator KAINE. So you would describe what existed before 2009 as rudimentary at best, even as we were 5, 6, 7 years into two wars?

Secretary Shinseki. Yes, that is correct.

Senator KAINE. Well, obviously, getting that system right is key. We have three freshmen right here. We all got elected in November, and people started writing Senator Kaine, Senator King, and Senator Baldwin that first day, and we did not show up until January 3rd. We had massive backlogs. And what they told us all is: Before you freak out about the backlog, you have to have a system for dealing with it.

I mean, I am just kind of stunned as I hear that we did not have a credible system for dealing electronically with veterans' claims until you started to do that work in 2009– 10, and we were already

7, 8 years into a war by the time we did it. No wonder we are having such challenges today.

One kind of claim that I am particularly interested in is mental health claims. I had a recent experience with an individual veteran in the Hampton Roads area who had called seeking mental health assistance—who had e-mailed the local VA seeking mental health assistance and was given an appointment 8, 9 months into the future.

When we checked it out, what we found is that if he had called by phone, there was an effective triage to try to determine if he needed mental health assistance right away. But if you e-mailed, which, frankly, is a little bit easier to do for some people that are trying to overcome the stigma of "I guess I need mental health assistance," to e-mail in was a little bit easier, there was no triage done on e-mails coming in seeking help.

You talked about the way you are trying to manage claims. Mental health claims are particular ones because I think a lot of mental health professionals say once somebody gets over that burden of saying, "Okay, I admit, I need help," if you do not take advantage of their request for help pretty much when they ask, 6 months later bad things could have happened. Somebody could have committed suicide, or other problems, or they may be in a mind-set where now they are self-medicating, and "I do not even want to come in for an appointment, I do not need help."

What are you doing within the VA on this mental health issue, which is so connected to veteran suicide, to try to triage and respond promptly to mental health claims?

Secretary Shinseki. Well, Senator, I am going to call on the expert here, Dr. Petzel, but let me just say, again, if we look at what we have tried to do in terms of budgeting to provide resources to address issues like mental health, since 2009 up to the 2014 budget, we have increased our investments in mental health by 56.9, almost 57 percent.

For the individual who is looking for mental health care, there is no claim to be filed, there is no waiting in line. For the veteran that is coming back from Afghanistan and Iraq, they present to a medical facility with identification, and they are enrolled, and their access to mental health is immediate. If it is urgent, it is within 24 hours. If it is urgent, there will be some scheduling. If it is routine, there will be another set of scheduling tasks.

We hold ourselves to a pretty high standard of 14 days for an initial appointment for a non-urgent condition. We are not where we want to be in meeting that standard, and, therefore, we hire staff to give us that capability. But this is an ongoing balance between our requirement just grew, we need to have staff to accommodate. And so that will continue.

Dr. Petzel?

Dr. PETZEL. Thank you, Mr. Secretary.

Senator Kaine, just to go through a couple of other things, one is that we have for phone, as you mentioned, the crisis hotline, which has worked very well—800,000 calls, 26,000 rescues from people harming themselves, and good, hot transfers of patients to immediate care.

As the Secretary mentioned, you can walk into either a clinic or the emergency room, and you will be seen immediately. Anybody with an urgent or emergent need will be evaluated immediately.

I would like to talk with your staff afterwards to find out about this e-mail call—

Senator KAINE. Good. We have some information to share with you.

Dr. PETZEL. —to see where that e-mail went and to find out exactly what happened.

For patients that are established, we have secure messaging where they can communicate back and forth with their providers. But I would want to find out where that e-mail went.

We are, as the Secretary mentioned, holding ourselves to a high standard of 14 days for the routine appointment, and we are getting better and better at both measuring and meeting that standard. Very importantly is making people aware of the fact that, one, these services are available; two, that it is okay to come, that it is okay to say, "I have a mental health problem." And we have two campaigns going on, one directed at veterans specifically called "Make the Connection," and another one directed at both veterans and family members, urging them to understand what the signs are, urging them to know what can be done, and urging them to get people into care.

Our biggest issue and our biggest problem really are the people that do not come to us. When somebody comes to us seeking care, we usually do an excellent job of taking care of them. It is reaching the others that we need.

Chairman MURRAY. Thank you very much.

Senator King?

Senator KING. You must not get up in the morning of a hearing like this and say, "Gee, I cannot wait to get over there for the questions." So I want to start with a compliment. The VA hospital in Togus is a gem. It is the oldest VA hospital. Togus, Maine, is the oldest VA hospital in the country. I was there just a couple of weeks ago. A good friend of mine's husband recently passed away at the hospice facility, the new hospice facility there. Nothing but positive comments about the treatment received at that facility. The staff you have there is fantastic, and it really is a model of serving our veterans well. So I want to share that with you. That is something that is really working.

I just want to express my frustration about the backlog and about the computer system. I do not understand, Madam Chairman, why Government agencies have so much trouble getting systems running. Amazon does it, eBay does it. If eBay, you know, had a system like this, they would have been out of business a long time ago. I do not understand why the FBI, the Veterans Administration, the Defense Department just cannot seem to get these systems going, and this is no answer, Mr. Secretary, but it is just frustrating. It costs us a fortune, and they never seem to work, and they do not talk to each other, and it is just very frustrating. I am going to spend some time here working on this.

I thought that the VA—I have always been told that the VA medical records system, electronic medical records system, was one of the best in the there, and now I am hearing it is—has something deteriorated in the last few years?

Secretary Shinseki. Senator, our electronic health record remains quality. At one time it was well up there, and I think over time others have closed the gap. But it still remains about the best electronic health record in this country.

Senator KING. But it is not interoperable with the Department of Defense?

Secretary Shinseki. It is not. And so for the past 4 years, two Secretaries, first Secretary Gates and then Secretary Panetta and I, and now Secretary Hagel and I will undertake dealing with the frustration you described, and that is, why don't we have a single, common, joint, integrated electronic health record?

Senator KING. And, of course, we ought to have one for the whole country. I would settle for the VA and the Department of Defense, but it would be nice if every hospital in America was not reinventing this.

Secretary Shinseki. Sure. And I think between the Secretaries, the intent was if we get this right, this will be of great use to—other health care systems in the country will not have to invest development dollars in a program they may not be able to afford. And I think this is what the President had in mind when he declared VLER, this Virtual Lifetime Electronic Record, that would do, you know, administrative data as well. But a key piece of that would be the Integrated Electronic Health Record that both DOD and VA were putting together.

Senator KING. Well, I commend you on that project and hope you will give it the highest priority, because once we get the systems in place that Senator Kaine mentioned, then everything else can fit. That will deal a lot with your backlog and all the other issues.

Senator Whitehouse asked a question about the chained CPI. Do you have a figure of what that would cost veterans over 10, 20, 30 years, and also what the escape hatch for low-income and disabled veterans that you mentioned would deduct from that? In other words, I am trying to get an idea of what we are—what are we talking about for numbers here?

Secretary Shinseki. I do not have the numbers. I did not the numbers that the Senator provided, and I will have to go and take a look at that.

Senator KING. Well, that overall number he mentioned of 230 billion I think is the number for the chained CPI for all of Government. But I would appreciate if for the record you could do some looking at what it would cost veterans and then what would be put back by the escape hatches that the President has proposed in his budget. It just gives us a better idea of what it is we are actually grappling with here, having the real numbers instead of speculation about what it would be save and what it would cost.

Secretary Shinseki. Okay. I will do that.

Senator KING. I was late for this hearing. I just came from a hearing at the Armed Services Committee with the Army, and we were talking about outplacement and what happens when somebody leaves the military, falls under your jurisdiction, and then has a hard time finding a job.

Are you satisfied with the Department of Defense's work on transitioning soldiers and sailors and marines into the private sector economy? It just seems to me they spend a lot of money on recruiting. Perhaps they could spend some money on what amounts to outplacement.

Secretary Shinseki. Well, Senator, we have for several years now worked very closely with DOD to create a Transition Assistance Program that is different than the one I remember when I left the military, and this one is intended for both Departments to share in that transition period so that when the uniform does come off, for our purposes we have the data we need to make decisions regarding health care needs for the long term, and benefits issues that a veteran may have. Not all veterans will have those issues, but for the ones who do, we need to have that handoff. And, also, a decision to go to college, that should be accomplished before the uniform comes off so that there is a vector on which a veteran is moving, whether it is to college, whether it is to vocational training, whether it is straight to employment. And that is work in progress.

Senator KING. Well, one thing the veterans have when they leave is tremendous training, and one of the problems across the country is that that training does not necessarily match the certification requirements of individual States. And I would urge a research project, if you will, to see what the certification requirements are and how we can work with the individual States. It is ridiculous that you have someone in the military who is trained as an electrician and cannot become an electrician in whatever the State is because they do not meet some apprenticeship requirement when that is what they have been doing.

So I would urge you. I think that is something that could be done that would ease this transition. It is very frustrating, if I were a veteran and had those kind of skills, that I could not get a job because I do not meet some kind of paper requirement when I have been doing it for 4 or 5 or 10 years in the military.

Secretary Shinseki. I would say, Senator, the military, as I recall, does document that work experience, and now it is a matter of having various trades and States accept it. And I would say at the last annual Governors conference, I do know that the First Lady had this discussion with the Governors present and asked them in each of their States to take a leadership role in this. And I understand some States have already legislatively begun to create those opportunities you describe.

Senator KING. Thank you. As a former Governor, I still believe in States rights, but I think this is one where the States ought to act with alacrity.

Thank you, Mr. Secretary.

Chairman MURRAY. Thank you.

Senator Merkley?

Senator MERKLEY. Thank you, Madam Chair, and thank you, Mr. Secretary, for all of your companions who are working so hard on these issues.

I wanted to first thank you very much for working closely with my team on the burial waiver issue. Very, very thoughtful, very thorough, and deep appreciation.

I wanted to ask you about the Veterans Job Corps. I am happy to see the budget include $1 billion in funding for this. The reason I am so interested in this is when I met with our soldiers overseas in Iraq and Afghanistan, many of them talked about their anxiety in finding jobs when they came home. And for those who cannot find jobs in this difficult job environment, it seems like having a volunteer corps—or a job corps, not a volunteer corps but a job corp, in which folks can get their feet back on the ground, create structure in their lives, create income while they are readjusting to life stateside would be enormously valuable and related to the broader issues we face in kind of the disorientation that soldiers have and their financial success in transition.

We had a vote on this in the Senate where we did not get cloture. I hope we are going to be revisiting it. But do you consider this to be an important, valuable initiative?

Secretary Shinseki. Senator, thank you for that question. Several initiatives here. I think you will recall that out of the White House there was a tremendous effort under a program called “Joining Forces” where the First Lady and Dr. Jill Biden reached out to the private sector and asked employers to step forward and provide, as I recall, up to 100,000 jobs for military spouses and veterans by the end of fiscal year 2013. That target was met in 2012, and I think they have increased their objective to something in the neighborhood of 250,000. So that is one effort.

On Veterans Job Corps, the proposal is to look at $1 billion in mandatory funds for up to 20,000 veterans over the next 5 years in conservation and restoration, law enforcement, and infrastructure projects on public lands. This is intended to address the issues that you described of members in the military coming back and having immediate access to the kinds of jobs that require skills and experience that they have had recently. So it is national parks and forests, national monuments, other public lands, everything from park maintenance projects to patrolling public lands, rehabilitating natural recreational areas, and then administrative, technical, law enforcement-related activities. That is the program, and it remains high priority.

Senator MERKLEY. Well, thank you so much for advocating for it, and I wanted to mention that I hope that if we can accomplish this, we can also include forest health jobs in our national forests because we have millions of acres that need to be thinned for better ecosystems, better timber stands, fewer fires, and less disease. And it is a very solid, robust way to be engaged in furthering a public good, if you will.

I wanted to turn to the suicide hotline or the veterans hotline, and I think the statistic that really strikes me in your testimony on page 15 is, “In the most serious calls, approximately 26,000 men and women have been rescued from a suicide in progress...” That is phenomenal. And how many others have been helped as they were maybe hours away or days away by the concern expressed, the access to resources, the chance to talk to other veterans?

I just want to make sure that this has all the support it could possibly have and to note that there is a group in Oregon that provides backup services to this line when they have a high demand and need additional folks. This is a group that has done a lot of work with our National Guard, and so I thank you for that contract to that group in Oregon.

But do we have the resources here that we need? And is this playing an important role?

Secretary Shinseki. Senator, I would just begin by saying, you know, one suicide by a veteran is a tragedy, and it is one too many, and that has been the approach we have taken for 4 years now. Our mental health budget, as I indicated earlier, over 2009 to 2014 has been increased by nearly 57 percent. You know, 57 percent is a percentage, but the 2014 request is for $6.9 billion. That is how much effort we are putting into this.

And one of the programs that is resourced by this is the National Veterans Crisis Line you described in Canandaigua, New York, probably in the last 5 years, near 800,000 calls, but the key factor here is the 26,000 interventions you describe.

What we have watched over time is those calls continue to increase. The number of crisis calls, the 26,000, have begun to taper off. And our understanding of these data points is that people are calling earlier, not at the last minute, and our clinicians online—these are actually professional mental health folks—are able to get them referred into mental health care. They are getting there. We see the trends. And our suicide rates have stayed flat. They are still too high, but we think we have a program here that works. But the crisis line is sort of that last resort. It is not the solution here, and so we are putting energy into research and trying to understand what DOD—how to deal with this better in the future.

And I know Dr. Petzel has something to add, but let me just try to stifle him for a moment and see if you have any other questions here.

Senator MERKLEY. Doctor, my time has expired, so I will mention three things, and I will leave it to the Chair as to whether—one, I wanted to mention the hard work on homelessness. I will follow up with some questions for the record about the estimates. I was surprised to see the 17-percent decrease. That is tremendous. I wanted to understand better how those statistics are put together, because I am not seeing the decrease in my State, so I want to understand that. But I applaud it.

Second, I want to emphasize the point that has been made about the disability claims. That is a huge issue.

And, finally, I want to echo Senator Whitehouse's concerned about the chained CPI.

Thank you.

Chairman MURRAY. Thank you very much.

Senator Nelson?

Senator NELSON. General, thank you for your services to our country and your continuing service to our country.

No doubt you are all the more frustrated in realizing that so many of the veterans retire, and where do they come? They come to my State of Florida. The Tampa Tribune points out recently that the Veterans Affairs Regional Office in St. Petersburg is behind on benefit claims processing; 70 percent of the claims are classified as backlogged and older than 125 days. And I am sure that is an enormous frustration to you. It clearly is to us. And so we wish you the best as you try to get your hands around this, and the money that you are spending on all of the IT, then you have to implement all of that IT.

I would merely bring up one other issue, and that is the one that you and I have—you graciously have talked to me individually about the Orlando VA hospital. It was supposed to be completed a year ago. In January, we got a report that says that it is 75 percent complete. And yesterday I got a report that it is 75 percent complete. And we have been assured that the VA says that it will be open August of this year.

What can you tell us, please?

Secretary Shinseki. Senator, I believe the original date was October of 2012, so we are behind schedule. Construction continues on this VA medical center. For the most part, it is complete. It is the main building that is still left to be completed.

Overall, several days have passed, but my number here says it is 79 percent. But we continue to make progress. There are people on-site.

The contractor has been served two cure notices and one show-cause notice for not staying with the schedule and the contracting timelines we had agreed to.

We received a response to the show-cause letter that was issued in January. We have just received the response, and we are going through it now and trying to be as collaborative with the contractor to get us to complete this project, you know, as we had expected. And—

Senator NELSON. Then does this imply that it will not be completed in August of this year?

Secretary Shinseki. I do not know that yet. I mean, we are dealing with a contractor's response to show-cause, and, frankly, the contracting folks are into this, and at some point I will get an assessment of what they—

Senator NELSON. Does this suggest incompetence on the part of the contractor?

Secretary Shinseki. Is this—say that again?

Senator NELSON. Does this suggest incompetence on the part of the contractor?

Secretary Shinseki. Since this is in a contract phase, allow me not to pass judgment here. I would just say we are behind schedule.

Senator NELSON. Well, that must be, of course, doubly frustrating to you who are trying to get all of this care done. For example, the community living center and the domiciliary, that is all complete.

Secretary Shinseki. That is correct.

Senator NELSON. But you cannot open it up until you get the rest of the complex complete.

Secretary Shinseki. That is correct.

Senator NELSON. And that is a domiciliary facility for about 60 beds for homeless vets. We cannot just accept this. It seems to me that from your office you ought to suggest that some heads ought to roll so that people know that we mean business when we set a contract and set some deadlines.

Are there financial, are there severe financial penalties in the contract for not completing on time?

Secretary Shinseki. I would say there are provisions for that. I am not knowledgeable enough to declare whether they are severe or not, but these are normal steps in the contracting process.

Senator NELSON. Maybe that suggests that we ought to rethink how we contract. If there are just provisions and there are no severe financial penalties or financial incentives, the carrot-and-stick approach, maybe our contracting is outdated.

Secretary Shinseki. I did not mean by the use of the word "provisions" that there were no carrot-and-stick opportunities here. They are there. I am just not familiar with exactly the details of it.

Senator NELSON. Well, I would request, since the Chairman of the Veterans Committee is here, Senator Sanders, I would suggest that since we have this continuous delay in the construction of a major VA facility in a State where veterans are moving to in droves, my State, that there be a response to the Committee of record, Senator Sanders' Committee, on what are the provisions and what are we going to do about it in future contracts so we do not have these kind of delays. Financial incentives of both benefits and penalties have worked in the past.

Secretary Shinseki. We do have those as part of the contract. I am happy to provide that for the record.

Senator NELSON. Thank you.

Chairman MURRAY. Senator Sanders, the Chairman of the Veterans Committee, has joined us. Thank you very much. Senator Sanders.

Senator SANDERS. Thank you, and, Madam Chair, let me apologize for being so late, but I was chairing a Subcommittee on primary health care for the last couple of hours, which takes me to one of the questions I would like to ask perhaps Dr. Petzel or the Secretary.

I just spent several hours on Saturday in White River Junction and being very impressed by some of the work they are doing in terms of diabetes prevention. But, Dr. Petzel, my impression is that the VA is actually cutting edge in terms of addressing, Madam Chair, what is clearly one of the health care crises facing our country. God knows how many people are coming down with diabetes, are going to lose their legs, are going to go blind, end up in kidney dialysis.

What is the VA doing in terms of treating people who are likely or at risk for diabetes? Mr. Secretary?

Secretary Shinseki. Mr. Chairman, let me call on Dr. Petzel to provide his insights, and I will try to wrap when he is done.

Dr. PETZEL. Thank you, Mr. Secretary.

Chairman Sanders, the concept that you described was people that are at risk for developing diabetes, and I want to just describe briefly a program that the VA is pioneering where we are taking a selected group of what we call pre-diabetics, people who have mildly elevated but not seriously elevated blood sugars, and enrolling them in a 16-week program involving nutrition and exercise to try and prevent them and teach them the life habits to prevent them from developing Type 2 diabetes in the future. Type 2 diabetes is an epidemic in this country, and the veteran population is not being spared that.

In addition to that program, we have extensive programs within our PAC systems, the Patient Aligned Care teams in primary care, to deal with diabetes. The emphasis, again, is on exercise and nutrition so that you do not have to take insulin, so that you do not have to take the medications that might be associated with it.

You are absolutely right, the VA is on the cutting edge.

Senator SANDERS. And not only that, if I might ask, you are doing some very interesting work with telehealth. I learned a little bit of a lesson. I thought, "Telehealth, well, that is nice. A psychiatrist can talk to a patient." It is a heck of a lot more than that. In other words, as I understand it, early treatment, if somebody has a symptom, a foot problem, that can be treated. If it is ignored, you could lose your foot. Is that correct?

Dr. PETZEL. That is correct.

Senator SANDERS. Tell us a little bit about what the VA is doing in that area.

Dr. PETZEL. Well, first of all, we were one of the first health care organizations to have a set of measures related to the care of diabetes, so we require a foot exam at least annually. We require an eye examination at least annually. We follow the blood sugar, we follow the cholesterol. We require the cholesterol to be below a certain level.

Senator SANDERS. Is that a cost-effective—I mean, forget the fact that people obviously do not want to go blind or lose their feet. In terms of saving money, if you amputate and have to treat that, isn't that pretty expensive?

Dr. PETZEL. This is very cost-effective care. Preventing the complications of diabetes not only enhances people's lives, but it saves money.

Senator SANDERS. Mr. Secretary?

Secretary Shinseki. I would just add, just to wrap here, dialysis. We have historically employed commercial support on dialysis, and here of late I have asked and Dr. Petzel has led in bringing freestanding dialysis capability back inside the VA, not a lot but enough to help us understand dialysis in the way that we should.

We are a health care institution. If we outsource all of our dialysis, it is out there and we do not think twice about it. If we do some of it in-house, it forces us to think about the question you are asking: What causes all of this that ends up in dialysis? And it will force us to put research dollars at the front end to solve the problem as opposed to at the back end outsource the service. So I think for VA this is an important step.

Senator SANDERS. Madam Chair—and this is an issue we look forward to working with you on. I have been getting around a little bit, going to some facilities, and, again, as I mentioned, I was at my own facility in Vermont just this Saturday. And you know what I noticed? They have built a really pretty much state-of-the-art gymnasium in the facility which they say is being utilized by some 400 veterans. People come down every morning to exercise, work together.

Can you give us a guess, anyone, as to how many of your VA facilities have exercise gyms?

Dr. PETZEL. Many of them do, Senator Sanders. I cannot tell you how many do. We would have to get back to you, take that for the record.

Senator SANDERS. All right. Let me ask you this also. I noticed when I went to L.A. and Brooklyn, New York, that there was a discussion of acupuncture being increasingly used and wanted by veterans in terms of, among other things, pain management. One of the problems that I understand is that if somebody utilizes acupuncture, that treatment has to be given by a physician with expertise in acupuncture.

Have you explored enabling folks who are experts in acupuncture but not physicians to be able to practice within the system? Mr. Secretary or Dr. Petzel?

Dr. PETZEL. You are correct, Senator Sanders. As it stands right now in the VA, acupuncture is administered by physicians, often anesthesiologists. We are exploring the possibility of providing the credentialing and privileging of people other than physicians who are trained in acupuncture.

Senator SANDERS. Well, we are going to help you because we are going to be introducing a pilot project to see if we can move that along.

But is that problem—and, again, I want to congratulate you. And, again, as the Secretary knows, my major criticism of the VA is they forget to tell the world what they are doing. It is an area that has to be worked on, because I think there is a lot—at a time when we are spending so much money on health care, and when the VA is coming up with cutting-edge improvements and cost-efficient programs, it would be helpful to the rest of the world to know about that.

That would be my questioning right now. Thank you, Madam Chair.

Chairman MURRAY. Thank you very much.

Let me follow up on Senator Kaine's question on the mental health, and he gave you a specific example, but as you know, this is something we have been very concerned about, making sure that we get access at a critical moment for someone coming in for mental health care. And you have asked for a $469 million increase in mental health, and I appreciate that.

Under the Mental Health ACCESS Act that we passed, we required VA to develop new tools to determine exactly whether our VA facilities were meeting that 14-day standard that your answer to Senator Kaine was on. We had found previously that that was not being met. I assume those new tools are in place now. Can you tell us now what the current wait times are, according to the new tools that have been put in place and the staffing, any staffing shortfalls that you have?

Secretary Shinseki. Dr. Petzel.

Dr. PETZEL. Thank you, Mr. Secretary.

Madam Chairman, we have done a number of things since we last talked about this in the Senate Veterans' Affairs Committee. I want to just go through, before I talk about the wait times, a few of the other things that have been done.

First of all, we have redone the way we measure wait times. We now use two different measures, depending on whether you are a new patient into the system or whether you are an existing patient that is going for either further treatment or another kind of treatment.

For new patients, it is the "create date," so when you call or you walk in and say, "I want to be seen," or are judged to be needed to be seen for mental health, that is the starting time.

Chairman MURRAY. Right.

Dr. PETZEL. And the appointment time then is measured from that "create date."

Chairman MURRAY. Okay. So knowing that, what are our current wait times? And my time is short, so I want—if you can just answer the question.

Dr. PETZEL. About 50 percent of our patients are being seen in less than 14 days, and about 50 percent are being seen in more than 14 days right now. That is from November. We do not have data since we haveten this going in the entire system.

The average wait time for an appointment for a new patient that is not walking in for an emergency is 15 days. So we are getting close, but we are not there, and I would openly admit that we—

Chairman MURRAY. And if you could answer me in writing on the staffing levels, because that is a critical part of this, and it is certainly important to all of us.

Dr. PETZEL. Right.

Chairman MURRAY. I just wanted to quickly ask a couple other questions. One of them is on the integrated health care record that has been referred to back and forth here between the Department of Defense and the VA. We knew from the Walter Reed time, scandal time, that this was a critical effort. A lot of money has been put into this to have a coordinated record system. We considered the Department's joint development of a single integrated electronic health care record as really a cornerstone of that whole solution, but the Departments have now abandoned the drug cartel of a single record in favor of just interoperability between the two systems.

We have a March 28th memorandum from the DOD Operational Test and Evaluation Director that criticizes DOD's approach to the iEHR development as being, quote, manifestly inconsistent with the President's Open Standards Agenda for electronic health care records and notes that this resistance appears to be based on an in correct assumption that using open standards will take too much time.

I disagree. I support the White House's approach to implementing open standards. Open-source development brings together Government, industry, academia, and drives innovation, and is the right way forward. Are you concerned that DOD's apparent preference for commercial software will make achieving true interoperability even more difficult?

Secretary Shinseki. Madam Chair, let me just say, like you, I am committed to what we have been asked to produce here, and I would say that over my 4 years of working with Secretary Shinseki Gates and Panetta and now Secretary Hagel that both Secretaries are committed to a single, joint, common, integrated electronic health record, open in architecture and nonproprietary in design, which is what the President asked us to go to work on.

For Secretary Hagel, who arrived and was not familiar with the previous history on iEHR, he asked for time to get into is and understand where the program was. And so I await the next opportunity for the two of us to sit down here and ensure that the program is on track as we have committed to.

Chairman MURRAY. Well, I hope that is going forward, and I will certainly push DOD to do the same.

There is a December 6, 2012, memo from the U.S. Chief Information Officer and U.S. Chief Technology Officer that requires VA and DOD to submit a number of documents regarding the status of iEHR program, and I would ask t you provide us with a complete set of those documents as well.

Secretary Shinseki. All right.

Chairman MURRAY. Finally, just really quickly on Washington State, I appreciate the VA hospital campus construction being part of the budget. As you know, that is ongoing. But we still have some clinics that are really now behind schedule. Bremerton is behind because the Navy decided not to pursue a joint clinic, and the budget request does not reflect that change. And there has to be some progress on opening the new clinic in the North Olympic Peninsula and addressing some of the staffing concerns.

So I would just ask you if you could let me know back— you do not have to do it at this moment—where we are. We have to expedite those clinics, and they remain a top priority of ours.

Secretary Shinseki. We will do that, Madam Chair.

Chairman MURRAY. Thank you very much.

Senator Kaine?

Senator KAINE. Thank you, Madam Chair. Just two sort of compliments to finish off.

First, the VA has five polytrauma centers around the United States where it is both care but also research about how to deal with these complex injuries we were describing earlier. One of them is in Richmond at the McGuire VA, and I was there about 60 days ago, and very impressive, and I think that is, as I understand it, not just a VA effort but a VA–DOD effort to deal with these complex kinds of injuries that we are seeing. That kind of collaboration is to be encouraged.

And, second, Mr. Secretary, in response to some questions of both Senator Sessions and Senator King, you were talking about work at the VA to help folks on training, job training programs that you have that are very specific to needs you have or skills that veterans have that probably ought to be dealt with in a very direct way. But you made a point that I think is a really good one, which is the right way to start to deal with veterans' unemployment is not to start with veterans, but it is to start that vector of post-military employment while someone is in the military, whether it is through credentialing or other kinds of training. The first bill that I put in—and it is kind of related to my Armed Services portfolio—is the Troop Talent Act that is very much about credentialing, but about during the active-duty phase of somebody's experience when they are picking up skills, why not have them get credit for the skills at their moment of maximum training, at the very moment that they obtain them? You know, there is good work we can do working with veterans to tackle unemployment issues, but if we go further upstream and start to deal with this question while somebody is in active service, I think we will find that we can move the numbers on veterans' unemployment in a much more significant way. And I think some of the programs that you have at the VA might offer us some instruction for how to do it earlier, and I look forward to working together with you on that.

Senator SHINSEKI. I am happy to work with you on that, Senator. Great points.

Senator KAINE. Thank you.

Thank you, Madam Chair.

Chairman MURRAY. Thank you very much.

Secretary Shinseki, thank you to you and your entire team for coming here today. And as I said before, a budget is a lot more than just numbers and spread sheets. It really is a reflection of our values and our priorities, and certainly one of our absolute highest priorities is caring for those who served and sacrificed for the Nation.

So I really appreciate your coming here and this discussion and looking at how we are going to look at our budget in the future.

Senator Sessions asked you a bit about what comes down the pike 10 years from now. We have to be looking at that as we have a large number of veterans returning, an aging veteran population. The challenges are not going away, and we cannot just budget by the moment. We really have to look at how this is impacting our future. So I very much appreciate you and your team for all your work.

So as a reminder to all my colleagues, additional statements or questions are due for today's hearing by 6:00 p.m., and I would ask, if there is no objection, that testimony for the record submitted by the Wounded Warrior Project be included in this record.

[The prepared statement of the Wounded Warrior Project follows:]

STATEMENT FOR THE RECORD

WOUNDED WARRIOR PROJECT

HEARING ON THE FY 2014 BUDGET: VETERANS PROGRAM

BEFORE THE

COMMITTEE ON THE BUDGET

U.S. SENATE

APRIL 23, 2013

Chairman Murray, Ranking Member Sessions and Members of the Committee:

Thank you for inviting Wounded Warrior Project to submit our views on the President's VA budget for Fiscal Year 2014, and for your timely focus on this plan.

WWP welcomes the commitment to veterans reaffirmed in this budget, and deeply appreciates the broad recognition it provides to the debt this country owes those who served and sacrificed. That recognition, manifest in funding increases at a time of fiscal constraint for important programs within the Department of Veterans Affairs signals an ongoing effort to stand by America's veterans.

Nevertheless, one can rightly look deeper and ask – more than a decade into a war that continues to shatter bodies and minds – whether this budget truly meets the very profound needs experienced by many of our wounded warriors. This surely is an apt lens through which the Committee can look.

VA does certainly have additional programmatic resource needs. Importantly, however, we see this budget as falling short in some key areas – both with respect to its failure to make timely programmatic investments in strategically important areas, and in maintaining a largely unchanging course in areas where we would have hoped for new and bolder vision.

To illustrate the point, it is noteworthy that this budget asks Congress to make permanent two tax credits to encourage employers to hire veterans. For many warriors, however, military careers were cut short by life-altering injuries, and the challenge of finding employment is compounded by the need to develop new skills, tools, training or education, even as they attempt to re-integrate into their communities and rebuild their lives. While the Post 9/11 GI Bill is an answer for some, many others need good counseling and support. VA's vocational rehabilitation and education program (VR&E) should be an answer, a key transitional pathway. VA has failed, however, to give this program the priority and resource support needed for this generation of wounded warriors to get the kind and extent of help they need. For too long, for example, the size of counselors' caseloads has limited their ability to provide the extent of support needed, particularly for those with PTSD and traumatic brain injury. It is disappointing, therefore, to see that VR&E staffing levels under this budget remain flat, despite a projected increase in workload. But absent any plan to increase funding for this important program, we urge consideration of another approach to better ensure adequate support for wounded warriors – establish a system of prioritization. Consistent with the system of prioritization already in law with regard to enrollment in the VA health care system,[1] the vocational rehabilitation program could be structured to establish relative priorities, such that the most severely injured would have higher priority for receiving needed rehabilitative services than a veteran with a substantially lower percentage of disability.

Last year, adopting provisions on long-term TBI care that originated in legislation introduced by Senator Boozman and Congressman Tim Walz, this Committee approved and Congress enacted the Honoring America's Veterans and Caring for Camp Lejeune Families Act. The Boozman-Walz provision requires that VA provide veterans suffering from TBI with the opportunity to maximize independence through community-based services such as supported employment and life-skills coaching. It further requires that rehabilitation focus not only on achieving functional gains but on sustaining them. This important provision was intended to remedy VA's failure to meet such basic expectations of TBI rehabilitation. We see no indication in the fiscal plan for FY 2014, however, that VA is in any way budgeting to implement this important provision.

In contrast, VA points with some pride to a significant increase in funding for mental health. While we applaud the commitment reflected in that budgeting decision, we do not see a commensurate basis for confidence that the funding will have the decisive impact for which one would hope. Nor do we see evidence of a clear strategic plan underlying the $7 billion mental health budget. Instead we see relatively little in the way of course-correction beyond a plan to increase funding. We see little in the budget to foster a belief, for example, that those warriors who need, but have been reluctant to seek, behavioral health care from VA will now visit VA facilities. Many warriors have begun -- only to drop out of -- treatment; the budget suggests nothing to win them back or to keep others from following that course. One resource that many of our warriors cite with approval is the Vet Center program. But despite the drawdown and the likelihood of greater numbers in need of help, the budget projects no growth in that program. The mental health challenges facing wounded warriors alone would lead one to believe that VA should look beyond its own facilities and plan to work with the communities where our warriors live. But the budget is devoid of a real strategy for engaging communities, or even of a plan to increase substantially the numbers of veterans who would be afforded mental health care through fee or contract arrangements. We do, however, see two promising signs: the hiring and training

[1] 38 U.S. Code section 1705.

of veterans to provide peer-support services is a very encouraging step, as is the steady growth in tele-mental health services. These are dwarfed, however, by a seeming need to be "doing something," that translates into a plan simply to increase funding.

In a similar vein, the budget proposes increases in funding in a number of high-visibility programmatic areas, several of keen importance to wounded warriors. To illustrate, the budget proposes increases in funding for prosthetics. What it does not do, however, is acknowledge the need to improve prosthetics care – an area in which VA's leadership role has declined and where a vision for change has yet to be realized.

Finally, we welcome the priority given VA's effort to remedy the long-festering compensation and pension claims backlog. Wounded warriors certainly suffer as the result of shortcomings in a system intended to provide timely disability compensation. We encounter too many warriors who after sustaining severe wounds, receive only limited military retired pay (often because of too-hurried military processing), and too often experience many months of severe financial need while VA completes the process of adjudicating the warrior's claim. While we at WWP have provided monetary and other supports to individuals who find themselves in such straits, there should be no excuse for leaving combat-wounded warriors in limbo. It bears noting, however, that these problems are not exclusively of VA's making. While VA does "own" serious claims-adjudication problems, we should be cautious in believing that additional funding alone will produce an optimal system. (We recognize that VA has instituted some important streamlining efforts, though the promise in those efforts will take time to realize.) Not only are there "upstream" problems that require DoD resolution, but long experience persuades us that timely, effective claims-adjudication will continue to elude the Veterans Benefits Administration (VBA) until it effectively grapples with some underlying managerial problems. Indeed, in framing the challenge numerically – viewing determinations of service-incurrence and extent of disability solely as work to be counted and sped through a system – VBA risks cementing in place a system that does not necessarily serve either the veteran or its workforce well. These are not after all assembly-line "widgets," but determinations critical to the well-being of a wounded individual. Understandably, the singular focus on "moving claims" has bred morale problems among adjudication staff. While appreciating that VBA is redesigning systems and harnessing technology to eliminate a claims backlog, there is room as well for a complementary focus – one aimed at instilling in leadership and management the goal of empowering employees to do good work, rather than instilling a fear of punishment for failing to meet numerical indicators. Leadership is a first step in establishing that much-needed cultural change.

Thank you for considering our views.

Chairman MURRAY. With that, this hearing is adjourned.
[Whereupon, at 12:24 p.m., the Committee was adjourned.]

Questions for the Record
Senate Budget Committee
Chairman Patty Murray

April 23, 2013, Hearing on U.S. Department of Veterans Affairs Budget Request for Fiscal Year 2014

Department of Veterans Affairs' (VA) Responses
Responses Provided to the Committee on August 12, 2013

Submitted By
The Honorable Kelly Ayotte

BOARD OF VETERANS' APPEALS

Question 2: According to your budget submission, in FY 2012, it took the VA an average of 866 days to resolve benefit appeals. Your goal is 625 for FY 2014 with an eventual goal of 400 days. Why does this take so long? What must be done to fix this? What measures do you have in place to ensure that VA reaches its very modest goal of 625 days? Do you think 400 days is an appropriate target? What date has the department set to reach its 400 day target?

Response: Veterans, dependents of Veterans, and Survivors of Veterans may choose to appeal all decisions regarding VA benefits. The VA appeals process is bifurcated, with most of the steps for processing an appeal occurring at the Veterans Benefits Administration (VBA) Regional Office (RO) level. If the matter is not resolved to the Veteran's satisfaction at the VBA level, the appeal may be transferred to the Board of Veterans' Appeals (BVA) for a final agency decision. In other words, BVA is responsible for rendering a final decision in a matter on appeal, but most of the appeals processing steps, which can be lengthy, take place at the VBA RO level.

In fiscal year (FY) 2012, the average processing times for appeals at the VBA RO level (i.e., first stage of a VA appeal) were as follows: 270 days from Veterans' initiation of an appeal by filing a Notice of Disagreement (NOD) to VBA's issuance of a Statement of the Case, and 692 days from Veterans' perfection of an appeal by filing a Substantive Appeal (VA Form 9) to certification of the appeal by VBA to BVA.

At the BVA level (i.e., second (final) stage of a VA appeal), the average processing time in FY 2012 was 251 days from BVA's physical receipt of the case to issuance of a BVA decision. Notably, this includes the Board's cycle time of 117 days. Cycle time measures the time from when an appeal is physically received at BVA until a decision is reached, excluding the time the case is with a Veterans Service Organization representative for preparation of written argument.

In contrast, the Appeals Resolution Time (ART) is a joint measure (e.g., VBA/BVA) that represents the average length of time it takes the Department to process an appeal from the date a claimant files an NOD at VBA until a case is finally resolved, whether the appeal is resolved at the VBA RO level or at BVA. Thus, the ART includes many appeals that are resolved at the VBA level and never come to BVA for decision. Note also that the ART measures the time to a final resolution, such as an allowance, a denial, or a withdrawal of an appeal; this measure does not include remand decisions, as a remanded appeal is not yet finally resolved. That said, many cases are remanded (i.e., sent back for further development) to the VBA RO (sometimes several times) before a final BVA decision is rendered. In this regard, it is important to note that the ART includes the average 445 days it takes for cases that are remanded to the VBA RO to be recertified to BVA; that is, the ART clock continues to run for the duration of the remand period until a final decision is issued. It is also important to note that, in FY 2012, BVA remanded approximately 46 percent of its cases. This high remand rate means that cases are in the system longer, and this is a contributing factor for an increased ART time. By law, unless BVA can allow an appeal in full, if there are actions that must be taken by VA to assist the Veteran in substantiating his or her claim (such as providing a new medical examination or obtaining copies of medical treatment records), BVA must remand (i.e., send the case back to VBA) to complete those actions, as BVA cannot complete those actions at its level.

The ART target of 625 days for FY 2014 and the strategic target of 400 days as reflected in the budget submission are mutually set by VBA and BVA. BVA recognizes that it and VBA unfortunately did not reach the FY 2012 ART target of 675 days. Appeals often represent the most complex cases, generally including multiple issues and theories of entitlement that adjudicators at the VBA and BVA level must consider and address. Adjudicators at both levels must closely review all of the evidence of record, weigh it, and issue written decisions that adequately explain to the Veteran (or other appellant) why the decision was reached, to include proper citation to controlling legal authority. This is a labor-intensive process that often requires review of hundreds, and sometimes thousands, of pages of records. Another critical component that impacts both VBA and BVA is judicial review by the Federal courts, to include the United States Court of Appeals for Veterans Claims (CAVC), Federal Circuit, and United States Supreme Court. As the final adjudicator in the appeals process within the Department, BVA not only has to craft decisions that are understandable to Veterans and other appellants, but it must also issue thorough, comprehensive, and legally correct decisions that will withstand judicial scrutiny. While VBA and BVA strive to issue final appeals decisions as quickly as possible, the inherent nature of the work and attention required to adjudicate these cases, as well as the due process protections built into the system, necessarily mean that final resolution of appeals takes some time. The 400-day strategic target is an aspirational goal, and VBA and BVA aim to reach it after FY 2015.

Both VBA and BVA are engaged in efforts to increase efficiencies in the appeals process. In particular, in March 2012, VBA established the Appeals Design Team (ADT) to generate and implement innovative ideas to help decrease lengthy appellate processing times and increase appellate processing quality. One ADT proposal spawned a successful pilot program at the Houston Regional Office wherein claimants who disagreed with a benefits decision were asked to use NODs on a standardized form, also known as a SNOD. The control time during the pilot for the SNOD form was impressive, at only 7.8 days compared to 98.8 days for the non-pilot control time in Houston. In April 2013, the Office of Management and Budget approved the SNOD form, and BVA is working closely with VBA and the Office of General Counsel on ways to standardize the form to help improve efficiencies in appeals processing. In addition, BVA has increased video teleconference hearings, which allows BVA Judges to reduce travel for hearings, and, thus, remain in the office and leverage the down time to work cases when an appellant fails to appear for a hearing. VBA and BVA have also partnered on a Joint Training Initiative to reduce remands to the field and the resulting rework that is required when BVA remands to VBA. Additionally, BVA is pursuing a Lean Six Sigma study of the BVA decision-writing process to find efficiencies to increase decision output. BVA is leveraging technology to further streamline operations, to include use of a Virtual Docket that allows for efficient electronic management of BVA hearings, and virtualization of hearing transcripts and mail processes, thereby eliminating the delay caused by adding paper copies to claims folders. Finally, BVA has set forth a number of legislative proposals that seek to streamline the adjudicatory process. These include: (1) allowing BVA more flexibility in scheduling video teleconference hearings in order to minimize travel time and expenses related to conducting in-person hearings in the field; (2) reducing the time period to initiate an appeal with an NOD from 1 year to 180 days; (3) clarifying that a timely filed Substantive Appeal (VA Form 9) is a jurisdictional requirement for BVA review; (4) simplifying the content requirements of BVA decisions, making them more understandable to Veterans; and (5) changing Equal Access to Justice Act fee requirements to better focus attorney energy at CAVC on achieving improved results for Veterans.

In addition to seeking the above-mentioned efficiencies, BVA is also aggressively hiring attorney staff to execute the recent $8 million additional funding provided to ensure that appeals are adjudicated in a timely manner. This additional staff will assist with maintaining and/or improving BVA's cycle time of 117 days, and a similar focus on appeals at VBA will likely be required for VBA and BVA to jointly reach the 400-day strategic target.

Questions for the Record
Senate Budget Committee
Chairman Patty Murray

April 23, 2013, Hearing on U.S. Department of Veterans Affairs Budget Request for Fiscal Year 2014

Department of Veterans Affairs' (VA) Responses
Responses Provided to the Committee on August 12, 2013

Submitted By
The Honorable Patty Murray
Chairman

OFFICE OF ACQUISITION, LOGISTICS, AND CONSTRUCTION

QUESTION 3: Acquisition Reform and Savings In these tight budgetary times, now more than ever the Department needs to be smart and strategic about how it does business. The President's budget projects $370 million in new acquisition savings. If successful, several initiatives, including strategic sourcing, will help VA be more efficient and achieve substantial savings. The Department's strategic sourcing initiative requires that VHA and the Office of Acquisition and Logistics work and collaborate together through the Strategic Acquisition Center. I understand this initiative has suffered repeated delays.

a. What is the current status of the Department's strategic sourcing initiative?

Response: VA has implemented a robust process for analyzing the Department's spending to identify potential strategic sourcing opportunities. As a result of this process, the Department has completed approximately 40 business cases outlining potential savings in various spend categories such as medical-surgical products, prosthetics, laboratory supplies, healthcare services, information technology, and facilities management. VA's Veterans Health Administration (VHA) and Office of Acquisition, Logistics, and Construction's (OALC) Strategic Acquisition Center (SAC) are actively pursuing seven new strategic sourcing agreements derived from these business cases.

VA has successfully entered into strategic arrangements for obtaining a broad spectrum of information technology (IT) products and services. VA is continuing to leverage existing strategic sourcing arrangements in support of critical and high visibility mission areas such as pharmacy operations, medical-surgical prime vendor arrangements, consolidated high-tech medical equipment purchasing, medical referrals, hearing aids, and burial flag support for Veteran interments.

In addition to VA's internal strategic sourcing efforts, VA is also collaborating with various Federal agencies under the umbrella of the Federal Strategic Sourcing

Leadership Committee (SSLC). Current SSLC focus efforts are primarily targeted at leveraging Federal spend for various IT product and services. VA is taking the lead on proposing various Federal level medical-surgical strategic sourcing initiatives (e.g., hearing aids/batteries, wheelchairs, urinary catheters, IV pumps and supplies, etc.). VA is also a recognized Federal leader in terms of participation in existing Federal Strategic Sourcing Initiatives such as office supplies and small package delivery services.

b. In 2010 Secretary Shinseki directed the Department to implement an Integrated Acquisition Model. What is the status of the IAM as a whole?

Response: The overarching goal of the Integrated Acquisition Model (IAM) was to correct long-standing systemic contracting weaknesses in the Department. Specific IAM objectives were established to: ensure unity of effort; clearly define lines of authority and responsibility; improve procurement customer satisfaction; leverage purchasing power (spend) through improvements in standardization and strategic sourcing; improve compliance with procurement laws, regulations, and business rules; improve contracting workforce competencies; and improve data quality and transparency. Much has been achieved in 3 years.

The Acting Chief Acquisition Officer has put in place significant governance, policy development, and acquisition support frameworks to achieve better acquisition outcomes. Improvements in execution are reflected by steady increases in key performance measures. For example, improvements have been achieved in contracting compliance, use of automated acquisition tools, competition in contracting, use of the electronic contract management system, and award of contracts on time. Our VA Acquisition Academy (VAAA) provides cost-effective, in-house training for our acquisition workforce professionals, including contracting specialists, program managers, and contracting officer representatives. VA has a robust acquisition intern training program to train replacements for an aging acquisition workforce. Our intern programs are designed to provide necessary training, education, and experience components to develop acquisition professionals with the skills and business acumen to develop quality business solutions at fair and reasonable prices. A recent Government Accountability Office report on acquisition workforce development recognized many VAAA best practices for consideration by other Federal agencies. Additionally, our contracting efforts with Service-Disabled and Veteran-Owned Small Businesses have far exceeded the Department's goals and we lead all other Federal agencies in this area. Additional activities include the following:

- Development of new training and assessment approaches to improve the effectiveness of our legacy acquisition workforce.
- Fostering a program management culture to improve program cost, schedule, and performance outcomes.
- Establishing a VA Acquisition Corps.
- Development of specialized contracting cadres at our Technology Acquisition Center to support IT program requirements and at our Strategic Acquisition Center to support medical-surgical program requirements.

- Acquisition data quality initiatives to significantly improve VA's ability to manage risk and make smart, data-driven decisions.
- Provide centralized commodity/item management services, improve standardization, and develop strategic sourcing solutions to better leverage healthcare spending.

Whereas the IAM began as a discrete improvement initiative with a limited set of objectives and a fixed schedule, the effort has evolved into a more flexible, more comprehensive management approach to developing and synchronizing both long-term and short-term solutions for overcoming deficiencies in VA's acquisition community. This initiative has evolved into a process by which VA continuously prioritizes and oversees corrective actions to both strategic and operational/tactical acquisition challenges.

c. Has the Department achieved its performance objectives through implementation of this integrated model?

Response: As described above, many of the IAM's initial objectives have been accomplished; however, others, while improving, have yet to be fully realized. For example, efforts to improve standardization across the Department continue but are not proceeding as rapidly as originally anticipated, and internal customer service is not where we believe it should be. Significant efforts are underway to improve both areas to include maturing the commodity management infrastructure and educating acquisition and non-acquisition professionals on their responsibilities in the acquisition process.

Questions for the Record
Senate Budget Committee
Chairman Patty Murray

April 23, 2013, Hearing on U.S. Department of Veterans Affairs Budget Request for Fiscal Year 2014

Department of Veterans Affairs' (VA) Responses
Responses Provided to the Committee on August 12, 2013

Submitted By
The Honorable Mark Warner

OFFICE OF GENERAL COUNSEL

Question 4: I have suggested that the VA consider creating a formal partnership between the VA and William & Mary Law School that will enable the Puller Clinic to serve as national models of civic engagement, service to veterans, and collaboration with the VA.

a. This has the potential to help decrease the backlog since the legal clinic works with the Veteran to submit a complete claims package with all the supporting documentation, which reduces the time spent by VA claims processors spending time chasing down missing paperwork and forms. Is this something that Secretary Shinseki would be willing to explore?

Response: VA appreciates the dedication of and contributions made by the Puller Clinic's faculty and students in assisting numerous Veterans with their claims for VA benefits. We have been in contact with the Clinic's faculty regarding their interest in establishing a national program of Veterans' claims assistance involving law schools throughout the country and the possibility of partnering with VA. VA would encourage the Clinic to pursue opportunities to expand the type of services it provides Veterans, especially in the area of assisting Veterans to file fully developed claims, which would help expedite processing of their claims and reduce the overall claims backlog.

b. How can the VA facilitate a system where the Puller Clinic serves as a template for other law schools across the country who wants to establish legal services clinics to help our Veterans?

Response: Although VA shares the Clinic's interest in having law schools serve Veterans nationwide and developing ways to reduce the claims backlog, there are some challenges that exist in partnering with an entity such as the Puller Clinic. For instance, to the extent the Clinic seeks partnership with VA so that VA can provide grant funds for legal services provided by law school clinics, VA lacks legal authority to provide funding for legal services to Veterans or to contract with an outside entity to provide legal services on our behalf. Furthermore, VA cannot use its appropriations to fund programs for which it lacks legal authority. In order to directly provide legal assistance to Veterans and/or provide financial assistance to legal services providers through new assistance programs or competitive grant programs, VA would need new statutory authority. VA, however, could refer Veterans to law school clinics such as the Puller Clinic in addition to recognized Veterans Service Organizations as a resource for claims assistance available without charge. VA will continue to welcome opportunities to communicate with the Clinic with regard to its efforts to provide assistance to Veterans.

Questions for the Record
Senate Budget Committee
Chairman Patty Murray

April 23, 2013, Hearing on U.S. Department of Veterans Affairs Budget Request for Fiscal Year 2014

Department of Veterans Affairs' (VA) Responses
Responses Provided to the Committee on August 20, 2013

Submitted By
The Honorable Patty Murray
Chairman
And
The Honorable Jeff Sessions
Ranking Member

OFFICE OF POLICY AND PLANNING

Question 2: LGBT Veterans All servicemembers, veterans, and their families, must be treated fairly and equally. Yet today, gay and lesbian servicemembers, veterans, and their spouses and families are denied equal benefits under the law. The Department has taken important steps towards ensuring that VA is a welcoming and safe environment for LGBT veterans and their families, including:

- Instituting a standardized visitation policy so that a veteran's loved one can be at his or her bedside,
- Extending burial rights to the domestic partner of a female veteran, and
- Creating the Office of Health Equity, to ensure the equitable delivery of health care to all veterans.

