(Slide 1) CREATING THE STRONGEST ECONOMY OF THE 21ST CENTURY

Introduction

(Slide 2) Good afternoon. As a Congressman from Texas, I am indebted to Charlotte. President James K. Polk, who campaigned for annexing Texas into the Union and signed the law creating the Lone Star State, was born in Mecklenburg County in 1795 only a few miles away from where we are meeting. Just imagine, without President Polk we Texans would have no United States from which we can periodically threaten to secede - a terrible thought!

(Slide 3) With jobs as the top concern facing Americans today, my belief is that our nation is experiencing a subpar economic recovery slowed by the uncertainty of business - small and large - over Washington policies and rational expectations by consumers that unprecedented deficits and debt threaten our economy and will lead to higher taxes in the future.

The answer to restoring America's economy is to first stop the job-killing proposals being considered in Congress today and turn our sights to a bolder goal: creating the strongest economy of the 21st century. An economy that will not merely stave off for a few years longer the dynamic challenge from China, but one that will serve as a magnet for international capital, innovation and entrereneurship for a hundred years.

Let's look first at the current situation.

Subpar Recovery

(Slide 4) When the National Bureau of Economic Research ultimately determines the trough of the current recession, it will likely identify it as occurring in the summer of 2009. Industrial production bottomed out last June (Slide 5) and real GDP began to grow in the third quarter of 2009. That said, payroll employment increased in March 2010 for only the third time in the last 27 months, and the unemployment rate remained stubbornly high at 9.7 percent.

(Slide 6) Whenever we place the start of the recovery, its pace will remain modest. According to this month's Blue Chip Consensus Forecast, real GDP is projected to grow by 3.1 percent in both this year and next. Payroll employment is projected to increase by an average of 117,000 per month this year and 202,000 per month in 2011. Consequently, the decline in the unemployment rate will be painfully slow. The unemployment rate is projected to be 9.4 percent in the fourth quarter of 2010 and 8.6 percent in the fourth quarter of nest year.

(Slide 7) The current recession that began in December 2007 is roughly equivalent in depth and length to the recession from August 1981 to November 1982. The peak-to-trough decline in real GDP was slightly larger in the current recession but the peak unemployment rate of 10.8 percent was higher during the 1981-82 recession. Assuming the trough occurred in June 2009, lets compare the performance of the two recoveries.

(Slide 8) Annualized real GDP growth averaged just 3.9 percent during the first two quarters of the Obama recovery compared with almost doubt that - a strong 7.2 percent - during the first two full quarters of the Reagan recovery. Looking forward with the Blue Chip Consensus Forecast, the Obama recovery looks even feebler. Annualized real GDP growth is expected to average 3.2 percent from the third quarter of 2009 through the first quarter of 2011, about half the average rate of 6.1 percent during the first ten quarters of the Reagan recovery.

(Slide 9) Payroll employment shrank by 890,000 during the first nine months of the Obama recovery, while payroll employment grew by 1.3 million during the Reagan recovery. Looking forward, payroll employment is expected to increase by only 2.6 million during the first 30 months of the Obama recovery compared with 8.5 million during the same period of the Reagan recovery. Obama job growth will likely be less than one-third of the Reagan recovery - a significant and troubling shortfall.

(Slide 10) Even with massive injections of fiscal and monetary capital, the unemployment rate actually rose by 3/10th of a percentage point to 9.7 percent during the first nine months of the Obama recovery while the unemployment rate fell by 1.3 percentage points during the first nine months of the Reagan recovery to 9.5 percent. Again looking ahead, the Obama rate is expected to decline by only 1.2 percentage points to 8.6 percent by December 2011 while the Reagan rate fell by 3.6 percentage points to 7.2 percent in May 1985. If projections hold, the Obama recovery will be three times weaker than the Reagan recovery.

Real Estate Woes

Why has the recovery from the recent recession been so middling? I'll address the Congressionally-driven uncertainty in a moment, but in part the answer is that a recovery after a recession caused by the popping of a credit-financed asset bubble tends to be slower than a recovery after a recession triggered by other causes. Since most of you are familiar with the economic problems caused by the collapse of the housing bubble, in the interest of brevity lets focus on commercial real estate.

(Slide 11) The workout of the commercial real estate sector may ultimately prove to be a more protracted drag on economic growth than the housing sector. Unlike most residential mortgage loans, permanent commercial mortgage loans typically require balloon payments at the end of 3 to 10 years. Of the $3.4 trillion in commercial mortgage loans outstanding, $1.4 trillion will mature between now and 2014.

