Joint Statement of Timothy F. Geithner, Peter R. Orszag, and Christina D. Romer
Before the Committee on Appropriations, U.S. House of Representatives
March 16, 2010

Chairman Obey, Ranking Member Lewis, and Members of the Committee, thank you for inviting us to testify this morning about the Troika forecast, the outlook for the American economy, and the Administration's economic agenda.

We come before you after a trying year for the Nation. A little more than one year ago, the economy seemed on the verge of a second Great Depression. Together with the Congress, the President worked aggressively to stabilize the financial system and bring the economy back from the brink. The worst now appears to be behind us. However, the country faces significant and ongoing challenges: high unemployment, the need to build a new and stable foundation for prosperity in the years and decades ahead, and a medium- and long-term fiscal situation that could ultimately undermine future job creation and economic growth. The big problems we face today were all years in the making, and it is our responsibility to address them without delay.

I. Rescuing the American Economy from the Great Recession

Responding to a Historic Crisis

In the months before President Obama took office, the American economy faced disruptions even larger than those that triggered the Great Depression. The disturbances to credit markets, the decline in wealth, and the rise in uncertainty were all much larger than those that hit the economy in late 1929 and early 1930. The result of these shocks was a terrible deterioration in economic conditions in late 2008 and early 2009. Real GDP declined at an annual rate of over 5 percent in the fourth quarter of 2008 and over 6 percent in the first quarter of 2009, and job losses averaged 650,000 per month in the fourth quarter of 2008 and 750,000 per month in the first quarter of 2009. The threat of a second Great Depression was frighteningly real.

That the shocks did not precipitate a second Great Depression is a testament to the swift and strong policy response by the Administration and Congress, together with the actions of the Federal Reserve and other financial regulators. With the unemployment rate now at 9.7 percent, the economy is obviously far from healthy. But over the past year, its trajectory has changed from uncontrolled freefall to approximate stability, with growth in all major private components of GDP last quarter.

The centerpiece of the policy response was the American Recovery and Reinvestment Act of 2009 (Recovery Act). Simply put, the Recovery Act is the boldest countercyclical fiscal action in American history. It was designed to fill part of the shortfall in aggregate demand caused by the collapse in private spending. It is providing tax cuts and increases in government spending equivalent to roughly 2 percent of GDP in 2009 and 2¼ percent in 2010. It is well diversified, because the decline was broad-based and because different kinds of stimulus affect the economy in different ways. Roughly one-third of the overall package—and an even larger fraction of the package implemented to date—consists of tax cuts. These include the Making Work Pay tax credit, which cuts taxes for 95 percent of America's working families, as well as important tax cuts for small businesses. The bill also includes crucial support for unemployed workers and others most directly affected by the recession; critical assistance to State governments, whose budgets have been devastated by the recession; and vital government investments in everything from roads and bridges to clean energy technologies.

The Recovery Act was part of a broader set of policies to turn the economy around. These policies included additional fiscal actions, such as the "cash for clunkers" program and important extensions of business tax cuts and support for the unemployed. On the financial side, they included the stress tests that led to greater confidence in the stability of our leading financial institutions and allowed them to raise crucial private funds, as well as the numerous actions undertaken by the Treasury and the Federal Reserve to maintain critical credit flows. In the housing market, they included the Home Affordable Refinance Program to help families refinance their mortgages at lower rates, the Home Affordable Modification Program to encourage responsible loan modifications, and numerous actions to maintain mortgage lending and bring mortgage interest rates to historic lows.

The policies have clearly helped to change the trajectory of the economy. Our financial markets are secure again, and most credit spreads—a common measure of default risk and financial market unease—are down almost to historical norms. Housing prices appear to have largely stabilized. Real GDP began growing in the third quarter of 2009 and grew at a robust 5.9 percent annual rate in the fourth quarter. Job losses have slowed to a trickle.

Experts from across the ideological spectrum assign these policy responses a key role in the economy's improved trajectory. In the case of the Recovery Act in particular, estimates from the Council of Economic Advisers, the nonpartisan Congressional Budget Office (CBO), and a range of private forecasters suggest that because of the Recovery Act, GDP in the fourth quarter of 2009 was between 1½ and 2½ percent higher than it otherwise would have been, that employment was between 1 and 2 million higher, and that these contributions will continue to rise in 2010.