The President's budget requests $911 million for VHA Central Office, which includes funding for the Office of Health Equity.

c. Additionally, in light of the ongoing litigation surrounding the constitutionality of the Defense of Marriage Act (DOMA), it is important that the Department be prepared in the event the Supreme Court finds DOMA unconstitutional. What steps is the Department taking to ensure it is prepared to offer benefits and services to eligible same-sex spouses of veterans in the event DOMA is struck down?

Response: On June 26, 2013, the Supreme Court held that section 3 of DOMA violates the due process and equal protection principles applicable to the Federal government by discriminating against same-sex couples who are married under State law.

Certain provisions in title 38, United States Code, define "spouse" and "surviving spouse" to refer only to a person of the opposite sex. See 38 U.S.C. § 101(3) and (31).

Under these provisions, a same-sex marriage recognized by a State would not confer spousal status for purposes of eligibility for VA benefits. Although the title 38 definitions of "spouse" and "surviving spouse" are similar to the Defense of Marriage Act (DOMA) provisions at issue in United States v. Windsor, no court has yet held the title 38 definitions to be unconstitutional.

VA and the Department of Justice are working together to assess the impact of the Windsor decision on the continued constitutional viability of sections 101(3) and (31) of title 38 and VA's obligations with respect to those statutes. Challenges to the constitutionality of the title 38 definitions of "spouse" and "surviving spouse" currently are pending before Federal courts in Cooper-Harris v. United States, No. 12-cv-887 (C.D. Cal.); McLaughlin v. Panetta, No. 11-cv-11905 (D. Mass.); and Cardona v. Shinseki, No. 11-3083 (Vet. App.). Senate bill S. 373, the Charlie Morgan Military Spouses Equal Treatment Act of 2013, which VA testified in support of on June 12, 2013 to the Senate Committee on Veterans' Affairs, would remove the requirement that a Veteran's "spouse" or "surviving spouse" be a person of the opposite sex.

Should the title 38 spousal definitions be revised or determined to be unconstitutional, VA will be prepared to update its policies and systems in a timely manner and ensure that the delivery and quality of Veterans' benefits remain at the highest standards. Our commitment to Veterans and their families will continue to be our focus as VA implements any necessary changes to comply with applicable law and guidance.

d. How will the Department be communicating potential changes to services and benefits to veterans if DOMA is ruled unconstitutional?

Response: If 38 U.S.C. § 101(3) and (31) are repealed or ruled unconstitutional, VA would begin recognizing same-sex marriages that are valid under the law of the state where the parties resided at the time of the marriage or the law of the state where the parties resided when the right to benefits accrued. These changes would be communicated to Veterans and their families by VA's Office of Public and Intergovernmental Affairs as well as other entities across VA, including the Veterans Health Administration, National Cemetery Administration, and Veterans Benefits Administration through digital media platforms (e.g., Web, social media), news media, key stakeholders, Veterans Service Organizations (VSOs), and state Veterans organizations.

e. Please detail the Department's timeline for implementing the necessary changes in policy to provide services and benefits to veterans and their same-sex spouses if DOMA is struck down.

Response: Presently, there are provisions in title 38 of the United States Code that limit the terms "spouse" and "surviving spouse" to mean persons of the opposite sex. On February 23, 2012, the Secretary of Veterans Affairs informed Congress that "consistent with VA's obligation to take care that the laws be faithfully executed, VA will continue to apply and enforce section 3 of DOMA and 38 U.S.C. § 101(3) and (31) unless and until Congress repeals those provisions or the judiciary renders a definitive verdict against their constitutionality." Should the title 38 provisions be repealed or determined to be unconstitutional, VA will build upon the work mentioned previously in our response to 2c and 2d to develop a proposed timeline for implementing necessary changes in policy.

10. You mentioned at the hearing ongoing conversations with DoD regarding the VA-DoD Integrated Electronic Health Records (iEHR). How would you describe the working relationship you have with Defense Secretary Chuck Hagel regarding this issue? Please provide me with an update on the progress you two have made regarding the VA-DoD iEHR.

Response: Over the course of Secretary Shinseki's tenure, he has had strong and collaborative relationships with each Secretary of Defense. In 2010, Secretaries Gates and Shinseki initiated quarterly meetings. Since that time, Secretary Shinseki has met with his Department of Defense (DoD) counterparts 13 times. Since Secretary Hagel's confirmation, he and Secretary Shinseki have met once. They recently participated together in a Senate Appropriations Committee roundtable and have an ongoing dialogue. VA is committed to developing a single, joint, integrated electronic health record – one that is open in architecture and non-proprietary in design. VA looks forward to continuing our work with DoD with the ultimate goal of improving the way we care for all Servicemembers, Veterans, and their families.

THE PRESIDENT'S FISCAL YEAR 2014 DEFENSE BUDGET REQUEST

WEDNESDAY, JUNE 12, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 10:30 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Wyden, Nelson, Whitehouse, Warner, Kaine, Sessions, Portman, Johnson, and Ayotte.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning, and welcome to the Senate Budget Committee hearing on the fiscal year 2014 budget request for the Department of Defense, and I want to thank Secretary Hagel, General Dempsey, and Under Secretary Hale for being here with us this morning.

The President has requested $526.6 billion in funding for DOD, with one-third going to operations, one-third going to personnel costs, and the remaining third used for investments. The President has also requested an additional $79.4 billion in Overseas Contingency Operations funding for DOD.

While the base budget request is essentially flat-lined, the Department is in a complicated position. They are finally ending the war in Afghanistan; implementing a new national security strategy; executing the pivot to Asia; and preparing for a range of potential problems, including North Korea, Iran, Syria, and the ungoverned spaces and extreme poverty that breed conflict. All of this has to be done with limited resources while facing continued sequestration.

Secretary Hagel, clearly you have a very difficult task in front of you.

A wide range of options has been put forward by many different groups to help meet these strategic goals while dealing with the budget constraints. None of them are easy, but I look forward to discussing them today. And I am especially interested in the findings of your Strategic Choices and Management Review.

I also want to highlight one of the Department's challenges in particular. After ending the war in Iraq, we are also finally winding down the war in Afghanistan. As we close out these campaigns, it is appropriate to draw down the funding that will no longer be needed. But this must be done responsibly, by finding the right balance between capabilities and capacity. At the same time, Congress needs to begin the process of modifying or repealing the Authorization for the Use of Military Force.

Overall, I support the President's commitment to that end. But this discussion is still in the early stages. We need to be sure that when we are ready to roll back the authorization, there is an appropriate and effective legal framework in place.

The new laws must be flexible enough to deal with rapidly changing events and our continuing efforts to protect the country from terrorists and atypical threats, while pulling back authorities that are only appropriate during wartime.

As we prepare for that discussion, I am very concerned about the effects sequestration is having now, and I am even more concerned about the long-term impact it will have if we cannot come together to replace it.

Civilian defense employees are being furloughed. The Air Force has now grounded 31 squadrons, and by the end of the fiscal year, two-thirds of Navy ships and squadrons will not be combat ready. And the Marine Corps believes a little less than half its combat units will not be combat ready by the end of the year, which is troubling to hear from the Nation's forces expected to respond to any situation at a second's notice. This should not be difficult.

Our colleague Senator McCain has called sequestration "devastating" to our military.

Speaker Boehner has talked about how it would "hollow our military."

Democrats agree sequestration is a terrible way to cut defense spending the same way it is a terrible way to cut spending on education, health care, and other national investments.

That is why the Senate budget takes a measured and fair approach to completely replace the sequester with a balanced mix of revenue and spending cuts. And it is why I believe one of our highest priorities right now should be coming together to get this done for the American people.

We could be well on our way to a compromise budget resolution. It has now been 81 days since the Senate passed our budget resolution. Since then, Republican leadership in the Senate and a minority of Senators have held this process hostage.

Let us be clear. Their obstructionism not only defies common sense, but it is dangerous.

I just described some of the most serious ways sequestration threatens our national security, and I imagine we will hear more of that today. Secretary Hagel and General Dempsey, we know these cuts will make it incredibly hard for you and our men and women in uniform to protect the country.

That is why Democrats have gone to the floor of the Senate 12 times now to ask consent to go to conference so we can move forward with fully replacing the sequester in order to protect our men and women in combat and our future readiness. We have been joined by Republicans like Senator McCain and Senator Collins, and many more have expressed public opposition to their leadership's obstruction. But, unfortunately, each time we have been blocked.

We want to do the right thing—talk and debate the issues with our House counterparts openly and follow regular order. Republicans have spent years saying the biggest problem was the Senate not passing a budget. Now that we have passed one, they are running away from regular order as quickly as they can.

And this is especially disappointing to me since Republican brinksmanship is how we ended up with sequestration in the first place. Continuing to manufacture crises is the only way to make the situation worse for the defense budget. Refusing to work together or compromise will force the Pentagon to deal with strict, across-the- board sequester cuts in future years, instead of the relative flexibility they would have in meeting lower spending limits under a budget and appropriations bills enacted through regular order. So I am hopeful that Republicans end their latest push toward brinksmanship and join us at the table in a budget conference under regular order.

And I want to be clear; I join the President, Leader Reid, and others in this: We are not going to negotiate over the debt limit. The United States is not going to default on our debt, and we are not going to let Republicans play political games with the global economy. We are still trying to fix the problems that were caused the last time that was tried in 2011. We cannot allow it to happen again.

To that end, the Senate budget resolution calls for $552 billion in discretionary defense spending in fiscal year 2014 and for $5.9 trillion over 10 years. The resolution also includes several reserve funds that allow for additional funding so long as it is offset appropriately. The Senate amount is significantly higher than the sequester levels, as well as the major bipartisan budget plans like the Simpson-Bowles Commission.

Now, after years of growth in the base defense budget—from $287.4 billion in fiscal year 2001 to $527.5 billion in fiscal year 2013—these reductions in growth will be significant. But they can be accomplished hand in hand with our military strategy and our need to ensure readiness for the current and future threats. There are still options available to meet these spending targets, and I hope we can work together to budget for the Department of Defense, with a focus on real threats, real needs, and common sense.

The Department needs to be reexamining how it can get the effects it needs as efficiently as possible, continue efforts to improve procurement to control costs and reduce waste, and work with Congress to determine how to balance force structure, modernization, readiness, and care for our service members and families.

Most importantly, the Senate's defense level is also part of an overall framework that would take a balanced, fair, and responsible approach to our budget by raising revenues, finding mandatory spending savings, and by cutting both defense and non-defense discretionary spending.

On the other hand, the House approach I believe is the wrong way to go.

In order to keep defense spending at the pre-sequester levels, Congressman Ryan's plan slashes other key areas of the budget. For example, international affairs funding— which is a vital part of our overall national security efforts—would be gutted under the House budget.

Marine Corps Major General James Mattis recently testified, “If you do not fund the State Department fully, then I need to buy more ammunition, ultimately.”

He is absolutely right, and I am very concerned that this type of unbalanced approach could have serious consequences.

Aside from the budget differences, there are several policy areas we need to address. Secretary Hagel and General Dempsey, I know you agree that the greatest strength of our military is the character and dedication of our men and women who wear the uniform.

Our service members volunteer to face danger, to put their lives on the line, to protect our country and its people. But there are some dangers that cannot be accepted and none of our courageous service members should ever have to face. Sexual assault has no place in our military; it goes against everything our services stand for.

It is absolutely unconscionable that a fellow service member, the person you trust to have your back and be there for you, would commit such a terrible crime. Worse is the prevalence of these crimes. The number of sexual assault cases has increased by more than a third since 2010. And of the estimated 26,000 cases in 2012, less than 3,000 service members reported these crimes.

Of those who bravely came forward to report the abuse, an astounding 62 percent of them were retaliated against in one way or another. That is absolutely unacceptable.

Equally troubling are the multiple reports of these crimes being committed by the very people who were responsible for preventing sexual assaults and helping victims. In fact, just last Saturday we learned the Army suspended the general in command of all Army forces in Japan over allegations that he failed in his duties to report and investigate a sexual assault.

This is an appalling situation that seems to get worse by the day. We need a cultural overhaul. We need to create a system where the protection and safety of victims is unquestionable, a system where those who commit these crimes and those who allow for this behavior are punished.

Secretary Hagel, you have taken some steps to help combat these terrible betrayals of trust, and we all really appreciate that. But it is also time for Congress to act on legislation to give victims the protections they deserve to seek justice and which gives the Pentagon the tools to deal with this growing crisis.

I believe the solution starts with a dedicated legal counsel—specifically for victims—that is with them every step of the way through what is a deeply personal and painful process, which is exactly what Senator Ayotte, who is on this Committee, and I have proposed in bipartisan legislation. And I want to especially thank Senator Ayotte for being such an outstanding partner on this and for all she has done to push this bill forward.

In addition to endorsements from important groups like the Service Women’s Action Network and the Military Officers’ Association, our bill now has 37 cosponsors and strong support from both parties, which should tell you we are doing the right thing.

Our bill is the Combatting Military Sexual Assault Act. It is aggressive and it is effective. It makes critical improvements to attack this unconscionable issue from several angles by empowering victims with special military lawyers to help guide them through the legal process; it prohibits sexual contact between instructors and trainees during basic training to make sure the terrible things we saw at places like Lackland Air Force Base and Aberdeen Proving Grounds will not happen again.

And the bill also ensures members of the National Guard and Reserves will always have access to sexual assault response coordinators. And finally, it ensures sexual assault charges receive fair, thorough consideration, sending them to only the highest courts-martial. This will ensure that no individual member of the chain of command can misuse their authority to deny justice and hurt the victim.

The provisions of this bill were put together very carefully. I believe it works with the steps that you and the services are taking. It will be effective and will get to the heart of the sexual assault problem. This is the legislation that is workable and will make a difference.

And, General Dempsey, I was pleased to see you give your support to the central provision of our bill—providing Special Victims' Counsels to victims of sexual assault—during the SASC hearing last week, and I thank you for that.

In addition to combating sexual assault, there is much work to be done in providing adequate mental health care to our service members and their families.

And I am pleased to see in your testimony today that the Department's fiscal year 2014 request would protect funding for mental health care. There are several different initiatives to expand access to care, including some being piloted in my home State of Washington. I look forward to hearing more from you about the effectiveness of those programs and which should be expanded to help more service members.

One of the key initiatives that needs to stay on track is the DOD-wide review of mental health care which I asked Secretary Panetta to begin. A similar review by the Army has provided very important lessons, but I still have some concerns. And that is why completing the DOD-wide review to identify gaps in care and improvements must be made. Secretary Hagel, as we discussed yesterday, that review needs to be completed soon, and I look forward to hearing from you on the response to that.

We also need to improve our understanding of suicide and efforts to prevent it. The Army recently released data showing there have already been 109 potential suicides this year—in the Army alone—compared to 49 Army casualties in Afghanistan. This is an absolute tragedy, not only because of how many we have had this year, but because each year the number of suicides goes up.

Home towns should never be more lethal than the battlefield, and we have to be working to turn this around.

Developing a seamless transition is another challenge that VA and DOD continue to face, though important progress has been made. This will be even more important as the war in Afghanistan now winds to a close and you begin to right-size our military forces.

I have worked with the Department to make the Transition Assistance Program mandatory. Along with a major overhaul of the curriculum, this has created a much more useful tool to assist service members leaving the military. I look forward to additional components and improvements that are coming.

Other requirements to expand job opportunities and eliminate barriers to getting civilian licenses and credentials are key to combatting the unemployment rate for veterans which is still far too high. And I would like to hear from you about what you are doing to collaborate with our States and the private sector to bring our training and licensing requirements closer together.

We have made a lot of progress working with employers to help them hire veterans, and I will continue to engage our private sector partners to help them understand the skills that veterans bring to the table and why they make some of the best employees.

Helping our service members transition into education programs, good jobs, or starting small businesses does not just benefit the service member. It helps us grow our economy and the middle class and builds on the investments we have made in our newest veterans, as they continue to help our communities, our businesses, and their fellow veterans.

I also want to continue working with you on the significant improvements needed in the Integrated Disability Evaluation System—IDES. In particular, this means developing an end-to-end technology solution to get service members through this process quickly and accurately. I wrote to Deputy Secretary Carter in June of last year calling for the Departments to develop a solution, but the goal is still a very long way off, and there are other steps we need to make to improve the process that we will work with VA on, such as ensuring they provide sufficient exams for the PEB decisions.

I am also concerned about the effort to develop systems to allow communication between the VA and DOD's medical records.

Clearly the best option would have been a single joint electronic health record system that is open-source. This would have been the most effective solution; it would have revolutionized the market. But the Department has backed away from that goal, and I think everyone in this room is concerned you spent hundreds of millions of taxpayer dollars—and thousands of staff hours over the last few years—trying to create an integrated IT platform with the VA only to announce you were unable to find a solution.

Now, I know there are significant questions about how to move forward, but I expect that you and Secretary Shinseki will clearly define a plan and ensure leadership remains behind this important project. The lack of seamless integration between our two largest Departments is one of the most critical areas to address in order to reduce costs, increase efficiencies, and make sure our service members and their families get the care they need and deserve.

Overall, considering the serious budget challenges we face, now more than ever we must finally have effective collaboration between the Department of Defense and the VA.

It is not easy to get the Government's two largest bureaucracies to work together efficiently. This is a common theme in many of the areas that I just discussed. It will require your direct attention, including evaluating whether the entities tasked with overseeing VA–DOD collaboration are effective. But with a former Deputy Administrator of VA as the Defense Secretary and with a former Chief of Staff of the Army now heading the VA, we should be well positioned to make progress.

With that, thank you very much, all of you, for being here today and for your service to the country.

And with that, I will turn it over to my Ranking Member, Senator Sessions, for his opening statement.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Well, the Chairman has got a lot for you to do, and we have a lot to do.

I want to welcome Secretary Hagel and General Dempsey and Comptroller Hale to the Committee. Your work on behalf of national security efforts and our men and women in uniform that help provide our security is so much appreciated. We have the finest military the world has ever known. They are courageous and dedicated. They have responded to our call time and time and time again, multiple deployments away from their families, and they have responded with such fabulous dedication.

In the past, I am not sure that would have happened. But it is happening today, and I think a lot of that is leadership, commitment, and dedication, and the quality of the people we have in our services.

But we are facing challenges now. We will talk about the budget challenge today, and the Chairman has mentioned other issues that we will be talking about.

The sexual assault problem is real. General Dempsey, I appreciated your frank testimony before the Committee last week, the Armed Services Committee, and I know we will have an additional hearing this afternoon, several hours on that very subject before the Armed Services Committee, because that crisis cannot continue. And I believe you were crystal clear you intend to make sure it does not. And, Secretary Hagel, I know you share that commitment.

And I am also concerned about the suicide rate in the military, and I know it is a priority. It has been talked about for several years, and our top officers have discussed it, but we have not gotten to the bottom of that. And I know you are working on that.

Madam Chair, I would like to take a moment, a personal moment, to express my appreciation to Marcus Peacock. You know he will be leaving us. He is my Staff Director, and he has just done such a fabulous job. I asked him to be the kind of leader that would work with your staff, and even though you and I can really tee it up sometimes on our different views, I believe our staffs have worked really well together, and I think Marcus deserves so much credit for that. He is a man of integrity and ability. He was at OMB, and I have just been so lucky to have him on my staff and want to personally say at this moment how much I appreciate you, Marcus.

Chairman MURRAY. And, Senator Sessions, I echo those comments. Marcus, thank you for your tremendous service.

Senator SESSIONS. You just have people every now and then that you run into that love their country, put the service to their Nation first, and work hard at it constantly, and he is just one of those.

And I am really excited that we will be able to add to our staff, as our Director, Eric Ueland, who is known all over the Senate as one of the finest Senate staffers we have had in the Senate in recent years, and we are blessed to have him on board, and I think you will enjoy working with him also.

The fiscal year 2014 budget request for the Department of Defense comes to us at a very challenging time. With a diverse set of escalating global threats and a continued domestic fiscal crisis, it is more important than ever that we work together to make sure our military has the capacity and the sources to ensure the Nation continues as a positive force in the world. I know all of you believe in that.

In evaluating the President's budget, I found the most troubling aspect to be the treatment of how the sequestration part of the Budget Control Act is treated. For the second straight year, the impact of these sequestration reductions on our national defense spending have been hidden from the Congress and the public at large.

Surely the President claims his budget replaces sequestration, but he fails to provide a plan that has any chance of passing in Congress. If there is one thing the Department of Defense does need now—and I believe you gentlemen would agree—it is a concrete plan, some certainty on how to provide for the defense in these difficult times.

Unfortunately, uncertainty has become the hallmark characteristic of defense budgets in recent years. This is clearly seen in looking at the last four Department of Defense requests for 2014 funding levels. In the fiscal year 2011 budget, the future year defense plan that you based your budget on and you projected to continue forecasted that we would spend $598 billion in fiscal year 2014.

In each subsequent budget submission, planned funding levels for fiscal year 2014 fell, culminating with your request this year for $527 billion, which is above the sequester number, as you know, significantly. That is a drop of $71 billion for DOD funding levels from what was projected just 4 years ago.

There will be some who say spending at the Department of Defense contributed to our current budget problems and, therefore, deserves to be cut more than other parts of the budget. Well, that is wrong. We need to know some facts that I think are indisputable. Consider the following:

Fifty years ago, the United States spent 46 percent of its budget on defense. Under the President's budget, just 17 percent of Federal spending will go to defense. The wars in Iraq and Afghanistan have been charged with causing our deficits and putting us in an unsustainable debt course. But they only amount to 4 percent of our total Federal outlays since 2001. The wars, yes, were costly, in blood and treasure both. But it really only amounted to 4 percent of the Federal Government spending. In effect, it was $1.4 trillion for both wars in Iraq and Afghanistan and $36 trillion for all other spending in the United States Government during that period of time.

In the post-September 11th era, we spent an average of 4 percent of our GDP on defense, which is 3 percent lower than the post-World War II average of 7 percent of GDP on defense. Under the President's budget, we are projected to spend only 3 percent of our GDP on defense over the budget window. By fiscal year 2023, the last year of the President's 10-year budget, defense spending as a percentage of GDP will hit an all-time post-World War II low of 2.4 percent.

Now, I am not saying we cannot manage our money better and keep our costs down, but the truth is it is not—the problem in our deficits are far deeper than the war, the wars, or the base defense budget.

While DOD is still trying to cope with an initial $500 billion in cuts from the caps under the Budget Control Act, sequestration would cause another nearly $500 billion in cuts. And this is occurring while many of the fastest growing drivers of our debt on the non-defense side of the budget are held harmless from any cuts. Many of them have no cuts whatsoever. This disparity, we will see that sequestration causes our national defense spending on DOD to contract by 11 percent, and non-defense spending at the same time over the next 10 years will increase 44 percent. That is inflation-adjusted 2012 dollars over the fiscal year 2014 2012 through 2023 period.

So, again, let me repeat that. Over this period of time, basically half of the cuts are falling on the defense budget, and that is only one-sixth of the Federal budget. The other five-sixths of the budget, many departments are having zero cuts, and have been increasing at far greater rates than the Defense Department. They will have an increase of 44 percent.

So we cannot stand by and allow this unbalanced approach to remain the law of the land. There is too much at stake. Senator Hagel, General Dempsey, I want to ask you to reduce spending, be tighter with your management, do everything possible to be effective and lean and efficient. I do not hesitate to ask you to do that, and I think we can improve there. But I want to say to you, I do not think we should ask you to be in a position where the cuts are too fast and it hammers morale in the military and those who work for our Government in the military. We do not want to be hammering procurement systems that cause us to have penalties, delays driving up the cost per item because we could not fulfill the contract plan that we had to produce it at a more cost-effective rate. We have just got to be careful when we ask you to reduce spending that we are not asking you to do things that are unwise, drive up costs, and reduce readiness and capability.

So we have a constitutional obligation to provide for the defense of this Nation of ours and a moral responsibility to pass a safe Nation on to our children.

So I know that you are here and Congress has been confronting this openly, which I am glad to see we are, but at some point I hope you will also look up that number, 1600 Pennsylvania Avenue. The President is the commander in chief of the United States military, and Congress has got certain matters that they can accept and certain things they cannot accept. And we need some leadership from the President to understand that there are things that he is not going to get and things he has asked for in his budget are not going to happen. And we need to be able to work together to see if we cannot find other places where we can cut spending.

Medicaid has been increasing over the last decade. There is no reduction in Medicaid. Food stamps have gone from $20 billion to $80 billion over the last decade. Four times it has gone up. Zero reductions in the sequester for food stamps.

So I would just say there are places around here we need to be looking at, and we can save some money and spread the reductions around and call on all our agencies to tighten their belts, too. And I do not think international affairs spending is sacred—the State Department needs to its their belt, too. You go in to see the salaries they get and the expensive embassies that they are building around the world. They have to tighten their budget, too, and spread this around some.

So I am concerned about it. It is hitting us right now because we are marking up the defense budget today and tomorrow. We are marking to an unrealistic number, I am afraid. And, Secretary Hagel, I know you have committed to giving us some information on how we could have more flexibility in the Defense Department and do a better job of confronting those challenges, and I hope you will do it.

Consider me a friend, an ally. I believe that we can work with the President, I believe we can work with the Senate. But right now things are not going in a good direction. I do not see a plan right now to get us there. And, Madam Chair, I hope this hearing will help us make improvements.

Chairman MURRAY. Thank you.

With that, we will turn it over to our witnesses today. I again want to thank all of you for taking time out of very busy schedules to come before us. Secretary Hagel, we will begin with you.

STATEMENT OF THE HONORABLE CHUCK HAGEL, SECRETARY, U.S. DEPARTMENT OF DEFENSE, ACCOMPANIED BY THE HONORABLE ROBERT HALE, UNDER SECRETARY OF DEFENSE (COMPTROLLER)

Secretary Hagel. Chairman Murray, Ranking Member Sessions, distinguished members of the Committee, thank you for the opportunity to discuss the President's 2014 budget.

I very much appreciate this Committee's continued support of our men and women in uniform. As you have noted in your opening statements, some of the specific programs that you have focused on, led on, have been very important to getting started and sustained.

As we discuss numbers, budgets, and strategic priorities, we will not lose sight of these men and women serving across the globe. As you all know, their well-being depends on the decisions we make here in Washington. And as you have noted, Madam Chairman, the President has requested $526.6 billion for the Department of Defense fiscal year 2014 base budget and $79.4 billion for Overseas Contingency Operations.

My written statement contains considerable detail on both budget requests. This morning, allow me to briefly focus on three areas before I take your questions: first, the continued budget challenges facing the Department in fiscal year 2013 as a result of sequestration: second, the Department's fiscal year 2014 budget request; and, third, how the Department is preparing for future budget uncertainty and the prospect of further reduced resources.

As you know, the Department has been forced to implement deep and abrupt cuts in the current fiscal year because of sequestration. According to the latest guidance from the Office of Management and Budget, the Department has cut $37 billion in spending through the remainder of this fiscal year. With our internal decision to shift the impact of sequestration away from those serving in harm's way and force readiness, the cuts now fall heavily on DOD's accounts that train and equip those who will deploy in the future.

The Department is also experiencing higher wartime costs than expected. As a result of these factors, the Department is facing a shortfall of more than $30 billion in our operation and maintenance budget for fiscal year 2013.

To deal with this shortfall, the Department has cut back sharply on facilities maintenance, instituted hiring freezes, cut overhead spending, reduced important but lower-priority programs, directed furloughs of nearly 700,000 civilian employees, and submitted a $9.6 billion reprogramming request to Congress.

Given the scale of this shortfall, the reprogramming and other steps we have taken to cut non-essential spending are not enough. While we have protected spending to sustain the war effort and defend America's vital strategic interests, the Department's day-to-day activities will be significantly disrupted for the remainder of this fiscal year. Each of the military services has begun to significantly reduce training and maintenance of non-deployed operating forces.

For example, the Army has stopped rotations at its key combat training centers for all but deploying units. More than a dozen combat coded Air Force squadrons either already have or will soon stop flying. And the Navy has curtailed deployments.

To avoid even more significant reductions to military readiness, I directed furloughs of up to 11 days for most of the Department's 800,000 personnel. I made this decision very reluctantly. I made it reluctantly because I recognize the significant hardship this places on our civilian personnel across the country and their families. But the current budget environment is requiring very difficult decisions and options.

The President's fiscal year 2014 budget continues to implement the $487 billion in spending reductions over 10 years agreed to in the Budget Control of 2011, as Senator Sessions noted. If the sequester-related provisions of the Budget Control Act are not changed, fiscal year 2014 funding for national defense programs will be subject to an additional $52 billion reduction in DOD funding. And if there is no changes, continued sequestration will result in roughly $500 billion in additional reductions to defense spending over the next 10 years.

The President's fiscal year 2014 budget replaces sequestration and gives the Department the time and the flexibility—the time and flexibility—to plan and implement spending reductions wisely and responsibly, and we can do that wisely and responsibly.

In particular, this budget enables the Department to support troops still at war in Afghanistan, protect readiness, modernize the military's aging new weapons inventory in keeping with the President's strategic guidance, and sustain the high quality of the all-volunteer force.

This budget also continues the Department's approach of the last couple of years of targeting growing costs in areas of support, overhead, acquisition, and pay and benefits.

Over the next 5 years, DOD has identified $34 billion in new savings across these categories. This includes weapons program restructuring and terminations. They achieve $8.2 billion in savings. Slowdowns in military construction are also included, and reductions in other lower-priority programs.

Our military compensation package preserves DOD's world-class pay and benefits while putting our military on a more sustainable path for the future. It includes changes to the TRICARE program to bring the beneficiary's cost share closer to the levels envisioned when the program was first implemented.

The Department of Defense also must be able to eliminate excess infrastructure. The President's fiscal year 2014 budget requests authorization for one round of base realignment and closure in 2015.

Now, as we all know, BRAC is an imperfect process, and there are up-front costs, but in the long term, there are significant savings. The previous rounds of BRAC are saving $12 billion annually. We cannot justify funding unnecessary infrastructure when we are reducing our force structure.

Since 2003, DOD has divested more than 100 foreign bases and operations, and we are on schedule to close or consolidate over 20 more overseas operations. Although there are clearly opportunities to achieve significant savings by improving efficiency, consolidations, and reducing overhead, the scale of the current spending reductions will also require cuts and changes to military operations.

The fiscal year 2014 budget request seeks to further align budget programs with the President's defense strategic guidance while continuing to reduce the size of the ground forces and retire aging aircraft and ships. This budget invests in key elements of our defense strategy, including implementing our rebalance to the Asia Pacific region; maintaining a safe, secure, and effective nuclear stockpile; increasing investment in cyber capabilities; and sustaining the growth of special operations. And this budget seeks to preserve a combat-ready force and sustain the high quality of an all-volunteer force.

The fiscal year 2014 budget reflects DOD's best efforts to match ends, ways, and means during a period of intense fiscal uncertainty.

It is obvious that significant changes to the Department's top-line spending would require significant changes to the budget plan.

Consequently, I directed a Strategic Choices and Management Review in order to assess the potential impact of further reductions and then plan for those continued reductions if necessary.

I have received the initial internal results of the review, and I am now reviewing them, and I will continue to share those results with Congress.

The Defense Department will continue find new ways to operate more affordably, efficiently, and effectively. However, as I have stated, continued cuts on the scale and timeline of sequestration would require significant reductions in core military capabilities and the scope of our activities around the world.

The President's fiscal year 2014 budget sustains our military strength in an environment of constrained resources, giving DOD the time and the flexibility to make the necessary reductions and adjustments over a 10-year time frame.

Hard choices will have to be made over the next few years. In the past, many modest reforms to personnel and benefits along with efforts to reduce infrastructure and restructure acquisition programs were met with fierce political resistance, and they were never implemented. As you all know, we are now in a totally different fiscal environment. New realities are forcing us to more fully confront these tough and painful choices and to make the reforms necessary to put this Department on a path to sustain our military strength for the 21st century and meet new and complicated global threats. This will require the continued support and partnership of the Congress, and I look forward to your questions after General Dempsey's statement.

Thank you.

[The prepared statement of Secretary Hagel follows:]

AS PREPARED – EMBARGOED UNTIL DELIVERY

SECRETARY OF DEFENSE CHUCK HAGEL SUBMITTED STATEMENT ON THE FY 2014 BUDGET REQUEST FOR THE DEPARTMENT OF DEFENSE SENATE BUDGET COMMITTEE WEDNESDAY, JUNE 12, 2013

Chairman Murray, Ranking Member Sessions, members of the committee, thank you for this opportunity to discuss the President's Fiscal Year 2014 budget request for the Department of Defense.

Allow me to express my appreciation to this committee for its continued support of our men and women in uniform and our civilian workforce. They are doing tremendous work and making great sacrifices, along with their families, as they have for the more than 11 years our nation has been at war. Whether fighting in Afghanistan, patrolling the world's sea lanes, standing vigilant on the Korean peninsula, supplying our troops around the world, or supporting civil authorities when natural disasters strike, they are advancing America's interests at home and abroad. Their dedication and professionalism are the foundation of our military strength.

As we discuss numbers, budgets, and strategic priorities, we will not lose sight of these men and women serving across the globe. As you all know, their well-being depends on the decisions we make here in Washington.

Fiscal and Strategic Context

Today, the Department of Defense faces the significant challenge of conducting long-term planning and budgeting at a time of considerable uncertainty – both in terms of the security challenges we face around the world and the levels of defense spending we can expect here at home.

Even as the military emerges – and recovers – from more than a decade of sustained conflict in Iraq and Afghanistan, it confronts an array of complex threats of varying vintage and degrees of risk to the United States, to include:

- the persistence of violent extremism throughout weak states and ungoverned spaces in the Middle East and North Africa;
- the proliferation of dangerous weapons and materials;
- the rise of new powers competing for influence;
- the risk of regional conflicts which could draw in the United States;
- faceless, nameless, silent and destructive cyberattacks.

Meanwhile, the frenetic pace of technological change and the spread of advanced military technology to state and non-state actors pose an increasing challenge to America's military.

This is the strategic environment facing the Department of Defense as it enters a third year of flat or declining budgets. The onset of these resource constraints has already led to significant and ongoing belt-tightening in military modernization, force structure, personnel costs, and overhead expenditures. It has also given us an opportunity to reshape the military and reform defense institutions to better reflect 21st century realities, as I outlined in a speech in April at the National Defense University.

The process began under the leadership of Secretary Gates, who canceled or curtailed more than 30 modernization programs and trimmed overhead costs within the military services and across the defense enterprise. These efforts reduced the Department's topline by $78 billion over a five year period, as detailed in the Department's FY 2012 budget plan.

The realignment continued under Secretary Panetta, who worked closely with the President and the Joint Chiefs of Staff to craft new defense strategic guidance and a FY 2013 defense budget plan which reduced the Department's topline by $487 billion over the course of a decade. Even while restructuring the force to become smaller and leaner and once again targeting overhead savings, this budget made important investments in the new strategy – including rebalancing to Asia and increasing funding for critical capabilities such as cyber, special operations, global mobility, and unmanned systems.

The President's request of $526.6 billion for the Department of Defense's base budget for FY 2014 continues to implement the President's Defense Strategic Guidance and enhances the Department's efforts at institutional reform. Most critically, it sustains the quality of the all-volunteer force and the care we provide our service members and their families, which underpins everything we do as an organization. The accompanying OCO request for $79.4 billion provides the resources to continue the responsible drawdown in Afghanistan and restore equipment damaged or worn out by more than a decade of war.

DoD's base-budget request for FY 2014 does not reflect the effects of sequester cuts that would occur if the Budget Control Act (BCA) is not changed. However, the President's Budget includes balanced deficit reduction proposals that are more than sufficient to allow Congress to meet BCA goals and then repeal sequester-related reductions.

Challenges in FY 2013

Before discussing the particulars of this budget request, however, allow me to address the profound budget problems facing the Department in FY 2013 and beyond as a result of sequester – because they have significantly disrupted operations for the current fiscal year and greatly complicated efforts to plan for the future. The Congress and the Department of Defense have a responsibility to find answers to these problems together – because we have a shared responsibility to protect our national security. DoD is going to need the help of Congress to manage through this uncertainty.

The FY 2013 DoD Appropriations bill enacted by the Congress in March addressed many urgent problems by allocating DoD funding more closely in line with the President's budget request, giving the Department authorities to start new programs, and allowing us to proceed with important military construction projects. Nonetheless, the bill still left in place the deep and abrupt cuts associated with sequester – some $37 billion in spending reductions. With military pay and benefits exempt from the sequester, and our internal decision to shift the impact of sequestration away from those serving in harm's way, the cuts fall heavily on DoD's operations, maintenance and modernization accounts that we use to train and equip those who will deploy in the future.

Furthermore, the military is experiencing higher wartime operating tempos, and higher transportation costs than expected when the budget request was formulated more than a year ago. As a result of all these factors, the Department is now facing a shortfall of more than $30 billion in our operation and maintenance (O&M) budget for FY 2013.

The Department has been doing everything possible to reduce this shortfall while ensuring we can defend the nation, sustain wartime operations, and preserve DoD's most critical asset – our world-class civilian and military personnel. To that end, we have cut back sharply on facilities maintenance, instituted a hiring freeze, cut overhead and all non-essential spending, reduced many other important but lower-priority programs, and worked to shift funds from investment to O&M accounts.

Still, these steps have not been enough to close the shortfall. While we have protected spending to sustain the war effort and defend America's vital strategic interests, the Department's day-to-day activities will be significantly disrupted for the remainder of the fiscal year. Each of the military services has begun to significantly reduce training and maintenance of non-deployed operating forces – steps that are having effects on military readiness.

Specifically:

- The Army has stopped rotations at its key combat training centers for all but deploying units. By the end of the year, this and other training cutbacks will leave most non-deployed Army units at unacceptable readiness levels.
- The Air Force has or will soon stop all flying at more than a dozen combat coded squadrons. These units will soon no longer be ready to fight on short notice.
- The Navy has curtailed deployments, including the decision not to send a second carrier strike group to the Gulf.

We have also recently submitted a $9.6 billion reprogramming request to Congress. Most of this reprogramming seeks permission to move unneeded military personnel funding, and non-executable or lower priority investment funding, into our O&M accounts that are experiencing the largest budget shortfalls.

To avoid even more significant reductions to military readiness, and after extensive review of all options with the DoD's senior military and civilian leadership on how we address this budget crisis, I have decided to direct furloughs of up to 11 days for nearly 700,000 of the Department's civilian personnel. I have made this decision very reluctantly, because I know that the furloughs will adversely impact DoD operations. I also recognize the significant hardship this places on our civilian personnel across the country and their families. But the current budget is requiring difficult decisions and options.

After required notifications, we will begin the furlough period on July 8 at the rate of one furlough day per week for most personnel. We plan to continue these furloughs through the end of the current fiscal year. If our budgetary situation permits us to end furloughs early, I would strongly prefer to do so. That is a decision I will make later in the year.

FY 2014 Budget Request

Let me turn now to FY 2014. If the sequester-related provisions of the Budget Control Act of 2011 are not changed, FY 2014 funding for national defense programs will be subject to a steeply reduced cap, which would cut DoD funding by roughly $52 billion further. And, if there is no action by the Congress, roughly $500 billion in reductions to defense spending would be required over the next ten years covered by the BCA.

As an alternative, the President's budget proposes some $150 billion in additional defense savings (measured in terms of budget authority) over the next decade when compared with the budget plan submitted last year. These cuts are part of a balanced package of deficit reduction. Unlike sequester, these cuts largely occur in the years beyond FY 2018 – which gives the Department time to plan and implement the reductions wisely, and responsibly, anchored by the President's defense strategic guidance.

The President's FY 2014 request reflects these changes. It continues to balance the compelling demands of supporting troops still at war in Afghanistan, protecting readiness, modernizing the military's aging weapons inventory in keeping with the president's strategic guidance, and sustaining the quality of the all-volunteer force.

The requested funding of $79.4 billion for FY 2014 OCO provides funds to continue the responsible drawdown in Afghanistan and is lower than the roughly $89 billion enacted for FY 2013. The top-line budget request of $526.6 billion for base-budget funding FY 2014 is essentially flat compared to the President's request for FY 2013, and roughly in line with what both the House and Senate have passed in their FY 2014 budget resolutions.

The following are the major components of the $526.6 billion base budget request for FY 2014:

- Military pay and benefits (including TRICARE and retirement costs) – $170.2 billion (32% of the total base budget);
- Operating costs (including $77.3 billion for civilian pay) – $180.1 billion (34%);
- Acquisitions and other investments (Procurement, research, development, test and evaluation, and new facilities construction) – $176.3 billion (33%)

The base budget presented today, at its most basic level, consists of a series of choices that reinforce each of the following complementary goals:

- making more disciplined use of defense resources;
- implementing the President's defense strategic guidance;
- seeking to sustain the readiness and quality of the all-volunteer force;
- supporting troops deployed and fighting in Afghanistan.

As I discuss each of these goals, I must note that, unfortunately, many of the reductions we are being forced to make in FY 2013 as a result of sequester run directly counter to the FY 2014 goals.

1. Making more disciplined use of defense resources

In developing the FY 2014 budget, the Department identified about $34 billion in savings over the current Future Years Defense Program (FYDP), which covers FY 2014 to FY 2018. These savings were used to help pay the costs of implementing the new defense strategy and to accommodate budget reductions.

These efforts continue the Department's approach of the last several years to first target growing costs in areas of support, overhead, acquisition, and pay and benefits, before cutting military capabilities and force structure.

Reducing Support Costs

In order to maintain balance and readiness, the Department of Defense must be able to eliminate excess infrastructure. Therefore, the President's FY 2014 budget requests authorization for one round of Base Realignment and Closure (BRAC) in 2015. While the commission would meet in 2015, the actual closing of any bases would involve a multiyear process that would not begin until 2016.

BRAC is a comprehensive and fair tool that allows communities a role in re-use decisions for the property and provides redevelopment assistance. BRAC is an imperfect process, and there are up-front costs for BRAC, and this FYDP adds $2.4 billion to pay them, but in the long-term there are significant savings. The previous five rounds of BRAC are now saving a total of $12 billion annually.

We cannot justify funding unnecessary infrastructure when we are reducing force structure. Since 2003, DoD has divested more than 100 foreign bases and operations and we are on schedule to close or consolidate over 20 more overseas operations.

We are also taking other important steps to cut back on support costs. We have begun a study of our Military Treatment Facilities, including many hospitals and clinics that are currently underutilized. By the end of this year we will have a plan in place that suggests how to reduce that underutilization while still providing high-quality medical care. This restructuring, coupled with a BRAC round and other changes, would permit us to plan on a cut in our civilian workforce that will comply with Congressional direction.

We are also continuing our successful efforts to hold down military health system costs. Due primarily to changes in payments to health care providers, our projected costs for FY 2014 are about four percent lower than those costs in FY 2012, a significant turnaround compared to health care trends over the past decade. But costs will soon start to grow again. Therefore, we continue efforts to slow the growth of medical care costs through actions such as re-phasing military construction, making full use of past changes in provider costs, taking advantage of the slowing of growth in medical costs in the private sector, and modest changes in user fees and co-pays.

Another important initiative is our effort to improve the Department's financial management and achieve auditable financial statements. We need auditable statements, both to improve the quality of our financial information and to reassure the public, and the Congress, that we are good stewards of public funds. We have a focused plan and are making progress. Our next goal is audit-ready budget statements by September 2014. We are working hard to achieve this goal, though the current budget turmoil is hampering our efforts significantly. I strongly support this initiative and will do everything I can to fulfill this commitment.

These and many other changes led to total savings of about $34 billion in FY 2014-2018, including $5.5 billion in FY 2014. However, we are concerned that these savings from more disciplined use of resources could be eroded by sequester, as we are forced to make inefficient choices that drive up costs. Today, for example, we are being forced to engage in shorter and less efficient contracts and cuts in unit buy sizes that will increase the unit costs of weapons.

Restructuring and Terminations of Weapons Programs

In this budget, the Department has shifted priorities within its modernization portfolios and achieved $8.2 billion in savings from weapons program terminations and restructuring. For example, by revising the acquisition strategy for the Army's Ground Combat Vehicle (GCV) program, the Department will save over $2 billion in development costs. In other cases the Department proposes evolutionary approaches to develop new capabilities instead of relying on leap-ahead gains in technology.

For example, the Department:

- Realigned investment funding and restructured the SM-3 IIB interceptor – a high-risk, high-cost system – to improve the capabilities of existing missile defense systems, resulting in savings of about $2.1 billion during the Future Year Defense Program (FYDP);
- Cancelled the Precision Tracking Space Satellite system – another high-risk project – saving $1.9 billion during the FYDP; the Department invested a portion of these savings in technology upgrades to existing ground-based radars and sensors.

To lessen the potential impact on local communities from the reductions in defense procurement, the Department is requesting an additional $36 million in support of the Defense Industry Adjustment program.

The Department is continuing to take steps to tighten the contract terms and reduce risk in our largest acquisition program, the F-35 Joint Strike Fighter. The FY 2014 budget request includes $8.4 billion for the Joint Strike Fighter.

Military Pay and Benefits

The costs of military pay and benefits are another significant driver of spending growth that must be addressed in the current fiscal environment. In this budget, the Department is submitting a new package of military compensation proposals that take into consideration Congressional concerns associated with those from FY 2013. These changes save about $1.4 billion in FY 2014 and a total of $12.8 billion in FY 2014-2018

This package includes a modest slowing of the growth of military pay by implementing a one percent pay raise for service members in 2014. The Department is also seeking additional changes to the TRICARE program in the FY 2014 budget to bring the beneficiary's cost share closer to the levels envisioned when the program was implemented – particularly for working age retirees. Today military retirees contribute less than 11 percent of their total health care costs, compared to an average of 27 percent when TRICARE was first fully implemented in 1996.

The proposed TRICARE changes include:

- For retirees, increases in TRICARE Prime enrollment fees, instituting an enrollment fee for TRICARE Standard/Extra, and increasing Standard/Extra deductibles.
- Implementation of an enrollment fee for new TRICARE-for-Life beneficiaries, while grandfathering in those who are Medicare-eligible at enactment.
- Increases in pharmacy co-pays and, where appropriate, mandatory use of mail order delivery of pharmaceuticals.
- Indexing of fees, deductibles, co-pays and the catastrophic cap to the growth in the annual retiree cost-of-living adjustment.

Survivors of military members who died on active duty or medically retired members would be excluded from all TRICARE increases. Even after the proposed changes in fees, TRICARE will remain a generous benefit – as it should be.

These adjustments to pay and benefits were among the most carefully considered and difficult choices in the budget. They were made with the strong support of the Joint Chiefs of Staff and Senior Enlisted Leadership, in recognition that in order to sustain these benefits over the long term without dramatically reducing the size or readiness of the force, these rising costs need to be brought under control.

2. Implementing and deepening our commitment to the President's defense strategic guidance

Spending reductions on the scale of the current drawdown cannot be implemented through improving efficiency and reducing overhead alone. Cuts and changes to capabilities – force structure and modernization programs – will also be required. The strategic guidance issued in January 2012 set the priorities and parameters that informed those choices, and the FY 2014 budget submission further implements and deepens program alignment to this strategic guidance.

The new strategy calls for a smaller and leaner force. Last year we proposed reductions of about 100,000 in military end strength between FY 2012 and FY 2017. Most of those reductions occur in the ground forces and are consistent with a decision not to size U.S. ground forces to accomplish prolonged stability operations, while maintaining adequate capability should such activities again be required. By the end of FY 2014 we will have completed almost two thirds of the drawdown of our ground forces, and the drawdown should be fully complete by FY 2017.

Last year DoD submitted proposals for changes in Air Force and Navy force structure; some were rejected by Congress. We continue to believe, however, that these reductions are consistent with our defense strategy and the need to hold down costs. Therefore, DoD is resubmitting several proposals from its FY 2013 budget submission that were not supported by Congress, including the retirement of seven Aegis cruisers and two amphibious ships at the end of FY 2014 when funds appropriated for their operation run out. Despite the growing importance of the Asia-Pacific – a mostly maritime theater – the high costs of maintaining these older ships relative to their capabilities argues strongly for their retirement.

The FY 2014 budget continues implementation of the Air Force total force proposal included in the FY 2013 National Defense Authorization Act. In response to state and congressional concerns about proposed reductions to the Air National Guard that DoD made in the original FY 2013 budget, the Department added back 44 aircraft to the Guard, 30 aircraft to the Air Force Reserve, and is taking away 31 aircraft from the active Air Force.

These shifts were forced primarily by political realities, not strategy or analysis. While this active-reserve compromise allows the Air Force to move forward with prior year retirements and transfers, and approved mission changes for many reserve units, it does require the Department to retain excess aircraft capacity. The Department's position continues to be that retaining excess air capacity in the reserve component is an unnecessary expenditure of government funds that detracts from more pressing military priorities outlined in the defense strategic guidance.

Increased emphasis on the Asia-Pacific and Middle East represents another key tenet of the new defense strategic guidance. This budget continues to put a premium on rapidly deployable, self-sustaining forces – such as submarines, long-range bombers, and carrier strike groups – that can project power over great distance and carry out a variety of missions.

This new strategy not only recognizes the changing character of the conflicts in which the U.S. must prevail, but also leverages new concepts of operation enabled by advances in space, cyberspace, special operations, global mobility, precision-strike, missile defense, and other capabilities.

3. Seeking to sustain the readiness and quality of the all-volunteer force

The high-quality of our all-volunteer force continues to be the foundation of our military strength. This budget seeks to ensure that our troops receive the training and equipment they need for military readiness, and the world-class support programs they and their families have earned. However, as in other areas of the budget, the steep and abrupt cuts caused by the FY 2013 sequester has harmed these programs. The remainder of this discussion outlines the goals of the FY 2014 budget, but they would be significantly impacted if sequester-level cuts persist.

Readiness Investments

Even in the face of flat and declining defense toplines, this budget seeks to press ahead with the transition from a counterinsurgency-focused force to a force ready and capable of operating across a full range of operations across the globe. The service budgets all fund initiatives that seek to return to full-spectrum training and preparation for missions beyond current operations in Afghanistan.

The Department continues its work to understand and quantify readiness activities as we seek to maximize our preparedness for real-world missions. We do not yet know the costs of fixing the readiness of the force following the six months of sequester cuts to training in this fiscal year. Therefore these costs are not included in the FY 2014 budget.

Family Support Programs

The Department's budget submission makes clear that people are central to everything we do. While sequester cuts would unfortunately counter many of these initiatives, especially for our civilian workforce, the initiatives remain important statements of the intent in this budget.

