Congress of the United States

JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)

Washington, DC 20510-6602

October 14, 2010

The Honorable Jeb Hensarling
Co-Chair
Joint Select Committee on
Deficit Reduction
129 Cannon House Office Building
Washington, DC 20515

Senator Patty Murray
Co-Chair
Joint Select Committee on
Deficit Reduction
448 Russell Senate Office Building
Washington, DC 20510

Dear Senator Murray and Representative Hensarling:

As co-chairs of the Joint Select Committee on Deficit Reduction, you face a difficult task in the coming weeks as you seek to craft a bi-partisan proposal to reduce federal deficits by $1.5 trillion over the next decade. Putting America back on the path of economic prosperity and fiscal sustainability requires tough decisions.

Many have suggested that deficit reductions of $1.5 trillion do not go far enough to convince financial markets that the United States is capable of reversing our unsustainable fiscal path. This has prompted a number of Senators and House members to urge the Joint Select Committee to go beyond the mandates of the Budget Control Act and to "think big." Unfortunately, the Budget Control Act of 2011 did not adequately focus on the structural reforms necessary to sustain any spending reductions upon which the Joint Select Committee may agree over the next decade.

My suggestions recognize that it is critical that the Joint Select Committee take the opportunity to put in place a durable system of fiscal restraints, or guardrails, that will not only put us on the correct path to economic prosperity and fiscal sustainability, but will keep us on that path. These guardrails can form the foundation of legislation that "goes big" or simply looks to meet the minimum requirements of the Budget Control Act.

Our budget process fails to draw upon important lessons of history, other developed countries -- our international competitors -- and our own fifty states. Earlier this year, I introduced H.R. 2416, the Maximizing America's Prosperity (or MAP) Act. That legislation was based upon two Joint Economic Committee Republican Staff studies that examined lessons from our competitors and our states as well as fundamental economic concepts.

The first key to designing a workable system is to choose the right metrics. We need a system that encourages the President and Congress to prioritize finite resources.

The key issue confronting us is how to best reduce the size of federal spending relative to the economy. From 1981 to 2001, the federal spending as a percentage of GDP declined from 22.2% of GDP to 18.2% of GDP. In that period, private sector employment grew by 50% or 37 million jobs. Unfortunately, over the last decade as federal spending rose to 25% of GDP, a level not seen since World War II, the U.S. economy has lost 2.3 million jobs.

The proper metric for measuring spending is total non-interest spending. Interest outlays are important but they are not directly controllable by Congress or the President. They are a function of economic conditions, monetary policy, and markets. Excluding interest payments will create a more stable and less volatile environment that will let federal policymakers focus on structural issues.

In terms of measuring the size of the economy, potential GDP as calculated by CBO represents the best choice of a measure of the size of the U.S. economy. Utilizing potential GDP has the advantage of taking the business cycle out of the fiscal policy equation. It would prevent deep spending cuts during economic downturns and act as a spending restraint during economic expansions.

Targeting non-interest spending as a percent of potential GDP also helps avoid significant policy traps. First, it prevents overly optimistic growth or revenue forecasts from masking the need for structural spending changes. Second, it focuses the attention of Congress on controlling what Congress can directly control – the amount of discretionary and entitlement spending.

While not endorsing the specific numbers set forth in the MAP Act, respected economists across the ideological spectrum like John Taylor, Simon Johnson, Jim Miller, and Robert Reischauer have testified that the metrics embedded in the legislation are the proper approach to federal spending caps. I would encourage the Select Committee to consider implementing this type of spending cap as part of its deliberations.

While MAP proposes reducing non-interest spending as a percent of potential GDP to 16.5% over the decade, the committee could choose a higher of lower number. Regardless of the choice of 16.5% or some other number, from an economic perspective MAP's metrics represent the best approach to constructing a performance metric.

Incidentally, I would point out that during the eight years Bill Clinton served as President, non-interest spending averaged 16.7% of potential GDP.

The second innovation in the MAP Act is its sequestration process. Rather than create exemptions for programs, MAP includes all programs in the enforcement mechanism, but treats them differently. MAP also recognizes that an enforcement mechanism must have flexibility. In other words, it is more important to meet the long-term objective than any individual year's spending cap. MAP limits across the board spending reductions for discretionary programs to 10% in any one year. For mandatory spending programs with inflation adjustments, inflation adjustments would be delayed if discretionary reductions did not bring spending into compliance with the caps. Those inflation adjustments would not be forgone. Instead, they would be delayed until the spending caps were met and would then be recaptured.

The third major provision of MAP that I want to highlight is the recognition that our federal budget process lacks prioritization. The President's budget serves as a policy wish list more often that it serves as a policy document – this is true in both Republican and Democratic administrations. MAP begins the process of prioritization by requiring that the President's budget submission comply with the statutory caps on spending. Second, MAP would require that the President attach a priority to all non-interest spending by categorizing spending into five categories from most essential to least essential. Each category would be required to contain at least 12% of total non-interest spending.

A fourth innovation contained in MAP is a permanent continuing resolution at 10% below the prior year's funding level. This would forever end the threat of costly government shutdowns and would incentivize Congress to complete work on annual appropriations bills in a timely fashion.

The last provision in MAP that I want to highlight is the creation of a federal sunset commission. This commission would make recommendations to Congress on what agencies could be closed or merged. As important, this would increase the accountability of federal departments and agencies to Congress and the American people. This approach has not only saved the taxpayers in many states large sums, but has resulted in a more responsive state government.

There are a number of other provisions in MAP that I would encourage the Select Committee to consider. I am attaching a copy of the legislation as well as the two studies conducted by my committee staff for your consideration.

The principles outlined in MAP represent a comprehensive and economically sound approach to controlling federal spending. Adopting those principles will not only keep us on the path to fiscal sustainability, but will also make the task less difficult. Those principles will create the best possible environment in which to make important fiscal decisions and are equally relevant to meeting the minimum requirements of the Budget Control Act or "going big."

Please let me know if you would like any further information, or if I or my committee staff can assist you in any way.

Sincerely,

Kevin Brady
Vice Chairman

Attachments