U.S. Currently Borrowing 40 Cents of Every Dollar It Spends

Admiral Mullen on Debt Threat

"Our national debt is our biggest national security threat."

–Admiral Mike Mullen, Chairman of the Joint Chiefs of Staff
"Tribute to the Troops" Breakfast
June 24, 2010

STANDARD
&POOR'S

Global Credit Portal®
RatingsDirect®

July 14, 2011

Research Update:

United States of America 'AAA/A-1+' Ratings Placed On CreditWatch Negative On Rising Risk Of Policy Stalemate

Overview

- Standard & Poor's has placed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the United States of America on CreditWatch with negative implications.
- Standard & Poor's uses CreditWatch to indicate a substantial likelihood of it taking a rating action within the next 90 days, or in response to events presenting significant uncertainty to the creditworthiness of an issuer. Today's CreditWatch placement signals our view that, owing to the dynamics of the political debate on the debt ceiling, there is at least a one-in-two likelihood that we could lower the long-term rating on the U.S. within the next 90 days. We have also placed our short-term rating on the U.S. on CreditWatch negative, reflecting our view that the current situation presents such significant uncertainty to the U.S.' creditworthiness.
- Since we revised the outlook on our 'AAA' long-term rating to negative from stable on April 18, 2011, the political debate about the U.S.' fiscal stance and the related issue of the U.S. government debt ceiling has, in our view, only become more entangled. Despite months of negotiations, the two sides remain at odds on fundamental fiscal policy issues. Consequently, we believe there is an increasing risk of a substantial policy stalemate enduring beyond any near-term agreement to raise the debt ceiling.
- As a consequence, we now believe that we could lower our ratings on the U.S. within three months.
- We may lower the long-term rating on the U.S. by one or more notches into the 'AA' category in the next three months, if we conclude that Congress and the Administration have not achieved a credible solution to the rising U.S. government debt burden and are not likely to achieve one in the foreseeable future.

Problems With Republican Balanced Budget Amendment

- Restricts ability to respond to economic downturns – compounds declines
- Uses Social Security funds to calculate balance and subjects program to same cuts as other federal spending
- Shifts ultimate decisions on budgeting to unelected and unaccountable judges
- State ratification process could take years to complete – need long-term debt reduction plan in place now

Turn Recession into a Depression

American Enterprise Institute Scholar Calls Balanced Budget Amendment a "Really Dumb Idea"

"Few ideas are more seductive on the surface and more destructive in reality than a balanced budget amendment. Here is why: Nearly all our states have balanced budget requirements. That means when the economy slows, states are forced to raise taxes or slash spending at just the wrong time, providing a fiscal drag when what is needed is countercyclical policy to stimulate the economy. In fact, the fiscal drag from the states in 2009-2010 was barely countered by the federal stimulus plan. That meant the federal stimulus provided was nowhere near what was needed but far better than doing nothing. Now imagine that scenario with a federal drag instead."

– Norman Ornstein, Resident Scholar at American Enterprise Institute
"Four Really Dumb Ideas That Should Be Avoided," *Roll Call*
January 26, 2011

The Washington Post

FRIDAY, JULY 15, 2011

A bad idea returns

Rewriting the Constitution is the wrong way to deal with the debt.

AMENDING THE Constitution to require a balanced budget is a bad idea that never dies. It's not surprising that the current avalanche of debt has inspired renewed calls. Given that the political system appears unable to discipline itself not to spend more — trillions more — than it takes in, why not tie lawmakers' hands to prevent them from piling ever more debt on the national credit card?

The answer: The constitutional cure, while superficially tempting, would be worse than the underlying disease. A balanced-budget amendment would deprive policymakers of the flexibility they need to address national security and economic emergencies. It would revise the Constitution in a way that would give dangerous power to a congressional minority.

The latest push from lawmakers advocating the amendment is to couple a vote on the proposal with an agreement to raise the debt ceiling. On the surface, this argument seems benign enough: Why not give states the chance to decide whether the Constitution should mandate a balanced budget? But policymakers have an independent responsibility to assess whether an amendment is wise. This one, especially in its latest incarnation, is not. It would require a two-thirds vote in both houses of Congress to run a deficit in any year. The same supermajority would be needed to enact any tax increase. Compare those hurdles to the version of the amendment that passed the House in 1995, which called for a slightly lower three-fifths vote in each house to pass an unbalanced budget or increase the debt ceiling and a mere majority vote to increase taxes.

Worse yet, the latest version would impose an absolute cap on spending as a share of the economy. It would prevent federal expenditures from exceeding 18 percent of the gross domestic product in any year. Most unfortunately, the amendment lacks a clause letting the government exceed that limit to strengthen a struggling economy. No matter how shaky the state of the union, policymakers would be prevented from adopting emergency spending, such as the extension of unemployment insurance and other countercyclical expenses that have helped cushion the blow of the current economic downturn. The 18 percent cap on spending is so severe that House Budget Committee Chairman Paul Ryan's economic plan would violate its strictures. So would any budget passed under President Ronald Reagan. With health-care costs rising and the number of retiring baby boomers increasing, it would be next to impossible to keep spending to that low share of the economy.

Both houses of Congress are expected to vote on the amendment next week, but a responsible lawmaker's obligation does not end at voting against this version. Even a less draconian rendition — without the spending cap or with lower thresholds for approving tax increases or running deficits — would be the wrong approach. If a balanced-budget amendment had been in place when the economy crashed in 2008, Congress would have been unable to respond with a stimulus package or efforts to stabilize banks and auto manufacturers. Even if you believe that was the wrong policy response, it is important that Congress retain the flexibility to craft the correct one.

The fiscal situation is perilous. It's commendable that members of Congress are trying to right it. The balanced-budget amendment remains a deeply flawed approach to achieving a noble goal.

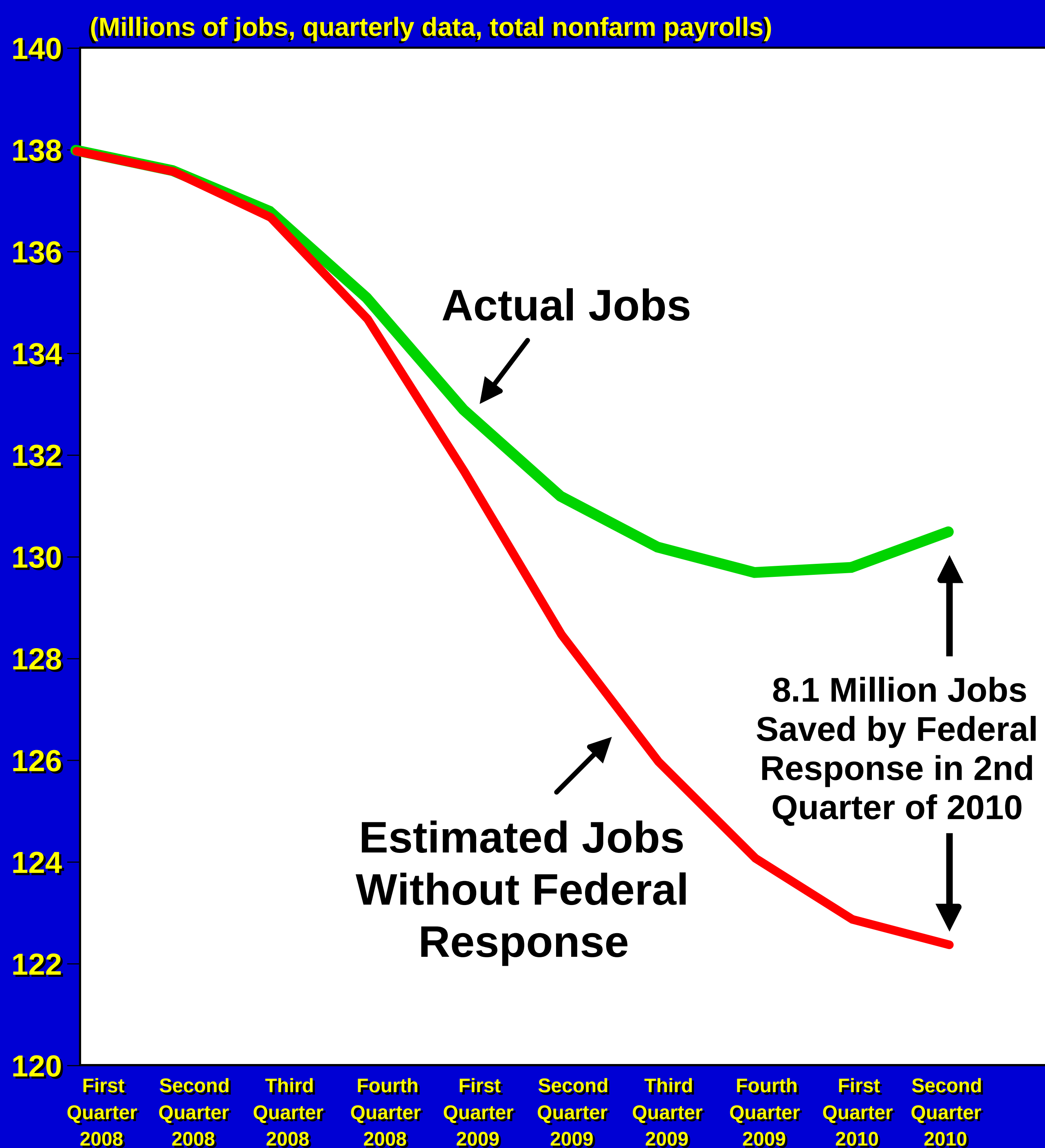
Economists Blinder and Zandi on Federal Government Response to Financial Crisis and Recession

