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PRESIDENT'S FISCAL YEAR 2014 BUDGET

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

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PRESIDENT'S FISCAL YEAR 2014 BUDGET

THURSDAY, APRIL 11, 2013

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

The hearing was convened, pursuant to notice, at 2:35 p.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Stabenow, Nelson, Menendez, Carper, Cardin, Bennet, Casey, Hatch, Cornyn, Thune, and Portman.

Also present: Democratic Staff: Amber Cottle, Staff Director; John Angell, Senior Advisor; Lily Batchelder, Chief Tax Counsel; Tiffany Smith, Tax Counsel; and Tom Klouda, Professional Staff Member, Social Security. Republican Staff: Jeff Wrase, Chief Economist.

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

The CHAIRMAN. The committee will come to order.

Alexander Hamilton once said, "The necessities of a nation in every stage of its existence will be found at least equal to its resources." In 1790, when Hamilton was appointed America's first Treasury Secretary, he set out to build our young Nation's financial system and pay down its debt. As Hamilton did this, he submitted the first budget to Congress and put the United States on track to be a thriving nation.

Today, more than 2 centuries later, we meet to hear from our new Treasury Secretary, Jack Lew, about this year's budget and the administration's plans to meet the necessities of our Nation.

The budget must be a reflection of our priorities, more than just numbers on a page, and should serve as a roadmap, guiding our Nation on a fiscally sustainable path. We must cut our debt, also invest in and protect our priorities, and create new jobs.

My bosses, the people of Montana, tell me they want to see a balanced plan that will bring us together and get the economy running at full speed and create jobs for folks in Montana and across the Nation. I was pleased that the President's proposal takes some steps to find a middle ground. It calls for spending cuts and deficit reduction of an additional $1.8 trillion, while at the same time continuing to invest in national priorities, such as education and infrastructure.

Of special importance to me, the budget supports my battle against veterans' unemployment. It would permanently extend the tax credit I authored for businesses that hire unemployed veterans.

Our veterans deserve to come home to good-paying jobs and a Nation that honors their sacrifices. Making these tax credits permanent would help bring down unemployment among our Nation's heroes.

I am also glad to see the administration addressing my concerns with bureaucratic red tape at the VA. Recent backlogs in disability claims are disgraceful. A 10-percent increase in funding for the VA will help veterans get the care and support they need and deserve.

The budget also makes important investments in keeping America safe by sustaining the current ICBM force through 2030. I led the Senate ICBM caucus in a letter to Defense Secretary Hagel last week calling for this. North Korea's recent actions have sent a clear wake-up call to the White House that a strong ICBM force is the best deterrent strategy to keep America safe, and also gives us the most deterrence for our money.

However, in many areas the President's budget is yet another example of how Washington still does not understand rural America. We cannot balance the budget on the backs of rural jobs. The President would cut $38 billion from agriculture jobs over 10 years, which I believe undermines our work toward a strong, long-term farm bill this year.

In Montana, agriculture supports 1 in 5 jobs. The farm bill is our jobs bill, and I will not support anything that gets in the way of our ability to get it done.

As we address our budget challenges and work to cut the debt, this committee must focus like a laser on creating jobs. Nearly 4 years into the economic recovery, close to 12 million people are actively looking for work. An additional 7.6 million Americans are stuck working part-time because they cannot find full-time jobs. Just last week, we heard that new job creation is at anemic levels: only 88,000 jobs were added to the economy in March, making it the slowest job growth in nearly a year.

Job creation must remain the top priority of the administration, this Congress, and this committee. Some economists have attributed this slow job growth to austerity measures, known as the sequester. The sequester cuts started to hit in early March, and the impact is being felt in Montana and across the country.

I voted for every bill I could to stop these indiscriminate cuts. I voted for the Democrats' plan to replace the sequester, and I voted for the Republicans' plan to give the President more flexibility in where the cuts should occur. Unfortunately, neither plan passed.

Frankly, I think we should try again. I was pleased to see that the President's budget looks to replace the sequester with more thoughtful cost-saving measures. The slow pace of our economic recovery demands that we replace sequestration with a responsible, long-term deficit reduction proposal that protects jobs and spurs the economy.

Much progress has already been made in reducing the deficit. Congress has enacted two budget-trimming bills that reduce deficits by $2.5 trillion over the next 10 years. When savings from ending the wars in Iraq and Afghanistan are added, Federal deficits will be reduced by almost $3.5 trillion over 10 years.

This belt tightening is having a real effect. The Congressional Budget Office projects a stable debt-to-GDP ratio over the next several years, and the deficit will be cut in half by 2015.

CBO also expects the rate of Medicare and Medicaid spending to slow significantly. Current projections for the programs' costs through the end of the decade are $200 billion less than they were in March 2010. That said, there is still more work to be done to responsibly cut our debt in a way that does not impede our economic recovery.

As I mentioned earlier, Mr. Lew, I am committed to strengthening Social Security and Medicare to ensure these programs will be there for future generations. The President has made some bold proposals in his budget to reform both programs.

The President's proposal calls for Medicare cuts well above the level passed in the Senate budget, and the Senate budget put a firewall around Social Security. I am disappointed by the President's proposal to change how cost-of-living adjustments are calculated for seniors and military retirees.

Cutting Montana seniors' benefits without asking the wealthiest Americans to chip in to the Social Security trust fund is not right. Any reform of Social Security should be for the solvency of the program, not deficit reduction. We will delve into these issues in more depth.

Finally, we have been hard at work on this committee for more than 2 years on comprehensive tax reform. The lackluster economic growth we are seeing shows we must simplify the code. We need a pro-growth tax code that closes loopholes while giving America's businesses the certainty they need to compete globally and plan and expand operations.

The Finance Committee is meeting weekly, discussing the code issue by issue and working together to modernize America's tax system. We are working to make it simpler and fairer for families.

Just 2 months ago you sat before this committee and told us you are going to work with us on tax reform. I appreciate that. You said you are willing to take on this challenge, and this committee will hold you to your word.

Today I look forward to hearing exactly how the budget helps your words become reality. The President's budget has proposed raising $600 billion in revenue over 10 years. The Senate budget proposed raising $975 billion over 10 years. It seems the President is working to carve middle ground, just like I am working to do when we close loopholes and simplify the code.

We will close billions of dollars of loopholes. Some of this revenue should be used to cut taxes for America's families and help our businesses create jobs, and some of the revenue raised in tax reform should also be used to reduce the deficit. It is all about finding common ground so we can move forward together.

Secretary Lew, we welcome you. This is your first appearance before the committee as Treasury Secretary. We appreciate that. So, let us remember our priorities and heed Secretary Hamilton's advice to look at the necessities of our Nation as we assess our resources.

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

The CHAIRMAN. Senator Hatch?

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

Senator HATCH. Thank you, Mr. Chairman.

Thank you, Secretary Lew, for joining us here today. We appreciate it. Yesterday, after a couple of months' delay, we received the President's fiscal year 2014 budget proposal. Now, while there are, in my opinion, a few glimmers of hope in the budget, it is overall a disappointment to me.

The President's budget never balances: not this fiscal year, not in 10 years, not ever. Instead, under the President's budget, the Gross National Debt would be $25.4 trillion in 2023, or 96 percent of our GDP at that time.

The economists in the Congressional Budget Office have repeatedly told us that such high levels of debt threaten economic growth and leave us in a position where we are unable to respond to unforeseen crises or emergencies.

In addition, the President's budget takes only baby steps towards reforming our unsustainable entitlement programs, falling fall short of the structural changes needed to preserve these programs for future generations.

Now, many have touted the proposals in this budget to adopt the chained CPI for many parts of the Federal Government, including Social Security cost-of-living adjustments, as a demonstration of the President's willingness to work on entitlement reform. While one may conclude that this is a step in the right direction, and I have, it is only a small step. In fact, in the grand scheme of things, it barely registers. Under the President's budget, overall Social Security spending over the next 10 years is virtually the same as it would be absent any of his proposals.

Put simply, that means, despite many claims to the contrary, this budget contains no substantive changes to Social Security. The story is the same on entitlement spending across the board. Of course, we know that, according to the experts, Social Security is going to go bankrupt from a disability standpoint, Social Security Disability, in 2016.

Again I will say, the story is the same on entitlement spending across the board. Over the next 10 years, according to the President's suggested baseline, we will spend $7 trillion on Medicare, $4.1 trillion on Medicaid, and $11.2 trillion on Social Security, for a combined $22.4 trillion.

With trillions of scheduled spending, the President's budget proposes to curtail spending on these programs by only $413 billion over 10 years relative to his adjusted baseline, which amounts to a minuscule 1.8-percent reduction in entitlement spending. Now, that is not reform in any meaningful sense. It is nowhere near the structural reforms we need to get our entitlement programs on a path to solvency.

In addition to increased spending, the President's budget calls for even more taxes. Now, this comes after the $1 trillion in taxes im-

posed under Obamacare and the more than $600 billion in taxes the President got out of the fiscal cliff deal.

The budget includes higher taxes on estates, the Buffett tax, a financial crisis responsibility tax, fresh taxes on retirement savings, more taxes on commercial aviation, increased taxes on energy producers, and on and on.

All told, the budget contains nearly $1 trillion in tax increases, which in my opinion is simply unacceptable. That said, I do have to say that I am encouraged by some of the proposals in the budget dealing with corporate tax reform. With this budget, the administration has finally admitted that it would be open to revenue-neutral corporate tax reform.

Many Democrats in the Senate have supported this position, though the idea was soundly rejected in the budget that recently passed in the Senate. Contrary to what the President has proposed, the Senate Democratic budget envisions higher taxes on corporations to finance even more government. It will be interesting to see how this apparent conflict will be resolved and which course my colleagues on the other side of the aisle really decide to take.

Of course, my praise for the President's proposal on tax reform is tempered by the fact that it is limited to the corporate side of the tax code. While the President seems content to lower rates on corporations in order to make them more competitive in our global economy, he also is apparently fine with asking flow-through businesses—which file as individuals—for even more taxes. If we want tax reform to result in real economic growth and to improve the competitiveness of American businesses, it needs to be comprehensive, focusing on both the corporate and individual tax codes.

Now these are just some of the concerns that I have with the budget that was released yesterday. In addition, there remain many unspecified details in the President's budget, which I hope we can begin to clarify at today's hearing with you, Secretary Lew. I look forward to the Secretary's testimony.

Once again, I want to thank you, Mr. Chairman, for holding today's hearing.

The CHAIRMAN. Thank you, Senator.

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

The CHAIRMAN. Mr. Lew, we appreciate very much you taking the time to come explain the President's budget. You know our regular practice. Your statement will be included in the record. Just speak for however long you want to just explain the budget.

STATEMENT OF HON. JACOB J. LEW, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary LEW. Thank you very much, Chairman Baucus, Ranking Member Hatch, and members of the committee. I appreciate this opportunity to testify on the President's budget.

Our economy is much stronger today than it was 4 years ago, but we must continue to pursue policies that help create jobs and economic growth. Since 2009, the economy has expanded for 14 consecutive quarters. Private employers have added nearly 6.5 million jobs over the past 37 months, and the housing market has improved. Consumer spending and business investment have been

solid and exports have expanded, but very tough challenges remain.

While we have removed much of the wreckage of the worst economic crisis since the Great Depression, the damage left in its wake is not fully repaired. Families across the country are still struggling, unemployment remains high, and economic growth needs to be faster. While we have made substantial 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 headwinds, including harsh, indiscriminate spending cuts from the sequester that will be a drag on our economy in the months ahead if they are not replaced with more sensible deficit reduction policies.

This is my first opportunity to appear before you as Treasury Secretary and to discuss from this vantage point how we need to confront these difficult challenges, but it is far from the first budget I have worked on. In my experience, a good budget offers practical solutions to the problems of its time.

The President's budget does that by making the investments that will drive a growing economy and by reining in our deficits responsibly so we can replace the across-the-board cuts from sequestration immediately and restore fiscal stability over time.

A good budget must also be grounded in reality, and this budget deals squarely with the world as it is now and as it will be in the future. It reflects the need for compromise to find a path that can command bipartisan support, and it recognizes issues of major consequence, like the fact that our demographics are shifting with the retirement of the baby boom and the number of retirees is growing; like the fact that millions of Americans are living in poverty today; like the fact that wages and incomes for middle-class Americans have not improved for more than a decade; and that, despite the significant strides achieved through the Affordable Care Act, health spending remains a key driver of long-term deficits.

This budget is animated by the simple notion that we can, and must, do two things at once: 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 long-standing approach to fiscal policy. When you compare the trajectory of our economic recovery with those of other developed economies in recent years, it is clear why the President remains so committed to this path.

I just returned from meetings in Europe, and it is clear that, in countries where austerity measures were implemented too quickly, those economies have stumbled. Ours is a different story. Notwithstanding the need to do more, our economy continues to expand with the support of growth-oriented policies even as we make meaningful progress to reduce our deficit.

It is important to bear in mind how meaningful that progress has been. In the last few years, the President and Congress have come together to hammer out historic agreements that substantially cut spending and modestly raise revenue.

When you combine these changes with the savings from interest, we have locked in more than $2.5 trillion in deficit reductions over the next 10 years. Today we are putting forward policies that will lower the budget deficit to below 2 percent of GDP and bring down

the national debt relative to the size of the economy over the next 10 years.

We restore the Nation's long-term fiscal health by cutting spending and closing tax loopholes, taking a fair and balanced approach. The budget achieves this balanced approach through very specific steps, such as reforming agriculture subsidies and eliminating tax preferences for companies that move operations and jobs overseas.

At the same time, the budget incorporates all elements of the administration's offer to Speaker Boehner last December, demonstrating the President's readiness to stay at the table, make very difficult choices, and find common ground.

Consistent with that offer, the budget includes things the President would normally not 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 the fiscal uncertainty that is a drag on 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 I know the significance of balancing the budget, and I will never take a back seat when it comes to fiscal responsibility.

Under President Clinton, I helped negotiate the ground-breaking agreement with Congress to balance the budget. As Budget Director, I oversaw three budget surpluses in a row and worked with many on the left and right on a plan to pay off our debt.

It will come as no surprise that I was profoundly disappointed to see those surpluses squandered, but that does not mean we should make deficit reduction our one and only priority, not when our world demands that we both confront our fiscal challenges and make targeted investments to propel broad-based growth.

So, in addition to ensuring that we have 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 have not added one dime to the deficit.

As the President explained in the 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, making sure American workers have the skills needed to do those jobs, and making sure hard work amounts to a decent living.

To generate more jobs in the United States, we focus on growing our economy by making it more competitive. The budget launches advanced manufacturing hubs around the country, invests in research and technology, and cuts red tape to expand domestic energy production, including clean energy and natural gas.

It also puts people to work right away repairing our deteriorating roads, railways, bridges, and airports so our economy can compete in the future. We have made considerable headway over the last few years to improve education and worker training, and we can go even further by helping students acquire the skills that today's economy demands.

That means joining with States to give every child a solid preschool education; that means reconfiguring high schools so students can get the high-tech, high-wage skills that businesses need; and it means making college more affordable.

Finally, the budget would help lift communities hit the worst by the recession, and it would adjust the minimum wage so that full-time workers are not stuck in poverty. The proposal I just outlined is part of the President's framework for growing our economy and cutting our deficits.

As this budget shows, we do not have to choose between the two, and we must not. We can adopt a powerful jobs and growth plan even as we embrace tough reforms to stabilize our finances. This is the way a budget will help make our economy stronger and help jobs now and in the future.

Before I close, I want to say that the debate that we are engaged in is very important. It is part of a complex sorting-out process that will determine our Nation's future. But everyone on this committee knows that the path before us is going to be a struggle. It will require difficult decisions that will directly affect the daily lives of millions of Americans—entrepreneurs and immigrants, soldiers and veterans, the young and the elderly, the working poor and the very well-off—and it really matters that we get it right.

With that in mind, I come here today optimistic about what we can accomplish. I believe we can find common ground to put a stop to the unnecessary stand-offs and manufactured crises, that we can come together to forge an agreement to right our fiscal ship, and that we can make the compromises that are necessary to meet our obligations to future generations.

I thank you for the opportunity to appear today, and I look forward to answering your questions.

The CHAIRMAN. Thank you, Mr. Secretary.

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

The CHAIRMAN. I wonder if you could explain how your chained CPI works, the proposal. As I understand it, it is about a 0.3-percent reduction in cost-of-living increases beginning in 2015, then there are other provisions for those over age 75, which I cannot quite comprehend. But if you could explain, what is it?

Let us take someone in Butte, MT who is 65, or let us say 67 years old. What reduction in benefits will she receive beginning in 2015? What dollar reduction will she receive? I suppose it is compounded too, so over time, when she gets a little older—I do not know what happens, going through the age-75 window, then out of the window, and so forth.

But explain what it is, please, and how much of a reduction will this lady in Butte, MT expect to see in her Social Security paycheck? I raise it also in the context of, I am a little concerned that

this is—I do not know. You could answer the question. Chained CPI is being used partially to reduce the debt.