The Department continues to support key programs in FY 2014 that support service members and their families, spending $8.5 billion on initiatives that include:

- Transition Assistance and Veteran's Employment Assurance – the Department continues to support the Transition Assistance Program (TAP) to ensure every service member receives training, education, and credentials needed to successfully transition to the civilian workforce.
- Family Readiness – the Department continues to ensure that family support is a high priority by redesigning and boosting family support in a number of ways.

The Department is also providing support to our people with a number of other important initiatives, including:

- Behavioral Health – the Department maintains funding for psychological health programs and expands those programs that are most effective, such as Embedded Behavioral Health, to provide improved access to care, improved continuity of care, and enhanced behavioral health provider communication.
- Suicide Prevention – the Department continues to implement recommendations from the Suicide Prevention Task Force and act on other findings from think tanks, the National Action Alliance's National Suicide Prevention Strategy, and DoD and Department of Veteran's Affairs (VA) Integrated Mental Health Strategy (IMHS).

Another area of focus has been Sexual Assault Prevention and Response. I have no tolerance for sexual assault in the military. This is a terrible scourge in our military and it must end. It will end. We will fix it. I have directed a number of initiatives to advance DoD's efforts to prevent and respond to the crime of sexual assault, along five lines of effort:

Accountability

- I directed DoD's Acting General Counsel to propose to the Congress changes to Article 60 of the Uniform Code of Military Justice (UCMJ) that would eliminate the ability of a convening authority to change findings in courts-martial, except for certain minor offenses. These changes would also require the convening authority to explain in writing any changes made to court-martial sentences, as well as any changes to findings involving minor offenses. These changes, if enacted, would help ensure that our military justice system works fairly, ensures due process, and is accountable.

- I have also directed the Service Chiefs to develop methods to evaluate military commanders' performance in establishing command climates of dignity and respect and in incorporating sexual assault prevention and victim care principles in their commands. This includes providing commanders the results of their subordinate's annual command climate surveys in order to enhance accountability and improve insight in command climate at every level of the chain of command.
- I have named a set of highly respected and experienced experts to serve on a panel called for in the National Defense Authorization Act for FY 2013. The panel will conduct an independent review and assessment of DOD's systems used to investigate, prosecute and adjudicate crimes involving adult sexual assault and related offenses. It will convene its first meeting no later than July 1st. I have spoken to the panel and asked it to accelerate its work and provide a final recommendation within 12 months.

Prevention

- I have directed the complete and thorough review of credentials and qualifications for DoD's sexual assault victim advocates, coordinators, and recruiters.
- I have directed DoD to improve the effectiveness of Sexual Assault Prevention and Response (SAPR) programs in recruiting organizations.
- I have directed DoD component heads to direct comprehensive and regular visual inspections of all DoD workplaces to include military academies to ensure that our facilities promote an environment of dignity and respect for all members and are free from materials that create a degrading or offensive work environment.

Investigation

- Consistent with the FY 2012 and FY 2013 National Defense Authorization Acts, DoD has established new policies to retain restricted and unrestricted reports for 50 years, and is developing policy for Special Victim Capability, which includes standards and training for prosecutors and investigators.

Advocacy

- DoD has implemented a sexual assault crisis intervention line, the DoD Safe Helpline, to give victims 24/7 global access to crisis support staff, implemented an expedited transfer policy for victims requesting transfer to a new unit, and expanded emergency care and services to DoD civilians stationed abroad.
- I have directed the Service Secretaries to implement methods to improve victim treatment by their peers, coworkers, and chains of command. Direct victim input will also be incorporated into these methods.

Assessment

- DoD has added sexual assault questions to DoD Command Climate Surveys and implemented policy to conduct assessments within 120 days for new commanders and annually thereafter, consistent with the FY 13 NDAA.
- I have begun holding a weekly review and progress meeting on DoD's various sexual assault directives to ensure that they are bringing about real change.

I receive weekly updates on the Department's prevention efforts in regularly scheduled weekly meetings. I also have an individual on my personal staff that I have tasked to oversee all of these directives and Department-wide efforts.

Everyone in this department at every level of command will continue to work together every day to establish an environment of dignity and respect, where sexual assault is not tolerated, condoned or ignored, where there is clear accountability placed on all leaders at every level. The leadership of this department has no higher priority than the safety and welfare of our men and women in uniform, and that includes ensuring they are free from the threat of sexual harassment and sexual assault. I will continue as Secretary of Defense to prioritize the Department's efforts to turn this problem around.

4. Supporting troops deployed and fighting overseas

The amendment to the FY 2014 President's budget includes $79.4 billion for Overseas Contingency Operations (OCO). Military operations in Afghanistan comprise a significant portion of the OCO request. Over the course of the year, American forces in Afghanistan are moving into a support role as Afghan forces take the lead. By February 2014, half of our troops there will have returned home, and by December 2014, United States' combat operations in Afghanistan will have ended. Still, the United States will maintain a commitment to Afghanistan's sovereignty and security, and we will continue to equip, train, advise, and assist the Afghan National Forces; support economic development and governance efforts; and pursue al Qaeda and its affiliated groups.

Of the total OCO request, $78.1 billion is for activities in support of Operation Enduring Freedom (OEF) and $1.3 billion is for finalizing transition activities in Iraq.

The Way Ahead: Strategic Choices and Management Review

The FY 2014 budget is a reflection of DoD's best efforts to match ends, ways, and means during a period of intense fiscal uncertainty. It is a balanced plan that would address some of the Department's structural costs and internal budget imbalances while implementing the President's defense strategic guidance and keeping faith with our men and women in uniform and their families.

It is obvious that significant changes to the Department's top-line spending would require changes to this budget plan. The Department must be prepared for any additional reductions to the defense budget that might result from Congress and the Administration agreeing on a deficit reduction plan, and it must be prepared in the event that sequester-level cuts persist for another year or over the long-term.

Consequently, earlier this year I directed a Strategic Choices and Management Review (SCMR) in order to assess the potential impact of further reductions up to the level of full sequester. The purpose of the SCMR is to re-assess the basic assumptions that drive the Department's investment and force structure decisions and to search for additional management efficiencies.

It is designed to help understand the challenges, articulate the risks, and look for opportunities for reform and efficiencies presented by resource constraints. Everything is on the table during this review – roles and missions, planning, business practices, force structure, personnel and compensation, acquisition and modernization investments, how we operate, and how we measure and maintain readiness.

I have received the initial internal results of the SCMR and am reviewing them now. The results will inform our planning for FY 2014 as well as our FY 2015 budget request, and will they be the foundation for the Quadrennial Defense Review due to Congress in February 2014.

It is already clear to me that achieving significant additional budget savings without unacceptable risk to national security will require not just tweaking or chipping away at existing structures and practices but, if necessary, fashioning entirely new ones that better reflect 21st century realities. And that will require the partnership of Congress.

The FY 2014 budget and the ones before it have made hard choices. In many cases, modest reforms to personnel and benefits, along with efforts to reduce infrastructure and restructure acquisition programs, met fierce political resistance and were not implemented.

We are now in a different fiscal environment dealing with new realities that will force us to more fully confront these tough and painful choices, and to make the reforms we need to put this Department on a path to sustain our military strength for the 21st century. But in order to do that we will need flexibility, time, and some budget certainty.

We will also need to fund the military capabilities that are necessary for the complex security threats of the 21st century. I believe the President's budget does that. With the partnership of Congress, the Defense Department can continue to find new ways to operate more affordably, efficiently, and effectively. However, multiple reviews and analyses show that additional major cuts – especially those on the scale and timeline of sequestration – would require dramatic reductions in core military capabilities or the scope of our activities around the world.

As the executive and legislative branches of government, we have a shared responsibility to ensure that we protect national security and America's strategic interests. Doing so requires that we make every decision on the basis of enduring national interests and make sure every policy is worthy of the service and sacrifice of our service members and their families.

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Chairman MURRAY. Thank you very much, Mr. Secretary.

General Dempsey.

STATEMENT OF GENERAL MARTIN E. DEMPSEY, USA, CHAIRMAN, JOINT CHIEFS OF STAFF

General DEMPSEY. Thank you, Chairman Murray, Ranking Member Sessions, distinguished members of the Committee. Thank you for this opportunity to discuss the budget proposal for fiscal year 2014.

This hearing comes during a period of extraordinary uncertainty. Risks to our Nation's security are increasing, but the resources for and the readiness of our forces are decreasing.

The will to win of our service men and women remains undaunted, but the means to prepare to win are becoming more uncertain by the day.

This budget was purpose built to keep our Nation immune from coercion. It is a responsible investment in an unrivaled joint force that is ready with options for a dangerous and uncertain future. It supports our forward deployed operations, upholds funding for emerging capabilities like cyber, and it reduces the conventional resources, the conventional and nuclear forces that have proven so essential to our defense over time.

Most importantly, it protects investment in our decisive advantage, which is, in fact, our people. It treats being the best led, the best trained, and the best equipped military as the non-negotiable imperative. It also makes sure that our wounded warriors and their families receive world-class care, family and medical services that are worthy of their service to the Nation.

There are some things this budget does not do. It does not reflect the full sequestration amount; rather, it imposes less reduction and it gives us more time to implement new cuts.

The consequences of full sequestration and its attendant risks to our national security will gain clarity in the weeks ahead. As you well know, the Senate asked us to provide our assessment of the impact on the joint force by the 1st of July.

Nor does this budget account for the costs of restoring lost readiness. We do not yet know the full costs to recover from the readiness shortfalls that we have experienced this fiscal year. As expected, we continue to curtail or cancel training and exercises across all services for those units that are not preparing to deploy. As a result, we are less ready every day for unforeseen crises or contingency operations. In effect, we are foreclosing on options.

And it is more expensive to become ready than it is to remain ready. This means that the costs to recover lost readiness will at some point compete with the costs of building the joint force we believe we need in 2020.

As our military power becomes less sustainable, we become less credible. We risk breaking commitments and losing the confidence of partners and allies. We lose the confidence over our defense industrial base and, worst of all, potentially the confidence of our men and women in uniform and their families.

Now, this outcome is not inevitable. Working together, we can uphold the readiness and the health of the force at an affordable cost. To do this, just as you said, Chairman, we need the certainty of a predictable funding stream, a reliable top line. We also need the time to implement tradeoffs in force structure modernization and readiness, as well as compensation. And we need the full flexibility to keep the force in balance. We simply cannot afford to postpone essential reforms through compensation and health care. Both must be allowed to grow more gradually.

We should stop pouring money into excess facilities and unwanted weapons systems. Real institutional reform is the only way to avoid repeating the mistakes of past drawdowns, and we do have a history of drawdowns.

We have an opportunity this time—actually, we have an obligation with this and any future budget to restore confidence. We have it within us to stay strong as a global leader and a reliable partner.

Thank you for all you have done on this Committee to support our men and women in uniform. I count on your continued support, and I look forward to your questions.

[The prepared statement of General Dempsey follows:]

STATEMENT OF

GENERAL MARTIN E. DEMPSEY, USA

CHAIRMAN

JOINT CHIEFS OF STAFF

BEFORE THE SENATE BUDGET COMMITTEE

FY14 DEPARTMENT OF DEFENSE BUDGET

JUNE 12, 2013

I. Introduction

Chairman Murray, Ranking Member Sessions, and distinguished Committee Members, it is my privilege to update you on the state of the US Armed Forces and to comment on the President's budget proposal for fiscal year (FY) 2014.

This year's posture testimony comes in the context of extraordinary uncertainty. Our Nation is going through an historic fiscal correction to restore the economic foundation of our power. As resources decline, risks to our national security interests rise. A more competitive security environment compounds these risks, increasing the probability and consequences of aggression.

This context calls out for our leadership. We can and must find it within ourselves to stay strong as a global leader and reliable partner. We must restore lost readiness and continue to make responsible investments in our Nation's defense.

II. Strategic Direction to the Joint Force

A year ago, I established four priorities to help guide our Joint Force through this period of uncertainty. Our way forward must be rooted in a *renewed commitment to the Profession of Arms*. This means preserving an uncommon profession that is without equal in both its competence and its character. Along the way, we must *keep faith with our Military Family*. This means honoring the commitments we have made to our service members and their families. They deserve the future they sacrificed so much to secure.

These two priorities serve as a source of strength for the Joint Force as we *achieve our national objectives in current conflicts*. This means achieving our campaign objectives in Afghanistan while confronting aggression toward America and its allies in all its forms, wherever and whenever it arises. It also means helping to secure the flow of commerce in the global commons, building the capacity of our partners, providing humanitarian assistance, and maintaining a credible nuclear deterrent.

These three priorities enable us to understand and *develop the Joint Force of 2020.* Our ability to build the force we will need tomorrow depends on the decisions we make today. This is a defining period in a defining year. Ensuring our future military is unrivaled and sustainable requires the right mix between current capacity and new capabilities. We must recapitalize current equipment where possible and modernize capabilities that preserve our decisive advantages.

III. Joint Force Operations

One thing has been certain over the last year – the Joint Force stood strong and responded to the Nation's call. After more than a decade of continual deployments and tough fighting, I remain humbled by the resilience and determination of our warriors.

In the past year, our service men and women have simultaneously fought, transitioned, and redeployed from Afghanistan. Never before have we retrograded so much combat power and equipment while continuing combat operations. Our forces performed superbly, transitioning to Afghan security lead in areas comprising over 85% of the population. In the process, we redeployed over 30,000 US troops, closed over 600 bases, and preserved Coalition cohesion. We were challenged by "insider attacks," but responded the way professional militaries do. We assessed and adapted. We reaffirmed our partnerships and moved forward jointly with more stringent force protection and vetting procedures.

Transition continues. In the weeks ahead, the Afghanistan National Security Forces will assume operational lead across all of Afghanistan. This milestone represents an important achievement on the Lisbon roadmap, reaffirmed at the Chicago Summit in 2012. At the same time, the International Security Assistance Force will transition primarily to training and advising. We are also working with NATO and the Afghan government on options for an enduring presence beyond 2014 to reinforce Afghan security and maintain pressure on transnational terrorists.

When I testified last year, the effects of the November 2011 border incident with Pakistan were still fresh, and tensions were as high as any time since the Osama bin Laden raid. Measured, but steady civilian-military engagement with Pakistani leadership led to the reopening of the Ground Lines of Communication in July 2012. We are gradually rebuilding our relationship – as reflected in the recent signing of a tripartite border document to standardize complementary cross-border operations – and will continue to do so with Pakistan's new leadership following its historic election last month.

The Joint Force has been vigilant well beyond South Asia and around the world. We continue to help deter aggression and counter the increasingly bold provocations from North Korea and Iran. We are supporting Syria's neighbors in their efforts to contain spillover violence while providing assistance to help with refugees. And, we are ready with options if military force is called for – and can be used effectively – to secure US national interests in Syria without making the situation worse.

Along with our interagency partners, we are also postured to detect, deter, and defeat cyber-attacks against government and critical infrastructure targets. We are part of interagency and multinational efforts to counter transnational crime. And, we remain relentless in our pursuit of al-Qa'ida and other violent extremist organizations, directly and through our partners. This includes al-Qa'ida-Arabian Peninsula (AQAP) in Yemen and, working with French and African partners, al-Qa'ida in the Islamic Magreb (AQIM).

Finally, in the context of a "new normal" – where the diffusion of power fuels insecurity and unrest – we continue to support reform across the Middle East and North Africa through military-to-military exercises, exchanges, and security assistance. We are also adjusting global force posture to reflect these risks in the context of our rebalance to the Asia-Pacific region.

IV. Our Joint Force Today

We have an experienced, combat-tested force. Never has our nation sustained such a lengthy period of war solely through the service of an All-

Volunteer military, which proudly celebrates its 40-year anniversary July 1st, 2013. Our warriors' will to win is undaunted, but the means to prepare to win are becoming uncertain. Military readiness is at risk due to the convergence of several budget factors. These same factors compound risk to the wellness of the Joint Force and our Military Family. As I testified in April, we need the help of our elected leaders to gain budget certainty, time, and flexibility.

Few have borne more of war's burden than our Military Family. For twelve relentless years, our service men and women have answered our Nation's call with unsurpassed courage and skill. Many have fallen or been grievously wounded in the service of our Country. We honor them most by caring for their families and for those who have come home with wounds seen and unseen.

We are unfailing in our praise for the sacrifices of our warriors in battle. But for so many of our veterans, returning home is a new type of frontline in their struggle. We cannot cut corners on their healthcare. We must continue to invest in world-class treatments for mental health issues, traumatic brain injury, and combat stress. Stigma and barriers to seeking mental health services must be reduced.

Suicide is a tragic consequence for far too many. As a Nation, we have a shared responsibility to address this urgent issue with the same devotion we have shown to protecting the lives of our forces while in combat. The Department is working closely with our interagency partners and the White House to increase our understanding of the factors leading to suicide and how to best leverage care networks to keep our Veterans alive.

The risks inherent to military service must not include the risk of sexual assault. We cannot allow sexual assault to undermine the cohesion, discipline, and trust that gives us strength. Therefore, working closely with the Secretary of Defense and Congress, we are examining the best ways to leverage additional education, training, and the Uniform Code of Military Justice. We are exploring every option, and we are open to every idea, that will help eliminate this crime from our ranks. As I testified last week, we are acting swiftly and deliberately to accelerate institutional change – to better protect victims, to prevent and respond to predatory and high-risk behaviors, and to ensure a professional work environment while at the same time preserving the right of the accused. We will not shrink from our legal and moral obligations to treat each other with dignity and respect.

Future success relies on opening our ranks to all of America's talent. The Joint Chiefs and I have supported the expansion of service opportunities for women. This decision better aligns our policies with our experience in war, and it serves to strengthen the Joint Force. Consistent with the law, we also extended some benefits to the same-sex domestic partners of service members. We are implementing both initiatives deliberately across all Services to ensure we uphold essential standards, guard against potential risks, and avoid creating new inequities for other members of the Joint Force.

Keeping faith with our Military Family will take a mutual commitment from fellow veterans and a grateful Nation. The next few years will define how we, as a Nation, view the 9/11 generation of veterans. America's future All-Volunteer force is watching.

They are also watching as we inflict risk on ourselves. With $487 billion in planned reductions already reflected in the Department's FY 2013 budget, sequestration's additional cuts jeopardize readiness not only this year, but also for many years to come. We cannot fail to resource the war we are still fighting. At the same time, we cannot compromise on readiness in the face of an uncertain and dangerous future. Our Joint Force must begin to reconnect with family while resetting and refitting war-torn equipment. It must retrain on the full-spectrum skills that have atrophied while developing new skills required for emerging threats. There are no shortcuts to a strong national defense.

When budget uncertainty is combined with the mechanism and magnitude of sequestration, the consequences lead to a security gap – vulnerability against future threats to our national security interests. And, as our military power becomes less sustainable, it becomes less credible. We risk breaking commitments to our partners and allies, our defense industrial base, and our men and women in uniform and their families.

This outcome is not inevitable. We can maintain the readiness and health of the force at an affordable cost, although this gets increasingly harder to do as uncertainty persists. But, we need help from our elected leaders to keep the force in balance and avert the strategic errors of past drawdowns. To this end, the Joint Chiefs and I continue to request your support for certainty, time, and flexibility.

Most importantly, we need long-term budget certainty – a steady, predictable funding stream. While the passage of the FY 2013 Appropriations Act provided relief from the Continuing Resolution, uncertainty over the FY 2014 topline budget and the full effects of FY 2013 sequestration remains. Last month, we submitted an amendment to the FY 2014 President's budget that includes $79.4 billion for overseas contingency operations (OCO) to support Operation ENDURING FREEDOM – mostly in Afghanistan – as well as finalizing the transition in Iraq. We also submitted a reprogramming request designed to offset our most critical FY 2013 shortfalls, especially in wartime funding. We appreciate your expedited review and support of both requests, which will bring important near-term budget certainty and help reduce our most urgent OCO shortfalls.

Additionally, we need the time to deliberately evaluate trade-offs in force structure, modernization, compensation, and readiness to keep the Force in balance. We do not yet know the full FY 2013 impact in these areas as we make key decisions about FY 2014 and beyond. Finally, we continue to seek the full flexibility to keep the force in balance. Budget reductions of this magnitude require more than just transfer authority and follow-on reprogramming authority. Everything must be on the table – military and civilian force reductions; basing and facilities; pay and compensation; and the mix among active, Reserve, and National Guard units.

There are no easy solutions, and no way to avoid sacrifices and risks as we work together to make the hard choices. But, the FY 2014 budget proposal helps us rebalance and strengthen readiness through these hard but necessary choices. It enables us to lower manpower costs, reduce unneeded infrastructure, and shed ineffective acquisition programs while maintaining support for the responsible drawdown of our military presence in Afghanistan. It provides an equitable and practical 2014 military pay raise of one-percent while protecting important education, counseling, and wounded warrior programs. Proposed infrastructure reductions include a request for BRAC authorization in FY 2015, although any closures would take multiple years and not begin until 2016. We simply cannot afford to keep infrastructure and weapons we do not need without getting the reforms we do need.

V. A Joint Force for 2020

The budget decisions we are making now will indicate whether we view our future Joint Force as an investment or an expense.

America is unmatched in its ability to employ power in defense of national interests, but we have little margin for error. An unforeseen crisis, or a contingency operation, could generate requirements that exceed the capacity of our immediately available forces. We are able to deter threats, assure partners, and defeat adversaries when we do so from a position of strength. We remain strong – and our Nation is secure – because we treat being the best led, trained, and equipped force as a non-negotiable imperative.

The secret to sustaining our strength with this or any future budget is simple – preserve investment in readiness, prioritize investment in people, and protect investment in decisive capabilities. Now, several months since the Joint Chiefs expressed deep concern about a readiness crisis, we continue to curtail or cancel training and exercises across all Services for units not about to deploy. The costs of recovering lost readiness are going up by the day. Inevitably, recovery in the years to come will compete with the costs of building Joint Force 2020.

It is our people that make us the most capable military in the world. They are our best hedge against threats to our homeland and interests abroad.

By 2020, we will require even greater technical talent in our ranks. But, developing technological skill must occur in concert with leader and character development. We must resist the temptation to scale back on education, including languages and cultural knowledge. Military service must continue to be our Nation's preeminent leadership experience. It is more important than ever to get the most from the potential and performance of every service member.

Investing in people is not just about their development and readiness. It is also about the commitment we make to their families. Unsustainable costs and smaller budgets mean we must examine every warrior and family support program to make sure we are getting the best return on our investment.

We need to reform pay and compensation to reduce costs while making sure we recruit and retain the best America has to offer. We must also balance our commitment to provide quality, accessible health care with better management and essential reform to get escalating costs under control. The FY 2014 budget would help control rising health care costs by initiating a restructuring of medical facilities to make them more efficient, without sacrificing quality or continuity of care, and by proposing fee adjustments that exempt disabled retirees, survivors of service members who died on active duty, and their family members. The Department of Defense is also working with Veterans Affairs to find efficiencies across health care systems.

As we work to get the people right, we must also sustain our investment in decisive capabilities. The FY 2014 budget continues to fund long-term capabilities that sustain our edge against resourceful and innovative enemies, while maintaining critical investments in science and technology, and research and development programs.

Emerging capabilities, once on the margins, must move to the forefront and be fully integrated with our general purpose forces. Special Operations Forces, for example, have played an increasingly consequential role over the past ten years. We have expanded their ranks considerably during this timeframe, and now we must continue to improve the quality of their personnel and capabilities.

Closely linked are our intelligence, surveillance, and reconnaissance capabilities – from sensors to analysts. We will continue to rely on proven systems designed for the low threat environments of Iraq and Afghanistan. At the same time, we must also develop and field sensors designed to penetrate and survive in high-threat areas. They will expand our ability to access and assess hard-to-reach targets.

This budget also sustains our investment in cyber, in part by expanding the cyber forces led by the U.S. Cyber Command. Despite significant investment and progress in the past year, the threat continues to outpace us, placing the Nation at risk. The FY 2014 budget increases funding for cyber security information sharing, but we need legislation to allow the private sector and U.S. interagency to share real-time cyber threat information – within a framework of privacy and civil liberty safeguards. In parallel, we must establish and adopt standards for protecting critical infrastructure.

The development and integration of these emerging capabilities will by no means amount to all that is new in Joint Force 2020. They must be integrated with our foundational and impressive conventional force capabilities. The FY 2014 budget protects several areas where reinvestment in existing systems – such as the C-130, F-16, and the Army's Stryker combat vehicle – sustains our competitive advantage. All are backed by our asymmetric advantages in long-range strike, global mobility, logistics, space, and undersea warfare. And, they must be connected with a secure, mobile, and collaborative command and control network.

This combination of increasingly powerful network capabilities and agile units at the tactical edge is a powerful complement to leadership at every echelon. It provides the basis to project both discrete and overwhelming power across multiple domains. It gives policymakers and commanders alike a greater degree of flexibility in how they pursue objectives.

As we set priorities and implement reductions, we must rely more on – and invest more in – our other instruments of national power to help underwrite global security. Fewer defense dollars only adds to the importance of relationships among defense, diplomacy, and development. When the political and economic foundations of our bilateral relationships are under stress, our military-to-military ties can serve as a model of professionalism and restraint for foreign militaries, and often help provide a channel for continued dialogue. Advancing American interests not only requires integration across all instruments of national power, but it also requires that our international partners accept a greater share of the risk and responsibility. Some are more ready and willing to do that than others.

VI. Conclusion

Although I am confident the Joint Force today can marshal resources for any specific contingency, our goal is to be able to offer military options that restore and maintain readiness while putting US national security on a sustainable path to 2020 and beyond. To do this, we must recruit and retain the most talented people. We must invest in their competence and character so they can leverage emerging and existing capabilities in our defense. It is an investment our predecessors made in decades past. We must do the same.

Our consistent first line of defense has been and always will be our people. They are our greatest strength. We will rely on our war-tested leaders to think and innovate as we navigate the challenges and opportunities that lie ahead. We need to seize the moment to think differently and to be different. But, we cannot do it alone. We need the help of our elected officials to give us the certainty, time, and flexibility to make change. Otherwise, the cuts that have already diminished our readiness will only get deeper, and the risks we will have to accept in the years to come will only increase.

We can and must stay strong in the face of declining budgets and rising risk. We must have the courage to make the difficult choices about our investments, about our people, and about our way of war. The Secretary's

Strategic Choices and Management Review (SCMR) is helping to identify options and opportunities as we move forward in partnership with Congress.

We have been down this road before. We can lead through this uncertainty and manage the transition to a more secure and prosperous future. I know your Nation's military leaders are ready – as is every single Soldier, Sailor, Airman, Marine, and Coastguardsman – to give their last breath to defend America and her allies.

Please accept my thanks to this Committee and Congress for all you have done to support our men and women in uniform. Together, we serve our Nation.

Chairman MURRAY. Thank you very much.

With that, we will turn to our questions, and, Secretary Hagel, let me begin with you. You asked for more time before cuts take place and certainty when it comes to the defense budget. The Senate budget that we passed here provides both. It actually starts by eliminating sequestration and replacing it with a balanced mix of savings and revenue and spending, including defense, and ensures that those savings in defense do not begin until fiscal year 2015, which will give the Department the time you have asked for to plan appropriately.

The Senate budget plan reduced defense spending by about $250 billion over 10 years. That is about half of the roughly $500 billion in cuts and sequestration. And by replacing the sequestration and ending this budgeting by crisis that we are doing, it provides certainty on the funding levels for DOD for the next 10 years.

Unfortunately, as I mentioned in my opening remarks, because we have not been able to go to conference, that is actually ensuring that we are going to have another round of sequestration on us very quickly, which will again be across-the-board, indiscriminate cuts from DOD funding in fiscal year 2014. And, frankly, I see that as a plan for failure.

So I think the most important thing we can do right now for the long-term good of our military is to follow regular order, go to conference, and then pass a compromise budget that fully replaces sequestration, and I really would like to do that if we can have the ability to do it. But I wanted to ask you today if you could comment on the long-term budget and the need for that that replaces the sequester and how that will affect your ability to plan and execute your national security strategy.

Secretary Hagel. Thank you for the general and broad question, because it does frame everything. It frames our ability to respond to the responsibilities we have for our national security well into the future.

I think much of what General Dempsey's testimony was about really focused on this. When we have the inability to plan and have no certainty from month to month, year to year, as to what our possibilities are for contracts, for acquisitions, for technology, for research, the technological advantage that we have in the air and the superiority we have at sea, the training, the readiness, all of these are affected by the lack of certainty for planning.

The chiefs say to me, when I have spent a lot of time with them, as the Chairman has over the last 3 months going through the review, "If you can give me any clarity on what kind of resources I have, I can build you an army with some degree of certainty, and I can build you a force structure that will match our strategic interests and our strategic guidance as to not only enhancing but preserving our national security interests around the world."

I cannot give them that, and when I cannot give them that, then we have to continually go back and adjust and adapt, and we are then forced to do some of the things that you have noted, as Senator Sessions did, as I did in my testimony, furloughs for people, a good example of that. You are not building a skill set in your civilian employment when that threat of employment is there, whether they are going to be not only furloughed but maybe RIF'd.

This gets into contractors. We often hear—and I suspect it will come up here—"Well, why do you use contractors?" Well, mainly why anybody uses contractors is because there is a specific skill set that you may not have in-house, and that is more expensive. So you are building nothing for the future because you are essentially using your readiness not only in employment and the military and planning for the future, just to protect the immediacy of unwinding a war in Afghanistan or the immediacy of our force structure and the priorities of our readiness.

So I know that is a long answer, but it does—everything I have said, it fits into, folds into your overall question. That is why time and flexibility are absolutely key here. If we have the flexibility and the time to bring this down, we can do that. That is manageable. And there are a lot of things that we should be doing, we can be doing to be more efficient and still protect the interests of this country and still be the most effective fighting force. But where we are essentially is when you are talking about the kind of abrupt cuts without slowing the growth, then what you are really bottom line saying is that you are going to cut your combat power. And in the end, combat power and the readiness and everything that fits into that is the one core asset that you must preserve and continually enhance for the future, whether it is cyber or anything else.

Chairman MURRAY. Okay. And I need to turn it over to Senator Sessions, but let me ask you specifically. Obviously the President had hoped that we would not have sequester in effect for 2014, so that is not included in your budget request. I know, General, you mentioned the Strategic Choices and Management Review that you expect to have out in a few short weeks. Is there anything that you are finding right now that you are going to face that you could share with us that would help us understand just for 2014, if we do not move forward and replace the sequester, what we will be facing?

Secretary Hagel. The reason that I directed a Strategic Choice and Management Review 3 months ago was, as I said in my comment, my opening statement, to prepare for what may eventually be a continued uncertainty of our resources. And so we asked all of our senior leadership to be involved and participate, as they did. We have our nine combatant commanders coming in for a 2-day conference this week. They have been involved. But the point is, to answer your question, that we have done this in order to project out as to what kind of limitations and planning that we are going to have to do to protect our defense capabilities based on, as your original question, the uncertainty of these budget issues.

As to the review and the results, as I said in my statement, I am looking at those; General Dempsey is looking at those. We are reviewing those. This was not intended to be a set of recommendations; rather, it was intended to be a set of choices based on these different possibilities and these different scenarios.

Chairman MURRAY. You would not want us to have this happen. You are planning for it. We will see what that is going to be in a few short weeks. My goal is to get us to conference and solve this so we can replace sequestration. I think that is critically important. But I think we are going to all have to be eyes open when you produce that report in a few weeks.

General?

General DEMPSEY. If I could add, Senator, by way of context, Senator Sessions mentioned that when we did our future-year defense plan 4 years ago, fiscal year 2014 was to be funded at $598 billion. If you count sequestration, it goes to $474 billion. So the way to think about sequestration is not that it is the deepest cut we have ever experienced in our history. We have had deeper cuts. But it is by far the steepest. And when the cut is steep, we limit the places we can go to get the money, because a lot of this money is unavailable in the short term. We can make long-term institutional reform, but you cannot sweep it up in the near term. That is the problem we are having.

Chairman MURRAY. Okay. I very much appreciate it.

Senator Sessions.

Senator SESSIONS. Thank you.

General Dempsey, I believe that is correct. It is pretty obvious when you look at it that is too rapid a reduction. So I guess you are saying there may be more savings that we could effectuate over time, but doing it on such a short-term basis requires damaging decisions to be made.

Just briefly, Secretary Hagel and General Dempsey, this $9.6 billion reprogramming requiest, as I understand it, we came out under the funding needs for OCO, the Overseas Contingency Operations, by about $9.6 billion. And I have been surprised to find out—and I understand—that you are having to take that out of the base defense budget.

Now, we all need to know there are two funding sources here: the base budget and overseas contingency operations. War costs are coming down in an independent way. Are you being asked to fund the shortfall in the war costs out of your base defense budget in addition to the other cuts that have fallen on the Defense Department?

Secretary Hagel. Let me just make a general comment, and then I will ask the Comptroller to answer specifically the numbers questions.

As you said, Senator Sessions, we have two budgets, different reasons. You accurately noted that we are $10 billion below last year's fiscal year 2013 request. Those numbers will continue to come down, and eventually we will, I hope, be able to phase out that process. But it is essentially to pay for war efforts, as you know. And when I was in the Senate—and I was actually on this Committee for 4 years—we financed our two wars essentially out of emergency supplemental appropriations. And that is where a lot of this started.

As has been noted, I think at least in my statement— and the Comptroller can address this—the additional costs as we reset and unwind and transition from Afghanistan have been significantly more. It costs an awful lot of money to get your people out, do it responsibly, get your equipment out, which we have an astounding amount of equipment in Afghanistan to do it right. It is a dangerous area. It is much more complicated than just moving down through the desert in Iraq to the port and then ship it out. It is different.

So that is another part of the OCO funding, but I just wanted to give you that maybe general sense of this, and then ask the Comptroller to go into more detail. Thank you.

Mr. HALE. Senator Sessions, we are funding the OCO shortfall in two ways. Part of it is by moving money around within OCO, delaying, for example, equipment that we would have bought to replace equipment damaged in Afghanistan, and out of our base budget. And you are correct, some of it is coming out of the base budget. I do not have in my head the exact split, but a substantial part is coming out of the base budget.

Senator SESSIONS. Well, to that extent, I mean, the whole war, the $1.4 trillion over the last 10 years or so that we have used on the war efforts have been emergency spending. And the base defense budget has been paid for under the budget accounts of the United States. So it seems to me—have you considered asking for a supplemental to avoid—additional cuts to the base budget. hese cuts are in addition, it seems to me, to the $52 billion you have to talk about FY 2014 for because you have to find more savings, and then those savings could have been used next year to pay for other cuts. Now they have to be used to fund war costs that we have normally been funding through supplementals.

Mr. HALE. Just let me give you the numbers. About $4 billion out of the base budget. The rest is—

Senator SESSIONS. Well, I would be interested in discussing that. But the difficulty we have, colleagues, on the sequester, sequester is part and parcel of the Budget Control Act that was passed in August of 2011. We raised the debt ceiling $2.1 trillion. We promised to reduce the growth of spending by $2.1 trillion over 10 years, and there were no tax increases in that. We did have an agreement that a committee would work on how to spread those cuts around to consider if they could not reform our entitlements. And the Committee could have proposed tax increases if they chose. But the law that passed was to reduce spending by $2.1 trillion, unwisely, as it turns out, on how the cuts were to fall, and they were too much on defense. But that is what passed.

And so I think there is a strong feeling in Congress that we have—it will be very corrosive of public integrity and the integrity of Congress to waltz in now and say less than 2 years later, about 2 years later, we are going to give up and forget what we said we were going to do when the going gets a little tough. So what should happen is we should look at this government, see how much more the Defense Department can handle over time in reducing spending, and look for ways to find other savings in our Government and stay on track.

We just had a $600 billion increase in taxes in January. I do not suppose any of that was used to fix this problem.

Now, Secretary Hagel, you stand behind the President's defense request proposal for 2014 and the out-year budgetary levels that accompany that proposal?

Secretary Hagel. Yes. As I said in my opening statement, Senator, that budget is a budget that sustains all of national security interests and protects those interests, keeps a strong, viable funding source, and continues to make the kind of adjustments and reductions that we need over the next 10 years.

Senator SESSIONS. So the plan that would cut $130 billion more than the President's request would still allow you to meet the strategic requirements that you believe the Nation must meet?

Secretary Hagel. I think we could manage with that additional cut on top of the President's $150 billion. But as I have said and the Chairman said—and the Chairman should respond to this as well—make no mistake, when you are taking those kind of numbers out of a budget, there will be adjustments to that budget. And that means adjustments to the strategic interests and how we implement those programs to protect those strategic interests.

I do not know, General Dempsey. You may want to respond.

General DEMPSEY. This review that the Secretary has led allows us to see the impact of not only the President's fiscal year 2014 submission but also the Senate's plan, and then full sequestration. And it does pose a series of choices which become pretty difficult.

When you add up the 487 that we were tasked to reduce, the Defense Department, by the Budget Control Act and then add the 500 to it—and we did some things with Secretary Gates in terms of efficiencies—it comes out to about $1.2 trillion. $1.2 trillion leaves a mark on the United States armed forces that would make it—we have not made this actual—we have not decided that it would make our current strategy infeasible, but it would put it at great risk and could make it infeasible.

Senator SESSIONS. When do you expect that report to be available for Congress?

Secretary Hagel. Well, as I said, the initial results have been completed. I have them. I am going through them. As I also noted, it is not a set of recommendations. It is a set of choices. Essentially, simply, it is what the Chairman just noted.

Senator SESSIONS. Well, we really need recommendations.

Secretary Hagel. Well, we will have recommendations for, obviously, our internal use, but as I also noted, we will be sharing this with the committees as to where we are going. We have to, because this is also going to guide 2015 budget requests and how we play this out for going into 2014.

Chairman MURRAY. Thank you very much, and I know we have both gone over. Our witnesses have to leave at 12:15, I believe, to go to the House, so we are going to try and keep everybody on track here as best as we can.

Senator Wyden.

Senator WYDEN. Thank you, Madam Chair. I welcome our guests. I just want to highlight two points before questions.

First, let me commend you, Madam Chair, and the Senator from New Hampshire, Kelly Ayotte, on your great work with respect to the sexual assault issue. This has gone on and on. This scourge has been debated for it seems like longer than—a longer running debate than the Trojan War. I very much support your leadership in this regard to get this rooted out finally.

Point number two, Senator Murray has stressed how important it is to have a bipartisan conference on the budget. This is a view that I very much share, and what is striking is outside the Senate—outside the Senate—security and economic thinkers, our leading thinkers of both political parties, say this is exactly the time for a long- term strategy. That is what a budget conference would provide us the ability to do, is to look at the 10-year window to tackle these issues. Senator Sessions makes the point with respect to health costs. Senator, I am laying out a Medicare reform proposal tomorrow. Other colleagues have as well. We should have the kind of bipartisan conference on the budget that Senator Murray talks about. I see Senator Portman and others are making the case of how important it is we tackle these issues in the long term, and I commend them.

Let me ask you, General Dempsey—and, Secretary Hagel, we enjoyed working together on the Intelligence Committee—the first question about the contractors. What is striking is the inability to really hone in on the numbers so that we can get a sense of how to tackle this issue.

Comptroller Hale, last February, you estimated that in terms of contractors, your calculation was that we had about 300,000. According to a GAO analysis that was published last month, there were over 710,000 full-time contractors working for the Department.

So let us start with you, General Dempsey, on this point. How do you explain the discrepancy in the numbers? And how are you and your colleagues going to get us the accurate figures so we can get on top of this issue?

General DEMPSEY. Well, actually when you get eventually over to Mr. Hale, I think we have accurate numbers. I do not know how—

Senator WYDEN. Well, no. We have right now—

General DEMPSEY. I think your 700,000 number is accurate.

Senator WYDEN. So what Comptroller Hale said last February, when he estimated—when he said it was 300,000, that was not accurate?

General DEMPSEY. Well, he is right there.

Senator WYDEN. Okay. Let us get him in.

Mr. HALE. There are different definitions, Senator Wyden. I was referring to the contractors where we have better data that are funded through what is called operation and maintenance. The best numbers we have for all our service contractors, about 700,000. The number is—we gave that to GAO.

Let me just say it is not as easy—

Senator WYDEN. Well, on that point, then get me in writing the difference between the types of contractors.

Mr. HALE. Okay. I will do that. It is not as easy as it sounds. When you do a fixed-price contract, the contractor has no obligation to tell you how many people have to be doing the job. They just do it, and if they do it right, they get paid. So we are actually going and modifying all our contracts—at some cost to the Government, I might add—and requiring they provide that data. So you will have more accurate information, but at some cost.

Meanwhile, we are doing the best estimates we can, and I think 700,000 is close for service contractors. Now, there are people working on weapons that would add to that number.

Senator WYDEN. In writing, the difference between the various contractors.

Mr. HALE. Got it.

Senator WYDEN. Let me ask one other question of you, General Dempsey. On the C–23 Sherpa aircraft—these are the big planes, the big cargo planes used in Sandy for delivering individuals, cargo—the message from the Congress has been, “Do not get rid of them. Do not divest them.” The Army’s response has been to order the Sherpas flown to Oklahoma to be boxed up and then I guess they are going to be divested. It is almost like the Army is saying, “If you will not let us divest them, we will not let the Guard fly them.”

Now, we have a lot of us here in the Congress— again, both political parties—who strongly support the role of the Guard, and these planes that were used in Hurricane Sandy and our State, and we are looking in the West particularly at horrendous fires this upcoming summer. This would be a chance to help the Guards’ critical domestic missions. I do not know how we are going to help those critical domestic missions by parking the planes in a hangar.

So what is your take on this? And what ought to be done?

General DEMPSEY. Well, Senator, the C–27—and this has been the subject of a great deal of analysis in terms of its cost, operating cost, and its utility. And the Army-Air Force cooperation was actually quite encouraging in the sense that the gap, if you will, as you have described it, with the retirement or the divestiture of the C–27 can be covered by the C–130.

Now, you know, there are some who disagree with that analysis, but if it has not been laid out for you, we can certainly—

Senator WYDEN. Well, that may well be. Let me wrap up with this, Madam Chair. Why are they in the hangars? Here we have what all sides have said is a significant number of aircraft. They are in the hangars. We want the Guard, whose work we support and admire, to have the tools. Why are they sitting in the hangars?

General DEMPSEY. Well, the Guard will have the tools, sir, but—

Senator WYDEN. But, still, the question is: Why are they in the hangars?

General DEMPSEY. Well, because it costs money to operate them. They are not operated for free.

Senator WYDEN. About as good a value as we can get in this country.

Thank you, Madam Chair.

Chairman MURRAY. Senator Johnson.

Senator JOHNSON. Thank you, Madam Chair.

Speaking of sitting in a hangar, General Dempsey, I would like to talk a little bit about Commander’s In-Extremis Forces (CIFs). It is my understanding that these are units of 40 special operations individuals that are basically there for rapid response, rapid deployment. Is that correct?

General DEMPSEY. Yes, it is one of several capabilities like that.

Senator JOHNSON. And we have one of those in Europe, C–110, it is called the European Commander’s In-Extremis Forces (EUCOM)?

General DEMPSEY. Each combatant commander has one.

Senator JOHNSON. Okay. There was a report on April 30th filed by Adam Housley that the EUCOM CIF was not at their homebase in Europe but actually deployed on a training exercise in Croatia. Is that correct?

General DEMPSEY. Are you talking about last September?

Senator JOHNSON. Yes, during Benghazi.

General DEMPSEY. It was on a training mission in Bosnia, right.

Senator JOHNSON. On the night of the terrorist attack in Benghazi, correct?

General DEMPSEY. That is correct.

Senator JOHNSON. What is the time to deployment of those forces? What is their standing order?

General DEMPSEY. Their response times are ratcheted up and down based on the threat. They can be anywhere from n plus 1, notification plus 1, which means they are sitting on the tarmac, up through about n plus 6, depending on the threat.

Senator JOHNSON. Now, according to Adam Housley, through a whistleblower, that individual stated that force could have been in Benghazi 3–1/2 hours, 4 to 6 hours, somewhere in that time frame. Is that correct? Were they at that stage of readiness?

General DEMPSEY. No, I would not agree to that timeline. The travel time alone would have been more than that, and that is if they were sitting on the tarmac.

Senator JOHNSON. Was the command of EUCOM CIF transferred during the Benghazi attack from European Command to AFRICOM?

General DEMPSEY. There was a point at which the CIF was transitioned over to AFRICOM, yes, sir.

Senator JOHNSON. At what point was that transferred?

General DEMPSEY. It occurred, as I recall now, during the night of September 11th.

Senator JOHNSON. Can you give me any kind of timeframe on that? Do you know exactly when it—

General DEMPSEY. No, not from memory. I can certainly take that—

Senator JOHNSON. Yeah, I would certainly like to find that out. Was that unit ever deployed anywhere?

General DEMPSEY. Anywhere after the Benghazi attack?

Senator JOHNSON. During the Benghazi attack, during that 12- to 24-hour period. Did they leave Croatia?

General DEMPSEY. They were told to begin preparations to leave Croatia and to return to their normal operating base in Stuttgart.

Senator JOHNSON. Okay. So, again, have you checked into specifically what their time to deploy orders were at that moment?

General DEMPSEY. Yes, not only for that particular element, but for fleet antiterrorism support teams. For all of the various response forces, we do have that timeline available.

Senator JOHNSON. Okay. So, again, what I want to know is what was their standing order time to deployment at the moment of the Benghazi attack? Was it T plus 1 or T plus 2? What was their standing order?

General DEMPSEY. Well, given that they were on training event, it was probably at n plus 6, but let me take it for the record.

Senator JOHNSON. Okay. Well, I appreciate that.

Senator JOHNSON. During our Foreign Relations Committee hearing on Benghazi, a number of people made the comment that the State Department simply did not have the funds to provide the security. Is it true that the Defense Department was providing security in Benghazi?

General DEMPSEY. There were six individuals under Department of Defense authority in Benghazi.

Senator JOHNSON. And the State Department does not pay for that, correct?

General DEMPSEY. That is correct.

Senator JOHNSON. Did the State Department, did Secretary Clinton ever contact the Department of Defense asking for additional security because she was getting requests from individuals in Libya for additional security?

General DEMPSEY. I do not know if she contacted the Department. I was not contacted.

Senator JOHNSON. Okay. Can you check that for me for the record?

General DEMPSEY. Sure.

Senator JOHNSON. Had Secretary Clinton or somebody from the Department of State contacted the Defense Department, would you have provided security in Benghazi?

General DEMPSEY. We routinely respond to Department of State requests for support.

Senator JOHNSON. And what they were really requesting, the people on the ground there, was not particularly a large deployment, correct? They were talking maybe about 16 security individuals?

General DEMPSEY. At one time we had 16 there, that is correct.

Senator JOHNSON. Okay. In your opinion, had we had just a minimal force, armed force of trained defense military individuals in the compound in Benghazi, would that attack have ever occurred?

General DEMPSEY. I have—I cannot speculate about that hypothetical because literally it is hypothetical. I mean, whether the—

Senator JOHNSON. Well, it is true the minimum number of special operations individuals repelled the attack then. When they came from the annex to the consulate, they basically repelled the attack, correct?

General DEMPSEY. Well, it was from the consulate to the annex, but the—

Senator JOHNSON. Well, the first time it was from the annex to the consulate, right?

General DEMPSEY. The first event occurred at the consulate to—

Senator JOHNSON. Right, and then we had special ops folks or, you know, contractors come from the annex to the consulate—

General DEMPSEY. That is correct.

Senator JOHNSON. —to repel the attack.

General DEMPSEY. To recover, that is right—well, to recover the individuals who had been attacked.

Senator JOHNSON. So I think the assumption would be if we had maybe four time full—16, which means four people full-time guards at that consulate, probably that attack never would have occurred.

General DEMPSEY. Well, if you are asking me would additional security forces have made a difference in any number of ways, the answer is yes, of course.

Senator JOHNSON. Okay. Well, thank you.

Thank you, Madam Chair.

Chairman MURRAY. Yes, Senator Kaine.

Senator KAINE. Thank you, Madam Chair. I would like to cede a couple of seconds at the start for Senator Wyden to finish up an inquiry.

Senator WYDEN. Thank you very much.

General Dempsey, our Guard says it is, in fact, the C- 23s that are in the hangars now, and they have been ordered to move C–23s there. So that is still the question, and if you could get back to me, I would appreciate it.

Chairman MURRAY. Senator Kaine.

Senator KAINE. Great. Thank you, Madam Chair, and welcome to the witnesses. Thanks for your service in a time of danger. I just was thinking this morning, you have been OPTEMPO in war for 12 years, you, the military in the United States. That is longer than the Revolutionary War. That is longer than the Vietnam War. That is longer than any period of OPTEMPO warfighting in the history of this country. So I am going to start with a thank you. And then I am going to say thank you for serving in a time of uncertainty. Both your written testimony and your oral testimony, Secretary Hagel, "Today the Department of Defense faces the significant challenge of conducting long-term planning and budgeting at a time of considerable uncertainty..."; and, General Dempsey, "This year's posture testimony comes in the context of extraordinary uncertainty." And when I read the testimony and heard it, it kind of struck me. You guys are good diplomats. You mentioned uncertainty as if it was a hurricane or something. It is Congress. It is not a hurricane. It is not an uncertainty like we do not know what is going to happen. You are dealing with a Congress that will not give you a budget, that will not give you a number. You might like the number. You might not like the number. But you are dealing with a Congress, the first of the three co-equal branches, that will not give you a budget around which you can plan the defense of this Nation.

So I appreciate the euphemisms in the testimony, and I think that is probably wise to do if you are sitting on that side of the Committee room. But that is what we are dealing with here. We are with a Congress that will not give you certainty, will not do its job. It is only Congress that can appropriate money, and Congress is not doing the job. It is just outrageous. And we sat through so many hearings, Madam Chair, whether it is in this Committee or on the Armed Services Committee, and we have had these same conversations for the last number of months, and we have, you know, kind of wanted to beat up on people on this side of the aisle when it is us, it is Congress that is not doing what needs to be done.

I am going to go to the floor at a little bit after noon, and I am going to make the 13th motion, Madam Chair, to put a budget that we passed in this Committee and then passed on the Senate floor into conference with the House. We passed it on the 23rd of March after a full Committee process where we had numerous amendments here and then a full process on the Senate floor, where we had numerous amendments there.

We passed it after hearing over and over again that the Senate would not pass a budget. And we passed one. And yet we are not allowed because of procedural rules in the Senate and, frankly, a desire, I think, by the House, we are not allowed to initiate a budget conference to try to give you the certainty that you need, the certainty that our Nation needs.

So, you know, I start really my thoughts with this sense of gratitude for service in a time of 12 years of war, but also service where you are facing an uncertainty that is completely under the control of the people who sit in this room and sit on this Capitol. And the fact that we are not giving it to you, that you can, you know, come here still with the spirit of equanimity, I applaud you for it.

