

Growing Risks to the Budget and the Economy.
Testimony of John H. Cochrane before the House Committee on Budget.
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Chairman Price, Ranking Member Van Hollen, and members of the committee: It is an honor to speak to you today.

Sclerotic growth is our country's most fundamental economic problem. If we could get back to the three and half percent postwar average, we would, in the next 30 years, triple rather than double the size of the economy—and tax revenues. Think what you can do with all that money!

Why has growth halved? The most plausible answer is simple and sensible: Our legal and regulatory system is slowly strangling the golden goose of growth.

How do we fix it? Our national political and economic debate just makes the same points again, louder, and going nowhere. Instead, let us look together for novel and effective policies that can appeal to all sides.

Regulation:

Let's get past "too much" or "too little" regulation, and *fix* regulation instead.

Regulation is too discretionary – people can't read the rules and know what to do.

Regulatory decisions take forever.

Regulation has lost rule-of-law protections. Agencies are cop, prosecutor, judge, jury and executioner all rolled in to one.

Most dangerous of all, regulation is becoming more politicized.

Congress can fix this.

Social programs

Let's get past spending "more" or "less" on social programs, and *fix* them instead.

Often, if you earn an extra dollar, you lose more than a dollar of benefits. No wonder people get stuck. If we fix these disincentives, we will help people better, encourage growth and opportunity--and in the end we will spend less.

Spend more to spend less.

Spending *is* a serious problem. But moving spending off the books does not help.

For example, we allow a mortgage interest tax deduction. This is exactly the same as collecting taxes, and sending checks to homeowners – but larger checks for high income people, people who borrow a lot, and people who refinance often.

Suppose we eliminate the mortgage deduction, and put housing subsidies on budget. The resulting homeowner subsidy would surely be a lot smaller, help lower-income people a lot more, and be better targeted at getting people in houses.

The budget would *look* bigger. But we would really spend less -- and grow more.

Taxes

Tax reform fails because arguments over the level of taxes, subsidies, or redistribution torpedo sensible simplifications. We could achieve tax reform by separating its four confounding issues.

First, determine the *structure* of taxes, to raise revenue with minimal economic damages, but *leave the rates blank*. Separately negotiate the *rates*. Put all tax incentives in a separate *subsidy code*, preferably as visible on-budget expenditures. Add a separate *income-redistribution code*. Then necessary big fights over each element need not derail the others.

A massive simplification of the tax code is, I think, more important than the rates – and easier for us to agree on.

Debt and deficits

Each year the CBO correctly declares our long-term debt unsustainable. Yelling louder won't work.

First, let's face the big problem: a debt crisis, not a predictable rise in interest rates. Crises are always sudden and unexpected, like earthquakes. Even Greece could borrow at remarkably low rates. Until, one day, it couldn't.

The answers are straightforward. Sensible reforms to Social Security and Medicare are on the table. Address underfunded pensions, widespread credit and bailout guarantees.

Buy some insurance. Like every homeowner shopping for a mortgage, the US chooses between a floating rate, lower initially, and a fixed rate, higher initially, but forever insulating the budget from interest rate risks, which are the essential ingredient of a debt crisis. Direct the Treasury and Fed to buy the fixed rate.

Above all, undertake this simple, pro-growth economic policy, and grow out of debt.

Concluding comments

You may object that fundamental reform is not “politically feasible.” Well, what’s “politically feasible” changes fast these days.

Winston Churchill once said that Americans can be trusted to do the right thing, after we’ve tried everything else. Well, we’ve tried everything else. It’s time to do the right thing.