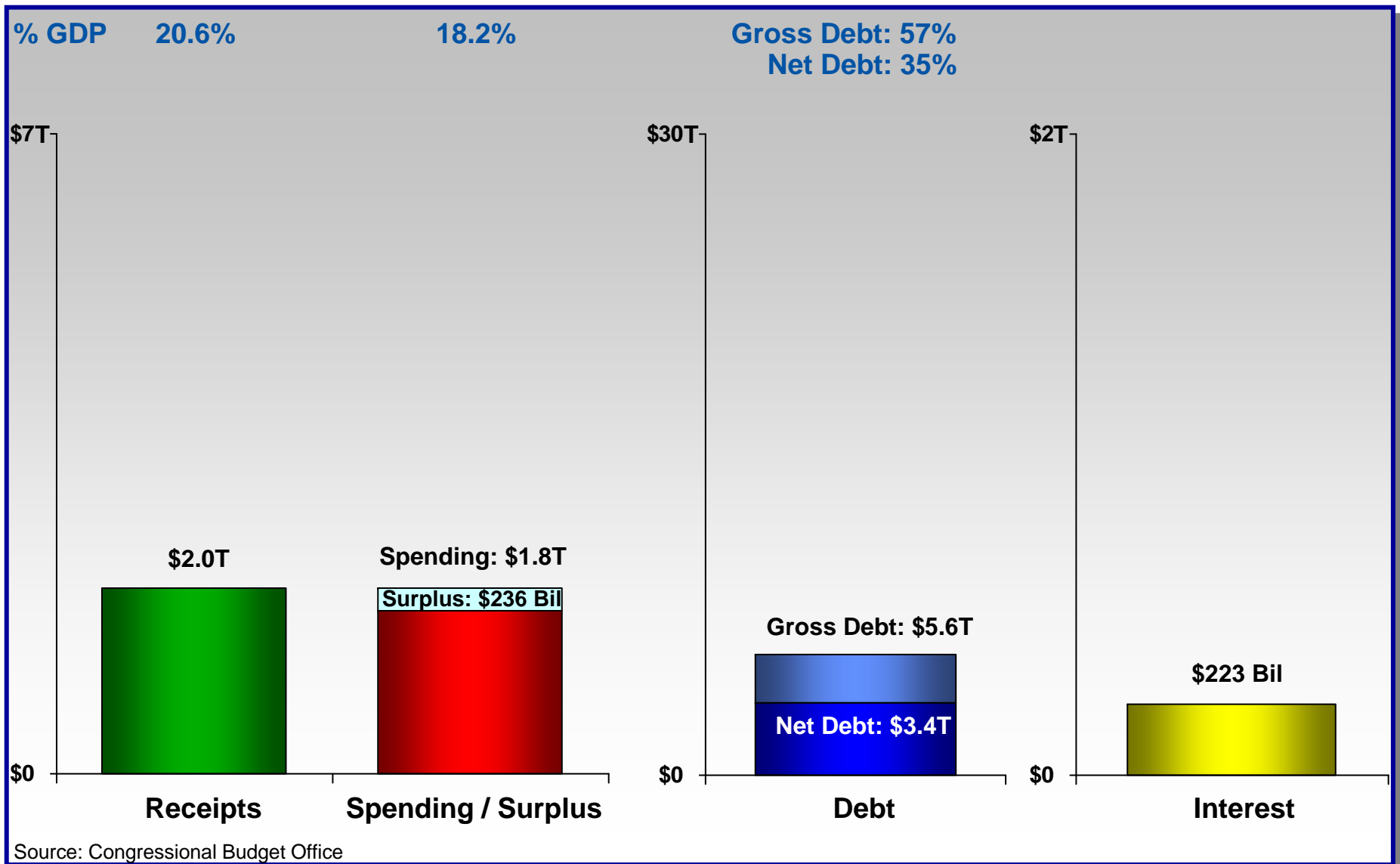


A Balancing Act: Federal Debt, Deficit, and Economic Recovery

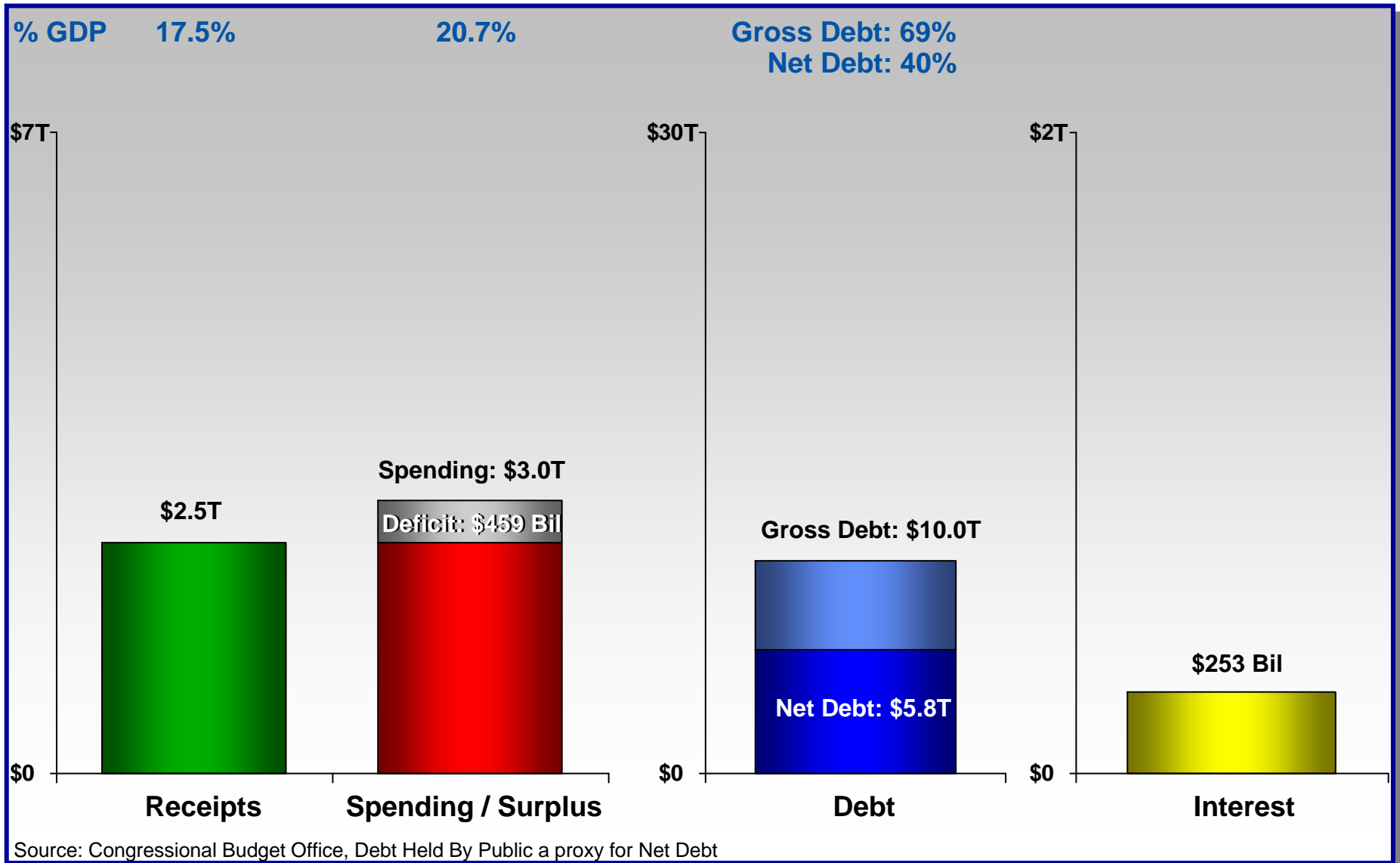
David M. Cote
October 20, 2010

Year 2000



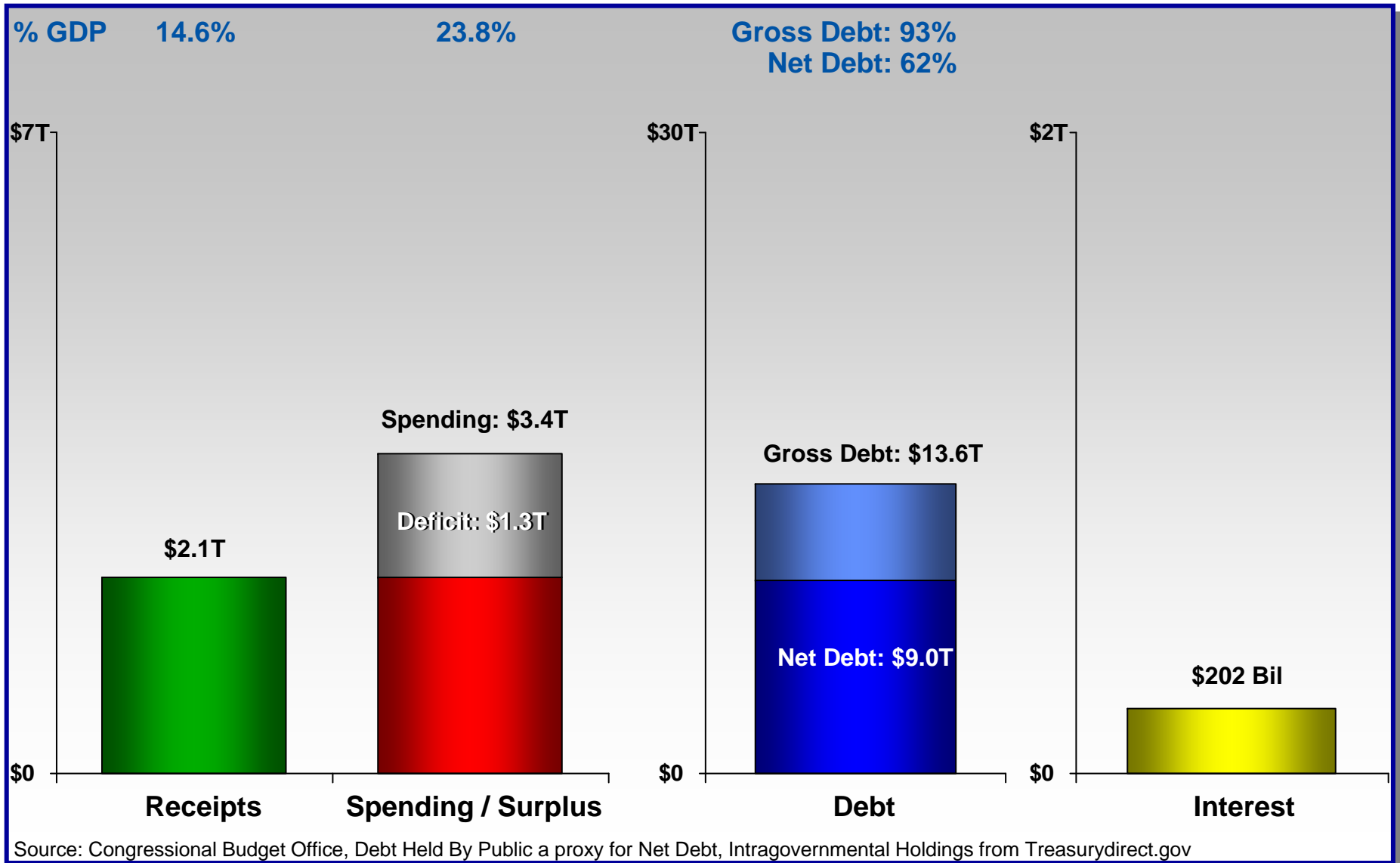
Budget Surplus Of \$236 Billion