To a couple of questions. Furloughs are of great concern to me in Virginia. So many DOD civilians have been furloughed. Furloughs to me are kind of a short-term strategy. If you have to do a steep cut in the way you used it, General Dempsey, "steep cut" furloughs, it is not really a long-term strategy. The longer-term strategy is, well, you know, if we finally get a budget number and it is a tight budget number, then, you know, everything is not worth everything else, you do not do across-the-board furloughs.

Talk a little bit, if you can—and I know July 1 is really the date for sharing with Congress your sense, but talk a little bit about furloughs as a long-term strategy, whether you would tend to use them or whether you would probably set that aside as you do with long-term challenges. And then I have one last question.

Secretary Hagel. Senator, thank you. Well, furloughs is not a strategy, as you have appropriately noted. It is a reaction. It is triage. It is a reality. And that is exactly, as I noted in my statement, why I was forced to make a decision after many weeks of review by the Comptroller and his staff—and all the chiefs, by the way— and all our senior uniform were involved in this. No one wanted to do this, Senator. But I had then a choice to make to go further in cutting into our readiness around the world, and I could not do that. And so, yes, it is the worst way to have to respond to anything, but it was a necessity, and we all came to the same conclusion.

The last point I would make, uncertainty, which I have talked about, you have all talked about. With this cloud of uncertainty continuing to hang over all of us, these kinds of issues, furloughs, all go with that for our workforce, are going to be something we are going to continue to live with. It is very unfair to these people. It is unfair to this country to have—to be put in that kind of a situation and then still ask these people to make the contributions they are and the sacrifices they are for this country.

Senator KAINE. Madam Chair, could I take 30 more seconds?

Chairman MURRAY. Okay. We do have a hard stop at 12:15.

Senator KAINE. I will take it off record. I will take it off record.

Chairman MURRAY. I appreciate it very much.

Senator Ayotte.

Senator AYOTTE. Thank you very much. Let me just thank the Chairman. I am very pleased that the bill that we have offered providing special victims counsel to victims of military sexual assault, I want to thank Chairman Dempsey and Secretary Hagel for supporting our efforts, and right now it is in the mark, and I will make sure that it continues in there.

Chairman MURRAY. Great. Thank you.

Senator AYOTTE. Thank you for your leadership on this. I have really enjoyed working with you, and this is such an important issue for our military.

I wanted to ask Chairman Dempsey, in follow-up to what Senator Johnson just asked you about the attack on the consulate in Benghazi, something that I have wanted to know an answer to, which is that on February 7th you testified before the Senate Armed Services Committee, and you were asked a question by Senator Graham, and he asked you whether General Ham had issued a stand-down order to the military personnel in Tripoli or elsewhere who were preparing to go to assist those in Benghazi.

Then we heard before the House Oversight Committee that Mr. Hicks, who was the former Deputy Chief of Mission, said that Colonel Gibson, who was on the ground in Tripoli, did receive a stand-down order, and so, General Dempsey, I have not had an opportunity to follow up with you based on the February 7th testimony. Mr. Hicks testified that he believed this stand-down order came from AFRICOM or Special Operations Command in Africa.

General Dempsey, can you help me understand who issued the stand-down order and what happened there, why the special forces that wanted to go with, I understand it, under Colonel Gibson in Tripoli were told not to go and who gave them that order, from there they wanted to go and help in Benghazi on that night?

General DEMPSEY. Yes, thanks, Senator. Based on that testimony, I went back and—

Senator AYOTTE. I had a feeling you would. That is why I wanted to—

General DEMPSEY. Yes, of course. And there were two different groups of—there were six people, not all working for the same command. Two of them were working with Joint Special Operations Command. They were collocated with another agency of Government in Tripoli. And four were working under the direct line of authority of Special Operations Command Europe—or AFRICOM, AFSOC. And it was the four you are speaking about. The other two went. The other four, by the time they contacted their command center in Stuttgart, they were told that the individuals in Benghazi were on the way back and that they would be better used at the Tripoli airport because one of them was a medic, that they would be better used to receive the casualties coming back from Benghazi, and that if they had gone, they would have simply passed each other in the air. And that is the answer I received.

Senator AYOTTE. Okay. So—

General DEMPSEY. So they were not told to stand down. A stand-down means do not do anything. They were told to—that the mission they were asked to perform was not in Benghazi but was at Tripoli airport.

Senator AYOTTE. Can I ask you, General, they had requested to go, though.

General DEMPSEY. That is correct.

Senator AYOTTE. They asked to go to support what was happening in Benghazi from Tripoli, correct?

General DEMPSEY. That is correct.

Senator AYOTTE. And they were told, from what you are saying, not to go because of the timing—

General DEMPSEY. Because of timing and that they would be—they would contribute more by going to the Tripoli airport to meet the casualties upon return.

Senator AYOTTE. I do not know if you know the answer to this today, but if you do not, can you get back to me on it? Can you tell me when they made the request and what the timing was of that request and when they were told to stay in Tripoli? I would appreciate a follow-up on that.

General DEMPSEY. Yes, I will.

Senator AYOTTE. Thank you very much.

Senator AYOTTE. I wanted to ask both Secretary Hagel and as well as you, General Dempsey, about the situation with al Qaeda in the Arabian Peninsula. I saw a May 2013 letter from General Holder talking about the AQAP being the most dangerous regional affiliate of al Qaeda and a group that has committed numerous terrorist attacks overseas. Would you tell me, what is the—how dangerous is this group?

General DEMPSEY. I think that that characterization of them is actually accurate. They are dangerous for two reasons. One is their aspiration to attack the homeland and Europe, which puts them—which makes them unique in many of the other affiliates. Many of the other al Qaeda affiliates are more local and regional. This one has global aspirations.

Senator AYOTTE. Where are they located?

General DEMPSEY. Well, they are generally located in southeast Yemen, generally.

Senator AYOTTE. Yemen? And what is the security situation in Yemen right now?

General DEMPSEY. Better than it has been in a very long time, but still relatively unstable. President Hadi has partnered with us in helping build up the Yemeni security forces.

Senator AYOTTE. But does he have full control of the country?

General DEMPSEY. No, he does not have full control of the country.

Senator AYOTTE. Right. And what about the prison break situation? There have been multiple prison breaks, even going—I mean, there were like six of them, the last one in 2011. Does he have any more security over that situation?

General DEMPSEY. As I said, Senator, the situation is improved since President Hadi became the head of state. He has changed leaders in some of the Republican Guard units. But it would not be possible for me to declare that it is a stable environment.

Senator AYOTTE. Okay. I thank you. I appreciate all of you being here. Thank you.

Chairman MURRAY. Senator Nelson.

Senator NELSON. Thank you, Madam Chair.

Later today, in the Armed Services Committee, we are going to consider a sense of Congress that I assume most people will agree with, Mr. Secretary, the sense of the Congress that commanding officers are responsible for establishing a command climate in which sexual assault allegations are properly managed and fairly evaluated and a victim can report criminal activity, including sexual assault, without fear of retaliation, including ostracism and group pressure from other members of the command.

Mr. Secretary, I am given to believe that a survey was conducted among victims, and 50 percent of the victims say that if they report the assault, they do not think it does any good. Are you aware of that survey? General Dempsey is shaking his head yes. Is that correct, General?

General DEMPSEY. It is.

Senator NELSON. Okay. Then my question to you, Mr. Secretary, is: Do you think that by removing the chain of command in order to prosecute sexual assault in the military, will that give the incentive for the victim—will that give more incentive for the victims to come forward?

Senator HATCH. Senator, thank you. First, let me respond to your first point about the resolution that you think will be presented in the markup. I would fully support every word of that, obviously.

Senator NELSON. I am sure that will be unanimous.

Secretary Hagel. As to your question, I have said first we need to look at every option, every possibility, which we are. As you know, there are 26 pieces of legislation on this. And we are listening to people, chiefs, panels, a litany, pages of things that we are doing and started doing the last 3 months. Not enough. We have to do more. But some things have to change. I think we all accept that.

Now, to your specific question, I have also said that anything we do, anything the Congress does, it needs to be done very thoughtfully, because there will be consequences to anything that comes out of this as to how we handle this in the future. I do not personally believe that you can eliminate the command structure in the military from this process, because it is the culture, it is the institution, it is the people within that institution that have to fix the problem. And that is the culture, the people are the culture. So I do not know how you disconnect that from the accountability of command.

Now, as I said, we need to change some things. We can do things much better. We will have to. But I think we have to be very careful when we talk about thinking the command structure out of this process.

Senator NELSON. Certainly it has been pointed out that cultural changes such as integration in the military, such as don't ask, don't tell, that the command structure was absolutely essential. In this case, we are talking about the reporting of a crime. Do you see a distinction there as to why the command structure should still be in place?

Secretary Hagel. Well, first, I think we all accept it is a crime, and it needs to be treated as a crime. The things that Senator Murray and others have been doing on victims' rights, special counsel, all the things that are going forward need to be done. We should have done them. We have not, but we will. All that has to be done.

Now, to your question, I do not think you can fix the problem, Senator, or have accountability within the structure of the military without the command involved in that. And I have believed, like in everything in life, accountability matters. You hold us each accountable. You are accountable, I am accountable, the general is accountable. And that is where I think we have had a disconnect on—not all of it. It is cultural. There are a lot of things involved here. But if you do not hold people accountable, then you are not going to fix the problem. You can pass all the laws you want, and that is not going to work. So that would be my response to your question.

Senator NELSON. Madam Chairman, since you want to move along, I will submit for the record an additional question on a different subject having to do, as we leave Afghanistan, is there equipment that we can leave there that will help Afghanistan society more readily be able to support themselves.

Chairman MURRAY. Okay. T

Chairman MURRAY. Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Chairman. Secretary Hagel, welcome back to your old haunts. It is a delight to have you here.

On the same subject that Senator Nelson was asking about, I am a believer that at some point you should just bring in the FBI and the Department of Justice and treat a rape like a rape and throw people in prison. But short of that, the Department of Justice has an Office on Violence Against Women, and it has an Office on Victims of Crime, both of which have considerable experience. I was a U.S. Attorney. I think highly of those offices. Do you have plans to engage with those offices to improve the type of services that are provided in the military and sexual assault situations?

Secretary Hagel. The answer is yes. We are doing those things. We are taking the initiatives internally that we need to do. A number of things we have already begun. A number of legislative proposals will be and are being put forward, as you know, that need to be, I think, accomplished as well. So the short answer is yes.

Senator WHITEHOUSE. And to a completely different topic, and then probably well beyond this budget year, but I think it is a budget issue this Committee may be facing for a while. The American military has an increasingly robust and increasingly frequent role in responding to international emergencies—tsunamis, earthquakes, famines, floods, and so forth. How significant a component do you see that being in the future of the military budget? Do you see that we should be expecting significant increases in that area? And from a strategic policy point of view, how would you evaluate that use of our American military in terms of building international good will and projecting American values?

Secretary Hagel. It is, I think, a critically important part of our foreign policy, clearly in our national interest. We, as you suggest, have had over the years significant capacity to help countries during these disasters. We have very recent examples certainly within our own country, the National Guard—the Reserves and National Guard in particular had the resources to do that. We should respond and we will continue to respond.

As to the budget, yes, those kinds of programs will continue. They need to continue. It is clearly in our interest around the world, and it is humanitarian. Where we can help, we will continue to help.

Senator WHITEHOUSE. But beyond the humanitarian value, you see that it is part of the strategic value that the military provides America in its relationship with foreign nations?

Secretary Hagel. Well, it is part of it. Our charge, our objective, our mission, our responsibility, is the national security of this country first. But that unfolds into many areas of how we do that. When you are making friends around the world, when you are developing partners and allies, you are developing the next generation of global citizens who see America helping them. I would say that cuts right directly to the national interest and security of our country, and we can do that, and we have been doing that. We do it better probably than anybody does, the military.

Senator WHITEHOUSE. It certainly is, I think, a point of pride that we can take as Americans how well we can deliver necessary humanitarian resources in the wake of a catastrophe, almost anywhere on the planet. There is nobody who matches us in that strength.

Lastly, on cybersecurity, we are continuing to try to find a way forward to develop a bipartisan bill here in the Senate in the wake of the President's Executive order, which I think was both a necessary and a correct step, but not a sufficient step because of the inherent limitations that attend an Executive order as opposed to full-blown congressional legislation.

Could you comment for a moment on where you see that theater of operations for the military and for the country? I would note that General Alexander has asserted—who I have the highest regard for, by the way, has asserted that he believes that the United States is on the losing end of the biggest transfer of wealth in the history of humankind as a result of cyber intrusions—not necessarily military ones, industrial espionage, but where do you see your role going forward on that?

Secretary Hagel. First, I recall our days together on the Intelligence Committee when we worked on this issue, and it has not gotten any less complicated, to your point.

As to our role, you may have noted that we have requested a significant increase in our cyber capacity in this budget, and we have continued to do that for the obvious reasons. I have said many times, Senator—I said it when I was in the Senate and out of the Senate—that I think cyber represents as great a threat to this country as any one thing, and there are a lot of threats—nuclear threats, weapons of mass destruction. But for the reasons you know and everybody who knows anything about this understand why I say that.

So this is an area that we have obviously cyber command responsibility for. General Alexander I think is on the Hill today, this afternoon, and as you know, he is dual hatted in his capacity as NSA Director as well as cyber command.

The Defense Department has essentially most of the assets here, as you know. This is an interagency issue, as everyone knows, where Homeland Security has a significant amount of the authority. How then do you not only just interagency—which I think is going along pretty well, but the bigger issues, the privacy issue, the business issues, and what I understand really led to the breakdown in your efforts here on the Hill and trying to find compromise legislation last December, that yet needs to be bolted together.

But we have a very significant part of this, but we have jurisdictional limitations, too, as to what we can do and what we cannot do. Our main responsibility is to protect our national security as defined by defense establishment, Government and so on interests.

But, again, as you know, when you veer out in the private sector and how far you can go, what legal authorities you have, what laws govern that are, I think, the large area of some contested debate.

Chairman MURRAY. Thank you.

Senator WHITEHOUSE. I thank all the gentlemen at the table for their services. Thank you, Chairman.

Chairman MURRAY. I appreciate that, and I know out of respect of your time, you have asked to be able to have a moment before you head to the House, so I appreciate all of you and your testimony today. I apologize to any Senators, Senator Kaine, for not getting their final question in. But Senators can submit additional statements or questions by 6:00 p.m. today, and we would ask that all of you get then back as quickly as possible. And, again, thank you very much for your service and for appearing before this Committee today.

Senator SESSIONS. Thank you very much.

Secretary Hagel. Thank you.

General DEMPSEY. Thank you.

[Whereupon, at 12:11 p.m., the Committee was adjourned.]

CHARRTS No.: SBC-01-001
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Ayotte
Witness: SecDef Hagel
Question: #1

Rosoboronexport Cooperation with DCAA

Question: Has Rosoboronexport fully cooperated with the Defense Contract Audit Agency (DCAA)?

Answer: DCAA was asked to review the pricing of Mi-17 helicopters procured under an Army contract. DCAA's audit objective was to review sales information for similarly-equipped Mi-17 helicopters sold by Rosoboronexport to determine if the price paid by the Army was comparable to prices charged by Rosoboronexport to other customers. Accordingly, DCAA made numerous requests for pricing information to Rosoboronexport. Due to the way the contract was structured, Rosoboronexport was not required to allow DCAA access to its pricing information. In response to DCAA requests, Rosoboronexport declined to provide any pricing information.

CHARRTS No.: SBC-01-002
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Ayotte
Witness: SecDef Hagel
Question: #2

S-300 Missiles

Question: Has Rosoboronexport transferred S-300 missiles to Syria? If Russia delivers the S-300 missile systems, would they pose a threat to our aircraft if the decision were made to establish a no fly zone over Syria? Could the S-300s pose a significant threat to Israeli aircraft if Israel felt compelled to strike in Syria to protect their interests and prevent Hezbollah from gaining access to dangerous weapons?

Answer: Deleted.

CHARRTS No.: SBC-01-003
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Ayotte
Witness: SecDef Hagel
Question: #3

MiG-29 Fighter

Question: Has Rosoboronexport transferred MiG-29 fighter aircraft to Syria? Would MiG-29M/M2 fighter aircraft pose a threat to U.S. F-15, F-16 and F-18 aircraft? Would the presence of additional MiG-29M/M2 aircraft in Syria increase the risk to pilots or change commander's decisions, if the U.S. pursued a No-Fly Zone over Syria?

Answer: Deleted.

CHARRTS No.: SBC-01-004
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Ayotte
Witness: SecDef Hagel
Question: #4

Mi-17 Unit Cost and Contract Price

Question: How many Mi-17 helicopters has the United State purchased from Rosoboronexport? What has been the unit cost per Mi-17 purchased? What was the total expense to the U.S.? Are there are there any future contracts to purchase additional Mi-17 helicopters? What is the contract unit cost per Mi-17? What is the total contract price to the U.S.?

Answer: The U.S. Army contracted for 63 military Mi-17V-5 helicopters through Rosoboronexport. As of July 16, 2013, 21 military Mi-17V-5s were delivered to Afghanistan. An additional 12 Mi-17V-5s are scheduled for delivery to Afghanistan during FY 2013, and the remaining 30 are scheduled to be delivered in FY 2014.

Cost Breakdown for Rosoboronexport Contract:

Fiscal Year	Quantity	Unit Price	Total Aircraft	Total Value
2012	21	$16,400,000	$344,400,000	$375,051,442
2013	12	$17,062,553	$204,750,636	$204,750,636
2014	30	$18,250,308	$547,509,240	$572,180,894

Note: Total Contract Value includes the cost for Aircraft, Initial Spares Package, and Engineering Services.

There are no future contracts planned to purchase additional Mi-17 helicopters from Rosoboronexport. All helicopters priced above are on Army contract W58RGZ-11-C-0072.

CHARRTS No.: SBC-01-005
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Baldwin
Witness: SecDef Hagel
Question: #5

Tactical Wheeled Vehicles (Oshkosh, Wisconsin)

Question: Thank you for your testimony today in front of the Budget Committee. I would greatly appreciate receiving answers to a few additional questions for the record that I have listed below. I am glad we are drawing down from over a decade of war in Iraq and Afghanistan. However, beyond this withdrawal, sequestration appears as well to be forcing an additional drawdown of funding for otherwise-desired, or even essential military equipment, such as vehicles. As you noted in your prepared remarks, "With military pay and benefits exempt from the sequester, and our internal decision to shift the impact of sequestration away from those serving in harm's way, the cuts fall heavily on Department of Defense's (DoD's) operations, maintenance and modernization accounts that we use to train and equip those who will deploy in the future."

In particular in Oshkosh, Wisconsin, we produce the tactical wheeled vehicles. The steep drop in DoD orders for these trucks is creating layoffs in the Wisconsin manufacturing sector and has imposed negative ripple effects for small businesses and workers' jobs throughout the region. Therefore I request a response to the following questions:

1. How much of a role is sequestration playing in DoD's decision to cut short orders for the tactical wheeled vehicles, from companies like Oshkosh?

2. DoD recently submitted a "reprogramming request" to Congress. The request asks permission to transfer funds, previously designated for purchasing Oshkosh vehicles, for other purposes. How much is this request driven by sequestration?

3. In what ways could these cuts, which hurt Wisconsin jobs and could actually increase costs to the taxpayer in the long run, also hurt the ability of DoD to respond quickly to emerging and unforeseen U.S. military needs?

Answer:

1. 1. The sequestration reduction to tactical wheeled vehicles totals $48 million, spread across FY 2011- FY 2013 funding, and is expected to have only minor impacts on affected programs. However, most Oshkosh produced vehicles, such as the Family of Medium Tactical Vehicles, the Family of Heavy Tactical Vehicles and the Palletized Load System Extended Service Program, were spared sequestration reductions.

2. The Department recently submitted a $9.6 billion reprogramming request to offset shortfalls in OCO funding driven by the fact the operating tempo exceeds the level anticipated in the FY 2013 budget and emergent high priority needs.

Significant offsets in investment programs were proposed to finance these readiness shortfalls, including $1.0 billion in tactical wheeled vehicle procurement ($740 million in FY 2013 OCO funding and $257 million in FY 2013 base funding). To date, the Defense committees have accepted only $26 million of the proposed tactical wheeled vehicle reductions. Because combat operations are drawing down, the Department assesses that the near-term risk associated with the proposed reductions is acceptable to maintain higher priority operational readiness, particularly with regard to those efforts funded in FY 2013 OCO (e.g., Mine Resistant Ambush Protected (MRAP) Modifications and High Mobility Multipurpose Wheeled Vehicle (HMMWV) Recapitalization).

3. The tactical wheeled vehicle portfolio, even with the proposed reductions, is adequate to meet the Department's anticipated operational requirements. The drawdown from combat operations in Iraq and Afghanistan is the predominant reason for the reduction in tactical wheeled vehicle procurement in FY 2014.

CHARRTS No.: SBC-01-006
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Coons
Witness: SecDef Hagel
Question: #6

Force Structure in Budget Scenarios

Question: I understand the Department of Defense is engaged in planning for multiple future budgets, depending on Congressional decisions made in the next few months. Please describe what a smaller military might look like in some of those small budget scenarios, as well as what missions it would and would not be able to carry out in order to provide a better idea of what Defense paradigms Americans have to choose from.

Answer: The Department stands committed to the FY14 President's Budget submitted to Congress as the best plan to meet U.S. national security requirements. Given the current state of legislation, DoD is planning for potential budget levels in FY15 that it may face; however, no decisions have yet been made. To reach the approximately $52B in annual cuts required by the Budget Control Act of FY 2011 the Department would have to do the following:

- Aggressively pursue efficiencies, including retiring lower-priority forces early
- Obtain Congress' assistance in slowing the growth in military pay and benefits, including changes the Department asked for in the past, but were rejected
- Acquire Congress' approval on a new Base Realignment and Closure (BRAC)
- Reduce the size of both military and civilian forces
- Slow modernization plans

The Department would seek to minimize the adverse impacts to readiness, but it is already starting from a low point after the significant adverse effects caused by the FY 2013 sequester. Details of the analysis are still premature, but the Department will be refining them over the next six months, and it will used to shape the President's Budget submission for FY15.

CHARRTS No.: SBC-01-007
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Coons
Witness: SecDef Hagel
Question: #7

Future Procurement

Question: As you budget for future procurement, should we expect more large-buy, multi-mission systems like the Joint Strike Fighter or the Littoral Combat Ship that have experienced significant cost overruns and program delays yet hold out the promise of great versatility and effectiveness, or do you anticipate a return to more limited scope platforms that can nevertheless be fielded more quickly and in greater numbers?

Answer: The complexity and scope of future procurement makes a general answer difficult. There are many criteria to consider in deciding procurement strategy. Requirements to procure weapons systems are based upon detailed threat assessments and the corresponding capabilities needed to defend the United States. The procurement strategy is also a function of the operational plans that will be employed to meet these known or predicted threats. As the threats are characterized, capabilities are prioritized to best meet the needs of the warfighter. A procurement strategy must strike a balance between filling capability gaps, meeting the need for modernization of aging assets and maintaining fiscal responsibility to the taxpayer. The Department continuously reviews procurement requirements in support of national strategies. The issues raised will be considered through the annual Program Budget Review process.

CHARRTS No.: SBC-01-008
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #8

Triad

Question: I'm pleased to see the President's budget request adequately funds the sustainment of the nuclear triad; however, I am concerned about the request in your budget specifically dealing with intercontinental ballistic missiles (ICBMs). In April, you testified before the Senate and House Armed Services Committees discussing your office's request for funds to perform an environmental impact statement (EIS) relating to an ICBM wing. We still have not heard an adequate explanation as to why the study is needed. I understand we need to get to New START levels, but New START does not require shutting down a missile wing. Can you elaborate more on the purpose of the EIS study? Is it looking at closing down an entire ICBM wing? Are you looking at the other two legs of the triad for this study as well? This study only causes more fear that the Department is preparing unilateral reductions in nuclear forces beyond the requirements of New START. Unilateral reductions to the triad and specifically the ICBM force will not yield strategic or fiscal benefits. ICBMs are the nation's most cost-effective strategic asset. This is a good example of a program with minimal cost-cutting potential that is vital to our national security. Would you agree that the ICBM force has continuously demonstrated it is a cost-effective component of our strategic triad?

Answer: I agree that the intercontinental ballistic missile (ICBM) force is a valuable and cost-effective leg of the Triad. At the same time, DoD must prepare for potential reductions in the ICBM force in order to meet New START Treaty limits. The fiscal year (FY) 2014 President's budget request includes funding for the environmental impact statement (EIS) associated with potential Treaty-related reductions. Because the possibility of future base realignments and closures, DoD believes it is prudent and cost-effective to complete a broader EIS than that needed to meet the minimal requirements under the New START Treaty. The EIS will address the effects of eliminating ICBMs and/or launchers at each of the three operational ICBM bases. These studies will support a fully-informed decision by FY 2015 on the reductions in U.S. forces needed to meet New START Treaty limits. If a decision is made to eliminate ICBMs and/or launchers, studying all squadrons at the three ICBM bases will help ensure a full and fair decision-making process. Furthermore, by conducting the EIS now, DoD hopes to promote cost savings and prevent EIS redundancies in the future. The Department is also engaged in preliminary engineering studies that are necessary to support decisions eliminating or converting bombers and submarine launch tubes.

CHARRTS No.: SBC-01-009
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #9

New START Force Structure

Question: Officials within the Office of the Secretary of Defense testified before the other body earlier this spring, and indicated that the decision on what the New START force structure will look like will be made before the end of the calendar year—I know the Air Force is engaged in a number of studies that will allow the Department to implement whatever option the Administration may choose. Would you be willing to detail some of those options?

Answer: I would prefer not to speculate on the options that the President could be evaluating. There are various options under consideration involving different combinations of eliminating or converting submarine launch tubes, bombers, and intercontinental ballistic missile (ICBM) silos. I am confident that whatever decision the President makes will preserve the Triad and retain a credible nuclear deterrent.

CHARRTS No.: SBC-01-010
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #10

Triad

Question: Our balanced triad that includes an intercontinental ballistic missile (ICBM) force that is always ready and on watch, the submarine force that is very difficult to detect and target, and a flexible bomber force that can generate in crisis has successfully protected the nation for many decades. Are you satisfied that the Department is sufficiently focused on sustaining the stability provided by a balanced triad? Are you committed to modernizing all three legs of the triad?

Answer: Yes. Sustaining the mix of intercontinental ballistic missiles, submarine-launched ballistic missiles, and nuclear-capable heavy bombers is essential to U.S. national security interests, and the Department of Defense remains committed to modernizing all three legs of the Triad.

CHARRTS No.: SBC-01-011
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #11

Nuclear Warheads and Strategic Delivery Vehicles (SDVs)

Question: On page 20 of the Nuclear Posture Review (NPR), it states; "The NPR conducted detailed analysis to determine and appropriate limit on nuclear warheads and strategic delivery vehicles (SDVs). After determining that the United States should retain a nuclear Triad under New START, the NPR went on to assess the appropriate force structure for each Triad leg, namely the required numbers of strategic nuclear submarines (SSBNs) and submarine-launched ballistic missiles (SLBMs), intercontinental ballistic missiles (ICBMs), and nuclear-capable heavy bombers." It went on to say the analysis focused on meeting four requirements:

- Supporting strategic stability through an assured second-strike capability;
- Retaining sufficient force structure in each leg to allow the ability to hedge effectively by shifting weight from on triad leg to another in necessary due to unexpected technological problems or operational vulnerabilities;
- Retaining a margin above the minimum required nuclear force structure for the possible addition of non-nuclear prompt-global strike capabilities (conventionally armed ICBMs or SLBMs) that would be accountable under the Treaty; and
- Maintaining the needed capabilities over the next several decades or more, including retaining a sufficient cadre of trained military and civilian personnel and adequate infrastructure.

It appears your first requirement pre-supposes our deterrence policy has been weakened to the point that we now must place additional emphasis on essentially the SSBN leg of the triad, which costs more to sustain than our land based ICBM force, without the same deterrent value.

Is there any specific reason why the number one requirement is not to sustain our current deterrence capability? What has changed that would cause us to choose to alter/further reduce specific platforms and/or number of warheads to end strength less than agreed upon in the New START treaty?

Answer: I support the President's objectives to reduce the number of nuclear weapons and their role in national security policy and to create the conditions that will allow others to join with us in this process. As the President already stated, reductions to U.S. nuclear forces beyond those in the New START Treaty are possible while still ensuring the security of the United States and its Allies and partners. Such reductions would be consistent with both Article VI of the Nuclear Non-Proliferation Treaty and with the conclusions of the 2010 Nuclear Posture Review (NPR).

CHARRTS No.: SBC-01-012
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #12

Intercontinental Ballistic Missile (ICBM) Force

Question: Given the Air Force Global Strike Commander' page 5 testimony to the House Armed Services Committee Strategic Forces Subcommittee stating: "Of the three legs of the strategic nuclear triad, the ICBMs are the most responsive to national leadership. Continuously on alert and deployed in 450 widely dispersed locations, the size and characteristics of the overall Minuteman III force presents any potential adversary with an almost insurmountable challenge should they contemplate attacking the United States. Because an adversary cannot disarm the ICBM force without nearly exhausting their own forces in the process, and at the same time, leaving themselves vulnerable to our sea-launched ballistic missiles and bombers, they have no incentive to strike in the first place. In this case, numbers do matter. The ICBM contributes immeasurably to both deterrence and stability in a crisis."

And again on 21 January 2010 on page 14 of his testimony to the Senate Armed Services Committee Subcommittee on Strategic Forces on 17 March 2010 "...the intercontinental ballistic missile in my view is extraordinarily important to the triad and to our overall defense posture. And without saying a specific number, I think numbers really do matter. By presenting a potential adversary with a fairly large, complex target set that he would have to deal with should he contemplate attacking the United States, it -- having a large number of ICBMs literally forces any adversary to exhaust his entire force in an attempt to defeat it or disarm it. And in the process, if he does that, then he's still faced with the other two elements or components of the triad, the manned bomber and the -- and the sea launch ballistic missile, which will provide for continuing deterrence after that attempt. So I think that's extraordinarily -- extraordinarily important. The other point is the ICBM is perhaps the most responsive of all elements of the triad, because it is land based. It's located in the continental United States. There are multiple and redundant communication paths to the -- to the launch control centers -- so a very responsive system. And by touting the strengths of the ICBM, I continue to be a champion for the manned bomber, as you would expect the commander of Air Force Global Strike Command to be, but also for the sea launch ballistic missile because of its tremendous survivability and power that it also brings to the deterrent and assurance equation. "

Is it logical to conclude, given the commander's assessment, the NPR will only de-mirv the ICBM force and retain the number of deployed weapons and launchers at 450? And if for some reason the analysis referred to in the body of the NPR has come to the conclusion there should be something less than 450 ICBM weapons deployed, the United States will continue to retain all 450 launchers?

Answer: The intercontinental ballistic missile (ICBM) force is a vital leg of the Triad and will remain so in the foreseeable future. The President's budget for fiscal year (FY) 2014 supports the current force of 450 ICBMs, and the "de-mirv" process as directed in the 2010 Nuclear Posture Review (NPR). The Department of Defense (DoD) will maintain the Minuteman III ICBM fleet in service until 2030. Furthermore, DoD recently began a Ground-Based Strategic Deterrent Analysis of Alternatives to study the full range of concepts to recapitalize the land-based leg of the Triad. However, the United States must make reductions in the number of strategic delivery vehicles and warheads in order to meet the limits of the New START Treaty. The bulk of reductions required to meet the Treaty's central limits will come from the conversion or elimination of systems that no longer have a nuclear mission while the remaining reductions will occur when the Department defines a new strategic force structure. DoD is currently assessing the appropriate force structure to meet the New START Treaty limits, and those decisions will be made by FY 2015. In the case of ICBMs, the Department established planning guidance that could retain up to 420 ICBMs.

CHARRTS No.: SBC-01-013
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #13

Energy Supply Reliability

Question: Energy supply reliability (especially fuel supply reliability) is extremely important to both our energy security and national security. The President's budget continues to essentially ignore not only one of our nation's most abundant domestic energy resources, but also our most reliable and virtually uninterruptable source of energy - coal. Past research conducted by DOE and DoD showed the viability of converting coal to a variety of fuels - including jet fuels.

Is not the reliability alone of this domestic energy supply sufficiently important to make coal-to-jet fuels a key component of the military's energy portfolio? Are you integrating this fuel source into your energy portfolio? If not, why not?

Have you recently met with DOE's National Technology Lab (NETL) to review the current status of the technology in this area and about possible strategies for moving forward in this area? If not, why not?

Part of having a strong defense is making sure our military has a flexible, reliable fuel supply. Relying on the nation's 240-year coal supply, coal-to-liquid (CTL) fuel can be delivered through existing pipelines and is readily useable today in existing markets, including for military uses. Would you agree that efforts by Congress to limit the DoD's options for using alternative fuels, such as CTL, have made our nation's military less energy secure and more dependent on imported oil?

Answer: As one of the world's largest consumers of petroleum, the Department of Defense (DoD) in interested in the long-term diversification of fuel supplies. That is why DoD qualified and certified a number of alternative liquid fuels for military use. As the Department considers a variety of alternative fuels, the primary goal is to ensure operational military readiness, improve battlespace effectiveness, and further flexibility of military operations through the ability to use multiple, reliable fuel sources for worldwide operations.

The investigated fuel alternatives include those based on coal, produced by the Fischer Tropsch conversion process, and blended 50/50 with petroleum-derived fuels. As part of the certification process, military aircraft, naval ships, and Army ground equipment were run for hundreds of hours on these Fischer Tropsch fuel blends.

For DoD to specifically contract for any alternative fuel in bulk, including coal-to-liquids fuels, they must be compliant with section 526 of the Energy Independence and Security Act of 2007.

To be compliant, they must have a life-cycle greenhouse gas footprint equal or less than petroleum fuels. In addition, all fuels, including coal-to-liquids, must be cost competitive with traditional fuels, except in the case of fuels purchased for research and testing, which are typically purchased in small amounts.

Current processes for coal-to-jet fuels are not domestically cost-competitive or less greenhouse gas intense than petroleum fuels. To address these challenges, DoD is working closely with the Department of Energy (DOE) on alternative fuels and is conducting joint research on coal-based fuels with DOE's National Energy Technology Laboratory. DoD is also aware of DOE's current efforts to use biomass and carbon capture and sequestration to reduce the greenhouse gas footprint of coal-to-liquid fuels. DoD's recent investigations related to alternative fuels focused on bio-based fuels due to their low carbon footprint, which makes it easier to meet the requirements of section 526. Because section 526 provides DoD a useful baseline as it develops the fuels of the future and has not constrained us, DoD supports the current law.

CHARRTS No.: SBC-01-014
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #14

Military Retirement and Health Care Benefits

Question: This budget proposal introduces readjustments of military retirement and health care benefits. I have heard many concerns about the increased burdens on our military men and women, and potential effects on recruitment and retention of an all-volunteer force. Will the increase in TRICARE fees be enough for a long-term solution to the increasing costs of this program? Does the Administration intend to make clear that any proposal to changes in benefits must include a grandfathering provision?

Answer: Increases in the TRICARE Prime enrollment fees for working age retirees and adjustments to retail and mail order pharmacy co-pays are important steps to managing costs, but there are many other actions the Department is taking as well to manage long term health care costs. Some examples include:

- The Department is creating a Defense Health Agency (DHA) with an initial operating capability of October 1, 2013. The intent of the Agency is to achieve greater integration of our direct and purchased care systems, assure medical readiness, improve employee health, enhance the experience of care, and lower health care costs. The creation of nine shared services (including facilities, logistics, health plan, and information technology) and six enhanced Multi-Service Market areas (eMSMs) are expected to generate savings and improve performance.
- In 2008, with the support of Congress, the Department championed changes in law (known as Federal Ceiling Price) that require pharmaceutical manufacturers to provide the Department discounts for drugs provided to TRICARE beneficiaries through retail network pharmacies. Federal Ceiling Price discounts for drugs are at least 24 percent less than the average manufacturer's price for its non-Federal customers, and the Department is now projecting savings of over $1.5 billion annually in drug costs.
- In 2009, by aligning its payments with Medicare rates (known as the Outpatient Prospective Payment System), the Department instituted changes in the way it reimburses private hospitals for outpatient services provided to TRICARE. When fully implemented, these changes will save the Department over $900 million annually.
- To further reduce costs, the Department is changing the way it buys medical products, by leveraging the bulk buying power of the military health system. A series of strategic price reduction initiatives are being implemented, saving the Department on average, $60 million annually.

These are a handful of cost saving and efficiency improving initiatives that the Department is pursuing in addition to seeking reasonable changes to the benefit. By following a holistic approach to addressing the rising costs of health care, the military health benefit will continue to be a rich reward for those who have served our country so well.

With respect to "grandfathering" proposed benefit changes, it's important to note that they do not contain such a grandfathering provision. However, safeguards are built in that protect the most vulnerable beneficiaries from proposed changes in cost-shares. Service members, and their families, who are medically retired from active service and families of service members who died on active duty are exempt. This multi-pronged effort continues to invest in health and health care and shares responsibility for managing costs.

CHARRTS No.: SBC-01-015
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #15

Number of Civilian Furlough Days

Question: Last month, the Department directed defense managers to prepare to furlough most civilian employees for up to 11 days. These furloughs will impact about 85 percent of the workforce, or 652,000 workers. What is the estimated saving associated with these furloughs? How were exemptions determined for portions of the workforce? Do you currently predict having to increase or decrease the number of furlough days?

Answer: The Department estimates the furlough will achieve approximately $2.1 billion in savings if 11 days of the furlough are executed.

The categorical exemptions were determined through a deliberative process assessing the legal commitments for the Department, potential impact on civilians deployed to combat zones, and consideration for life, safety, and property for the military members and civilians in the Department. Civilian positions that were funded from non-Defense sources or that would not create a savings to the Department were excluded as well. Additionally, the Military Services submitted specific requests for exceptions, such as the Department of the Navy Shipyard workers which would adversely impact mission readiness if the employees were to be furloughed.

The number of furlough days is predicated upon the Department's FY 2013 operating budget shortfalls due to sequestration and in order to meet critical wartime requirements. The Department has taken many steps to close this shortfall including sharp cuts in facilities maintenance, hiring freezes, and layoffs of temporary employees. DoD also asked Congress to let us reprogrammoney from our investment accounts into operating accounts. The ability to reprogram could reduce the number of furlough days needed to cover the operating budget shortfalls.

CHARRTS No.: SBC-01-016
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Enzi
Witness: SecDef Hagel
Question: #16

BRAC

Question: The budget requests an additional round of BRAC in 2015 to eliminate excess infrastructure and includes $2.4 billion to cover implementation costs. Last year, GAO found the BRAC implementation costs for the last round of closures grew to about $35 billion, exceeding the initial 2005 estimate of $25 billion by 67 percent. How would the proposed 2015 BRAC round be different than the 2005 experiences? Do you foresee the possibility that a 2015 BRAC could cost more than you currently estimate?

Answer: If the Department receives authority to conduct a Base Realignment and Closure (BRAC) round, the underlying assumption is that the scope in terms of cost and savings will be similar to that of the 1993 and 1995 rounds (lower costs and savings with quicker payback and a focus on efficiency). The 1993 and 1995 rounds cost an average of $9.4 billion in today's dollars and saved $2.4 billion annually in today's dollars. The payback was quick because savings accumulated during implementation ($9.1 billion) nearly equaled costs.

While the BRAC 2005 round cost $35 billion, and resulted in cost growth above its $21 billion projection, the Government Accountability Office validated the savings of approximately $4 billion annually. However, that leaves considerable time before savings overtake costs.

The Department cannot afford another $35 billion BRAC round. However, the key factor that drove the cost of the last BRAC round was the willingness to accept recommendations that were not designed to save money. Nearly half of the recommendations from the last round were focused on taking advantage of opportunities that were only available under BRAC, to move forces and functions to where they made sense, even if doing so would not save much money. They were pursued because the realignment itself was the determining factor. This "Transformation BRAC" cost almost $30 billion and resulted in a small proportion of the savings from the last round, but it allowed the Department to improve the distribution of its forces with its infrastructure in a way that is extraordinarily difficult outside of a BRAC round. It was an opportunity that the Department seized when budgets were higher.

The remaining recommendations made under BRAC 2005 paid back in less than 7 years, even after experiencing cost growth. These "Efficiency BRAC" recommendations cost only an estimated $6 billion with an annual payback of approximately $3 billion. This part of BRAC 2005 paid for itself speedily and will produce savings for the Department in perpetuity. In other words, a BRAC round that is focused on efficiency recommendations can succeed and makes eminent sense in today's fiscal climate.

CHARRTS No.: SBC-01-021
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #21

Active Versus Reserve Forces

Question: There has been recent discussion about using more reserve component units in order to retain some additional personnel, but also to save money. Part of the discussion was the early release of a draft report on this topic which was required by the 2012 defense authorization bill. After it was released, the Pentagon said it did not stand by the report.

What are the Department's views on the proper mix of active and reserve forces, both in terms of cost efficiency as well as readiness? Please provide the Committee with a copy of the final Cost Analysis and Program Evaluation (CAPE) report on active versus reserve costing being undertaken pursuant to section 1080A of the 2012 National Defense Authorization Act (NDAA).

Answer: The draft report that was leaked to the press was not fact-checked, edited, coordinated with stakeholders, or seen by the Department's leadership. In circumventing the review process, the leaked material does not reflect DoD's official position. Additionally, the summary of the study reported in the press was distorted.

The results of the report, however, are neither startling nor controversial. Active Component (AC) and Reserve Component (RC) units are not equal, since the AC is a full time force and the RC is a part-time force. RC units cost less than AC, but typically have a lower level of readiness and can sustain a lower peacetime operational tempo; RC units normally receive less annual training, require more advanced warning to act, and need more time to adapt to changing demands. AC units cost more than RC, but have a higher level of readiness and can sustain a higher peacetime operational tempo; in general, these forces receive more annual training, require little advanced warning to act, and are able to adapt more quickly to changing demands. AC forces normally fill key roles involving forward stationing (e.g., forces in Korea), sustained high readiness (e.g., nuclear alert forces), and large unit collective skills needed early in a conflict (e.g., Army Armored Brigade Combat Teams).

The report identifies the cost of pay and benefits as a primary difference between AC and RC forces. There is no surprise that part-time (RC) manpower costs less than full-time (AC) manpower. Differences in manpower cost decrease rapidly with more frequent use of RC personnel. On an annual basis, a reservist in part-time (dwell) status is far less expensive than an AC service member; the cost for a drilling reservist is about 15 percent that of an active service member. However, once the reservist is brought on active duty, the costs are roughly the same; the cost of an activated reservist is about 80 to 95 percent that of an active service member, depending on rank and the extent of compensation elements included in the cost comparison.

The report also looked at unit cost, which is a combination of personnel cost and unit training costs. Again, part-time RC units typically maintain a lower level of readiness than active units—though this varies greatly by unit type. An RC unit in dwell costs 20 to 50 percent that of an AC unit, with higher cost units having higher readiness than lower cost units; once activated, the costs quickly grow to parity.

The report is in its final stages of coordination within the Department. Once the review process is completed, DoD will deliver the report to the Congress. In the interim, the Department would be pleased to present a briefing summarizing the report to members of Congress or staff who are interested. To date, the Department has shown the briefing to SASC staff members and to a member of Senator Leahy's staff.

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Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #22

Deferring Needs

Question: There is concern that steps which have been taken to lessen the effects of sequestration this year may create a larger problem down the road, especially if sequestration is allowed to continue. Some acquisitions can be put off, and some equipment can be used longer than originally planned. But postponing maintenance on ships, or replacing equipment does not eliminate the need for those improvements. The same is true for investments that are necessary in providing for the care or our servicemembers or quality of life for their families. How are you balancing these needs to prevent the Department from developing left with either a large backlog or unusable equipment?

Answer: There is a general consensus that sequestration introduces inefficiencies in everything the Department does. Reducing procurement quantities below economic production rates, delaying maintenance on weapons and facilities, and deferring certain family support activities, is both wasteful and unproductive. In the face of this challenge, the Department is attempting to re-balance its priorities while still at war, which makes it particularly demanding. The Department is focused on ensuring that deployed forces are 100 percent supported, while preserving the funding for critical readiness activities. Unfortunately, this forced the Department to temporarily reduce non-war costs and certain activities and overhead functions. Some of these reductions and deferments has fallen most severely on training, facility maintenance, and the Department's civilian personnel. These deferred costs will have to be restored in the future unless the Nation is willing to assume greater military risk, which I believe to be unacceptable in today's national security environment. Notwithstanding, I am committed to work closely with military leaders and members of Congress to minimize the long-term impact of sequestration and ensure that we do not have to sequester funds again.

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Member: Senator Murray
Witness: SecDef Hagel
Question: #23

Integrated Electronic Health Record

Question: As servicemembers leave the military, VA and DoD must provide coordinated health care and timely claims processing. An end-to-end information solution is essential to these efforts. Until the Departments backed away from their goal, the initiative to jointly develop a single, integrated, electronic health record was considered a cornerstone of this solution. What steps are being taken to ensure accountability and oversight of the Interagency Program Office and the electronic health records program? How can VA and DoD work together more effectively to ensure interoperability of the Departments' health records?

Answer: Secretary Shinseki and I are both committed to the goal of providing seamlessly interoperable healthcare data interchange between the Departments of Defense (DoD) and Veterans Affairs (VA). Additionally, my restructuring of the DoD's healthcare software modernization effort, as described in the May 21, 2013, memorandum, is intended to refocus efforts on achieving near-term interoperability while separately pursuing a competitive acquisition process to satisfy DoD clinical software modernization needs. Acquisition oversight for both efforts will fall under the Under Secretary of Defense for Acquisition, Technology, and Logistics. The Acting Under Secretary of Defense for Personnel and Readiness will remain the overall lead for coordination on healthcare with Veterans Affairs.

Providing high quality healthcare for current Service members, their dependents, and our Veterans is among our Nation's highest priorities. The Departments of Defense (DoD) and Veterans Affairs (VA) are committed to fulfilling that responsibility. The two departments are committed to ensuring high quality care and continuity of care as Service members' transition to Veteran status. These commitments are enabled by the seamless transfer of electronic health data between DoD and VA.

To meet our obligation, we are managing towards two distinct objectives: the first objective is focused on the seamless transfer of standardized data between DoD and VA, building on the efforts of the last 10 years that have resulted in the current sharing of millions of electronic data elements. In support of this foundational phase, we have accomplished the following through joint DOD-VA collaboration on the integrated Electronic Health Record (iEHR):

- Clinical Capabilities: Established an enduring and robust relationship between our clinical communities in the Interagency Clinical Informatics Board (ICIB) that defines our common clinical care capability needs.
- Data Standardization: Where national standards do not exist, VA has adopted the DoD Health Data Dictionary (HDD) for clinical data.

- Data Mapping: We have mapped clinical data in seven of the most used data domains to national standards and the HDD, and are starting on the path to mapping the rest of the 40 additional domains.
- Data Centers: VA has agreed to use DoD data centers to host a large fraction of VA's healthcare data in order to facilitate a single data structure. Twelve VA medical centers are presently supported out of DoD data centers and we are on track to complete this consolidation in 2015.
- Identity Management: VA has adopted the DoD identifier as the identifier the two agencies will use to uniquely identify veterans.
- Data Access for Clinical Care: We are deploying a joint viewer that displays both DoD and VA data in a single screen. The viewer is currently at nine sites and it is proving invaluable to clinicians treating our severely wounded Service members transitioning care from DoD treatment facilities to VA polytrauma centers.
- VA and DoD will continue to cooperatively pursue standards-based interoperability and create seamless integration of DoD and VA electronic health record data in more than 25 clinical domains and have this data available to clinicians.

The second objective is to modernize the software systems supporting both organizations. Our objective is to provide health care delivery systems with the technology tools necessary to sustain and enhance healthcare delivery. Both VA and DoD have identified the need to update their respective healthcare management systems, replacing or enhancing existing legacy systems to give clinicians and patients the best healthcare software support, including state-of-the-art clinical decision support and analytics.

- DoD is in the process of developing a competitive acquisition to replace its Armed Forces Health Longitudinal Technology Application (AHLTA) at the best possible value. VistA based systems, including the enhanced VA system, will be considered as a viable alternative during the DoD acquisition process.
- VA, with its large installed base, trained workforce, and in-house IT staff, is enhancing its healthcare management system based on an evolved Veterans Health Information Systems and Technology Architecture (VistA).

Our goal remains to achieve seamless integrated electronic health data exchange based on standards and open architecture design principles. DoD and VA will continue to work closely together in achieving these objectives and to meet the President's vision of healthcare data that can move seamlessly among VA, DoD, and commercial healthcare providers. We are currently collaborating and working together to update the Joint Strategic Plan (JSP) and other documentation to accurately reflect these objectives.

CHARRTS No.: SBC-01-024
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #24

Incremental Funding

Question: As the Department's budget comes under pressure from sequestration, incremental funding is increasingly being used to fund expensive procurement programs. This method of funding spreads the costs of these very expensive programs over many years, rather than fully funding them. This method of funding leads to a lack of transparency in the full costs of programs, creates liabilities for current and future budgets, makes the Department's budget less flexible, and ultimately ties the hands of Congress because funds are obligated before Congress has authorized the program. Incrementally funding our acquisition programs, as you probably will agree, is not ideal. Is the Department taking steps to curb incremental funding? Are there any plans to move back to use of full funding? Are there plans to expand incremental funding for any other procurement programs within the Department?

Answer: I share you concern about not fully-funding procurement programs, a practice which has been slowly growing during the past several fiscal years. Some individuals, both in the Department of Defense and in Congress, have acquiesced to the idea that incremental funding makes equipment and weapons more affordable. Unfortunately, the truth is quite the opposite. Incremental funding is a product of undisciplined programming and budgeting, which defers funding requirements to future years, and constrains funding options to both the Department and future Congresses. The misconceived argument that it allows the Department to buy more equipment completely ignores the fact that incrementally-funded procurement efforts introduce programmatic risk to acquisition programs and, in the long run, higher costs.

I acknowledge that certain programs, such as aircraft carriers costing upward of $12 billion may force the Congress and the Department to consider an incremental approach. But this incremental strategy should be limited, and constrained to a select number of a high priority and expensive weapons that take several years to build. I look forward to working with Congress to buy what we can afford, and not be fooled by budgeting gimmicks that hide the real cost of acquisition programs.

CHARRTS No.: SBC-01-025
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #25

Improper Payments

Question: A recent GAO report highlighted that DoD made nearly $1.1 billion dollars in improper payments in 2011 while also failing to implement key provisions of the Improper Payments Information Act of 2002, the Improper Payments Elimination and Recovery Act of 2010, and Office of Management and Budget requirements for fiscal year 2011. GAO also found that DoD's financial report was neither reliable nor statistically valid because of long-standing and pervasive financial management weaknesses and deficiencies. The claims made in this report are troubling especially in a time when DoD cannot afford to lose nearly $1 billion a year because of improper payments.

How will the Department change its current operations to ensure that improper payments are significantly reduced or eliminated? How will the Department ensure that its financial reports are reliable and that financial management issues are addressed?