(Slide 12) More than one-half of all commercial mortgage loans, including almost all of construction and development loans, are in commercial banks and other depository institutions. Another fifth are in commercial mortgage-backed securities, known as CMBS.

(Slide 13) Unlike the agency residential mortgage-backed securities, home equity loans, and residential mortgage loans that were concentrated in large banks, commercial mortgage loans make up a much larger share of the assets of community and regional banks than of large banks.

(Slide 14) Prior to the financial crisis, CMBS had funded about one-quarter of all permanent commercial mortgage loans. New CMBS issuance collapsed from $230 billion in 2007 to just $3 billion in 2009. Although Wall Street economists expect that new CBMS issuance will pick up to between $20 billion and $30 billion in 2010, many project owners with maturing commercial mortgage loans that formerly would have had their loans refinanced through CMBS are now seeking bank refinancing.

(Slide 15) The performance of commercial mortgage loans in both banks and CMBS has deteriorated. At year-end 2009, the delinquency rate for commercial mortgage loans had risen dramatically to 8.8 percent for banks and 5.6 percent for CMBS.

The fall in commercial real estate prices and the contraction in acceptable loan-to-value ratios mean that banks are demanding that owners make large equity injections before refinancing existing projects. Inevitably, there will be many foreclosures because their owners cannot supply the required equity.

Weakness in the commercial real estate sector will have repercussions in the broader economy. Regional and community banks are an important source of credit for small enterprises, and small enterprises often use real estate as collateral for loans.

My belief is that federal regulators at the Federal Reserve Bank, FDIC and OCC have over-corrected and are making the commercial real estate challenge worse by, in effect, categorizing every real estate loan as a problem loan. This discourages local and regional banks from renewing loans under reasonable terms - even those that are performing and cash flowing.

Federal regulators are mistakenly applying one-size-fits-all portfolio limitations regardless of contracting or growing regional markets, have failed to recognize the demand that has shifted locally from the collapse of the CMBS option, and whose bank examiners are rigid and at times punitive when applying CRE guidelines.

Although federal regulators assure us their guidelines are just that, guidelines, in the real world any bank that exceeds or even approaches concentration limits invites a special visit from their friendly bank examiner. The federal goal of ‘diversification” of commercial real estate portfolios has quickly translated into “deny or dump” for local bankers. This restricted availability of credit will make a big economic problem a bigger one and further slow our economic recovery.

Policy Uncertainty

(Slide 16) While weakness in the commercial and residential real estate sectors may be an unavoidable drag on economic growth, Washington is also retarding economic growth by contributing to uncertainty. In my conversations with business people in Texas and throughout the country, I hear again and again that businesses of all sizes are delaying critical hiring, investment and expansion decisions for fear of proposals by the White House and Congressional Democrats regarding costly health care mandates, higher energy prices, increased regulation and higher taxes on industries, capital and international business.

There is good cause for that uncertainty. The health care bill is poorly written, containing billions of dollars of tax increases, confusing mandates and incentives - and a the end of the day will drive up health care premiums and federal spending on health care. Energy costs will driven up by cap and trade legislation and a misguided effort to increase taxes on domestic exploration and production of traditional oil and gas. Burdensome regulation is being aggressively pushed for a variety of industries, and the White House continues its assault on American companies reaching customers overseas with a $120 billion in tax increases on international business.

As one owner of a mid-sized company told me, “It’s hard enough to predict the market, but trying to predict Congress, too? Forget it.”

That uncertainty among job creators is mirrored by consumers anxiety not only with job security but with staggering annual deficits and dangerous levels of debt that they believe in the long term weaken America’s economic growth, risk inflation, create an unsustainable debt burden on the government and will inevitably lead to higher taxes on all income classes.

Administration efforts to stimulate the economy are being more than offset by the extreme political agenda that the Administration is pursuing. Washington is “frightening the horses” and the impact on the economy is palpable. Here’s a suggestion for the White House and Congress: Stop!

Strengthening the Recovery

(Slide 17) First, take off the table cap and trade proposals, card-check legislation, EPA regulation of green-house gases, and increased taxes on capital, energy, international business and "the wealthy". The public is smart. They see through the "blame-onomics" and understand higher taxes neither strengthen the economy nor increase our international competitiveness. They also recognize that Washington could double the taxes on every American and would still be running annual deficits. They are rightly focused on the need for Congress to rein in spending.