Year 2008



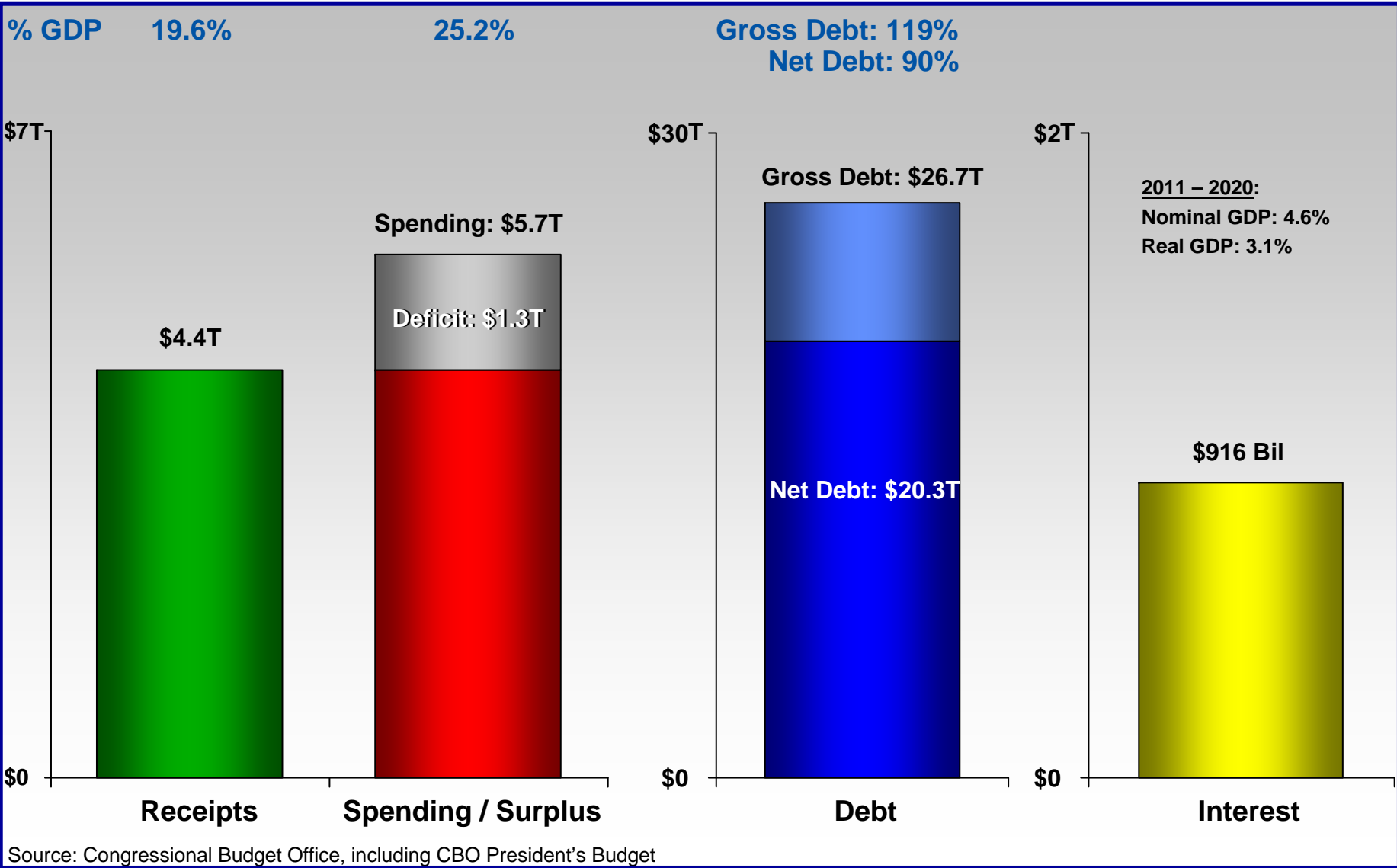
Budget Deficit Of \$459 Billion

Year 2010



Budget Deficit Of \$1.3 Trillion

Year 2020



By 2021, Interest Rises To \$1 Trillion

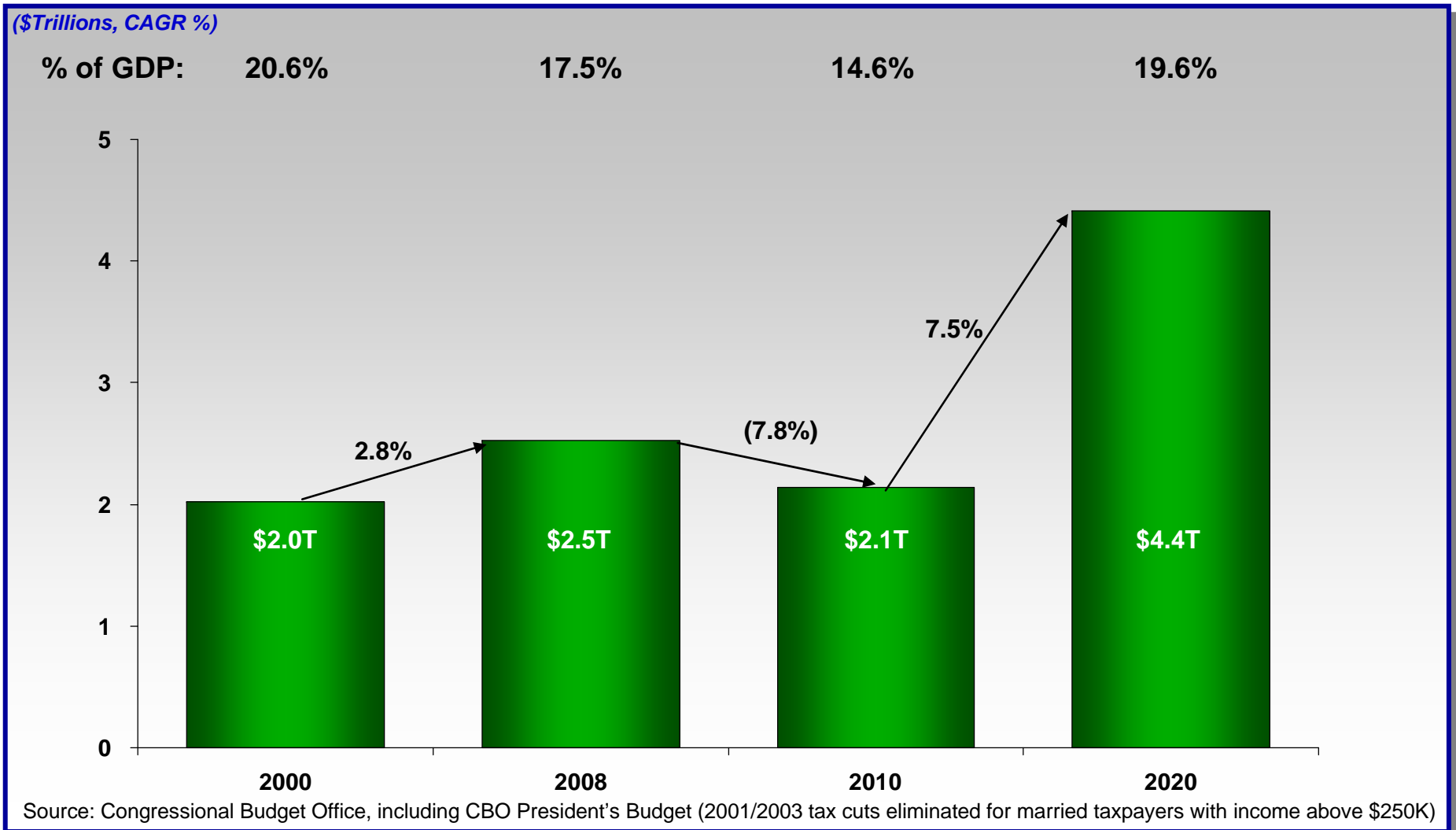
How Much Is A Trillion Dollars?