Answer: To address your first question, the Department of Defense (DoD) is also concerned about the annual estimate of improper payments. It is important to understand that the nearly $1.1 billion the Government Accountability Office (GAO) cites in its report, GAO-13-227, "DoD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements," dated May 13, 2013, represents both underpayments and overpayments. During the timeframe of this report (Fiscal Year (FY) 2011), the estimated amount of overpayments was $683.1 million and the estimated amount of underpayments was $456.4 million. Further, a billion dollars was not lost. Instead, most underpayments were later disbursed correctly, and the overpayments were recaptured or placed into collection. In the FY 2012 DoD Agency Financial Report (AFR), the Department reported $882 million in overpayments and underpayments, a 20 percent reduction from the FY 2011 total.

Since the time period reviewed by GAO, DoD has implemented several improvements to our improper payments program:

- The Defense Finance and Accounting Service (DFAS) now uses statistically valid sampling to produce improper payment estimates for annual AFR inclusion.

- Starting with FY 2012 AFR reporting, all program results are based on statistically valid sampling methodologies approved by the Office of Management and Budget (OMB) and that meet the guidance requirements of OMB Circular A-123, Appendix C.

- The DFAS, TRICARE Management Activity, and U.S. Army Corps of Engineers are participating in the Do Not Pay program, required by the Improper Payments Elimination and Recovery Improvement Act of 2012. The Department of the Treasury (Treasury) portal allows these agencies to ensure payments are not made to deceased persons or to commercial entities that are currently debarred or suspended from federal contracting.

- The DFAS Debt Management operation implemented a centralized offset program in December 2011 that provides the opportunity to automatically offset a pending invoice from a vendor or contractor that was overpaid in a previous transaction. If no pending invoice is available after 61 days, a debt is automatically transferred to the Treasury for collection.

- All disbursing Components use prepayment controls to prevent improper payments. The DFAS tool, Business Activity Monitoring, is constantly enhanced through logic changes based on regular analysis of why improper payments still slip through the system edits.

The Department's Financial Improvement and Audit Readiness (FIAR) initiative addresses your second question. The Department is committed to achieving audit readiness on the Schedule of Budgetary Activity by September 30, 2014, and on the full financial statements by September 30, 2017. Achieving audit readiness means the Department will have improved financial practices, processes, and systems, and strengthened internal controls so that the financial information used to manage the Department is accurate and reliable. More progress was made in the past 4 years than in the preceding 18 years since the passage of the Chief Financial Officers Act of 1990. Attaining FIAR goals—audit ready budgetary execution in FY 2015 and beginning full scope audits by FY 2018—will also reinforce public confidence in the Department's ability to safeguard against improper payments program and in its overall stewardship of taxpayer dollars.

CHARRTS No.: SBC-01-026
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #26

Duplicative or Poor Performing Programs

Question: The Department is undergoing some serious acquisition reform efforts and continuing to make progress in ensuring that we procure our weapons in a cost-effective and timely manner. Aside from those programs listed in the President's terminations and reductions report, what duplicative programs has the Department eliminated since 2011 and how will poor performing programs be improved, restructured, or cut going forward?

Answer: The Department did not eliminate any purely duplicative Acquisition Category I (ACAT I) programs aside from those listed in the President's 2011 report on *Terminations, Reductions, and Savings.*[1] Other ACAT I programs were eliminated since then, but for reasons other than duplication.

Addressing problem programs requires a range of approaches. For example, the Under Secretary of Defense for Acquisition, Technology, and Logistics launched earlier this year Better Buying Power (BBP) 2.0, a continuation of the Better Buying Power initiative first introduced in 2010. BBP 2.0 represents the Department's commitment to continuous process improvement in the defense acquisition system with the following goals: achieving affordable programs, controlling costs throughout the product lifecycle, incentivizing productivity and innovation in industry and government, eliminating unproductive processes and bureaucracy, promoting effective competition, improving tradecraft in the acquisition of services, and improving the professionalism of the total acquisition workforce. Poorly-performing programs are being improved through a renewed emphasis on acquisition fundamentals, improved situational awareness, better risk and incentives management, streamlined decision making, and empowering the workforce and its leaders to think through and apply the best approach to each challenge. Programs are restructured on a case-by-case basis for such reasons as to address issues or to improve the coordination with other programs. Programs are also being given cost constraints for both production and sustainment to drive the tradeoffs necessary to keep Defense programs within affordable limits. Programs that are no longer affordable will be terminated in ways that work to extract value while minimizing cost.

[1] The only purely duplicative ACAT I program eliminated since 2011 was the F-136 Engine. It was to be an alternative second engine for the F-35 Joint Strike Fighter, and it was listed in the President's 2011 report.

CHARRTS No.: SBC-01-027
Senate Budget Committee
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Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #27

Readiness and Environmental Protection Integration

Question: The Department recently announced that projects to address encroachment at Joint Base Lewis-McChord and Eglin Air Force Base were selected as winners of the Readiness and Environmental Protection Integration (REPI) Challenge. The two projects leveraged $5.25 million of REPI program funds with $25 million in non-REPI program funding to protect over 23,000 acres in the vicinity of those two installations to combat encroachment. Could additional funding for more REPI challenge projects result in similar outcomes at other installations and assist in getting "ahead of the curve" in protecting those installations from encroachment in the context of the greater training intensity associated with a return training for full spectrum operations?

Answer: The FY 2013 REPI Challenge was designed to encourage innovative approaches and identify new sources of partner funding in order to both accelerate the timing and expand the scale of efforts to protect the Nation's vital test and training installations, ranges, and associated airspace from encroachment. In FY 2013, proposals meeting the stringent criteria for the REPI Challenge were received for projects that would protect vital missions from encroachment at 19 installations in 16 states. Those proposals identified over $117 million in new partner funding and identified over 158,000 acres where landowners indicated their willingness to participate in the REPI program. With the funds set aside for the 2013 Challenge, two projects were selected. Those two projects, Joint Base Lewis-McChord and Eglin Air Force Base, leveraged $5.25 million of REPI program funds with $25 million in non-DoD partner funding to protect over 23,000 acres in the vicinity of those two installations to sustain their missions. The REPI Program in general, and the REPI Challenge in particular, advance innovative, cost-shared partnerships that deliver better value to the taxpayer in protecting essential training, testing, and operational capabilities for the Warfighter. The REPI Program consistently obligates its funding. In the FY 2014 Presidential budget, the Department requested $50.4M which balances fiscal realities with the need to protect installations from encroachment.

CHARRTS No.: SBC-01-028
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #28

Training frequency

Question: Secretary Hagel's written testimony highlighted the need, even in a fiscally constrained environment, to support a "return to full spectrum training and preparation for missions beyond current operations in Afghanistan." Will a return to full spectrum training involve an increase in the frequency, scope, and scale of readiness training at DoD installations and ranges in the United States? Would such an increase make the impacts of encroachment on those installations and ranges a matter of even more concern than it is in today's training environment?

Answer: Yes. Full spectrum training emphasizes combined arms, and force-on-force training, which increases the scope and scale of training. This type of training results in more noise and increase challenges from incompatible development.

With the drawdown in Afghanistan, there will also be an increase in home station training adding to the scale of training on DoD installations. As such, the Department anticipates greater competition for training land, ranges, and airspace, which may be exacerbated by existing encroachment restrictions and incompatible development.

These are not new challenges for the Department. Since 2002, the Department has been proactively identifying ways to avoid, or at least mitigate, encroachment challenges through the Sustainable Ranges Initiative. As part of that program, DoD actively engages with states, communities, non-governmental organizations, and other stakeholders in developing cooperative solutions to promote compatible development and protect access to the ranges, sea, and airspace used to train the Force. The Department will continue to be proactive in addressing encroachment challenges in the future.

CHARRTS No.: SBC-01-029
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Murray
Witness: SecDef Hagel
Question: #29

Strategic Choices and Management Review

Question: A May 29, 2013, memorandum written by Deputy Secretary of Defense Carter stated that "we will produce a White Paper that documents the options we considered and their implications for both management and strategy." Understanding that the Strategic Choices and Management Review (SCMR) is not a refutation of the President's Budget Request, but rather a strategic planning document to consider all eventualities, the Committee is deeply concerned about the potential effects of further sequestration. In order to facilitate the Committee's responsibility to properly budget for national defense, please provide the Committee a copy of the white paper described in the memorandum, and please keep the Committee fully apprised of the findings or recommendations of the SCMR.

Answer: The SCMR did not produce a White Paper as detailed in the May 29, 2013 memorandum. That said, the Department is prepared to share findings with Congress in the coming months.

As you wrote, the SCMR is not a refutation of the President's FY 2014 Budget Request. The Department stands committed to the President's Budget Request as the best plan to meet U.S. national security requirements. In fact, the SCMR demonstrated that, out of all the budget scenarios under consideration, only the President's budget enables DoD to meet the tenets of the Defense Strategic Guidance.

The sequestration-level caps will break parts of the strategy. Sequester is irrational, mindless, and damaging. The $37 billion in FY 2013 sequestration cuts are having a damaging impact on readiness, which limits the nation's military options for responding to crises. Sequestration is already creating a legacy of limited defense to protect U.S. national security. The Department will still have an obligation to defend the country and maintain global responsibilities. And, in the long term, it will preserve the best possible force to do so. But sequestration-level caps will limit what the Department can do—now and in the future.

CHARRTS No.: SBC-01-032
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Toomey
Witness: SecDef Hagel
Question: #32

Strategic Choices and Management Review

Question: As the sponsor of legislation to combat sexual assault in the Department of Veterans Affairs, I am greatly alarmed by recent reports about the soaring incidence of sexual assaults in DoD. I would appreciate your clarification of an apparent inconsistency in your department's approach to the issue. My information is that you have recommended removing the power of commanders to overturn convictions, amid recent cases in which commanders have done so without explanation. But the service chiefs staunchly oppose taking away the power of commanders to decide which cases get prosecuted. As you know, the latter is a provision in recently introduced Senate legislation. How do you explain this seeming inconsistency?

Answer: I proposed that Congress limit but not remove the authority of convening authorities to disapprove findings of guilty after court-martial convictions, while retaining their authority to approve or mitigate sentences. The Joint Chiefs supported my proposal.

The proposal you address would remove commanders from being convening authorities. This is a fundamentally different issue than a convening authority's role after a court-martial conviction. It was this proposal to remove commanders from being convening authorities that the Joint Chiefs opposed. I have asked the Response Systems Panel, an independent advisory committee that I established pursuant to section 576 of the National Defense Authorization Act for Fiscal Year 2013, to include an assessment of the commander's role in the military justice process and to expedite their report to me by completing its review in one year. I look forward to reviewing the Panel's report, and to working with Congress as we seek every way possible to eliminate sexual assault from the military.

CHARRTS No.: SBC-01-033
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Toomey
Witness: SecDef Hagel
Question: #33

Sexual Assault

Question: General Dempsey stated that there are "inadequate protections" to prevent convicted sex offenders from serving in the military. What are the current measures, if any, to prevent this and planned measures to fix the problem going forward?

Answer: The Department of Defense (DoD) policy prohibiting the enlistment or commissioning of any individual convicted of a felony sex-related offense has been in place since July 2009. Since implementation of that policy, no waivers were approved for these offenses, nor am I aware of any applicant being accessed with a known felony sex-related offense.

During the screening process, any information identifying a felony conviction for sexual assault or other sex related crimes is an automatic disqualification for military service, without exception. The following screening practices are used to provide the best possible information to determine an applicant's fitness to serve.

- Recruiters question every recruit and obtain documentation about basic qualifications (e.g., education level, police involvement, family status, and work history.)
- Applicants are required to answer questions about any problems with law enforcement agencies, arrests, charges, citations, parole or probation, and detention.
- Applicants undergo a background investigation (NACLC – National Agency Check, Local Check, with Credit). The NACLC includes local police checks, FBI fingerprint checks, and national and local data base searches for arrests and other police involvement.
- The Military Entrance Processing Stations then check the information the recruiters obtain and address any problems or issues.
- During the medical history and physical exam, the recruits must disclose family or emotional problems, psychiatric history, or drug and alcohol use.
- The Standard Form 86, Questionnaire for National Security Positions, which every recruit must complete as part of the background screening, includes questions about any legal infraction regardless of outcome.

- Those entering through the Delayed Entry Program (the majority of recruits) are interviewed again and undergo a recheck of qualifications just before entrance on to active duty.

The DoD Sexual Assault Prevention and Response (SAPR) Directive 6495.01 (reissued 23 January 2012) is equally clear on the prohibition of moral waivers. It states that the "[e]nlistment or commissioning of personnel in the Military Services shall be prohibited and no waivers are allowed when the person has a qualifying conviction for a crime of sexual assault."

The "qualifying conviction" definition includes juvenile adjudications, which goes beyond the NDAA FY 2013 (§523) language. A "qualifying conviction" is defined as a "State or Federal conviction, or a finding of guilty in a juvenile adjudication, for a felony crime of sexual assault and any general or special court-martial conviction for a Uniformed Code Of Military Justice (UCMJ) offense, which otherwise meets the elements of a crime of sexual assault, even though not classified as a felony or misdemeanor within the UCMJ. In addition, any offense that requires registration as a sex offender is a qualifying conviction."

Given the current policies and prohibitions that are in place and the thorough screening processes that are used, it is extremely unlikely that a person with a qualifying conviction would be able to join today's military. However, the databases that we rely on to identify possible sex offenders are only as good as the input provided by states and local law enforcement agencies. In light of this fact, the Department will continue to look for new and innovative ways to identify potential sex offenders and to bar them from becoming members of today's military.

CHARRTS No.: SBC-01-034
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Warner
Witness: SecDef Hagel
Question: #34

Military Whistleblower Protection Enhancement Act (MWPEA)

Question: As Congress works to eliminate the epidemic of sexual assaults in the military, we need to ensure those who come forward to report that something is wrong are not further victimized by retaliation. Whistleblowers help guard the federal government against waste, fraud, and abuse, and protections for military whistleblowers are the weakest in the federal system. I recently introduced the Military Whistleblower Protection Enhancement Act (MWPEA) which provides service members with a means to seek relief from reprisals and to hold subjects accountable. Do you support the provisions in the Whistleblower Protection Act and how would you best implement these provisions to ensure that whistleblowers are not further victimized by retaliation?

Answer: I support appropriate protections for all whistleblowers, military and civilian; because I believe that whistleblowers provide valuable assistance to leadership in helping ensure that the Department of Defense performs its functions efficiently and effectively. Reprisals against whistleblowers subvert the whistleblower program; those engaging in reprisal actions should be held appropriately accountable; whistleblowers who are victims of reprisal should have access to appropriate remedies. I fully support the purpose of the Military Whistleblowers Protection Enhancement Act, and look forward to working with you to enact legislation that improves the current whistleblower protection program.

CHARRTS No.: SBC-01-035
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Warner
Witness: SecDef Hagel
Question: #35

Strategic Choices and Management Review

Question: DoD has completed the Strategic Choices and Management Review (SCMR), an exercise that looked at cutting DoD's budget at three levels — $100 billion, $300 billion and $500 billion — over the next decade. Which option provides the best balance in terms of both reducing spending and preserving capability?

Answer: The Department stands committed to the President's Budget for FY14 that was submitted to Congress as the best plan to meet U.S. national security requirements. Also, it is important to understand that the SCMR is not a set of recommended actions under various DoD topline assumptions—it is a set of options for consideration. After there has been a thorough review of the results of the SCMR, the Secretary of Defense will share them with the President to give him a sense of the choices that would have to be made if the DoD topline remains sequestered beyond FY13.

The Department's capabilities will be increasingly impacted as the level of funding is reduced. DoD will have to choose which missions it will no longer be able to afford to do, in-line with U.S. national security needs.

CHARRTS No.: SBC-01-036
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Warner
Witness: SecDef Hagel
Question: #36

OHIO Class Replacement Funding

Question: Although numerous studies have validated the requirement for the Ohio class replacement submarine, the current ship building budget does not provide enough funding for the required number of submarines. Are you considering funding the Ohio class replacement through the DoD strategic accounts as a way to pay for this critical system? What would be the impact of a delay in the Ohio class replacement?

Answer: The Navy will procure the lead ship of the OHIO Replacement SSBN in FY 2021 and remains committed to procuring 12 ships to replace the current class of 14 OHIO SSBNs to fulfill the sea-based leg of the national strategic deterrent requirement.

At this point in time, the Department intends to fund the procurement of the OHIO Replacement SSBN from Navy shipbuilding accounts and not through DoD strategic accounts.

The consequence of a further delay in the procurement of the OHIO Replacement program is that it will delay delivery of the new submarine units while the current OHIO SSBN will decommission on a fixed schedule. This would reduce the total SSBN force structure below that required to provide 10 operational SSBNs during the 2031-2042 transition period from the OHIO Class to the OHIO Replacement and will prevent meeting the U.S. Strategic Command at-sea requirements.

CHARRTS No.: SBC-01-037
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Warner
Witness: SecDef Hagel
Question: #37

DoD Educator Furloughs

Question: Although the Department of Defense has taken significant effort to reduce the number of furlough days for DoD civilians, these furloughs will have a disproportionate impact on Virginia, as 88,000 hardworking people will have to take a pay cut in Virginia. I still believe that we should not apply furloughs to the entire DoD work force. In particular, I still have concerns about the decision to include DoD educators in the pool of civilians subject to furloughs. Do you believe a mandated furlough across all DoD agencies is the right approach? How much will be saved as a result of furloughs and will you consider reducing furloughs below 11 days? Do you still intend to close DoD schools this fall one day per week? Does that break faith with military families, especially those who are deployed to combat zones?

Answer: There is no doubt that furloughs will hurt our employees; the furlough will also adversely affect our defense communities; the furlough will cause inefficiencies in our operations, and will erode our strength. However, the Department is also seriously concerned with the adverse effects on readiness caused by cutbacks in training and maintenance. The reductions in readiness will endanger the lives of service men and women if contingencies occur, forcing inadequately trained forces into action to defend the Nation. The Department continues to attempt to identify ways to reduce the number of furlough days without further degrading readiness, but today there are no such solutions. The current estimate of savings form an 11-day furlough is $2.0 billion. As I stated in my May 14, 2013 memo, if the budgetary situation permits us to end furloughs early, I strongly prefer to do so.

As a result of the proposed furlough, DoD schools may close for up to 5 days of instructional time at the beginning of the new school year. The focus of the Department of Defense Education Activity (DoDEA)'s furlough planning is to minimize as much instructional loss as possible. DoDEA will continue to meet all grade level and subject area educational standards, while sustaining a full-year of academic credit for School Year 2013-2014.

The decision to include DoDEA educators in the furlough does not break faith with military families. Military families recognize that to preserve vital support to warfighters DoD is forced to make many difficult decisions concerning furlough, and the consequences reach across the entire Department.

CHARRTS No.: SBC-01-038
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Whitehouse
Witness: SecDef Hagel
Question: #38

Cybersecurity

Question: Does the Fiscal Year 2014 Defense Budget Request submitted by the Administration assume that the Department of Defense will take on any cybersecurity tasks or responsibilities currently held by the Department of Homeland Security? Please explain the reasoning behind such an assumption or the reason that such an assumption is not reflected in the request.

Answer: No, the Department's Fiscal Year 2014 Defense budget request does not assume taking on any cybersecurity tasks or responsibilities currently held by the Department of Homeland Security (DHS). DHS is responsible for a distinct and very important cybersecurity mission, and the Department of Defense (DoD) depends upon DHS to be a capable, close partner in support of national cybersecurity efforts. The Department's budget request reflects the requirements associated with DoD responsibilities and reflects the Department's share of those cybersecurity activities or tasks that are shared with DHS.

CHARRTS No.: SBC-01-031
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Sessions
Witness: GEN Dempsey
Question: #31

Strategic Choices and Management Review

Question: During your testimony today, you stated that the Department of Defense's budget, if you include the full impact of sequestration, would be cut by about $1.2 trillion. This number also includes Secretary Gates' efficiency initiatives and the initial cuts from the Budget Control Act of 2011. Could you please provide a table that shows the level and source of these cuts, as well as define your initial baseline for measuring these cuts?

Answer: Secretary Gates submitted proposed over $100 billion in savings in FY11-16. These reductions were achieved through a combination of program reductions and compensation and organization reform.

The Budget Control Act of 2011 reduced the Department's topline by $487 billion in FY12-21 from the PB12 baseline. Informed by this reduction, the Department adopted a new Defense Strategy that:

- created a force that is smaller and leaner, but also agile, ready, flexible, and technologically advanced,
- rebalanced our global posture toward Asia-Pacific/Middle East,
- built innovative partnerships and strengthen alliances, and
- protected and prioritized investments in new capabilities.

Sequestration, if implemented fully, would reduce the Department's topline by roughly an additional $500 billion and be deeply destructive to national security, likely requiring a significant change in the new defense strategy. Secretary Hagel's Strategic Choices and Management Review (SCMR) is assessing the potential impact of further reductions and planning for those continued reductions, if necessary.

In all, these reductions come out to nearly $1.2 trillion in reduced DoD buying power, leaving a significant mark on the United States armed forces. The attached table shows the estimated level of these cuts and the applicable baselines.

Then-year Dollars in Billions

	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY12-21
FY11 Budget	**564**	**585**	**605**	**623**	**642**	---	---	---	---	---	---
Gates Efficiencies	*-11*	*-14*	*-19*	*-25*	*-31*	---	---	---	---	---	*-100*
FY12 Budget	**553**	**571**	**586**	**598**	**611**	**622**	**633**	**644**	**656**	**667**	**6,141**
Budget Control Act Cuts	*-23*	*-45*	*-53*	*-52*	*-55*	*-54*	*-54*	*-52*	*-50*	*-50*	*-487*
FY13 Budget	**531**	**525**	**534**	**546**	**556**	**567**	**579**	**592**	**605**	**618**	**5653**
Delta PB14 to FY 13	*-1*	*3*	*-7*	*-5*	*-5*	*-7*	*-10*	*-15*	*-18*	*-22*	*-88*
PB14 Request	**530**	**528**	**527**	**541**	**551**	**560**	**569**	**577**	**587**	**596**	**5,565**
Sequestration	---	*-37*	---	---	---	---	---	---	---	---	*-37*
Delta to Discretionary Spending Limit	---	---	*-52*	*-52*	*-52*	*-48*	*-45*	*-41*	*-37*	*-33*	*-361*

Numbers may not add due to rounding

Hearing Date: Jun 12, 2013
Hearing: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Wyden
Insert: (Page 54, Line 21)
Witness: GEN Dempsey
File Name: SBC-01-002-IFR

(The information follows):

The Commander's In-Extremis Force (CIF), at the time located in Croatia conducting training, was ordered to move on 12 Sep 2012 at 0028 Easter European Time to Sigonella, Italy and subsequently to Souda Bay or whatever location was most advantageous to support missions. It was at this time the shared EUCOM/AFICOM CIF was "transferred" to AFRICOM control.

Hearing Date: Jun 12, 2013
Hearing: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Johnson
Insert: (Page 55, Line 21)
Witness: GEN Dempsey
File Name: SBC-01-003-IFR

(The information follows):

[Deleted]

Hearing Date: Jun 12, 2013
Hearing: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Ayotte
Insert: (Page 67, Line 9)
Witness: GEN Dempsey
File Name: SBC-01-004-IFR

(The information follows):
The exact time of the communications between LTC Gibson and SOCAFRICA's Joint Operations Center regarding LTC Gibson's proposed movement to Benghazi the morning of September 12, 2012 cannot be determined. The Department's best estimate is that it occurred between the completion of the US Embassy in Tripoli evacuation at approximately 0500 Eastern European Time (EET), and the departure of the Libyan C-130 destined for Benghazi which LTC Gibson and the three other DoD personnel (including a special forces medic) wished to board. Due to night flight restrictions on the Libyan C-130 crew, it is estimated the aircraft departed between 0600 and 0630 EET.

Though the rationale for remaining in Tripoli was not communicated to LTC Gibson that morning, he accepted and followed the order to remain in place. The decision by SOCAFRICA to order LTC Gibson to remain in Tripoli was based on the following known facts at the time:

(1) Social media indicated an attack on the US Embassy in Tripoli could be imminent. This report led to the evacuation of embassy staff at dawn on September 12th. Because there were only a handful of diplomatic security personnel and local nationals to protect embassy staff, LTC Gibson and his team were ordered to remain in place to assist in providing security.

(2) SOCAFRICA was aware that all US personnel in Benghazi were accounted for and would soon be enroute to Tripoli. For this purpose, SOCAFRICA determined LTC Gibson and his team would be most effective in Tripoli to provide assistance to wounded personnel arriving from Benghazi. The decision proved crucial in that LTC Gibson's medic was instrumental in saving the life of one of the wounded from Benghazi. Had the four traveled to Benghazi, they would have been ineffective to provide any assistance to anyone. By the time the Libyan C-130 arrived in Benghazi, the flight with all remaining American personnel had already departed for Tripoli.

For event sequence context, it must be noted that once the remains of Ambassador Chris Stevens were identified at approximately 0300 EET, all US personnel in Benghazi were accounted for. At this point, the mission shifted from a potential hostage rescue mission to an evacuation mission. All US personnel were evacuated from Benghazi at 1000 EET, within 12.5 hours of the initiation of the attack.

CHARRTS No.: SBC-01-017
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Johnson
Witness: GEN Dempsey
Question: #17

Question: You testified that the command of the U.S. European Command Commander's In-Extremis Force (CIF) was transferred from EUCOM to AFRICOM at some point on the night of Sept. 11, 2012. At what time, exactly, did the transfer take place?

Answer: The Commander's In-Extremis Force (CIF), at the time located in Croatia conducting training, was ordered to move on 12 Sep 2012 at 0028 Eastern European Time to Sigonella, Italy and subsequently to Souda Bay or whatever location was most advantageous to support missions. It was at this time the shared EUCOM/AFICOM CIF was "transferred" to AFRICOM control.

CHARRTS No.: SBC-01-018
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Johnson
Witness: GEN Dempsey
Question: #18

Question: You testified that the EUCOM CIF, while training, was told Sept. 11, 2012 to begin preparations to leave Croatia and to return to their normal operating base in Stuttgart. At what time, exactly, was the unit given this order? Were any notifications or orders given to the CIF before their return to Stuttgart? Please include the timeline for all notifications, including standby and deployment orders given to the unit on Sept. 11-12 and for the seven days before and after that.

Answer: The EUCOM Commander's In-Extremis Force (CIF) was order to move to Sigonella, Italy and subsequently to Souda Bay, or whatever location was most advantageous to support missions, on 12 Sep 2012 at 0028 Eastern European Time.

A CIF operates under standing orders to maintain readiness at all times for contingency operations. The seven days before the incident, the shared EUCOM/AFRICOM CIF maintained its standard alert posture. Within the first two and half hours of the attacks, the shared EUCOM/AFRICOM CIF was transferred to CDRUSAFRICOM authority and continues to maintain an elevated posture.

CHARRTS No.: SBC-01-019
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Johnson
Witness: GEN Dempsey
Question: #19

Question: What was the notification time of EUCOM CIF on Sept. 11, 2012, and for the seven days before that and the seven days after — notification plus what, please? If the time changed during that 14-day period, please specify the N-plus times before and after the changes, and when the change took place.

Answer: [deleted]

CHARRTS No.: SBC-01-020
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Johnson
Witness: GEN Dempsey
Question: #20

Question: Did the State Department or Secretary Clinton ever contact the Department of Defense asking for additional security because she was getting requests from individuals in Libya? If so, when? Please specify all requests in 2012, including any on Sept. 11 or 12, as to the type of request, the date and time, and the response that was given.

Answer: Our support to U.S. Embassy Tripoli had been on-going since Sep 2011. Per Department of State request, a Site Security Team (SST) was deployed for 120 days and was subsequently extended twice in response to State's request. The second extension request occurred on March 5, 2012. The Secretary of Defense approved this request on March 23, 2012 and the SST was extended for an additional 120 days. The second extended mission was completed on August 3, 2012. The Department of Defense did not receive further requests from the State Department. During the 11 months of Department of Defense support to Department of State, we only received requests to provide security at the US Embassy in Tripoli, not the consulate in Benghazi.

In reaction to the attacks on September 11, 2012, the shared EUCOM/AFRICOM Commander's In-Extremis Force (CIF) was ordered to move on 12 Sep 2012 at 0028 Eastern European Time to Sigonella, Italy and subsequently to Souda Bay or whatever location was most advantageous to support missions. Additionally, the Secretary of Defense ordered one Fleet Anti-Terrorism Team (FAST) Platoon to Benghazi and one FAST to Tripoli. On 12 Sep 2012 one FAST deployed to Tripoli and the other to Souda Bay, Crete, to posture for response to additional regional unrest.

CHARRTS No.: SBC-01-030
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Nelson
Witness: GEN Dempsey
Question: #30

Strategic Choices and Management Review

Question: Please describe the types and quantity of equipment, shelters, portable buildings, generators, and other non-military specific property usable by the Afghan populace, and any plans to leave this in Afghanistan. Please provide a business case description if these actions are performed.

Answer: The majority of U.S. military equipment in Afghanistan is being redeployed to fulfill enduring requirements. It is cost prohibitive to retrograde and reset non-military specific items that are not part of the Service's force structure.

- The Department offers foreign excess personal property (FEPP) to the Government of the Islamic Republic of Afghanistan (GIRoA) for substantial benefits pursuant to 40 U.S.C. Chapter 7. Since January 2012, the Department has transferred over 200,000 items to GIRoA with a fair market value of $28 million. The transportation cost to return these items to CONUS would have been $464 million, resulting in a net cost avoidance of $436 million (see attachment)
- Examples of equipment transferred include:
  - Air Conditioners
  - Generators
  - Storage Containers
  - Laundry equipment
  - Barriers
  - Forklifts
  - Water and fuel tanks
  - Tents
  - Cafeteria Equipment (e.g., coolers, freezers)
  - Base operating support equipment

CHARRTS No.: SBC-01-031
Senate Budget Committee
Hearing Date: June 12, 2013
Subject: The President's Fiscal Year 2014 Defense Budget Request
Member: Senator Sessions
Witness: GEN Dempsey
Question: #31

Strategic Choices and Management Review

Question: During your testimony today, you stated that the Department of Defense's budget, if you include the full impact of sequestration, would be cut by about $1.2 trillion. This number also includes Secretary Gates' efficiency initiatives and the initial cuts from the Budget Control Act of 2011. Could you please provide a table that shows the level and source of these cuts, as well as define your initial baseline for measuring these cuts?

Answer: Secretary Gates submitted proposed over $100 billion in savings in FY11-16. These reductions were achieved through a combination of program reductions and compensation and organization reform.

The Budget Control Act of 2011 reduced the Department's topline by $487 billion in FY12-21 from the PB12 baseline. Informed by this reduction, the Department adopted a new Defense Strategy that:

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Sequestration, if implemented fully, would reduce the Department's topline by roughly an additional $500 billion and be deeply destructive to national security, likely requiring a significant change in the new defense strategy. Secretary Hagel's Strategic Choices and Management Review (SCMR) is assessing the potential impact of further reductions and planning for those continued reductions, if necessary.

In all, these reductions come out to nearly $1.2 trillion in reduced DoD buying power, leaving a significant mark on the United States armed forces. The attached table shows the estimated level of these cuts and the applicable baselines.

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Senate Budget Committee
Hearing Date: June 12, 2013
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Answer: The Commander's In-Extremis Force (CIF), at the time located in Croatia conducting training, was ordered to move on 12 Sep 2012 at 0028 Eastern European Time to Sigonella, Italy and subsequently to Souda Bay or whatever location was most advantageous to support missions. It was at this time the shared EUCOM/AFRICOM CIF was "transferred" to AFRICOM control.

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A CIF operates under standing orders to maintain readiness at all times for contingency operations. The seven days before the incident, the shared EUCOM/AFRICOM CIF maintained its standard alert posture. Within the first two and half hours of the attacks, the shared EUCOM/AFRICOM CIF was transferred to CDRUSAFRICOM authority and continues to maintain an elevated posture.

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Senate Budget Committee
Hearing Date: June 12, 2013
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Member: Senator Johnson
Witness: GEN Dempsey
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THE PRESIDENT'S FISCAL YEAR 2014 EDUCATION BUDGET REQUEST

TUESDAY, JUNE 18, 2013

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 10:35 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, chairman of the committee, presiding.

Present: Senators Murray, Wyden, Nelson, Stabenow, Whitehouse, Kaine, Crapo, Johnson, and Ayotte.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning. This hearing will now come to order, and I want to thank Senator Johnson, who is standing in today for our Ranking Member, Senator Sessions, and all of our colleagues who are joining us for this hearing today, as well as the members of the public and those who are watching online.

I also want to thank our witness today, Secretary of the Department of Education, Arne Duncan, for being here to testify and answer our questions. We really appreciate your participation today.

The specific of today's hearing is to discuss the President's Fiscal Year 2014 Education Budget Request, but I am hoping the conversation will be broader than that, because our students and our families are facing some very serious challenges today and those challenges are going to get worse, not better, if we fail to act.

Now, when I worked with my colleagues here on this committee to write the Senate budget that passed just a little more than two months ago, one of our highest priorities was investing in programs that would pay off for our country over the long term and ensuring the United States continues to lead in so many sectors for years to come. We thought it was important to protect our economic recovery and work to create jobs today, of course, and we certainly all agree we need to work together to tackle our long-term fiscal challenges.

But we were also very focused on looking beyond the current crisis and making sure that we are building a strong foundation for long-term and broad-based economic growth, because as any business owner will tell you, no matter how challenging the current environment is, you never want to cut the investments that will allow you to compete and prosper once that crisis ends. And as any farmer will tell you, no matter what happens, you never want to eat your seed corn.

I have heard a lot from my Republican colleagues over the past few weeks, who want to spend time now debating what our fiscal challenges are over not just the 10-year window, but for the years beyond, as well. They think the 10-year window does not show the full scope of our challenges and want to focus on our problems decades from now.

And I certainly agree, we should all be working together to tackle our long-term budget challenges. They are real and they will not go away if we just ignore them. But I do not think working together on our 30-year problems means that we should ignore our 30-day problems, and I do not think it means we should not be working right now in a bipartisan budget conference so that we can do everything possible to bridge the divide between the House and Senate budgets, to replace sequestration in a fair and responsible way, to return our budget process to regular order and give the American people some confidence that their Government can operate without lurching from crisis to crisis.

I also hope that anyone focused on our 30-year fiscal challenges would also be concerned about our other 30-year challenges. Are we going to be a Nation that continues to lead the global economy 30 years from now? Will the children of today, who will be the workforce of 30 years from now, have the education and training they need to fill the jobs our businesses will be creating in 2043? Are we going to be able to compete with countries like China and Brazil and India that are making serious investments and major commitments to educating scientists and engineers? That is the kind of 30-year thinking I think we should be doing, too, and that is what so much of what we are going to be discussing today is all about.

Investments in education, from early childhood programs through college, are some of the smartest the Federal Government can make. According to a study done at the University of Chicago by Nobel Prize winner Dr. James Heckman, high-quality early childhood education programs have a 7 to 10 percent rate of return through better educational outcomes.

We also know that those with a high school diploma or less are more likely to be unemployed, to be among the long-term unemployed, and to earn substantially less than their counterparts. And according to the Bureau of Labor Statistics, workers with a college degree can expect to make about a million dollars more over the course of their careers than those with just a high school diploma.

Among our Nation's manufacturers, 82 percent report a moderate to serious skills gap in their skilled positions. Seventy-four percent say that this skills gap has negatively impacted their business, and 70 percent expect it to get worse. McKinsey Global Institute estimates that the U.S. will need to produce roughly a million more postsecondary degrees by 2020, 40 percent more than today, to ensure we have the skilled workers that our economy needs. Tony Carnevale, the Director of the Georgetown University Center on Education and the Workforce, who testified, actually, before this committee back in February, estimated that by 2018, nearly two-thirds of U.S. jobs will require some education or training beyond a high school diploma.

So, we have a lot of work to do when it comes to making sure our students and our workers are getting the education and training they need. But, unfortunately, our current path is taking us in the wrong direction. Sequestration, which was never intended to take effect and was written into the bipartisan Budget Control Act to bring both sides together to the table to compromise, is starting to hit children and students hardest in communities across our country. These children and students did not cause the debt and deficit challenges we are focused on addressing, but under sequestration, they bear one of the largest impacts of this cut.

I saw this firsthand myself in a recent visit to a Seattle pre-kindergarten classroom. After I had an opportunity to read a story to the students at Denise Louie Education Center, I sat down and had a conversation with the staff about the $130,000 that had been cut from their center's budget this year due to sequestration and how that was going to affect the low-income children that they serve. They told me that to manage the cuts so far, the already cash-strapped center had to eliminate two full weeks of their preschool program that so many of our local parents depend on while they are at work. They have had to eliminate a classroom. They have cut slots for children. And they have let staff go. They are fighting to serve as many children as they can, but they told me it is only going to get harder if these sequestration cuts continue.

This story is being told thousands of times over in communities all across this country. Hundreds of thousands of children will lose access to Head Start programs if sequestration continues.

We also know these automatic cuts will be very harmful in our school districts, particularly those with high populations of low-income, military, and Native American children. Cuts to Title I and IDEA and Impact Aid are going to lead to teacher layoffs and reduce supports and services for these children who we know are among the most vulnerable.

For those reasons and many more, the Senate budget fully replaces sequestration with an equal mix of responsible spending cuts and new revenue from those who can afford it the most and it does not unfairly hurt the families we need to invest in. I know that the President's budget proposal replaces sequestration, as well, and I am going to keep working with Republicans and Democrats to replace those automatic cuts that hit both defense and nondefense spending in a way that does not place the entire burden on the backs of seniors and families.

Now, the House Republican budget took a very different approach. Their budget makes no attempt to replace sequestration in a balanced or fair way. It does not call on the wealthiest Americans or biggest corporations to pay a penny more towards their fair share. And it simply ignores the BCA caps on the defense side, which would lead to another round of sequestration in fiscal year 2014 if it was ever enacted. Instead, House Republicans shift the entire burden of the cuts onto our children and our families and our communities. Their recently released spending levels for education programs came in at 18.6 percent below sequestration levels. That would mean bigger cuts—much bigger cuts—to Title I, to IDEA, to Impact Aid, to Pell Grants, the very core programs that support education in our country, and it would mean we could not even consider new investments in our students to make sure they can compete in the global economy. The House Appropriations Committee has been clear. They do not think those numbers are actually workable, and they are right. They are not.

So I am looking forward to discussing this further today and I am certainly going to keep fighting to make sure we are moving our students and our schools forward, not backward. And I am also interested in hearing more about the Administration's other education priorities today. Of course, ensuring access to early childhood education has been a longstanding priority of mine, so I was very heartened to hear the President speak about early learning in his State of the Union, and I was very glad to see such an emphasis on birth-through-5 learning opportunities in both your budget, Secretary Duncan, as well as in the HHS budget. I am looking forward to working with you to make all of our children in our country have access to pre-kindergarten, which we know is such an important step to ensuring the academic success of all of our young people.

As we all know, our college students and their families are up against a critical deadline, as well, July 1, coming very fast at us. The current fixed interest rate on Stafford Federal subsidized loans will double to 6.8 percent unless we here in Congress take action. That does not make sense to me, and it needs to be stopped. Students are taking on more and more debt and struggling to pay it back today. So the last thing we should do is make it even harder for them.

So I, personally, strongly support extending the current interest rate cap on these loans to make sure students are protected when interest rates rise, and I am going to keep fighting for that in the coming weeks and I hope Congress can work now on a bipartisan basis to help keep interest rates low for our college students. This is a short-term solution, of course, and we need to keep working to make sure our higher education system is working for students and for businesses that depend on it to graduate workers ready to fill our 21st century jobs.

I am certainly interested in hearing more of your thoughts on this issue, Secretary Duncan, as well as the other policies in your budget that impact our students and families.

As we all know, the budget debate here in Washington, D.C. is often centered around abstract numbers and far too often ends up being mired in partisanship and budget games. But what should not be controversial or partisan is the idea that we should be investing in our students and making sure our country is positioned to compete and win in the 21st century economy. That is what this hearing is about today, and that is what I am working toward as I continue urging Republicans to join us in a budget conference that they have spent years saying they wanted and work with us on a budget deal to put our country on a responsible path this year, next year, and for years to come.

With that, I will turn it over to Senator Johnson for his opening statement.

OPENING STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. Well, thank you, Madam Chair, for calling this hearing. It is obviously very important. I want to welcome the witnesses and thank you for coming to give us your testimony and answer questions, Secretary Duncan and Mr. Skelly.

You know, there is no doubt about it that we all know that education is really key. I think we share that same goal, that we want to make sure that our children are armed with the tools to lead a successful and productive life. You know, when I meet with students, I frequently cite the three things that if you either do or avoid doing, you will have a pretty good chance to lead a successful life.

The first one of those is really to make sure you graduate from high school, at least. You know, getting as much education beyond that is going to dramatically increase your chances of being successful in life. And then, of course, do not do drugs. And do not have a baby out of wedlock. Get married first. If you just basically follow those three rules, you have a very high probability of leading a successful life; so education, obviously, is important.

Madam Chair, I am glad you talked about the 30-year budget window because I think that is going to be a relevant discussion. I hope maybe at some point in time we can hold a hearing, sooner rather than later, on that. The reason, certainly, somebody like me is concerned about that, the numbers in the budget, is because if we do not get our debt and deficit under control, if interest rates spike just to a 30-year average, the last 30-year average, about 1.5 percent, or 5.3 percent, we could add $600 billion per year in terms of interest expense. I mean, talk about crowding out valuable spending on things like education. That is one good way of doing it.

What I would like to do, and I just found out, I was going to stand in for our Ranking Member yesterday, so I did not have much time—I really put my staff through the wringer, and I appreciate the Secretary reaching out and finding out what we would like to talk about—I would like to throw just a few facts and figures on the board here, just to lay out in terms of what we spend, what we do invest, and we have been investing heavily in education.

From a business perspective, if you are going through any kind of budget process, you want to know the numbers and you want to have the measured results. One thing I found out just in this very quick exercise of the last day or so, it is very hard to come up with the measured results. This seems to be one area that people have not been particularly really interested in getting detailed measurements over a long period of time, but we certainly can measure some spending.

So I have the first chart on here talking about what we have spent overall, and I have used my starting point as really when we established the Department of Education on the Federal level, 1978. And then we are using 2011 numbers because those are the ones that were available. And these are all, by the way, adjusted for inflation. So K through 12 in 1978, we were spending about $321 billion, again, in 2011 dollars. Today, we are spending $700 billion per year. That is a 118 percent increase.

And, by the way, let me just back up to stipulate that from 1980 until the year 2011, our population has increased about 38 percent. So you would expect spending to go up 38 percent. We have increased spending 118percent.

In terms of college, we have gone from $175 billion of spending up to $483 billion per year. That is a 176 percent increase.

So in terms of total education spending on an annual basis, we have gone, in inflation-adjusted dollars, from $496 billion per year to almost $1.2 trillion per year. Again, put that number in perspective. That is eight percent of our economy.

So, again, we all think education is very important, but we are investing in it. We are spending money. More than 10 percent of our entire economy is what we put in education. The question is, are we getting the results?

Just real quick in terms of spending per student, K through 12, 1978, we were spending about $7,300 per student. Now, we are spending about $13,000 per student. That is a 79 percent increase. In terms of college spending, $14,822 in 1978. Today, we are spending $21,857. That is a 48 percent increase.

In terms of college aid, we have gone from 1978, spending about $4,500 per student up to close to $15,000 per student as tuition rates have basically done the same thing, from about $4,600 per year to a little under $14,000. So student aid has certainly kept up with the increase in tuition.

But, again, you take a look at those percentage changes, way above the percent increase in terms of population.

The next slide. So what has all that spending got us in terms of results? You know, the NAEP score in terms of reading in 1978 was 285. Today, it is at 286. That is a 0.4 percent increase improvement. The NAEP score in terms of math went from 300 to 306. That is a 2percent increase.

In other metrics, kind of late-breaking, in terms of world rankings, I have seen a number of different studies. In 2009, Program for International Student Assessment ranked the U.S. 14th in reading, 17th in science, 25th in math. In 2012, a Pearson study, the Economist Intelligence Unit said, in general, we rank 17th. So, unfortunately, we are, at best, in the middle of the pack in terms of world rankings. That is not very good.

And you mentioned student loans. In 1978, again, in inflation-adjusted dollars, our children were indebted to the tune of about $304 billion in 2011 dollars. Today, that number is about $1 trillion. In other words, we have enticed our children to take on massive amounts of student debt, and unfortunately, a Northeastern University study, I think came out last year, found that 50 percent of recent college graduates are either unemployed or underemployed in their field. We are not doing a very good job in terms of directing our kids into the types of fields that employers actually value.

Another statistic that I think is interesting is the number of years to complete a 4-year college degree. I do not have the hard number on this, but I know in Wisconsin, talking to educators, they were saying it is about 5-1/2 years. I have heard the national average is 6 years to complete a 4-year B.A. I mean, we have to understand what is going on there.

Next graph. One of the projects that I had undertaken is sort of a then and now study of what do we spend and how does it compare against inflation. And one of the points I want to make is in a free market competitive society, we have realized enormous productivity gains in the free market economy. So, in other words, inflation-adjusted spending per household for appliances has actually declined 64 percent. For clothing, it has declined 57 percent. Food, it has declined 32 percent. Again, that is because consumers, individuals, are going in a free market competitive environment, and as a result of that competition, productivity gains have been tremendous.

Unfortunately, in things like education, which is basically paid for by the government, we have seen a 195 percent increase, basically, a doubling—a more than doubling of spending. And, again, it is due to government spending as opposed to individuals.

Last slide. This is one I use in my PowerPoints all the time, talking about the annual cost of college. Back in the 1960s, on average, it cost a little over $1,000 for room, board, and tuition for an average college. Had that figure grown just by the rate of inflation, today, college students would be spending about $7,400 per year, room, board, and tuition. In fact, they are spending close to $18,000. So the cost of one year in college has risen at 2.4 times the rate of inflation.

Just to kind of conclude my remarks, I mean, that is the question I have. I mean, what is so different about what we are spending on education that its costs have risen by 2.4 times the rate of inflation? Those are some serious questions we need to ask as we are talking about investing more. Now, the President is proposing spending money on early childhood development. We have to really take a look at what we have spent and what have been the results, and that is what, hopefully, we will get to at the bottom of this hearing.

Thank you, Madam Chair.

Chairman MURRAY. Mr. Secretary, thank you very much for your passion on these issues and for coming today to testify before the committee. You can go ahead with your remarks.

STATEMENT OF HONORABLE ARNE DUNCAN, SECRETARY, U.S. DEPARTMENT OF EDUCATION

Secretary Duncan. Thank you so much, and good morning, Madam Chairman and members of this committee. I am pleased to be here today to talk with you about President Obama's vision for investing in education in ways that ensure a quality opportunity for every child and that deliver a strong return on investment, or ROI, for the taxpayers' dollar.

As you walk through this conversation, I am going to ask you to think about a 4-year-old little girl, because this is not just about programs and accounts and budgets. It is about the consequences of the choices we make for real families and real children, yours and mine. It is not about cheap words and empty sayings. It is about the values we choose to live by.

This little girl is named Tokyo. She is four years old and she lives in Takoma Park, Maryland. I met her a few months ago. Her mom is currently studying under a Pell Grant to become a music teacher. And Tokyo is lucky. She has had a great experience in preschool and she already reads at a third grade level. She is ahead of the game right now. Every one of our babies deserves a system that starts them strong and supports them at every step, and unfortunately, as all of you know, that is not the reality for anywhere near enough of our Nation's young children.

I hope we can all agree that improving our education outcomes is a vital national interest. The decisions we make will have a major impact on our economy, on our country's economic competitiveness, and on that 4-year-old little girl's chances of having the good life she deserves as part of a thriving middle class. That is a core American value. But right now, frankly, it is in some danger.

You already know that we have lost our place as the global leader in college completion, that today, we rank about 14th. That is no badge of honor. Collectively, we should be ashamed.

Here is another indicator that should concern us. Let us look at what is happening in employment for our Nation's young adults. In 2000, we were doing better than France, Britain, Japan, Germany, and Canada. But by 2011, we were doing worse than all of them. Why? David Leonhardt, the Pulitzer Prize winning economics writer, said, and I quote, "The United States has lost its once large lead in producing college graduates, and education remains the most successful job strategy in a globalized technology-heavy economy." And that is why we have been working so hard to improve opportunities for every child to again make the United States the global leader in college completion. Fourteenth is simply not good enough.

We have been working for 4 years to raise standards, to improve teaching and learning, establish strong systems for technology and data, fix our Nation's most broken schools, and make college more affordable and accessible, and we have made some real progress. Accountability matters. Results matter. Metrics might not tell the whole story, but they do not lie, either.

Let me walk through where we are at today. Our Nation's high school graduation rates are at their highest level in almost three decades, in 30 years. That is a major, major step in the right direction, because as all of you know, today, if you drop out of high school, you are basically condemned to a life of poverty and social failure. This work is that serious and the stakes today are that high.

That improvement is due, in part, to meaningful progress in fixing our Nation's lowest performing schools. Today, there are 700,000 fewer students attending chronically failing high schools than when President Obama was elected. We have a long, long way still to go, but the trends are absolutely going in the right direction.

We have 9.4 million low-income students who are now attending college on Pell Grants. That is an increase of over 50 percent. We have seen a major jump in students attending college, especially a student from the minority community. African American students, 38 percent are attending today versus just 30 percent in 2000. For Hispanic students, today, it is up to 32 percent attending college compared to 22 percent in 2000.

And we are beginning to see the payoff. As you may have seen in the news last week, the proportion of young people with college degrees has hit a new high. In 1995, a quarter of American young people had a Bachelor's degree. Now, it is a third. And women and minorities are a big part of this change. That is great news, but it does not make us the global leader. Our competitors have not been resting. We still have a long, long way to go, and our collective challenge is to get better faster despite the tough economic times. Our children, our communities, and our country cannot wait.

We are doing everything we can to help States unleash pent-up energy for innovation and reform and move away from the old broken system of No Child Left Behind. Thirty-seven States and D.C. are already approved for ESEA flexibility, with ten other States looking for approval, and we are continuing to work with them.

But for all the progress, we know there is still so much work ahead of us. Too many kids, especially low-income kids and minorities, are not receiving the education they need to reach their middle-class dreams, and let us look at the numbers. Fully 96 percent of kids from the highest-income group complete high school, while only 63 percent of those from the lowest-income quartile do. And when we look at who graduates from college, the income gap is staggering. Fewer than one in ten of our low-income children graduate from college. That hurts us as a country, in jobs, in international competitiveness, and what it means for the lives of kids in poverty.

What is the most important single thing we can do in education to change these outcomes? I am convinced it is to invest in preschool. Madam Chairwoman, you already know all of this. As a former preschool teacher of 7 years and a school board member who fought so hard to rescue preschool programs in Washington State, you have literally lived this. But give me a couple minutes to try and lay it out for your friends and colleagues here.

