

**Testimony of David M. Cote
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**Before the House Committee on Financial Services
United States House of Representatives
Washington, DC**

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Chairman Hensarling, Ranking Member Waters, and distinguished Members of the Committee, my name is David Cote. I am Chairman and CEO of Honeywell International. It is my pleasure to appear before you today to discuss the continued importance of addressing our nation's long term debt problem.

As a country, we have a lot of strengths... but the rest of the world isn't standing still. We need to recognize (1) that we are in a different global economy than we were twenty years ago, (2) that the global economy will change substantially over the next 20 years, and (3) that it will move forward with us or without us.

In business and government, it's helpful to drive a common agenda by looking at what's going on outside of what we control. At Honeywell, our actions have to be determined by looking at what customers, competitors, and technologies are doing.

According to the economic statistics from Global Insight and the US Department of Agriculture, (Chart 1) in 1990 the US represented 27% of World GDP, by 2010 it was 26%, and over the ensuing twenty years the percentage of World GDP generated from the US will decline to 24%. Other developed countries (Western Europe, Japan, Canada, etc.) declined from 50% in 1990 to 41% in 2010 and will decline further to 29% of World GDP by 2030. And importantly, High Growth countries or what some call the Developing economies have grown from 23% of World GDP in 1990 to 33% in 2010 and will continue growing to 47% of World GDP by 2030. In other words, what we think of as "Developing Countries", in 20 years will account for half of the World's GDP. That's

a big deal. If we are going to compete and win in this new world, we need to focus on having our own American Competitiveness Agenda.

Eight Areas

There are eight areas where we can make a difference now.

Today I am going to primarily focus on the first, addressing the long term debt. I will briefly mention the other seven because I believe we need to be doing all of these things if we are going to compete and win in this century.

As we develop our American Competitiveness Agenda, I'd suggest another principle I use with my business teams. That is, that life and business are always about trying to accomplish two seemingly competing things at the same time. In business for example, do you want low inventory or do you want good product availability, do you want good short-term results or good long term results, do you want empowered employees closest to the action to be able to make

decisions or do you want good controls so nothing bad happens. In every case, you want both.

I'd argue the same principle holds true in government. But said a bit differently, there is truth on both sides of the arguments made by Democrats and Republicans. The trick is to work together and accomplish both.

We need to make the pie bigger and we need to ensure everyone has a stake in the system. We need to regulate and we need to enable. We need to cut spending and make the right investments in our future.

Debt

We should look at our debt, our spending, and our tax profile not just through the lens of Democrat vs. Republican but also in terms of increasing global competitiveness.

The baby boomer generation (my generation) is retiring and medical costs will rise as a result, even if we better control medical

costs. While we can put our heads in the sand for a few years and talk about declining deficits, that demographic freight train is still coming.

The path is politically difficult perhaps but will have to be addressed. Sooner rather than later is easier on everyone, especially the recipients.

If we focus just on this decade (Chart 2) we can probably argue there's no issue even though we are at a debt level comparable to some of the troubled European countries. If we expand this to the next decade (Chart 3) though we see it doesn't look as bright. And remember this doesn't predict any recessions. In the course of the next 20 years I'd say there's a good chance of at least two or perhaps three recessions which will worsen this picture. Additionally, CBO estimates that in 2023 we will be spending about \$825 billion in interest. Extrapolating that same baseline says that in 2025 just eleven years from now we will be spending a trillion dollars a year just in interest.

We're all familiar with millions and billions so a trillion just seems like the next number, so how do we put a trillion dollars into perspective (Chart 4)? If you had spent a million dollars per day since Jesus Christ was born 2013 years ago, you still would not have spent a trillion dollars. We will be spending that much every year just for interest... unconscionable.

To put our debt further into perspective (Chart 5), our debt as a percentage of GDP is about the worst in our history, only eclipsed by WW II when we had a really good reason to borrow.