"We find that its effects on real GDP, jobs, and inflation are huge, and probably averted what could have been called Great Depression 2.0.

"...When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policymakers had not acted at all. If the comprehensive policy responses saved the economy from another depression, as we estimate, they were well worth their cost."

– **Alan S. Blinder and Mark Zandi**
How the Great Recession Was Brought to an End
July 27, 2010

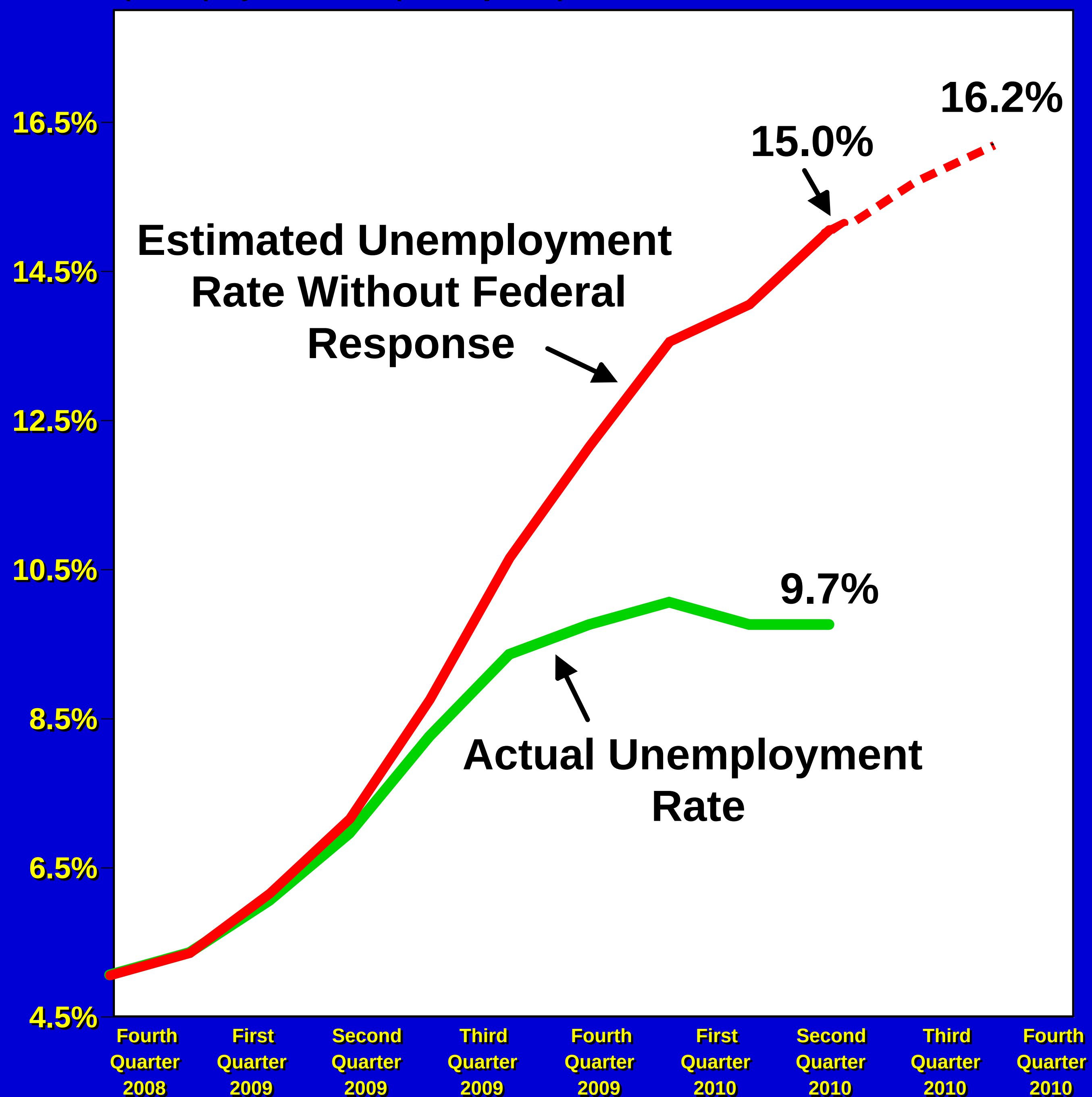
Jobs Picture: With and Without Federal Response to Financial Crisis and Recession



Sources: U.S. Department of Labor; Alan S. Blinder and Mark Zandi, *How the Great Recession Was Brought to an End*, July 27, 2010

Unemployment Rate: With and Without Federal Response to Financial Crisis and Recession

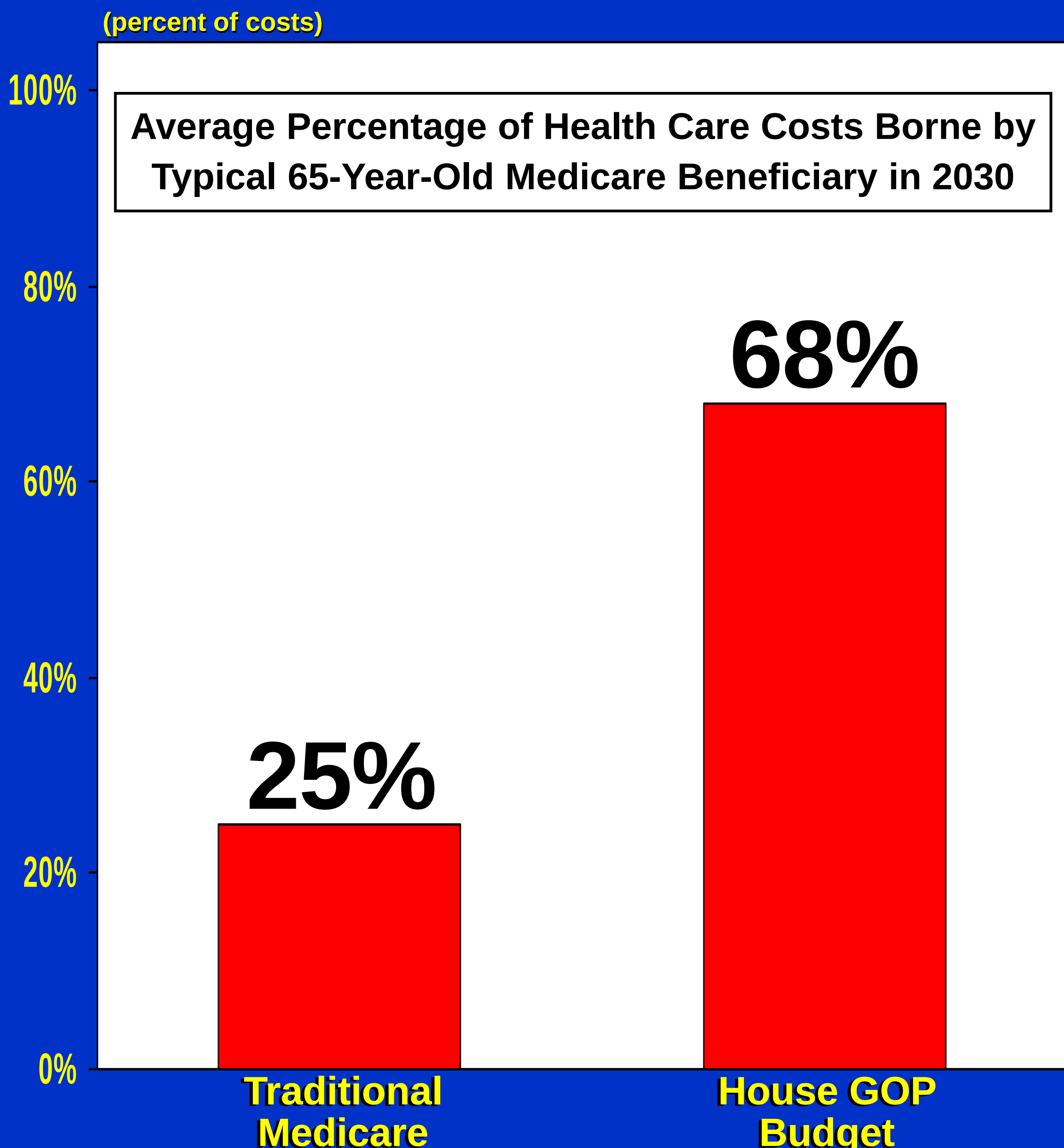
(Unemployment rate; quarterly data)