(Slide 18) Second, we should remove the barriers to increasing domestic energy production. Allowing the domestic oil and natural gas industry to expand responsibly would bolster economic growth and employment. A recent study commissioned by the National Association of Regulatory Commissioners (NARUC) found that removing federal restrictions on oil and natural gas field development would boost GDP by $2.36 trillion and support nearly 13 million jobs over the next 20 years.

Making domestic production of fossil fuels overly restrictive or costly in order to promote politically preferred alternatives will boost energy imports and increase our foreign dependency. The NARUC study estimates that the U.S. would import 4.1 billion barrels more oil from OPEC countries over 20 years, if domestic restrictions stay in place.

(Slide 19) The Obama Administration's agreement to drill off the coast of Virginia and on the North Slope of Alaska affects only specific leases already in preparation. Congressional action will be required to drill in the eastern Gulf of Mexico. Along the South Atlantic coast, the Obama Administration has authorized studies but not production. A large amount of oil and natural gas is kept off limits, "in return for blessing a few leases already underway," as *The Wall Street Journal* observed.

Instead of promoting production, President Obama has sought to increase taxes on the oil and natural gas industry. The Office of Management and Budget (OMB) projects that all its proposed tax increases for oil and gas companies will boost federal tax payments from the industry by $18.2 billion from 2011 to 2015. In addition, the Administration wants to levy an excise tax on oil and gas production in the OCS.

Third, the United States taxes capital income in general far too heavily. During the last two decades, countries around the world have been slashing their corporate income tax rate to stimulate job-creating business investment while the United States has largely stood pat. (Slide 20) In 1990, the average combined federal and state corporate income tax rate in the United States was 38.7 percent, 6 percentage points lower than in other OECD countries. Today, it is 39.1 percent and 9 percentage points higher than in other OECD countries. In 23 of the 50 states, the combined federal and state corporate income tax rate is now higher than in all other developed countries. In North Carolina, the combined federal and state corporate income tax rate exceeds that in every developed country except Japan.

(Slide 21) Most developed countries tax multinational corporations on a territorial basis; that is, a corporation pays tax only on the income earned with a country's borders. In contrast, the United States taxes the worldwide income of U.S. multinational corporations. To offset the disadvantage of the double taxation of foreign income, Congress developed a system of deferrals and credits for foreign taxes paid.

(Slide 22) In his Budget for fiscal year 2011, President Obama proposed a slew of international tax provisions designed to raise about $126 billion over ten years. Given the competitive disadvantage that our tax system already places on U.S. multinational corporations, Congress should not tinker with deferrals, foreign tax credits, 80/20 company rules, and transfer pricing to raise a quick buck.

The real cost of this revenue grab will be lost American jobs. U.S. technology companies already pay a higher effective tax rate their foreign rivals. While the effective tax rate for U.S. companies fall in the mid-twenties to the low-thirty percent range, their foreign rivals enjoy effective tax rates from the low-teens to the low-twenty percent range. These international tax proposals by President Obama and Congressional Democrats would exacerbate the advantage that foreign multinational corporations have over their American rivals.

(Slide 23) Recognizing the importance of corporate research and development to technological leadership, economic growth, and job creation, the United States enacted the R&D tax credit in 1981. Seeing the benefits of a R&D tax credit, other countries enacted generous R&D tax credits. By 1996, the U.S. had fallen to seventh place in R&D tax benefit among OECD countries. By 2004, we fell to 17th place. On December 31, 2009, Congress allowed the R&D tax credit to expire.

United States competes with other developed countries over where multinational corporations will conduct their R&D. Corporate R&D creates some of the highest skilled, best-paid jobs in the world. We want corporations to conduct their R&D in the United States to maintain the technological edge of U.S. firms and strengthen the long-term competitiveness of the U.S. economy. This lapse in the R&D tax credit is incomprehensible.

(Slide 24) Our tax depreciation schedules for commercial and residential real estate are too long. At a 10 percent discount rate, the present value of tax depreciation is only $251 for every $1,000 invested in a commercial real estate project and $320 for every $1000 invested in a residential real estate project.

(Slide 25) Finally, with the expiration of the 2001 and 2003 tax reductions at the end of this year, the maximum tax rate on capital gains will increase from 15 percent to 20 percent, while the maximum tax rate on dividends will explode from 15 percent to 39.6 percent. In 2013, the maximum tax rates on capital gains and dividends are scheduled to increase by another 3.8 percentage points to 23.8 percent and 43.4 percent, respectively.