A heavy debt burden could hike up interest rates and inflation rates, and it very well could slow our entire economy. For those who think this is just a Wall Street problem, look at it this way: When 10 year Treasury notes go to 7%, and as a result home mortgages go to 10% and car loans to 13%, families will have fewer dollars ... that's now a Main Street problem.

In addition to the amount of spending, the composition of spending changes over the next ten years (Chart 6) with mandatory spending on autopilot going from about 2/3 to about 3/4 of our total budget. In other words, discretionary spending declines to 24%, of which half of that is defense. Even today only about 7% of our entire spend is for education and infrastructure. Another way to think about it is that our government spending overwhelmingly focuses on transfer payments, not investment. Transfer payments help perhaps to equalize distribution but investment is what grows the pie. We need to increase our investments and decrease our entitlements if we're going to compete. Changes made now can have a big effect in the second decade and allow people and systems time to adjust so it's much less onerous.

Entitlements need to be reformed now to reduce spending, and a revenue increase is needed as a reasonable compromise. Revenue should be approached through tax code simplification. Congressman

Dave Camp's efforts to get this effort going should be applauded. The last time we simplified the tax code was about 30 years ago. There's a scientific principle called entropy that says all organized systems evolve to chaos. And that's where we are now. If we had set out to create a system that was unfair, confusing, and globally uncompetitive, we couldn't have done this good a job. We need to rid ourselves of the euphemistically named tax expenditures and use it to significantly reduce rates. We can then raise revenue through a slight increase in these lower rates and we should re-visit our policies on items like the capital gains rate, carried interest, and minimum rates over certain income levels.

To compete effectively on this increasingly competitive world stage, we have to have a strong balance sheet. We don't have a strong balance sheet today and it will worsen over time with our current plan. If you want another way to think about the impact of our debt in this new world, think of it this way. In 25 years, at current rates, China will

eclipse the US as the biggest economy in the world. At that same time, at current projections, US debt will be over 100% of GDP. Is that the legacy we want to leave our kids and grandkids?

Infrastructure

I want to briefly mention the other seven areas that I believe are also important to our future competitiveness.

The second area is infrastructure development. According to a widely cited 2011 Economist magazine article called “Life in the Slow Lane”, China spends about 9% of GDP on infrastructure , Europe spends about 6%, and the US a little over 2%.

We need better roads, bridges, and ports. We also need to upgrade our Air Traffic Management system from its current 1950’s baseline and we need to advance broadband. While we do have to cut overall spending drastically, there is such a thing as good spending -

investment spending that grows the pie. We shouldn't throw the baby out with the bath water.

Math and Science Education

The same is true for the third area...education and more specifically, Math and Science. Math and Science has to become a stronger part of our curriculum. We have all seen the studies showing our decreasing position versus the rest of the world in this area. It's not an area where I'm an expert but it feels to me like we have a system designed by elitists for whom the system worked. Not everyone learns the same way or at the same rate. We could learn to be more flexible in how we teach and recognize not everyone likes school and a number of them hate it.

So why not gear learning to the ways kids find it interesting and to the number of years they are likely to stay interested. Given computer proliferation and aptitude, it would seem we could also do more on-line. The German model of apprenticeship is worth understanding.

Copying it exactly would be unlikely to work here but there are ideas and best practices that can be gleaned and applied in an American way.

Immigration

The fourth area is Immigration. To the extent we can have thoughtful policies that increase our population with people who want to work hard and realize the American Dream that's a wonderful thing and it's what brought my ancestors to New Hampshire from Quebec to work in the textile mills. I do understand the need for less permeable borders... but we also can't deny there are millions here already.

Population and productivity drive the size of an economy. We will never be the most populous country so we have to focus on being the most productive, most innovative country in the world. Making it attractive for the best and brightest around the world to come here,

live here, become citizens, and take their shot at becoming a millionaire will help us do that.