Sources: Bureau of Labor Statistics, U.S. Department of Labor; Alan S. Blinder and Mark Zandi, "How the Great Recession Was Brought to an End," July 27, 2010
Note: Percent of civilian labor force.

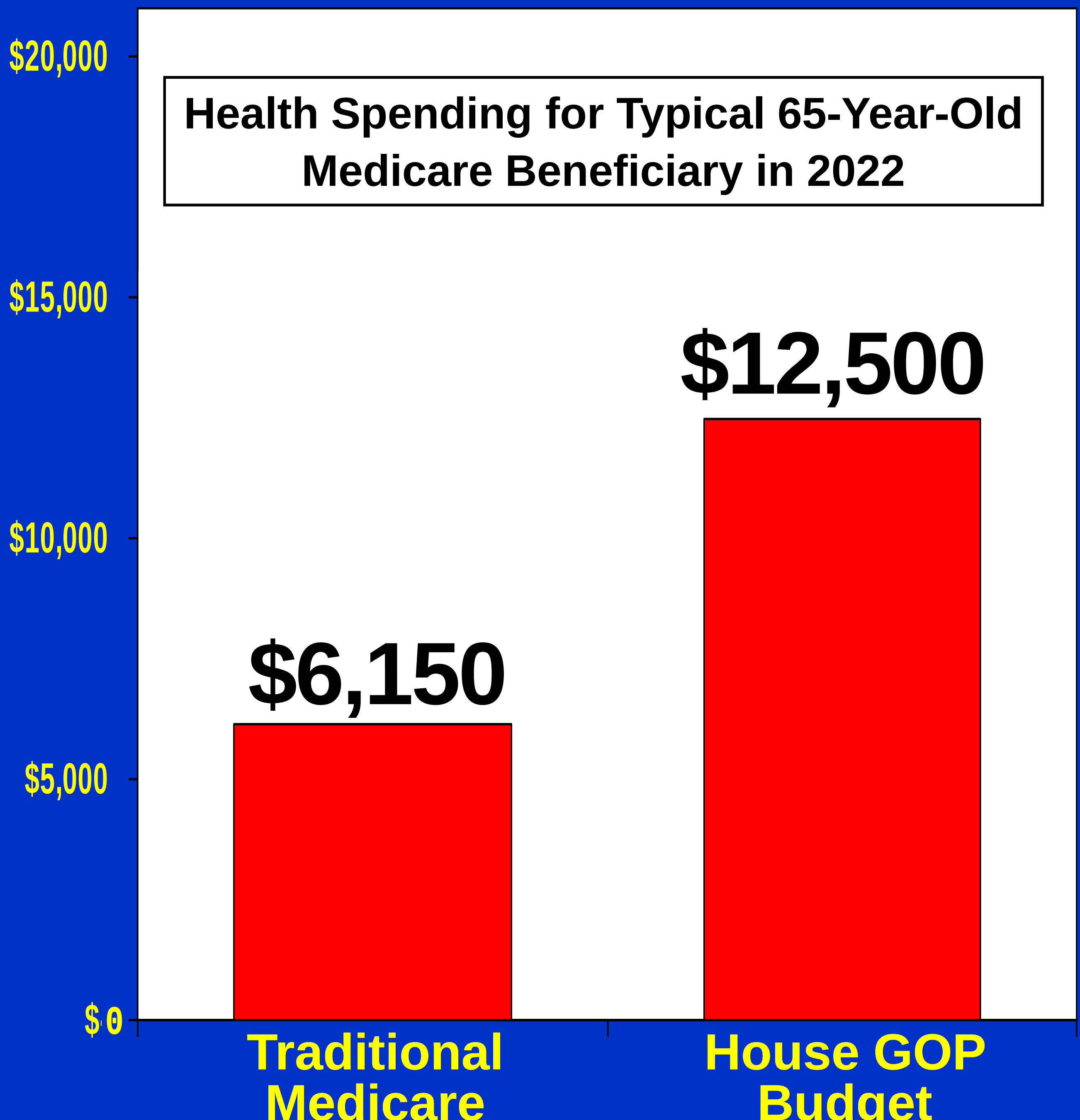
Cut, Cap, and Kill Medicare

House Republican Plan Would Dramatically Increase Health Care Spending by Seniors