My view very strongly is that Social Security should be handled outside of debt and deficit reduction. Second, I do not know why—and I do not see it in this proposal—you do not increase the cap on earnings to a higher rate. To me that is a lot more fair, how to find more revenue for the Social Security trust fund, than it is to reduce the benefits that this lady in Butte, MT is going to get in 2015. Explain the proposal, please.

Secretary LEW. Well, Mr. Chairman, I guess I would like to begin by saying the President has made clear that, while he has put chained CPI in his budget and it is something he did propose in December to Speaker Boehner as part of an overall package to reach a bipartisan agreement on our long-term deficit, it is not his first choice of policy.

We have been through 2½ years of negotiations where, at every stage of the negotiations, we have heard clearly that one of the things that will have to be in any deal, we are told by Republican leaders, is chained CPI.

The President agreed to it for the reason that he wanted a deal, and because it can be justified technically. What chained CPI does is, it just changes the way we measure inflation increases. It does not actually cut anyone's benefit from what it is today. It changes the measure by which inflation increases will be calculated in the future.

The CHAIRMAN. It will be cut more than it otherwise would be.

Secretary LEW. The changes with inflation increases will be in the future.

The CHAIRMAN. But she will receive less than she otherwise would receive.

Secretary LEW. Yes. And the principle behind chained CPI is that, as prices for one kind of good or service go up, people choose what to buy. So, if you are buying apples, oranges, and bananas, and the price changes, you will change the mix of apples, oranges, and bananas.

Most economists believe that chained CPI actually reflects more accurately what is the inflation rate, but I am not going to disagree that it is a lower adjustment than the adjustment that would be in place if we did not make the change.

That is a real impact, and it is something that we should only do if it is part of a broad plan where there is shared sacrifice and everyone is doing their part. The President has made clear that he is not going to accept a deficit-reduction package that disproportionately puts the burden on that retiree.

The CHAIRMAN. Why not increase the wage cap?

Secretary LEW. I think if we were to propose increasing the wage cap, I do not think it would probably meet the same definition of looking for that middle ground where the parties could agree. It is something that has been discussed in Social Security reform.

Were we discussing Social Security reform, I would agree with you that it is something that should be looked at, but I think in the context of trying to reach a bipartisan agreement to get our fiscal house in order, we have heard loud and clear that there are

one, two, or three critical issues that would have to be in, and we have been told by leaders on the other side that this is one.

It is something that we can justify, so I am not walking away from the proposal. I can defend it as being a more accurate measure of inflation, but it does put a burden on anyone who would receive benefits.

Now, we do have a provision in our proposal—and we would only accept chained CPI if a provision of this sort were included—that for those who are most on the margin, that there be some adjustment in their benefit so that, if you are on a very minimal disability benefit, if you are very old, in a category of retirees who are most vulnerable, that there would be an adjustment in your benefit.

Some of the savings that we would get from switching to chained CPI would go towards making those adjustments. We think that is critical and the only fair thing to do. This effort to reach a bipartisan agreement on putting our fiscal house in order is something that is going to require sacrifice from all.

It is one of the reasons we believe so strongly that revenues have to be part of the package. I do not think you can ask a retiree to pay that burden if you are not asking those who have the highest incomes to take some reduction in the benefits they get from their deductions in the tax code, which is where tax reform and raising revenue through tax reform comes in.

The CHAIRMAN. My time is expired.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Mr. Secretary, I am sorry. It does not appear to me that this budget does much as far as addressing the runaway, out-of-control, unsustainable entitlement spending. The budget does take one small step forward by proposing a switch to the chained CPI for indexing Federal programs, though it allows for carve-outs even on that provision, as you have mentioned.

The budget proposes to curtail spending on Social Security, Medicare, and Medicaid by only $413 billion over 10 years relative to the President's adjusted baseline, which amounts to only a 1.8-percent, as I view it, reduction in an entitlement spending base of $22.4 trillion over the next 10 years.

Now that, in my opinion, is nowhere close to being what is needed. The budget includes nothing resembling structural changes to entitlements, by which I mean changes in eligibility requirements and fundamental reforms such as the Medicare and Medicaid reforms I proposed, which I shared with the President just last month. I gave five major approaches there.

Now, Mr. Secretary, what further changes to entitlements, including changes in eligibility requirements and other structural changes, is the administration willing to consider in order to help ensure that Medicare and Social Security will be around for future generations, or is the administration content with the small steps taken in this budget? I do not think we can keep playing with this. I think we have to attack these problems, and we cannot just continue to go down the road and ignore them, at least in my opinion.

Secretary LEW. Senator, I think I would have a different characterization of the proposal. I do not think they are small steps. I

think $400 billion of savings in Medicare over 10 years is more than the savings over 10 years in the House Republican budget. It is the largest Medicare savings, I believe, that has been proposed in the context of a budget. These are very serious steps.

In Medicare, we have essentially proposed means-testing the program through an income-related premium that says that, if you can afford to, you are going to pay for Medicare when you retire. That is a structural change.

When I met with leaders over the last 3 years and they named three structural changes we needed to do, one of them was chained CPI, a second was means-testing Medicare. The President has included two of those in this budget, and that is an enormous amount of movement. I think that to treat this as a small step is actually something that would jeopardize our ability to find an agreement in the reasonable middle.

Senator HATCH. I am not saying it is a bad step, but it does not put us down the road as far as handling these problems. Like I say, there is no way of balancing the budget ever under the President's program. That may be a little unfair, since it is only covering so many years. I do not mean it to be unfair.

But I am very concerned about it, because I hear every day that the Social Security disability program is going to be bankrupt in 2016 and that people are over-utilizing the program, people are in some ways defrauding the government: unwilling to work, unwilling to carry their load. I mean, there are a lot of things that I think we have to get under control or there will not be money there for anybody.

Secretary LEW. Well, Senator, I actually think we make important steps in this budget. We do not represent that this budget is the long-term Social Security plan. The President has said for a number of years that we need to engage in long-term Social Security reform. I would personally make the argument, based on the experience we have had over the last 30 years, that for us to reach a bipartisan agreement on Social Security reform, it would be a lot better if it was not in the context of a deficit-reduction bill. We would have an easier——

The CHAIRMAN. Then why are you doing that here?

Secretary LEW. Well, we are not, actually, Mr. Chairman. What we are doing is, we are including one provision that has broad effect across the government, is a technical change which has an effect—I am not challenging that it has an effect that will mean smaller increases—but it also will affect the indexing brackets for the tax code. It is a more general policy. We have not put it forward as a Social Security reform solution. It will have some benefits to the Social Security trust fund, a not insignificant benefit, and that is a good thing, and that stays within the trust fund.

The CHAIRMAN. I took some of Senator Hatch's time. Go ahead, Senator. Go ahead.

Secretary LEW. Senator Hatch, if I could just respond to the question of, is it big enough and does it accomplish enough——

Senator HATCH. Sure.

Secretary LEW. This budget would bring down the deficit as a percentage of GDP to under 2 percent in the 10th year. That will mean we would have gone from a double-digit, over 10 percent of

the GDP deficit, to under 2 percent. That is an enormous change over a relatively short period of time. We have never said that this does all the work for all time.

If you look at the 1980s and the 1990s, it took many attempts, and many successful attempts, to actually get to the point of balancing the budget. I think this budget does an enormous amount of good. If we could agree on this, it would be the right thing for the country for growth and for fiscal policy.

Senator HATCH. Well, I have to tell you, I disagree with you on that. I think we could solve Social Security just by getting together and resolving the problems and making some tweaks that mean Social Security will be there for our kids and our grandkids, and in Elaine's and my case, even great-grandkids.

So I am very concerned about the continued tendency we have of just kicking the can down the road and not really facing these problems like we should face them. Look, I am counting on you to face them.

I know that you are only one person in the administration, but nevertheless you are a lead person when it comes to these issues, and I hope that we can get you to do a better job in what we can do over the next 10 years in getting spending under control and also saving these programs that really are important but are not going to be there if we keep going the way we are going—or at least they are not going to be there to the extent that they are now.

The CHAIRMAN. Yes.

Senator Stabenow?

Senator STABENOW. Thank you very much, Mr. Chairman.

Welcome again to the committee. It is always good to see you. Obviously, with any budget, there are things that we look at that we agree with and things that we disagree with. Let me just start big-picture and thank you and the President for giving us a balanced approach. We have all been aiming for at least a $4-trillion deficit-reduction plan to be able to turn the corner on the huge debt that we have.

Of course, we have already put in place $2.5 trillion of that, so now the question is, how do we do the rest of it in a way that actually grows the economy and is fair to middle-class families and does not just put the burden on seniors or families and so on, as I believe much of the $2.5 trillion in cuts already has done?

I want to first also say that I appreciate very much your focus on veterans and what is a completely, totally unacceptable backlog at the VA. I share the chairman's comments on that and urge you to be moving as fast as possible there.

I share the concerns about chained CPI and believe that, while we need to—and can—address long-term what needs to be done to strengthen Social Security with incremental change, it should not start by cutting benefits. There are other options for us that I think are much more fair, and I would hope that we would be doing those.

I also want to just stress my support for what you have done in terms of focusing on jobs. I do not think we will ever get out of debt with over 11 million people out of work, so we need to focus on jobs. I do not think we have a strong economy unless we make things and grow things, fundamentally.

So I want, as chair of the Agriculture Committee, with that hat on, just to indicate that I am supportive of what you have done in terms of limiting the direct payment subsidies, but I am very concerned about the cuts in conservation in this budget, as well as in crop insurance, so that is something that this Senate is taking a different approach on.

But let me ask you a question related to making things and how we incentivize things. We talked this morning in our discussions on tax reform about section 199. I noticed that, in the framework for business tax reform, the President proposes to strengthen section 199 deductions and target them more towards manufacturing and establish an even stronger incentive for advanced manufacturing.

Of course, everyone looks at me and sees automobiles, and I stress with colleagues that there is much more about manufacturing, from bio-medicine, bio-tech, clean energy, and so on. But I wonder if you might discuss more your vision as it relates to this very important section of the tax code.

Secretary LEW. Senator, as we look to the economy of the future, we have to focus on advanced manufacturing. Even in the auto industry, as you know better than anyone else, one of the reasons we are going to be competitive in the future is that we are developing the technology of the future where we can have more fuel-efficient cars, and that is driven by advanced manufacturing.

So we have tried to gear our budget towards the kinds of incentives that would help create a strong economy today with growing jobs today. That is why we have the provisions that we do on infrastructure, for example. We need the jobs to build the infrastructure. We also need the roads, the bridges, the ports, and the airports, because, when we manufacture things, we have to be able to ship them.

As we look down the road, research and development and advanced manufacturing kind of go together. The United States has stayed at the cutting edge because we stayed at the cutting edge of knowledge. We are still at the cutting edge of knowledge. We have tried to bring our tax policy and our research and development policy in alignment so that we are encouraging the kinds of manufacturing to take place to take advantage of the knowledge we are creating in research and development.

Senator STABENOW. Thank you.

Then, just finally, I would say I was very pleased—as we look again at tax policy, at how we make sure we are doing things here at home and supporting investment at home—that a bill of mine that we have debated was passed here. It is called the Bring Jobs Home Act, and it stops incentives like allowing the write-off for closing up a plant, moving expenses, and so on, to send jobs overseas. I was pleased to see the President has a similar proposal in his budget and would ask that we continue, that you continue, to really focus on how we incentivize actually making things in America.

Secretary LEW. I think, as you know, we think we have to do two things. We have to make it less attractive to move jobs overseas with provisions like that, and we have to make it more attractive to invest in the United States. We need to do that through specific incentives and through business tax reform where we lower our

rates and have our statutory rate be more competitive with other countries. So we view these provisions as being very much interconnected.

Senator STABENOW. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cornyn?

Senator CORNYN. Thank you, Mr. Chairman.

Mr. Secretary, I want to start off by asking—with all due respect, the President's budget was released more than 2 months after the statutory deadline when it was due. The Senate has moved forward, under Chairman Murray and Ranking Member Sessions, and passed a budget; the House has passed a budget. Then here comes, 2 months after the statutory deadline, the White House's budget proposal. How are we supposed to take this seriously?

Secretary LEW. Senator, I think we would all agree we have a lot of work ahead of us for there to be an agreement where the House and the Senate come together. We very much want that budget conference to be successful.

We have done everything we can to create the kinds of positive signals, and not just signals, but taking considerable political risk putting things that are very big concessions on the part of the President out there to try to drive the process forward.

I think, if we are going to reach an agreement, it is going to be both sides moving off of things that are dear to them and making decisions that are hard. We have just spent a fair amount of time talking about chained CPI. That is a very hard thing for the President to put on the table. I hope that there is a response that——

Senator CORNYN. With all due respect, that is not hard for the President. He does not have to stand for election again. He recognizes that that is one of the elements of restoring Medicare and Social Security to sustainability. Right now they are on a path toward insolvency.

Secretary LEW. Senator, I think the chairman's questions indicate that it is very hard. It is very hard for an awful lot of Senators and members, it is very hard for people who are going to see their increases smaller. I am not saying we do not support doing it. It is in the President's budget, and we support it.

But I think treating it as if it is easy actually makes it harder to reach an agreement, because we are doing something hard, and we know that revenues are going to be hard for you. A balanced package is going to have to include both.

Senator CORNYN. Well, you talk about balance. The fact is, this budget proposal never balances. Is that not correct?

Secretary LEW. Our goal in this 10-year window was not to reach balance.

Senator CORNYN. Is that not correct?

Secretary LEW. I am not going to look at the far out-years. This is a 10-year budget.

Senator CORNYN. No, I am talking about a 10-year budget proposal which never balances.

Secretary LEW. No. I am saying, in the 10 years, it does not balance, but it reduces the deficit to under 2 percent of GDP. I think the programs that I have seen proposed that would reach balance within the 10-year window do much harm. We could have a debate

about the policies that are in them, but the goal here would be to restore stability to the U.S. fiscal policy and put us on much stronger footing.

Senator CORNYN. Do you agree that the growing Federal debt is a threat to economic growth and private sector job creation?

Secretary LEW. I think that, as this budget indicates, we think we have to stabilize the deficit and the debt as a percentage of GDP and——

Senator CORNYN. Secretary Lew, with all due respect, you are not answering my question. I asked you, do you think that growing the Federal debt has a negative impact on economic growth and thus stymies job creation?

Secretary LEW. Senator, I am answering the question. I think the question is, as a percentage of GDP, is our deficit and our debt something that is compatible with economic growth? I think our budget proposes a path that is.

Senator CORNYN. Well, is it not true that the gross Federal debt grows by $8.2 trillion, to $25.4 trillion, by the end of this budget in 2023?

Secretary LEW. Senator, gross of the Federal debt is a measure that is not what is typically used to measure exposure of a government. It is debt held by the public that is the measure that is typically looked at, both in the United States and internationally. We are stabilizing the debt held by the public and bringing it to a level that is consistent with international standards.

Senator CORNYN. Well, the question I have is, does this budget not grow the Federal debt by some $8 trillion over the 10-year window?

Secretary LEW. The budget actually reduces—the baseline grows quite rapidly. The budget reduces the growth.

Senator CORNYN. No, I am talking about the debt. I am not talking about the annual deficit. Is it not true that the gross Federal debt under this budget grows by $8.2 trillion over 10 years?

Secretary LEW. If there were no budget, the gross Federal debt would grow just because of the ongoing service of the debt and other issues. So the question is, are we improving things compared to the baseline? The answer is, we are improving it, and we are doing it in a way that is consistent with growth and creating jobs.

Senator CORNYN. Well, let me ask you about—Carmen Reinhart and Kenneth Rogoff have written a book covering 700 years, if I am not mistaken, of fiscal crises and looked at the impact of large debt on economic growth. They have opined that a debt that exceeds 90 percent of the Gross Domestic Product reduces economic growth by about 1 percent.

Currently, our gross debt is 106 percent of GDP and, under the President's proposal, gross debt would reach 97 percent of GDP in 2023. Do you not agree that this large Federal debt has a negative impact on economic growth and the kind of unemployment problems that the chairman talked about in his questions?

Secretary LEW. Senator, I think it is important that we accomplish the deficit reduction and the reductions in the rate of growth of debt that are proposed in this budget, because I think, unattended to, the trend up is dangerous. I think that we do reach a level here that is sustainable and that most economists agree is

sustainable because the economy is growing fast enough to sustain it. We have never said that this does all the work for all time.

The President has said, if we could do this, we would have righted the ship, and then we go on. If you look at the 1980s and 1990s, it took many, many pieces of legislation to get the job done. This would be an enormous accomplishment, and it would be consistent with good growth and job creation.

Senator CORNYN. Are you pleased with the 0.6-percent increase in the Gross Domestic Product that our economy saw in the last quarter?

Secretary LEW. I think that, if you look over the last 14 quarters, our economy has been growing in the 2.5-percent range, and we are doing better than most other developed countries. But we say flat-out, it is not good enough; we need to do better. One of the reasons I think it is so important to replace the sequester with sensible policies is that the sequester is going to cost half a percent of GDP growth, and I do not know how anyone could support that.

