Embargoed Until 10:00 a.m. EST, February 2, 2010

Treasury Secretary Timothy F. Geithner
Written Testimony
Senate Committee on Finance
February 2, 2010

Chairman Baucus, Ranking Member Grassley and members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2011 Budget.

The U.S. economy is still in the midst of one of the most challenging periods in our nation's history. We have pulled back from the brink of financial collapse and a historic recession. The overall economy grew at an annual rate of 4 percent over the last six months of 2009, but millions of Americans remain out of work and the economic pain of the recession can still be felt throughout our nation. This crisis has caused enormous damage to the basic economic security of tens of millions of Americans.

This is why we have a lot of work to do together to make sure that as overall economic growth recovers, so does job growth. We must restore confidence in the economy's fundamental resilience, and we are taking the steps to ensure sustainable growth going forward that is more widely shared among the American people.

Our immediate priority is to work together to encourage the creation of more and, better-paying jobs. We can only achieve that objective if we are committed to laying a foundation for job creation in the private sector. In the short-term that means ensuring that the true engines of job creation, America's businesses, have the right incentives to expand and hire through new targeted measures in 2010 that will speed job creation.

But laying a new and stronger foundation for the private sector requires more: it requires an equally strong public commitment to invest in the innovation, modern infrastructure, and the education of our future and present workers. These investments will enable our businesses to compete, increase productivity, and most importantly, will help create good, well-paying jobs. In the long-term, this new foundation requires the creation of a strong investment climate by showing our commitment to return the deficit to sustainable levels and establishing the right rules to restore trust in the core functions of our financial system. When recovery is firmly in place and the economy is back on its feet, we need to begin the process of bringing down the deficits that Washington has been accumulating for almost a decade. These deficits are too high and left unchecked they will burden our children and grandchildren, and could drain investment from the private sector, drive up interest rates and threaten the very prosperity we are seeking to produce.

The commitment in this Budget to job creation, innovation, investment in the skills of our people and fiscal sustainability is essential to setting the stage for the kind of broad-based economic growth that will provide middle-class Americans with rising living standards and financial security.

Pursuing these goals requires a careful balance. It means not turning too quickly away from our immediate goals of jobs and recovery, while also not ignoring the long-term health, education and energy challenges that our nation cannot afford to further ignore. And it means laying out a clear path to fiscal sustainability, and demonstrating our commitment to walk that path by taking the first critical steps along it.

Recovery and Job Creation

As the President said last week, jobs must be our most immediate focus. That means that even before we get to our FY 2011 Budget, we will work with Congress to enact legislation to accelerate the pace of job growth.

First and foremost, we will do this by providing businesses – especially small businesses that have been major job creators in recent years –with tax cuts and other incentives to put more Americans back to work quickly.

The Administration proposes to extend Recovery Act business tax relief, and to create a new, temporary tax credit for job creation. We will extend Recovery Act measures that allow small businesses to deduct the full cost of new investments in qualifying equipment. And we will allow all businesses to take bonus depreciation deductions this year for qualifying capital investments.

Under our new "Small Business Jobs and Wages Tax Cut," all businesses will be eligible for a $5,000 tax credit for every new employee they hire in 2010. An additional bonus amount will be available to firms that increase their payroll by adding hours or raising wages, with the total credit amount capped at $500,000 per firm. Because it will use a 2009 baseline, there are no games or accounting tricks any business could perform to get the job or wage tax cut without actually increasing jobs or wages.

In order to get money out to businesses quickly and thus provide a fast-acting incentive to hire, firms will be able to claim the credit on a quarterly, rather than annual, basis. We expect that over one million small businesses that are growing jobs or wages will receive the credit.

This combination of tax measures will boost the pace and quantity of business investment and, with it the number of new jobs that businesses create.

To cope with the difficulty that small businesses face in getting bank credit, the Administration is proposing legislation that will use $30 billion from TARP to create a new separate program designed to provide capital to small and community banks. Our proposal includes a carefully-designed incentive structure that improves the terms of the capital the more a small bank expands lending to small business. And we will explore additional ideas from Congress on other ways this facility could work to expand lending to credit-worthy small businesses.