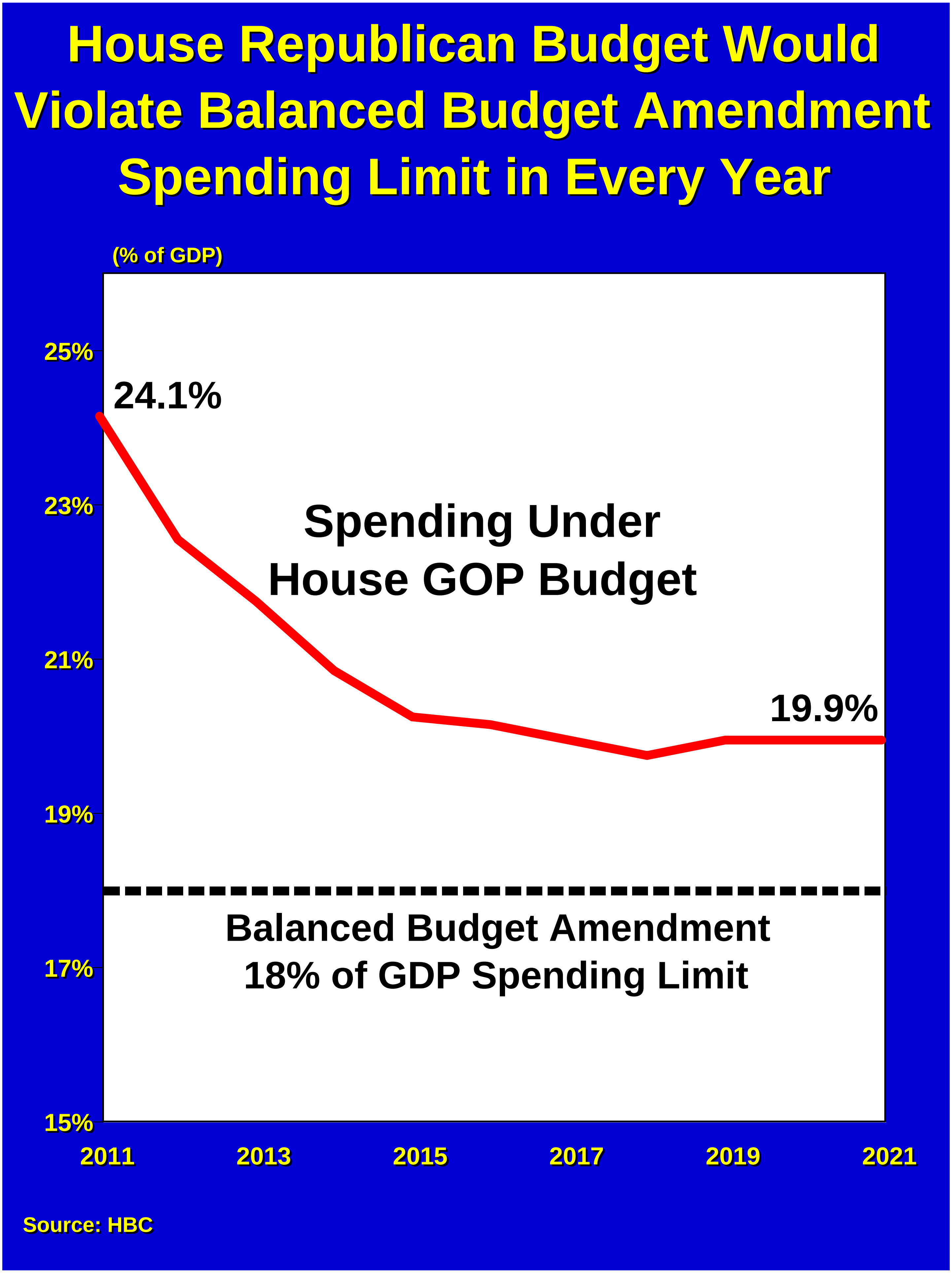


Source: CBO
Note: Traditional Medicare figure based on CBO's extended baseline scenario. Represents total traditional Medicare spending on a comparable basis to total spending under the House GOP plan.

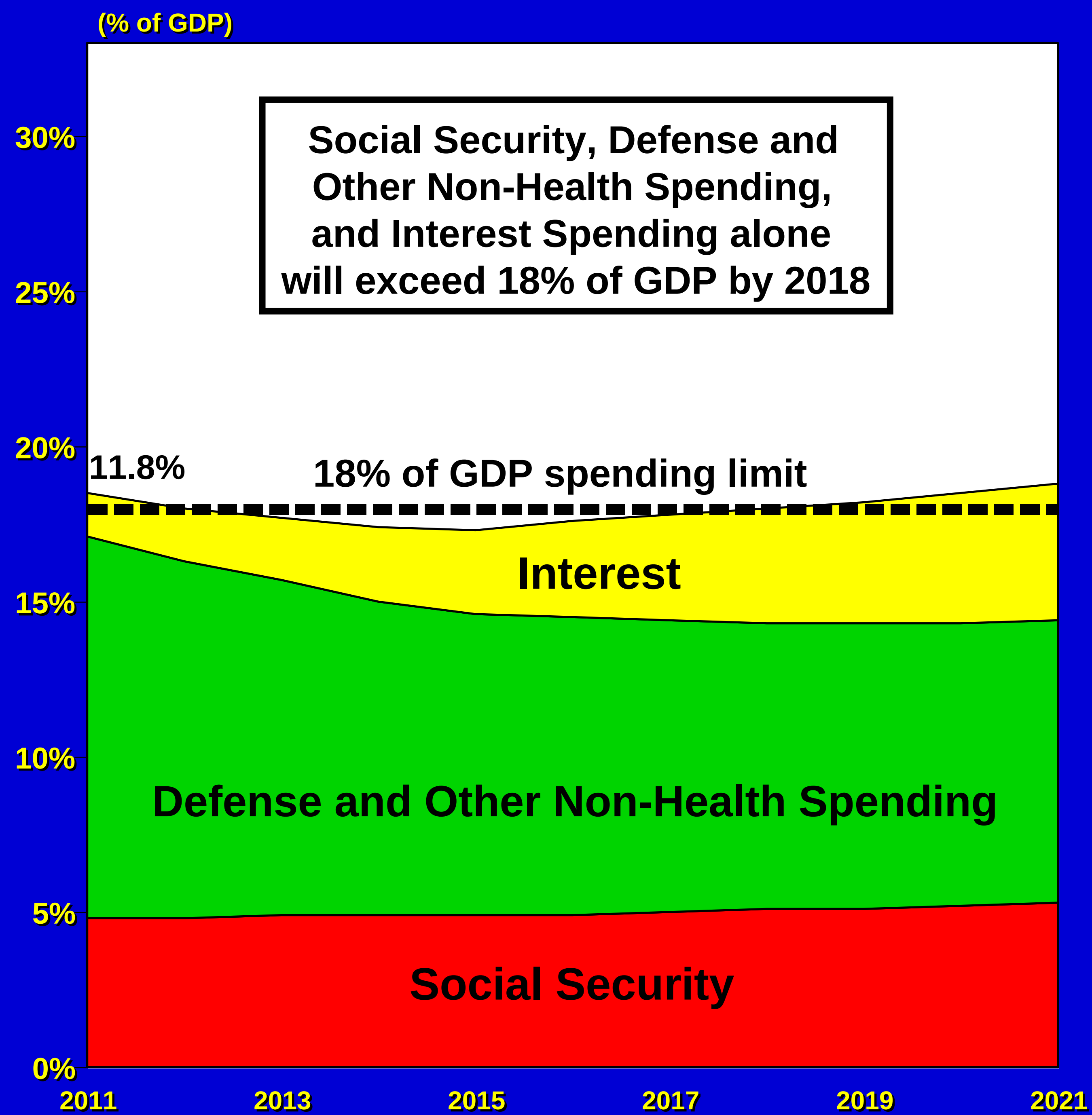
Seniors Pay Twice as Much on Health Care under House Republican Plan



Source: CBO, CBPP
Note: Traditional Medicare is CBO's alternative fiscal scenario, projected to 2022.


House Republican Budget Would Violate Balanced Budget Amendment Spending Limit in Every Year
(% of GDP)
25%
23%
21%
19%
17%
15%
24.1%
Spending Under House GOP Budget
19.9%
Balanced Budget Amendment 18% of GDP Spending Limit
2011
2013
2015
2017
2019
2021
Source: HBC

