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Congress of the United States

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

Washington, DC 20510–6602

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October 14, 2011

The Honorable Patty Murray
Co-Chair, Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

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

Dear Senator Murray and Representative Hensarling:

I want to thank each of you for your service on the Joint Select Committee. Your work to address the fiscal challenges facing our nation can play a significant role in moving our country in a positive direction. The Joint Select Committee's recommendations will be closely watched in our country and abroad for evidence that the United States is bringing new levels of bipartisanship and responsibility to solving deficit and debt problems that have been years in the making.

I am writing to you in my role as Chairman of the Joint Economic Committee (JEC). This letter represents my views, not the views of the full Committee. Created by the Employment Act of 1946, the JEC is a bicameral Congressional Committee that advises Congress on economic policy. By reviewing economic conditions, tracking key indicators, holding hearings with some of the top economic minds in the country, and tapping the expertise of business, government, labor and non-profit leaders, the Committee examines policies Congress can enact to strengthen the economy.

So far in the 112th Congress, the JEC has focused on the state of the labor market, examined policies to strengthen the U.S. manufacturing sector, reviewed the impact of the Great Recession on particular groups, including veterans, and analyzed specific policies to boost job creation and bolster the economic recovery. The Committee has heard from Federal Reserve Chairman Ben Bernanke, Bureau of Labor Statistics Commissioner Keith Hall, leading economic forecasters such as Mark Zandi of Moody's Analytics, and private-sector leaders, such as Dr. Stephen Tang, the President and CEO of University City Science Center in Philadelphia, Pennsylvania.

Guiding the Committee's work has been the realization that policymakers must simultaneously accomplish two key objectives: incentivizing and strengthening economic growth in the short-term while also putting in place policies that will get the nation's fiscal house in order in the medium- and long-term. That is precisely the challenge in front of the Joint Select Committee, as you work to identify at least $1.5 trillion in budget savings between 2012 and 2021 while ensuring that any short-term fiscal contraction does not harm the still-fragile economic recovery. Meeting this deficit-reduction target will be a critical step in the continuing efforts at reducing our long-term deficit.

Outlined below are some specific policies I respectfully ask the Joint Select Committee to consider as you analyze deficit-reduction options in the coming days. In addition, my staff on the JEC has analyzed the economic impact of two different deficit-reduction scenarios. A summary of that analysis is provided below. Again, I appreciate all of the hard work you are doing and look forward to reviewing the Joint Select Committee's final legislative proposal.

<u>Balanced Deficit Reduction Leads to Stronger Economic Growth than Automatic Cuts</u>

Recent data show that the recovery from the recession has been less robust than previously understood. GDP grew at less than a 1 percent annual rate in the first half of 2011 and economic output in the United States still has not returned to levels reached before the Great Recession began. Job growth has slowed since the early part of 2011 and has not been sufficient to bring down the unemployment rate, which is currently at 9.1 percent. As Federal Reserve Chairman Ben Bernanke testified before the JEC earlier this month, the recovery "is close to faltering." Additional fiscal contraction would present an additional headwind.

To better understand the economic impact of different deficit-reduction alternatives, the JEC staff conducted an analysis comparing two scenarios. In Scenario 1, the Joint Select Committee recommends and Congress passes a $1.5 trillion deficit savings package over ten years that is balanced between spending cuts and revenue increases. The deficit reduction is backloaded with less fiscal contraction in 2013 than in subsequent years. This scenario would lower economic growth by 0.5 percentage point in 2013 on top of the 0.2 percentage point reduction resulting from the basic cuts to discretionary spending already specified in the Budget Control Act of 2011 (BCA).

In Scenario 2, the Joint Select Committee either doesn't recommend deficit savings or those savings are voted down by Congress. An additional $1.2 trillion in discretionary spending cuts over ten years is triggered, with the cuts beginning in 2013. This scenario would lower economic growth by 1 percentage point in 2013, on top of the 0.2 percentage point reduction from the basic BCA cuts.

In short, the $1.2 trillion trigger would lead to economic growth 0.5 percentage point lower in 2013 than would result from a balanced, backloaded $1.5 trillion deficit-reduction package. That translates into a difference of about $85 billion of gross domestic product in 2013.

Revenues

As just described, a balanced deficit-reduction package will lead to stronger economic growth than would be achieved if the automatic spending cuts, detailed in the Budget Control Act, are triggered. But, of course, the revenue discussion is more complex than simply balancing the share of the deficit reduction that should be accomplished through revenues versus spending cuts.

There's a strong bipartisan consensus that the U.S. tax code is broken. Unwieldy and inefficient for both corporations and families, the tax code needs to be rewritten. A simpler income tax system would enhance efficiency. Lower marginal tax rates could increase economic activity.

However, we must be cautious about promises that tax cuts can pay for themselves. Advocates of so-called "dynamic scoring" argue that we can cut taxes and the increased growth and tax revenue will be so great as to fully pay for the tax cuts – i.e., be deficit-neutral or even reduce the deficit. Even leading economists who believe tax cuts boost revenue, such as Gregory Mankiw, former Chairman of the Council of Economic Advisers under President George W. Bush, estimate that less than 33 percent of the revenue loss from a lower capital gains tax rate would be made up by higher growth. That means two-thirds of the revenue loss is simply lost revenue, which, of course, leads to higher deficits. So, if the Joint Select Committee is considering changes to the tax code, I encourage you to be very mindful of the impact on the budget deficit of any tax cuts.

The fact that lower tax rates won't fully offset lost revenue from new rates is not an argument against tax reform. Quite the contrary: tax reform is needed. I would encourage the Joint Select Committee to assign the relevant Congressional committees the work of overhauling the individual and corporate tax codes. The overhaul would strengthen the U.S. competitive position and foster stronger economic growth. The changes to the tax code would have to meet the revenue increase targets laid out by the Joint Select Committee while preserving the progressive elements of our tax code and protecting America's most vulnerable citizens, including our children and the elderly.