On average—on average—children from low-income families start kindergarten at 5 years old in the fall. The average child from a disadvantaged community starts kindergarten 12 to 14 months behind their peers in language development and pre-reading skills. That is morally unacceptable and it is educationally unsound, and we know how to fix it.

As you quoted, Nobel Prize winning economist James Heckman says this is one of the few public investments with no trade-off, because the return on investment, the ROI, on preschool is so high. In the second sentence there, he says, and I quote, "It reduces"—this investment "reduces the inequality associated both with the accident of birth and, at the same time, raises the productivity of society at large."

But to date, we are simply not serious about preschool in this country. Other countries are out-innovating and out-investing us in this space. The United States today ranks 28th among Organisation for Economic Co-operation and Develpment—OECD countries in the enrollment of 4-year-olds in early learning. And maybe that is not surprising. The United States ranks 25th among OECD countries in public funding for early learning. If we expect to compete effectively in a global economy, we have to invest in what matters most.

President Obama's Preschool for All proposal can be a game changer in expanding access and improving quality for the children and families who need it the most. It is a major investment to tackle a major issue.

Think about that 4-year-old girl. Whether she is from Henrico County, Virginia, or Middletown, Ohio, or Montgomery, Alabama, she deserves a supportive word-rich environment. She may not have the home life that can pick up the academic slack, but she deserves access to preschool.

Our business leaders understand what is at stake here. People like James Zimmerman, the former CEO of Macy's, and John Pepper, former CEO of Proctor and Gamble and head of the Board at Disney, have said, and I quote, "Universally available pre-kindergarten is not only the right thing to do, but the smart thing to do." Other countries have realized this. China reportedly has set a goal of giving 70 percent of all children three years of pre-kindergarten education. And we have hundreds of both CEOs and military leaders who have signed letters urging us collectively to work together and to invest.

Why is this the smart thing to do? Because of ROI, return on investment. James Heckman found that for every dollar we invest in preschool, every single dollar returns seven dollars. About four dollars from that dividend comes from increased earnings, increased tax payments from greater productivity, and decreased public assistance. The remainder, almost three dollars, comes from reduced costs, reduced costs of crime, cops, and jails. We simply should ask ourselves, preschools or prisons? Where do we want to invest? What do we value, and what do we stand for?

Some folks would prefer that we not fund early learning with a cigarette tax, and if you have other, better ideas about how we should fund this opportunity for our young people, I am absolutely happy to have that conversation. But we have to invest.

Today, less than three in ten, less than 30 percent of 4-year-olds have access to high-quality pre-K. The status quo is not good enough. This is fundamentally a question of investment. We cannot do this by wishing it or by magic. We are talking about a million of our Nation's babies who will finally get a leg up and a chance. One- point-one million 4-year-olds who have been left out. We cannot solve this problem for free. We have to invest.

And many States are already making serious investments here, States like Oregon and Georgia and New Jersey and Washington. They realize the impact here and they are leading the way. Governors from both parties, Republicans and Democrats, are showing courage and vision here. They need a partner with us here in Washington.

Affordable early learning is the most important thing we can do in education to help strengthen families. But I can also tell you what does not help. What does not help is incoherent cuts to programs serving our most vulnerable students.

Sequestration, as you talked about, Madam Chairwoman, continues to hurt low-income and special needs students, young families counting on Head Start programs, the children of military families, and communities whose schools rely on Impact Aid. Why is any of this okay? Why do we have the political will to fix lines in airports but not to invest in vulnerable children and families? That simply makes no sense to me whatsoever.

We also need your help to keep interest rates low on student loans, which will require your action before July 1 to prevent rates from doubling. We know you share that concern and want to keep working with you to find an approach that will help keep college affordable for students and families now and in the future.

By the same token, to make college more accessible, we have dramatically simplified paperwork to make it easier for families to gain access to Federal student aid, and the result will be even more high-needs students attending college, many actually being the first in their families to achieve that dream.

In K-to-12, ESEA flexibility has provided crucial space for innovation and systemwide improvement, the best help we can give States until you collectively reauthorize and fix ESEA. Under ESEA flexibility, we are seeing States show real courage, raising standards, refining systems of support and accountability for schools, and holding more schools accountable for the learning of students with special needs.

We have also acted to improve services for students with special needs. During our Administration, we have requested hundreds of millions of dollars in increased funding in addition to the unprecedented $11 billion provided under the Recovery Act, including significant improvements at the preschool level.

We are also focused on the needs of students in rural communities. Many of our 2014 competitive grant proposals will include criteria or priorities specifically targeting rural communities, and we welcome the input of Congress as we work to ensure that all of our competitive grant programs give strong opportunity to rural schools and students. We want to see every community in America have excellent educational opportunities.

What that improved opportunity adds up to is a return on investment for our economy and for our families. According to a recent Brookings study, the benefits of a college degree can be compared to an investment that returns 15.2 percent a year.

We know that the engine of our economy in a globally competitive environment is having the best-educated workforce in the world, and we know that giving every child an opportunity is the right thing to do. It is who we are as a country.

Thank you so much. I look forward to your questions.

[The prepared statement of Secretary Duncan follows:]

DEPARTMENT OF EDUCATION
Statement by

Arne Duncan
Secretary of Education
on the
U.S. Department of Education Fiscal Year 2014 Budget Request

June 18, 2013

Good morning Chairman and Members of the Committee. I'm pleased to be here today to talk with you about President Obama's priorities and plans for the Department of Education, particularly as they relate to the President's fiscal year 2014 budget request for education.

This morning I'll sketch out some important progress made in the President's first term, highlight some of the urgent educational challenges that remain, and briefly describe key elements of the President's education 2014 Budget, including the President's plan to dramatically improve our return on investment (ROI) in education through the Preschool for All initiative.

The overall message here is that education is not just another expense in the Federal budget—it's an investment. In fact, it is one of the most critical investments in the future that we, as a Nation, can make. America cannot win the race for the future without investing in education—it's that simple.

As the Members of this Committee well know, budgets entail value choices. They reflect the aspirations of our citizens and leaders. And I am glad to say that, for the most part, Federal education funding has enjoyed bipartisan support, even in tough times. And in this time of fiscal challenges, it is important to work for what President Obama calls "smarter government." We don't always live up to this goal in Washington. But I've yet to meet a lawmaker who has stated a preference for dumber government.

Unfortunately, sequestration, with its indiscriminate cuts to education, the military, and other critical public investments, is just that: dumb government.

You won't see our high-performing competitors funding education by sequester. In a knowledge-based, globally-competitive economy, our competitors are determined to invest in education. They want to accelerate their progress, not cut back on public education.

South Korea's investment in education, as a percentage of GDP, increased by nearly a third from 2000 to 2009, whereas our investment, as a percentage of GDP, increased by just 6 percent. Education spending as a percentage of GDP rose at more than twice the U.S. rate in many other countries as well during the last decade, including Australia (up 15 percent), Denmark (18 percent), and the Netherlands (21 percent).

Today, the U.S. is one of only four Organisation for Economic Co-operation and Development — OECD — countries where students in low-income schools have to cope with higher student-to-teacher ratios than their peers in more advantaged schools.

But the question is not just whether we should continue to invest in education, but how can we make smarter investments in education? How can our education system become more productive? One way to answer these questions is to look at the return on investment in our education policies.

Progress During President Obama's First Term

During the President's first term, the Administration worked hand-in-hand with the Congress to make critical new investments in education. We launched new programs like Race to the Top and Promise Neighborhoods, redesigned the School Improvement Grants (SIG) program, and dramatically expanded the Pell Grant financial aid program for low-income students. A key goal was to challenge the status quo where it had become unproductive.

We also wanted to build on a development that none of the experts foresaw, the decision by 46 States, plus the District of Columbia, to come together to design and adopt the Common Core standards. For the first time, almost every State is supporting higher standards that show if students are truly college- and career-ready—whether they are from Mississippi or Massachusetts. This was a sharp change from what we saw in the 4 years from 2005 to 2009, when 19 States actually lowered their academic standards for students. We can thank courageous State leadership for stopping this dummying down of standards.

Today, we are starting to see the payoff of those first-term investments and setting higher expectations for our students. In 2010, the on-time high school graduation rate hit its highest level in 3 decades. In 2008, less than two-thirds of Hispanic students graduated on time from high school. Today, about three in four Hispanic high school students graduate with their class.

Because the graduation rate of Latino students rose from 2008 to 2011, an additional 164,000 Latino students graduated on time. That is 164,000 people with a better chance of getting a good job, owning their own home, and supporting a family.

On-time graduation rates for African-American students are up, too. In 2008, only about three in five black students graduated from high school on time. Today, two in three do so, resulting in an additional 83,000 African-American students graduating on time in 2011.

These gains are due in part to a sharp drop in the number of high school dropout factories—schools where fewer than 60 percent of ninth graders graduate 4 years later. Since 2008, the number of high school dropout factories has dropped by almost 20 percent, from about 1,750 high schools to roughly 1,425 high schools.

For our families, that means nearly 700,000 fewer teenagers are trapped in those high schools today than in 2008. That is a big step in the right direction.

In higher education, we're seeing substantial increases in college enrollment, too, especially for Hispanic students. More than half-a-million additional Hispanic students—about 550,000 in all—are enrolled in college today than were enrolled in 2008. That is 550,000 more people who are getting their shot at the American dream and the opportunity to thrive in a globally competitive world. And overall, the number of Pell Grant recipients has increased more than 50 percent, from 6.2 million in 2008 to more than 9 million 3 years later. That is the biggest expansion of educational opportunity in higher education since the GI Bill.

In a knowledge-based economy, the ROI for many of the strategies the Administration has pursued is huge. We believe our efforts to support and strengthen the teaching profession through improved teacher evaluation, better professional development, and the RESPECT initiative will pay large, long-term dividends for our children and our communities.

Economists at Harvard and Columbia have documented that having a good teacher rather than an ineffective one can increase the lifetime earnings of a class of students by over $260,000. Multiply that by the number of classes a teacher would instruct over the course of her career, and it is clear that even a single good teacher can have a multi-million dollar effect on the economy.

The ROI for attending college is huge, too, with the average college graduate earning $2.3 million during his or her lifetime, or about $1 million more than the $1.3 million in lifetime earnings for an individual with just a high school diploma. And unlike when I and many members of the Committee were growing up, there are no good-paying jobs for high school dropouts.

The ROI on High-Quality Early Learning

In developing the President's 2014 budget request for education, this emphasis on ROI led us to ask, what is the smartest use of our education dollars? The answer, I believe, is that high-quality early learning is the best education investment we can make in our children, our communities, and our country. As President Obama has said, "if you are looking for a good bang for your educational buck," high-quality preschool is the place to look.

In the near-term, high-quality preschool reduces placements in special education. It reduces grade retention. It boosts graduation rates. In the long-term, high-quality preschool both increases the odds of holding a job and decreases crime and teen pregnancy.

Nobel laureate James Heckman recently examined evidence from a rigorous, longitudinal evaluation of the Perry Preschool project and found that this high-quality preschool program returned seven to twelve dollars for every one dollar it invested. A longitudinal study of the Chicago Child Parent Centers also found an ROI of seven to one.

States like Oklahoma and Georgia know about these data and are leading the way in creating universal preschool programs. In fact, numerous States led by GOP governors—including Alabama and Michigan—are investing in quality and expanding coverage to more 4-year-olds.

Not only are States investing in high-quality preschool, voters are approving sales tax and property tax increases to fund preschool initiatives. Last November, voters in San Antonio, Denver, and St. Paul, Minnesota, approved tax increases to support preschool programs in their communities.

Voters and parents understand that in today's global economy, ensuring access to high-quality preschool is not a luxury but a necessity. They understand that investing in high-quality preschool is a win-win proposition, with a big economic return. And they understand that we have to stop playing catch-up in education. We have to level the playing field for young children, so everyone can begin kindergarten at the same starting line.

The Theory of Action for the President's Preschool Plan

Our focus on ROI is a key justification for President Obama's groundbreaking preschool proposal. Preschool for All would invest $75 billion in mandatory funding over 10 years to create a new Federal-State partnership that would enable States to provide universal high-quality preschool for 4-year olds from low- and moderate-income families, up to 200 percent of the poverty line. Preschool for All also would provide incentives for States to serve additional children from middle-class families. In addition, a $750 million discretionary request for Preschool Development Grants would help build State capacity to implement the high-quality preschool programs required by Preschool for All.

Contrary to what you may have heard, the President's plan would not be a new Federal entitlement program. States would use Federal funds to create or expand high-quality preschool programs in partnership with local school-based and community providers. States would provide an increasing match for the program, and every cent of the $75 billion provided by the Federal Government over the next 10 years would be paid for by increases in taxes on cigarettes and tobacco products.

Our theory of action in expanding high-quality preschool is going to be the same as it was in the first term for initiatives like Race to the Top, with a strong emphasis on supporting and partnering with States, incentivizing innovation, and identifying what works to strengthen education and accelerate achievement. That means that at the Federal level, we should be tight on ends but loose on means. The Department should set a high bar for quality in preschool programs. But it should leave it up to State and local leaders to choose the best means for reaching that bar.

Under the President's plan, States would be required to meet quality benchmarks linked to better outcomes for children—like having high-quality State-level standards for early learning, qualified and well-compensated teachers in all preschool classrooms, and a plan to implement comprehensive assessment and data systems.

The urgent need today for greater access to high-quality preschool for children from low- and moderate-income families is not really in dispute. Fewer than 3 in 10 4-year-olds today are enrolled in high-quality preschool programs. And we know that, on average, children from low-income families start kindergarten 12 to 14 months behind their peers in language development and pre-reading.

Despite these data, the United States ranks 25th out of the 29 member nations of the OECD in public spending on early learning as a percentage of Gross Domestic Product (GDP), and 28th among OECD nations in the enrollment of 4-year-olds in early learning. The Czech Republic and Chile devote more government spending to early learning, as do Iceland and Italy.

Other Priorities in the President's 2014 Request for the Department of Education

These preschool proposals are part of an overall request of $71.2 billion in discretionary appropriations for the Department of Education in fiscal year 2014, an increase of $3.1 billion, or 4.5 percent, over the fiscal year 2012 level.

In addition to early learning, this request is focused on strengthening K-12 education, making our schools safer and creating positive learning environments, supporting career-readiness for all, improving affordability and quality in postsecondary education, and supporting the Administration's Ladders of Opportunity initiative for high-poverty communities.

Strengthening K-12 Education

The 2014 request provides essential funding for traditional State formula grant programs that are the foundation of Federal support for State and local efforts to ensure that all students meet college- and career-ready standards, including a $14.5 billion request for the Title I Grants to Local Educational Agencies program and $11.6 billion for the Individuals with Disabilities Education Act Grants to States program. At the same time, we would continue our emphasis on creating meaningful incentives to leverage more effective use of Federal education funding in key areas such as putting a great teacher in every classroom and a great leader in every school; building local capacity to support successful school turnarounds; and improving teacher preparation and classroom instruction in science, technology, engineering, and mathematics (STEM).

Reforming Federal Support for Effective STEM Education

The Administration is proposing a comprehensive reorganization of Federal STEM education programs as part of a Governmentwide realignment that would reorganize or restructure 116 programs across 13 agencies.

Reforming Federal support to support an effective, cohesive national STEM education strategy is a top Administration priority. Scientists and engineers are key innovators in our society. They play an essential role in developing new industries and opportunities that create jobs and spur economic growth. Our Nation depends on an innovation economy, and America's capacity to build and create should never be limited by a shortage of talent in the STEM fields.

At the core of this strategy for improving K-12 STEM education is a $150 million request for STEM Innovation Networks, which would support creating partnerships among school districts, institutions of higher education, research institutions, museums, community partners, and business and industry. These networks would develop comprehensive plans for identifying, developing, testing, and scaling up evidence-based practices to provide rich STEM learning opportunities in participating local educational agencies (LEAs) and schools. They also would work to leverage better and more effective use of the wide range of STEM education resources available from Federal, State, local, and private entities, including federally supported science mission agencies.

Other key elements of the Department's STEM request include $80 million for STEM Teacher Pathways to support the President's goal of developing 100,000 new effective STEM teachers by recruiting, training, and placing talented recent college graduates and mid-career professionals in the STEM fields in high-need schools; and $35 million to establish a new STEM Master Teacher Corps, which would identify teacher leaders in STEM fields who would take on leadership and mentorship roles in their schools and communities aimed at improving STEM instruction and helping students excel in math and science.

More Effective Teachers and School Leaders

Consistent with the Administration's proposal to reauthorize the Elementary and Secondary Education Act (ESEA), the President's Budget would provide $2.5 billion for Effective Teachers and Leaders State Grants to provide flexible, formula-based support for States and LEAs that commit to improving their teacher and principal evaluation systems and to ensuring that low-income and minority students have equitable access to teachers and principals who are effective at raising student achievement. We also would renew our request for a 25 percent national activities set-aside totaling nearly $617 million that would allow the Department to build evidence on how best to recruit, prepare, and support effective teachers and school leaders and to invest in efforts to enhance the teaching and leadership professions.

In addition, the budget includes $400 million for the reauthorized Teacher and Leader Innovation Fund, an increase of $100 million over 2012, to help States and LEAs improve the effectiveness of teachers and leaders in high-need LEAs and schools, in particular by creating the conditions to identify, recruit, prepare, support, retain, and advance effective and highly effective teachers, principals, and school leadership teams in those schools. We also are asking for $98 million to support a redesigned School Leadership Program that would more than triple the Federal investment in training for principals. This proposal would promote evidence-based professional development for current school leaders aimed at strengthening essential leadership skills—such as evaluating and providing feedback to teachers, analyzing student data, developing school leadership teams, and creating a positive school climate.

Supporting School Turnarounds and Data-Based Innovation

We would expand our commitment to helping States and school districts turn around their lowest-performing schools through a $659 million request for the reauthorized School Turnaround Grants (STG) program. The request includes an increase of $125 million that would be used for competitive awards to help school districts build their capacity to implement effective interventions in persistently lowest-achieving schools or priority schools, and to sustain progress in schools that have successfully completed a 3-year STG project. In addition, the

Department could use up to $25 million of these funds to build district capacity by expanding the School Turnaround AmeriCorps initiative, a new partnership with the Corporation for National and Community Service that places AmeriCorps members in low-performing schools to support their school turnaround efforts.

The request also would strengthen K-12 education through a $215 million proposal for Investing in Innovation (i3), an increase of $66 million, to expand support for using an evidence-based approach to test new ideas, validate what works, and scale up the most effective reforms. Up to $65 million would be available for the Advanced Research Projects Agency for Education (ARPA-ED), an initiative modeled on similar entities at the Departments of Defense and Energy that would aggressively pursue technological breakthroughs with the potential to dramatically improve the effectiveness and productivity of teaching and learning. And an $85 million request for statewide longitudinal data systems (SLDS) would provide an increase of $47 million to support the development of P-20 reports and tools to inform policy-making at the State and local levels, as well as the development of in-house analytic capacity for States and school districts.

Supporting Career-Readiness for All

To out-innovate and out-compete the rest of the world, secondary schools and postsecondary institutions need to strengthen the links in our education system to better support career training and skills. The President's 2014 Budget seeks to promote career-readiness for all, in large part through a $1.1 billion request for a reauthorized Carl D. Perkins Career and Technical Education (CTE) program. The reauthorized CTE program would strengthen alignment among secondary and postsecondary CTE programs and business and industry, and create a better accountability system for improving academic outcomes, technical skills, and employability outcomes.

We also are proposing $300 million for a new High School Redesign program, which would support partnerships of school districts, employers, and postsecondary institutions that would redesign high schools in innovative ways to ensure that all students graduate from high school with (1) college credit, earned through dual enrollment, Advanced Placement courses, or other postsecondary learning opportunities; and (2) career-related experiences or competencies, obtained through organized internships and mentorships, structured work-based learning, and other related experiences.

In addition, we are asking for $42 million to fund a demonstration and evaluation of Dual Enrollment programs. This proposal would establish or expand dual enrollment programs, aligned with career pathways and local workforce needs, which offer high school and adult students the opportunity to earn college credits while enrolled in a high school or GED program. Research has shown that participation in dual-enrollment programs is linked to increased high school graduation, higher rates of college enrollment and persistence, and higher college credit accrual rates.

Affordability and Quality in Postsecondary Education

The 2014 request continues to support the President's ambitious goal that America will once again have the highest proportion of college graduates in the world by 2020. The urgent and growing need for higher education reflected in the 2020 goal comes at a time when paying for college is a challenge for many American families. As a consequence, the President's budget proposes comprehensive reforms to increase affordability and quality in higher education, including $1 billion for a new Race to the Top–College Affordability and Completion competition. That competition would drive change in State higher education policies and practices to improve college access, affordability, completion, and quality. The request also includes $260 million for a First in the World fund, modeled after the Investing in Innovation (i3) program, which would make competitive awards to encourage innovation in higher education to tackle and improve college completion rates, increase the productivity of higher education, build evidence of what works, and scale up proven strategies. Funding would also support validation systems for competency-based learning, which has the potential to improve completion rates, and Pay For Success awards to programs that can demonstrate good outcomes for students.

In addition to promoting systemic reforms in higher education, the President's 2014 request includes student aid proposals that would make college more affordable, including linking student loan interest rates to market rates and preventing a scheduled July 1, 2013, doubling of Subsidized Stafford Loan rates from 3.4 percent to 6.8 percent. The President's budget would expand repayment options to ensure that loan repayments for all student borrowers do not exceed 10 percent of a borrower's discretionary income, and significantly increase aid available under the Campus-Based Aid programs. For example, the request includes a $150 million increase for the Work-Study program as part of an effort to double participation over 5 years, as well as reforms to the Perkins Loans program that would expand loan volume by some eight and one-half times, up to $8.5 billion, while making Perkins Loans available at up to an additional 2,700 college campuses.

Building Ladders of Opportunity—and Promise Zones

The President's 2014 Budget for education would help directly address the growing concern that too many communities in America—urban, rural, and, increasingly, suburban—suffer from the negative effects of concentrated poverty, including developmental delays among young children, poor educational outcomes, high rates of crime and incarceration, health problems, and low employment. One new strategy for addressing the challenges of concentrated poverty is the Promise Zones initiative, which will revitalize high-poverty communities across the country by attracting private investment, increasing affordable housing, improving educational opportunities, providing tax incentives for hiring workers and investing in the Zones, and assisting local leaders in navigating Federal programs and cutting through red tape.

This interagency effort will explore opportunities to make better use of all available resources—Federal, State, and local—to address the negative effects of concentrated poverty. The President's budget would support Promise Zones through significant requests in his signature place-based programs, including $300 million for the Department of Education's

Promise Neighborhoods, a $400 million request for the Department of Housing and Urban Development's Choice Neighborhoods program, and $35 million for the Department of Justice's Byrne Criminal Justice Innovation Grants program, in addition to tax incentives to promote investment and economic growth.

Making Schools Safer

In January of 2013, President Obama released his plan to reduce gun violence, make schools safer, and increase access to mental health services. The 2014 request supports this plan's common-sense proposals with new investments designed to improve school emergency plans, create positive school climates, and counter the effects of pervasive violence on students. For example, we are asking for $30 million in one-time emergency management planning grants to States to help their LEAs develop, implement, and improve emergency management plans designed to enable districts and schools to prepare for, prevent and mitigate, respond to, and recover from emergencies and crisis events.

The request also includes $50 million for School Climate Transformation Grants, to be coordinated with related proposals at the Departments of Justice and Health and Human Services. These grants would help create positive school climates that support effective education for all students through the use of evidence-based behavioral practices. Funds would be used to scale up a multi-tiered, decision-making framework that has been shown to reduce problem behaviors, decrease bullying and peer-victimization, improve the perception of school as a safe setting, and increase academic performance in reading and math. In addition, $25 million for Project Prevent grants would help school districts in communities with pervasive violence break the cycle of violence through the provision of mental health services to students suffering from trauma or anxiety (including PTSD), conflict resolution programs, and other school-based strategies to prevent future violence.

I want to close by talking briefly about school safety and gun violence. This issue is very personal for me. Frankly, it's something that has haunted me from the time I was a little boy, growing up on the South Side of Chicago.

I grew up playing basketball on the streets in many of Chicago's inner-city communities. I had older teenagers who looked out for me and who helped protect me. Far too many of them ended up being shot and killed. After graduating from college and playing ball overseas, I came back to Chicago to run an "I Have a Dream" program for a class of sixth graders. One of my first memories was of one of our young men, Terriance Wright, whose teenage brother was shot one afternoon.

Going to that funeral, and trying to help that family through that process, was brutal. We have far too many parents burying their children—that is not the natural order of life. When I led the Chicago Public Schools, we lost one child due to gun violence every 2 weeks. That is a staggering rate of loss. In Chicago, we took steps that no public school system should ever have to take. We created burial funds for families that couldn't afford to bury their children.

On my wall in my office in Chicago, I kept a picture that one of our teenagers had drawn for me. It was a picture of him as a fireman. And the caption that he wrote to go along with it was: "If I grow up, I want to be a fireman." That's a deep statement about this young man's world. Think about what it means that so many of our youth today think about "If I grow up," not "When, I grow up."

Everything we are preaching to young people about going to college, building careers, deferring gratification, and planning for the future, is all undermined when a child is afraid they will get caught up in the craziness of gun violence. We need all our children, whether it is in Newtown, Connecticut, the South Side of Chicago, or Aurora, Colorado, to think of themselves in terms of "when I grow up."

Conclusion

The need for investment in education is urgent. And I say to the committee, whether you are Republican or Democrat, our children and our country cannot wait. We cannot postpone providing every child with a world-class education.

I look forward to working with you to develop and implement a fiscal year 2014 Budget for education that reflects the needs of our children and our Nation. And I would be happy to take any questions now that you may have.

Chairman MURRAY. Thank you very much, Mr. Secretary.

Let me start out with sequestration. I am very concerned and have said repeatedly that this managing our country by crisis to crisis is really hurting families across the country and sequestration is particularly damaging, as I talked about in my opening statement. We replaced sequestration in the budget that the Senate passed. As I said, it was never intended to take place. We did invest in education and research and development and in infrastructure that are priorities that will help our country remain competitive in the future. But I am very concerned about this sequester and its impact right now on children and middle-class families, as well as, by the way, the 2014 House spending bill, which is, on the Labor, Health, and Human Services side, shockingly low.

I wanted to ask you, as we start out here, can you give us some sense of what you are hearing from States and school districts and colleges about the impact of the current and the actually future sequester cuts, as well?

Secretary Duncan. Well, let me just show you a couple of headlines from papers around the country in the past couple days. Spending cuts taking hard toll on Head Start. Sequester closing home base Head Start programs. Sequester impacting Head Start. So almost every day from across the country, we are seeing real stories of real kids being hit—of job losses, programs ending early.

Let me just walk you through the numbers. Sequester leads to a cut in IDEA Part B spending for children with special needs, $598 million. Those kids are all coming back to school this fall. They are not disappearing. Title I, poor kids, $725 million. Workstudy, people working hard to try and pay their way through college, $49 million. And one I think people do not fully understand, the name is Impact Aid. Impact Aid is $60 million. Impact Aid funds those communities that do not have a property tax base. Those communities are generally Native American Reservations, children who desperately need a better education, and children of military families around military bases. And the fact that we allow these children's parents to go overseas and lose their lives fighting for our freedom and then give them an inferior education, again, is mind boggling to me. It is absolutely staggering. So why we allow these kinds of things to happen—we are not living our values.

Chairman MURRAY. And I, as a former school board member, know that those people back in Washington, D.C. make these big line cuts, but you sitting there in your community have to face a lot of parents who, with tears in their eyes, who are not getting what they need for their kids. So this is big.

And the 2014 House spending levels which will be on top of sequestration, can you talk about that?

Secretary Duncan. Yes. So sequestration, the short math is a 5 percent cut, and I gave you those numbers. The House budget is a 19 percent additional cuts on top of that. So the math there would be $2.5 billion less for Title I, poor children; $2 billion less for IDEA Part B children with special needs; $4.5 billion less for Pell Grants, so, again, do we want more people having access to college or less? Do we want a more educated workforce or a less educated workforce? One-point-five billion less for Head Start; and

$200 million less for Impact Aid, for military families and Indian kids.

And let me just be really clear. I spend more of my time looking at our international competitors, because jobs are going to go to the country with the best educated workforce. I think it is really important that we try and keep these jobs in this country. Other nations, our competitors, are not managing their education strategy via sequester. They are out-educating, they are out-investing, they are out-innovating. South Korea, by every measure, is out-educating us, is probably the world's leader in college graduation rates. In the past decade, they have increased their education spending by about a third. We have increased by about 6 percent.

So other countries are not sitting passively by while we continue to be dysfunctional here. They have long-term commitments to doing the right thing for their children and for their country, and I just think, right now, we are poorly serving not just our children, but our Nation's economic competitiveness because of the—

Chairman MURRAY. And where we are going to be 30 years from now.

Secretary Duncan. —because of the dysfunction here.

Chairman MURRAY. Okay. But let me ask you about interest rates. I am really concerned about the impact on families today. I listened to Senator Johnson's opening statement. Actually, State support for higher education has been on a 20-year decline in this country, and tuition and fees have gone up above inflation rates, and those increased costs are being directly impacted—impacting our students and their families.

The same thing with interest rates. We both talked about it. Two weeks from now, the student loan interest rate is going up. Can you talk a little bit about what that is going to mean to our families today?

Secretary Duncan. Yes. Well, this is happening at a time, again, when we are desperately trying to increase college enrollment rates and college completion rates, and again, we are 14th in the world, and the President has challenged us to be first in the world. I think that is a really important accountability measure for me and my team. Can we help lead the country to being first in the world in college graduation rates again? Anything we do to make college less affordable, less accessible, is a step in the wrong direction.

And Congress has an opportunity to work in a bipartisan way to fix this and not have student interest rates get worse. Again, we want to improve things. All this is doing is trying not to make things worse.

Chairman MURRAY. And can you explain the Administration's opposition to the House bill and the rate increase that it represents for low- and middle-income families.

Secretary Duncan. So, again, it is so important that we put in place a fix. Now, I would personally prefer a longer-term fix. I am open to a shorter-term fix. What I am not open to is doing nothing. And so we can—you know, lots of folks are engaged here, Democrat, Republican, House, Senate, so I am actually hopeful we can get this done. We all need to compromise. We all need to come to the middle. But inaction would lead to a doubling of rates to 6.8 percent and that is untenable.

Chairman MURRAY. And your opposition to the House bill, can you—

Secretary Duncan. There are parts, and there again, people are making a good faith effort. There are parts in there that make sense, but we do not want to balance the budget on the backs of young people and so we think this should be budget neutral. This should not be used to reduce the deficit.

Chairman MURRAY. Okay. I appreciate that. And I agree. We need to look at the cost of higher education and all the impacts on that. But in the meantime, right now, we need to keep the interest rates low and look at the longer-term proposals—

Secretary Duncan. That is the least we can do. Again, this is not—if we get this done, this is not a Profile in Courage. This should be low-hanging fruit that we just get done together and move on to the next tougher challenge and the next tougher challenge. If we cannot get this done, that is a really sad statement.

Chairman MURRAY. Okay. Thank you very much.

Senator JOHNSON.

Senator JOHNSON. Thank you, Madam Chair.

Let me go back to my last slide there. I do not have to put it up, but the basic point, had the cost of college just grown by the rate of inflation, it would be 2.4 times lower than it is today. So, Mr. Secretary, what explanation do you have that the cost of college has increased to 2.4 times the rate of inflation over that time period?

Secretary Duncan. Well, I do not think you or I or anyone here wants to defend the increasing costs of college. So what we have proposed in our budget is a billion-dollar investment, a race to the top—

Senator JOHNSON. But, Mr. Secretary, we have invested. I mean, my point being, my earlier slide when I was talking about the modest spending in 2011 dollars, whether it is K through 12 up 2.4 times, college up 2.8 times—

Secretary Duncan. No, I have the question. Let me—give me a chance to answer.

Senator JOHNSON. Sure.

Secretary Duncan. So, there are a couple of explanations. First of all, and not to justify raising the cost, part of the increased costs are actually that more people are going to college. So part of that is a good thing.

Senator JOHNSON. No, this is per student spending.

Secretary Duncan. Okay. Then, again, what we are proposing is a race to the top for higher education to change behavior. And let me tell you, this is complicated, so give me one second on this. This has to be about shared responsibility.

So we need States to invest in higher education. In tough economic times, 40 States cut funding to higher education, and then costs go up there. Forty States did not cut funding to prisons. Again, it is really interesting to me how people make those choices. And we also want to incentivize universities to keep their tuition down and increase the efficiency. And so we need to move everybody— the Federal level, State level, universities—to do the right thing, to increase productivity, to use technology in different ways—I think technology can be very helpful here—and to make sure we are keeping costs down and increasing completion rates.

Senator JOHNSON. But, we have thrown money at the problem. I mean, when you are increasing spending at 2.4 times what we were spending—again, these are inflation- adjusted dollars. So we are spending 2.4 times, at a minimum, in education today than we were 30 years ago, and we have not gotten the results. So we have been throwing money at the problem. I mean, when you are spending 2.4 times and the costs rise at 2.4 times the rate of inflation, do you kind of correlate those two facts, that we are throwing money at it—

Secretary Duncan. I think, again—

Senator JOHNSON. —and does that possibly increase the costs?

Secretary Duncan. —there is a complexity here that you have to get past the sound bites. We need to be able to look at a couple of different things.

Senator JOHNSON. No, you are trying to get past the numbers.

Secretary Duncan. No, I am not. Not at all, Senator. I have been a very strong proponent of challenging universities to keep their tuition down. There is no—

Senator JOHNSON. But this is beyond universities. I mean, this is just our education system itself.

Secretary Duncan. No, you are talking about higher education.

Senator JOHNSON. Well, in this one. But, I mean, in general, the cost per student is higher.

Secretary Duncan. Well, let me—let us stay on higher education for a minute and then we can talk K-to-12. So on higher education, I am right with you, that we need to challenge universities to keep tuition down, to make sure they are becoming more efficient by using technology in different ways. You have seen some places start to break through. There have been very few incentives to do that.

The conversation I would like to have is interesting to me. We have undoubtedly the best system of higher education in the world. It is also a very inefficient marketplace. Young people with 7,000 choices do not always pick the best choice, and so now we use some transparency to help people make better choices, and now we want to incentivize universities to do the right thing. We produce a scorecard, as you know, to try and give transparency and help people make better choices. So I—

Senator JOHNSON. So you are asking for a Federal Government solution. What I tried to do in my one slide there, is show that where the government controls the spending, the cost of education has risen dramatically. We have not had the productivity gains. Where consumers, individual consumers make those choices, we have had huge productivity gains over the last 30 or 40 or 50 years. So—

Secretary Duncan. Again, I—

Senator JOHNSON. —again, your solution is more government spending, which everybody calls investment.

Let me ask you one other potential problem. Since, particularly, the 1960s, we have had the formation of and the rise of public sector unions. Do you think that in any way, shape, or form has contributed to the rising costs of education?

Secretary Duncan. I do not know the correlation there. It is interesting. I look at outcomes. I look at results for children. And if you look at two of the highest performing States in the country by every measure, one is Massachusetts, one is Maryland. Both actually have fairly strong unions. You look at some other States that have very weak unions in their States and student performance is much lower. So I think it is really interesting that some people like to say this contributes to that. But if you look across the nation, some of our highest performing States actually are fairly strong union States.

Senator JOHNSON. When you take a look at per student spending—we talked about global rankings—I have a couple figures, and that is part of the problem is you have different studies. But in prep material by the Budget Committee here, they are showing about $11,000 per K through 12 student. I have about $13,000. The OECD average is about $8,200 there. So we spend more than our global competitors and our results are quite a bit less, are they not?

Secretary Duncan. No, that is accurate. Let me just take it one step further. Again, I spend a lot of time looking at these international comparisons. So two things are true. On a per pupil basis, relative to other OECD industrialized countries, we do spend more. Where we are nearly at the bottom internationally is we spend much less on our most disadvantaged kids and they are much more generous in their investment in the kids who need the most help.

Senator JOHNSON. Just a quick question. Around the world, how many other education systems are unionized?

Secretary Duncan. I do not have the number off the top of my head. Many. Many.

Senator JOHNSON. Okay. Thank you, Madam Chair.

Secretary Duncan. Just quickly on that, we actually do an international conference each year. We bring in the highest performing and the most rapidly improving nations from around the world, and we bring in my counterparts, the secretaries of education, and we bring in the union leaders from that country and figure out how we can all work together and sort of get past the traditional animosity and in a collaborative manner get better results for kids. There have been some fascinating international meetings. This has never happened before.

Chairman MURRAY. Thank you.

Senator STABENOW.

Senator STABENOW. Thank you very much, Madam Chair, and I thank you, Mr. Secretary.

First, let me just follow up on the conversation you just had. When you are comparing to other countries, are those countries—the comparisons you are making are in public funding, correct?

Secretary Duncan. Yes.

Senator STABENOW. They are making public investments.

Secretary Duncan. Right, and we also—again, all these—the important comparisons to make, many other countries have much less diversity than we do. Many other countries have much less inequities—

Senator STABENOW. Correct.

Secretary Duncan. —in terms of income, income gaps, yes.

Senator STABENOW. Well, the reason I am raising it, when China is doing it, they are not doing it through private for-profit entities. This is public funding.

Secretary Duncan. This is absolutely—

Senator STABENOW. So everybody else in the world understands—

Secretary Duncan. Yes.

Senator STABENOW. —there is a public function that we are all benefitting from—

Secretary Duncan. Again—

Senator STABENOW. We are the only ones debating whether or not somebody should make a profit off of something that is important to everybody—

Secretary Duncan. So, South Korea, which leads the world right now in education in many indicators, has increased its public funding for public education by about a third in the past decade. They see it as an investment in—

Senator STABENOW. As an investment. So this is something—

Secretary Duncan. —in their economic competitiveness.

Senator STABENOW. Yes. I think that is just an important thing. We seem to be the only ones—you know, I find it interesting—first of all, thank you for your and the President's dedication on the early childhood education effort. There is no question that we need to give children a better start in the beginning. There is no question that the strength of our country has been our ability to out-educate and out-innovate the competition, and we make things and grow things, and you put that all together, that created the great American middle class—

Secretary Duncan. Yes.

Senator STABENOW. —which is shrinking at this point as we are having fewer investments in those things, while everybody else around the world says, we want to be like America. So they are doing what we used to do and we are now having this debate about whether or not the public sector should be a part of this great effort to be globally competitive. Nobody else in the world has that debate but us right now.

Secretary Duncan. Yes.

Senator STABENOW. But let me ask you, when we—we see on the one hand the need on early childhood, and then we see what is happening to students and student loans and there is no question about it that our young people are coming out of college with thousands, tens of thousands, in some professions and some degrees, hundreds of thousands of dollars in debt. You could buy a big new house in Michigan for the debt that many of our medical students are coming out with, or other graduate degrees, and it puts them under a huge situation and, frankly, relates to whether or not they choose to go into primary care or a specialty so they can afford to get out of debt. So a lot of choices being made based on how do I get out of debt.

So I just want to go back to this question that is in front of us on July 1, because for me—I mean, would you agree that the goal has to be that student interest rates should not increase costs for students short term or long term, because part of what we are seeing in the proposals that are coming forward is they sound good in the short run, but there is no cap. And then you look long term and it is worse for students.

Secretary Duncan. So—

Senator STABENOW. So, would you not agree, we need to look at the short term in solving the problem, and make sure that when we get done, that the next generation you are talking about is not in worse shape because of the long-term solution?

Secretary Duncan. Yes, but again, I think this is the minimum goal. What we are trying to do here—

Senator STABENOW. Absolutely.

Secretary Duncan. —is not make the problem worse—

Senator STABENOW. This is the minimum, not make it worse.

Secretary Duncan. I want to make college more accessible, more affordable, make sure more people from disadvantaged backgrounds have access, make sure people do not have tremendous debt at the back end—

Senator STABENOW. Absolutely.

Secretary Duncan. So this is a minimum step in the right direction that we need to have the political will to work together and figure out.

Senator STABENOW. So the minimum is just do not do harm, keep the rates—

Secretary Duncan. Do not make things—do not make it—

Senator STABENOW. Do not make—

Secretary Duncan. Do not make a bad problem worse.

Senator STABENOW. Right. So, July 1, we need to keep the interest rates where they are, and then deal with a number of things that have come up that I think are really important for us to look at. Major banks get a better deal on interest rates to the discount rate than college students. Now, I understand people can debate that, sort of, risk levels and so, but there is something to think about here when we look at who is getting the better deal on interest rates in this country and where our long-term interests are. And when we look at the fact that the total debt load for students right now is over a trillion dollars and where that money could be going, if, in fact—

Secretary Duncan. It is a big number—

Senator STABENOW. It is a big number.

Secretary Duncan. This actually is an interesting sort of public sector-private sector debate. One thing we did, which you might not agree with, Senator Johnson, which I am actually really proud of, is that we stopped subsidizing banks that are making loans, saving about $68 billion. We used $28 billion for deficit reduction and used $40 billion to increase Pell Grants.

Senator STABENOW. Right.

Secretary Duncan. That additional funding helped us to go from 6 million Pell recipients to 9.6 million. So it is just interesting how we can try and get to the right answer. Again, wildly controversial here in Washington. I thought it made a lot of sense around the country. The fact that we have had a more than 50 percent increase in Pell Grant recipients, that is a pretty big deal.

Senator STABENOW. Right. And, Madam Chair, just in—I know my time is up. Let me just say that as we go forward on a final solution, I know you share my concern that we not end up—we are talking about deficit reduction, which is a good thing, when we took the subsidy from the banks.

Secretary Duncan. Yes.

Senator STABENOW. But we do not want to tax students with more debt in order to go to deficit reduction as a country. That makes absolutely no sense to do, and so I look forward to working with you on that.

Secretary Duncan. And I will say that I have had bipartisan interest in—bipartisan commitment to that idea, the Republicans and Democrats who agree that that is not the right way to balance the budget.

Chairman MURRAY. Thank you.

Senator AYOTTE.

Senator AYOTTE. Thank you, Madam Chairman.

Thank you, Mr. Secretary, for being here, I wanted to ask you about the student loan issue that certainly other Senators and Senator Stabenow have just touched upon, which is, as we all know, if we do not act by July 1, the new interest rate for subsidized Stafford loans will double to 6.8 percent.

And it just strikes me, as I see where we are right now, that the proposal of the Senate Republicans is not that far off from where the President is on this issue, and the President and Senate Republicans have put forth proposals that are market-based that lock in rates for the life of the loan. So I guess I wanted to ask you, and also to address all borrowers, which I think is really important. We cannot just carve out—let us have some certainty for all borrowers and really affordable loans for all borrowers.

So where are we on this? I firmly believe this is an area where we can come up with a bipartisan agreement. When I see what the President has, when I see what Republicans are putting forth, where are the discussions on this and can we move this forward so that we are not waiting until the last minute on July 1, so that we can resolve this for the American people?

Secretary Duncan. I would love that. Congress seems to only act in the 11th hour, so if we could set a new precedent here, that would be fantastic. But, again, I am like you. I am hopeful, and people think I am crazy or naive. I think, again, the White House, Republicans in the House, Republicans in the Senate, Democrats in the House, Democrats in the Senate, everyone is engaged. Every single one of you is asking about this—

Senator AYOTTE. And I do not think we are that far off.

Secretary Duncan. I think there are some differences, but I think they are resolvable. And, again, we all have to compromise—it's how a democracy works.

Senator AYOTTE. Right.

Secretary Duncan. We all have to compromise. We all have to come to the middle. But I am very hopeful that this can get done.

Senator AYOTTE. So, have you been engaged in any discussions on this?

Secretary Duncan. I am talking to people every single day.

Senator AYOTTE. Okay. Well, I am hopeful that we can get this done, too, and when I look at what the President has put forth, when I look at certainly what Senate Republicans have put forth, I think there is a way to resolve this on a bipartisan basis for the obviously, the students and the parents in this country.

So I thank you on that and wanted to ask you about the issue of—there was a quote that troubled me, and someone may have already asked you about this, but in an interview last week, you mentioned that schools are going to play a role in the implementation of the Affordable Care Act. I believe it was a statement you made to Politico, and you said that, quote, "we actually have a team here that is sort of helping on ACA implementation." Can you tell me what you meant by that in terms of—

Secretary Duncan. Sure.

Senator AYOTTE. —the Department's involvement in ACA implementation?

Secretary Duncan. If schools have questions, if districts have questions, we have one or two people who are there to help provide answers.

Senator AYOTTE. But are you dedicating special staff? Is there an education piece that is being brought in the schools on the Affordable Care Act?

Secretary Duncan. I would not say that. One piece in the Affordable Care Act that I thought was very encouraging was an investment in school-based health care clinics. So that is not through our Department. That is through HHS, which we have tried to partner with—Secretary Sebelius has been a great partner in lots of ways to increase the number of schools with school-based health care clinics.

Senator AYOTTE. Will your Department be involved in disseminating or requiring schools to disseminate information about the Affordable Care Act?

Secretary Duncan. We have not done anything like that.

Senator AYOTTE. Okay. Are there any plans to do that?

Secretary Duncan. Not that I am aware of.

Senator AYOTTE. Okay.

Secretary Duncan. Again, we just want to be a resource, and if people have questions, we want to be available to try and answer them.

Senator AYOTTE. Okay. So what your answer was, that you are just being a resource, it is not that the Department of Education is taking a role, a particular role in the Affordable Care Act?

Secretary Duncan. We want to be a resource.

Senator AYOTTE. Okay. You know, obviously, the concern I have is that, certainly, to the extent it is an issue of allowing children to know that they can stay on their parents' insurance until age 26, I understand that as a piece. But to make the Department of Education have any role in disseminating information about it troubles me in terms of even how we would fund that, given your main function. So that is why I raised the issue.

Secretary Duncan. No, that is a fair question, and I think there is no conflict there. But, to be clear, I have been very clear in many graduation speeches, letting young graduates know that they could stay on their parents' insurance until age 26.

Senator AYOTTE. Well, I can—

Secretary Duncan. I have to say, it is one of the biggest applause lines I get.

Senator AYOTTE. I can understand that.

Let me ask you, Secretary, about the STEM education piece—

Secretary Duncan. Yes.

Senator AYOTTE. and I know I do not have a lot of time left, but this is an area which I think is very important for the country, for us to move forward. But in 2010, GAO found a massive amount of duplication, 13 agencies spending over $3 billion on 209 STEM programs and a degree of overlap in 83 percent of these programs. So they recommended that it be guided by a robust strategic plan. Where are we in terms of using taxpayer dollars more efficiently to get a better outcome in the STEM education area?

Secretary Duncan. This is extremely important. A lot of that conversation is where are the jobs of the future, and we all know so many of the high-wage, high-skilled jobs of the future are in the STEM fields, and we have significant unfilled jobs today with employers who are looking for skills that we are not providing. So this is one I take very seriously.

The President has challenged us and challenged the entire Administration to coordinate. We want to invest, and we are going to do a much better job working with our sister agencies across the Administration. We want to invest in a couple of different areas. We have found movement where we provide some funding, but where there is local skin in the game, private sector business community, higher education, K-to- 12, we find where we leverage investments, there is a huge amount of movement. And so we want to invest in what we call STEM Innovation Networks, Innovation Hubs around the country, see who wants to work there.

We want to create a STEM Master Teacher Corps. So many of our children start to turn off to the STEM areas not in high school, but in the fourth and fifth and sixth grades, where they have teachers who are not comfortable and confident with the content knowledge. And so we, as a country, have to get much better in this area and we are committed to doing everything we can to provide leadership, not just in the Department of Education, but Administration-wide, to support this effort.

Senator AYOTTE. Thank you. I thank you for being here and I will have a couple of follow-ups for the record. Thank you.

Secretary Duncan. Thank you.

Chairman MURRAY. Senator Kaine.

Senator KAINE. Thank you, Madam Chair, and thank you, Secretary Duncan, for being here.

I would like to have that last chart that Senator Johnson had back up, if I could, showing inflation-adjusted cost of tuition over time, if you could find that chart. There we go.

Secretary Duncan, you made a point in connection with this chart that I want to drill down on, because I think it is very important, about two solutions. I do not view the big red number at the end as an indication that government has just been throwing money at it. I do view it as calling for a couple of potential reforms.

If you look at the chart from 1964 to 1988, it did not change that much, the actual dollar, an inflation-adjusted number, and 1988 was not that far off. It looks like the huge change was between 1988 and 2010, and I can just tell you, from my experience as Governor, you made a point that is very right. The amount of State support for higher education in many States has been on a very flat path and in some States actually a declining path, and if you actually—

Secretary Duncan. Forty States declined.

Senator KAINE. Forty States. And if you look at between the late 1980s, when sentencing, mandatory minimums, three strikes you are out started to hit, the growth in State funding for prisons and incarceration dramatically exceeded the growth in State funding for higher education. So in Virginia, for example, you go to University of Virginia—UVA, you go to the college of William and Mary, the percentage of the school's budget that is State general fund support has declined very dramatically. When State funding declines, tuition goes up—

Secretary Duncan. Yes.

Senator KAINE. —and that has been a huge factor in tuition increases. And I say this as a Governor.

Secretary Duncan. Yes.

Senator KAINE. I have some complicity in this. We were dealing with a very difficult budget situation and it made it hard for us to fund higher education to the degree that we wanted.

So the red number that is growing is not just, well, government has been throwing money at the problem. To the contrary, tuitions often go up because State governments, for a variety of reasons, many of them legitimate financial issues, have had a hard time funding higher education. So that is one issue. So keep pressure on States to fund.

But you did mention the second one, as well. We have to keep pressure on universities to control costs. I mean, I think we all have the experience of going to universities and seeing how they often compete with each other based on the quality of the gym and the dining room and all kinds of facilities that are not necessarily curricular.

And to the same degree that this Administration, I think, has done good work on requiring for-profit colleges, you want Pell Grant monies, you want Stafford loan monies, show us that you have a graduation rate, show us that you have post-graduation employability statistics, we ought to have the same discussion with some carrots but also with some sticks with the entire higher education community, public, private, and nonprofit. You want Pell Grants? You want Stafford loans? Show us that you are doing things to control the costs.

Part of it is a lack of cost control in the university community, public and private. But part of it is declining State support, not throwing money at a problem, it is that we are taking money out of higher education at the State levels.

Secretary Duncan. So you have lived this and you understand this at a really intuitive level. So I agree with everything that you said. I would love to see a chart over—for every State, you get some money, so we would have to do it for every State over the past 20 or 30 years, State spending on higher education versus State spending on incarceration. That would be a fascinating chart to look at.

Senator KAINE. I know exactly what that chart would look like.

Secretary Duncan. Yes. In some States, it is—the contrast is staggering. So, again, what do we value? Where do we want to put scarce taxpayer dollars? What is important to us growing a vibrant and thriving middle class? Is it locking more people up or is it educating them?