- If you spent \$1 million per day since Jesus Christ was born

= \$1M x 365 x 2010 = \$733 Billion
- You would still not have spent a trillion dollars

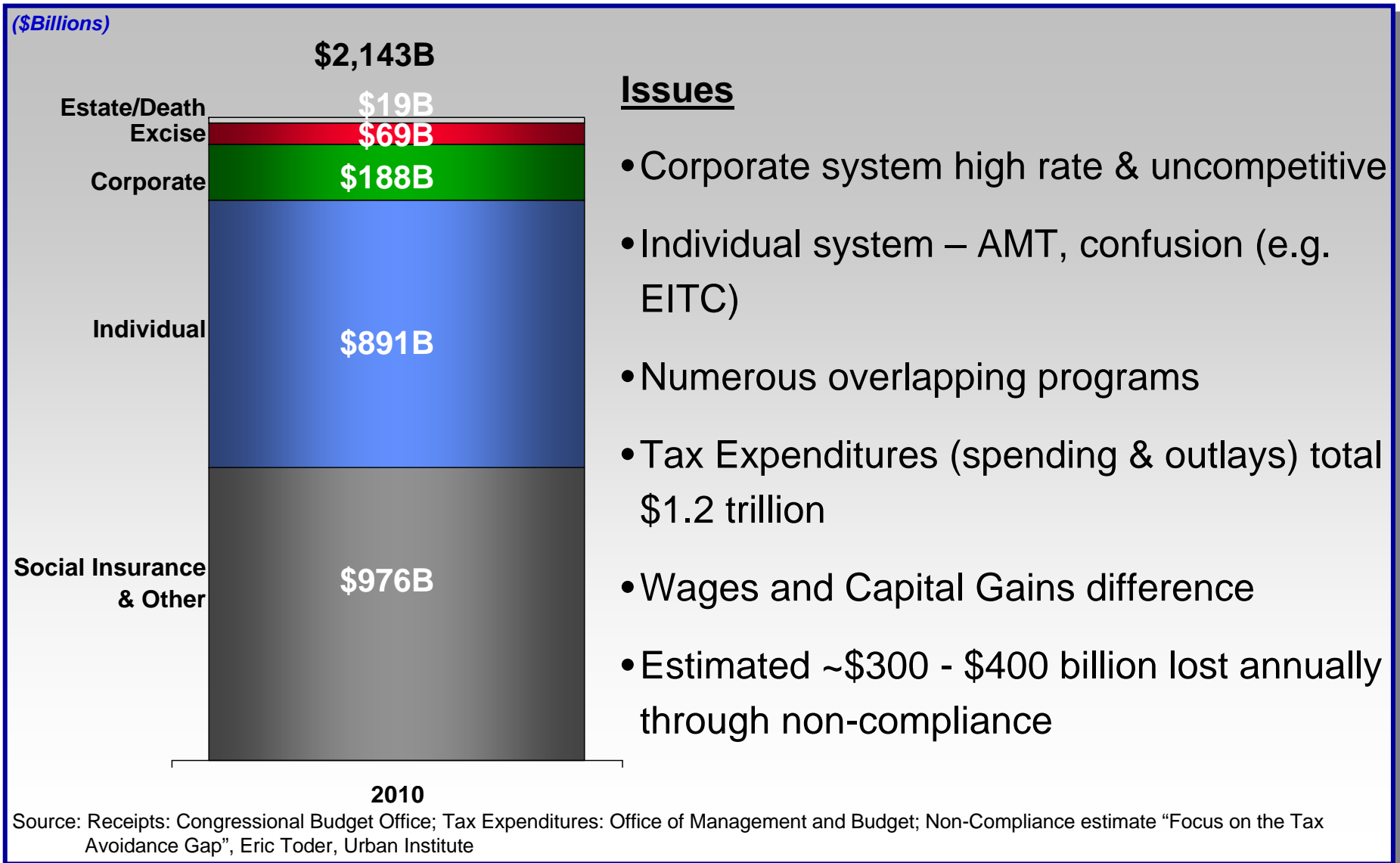
By 2021...That Will Be Our Annual Interest Bill Alone

