Statement of John Engler
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Before the
Committee on the Budget
United States Senate
Hearing on
"The Benefits of a Balanced Budget"
March 2015

Good morning, Chairman Enzi, Ranking Member Sanders, and members of the Committee.

My name is John Engler, and I am President of Business Roundtable, an association of CEOs of major U.S. companies operating in every sector of the economy.

Business Roundtable CEOs lead companies with $7.2 trillion in annual revenues and nearly 16 million employees. Member companies comprise more than a quarter of the total market capitalization of U.S. stock markets and invest $190 billion annually in research and development (R&D) – equal to 70 percent of total U.S. private R&D spending. Our companies pay more than $230 billion in dividends to shareholders and generate more than $470 billion in sales for small and medium-sized businesses annually.

Thank you for the opportunity to appear before you today to discuss the pressing need to address America's major fiscal challenges and the economic benefits associated with a balanced budget.

First, I would like to commend this Committee for your work to produce a serious budget resolution. Congressional passage of a serious budget plan would go a long way toward restoring America's confidence in government. In addition, a budget resolution serves the important purpose of informing the national debate on policy and spending priorities that will affect all Americans.

Despite near-term projections of a declining federal budget deficit, annual deficits are projected to begin expanding further in the next few years. For the United States, this is an unsustainable fiscal path. To avoid this fate, America needs a balanced approach to fiscal reform that controls government spending while enacting policies to attain robust economic growth.

Business Roundtable members believe that strengthening the U.S. economy requires the federal budget process to be conducted in a timely, responsible and predictable manner. Recent history has taught us that the American economy pays a steep price for budget showdowns and fiscal uncertainty.

Given the need to reduce future annual federal budget deficits, Congress and the Administration should establish economic growth as a core principle of fiscal and budget reform. Without healthy growth, it will be dramatically more difficult – if not impossible – to reduce future deficits and secure America's fiscal future.

The highest priority of Business Roundtable is achieving sustained, robust growth of the U.S. economy. A growing economy provides more and better paying jobs – the means by which we can achieve a higher standard of living for all Americans.

We believe that Congress and the Administration must work together to adopt pro-growth policies to put America on a fiscal path toward stability and prosperity. These policies include enacting pro-growth tax reform, expanding U.S. trade, investing in physical and digital infrastructure, fixing our broken immigration system and adopting a smarter approach to regulation.

Ultimately, modernizing Medicare and Social Security is also a critical element for ensuring long-term fiscal stability and our country's prosperity.

A. The U.S. Federal Budget's Unsustainable Path

While budget deficits have been the subject of fewer headlines over the past year, the business community remains deeply concerned about their impact on the U.S. economy. According to the Congressional Budget Office's (CBO) March projections, federal deficits are expected to remain stable in the near term, but more than double over the next decade. (See figure 1).

Specifically, annual deficits are forecast to increase from $483 billion in fiscal year 2014 to $1.0 trillion in fiscal year 2025. If such a scenario plays out, federal government debt will increase by $7.2 trillion over the next decade, and the debt held by the public will increase to 77 percent of GDP by 2025 – the highest ratio since the immediate aftermath of World War II.[1] As recently as 2007, debt held by the public was 35 percent of GDP.

After four years of trillion dollar deficits between 2009 and 2012, deficits have come down by more than half as the economy gradually recovered from the Great Recession. The improving economy contributed to government revenues increasing by 9 percent from 2013 to 2014, including a 17 percent increase in revenues from corporate income taxes. All of this despite U.S. GDP growth not exceeding 3 percent in any single year.

Clearly, America should pursue a balanced approach to fiscal reform that controls government spending while enacting policies to achieve robust economic growth. Government outlays are projected to increase from $3.5 trillion in 2014 to $6.1 trillion by 2025.[2] Driving this increase will be spending on the entitlement programs. The CBO forecasts that spending on Medicare, Medicaid and Social Security along with net interest on the debt will account for 85 percent of

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[1] Congressional Budget Office. (March 2015). "Updated Budget Projections: 2015 to 2025."
[2] Ibid.

the increase in outlays over the next 10 years. By mid-century, in fact, spending on Social Security, government health-care programs and interest on the debt would equal 100 percent of revenues – leaving discretionary spending a thing of the past.

