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FROM ANGST TO A TRUE PROSPERITY

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Good evening. Why did a group of Senators and Representatives allow the federal government to shut down for 16 days? What caused the ruckus?

This confrontation reflected a deep angst about our country's economic future. Ordinary people, including many opposed to such confrontational tactics, fear that the American dream of individual liberty, opportunity, and broad-based prosperity is slipping away. On Main Streets across this continent, Obamacare crystalized the long-developing sentiment that Washington had become an overly expensive, meddling nanny, creating a culture of dependency. Consequently, Obamacare became the focus of public ire.

As a tactic, tying the defunding of Obamacare to the funding of the rest of the federal government did not work. If you want to change Washington, there are only three numbers that matter: 218 Representatives, 51 Senators, and one President. No President in American history has ever signed a bill into law repealing his major legislative achievement. It was "a bridge too far" to believe that President Obama would be the first. The repeal of Obamacare must await the election of a Republican Senate and a Republican President.

Yet, the angst remains. There is a wide and expanding Growth Gap between our current recovery and other recoveries since 1960. Some Americans doubt whether we will hand on a better, more prosperous country to our children and grandchildren. How we should close this Growth Gap and re-invigorate the American dream is the subject of my talk tonight.

True Prosperity

President Calvin Coolidge said that prosperity entailed more than material plenty and the mere accumulation of wealth. A truly prosperous people regarded wealth, not as an end in itself, but as a means to achieving a greater end—the betterment of the entire country, meaning Americans in all walks of life—the rich, those aspiring to be rich, and the less fortunate. Coolidge stated:

*[T]he accumulation of wealth cannot be justified as the chief end of existence ... So long as wealth is made the means and not the end, we need not greatly fear it.*¹

¹ Calvin Coolidge: "Address to the American Society of Newspaper Editors, Washington, D.C.," January 17, 1925. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. Available at: <http://www.presidency.ucsb.edu/ws/?pid=24180>

Coolidge continued:

*In all experience, the accumulation of wealth means the multiplication of schools, the increase of knowledge, the dissemination of intelligence, the encouragement of science, the broadening of outlook, the expansion of liberties, the widening of culture.*²

Coolidge was not speaking of a socialist utopia, in which federal bureaucrats direct resources through entitlements, redistribution programs, and regulations to solve perceived social problems. Rather Coolidge sought a broad-based economic growth that would empower individuals working through private voluntary organizations, which we now call “civil society,” to alleviate suffering and advance knowledge.

During the New Deal and the Great Society, the wisdom expressed by President Coolidge was largely suppressed. Then it was all but forgotten. Too many Americans began to trust government to act in an impartial, omniscient, and benevolent manner to address social problems through entitlements, redistribution programs, and regulations.

In 1962 with the publication of *The Calculus of Consent*, Nobel laureate James Buchanan and Gordon Tullock—both public choice economists—disproved these Pollyannaish notions of government, showing that politicians and bureaucrats act in their own self-interest.³ Then in 1981, President Ronald Reagan prominently displayed Coolidge’s portrait in the Cabinet Room. Now with Amity Shlaes’ recent, brilliant biography of Coolidge, Coolidge and his ideas are enjoying an intellectual revival.

The Growth Gap

Tying in with the Coolidge revival and the current angst felt by many Americans is the growing national problem that I have highlighted as Chairman of the Joint Economic Committee: the Growth Gap.

In the near term the Growth Gap is the difference in economic performance between our current recovery and an average post-1960 recovery. For those seeking work, the gap is real and widening.

When compared with an average post-1960 recovery, the Obama recovery has produced \$1.3 trillion less in real GDP and almost 4.3 million fewer private sector jobs. When compared with the strong Reagan recovery, the gap is staggering—\$1.9 trillion less in real GDP and 6.6 million fewer private sector jobs.

What does this mean for the average American? For every man, woman, and child, the current recovery has produced the equivalent of \$2,930 less in real disposable income per capita and \$4,103 less than the Reagan recovery.

² *Ibid.*

³ James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962).

Even more troubling is the serious damage that current policies are inflicting on future economic growth. Earlier this year, the Congressional Budget Office reduced its estimate for future growth in potential real GDP from 3.2 percent to 2.2 percent. A one-percentage point difference may not sound like much, but it is huge. Over the long-term—the next 50 years—a one-percent Growth Gap is the staggering difference between a \$50 trillion economy and an \$80 trillion economy that is 60 percent bigger in 2062.

In an era where many experts see America giving way to China as the world's dominant economy in the 21st century, closing the growth gap is the key to a second American century as the world's economic superpower.

