SPEECH

September 23, 2013

No More Standoff: Let's End the Fiscal Deadlock in Washington

"No More Standoff: Let's End the Fiscal Deadlock in Washington"

Paul Schott Stevens
President and CEO
Investment Company Institute

September 23, 2013
ICI Tax and Accounting Conference
San Antonio, TX

Thank you, Greg [Gregory K. Hinkle, Vice President and Treasurer, T Rowe Price, and chair, ICI Tax Committee], for those kind words and for your help in putting together this excellent program. ICI relies on the expertise and energy of countless industry leaders like you, and we are deeply grateful for your—and their—many contributions to our work.

I am most honored to address the Tax and Accounting Conference. It is one of the most important events on our calendar each year, because of the significance of these matters to our shareholders. To all here, thank you for everything that you do on their behalf!

It is always a pleasure for me to spend time with ICI members, and I have long enjoyed the beauty of the Texas Hill Country.

But there is another reason why I'm glad to be here.

I'm not in Washington.

I first visited Washington in high school, to take part in the national championship debate tournament. That was many years ago, and eventually I made my career there—taking part in many a debate since.

I never tire of the scenic beauty, the inspiring monuments, or the echoes of history that I encounter throughout our nation's capital.

But there are times when the town can drive a person to distraction—and this is one of them.

The problem is the federal budget.

Looking at it from here in Texas, the budget battle between Republicans and Democrats resembles nothing so much as that tired cliché of Western movies—the standoff.

That's where the bad hombres are all glowering at each other, trying to figure out how to get away with the loot. No one wants to slap leather because no one knows who'll be left standing if they do.

A week from tomorrow, on October 1st, the federal government will start a new fiscal year. But as of today—T-minus-8 and counting—there's no authority for the government to make any discretionary expenditures in that new year. While federal agencies can maintain essential services in defense and public safety, much of the government could be shut down for lack of funding.

And even if our national leaders in the White House and on Capitol Hill manage to ride out of that canyon—probably by passing a stop-gap funding bill that lasts for a couple of months—they're likely to be back in a box just a few weeks later.

Treasury Secretary Jack Lew has said that his department will be pushing up against the debt ceiling—the statutory limit on how much the government can borrow—by late October. Failure to raise the debt ceiling could result in a shutdown of government services and—even more frightening—a default on Treasury securities.

The current federal debt ceiling, by the way, is 16.7 trillion dollars.

Living in Washington, you get used to billions of dollars, and even hundreds of billions—but 16.7 trillion dollars is a number that gets attention even among the most jaded.

Still, it's not enough for the scale of the federal deficits we've compiled and the spending that we contemplate.

I won't take the Western movie analogy any further, but this isn't the first time that the Obama White House and the Republican majority in the House of Representatives have been in a standoff like this—and gone down to the wire with America's finances.

I'm sure you all remember the summer of 2011, when a similar stalemate over the debt ceiling brought the government to the edge of default. That confrontation was so messy that even after default was averted, Standard & Poor's felt compelled to issue its historic downgrade of the United States' sovereign debt rating.

That episode, and the "fiscal cliff" of 2012, offer some very important lessons—but the problem is they haven't been learned widely enough in Washington.

Times like this bring to mind the words of our first president, George Washington. In his Farewell Address at the end of his eight years in office, Washington admonished the country against the dangers of dangers of "faction" and "party dissension."

"A wise people" Washington said, should "discourage and restrain" such impulses, because partisanship "serves always to distract the public councils and enfeeble the public administration. It agitates the community with ill-founded jealousies and false alarms, [and] kindles the animosity of one part against another."

Washington's words were extraordinarily prophetic of ills that afflict contemporary politics. Today, the quest for partisan advantage—on all sides—prevents our leaders from building the national consensus needed to make difficult choices on a host of issues.

Nowhere is that clearer than in the approach that Washington, DC, takes to our burgeoning fiscal crisis.

Let me try to set the scene of the current standoff in the capital—though I must warn you, the situation changes daily.