(Slide 26) Our excessive taxation of capital income compared with our competitors is a self-inflicted wound that can be healed. We should:

- Reduce the federal corporate income tax so that the top combined federal and weighted average state corporate income tax rate is no more than 25 percent,
- Move to a territorial system for taxing corporations,
- Make the R&D tax credit permanent,
- Shorten the tax depreciation schedule for commercial and residential real estate to 20 years, and
- Instead of increasing tax rates on dividends and capital gains, we should eliminate the double and triple taxation of the same stream of corporate income by eliminating the taxes on dividends and capital gains.

Two other areas are critical to economic recovery, the flow of credit to small businesses and exports.

(Slide 27) With respect to lending, we should ensure that federal bank examiners do not overreact to the weakness in the commercial real estate sector and press regional and community banks to reduce credit to small, creditworthy enterprises and performing real estate projects. In response to questions during a Joint Economic Committee hearing, Federal Reserve Chairman Ben Bernanke acknowledged this problem:

> *"[I]t's a very high priority of the Federal Reserve to work with our banks and examiners to make sure that there's an appropriate balance. That is, loans have to be appropriately underwritten. They have to be sufficiently likely to be repaid … But on the other hand, we certainly don't want a modern equivalent of red-lining."*

(Slide 28) Finally, our economic growth is increasingly dependent on the ability of American companies to compete and win in foreign markets. 95 percent of global consumers and 75 percent of global purchasing power reside outside of the United States. Today, one of every 3 jobs in agriculture and one of every 5 jobs in manufacturing is trade-dependent.

(Slide 29) The United States has signed free-trade agreements with Colombia, Panama, and South Korea that are awaiting Congressional approval. According to the Administration's own analysis, these agreements would boost U.S. exports by over $13 billion and create over 250,000 American jobs.

Approving the agreements with Colombia and Panama would merely make free trade a two-way street for American exports of goods and services, which are now subject to significant tariffs and non-tariff barriers. Most goods from Colombia and Panama already enter the U.S. duty-free under existing preferential arrangements we offer to developing countries. Because of the delay, U.S. companies have paid more than $2.7 billion in tariffs to Colombia that would be eliminated under the agreement.

(Slide 30) As to all of these agreements, the world is not waiting on the United States. There will be about 600 bilateral or regional free trade agreements in force by end of 2010, and the United States is a party to free trade agreements with only 17 countries.

The European Union has negotiated a free trade agreement with South Korea. A recent study by the Chamber of Commerce found that U.S. exports of goods and services to the world would decline by $35.1 billion, if the United States fails to implement its free trade agreement with South Korea while other trading partners implement theirs. The EU is nearly finished negotiating with Colombia as well. Canada is also moving ahead to seize these markets for its exporters, ahead of us. There is no doubt that these initiatives will cost thousands of American jobs.

Fiscal Irresponsibility

(Slide 31) The most serious long-term economic challenge the United States confronts is its unsustainable fiscal position. According to the Congressional Budget Office (CBO), federal outlays under President Obama's Budget would exceed federal receipts in each fiscal year through 2020 by between $724 billion and $1.5 trillion annually. Cumulative deficits for fiscal years 2011 through 2020 would be $9.8 trillion.

(Slide 32) President Obama and Congressional Democrats have not tried to reduce unsustainable federal budget deficits by restraining the growth of federal spending. In this year's Budget, the OMB increased its projection for cumulative federal outlays during fiscal years 2010 to 2019 by $1.65 trillion.

After boosting non-security discretionary spending as part of the stimulus package last year, President Obama now proposes to freeze such spending for 3 years. Yet, his freeze would not rescind the unspent portion of stimulus funds. Discretionary non-security spending accounts for only 12 percent of total outlays. Merely freezing discretionary non-security spending without rescinding the unspent stimulus funds would not significantly reduce federal budget deficits.

(Slide 33) At the end of fiscal year 2009, publicly held federal debt was $7.5 trillion, or 53 percent of GDP. By the end of fiscal year 2020, President Obama's deficit spending will boost publicly held federal debt to more than $20 trillion, or 90 percent of GDP, according to the CBO.

(Slide 34) Although the Administration's economic forecast is significantly more optimistic than the most recent Blue Chip consensus forecast for the years 2011 to 2016, federal debt keeps growing at a rate faster than GDP in every year of this Budget. Consequently, the CBO projects that federal interest expense will increase from $209 billion, or 9.9 percent of federal receipts, to $916 billion, or 20.7 percent of federal receipts, by 2020.

