



# HOUSE COMMITTEE ON THE BUDGET

Chairman John Yarmuth

November 15, 2019

## Hearing: Reexamining the Economic Costs of Debt

### Fears of an imminent debt crisis are misplaced

The federal debt as a share of the economy has more than tripled since 1980 and now sits at its highest level since just after World War II. However, we have seemingly evaded many of the predicted negative consequences of high and rising debt. These developments have motivated economists to reassess the economics and impacts of government debt and deficits in our current era. On November 20<sup>th</sup>, the House Budget Committee will hear testimony from a variety of perspectives on this fresh debate and its implications for budget policy going forward.

**Our recent economic experience has defied textbook theories about debt** — Traditional economic theory has long warned that persistent budget deficits and rising government debt would increase interest rates and discourage private-sector investment, curbing economic growth over the long run. But over the last several decades, interest rates have instead steadily declined to record lows even as the debt has soared to near-record highs. Today, with publicly held debt at [79 percent](#) of GDP, the United States pays a significantly [lower](#) interest rate on a 10-year loan than it did 20 years ago – when the government was running consecutive budget surpluses and debt fell to 34 percent of GDP. Interest rates are also expected to remain relatively low going forward, despite projections that debt will rise to unprecedented levels over the next 30 years.

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**Deficits and debt appear to be less costly today** — In light of the sustained decline in interest rates since the 1980s, economists have put forth new arguments that suggest the costs of debt and deficits are likely [smaller](#) today – and will be going forward – than in previous years. With interest rates on government debt forecast to remain low, the United States will pay [less](#) interest than it otherwise would, allowing it to sustain higher debt levels. Deficits may also inflict less harm on investment and future economic output. These conclusions dovetail with [alternative](#) economic theories that have long argued that debt fears are unfounded and overblown. Despite their critical differences, both mainstream and alternative schools of thought increasingly agree that government debt appears to be less risky, less costly, and less cause for immediate concern than conventional wisdom suggests.

*This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and may not necessarily reflect the views of all members.*

**We should prioritize addressing deficits in the real economy** — A more sober and realistic view of the costs of debt makes it clear that our fiscal policy should be driven by our nation’s needs, rather than an excessive and inflexible focus on debt. Accordingly, the most urgent priority facing policymakers today is addressing deficits in the real economy, rather than in the budget. Failing to tackle severe and persistent infrastructure, education, and health outcome deficits is arguably more damaging to our economic and fiscal outlooks than the risks posed today by higher debt. Going forward, we should commit to making critical investments that improve the livelihoods of American workers and families, combat climate change, and foster a productive and dynamic economy over the long run. Additionally, with interest rates low, these investments are cheaper to make today and are likely to provide a bigger boost to the economy.

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**Deficits still matter** — While deficits may be less problematic today than in the past, that does not mean they no longer pose problems. Interest rates are projected to remain low for the foreseeable future, but as we saw with the Great Recession, predictions about the economy can be devastatingly wrong. Because we cannot be sure that the economy will follow its projected path – and because no one knows the exact conditions under which debt may actually inflict serious economic harm – basic risk management principles clearly dictate limits on when and how we use deficits. Restraining deficits is also important given that growing debt may make policymakers more [reluctant](#) to respond to future economic downturns – a particularly dangerous risk in light of the larger role fiscal policy will need to play in fighting recessions going [forward](#). While policymakers should recognize that we have the budget capacity to fight the next recession whenever it comes, taking the current political reality into account suggests another reason we should keep deficits in check and think more seriously about when and for what purposes we use them.

**Our real fiscal challenge is long term**— The diminished costs of debt have made reducing deficits in the near-term less urgent. In fact, doing so could even be counterproductive: with the economy slowing and the Federal Reserve constrained in its ability to offset drags on growth, drastic spending cuts in the name of deficit reduction would actually weaken our economy. Over the longer-term, however, the United States faces a critical and unsustainable fiscal challenge driven by an aging population and growing health care costs. Returning our debt to a sustainable path over the next several decades will in part require correcting the gross revenue imbalance in our budget. Revenue as a share of GDP has fallen well [below](#) the historical average – particularly when compared to other years in which unemployment was below 5 percent – and is not rising commensurate with the needs of our aging population. Addressing this revenue shortage can help relieve pressure on our long-term fiscal outlook and allow us to gradually return our debt to a sustainable path.

**The Republican tax law is emblematic of wasteful deficits** — True to their playbook, Republicans temporarily quieted their deficit hysteria when they passed their tax cut for corporations and the wealthy in 2017. Two years later, it has [failed to provide](#) any meaningful boost to our economy and now appears on track to increase the debt by even [more](#) than its initial \$1.9 trillion price tag. As the poster child for irresponsible and wasteful deficit-financed policy, the Republican tax cut underscores the need to be wiser about how we use deficits going forward. Deficits that support critical investments in families, communities, and environmental resilience – investments that improve current and future living standards and boost our long-term growth potential – are justified uses. So are fighting recessions and avoiding needless and destructive austerity traps. Tax cuts for the wealthy, however, are not.

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This upcoming hearing is an opportunity for the Budget Committee to learn more about this growing debate on the costs and consequences of debt, the different perspectives that are driving this important conversation, and the implications of recent economic developments for how we think about our fiscal challenges. Expert witnesses include:

- **Olivier Blanchard, Ph.D.**  
Senior Fellow, Peterson Institute for International Economics;  
Professor of Economics Emeritus, MIT
- **L. Randall Wray, Ph.D.**  
Professor of Economics, Bard College;  
Senior Scholar, Levy Economics Institute
- **Jared Bernstein, Ph.D.**  
Senior Fellow, Center on Budget and Policy Priorities
- **John Taylor, Ph.D.**  
Professor of Economics, Stanford University;  
Senior Fellow, Hoover Institution