If we do not meet this challenge now, the future becomes ominous. Spending on government entitlement programs is projected to continue to grow faster than the economy over the next decade and beyond, more than offsetting projected decreases in discretionary spending as a share of the economy. Such rapid increases in government spending will result in slower economic growth and reduce workers' wages and limit the earnings of future generations. Compound that through higher taxes that further reduce employment and investment, or through larger deficits that draw private capital from productive, wage-increasing and job-creating investments, and you have a result that should be terrifying.

Net interest payments on the debt represent the fastest growing component of government spending. As interest rates rise and annual deficits continue, the government's cost of financing its borrowing will increase sharply from $229 billion in fiscal year 2014 to $808 billion in fiscal year 2025. As a share of the economy, net interest payments will climb from 1.3 percent of GDP in 2014 to 2.9 percent in 2025.[3] CBO's long-term projections show net interest payments continuing to increase relative to the size of the economy in the decades beyond. (See figure 2). The large and growing debt will likely further increase the interest rate the government must pay to borrow funds. With public debt approaching 100 percent of GDP, each one percentage point increase in interest rates translates into an increase in the deficit of one percentage point of GDP. The hard fact is these growing deficits will in turn further drive up government debt and future borrowing costs.

Mr. Chairman, the federal government is on an unsustainable and dangerous fiscal path that threatens the U.S. economy. It will be important to reduce future deficits and achieve more fiscally sound budget management, and to do this by passing laws and adopting regulations that support economic growth rather than hamper it.

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[3] Ibid.

B. Budget Discipline in Michigan

As a former governor of Michigan, I know first-hand the difficulties of reining in spending. Budget discipline has been a priority for me throughout my public life. It's a matter of principle and good policy.

As a newly elected governor in 1991, my state was faced with a $1.8 billion deficit. Like almost all states, Michigan's constitution requires a balanced budget. We could have played the usual budgetary games: shift funds, extend payments, borrow against the future or simply raise taxes. But I proposed, as did the Michigan Legislature, that the state and its people could no longer accept business as usual.

In the 1990s Michigan's budgets downsized state government, reduced the number of state employees, reduced property taxes, reformed welfare and made education a priority. These changes served the people of Michigan well. With a balanced budget and a smaller tax burden, Michigan became attractive for investment and a leader in recruiting new businesses.

During my tenure as governor from 1991 to 2003, I was privileged to sign major tax changes into law, saving Michigan taxpayers some $32 billion. Some 800,000 new jobs were created and Michigan's unemployment rate went down to a new low. Finally, after 25 years, we were able to restore Michigan's credit to a AAA rating.

At the same time, governors in other states were also enjoying success. The lesson for this Committee is this: Balanced budgets are achievable and the economic benefits of responsible budgets are clear. We see this truth not only by looking back at Michigan but also other states – e.g., Wisconsin, Ohio and Indiana – where leaders made difficult but necessary policy decisions.

C. Deficit Reduction Remains a National Imperative

Reducing the federal budget deficit is a national imperative. Business Roundtable believes that the most important contributor to future U.S. economic growth can be private sector investment. This is the investment in equipment, software, intellectual property and new factories that increases the productivity of American workers, supports higher wages and job creation, and leads to the economic growth that supports increased living standards now and for future generations.

Government budget deficits reduce private sector investment and are bad for the American economy for a number of reasons. First, large budget deficits drive up the cost of capital and "crowd out" private investment. As financial conditions normalize in the coming years, large budget deficits will place significant upward pressure on interest rates and reduce the credit needed for the housing industry and to support private investment. Lower private investment spending means a lower U.S. capital stock – fewer new factories, with less equipment and less R&D to support American workers. This in turn will mean lower productivity growth, lower wage growth and lower GDP growth. The result is a lower living standard for the American people.

Second, large budget deficits and government debt levels create risks that undermine confidence in financial markets and can cause painful financial crises, with real and lasting repercussions throughout the economy. One never knows exactly when a collapse in investor confidence will occur or what might serve as the trigger. However, as events in recent decades have illustrated, no country is immune to such risks. It is not just countries with extremely high debt levels, such as Greece, that have been damaged. Weak fiscal conditions in South Korea, the United Kingdom and Sweden, for example, have contributed to sharp losses of confidence in these markets, collapses in currency values and spikes in interest rates.[4] The U.S. business community believes it is irresponsible to take any unnecessary risks of this sort.