Four Major Reforms to Close Growth Gap

Specifically, four major reforms must be accomplished in order to close the Growth Gap and achieve a true prosperity. These are: (1) Monetary Reform; (2) Regulatory Reform; (3) Spending Reform; and (4) Tax Reform.

(1) Monetary Reform

As a senior member of the House Ways and Means Committee, I have generally focused on fiscal policy—taxes, trade, and health care. Once I became chairman of the Joint Economic Committee, I've had the opportunity to examine the foundational role of monetary policy in the health of our economy.

Fiscal policy matters. In fact, the fiscal roadblocks of regulation, the Affordable Care Act and an outdated tax code are hampering a full, sustainable recovery. But improvements in fiscal policy can be offset with the wrong monetary policy. The opposite is also true: monetary policy cannot fix what fiscal policy has wrong.

The right monetary policy must focus on what it can achieve—price stability—because stable prices are the foundation for economic growth and job creation.

During the Great Moderation—1983-2000—we enjoyed sustained prosperity and low inflation because Fed Chairmen Volker and Greenspan determined that the best way to promote full employment was by focusing exclusively on achieving stable prices.

This approach succeeded, but since 2002 monetary policy has gone into discretionary and interventionist hyper-drive. Late in 2008, the Fed invoked the employment half of its dual mandate—for the first time ever—to justify its extraordinary actions. In so doing, the Fed explicitly deviated from the view that monetary policy could best contribute to achieving full employment by focusing solely on price stability. All subsequent FOMC policy statements have prominently mentioned the full employment half of the dual mandate, using it to justify Quantitative Easing; QE2; Operation Twist; QE3 and QE-Infinity

While these policies have been good for Wall Street, Main Street has not kept pace. Seniors and savers have been penalized with interest rates artificially stuck at low levels. And the Fed's elevated balance sheet increases the risk for future inflation because excess reserves represent the fuel for inflation should the economy pick-up steam. The Fed talks of the benefits of QE, but risks are real as well.

There was some hope of a return to a rules-based policy when in January 2012 the FOMC issued a Statement of Longer-Run Goals and Policy Strategy, in which the FOMC noted:

The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market. These factors may change over time and may not be directly measurable. Consequently, it would not be appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the maximum level of employment, recognizing that such assessments are necessarily uncertain and subject to revision.⁴

Nonetheless, any hope that this statement represented a shift by the FOMC quickly faded with the Federal Reserve's December 2012 adoption of QE-Infinity tied to the unemployment rate—the very measure it cannot influence.

Further, the September FOMC decision to not taper QE-Infinity—notwithstanding market expectations to the contrary—raises new doubts with respect to the Fed's willingness and ability to break Wall Street's monetary morphine addiction. Yes, Wall Street may respond well to the morphine, but for many ordinary Americans—especially seniors and savers—and the broader economy, the Fed's policy does harm.

It is harmful for the Fed to continue to keep interest rates at extraordinarily low levels and pick winners and losers by investing in non-Treasury assets, such as mortgage-backed securities. Moreover, the recent nomination of Janet Yellen to replace Ben Bernanke as Chairman of the Federal Reserve System does not bode well for returning the nation's monetary policy back to a rules-based system of normalcy.

Now—on the 100th anniversary of the Fed's creation—it is time to inaugurate a major monetary reform. It will be difficult to reach consensus on reform with the current divided government, but getting monetary policy right is too important to wait until the stars perfectly align.

We can lay the foundation for monetary reform now by establishing a Centennial Monetary Commission as embodied in legislation that I have introduced with 25 House cosponsors. The Commission would be modeled after the successful 9/11 Commission and the original National Monetary Commission created after the Panic of 1907. The Commission would be brutally bipartisan, which is essential for a major reform to have the necessary credibility before Congress and the public. The Commission would: (a) Review the past century of monetary policy; (b) Evaluate the various credible approaches to monetary policy; and (c) Recommend a course going forward, which the Congress would consider.

⁴ Press Release, Federal Open Market Committee Statement of Longer-Run Goals and Policy Strategy (January 25, 2012). Available at: <http://www.federalreserve.gov/newsevents/press/monetary/20120125c.htm>

While the Monetary Commission is designed to be an open contest of ideas, my vision for where monetary policy should be is found in my Sound Dollar Act, cosponsored by 52 of my House colleagues and led in the Senate by Sen. Mike Lee. I would gladly submit this proposal for review by the commission.