Our budget process has long been broken. This year was notable in that the Senate actually adopted a budget for the first time in four years.

But the Senate and House couldn't agree on the broad spending outline, and so they have enacted neither a budget nor the detailed spending bills that tell agencies how much money they have.

Instead, actual spending has been based on a series of short-term spending resolutions—known as "continuing resolutions," or "CRs"—to maintain funding. If a new CR isn't passed by both houses by September 30, funding stops—and a government shutdown ensues.

Last week, the Republican-controlled House passed a continuing resolution for the first few months of fiscal 2014. Linked to the House CR was a measure that would delay funding for implementation of the Affordable Care Act, otherwise known as ObamaCare. The CR also preserved the automatic spending cuts—called "sequestration"—that took effect last March.

No one expects the Democrat-controlled Senate to accept the House version.

Senate Democrats clearly will reject the move to defund ObamaCare—and as they premised the Senate's own budget bill on an end to sequestration, they are disposed to support an increase in spending, not a freeze.

The struggle over these contentious issues will determine whether a CR to keep the government funded in the new fiscal year will pass—with a shutdown as the alternative.

The two sides are equally far apart on the debt ceiling. House Republicans have conditioned any further increase in the debt limit on dollar-for-dollar cuts in federal spending. The President and Congressional Democrats repeatedly have said, however, that they will not negotiate and will accept only an unconditional increase in the debt limit.

There you have it, in a nutshell—the partisan priorities that are driving the nation into not one, but two, near-term showdowns over federal finance.

In my judgment, both parties are to blame for the standoff.

No one should take lightly the prospect of government shutdown or default.

Flirting with default in particular could be ruinous—for investors, markets, the economy, and our nation’s standing globally.

U.S. Treasury securities trade in the deepest, most liquid market in the world. Their interest rates set the benchmark for all other debt issuers. But that market depends for its stability first, on the unquestioned “full faith and credit” of the United States and second, on the certainty of its regular operations. Take those away, and we are truly in uncharted and dangerous waters. No one can say for sure what will happen—but it won’t be pretty.

In the weeks before the 2011 debt ceiling impasse was resolved, yields on short-term Treasury securities and other money market instruments, such as repurchase agreements, spiked sharply. The rate on the Treasury bill set to mature on August 4, 2011, rose from slightly above zero in early July to almost 30 basis points by the end of that month.

An actual default would be worse by several orders of magnitude. Even now, with the growing uncertainty, Treasury is scaling back its auctions of bills—squeezing the supply of securities that are in high demand. Future auctions beyond the debt ceiling date may yet be altered.

The credit of the United States emphatically should not be put in question in this way.

Let me say with equal force, however, that those who dismiss or minimize our current budget problems are also playing with fire. The risks they are taking may be less immediate, but they are no less consequential. And the longer they delay action, the larger and more difficult the solutions become.

Last week, Treasury Secretary Lew declared that, “[O]ur deficit has fallen faster than at any point since the demobilization after World War II, and should continue to decline relative to [gross domestic product] over the 10-year budget forecast.”

That earned the Secretary a rebuke from the Washington Post’s Fact-Checker column, which said his statement was “much like a magician’s trick. It distracts attention from the more troubling news about the debt on the horizon.”

What’s that troubling news?

Let’s start with a look back. Since September 30, 2007, the gross national debt has risen by 7.9 trillion dollars—yes, I’m still talking in trillions—or an average of 1.3 trillion dollars every year for six years. The slowdown that Secretary Lew was praising meant that the debt increased in fiscal 2013 by only 836 billion dollars.

The national debt is now larger than the American economy. As the end of fiscal 2013, the debt is 105 percent of U.S. gross domestic product—our annual production of goods and services. Only once before in our history has the federal debt matched the size of the entire economy, and that was when the Greatest Generation had just finished fighting World War II.

The tax and spending bargains reached so painfully in the past three years have slowed the growth of debt, at least for the short term. But the long-term projections of the Congressional Budget Office (CBO), released last week, show that progress will be short-lived: by 2018, the debt held by the public will be rising again, as a share of GDP, toward new record levels.