We should be clear about the challenge ahead. Rewriting the tax code is a major undertaking that will engage – and at times antagonize – many of America's most powerful interests. Working families have already been hit hard by the recession and any revenue increases should not fall on them. The Joint Select Committee can help steer the process by laying out clear parameters and principles to guide the Congressional committees.

Rooting Out Waste, Fraud and Abuse

Identifying and eliminating waste, fraud and abuse is one component of a comprehensive deficit-reduction package. As the former two-term Auditor General of Pennsylvania, I know how important it is to root out waste, fraud and abuse. It's critical to both finding needed savings and to ensuring that taxpayer dollars are being used effectively. In light of the federal government's current fiscal challenges, savings achieved from identifying waste, fraud and abuse should be applied directly to deficit reduction.

Federal agencies have already identified tens of billions of dollars in efficiency savings that could be used to reduce the deficit. I encourage the Joint Select Committee to look under every rock and into every corner to eliminate waste. Some of the digging has already been done. A March 2011 GAO report, "Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue," identified hundreds of billions of dollars in waste. Waste and fraud rob us of needed dollars, take a toll on employee morale, and lead to cynicism among all of us. While I recognize that eliminating waste, fraud and abuse, by itself, will not achieve all of the deficit reduction required, it's an important first step and a critical element of the Joint Select Committee's work.

Short-Term Initiatives to Support the Recovery and Strengthen Economic Growth

In the past several months, as noted above, a broad range of economic indicators have shown weakening economic conditions in the United States and abroad. U.S. job growth has slowed in the past half-year, averaging just 72,000 per month since April. The unemployment rate has been stuck at 9 percent or higher for six straight months. 14 million Americans are unemployed and 45 percent of the unemployed have been jobless for six months or more. Household incomes are continuing to decline, falling more in the two years after the recession ended than during the recession.

Targeted, timely actions are needed to create jobs and strengthen the economy. Getting the economy growing again at a healthy rate is also vital for sustained deficit reduction. Highlighted below are three proposals that enjoy bipartisan support and that would have an immediate, positive impact on employment and economic growth.

1) Providing new incentives to hire. There are several proposals in Congress to encourage business hiring by reducing the cost of labor. The Small Business Job Creation Tax Credit Act, which I recently introduced, is one approach. It would create a one-year quarterly tax credit of up to 20 percent of the increase in total payroll. Firms can benefit from the credit by increasing their hiring, increasing the hours of their employees, or boosting wages. All firms would be eligible, but small firms would receive the largest incentive. The CBO has scored this kind of proposal as one of the most efficient and cost-effective ways to increase employment and boost economic growth. And economist Alan Blinder, a former Vice Chairman of the Fed, has said that – if he could do just one thing to jumpstart the economy – he would enact a large-scale tax credit to incentivize new hiring.

2) Spurring innovation. Policies that encourage or enable innovation-creating investments and research that wouldn't otherwise occur in the private sector will boost the United States' competitive position and lead to job creation. Efforts to incent additional research and development in the high-growth life sciences industry are one example. Life sciences play a key role in driving innovation and job creation in Pennsylvania and across the country. The Life Sciences Jobs and Investment Act would double the R&E credit from 20 percent to 40 percent on the first $150 million of R&D in life sciences – providing a new incentive for small and medium-sized businesses to invest in life sciences R&D.

3) Cracking down on currency manipulation. The link between currency manipulation and U.S. job loss is troubling. A recent report by the Economic Policy Institute found that the U.S. trade deficit with China has cost the United States 2.8 million jobs during the last ten years. China has kept its currency – the yuan – artificially low for years to make it easier to export its products to the United States and other parts of the world. China's undervaluation of the yuan is a significant cause of the U.S. trade deficit with China, which grew from $83 billion in 2001 to $273 billion in 2010. If the yuan and satellite currencies in the region were revalued to equilibrium levels, we could create up to 2.25 million U.S. jobs, according to EPI. The Currency Exchange Rate Oversight Reform Act is bipartisan legislation, recently passed by the Senate, which will trigger actions against China and other countries if they use their currency for unfair competitive advantage. The legislation will impose stiff new penalties, including duties on countries' exports, making it more difficult for China to export its products to the United States.

These are a just a few examples of proposals now on the table that would sustain the recovery and strengthen the economy. My colleagues on both sides of the aisle have offered many other sound proposals. We need to put aside partisan politics and finger pointing to take action that will spur job creation and put Americans back to work.

To conclude, the Joint Select Committee on Deficit Reduction has been charged with an enormous responsibility – recommending an additional $1.5 trillion in savings over ten years. It's a responsibility that requires balancing short- and long-term needs, distinguishing between core investments that must be preserved and spending that we can live without, and utilizing both spending cuts and revenue increases. I encourage the Joint Select Committee to think hard about the timing of its spending cuts. As Federal Reserve Chairman Bernanke has noted, "a substantial fiscal consolidation in the shorter term could add to the headwinds facing economic growth and hiring." Similarly, as we take actions to get our long-term deficit under control, it's imperative that we protect the most vulnerable among us. For example, Medicaid, which provides health care to millions of low-income children and long-term care for millions of older Americans, should not be weakened or undermined. Finally, the working families who have built this country and have already sacrificed a great deal during the recession should not be impacted.

Thank you again for the important work you are doing. Please feel free to contact me directly if you have any questions or would like to discuss any of these matters in greater detail.

Sincerely,

Bob Casey

Robert P. Casey, Jr.
Chairman
Joint Economic Committee