

EMBARGOED FOR DELIVERY

The Honorable Jacob J. Lew
United States Department of the Treasury
U.S. House of Representatives Committee on Ways and Means
February 11, 2016

Chairman Brady, Ranking Member Levin, Members of the Committee, thank you for the opportunity to appear before you today.

As President Obama said in his State of the Union address, this is a time of extraordinary change and, to make this change work for us, we as a country must focus on the future by confronting head-on some of our biggest challenges. The President concentrated on four key areas to which we must attend in the coming years, specifically: (i) fostering economic opportunities for all Americans; (ii) leveraging new technologies to solve urgent problems such as climate change; (iii) pursuing a smart foreign policy that protects our national security; and, (iv) working together to improve our political discourse. What we do in each of these key areas is crucial to our future as a nation. As Treasury Secretary, I focus most of my time in the area President Obama addressed first, namely how to spur growth and opportunity in our new economy. Today, I will discuss the major aspects of the President's Budget and how this Budget lays out a vision for what we need to do as a country both now and over the next five or 10 years and beyond to create growth and make sure that opportunity is broadly shared.

Before turning to what we need to do for our economy over the long-term, let me first note the progress we have made over the course of the Administration.

HOW FAR WE HAVE COME

In the seven years since President Obama took office amidst the worst financial crisis since the Great Depression, we have seen a sustained economic recovery and an unprecedented decline in the federal budget deficit. Since my testimony a year ago, our economy has continued its record-breaking streak of private sector job creation, which has reached nearly six consecutive years and 14 million jobs. Over the last two years, we have experienced the strongest job creation since the 1990s. At 4.9 percent, the unemployment rate is half of its 2009 peak. Consumer confidence is strong and small businesses are planning further increases in their payrolls. Rising home prices have restored trillions of dollars in home equity to homeowners.

Last year, we celebrated the five-year anniversaries of two major pieces of legislation—the Affordable Care Act (ACA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)—that have had an important impact on the economic security of American households and the stability of our financial system, an essential prerequisite for long-term growth. As the coverage provisions of the ACA have taken effect, nearly 18 million more Americans have gained coverage. The ACA has also improved coverage for those who already had health insurance, and changed the incentives for hospitals, doctors, and other providers to encourage higher quality, more efficient care. Health care inflation has been notably slower over the past five years, and, for the first time ever, more than 90 percent of Americans have health care coverage. And Dodd-Frank has put in place protections that ensure that the financial system today is better capitalized, less leveraged, and far safer than it was prior to the crisis. It also

created the Financial Stability Oversight Council, a body that looks across the entire financial system to identify future threats to financial stability, and the Consumer Financial Protection Bureau, an agency whose sole purpose is to protect Americans from unfair, deceptive, or abusive financial practices.

The Administration has also worked hard to make our tax system stronger and fairer. Legislation enacted since early 2009 has decreased average tax bills by several hundred dollars for those in the lower third of the income distribution, while ensuring that those at the top pay a fairer share, especially among families in the top 1 percent and top 0.1 percent. Through policies like the Recovery Act expansions of the Earned Income Tax Credit, the Child Tax Credit and the American Opportunity Tax Credit (recently made permanent); ACA subsidies for purchasing health insurance; higher tax rates on dividend and long-term capital gains income; and reinstating the top rate on the highest earners to the level that prevailed in the 1990s, after-tax income increased substantially for lower-income families and the overall tax system became more progressive during this Administration. We have also made the Tax Code more stable and predictable by making major individual and business provisions, such as the Research and Experimentation (R&E) Tax Credit and enhanced small business expensing, permanent in last year's agreement, providing the certainty businesses need for effective planning.

Notwithstanding some of the recent volatility we have seen in the financial markets, economic growth continues at a solid pace. Real GDP expanded 1.8 percent last year. Private domestic demand—the demand generated by American households and businesses—was the principal driver of growth, expanding at a solid 2.7 percent. Both private sector forecasters and the IMF expect the underlying strength in domestic demand to continue this year, with real GDP growth picking up to around 2.5 percent. This pace of expansion substantially exceeds that of many of our major trading partners, and, in fact, soft demand from abroad for our exports has been, and will continue to be, a significant drag on U.S. growth. While a widening trade deficit is natural in these circumstances, the rest of the world cannot depend on the United States to be the sole engine of growth. That is why this Administration has consistently worked with our international counterparts to encourage the implementation of strong and comprehensive policies to support growth.