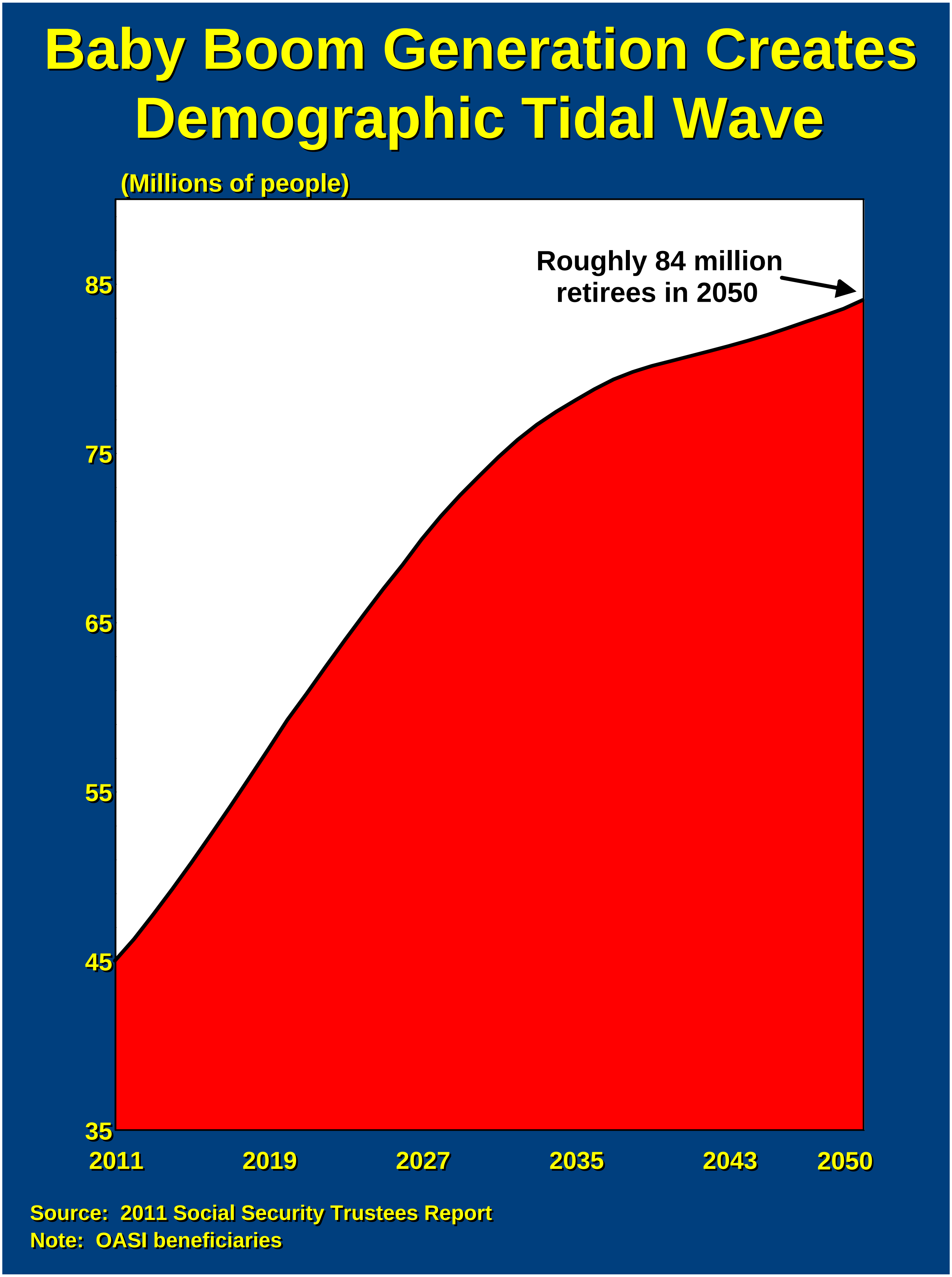
Balanced Budget Amendment 18% of GDP Spending Limit is Draconian and Unrealistic



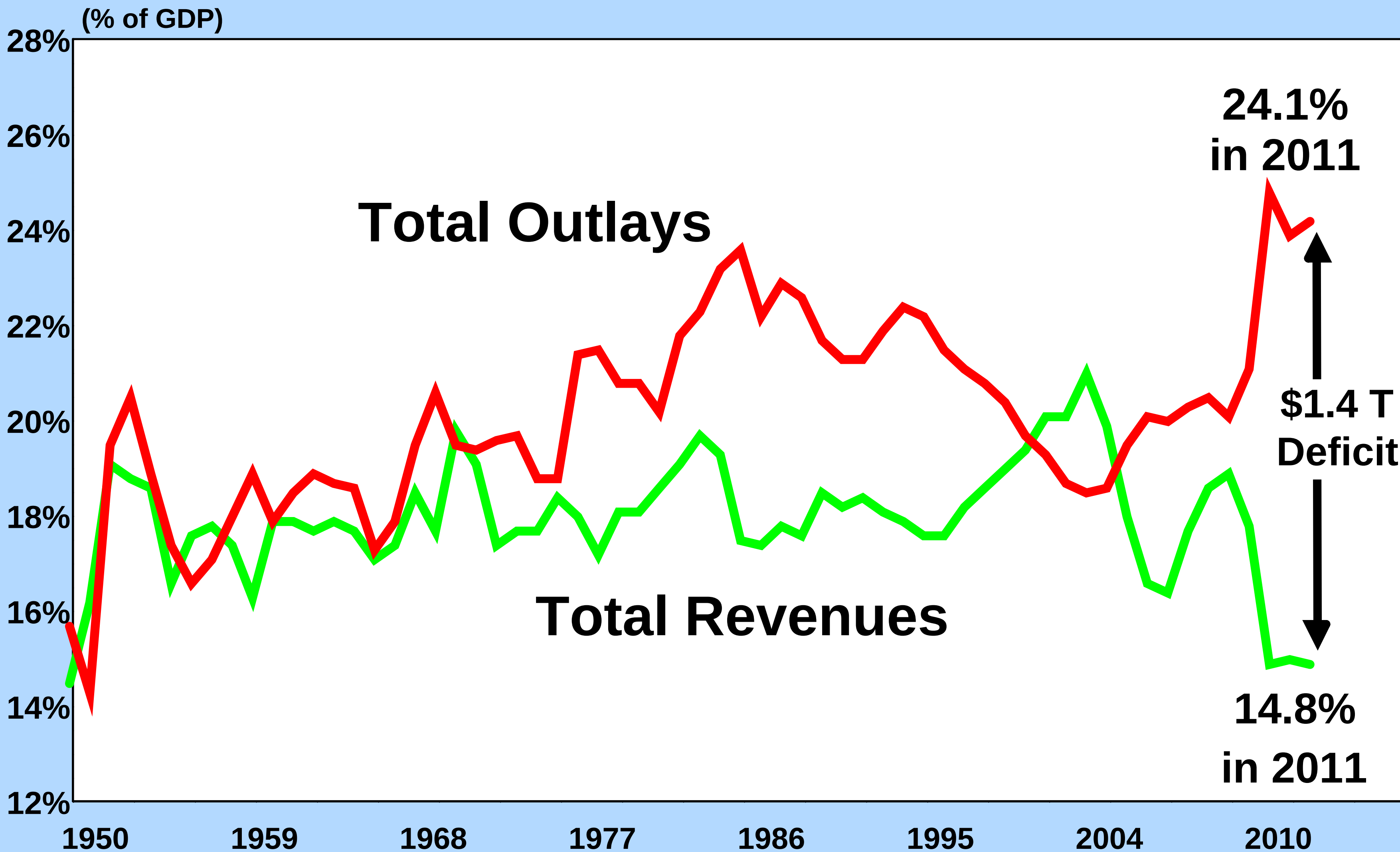
Source: CBO
Note: Social Security, Defense and other non-health spending, and Interest spending under CBO Alternative Fiscal Scenario.

Cut, Cap, and Balance Plan

- Caps spending going forward at draconian and unrealistic levels
  - fails to account for retirement of baby boom generation and rising health costs
  - provides no war funding for 2013-2021, so future war costs will squeeze out other priorities


Baby Boom Generation Creates Demographic Tidal Wave
(Millions of people)
Roughly 84 million retirees in 2050
85
75
65
55
45
35
2011
2019
2027
2035
2043
2050
Source: 2011 Social Security Trustees Report
Note: OASI beneficiaries

Spending and Revenues



Sources: OMB, CBO

The Washington Post
SUNDAY, MAY 1, 2011

On the way to a surplus, a $12 trillion U.S. detour

In 2001, the nation looked to be debt-free in a decade. In 2011, it's anything but.

BY LORI MONTGOMERY

The nation's unnerving descent into debt began a decade ago with a choice, not a crisis.

In January 2001, with the budget balanced and clear sailing ahead, the Congressional Budget Office forecast ever-larger annual surpluses indefinitely. The outlook was so rosy, the CBO said, that Washington would have enough money by the end of the decade to pay off everything it owed.