Large and persistent budget deficits also generate policy uncertainty. Even if a full-blown crisis is avoided, research shows that policy uncertainty itself can undermine consumer and business confidence. (See figure 3).[5] Even mildly lower levels of business confidence and capital investment can have depressing effects on growth that cumulate over time. (See figure 4.)[6]

Third, large budget deficits can restrict the range of government policy responses in the face of unexpected and severe events, such as a deep recession, a catastrophic natural disaster, or a national security crisis. Such events often precipitate a rapid increase in spending or a sharp decrease in revenues that could rapidly widen the deficit. If the government's books are in good shape at the start of such a challenge, the situation will be more manageable. However, if governments are running major deficits, the additional burden will significantly increase the risk of a financial crisis, or limit the government's capacity to respond in general.

Finally, large budget deficits increase the risk that debt levels will rapidly spiral out of control if there are shifts in interest costs or sharp reductions in economic growth. The average yield on all U.S. government debt is about 2 percent today – one of the lowest rates in American history.[7] The CBO forecasts the yield on the 10-year Treasury note to increase from about 2 percent today to 4.6 percent by the end of the decade.[8] If inflation expectations shift or if foreign investors take a dimmer view of U.S. investment prospects, this yield could move up significantly in coming years. Increased interest costs could rapidly increase the deficit and

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[4] Currency and financial crises in the 1990s in South Korea, the U.K., and Sweden were precipitated by outsized budget deficits. Budget deficits in South Korea, the U.K., and Sweden peaked at 4.6%, 7.6%, and 9.0% of GDP, respectively, prior to each country's crisis. All data taken from IFO Economic Situation Surveys.

[5] See Baker, S., Bloom, N., and Davis, S. (January 2013). "Measuring Economic Policy Uncertainty". Chicago Booth Research Paper no.13-02. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2198490.

[6] Macroeconomic Advisors. (October 2013). "The Cost of Crisis-Driven Fiscal Policy", prepared on behalf of the Peter G. Peterson Institute. Retrieved from http://pgpf.org/special-reports/the-cost-of-crisis-driven-fiscal-policy.

[7] Treasury Direct. (February 2015). "Public Debt Average Interest Rate: February 2015". Retrieved from http://www.treasurydirect.gov/govt/rates/pd/avg/2015/2015_02.htm.

[8] Congressional Budget Office. (January 2015). "The Budget and Economic Outlook: 2015 to 2025", page 9.

create a vicious circle of higher interest costs and higher deficits that undermine growth and job creation. Again, these risks threaten economic stability.

D. Policy Solutions to Improve America's Fiscal Future

A sustained effort to reduce budget deficits in coming years is a national imperative. "How" we reduce the debt is just as important as "how much" we reduce it. Business Roundtable believes that we need to move toward a balanced budget with a collection of actions that are responsible, balanced, and that enhance growth. Today, I will discuss three components of a balanced solution that our elected leaders must address:

1. Strengthen Medicare and Social Security

One priority is dealing with the entitlement programs. Spending on Social Security, Medicare, Medicaid, and other government health programs is set to rise from 9.7 percent of gross domestic product in 2014 to 11.9 percent by 2025. This is an increase of $1.6 trillion – significantly more than enough to fund the Legislative Branch, Judicial Branch and Executive Office of the President for an entire decade. Despite this looming fiscal danger, entitlement spending has not received the necessary focus of Congress, even throughout the budget battles of the last several years.

For future generations of American retirees to rely on the assurance of basic retirement security, changes are needed to strengthen and sustain Medicare and Social Security.[9] Our proposals would gradually bring these programs into alignment with America's fiscal and demographic realities while fully protecting current retirees and those near retirement. Our goal is to preserve the safety net for future generations. Specifically, Business Roundtable supports:

- Gradually increasing the eligibility age for full benefits,
- Updating, as suggested by the President, the method of computing cost-of-living adjustments,
- Implementing means testing for higher-income recipients and expanding competitive models of care within Medicare.

Acting sooner rather than later means the changes can be gradual, current retirees and those near retirement would be fully protected, and the programs can be strengthened, which preserves the programs for future generations.