Tort Reform

The fifth area is tort reform. It sounds like an old refrain coming from a Businessman, but it is true. We have let the pendulum swing too far in an attempt to root out society's inequities, to the point where our tort system is a mystery to the rest of the world. This is another area where working together we can achieve a better balance, providing fairness for people who have suffered inequities while also providing fairness for the companies that invest and provide jobs.

Patents

The sixth area is a robust Patent Office and process. The significance of encouraging innovation was recognized over 200 years ago by our Founders who went so far as to include protection of

innovation in Article 1, Section 8 of the Constitution. Our Patent office is woefully underfunded, litigation of real issues takes years, and the patent application process takes way too long. The recent reforms, which we supported, helped in some areas but also made the process longer and more cumbersome. If we want to continue as the most productive country in the world, we have to ensure that smart innovation is protected and encouraged, just like the framers of our Constitution envisioned.

Energy

The seventh of the eight areas for American Competitiveness is Energy Policy. In the debate of energy generation vs. energy efficiency, the answer is to do both. There is huge opportunity for efficiency. We've estimated that just aggressively using existing Honeywell products could save the US 20-25% of its annual energy bill. Imagine the impact with everyone else's stuff included. We should encourage

energy efficiency everywhere but that takes time. In the meantime, we need more oil, gas, and renewables now.

Free and Fair Trade

The eighth area is Free and Fair Trade. Twenty years ago there were only about a billion people involved in the global economy... basically the US, Western Europe, and Japan. Today there are about 4 billion people participating in the global economy with the addition of China, India, former CIS states, and Russia, plus numerous other countries that have recognized prosperity for their citizens comes from a robust private sector.

With about 75% of the world's GDP and 95% of world population outside the US, we have to be in there. Open trade relationships benefit both countries. The rest of the world is moving this way, and we're not. While there are legitimate concerns about labor and

environmental laws, helping those disrupted by trade, and adherence to agreements, this is again a case where we need to work together to achieve the best balance of both. Our best opportunity to have this impact on other countries is right now with TPA and the trade agreements.

Summary

There is an economic Olympics going on right now. We can't just focus on beating the other Americans on our team. We need to look at all the other teams that are competing and we have to beat them.

We have been on top for so long that it's easy to forget what got us here. The same phenomenon occurs with companies. Where a very successful company starts down the path of decline because they start believing they're successful because they're the best instead of

realizing they're successful because they stayed at the leading edge of innovation and productivity.

It is important to have a vibrant democracy. At the same time we can't let our commitment to democracy evolve into an excess of discordant pluralism and infighting that incapacitates our ability to make a collective decision reconciling those divergent viewpoints and then acting...actually doing something to address our debt and improve our competitiveness.

We have an important choice to make in the next few years. Do we still have that will, that ability to compete? Or have we become so enamored of reveling in our discordant pluralism that we no longer care if we pass on a brighter future to our kids and grandkids? Do we still have that will, that ability to train hard? Or do we want to sit on the couch and watch others do what we could have done?

The choice is simple ... and stark. Are we so focused on our arguments that we've forgotten what made us great ... hard work, math

and science, technical skills, a dynamic economy, a sense of purpose, relying on ourselves and not blaming others, taking personal ownership of our future, and being able to individually act in our self interest while not forgetting our collective purpose.

Some people in the world and some countries even, believe our time has passed. That a once great economic and military power has taken the first steps on the path to decline. That we cannot resolve our internal differences to make the difficult choices needed as a society. That having achieved greatness, we've forgotten what got us here ... and can no longer act.