Voices of caution were swept aside in the rush to take advantage of the apparent bounty. Political leaders chose to cut taxes, jack up spending and, for the first time in U.S. history, wage two wars solely with borrowed funds. "In the end, the floodgates opened," said former senator Pete

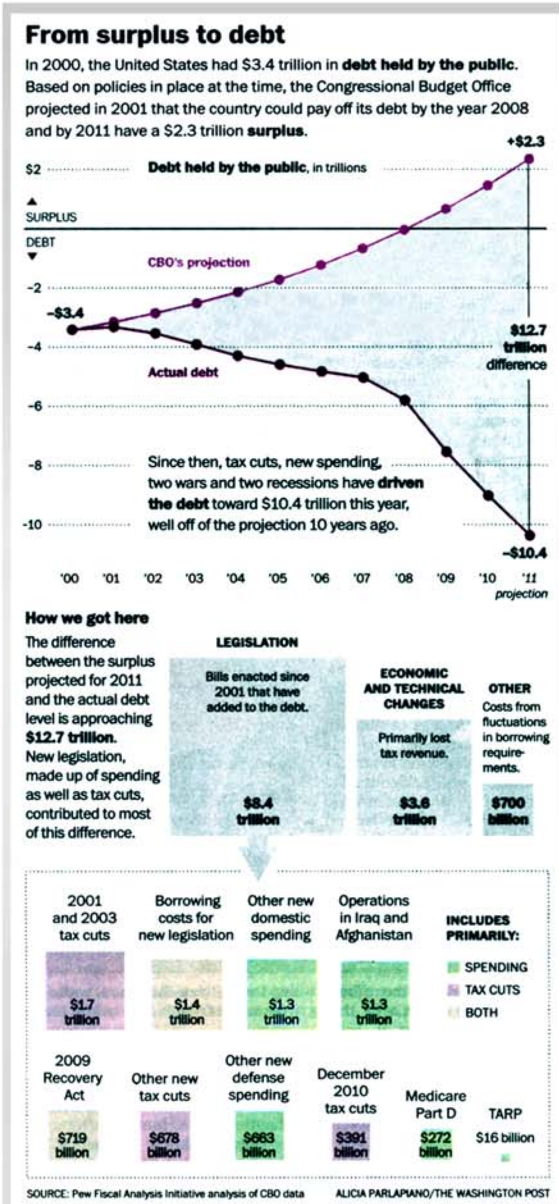
> The biggest culprit, by far, has been an erosion of tax revenue triggered largely by two recessions and multiple rounds of tax cuts. Together, the economy and the tax bills enacted under former president George W. Bush, and to a lesser extent by President Obama, wiped out $6.3 trillion in anticipated revenue. That's nearly half of the $12.7 trillion swing from projected surpluses to real debt. Federal tax collections now stand at their lowest level as a percentage of the economy in 60 years.

the tax bills enacted former president George W n, and to a lesser extent by Pr ent Obama, wiped out $6.3 ion in anticipated revenue. at's nearly half of the $12.7 t llion swing from projected surpluses to real debt. Federal tax collections now stand at their lowest level as a percentage of the economy in 60 years.

Big-ticket spending initiated by the Bush administration accounts for 12 percent of the shift. The Iraq and Afghanistan wars have added $1.3 trillion in new borrowing. A new prescription drug benefit for Medicare recipients contributed $272 billion. The Troubled Assets Relief Program bank bailout, which infuriated voters and led to the defeat of several legislators in 2010, added just $16 billion — and may eventually cost nothing as financial institutions repay the Treasury.

Obama's 2009 economic stimulus, a favorite target of Republi-

debt — and of the difficulty of re-balancing the budget without new tax revenue.

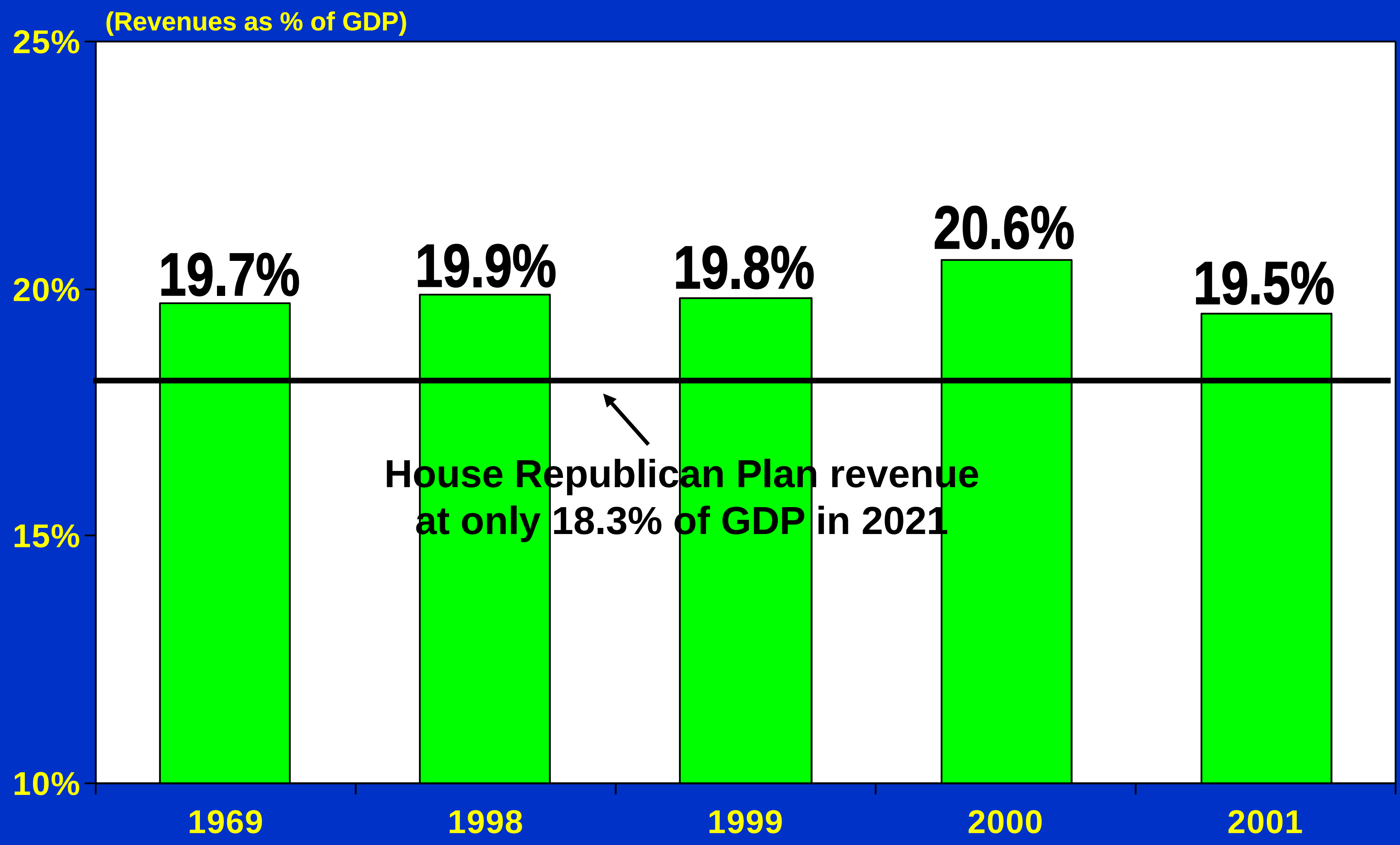


SOURCE: Pew Fiscal Analysis Initiative analysis of CBO data — ALICIA PARLAPIANO/THE WASHINGTON POST

donment of fiscal discipline in the wake of the surpluses clearly didn't help. "Nobody pushed for paying for this stuff," he said. Not even after "it became very clear in the middle of 2003 that the line had turned on us. And the surpluses as far as the eye could see were no longer there."