The CHAIRMAN. Thank you, Senator.

Senator Carper?

Senator CARPER. Thank you, Mr. Chairman.

Before me I have three cups or glasses. This is a glass of water, this is a glass of water over here, and this is an almost empty cup of coffee. I have said to the President any number of times since the Deficit Commission completed its work, oh, gosh, over 2 years ago, "Mr. President, if we believe that a comprehensive, broad-based deficit-reduction plan similar to what the Deficit Commission recommended, 11 out of 18 recommended this is where we want to go, why do you want to start off over here in terms of offering deficit reduction plans?" He said, "Well, this is the way it works. The Republicans are over here; if we want to end up here, we do not start off right here." He said, "What we have done is start off over here."

I have said to the President, "Mr. President, you have to lead. You have to show a willingness to lead on this." You have to come to the table and say, it is not just enough revenues. We know we need more revenues. We need to find ways to save money in entitlement programs and save the programs for future generations and save some money and not savage older people, and we need to change the culture in our government to, how do we get better results for everything that we do?

I think the President, and I would just say this to my Republican colleague—he is not here anymore. His proposal is not over here anymore. It ain't here, but he has come a long ways. Some might think, well, he has done relatively little; we have chained CPI and a couple of other things.

Actually, people in my caucus, they think he has gone maybe too far. I think he is on the right track. I want to applaud what he has done, and none of us has had a chance to study every bit of his proposal, but I think he is on the right track. I want you to take him a message and say—in the Navy we used to say, when people did a particularly good job, Bravo Zulu. But that is the message: Bravo Zulu.

Let me just say, some of my colleagues will remember when—oh gosh, it was a couple of months ago—Ben Bernanke, Chairman of

the Federal Reserve, came and met with us in private. During the course of that meeting, he said, "If we are really interested in growing the economy, what we need to do is demonstrate that we can govern. We—and that includes the executive branch—need to demonstrate that we can be fiscally responsible, and we need to demonstrate that we can provide some certainty with respect to the tax code."

If we want to grow the economy, that is what we need to do, and certainly we need to pull back the reins on spending. But he said we need to continue to make investments, smart investments in the workforce, especially the STEM skills—Science, Technology, Engineering, Math—and number two, infrastructure, broadly defined—not just transportation, but broadly defined.

The third thing he said we need to do is to incentivize the investments in research and development and products and technologies that can be commercialized to create products and services we can sell all over the world. Those are things that he said we want to do.

I think if we really look at what the President has proposed, it is consistent with the values and the recommendations that have been suggested to us by, not a Democrat, not a Republican, but by a guy who is pretty smart and who has thought a lot about these issues.

I want to ask you, if I can, we had some discussion earlier today, all of us Democrats, Republicans on this committee, and we talked about the research and development tax credit. It is stop and go. It is stop and go. Instead of being permanent, we let it run for a while, and then it stops. Then it dies for 6 months, and then we crank it up again.

What Senator Portman and I are working on is a proposal that simplifies it, that makes it permanent, and tries to find a way to maybe extend it to help small start-up companies, more innovative companies, if we can, in the first place. Give us a little advice on that. What does the administration think with respect to the R&D tax credit, and are we maybe on the right track or not?

Secretary LEW. Senator, first, thank you for the kind words about the budget. I will take them back to the President. We agree on research and experimentation, that having there be certainty that it is going to be there is a good thing. There are only a few tax credits we have put in and made the proposal to make permanent, and it is one.

The challenge in tax reform will be to go through all of the different provisions in the tax code that affect business decisions and reach the agreement of what we can and cannot afford to do. I, for one, think it would be a better decision to decide what you are going to do, make what you do permanent, and not have these constant debates over expiring provisions.

Having been in the business world, I know how confusing it is when you do not know, towards the end of the year, whether a provision will be the same or different in just a few months' time. When you are in a business where placing something in service by a certain date is a key issue, it is a gamble whether or not you will qualify, and it changes the economics.

So, in tax reform, some things will have to go. There is not going to be room for everything. But I, for one, believe it is better policy to make permanent policy and then revisit the tax code from time to time than to have lots of stop-and-go decisions.

Senator CARPER. Good. Thanks.

If I could just add one last, quick thing. One of my disappointments in the President's budget proposal was his approach on tax credits for electricity developed by wind. It calls for just relying on the production tax credit. If we ever want to harness the wind off of our shores, it has to be through an investment tax credit.

With the production tax credit, we will not have one windmill farm off the east coast of our country. I would just lay that at your feet. Olympia Snowe and I have offered legislation to pass this. Let us say the first 3,000 megawatts or 2,000 megawatts of electricity generated would be eligible for a 30-percent investment tax credit. Unless we take an approach like that, we are never going to see offshore wind, at least not in our life.

Secretary LEW. I think, Senator, you know that development of renewable resources is very important. We have tried to put in the budget a combination of policies to create incentives for new technologies; obviously, the trade-offs of what you can afford and the boundaries of the fiscal plan are limited. But we look forward to working with you and other members on this issue.

Senator CARPER. You bet. Thanks so much. Thanks for coming; thanks for your hard work. Bravo Zulu.

Senator HATCH [presiding]. Thank you.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman.

Mr. Lew, welcome back to the committee. Thank you for your service.

I want to ask a question about something that was included in the budget that appears to re-litigate something that was just settled in the fiscal cliff deal, and that is the estate tax rules. Those were made permanent. Those were provisions that were enacted. It was a bipartisan bill, as you know, a big vote. Nothing else in that particular piece of legislation was re-litigated, but we did re-litigate the estate tax.

I guess I am curious as to why the administration felt it necessary to go back to the 2009 parameters when it comes to that, which would lower the exclusion amount from $5 million to $3.5 million, and second, would raise the tax rate. I am wondering if you are aware what that means, that you would have roughly triple the number of farms subject to the estate tax and more than double the number of small businesses subject to the estate tax in doing that.

By the way, there was a vote on the budget 2 weeks ago here in the Senate, and it got 80 Senate votes, Republican and Democratic, basically stating that the estate tax should either be repealed or reduced. So I guess my question is, why are we relitigating this after we just made it permanent when it has this kind of an impact on the very people whom we want to see creating jobs?

Secretary LEW. Senator, the estate tax is an issue that has been debated for many years, and it has been adjusted on many occa-

sions. The provision that was in the bill is one that was no secret. We agreed to it as part of an agreement, but we did not think it was very good policy, so it is not a surprise that we think the old rates and thresholds are better policy.

We also did not think that it was right to propose a change immediately. A number of provisions are going to be revisited in 5 years, and we thought revisiting the estate tax in 5 years was appropriate. I do not think any of the things we do are permanent in the sense that future tax reform, future tax bills, cannot reconsider them, but every year you should not be reopening things. So we did not propose anything sudden. There is going to be a debate over tax reform.

We think that, in the context of all the puts and takes and the hard trade-offs, that the estate tax should be part of that. I do not think we agree on the impact on small farms and small businesses, but I would look forward to working with you on that. We certainly do not mean to be creating burdens for small businesses and small farms.

I think that it is also not the only issue. We thought the refundable credits should have been dealt with on the same basis as the estate tax, and it was done for 5 years. So our policy preference, if we were able to just enact a bill on our own, would be for the refundable credits to be permanent and to have a permanent treatment of the estate tax at the levels we have proposed.

We understand it is going to take an ongoing discussion, but we think it is entirely consistent with where our view was at the end of last year and have tried very hard not to make it any kind of a sudden reversal.

Senator THUNE. Well, we can debate the impacts, but, if you look at what land values have done in places like the Midwest, you have a lot of people who are land-rich and cash-poor who would be harmed if we went back. That is why I think it was extended.

This is what we agreed to in the 2010 amendments, and then agreed to extend. I thought we had sort of settled that issue. So I think it is unfortunate that we are trying to come back and review this in light of the impacts that it would have on small businesses and farm and ranch families.

One other question I wanted to ask you has to do with—there were a number of things in the budget. In fact, there were some tax expenditures that were expanded. I do not have the specifics in front of me, but I am told it is about $100 billion. There are specific areas in which there are taxes raised to fund specific things.

The whole idea of tax reform, in many of our minds at least, was to get away from that in the tax code, to get the rates down—broad-based tax rate reform, lowering rates—and allow the market more to decide many of those things. It seems like what you are doing in the budget is heading in the opposite direction, rather than looking at greater simplification and fewer of these special provisions in the code that are favorable to a specific industry.

Instead we have really been talking about—most of us have, at least, I think—getting away from a lot of that and really going to where we have rates reduced, which I think would benefit all the actors out there in the economy in a way that I think would create jobs and generate economic growth. So tell me a little bit why we

are kind of going backwards, in my view, in terms of that approach.

Secretary LEW. Senator, I guess I would describe it as more of a transition issue. I think we agree on where we want to get to. We want to get to a tax reform discussion where we broaden the base by eliminating lots of special deductions and credits and lowering the rates to improve the competitiveness of U.S. businesses so we create growth and more jobs. So I think we agree on that.

At the same time, in a world before tax reform, anything we do, we have to pay for. So I do not think we can say we are accomplishing deficit reduction and then propose things that we say we will pay for later out of tax reform.

So, if we go through this process, and we get to the point where we have a fiscal agreement where we agree on the amount of revenue we are going to raise in tax reform—we do business tax reform and individual tax reform—these issues will get resolved in a way that, in the future, everything would have to be pay-go, in our view.

Until then, we did think it was important to extend the research and experimentation credit, and we thought we had to pay for it. So I would describe it more as a transition issue than as going backwards. If we had not put pay-fors in our budget and we had expansions of either tax or spending programs, then we could not say we were hitting our fiscal targets.

So we are trying to accomplish two goals. Our driving concern is growth in job creation. We feel we need to get the deficit and the debt to a controllable point. We have, I think, accomplished both of those goals in the frame of our budget and would look forward to working on a bipartisan basis to getting agreement so we could move forward.

Senator THUNE. Mr. Chairman, one quick question. Macroeconomic scoring. Rob Portman offered an amendment to the Senate budget that was approved. Obviously, the budget is probably not going to end up going anywhere, but your thought on whether or not that might not be a good way of looking at many of these policy decisions and the behavioral impacts and what they would do to revenues. "Yes" or "no" on macroeconomics?

Secretary LEW. Well, if you will permit me, it is a little more complicated than "yes" or "no." Senator, we have discussed this; Senator Portman and I have discussed this. I think that there is a big difference between asking, should we look at an estimate and, should we score bills according to that estimate?

As I understand the vote that took place in the Senate, it was that there should be scoring, what we call dynamic scoring. I think it is a very different proposition to scoring a tax bill that way, and our view is we should use traditional scoring for legislation.

Senator THUNE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman.

Secretary Lew, thank you very much for being here and for what you are doing. So let me first start off by saying something nice. I think the budget that you have presented is balanced in that you look at ways in which we can manage our deficit and get it to a

responsible level, and you get savings in every area, including in our tax expenditures, which I think is critically important, and I applaud you for putting that into your budget.

I also want to compliment you on the growth initiatives. The only way that we are going to be able to get our economy growing and be able to get our budget into a proper, manageable deficit is by creating more jobs. I thank you for what you did in your budget on the ITC, on American opportunity tax credits, what you have done on infrastructure financing.

I think all those are extremely important provisions that we need to get done and would help greatly to create the jobs that we need in our economy. So, I thank you for those provisions that you have included in your budget.

I have some concerns, putting it mildly. The way that you treated our Federal workforce, I find just wrong. We have had conversations about this in the past. I am deeply disappointed. We have gone through this many times in the last year or so, and I thought we had reached some understandings on Federal retirement contributions and issues like that, but once again you have raised the issue that is going to cause some real heartburn, I must tell you, among those of us who very much recognize how our Federal workforce has already sacrificed, has gone through 2 years of pay freezes, and now you are expecting more. I find that disappointing.

I want to talk about what you are doing on retirement savings in your proposal, because there are two provisions here that, working together, I think could cause some significant concern. I understand your proposal on the 28-percent limitation, and it is a generic way to deal with a problem dealing with higher-income taxpayers, and that certainly has merit.

But, when you couple that with some of the other provisions you have, it seems to me that you are going to make it more difficult for people to put money away for retirement. The specific provision I would hope you would comment about is, I have read your proposal dealing with the maximum annuity permitted from a tax-qualified defined benefit plan, basically allowing a benefit of $205,000, and then it goes into a lot of conditions there.

Then, once you reach that limit, you cannot make any further contributions unless, of course, the performance in the market is less than what you need in order to be able to pay for that amount, and then you can make a certain amount of contribution up to a certain other limit, and then you cannot make it again, and it goes on and on.

My point is, we already have too much complexity in the laws. This is another major complexity that you are adding. When businesses are trying to decide whether they are going to have a plan or not, the number-one thing I hear the most of is the complexity issues and falling into traps, and is it really worthwhile for us to do this or not?

So it seems to me that this proposal, coupled with the limit, is going to mean less people are going to put money away for retirement rather than more, putting more pressure on government programs. In this country, in the best of times, people do not put enough money away for savings and for retirement savings.

So where is the sensitivity of the administration to try to help people save more?

Secretary LEW. Senator, I know this is an area that you have worked on for many years, and I applaud your work in this area. I think we very much share the goal of encouraging retirement savings. That is why we continue to have the auto-IRA proposal.

Senator CARDIN. But in the auto-IRA, the one thing that we found out is that, for lower wage workers and younger workers, the tax incentive, in and of itself, is not enough to get them to put money into a retirement plan. You need an employer's contribution and a saver's credit. If they do not qualify for a saver's credit and you do not have an employer-sponsored plan, I do not think the IRA will substitute for an employer-provided incentive to save.

Secretary LEW. But there has been a fair amount of research done that suggests that just this change from opting in to opting out will make a big difference in participation rates, and that would be very important.

On the question of the $3-million limit, there are tough choices in this budget. We look at a retirement landscape where the average American family has more like $50,000 than $3 million saved for their retirement. Our goal is to bring up the number of people who are taking care and take the pressure off of Federal programs. It is getting more people to go from 50 to 100 than getting more people up to 50.

At $3 million in an IRA, that is a very, very rarified level of savings. We are not saying people cannot contribute, we are just saying that the tax benefits are not going to be the same. So you can still contribute, you just cannot contribute with before-tax dollars.

Senator CARDIN. I just will leave you with this point. We will get back to this debate. The complexity that you add, when individuals make the decisions whether to sponsor plans or not, all this just adds to a decision made by a small company particularly, that it does not pay for them to get into the field; therefore, none of their employees get the help.

Secretary LEW. Well, I would look forward to working with you. That is certainly not the intention of the provision, and we would look forward to working on something that has the right effect and fits within the budget framework.

The CHAIRMAN. Thank you, Senator.

Senator Bennet?

Senator BENNET. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for your testimony. Could you give us a little bit of a window into the next 10 years, that is, the second 10 years, and what the effect of these proposals looks like in those out-years?

Secretary LEW. Well, obviously provisions liked chained CPI and the Medicare means-testing through the income-tested premium have growing effects in the out-years, just because the base grows and more people come in. I do not have the numbers in front of me in terms of the second 10-year impacts overall.

This is a budget that would put us, at the threshold of those next 10 years, in a place where the debt would be in the 70s as a percentage of GDP, mid-70s, the deficit would be under 2 percent, and,

between now and 10 years from now, we still have other work to do.

We know, on a bipartisan basis, we need to do Social Security. We need to do work to make sure Social Security is funded for 75 years. So there are other things that we will do. This is not the only piece of legislation for all time.

I would make the case that this puts us in a very strong position to then look at the solvency of Social Security without their being the complexity of it being thought of as a deficit-reduction measure, but really for the purpose of saving Social Security. I think the same about Medicare.

There are things in this budget that would bring down the costs of Medicare. There are things that are happening, some of which are scored, some of which are not, that are helping to bring down the growth of health care costs. We need to keep working on that.

Senator BENNET. What is amazing to me is that people in Colorado, I think, understand very well what you just said, and people in Washington, DC seem to have a hard time understanding it. There is a generation of people who think none of these programs is going to be there for them if we do not fix them, and they want us to fix them. I think increasingly they also would like to see a bipartisan approach to this fiscal problem that actually results in meaningful compromise, so we can get on to all the other work that we need to do.

I wonder, in that context—because you were here during the Clinton years; you have been here during other years—when you think about things like the ratio of what we are spending to our GDP, the ratio of revenue as a percentage of our GDP in historical terms, where do we find ourselves after this budget is enacted?

I think a fair standard—I mean, obviously one has to net for demographic changes and other kinds of things—but a fair standard, in my view, is, what was our parents' commitment to the next generation? What was our grandparents' commitment to the next generation? Are we living up to those commitments?

Secretary LEW. Senator, I think this budget will reduce the growth trend, but it will not take away what is one of the fundamental drivers on the spending side, which is the demographic issue. As my generation, the baby boom, approaches and passes the retirement age, there are going to be 30 million more people retired. No matter what we do on the margins, just the base of covering that population in Social Security and Medicare is something that we have seen coming for literally 50-plus years.