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[9] Business Roundtable. (January 2013)."Social Security Reform and Medicare Modernization Proposals", available at http://businessroundtable.org/resources/social-security-reform-and-medicare-modernization-proposals.

2. Enact Pro-Growth Tax Reforms

Another priority for reducing future budget deficits should be to promote faster economic growth, and nowhere can this be achieved more effectively than through tax policy. A powerful symbiotic relationship exists between growth and sustainable budgets. Policies focused on growth can expand the American economic pie, reduce relative debt burdens, and put the country on a more sustainable fiscal path. CBO estimates that adding a sustained one-tenth of one percent to GDP growth would reduce budget deficits by more than $300 billion over a decade. A sustained increase in the growth rate of GDP of a full percentage point annually would reduce the budget deficit by $3.3 trillion over a decade.[10]

To reinforce that point on growth: Had the United States not experienced the 2008 recession and had maintained the previously forecasted economic growth, total economic output between 2008 and 2017 would have been $12 trillion greater. Naturally, that kind of economic performance makes addressing budget priorities a much less disagreeable task.

Pro-growth tax reform is particularly well-suited to boosting America's economic output and easing our fiscal position. Today, the U.S. corporate tax system hinders the ability of U.S. companies to grow and compete in the world economy with the consequence of less investment in the United States, and a weaker economy with fewer job opportunities and lower wages. The ability of American companies to compete and invest abroad is vital for opening foreign markets to U.S.-produced goods and expanding the scope of investments in R&D and other activities in the United States.

The Business Roundtable key tax reform recommendations for corporations include:

- Setting the corporate tax rate at a competitive 25 percent; and

- Adopting a modern international tax system (a "territorial-type" tax system) that ends the taxation of U.S. corporations' active foreign earnings above and beyond foreign taxes paid and permanently removes the penalty for returning foreign earnings to the United States, thereby aligning the U.S. system with the tax systems of our major trading partners.

Business Roundtable supports these reforms being undertaken in a fiscally responsible manner, understanding that rate reduction will require base broadening such as elimination or modification of tax credits and deductions to offset the revenue loss. As for the U.S. international tax system, reform should be accompanied by appropriate safeguards to protect America's tax base, consistent with the rules of our major trading partners.

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[10] Congressional Budget Office. (January 2015)."The Budget and Economic Outlook: 2015 to 2025," page 133.

These reforms would have major growth effects for the economy and for the budget. Business Roundtable commissioned Rice University Professors Diamond and Zodrow to independently analyze former Ways and Means Chairman Dave Camp's proposed Tax Reform Act of 2014.[11] Among other benefits, they concluded: The legislation would increase U.S. annual GDP by 0.9 percent two years after enactment and by 2.2 percent after 10 years. Smart tax reform proposals such as these would simultaneously enlarge the U.S. economic pie and substantially close the fiscal gap.

Business Roundtable believes that business tax reform that results in a modern tax system with competitive rates and competitive international tax rules would be one of the most effective means of accelerating business investment, boosting job creation and wages, and providing greater opportunity for America's working families. Enactment of a competitive tax system in a fiscally responsible manner while restraining spending growth would serve as a powerful magnet for investment and job creation, reversing recent economic decline and stagnation, and securing the economic well-being of American families now and for future generations.

3. Pass Immigration Reform to Reduce Deficits

Immigration reform is another priority that would brighten the country's long-term fiscal outlook. The immigrant population, on average, is younger than the overall U.S. population, and immigration reform policies that resolve the status of undocumented immigrant workers and establish the rules for their participation in the U.S. economy would help offset the effects of the country's aging workforce and contribute new revenue to the federal government through collection of payroll and income taxes.[12]

In an analysis of immigration reform legislation that passed the Senate in 2013, CBO found that enacting immigration reform legislation would, on net, decrease federal budget deficits by $197 billion over the next 10 years and by $700 billion over the subsequent decade.[13]

The Bipartisan Policy Center, using slightly different economic assumptions, estimated that federal deficits would decrease by almost $1.2 trillion over a 20-year period. [14] Further, the Social Security Administration estimated that legislation would be a net positive for the program's finances, generating more than $275 billion in new revenue for Social Security by 2024.[15]

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[11] Diamond, J. and Zodrow, G, Tax Policy Advisers LLC. (March 2014). "Dynamic Macroeconomic Estimates of the Effects of Chairman Camp's 2014 Tax Reform Discussion Draft," available at http://businessroundtable.org/media/news-releases/new-study-shows-ways-and-means-committee-chairman%E2%80%99s-tax-draft-would-boost-us-gdp.