montgomeryl@washpost.com

Last Five Times Budget in Surplus, Revenues Near 20% of GDP



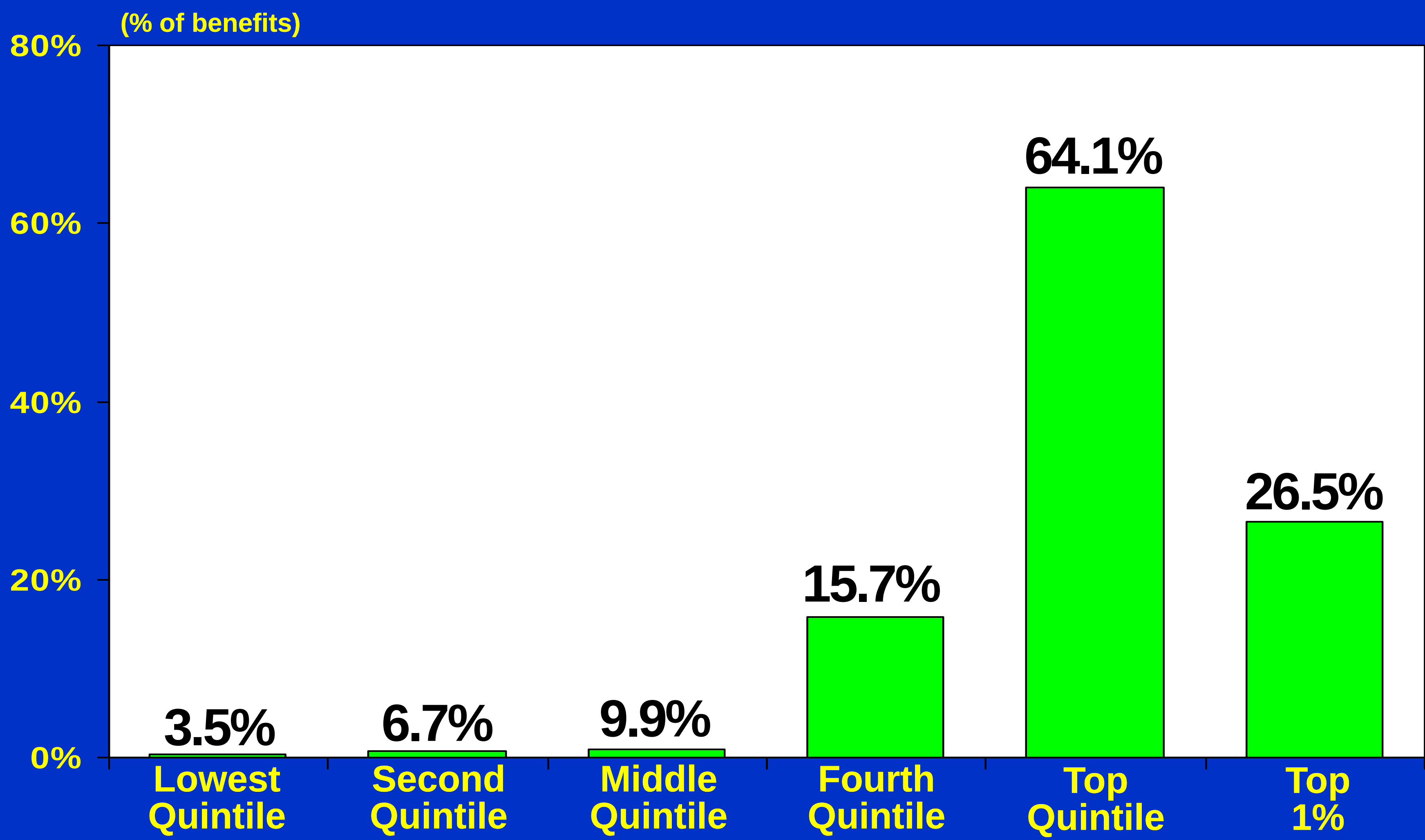
Source: OMB

Economist Feldstein on Need to Reduce Tax Expenditures

"Cutting tax expenditures is really the best way to reduce government spending.... [E]liminating tax expenditures does not increase marginal tax rates or reduce the reward for saving, investment or risk-taking. It would also increase overall economic efficiency by removing incentives that distort private spending decisions. And eliminating or consolidating the large number of overlapping tax-based subsidies would also greatly simplify tax filing. In short, cutting tax expenditures is not at all like other ways of raising revenue."

– Martin Feldstein
Professor of Economics at Harvard University
Chairman of Council of Economic Advisers under President Reagan
"The 'Tax Expenditure' Solution for Our National Debt,"
Wall Street Journal
July 20, 2010

Distribution of Benefits from Tax Expenditures



Source: Tax Policy Center
Note: Distribution of benefits in 2015.

Preserve, Protect, and Defend Tax Havens and Tax Shelters

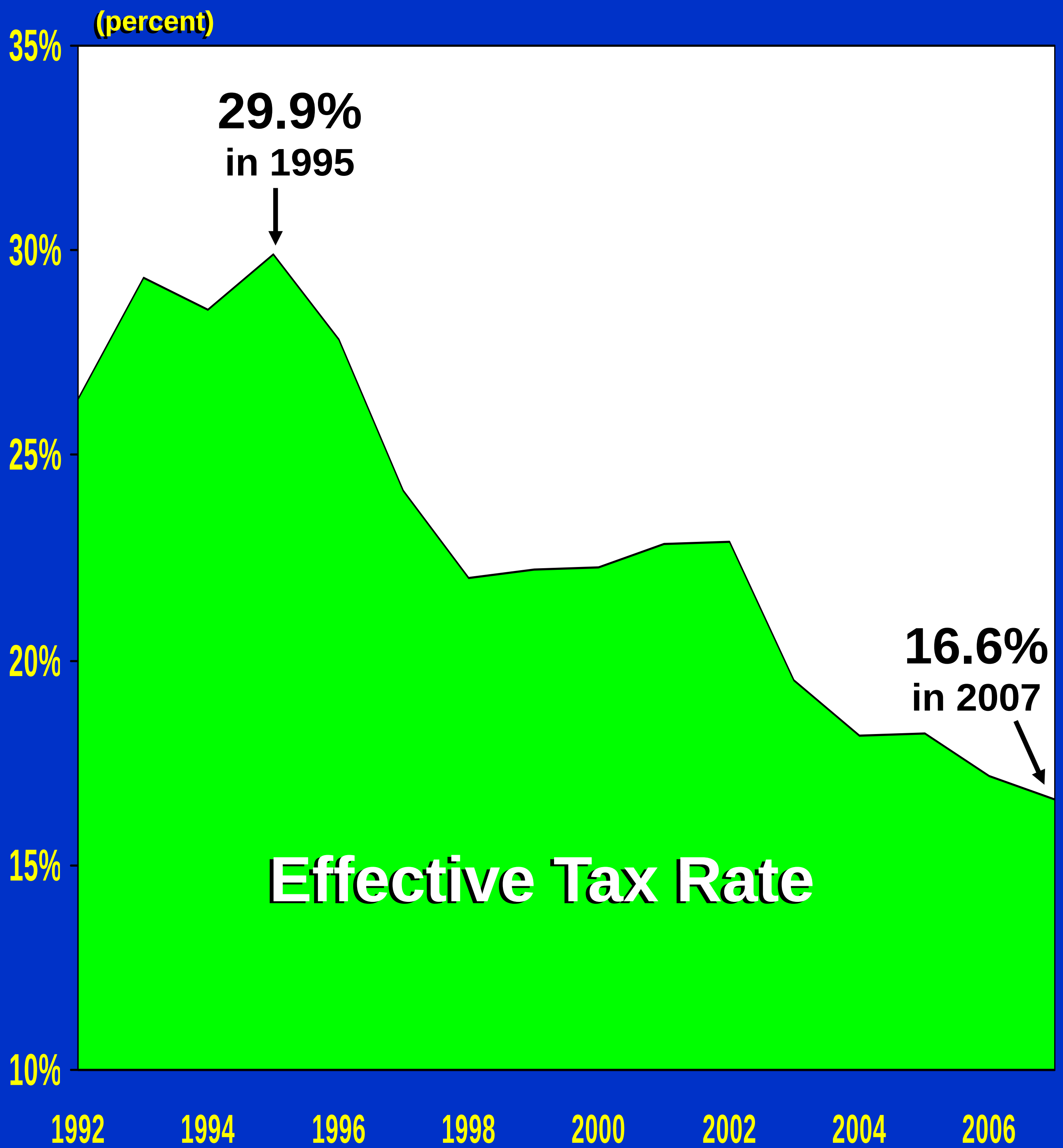
Five-Story Cayman Islands Building That 18,857 Companies Call Home

Offshore Tax Haven Abuse Proliferating

"Experts have estimated that the total loss to the Treasury from offshore tax evasion alone approaches $100 billion per year, including $40 to $70 billion from individuals and another $30 billion from corporations engaging in offshore tax evasion. Abusive tax shelters add tens of billions of dollars more."