And those projections assume that “sequestration”—the automatic spending cuts imposed on defense and domestic discretionary spending as of last March—continues indefinitely. If you know Washington, you know that sort of spending discipline is unlikely to stick. In fact, as I mentioned earlier, the Senate voted earlier this year to unwind sequestration—undoing the only major source of discretionary spending restraint.

These long-term projections reflect a budgeting reality that is finally arriving with a vengeance—the dominance of mandatory spending.

The immediate budget battle over government funding for fiscal 2014 is focused on “discretionary” spending—the spending that Congress authorizes and appropriates every year. Discretionary spending includes most of what we think of as the agencies and functions of the federal government—the IRS, the FBI, environmental protection, financial regulation, and, of course, the national defense.

But the spending Congress controls each year is increasingly swamped by the spending that’s on auto-pilot—so-called “mandatory spending.” These are the set-it-and-forget-it programs, like Social Security, Medicare, and veterans’ benefits. And it is these programs, outside the annual spending process, that increasingly drive the federal budget.

Consider this—over the next 10 years, CBO projects that mandatory outlays will represent 61 percent of federal spending. Interest payments on the national debt—another auto-pilot item—will consume 11 percent. Discretionary spending will account for just about one-quarter of federal spending—27 percent.

In fact, mandatory spending has become so dominant that eliminating all domestic discretionary spending would just barely balance the budget.

That’s just in the next 10 years. Here’s how CBO describes the situation 25 years out: in 2038, federal spending for health care and Social Security will be running at twice the average level of the past 40 years, while “total spending on everything other than the major health care programs, Social Security, and net interest payments would decline to…a smaller share of the economy than at any time since the late 1930s.” [Emphasis added.]

That’s staggering. And rather than address the growth of mandatory spending, recent policy has tended to tilt the balance further. The automatic cuts of sequestration, for example, apply only to discretionary spending—leaving mandatory programs unscathed.

Let me be clear—the programs funded through mandatory spending are very important. For example, on many occasions I have expressed strong support, personally and on ICI’s behalf, for Social Security as the foundation of Americans’ retirement security. Fulfilling our social contract by putting Social Security on a sustainable footing for the indefinite future is nothing less than a moral obligation.

But paying our own bills—as a nation, as a generation—that, too, is a moral obligation.

It’s one thing to leave our children a debt to pay for a war fought to ensure freedom, or an asset that’s making their country stronger and providing a return in economic growth.

It’s another to spend on our own needs and say “charge it to the kids.”

If I may quote George Washington again, he warned against “ungenerously throwing upon posterity the burden which we ourselves ought to bear.” Yet that’s what our current fiscal policies are doing.

And the consequences of that course could be dire.

CBO notes that large and persistent federal deficits could reduce the total amounts of national saving and income, as government borrowing “crowds out” investment in private capital goods that make our workers and our economy more productive.

Financing that debt will demand an increasing share of the budget for interest payments.

And growing federal indebtedness, CBO notes, will increase the likelihood of a fiscal crisis.

Keep in mind that, more and more today, America’s creditors are overseas. Roughly half of the debt held outside the federal government is owed to foreigners. If we Americans are puzzled by our long-running fiscal standoff, imagine how it could affect confidence in our policies overseas. A lenders’ strike abroad could trigger a financial and economic crisis that would make the tech and mortgage busts look like mere blips. Now I’ve painted a pretty bleak picture.

And I’ve laid myself open to an obvious question: “OK, Paul, do you or ICI have a secret plan to address our deficit and debt problems?”

No—we do not.

What we do have is a sense of the urgent need to address these issues—for our leaders to set aside their partisan political interests and to negotiate seriously and in good faith.

To Republicans I’d say: let’s not risk shutting down the government by tying up a continuing resolution in further fruitless positioning over ObamaCare, and let’s avoid even the slightest suggestion that our nation will default on its financial obligations.

To Democrats I’d say: sustaining government in the short term while dismissing or ignoring the urgent need for long-term budgetary action—particularly reform of mandatory spending—is no less dangerous a course.