[12] See Ortman, J, Velkoff, V, and Hogan, H. (May 2014). "An Aging Nation: The Older Population in the United States." Census Bureau. Retrieved from http://www.census.gov/prod/2014pubs/p25-1140.pdf.

[13] Congressional Budget Office. (2013). "The Economic Impact of S. 744, the Border Security, Economic Opportunity, and Immigration Modernization Act."

[14] Bipartisan Policy Center. (2013). "Immigration Reform: Implications for Growth, Budgets, and Housing."

[15] Social Security Administration. (2013). "Letter to Senator Marco Rubio." Office of the Chief Actuary, May 8, 2013.

In all, economic studies performed by researchers from across the political spectrum that consider both the costs and benefits of immigration reform demonstrate that the budgetary impacts are overwhelmingly positive. As such, enforceable and common-sense immigration policies should be a component of government efforts to achieve long-term fiscal stability.

E. Conclusion

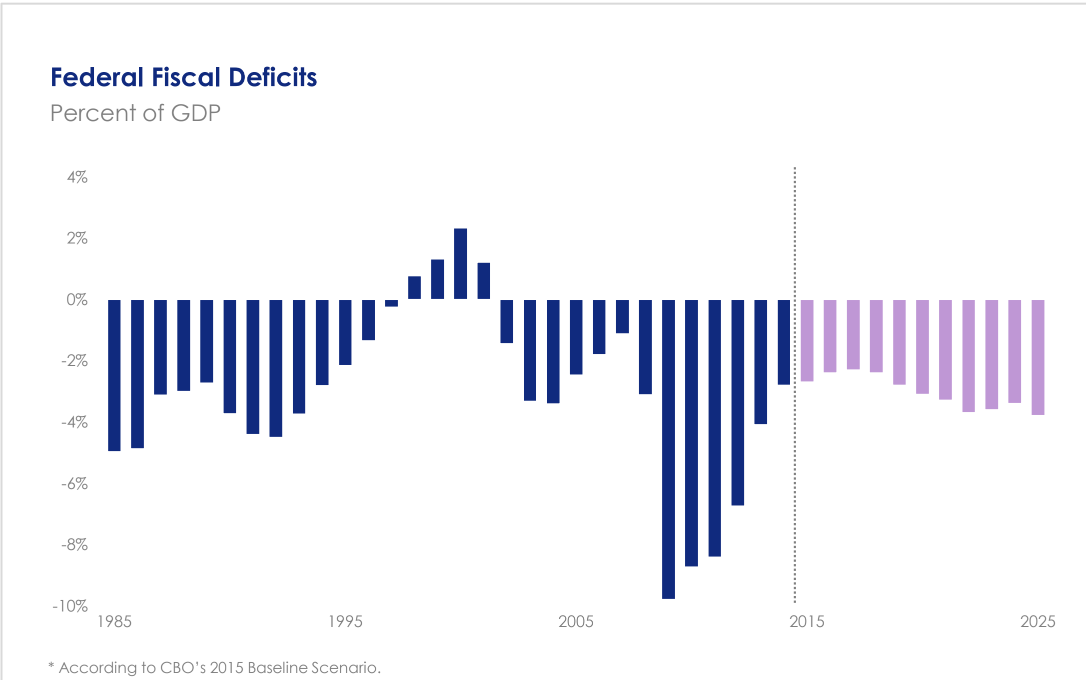
Mr. Chairman, thank you again for the opportunity to discuss an issue that I know both you and I consider an economic imperative. Business Roundtable supports this Committee's dedication to fiscal stability and is ready to support smart, effective and responsible policies that will help us achieve this goal.

Business Roundtable believes that many policies should be enacted to achieve more vigorous economic growth in a fiscally responsible manner. My testimony has highlighted just three areas – modernizing entitlements, tax reform, and fixing our broken immigration system. As indicated at the start of my testimony, a "pro-growth" agenda should also embrace expanded trade, investment in physical and digital infrastructure and a smarter approach to regulation.