I think the question of what we are prepared to do in terms of spending as a percentage of GDP has to be connected to the basic core question: are we committed to Social Security and Medicare being there? Because, unless we are going to tell the baby boomers that they are not going to qualify, then there are going to be pressures driving up spending.

There is only so far you can cut discretionary spending. We have already gone pretty far, and this budget goes a little farther. Pretty soon you are not doing the things you need. You are eating your feed corn if you are not doing education, research and development, and infrastructure. So I think that these drivers of demographics are very important.

We have put in this budget important meaningful reductions, and we are open—not just open, but the President for 3 years now has been putting forth principles for Social Security reform. I have spoken in this committee and in various Senate forums that I have heard loud and clear: doing that kind of work in the context of the fiscal challenge we have is almost impossible.

So I think we need to get this work done, but I would hope there is no one in this room who does not want to be able to get to the point where we could say Social Security is sound for 75 years. We are not on the doorstep of a disaster. We have until 2037, I believe, in terms of the trust fund's solvency. But it is better to do it sooner rather than later, which is what the President has been saying for 3 years.

Senator BENNET. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Casey?

Senator CASEY. Thank you, Mr. Chairman.

Mr. Secretary, thank you for being here today, thank you for your testimony and for your public service, your continuing public service. The last time we were here, we were going through all the years you have been serving; we will not reprise that today.

I wanted to first of all commend a part of the budget proposal that deals with strategies that we know will lead to some measure of job growth, especially in the absence of a continuing reduction in the payroll tax. With that off the table and not operative, having other strategies in place like a tax credit for hiring and increasing wages, as the budget contemplates, will be helpful.

I have legislation, and have had it for a while, to do just that. So I want to commend that and maybe come back to it. But I wanted to ask you a specific question on another, but I think related, topic, and that is Trade Adjustment Assistance.

I know that in your testimony—I will just set forth this as a predicate to my question—on page 6, you say at one point, "One specific focus is modernizing, streamlining, and strengthening government delivery of job training services. The budget proposes a universal displaced worker program that will reach over 1 million workers," and it goes on from there.

The impact or the result of that proposal, of course, would be to eliminate what we know of as Trade Adjustment Assistance, which I think is a mistake. When I consider it in the context of, not just the numbers—for example, in Pennsylvania, I guess the latest number from 2010 was we had over 200 Trade Adjustment Assistance petitions and a little less than 16,000 Pennsylvania workers covered by Trade Adjustment Assistance.

The value of it—and you know this; you have worked on this—is that, when someone is in an industry and a trade, and the economic winds blow so hard and in such a devastating way that they get their feet knocked out from under them, it allows them to be retrained. It allows them to have health care costs shared so they can get over the bridge from losing a job because of unfair foreign competition to a position of getting a new job or a new career.

So I am very concerned about the proposal because of the benefits we have seen with TAA. The administration, I thought, did a

great job of enhancing Trade Adjustment Assistance, and I just wanted to have you speak to that.

Secretary LEW. Senator, I have to apologize a little bit on the detail here since, in my current role, I did not work on all the spending-side issues in detail.

Senator CASEY. All right.

Secretary LEW. As OMB Director, I did. I am going on memory here, as opposed to exactly what is in the budget.

Senator CASEY. Sure.

Secretary LEW. The intention in the proposal that we have on training is not to cut back on the availability of retraining support, but to broaden it, in a sense to give the kind of benefits that go to people who are affected by trade more broadly so that we have a stronger, more agile workforce that can be prepared for the jobs of the economy of today and tomorrow.

It is very important, as we pursue trade policies that open markets and in a sense also open our markets, that we provide the kinds of protections to workers who are adversely affected, if in fact the changing flows of trade have an impact on them.

I think that, overall, the proposals in the President's budget actually offer more, not less, protection, but I would be happy to have someone get back to you with more detail on the specific provisions that were included this year.

Senator CASEY. I appreciate that. My concern is, with this change, even though it is in the interest of consolidation and streamlining, that we would badly degrade our ability to provide that kind of assistance. But we can talk more about it.

I wanted to get back to the first question I raised about a tax credit to incentivize hiring. If you could just talk about what undergirds that policy and how important you think that is in terms of our economic growth and being able to create jobs in the near term.

Secretary LEW. Senator, we have tried, over the last number of years, to have broad incentives for hiring, incentives overall, incentives for small businesses, and this budget is really built around the core principle that what we need to do is promote growth and job creation.

We would look forward to working with you as we go forward on how to create the best incentives. Even our core principles on business tax reform are all about investing in the United States, creating jobs in the United States, and making the tax code more friendly to doing business in the United States.

Senator CASEY. Thank you, Mr. Secretary.

The CHAIRMAN. Thank you, Senator.

Senator Nelson?

Senator NELSON. Mr. Secretary, would you like some good news?

Secretary LEW. I always like good news, Senator.

Senator NELSON. Your Special IG for the spending of the TARP money on the Hardest Hit Fund has just accepted my request for an investigation on how the Hardest Hit Fund was not utilized in the State of Florida, and then how it was misused in the State of Florida by the government of the State of Florida.

Indeed, the Hardest Hit Fund was to help those people stay in their homes who had lost their jobs, and it was money out of TARP

under the theory that, if you can stay in your home, at the end of the day, it is going to be a lot better for their quality of life, a lot better for the values in the neighborhood, and it is going to cost the various levels of government a lot less to help people through this severe recession.

Well, lo and behold, the State of Florida would never spend the money. They spent only 16 percent of the money that was allocated to Florida, and in some cases, where they spent the money was, it went to n'er-do-wells who never should have gotten it in the first place.

This of course, to me, is an outrage in a State that is one of the ones, along with Nevada—my State of Florida was one of the ones hardest hit in the housing crisis, with people suffering as a result of the foreclosures, et cetera. I wanted to let you know that the Inspector General just let me know a few moments ago that they are conducting that investigation, and I think justice is being served.

Now, I want to call to your attention something that this committee is doing that I have been working on with the chairman in my capacity of leading the Aging Committee. I had hearings 2 years ago in this committee and just yesterday in Aging on the fact that people are ripping off the taxpayer by stealing identities, primarily Social Security numbers, filing tax returns, and getting tax refunds, and your people are saying that this is over $5 billion a year in lost revenues to the Federal Government.

So, it is of gargantuan proportions. I want to thank you, because you have included one part of the comprehensive approach to this problem in your budget, and that is the Death Master File. As of now, immediately upon death, Social Security publishes the Social Security numbers of the deceased. They are out there in the public domain. As a matter of fact, it is easy pickings for the crooks to take that identity. They get the identities other ways. They rob people's mailboxes and get their Social Security checks. So that is one part of it.

What I want you to do, Mr. Secretary, is to take a look at the comprehensive bill that Senator Cardin, I, and Senator Schumer have filed in approaching this issue. The chairman is having a hearing on this in the full Finance Committee on tax day in just another week, and we would welcome the administration's support on the comprehensive approach to this problem.

Secretary LEW. Senator, I would be happy to take a look at the bill, and we can get back to you on that. In terms of the problem, it is one that we share very much the concern over. Our concern is not just with the Death Master File issue that you raise, it is very much—if anything, more so—with the effect it has on living people who are, unbeknownst to them, losing their Social Security checks.

I think you know better than anyone, no matter how well we do, we have to keep up with the effort because the cyber-criminals who steal identities are always trying to get a step ahead. So, whatever protections you put in place, as soon as they are in place, you have to keep working on it because somebody is going to figure out a way to get around it. We look forward to working with you on that. There should not have to be a fear of lost identity, and we will work with you to do the best we possibly can.

Senator NELSON. Mr. Secretary, as a point of personal privilege, I want to thank you, in your previous role as Chief of Staff, for working through some very thorny times 2 years ago on America's space program. As a result of us coming to closure and getting a bill that we passed out of the Senate unanimously and out of the House with a three-quarters vote, we now have America's manned space program back on track.

In the budget that you have submitted for going and capturing an asteroid, bringing it into a stable lunar orbit, and then going and mining that asteroid and doing the kinds of things that we have to do to develop the technologies to go to Mars, which is the President's goal, it is working. People are finally recognizing it. I want to thank you for your personal intervention 2 years ago to help us bring consensus and get things back on track in our human space program.

Secretary LEW. Thank you, Senator. I am glad that we are making progress.

The CHAIRMAN. Thank you.

Senator Portman?

Senator PORTMAN. Thank you, Mr. Chairman.

Secretary Lew, it is good to have you before the committee as our new Treasury Secretary. We are talking about the budget today, so I cannot help myself. As two former budget directors here, this is going to get really wonkish and boring very quickly. But look, there are a couple of things in the budget I am pleased with. As you know, one is the way you dealt with corporate taxes, which I want to talk about in a second.

The second is the fact that you are willing to take a first step—a small step, albeit, in terms of the size of the problem—with regard to our vital, but unsustainable, entitlement programs. I will say, just in answer to previous questions, there might have been some confusion.

I will simply assert, without trying to get into an argument here, that, if you look at the baseline that we deal with, which is the Congressional Budget Office baseline—which just means that, if we go on auto-pilot and do not do anything, this is what the projection is on spending, what it is on taxes—this budget does not make a dent in the huge problem we all know we face: historic levels of debt and unacceptable deficits with an impact on today's economy and future generations.

If you do an apples-to-apples comparison, the debt as a percent of the GDP is slightly higher in your budget as compared to just if we did nothing. With regard to the next several years, including every year of the Obama administration, as you know, the deficit, even in nominal terms, is higher than it is under the CBO baseline.

So I am disappointed, as you can imagine, on that front, because I do not think it is up to the task that we have before us, which I think is an urgent one. But having said that, I do think, again, there are some hopeful things.

On Social Security, I share the sentiments of some of my colleagues on this side of the aisle in saying we appreciate your looking at this issue and helping us to figure out ways to deal with the fact that, according to the Congressional Budget Office, we are seeing this doubling really of the entitlements over the next 10 years,

specifically with Social Security. As you know, there is a $77-billion shortfall this year as compared to payments out and payroll taxes in.

You mentioned the trust fund. It is not 2036 anymore; unfortunately, it is now 2033 for the Old Age and Survivors trust fund. It is 2016 when the trust fund goes bankrupt, as you know, for disability. So we have a huge problem here, and again I want to applaud you for taking that step of using the right measurement for inflation.

If you could just briefly, given your vast experience in this and now at Treasury, talk about how that also is going to result in additional revenue, and why.

Secretary LEW. Thank you, Senator. I will beg to differ on the analysis of the effect of our budget on the debt, and I would look forward to a conversation where we could go through all the detail on it.

The CPI affects many different aspects of the government, as you know, on the spending side and on the revenue side. Tax brackets are indexed to it, as are many benefit programs. And, as I was saying to the chairman earlier, changing that cross-cutting measure is something that we will do in the context of an overall balanced approach to dealing with our deficit problem over the next 10 years and getting to a place which we believe is sustainable: a deficit of under 2 percent of GDP.

But it does have an impact. I mean, it has an impact on both the spending side and on the tax side. It will mean slower rates of increase in benefits, it will mean more rapid movement from one tax bracket to another. I think that these are issues that are real, but, if we are able to back out sequester and not be on a path towards the kind of mindless cuts that are hurting our national security and so many domestic priorities, if we are in a place where we can deal with the tax and other issues that we have put forward so that we can make sure we are training the workforce for the future and we have incentives for growth and for job creation, I think the net benefit will be a stronger economy that helps even the people who are paying a price. That is why the shared sacrifice is worth it.

But it will have an effect, and it is very real. I do not know if you were in the room when I said this earlier, and I do not mean this in any way as an argumentative point, but I think this is just like the reality of the policy: this is hard. If it is not treated as doing something hard, it is not going to help us to reach the kind of sensible center. It is hard on both sides.

Senator PORTMAN. These are hard decisions. But as you indicate, the most important thing we can do is to restrain the spending, but at the same time grow the economy to ensure that we have more revenue coming in through growth and people have more job opportunities. The jobs numbers were so disappointing last month, and this is why your corporate reform proposal, I think, is critical.

I will say, in this budget, as compared to your previous budgets, you did not take the preference closings, the loophole closings, and use them to reduce the deficit. Rather, you said they would be used for deficit-neutral and revenue-neutral tax reform. I think that is positive.

I will say that I think the plan is not consistent necessarily with what you said earlier, which is a need to transition to a simpler and broader base in the corporate tax code, because you also, as you know, add about $54 billion in newer, expanded tax preferences that I think are tough to defend on an economic efficiency basis.

So I am not talking about the R&D credit, which I agree with you on and agree with what my colleague Tom Carper said, whom I am working with on that, but I do think we have to avoid this temptation of continuing to complicate the code if we are going to get at this, as you say, goal of getting to a broader base that will improve economic growth for everybody.

The final question is on the international side. That is one area where you did not speak to this concern that we hear from businesses all around the country, that we are competing really with one arm tied behind our back. If you could just address that briefly. Do you think that we should have a level playing field with foreign competitors to the extent that American businesses are not disadvantaged globally?

Secretary LEW. Senator, I think that one of the real benefits of doing business tax reform is that we can make doing business in the United States more competitive and more attractive. Our statutory rate is high relative to other countries. Our average rate is in the middle. If we broadened the base and lowered the rate, that alone would make us more competitive.

I know in the debate about whether we should have a worldwide or territorial system, I have said this before here, and I really believe this: it is not so much of a choice between the two. It is a question of how we get to a hybrid that works to make the U.S. investments attractive without losing an amount of revenue we cannot afford in the fiscal frame.

It is going to be hard enough to raise the revenue that we need just to hit the contours of a bipartisan deficit-reduction package. I do not think we are going to be able to lose revenue in the course of doing business tax reform to do it. So we have tried to build a path towards the middle. We have taken some criticism for some of the provisions on our own side, and we are very, very much hoping that this is an opportunity to engage.

Senator PORTMAN. You also have some support on your side on this. I would just say that roughly $1.7 trillion that is locked up overseas now is part of how to pay for, as you say, some of these reforms, and that is an exciting opportunity.

I have overstepped my time here, so thank you, Mr. Chairman. Thank you, Mr. Secretary.

The CHAIRMAN. Yes. Thank you, Senator.

Mr. Secretary, you have a great opportunity here, an opportunity to solve a problem no previous Treasury Secretary has solved, at least in my memory. That is the tax gap. It is big. It is huge. It is 300, 400 maybe, probably higher than that, billions of dollars a year of taxes legally owed but not collected and paid.

One of your predecessors, Secretary Paulson, sitting right where you are now, did not address it. I asked him, what are you doing to address the tax gap? He did not say much. I asked him to give

us a plan, data, benchmarks, dates by which he would begin to make sure that that gap was addressed and reduced.

He would not do it. He did not do it. I got stonewalled. I went so far as to say I was going to hold up a couple of Assistant Secretaries until you give us something, and finally they gave us something that did not amount to anything. I cannot for the life of me understand. I know a lot of things are hard work. This is hard work too.

But, for the life of me, I do not understand why the U.S. Government does not get its act together, the IRS and the Treasury Department, to essentially solve that problem. Just think of all the legitimate taxpayers in this country; they are paying their taxes. They do not like filing—pretty soon we are getting up to April 15th—but they do. They are good Americans.

We still have a pretty high voluntary rate in this country. But why in the world can you not, as Treasury Secretary, finally take advantage of this opportunity, as a new Treasury Secretary, to do something about this? If you could just address that, please, because I just, for the life of me, cannot understand why we have not solved this in the past.

Secretary LEW. Mr. Chairman, I would be happy to take a hard look at that. It is not something that we have worked on in detail in these past few weeks. I am not sure what inquiries were made when Secretary Paulson was there, but I am happy to go back and look and see——

The CHAIRMAN. I ask all Treasury Secretaries this question.

Secretary LEW. Yes.

The CHAIRMAN. Irrespective of Secretary Paulson, I am asking you to do something about it.

Secretary LEW. I hear the question, and I will follow up with you on it.

The CHAIRMAN. Would you? I mean, Mr. Secretary, I am serious about this.

Secretary LEW. Yes.

The CHAIRMAN. I do not want this to be just shoved off. I want you to deal with it directly and honestly——

Secretary LEW. I will take personal——

The CHAIRMAN [continuing]. With some numbers. This is what it is, this is what we have to do about it. It ties into, I am sure, a lot of Medicare fraud that goes on in this country, a lot of billing which is fraudulent. That could be part of the tax gap. That is fraudulent. The tax gap only addresses taxes legally owed and not paid as opposed to fraudulent billing.

Secretary LEW. Right.

The CHAIRMAN. Senator Nelson talked about the master file and all the fraud there. I urge you to spend a little time with HHS and CMS and try to find out some way to address that as well.

Secretary LEW. In principle, I cannot disagree with the idea that legally owed taxes should all be collected. The reason why it has been a problem is something I will look into and get back to you directly on.

The CHAIRMAN. Would you, please?

Secretary LEW. Yes.

The CHAIRMAN. And also solve it. That would be better yet.

Secretary LEW. Better yet.

The CHAIRMAN. All right.