Receipts Analysis



Receipts Grew 0.6% Annually 2000-2010
Receipts Growing 7.5% Annually 2010-2020

2010 Receipts Composition



Cumbersome, Confusing, Ineffective System

2010 Tax Expenditures

(\$Billions)

	<u>Total</u>
Employer contributions to health insurance	\$160
Exclusion for pensions & retirement plans	95
Deductibility of mortgage interest	92
Earned income tax credit	58
Making work pay	56
Child credit	53
Capital gains	45
Qualified Dividends	38
Charitable Contributions	38
160 Other Exclusions	<u>484</u>
Subtotal	1,119
Payroll Taxes associated with above	<u>101</u>
Total	<u>\$1,220</u>

Source: Office of Management and Budget Analytical Perspectives

Popular And Expensive

How High Would Individual Rates Need To Rise To Reduce The Budget Deficit To 2% Of GDP From 2015-2019?

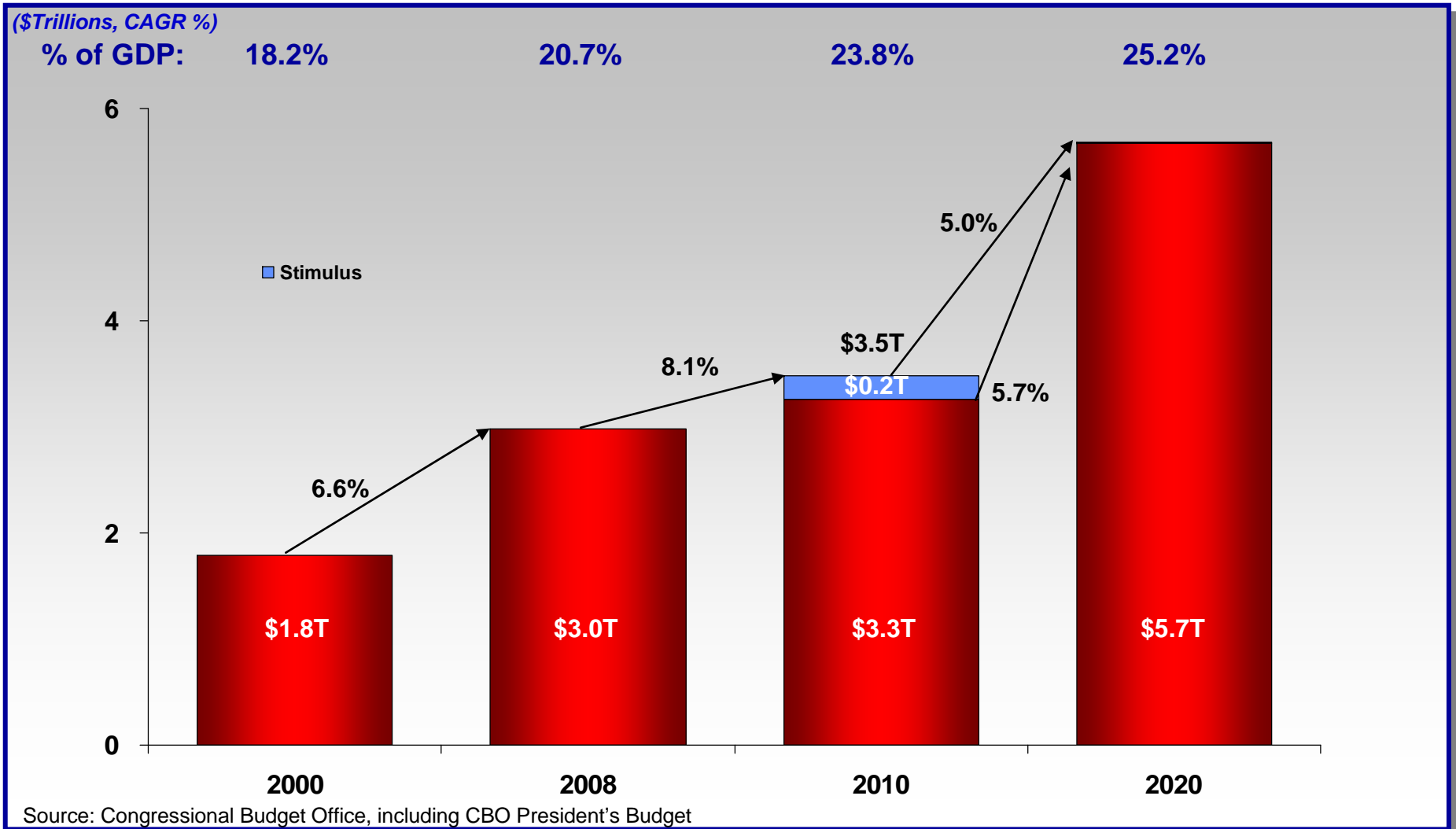
Current Tax Rates	Raise All Rates Proportionately	Raise Top Two Rates Only
10%	15.8%	10%
15%	23.7%	15%
25%	39.5%	25%
28%	44.2%	28%
33%	52.1%	100%*
35%	55.3%	100%*

Source: **Tax Policy Center**, authors Rosanne Altshuler, Katherine Lim and Robertson Williams, "Desperately Seeking Revenue," *National Tax Journal*, June 2010 (updated tables provided by authors).

Notes: The table shows how high the rates would have to be to reduce the average deficit to 2% of GDP for the years 2015-2019. The table shows the tax rate for 2019 against a baseline that assumes a) extension of all individual income tax provisions included in EGTRRA and JGTRRA; b) maintaining the estate tax at its 2009 parameters; c) extending the 2009 AMT patch and indexing the AMT exemption, rate bracket threshold, and phase-out exemption threshold for inflation; d) the budgetary effects of the 2010 healthcare reform act; e) extending several provisions that were enacted or modified in the American Recovery and Reinvestment Act of 2009; and f) extending other expiring provisions that have been in effect for a number of years. The second column shows an experiment in which all rates were raised proportionately. The last column shows an experiment in which rates were proportionately raised on single taxpayers with income over \$200,000 and married couples filing jointly with income over \$250,000. The calculations do not assume any behavioral response to the higher rates. If behavioral responses to the change in rates were taken into account, the rates would have to be even higher. See Altshuler, Lim and Williams (2010) for details.