Of course, the economy is far from fully recovered, and significant challenges remain. Most obviously, the current unemployment rate of 9.7 percent is unacceptable by any metric, and employment is 8.4 million below its level before the recession.

The Administration Forecast

Prior to each Budget, the "Troika"—the Council of Economic Advisers, the Office of Management and Budget, and the Treasury—work together to produce an economic forecast. This year, our forecast was finalized on November 17, 2009, and so reflects data through mid-November. All forecasts are subject to substantial margins of error. And, in the wake of a severe downturn such as the one we have just been through, usual patterns provide less guidance than in more ordinary times. But we have based the Budget projections on our best estimates of what lies ahead.

GDP growth. For GDP, the forecast projects moderate growth of 3.0 percent (on a fourth-quarter-to-fourth-quarter basis) in 2010, followed by somewhat higher growth of 4.3 percent in both 2011 and 2012. Compared with the recoveries from other severe recessions, the projected growth is relatively modest, particularly in 2010. This reflects a combination of factors, including the limitations on monetary policy coming from the fact that interest rates cannot go below zero; the weakened state of households' and firms' balance sheets; the continuing caution of households and firms following the searing events of the past two years; and the weak condition of State and local government budgets.

Employment and unemployment. In terms of the labor market, the forecast projects average job growth of about 100,000 per month in 2010, about 200,000 per month in 2011, and about 250,000 per month in 2012. Typically following a recession, we see increases in productivity, temporary employment, and the length of the workweek before employment begins to recover. For the most part, developments in recent months have been following this pattern. Productivity growth has surged; temporary help employment has risen for 5 consecutive months; and the workweek has been generally rising. We expect to begin seeing job gains by sometime this spring.

Because of normal growth in the population and the fact that some workers are likely to reenter the labor force as the economy improves, it typically takes employment growth of somewhat over 100,000 per month to bring the unemployment rate down. Because we do not expect job growth substantially over 100,000 per month over the remainder of the year, we do not expect substantial further declines in unemployment this year. Indeed, the rate may rise slightly over the next few months as some workers return to the labor force, before beginning a steady downward trend. It is also worth noting that the productivity growth we have seen in the last three quarters is the fastest in nearly 50 years. This rapid growth in output per hour has allowed firms to raise production without hiring additional workers. This record pace of productivity growth almost certainly will not be maintained much longer, implying that further increases in output will require additions to the labor force.

As the pace of job creation picks up in 2011 and 2012, there is likely to be greater progress in reducing unemployment. Nonetheless, because of the severe toll the recession has taken on the labor market, the unemployment rate is likely to remain elevated for an extended period. The forecast projects that in the fourth quarter of 2011, the unemployment rate will be 8.9 percent, and that by the fourth quarter of 2012, it will be 7.9 percent.

Inflation. Because of the high levels of slack in the economy, we expect inflation to remain low and see little risk of substantial increases in inflation. At the same time, inflation expectations appear to be well anchored, and so we do not expect inflation to fall substantially further or turn into outright deflation. We project inflation (on a fourth-quarter-to-fourth-quarter basis, as measured by the GDP price index) of 1.0 percent in 2010, 1.4 percent in 2011, and 1.7 percent in 2012.

These forecasts are very much in the range of both the private forecasters surveyed by Blue Chip Economic Indicators and the central tendency of the Federal Reserve's Federal Open Market Committee forecasts. The one prominent forecast that differs importantly from the Administration's is the forecast released by CBO in January, which is considerably more pessimistic about the economic outlook. However, as CBO noted, it is required to make its projections under the assumption of no changes to current law. Thus, it is forced to assume that no additional fiscal support is provided to the economy—and, indeed, that there is substantial fiscal retrenchment due to the scheduled expiration of the 2001 and 2003 tax cuts at the end of this year. This is not what the Administration has proposed, and CBO noted that in the absence of these assumptions its forecast would resemble other prominent forecasts.