We also call for extending through September of the effective Recovery Act measures that supported up to $15.4 billion in Small Business Administration loans through lower fees and higher guarantees during this difficult time. And we will support legislation to increase the loan size of the SBA's two most heavily-used guarantee programs.

Second, the President has proposed measures to spur immediate job growth by creating incentives to invest in our environment and energy security. In addition, the Budget includes an extra $5 billion to expand the number of firms eligible to receive a tax credit for investments in U.S. factories that produce clean energy products. This will boost jobs by helping to build a strong U.S. clean energy industry. And because it is an expansion of an existing program, there are already worthy businesses ready to receive the benefit so that the additional amount will go to work quickly creating new jobs.

The President is also proposing new incentives for consumers who retrofit their homes to make them more energy-efficient, and we are seeking to expand several Recovery Act initiatives that promote energy efficiency and clean energy and that have been particularly popular and effective at job creation.

Third, the President is proposing to boost infrastructure investment beyond what was included in the Recovery Act so that we can continue modernizing our transportation and communications networks. This increase will support needed public works, provide private sector companies with new work, and spur additional hiring.

As we take all of these steps to get Americans back to work, we need to extend Recovery Act relief for those most hurt by the nation's economic troubles. This will include emergency assistance to seniors, unemployment compensation and COBRA assistance for the unemployed, and relief to revenue-strapped states and localities to help prevent layoffs.

Building a New Foundation

While our first aim must be to restore job growth, the FY 2011 Budget looks beyond the immediate recovery to build a new and stronger foundation for growth in the years ahead. Our aim in doing so is to produce growth that once again raises the living standards of all Americans.

We cannot afford an economic expansion like that of the past decade when, as the President said last week, jobs grew more slowly than during any previous recovery; the incomes of average American households declined while the costs of health care and college reached new highs; and much of our growth was built on the sands of a real estate and financial boom.

In order for Americans to thrive, this nation must rely, as it always has, on a vibrant private sector. Our entrepreneurs, small and large businesses, workers, and nonprofit organizations must be the engines of productivity growth and the primary creators of new, high-quality jobs. Washington's role must be to create optimal conditions for small and large American businesses to grow, innovate and create jobs.

Government can play this important role by helping to ensure that families can save and that businesses have ready access to the credit needed to grow; by helping to expand the body of technical knowledge and the quality of public infrastructure to encourage new businesses and greater productivity; by expanding the market for American goods and services by increasing our exports to the rest of the world; and by helping Americans to better educate themselves in order to best employ the latest knowledge and compete in an increasingly globalized marketplace.

The President's Budget outlines policies to make important progress on all of these objectives.

A strong, healthy financial system is crucial for sustainable growth, job creation, and broad-based prosperity. Such a system helps families save for a house, a child's education and retirement. And it channels those savings into investments that let businesses grow, hire, and raise incomes.

Our financial system is far stronger today than it was a year ago. But it is operating under the same rules that led to its near-collapse and a dangerous recession. These rules must be changed to keep the system from taking unjustifiable risks and so that it can fuel growth.

We need a financial system that is safer; in which financial firms, especially large ones, have more capital to absorb their own losses and cannot take risks that threaten the whole economy. Consumers need to be given the information they require to make the decisions that are right for them and they need to be protected from unfair and fraudulent practices. The government needs to have the authority that it did not have in the recent crisis to break apart and unwind failing firms in ways that limit damage to the system as a whole.

The Administration has proposed reforms that would accomplish these goals, and the House has already passed legislation. We must finish the job of enacting comprehensive reform for the sake of people's financial safety and to ensure growth.