* It is impossible to reduce the deficit to 2% of GDP by raising the top two income tax rates alone. If you raised the top two rates to 100%, and assumed absolutely no ill economic effects from doing so, you would still not reduce the deficit to 2% of GDP. The authors capped the rates at 100% in their experiment.

Spending Analysis

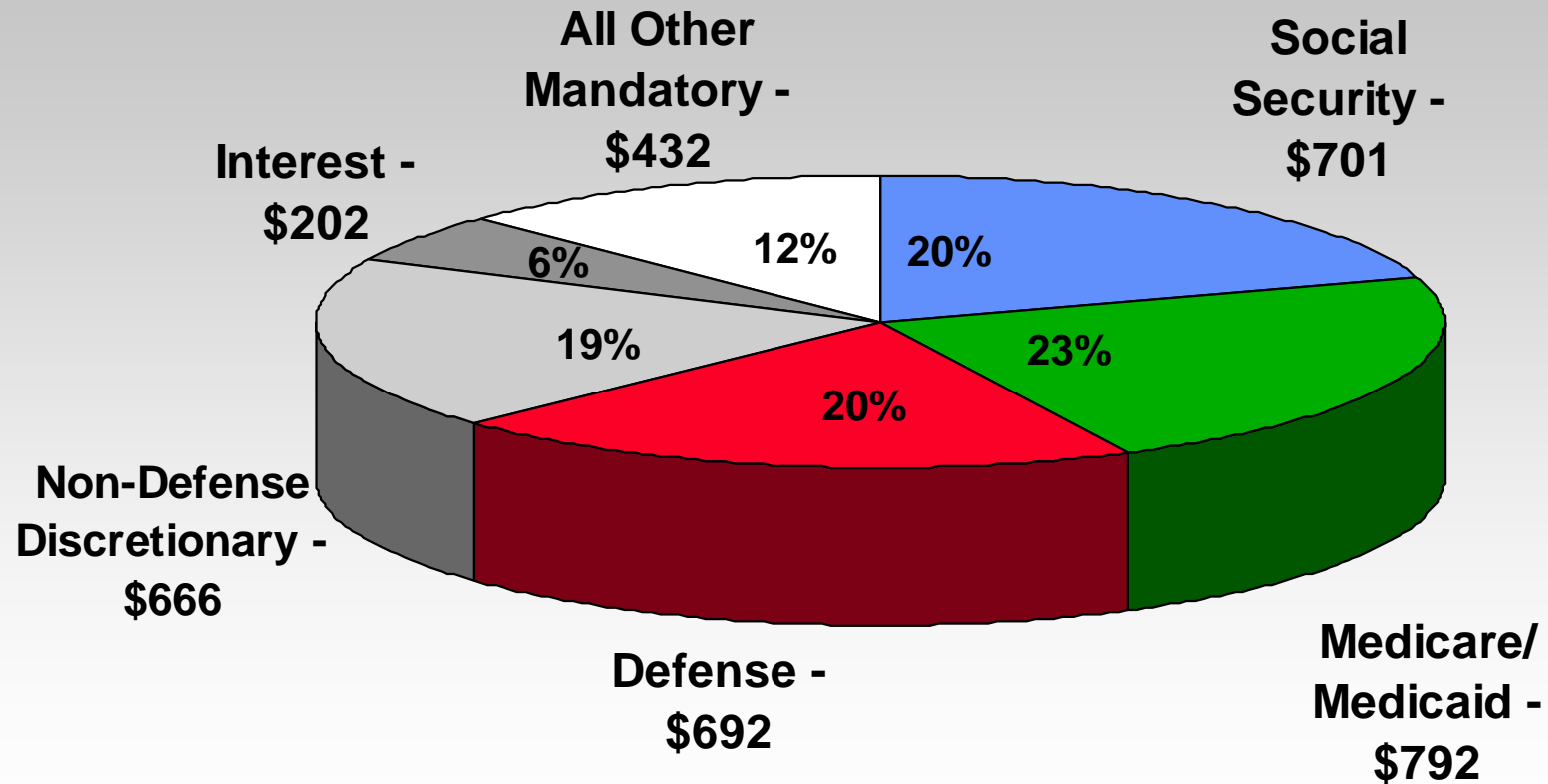


Spending Grew 6.9% Annually 2000-2010
Spending Growing 5.0% Annually 2010-2020

2010 Spending Composition

(\$Billions)