Developments since November have not led to large changes in the economic outlook. The most significant development was the good news that GDP growth in the fourth quarter of 2009 was much higher than we and virtually all other analysts expected in mid-November. In considerable part because of an unexpectedly rapid slowing of inventory liquidation, GDP grew in the fourth quarter at a very strong 5.9 percent annual rate. Another favorable development was the fall in the unemployment rate by three-tenths of a percentage point in January, and the maintenance of that lower rate in February. As a result, at this point it appears possible that the average unemployment rate in 2010 will be slightly below our November forecast.

The Need for Additional Targeted Measures to Spur Job Creation

As with any forecast, the forecast underlying the 2011 Budget is just an estimate, and there are risks to it in both directions. In thinking about the risks, there are two key points to keep in mind. First, because of the severity of the downturn that began over two years ago, even in the best case unemployment will remain elevated for an extended period. Second, the Budget was released before specific policy options to spur job creation had been finalized, and the exact form that these proposals take will influence the actual pace of job creation. The President has recently proposed specific high-impact measures to spur job creation, which would improve the outlook for output and employment if implemented.

One cost-effective policy is continued support for those most directly affected by the recession. Precisely because of their difficult circumstances, these families are likely to spend a large fraction of the continued support they receive. Thus, the support not only directly helps them weather the recession, but also stimulates demand and improves the condition of the overall economy. Likewise, the weak budgetary conditions of State governments mean that any additional fiscal support to the States will prevent cuts to vital services and counterproductive tax increases, and so also have strong effects.

Another cost-effective program is the Administration’s proposal to inject $30 billion of capital into smaller banks, which are a key source of lending to the small businesses that are facing difficulties obtaining credit and are critical to the recovery. Because the program would include incentives for increased lending and because the capital could be leveraged several times into new loans, the program has the potential to contribute significantly to job creation at little long-run cost to the taxpayer. Moreover, the Administration has proposed eliminating capital gains taxes on investments in small businesses; using TARP funds to provide lower-cost capital to CDFIs to boost small business lending in hard-hit areas; and extending and expanding two successful Small Business Administration programs. The Administration also supports tax incentives for investments in home energy retrofitting and carefully chosen additional infrastructure investments, which could prove effective in spurring the recovery.

Finally, one measure that could have a strong effect on job creation in particular is a payroll tax credit for new hiring, such as the Administration’s proposed Small Business Jobs and Wages Tax Cut or the payroll tax credit for hiring unemployed workers proposed by Senators Schumer and Hatch. These proposals rely on the basic economic principle that if you want more of something—in this case, hiring—you should lower its price. The proposals offer significant benefits to firms that undertake new hiring. Estimates by the Council of Economic Advisers, CBO, and a range of private analysts suggest that such credits have the potential to have a large impact on job creation at a relatively moderate budgetary cost. We also believe that the current situation—where for many firms the question is not whether to hire but when—is one that may make such programs particularly effective.

II. Investing in a New Foundation for Growth

As great as the economy's immediate challenges are and have been, our country's economic problems are also deeper and more long-standing. For nearly a decade, typical American families had seen their incomes stagnate instead of rising steadily as they had for generations. Much of the economic growth that we had experienced in the past decade was fueled by consumers and the Government running up large debts, aided by a financial system better at making short-term profits than managing long-term risks. And as a country, we were failing to invest in education, new energy technologies, and basic research and development.

In order to build a new foundation for American prosperity, we must reverse these trends, and the President's Budget outlines policies that will make important progress in doing so:

Financial Regulatory Reform

A strong, healthy financial system is crucial for sustainable growth, job creation, and broad-based prosperity. Such a system helps families to save for a house, a child's education, and retirement, while at the same time channeling those savings into investments that enable businesses to grow, hire, and raise incomes.

Although our financial system is far stronger today than it was a year ago, it is operating under the same rules of the road that led to its near-collapse and to a historic recession. We need a financial system in which financial firms—especially large ones—have more capital to absorb their own losses and cannot take risks that threaten the whole economy. Consumers need to be given better information to make the decisions that are right for them, and they need to be protected from unfair and fraudulent practices. The Federal Government needs to have authority to break apart and unwind failing firms in ways that limit damage to the system as a whole. The Administration has proposed reforms that would accomplish these goals, and the House has already passed legislation. We must now finish the job of enacting comprehensive reform for the sake of people's financial safety and to ensure growth.