At the very core of the Administration's efforts to build a new foundation for growth are our efforts to encourage American innovation. We already made the largest investment in basic research funding in history last year, and we propose to build on that. Even with our tight fiscal constraints for discretionary spending, our Budget for the next fiscal year will increase civilian research and development (R&D) by 6.4 percent. Our aim is to help create the conditions for greater economic productivity and the emergence of new growth- and job-creating businesses. And with most of these new investments offset by reductions in military R&D, we will pursue this aim without increasing the size of government or government spending.

As the President has said, no area is riper for R&D-driven innovation than energy. Whether you are a consumer watching the cost of filling your gas tank go up or a scientist tracking how climate change is affecting our planet, it is clear that we can no longer afford our heavy reliance on fossil fuels to power our economy.

The transition from fossil fuels to clean energy will challenge both America’s technical ingenuity and our political will. But the challenge holds out tremendous possibilities not just for improving our health and the environment, but for creating new, high paying “green” jobs and driving the recovery of America’s manufacturing economy.

This Administration is committed to creating clean energy and green jobs. The Recovery Act is already investing $90 billion in clean energy technologies. And our FY 2011 Budget extends that commitment. As I have already mentioned, it expands by $5 billion our Advanced Energy Manufacturing Tax Credit, a 30 percent credit for qualified investments in new, expanded or re-equipped clean energy projects. It substantially expands support for construction of new nuclear power plants by increasing loan guarantee authority for such projects by $36 billion. It funds a $500 million credit subsidy to support $3 billion to $5 billion of loan guarantees for energy efficiency and renewable energy projects. It continues work begun under the Recovery Act to modernize our electrical grid so that it is smarter, stronger, more efficient, and helps foster the growth of wind and solar energy projects.

We will make parallel investments in infrastructure with the intention of taking full advantage of the knowledge generated by the new R&D we are funding. These investments are designed to be launched as quickly as possible in order to create jobs. They will include increasing a $7.2 billion program to expand access to broadband computer networks, and following through on our five-year, $5 billion commitment highlighted by the President last week in Florida to develop high-speed rail.

We are also proposing to expand and make permanent the very successful Build America Bond program, which was part of the Recovery Act. Build America Bonds have expanded the investor base for municipal bonds and lowered borrowing costs, helping to restore a badly damaged municipal finance market and support job creation through new infrastructure projects. States and localities have already issued over $64 billion in such bonds through the end of December. The President's Budget proposes making Build America Bonds permanent with a subsidy rate that makes extension revenue-neutral. The Budget also proposes expanding the eligible uses of these bonds, allowing them to support financing for nonprofits and a wider range of municipal borrowing.

A critical component for building a new foundation for stable, long-term growth, and a complement to our efforts to increase R&D and innovation, is opening up foreign markets to American goods and services. The President has set a goal of doubling our exports over the next five years and thereby supporting two million American jobs.

Our Budget will substantially increase funding to expand exports, especially those produced by U.S. small businesses. The Budget will provide a 20-percent increase in Commerce Department funding that promotes exports from small businesses, as well as funding for the Import-Export Bank to expand U.S. small business use of the Bank's financial export assistance.

History shows that, besides R&D, the investment that pays the greatest returns in improved productivity and greater prosperity is education. The Budget makes substantial new investments in this area, as well.

The Budget will provide new incentives for the rising generation of students to train as scientists and engineers. And because in order to succeed in a global economy higher education is a necessity and not a luxury, the Administration proposes to increase community college graduation by 5 million students by 2020.

The Budget increases maximum Pell Grants awards to $5,710, and further propose to make Pell Grants an entitlement program, to further the President's commitment that coming from a lower-income family should never be a barrier to any young person with high educational aspirations. In addition, it will extend the American Opportunity Tax Credit, which provides a tax incentive of up to $2,500-a-year toward college costs – or up to a total of $10,000 for a young person getting a four – year degree.

The Budget will support the Administration's efforts to make major reforms and improvements in the nation's elementary and secondary schools to help students graduate so that they are ready for postsecondary education or a career. It will expand the Recovery Act's successful Race to the Top competition for funds to include not only states, but individual school districts, and by investing in a new competitive fund to encourage states to develop innovative techniques for recruiting, retaining and rewarding effective teachers.

