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## **Introduction**

Chair Heinrich, Vice Chair Schweikert, Members of the Committee, thank you so much for extending me the opportunity to testify before you today. My testimony will broadly cover three important aspects of today’s topic.

First, I will discuss how we might assess the economic risks posed by our current fiscal trajectory. Too often in our national discussion of federal fiscal policy, we skip over the critical first step of interrogating just what those risks actually are, how big they might be, and how certain we are of them coming to pass. Given the uncertainty surrounding the risks posed by rising debt, I argue that we should approach our fiscal future from a “risk management” standpoint.

Second, I’ll consider how to use “risk management” to evaluate policies designed to alter our fiscal trajectory. Not all risk reduction is created equal. We want to meaningfully reduce our future risks, without causing undue harm today.

Finally, I will turn to a brief discussion of how federal fiscal policy has changed over the past several decades, and how those changes have affected the fiscal outlook. To the extent that the current trajectory does carry real risks, it is valuable to understand what policies have contributed to exacerbating or mitigating those risks because that can help us identify which areas of the federal budget deserve the most attention.

It’s useful to begin where almost everyone agrees. Debt, as a percent of our economy, cannot rise forever without there eventually being some negative consequences. Many economists reasonably worry that an ever-increasing debt load could result in higher and higher interest rates, crowd out private investment and lead to slower economic growth, and could force us to spend a larger and larger share of our national resources paying off old debt, rather than investing for the future, among other plausible risks.

There is little to suggest that current levels of national debt are causing any of these potential harms, yet there is a real risk that any or all of these harms could come to pass in the future, as debt continues to rise. Reasonable projections, including those from the Congressional Budget Office, forecast a persistent mismatch between revenues and spending, which causes the debt to rise, as a percent of GDP, forever and ever. That is quite obviously a risky debt trajectory.

But how risky?

Surprisingly, that is a question without a clear answer. It is important to approach questions of our fiscal future with a degree of humility. Projections are inherently uncertain, fiscal risks have been overstated in the past, there are aspects of U.S. fiscal and economic policy that make it difficult to compare to other countries' experiences. And, crucially, it turns out that there is remarkably little agreement on the magnitudes of the risks we face.

Take interest rates, for example. For decades, many economists believed and warned that higher debt would necessarily mean higher interest rates. And after all, that relationship should make sense. As a borrower takes on more debt, lenders perceive that borrower to be a riskier bet, and therefore demand a higher interest rate before they are willing to lend more.

But in fact, the observed relationship between publicly held debt and interest rates has been just the opposite. Interest rates on federal debt have actually fallen precipitously over the past four decades, even as debt has risen substantially. Today, of course, interest rates are, indeed, higher than they were two years ago, but they are still roughly equal to the rates of the early 2000s, when debt was roughly 65 percentage points of GDP lower than it is today.

Furthermore, interest rates today are much lower than they were in the 1980's, when the debt was 70 percentage points of GDP lower than it is now. Moreover, most of the recent rise in interest rates occurred during fiscal year 2022, a year in which the debt actually fell slightly as a percent of GDP.

None of that should be taken to mean that interest rates will stay low forever or that the assumed relationship between debt and interest rates is actually the reverse of what economists once believed. But the past 45 years of history should teach us to be humble about our basic assumptions today.

Similarly, a traditional concern is that more government borrowing will “crowd out” private investment, as the federal government absorbs some of the credit that would otherwise have gone to private borrowers. This “crowding out” effect is then supposed to reduce national income over time as the country forgoes productive private investments in favor of less productive uses by the public sector.

As it turns out, the evidence for both the phenomenon itself and the underlying theory is quite mixed, to say the least. Some academic studies have found a significant crowding out effect. Others have found almost none.<sup>1</sup> And some studies have even found that public investments have had a so-called “crowding-in” effect, whereby private investors follow the public sector’s lead and total investment goes up, not down.<sup>2</sup>

Once again, the lesson from the evidence is not that there are no potential harms from rising debt, but rather that higher debt creates risks. Those risks are of an uncertain magnitude, but that does not make them nonexistent.

Indeed, the most responsible course is to take a “risk management” approach to our long-term fiscal trajectory. Prudent and responsible governance means neither ignoring those risks, nor trying to eliminate them entirely. It means taking appropriate steps to mitigate risks and minimize them, without causing necessary harm now. After all, it would be a poor swap to trade the uncertainty of potential damage of unknown magnitude in the future for the certainty of major damage today.

That’s why it is important to consider both the benefits and the costs associated with any policy intervention designed to reduce fiscal risks. The more certain we are about those risks, the more the benefits will outweigh the costs, and vice versa. Today, as we sit here discussing these issues in this hearing, the risks are quite uncertain. This should make us cautious about taking drastic actions.