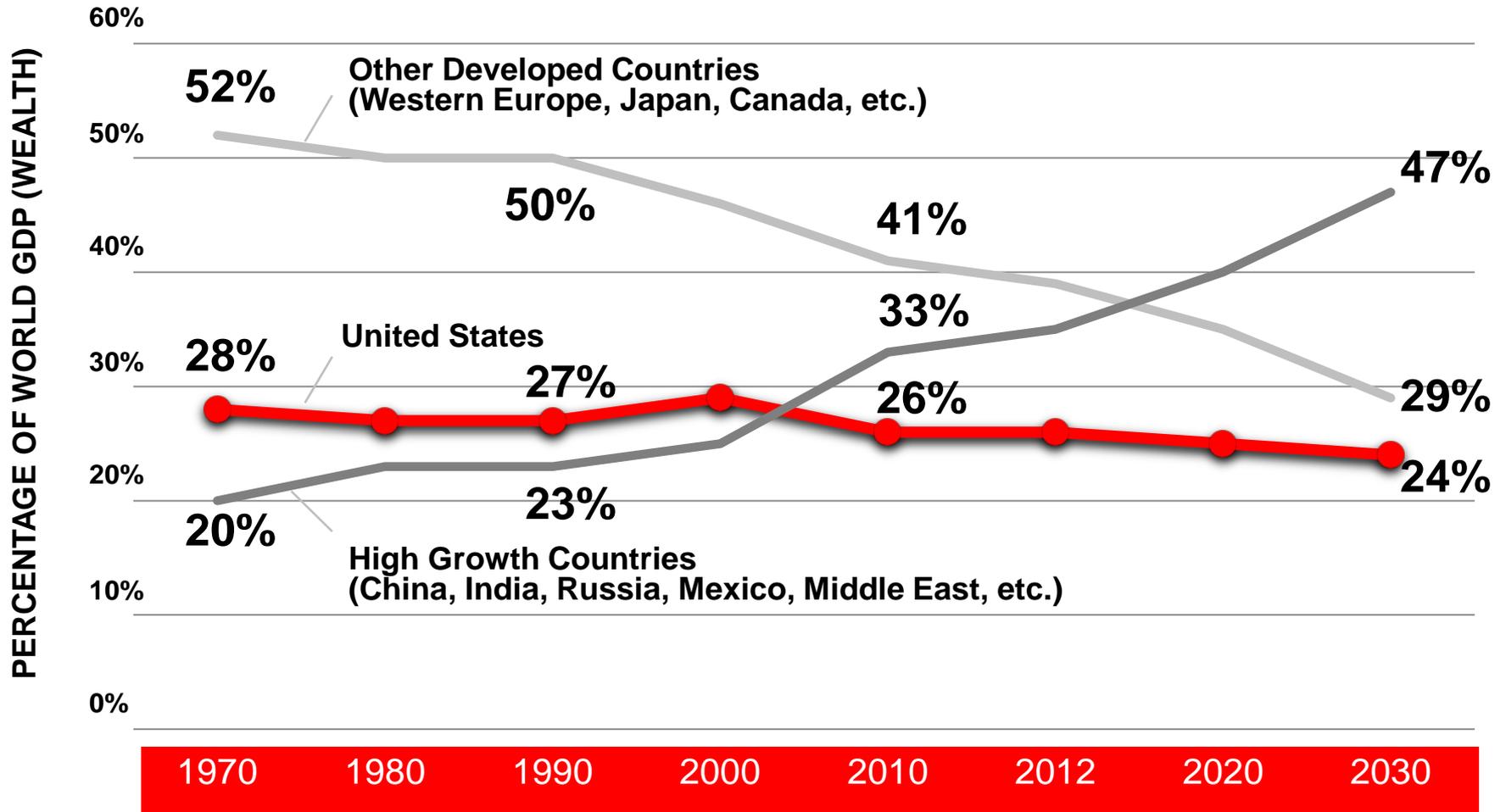
I do believe our form of Government is the best there is. It has proven over 200 years to be the most sustainable and responsive to change, appealing to the basic need for freedom and inclusion that resides in every person. We must never forget though, that the long term stability of our system and our belief in the enduring strength of

our system, cannot be an excuse to not act when confronted by great changes in the world. We shouldn't wait for a crisis to act on our long term debt. We need to start acting now.

We need Government that pulls together, rather than pulling apart. We need your leadership to make it happen.

