Joint Economic Committee
Republicans
Representative Kevin Brady
Vice Chairman

NEWS RELEASE

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STATEMENT OF
VICE CHAIRMAN KEVIN BRADY

What is the Real Debt Limit?

Washington, DC – When the Joint Economic Committee must hold a hearing on what the real debt limit is, the American people know instinctively that their federal government is borrowing too much. One does not really want to contemplate the grave consequences if creditors were to lose faith in the federal government to repay its debts.

The United States supplies the world's primary reserve currency; has the world's largest economy; and is source of much of the world's technological progress and economic development. The federal government should never violate its real debt limit because the consequences of exceeding it would be calamitous not just for the United States but indeed the entire world.

Nevertheless, the JEC must hold this hearing because the question now is asked: What is the real debt limit? Amazingly there are some that do not believe the U.S. has a serious debt problem. Given the anemic recovery, these individuals argue that President Obama's deficit spending splurge should continue. "Don't worry because interest rates on Treasuries remain low, and the federal government can print more money to pay all its debts," they say.

I hope that today's hearing sheds light on the fallacy of this mindset and puts an end to it.

Keynesian theory tells us to ignore the level of federal debt and continue deficit spending until full employment has been achieved. Well, we simply cannot ignore the debt anymore.

According to recent economic studies, when gross government debt relative to size of the economy exceeds a certain threshold, the economic growth and job creation slow dramatically. Economists Carmen Reinhart and Kenneth Rogoff put the threshold at 90%, while another study by economists at the Bank of International Settlements put it at 85%. The page in the Keynesian playbook on what policymakers should do when gross government debt exceeds this threshold and high unemployment persists is—blank.

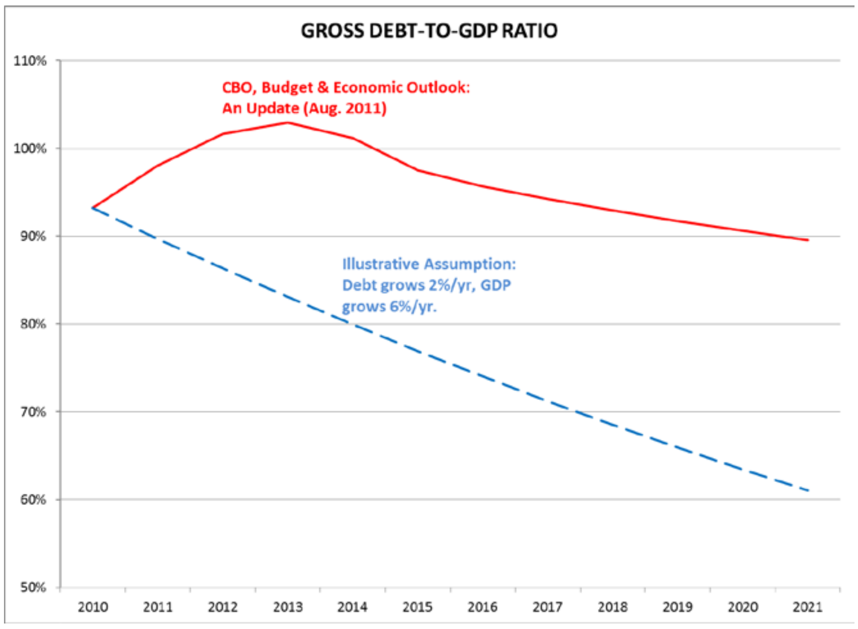
Gross federal debt already exceeds 98% of GDP and is on course to exceed 100% next year according to the Congressional Budget Office (CBO). Now that we are staring at that empty page in the Keynesian playbook, we have to forge a new path.

The dynamics of rising federal debt relative to our economy are dangerous. The federal government must stay clear of the undertow of deteriorating economic performance, rising interest rates, and higher tax rates.

To begin, we must discard fiscal policies that have not been working. Economists John Taylor and Michael Boskin have detailed how the Obama "stimulus" and other federal spending were wasted on transfers that produced no lasting growth. We cannot afford another round of "stimulus" disguised as a "jobs" bill.

Growth is what we need. In the following chart, the top line shows the gross debt-to-GDP ratios for the next ten years as implied by CBO's projections since the Budget Control Act was adopted. The average annual growth rate during the forecast period is 4.2% for gross debt and 4.6% for nominal gross domestic product (GDP)—just slightly higher. This is why the ratio of the two ends close to where it starts. The blue line shows the ratio if the debt grew only 2% while nominal GDP grew 6% per year.

(OVER)



The U.S. economy must grow significantly faster than federal debt to move the ratio down from the dangerous levels around 90%. In the CBO's outlook for the Administration's budget, that fails to happen; the spread in trajectories of debt and economic growth is too small.

Viewed this way, it is obvious that the country's economic policies must change, and not only with regard to federal spending and borrowing. Myriad regulations that hamstring economic activity and discourage private investment must be reversed, and the anti-employer attitude must go.

We know that entrepreneurs, investors, and consumers on Main Street fear the consequences of the rising federal debt. The real debt limit is upon us. We must act credibly to contain federal debt and release the private economy so that it can grow as it has in the past and how it must grow again.

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