Meanwhile, we continue on a sound fiscal path. The deficit for fiscal year 2015 was roughly \$150 billion or three-quarters of a percent of GDP lower than we anticipated in our Budget one year ago. From fiscal year 2009 to 2015, the deficit as a share of GDP fell by almost three-quarters to 2.5 percent. Only the period of demobilization following the end of World War II saw a faster pace of fiscal consolidation. Since 2011, four fifths of the deficit reductions we have achieved have been from spending cuts.

And over the past three years, we have seen real progress in returning to fiscal policy that boosts our economy. The Administration began with bipartisan efforts to stabilize and restore growth to our faltering economy with targeted investment, but subsequent fiscal policy choices hurt, rather than helped, the economic recovery. In March 2013, sequestration cuts that were never intended to take effect were implemented, reducing GDP by 0.6 percentage points and costing 750,000 jobs. But later that year, following a series of damaging and unnecessary debt limit stand-offs and a protracted government shutdown, policymakers finally began to turn away from

manufactured crises and austerity budgeting. The President worked with Congress to secure a two-year budget agreement that replaced a portion of the harmful sequestration cuts with more balanced and sensible deficit reduction measures. This allowed for higher investment levels in 2014 and 2015, a significant contribution to the improvement in the labor market over the past two years. Between its peak in 2009 and the end the 2015, the deficit dropped by almost 1 trillion dollars, or over 7 percent as share of GDP. An increase in revenues as a share of GDP and a decrease in spending as a share of GDP played roughly equal roles in the decline

Again for 2016, when harmful sequestration cuts were scheduled to return, the President worked with congressional leaders from both parties to secure another two-year budget agreement (the Bipartisan Budget Act of 2015 or BBA), showing that the right results for the country can be achieved when we work together. The BBA will create an estimated 340,000 jobs in 2016 alone, while supporting middle-class families, investing in our long-term growth, protecting Social Security, and safeguarding our national security. Finally, the year-end FY 2016 omnibus appropriations act included a bipartisan agreement to extend expiring tax provisions that will, among other things, boost support for research and development and clean energy investment in the private sector, provide permanent tax relief to working families, and simplify and cut taxes for small businesses.

Still, more needs to be done. Non-defense discretionary funding in 2017 will be at its lowest level since 2006, adjusted for inflation, even as the need for pro-growth investments in infrastructure, education, and innovation has only increased due to the Great Recession and its aftermath. Inflation-adjusted defense funding will also be at its lowest level since 2006. And without further action from Congress, the sequester will come back into effect in 2018 and put at risk the economic progress we have made.

We must also not leave behind our communities in distress. Nowhere is this more evident than with the 3.5 million Americans living and working in the Commonwealth of Puerto Rico. While the economic health of our nation has improved dramatically since President Obama took office, Puerto Rico's economy continues to suffer. Their unemployment remains above 12 percent. Outmigration continues to accelerate. And the Commonwealth's debt is unsustainable. As a result, the Administration proposed a comprehensive plan to address Puerto Rico's financial challenges and we encourage Congress to act with the haste this crisis requires. This must begin with legislation to permit a financial restructuring along with new oversight, neither of which cost any taxpayer dollars.

THE FY 2017 BUDGET AND WHERE WE ARE GOING

Despite the significant progress we have made over the past seven years, we have much more to do to address fully the challenges associated with our new economy. As the President indicated in the State of the Union, the most significant and most pressing of our economic challenges is how we ensure that the benefits of our growth are shared by all Americans. While more Americans have jobs than ever before, millions of Americans are still searching for work and millions of part-time workers are still searching for full-time opportunities. We are still not seeing enough growth in household income and wages, and too many American families still

have limited savings, impairing their ability to cope with an economic shock such as job loss, let alone retirement.

The President's FY 2017 Budget is designed to address these and other pressing problems. It puts forward the building blocks of a social compact for the 21st century, creating the conditions for sustained economic growth while upholding the basic American belief that everyone who works hard should get a fair shot at success.

The President's FY17 Budget shows that investments in growth and opportunity are compatible with putting the nation's finances on a strong and sustainable path. The Budget substitutes more balanced deficit reduction and ends sequestration, while making other critical investments and addressing our fiscal challenges over the next 10 years. It keeps deficits below 3 percent of GDP while stabilizing debt and putting it on a declining path through 2025—key measures of fiscal progress.

The Budget accomplishes these goals by more than paying for all new investments and continuing to achieve significant deficit reduction. The Budget includes roughly \$375 billion of health savings that grow over time and builds on the ACA with further incentives to improve quality and control health care cost growth. It also includes smart tax reforms that promote growth and opportunity, while strengthening tax policies that help middle-class families afford child care, higher education, and a secure retirement.