Among the *Sound Dollar Act*'s major reforms are to: (a) Clarify that the Fed's mandate is to achieve price stability, which is the best long-term foundation to achieve full employment; (b) Get the Fed out of the markets by allowing it to only purchase and hold Treasuries on its balance sheet, except temporarily in emergencies; and provide a smooth, orderly unwinding of all non-Treasury assets on the balance sheet in a way that would not disrupt the housing market; (c) Have the Fed formally articulate its lender-of-last-resort policy to provide stronger guidance to the market about what actions it will take in a crisis. So doing will reduce moral hazard, and—provided the Fed adheres to the statement—go far toward eliminating too-big-to-fail; (d) Accelerate the release of transcripts of the FOMC from five years to three; (e) Ensure the entire voices of the economy are heard by placing all 12 district Fed presidents as voting members; and (f) Close a \$50 billion slush fund within the Treasury.

The time to begin the reform is now; let's have a fair hearing with every credible approach on the table.

(2) Regulatory Reform

Next, we must set boundaries for the expansion of federal regulation, and reform our rulemaking process. In a typical year, regulatory agencies will pass more than 3,500 regulations.

President Reagan institutionalized cost-benefit analysis in rulemaking by executive order, directing executive agencies to systematically analyze their approaches to a problem and select the most cost effective among the alternatives that produces benefits greater than costs.

Every President since Reagan has officially endorsed this requirement, but in practice agencies have watered down, coopted, or eluded it. Most rules are not subjected to objective cost estimates. Of 3,708 rules issued in 2012, only 14 were included in the Office of Management and Budget *Report to Congress on the Benefits and Costs of Federal Regulations*. This number is so small because only so-called major regulations—those with an annual estimated economic impact of \$100 million or more—are subject to such analysis. Moreover, executive orders apply only to the executive agencies. Independent regulatory agencies with significant powers—such as the SEC and the Federal Reserve—are exempt.

Limitations on analysis don't end there. Some laws explicitly prohibit quantitative consideration of costs in rulemakings. For instance, the EPA must base regulations on what it determines to be safe for public health. The Office of Information and Regulatory Affairs is supposed to oversee significant agency rulemakings, but it is part of OMB and takes direction from the President. Therefore, it does not provide an independent check on rulemakings, and it may not be an effective regulatory gatekeeper.

Huge regulatory challenges to the economy lie ahead. Large numbers of new regulations implementing the *Dodd-Frank* law, ObamaCare, and ever tighter environmental requirements are being written, many of them without adequate analysis of costs and benefits.

We need better economic analysis in rulemaking. We must reinvigorate and extend what President Reagan started. With the benefit of better analysis, we can achieve more effective regulation and avoid rules whose costs exceed their benefits. We must broaden the requirement for economic analysis of costs and benefits to all agencies and even to cases where the law prohibits its use in rulemaking.

Senator Coats from Indiana and I are working to anchor sound economic principles for analysis in statute and instruct agencies to conduct rulemakings for the details so they incorporate stakeholders' views. We plan to introduce the proposal very soon.

(3) Spending Reform

Few issues better highlight the angst felt by many Americans than their concerns over large, persistent federal budget deficits and the accumulation of federal debt. However, we would do well to learn from Nobel laureate Milton Friedman, who held that the single best measure of the burden of government was government spending relative to the size of the economy.

More recently, Dan Mitchell of the Cato Institute coined a Golden Rule for a pro-growth fiscal policy: Government spending growth should not exceed private sector growth. Yet, the opposite is true today. Red flags emerge when comparing present spending to historical spending trends. After the recent revision to GDP, federal spending averaged 18.9 percent of GDP from the end of World War II through fiscal year 2000. In fiscal year 2012 it stood at 22.0 percent in 2012 with OMB's projections for 2013 coming to 22.7 percent.

How can we reverse this trend? Three years ago, I asked JEC Republican staff to examine fiscal consolidations around the world to identify what works. They found:

- (a) Successful fiscal consolidations focused almost entirely on spending reductions, and any new revenues were from non-tax sources such as asset sales and user fees. "Balanced" consolidations that included significant tax increases failed to achieve their deficit- or debt-reduction goals.
- (b) Fiscal consolidations can be pro-growth if spending reductions are: large, credible, and politically difficult to reverse. Examples include: (1) eliminating agencies or programs; (2) right-sizing the government workforce; (3) eliminating subsidies to businesses; and (4) reforming entitlement programs. And,
- (c) Successful, pro-growth fiscal consolidations were top-down, not bottom-up. Governments set specific targets for spending, forcing all programs to compete for available funds within the target.

