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JOINT ECONOMIC COMMITTEE

Congressman Kevin Brady
Ranking Republican House Member

PRESS RELEASE

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STATEMENT OF CONGRESSMAN KEVIN BRADY

I would like to join in welcoming the witnesses appearing before us today. Current financial and economic conditions pose serious challenges to policy makers.

It is widely agreed that nothing else we do will matter much until the issue of how to dispose of toxic bank assets is resolved, but neither the Bush nor Obama administrations have devised a solution to this admittedly difficult problem. The recent Treasury proposal has not been well received because it did not clearly address this issue. The Economist magazine, for example, said that it looked “depressingly” like TARP I: “timid, incomplete, and short on detail.” The lack of specifics has undermined confidence and contributed to financial market instability. A better approach is needed to help foster recovery.

The collapse of the credit boom and fall in related asset values has already wiped out many trillions of dollars of wealth held by both households and financial institutions, while plunging the economy into a deep recession. It also appears that the financial position of the federal government will deteriorate sharply over the next decade. The Congress has passed a partisan stimulus bill that relies heavily on deficit spending to boost the economy. However, as economist John Taylor noted in a recent paper presented at the annual American Economic Association meetings, “there is little empirical evidence that government spending is a way to end a recession or accelerate a recovery.”

The 2009 budget situation was projected to deteriorate dramatically, but the stimulus legislation makes the situation even worse. Federal spending is expected to increase to at least $3.7 trillion, an increase of $685 billion or 23 percent in a single year. Federal spending as a percentage of GDP is set to increase from 20.9 percent to 25.7 percent, a post WWII high. The huge increase in federal spending, along with a fall off in revenue, will push the deficit to at least $1.4 trillion in 2009, a record level and a staggering 200 percent increase over its level of the previous year. The real budget outlook is actually considerably worse because the CBO calculations do not include a number of items that will further enlarge the deficits.

The enormous increases in deficit spending will push the publicly held debt from $5.8 trillion in fiscal 2008 to $7.4 trillion in 2009. The publicly held debt as a percent of GDP is expected to increase from 40.8 percent in 2008 to 51.8 percent in 2009, a large 11 percentage point increase in only one year. Moreover, the added spending of the stimulus bill will push this debt-to-GDP ratio to about 60 percent by 2011. One recent paper released by the Brookings Institution suggested that $1 trillion annual deficits could persist for each of the next ten years under what the authors consider to be optimistic economic assumptions.

The prospect of borrowing over a trillion dollars for questionable programs thrown together with little procedural deliberation has rightly given the American people pause. However, bailouts for the financial sector, auto industry, and others could add trillions to the projected debt in coming years. According to a recent Bloomberg report, “…the stimulus package the U.S. Congress is completing would raise the government’s commitment to solving the financial crisis to $9.7 trillion, enough to pay off more than 90 percent of the nation’s home mortgages….” Nearly $8 trillion of this total reflects lending and guarantees provided by the Federal Reserve and Federal Deposit Insurance Corporation (FDIC). Clearly, trillions of dollars of exposure to distressed borrowers does not enhance the financial position of the U.S. government.

In a recent influential paper, economists Carmen Reinhart and Kenneth Rogoff examine the history of financial crises. Among their findings is that the debt of the central government jumps an average of 86 percent in the years following a financial crisis. This would translate into a level of $11 trillion for U.S. publicly held debt in a few years. Unfortunately, current trends suggest we are well on our way to this kind of outcome.

The U.S. Treasury is expected to raise as much as $2 trillion in 2009 to finance the extraordinary financial demands placed by recession, growing bailouts, and stimulus measures on the government. Similar steps by other major countries will intensify the upward pressures on interest rates. The recent increases in long-term mortgage rates are especially troubling given the condition of the housing sector.

Furthermore, the looming retirement of the baby boom generation will cause entitlement spending to accelerate faster and faster in coming decades. It is widely recognized that without policy changes, long-term imbalances in entitlement programs will cause publicly held federal debt to balloon out of control. In 2007, the Congressional Budget Office (CBO) projected under an extended baseline scenario that publicly held federal debt will eventually climb to 239 percent of GDP without policy changes.

One risk is that the high levels of deficit spending and debt accumulation may signal to global financial markets that the United States is unwilling to resolve its long-term budgetary problems. As a result, U.S. interest rates could increase significantly. As the recent paper released by Brookings notes, "…Recent trends in credit default swap markets show a clearly discernable uptick in the perceived likelihood of default on 5-year U.S. senior Treasury debt, a notion that was virtually unthinkable in the past…although fiscal policy problems are usually described as medium- and long-term issues – the future may be upon us much sooner than previously expected."

The bottom line is that the fiscal position of the federal government is deteriorating significantly and the outlook is fairly grim. The looming possibility of large bailouts could add trillions of dollars to the national debt. The truth is that this country simply cannot afford to make further spending commitments and must consider entitlement reforms and other measures to restrain the growth of runaway deficit spending. American families cannot afford policies that ignore surging federal spending, lay the groundwork for higher taxes and inflation, and undermine the prospects for future economic and employment growth.

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