"A Balancing Act: Federal Debt, Deficit, and Economic Recovery"
Speech at the U.S. Chamber of Commerce
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The seeds of the next recession have already been planted. The debt burden accumulated over the next ten years will sink us. And a decision will get made… one of two ways. One way is to do it now, proactively, and thoughtfully. The second way is to wait until the Bond Market forces us to do it. We can ask Greece what that's like.

This presentation will start and end with the same message. That is "Do we still have the Political Will to do the hard things required in life? Would we rather pull together… or pull apart?" It's an important question for all of us Americans.

Some countries don't think America will ever be able to fix the issue because we no longer have the Political Will to get the tough things done, that our time is past, that we'd rather argue and blame others than take responsibility for a collectively critical decision. As an American, I disagree with that view…. but I also know it requires the American people to push and the President and the Congress to lead to make it happen. And each of you can help.

Hopefully I have your attention… so… let's begin.

Chart 1

These next four charts are all formatted the same way and show the year 2000 (this chart), 2008 (recession onset), 2010 (recession aftermath), and 2020 (what we look like then).

In the year 2000, starting at left, we had tax receipts of $2 trillion representing 20.6% of GDP and we spent $1.8 trillion or 18.2% of GDP resulting in a $236 billion surplus. Our net debt or debt held by the public totaled $3.4 trillion representing 35% of GDP. The interest bill that year on $3.4 net debt was $223 billion. The difference between gross debt and net debt is money put into Trust Funds like Social Security which is then borrowed by the Federal Government. While there is no cash in these Trust Funds, depending on how you look at it, the Trust Funds have IOUs from the Federal Government or are invested in Government bonds. Either way, the financial effect for the Federal Government is the same.

Chart 2

In 2008, receipts, while up $500 billion, are down to 17.5% of GDP. Spending is up $1.2 trillion to 20.7% of GDP resulting in a deficit of $459 billion. Net debt has grown $2.4 trillion to $5.8

trillion or 40% of GDP and the annual interest bill on that balance is $253 billion.

Chart 3

In 2010, because of the recession impact, receipts are down to $2.1 trillion while spending is up to $3.4 trillion resulting in a $1.3 trillion deficit. Net debt in the two years has grown $3.2 trillion to $9.0 trillion overall representing 62% of GDP. Additionally, about $4 trillion of that debt is held outside the US and about $1 trillion of that debt is held by China. The interest bill actually goes down, even with higher debt because rates are so low as we climb out of the recession.

Chart 4

And if you think that's a problem, here's what's ahead of us in 2020. Even with receipts up to $4.4 trillion we spend $5.7 trillion for a deficit of $1.3 trillion. Net debt grows to $20.3 trillion or

90% of GDP. Gross debt will be 119% of GDP. Just for the record, the Greece crisis occurred with debt of 113% of GDP. The interest bill goes to $916 billion and in the following year reaches about a trillion dollars. This is all with GDP growing 4.6% annually on a nominal basis, 3.1% real. For those of you who may think we can grow our way out of this, an additional 1% of GDP growth over the next ten years, so 5.6% instead of 4.6%, would reduce the debt by about $3 trillion. While it certainly helps, we would still have a $17 trillion net debt. And I think most would agree that having GDP grow 5.6% a year for 10 years would be "sporty" given we haven't done that since the eighties. The prospect of growing our way out of this issue is unrealistic.

Getting back to that interest number of a trillion dollars in 2021, that assumes ten year bond rates go from about 3% today to about 6% in 2020. You have to question given today's low rate environment, if the debt grows that much, would rates go even higher making this worse.

Chart 5

And how much is a trillion dollars? How do we put it into perspective? We work with millions and billions… but how to explain a trillion dollars to someone and how much that is? This is the best way I've found to get across the enormity of a trillion dollars. If you had spent a million dollars a day, every day, since Jesus Christ was born 2010 years ago, you would still not have spent a trillion dollars. And by 2021, that will be our annual interest bill alone!

Chart 6

So how and why do we find ourselves in this predicament? Let's look first at receipts and then spending. This chart assumes the end of the 2001 tax cuts for anyone making more than $250,000 a year. Receipts grow 7.5% a year to $4.4 trillion or 19.6% of GDP in 2020.

Chart 7

We gather these receipts ineffectively and inefficiently. The Corporate system is uncompetitive. The individual system is very confusing. Lots of overlapping programs. Tax expenditures (really spending by another name) total $1.2 trillion. We tax wages and capital gains differently. And a lot of money is lost through non-compliance. It's cumbersome, confusing and ineffective.

Chart 8

This chart is a listing of tax expenditures…otherwise called tax breaks, tax fairness, or loopholes depending upon your point of view. Either way, it's a lot of money given in tax breaks. Eliminating them entirely would allow a rate reduction of about 43% for individuals and 25% for Corporations. So why don't we?

Thus far, the answer is like anything else…spending is popular and every one of the 169 tax expenditure line items from 2010 has a very vocal supportive constituency.

Chart 9

This analysis from The Tax Policy Center gives you a sense for how much rates would have to rise in 2020 to solve for a 2% annual deficit. Not resolving it… just reducing it to 2% of GDP. The first column is where we are today. The second is what rates would go to if we raised all rates proportionally by 58%. And for those who believe the wealthy should just pay more, if we focused on just the top 2 brackets (highlighted in the red brackets) and left everyone else alone, their rates would go to above 100%. Most would consider that confiscatory. Additionally, in 2008, taxpayers with over $100,000 of income filed 17% of returns and paid 71% of taxes… and taxpayers with over $500,000 of income filed 1% of returns and paid a third (32%) of all taxes. By the way, my understanding is that in 1932 President Hoover raised the tax rate from 25% to 63% to balance the budget and Franklin Roosevelt raised it to 79% in 1936 and we all know how that turned out.