(Slide 35) This estimate may be too low. This graph compares gross federal debt as a percent of GDP and federal budget deficits as a percent of GDP with those of five EU member-states, known collectively as the PIIGS, which are experiencing severe fiscal difficulties. Like the PIIGS, the financial market will recognize that the United States is on an unsustainable fiscal path and demand higher interest rates. This fallout is on vivid display in the resurgent interest rate spread between Greek and German government bonds since Greece's public debt turned out to be much larger than previously believed. If interest rates rise faster and higher than OMB assumes, the federal government's interest expense could increase to more than $1 trillion dollars per fiscal year before the end of the decade.

Resolving the Long-Term Fiscal Crisis

(Slide 36) The United States must reform Social Security, Medicare, and Medicaid to put its fiscal house in order. In the current fiscal year, Social Security outlays will be $703 billion, or 4.9 percent of GDP, while Medicare and Medicaid outlays will be $726 billion, or 5.0 percent of GDP.

According to the CBO, Social Security, Medicare, and Medicaid will account for almost all of the real growth in federal spending other than interest payments between now and 2080. Under a scenario in which current policies are unchanged, the CBO projects that Social Security outlays will climb to 6.0 percent of GDP by 2035 and then will level off to 6.2 percent of GDP by 2080. Most of this increase is due to the aging of the U.S. population.

Compared with Social Security, Medicare and Medicaid are in critical condition. The CBO projects that the combined outlays for Medicare and Medicaid will soar to 10.0 percent of GDP by 2035 and will then continue to balloon 18.0 percent of GDP by 2080. While the aging of the U.S. population plays the primary role in the near term, the primary cause of the soaring outlays for Medicare and Medicaid in the long term is the rapidly rising per capita cost of health care. In Washington jargon, this is known as excessive cost growth.

(Slide 37) Since 1970, nominal health care spending has grown 2.4 percentage points faster than nominal GDP. Health spending has grown from 7.2 percent of GDP in 1970 to 16.2 percent of GDP in 2008 and is projected to be 20.3 percent of GDP by 2020.

A complete discussion of all of the issues involving Social Security, Medicare, Medicaid, and the recently enacted health care legislation would take several speeches. Given the limits of time, I would like to discuss an important first step toward solving the long-term fiscal challenges this country confronts.

(Slide 38) I have offered legislation, H.R.311, known as *The Spending Reform Act*, which would reduce federal budget deficits and soaring federal debt over the near term and begin to resolve the long-term fiscal challenges posed by Social Security, Medicare, and Medicaid. This bill has four major components:

- First, this bill would freeze real discretionary spending, limiting the growth in total annual appropriations to the inflation rate, except during a war or other emergency when this cap could be waived by a supermajority vote.

- Second, this bill would set a sunset date for each federal department and agency and establish a federal sunset commission. This commission would review the performance of each federal department and agency and recommend to Congress whether the agency or department under review should continue, should be substantially reorganized, or should be abolished entirely.

- Third, this bill would establish a Joint Select Committee on Earmark Reform, composed of 16 Members divided equally between the House and Senate and between Democrats and Republicans. The committee would make recommendations on how to reform the earmarking process to end abuses.

- Fourth, this bill would create a 16-member bipartisan commission to study the long-term insolvency of Social Security, Medicare, and Medicaid, hold public hearings, and propose a permanent solution. If the Commission were to agree on a specific plan by a vote of ¾ of its members, Congress would be required to take an "up-or-down" vote on the commission's plan. The President or Members of Congress would be able to offer alternative plans that would also be subject to an "up or down" vote.

Conclusion

(Slide 39) Now is the time to be bold. Creating the strongest economy of this century will require lawmakers and community leaders to take a hard look at the challenges of today and beyond. Re-establishing America as the best business climate in the world will require vision and innovation and determination.

Perhaps the inspiration can be found here.

During the Revolutionary War, while conducting the southern campaign of 1780-81 the British commander, Lt. Gen. Lord Charles Cornwallis, reportedly described Charlotte as a “hornet’s nest of revolution” because of the fierce patriotism of its inhabitants.

Remembering the critical American victories nearby at Kings Mountain in October 1780 and Cowpens in January 1781, we should invoke that same spirit of determination to overcome our current economic challenges and ensure a bright future for our children and grandchildren.