Education and Job Training

Sound investments in education and job training in education are crucial to building the skills and productivity of the Nation's current and future workers. The Budget supports the Administration's efforts to make major reforms and improvements in the nation's elementary and secondary schools—by, for example, expanding the Recovery Act's successful Race to the Top competition to include not only States, but also individual school districts, and by investing in a new competitive fund to encourage States to develop innovative methods for recruiting, retaining, and rewarding effective teachers.

To further the President's commitment that a family's finances should never be a barrier to higher education for a qualified student, the Budget proposes making permanent the 2010 increase in the maximum Pell Grant award to $5,550 and raising it thereafter at a rate a percentage point faster than inflation; the Budget would also make Pell a mandatory program in order to provide greater funding certainty for students aspiring to college. The Budget would extend the American Opportunity Tax Credit, which provides a tax incentive of up to $2,500 per year toward college costs (up to $10,000 for a young person earning a four-year degree). Furthermore, the Budget proposes to assist overburdened student loan borrowers by reducing monthly payments and shortening the repayment period so that these borrowers would pay a maximum of 10 percent of their discretionary income in loan repayments and would have their remaining debt forgiven after 20 years. And the Budget proposes to increase community college graduation by 5 million students by 2020 and provide new incentives for the rising generation of students to train as scientists and engineers.

To keep Americans building new and marketable skills throughout their working lives, the Budget provides $19 billion for job training and employment programs Government-wide, a $1.1 billion, or 6 percent, increase from 2010. This level includes two new innovation funds that will test and evaluate new approaches to training disconnected youths, building regional partnerships, and supporting apprenticeships. The Budget will also support a ten-year extension of Trade Adjustment Assistance Act assistance for American workers who have lost their jobs due to imports or shifts in production overseas, and provide additional support for training in green jobs.

Research and Innovation

At the very core of the Administration's efforts to build a new foundation for growth are efforts to encourage American innovation. We already made the largest investment in basic research funding in history last year, and we propose to build on that: the Budget would increase civilian research and development (R&D) by 6.4 percent, with the aim of helping to create conditions for greater economic productivity and the emergence of new growth- and job-creating businesses.

But while continuing the commitment to double funding for three key basic research agencies—the National Science Foundation, the Department of Energy's Office of Science, and the National Institute of Standards and Technology—the Budget also eliminates programs that are not effectively achieving their goals. For example, the Budget cancels NASA's Constellation program, which was intended to return astronauts to the Moon by 2020, but has run severely behind schedule and over-budget. In place of Constellation, the Budget proposes to leverage international partnerships and commercial capabilities to set the stage for a revitalized human space flight program, while also accelerating work—constrained for years due to the budget demands of Constellation—on climate science, green aviation, science education, and other priorities.

Clean Energy

Although it is clear our Nation can no longer afford its heavy reliance on fossil fuels to power the economy, the transition from fossil fuels to clean energy will challenge both America's technical ingenuity and our political will. Yet this challenge holds out tremendous possibilities—not just for improving our health and the environment, but also for transforming our economy into the world leader in clean energy technologies.

The Recovery Act is already investing $90 billion in clean energy, and the Budget extends that commitment. It would expand by $5 billion our Advanced Energy Manufacturing Tax Credit, a 30 percent credit for qualified investments in new, expanded, or re-equipped clean energy projects. It would also substantially enhance support for construction of new nuclear power plants by increasing loan guarantee authority for such projects by $36 billion. It would fund a $500 million credit subsidy to support $3 billion to $5 billion of loan guarantees for energy efficiency and renewable energy projects. And it would continue work begun under the Recovery Act to modernize our electrical grid so that it is smarter, stronger, and more efficient, and so that it helps to foster the growth of wind and solar energy projects.