Finally, this budget is designed to give middle – class Americans a chance to get back on their feet and contribute to this economy. That commitment has been central to the Administration's policies from the outset. The middle class was the focus of the Recovery Act. And soon after taking office, the President created a Middle Class Task Force, led by Vice President Biden, aimed at raising the living standards of working families.

In this budget, we build on that commitment. We are proposing to extend the lower- and middle-class tax cuts that are scheduled to expire at the end of 2010. Among its effects, this extension will ensure that 97 percent of small business owners who file individual income tax returns will be spared an increase in their tax rates. The Budget will also extend the Recovery Act's Making Work pay tax credit. And through the initiative of Vice President Biden, we will expand the Child and Dependent Care Tax Credit to help those who are working or going to school and are also responsible for caring for others.

We will further assist tens of millions of middle - class families if we pass health care reform that protects every American from the worst practices of the insurance industry, gives small businesses and uninsured Americans a chance to choose an affordable health care plan in a competitive market, and requires every insurance plan to cover preventative care.

The Administration and Congress have worked hard over the past year on health care and we have no intention of letting the chance for real reform slip away. It is crucial to remember that beyond the difference reform would make to the quality, cost and coverage for tens of millions of Americans, reform would reduce the growth of health care costs. This would be of immense importance to the efficiency of our economy and to our ability to reduce deficits over the long-term.

The Fiscal Imperative

American families are making tough choices in difficult times; Washington must do the same.

Every American knows that the path of our deficits is too high and that if they persist long after this recession ends, they will pose a corrosive threat to our economic future.

That is why we believe that even as we take emergency action to spur demand and job growth, it is not too early to begin the process of imposing policies that can start bringing the deficit down to sustainable levels once recovery and job growth have a firm footing. Failure to show our commitment to bring down medium-term and long-term deficits can weaken a recovery. Failure will mean higher rates for families that want to buy a home or businesses seeking to start or expand. Failure will limit the government's ability to respond in future crises.

Of course, in tackling this problem, we must strike precisely the correct balance with the job- and growth-spurring measures required to assure recovery, and the investment in innovation and education to lay a new foundation for future growth. If we fail to do so, we risk driving the economy back into recession, causing immense additional harm to middle-class families and making it even harder to fix our fiscal problems.

This last point bears repeating. Advocating deep and immediate cuts would damage growth, exacerbating our fiscal challenges.

On the day that President Obama took office, the budget deficit for 2009 stood at $1.3 trillion – 9.2 percent of GDP – and the projected 10-year deficits for the following 10 years were $8 trillion.

These huge deficits are the result of the prior Administration's decision to enact large tax cuts and a prescription drug bill without paying for them. Over the next ten years, those measures alone are projected to add $5.8 trillion to the deficit, including interest expense on the additional associated debt.

The impact of the policies on our nation's debt burden was magnified by the great recession the President inherited and its impact on revenues and automatic increases in spending on safety net programs. Together these automatic changes will increase deficits by about $2.4 trillion over the next ten years. Simply put, over $8 trillion of the projected deficits we faced as we put together this budget were due to the fiscal policies of the last eight years and the effects of the deep recession this President inherited. A much smaller amount – less than one tenth of the effect of the unpaid for policies and the recession – is attributable to the cost of the means by which we supported and pulled the economy out of crisis.

Deficit trends of this level are not sustainable. Beginning to correct them will require cutting deficits enough to stabilize the debt-to-GDP ratio at a manageable level so it is no longer rising. This requires cutting the deficit to 3 percent of GDP. This Administration is committed to achieving the goal of deficits that are roughly 3 percent of GDP by 2015. Doing so would mean that the on-going expenses of government will be completely covered by incoming revenues; the only thing adding to the deficit will be interest costs on the accumulated past deficits.

This is an ambitious goal. The deficit in the current fiscal year is expected to reach 10.6 percent of GDP. To reach our 3 percent fiscal target between now and 2015, we must lower deficits as a share of GDP by more than they have been reduced in any five-year period during the past six decades.