Senator Hatch?

Senator HATCH. I just have one more question, maybe two, to ask you. Once again, let me clarify for you, Mr. Secretary, that the steps in the budget on entitlements are really relatively minor. I do not care what rhetoric is there. The $400 billion in cuts you keep talking about are mostly derived from provider cuts and imposition of government price controls on prescription drugs for seniors. There is nothing structural on Medicare and Medicaid. Simply cutting providers is not structural reform. It is just not, plain and simple.

Now, your budget cuts a courageous 1.8 percent from more than $22 trillion that the big 3 entitlements will spend over the next 10 years. I think you all have actually walked away from the real structural reforms that the administration itself has proposed in the past, including Medicare age eligibility and blended rates in Medicaid. I mean, what happened to those in this budget? So, claiming that this budget is an act of courage on entitlements is exactly that: it is just a claim. It is not reality.

Now, I would be happy to hear your response to that, but I am concerned about it. I do not want to have anybody suffer, but we are all going to suffer in the future if we do not get this awful budget under control. Now is the time to do it, not 4 years from now. So I am very concerned about that.

Secretary LEW. Senator, I think, if you look at the provisions in our budget, there are structural changes that are quite significant.

Senator HATCH. Like?

Secretary LEW. The means-testing through income-related premiums raises premiums for Part B and Part D by $50 billion. That is essentially taking away benefits that would have been free by saying, you have to pay for them. It is the same as means-testing. It is a mechanism for doing it. We have modified the Medicare Part B deductible for new beneficiaries, meaning that the deductible goes up an increment each year. That means more money out of pocket.

It is something we have heard called for for years, and it is in our budget. We have introduced home health cost sharing for new Medicare beneficiaries. I think it is important to have some of these things hit for new beneficiaries, not existing beneficiaries. If you are already 85, it is very hard to even have a small burden.

Encouraging supplemental coverage, the Part B, the Medigap coverage, to be more efficient—right now we pay an awful lot of money because there is no first-dollar exposure. We have said that we are going to have a special Part B premium to take away some of the benefit of having Medigap coverage. We adjust the cost sharing for the Part D subsidies.

So we have a list of very specific, real structural changes. I think that these are probably the most structural changes you have seen in a budget in a long time in terms of the impact on beneficiaries. It is a red line that an awful lot of Democrats never wanted us to cross. These, combined with the chained CPI, are real structural changes. We can debate whether or not it is big enough. It is a meaningful first step. But I think they are real. They are very real.

Senator HATCH. How much do they amount to?

Secretary LEW. There are $70 billion, roughly, of structural reforms.

Senator HATCH. And an almost $4-trillion budget.

Secretary LEW. Well, when we did the Balanced Budget Agreement, $70 billion was a lot of money.

Senator HATCH. I think so too. It is just that it is not a lot of money in the overall effort to try to get spending under control and get this government under control. I think you have a tough job. I do not think there is any question about that. I think Republicans have had a tough job from time to time too. But unless we find some way of resolving some of these conflicts really, fully, structurally, and not just here and there, we are not going to get things under control.

Secretary LEW. Senator, if I could respond on the retirement age question that you asked.

Senator HATCH. Sure.

Secretary LEW. We have taken different positions at different times. In 2011, when we were trying to reach a bipartisan budget agreement, the President was open to this idea. Between 2011 and now, we have done a lot of analysis which has actually caused us to rethink whether it was a policy that accomplished what we thought it did.

In fact, it does not reduce health care spending. What it does is, it shifts the cost from the Federal Government to retirees. It actually increases national health care spending because, when you move from Medicare to private health insurance, health care spending goes up, not down. If our goal is to control how much of our economy goes to health care, raising the eligibility age does not do that. It is something that does save the Federal Government money, but it makes seniors pay the money, and they end up paying more for less.

So we have put in other proposals that we think do a better job of accomplishing the real goal, and we view these as the kinds of proposals that are more than a good-faith effort. They are a serious move.

I understand there is a desire that some have to go farther, but if we draw the line and say we are not going to consider anything unless it is above a certain amount, I think the chances of reaching an agreement go down. We have tried to increase the likelihood for a bipartisan budget agreement which would unlock the door to tax reform, which would unlock the door to removing the uncertainty over our economy, and I hope we can do that.

The CHAIRMAN. Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman. Thank you for keeping the opportunity available.

Mr. Secretary, I am sorry that I did not hear all the other testimony. I was chairing a hearing on Syria, which is obviously very important to us. But I wanted to get here to raise a concern or two I have. Again, congratulations on your successful confirmation, which I was pleased to vote for.

I want to echo the chairman's concerns about the chained CPI. I think it has real effects upon seniors and veterans. I understand

the desire of the White House to find a middle ground to strike a deal, but that is one of those issues that may be a step too far.

But I specifically wanted to say I see the administration's infrastructure investment plan, and there are many elements of it I applaud, including the reform of the Foreign Investment in Real Property Tax Act laws to increase investment in the U.S. and create jobs.

As you know, these tax rules were drafted 30 years ago, before the current crisis could be foreseen, and impose significant penalties on foreign investments in domestic real estate that do not exist in other types of U.S. investments, such as corporate stocks and bonds.

To me it is pretty common-sense, especially given the current economic circumstances, that we should be looking at ways to reduce penalties for foreign investment in the United States. But my understanding is that the administration is making this a legislative proposal, even though the Treasury Department has the authority to begin reforming FIRPTA rules tomorrow. So, am I right about that, that you are seeking a legislative proposal?

Secretary LEW. I believe that is correct, Senator. I would have to go back and check on where the line is between what we have administrative authority for and—we do not usually ask for legislation if we think we can do it.

Senator MENENDEZ. We had a great deal of conversations with your predecessor in this regard, and I think we had moved forward in an understanding that, in fact, you can administratively deal with what you want to achieve legislatively by repealing the relevant parts of the 2007–55 IRS notice while Congress works on the rest of the issue.

I would just say, I urge you to look at that. We have bipartisan legislation here that does basically this, but we have always advocated that the administration, including the last several years when we raised this with Secretary Geithner, has the power to do this. I would just echo the words of the President: what are we waiting for? It is one of those things that you already put in your own infrastructure development that you have a great ability to ultimately affect in the short term. So, can you look at that and get back to me?

Secretary LEW. Senator, I will go back and look at it and get back to you.

Senator MENENDEZ. I would appreciate that.

I also appreciate that the budget includes a proposal to eliminate capital gains on investments in small businesses, an effort that I am taking over from Senator Kerry. He used to do this, and I was strongly supportive of it. I am keenly interested in how any business tax reform proposal affects small businesses.

Earlier today, we were discussing, among members of the committee, different opportunities, and one of the ones that I look at is the vast majority of small research-intensive companies that are not yet profitable, like, for example, in the biotech field, in the cutting edge of what allows us to be globally competitive, yet they have huge dividends to develop.

But they take sometimes more than a decade to mature, so I hope that you would work with me and with the committee to en-

sure that, as we look at business tax reform, that we will take into account the needs of these companies to assure that America remains the best country in the world in producing successful, cutting-edge small businesses. Is that something that you can be supportive of?

Secretary LEW. Senator, we very much have been working to try to create incentives for small businesses to invest and hire and grow. Over the course of this administration, we have had, I believe, 18 separate incentives outside of the context of tax reform. That has meant rather complicated provisions. One of my own personal concerns for small business is, if you have to jump through an awful lot of hoops to get the benefit, it may be that, even though the benefit is there, you do not get it.

I think as we work together through tax reform, one of our goals ought to be to make the system simpler so that it is easier for small businesses to incorporate and not be subject to tax burdens that are unfair. We will look forward to working with you on that. As we lower the corporate tax rate, I think you will actually see some migration of businesses from the partnership form to the corporate form.

Senator MENENDEZ. I appreciate the simplification aspects, and those are desirable. My final point here is that many of what we consider some of the best-paying jobs—some of the important research on Alzheimer's, Parkinson's, certain cancers—are being done by small biomedical and biotech firms.

Of course, their breakthroughs often take a decade or more, and there is no profit margin, so, at the end of the day, how we treat them in the tax process can either spur the industry and have it grow and have us continue to be a leader in the world, or can oppress it, because the big guys, they have the tax liabilities from which to get the benefits. These smaller ones do not.

Thank you, Mr. Chairman.

Secretary LEW. We would look forward to working with you.

Senator MENENDEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Mr. Secretary, when are we going to reach our debt limit?

Secretary LEW. Well, the debt extension set a date certain of May 18th, I believe. So the debt limit gets hit because that is the date set when it expires. It was not an amount, it was a date.

The CHAIRMAN. All right.

So what extraordinary measures can you take, and how long can you delay that?

Secretary LEW. To the extent that we have to use extraordinary measures, as you know, it is very difficult to predict with great precision. It is particularly difficult this year because we had a late tax filing season, given the late enactment of the tax bill, so we do not have as clear a picture on what the revenues look like as we normally do. We will have a better idea at the end of the tax filing season.

The CHAIRMAN. By what date, roughly?

Secretary LEW. Well, I cannot give you an exact date.

The CHAIRMAN. Roughly. Roughly.

Secretary LEW. Our view is that the right thing is for the debt limit to be extended by May 18th so we do not get into the question

of how much time can extraordinary measures get you. I know in the past Treasury was pressed to give a specific date and then the date was challenged, because you do not really have a specific date. It depends on what the cash flow is.

The cash flow this year is particularly difficult to predict because sequester is a whole new phenomenon. It is slowing down spending in some areas, but maybe not as fast as would be expected. We also have some very lumpy receipts that may or may not come in. So I am not sure I could give you a date plus or minus a month right now. I think that the real message is that, when we hit the debt ceiling, it should be extended. Putting us in a space where there is uncertainty as to when we actually run out of room because of extraordinary measures would be a mistake.

The CHAIRMAN. There are some who suggest that, if and when the limit is reached, that Social Security be paid, interest on the debt be paid, but then the Treasury Secretary has discretion on which other programs to pay, I guess depending upon how quickly the money comes in.

Could you address that proposition, please?

Secretary LEW. I think the suggestion that we can prioritize what payments we may totally misses the point. Every obligation that we have as a Federal Government has been authorized by Congress, and it is backed by our full faith and credit. For the entire history of the United States, we have paid our bills.

To introduce the notion that there are some bills we pay and other bills we do not pay just suggests that we are going to default on one or another obligation. I think that would be a mistake. I think that it would just put us into a totally different place than we have ever been. There is a reason why the United States is the rock-solid standard for safety and security. I think we have a solemn obligation to maintain that.

The CHAIRMAN. Well, I agree with you. I just wanted you to get that statement on the record.

There has been a lot of discussion about increases in Medicare costs that I find do not always, in my perspective, hit the main point. The main point is, as you mentioned earlier, it is not only because of demographics, more seniors every year—I think it is 10,000 new seniors every day—but it is also because health care costs are going up. It is both. It is not only demographic, it is just, health care costs in this country for everybody, for seniors and for everybody, are going up.

I think—and I do not know if you have analyzed this—the ratio is about 60/40. Sixty percent of the increase in Medicare costs is due to more seniors, and 40 percent is just due to health care costs going up. The proposals that I see in the budget and I see elsewhere only address the 60 percent side of it; they only address the 40 percent side of it.

I would just be interested in your thoughts as to what you think is the cause for U.S. health care costs going up as high as they are. I know the bill we passed is supposed to address some of that but does not completely, although there are some provisions in there which are designed to address and slow down the rate of growth in health care costs. I know that CBO has made some estimates that the rate of growth has come down, and so forth.

But I just would like to see the administration put more emphasis on some of the causes for the increase of health care costs in this country. A lot of them revolve around Accountable Care Organizations and all the provisions that are in the Act. But there are some who think that we could dramatically reduce health care costs if fee-for-service were significantly reduced.

Right now, only about 5, 10 percent of Medicare payments that were fee-for-service are no longer fee-for-service, which is a very slow change to reimburse based on quality and outcomes as opposed to quantity. I am just surprised and disappointed that there is not more emphasis in the administration's budget on more quickly addressing costs. I would just like your thoughts about that.

Secretary LEW. Mr. Chairman, this is a very important question. It is something that, from the beginning of this administration, we have focused on. The Affordable Care Act actually did make a big difference. I think that the observation that CBO made that we are seeing a reduction in the rate of growth of health care costs is very significant.

I think that that reduction has been realized even before many of the provisions of the Affordable Care Act are actually in place. So I think we can expect to see more progress than was originally projected. One of the challenges we have, and this is one of the places where budget scoring and policy do not tie together——

The CHAIRMAN. I understand all that. I understand all that. But I am just urging you, as creative as you are, to find some way to address that.

Secretary LEW. Look, I think this question of quality versus quantity is critically important. Most of the legislative proposals that you can come up with are very hard to get scored. I think we have to do things even if they do not score, if we think they are the right policy to bend the cost curve.

The CHAIRMAN. I agree.

Secretary LEW. Simple things like fitness and weight. We know that the costs to Medicare and the health system overall are growing in large part because of things that people control in their own daily lives. You do not get scoring for things that deal with that, so it is sometimes treated as kind of a silly set of issues because it feels soft, but, if you know that heart disease, diabetes, and all other kinds of things that end up meaning quality of life is lower and costs of health care are higher, it ought to be something we deal with.

Because we are in this world of doing things with an eye towards deficit reduction, I am afraid we miss some of the opportunities to do things that actually really will change the direction of health care costs. I think that we have to be willing to do some things, even if they do not score.

The CHAIRMAN. Did you read that Steve Brill piece in *Time* magazine?

Secretary LEW. I did when it came out.

The CHAIRMAN. You read it?

Secretary LEW. Yes.

The CHAIRMAN. Your view of it?

Secretary LEW. I read it very quickly. I would rather look at it in more detail before offering a view. I think that there have been

lots of stories about examples of things in the health care system that require attention. Frankly, a lot of those things will be getting attention in the course of the implementation of the Affordable Care Act. I think one of the questions we have to ask is, when the Affordable Care Act is fully implemented, what remains to be done? I would be happy to go into that.

The CHAIRMAN. I just urge you to read it again more slowly and——

Secretary LEW. I am reading things more and more quickly in magazines these days.

The CHAIRMAN. I know you are, but that was a very important piece.

Secretary LEW. Yes, it was. It was.

The CHAIRMAN. It is similar to the Atul Gawande piece that got the President's attention a couple of years ago.

Secretary LEW. From the *New Yorker*.

The CHAIRMAN. The *New Yorker*. It got a lot of people's attention. But this is another one that is an important piece.

Thank you very much.

Secretary LEW. Thank you, Mr. Chairman.

The CHAIRMAN. And again, good luck to you.

[Whereupon, at 4:25 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Administration's Fiscal Year 2014 Budget

Alexander Hamilton once said, "The necessities of a nation in every stage of its existence will be found at least equal to its resources."

In 1790, when Hamilton was appointed America's first Treasury Secretary, he set out to build our young nation's financial system and pay down its debt. As Hamilton did this, he submitted the first budget to Congress and put the United States on track to be a thriving nation.

Today, more than two centuries later, we meet to hear from our new Treasury Secretary Jack Lew about this year's budget and the Administration's plans to meet the necessities of our nation.

The budget must be a reflection of our priorities. More than just numbers on a page, it should serve as a roadmap, guiding our nation on a fiscally sustainable path. It must cut our debt and also invest in and protect our priorities and create new jobs.

My bosses - the people of Montana - tell me they want to see a balanced plan that will bring us together, get our economy running at full speed and create jobs for folks in Montana and across America.

I was pleased the President's proposal takes some steps to find a middle ground. It calls for spending cuts and deficit reduction of an additional $1.8 trillion while at the same time continuing to invest in national priorities such as education and infrastructure.

Of special importance to me, the budget supports my battle against veterans' unemployment. It would permanently extend the tax credit I authored for businesses that hire unemployed veterans.

Our veterans deserve to come home to good-paying jobs and a nation that honors their sacrifices. Making these tax credits permanent will help bring down unemployment among our nation's heroes.

I'm also glad to see the Administration addressing my concerns with bureaucratic red tape at the VA. Recent backlogs in disability claims are disgraceful. The ten percent increase in funding for the VA will help veterans get the care and support they need and deserve.

The budget also makes important investments in keeping America safe by sustaining the current ICBM force through 2030. I led the Senate ICBM caucus in a letter to Defense Secretary Hagel last week calling for this. North Korea's recent actions have sent a clear wakeup call to the White House.
A strong ICBM force is the best deterrence strategy to keep America safe, and it also gives us the most deterrence for our money.

However, in many areas the President's budget is yet another example of how Washington doesn't understand rural America. We cannot balance the budget on the backs of rural jobs.

The President would cut $38 billion from agriculture jobs over ten years. It undermines our work toward a strong, long-term farm bill this year. Agriculture supports one in five Montana jobs. The farm bill is our jobs bill, and I won't support anything that gets in the way of our ability to get it done.