We have a lot of work to do, but we are encouraged by your efforts to achieve fiscal stability. I am happy to answer any questions you may have.

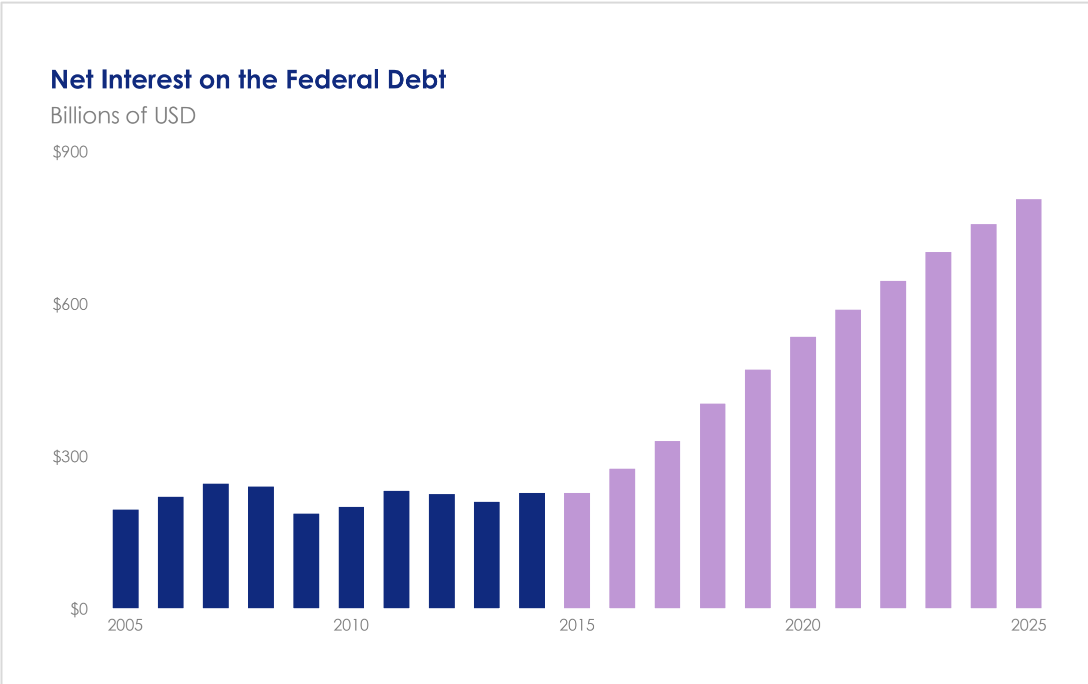
A. Charts

Figure 1: Federal Fiscal Deficits, 1985-2025



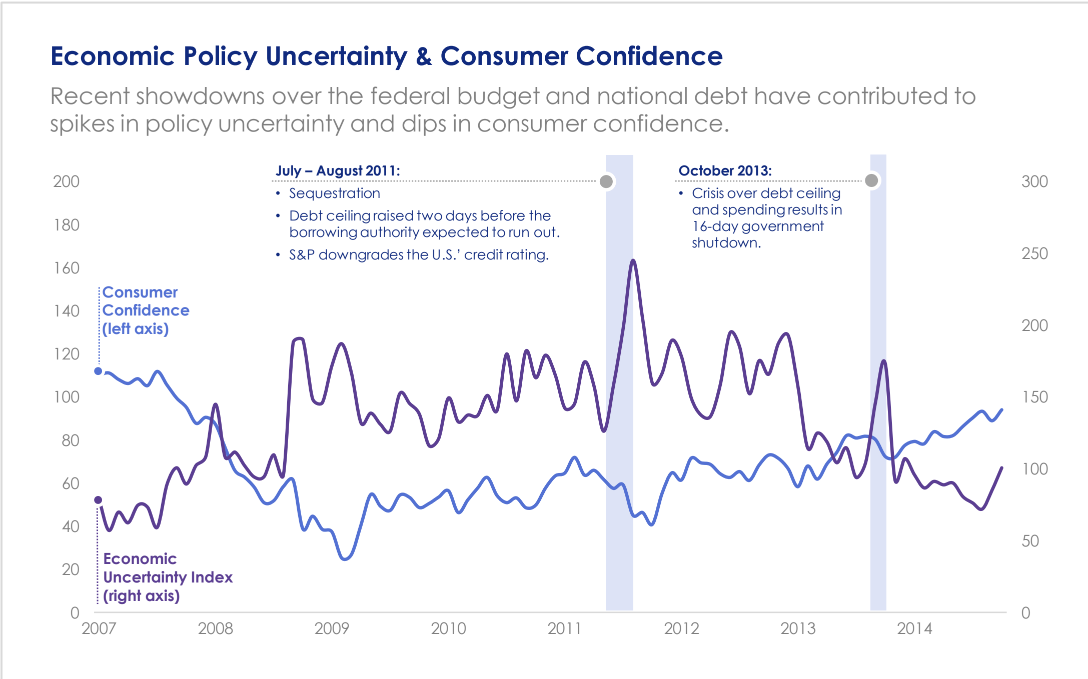
Source: Congressional Budget Office. (March 2015). "Updated Budget Projections: 2015-2025", page 2.