Infrastructure

For too long, our Nation avoided making the necessary investments in the roads, bridges, levees, waterways, communications networks, and transit systems needed to keep pace with the times. Outdated infrastructure burdens our communities in a number of ways: longer commutes, businesses choosing to locate elsewhere including overseas, and growth and job creation held back. Through the Recovery Act, we made the largest investment in our Nation's infrastructure since President Eisenhower called for the creation of the national highway system half a century ago.

The Budget will build upon the Recovery Act's infrastructure investments. For example, the Budget proposes to invest $4 billion in a new National Infrastructure Innovation and Finance Fund to invest in projects of demonstrable merit and of regional or national significance. And it would also follow through on the Administration's five-year, $5 billion commitment to develop high-speed rail routes.

The Budget would also expand and make permanent the Recovery Act's successful Build America Bond (BAB) program. The BAB program has expanded the investor base for municipal bonds and lowered borrowing costs for States and localities, helping to restore a badly damaged municipal finance market and support job creation through new infrastructure projects. States and localities have already issued $78 billion in such bonds through the end of February. The Budget proposes making the BAB program permanent with a 28 percent subsidy rate that makes extension revenue-neutral. The Budget also proposes expanding the eligible uses of these bonds, allowing them to support financing for nonprofits and a wider range of municipal borrowing.

Export Promotion

A critical component in building a new foundation for stable, long-term growth—and a complement to the Administration's investments in research and innovation—is opening up foreign markets to American goods and services. The President has set a goal of doubling our exports over the next five years and thereby supporting two million American jobs. The Budget would substantially increase funding to meet this goal and expand American exports, especially those produced by small businesses. For example, the Budget would provide a 20-percent increase in Commerce Department funding to promote exports from small businesses, as well as increased funding for the Export-Import Bank to expand use of the Bank's financial export assistance among U.S. small businesses.

III. Restoring Fiscal Discipline

Unfortunately, beyond the current unemployment picture and the urgent need to build a new foundation for long-term prosperity, we also face a substantial fiscal deficit. On the day the Administration took office, the budget deficit for 2009 stood at $1.3 trillion, or 9.2 percent of GDP—higher than in any year since World War II. And, over the following ten years, projected deficits totaled $8 trillion.

Short-Term Deficits

The deficit increased substantially in fiscal year 2009, which began on October 1, 2008. Given the depth of the economic downturn in late 2008, an increase in the deficit as we entered 2009 was to be expected—and, indeed, such an increase was temporarily desirable because it increased aggregate demand in the economy. The increase in the deficit during 2009 reflected a decline in revenue and an increase in spending, both of which were already apparent before the Administration took office. For example, on January 7, 2009, the Congressional Budget Office (CBO) issued its Economic and Budget Outlook for Fiscal Years 2009-2019. In that document, CBO projected that Government spending would rise from 20.9 percent of GDP in fiscal year 2008 to 24.9 percent of GDP in fiscal year 2009. In reality, Government spending in fiscal year 2009 turned out to be roughly what had been predicted a year earlier (24.7 percent), according to

CBO's updated Economic and Budget Outlook issued in January of this year. (The mix of spending was slightly different from what CBO had initially projected, with somewhat lower mandatory spending and somewhat higher discretionary spending as a share of the economy.)

Medium-Term Deficits

In addition to the 2009 deficit, the Administration also inherited an $8 trillion ten-year deficit. Even these figures, moreover, understate the fiscal shortfall the Administration actually inherited for the next decade. As of last winter, the depth of the current recession was not yet fully apparent. Since we released our Budget overview last February, the deterioration in our economic and technical assumptions added another $2 trillion to the deficit through 2019, as it became clear that we were in the midst of the worst recession since the Great Depression.

As a result, without changes in policy, deficits would total $10.6 trillion over the next ten years—and would fall from their current levels to an average of about 5 percent of GDP in the second half of the decade.

This unsustainable starting point largely reflects two factors: a failure to pay for policies in the past and the impact of the economic downturn.

- More than half of these deficits can be linked to the previous Administration's failure to pay for the 2001/2003 tax cuts and the prescription drug bill. Over the next ten years, these two unpaid-for policies are slated to add $5.8 trillion to the deficit, including interest expense on the additional associated debt. Put differently, if these two policies had been paid for, projected deficits—without any further deficit reduction—would be about 2 percent of GDP per year by the middle of the decade, and we would have been on a sustainable medium-term fiscal course.

