Joint Economic Committee
Representative Kevin Brady ● Chairman

CHAIRMAN KEVIN BRADY
JOINT ECONOMIC COMMITTEE
October 11, 2013

The Way Forward from
Government Shutdown and Debt Ceiling Confrontation toward
Long-Term Fiscal Sustainability and Economic Growth

Vice Chair Klobuchar, distinguished witnesses, and my fellow Americans.

Today, the federal government remains partially shut down, and the Treasury estimates that it will hit the debt ceiling on Thursday, October 17th. If President Obama and Congress cannot reach an agreement to increase the debt ceiling by the middle of next week, the United States could default on its obligations, the economic consequences of which are too grim to contemplate.

Time is too short for the Washington "blame game." America will not default on our debt. Nor will the debt ceiling be lifted without addressing the unsustainability of the government's finances. Given our divided government, any solution therefore must be bipartisan.

In the past, Democrats and Republicans have used the debt ceiling as a responsible means to shore-up America's financial house—the *Omnibus Budget Reconciliation Act of 1990* came about through debt ceiling and sequester negotiations between congressional Democrats and President Bush, and the *Budget Control Act of 2011* came about through debt ceiling negotiations between House Republicans and President Obama.

Negotiations over the debt ceiling provide both parties with an opportunity to enact a 21st century strategy to put America's finances in order for the long haul. Therefore, I'm proposing a way forward for President Obama, Leader Reid, and Speaker Boehner to reach a bipartisan solution.

To build an office building, you start with the foundation, erect the steel skeleton, and then build out the specific offices. In past fiscal battles, however, Washington has often gotten the order wrong. Budget negotiations have often failed because we began by arguing over specific tax changes or spending cuts before we agreed on a goal and how to measure the progress toward the goal.

As Nobel laureate Milton Friedman taught, the best single measure of Washington's burden on Main Street is federal spending as a share of the economy. In the near term, the *Budget Control Act of 2011* has helped to restrain runaway federal spending, producing the first back-to-back decline in federal spending in a half century. Yet, the Act wasn't built to last, capping only discretionary spending. Indeed, the Congressional Budget Office (CBO) projects that the explosive growth of entitlements will cause federal spending to balloon to 26% of GDP over the next 25 years. That's a long-term problem both parties agree we cannot ignore.

Therefore, the first objective of any negotiations over the debt ceiling should be to set a reasonable limit for federal spending in comparison to the size of America's economy. Then the negotiations should establish a glide path to bring federal spending within the limit over time and guardrails to keep future Congresses and Presidents within those limits. How you set those limits matter.

A smart, bipartisan spending limit would restrain the spending that Congress can control—program and entitlement spending—while acknowledging the spending Congress cannot control—interest payments on the federal debt.

So how best to tie controllable federal spending to the size of the economy? GDP as a measurement is revised looking backward and fluctuates with the business cycle, allowing unsustainable spending blowouts in boom years, but then requiring politically unsustainable, economically unwise reductions during recessions. A far more stable denominator for any sustainable spending limit would be potential GDP. This is a long standing economic metric that reflects what GDP would be at full employment with no inflation. The Congressional Budget Office already calculates potential GDP in its annual *Budget and Economic Outlook*. Its projections of GDP in years 6 through 10 are considered potential GDP. By using this metric as the denominator, we can eliminate the boom-and-bust problems associated with GDP and create a more solid foundation for lawmakers to build upon.

What should be the target level of a spending cap? The prosperous 1990s can serve as a model. From 1981 to 2001, total federal spending declined from nearly 23% of GDP to under 18% while the population soared and entitlements grew. The economy, far from suffering, generated more than 35 million new jobs along Main Street—an increase of nearly 50%.

That's why I would recommend a steady glide path that would lower controllable spending over 10 years to 16.5% of potential GDP, bringing the size of the federal government back to a long-term sustainable level close to its average in the second Clinton term. President Obama and congressional Democrats might prefer a higher spending cap. But once we agree on the metrics—the foundation of a modern, enforceable spending cap—we can negotiate on the appropriate level to right-size America's government for the 21st century.

Budget innovations should also change Washington's thinking. Under this new foundation, to increase federal spending lawmakers would have to increase the nation's economic output potential. That requires growing the labor force at a faster pace – a good thing – and increasing productivity, also a good thing. Savings can get us halfway back to sustainable fiscal ground, but economic growth is needed to finish the job.

This would also create a strong incentive for the President and Congress to tackle tax reform and entitlement reform. Dave Camp, Chairman of the House Ways & Means Committee, has proposed establishing a firm timetable for each chamber in Congress to consider and pass their best idea of a simpler, fairer, flatter tax code. Lawmakers in both parties, non-partisan commissions, and the White House have proposed ideas to extend the life of Social Security and Medicare. Along with establishing smart, bipartisan spending guardrails, these are long-term approaches that could directly correlate with meaningful extensions of the debt ceiling.

Now is the time to enact a 21st century solution to ensure America's fiscal future. I look forward to the testimony of today's witnesses.