Thank you.

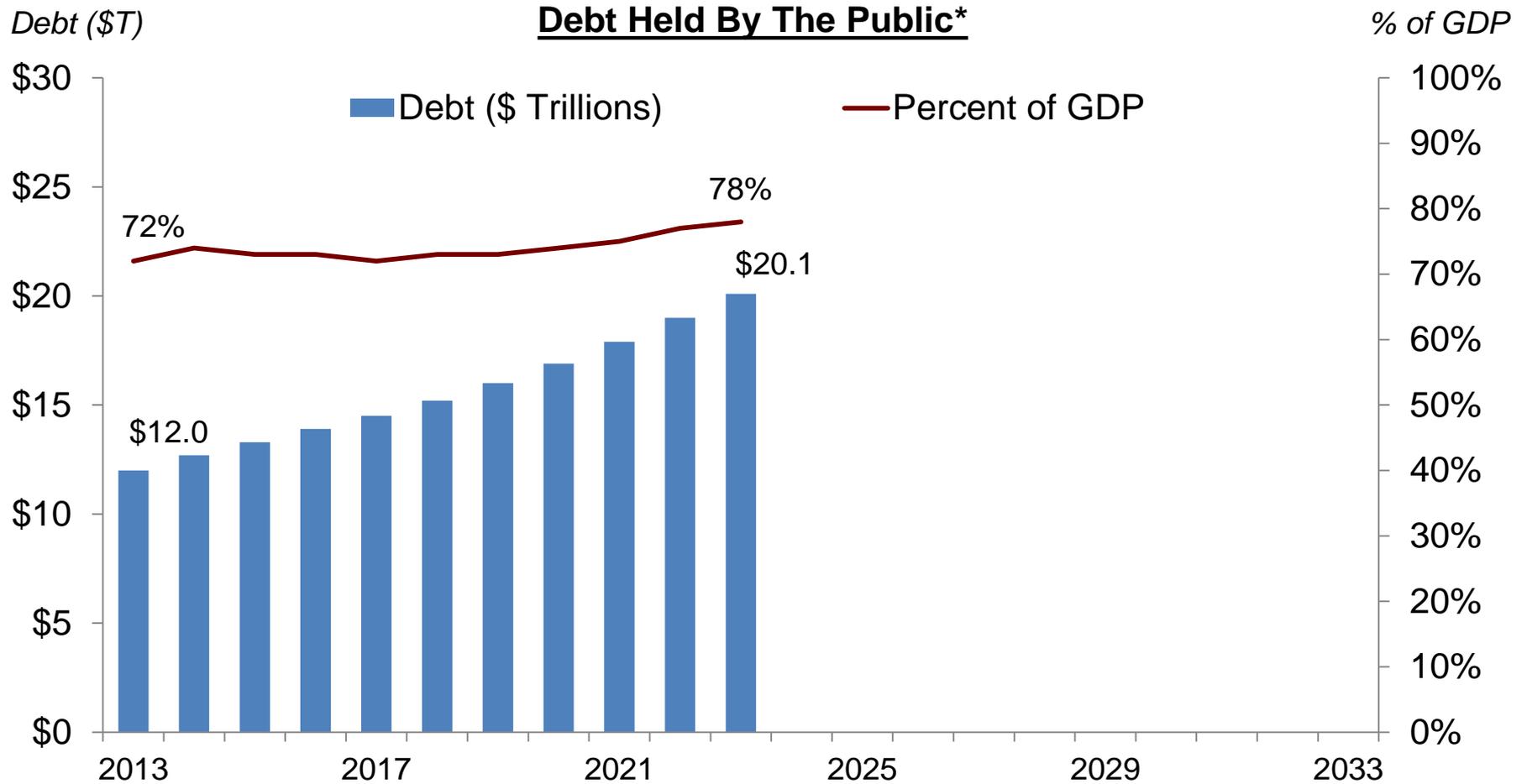
Global Competitiveness



Source: Economic Research Service, US Department of Agriculture (1970 - 2030)