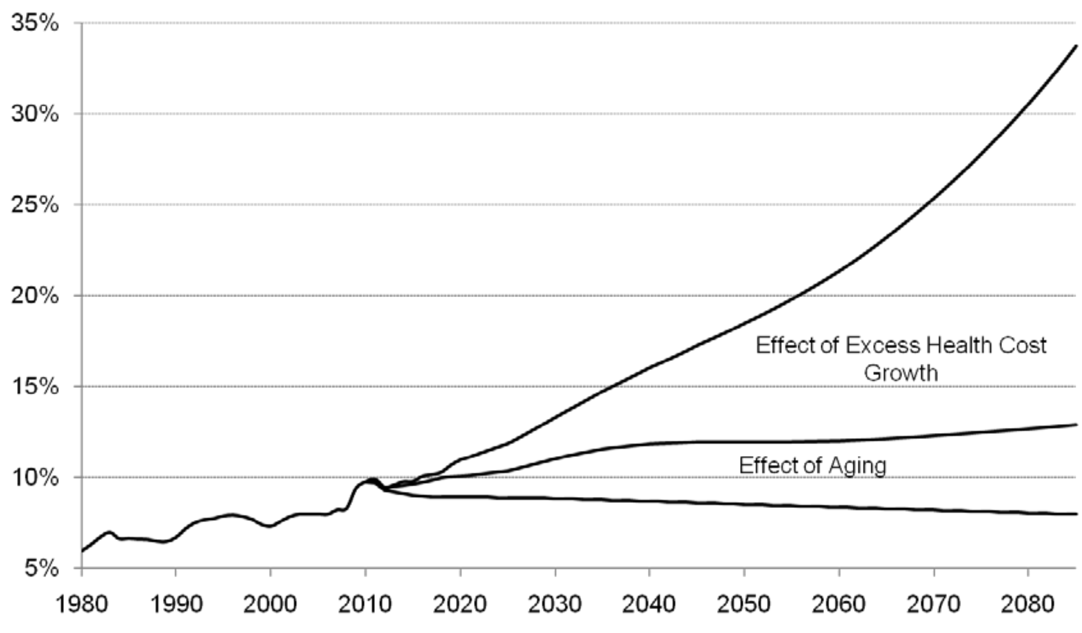
- The recession that began in December 2007 also adds considerably to the projected deficits. When the economy enters a recession, the Federal Government's receipts automatically fall and the costs for certain programs, such as unemployment insurance, automatically rise. Over the next ten years, these automatic stabilizers are projected to add about $2.4 trillion to the deficit, including interest expense.

Finally, it is worth noting that the Recovery Act—which, as discussed, has been key to restoring economic growth—plays a relatively small role in the projected deficits compared to these other costs. Over the next ten years, the deficit impact of the Recovery Act is less than one-tenth the size of the combined costs associated with 2001/2003 tax cuts, the prescription drug bill, and the automatic effects of the recession on the Federal budget.

Summed together, this fiscal legacy—the unpaid-for 2001/2003 tax cuts and prescription drug bill, as well as the worst recession since the Great Depression and our necessary response to it—accounts for $9 trillion of the projected deficits under current policies. They are the reason that our medium-term deficits are on an unsustainable course.

Long-Term Deficits

As our horizon extends beyond the next decade, the role of health care costs in driving our budget deficits becomes more prominent. The figure below shows the projected growth of Medicare, Medicaid, and Social Security spending over the next 75-years, assuming historical excess health care cost growth continues. The top line shows the actual forecast of spending growth, taking into account both the aging of the population and the excess growth of health care costs. The middle line removes the impact of excess cost growth, and the bottom line removes the impact of both excess cost growth and the aging of the population. This figure illustrates two things. First, that we are on an unsustainable path. Within the next half century, spending on these three programs is projected to exceed 20 percent of GDP, more than double their current share of the economy. Second, that we cannot close the long-term fiscal shortfall without slowing the rate of health care cost growth. Reducing excess cost growth by 15 basis points (0.15 percentage points) generates more savings than closing the entire Social Security deficit over the next 75 years.