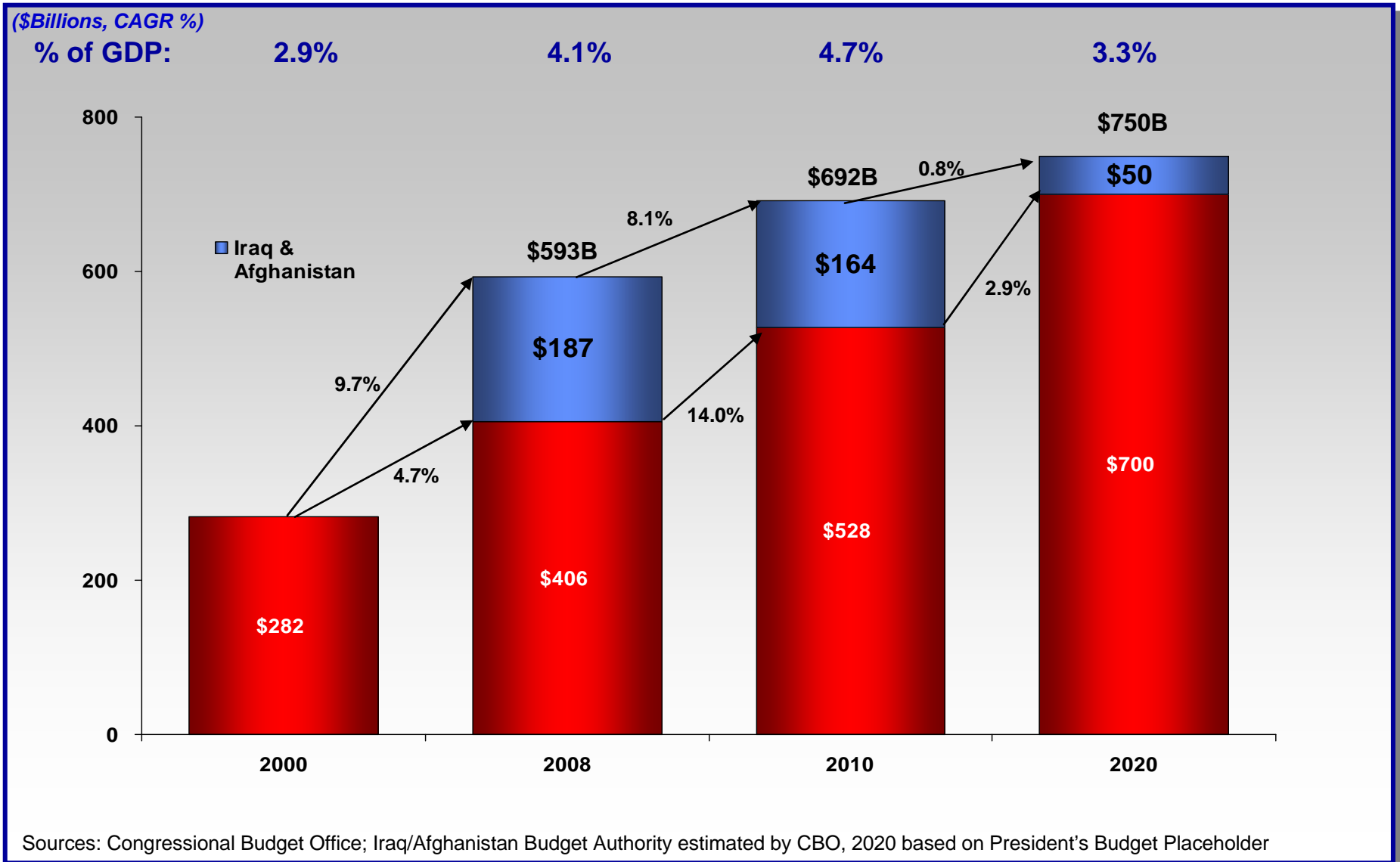
Total: \$3,485B



Source: Congressional Budget Office

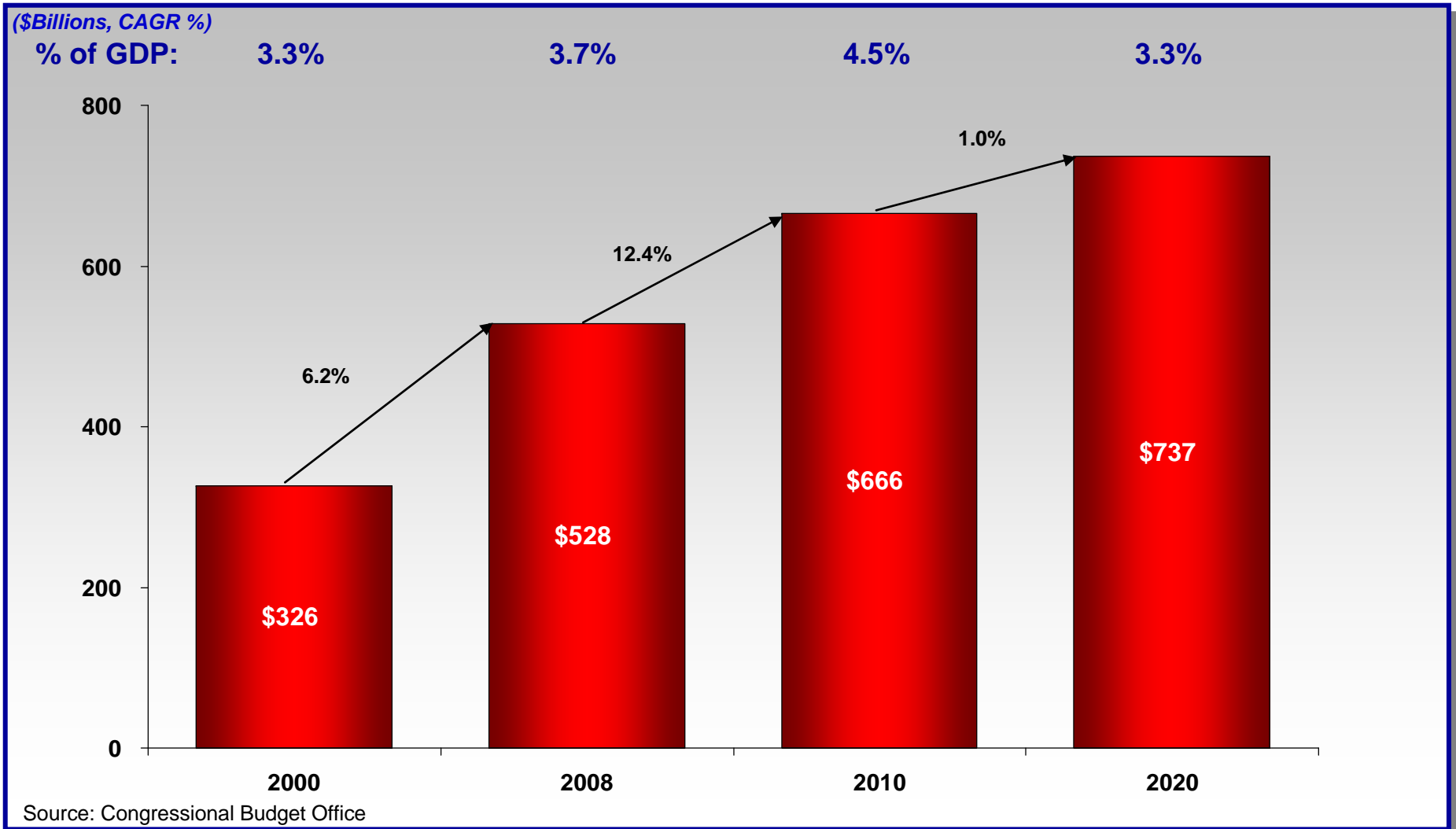
More Than Half Of Spending On "Auto-Pilot"

Spending Analysis – Defense



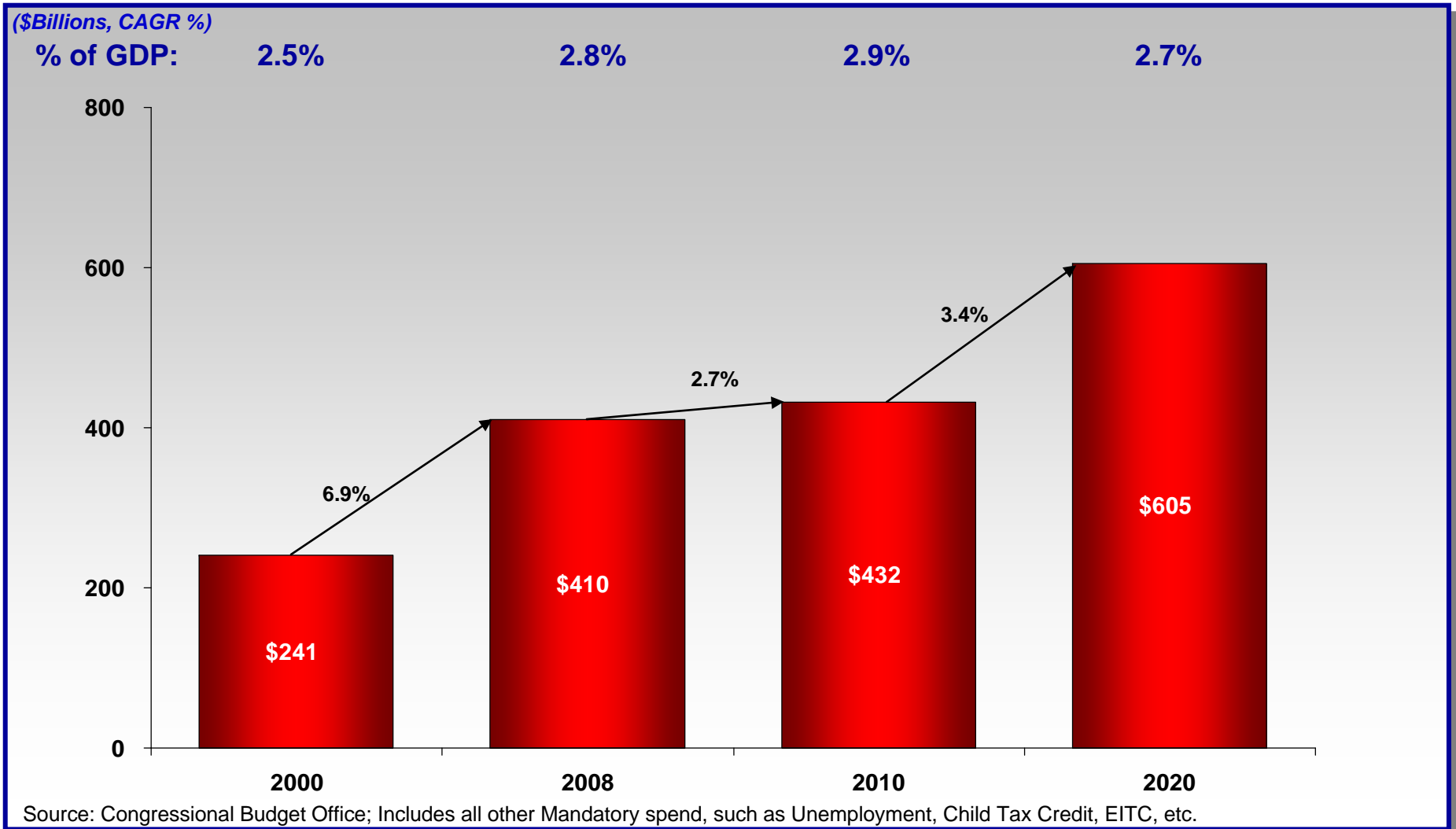
Spending, Excluding Wars, Continues To Grow