The President's Budget proposes a series of actions that would begin to put us back to a responsible, sustainable fiscal path. Let me highlight those changes:

The Budget will freeze all non-security discretionary funding for three years (2011-2013) at 2010 nominal levels, with funding after the three years increasing only at about the rate of inflation. The freeze will reduce deficits by $250 billion through the end of the decade. Among other things, it will require us to eliminate or consolidate funding for several education programs even as we make significant targeted investments to improve education. It will mean reducing spending on the National Park Service, terminating the Brownfield Economic Development Initiative for poor areas that the President advocated during the election campaign and still supports.

In addition, we need to restore the basic set of disciplines that helped make sure that if Congress proposes new policies or tax cuts, these are paid for with offsetting cuts or changes in policy. In the 1990s, Washington started to live by the budget rule and the basic common sense principle that if the President and Congress wanted to pass an expensive tax cut or entitlement increase – however worthy – they had to find offsetting measure to ensure it did not increase the deficit or debt. This common sense rule – called PAYGO – helped Washington move from large deficits to surpluses. If Washington had lived up to this principle during the last decade it would have served as a bulwark against the unpaid for tax cuts and entitlement increases that make up the heart of the current deficit and debt. Reinstating PAYGO will help return the government to fiscal sustainability.

The Budget will include proposals to close the "tax gap" by collecting more of the taxes that are owed, but are not paid. This is critically important. Tax evasion not only reduces tax revenue, thereby resulting in an implicit tax increase on those Americans who pay their taxes, it also reduces the faith Americans have in the tax system, starting a vicious cycle that can result in even more evasion. I appreciate this Committee's longstanding interest in, and leadership on, efforts to reduce the tax gap. I look forward to working with the Committee to address this important issue.

The Budget will provide nearly $250 million in new enforcement initiatives to improve compliance, which will build on the foundation established in the FY 2010 budget to hire nearly 2,000 new employees dedicated to addressing international tax evasion by businesses and affluent individuals, improving information reporting, and broadening collection activities.

Since President Obama took office, the United States has aggressively pursued international tax agreements to further cross-border tax information exchange. In the past year alone, the United States has signed agreements improving tax information exchange with Switzerland, Luxembourg, Liechtenstein, Gibraltar, Monaco, and Chile. The United States also is working multilaterally to make sure that countries meet international standards on tax transparency and information exchange. The Administration is committed to preventing the facilitation of offshore tax evasion. Finally, the Internal Revenue Service has vigorously pursued enforcement actions against those hiding money offshore. All these efforts are being undertaken to address a fundamental concern: Again, tax evasion, especially through the use of offshore entities and accounts, undermines confidence in our tax system and results in an implicit tax increase on those who pay the taxes they owe.

Our Budget will include a number of proposals to increase information reporting and withholding. The most significant proposal involves addressing the use of offshore entities and accounts to evade U.S. taxes. This initiative will result in billions more in revenue over the budget window and just as importantly send the message that if you hide income and assets offshore to evade tax, we will find you and you will pay. I applaud the leadership this Committee has shown on the issue.

We are also proposing substantive changes to our tax laws to address rules that yield unfair and economically inefficient results. For example, our proposals to reform our international tax rules, to address those aspects that disadvantage investment in the United States and encourage companies to ship jobs overseas. Of course, we recognize that this is an area where our tax law must strike a balance. We are concerned about the competitiveness of U.S. companies abroad and recognize that the growth of U.S. companies globally can benefit the United States. But we recognize that allowing a company that moves jobs or investments overseas to gain a competitive advantage through our tax code against a competitor that chooses to expand investment and job growth in the United States is unfair and is bad policy. This Budget seeks to strike that balance by limiting our proposal regarding the deferral of expenses only to interest. In addition, we drop a previous proposal to limit the ability of taxpayers to elect the tax status of business entities under the so-called “check-the-box” rules. We remain concerned about the misuse of those rules to inappropriately avoid U.S. taxes, and thus are proposing tighter rules regarding the use of foreign tax credits, as well as a new provision to backstop our transfer pricing rules that will subject to immediate U.S. tax excessive returns on intangibles transferred to low-tax foreign affiliates. Our goal in these proposals is to limit the role taxes play in business investment decisions by reducing implicit tax incentives to move investment and jobs overseas. We are, of course, open to discussing how best to achieve that goal.