We have to challenge—again, this is about shared responsibility, so we have to challenge States to do the right thing and we have to challenge universities to do the right thing. Most of our funding—the vast majority of our funding has been on inputs, on access. Very little is on outcomes, your point about, you know, Pell and other things- -

Senator KAINE. Right.

Secretary Duncan. —and we are spending lots of time thinking about what we could do differently there.

But, again, I go back both in the early learning space and in the K-to-12 space. We are seeing some pretty transformational change in part due to race to the top opportunities.

Senator KAINE. Mm-hmm.

Secretary Duncan. We have not had a race to the top type competition in the higher education space, and that is what we are proposing—

Senator KAINE. Good.

Secretary Duncan. —in this year's budget, to, again, incentivize three things: To incentivize States to invest; to incentivize universities to keep costs down; and to incentivize universities to build cultures of completion.

The final thing I will say, quickly, is that when I—

Senator KAINE. Because I have one more quick question, and I have—

Secretary Duncan. Sorry. Sorry. I will be quiet. Go ahead.

Senator KAINE. Let me do this. I do not know whether this is a terminology question or a policy question, when I hear discussions of college completion, college graduation rates, U.S., State, or compared to international norms. I always wonder about the fantastic graduates of the Newport News Shipbuilding Apprentice Academy, who often have a high school degree, or maybe they have been in the military, or sometimes they have a Master's degree and they want to go back and learn how to be a shipbuilder and welder. And they are tremendously trained and they have great jobs and they make great livings for their families, but I worry that we do not count them, and if we do not count them or talk about them and as we focus on our educational programming, we have too narrow a view of what higher education is.

You have done a great job, I think, of making sure that community colleges are always at the table when we are talking about college completion, but I do not think we are yet doing a good enough job of really explaining, incentivizing, funding, and planning the right way for post-high school education to include career and technical offerings that are not offered on a college campus, because those are some of the best-paid jobs in Virginia and some of the best workers building the largest manufactured items on earth, but I do not know that they get counted in the college completion statistics.

Secretary Duncan. So, again, I think you and I see the world very similarly. So I always try and talk about college and careers, college and careers, and for me, the goal is to have everyone graduate from high school prepared for some form of learning beyond that—4-year universities, 2-year community colleges, trade, technical, and vocational training. And we should count all that. We value all that. We have—

Senator KAINE. But do we count that in our, you know, as we measure college graduation or as the international norms measure college completion and they rank us 14th in the world, are they measuring people who do not go to community college? They do not go to a for-profit college, they do not go to a traditional 4-year college, but they get a welding certificate from the Newport News Shipbuilding Academy.

Secretary Duncan. That is not measured in college completion rates and it is an important indicator—

Senator KAINE. Yes.

Secretary Duncan. —and it is a separate—part of what we are proposing is to do a lot more of this at the high school level, to have a high school level redesign in order to have a much greater emphasis on career and technical education, and vocational education, or whatever you want to call it. Some schools do an amazing, amazing job with this. Not enough do.

Senator KAINE. It is something I would like to work on. Thanks.

Chairman MURRAY. Thank you very much.

Senator WHITEHOUSE.

Senator WHITEHOUSE. Thank you, Chairman.

Good morning, Mr. Secretary.

Secretary Duncan. Good to see you.

Senator WHITEHOUSE. We have just been through the education bill on the HELP Committee and there was a considerable discussion about the burden that the Department of Education imposes on State and local communities, and I would like to give you a chance to answer some questions about that.

Let us start with the simplest one, which is how many FTEs does the budget you have proposed for the Department of Education support, Federal FTEs?

Secretary Duncan. Forty-two-hundred full-time equivalent positions.

Senator WHITEHOUSE. Forty-two-hundred. People brought—

Secretary Duncan. For the record, we are one of the smallest Federal agencies, just to put that out there.

Senator WHITEHOUSE. People brought books this thick to the hearing that were their binders for filings that had to be made to the Department of Education. Have you done any formalized studies, or has GAO or anybody done any formalized studies to quantify the externalized costs that your programs impose on State and local communities, and if so, when, and what are the results of those studies?

Secretary Duncan. Well, beyond studies, what we have actually tried to do is provide flexibility. We thought so much of No Child Left Behind—NCLB— was broken, was onerous, was top-down from Washington, and we have had 37 States, including your home State, and another ten coming apply for flexibility. Frankly, we wanted Congress to fix No Child Left Behind. Congress has been pretty broken. So we were lucky enough to have the flexibility to provide waivers and much greater flexibility, and we are seeing 37 States, again, across the political spectrum, jump at this. And we are working with an additional ten States, so it is virtually every State in the country.

So, I want to be clear. We are not just looking at this. We are actually taking concrete action that seems to be universally appreciated.

Senator WHITEHOUSE. Well—

Secretary Duncan. And let me also say—

Senator WHITEHOUSE. —there are two different things.

Secretary Duncan. Okay.

Senator WHITEHOUSE. One is the sort of handcuffs that No Child Left Behind put on school districts. The waivers that you have granted have allowed more flexibility, have allowed them to escape the handcuffs, have allowed them to teach much more to the child rather than to the test and so forth. So that has been good from a policy point of view, but it may or may not make it easier for them to cope with the pure, sheer administrative burden of reporting and compliance and waiver application and grant Administration and all of that stuff.

And if you have not ever done a kind of comprehensive study of how much of that cost gets externalized to States and to cities, I would like to ask you to work with us on figuring out a way we could get that done. It has a general component, which is if it is too high, then it is a waste of effort and it is taking away from kids. And it has a focus component, because small school districts, like those in Rhode Island, and rural school districts and people who do not have an enormous amount of bureaucratic infrastructure to cope with Federal requirements, are put at a disadvantage in terms of how they deal with those responsibilities.

Secretary Duncan. It is—

Senator WHITEHOUSE. Also, there is a bias, as well as a burden, that is potentially put in there. And I think it is worth attending to and finding out what the story is because, otherwise, we are going to keep seeing these big binders being brought in to hearings. They will be anecdotal concerns, but we will not really have solid evidence. And you are telling me, I think, that we do not really have solid evidence, right?

Secretary Duncan. We have done some work and we can always do more. I think it is a very real point. You hit on both of them. You do not want to waste people's time and you do not want to make it impossible for a small district or a rural district to access resources. So none of that is in the public's best interest.

So it is fascinating. When I travel, I always—everywhere I go, I ask people, tell us where we are being redundant, tell us where we are being duplicative. The last thing I want to do is waste your time. I have been on the other end of this stuff. I have lived this. So whatever came out of your hearing, whatever concrete evidence—it may be anecdotal, like this report, you asked for three times. Or, this is one piece of paper rather than 50. Whatever concrete evidence came out of that, I would love to hear that and I would love you to hold me personally accountable for looking into that and figuring out where we can reduce burden. I have zero interest in making people spend time on bureaucracy rather than teaching kids to read and keeping them in school.

Senator WHITEHOUSE. My last question is about Pell Grants, which we take very seriously in Rhode Island. We have a lot of loyalty to Senator Pell. When those things kicked off, they paid about 70 percent of regular State college education. Now, it is closer to 30 percent.

Secretary Duncan. Yes.

Senator WHITEHOUSE. The Republican budget in the House would flatline it for the 10-year budget period, as I understand it. What is your plan and what impact would the difference between where the Republicans budget it and where you would budget it, what impact does that have in the real world for lives?

Secretary Duncan. Well, again, I think all of us, regardless of our politics or ideology, I think, and I desperately hope, we want to have the best educated workforce in the world. We want to have the highest percent of college graduates. And there is a study that came out just yesterday from the Council on Foreign Relations. I encourage all of you to look at this, college degree attainment. We are third amongst 55- to 64-year-olds, so older folks. But we are 13th amongst 25- to 34-year-olds. So we are losing ground here. We are not maintaining. We are not stagnating. We are actually going south relative to other countries.

So anything that makes college more affordable, more accessible, I am for. Anything that makes college less affordable, less accessible, I think we cut off our nose to spite our face.

And, just quickly, my staff just handed me a note—under the flexibility we have done, they actually did do a study. We estimate a reduction in burden of over three million hours with a cost savings of approximately $50 million for SEAs and LEAs. So not that we cannot do more, not that we should not do more, but this is we something that we are thinking about very, very seriously.

Senator WHITEHOUSE. For the record, Madam Chair, can I get the—afterwards, if you can get me a citation to that study or a copy of it. Thank you, Madam Chair.

Chairman MURRAY. Senator Wyden.

Senator WYDEN. Thank you, Madam Chair.

Secretary Duncan, I do not get to see you often because of committee assignments, but when I read your comments, particularly on education issues, the way you link opportunity and accountability, I think, makes a lot of sense and ought to be our philosophical underpinnings in this area.

Also, I want to take note of the fact that constituents often ask whether I have had to guard you in any basketball game with the President, and I have said, thank goodness, no, because he is talented and I was too small—

Chairman MURRAY. I do not get that question.

[Laughter.]

Senator WYDEN. Well, I was too small, and I made up for it by being slow, neither of which are challenges for the Secretary.

Here is my question, Mr. Secretary, and it deals with the question of higher education and the question of what our policy is going to be in the future. Historically, we have said our focus will be on access and trying to make sure we get students in the door. And I do not take a back seat, and I know you do not, in terms of access, Pell Grants and Stafford loans at affordable rates.

But it seems to me we are now moving in the direction of adding another component, and that is value. That is what the Administration has sought to do in The Collefe Scorecard. That is, as you know, what is behind the legislation with Senator Rubio, the bipartisan bill, the Student Right To Know Before You Go Act. And I think we both want to make sure that we can get information out about graduation rates and debt levels and remedial education, and my reason for bringing it up is the question of how it is going to be possible to get what students are likely to earn when they get a degree from a particular school. And I have students ask me about this constantly. They do not want this to be the only measure of their education, but they want it to be one measure.

Now, on the issue of employment and earnings, the scorecard, and we just looked at it, is basically left blank, and I know this is a very difficult area to address administratively, and that is because of the existing Congressional ban on the unit record type system.

Secretary Duncan. Yes.

Senator WYDEN. So, Senator Rubio and I worked with a variety of colleagues and experts, privacy experts, education experts, but what is your thinking in terms of how we can particularly find a way—because I think Senators of all political philosophies want to work with the Administration on this—how can we figure out a way to get that information out in a usable fashion? I think our bill is one. It is not the only possible way, but particularly because I think the Administration bumped up against the Congressional ban with respect to unit records, how do you see tackling this?

Secretary Duncan. So, let me just back up for a second.

Senator WYDEN. Yes.

Secretary Duncan. Your basic premise is exactly right, that, yes, we want to encourage access and opportunity. We desperately have to do that. But for me, the goal is not to have more kids enter college. The goal is to have a lot more complete college. And, collectively, we have not had enough either incentives or disincentives, carrots and sticks, to change behavior there. We talked about time to completion and other things. We have a lot of hard work to do.

I just so appreciate your leadership. I appreciate you working in a bipartisan way. What we tried to do last year is, on a voluntary basis, produce a Scorecard. All we can do on a voluntary basis is do that. If Congress acts, then we have a chance to do something. We hope to add earnings to the Scorecard later this year, and we all need to collectively find this right balance. It is critically important that we maintain individuals' privacy and have all those safeguards there, but at the same time have much greater transparency.

And I said earlier, before you were here, that it is so interesting to me that we have unquestionably the best system of higher education in the world, 7,000 choices, for profit, nonprofit, public, private, 4-year, and 2-year institutions, but we have a very inefficient marketplace. We have young people choosing the wrong schools for the wrong reasons. It is because the process is so overwhelming. So whatever we can do to provide transparency, I am a big believer that that helps to change behavior.

The last thing I will say, quickly, is when I led the Chicago Public Schools, we tracked college completion rates for our grads very closely. We saw young people with identical scores, identical Grade Point Averages—GPAs, going to two different schools, some graduating students at 80 percent and some graduating students at 25 percent. The difference was staggering. And so we, frankly, started to steer kids towards certain institutions of higher education and, frankly, away from others. And I think we need to have a much more informed population. And again, the goal is not to go. The goal is to walk out with a diploma at the back end.

Senator WYDEN. Well, those are points well made, and I think what I would like to do is have our staff follow up with yours. They have been very helpful. Because I think that the challenge, particularly administratively, is you bump up against this flood, you know, Congressional ban, and then there are some questions about what you can collect and what you can publish, and is it short term or is it long term. We can get this done.

I appreciate the approach the Administration is talking about, and this, in my view, Mr. Secretary, would be a transformation of Federal education policy. It will keep our historic focus on access, and that is something that we should never budge an inch away from. But I think adding value, as you and the President want to do, makes a lot of sense, and I look forward to working with you.

Secretary Duncan. Thank you for your leadership.

Senator WYDEN. Thank you, Madam Chair.

Chairman MURRAY. Senator Nelson.

Senator NELSON. Good morning, Mr. Secretary.

Secretary Duncan. Good to see you.

Senator NELSON. I am at a loss to understand why the Administration is proposing to cut STEM funds in half and to reorganize it through the Department of Education, National Science Foundation, and the Smithsonian. I have seen STEM work so well, STEM funds through an agency, such as NASA, where peer review funds are going on a specific NASA mission, and yet that is being cut out in the Administration's proposal. So why do you think this reorganization is going to help us get, at the end of the day, where we all want to get to, which is the emphasis, of course, on the STEM education?

Secretary Duncan. So, I do not think we are looking to cut STEM budgets in half at all. So I think that is not correct, and I will just walk through potential increases we are looking for: STEM Innovation Networks, $150 million; STEM Master Teacher Corps, $35 million; STEM Teacher Pathways Program, $80 million; Effective Teaching and Learning, $150 million. But, let me be clear. What we are trying to do is better coordinate across the Administration, and it is a desperately important investment. I think there have been lots of pockets of excellence, one-offs. I do not think we have done enough to incentivize local communities to have buy-in. Charlie Bolton is a great friend. He is doing an amazing job.

We want to all work together, you know, without ego and without bureaucracy in silos and that is the only goal here. My interest is seeing a lot more students have access to teachers who love the

STEM fields. My interest is to have a lot more young people who choose to major in the STEM areas when they go to college. And as you know, so many people go to college wanting to major in it and then they wash out because they are not prepared.

So that is—I think we all have the same long-term goals. We can sort of walk through how we do it. But, I do the President has challenged us to help provide some leadership across the Administration so that we are all not operating in our silos but are working together to try and make sure young people are prepared for where so many of the jobs of the future are going to be.

Senator NELSON. I will just mention in passing that since you are a great student of history and educational history, you know what happened to this country when we had these extraordinary "gee whiz" successes in the great space race back in the late 1950s and the early 1960s. And I would hope that as we get our space program cranked up again and that we start to see some of the "gee whiz" things pursuing the goal that the President has laid out, which is to go to Mars, that that might bring a lot more young people into these fields of high technology, which clearly happened during the 1960s.

Secretary Duncan. Yes. No, I would be happy to follow up in any way, and again, we have a real shortage of math and science teachers in this country, which I think if we do not fundamentally address that, we will never produce the students that we need long term. Not everyone agrees with me on this, but I have publicly proposed that we pay math and science teachers more money to work in disadvantaged communities and in rural communities and the inner city. We have had a couple decades' shortage and I do not want to just admire the problem. I want to do something about it.

Senator NELSON. On another subject, and this will be my final question, why do you not just state for the record for the committee, if we had the continuation of the sequester, what impact that that would have on student aid programs.

Secretary Duncan. So, again, this is just the sequester that I will address, and the House budget is much worse, which we talked about earlier. But the impact of the sequester—

Senator NELSON. Think of both, then.

Secretary Duncan. The impact of the sequester is a $598 million cut for IDEA Part B, children with special needs; a $725 million cut for poor children, Title I; a $49 million for Work-Study, young people working hard to get through college and graduate; and for Impact Aid, children of military families, Native American children, who rely heavily, disproportionately on our Federal funding, a $60 million cut. So that is the sequester.

With the House budget, which is an additional 19 percent cut on top of the 5 percent sequester cut, those numbers get even more devastating: A $2.5 billion cut for Title I for poor kids; a $2 billion cut for IDEA, children with special needs; $4.5 billion less for Pell Grants; $1.5 billion less for Head Start, and we talked extensively about how important it is to get our babies off to a great start from ages zero to 5; and finally, $200 million less for children of military families and children on Native American reservations.

Senator NELSON. That speaks for itself. Thank you, Madam Chairman.

Chairman MURRAY. Thank you very much.

Mr. Secretary, as you know, I have been passionate about early childhood education forever. It is what got me involved in politics and continues to keep me going. I was thrilled when the President talked about the importance of investing in early learning in his State of the Union address and glad to see the new investments in children from birth through 5 in both your budget and the HHS budget. Those investments echo what we put in place in our budget a few months ago, and it is a priority that I know we share.

I was out talking to a kindergarten teacher just a few weeks ago who told me that 80 percent of the kids do not come to her classroom in the fall with any kind of pre-K education, which means that she says I have so many kids who do not know how to turn a page when they open their book, do not know how to hold the scissors or a pencil. The disparity is just incredible, and how far she has to bring those kids to catch them up to where they need to be. So, to me, this is absolutely imperative.

And I know you have been traveling around the country talking to both Democratic and Republican Governors about their support for this and I wanted you to talk a little bit about why the—what the Governors are saying to you, why this is so important.

Secretary Duncan. Yes. Well, again, I just think, going forward, your personal leadership and passion and insightfulness on this is going to be so helpful. I think a lot about—I have never had a job before where I know I am going to get fired. I have a time-limited span here, 3 years, 6 months, whatever it might be. And I think a lot about what are not the 15 things I can do, but what are the two or three most important things I can do to help the country while I am here.

And, arguably, at the top of the list would be dramatically expanding access for our babies to high-quality early childhood education, that it is the great equalizer. And I just keep saying, education, we have to get out of the catch-up business and get our children starting kindergarten on a more level playing field.

And, again, the return on investment—ROI, the economic reality—this is not just some feel good thing. The ROI on this is pretty staggering, seven-to-one. How many of your investments in the stock market are getting seven-to-one? Pretty good deal. Pretty good deal.

And for all the dysfunction here in Washington, again, I am actually hopeful, because you have Republican and Democratic Governors who are investing very heavily. I mean, these are still tough economic times. These are not easy decisions. But you can go to Michigan and Alabama and Mississippi, you go to Massachusetts, you know, a million places I can talk about, Nevada, where people are really— Washington, your state—where Governors in tough times are investing because they get it. They get the ROI.

What is so interesting to me is that all of them invest—virtually every single one of them still has long waiting lists. There is tremendous unmet need. And people sort of say, well, just let the Governors do it. Again, today, less than three in ten, less than 30 percent of our 4-year-olds have access to high-quality early childhood education.

So if we want to get just a tiny bit better, I want to be transformational here. I want to change the course of these kids' lives forever and for our country. And so to do that, yes, we need Governors' leadership and tremendous bipartisan support. The majority of Governors in their State of the State speeches talked about this. Many of these Governors are investing, they are not just talking about it. They are putting skin in the game. But they are not getting to where they need to go, and Michigan recently, Georgia recently, is oing some good things, but still has an 8,000-kid waiting list, so is not even close—

Chairman MURRAY. Right, and not to mention the fact, the mobility of kids, if we just have kids moving around the country, as we do today, and you have kids coming from States that do not invest in it, it is a national issue.

Secretary Duncan. The final thing I will say is just again to emphasize why your leadership is so important. Two- and three- and 4-year-olds do not vote. They do not have Political Action Committee—PACs. They do not have lobbyists. Far too many politicians are wired to think short-term. This is the ultimate long-term play. We will not see the full dividends for 10, 20, 30, 40 years, 50 years. But with vision and foresight and leadership like yours, I think we have a chance to change our country for the next couple decades here and I am going to do everything I can to make sure we provide those opportunities.

Chairman MURRAY. And, finally, what do you see happening internationally? If we are cutting all of these programs back through sequestration and not doing the right thing, what are other countries doing?

Secretary Duncan. Well, again, this is a Council on Foreign Relations report yesterday, so hot off the press. It shows the U.S. ranks first in high school degree attainment for our 55- to 64-year-olds, our folks moving towards retirement, but we are tenth among 25- to 34-year-olds.

Chairman MURRAY. So what does that do for our competitiveness?

Secretary Duncan. Where are the jobs going to go? Are the jobs going to go to where we are less educated or more educated? Jobs can go anywhere in a globally competitive economy. That is high school. College degrees, we are third amongst 55- to 64-year-olds, but 13th among 24- to 34- year-olds.

And so this is—yes, it is about education, but it is about so much more than education. It is about fighting to have a strong and vital middle class. It is about keeping great jobs, high-wage, high-skilled jobs in this country. And employers are going to go to where the most educated workforce is, and I hope to goodness it is here, but they will go to China, India, or South Korea or Singapore or wherever it might be where they can get an educated workforce, and the middle class—

Chairman MURRAY. So, the investment that we make today is absolutely critical 10, 20, 30 years from now.

Secretary Duncan. Absolutely. And if we do not change direction, I worry about where our country is going. This is not—the status quo is not good enough. We should be ashamed that we are not leading the world in these things. And we have rested on our laurels for far too long. We have become complacent and other countries have simply passed us by, and then we wonder why we struggle economically.

Chairman MURRAY. Thank you very much.

Senator JOHNSON.

Senator JOHNSON. Thank you, Madam Chair.

I just have to challenge the notion that we are not spending enough on education. I do not think it is a spending problem. But, again, to reiterate what I was saying before, in total in 2011—I do not have the exact numbers for 2012 or 2013—we spent basically $1.2 trillion educating our kids. That is eight percent of our economy. You can compare that, again, in inflation-adjusted dollars, to 1978, where we spent $496 billion, again, inflation-adjusted. So that is 2.4 times the level of funding into education. It is not a matter of how much money we are spending. I mean, do you dispute that basic funding level?

Secretary Duncan. I think that—

Senator JOHNSON. I mean, it is very easy to say, well, so now compared to last year when we were spending a lot of money, we are going to spend a little bit less, but we are pouring money into education. By the way, we put men on the moon spending a whole lot less on education and we actually had pretty good science and math programs back then.

Secretary Duncan. So, Senator, I have never advocated for investing in the status quo. Everything we have done, we have tried to drive a vision of reform and make some very tough calls, and early childhood space is not about access. It is about high quality. K-to-12 is about increasing graduation rates. Higher education is about increasing graduating rates. But I think if we share—we can debate how we get there, but if you agree with me that being 14th in the world in college graduation rates is unacceptable, of having a high school graduation rate below so many countries, if we agree that is unacceptable, what I would love to do is have a conversation about how we get better outcomes—

Senator JOHNSON. Sure.

Secretary Duncan. —and how we help keep those jobs in this country.

Senator JOHNSON. I think our educational outcomes are totally unacceptable. But, again, it is not a problem of money.

Secretary Duncan. Well, let me—

Senator JOHNSON. Again, we have been pouring money into it.

Secretary Duncan. Hold it. You keep saying—let me just challenge you.

Senator JOHNSON. Yes.

Secretary Duncan. On the early childhood space, if less than three in ten 4-year-olds have access to high-quality pre-K, if our goal is to get a million more children ready for kindergarten when they enter, I do not have a cheap way to do it. It is an investment. This means—

Senator JOHNSON. Well, maybe we have to reallocate, reprioritize spending, then. You know, one of the things I was trying to point out in my charts is, coming from the private sector, you look at anything else, almost anything else in the private competitive sector, there have been huge productivity gains. And in education, with computers, we should have huge productivity gains, but we do not. We are spending more per pupil and we are getting terrible results. I mean, what is the answer for that? It is not throwing more money at it.

Secretary Duncan. Well, again, so there is a level of complexity. I just want to try and get you beneath the talking points. And so—

Senator JOHNSON. It is not—no, this is not talking points. I was heavily involved in the education system and I am looking at it as an accountant. We are spending a lot of money per pupil—

Secretary Duncan. So—

Senator JOHNSON. —and we are not getting the results. That is not a talking point. That is a fact.

Secretary Duncan. So what we are trying to do, technology can be a huge game changer, and you may have seen—

Senator JOHNSON. But it has been around for 10 years and has not been a game changer.

Secretary Duncan. I agree with you, so we agree on the problem. The question is how we get there. Part of the challenge is lack of broadband access in many of our communities, and we have talked about dramatically increasing broadband access. Technology education moves far too slow. Technology has changed how we do business. It has changed how we interact—

Senator JOHNSON. I will say, government-run programs, government-funded programs run way too slow.

Let us talk about early childhood development before I run out of time here. GAO conducted a study on duplicative programs. There were 45 early learning and childhood programs. And then the Department of Health and Human Services in 2012 issued a study about the Head Start preschool program and found it had little to no impact on the cognitive, socio-emotional, or parenting practices of participants by the time they reached the third grade. How do you respond to that? Again, we are looking at, hey, let us pour more money into it—

Secretary Duncan. No—

Senator JOHNSON. If what we have does not work, why would we want to pour more in?

Secretary Duncan. Very simple. There are lots of studies, and we can give them to you, that show city after city, State after State, where we have seen big benefits. About 20 percent—what that study measured, again, you have to look at the detail. That study evaluated children who had access to Head Start, not who actually attended Head Start. And about 20 percent of the kids in that study never actually attended Head Start.

So, yes, we need high quality. For the first time ever, and I give her great credit, Kathleen Sebelius is making Head Start programs recompete, and if they are not getting results, they have to come back in or they will be cut. But, again, look below the headlines. If the study looked at 20 percent of kids who had access but did not attend, just pause for a second.

Senator JOHNSON. Okay. But let me conclude here, again. Again, I am all for education. I understand it is absolutely vital. But the other reason I am looking at a 30-year budget window is when we are trapped in a 10-year budget window, we are grossly underestimating the real problem here.

So you take a look at the first decade and it is maybe a $6 or $7 trillion deficit. You project that out, and the numbers we are coming up with—they are preliminary, but they have been reported, so I will say they—we are talking about over 30 years, $72 to $107 trillion deficit from the Federal Government. That is a huge problem, and unless we start addressing it—and if our solution to all these other problems is just throw more money at them—

Secretary Duncan. No—

Senator JOHNSON. —more money that we simply do not have—

Secretary Duncan. I think we have to—and maybe you will agree, maybe you will disagree—I think we have to walk and chew gum at the same time. Look what we did in reforming student loans. We saved $68 billion. We took $40 billion to increase access to Pell Grants. We did that without going back to taxpayers for a nickel. Do you think that is good government?

Senator JOHNSON. Well, again, I am happy to prioritize spending, and I am happy to work with you to prioritize that spending. But again, you do need some general understanding of the huge problem we are facing and we cannot just keep throwing more money at the problem. We have to actually start looking at how much we have spent and measure the results and realize, well, if that has not been working, we have to look at some other program.

Secretary Duncan. I one hundred percent agree, and again, I want you to look at high school graduation rates, college graduation rates. We are measuring this every single day. We are looking at differences in achievement gaps. If we are not seeing progress, I would be having a very different conversation. We have a long way to go, but you are seeing movement in the right direction. And, again, never pushing to invest in the status quo, trying to drive a vision of reform.

But, again, I go to James Heckman, who is much smarter than I, Nobel Prize winning economist. He tells me we get a seven-to-one investment. You are a very astute businessman. I think we need to listen. I think we need to pay attention.

Senator JOHNSON. Well, let me just say, I truly appreciate your efforts and your dedication to the problem. I really do, so thank you, Mr. Secretary.

Secretary Duncan. Thank you.

Senator JOHNSON. Thank you, Madam Chair.

Chairman MURRAY. Senator Whitehouse, did you have any additional questions?

Senator WHITEHOUSE. No.

Chairman MURRAY. Well, Mr. Secretary, I really appreciate your coming today. I really believe that we have to make the investments that we need to make today so that ten, 20, 30 years out from now, we have a strong, viable workforce and a country that is strong competitively and those investments that we make are really why we have focused so hard on this. That is what you do every single day, and I just want you to know how much I appreciate this discussion and look forward to working with you on this.

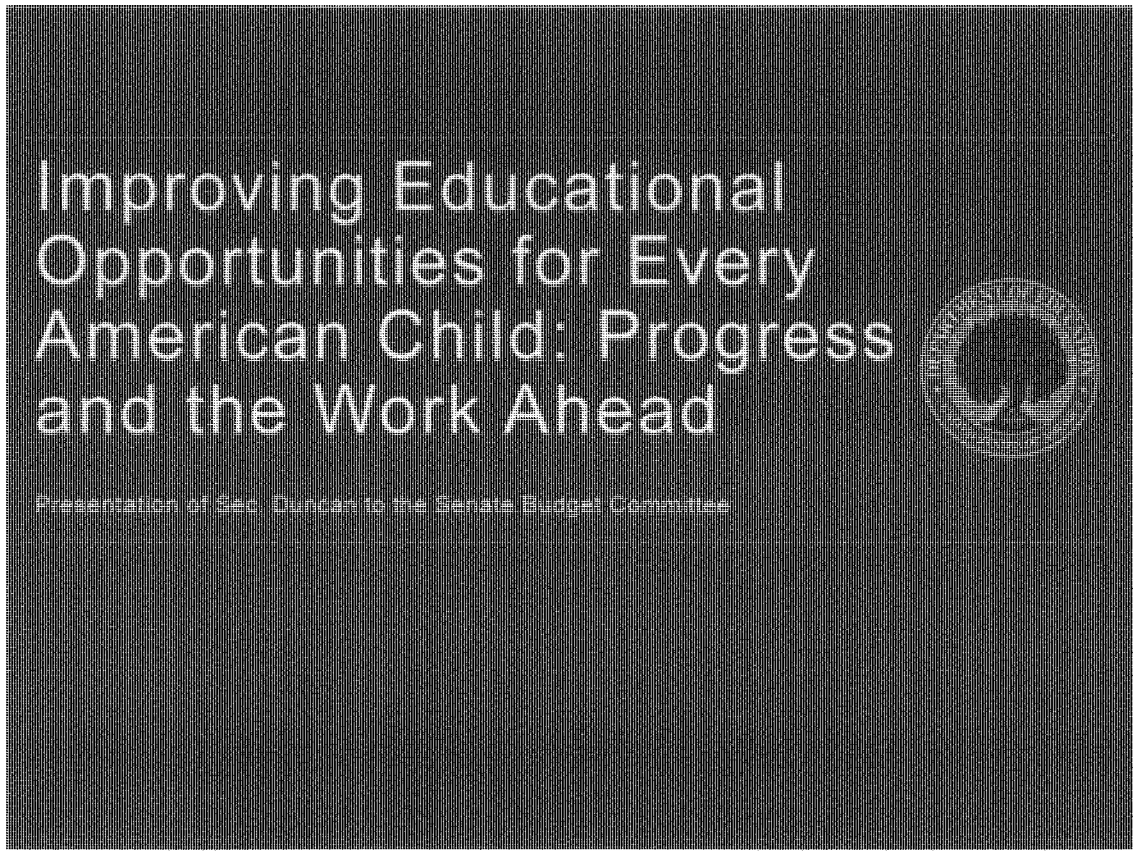
So thank you very much for that, and I want to thank all of our colleagues who participated today. The record will be open for any additional questions, due by 6:00 p.m. today.

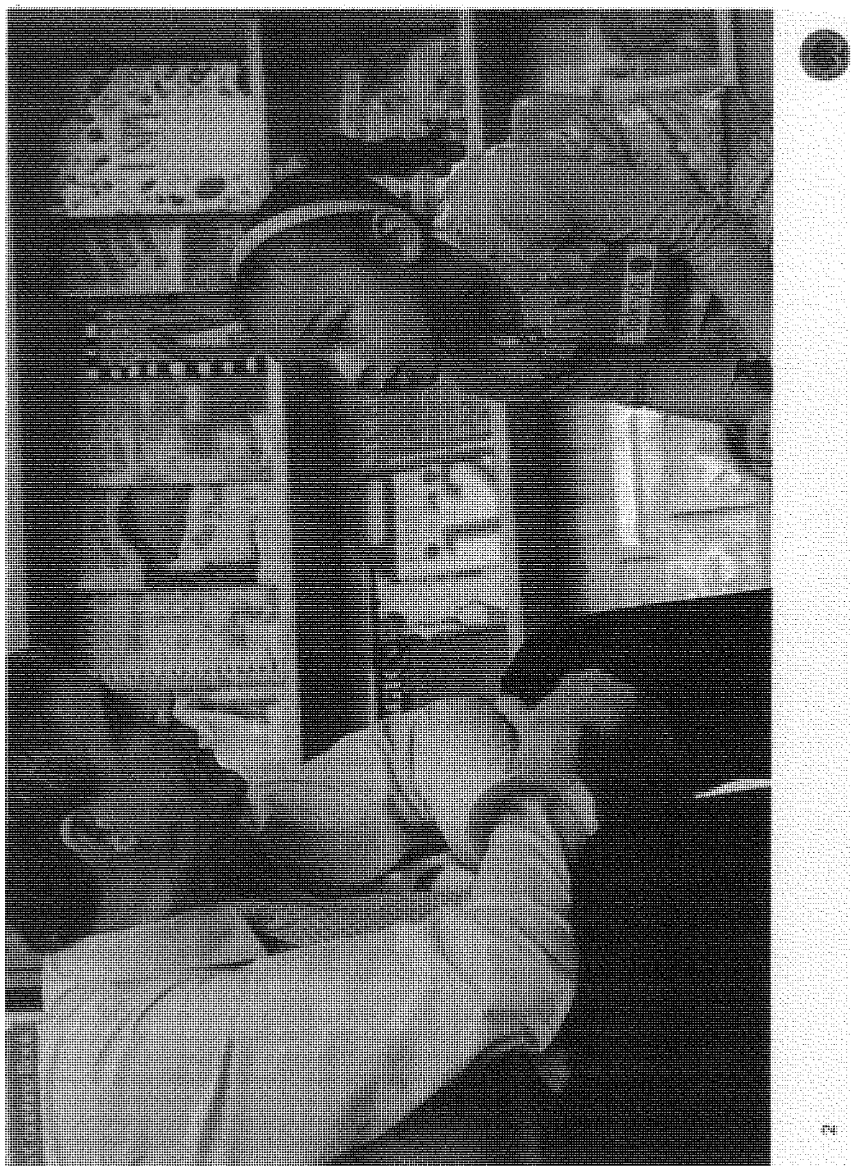
And, again, Mr. Secretary, thank you very much.

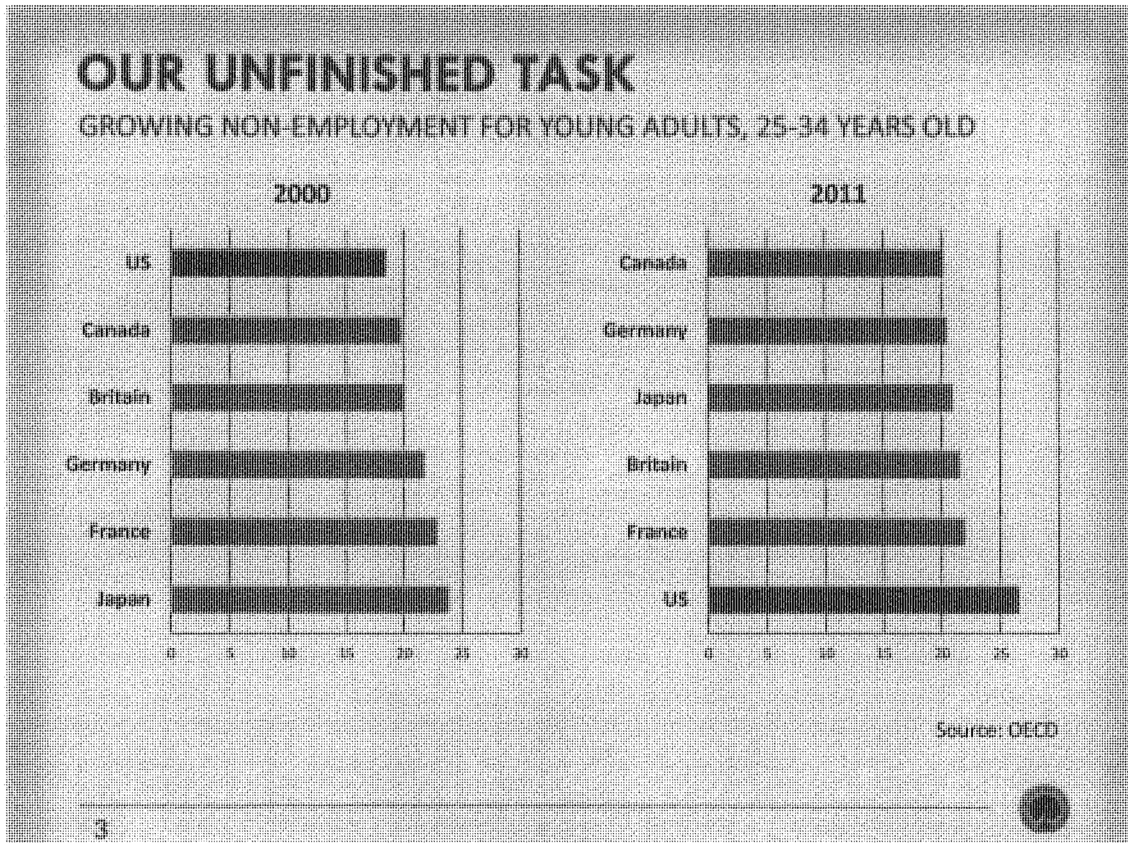
Secretary Duncan. Thanks for the opportunity.

Chairman MURRAY. The committee is adjourned.

[Whereupon, at 12:13 p.m., the committee was adjourned.]


Improving Educational Opportunities for Every American Child: Progress and the Work Ahead
Presentation of Sec. Duncan to the Senate Budget Committee




OUR UNFINISHED TASK
GROWING NON-EMPLOYMENT FOR YOUNG ADULTS, 25-34 YEARS OLD
2000
US
Canada
Britain
Germany
France
Japan
0
5
10
15
20
25
30
2011
Canada
Germany
Japan
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France
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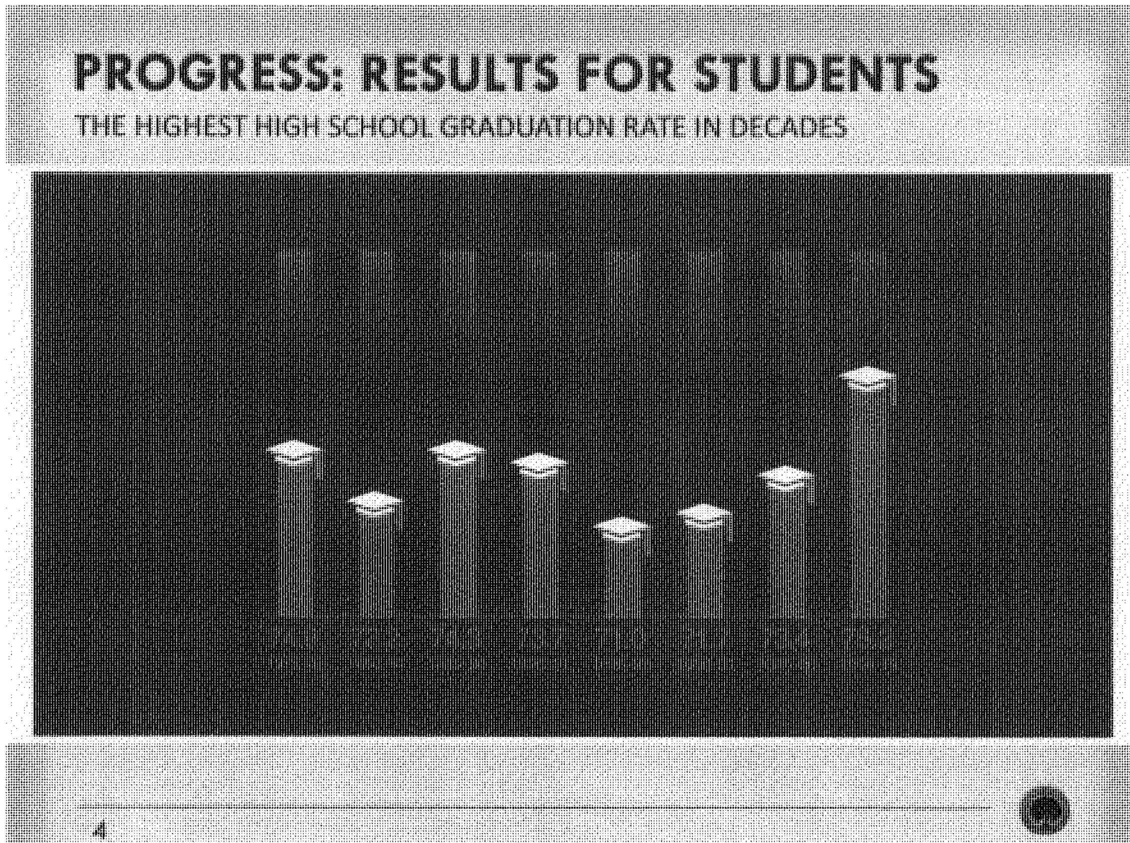
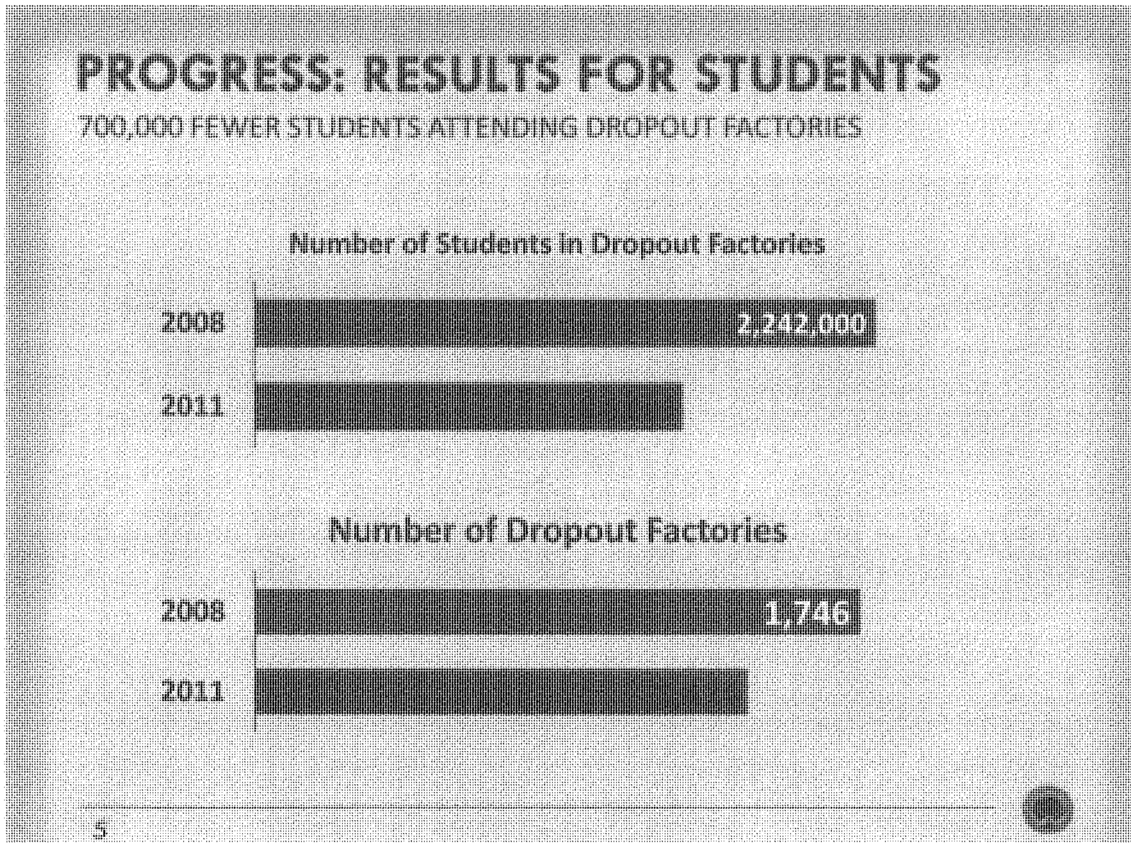
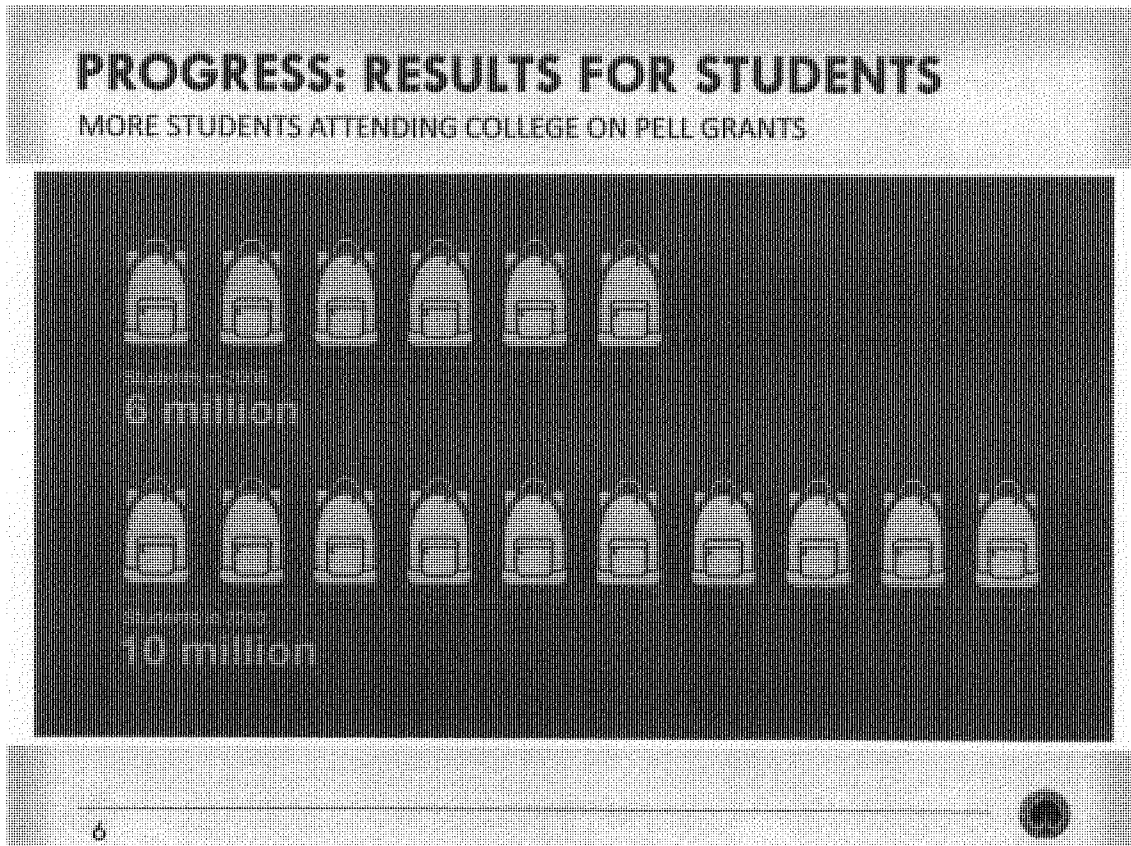
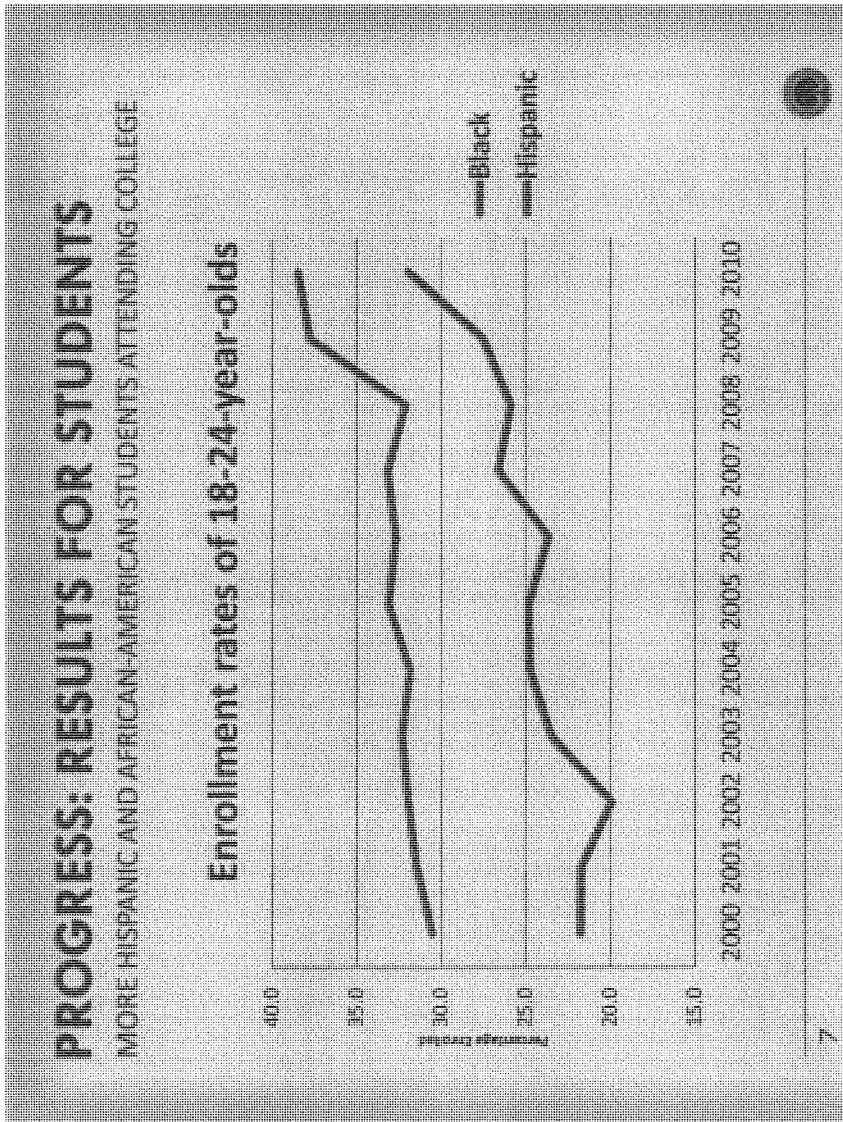
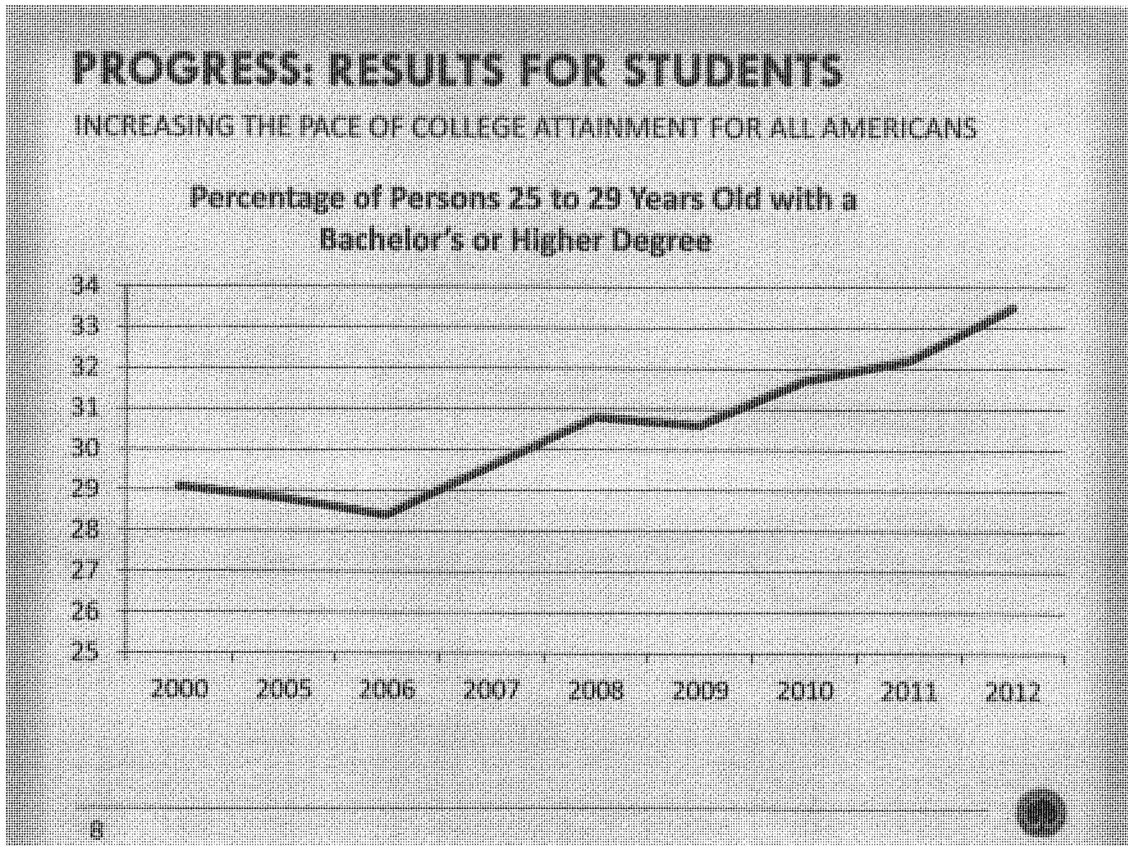
Source: OECD
3