Policies to Reduce the Deficit and Restore Responsibility

That is how these projected deficits over the next decade arose and how our long-term fiscal future is dominated by health care costs. But whatever their cause, our future prosperity may be threatened if we do not address our medium- and long-term fiscal trajectory. Of course, we must bear in mind that it is not a sensible to begin fiscal contraction when the unemployment rate is nearly 10 percent. What we need to do is put into place sensible measures to reduce the deficit as we recover from the recession. So what are we doing?

First, we have already taken action to ensure that we do not make the fiscal hole deeper. Congress has now enacted statutory pay-as-you-go (PAYGO) legislation. PAYGO forces us to live by a simple but important principle: Congress can only spend a dollar on a non-emergency mandatory spending increase or tax cut if it saves a dollar elsewhere. In the 1990s, statutory PAYGO encouraged the tough choices that helped move the Government from large deficits to surpluses, and it can do the same today.

Second, as the economy recovers, the deficit will naturally decline. Our projections show the deficit falling from roughly 10 percent of GDP to roughly 5 percent of GDP by the middle of the decade as a result of this effect.

The President's Budget represents another important step toward fiscal sustainability. The Budget reduces deficits by $1.2 trillion over the next 10 years—not including savings associated with our presumed ramp-down of operations in Iraq and Afghanistan. If those savings are included, deficit reduction under our Budget comes to $2.1 trillion. Furthermore, the President's Budget cuts the inherited deficit in half as a share of GDP by the end of the President's first term.

The deficit reduction steps include:

<u>Imposing a three-year freeze on non-security discretionary funding</u>. Over the past year, a surge in Federal spending has helped to bolster macroeconomic demand, while also funding long-needed investments that are helping to build a new foundation for economic growth. But, as the economy recovers, we need to rebalance our spending priorities, as we transition from jumpstarting the economy to restoring fiscal sustainability. That is why the President's Budget proposes a three-year freeze in non-security discretionary funding (that is, discretionary funding outside of defense, homeland security, veterans affairs, and international affairs), with funding thereafter increasing roughly with inflation. The proposed freeze in non-security discretionary funding from 2010 to 2011 is well below the 5 percent average growth in such funding since the early 1990s. And over the next 10 years, this policy saves $250 billion relative to continuing the 2010 funding levels for these programs adjusted for inflation.

Requiring the financial services industry to fully pay back the costs of the Troubled Asset Relief Program (TARP). Assisting the financial services industry was necessary to prevent an even worse financial meltdown—and even greater repercussions throughout the entire economy. But this step rewarded firms that had taken excessive and unreasonable risks. The Administration is calling for a Financial Crisis Responsibility Fee on the largest Wall Street and financial firms that will last at least 10 years, but longer if necessary, to compensate the taxpayers fully for the extraordinary support—both direct and indirect—that they provided through the TARP program. This fee would be limited to financial firms with over $50 billion in assets. As it would be based on an institution's size and exposure to debt, it would also further the Administration's financial reform goals by encouraging firms to reduce their size and leverage—which were two major contributors to the financial crisis.

Allowing the 2001-2003 tax cuts for households earning more than $250,000 to expire. The Budget proposes allowing most of the 2001/2003 tax cuts to expire in 2011, as scheduled, for those families making more than $250,000 ($200,000 for single individuals). The additional revenues gained would be devoted to deficit reduction. These tax cuts were unaffordable at the time they were enacted, and remain so today. The Budget would simply return the marginal tax rates for these wealthiest Americans to what they were prior to 2001. Altogether, allowing these tax cuts to expire would save $678 billion over the next ten years relative to current policy.

Limiting the rate at which itemized deductions can reduce tax liability to 28 percent for families with incomes over $250,000. Currently, if a middle-class family donates a dollar to its favorite charity or spends a dollar on mortgage interest, it gets a 15-cent tax deduction, but a millionaire who does the same enjoys a deduction that is more than twice as generous. By reducing this disparity and returning the high-income deduction to the same rates that were in place at the end of the Reagan Administration, the Budget raises $291 billion over the next decade.