As we address our budget challenges and work to cut the debt, this committee must focus like a laser on creating jobs. Nearly four years into the economic recovery, close to twelve million people are actively looking for work. An additional 7.6 million Americans are stuck working part-time because they can't find full-time jobs. And just last week, we heard that new job creation is at anemic levels. Only 88,000 jobs were added to the economy in March, marking the slowest job growth in nearly a year.

Job creation must remain the top priority of the administration, this Congress and this committee. Some economists have attributed the slow job growth to austerity measures, known as the sequester. The sequester cuts started to hit in early March and the impact is being felt in Montana and across America.

I voted for every bill I could to stop these indiscriminate cuts. I voted for the Democrats' plan to replace the sequester, and I voted for the Republicans' plan to give the president more flexibility on where the cuts occur. Unfortunately, neither plan passed the Senate. Frankly, I think we should try again. I was pleased to see the President's budget looks to replace the sequester with more thoughtful cost saving measures.

The slow pace of our economic recovery demands that we replace sequestration with a responsible, long-term deficit reduction proposal that protects jobs and spurs the economy. Much progress has already been made in reducing the deficit.

Congress has enacted two budget trimming bills that reduced deficits by $2.5 trillion over the next ten years. When savings from ending the wars in Iraq and Afghanistan are added, federal deficits will be reduced by almost $3.5 trillion over ten years.

This belt tightening is having a real impact. The Congressional Budget Office projects a stable debt-to-GDP ratio over the next several years. The deficit will be cut in half by 2015.

CBO also expects the rate of Medicare and Medicaid spending to slow significantly. Current projections for the programs' costs through the end of the decade are $200 billion less than they were in March 2010.

With that said, there is still more work to be done to responsibly cut our debt in a way that doesn't impede our economic recovery.

As I mentioned earlier, Secretary Lew, I am committed to strengthening Social Security and Medicare to ensure these programs will be there for future generations. The President has made some bold proposals in his budget to reform both programs.

The President's proposal calls for Medicare cuts well above the level passed in the Senate budget. And the Senate budget put a firewall around Social Security.

I'm disappointed by the President's proposal to change how cost of living adjustments are calculated for seniors and military retirees. Cutting Montana seniors' benefits without asking the wealthiest Americans to chip in to the Social Security trust fund isn't right. Any reform of Social Security should be for the solvency of the program, not deficit reduction. We will delve into these issues in more depth shortly.

Finally, we have been hard at work in this committee for more than two years on comprehensive tax reform.

The lackluster economic growth we're seeing shows we must simplify the tax code. We need a pro-growth tax code that closes loopholes while giving America's businesses the certainty they need to compete globally and plan and expand operations.

The Finance Committee is meeting weekly, discussing the code issue by issue and working together to modernize America's tax system. We are working to make it simpler and fairer for families.

Secretary Lew, just two months ago you sat before this committee and told us you were going to work with us on tax reform. You said you were willing to take on this challenge and this committee will hold you to your word. Today I look forward to hearing exactly how the budget helps your words become a reality.

The President's budget has proposed raising $600 billion in revenue over ten years. The Senate budget proposed raising $975 billion over ten years. It seems the President is working to carve a middle ground, just like I am working to do when we close loopholes and simplify the tax code.

We will close billions of dollars of loopholes. Some of this revenue should be used to cut taxes for America's families and help our businesses create jobs, and some of the revenue raised in tax reform should also be used to reduce the deficit. It's all about finding common ground so we can move forward together.

Secretary Lew, we welcome you to your first appearance before the Senate Finance Committee as Treasury Secretary. So let us remember our priorities. As America's first Treasury Secretary advised, let us look to the necessities of our nation as we assess our resources.

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STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF APRIL 11, 2013
PRESIDENT'S FISCAL YEAR 2014 BUDGET

WASHINGTON - U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following remarks during a Senate Finance Committee hearing examining the President's budget proposal for Fiscal Year (FY) 2014 with Treasury Secretary Jack Lew:

Thank you, Chairman Baucus, for holding today's hearing, and thank you Secretary Lew for joining us here today.

Yesterday, after a couple months of delay, we received the President's fiscal year 2014 budget proposal. While there are a few glimmers of hope in the budget, it is, overall, a disappointment.

The President's budget never balances. Not this fiscal year, not in ten years, not ever.

Instead, under the President's budget, the gross national debt would be $25.4 trillion in 2023, or 96 percent of GDP. Economists and the Congressional Budget Office have repeatedly told us that such high levels of debt threaten economic growth and leave us in a position where we are unable to respond to unforeseen crises or emergencies.

In addition, the President's budget takes only baby steps toward reforming our unsustainable entitlement programs, falling far short of the structural changes needed to preserve these programs for future generations.

Many have touted the proposal in this budget to adopt chained-CPI for many parts of the federal government – including Social Security cost-of-living adjustments – as a demonstration of the President's willingness to work on entitlement reform.

While one may conclude that this is a step in the right direction, it is only a small step. In fact, in the grand scheme of things, it barely registers.

Under the President's budget, overall Social Security spending over the next ten years is virtually the same as it would be absent any of his proposals.

Put simply, that means, despite many claims to the contrary, this budget contains no substantive changes to Social Security.

The story is the same on entitlement spending across the board.

Over the next ten years, according to the President's adjusted baseline, we will spend $7 trillion on Medicare, $4.1 trillion on Medicaid, and $11.2 trillion on Social Security for a combined total $22.4 trillion.

With trillions of scheduled spending, the President's budget proposes to curtail spending on these programs by only $413 billion over ten years relative to his adjusted baseline, which amounts to a minuscule 1.8 percent reduction in entitlement spending.

That is not reform in any meaningful sense and is nowhere near the structural reforms we need to get our entitlements on a path to solvency.

In addition to increased spending, the President's budget calls for even more taxes. This comes after the $1 trillion in taxes imposed under Obamacare and the more than $600 billion in taxes the President got out of the fiscal cliff deal.

The budget includes: higher taxes on estates, the Buffett tax, a financial crisis responsibility tax, fresh taxes on retirement savings, more taxes on commercial aviation, increased taxes on energy producers, and on and on.

All told, the budget contains nearly a trillion dollars in tax increases, which is simply unacceptable.

That said, I do have to say that I am encouraged by some of the proposals in the budget dealing with corporate tax reform.

With this budget, the administration has finally admitted that it could be open to revenue-neutral corporate tax reform. Many Democrats in the Senate have supported this position, though the idea was soundly rejected in the budget that recently passed in the Senate. Contrary to what the President has proposed, the Senate Democratic budget envisions higher taxes on corporations to finance more government.

It will be interesting to see how this apparent conflict will be resolved and which course my colleagues on the other side of the aisle decide to take.

Of course, my praise for the President's proposal on tax reform is tempered by the fact that it is limited to the corporate side of the tax code. While the President seems content to lower rates on corporations in order to make them more competitive in our global economy, he is also apparently fine with asking flow-through businesses – which file as individuals – for even more taxes.

If we want tax reform to result in real economic growth and to improve the competitiveness of American businesses, it needs to be comprehensive, focusing on both the corporate and individual tax codes.

These are just some of the concerns I have with the budget that was released yesterday.

In addition, there remain many unspecified details in the President's budget which I hope we can begin to clarify in today's hearing with Secretary Lew. I look forward to the Secretary's testimony and, once again, I want to thank you, Mr. Chairman, for holding today's hearing.

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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.

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.

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.

Senate Committee on Finance
Questions for the Record
"The President's Fiscal Year 2014 Budget"
Questions for The Honorable Jacob J. Lew
Hearing Date: April 11, 2013

Questions from Chairman Max Baucus (D-MT)

Question 1:

Since 1974, Trade Adjustment Assistance, or TAA, has been the foundation of expanding trade. TAA has helped hundreds of thousands of workers, firms, ranchers, and farmers. It helps these citizens better compete in the global economy. In 2011, I worked out a deal with the Administration and Ways and Means Chairman Camp to renew and extend TAA, but the program expires at the end of this year. It is important that a TAA extension be enacted this year. Will you commit to working with me and with my colleagues to get TAA enacted?

Assistance for displaced workers has long been central to U.S. trade policy, including the President's trade agenda. We are committed to working closely with you and other stakeholders to address the needs of trade-affected workers.

Question 2:

Last month, the Finance Committee held a hearing on the Administration's trade agenda, which is ambitious and bold. USTR is working to bring home a high-standard TPP agreement and the negotiation with the European Union will soon be launched. USTR also has a strong enforcement agenda, ensuring our trading partners play by the rules. I support the President's 2014 budget request that provides USTR with over $56 million. USTR needs sufficient funding to help U.S. exporters and create American jobs here at home. But USTR's actual funding has been slashed in past years. How will you ensure USTR is funded at the level proposed in the President's budget? And do you think this funding is enough to carry out the Administration's ambitious agenda?

Trade is critical to U.S. prosperity as an engine of growth and job creation. I strongly support the Administration's ambitious trade strategy, which not only includes TPP negotiations, but also the recently launched Trade in Services Agreement (TiSA) and Transatlantic Trade and Investment Partnership (T-TIP). USTR has the U.S. government lead on trade policy, and as a key part in the interagency trade policy team, Treasury has worked closely with USTR in actively fight protectionism and open new markets. Treasury, however, does not play a role in determining funding levels for other agencies.

Questions from Ranking Member Orrin G. Hatch (R-UT)

Question 1:

Please identify Treasury's current estimate of what the statutory debt limit will be on May 19 of this year, and your best estimate of the date on which the statutory debt limit is likely to be reached. I understand that such estimates are challenging to make, given changes to tax laws brought on by the so-called "fiscal cliff deal," but I am confident that Treasury has made such estimates. If not, then please explain how Treasury's debt management team is making debt issuance plans without having estimates of the dates identified above.

On May 19, 2013, in accordance with the No Budget, No Pay Act of 2013, the statutory debt limit was increased to $16,699,421,095,673.60. At that time, the outstanding debt subject to the limit was at the debt limit. As a result, Treasury needed to resort to the use of extraordinary measures in order to avoid exceeding the debt limit. With the caveat that projections this year are particularly uncertain for a number of reasons, we estimate that the extraordinary measures will not be exhausted until after Labor Day. Treasury remains confident that Congress will act to raise the debt limit when necessary, and on that basis will continue to make debt issuance decisions that fund government expenditures at the lowest possible cost to the taxpayer.

Question 2:

The President's budget proposes limited adoption of the chained CPI for use in indexing some federal programs, including indexation of income tax brackets. Of course, the use of the chained CPI in indexation of tax brackets would accelerate bracket creep, leading to increased taxes for many taxpayers, including many middle-class taxpayers.

The budget also proposes to use the more accurate measure of inflation based on the chained CPI, but with the proviso that there be "protections for the most vulnerable." There is little specificity, however, about who receives those protections—that is, which gets carved out of any move to the chained CPI.

According to Treasury's General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals (a.k.a. the "Greenbook"): "The chained CPI-U (C-CPI-U) would...better reflect changes in the cost of living." However, the President's budget does not apply changes in indexation of all federal programs from the CPI-W or CPI-U to the C-CPI-U. Rather, it picks and chooses which parameters of federal programs would be changed to the C-CPI-U and which would not. Moreover, the President identifies that he is open to switching to the chained CPI only if the change includes substantial revenue raised through tax reform, along with additional measures "to protect the vulnerable and avoid increasing poverty and hardship."

Those protections include new "benefit enhancements" and lack of inclusion in any switch to the chained CPI of the Supplemental Security Income program, means-tested veterans' pensions, the Montgomery GI Bill-active duty or the post-9/11 GI Bill benefits, the Supplemental Nutrition Assistance Program, child nutrition programs, Pell Grants, and poverty guidelines.

The President's budget projects that his proposed partial switch to chained-CPI indexation would result in $230 billion of deficit reduction over a 10-year period composed of $100 billion of additional receipts and $130 billion of reduced outlays.

Please identify all federal programs and parameters of federal programs to which inflation indexation is applied using the CPI-U or CPI-W or other non-chained price index. Please, also, identify to which programs and parameters the President's proposal to switch to the chained CPI (C-CPI-U) applies, and to which it does not apply when it was arrived at that the switch would lead to receipt increases of $100 billion over 10 years and outlay decreases of $130 billion. Finally, please provide a detailed reconciliation of the budget's projected 10-year budgetary effects of the President's proposed partial switch to C-CPI-U indexation with the budgetary effects projected by the Congressional Budget Office found at http://www.cbo.gov/sites/default/files/cbofiles/attachments/Government-wide_chained_CPI_estimate-2014_effective.pdf.

In the interest of achieving a bipartisan deficit reduction agreement, the President's Budget includes his compromise offer to Speaker Boehner to use the chained Consumer Price Index (CPI) to compute cost-of-living adjustments in major federal programs and the tax code. However, the President has made clear that any switch to the chained CPI must be part of a broader deficit reduction package that is balanced between spending cuts and revenue increases from tax reform. It must also be coupled with measures to protect the vulnerable and avoid increasing poverty and hardship. That is why the chained CPI proposal in the Budget includes a Social Security benefit enhancement for the very elderly and others who rely on Social Security for a long period of time and does not apply the chained CPI to means-tested benefit programs.

The CBO score cited above was released on March 1, 2013, prior to the release of the President's FY 2014 Budget request, and was for an illustrative proposal. When the CBO scored the actual chained CPI proposal in the FY 2014 Budget[1], it estimated savings over the FY 2014-2023 period totaling $232.7 billion, which is nearly identical to the $230 billion of deficit reduction that OMB scored in the President's FY 2014 Budget. CBO estimated $133 billion in 10-year savings resulting from outlay reductions, of which slower growth in Social Security benefits accounts for two-thirds. The savings from other federal programs with COLAs (primarily civil

[1] http://www.cbo.gov/sites/default/files/cbofiles/attachments/44231_ChainedCPI_0.pdf

service retirement, military retirement, and veterans' compensation) and refundable tax credits (the EITC and the child credit) account for most of the remaining outlay reductions.

With regard to revenues, indexation via chained CPI would slow the growth in income tax bracket threshold values, and the personal exemption and standard deduction would affect phase-out ranges and other parameters for credits, deductions, and exclusions.

Question 3:

Given that the President proposes switching some federal programs and parameters of those programs to inflation indexation using the chained CPI, but not others, it appears that the switch has not been proposed because the administration believes that the chained CPI is a better measure of a cost of living index than is the CPI-U or CPI-W. However, that may not be true because the Treasury "Greenbook" identifies that the C-CPI-U "better reflects changes in the cost of living."

Does the administration believe, as Treasury's "Greenbook" states, that the C-CPI-U better reflects changes in the cost of living? If so, then would it not be better to change all indexation based on the CPI-U or CPI-W to indexation based on the C-CPI-U, and generate protections for the most vulnerable by altering other (than indexation) aspects of federal programs that apply to the most vulnerable?

In his FY 2014 Budget, the President called for chained CPI, a reform that he normally would not propose but is willing to support in the context of a balanced deficit reduction package. The President is also only willing to support a move to chained CPI if it is part of a broader deficit reduction package that is balanced between spending cuts and revenue increases from tax reform. Also, vulnerable populations must be protected, which is why the Budget proposes to switch to chained CPI only in programs that are not means-tested and incorporates protections for the very elderly and others who rely on Social Security for long periods of time.

Question 4:

The President's budget contains a proposal to index all penalties in the Internal Revenue Code to inflation (e.g., page 207 of Treasury's "Greenbook"). Please provide a list of penalties to which the indexation proposal would apply. Please, also, identify whether the proposal envisions indexation to the CPI-U or C-CPI-U or to some other price index, and the reason for whatever is the index that has been chosen.

The Internal Revenue Code contains well over 100 penalty provisions. The President's Budget proposal is intended to apply to penalties where a fixed dollar amount is specified in the statute, such as the $500 penalty imposed under section 6682(a) on individuals who make false statements with respect to withholding. The proposal is not intended to apply to other penalties,

such as those penalties where the statute sets the penalty amount at a percentage of a dollar amount. For example, the proposal would not apply to the accuracy-related penalty on understatements imposed under section 6662(a), which is 20 percent of the tax underpayment to which the penalty applies.

For presentation in the Budget, the revenue effect of indexing penalties was estimated using the CPI-U, however, the proposal to use the C-CPI-U to index all tax provisions would apply to indexed penalties.

Question 5:

The President's budget identifies "openness" to limited chained CPI adoption, so long as certain conditions are met. One of the conditions is to couple limited chained CPI adoption with "measures to protect the vulnerable and avoid increasing poverty and hardship." Those measures include a benefit increase equal to 5% of the average retiree benefit, or approximately $800 per year if the proposal were in effect today. Please provide details of that proposal, including the projected 10-year budget cost of outlays associated with the proposal.

The President's FY 2014 Budget contains the President's compromise offer to Speaker Boehner from December. As part of that offer, the President was willing to accept Republican proposals to switch to the chained CPI. However, the Budget makes clear that the openness to chained CPI depends on two conditions: the change must be part of a balanced deficit reduction package that includes substantial revenue raised through tax reform, and it must be coupled with measures to protect the vulnerable and avoid increasing poverty and hardship.