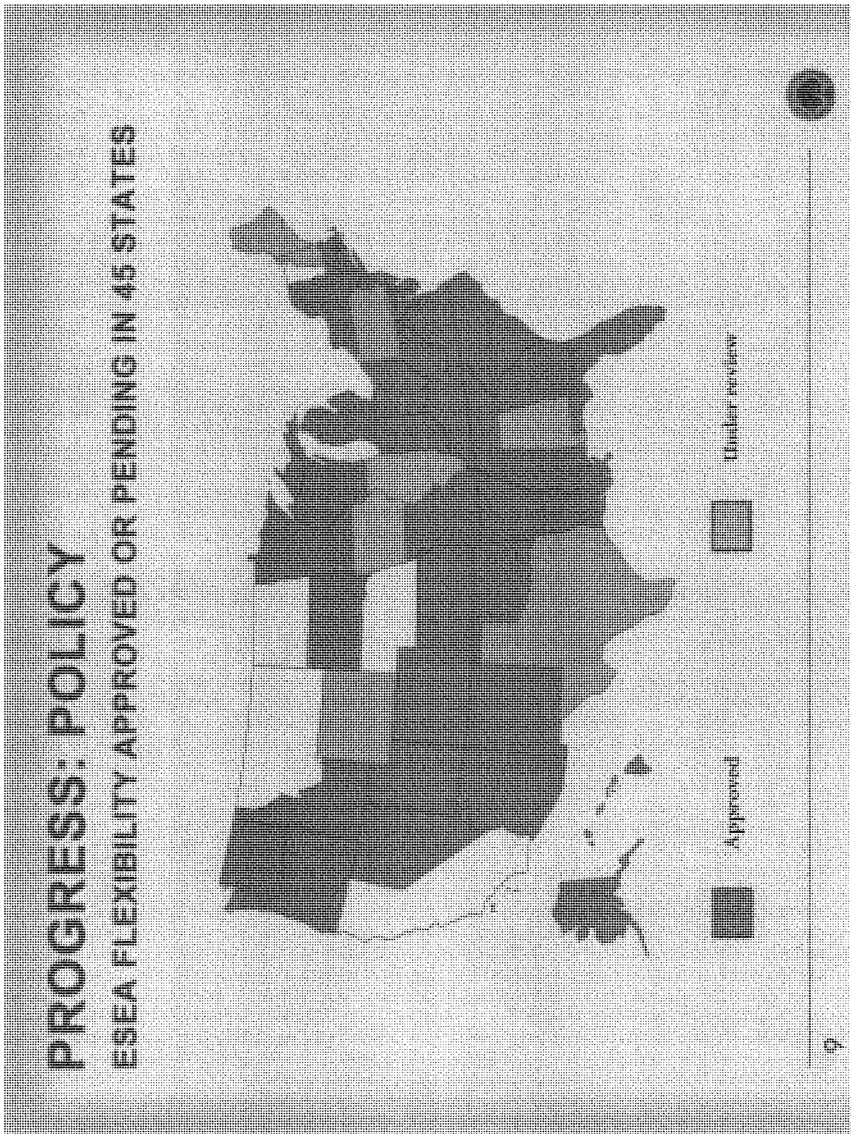

PROGRESS: RESULTS FOR STUDENTS
THE HIGHEST HIGH SCHOOL GRADUATION RATE IN DECADES
4

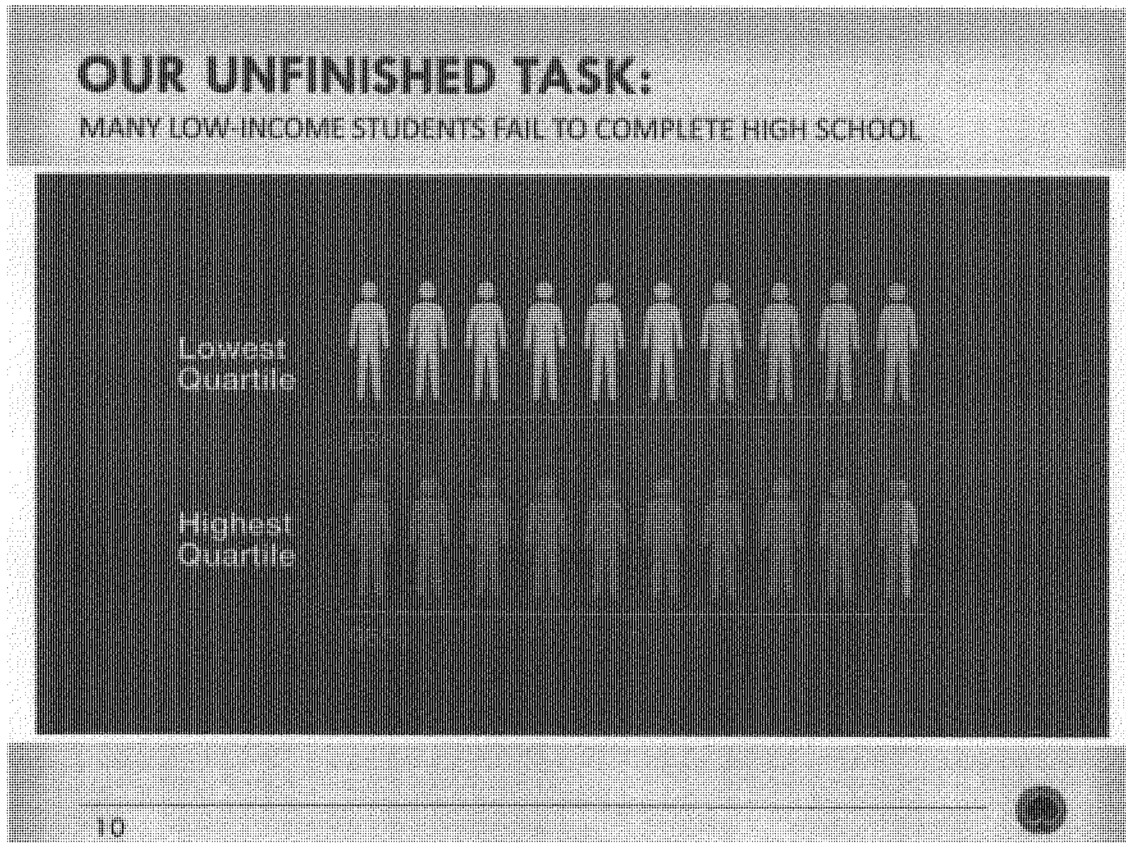

PROGRESS: RESULTS FOR STUDENTS
700,000 FEWER STUDENTS ATTENDING DROPOUT FACTORIES
Number of Students in Dropout Factories
2008
2,242,000
2011
Number of Dropout Factories
2008
1,746
2011
5

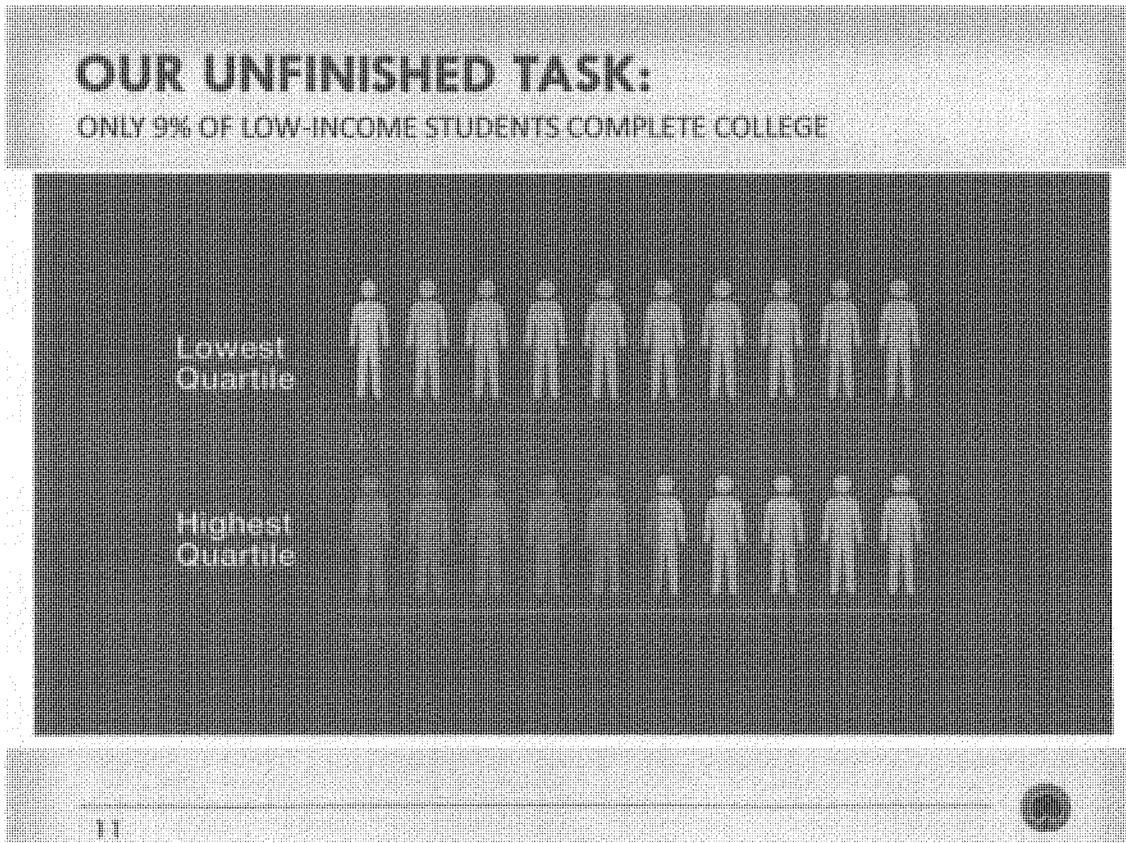

PROGRESS: RESULTS FOR STUDENTS
MORE STUDENTS ATTENDING COLLEGE ON PELL GRANTS
6 million
10 million
6


PROGRESS: RESULTS FOR STUDENTS
MORE HISPANIC AND AFRICAN-AMERICAN STUDENTS ATTENDING COLLEGE
Enrollment rates of 18-24-year-olds
40.0
35.0
30.0
25.0
20.0
15.0
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010
Black
Hispanic
7


PROGRESS: RESULTS FOR STUDENTS
INCREASING THE PACE OF COLLEGE ATTAINMENT FOR ALL AMERICANS
Percentage of Persons 25 to 29 Years Old with a Bachelor's or Higher Degree
34
33
32
31
30
29
28
27
26
25
2000
2005
2006
2007
2008
2009
2010
2011
2012
8


PROGRESS: POLICY
ESEA FLEXIBILITY APPROVED OR PENDING IN 45 STATES
Approved
Under review

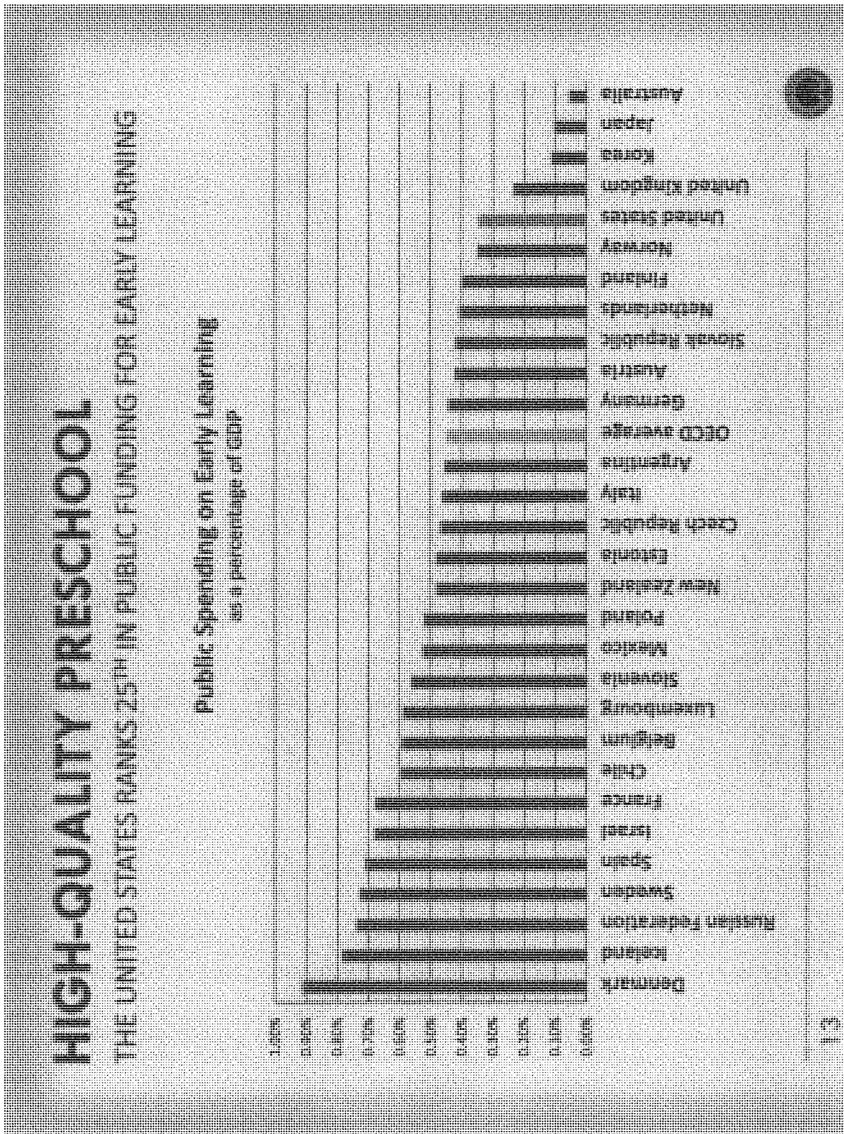

OUR UNFINISHED TASK:
MANY LOW-INCOME STUDENTS FAIL TO COMPLETE HIGH SCHOOL
Lowest Quartile
Highest Quartile
10


OUR UNFINISHED TASK:
ONLY 9% OF LOW-INCOME STUDENTS COMPLETE COLLEGE
Lowest Quartile
Highest Quartile
11

"Investing in disadvantaged young children is a rare public policy with no equity/efficiency tradeoff. It reduces the inequality associated with the accident of birth and at the same time raises the productivity of society at large."

— James J. Heckman,
Nobel Prize winning economist

12


HIGH-QUALITY PRESCHOOL
THE UNITED STATES RANKS 25TH IN PUBLIC FUNDING FOR EARLY LEARNING
Public Spending on Early Learning
as a percentage of GDP
Denmark
Iceland
Russian Federation
Sweden
Spain
Israel
France
Chile
Belgium
Luxembourg
Slovenia
Mexico
Poland
New Zealand
Estonia
Czech Republic
Italy
Argentina
OECD average
Germany
Austria
Slovak Republic
Netherlands
Finland
Norway
United States
United Kingdom
Korea
Japan
Australia
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Lawrence H. Summers
Senate Budget Committee Responses
June 18, 2013

Senator Murray

Question 1:

Question: Many of my colleagues have said that deep spending cuts will lead to stronger economic growth. In fact, they argue that the reason we aren't growing faster is because we are spending too much right now. As support for this argument, they point to academic studies by Harvard economists and the IMF.

This is contrary to what I understand mainstream economic theory to say. While the economy is still weak, further contraction in government spending would seem to be a drag on growth. I understand your recent work has shown that the bang-for-the buck of fiscal policies is actually much higher when the economy is weak, as it is now.

Could you comment on this argument for "expansionary austerity"? The idea that the more we cut the faster our economy will grow.

RESPONSE: As your question suggests, fiscal policy likely has a greater impact in environments like the present, where we have substantial slack in the economy and very low interest rates. Under other circumstances, it is possible that reductions in government spending could lead to economic expansion. However, these "other circumstances," involving high capital costs and potential for export growth to a strong world economy, are distinct from the circumstances we are in today.

IMF researchers concur with this opinion and they now believe that observers have underestimated the size of fiscal multipliers, in the current environment. By underestimating the fiscal multiplier, observers have also underestimated how damaging austerity is to an economy, at a time like the present. In the IMF's World Economic Outlook (October 2012), Chief Economist Olivier Blanchard notes that "The main finding, based on data for 28 economies, is that the multipliers used in generating growth forecasts have been systematically too low since the start of the Great Recession... This finding is consistent with research suggesting that in today's environment of substantial economic slack, monetary policy constrained by the zero lower bound, and synchronized fiscal adjustment across numerous economies, multipliers may be well above 1."

<u>Lawrence H. Summers</u>
<u>Senate Budget Committee Responses</u>
<u>June 18, 2013</u>

Senator Coons

Question 1:
I'm concerned about the long-term unemployed. Economic data shows that short-term unemployment (those who have been unemployed for 14 weeks or less) is down near the levels observed in the 1991 and 2001 recoveries. However, those unemployed for 27 weeks or more is still very high. As of the end of April, 4.4 million Americans, or 37 percent of the unemployed. had been without a job for 27 weeks or longer.

Can you describe austerity's impact on the long-term unemployed?

Additionally, what policy measures would make the most impact in reducing the rate of long-term unemployment?

RESPONSE: I share your concern about the long-term unemployed. The relevant scholarship makes clear that the longer a person has been unemployed, the more difficult time he/she has finding a new job. This is the source of the hysteresis effect I referenced in my testimony, and this is just one of the reasons why measures to promote demand and accelerate recovery are important not only for the short run, but also for the long run. A number of experiments have been performed to test unemployment insurance as a tool to promote reemployment. These experiments should be carefully evaluated, and consideration should be given to unemployment insurance reform to promote reemployment. There is also a case for careful consideration of tax credits along the lines of the payroll tax break for new hires proposed by Senator Schumer and Senator Hatch in 2010 to provide employers an incentive to hire the long-term unemployed.

Senator Coons

Question 2:
Manufacturing is critically important in the United States. The sector makes up 12% of our economy, while providing high quality jobs.

According to the Bureau of Labor Statistics, from 2000 to 2009, 6 million factory jobs were lost in the United States. Over the last three years, we've seen a rebound, with the US adding more than 500,000. Yet, government spending is slowing the recovery in manufacturing. This week, the Institute for Supply Management's factory index fell to 49, its lowest level since 2009. A level of 49 indicates a contractionary phase for the sector.

According to Bloomberg News and several analysts, the low level is the result of slow corporate spending and government spending cutbacks.

Can you comment on the impact of austerity on manufacturing?

Additionally, what types of policy measures would promote continued recovery in manufacturing?

RESPONSE: In any economy, the performance of manufacturing is sensitive to the overall performance of the economy. Hence, measures that impede economic growth are likely to also impede the manufacturing sector.

I believe the core policy measures that would promote continued recovery in manufacturing are policies that promote US competitiveness. As such, a case can be made for corporate tax reform and measures that promote innovation such as increased federal support for R&D. Additionally, policies that support low cost energy such as those that encourage the development of renewables and fossil fuel resources, as well as measures to increase the skills of our workforce (by improving primary and secondary education, increasing access to higher education and working to ease the transition from school to work) would augment our nation's competitiveness and consequently benefit the manufacturing sector.

Senator Coons

Question 3:
The rest of the world is catching up to the United States in private sector investment in research and development. We know that investing in R&D boosts productivity and can lead to the creation of new products, services, and sectors. Yet, federal support of private sector R&D should be improved.

RESPONSE: We need to make the R&D credit permanent and simplier. Moreover, according to the GAO, over half of the credit goes to firms with $1 billion or more in receipts. Meanwhile, the most innovative startups are shut out of the R&D credit (because they lack an income tax liability). This creates a big policy gap: according to the Kauffman Foundation, startups create the most net new jobs in the United States.

Could you comment on the importance of the research and development credit?

Additionally, could you comment on the importance of making the credit accessible to highly innovative, early-stage companies?

I support the continuation of the R&D tax credit. However, as you note, there is room for improvement with respect to federal support of private sector R&D, particularly given the abuse of the credit by some firms looking to reduce their tax liabilities. I would favor the exploration of provisions which would extend the ability to carry forward unused R&D credits as a way of helping early stage companies. However, I believe it is important to be prudent when extending the R&D credit to avoid certain kinds of abuses where the credit is taken in cases that do not relate to the research and development of new products.

Senator Coons

Question 4:
It's been more than 70 days since the Senate passed our budget, but we still need to reconcile it with the House of Representatives' budget for it to become a forceful resolution – a budget resolution – that drives the decisions of the Congress. It is important that we do that because it has been several months since sequestration began. All of us, as Senators, are hearing from our home states the very real, very human impact of these across-the-board spending cuts that have begun to really bite.

The sequester exists because of a lack of political will to come together, to resolve a fundamentally different vision between the Senate and the House enacted in our respective budgets. This sequester exists because we haven't come together, across the House and the Senate, in the way that for 200 years or more this Congress has done, when we pass a bill and when the House passes a bill, it's supposed to go to conference for reconciliation, resolution, and ultimately passage.

Dr. Summers, in your experience in the executive branch, can you comment on whether you've seen something like this before?

Additionally, can you comment on the sequester's dampening of impact economic growth?

RESPONSE: The CBO has estimated that the sequester will reduce the GDP growth rate in calendar year 2013 by 0.6 percentage points. As I described in my prepared remarks, the negative impact of the sequester on economic growth substantially offsets the sequester's attempt to lower the debt/GDP ratio through two channels: first, by reducing the GDP growth rate, the sequester reduces the denominator of the debt/GDP ratio. Second, lower GDP during 2013 means lower tax revenue, which increases the budget deficit. When we account for these spillover effects, the CBO estimates imply that, the sequester will likely have a negligible effect on our debt/GDP ratio, at the end of the day, while causing imposing significant human costs.

The CBO estimate seems to be a reasonable assessment of the impact of the sequester on aggregate growth. Beyond this aggregate impact, there are clearly troubling sectoral impacts, like the impact on Head Start, on national security spending, and on programs like Meals on Wheels. I very much hope that it is possible to move to a more rational approach to containing deficits. Containing deficits is important to our country's future; however, I do not believe the sequester is the best means to achieve this end.

Lawrence H. Summers
Senate Budget Committee Responses
June 18, 2013

Senator Sessions

Question 1:

Dr. Summers, your recent article in the Washington Post says that Austerity would hurt U.S. jobs and economic growth. While you admit that deficit financing is not sustainable you say that, "... the effects of contractionary fiscal policies might actually increase debt burdens because of their negative economic impacts." You however fail to distinguish between public growth and private growth. Further, you fail to distinguish between the type of contractionary policy, increasing taxes versus reducing spending. Do you feel that these two choices yield different results?

Dr. Valerie Ramey says that while increased government spending increases employment but "virtually all of the effect is through an increase in government employment, not private employment," and that private spending likely falls as government spending increases. This argument is bolstered through her research and the work done by other economists.

Can increases in government spending cause crowding out of both private investment and private employment? Leading to depressed economic activity in the short term and causing increased debt hindering long term growth.

RESPONSE: These are much debated matters among economists where the empirical evidence can be read in different ways. Professor Ramey is a respected scholar who has done important work. However, I read the evidence differently than she does. Because of differences in initial conditions across different countries and different US regions, there are surely differential impacts of government spending and taxation. However, the nature of these differences depends on the precise form of expenditure policy and taxation policy. I regard the CBO's estimate of the effect of the American Reinvestment and Recovery Act as being broadly reasonable. The CBO found that for calendar year 2012, the American Reinvestment and Recovery Act "raised real GDP by between 0.1 percent and 0.8 percent" and "increased the number of people employed by between 0.2 million and 1.1 million."

Senator Sessions

Question 2:
Economists have debated the effect of the government multiplier and if the multiplier is less than one because of the effect of government spending on private investment, specifically crowding it out. Economists agree that sound fiscal balances and restraint of government spending are advantageous in the long run. However, it is often argued that government spending is beneficial in the short run. How beneficial government spending is in the short run is the question. Do you believe that crowding out exists and that private investment can be hindered by excessive government spending in the short run?

And, if you feel that the government multiplier is greater than 1, despite crowding out, at what point do we stop sacrificing the long term in favor of the short term?

RESPONSE: The importance of crowding out depends on whether or not interest rates have risen significantly. There is no evidence that, given the current liquidity trap circumstances, government spending has had a significant impact in raising capital costs and crowding out investment. My prepared testimony describes the difference between the current economic environment and other environments like in 1993, where crowding out is important. Today's environment is distinctly different from that of the 1990s. Today, high levels of unemployment, low levels of job vacancies and deflationary pressures all indicate that the level of output is not constrained by the economy's capacity, but instead by the level of demand.

IMF researchers now believe that observers have underestimated the size of fiscal multipliers, in the current environment. By underestimating the fiscal multiplier, observers have also underestimated how damaging austerity is to an economy, at a time like the present. In the IMF's World Economic Outlook (October 2012), Chief Economist Olivier Blanchard notes that "The main finding, based on data for 28 economies, is that the multipliers used in generating growth forecasts have been systematically too low since the start of the Great Recession… This finding is consistent with research suggesting that in today's environment of substantial economic slack, monetary policy constrained by the zero lower bound, and synchronized fiscal adjustment across numerous economies, multipliers may be well above 1."

Senator Sessions

Question 6:
Critics have suggested that austerity in Europe has not worked. Their argument is that many European countries have entered (or prolonged) a recession after engaging in austerity measures.

Based on past testimony, it seems that the type of fiscal consolidation determines how a country will weather austerity. What types of fiscal consolidation are going on right now in Europe? And what might we expect from those consolidation efforts moving forward? Do you feel that a change in the structure of their austerity measures may yield different results?

RESPONSE: It is difficult to generalize across Europe. But, in general, in environments with very low interest rates and excess capacity (like Europe today), I would expect that either tax increases or spending cuts are likely to be contractionary. The exact impact will vary across countries. As seen in the figures of my prepared testimony, more austerity is associated with worse economic outcomes. This general pattern has been confirmed by other researchers, including the IMF, using alternate methodologies.

Senator Sessions

Question 7:
When the UK began their austerity program they initially rolled out higher tax cuts before they instituted significant spending reform. By their own admission they feel they should have instituted spending reform first and limited the size of tax increases. Further, IMF economists have shown that nations that raise taxes suffer twice as much than nations that cut spending. Do you believe that this lesson is one that should be considered for the United States?

RESPONSE: It is always desirable to have lower rather than higher marginal tax rates, all else equal. However, in a demand-constrained economy like that of the UK, I believe that the primary issue is the level of aggregate demand. In circumstances like those the UK currently faces, either tax increases or spending cuts reduce aggregate demand.

The IMF does study the difference between cutting expenditure and increasing tax revenue. In particular, IMF researchers note that "it appears that the difference in monetary policy responses accounts for much, though probably not all, of the difference in output performance" (IMF World Economic Outlook, October 2010). However, today, interest rates are extraordinarily low. Hence, the IMF's conclusion suggests that, in today's environment, the two types of austerity may not be that different (in their negative impact on economic growth).

Lawrence H. Summers
Senate Budget Committee Responses
June 18, 2013

Senator Wyden

RESPONSE: Thank you for the opportunity to discuss potential programs to promote growth of our nation's economy. As I described in my prepared remarks, a 1 percent increase in the growth rate of GDP maintained for 10 years would reduce cumulative deficits by more than $3 trillion. Hence, I agree on the importance of economic growth.

As also discussed in my prepared testimony, I agree tax reform has substantial potential benefits. Furthermore, if we can identify specific special interest subsidies that should be scaled back, supporting middle class families through increasing the standard deduction and reducing the marginal tax rate are proposals that merit further study.

Additionally, a sustained commitment to infrastructure investment, improving our primary and secondary school systems and increasing access to higher education, and promoting exports by reducing trade barriers with other countries and enforcing our trade laws are examples of other policies that will help stimulate economic growth.

A number of factors make now an especially good time to re-invest in America's future. Not only can the government borrow at extraordinarily low interest rates, there is also substantial excess capacity in the economy. Re-investment in our public infrastructure and schools can help spur economic growth, raise future productive capacity, reduce unemployment (particularly amongst construction workers), and lower future deficits.

Lawrence H. Summers
Senate Budget Committee Responses
June 18, 2013

Senator King

Question 1:

There is a clear need for immediate federal investment in America's aging infrastructure networks. In your testimony, you suggested that Congress take advantage of current low interest rates to fund medium and long-term projects, such as sustained federal investment in infrastructure, that would reduce future debt burdens. Along with low interest rate levels, what other factors create today's low opportunity cost for federal investment in infrastructure?

RESPONSE: As mentioned in my written testimony, I too believe the moment is ripe for investment in American infrastructure. Since this investment would reduce our future infrastructure obligations today, we should take advantage of this opportunity, especially given the very low level of interest rates. In addition to low capital costs, the relatively high rates of unemployment (particularly among the less-skilled and those in construction) and the low materials cost associated with economic slack make investment in infrastructure attractive at this time. A major effort to upgrade our nation's infrastructure can help spur economic growth, raise future productive capacity, reduce unemployment, and lower future deficits.

Senator King

Question 2:

In today's hearing, you proposed that lawmakers should consider embarking on a 10 year program of renewed investment in infrastructure, with the understanding that the revenues to pay for it would kick in at some point that was "macro-economically appropriate." Please elaborate on what macroeconomic triggers you believe would provide appropriate thresholds and how you believe this proposal could generate sustained federal investment in our nation's infrastructure networks.

RESPONSE: A ten-year program of renewed investment in infrastructure would by definition represent a sustained investment commitment. Appropriate macroeconomic triggers would likely involve some combination of the unemployment rate, inflation rates, and perhaps the level of medium-term interest rates. Triggers built on variables like these would be appropriate and further rigorous study can aid in estimating the specific numerical threshold.

QUESTIONS SUBMITTED BY SENATOR PATTY MURRAY

STUDENT LOAN DEBT

Question. Cumulative student loan debt exceeds $1 trillion and is more than credit card debt. According to the New York Federal reserve, student loan debt balances continue to grow and delinquencies are rising.

Reports from the Center for American Progress have highlighted that borrowers are unable to re-finance and take advantage of low interest rates and the Consumer Financial Protection Bureau has outlined the domino effects high student loan debt has on the broader economy.

Aside from income-based repayment, which applies only to Federal loans, is there anything more that can be done to address student loan debt?

Answer. In an effort to help students and their families make more educated decisions about planning and paying for college, the Department produced several tools and resources. The following tools and resources include repayment information, such as Income-Based Repayment—IBR.

Repayment Estimator

When a user signs in, the Repayment Estimator automatically retrieves Federal student loan information available in the National Student Loan Data System (NSLDS). The user is able to view and compare the repayment amount under each of the repayment plans. Options allow comparisons of all aspects of the repayment plans. Graphics take information beyond numbers to present at a glance comparisons between monthly payment amounts, total amounts paid, and total interest paid based on each plan.

Financial Awareness Counseling Tool (FACT)

In June 2012, the Department introduced the Financial Awareness Counseling Tool to provide students with financial management basics, information about their current loan debt, and estimates for student loan debt levels after graduation. The tool offers five interactive tutorials covering topics ranging from managing a budget to avoiding default. Students are able to access their individual loan history and receive personal feedback that can help them better understand their financial obligations. Since the launch of the tool last year, FACT has been accessed nearly 1.8 million times.

Entrance and Exit Counseling

In March 2013, the existing entrance and exit counseling tools were re-vamped to have the same look and feel as the Financial Awareness Counseling Tool—FACT. Beyond the required functions, the entrance and exist counseling tool also helps create financial awareness. The exit counseling tool now provides a borrower with the ability to select their repayment plan, which is then sent to the borrower's servicer. The Department expanded the Repayment Estimator to include all income-driven repayment plans. This tool can be accessed in entrance and exit counseling, as well as with FACT. Borrowers can access all the counseling tools and calculators on the StudentLoan.gov website, which is the same site where borrowers can complete promissory notes, view disclosure statements, and apply for a PLUS loan.

StudentAid.gov

In July 2012, the Department introduced StudentAid.gov, a consolidated website that provides straightforward and easy-to-understand information about planning and paying for college. Available in English and Spanish and fully accessible on smartphones and tablets, the website combines content and interactive tools from several websites and features instructional videos and infographics to help answer frequent questions about financial aid. Topics covered on the site include: how to prepare for postsecondary education; an explanation of the various types of student aid available (such as loans, grants, scholarships, and work-study jobs), who is eligible to receive loans and grants, how to apply, and how to manage student loans after leaving school.

INCOME-BASED REPAYMENT PROGRAMS

Question. What is the Administration doing to educate borrowers about income-based repayment (IBR) programs?

Answer. To help inform borrowers about their repayment options, the Department recently transitioned the IBR Application into a new Income-Driven Repayment (IDR) e-application to feature not only IBR, but also Income-Contingent Repayment and Pay As You Earn. The new IDR application contains a built-in repayment amount estimator to help borrowers see the difference in monthly payments for the different IDR plans. The IDR application was implemented in December 2012. We have had 463,198 applications submitted since inception.

Additionally, the Department conducted an online outreach campaign to highlight repayment options to current college students, recent graduates, and borrowers in May-June 2013 (to coincide with graduations). The campaign included outreach on Facebook, Twitter, YouTube, LinkedIn, and other websites, particularly those accessed from mobile and tablet devices. The campaign resulted in approximately 122 million audience impressions and more than 354,000 clicks, which drove users directly to Federal Student Aid repayment tools and resources.

As a result of these and other tools developed by the Department, over the past year the number of Direct Loan borrowers in the IBR program has more than tripled from approximately 280,000 in June 2012, to over 900,000 today.

STANDARD REPAYMENT PROGRAMS

Question. In some instances, isn't standard repayment better for the student than paying more interest on the loan?

Answer. The selection of the best repayment option is based on the borrower's objectives and determined by several factors including current income, the terms of the loan(s), interest rate(s), current balance, and others. The Department encourages borrowers who have the ability to meet their financial obligations to do so. The sooner a borrower can pay off their loan, the less interest they are likely to pay.

Borrowers have access to several tools developed by the Department, including the repayment comparison calculator (at http://studentaid.ed.gov/repay-loans/understand/plans/standard/comparison-calculator) to determine what their monthly and total repayment amounts will be, and what the expected length of repayment would be under various repayment plans based on their circumstances.

STUDENT LOAN INTEREST RATES – VARIABLE RATE STUDENT LOAN PROPOSAL

Question. The President's budget proposed an uncapped variable rate student loan based on 10-year Treasury notes plus additional percentages for Subsidized (0.93%), Unsubsidized (2.93%) and PLUS loans (3.93%).

Previously, when we have had variable student loan interest rates, those rates have been based on 91-day Treasury rates plus an additional percentage. Why did the Administration decide to base your variable interest rate proposal on 10-year Treasury notes?

Answer. The 10-year Treasury rate was selected because it is more representative of the results achieved from the yield curve the Department uses to estimate Government borrowing for the purposes of discounting loan subsidy.

PAY AS YOU EARN REPAYMENT PLAN

Question. As part of your interest rate proposal, you recommend expanding a form of student loan debt repayment called Pay As You Earn to all borrowers. Wouldn't your proposal include older loans already in repayment?

Answer. Yes, our proposal would allow all borrowers currently in repayment who qualified for partial financial hardship to select the Pay As You Earn repayment plan. We anticipate that the overwhelming majority of borrowers already in repayment that opt to switch to Pay As You Earn would be borrowers currently in the Income-Based Repayment plan.

LOAN DEFAULT RATES

Question. Don't these Pay As You Earn loans have lower default rates when compared to more recently disbursed loans?

Answer. While the economic downturn has led to increased default rates for borrowers in all stages of repayment, assuming the economy recovers as expected, we do not anticipate that lifetime default rates would increase substantially for more recently disbursed loans in any repayment program, including Pay As You Earn.

VARIABLE RATE STUDENT LOAN PROPOSAL AND INTEREST RATE CAP

Question. Does this really replace a cap on interest rates?

Answer. Enrolling in Pay As You Earn, or any similar repayment plan, where a borrower's income is taken into account, protects borrowers from being overburdened with loan debt. This really is a more meaningful step to limiting loan debt burden than setting a cap on interest rates. Interest rate caps tend to be set at an arbitrary figure; even if they are selected after much research and debate, they still are not effective at addressing the specific circumstances of many borrowers. Income-based repayment plans such as Pay As You Earn are able to provide for borrowers, at an individual level, repayment terms compatible with their outstanding loan balances, discretionary income, and other personal factors.

QUESTIONS SUBMITTED BY SENATOR RON WYDEN

THE COLLEGE SCORECARD – EMPLOYMENT AND EARNINGS DATA

Question. The President's budget clearly prioritizes getting students and families better information on postsecondary education outcome metrics to guide their decision making, and, the President's College Scorecard is testament to this priority. However, in the area of employment and earnings, the Scorecard is basically left blank. What are the Administration's plans for filling in this section? Specifically: are there plans to collect and publish wage data at the program level, and, if so, when; for how many years after graduation will data be collected (e.g. will it only be short term or would it be longer term, for example, 5-10 years, post-graduation); what data source will be used and how will they be connected; and, how does the Administration plan to do this in a way that doesn't violate the existing congressional ban on a unit record type system?

Answer. The Department has been working to make information about the earnings of former students available for the College Scorecard. We are continuing to work on this and hope to have that data available within the next few months. Making this data available will not only help students think about where to attend college, but also help them make responsible student loan borrowing decisions. In addition, throughout this process, the Department is cognizant of the congressional ban on a unit record type system and is exploring ways to make this data available without violating the ban. The process of producing this data is still in the formative and deliberative stage. The Department will be happy to discuss earnings data in more detail upon its release.

PAY FOR SUCCESS INDICATORS

Question. The aim of Pay for Success is to provide students with alternate pathways for high-quality, low-cost higher education with providers being reimbursed for costs only if students succeed.

The budget indicates that demonstrated competencies, passage of field–appropriate licensing tests, and job placement are possible indicators of success. Can you provide additional details on this proposal; for example, how will these indicators be determined?

Answer. The Administration's 2014 Budget Request includes $260 million for a First in the World (FITW) Fund, which would provide up to $75 million to 1) support projects to develop validation systems that identify competencies, assessments, and curricula for specific fields and 2) make performance-based awards using the Pay for Success (PFS) model, to reward non-accredited providers of free 2-year degrees that can demonstrate that their interventions yielded successful outcomes.

An applicant seeking Pay for Success awards under this initiative would propose, subject to departmental approval, the specific measure(s) that would be used to verify whether or not its intervention was successful.

TRANSPARENCY OF PAY FOR SUCCESS INDICATORS

Question. Will the agreed–upon indicators be transparent?

Answer. Yes, the indicators and methodology used to measure the Pay for Success provider's performance would be transparent to, and agreed-upon by, both the applicant and the Department.

VERIFICATION OF PAY FOR SUCCESS INDICATORS

Question. How will the Pay for Success outcomes be verified?

Answer. An independent assessor would verify that the intervention was successful using a methodology that is transparent to both the Pay for Success provider and the Department.

APPLICATION OF PAY FOR SUCCESS FINDINGS

Question. How would findings from this experiment on an outcomes-focused delivery model inform the broader conversation around higher education quality beyond just 2-year degrees?

Answer. The Administration believes that the First in the World (FITW) initiative, which would advance competency-based learning through the establishment of validation systems and enable thousands of students to complete free 2-year degrees while minimizing the risk to the Federal Government, has enormous potential to inform the higher education quality conversation.

POSTSECONDARY INSTITUTIONAL RESPONSIBILITY FOR COLLEGE COMPLETION AND STUDENT DEBT

Question. We are all too familiar with skyrocketing debt and increasing default levels. The Federal Government invests hundreds of billions in dollars in helping students go to college, but too many students don't complete college and end up buried in debt. What responsibility do institutions have for these issues?

Answer. The Administration has made affordability and quality in postsecondary education a priority in this year's President's Budget. However, we also know that these priorities are part of a shared responsibility between the Department, institutions, States, and students. Because of this shared responsibility to educate students, we encourage institutions to show, and would like to reward those that demonstrate, this commitment. Through our campus-based aid proposal, institutions that are able to engage in innovation to this end — such as by getting students, particularly those from low-income backgrounds into their institutions, through to graduation and into careers — would see a greater Federal investment for their success.

Additionally, we believe that this type of proposal, as well as other efforts we've made to create more transparency in postsecondary education (for instance, the publication of cohort default rates, and other ever-more-easily accessible institution-level data), will help spur institutions into taking action to determine why certain students aren't completing, find ways to prevent that, and develop more and better tools for understanding and managing college costs.

LINKING FEDERAL FINANCIAL AID TO INSTITUTIONAL EDUCATION OUTCOMES

Question. Should we consider tying some of the hundreds of billions of dollars in Federal financial aid to institutional outcomes?

Answer. The 2014 President's Budget proposed a similar reform, which we believe would help make college more affordable and institutional funding more transparent. In this proposal, campus-based aid would be targeted to institutions that provide quality education at a reasonable price. Institutions that would be successful under this new formula would be those that offer relatively lower tuition and/or restrain tuition growth, and those that offer high quality education and training to prepare their graduates for jobs and their responsibility to repay their student loan obligations. It is important the Federal Government maintain its investment in students, but it does not make sense to keep investing in those institutions that continually fail to meet their obligations to students. We are happy to further discuss this proposal with Congress in either the context of the 2014 appropriations process or the Higher Education Act reauthorization.

QUESTIONS SUBMITTED BY SENATOR ANGUS KING, JR.

UNFUNDED FEDERAL MANDATES — IDEA AND TITLE I

Question. In this time of diminished revenues and contracting State budgets, every dollar counts. The Federal Government has never followed through on its commitment to fund the Individuals with Disabilities Education Act (IDEA) at 40% (indeed, it has never exceeded 19%). As a former governor, these unfunded mandates are frustrating. What is the Administration doing to maintain or enhance the Federal Government's commitment to programs like IDEA and Title I?

Answer. We have maintained strong continued support for key "foundational" Federal education formula grant programs, such as Title I and Special Education Grants to States, while at the same time investing new resources in competitive grants to spur innovation by States and districts aimed, in part, at helping to leverage more effective use of Federal formula grant funds. We do not agree, however, with the characterization of Title I Grants to Local Educational Agencies and IDEA Part B Grants to States as "unfunded mandates;" rather, these programs provide significant Federal support for State and local efforts to carry out their responsibilities, typically defined in State law, for meeting the educational needs of all children. The requirements that accompany these programs are aimed primarily at ensuring that funds are spent consistent with the intent of Congress and at protecting taxpayer funds from fraud, waste, and abuse.

The sequester, of course, has made it much more difficult to maintain our commitment to key formula grant programs like Title I and IDEA, which is why the President's 2014 Budget Request assumes that the sequester will be reversed as part of a comprehensive, long-term deficit reduction agreement that balances spending cuts and new revenues. We fully agree that "every dollar counts," especially when it comes to key investments like education, and we remain determined to restore essential funding for Federal education programs by reversing the sequester.

RURAL SCHOOL DISTRICTS FUNDING ALLOCATIONS

Question. Under President Obama's tenure, the Department of Education has shifted focus significantly towards utilizing competitive grants for awarding discretionary funding. While competitive grants may work well for urban areas and larger school districts, I am worried that rural schools are getting left behind, as they do not have the adequate personnel and resources to pursue these grants. What does the Administration anticipate specific allocations of funding to be that would go to rural school districts?

Answer. The Administration is not proposing specific set-asides of rural funding in its competitive reform programs, but we recognize that more than half of all school districts and about one-third of all public schools are located in rural areas, many of which have unique needs and face unique challenges. Consequently, we have worked hard, and with considerable success, to ensure that such districts and schools have a fair opportunity to compete for Federal education funds. Under the Race to the Top–District competition, for example, the Department has included an absolute priority for rural districts to help ensure that students from locales of all sizes are served by the program. We also allowed consortia of districts to apply, which was helpful to rural districts, since they often have difficulty competing on their own. Nearly half of the districts that won Race to the Top–District funds are rural.

In the Early Learning Challenge competitions, we awarded grants to many States with large rural populations, such as Tennessee, Georgia, North Carolina, Minnesota, Ohio, Kentucky and Louisiana. In our FY 2013 competition for the Early Learning Challenge program, we are encouraging applicants to serve rural areas through a definition of "children with high needs" that includes children who reside in high-poverty rural areas and through the inclusion of selection criteria that allow the Department to fund applicants that propose to serve rural States and communities.

Under the Promise Neighborhoods program, we established an absolute priority for applicants that propose to serve at least one rural community. The Investing in Innovation (i3) competition also has an absolute priority that focuses on students in rural communities. As a result, rural entities have been well represented among the grantees in both of these programs.

Rural schools have been well represented under the School Improvement Grants (SIG) competition as well. In FY 2009, rural schools constituted 20% of SIG-eligible schools, but were more than 23% of the schools that received awards. In FY 2010, 17.5% of SIG-eligible schools were rural while 19% of SIG awards went to rural schools.

STATE MATCHING REQUIREMENT FOR PUBLIC PRESCHOOL PROGRAMS

Question. Maine has a State funding formula which provides subsidy for public preschool programs beginning in the second year of the program implementation. Does this new subsidy funding meet the Secretary's intention that a State will have "new" funds to match the Federal funding for public preschools programs?

Answer. We would need more detail on how the Maine funding formula works in order to make a final determination, but, in general, the matching requirement proposed for Preschool for All would require increased investment by States in response to Preschool for All, and not existing subsidies.

RACE TO THE TOP-EARLY LEARNING CHALLENGE GRANTS

Question. Does the Secretary anticipate having a specific allocation that would go to rural states for Race to the Top–Early Learning Challenge grants?

Answer. No, our FY 2013 Early Learning Challenge competition does not include a specific set-aside for rural States. Instead, we are encouraging applicants to serve rural areas through (1) a definition of "children with high needs" that includes children who reside in high-poverty rural areas and (2) selection criteria that allow the Department to fund applicants that propose to serve rural States and communities.

QUESTION SUBMITTED BY SENATOR KELLY AYOTTE

GAO STUDY OF DUPLICATIVE FEDERAL STEM PROGRAMS

Question. Secretary Duncan, especially in today's global economy, the importance of a quality education cannot be understated. In order to remain globally competitive, the United States must have a world-class education system and we must increase the ability of our students to excel in the fields of science, technology, education, and mathematics – or STEM.

A focus on STEM is important to our country's future. That's why I found a report from the Government Accountability Office (GAO) on STEM programs to be especially troubling. The GAO found that, in fiscal year 2010, 13 agencies spent over $3 billion on

209 STEM programs—and GAO identified some degree of overlap in 83% of these programs. GAO stated that, "agencies' limited use of performance measures and evaluations may hamper their ability to assess the effectiveness of their individual programs as well as the overall STEM education effort." The Agency recommended that STEM programs be guided by a "robust strategic plan."

We owe it to our children to use taxpayer dollars in as effective a manner as possible. Specifically, what actions, steps, or efforts are being undertaken by the Department of Education to consolidate not only duplicative STEM programs, but also teacher quality programs and other Federal programs identified by GAO as duplicative, so that taxpayer dollars flow to help our kids, rather than feed a complicated maze of programs that offer duplicative or fragmented services?

COMPREHENSIVE PLAN TO REORGANIZE FEDERAL STEM PROGRAMS

Answer. President Obama shares your concern over the fragmented and largely ineffective Federal investment in STEM education, and his FY 2014 Budget Request includes a wide-ranging proposal that specifically responds to the issues highlighted by the GAO report. In particular, the President's proposal would reorganize or restructure 114 programs across 13 agencies as part of a comprehensive effort to improve the delivery and impact of Federal investments in science and technology, engineering and mathematics (STEM) education. The goal is to eliminate the patchwork of STEM education programs that have proliferated in Federal agencies over time and simultaneously increase the impact of Federal investments in high priority areas, including K-12 instruction and informal education activities.

At the Department of Education, this proposal focuses on more effective investment in elementary and secondary STEM education through a $265 million investment in a new, coordinated STEM Innovation initiative that includes three components: $150 million for STEM Innovation Networks involving consortia of school districts, institutions of higher education, research institutions, museums, community partners, and business and industry that would develop comprehensive plans for identifying, developing, testing, and scaling up evidence-based practices to provide rich STEM learning opportunities in participating LEAs and schools; $80 million for STEM Teacher Pathways, which would support the President's goal of developing 100,000 new effective STEM teachers through competitive grants for recruiting, training, and placing talented recent college graduates and mid-career professionals in the STEM fields in high-need schools; and, $35 million to establish a new STEM Master Teacher Corps comprised of teachers who would be selected based on their expertise, leadership, and service in improving teaching and learning in STEM subjects and who would make a multi-year commitment to build a community of teaching practice focused on helping students excel in math and science.