Economic Recovery Solutions

Testimony before the Economic Stimulus Working Group

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Leader Boehner, Congressman Cantor and members of the working group, I want to thank you for the opportunity to appear before you today to discuss options for a stimulus package.

I also appreciate the President-elect's willingness to solicit input from our party. We are committed to working together to strengthen the economy.

These are not ordinary times. Yes, we have had bubbles before. And we have experienced recessions. But this was no ordinary bubble and this is no ordinary recession. This bubble encompassed the largest investment sector of our economy—housing. And when it deflated, it evaporated not billions, but trillions of dollars.

The first impact was to our nation's pool of investment capital—capital that sustains businesses, capital that finances new enterprises, capital that promotes education and discovery. This pool of investment capital was held by banks, by investment banks, by institutions and even by individual investors. And it has shrunk by trillions of dollars.

It didn't take long for America's families to feel the impact either. The net worth of American families has shrunk by approximately $11 trillion. This translates into about $400 billion less annual spending by consumers. And that $400 billion drop in consumption would lead to a deepening downward spiral of business failures and unemployment.

Exports won't make up the shortfall: most of the world is in a recession and the dollar has strengthened as fear has struck the currency markets. Investment won't make it up either given the hit taken by the pool of investment capital. What's left is the government sector.

There are two ways Washington can put money into the economy—one is by sending it back to the taxpayers and the other is by spending it. Of the two, it's the former that has the bigger bang for the buck. Research by Christina Romer, the President-elect's Chairwoman for the Council of Economic Advisors, shows that tax cuts have a substantially greater multiplier effect than does spending on infrastructure projects.

Tax cuts should be the centerpiece of any stimulus plan. The President-elect has proposed refund checks for taxpayers. Experience shows, however, that a one-time check has very little positive impact. The 2008 stimulus led to checks being sent out in May, June and

July of last year. Sure enough, disposable income rose in those months, but as Hoover Institution economist John Taylor has shown, consumption did not (Fig. 1).

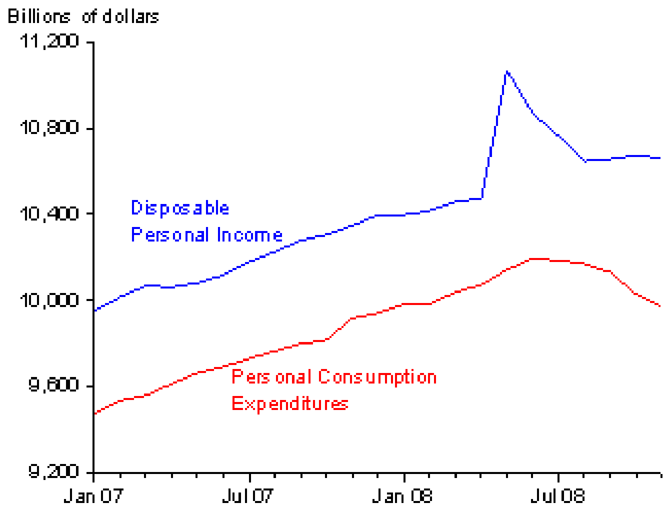

Figure 1. Income and consumption before, during, and after the May-July economic stimulus program

Updated Figure from "The State of the Economy and Principles for Fiscal Stimulus" Testimony before the Committee on the Budget United States Senate John B. Taylor November 19, 2008

And further, even if consumption were to bump up, it would not lead businesses to expand and to add jobs. Business people are smart enough to recognize a one-time, short-lived bump for what it is.

The best medicine for a sick economy is permanent tax relief. I'd recommend eliminating the tax on savings for middle income Americans—no tax on interest, dividends or capital gains. This accomplishes three things: it puts money into the consumer's pocket, it helps replenish the pool of investment capital, and it encourages more Americans to become owners of American business.

The same principles apply to business tax relief. A rebate check would be a welcome sight to every businessperson. But a rebate check isn't going to incentivize businesses to expand, to invest for greater productivity, or to hire more people. It's lower future tax rates that do that. And there sure is room to cut corporate tax rates—we are at the top of the heap, along with Japan, the nation that has suffered through a decade-long downturn.

