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BANKTHINK

By Eugene A. Ludwig

Don't Forget About the Simpson-Bowles Plan

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One key to the well being of the banking industry is of course the economy. Even the best management and board cannot immunize a banking company from the effects of local and national economic malaise.

The economy is edging its way off the bottom and into positive territory. But all this may change in nine months when we have to face what Federal Reserve Chairman Ben Bernanke has referred to as a "fiscal cliff."

Right around the new year, the 2001 and 2003 tax cuts are set to expire, we are likely to bump into the debt ceiling, the $1.2 trillion across-the-board "sequester" will take effect, an immediate and steep reduction in Medicare physician payments will occur, and the budget patch that protects millions of middle class taxpayers from the alternative minimum tax will vanish. The temporary payroll tax cut and unemployment insurance extensions will also disappear.

Combined, these automatic tax and expense changes would cut 10-year deficits by more than $6.8 trillion relative to realistic current policy projections - enough to put the debt on a sharp downward path. The trouble is that these abrupt changes would be extremely disruptive to economic growth and to certain essential governmental functions - for example, the military.

The nonpartisan Committee for a Responsible Federal Budget says allowing these changes to occur would be equivalent to taking 3.5% of GDP out of the economy in 2013-14 alone.

What is needed is the breakthrough budget deal that has thus far eluded Congress and the administration. In the absence of a convincing resolution to our budget problems, debt will continue to pile up. Sooner rather than later, interest rates will increase, as they have in Europe, digging the government's hole even deeper.

On our current path, debt held by the public would outstrip the entire U.S. economy, growing to as much as 126% of GDP by 2035. It is possible that interest payments on the debt could rise to nearly $1 trillion by 2020. These mandatory payments-which buy absolutely no goods or services-would squeeze out funding for all other priorities.

There is one sensible way out of the corner: revisiting the compromise reached many months ago by the bipartisan National Commission on Fiscal Responsibility and Reform. Set up in 2010, this panel, the Simpson-Bowles Commission, produced a bold, comprehensive plan for restoring fiscal discipline. The Simpson-Bowles plan would stabilize the debt by shrinking the deficit by $4 trillion over 10 years. The plan was endorsed by a majority of commissioners, including three Republican and three Democratic members of Congress.

The plan was not initially embraced in Washington. When it failed to garner a supermajority of votes from commission members, it lost its chance for an automatic endorsement. In late March, the House voted against a bill that would have used Simpson-Bowles to guide the 2013 budget. However, it has stayed in the national dialogue as a powerful nonpartisan solution available to our looming fiscal crisis; and its underlying soundness speaks to the extraordinary credibility of its namesakes and advocates.

I have heard co-chairs Alan Simpson (former U.S. Senator from Wyoming) and Erskine Bowles (former chief of staff to President Clinton), as well as former Federal Reserve vice chairman Alice Rivlin (a member of the Simpson-Bowles Commission) speak eloquently and convincingly on their plan and I would encourage you to take a look at momentoftruthproject.org.

No plan, of course, is perfect, and Simpson-Bowles is no exception. I like some elements of this plan more than others, and I daresay the same will be true for you. However, there is much more to like than not. For instance, the plan would phase in tax and revenue changes over time to avoid sending the economy into a tailspin. The proposal raises revenues but reduces marginal income tax rates to levels not seen since the Reagan era. Entitlements are not sacred, and Simpson-Bowles would slow their growth and ensure Social Security is financially solvent.

At a time when bankers are preoccupied with the sweeping regulatory changes wrought by the Dodd-Frank Act, it may seem like an additional and less essential burden to devote much intellectual energy to the federal budget. But business leader engagement is needed to set our fiscal house in order, and time is not our friend on this critically important issue. I would urge you to take a hard look at the Simpson-Bowles compromise and consider supporting it.

If that is not your cup of tea, I would encourage you to push for some other compromise that does stabilize the debt and keeps America from falling off the fiscal cliff.

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