Spending Analysis – Nondefense Discretionary



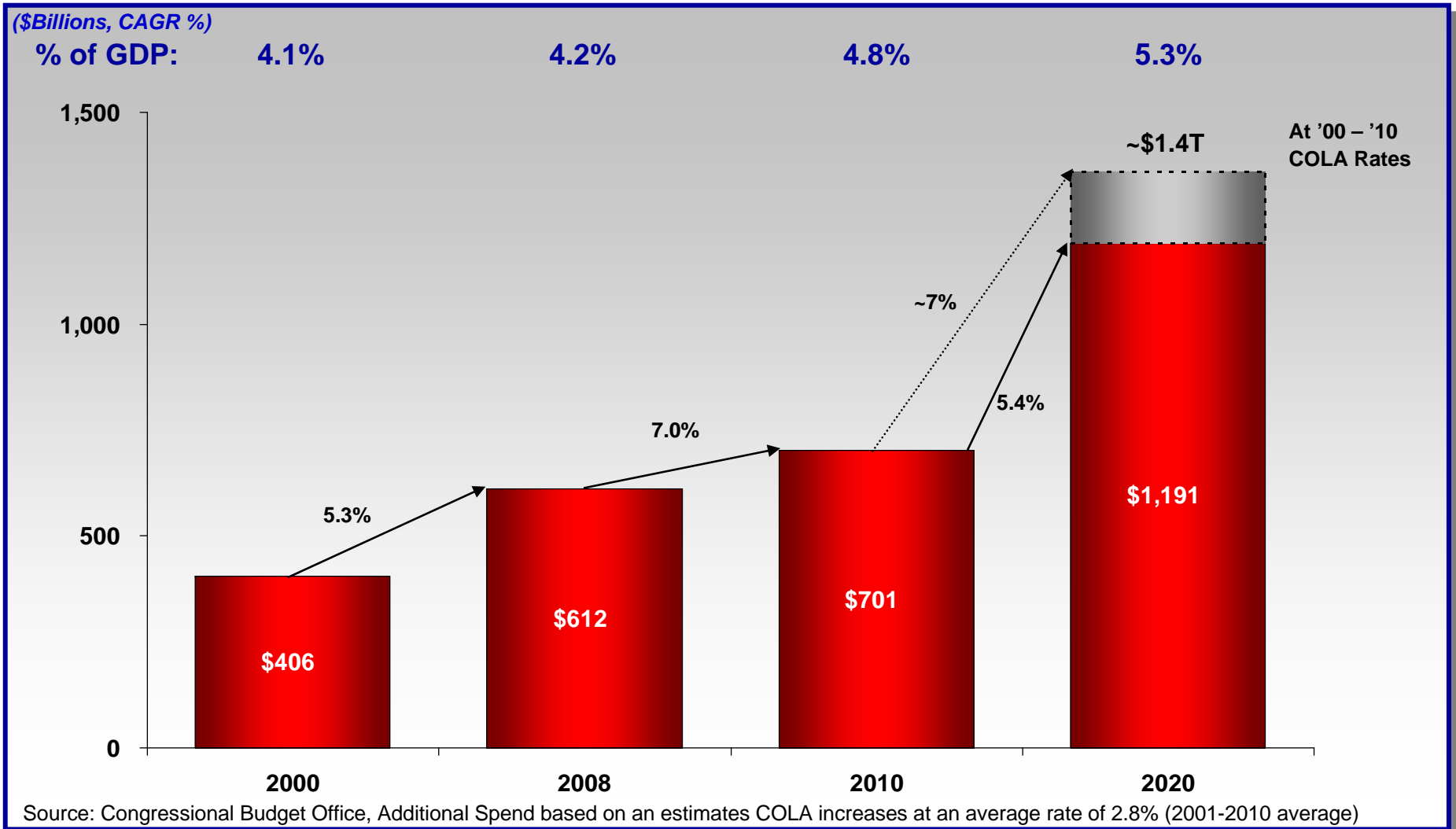
Spending Grew 7.4% Annually 2000-2010
Spending Growing 1.0% Annually 2010-2020