World GDP to Change Substantially

Total Debt



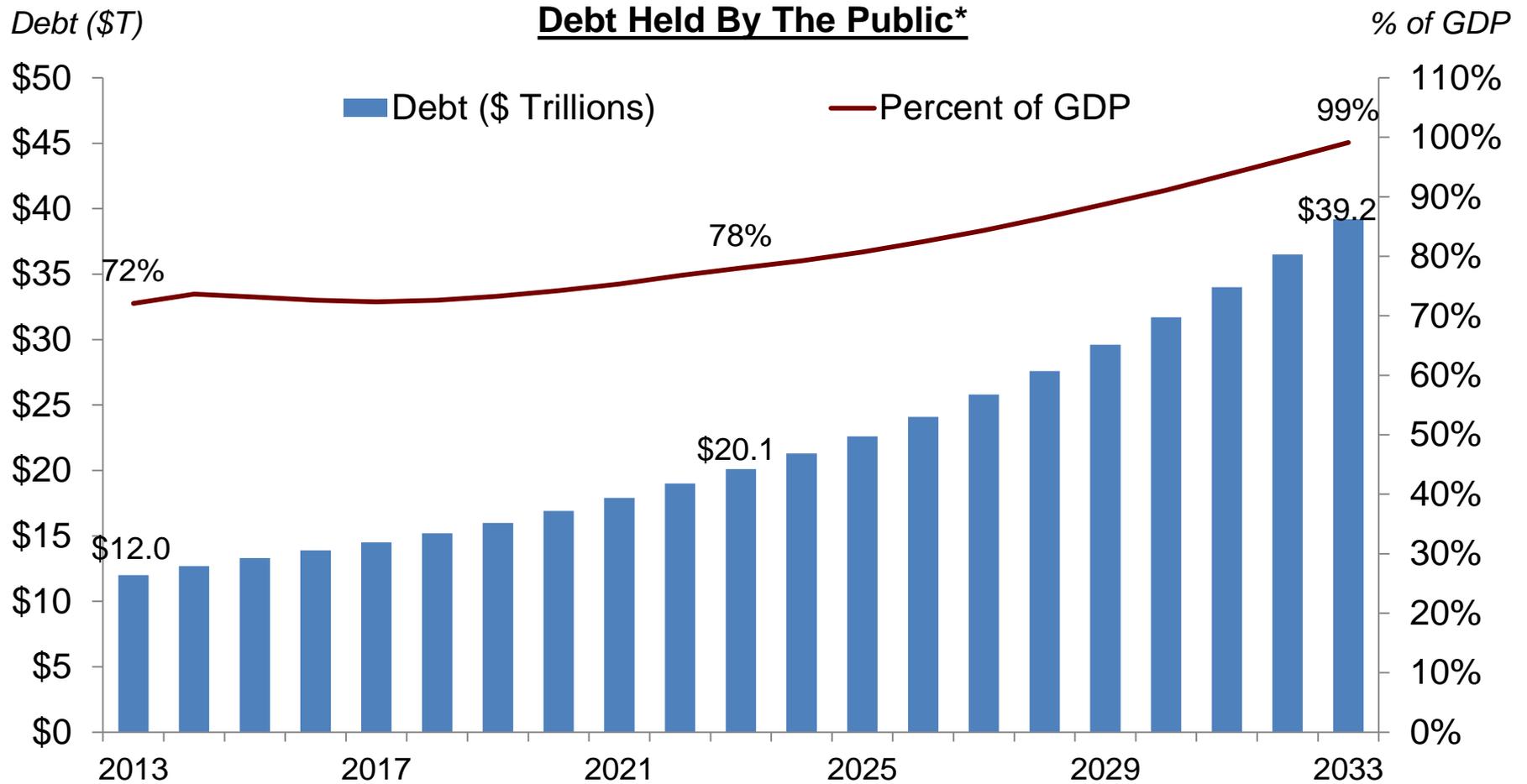
Source: Congressional Budget Office

* Debt Held By The Public excludes debt that the federal government owes itself through borrowings from various trust funds like Social Security.