The following points offer some details about the proposal:

- The benefit enhancement would be equal to five percent of the average retiree benefit, or about $800 per year if the proposal were in effect today.
- It would phase in over ten years, beginning at age 76, or (for other beneficiaries, such as those receiving Disability Insurance) in the 15th year of benefit receipt.
- The benefit enhancement would begin in 2020, phasing in over 10 years for those 76 or older (or in their 15th year of eligibility or beyond) in that year.
- Beneficiaries who continued to be on the program for an additional 10 years would be eligible for a second benefit enhancement, starting at age 95 in the case of a retired beneficiary.
- Because of the benefit enhancement for the very elderly, the Budget proposal would not increase the poverty rate for Social Security beneficiaries according to SSA estimates.

In its analysis of the President's FY 2014 Budget, CBO projected that the President's enhanced benefit proposal would lower the savings from switching to chained CPI by $18.5 billion over

the next decade. CBO estimates that the total net deficit reduction from the President's chained CPI proposal – including the enhanced benefit as well as other components – would be $232.7 billion through Fiscal Year 2023.

Question 6:

The President's budget identifies "openness" to limited chained CPI adoption, so long as certain conditions are met. One of the conditions is that the chained CPI not be applied to means-tested benefit programs. Please provide a detailed list of means-tested benefit programs to which adoption of the chained CPI would not apply.

The President's Budget proposal does not apply chained CPI to any means-tested benefit programs, including: Supplemental Security Income, means-tested veterans' pensions, the Supplemental Nutrition Assistance Program, child nutrition programs, Pell grants, and poverty guidelines used to determine eligibility for various federal programs.

Question 7:

The mortgage giants, Fannie and Freddie, were put into conservatorship back in 2008. In February of 2011, Treasury came out with a paper containing already-known possible ways to reform the government's role in the housing finance system. I asked you which of the options presented in Treasury's 2011 paper you support, if any, and you declined to provide an answer. Now, in April of 2013, almost five years after Fannie and Freddie were placed in conservatorship, we still do not have a specific reform plan backed by the administration and I still do not know your preferences.

As time passes, and the condition of the portfolios of Fannie and Freddie improve and become more profitable, there is high risk that the administration will simply settle for the status quo, with Fannie and Freddie dominating the mortgage finance system. As they become profitable once again with recovering housing markets, they become a cash cow, providing the federal government with funds to use for even more spending. It becomes easy for the administration to become addicted to the revenue stream from the mortgage giants, while ignoring the need for reform by arguing that housing markets remain too fragile to do anything. Fannie and Freddie crowd out the private sector, which should be the dominant provider of mortgage credit and the dominant actors in the housing finance system, and we need reforms.

Why is it taking so long for the administration to act on reform of Fannie and Freddie? I would also like to ask you, again, what is your preferred option for reform of Fannie and Freddie and return of the private sector to mortgage finance?

The Administration is committed to a sustainable housing finance system that does not allow the GSEs to return to their previous form, where private gains were allowed at the expense of taxpayer losses. Any future system must also protect taxpayers and financial stability, promote private capital taking on more mortgage credit risk in a responsible way, and meet the needs of our nation's rental population. At the same time, we must preserve access to credit for American families, including long-term fixed rate mortgages and better target government support for low- and moderate-income Americans, including the development of affordable rental options. Our housing finance system must also include stronger and clearer consumer protections and must establish a level playing field for all participating institutions.

Question 8:

Secretary Lew, you have recently identified that the administration supports revenue-neutral corporate tax reform, in the interest of making corporations more globally competitive, but that the administration does not support comprehensive tax reform unless revenue is raised—which means yet another tax hikes on individuals and flow-through businesses. Evidently, competitiveness of flow-through businesses is not much of a concern of the administration. The President's budget does include a scattering of provisions aimed at small businesses, but not fundamental tax reform that would apply to flow-through businesses and help their competitiveness.

It appears that you believe that if we follow the administration's preferred path, flow-through businesses would just change the decisions they make about how they organize. For example, partnerships could be forced, because of changes in the tax code, to reorganize as corporations. Of course, if they do, there would be erosion of the tax base that you intend to rely upon when you advocate for even higher personal-income taxes on upper-income earners, which includes flow-through businesses, thereby defeating part of your efforts to squeeze more revenue out of the economy.

In your preferred plan to engage in revenue-neutral corporate tax reform, but revenue-raising personal tax reform, do you anticipate shifts in organizational forms of businesses that would erode the tax base that you would be trying to hit yet again? And, if you do, does that mean you will need large tax increases in the personal income tax code?

One of the principles laid out for business tax reform is that the reformed system should make tax filing simpler for small businesses and entrepreneurs, while also providing them tax relief.

Consistent with this goal, the *President's Framework for Business Tax Reform* proposes to simplify tax compliance for small businesses and provide a net tax cut to small businesses by (among other things) raising to $1 million the amount of investment that a small business can expense annually and by raising to $10 million the gross receipts cut off for using the cash method of accounting.

You asked about how businesses might alter their organizational form in response to changes in tax rates and other tax rules. We recognize the possibility of such effects, and the revenue estimates and other analyses that Treasury does of proposed and actual changes in tax rules routinely includes such effects, when relevant. Without having a specific plan to ground the discussion, it is not possible to discuss in detail the extent to which businesses would change their form of organization and the effect of such changes on overall tax revenue. However, any analysis of the issue requires taking into account the taxes that corporate shareholders pay on dividends and capital gains, in addition to taxes paid directly by the corporation and comparing those to the taxes paid by the owners of flow-through businesses on the same income. These considerations can reduce substantially the tax incentive to switch from a flow-through business to a corporation.

Question 9:

The administration keeps asking for tax hikes and to have a tax system at least as progressive as it is, or as it was under Clinton, or whatever is the goalpost of the day. However, I have never been able to get the administration to commit to what it means by progressivity. That is, how do you define progressivity in terms of things we can measure, like different income groups' tax liabilities as a percent of their income, or different groups' shares of the total tax burden, or different groups' shares of after-tax income?

Without knowing what you mean by progressivity, it is impossible to understand targets like moving to a tax code that is at least as progressive as it is today.

Let me give it another shot by asking you to be precise about what you mean when you talk of progressivity of the personal income tax code.

What do you mean, in terms of things that can be measured, when you say you want a personal income tax system at least as progressive as it is now? Please be precise.

A tax system is said to be progressive if the average tax rate rises with income. Tax system A would be said to be more progressive than tax system B if the average tax rate rises more steeply with income under System A than under System B.

Comparing tax system A with tax system B, that is assessing the distributional effects of a tax change, can be challenging because tax effects often are not spread evenly across the income

distribution, or even across taxpayers with similar income but different demographic characteristics, and because the overall level of tax can change under the proposal being analyzed. Treasury's standard approach begins by looking at tax changes as a percentage of after-tax income, with taxpayers frequently grouped by income decile. One would call a tax change progressive if its tax increases were larger relative to income at higher income levels than at lower income levels (or if tax decreases were smaller in magnitude relative to income at higher income levels). In some cases the tax change could have ambiguous effects on progressivity, and judgment is required in assessing the overall effect of the tax policy change (for instance where there is not a clear pattern of increasing or decreasing tax changes throughout the income distribution).

Question 10:

The Disability Insurance Trust Fund is projected by the Social Security Trustees to be exhausted by 2016, at which time disability insurance benefits will be slashed absent legislative action. The Trustees have stressed that action is urgently needed. However, I don't see any meaningful suggested reforms in the President's budget that would come close to shoring up the Disability Insurance Trust Fund by 2016. And I simply do not believe that the answer is just to reallocate payroll tax revenue intended for the Old Age and Survivors Insurance Trust Fund into the Disability Insurance Trust Fund without reforms.

In light of the impending exhaustion of the Disability Insurance Trust Fund, what reform does the administration favor that would prevent the scheduled slashing of benefits as early as 2016?

The President's Budget does call for improved Disability Insurance program integrity, as well as testing new techniques to move people with disabilities back to employment and to help people with disabilities remain in the workforce. At the same time, we must be mindful of our obligation to this vulnerable population. When the Disability Insurance Trust Fund faced a shortfall in the 1994, policymakers implemented reforms necessary to extend the Trust Fund exhaustion date, much as they did in 1983 when Social Security faced shortfalls. I look forward to working with you on ways to address the exhaustion of the Disability Insurance Trust Fund, and more broadly on ensuring the financial health of the entire Social Security program for generations to come.

Question 11:

The President's budget includes a proposal to add a Rail Account to the Highway Trust Fund. The budget proposes $40 billion in contract authority over 5 years for intercity passenger and freight rail activities and proposes $88 billion in resources above baseline for transportation-related activities under the Highway Trust Fund. The only offset proposed by the President's budget is the application of a portion of the savings from the drawdown of the wars overseas.

Currently, transportation funding is classified both as mandatory and discretionary depending on whether it is contract authority or outlays. The President's budget quotes the National Commission on Fiscal Responsibility and Reform, which said that: "This hybrid treatment results is less accountability and discipline for transportation spending and allows for budget gimmicks to circumvent budget limits to increase spending."

I have three questions related to transportation spending. First, isn't the use of savings from the drawdown of overseas wars the sort of budget gimmick to circumvent limits to more spending that the Fiscal Commission warned us about? Second, once this budget windfall from war drawdown is exhausted, how does the administration propose to maintain the new higher levels of transportation spending called for in the budget? Third, if events in places such as Korea or Iran or anywhere else required additional resources, would the administration recommend supplying those resources by decreasing the new transportation spending proposed in the budget?

The baseline budget projections released by both CBO and OMB do not reflect the President's policy of responsibly drawing down our military presence in Iraq and Afghanistan. In its analysis of the President's Budget, CBO estimates that this policy will save roughly $600 billion over the next decade, not counting interest effects. In addition to these spending cuts, the President also supports capping overseas contingency operation funding at his proposed levels, both to close a potential avenue for exempting appropriations from the BCA caps, as well as to have the savings from the President's policy reflected in current law.

The President believes that there is a critical near-term need to rebuild the nation's transportation infrastructure. That is why the Administration is proposing to increase investments in infrastructure, even while stabilizing the debt and moving it on a downward trajectory as a share of GDP. By putting us on sound financial footing, we will be able to handle unforeseen draws on the budget.

Question 12:

The President's budget includes a significant increase in federal excise taxes on tobacco products. For example, the current tax on cigarettes is equivalent to about $1.01 per pack, and the budget proposal would increase that to about $1.95 per pack. This proposal has been justified on public health grounds and as a way to help pay to set up what would become a new entitlement of federally funded pre-K schooling.

A stated goal of this proposal is to reduce smoking, based on a belief that higher excise taxes will drive people away from tobacco. But, of course, the federal government makes significant resources available to help people quit smoking. The Centers for Disease Control has resources for smoking cessation, and there are websites such as smokefree.gov and BeTobaccoFree.gov available as well. I'm sure there are many other resources.

I have three questions about this proposal. First, can you tell me how much money the federal government spends on smoking cessation programs? Second, given the importance the administration places on setting up a new pre-kindergarten entitlement, does it make sense to support such a program using a tax on products that the administration wants people to stop using and commit significant resources toward such an effort? Third, don't you see the inherent problem with setting up a new spending program funded by a tax on what most want to see as an eroding base?

While tobacco consumption in the United States has declined recently, the health effects of tobacco use remain a major public health problem. According the Centers for Disease Control and Prevention (CDC), cigarette smoking causes one out of every five deaths in the United States each year. In addition, tobacco use costs the United States nearly $200 billion per year (this includes both loss of productivity due to death and health-related costs).

The Department of Health and Human Services (HHS) accounts for a substantial share of the government's smoking cessation programs. Approximately $585 million in funding for the CDC, the National Institutes of Health, and the Substance Abuse and Mental Health Services Administration is intended to further help reduce smoking among teens and adults and support research on preventing tobacco use, understanding the basic science of the consequences of tobacco use, and improving treatments for tobacco-related illnesses. In addition, the Food and Drug Administration regulates the manufacturing, marketing, and distribution of tobacco products.

Despite a decrease in tobacco consumption in recent years, federal excise tax collections for tobacco products remain a strong source of revenue. The Federal government collected roughly $16 billion per year from these taxes in recent years ($15.7 billion in FY 2012 and $16.2 billion in FY 2011). According to empirical estimates from many experts, price increases, like those caused by taxes, are a very effective way to reduce smoking, especially among young adults.

Consequently, the federal taxes on tobacco have the dual benefits of raising revenue and reducing smoking, and hence smoking's attendant health damage.

Based on the empirical evidence, we believe that the increased tax rates proposed by the President will reduce tobacco consumption. But we see this as a benefit, not as a problem, because lower consumption means better health. The reduced consumption is not enough to wipe out the net revenue gain from raising the tax on tobacco. Even after accounting for the reduction in tobacco use, the proposed tax increase will provide the revenue necessary to fund the President's pre-kindergarten initiative.

Question 13:

The President's budget would limit an individual's total retirement savings to an amount equal to the current limit on defined benefit plans, currently $205,000 per year. Of course, the Internal Revenue Code used to have a provision that imposed an excise tax on retirement savings above that same limit. It was known as the "success tax" because it penalized people who had successfully saved and invested for retirement. The approach now seems to be the imposition of a cap. Congress repealed just this sort of policy in 1997 on a bipartisan basis, and the reasons were explained in the legislative history. I quote from the Conference report: "The Committee believes that the limits on contributions and benefits on each type of vehicle are sufficient limits on tax-deferred savings. Additional penalties are unnecessary, and may also deter individuals from saving. The excess accumulation and distribution taxes also inappropriately penalize favorable investment returns." Congress passed the law. President Clinton signed the law. Why should we now go back to that old policy that Congress previously rejected?

The Administration's proposal should be viewed in the larger context of efforts to reduce the deficit over the medium and long term. Given fiscal realities, the Federal government needs to make tough choices about exactly which tax incentives are needed and how much incentive is appropriate. Moreover, applying an overall limit that applies to all retirement plans helps level the playing field between individuals covered by only one type of tax-favored retirement savings vehicle and those who are able to obtain coverage under multiple types. The proposal provides the current set of tax incentives for new contributions or accruals that would provide a lifetime benefit recognized as reasonable under the current law limit for defined benefit plans. Accordingly, the proposal differs significantly from the law that was repealed in 1997, which applied an additional tax on excess retirement distributions in a year (and excess accumulations remaining at death). The new proposal does not penalize investment success; it simply discontinues special tax-favored treatment with respect to additional contributions once an

individual has accumulated enough retirement savings to provide for a reasonable level of retirement income. The taxpayer of course is free to accumulate as much in taxable investments as desired and can use the proceeds in any way desired (such as to support retirement consumption). The proposal will reduce the deficit, make the income tax system more progressive, and distribute the cost of government more fairly among taxpayers of various income levels.

Question 14:

The President's budget would limit an individual's total retirement savings to an amount equal to the current limit on defined benefit plans, currently $205,000 per year. The White House said that the proposal: "Ends a loophole that lets wealthy individuals circumvent contribution limits and accumulate millions in tax-preferred retirement accounts." However, in fact, this proposal applies to people who comply with all of the limits on contributions under current law. Circumvention is not required. Small business owners who have played by the rules, saved within the contribution limits, and provided matching and other contributions to their employees, will see the rules changed midstream. Small business owners would be punished for doing right by their workers and for saving and investing successfully. And taxpayers who save diligently and invest wisely would also be punished. Why, at a time when we are worried that people are not saving enough for retirement, would the Administration propose such a policy?

The Administration proposed this policy because it will reduce the deficit, make the income tax system more progressive, and distribute the cost of government more fairly among taxpayers of various income levels, while still providing very substantial tax incentives for reasonable levels of retirement saving. The proposal does not punish people who have saved and invested successfully, it merely limits the tax benefits for additional savings once an individual has accumulated enough retirement savings to provide for a reasonable level of retirement income. While we all agree that most Americans are not saving enough for retirement that concern does not extend to the few individuals who have accumulated many millions of dollars in tax-preferred savings vehicles, more than sufficient to provide $205,000 per year for the combined lifetimes of the participant and a spouse. Of course, the proposal does not affect the ability of individuals to save additional amounts outside of the tax-favored system, and we encourage this activity.

Question 15:

The President proposes a 28 percent limitation on itemized deductions and on other exclusions. The proposal would apparently apply to those in the 33-percent bracket. So, under current law, an itemized deduction of say $100 for someone in the 33-percent bracket will reduce their tax by $33, but the President wants their tax to be reduced by only $28. This would be a $5 increase in that person's taxes. However, for 2013, the 33 percent bracket starts at $183,250 for single people and $223,050 for married couples. But the President has pledged that he wouldn't raise taxes for singles below $200,000 and married couples below $250,000. So, President Obama is explicitly proposing to increase taxes for those who he pledged would not have their taxes increased. Therefore, this represents a reversal of the President's pledge, does it not? Can you explain please?

The proposed limitation would be effective in 2014. 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 two personal exemptions and the standard deduction would have AGI of $247,950. Most high-income taxpayers will claim itemized deductions in excess of the standard deduction or will claim more than two personal exemptions or will earn tax-favored income that is not included in AGI.