– Press Release
Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations
February 17, 2007

Effective Tax Rate for 400 Wealthiest Taxpayers



Source: IRS

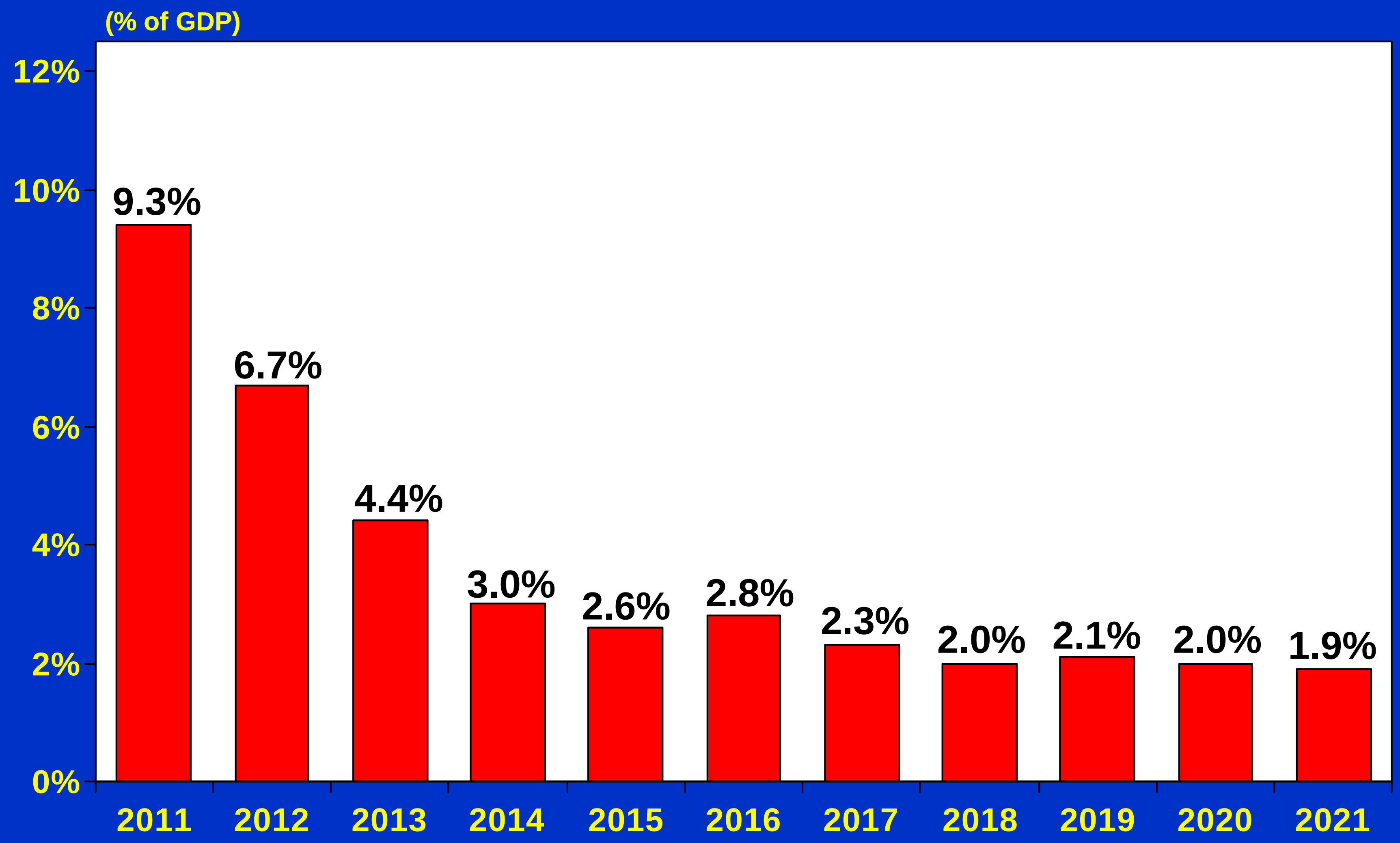
Last Time Top Rate Was 39.6%, We Experienced Longest Period of Uninterrupted Economic Growth in U.S. History

- 39 quarters of economic growth
  - 1991–2000
- 24 million jobs created
  - Best record ever

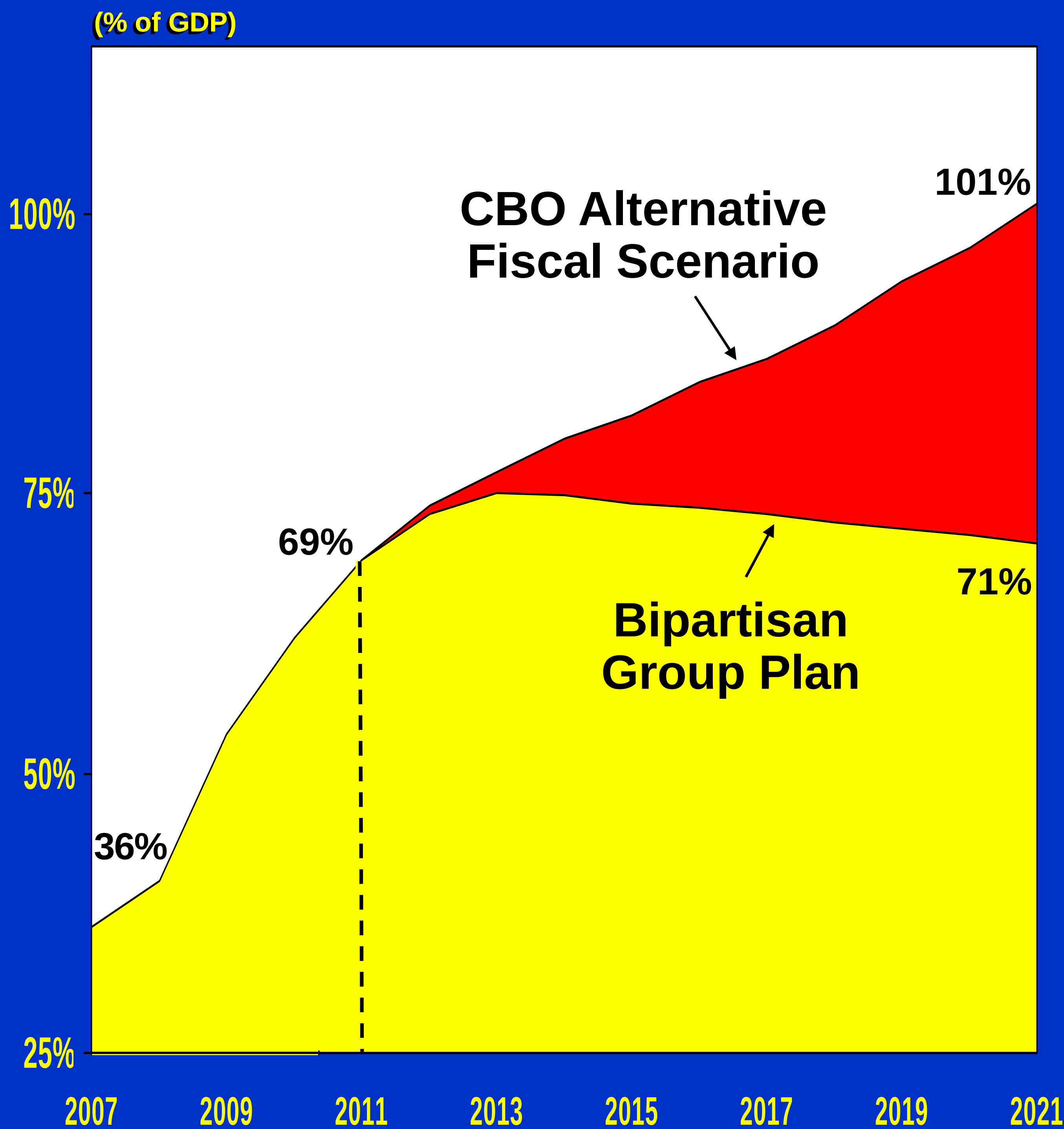
Groups Proposing Roughly $4 T in Deficit Reduction Over Ten Years

- Fiscal Commission
- Bipartisan Policy Center
- American Enterprise Institute
- Center for American Progress
- Heritage Foundation
- Roosevelt Institute

Deficit as Percent of GDP Under Bipartisan Group Plan



Debt as Percent of GDP Under Bipartisan Group Plan



Note: Publicly-held debt.