Our proposals to allow some of the Bush Administration’s individual tax cuts to expire as scheduled and to limit the value of certain tax benefits are restricted to those with the highest incomes. Moreover, we again propose that the income earned on a so-called "carried interest" be taxed as ordinary income and not at preferential capital gains rates, so that private equity and hedge fund managers pay tax on their compensation under the same rate structure as average Americans.

The new Budget will include the President’s Financial Crisis Responsibility fee to be imposed on our largest financial firms. The fee will raise $90 billion over 10 years. And it will be extended beyond that period in the event that the cost to the taxpayers of saving the financial system turns out to be greater than that. This last point is another one that bears repeating; the fee can and will be extended until every penny of taxpayer assistance to the financial system has been repaid and the cost of the rescue to taxpayers is zero.

The Administration’s Budget will cut the deficit as a share of GDP by half as a share of the economy, from the 9.2 percent of GDP the President inherited in 2009 to 4.2 percent of GDP in 2013. The deficit will fall further in 2014, to 3.9 percent.

But this is not enough.

That is why the Administration supports the creation of a bipartisan Fiscal Commission. The Commission will be charged with identifying policies that could win the necessary political support to complete the job of achieving fiscal sustainability. Specifically, it would be asked to propose how to balance the budget exclusive of interest payments on the debt by 2015.

Both Democratic and Republican administrations have turned to similar bodies when the nation faced complex and contentious fiscal decisions. For example, in 1981, President Reagan established by Executive Order the so-called Greenspan Commission to cope with financing problems of Social Security. We could make progress tackling today’s fiscal problems with similar bipartisan action.

While the new Fiscal Commission’s first job will be to balance the operating budget of the government—the budget absent interest payments on the debt—by 2015, the panel also would be charged with proposing changes to address the unsustainable rate of growth in entitlement spending and the long-run gap between government revenues and expenditures. The nation will be challenged anew to maintain fiscal balance as the Baby Boom generation retires, especially if we fail to reform health care. This will make the Commission's latter charge as difficult, and important, to meet as its immediate one.

Finally, I want to highlight progress we achieved over the past year in rescuing our financial system and our economy at a lower cost to taxpayers than many anticipated.

Treasury has taken steps to dramatically bring down the cost of the Troubled Asset Relief Program (TARP), which helped stabilize the financial system, and to shift the focus of the program to small business and housing. As a result of careful stewardship and improved financial conditions, the projected cost of TARP has fallen from $341 billion last August to $117 billion in this Budget, and we have removed an additional $250 billion reserve in place in the event that additional financial stabilization efforts were necessary. If Congress joins with the President in enacting the financial fee, American taxpayers will not have to pay one cent for the financial rescue.

Conclusion

While our country is in a stronger position today than it was one year ago, we still face tremendous challenges. In meeting those challenges, the true engine of job growth and prosperity, the private sector, must lead the way. But the government must help create conditions that allow businesses to thrive.

We must work together to spur job growth, to invest in ways that make our economy stronger in the future, and to lay the foundation for long-term growth. And we must work together to ensure that our government goes back to living within its means.

These goals reinforce each other; they are not in conflict. Without growth, we cannot begin the process of restoring fiscal responsibility. Without confidence that we can bring down our long-term deficits, it will be harder to make sure we are getting Americans back to work and improving economic security.

We are a strong and resilient country. We have successfully confronted great economic challenges in the past, and we will do so again. This is a question of will, not ability. The American people want to see us do this together – to work to solve the problems that we all face and to get the economy back on track.

I look forward to working with you in a bipartisan manner on this endeavor.

Thank you.