The Budget also shows that responsible deficit reduction can be achieved without cuts in critical aid to poor Americans and without undermining our commitments to seniors and workers. The Budget puts us on sound fiscal footing even as it modernizes benefits for workers, invests in evidence-based efforts to reduce poverty and promote opportunity, and protects Social Security and Medicare.

Reforming the Tax Code

In 2012, the President first laid out his Framework for Business Tax Reform, and the President's Budget continues to put forward a robust business tax reform plan to support economic growth, encourage businesses to create good, high-paying jobs in America, and expand opportunity so our nation's economic gains support a strong middle class. Fixing America's business tax system is essential to promoting long-term growth and broad-based prosperity. Over the three decades since we last rewrote it, the tax system has become heavily burdened by loopholes and inefficiencies. Businesses are forced to focus too much attention on tax planning and financial engineering rather than growing the top line of their businesses.

One clear indication of the need for reform is the pace at which companies are pursuing corporate inversions to avoid paying U.S. income taxes. While inversions may be legal, it is wrong for these companies to take advantage of U.S. infrastructure, education, support for research, and rule of law, and yet avoid paying their fair share of U.S. taxes. While the Administration has used its administrative authority to reduce the economic benefits of these transactions and to limit them to some extent, the only real solution is for Congress to enact business tax reform that addresses the root inefficiencies that cause these problems and

specifically closes the inversion loophole. The growing bipartisan consensus in Washington on how to achieve business tax reform creates the opportunity to take this key step sooner rather than later. In the meantime, Congress should act this year to change our tax laws to stop corporate inversions.

The Budget again calls for a fiscally-responsible business tax reform, and makes a number of concrete tax reform proposals, including a complete reform of our international tax system. Last year's permanent extension of several important business tax provisions, including the R&E Credit, advanced important components of our tax reform agenda. But that legislation did not offset the budgetary impact of those cuts and leaves the job of reforming our business tax system undone. Though the end-of-year legislation on certain business tax extenders was a first step, we need to take further steps to enact a comprehensive business reform plan, that, taken together with the extenders legislation, is deficit-neutral in the long run.

Building a 21st Century Infrastructure

While last year's surface transportation reauthorization bill, the Fixing America's Surface Transportation (FAST) Act, will help address our nation's crumbling infrastructure, we should not be content with merely repairing aging roads, bridges, rail, and transit systems. Transportation infrastructure has been a key ingredient of economic growth in this country nearly since its inception. And infrastructure investment provides a double return: in the short-term, it creates middle-class jobs across a range of skills and sectors; in the long-term, it provides assets that meet the needs of a growing economy and make our towns and cities more attractive to new business investment. Investments in our transportation network can also help us tackle the threat of climate change. Today, the transportation sector contributes nearly thirty percent of U.S. carbon emissions. We will need to move to a cleaner, low-carbon transportation system that is also more resilient to the impacts of climate change.

To help make this transition, the Budget proposes to invest \$20 billion per year to shift Federal investments towards cleaner transportation options like rail and transit; \$10 billion per year in new and innovative grant programs that partner the Federal government with local and state governments to accelerate the move towards smarter, cleaner, and more integrated communities; and \$2 billion to accelerate development and deployment of clean vehicle technology.

To fund these investments, the Administration has proposed a \$10.25 per barrel fee on oil, which would be gradually phased in over five years. There are many costs associated with fossil fuel use, and given our highly oil-dependent transportation environment, an oil fee will ensure that we better manage our resources to reflect those costs. These resources would also provide for long-term solvency for the Highway Trust Fund, renamed the Transportation Trust Fund in the President's Budget to reflect its multi-modal nature, beyond the current extension.

The private sector can play a valuable role in helping to maximize limited public resources for infrastructure. Effective public-private partnerships are a growing procurement alternative for state and local governments; these arrangements may accelerate the delivery of complex projects, leverage the resources and expertise of the private sector, mitigate construction and operational risks, and reduce the likelihood of deferred maintenance. The Budget includes a

number of proposals to take small steps to level the playing field for private investment in public infrastructure projects where appropriate, including renewing our proposal to create Qualified Public Infrastructure Bonds, which would extend tax-exempt benefits to certain public-private partnerships, and introducing the Financing America's Infrastructure Renewal program, which would provide direct loans to U.S. infrastructure projects developed through public-private partnerships.

Finally, the Budget maintains its support of our long-standing infrastructure bank proposal, which would help target and manage the complexity of implementing economically and regionally significant infrastructure investments. There are a number of creative ideas in Congress about how to boost our infrastructure investment, and I look forward to continuing to work with Congress to build a 21st century infrastructure.