Figure 2: Net Interest on the Federal Debt



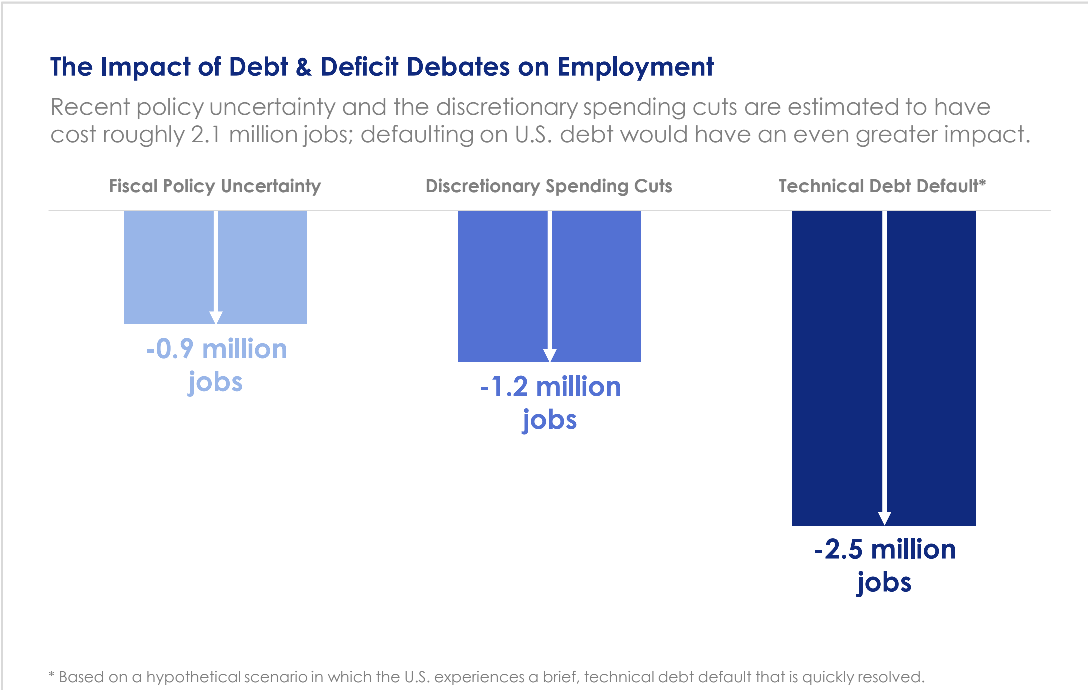
Source: Congressional Budget Office. (March 2015). "Updated Budget Projections: 2015-2025", page 2.

Figure 3: Economic Policy Uncertainty and Consumer Confidence



Source: Baker, S., Bloom, N., and Davis, S. (January 2013). "Measuring Economic Policy Uncertainty". Chicago Booth Research Paper no.13-02. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2198490.

Figure 4: The Impact of Debt and Deficit Debates on Employment



Source: Macroeconomic Advisors. (October 2013). "The Cost of Crisis-Driven Fiscal Policy", prepared on behalf of the Peter G. Peterson Institute. Retrieved from http://pgpf.org/special-reports/the-cost-of-crisis-driven-fiscal-policy.