Ultimately, there is no political advantage—not for Congress, not for the President—to be had in increasing the instability and risk that our economy faces due to unsustainable deficits and debt. The sooner more of our leaders recognize that, the sooner they can set our nation on a healthier path toward sustainable growth. Let me just touch on one other important aspect of the fiscal policy debate—fundamental tax reform.

The chairmen of the tax-writing Senate Finance and House Ways and Means committees have both expressed their intention to draft tax-reform bills in October. They have set a goal of passing tax reform this fall. The chances of that happening are, frankly, quite remote.

But their recent work—in particular the “blank slate” approach advocated by Senate Finance Chairman Max Baucus [D-MT]—has cast into doubt how Congress will treat any number of long-standing tax provisions.

ICI can support tax reform that would broaden the tax base and lower rates on both the corporate and individual income taxes. At the same time, we are strongly opposed to limits or reductions on tax incentives for retirement savings—and we have told Congress of our opposition in no uncertain terms.

Is this a contradiction? Is this another example of what the late Senator Russell Long from my home state of Louisiana used to say—“Don’t tax you; don’t tax me. Tax that feller behind the tree”?

No—it is not.

ICI supports tax reform because it believes the tax system should encourage and reward savings and capital formation—not spending and consumption. A tax code that promotes savings will increase investment, economic growth, employment, and prosperity for us all.

The tax incentives for retirement savings have been instrumental in helping Americans set aside 13.8 trillion dollars in defined contribution plans, private defined benefit pensions, and individual retirement accounts [IRAs].

Just as important, these savings are retirement savings—long-term investments dedicated to providing security for working Americans in their old age. Our employment-based retirement system takes an enormous potential burden off of government—the provider of last resort. Any budget strategy that seeks to restrain the growth of mandatory federal spending must recognize the crucial need to preserve the incentives for employer and individual retirement savings.

We also need to point out—and do point out, as often as possible—that retirement tax incentives are fundamentally different from other “tax expenditures” in the code. Retirement tax incentives are a deferral of taxes—not a tax deduction or exclusion. Retirement savers who make tax-deferred contributions ultimately do pay taxes on their contributions when they withdraw funds in their retirement. That’s not the case for, say, employer-paid health care premiums, or home mortgage interest.

This fundamental difference undermines the case for capping retirement tax incentives—and I’d refer you to the extensive research we’ve done on this topic, published on www.ici.org/retirement.

A related issue is that many of the proposals for limiting retirement tax incentives are unbalanced—they target tax benefits for defined contribution plans, but leave untouched the equivalent incentives to fund defined benefit plans. This introduces a bias in tax policy that favors the public sector—where DB plans are still prevalent—over private employers, for whom DC plans are now the dominant model. National policy should not tilt the tax treatment of retirement savings toward public employees.

Finally, let me just note that these tax incentives are part of a very successful system of retirement provision—and one that Americans overwhelmingly support.

You may not get that impression from the press reports that you read about a looming “retirement crisis.” But let me tell you—the data belie the media’s alarmism.

ICI’s research shows that assets specifically earmarked for retirement have increased nearly sixfold since 1975, even after adjustment for inflation and population growth.

Both the share of retirees receiving income from private-sector retirement plans and the amount of income that those retirees receive has gone up over time, not down.

Americans overwhelmingly are confident that retirement plan accounts can help individuals meet their retirement goals.

And they agree—by a margin of four to one—that incentives for retirement savings should be a national priority. Why do we take these fiscal issues so seriously?

U.S. registered investment companies serve more than 90 million investors. These are Americans who are investing for a brighter future—a secure retirement, a better education, or a solid financial foundation. They need responsible action by their government to protect the health of the economy and the financial markets on which they depend. They want Congress and the Administration to work together to put America on a path of fiscal responsibility.

The health of our markets, the prosperity of our nation, and the security of future generations all depend upon it. Let's hope that Washington wakes up to those facts—and soon.

Thank you.
