Joint Economic Committee
Republicans
Representative Kevin Brady
Vice Chairman

NEWS RELEASE

Opening Statement of Vice Chairman Brady

How Fiscal Rules Can Restrain Federal Overspending

July 27, 2011

Washington, DC - The United States is on the precipice of a financial crisis because Washington spends too much relative to the size of our economy. Under President Obama, federal spending has grown far beyond the ability of our tax system to generate revenues from American families and businesses sufficient to pay for Washington's overspending. The resulting large budget deficits are causing an unsustainable accumulation of federal debt.

Business investment in new buildings, equipment, and software drives job creation, not federal spending. Today, both large corporations and entrepreneurs are not investing because of uncertainty. They fear higher taxes and new burdensome regulations. Consequently, job creation is anemic, the unemployment rate remains stubbornly high, and American families are suffering.

As entrepreneur Steve Wynn, a self-identified Democrat, observed, "[T]his administration is the greatest wet blanket to business and progress and job creation in my lifetime. … Everybody complains about how much money is on the side in America. You bet. … [T]he business community in this country is frightened to death ..."

Overspending cannot be cured by a so-called "balanced approach." A study, *Spend Less, Owe Less, Grow the Economy*, published by JEC Republican staff on March 15, 2011, found that successful fiscal consolidations by our global competitors were composed of at least 85 percent spending reductions with additional revenues largely from non-tax sources such as asset sales. Balanced approaches that included both spending reductions and tax increases failed in other countries.

Instinctively, Americans know that federal spending must be reduced. Nevertheless, Washington has demonstrated that it cannot maintain a spending diet. Public choice economists have identified many biases in our political system against fiscal restraint and for higher federal spending.

When I became Vice Chairman, I asked the JEC Republican staff to examine what constitutional and statutory tools our global competitors and our states use to control their government spending. The results were published in the study, *Maximizing America's Prosperity*, on June 21, 2011.

This study found that our global competitors capped the spending of their national government relative to the size of their economy to put their fiscal house in order. Washington must do the same.

Washington should also consider using a number of tools that our states employ to control their spending, including the item-reduction veto and sunset laws. The item-reduction veto allows state governors to reduce specific items in appropriations bills without vetoing an entire bill. Sunset laws require the periodic review of all state agencies and programs. State agencies and programs expire if the legislature does not renew them before their sunset date.

Interestingly, the study found that effectiveness of state tax and expenditure limitations have varied greatly based on their design. In particular, expenditure limits tied to measures of a state's actual GDP have been breached during recessions when mandated spending cuts proved to be politically unsustainable.

Today's hearing will examine how these lessons can be applied to the federal government. Like our global competitors, Congress must establish spending caps. Yet, from our states, we have learned that the durability of spending caps through business cycles depends in large part on their metrics.

In my opinion, caps should be placed on federal non-interest spending. Congress can control discretionary and entitlement spending through legislation. However, interest spending is a function of past fiscal decisions, the Federal Reserve's monetary policy, and financial market conditions largely beyond the control of Congress.

Clearly, any spending caps should be related to the size of the economy over time. However, actual GDP poses a problem because it fluctuates with the business cycle. Therefore, spending caps based on actual GDP allow rapid spending growth during booms only to force large, politically unsustainable spending cuts during recessions.

A better choice is potential GDP. Potential GDP is a measure of what GDP would be at full employment without inflation. It is a well understood and a widely used economic concept. For example, Stanford University economist John Taylor uses potential GDP in the "Taylor rule" to estimate what the Federal Reserve's target rate for federal funds should be. The Congressional Budget Office already calculates potential GDP for its 10-year budget window.

Potential GDP is the GDP family's smarter brother. Using potential GDP provides a more stable path for non-interest spending through time, eliminating the spending blowouts on the upswing and preventing draconian spending cuts or the downswing that have not proven to be politically sustainable.

Given the differences between Republicans and Democrats on the size and scope of the federal government, it is unlikely that we will agree on the level of spending caps. However, I hope that we could agree on the metrics used to design spending caps.

I look forward to hearing the testimony of today's witnesses.

###