Next 10 Years ... Can Probably Get By... If No Recession

Total Debt

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Source: Congressional Budget Office (2013 – 2024); CRFB projections (2025 – 2033)

* Debt Held By The Public excludes debt that the federal government owes itself through borrowings from various trust funds like Social Security.

Second Decade A Very Different Story... Clearly An Issue

What's a Trillion Dollars?

If you had spent a million dollars a day since Jesus Christ was born 2013 years ago....

\$1,000,000 x 365 Days x 2013 years =

\$735 Billion

You still would not have spent a trillion dollars.....

And That Will Be Our Annual Interest Bill

Historical Comparisons

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	Year	Net Debt % GDP*
Revolutionary War	1790	30%
Civil War	1866	31%
World War I	1919	33%
World War II	1946	106%
Reagan Budgets	1993	48%
Today	2013	72%

Source: Congressional Budget Office

Note that these data reflect recent revisions by the Bureau of Economic Analysis to estimates of GDP in past years

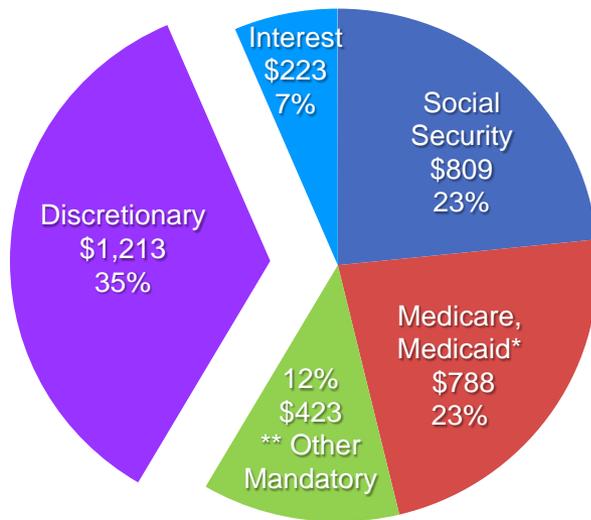
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Current Debt to GDP of 72% Eclipsed Only By World War II

Where Is The Money Going?

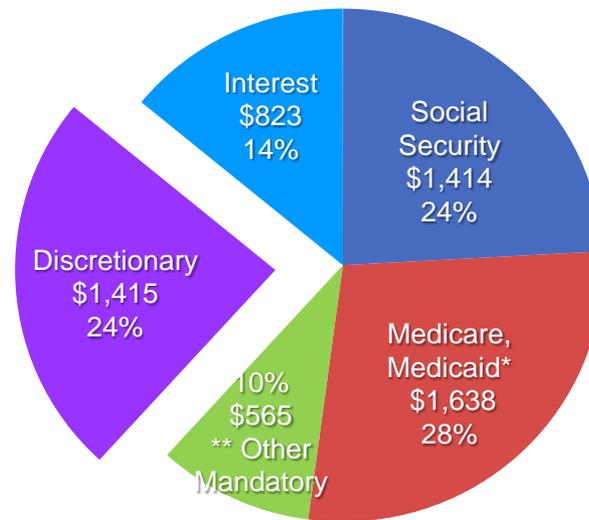
Mandatory % of Total	65%	76%
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\$3.5 Trillion



2013

\$5.9 Trillion



2023

Source: Congressional Budget Office

* Medicare, Medicaid also Includes other health care costs for federal and military retirees, and subsidies and spending related to the Affordable Care Act

** Other mandatory spending includes a number of automatic spending programs, including those for low-income individuals such as food stamps, various subsidies such as agriculture, and federal civilian and military pension spending.

Mandatory Spend Increases From 2/3 to 3/4 of Total Spending