In my view, sending out one-time refund checks to consumers and to businesses is not the best course—it adds to a monstrous budget deficit without significantly boosting the economy. The right course is permanent tax relief, designed to spur growth, investment, and jobs. It should go without saying that raising taxes should be out of the question. It is a positive development that the President-elect has chosen not to seek an immediate repeal of the Bush tax cuts. We should go further to seek a permanent or even a temporary extension.

President-elect Obama has also proposed a short term business incentive tied to hiring new workers. That's not a terrible idea, but it would be less effective than allowing businesses to expense capital equipment purchased this year and next. That would lead them and their suppliers to add employees, and it would boost productivity, raising wages and improving our competitiveness abroad.

The spending portion of the stimulus should be limited to those things which are urgently needed and which we had already planned to buy in the future. Infrastructure projects will be included, but because they invariably face delays for engineering, environmental reviews and contracting, they can take a long time to actually boost the economy. They should be part of the picture, but not the whole canvas.

I would like to see a significant portion of new spending to be devoted to the maintenance, repair, replacement and modernization of our military equipment and armament. Since the 1990's dismantling of our military, we have tended to live off the assets that had been purchased in the past. These have been extensively employed in two Gulf wars and in Afghanistan. Bringing forward needed replacement and repair will boost the economy, enhance our national security, and importantly aid our men and women in uniform.

I would also add spending for energy research and energy infrastructure. Energy independence is an economic and strategic imperative.

With new spending on the agenda, Republicans should make sure that there is no parade of pork. All spending projects should be selected by the responsible federal agency according to explicit and public criteria. Republicans should commit to vote "no" on any stimulus bill with earmarks that have not been voted upon by the entire body.

I know that cities and states have various financial challenges of their own. Some have built rainy day funds for times like these. Others have not. As a governor who welcomed the help you provided to us in the last recession, I won't prescribe zero help for the states. But I do believe that it is critical for cities and states to use this time to finally align spending with revenues.

Today, we are rightly focused on a stimulus to stop the economic decline and end the recession. But if we are not careful, it could add to the risk of something even worse than a recession. If we continue to leverage the public sector, to pile on more and more debt, and to ignore the looming entitlement liabilities, we could precipitate a worldwide collapse of confidence in America—in our currency, in our credit-worthiness, in our competitiveness, in our future. We cannot write bailout checks to every petitioner, spend hundreds of billions on a laundry list of infrastructure goodies, nor reduce taxes without also reducing government obligations. The ballooning deficits must be balanced with budget restraint and responsibility when the economy recovers.

This stimulus package should include a commitment to reform entitlements—Social Security, Medicaid and Medicare. Senator Gregg is right to have proposed a bi-partisan commission to do just that. He is right, and now is the right time. A stimulus bill, combined with a projected deficit of $1.2 trillion, could send us down the road to ruin if we do not muster the courage to reform entitlements and to rein in future government spending.

Let me add a thought about regulation. Smart regulation is good; dumb regulation is bad. Housing finance is one of the most highly regulated sectors of our economy. And no one will claim that that regulation was very smart. Yes, we need to improve regulation, in housing and in financial services. But the right course is to make regulation that is effective. Smart regulation will make these sectors more productive and more competitive. Simply layering on burdensome regulatory schemes will depress these industries, kill more jobs, and slow economic recovery.

And there is one very bad idea that is being promoted by a special interest group. It is an idea that would have devastating impact on the economy—short term and long term. It would lead investors to send their funds elsewhere, businesses to expand elsewhere and jobs to relocate elsewhere. It is the plan to virtually impose unions on all small, medium and large businesses by removing the right of workers to vote by secret ballot. Card check is a very bad idea under any circumstances. In these circumstances, it would be calamitous.

In sum, we are presented with economic peril unlike anything we have faced during our lifetimes. I do indeed believe that careful, skillfully crafted stimulus can improve the prospects for recovery. But excessive and sloppy spending and one-time refund checks could have the exact opposite effect than that which the stimulus seeks. And in the final analysis, we must remember that it is the private sector—the home of entrepreneurs, workers, managers, and visionaries—the private sector, not government, that creates jobs, boosts wages, and provides for our future. What gives me my confidence is this: I believe in the American people. Thank you.