

**EMBARGOED FOR DELIVERY
UNTIL 2:30 PM ET, APRIL 11, 2013**

**Statement of Secretary Jacob J. Lew
Committee on Finance
United States Senate
April 11, 2013**

Chairman Baucus, Ranking Member Hatch, 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.

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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.

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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

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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

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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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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.