Eliminating funding for inefficient fossil fuel subsidies. As we work to create a clean energy economy, it is counterproductive to spend taxpayer dollars on incentives that run counter to this national priority. To further this goal and reduce the deficit, the Budget eliminates tax preferences and funding for programs that provide inefficient fossil fuel subsidies and undermine efforts to deal with carbon pollution. The Budget proposes eliminating 12 tax breaks for oil, gas, and coal companies, closing loopholes to raise nearly $39 billion over the next decade.

Health Insurance Reform

In addition to these specific policies to address the medium-term deficit, the Administration has also faced head-on the primary driver of our long-term fiscal shortfall—rising health care costs. The President's proposal—and the health insurance reform legislation that the House and Senate have already passed—would not only reduce the deficit over the next decade as scored by the non-partisan CBO, but perhaps more importantly would create an infrastructure that would help to improve quality and constrain costs over the long term. Indeed, final legislation would aggressively test different approaches to delivering health care and move toward paying for quality rather than quantity. In the Recovery Act, we took steps toward greater quality at lower cost by making historic investments in health information technology and research into which treatments work and which do not. Comprehensive health insurance reform would build on these investments by providing tools and incentives for physicians, hospitals, and other providers to improve quality.

Comprehensive reform would also include an Independent Payment Advisory Board—composed of doctors and other health care experts—that can enable Medicare and the health system as a whole to keep pace with innovation and the dynamic health care marketplace. The Board would help to make sure that reforming the health care system is not a one-time event, but rather an ongoing process over time, creating a continuous feedback loop where we generate more and better information about what is working in the health care delivery system and then rapidly bring those initiatives to scale. And reform would include an excise tax on the highest-cost insurance plans. The proposed tax on "Cadillac" health insurance plans will do more than help pay for reform; it will help to slow health care cost growth and thereby also give Americans a pay raise.

Congress must now take the final steps toward this promise of fiscally responsible health reform—the stakes are high, both for the millions of Americans who lack a stable source of health insurance coverage and for the fiscal wellbeing of the Nation itself.

*****

Taken together, the more than $1 trillion in deficit reduction proposed by our Budget represents an important step toward fiscal responsibility over the medium term, and the health legislation under consideration would help to reduce deficits over the longer term.

Fiscal Commission

The President has now proposed two budgets that reduce out-year deficits. But even with this substantial deficit reduction, the Nation will still face unsustainable medium- and long-term deficits. The only way to solve the remainder of our fiscal challenge is to do so in a bipartisan fashion. That's why the President has called for the creation of a bipartisan Fiscal Commission to identify policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run.

Specifically, in addition to addressing our long-term fiscal imbalance, the Commission is charged with balancing the budget excluding interest payments on the debt by 2015. This result is projected to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers. The magnitude and timing of the policy measures necessary to achieve this goal are subject to considerable uncertainty and will depend on the evolution of the economy. In addition, the Commission will examine policies to meaningfully improve the long-run fiscal outlook, including changes to address the growth of entitlement spending and the gap between the projected revenues and expenditures of the Federal Government.

IV. Conclusion

The policies we have enacted in the last year and those proposed in the President's Budget seek to restore economic and fiscal health after years of poor decisions. While we have much work left to do to accomplish this goal, our economic freefall has been stopped; financial markets have calmed; and the Recovery Act returned our economy to growth in the third quarter of last year. We are making new investments—in financial regulatory reform, education, research and innovation, clean energy, infrastructure, and export promotion—that will build a new foundation for shared prosperity among all Americans. On the fiscal front, the President's Budget puts on the table more than $1 trillion in deficit reduction over the next ten years by imposing historic restraint on the growth of non-security discretionary funding and restoring fairness and balance to the tax code.

These are key steps forward, but they are not enough. Although the rate of job loss has slowed dramatically, job gain has not yet begun, and the Administration will not be satisfied until the many Americans seeking work can find it. Moreover, while our Budget significantly reduces projected deficits, they remain undesirably high.

The Administration is committed to addressing these challenges facing our Nation, and we look forward to working with you in the weeks and months ahead to do so.