Spending Analysis – All Other Mandatory



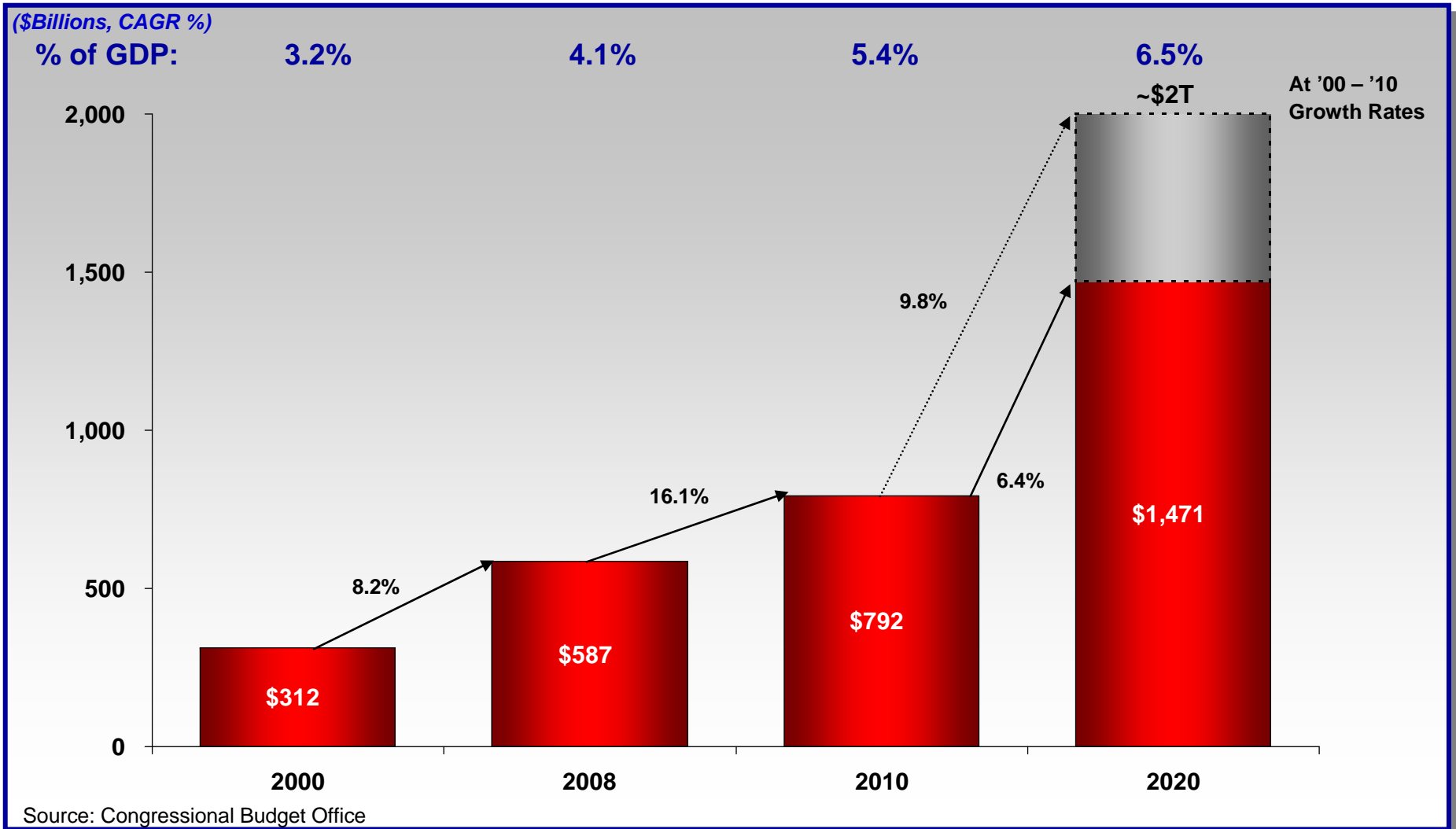
Spending Grew 6.0% Annually 2000-2010
Spending Growing 3.4% Annually 2010-2020

Spending Analysis – Social Security



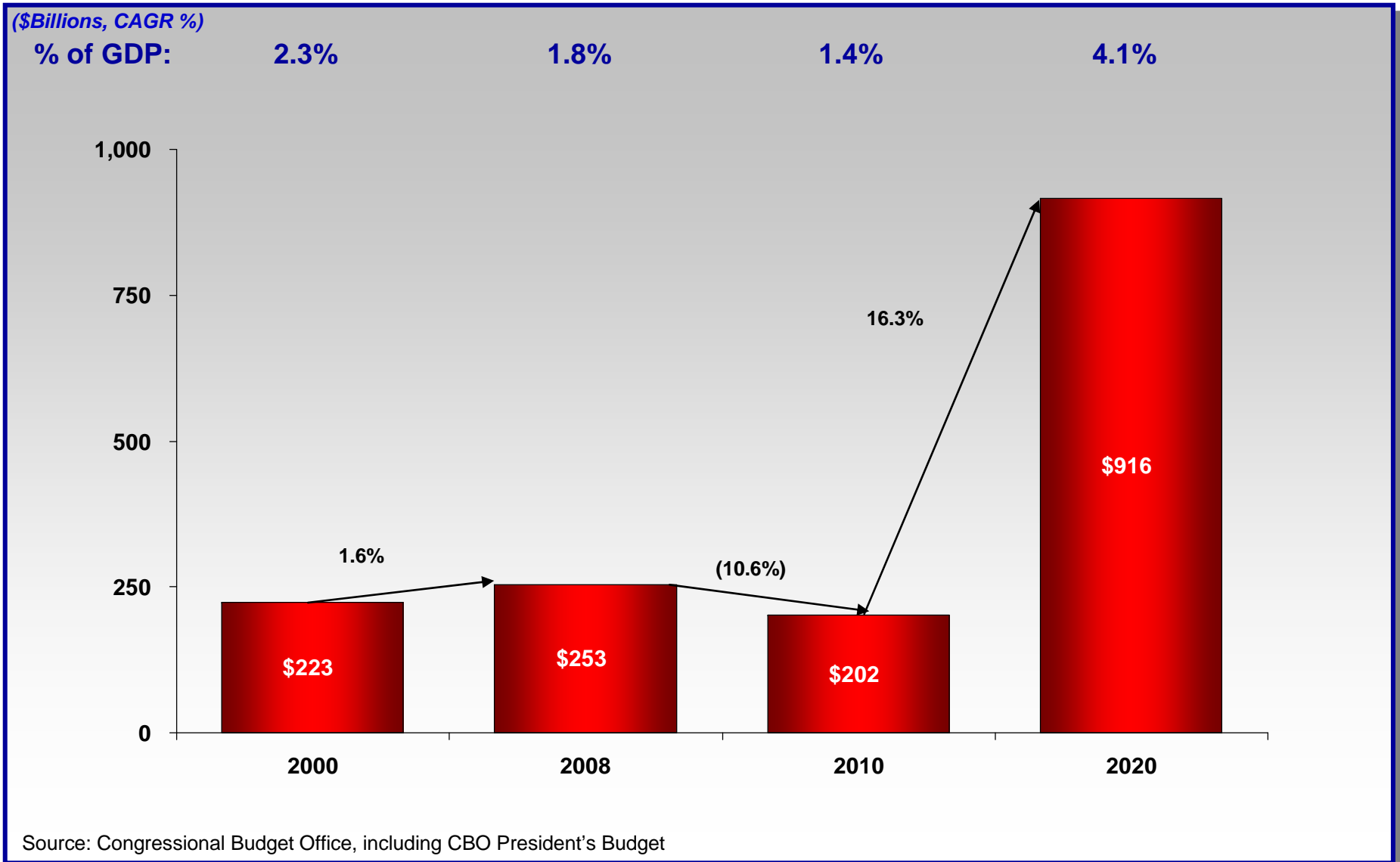
Spending Grew 5.6% Annually 2000-2010
Spending Growing 5.4% Annually 2010-2020

Spending Analysis – Medicare/Medicaid



Spending Grew 9.8% Annually 2000-2010
Spending Growing 6.4% Annually 2010-2020

Spending Analysis – Interest



Reminder...2021 Interest Would Be \$1 Trillion

How To Resolve

- **Fix Issue 100% with Taxes**

- Go from 14.6% of GDP in 2010 to 25.2% of GDP in 2020 (vs. 19.6% in President's Budget)
- Results in a 28% increase in Taxes

- **Fix Issue 100% with Spending**

- Go from 23.8% of GDP in 2010 to 19.6% of GDP in 2020 (vs. 25.2% in President's Budget)
- Results in a 22% reduction in real or perceived benefits in 2020

Source: Congressional Budget Office, including CBO President's Budget

Neither Likely Palatable To Majority Of Voting Public

Summary

- **Problem Is Real...And It Is Structural**
- **Decision Will Happen...Question Is:**
 - Do we do it proactively / thoughtfully
 - Or does Bond Market do it for us
- **There Are No Easy Choices**
 - Neither higher taxes nor spending cuts appealing to voters or Congress
- **A Time For Pulling Together...Not Pulling Apart**

Do We Still Have The Political Will To Be A Great Country?