Question 16:

As you know, many of us are concerned about the lack of detail coming out of the administration on the establishment of exchanges, leading many of us – on a bipartisan basis – to believe that exchanges may not be up, and running starting October 1. Can you discuss the progress made by the IRS to be ready to determine eligibility for tax credits? Has the administration completed contracts to build the eligibility determination system that will hook up to the federal data services hub? Are you confident that eligibility determinations will be made in real time starting October 1?

In October 2013, the IRS will have systems in place to support the timely Marketplace Exchange Open Enrollment. The IRS's major role is the provision, upon the applicant's request, of certain tax information through the HHS Data Services Hub to the Marketplace. The Marketplace will use the IRS data, together with appropriate information from other sources, to make income-based eligibility determinations for an applicant who chooses to request financial help with obtaining coverage. The Marketplace will work with the applicant on the options, including the

advance payment of premium tax credits to the applicant's insurance company to make insurance premiums more affordable. In addition, the IRS is providing a premium tax credit computation service for use by the Marketplace when it calculates an applicant's various options. This service, using data inputs from the Marketplace, is offered so that the same calculation methodology is used both when the Marketplace makes the determination about advance payments of premium tax credits and when the final premium tax credit is computed on the later tax return. The IRS has made significant progress and the bulk of the systems development work is complete. To ensure the systems function as planned, in addition to internal testing, the IRS is currently testing with HHS/CMS. The IRS is also developing management processes that will be in place to ensure consistent support once the systems are operational.

Question 17:

In a letter to the President, I raised concerns with the lobbying efforts of multiemployer plans requesting access to Advance Premium Tax Credits (APTCs) for collectively bargained plans, mostly because of the unions' concerns with the rising cost of health care, despite the administration's claims that the law would reduce health care costs. Do you agree that multiemployer plans meet the minimum essential coverage test? If so, do you also agree that enrollees in such plans will therefore be prevented from accessing APTC?

My understanding is that multiemployer plans generally would constitute eligible employer-sponsored plans and minimum essential coverage. The Affordable Care Act provides than any employee who is enrolled in such a plan (whether or not a multiemployer plan) is not eligible for a premium tax credit under Internal Revenue Code section 36B.

Question 18:

The tax on health insurance is one of many factors causing premiums to rise. There is a real threat that small employers will be forced to terminate employee coverage and send their workers to exchange-subsidized coverage. In the latest CBO baseline projections, the number of workers who lose their employer-sponsored coverage is estimated to rise from 4 million to 7 million. Do you share my concern that rising premiums will cause more and more workers to enroll in exchange-subsidized coverage, increasing the cost of the ACA and increasing future deficits?

We expect the Affordable Care Act to have a small impact on enrollment in employer-sponsored coverage. The explanation accompanying the revised estimates of the Congressional Budget Office (CBO) baseline makes clear that the revision was for reasons unrelated to premiums. CBO revised upwards their projections of both the baseline number of people with employment-based coverage and the number of people in the subsidy range. The CBO explanation indicates

that these factors, combined with the reduction in marginal income tax rates under the American Taxpayer Relief Act of 2012, resulted in the change from 4 million to 7 million employees shifting out of employer-sponsored coverage. CBO continues to estimate that overall the ACA will reduce the Federal budget deficit by hundreds of billions of dollars over the next two decades.

Question 19:

Would the standard deduction be subject to the 28 Percent Limitation on Itemized Deductions?

No.

Question 20:

The proposal would apparently apply to those taxpayers in the 33-percent bracket. So, under current law, an itemized deduction of say $100 for someone in the 33-percent bracket will reduce their tax by $33, but the President wants their tax to be reduced by only $28. That is, this would be a $5 increase in such person's tax, if the President's proposal were adopted. However, for 2013, the 33 percent bracket starts at $183,250 for single people and $223,050 for married couples. But the President has pledged that he wouldn't raise taxes for singles below $200,000 and married couples below $250,000. If those numbers, properly adjusted for 2013 would be $207,350 and $251,700. So, President Obama is explicitly proposing to increase taxes for those below the thresholds he said should not have their taxes increased and that he pledged would not have their taxes increased. So, this represents a reversal of the President's pledge, does it not? Can you explain that please?

Please see answer to question 15.

Question 21:

On page 135 of the Green Book, you state that "If a deduction or exclusion for contributions to retirement plans or individual retirement arrangements is limited by this proposal, then the taxpayer's basis will be adjusted to reflect the additional tax imposed." I would like to understand this better. Under current law, please consider the scenario where John makes a non-deductible contribution to a traditional Individual Retirement Account of $1,000. Let us assume that John is in the 10% marginal tax bracket. John's basis in this IRA would be $1,000. Do you agree? Now let us assume for a moment that Congress were to enact the President's proposal to reduce the value of certain tax expenditures. And suppose that Crystal makes a $1000 deductible contribution to an IRA. Furthermore suppose that Crystal is in the 38% tax bracket. (I realize that there is not

currently a 38% bracket, but there certainly might be in the future, and I think that helps illustrate a point.) But for the enactment of the 28 percent limitation, Crystal would have reduced her income tax by $380 by virtue of this contribution. Do you agree? However, because of the enactment of the 28 percent limitation, Crystal would only reduce her tax by $280, right? That is, she would still pay $100 of tax on the $1000 contribution. What would Crystal's basis in the IRA be?

a. **Would it be $100, because that is the amount of tax she paid?**

b. **Or would it be $1000, because she should be treated the same as if she made a non-deductible contribution to a traditional IRA while she was in the 10% bracket? That is, Crystal and John each paid $100 of tax on their $1000 contributions to their IRAs, and thus should perhaps have the same basis.**

c. **Or, had she made a non-deductible IRA contribution, she would have paid $380 of tax giving rise to $1,000 of basis in the IRA, then, since she paid $100 of tax, it should give rise to $263 (i.e., 100/380 * $1,000) of basis?**

d. **Or would it be some other amount?**

Based on discussions with our Office of Tax Policy, it is my understanding that in your hypothetical example, John's IRA basis is $1000, the amount of the non-deductible IRA contribution. Crystal's deductible IRA contribution would have reduced her income tax by $280. The additional tax of $100 paid by Crystal as a result of the limitation on the deduction would give rise to basis of $263 (as outlined in your question).

Question 22:

This is a follow-up to our question and answers in writing from February 2013. You have written that there is a longstanding agreement between OMB and Treasury that only IRS legislative rules that constitute "significant regulatory actions" are subject to E.O. 12866 reviews. You furthermore wrote: "[T]he initial agreement is memorialized in a Memorandum of Understanding between Treasury and the Office of Management and Budget, which was signed by Peter Wallison and Christopher DeMuth on April 29, 1983." Surely there have been updates to this 1983 MOU. Please list for me what additional MOUs there have been since then between Treasury and OMB, and briefly state what there subject matter is. In particular, is there an MOU between Treasury and OMB dealing with the Congressional Review Act?

The longstanding agreement between Treasury and the Office of Management and Budget (OMB), originated during the Reagan Administration and memorialized in a Memorandum of Understanding (MOU) dated April 19, 1983, is still in place. There have been no further MOUs between the Treasury and OMB on this issue, although the understanding reflected in the 1983 MOU has been reaffirmed over the years.

Questions from Senator Maria Cantwell (D-WA)

Question 1:

In the past, the President's Budget has consistently proposed a one-year extension of the state and local sales tax deduction – a provision that has been extended since 2004. However, the President's Fiscal Year 2014 Budget proposal fails to either extend or make permanent this important tax deduction. As you know, the deduction for state and local income taxes is in the tax code and is "permanent." However, the state and local sales tax deduction, which costs a fraction of the permanent deduction for state income taxes, is temporary. The ability to deduct state and local sales taxes impacts over 11 million constituents from across the country who reside Washington, Alaska, Florida, Nevada, South Dakota, Tennessee, Texas and Wyoming. The ability to claim the sales tax deduction puts an average of nearly $500 back into the pockets of over 950,000 Washingtonians, which translates into additional consumer spending necessary to get the economy growing.

a. **The President states that his goal is to "eliminate special tax breaks and loopholes so the wealthiest pay their fair share". As the President has chosen to not extend the state and local sales tax deduction in his budget, does the President consider the state and local sales tax deduction a special tax break or loophole?**

b. **What is the justification for treating my constituents differently by maintaining the permanent deduction for state and local income taxes and not extending the deduction for state and local sales taxes?**

Temporary provisions create uncertainty for taxpayers and for 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 raises the revenue needed to pay for important national priorities. The Administration has taken a step in this direction by not proposing to temporarily extend any individual income tax provisions, except for the exclusion from income for cancellation of certain home mortgage debt, which is directly related to the recent economic downturn and thus an appropriate temporary tax provision. In addition, the President has articulated a set of broad principles dealing with revenue, efficiency, and equity that fundamental tax reform should meet. I would be happy to work with you on tax reform proposals that are fiscally responsible, fair, and provide permanence.

Questions from Senator Robert P. Casey, Jr. (D-PA)

Question 1:

I know that the Administration is working hard to finish negotiations on the Trans-Pacific Partnership (TPP). News reports suggest that Japan is close to joining the negotiations. I am concerned by Japan's recent efforts to manipulate its currency, particularly as it looks to enter into a major trade agreement with the United States. As Treasury secretary, how do you plan to address Japan's recent actions?

In April, the eleven TPP countries welcomed Japan's participation in the TPP negotiations, pending the completion of domestic procedures. TPP countries are now completing their respective domestic processes. In the case of the United States, this involves a 90-day consultation period with Congress, which is currently underway.

With regard to currency matters, Treasury has emphasized the importance of market-determined exchange rates both bilaterally and multilaterally, including in the G-7, G-20, IMF, and the WTO, in promoting more balanced global trade and faster and more efficient global adjustment of external imbalances. All G-20 countries have committed to moving more rapidly toward market-determined exchange rate systems, avoiding persistent exchange rate misalignments, refraining from competitive devaluations, and not targeting exchange rates for competitive purposes. G-7 members have made clear that policy tools should be designed to deal with domestic growth using domestic instruments and should not target exchange rates. Japan has had weak growth and deflation for a long period of time. As long as they stay within the bounds of international commitments, growth is an important priority. The Administration will closely monitor Japan's policies and the extent to which they support the growth of domestic demand.

The United States benefits from an economically vibrant and rapidly growing domestic market in Japan to help support growth in the Asia-Pacific economy and our own economy back home. Macroeconomic stimulus will be supportive in the short-term but cannot be a substitute for structural reform that raises productivity and trend growth. It is important that Japan take fundamental and thorough steps to increase the dynamism of the domestic economy, by easing regulations that unduly deter competition in its domestic economy. The Trans-Pacific Partnership (TPP) Agreement can play an important role in promoting high standards, economic reform, market opening, and greater competition in Japan.

Question 2:

The budget speaks to the need to target research and development resources to those areas most likely to directly contribute to the creation of transformational technologies that can create businesses and jobs of the future. One such area is our domestic life sciences industry. I believe investment incentives are key to creating and retaining the science-based workforce we need to keep our edge in this essential field. I am concerned that we are already losing ground. In 2005, the National Academies Committee on Science warned that, "Having reviewed the trends in the United States and abroad the committee is deeply concerned that the scientific and technological building blocks critical to our economic leadership are eroding at a time when many other countries are gathering strength." It is out of this concern that I have introduced legislation to enhance the R & D support for this industry. How does your budget address support innovation key industries such as the life sciences?

The Administration shares your commitment to fostering innovation. The Administration's FY 2014 Budget includes a proposal to make the Research and Experimentation (R&E) credit permanent to reduce the uncertainty businesses face when making decisions to invest in research projects, which often take place over several years. In addition, the Budget proposes to increase the credit rate for taxpayers using the Simplified Alternative Credit from 14 percent to 17 percent. These proposals support business innovation in all industries, including life sciences.

In addition to the R&E credit proposal, the Budget proposes a set of more flexible standards for public-private research arrangements that can be financed using tax-exempt bonds.

Question 3:

The need for investment in infrastructure that serves the inland waterways system across the country is great. I have introduced the Revitalizing in Vital Economic Rivers and Waterways (RIVER) Act that contains several provisions that will make our waterways more viable in the long term and prevent failure in the near term. If one of the locks failed in the Pittsburgh region, it would have a detrimental economic impact of $1 billion. Included in the RIVER Act is an industry-backed revision to fuel user fee from to change it from 20 cents to 29 cents per gallon. The current fee has not been revised since 1994 and does not generate enough revenue to adequately fund the Inland Waterways Trust Fund. Included in the President's budget proposal is a special recreational user fee as opposed to addressing the barge industry user fee. What is the Administration's position on increasing barge industry user fee? Does the Administration's proposal to increase the special recreational user fee generate enough funding to address the needs of operations and maintenance on the system?

The Administration's FY 2014 Budget proposes an annual inland waterways user fee per vessel to increase the amount paid by commercial navigation users sufficiently to meet their share of

the costs of activities financed from the Inland Waterway Trust Fund. The Administration believes this is an efficient way to allocate construction and rehabilitation costs across the spectrum of users of the inland waterway system. The Budget projects over $80 million in new revenues from the proposed fee in FY 2014, and $1.1 billion between 2014 and 2023.

Question 4:

The budget includes a tax credit for the production of advanced technology vehicles. I have legislation called the Natural Gas Energy and Alternatives Rewards Act (NGEAR), which pursues a similar goal of speeding our transition away from vehicles dependent on foreign oil. In addition to natural gas, Pennsylvania has companies innovating in technology for bi-fuel and hydrogen and fuel-cell vehicles. Would these types of vehicles—natural gas, bi-fuel and hydrogen and fuel-cell vehicles meet the criteria as outlined by Treasury?

Advanced technology vehicles such as natural gas, bi-fuel, hydrogen, and fuel-cell vehicles would satisfy the criterion that the vehicles operate primarily on an alternative to petroleum. Whether these vehicles would meet the other specified criteria (e.g., whether there are few vehicles in operation in the United States using the same technology and whether the technology used by the vehicle exceeds the target miles per gallon equivalent by at least 25 percent) would need to be determined on a vehicle-by-vehicle basis.

Question 5:

I have been approached by several charitable organizations in Pennsylvania regarding the delay in IRS processing of their 501(c) (3) applications. These organizations are doing worthy and necessary work in Pennsylvania, and are finding it nearly impossible to operate during the one year plus it is taking to receive a 501(c) (3) designation. What are Treasury's plans to address this untenable wait time?

I agree with you that it is important that the IRS process applications for tax-exempt status in a timely fashion. It is a long-standing practice of Treasury not to be involved in the details of tax administration, especially in regard to individual taxpayers. In May, the President appointed Mr. Werfel as acting head of the IRS. Mr. Werfel's recently-issued report on the activities of his first thirty days, which addresses delays of processing of certain applications for tax-exempt status, demonstrates his commitment to the important issue of timely application processing.

Question 6:

I understand that the Affordable Care Act includes new 501(r) requirements for hospitals applying for 501(c)(3) designations. At this time these rules have not been finalized. Given this, why are Pennsylvania hospitals being held to 501(r) requirements in 2013, prior to the full implementation of the Affordable Care Act next year?

Although many provisions of the Affordable Care Act do not go into effect until 2014, Congress made most of the requirements of section 501(r) immediately effective. Thus, the section 501(r) provisions became effective for tax years beginning after March 23, 2012. Treasury and the IRS have moved quickly to work with hospitals and other stakeholders to develop guidance for hospitals regarding how to comply with these statutory requirements. Treasury and IRS issued proposed regulations on June 26, 2012, and April 5, 2013, that hospitals may, but are not required to, rely on now. Treasury and IRS continue to work diligently and expeditiously to finalize the section 501(r) regulations, taking into account the significant number of public comments received on the proposed rules.

Questions from Senator Mike Crapo

Question 1:

Secretary Lew, 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. If this occurs:

a. **Is there a requirement that the taxpayer be repaid for any money taken by the FHA and if so what will be the plan for that repayments?**
b. **Will you commit to informing the Congress and the public as soon as this occurs?**

For FHA's loans guaranteed before 2014, the President's FY 2014 Budget forecasts that the FHA Mutual Mortgage Insurance (MMI) Fund, which provides the resources to support FHA's single family and reverse mortgage guarantees, will use $943 million of its mandatory appropriation authority to supplement its reserves at the end of FY 2013. The MMI Fund currently has approximately $36 billion in cash available to pay claims, so this is not a cash problem; it is one of setting the right size of loan loss reserves aside.

The $943 million figure is based on the annual re-estimate of the reserves FHA will need to hold, for the payment of expected losses over the next 30 years on its portfolio of guaranteed loans as of last September, based upon Federal Credit Reform Act (FCRA) scoring.

The actual need for a mandatory appropriation from the Treasury General Fund to the 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. Should there be a need for a mandatory appropriation to FHA, it would be drawn from FHA's permanent and indefinite authority, in the same way that mandatory appropriations are drawn under this standing authority for all federal credit programs.

FHA is responsible for communications on the MMI Fund, so any such questions related to the fund should be directed to them.