Congress has had a mixed record on controlling federal spending because we don't always choose the right goals and measurements, and we do things in the wrong order. If Congress could just control spending, then deficits and debt will take care of themselves. Thus, Congress must construct a viable spending cap—guardrails against future spending.

Typically spending caps default to a cap on total federal spending. Yet total spending—the numerator for traditional spending caps—includes interest payments over which the current Congress has little control. Moreover, including interest spending makes tax increases look like spending cuts and tax cuts look like spending increases—an inherent bias against conservative budgeting.

Interest payments will consume an increasing share of federal spending when interest rates normalize. This creates a strong political urge to “bust” the spending cap to rather than crowd out popular spending. Hence, a cap on total spending is not an ideal spending cap numerator.

Next, GDP is the typical spending cap denominator. Yet, GDP is prone to great fluctuations with the business cycle. The economy booms, GDP jumps, and the cap on federal spending follows facilitating more spending. The economy tanks, GDP plummets, and Congress is reticent to cut spending to track with the economy. Moreover, though we support reducing federal outlays, it is politically impossible to cut spending when the economy is in recession. Further, congressional and agency planning and budgeting is very difficult with a constantly moving cap. Various legislative proposals have tried to work around this by using a moving average of past GDP, but these proposals still remain susceptible to GDP fluctuations. Thus, GDP is a faulty spending cap denominator.

There is a better approach: Cap non-interest spending as a percent of potential GDP.

- Non-Interest Spending: Debt, deficits and interest are symptoms of our fiscal woes; uncontrolled mandatory and discretionary spending are the disease. To treat the disease, Congress should place a cap exclusively on the mandatory and discretionary spending that it can actually control.
- Potential GDP: This is what GDP would be if the economy was operating at full employment without inflation, and it is what CBO uses for its budget and economic projections in forward years. Using potential GDP as the denominator of a spending cap is advantageous over actual GDP because it keeps spending lower in economic booms and it doesn't require unenforceable cuts during a recession.

These are manageable spending reforms, and they are embodied in my *Maximizing America's Prosperity (MAP) Act*, which I will soon re-introduce.

(4) Tax Reform

Spending cuts can get us halfway back to a balanced budget, but American needs much stronger economic growth to finish the job. Transforming our costly, complex and unfair tax code into one “built for growth” of families, businesses and the U.S. economy is absolutely essential to ensuring meaningful jobs and economic prosperity to more Americans as we move forward. I applaud the relentless initiative of Ways & Means Committee Chairman Dave Camp in driving toward the first fundamental reform of the tax code since President Reagan.

While Congress weighs consumption, flat tax and Reagan-style reforms, it should keep in mind that reducing both tax rates and the cost of capital is essential to pro-growth tax reform.

The cost of capital—which is the required return necessary to make an investment, such as building a new factory, worthwhile—is important. That’s because private business investment in plants, equipment, computers, software, etc. is the primary driver of private sector job growth. When businesses invest, they hire.

Tax reform that raises the return required to make an investment worthwhile can offset the positive impact of lower rates and dampen job creation in the private sector. The ability to raise capital affordably, invest it, recover it quickly, and reinvest it is critical to goods-producing sectors of the economy, such as energy and manufacturing. We need to be cautious about unintended consequences if cost recovery timeframes were extended in a fashion that raised the cost of capital to the point that making investments could no longer be justified based on increased risk.

Conclusion

My talk this evening, like the agenda we pursue at the JEC, is not about numbers, statistics, and dollars and cents. It is about people and the negative effects that misguided economic policies have on people, most of whom are hard-working Americans seeking to hold their own, while longing for a time when they might get ahead, just like their parents and grandparents once did.

President Coolidge favored “economy in government” not because he wished to save money, but because he wished to empower people. He knew that every wasted dollar and frivolous regulation made life all the more hard on them. “Economy,” he said, “is idealism in its most practical form.”⁵ Nearly a century after Coolidge uttered those words; we know what must be done to achieve a responsible prosperity and re-empower ordinary Americans. We have done it before, and can do it again.

“There are no easy answers,” President Reagan reminded us. “But there are simple answers. We must have the courage to do what we know is morally right.”⁶

⁵ Calvin Coolidge: “*Inaugural Address*,” March 4, 1925. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. Available at: <http://www.presidency.ucsb.edu/ws/?pid=25834>

⁶ Ronald Reagan: *A Time for Choosing: The Speeches of Ronald Reagan 1961-1982*, (Regnery Gateway / Americans for the Reagan Agenda, 1983), p.56.