Providing Opportunity Through Education

The United States was one of the first countries to provide public high school education, and as a result we were one of the most highly educated populations in the 20th century. Now it's time to ramp up our workforce for the 21st century by ensuring broad access to high quality education, starting with pre-K, as well as training for those who are already out of the education system. And we must make sure that once they complete their schooling, our students are not burdened with a mountain of debt that they cannot repay.

The Budget recognizes that changes in our economy make it more essential than ever that workers have the right education and training. It thus includes policies that enhance educational opportunities from pre-K through college. We propose to provide pre-K for all; offer every student hands-on computer science and math classes; and make community college and career and technical schools free for responsible students. Furthermore, this year's Budget introduces a tax credit to incentivize employers to join consortia with community colleges. This will help drive development and resourcing of career training programs that train for real employment needs in the region and provides a hiring tax credit when consortia employers hire new workers out of the program. In addition, for those already in the workforce who are struggling with the rapid change in the economy, the Budget also provides for job retraining so they can bring new skills to bear. Finally, the Budget provides funding to implement the Administration's ongoing efforts to ensure that student loan contractors provide high-quality loan servicing to students. This funding will also allow the Department of Education to provide enhanced oversight and strengthen enforcement activities, such as pursuing schools that engage in deceptive or misleading practices toward students, including veterans.

Providing a Safety Net for Working Families

The Budget again proposes a set of policies that will raise the incentives for working, including raising the minimum wage and reducing taxes on working families. For example, it proposes to strengthen the Earned Income Tax Credit for workers without dependent children—the only group that the federal tax code taxes into poverty or taxes deeper into poverty. The Budget also addresses some new needs of working families, given changes in the relationship between workers and their employers over time. For example, it proposes expanded unemployment

insurance and introduces a new wage insurance program to help families stay on their feet when their wage earners are underemployed as part of a job transition. The President's plan would ensure that workers have access to wage insurance that would replace half of lost wages, up to \$10,000 over two years. Displaced workers making less than \$50,000 who were with their prior employer for at least three years would be able to leverage these resources to help them get back on their feet and on the way to a new career.

Similarly, the Budget addresses holes in our unemployment insurance system, including by expanding coverage to many part-time, low-income, and intermittent workers, and workers who leave work for compelling family reasons. It would also ensure that states provide 26 weeks of coverage. This is coupled with a plan to make it easier for companies to avoid lay-offs through work-sharing, while incentivizing states to offer and allow retraining for workers on unemployment insurance or to provide relocation vouchers or subsidized employment. In addition, it would expand intensive career counseling to long-term unemployed, discouraged, and part-time workers.

Encouraging Retirement Savings

While the vast majority of people understand the benefits of saving for retirement, it is a fact that many Americans have very limited savings, and some have no retirement savings at all. Low- and moderate-income households have especially low levels of accumulated assets, and as many as 78 million working Americans do not have a retirement savings plan at work. To help people start saving, late last year Treasury launched the *myRA* retirement program. It is free to get started, there are no minimum balances or fees, and there is no risk of losing money because savings are invested in risk-free U.S. Treasury securities. *myRA* fills a crucial gap in the retirement savings system by providing an option for people who do not have access to a retirement savings plan at work. It helps people get started saving by allowing people to contribute any amount, no matter how small, and it does not conflict with private retirement options since the balance is ultimately rolled over into a private-sector IRA after 30 years or once it reaches \$15,000, whichever comes first.

But, this just scratches the surface. The Budget proposes to expand access to workplace retirement savings opportunities by encouraging more employers to offer plans and making it easier for workers to participate by enabling small businesses to come together and create pooled 401(k) plans at lower cost and with less burden than they would have on their own, automatically enrolling workers without access to a workplace plan in an IRA, providing tax credits for small businesses that begin offering retirement plans or choose to automatically enroll workers in existing plans, and allowing long-term, part-time workers to participate in their employer's plan.

Conclusion

The policies in this Budget will create a stronger, more inclusive economy today and in the future, while also maintaining fiscal responsibility. Of course, this Budget does not address every challenge we face in the long term. For example, we must strengthen Social Security to keep true to our commitments to previous and future generations of workers. And while

business tax reform would significantly boost the economy, there are also significant challenges and inefficiencies on the individual side that we must address.

Our problems will undoubtedly not all be solved in the next 11 months—far from it. But there is still much we can accomplish. As the President said in his State of the Union address, progress is not inevitable but rather is the product of choices we make together as a nation. We face a number of big choices in the coming years. And though responsibility for addressing our nation’s biggest problems will soon pass from this Administration to the next, we all have a stake in our country’s future. Whether you hold public office, run a small business, serve in the military, or are struggling to find a job, we all have duties as citizens—to vote, to engage, to speak out for what we believe in—that we must exercise to foster an America of the future that reflects our shared goals and values.