Chart 10

In analyzing spending, we can see it rises throughout the 20 year period and grows from 18.2% of GDP in 2000, to 23.8% in 2010, and by 2020 its $5.7 trillion or 25.2% of GDP.

Chart 11

So what comprises spending? This breaks out 2010 and you can see each of the pieces. Importantly, more than half of all spending is on Automatic Pilot, meaning we have an open-ended financial commitment. Congress does not consider these in their annual spending authorization because the program is the program regardless of the cost. Mandatory spending for Medicare/Medicaid, Social Security, Interest, and other programs adds to 61% of our total spend. So let's look at each segment of our spending.

Chart 12

Defense spending has grown significantly over the last 10 years…it's up 87% excluding the wars and 145% including the wars. Over the next 10 years, even excluding the wars it's planned to grow another 33%. I'm not trying to make any value judgments on any of these charts by the way. These are just the facts.

Chart 13

Non-defense discretionary spending represents all the other Government Departments. So… Agriculture, Commerce, Veterans Affairs, Homeland Security, etc. While it grew about 7% annually in the last decade, thru 2020 it's planned to grow 1% a year.

Chart 14

All other mandatory spending represents programs like Federal Employee Retirement & Disability, Unemployment, Food & Nutrition Assistance, Veterans Benefits, TARP, Fannie/Freddie, EITC, etc. This segment grew 6% annually in the last decade and is expected to grow 3.4% annually in the next.

Chart 15

Now it starts to get even tougher. Social Security grows by half a trillion dollars primarily because my generation, the baby boomers, starts moving thru the system. There is very little COLA or inflation impact (about 1.2% annually) assumed in this coming decade. If inflation were to result in COLAs equal to the last decade (about 2.8% annually), which was considered low inflation environment, it would add $200 billion more to the 2020 spend.

Chart 16

The same phenomenon, us aging boomers, affects Medicare and Medicaid which almost doubles by 2020. As big as that number is, it assumes the 9.8% annual rate of growth in the last decade slows to 6.4% in the next. The lower forward growth rate projected by CBO is predicated on the impact of the new healthcare bill and actions like allowing enactment of lower reimbursement rates for doctors. So if these expenditures grew at the same rate in the next decade as they did in the previous one, the spend grows to $2.0 trillion rather than the currently projected $1.471 trillion. That's a huge difference.

Chart 17

We discussed interest earlier. The 2020 number of $916 billion assumes an average ten year rate of about 6% vs. about 3% today. If debt does get this bad where net debt is 90% of GDP, it's reasonable to believe rates would be higher than this…making this chart look a lot worse. As a reminder, in 2021 we would reach about a trillion dollars a year in interest alone. Interest would be the third biggest expenditure, with only Medicare/Medicaid and Social Security being higher. It would be bigger than Defense spending, bigger than spending on all the other Government agencies combined… that's just an incredible and appalling amount of money. A sad state of affairs, if we let it happen.

Chart 18

While the math is simple, the politics are hard because voters don't like higher taxes and they don't like reductions in the real or perceived benefits of spending. But those are the only two real choices.

If we were to solve the problem 100% with taxes, it's a 28% tax increase based on percent of GDP. If solved 100% with spending, there's a 22% reduction required.

No one likes it, but it's a decision that needs to be made.

Chart 19

The problem is real…and it's structural. We can't grow our way out of this. Some may think this histrionic when it's more likely to be like Cassandra, the prediction of disaster which does come…but no one believes.

And a decision will come. We can do this thoughtfully and proactively and do it now. Or we can wait, let the debt build, wring our hands, and let the Bond Market force us into a decision… and that will be decidedly more unpleasant.

Foreign investors hold over 45% of our $9 trillion in debt today. How long will they continue to hold our debt as it grows to $20 trillion? What happens to interest rates, to the dollar, to our triple A rating, to jobs?

While the problem builds slowly and inexorably, financial markets respond abruptly. When that decline does happen, it won't be a case of minor monthly changes that give us 15 months to adjust. The hurt will come overnight as the herd moves against us. And then it's too late.

There are no easy choices to be made. Neither higher taxes nor lower spending are liked by the voting public or Congress. That's how we got to a place like this. Every piece of taxes, tax relief, spending, or spending cuts has a vocal constituency. Many will look for whom to blame for purposes of gaining political advantage. Many will argue about whether it's a spending problem or a tax problem. Many will want to just argue making it a “battle of ideas”. The issue with all that is… we are where we are, there’s plenty of blame to go around, and we need to act.

There does come a time when we collectively have to do what’s best for the country. We have to come together… Democrat and Republican, old and young, business and labor. Polemics have to be put to the side. I’ve often said Democracies seem uniquely suited to putting up the traffic light after the 4th accident. We’ve already seen the first accident. It’s time to act.

Andy Stern, a fellow Commission Member, sent me an article a couple weeks ago that perfectly encapsulates the political issue. We revel in our pluralism… and pluralism is generally a good thing… everyone has a voice… argues for their self interest… and gets heard. And from that cacophony, decisions can be distilled.

But there does come a time when a problem is so big it requires everyone pulling together… not pulling apart. This is one of those times… this is one of those issues.

The choice is simple… and stark. Are we so focused on our entitlements that we've forgotten what made us great… hard work, math and science education, technical skills, a dynamic economy, a sense of purpose, relying on ourselves and not blaming others, taking personal ownership of our future, being able to individually act in our self interest <u>while not forgetting</u> our collective purpose.

Some people in the world, and some countries even, believe our time is past. 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.

We have a choice.., are they right?… or are we still a force to be reckoned with? Do we still have the Political Will to be a great country?

Thank you.