But even so, there likely are policies we could pursue over the near term for which the benefits from reducing fiscal risk—however uncertain—nevertheless outweigh the costs. Policies that promote and accelerate shared, broad-based economic growth, for example, are going to both help improve people’s lives and reduce fiscal risks in the future. We know that investments in early childhood education and in scientific research and technology development are going to pay enormous dividends, expanding our

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<sup>1</sup> The Congressional Budget Office gives a good rundown of the literature [here](#).

<sup>2</sup> The White House Council of Economic Advisers provides an overview of the research showing crowd-in effects [here](#).

economy in ways that will benefit all Americans and simultaneously make it far easier to reduce the risk posed by increasing debt.<sup>3</sup>

Put another way, the best approach to reducing our debt-to-GDP ratio is by expanding GDP. And indeed, it is noteworthy that recent economic growth has produced exactly that result. The CBO's projections of long-term debt, as a percent of GDP, have actually declined in each of the last four years, in part because CBO's estimates of the size of the economy have increased.

The CBO's most recent forecast put debt in 2050 at roughly 20 percentage points of GDP lower than its forecast in January 2020, before the pandemic. In response to the pandemic, the federal government spent more than \$4 trillion, and yet debt projections today are better than they were before the pandemic largely because the CBO now believes the economy will be much bigger than it forecast it would be before the pandemic.<sup>4</sup>

Of course, the converse is also true and worth explicitly mentioning. Policies enacted in the name of fiscal risk reduction that slow or impede shared growth—either by cutting productive investments or by increasing inequality—are not only harmful on their own merits but are also likely to fail to achieve their stated goal.

Indeed, if we are to take a serious approach to fiscal risk management, we should start by understanding which policies have contributed to increasing fiscal risks in the past, and which have contributed to reducing them.

Simply put, the primary (if not sole) reason why current projections have the debt rising in perpetuity instead of falling is because of tax cuts. If not for the series of tax reductions enacted in 2001 and 2003 and then extended in 2010 and 2012, and then added to in 2017, the debt, as a percent of GDP, would be on a permanent downward trajectory.<sup>5</sup>

How do we know this? We know this because we can directly identify what fiscal policies have changed relative to the last time debt was projected to be stable or declining. That was in 2012, before the majority of the Bush tax cuts were permanently extended. In June of that year, the CBO released long-term projections that showed the debt declining forever. Without those tax cuts, which were slated to expire after 2012

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<sup>3</sup> For one important study of the economic benefits of public investments see, for example, [here](#).

<sup>4</sup> The January 2020 Long-term Budget Outlook can be found [here](#).

<sup>5</sup> Bobby Kogan at the Center for American Progress discusses this in more detail [here](#).

(and obviously before the 2017 tax cuts) the tax code would have been able to generate sufficient revenues to fully finance the federal government's spending commitments—even as those costs rose with an aging population—without having to take on debt faster than the economy grew.<sup>6</sup> In other words, without the tax cuts enacted over the past several decades, there would be no fiscal risk from rising debt.

Put another way, we know that tax cuts are responsible for our riskier fiscal posture because spending projections today are *lower*, not higher, than what the CBO expected a decade ago. Let me repeat that. We will spend less over the next decade, as a percent of GDP, than what the CBO thought we would be spending the last time it forecast a permanently declining debt-to-GDP ratio. So if debt is now rising instead of falling, and spending is lower, the culprit has to be lower revenues.

And that's exactly what we see. Take this very year as a good example. The CBO now expects the federal budget deficit in fiscal year 2024 to be about 4 points of GDP higher than what it expected it would be back in 2012. And yet, primary spending this year—that is spending aside from net interest payments—is almost exactly the same as what CBO projected. That's right. The deficit is higher, but spending is the same. That means the entire reason why the deficit is higher today than what was expected a decade ago is because revenues are also about 4 percentage points of GDP lower, reflecting the extension of the Bush-era tax cuts at the end of 2012 and the enactment of the Trump tax cuts in 2017.

And it also must be noted that a disproportionate share of the reduced tax revenue has gone to very high-income households. Across all of the tax cuts enacted since 2001, close to half of the total benefit has gone to the richest 5 percent of households.<sup>7</sup> For a household in the richest 1 percent, their combined tax cut from all the changes enacted since 2001 is roughly 45 times larger than the tax cut for a family in the middle income quintile.

Furthermore, a recent academic study found that 81 percent of the benefits from the 2017 corporate tax rate cut went to the top 10 percent of the income distribution.<sup>8</sup>

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<sup>6</sup> CBO, June 2012 Long-Term Budget Outlook [here](#). Note the Bureau of Economic Analysis has since updated its GDP concept, so the GDP that CBO uses in its 2012 projection cannot be directly compared to current projections. The calculations in this testimony adjust the 2012 GDP numbers to account for this difference.

<sup>7</sup> Tax Policy Center [analysis of the combined effect of the 2001-2006 tax cuts](#) and Tax Policy Center [analysis of the 2017 tax cuts](#).

<sup>8</sup> A summary and explanation of the recent study from Patrick Kennedy, Paul Landefeld, Jacob Mortenson, and Christine Dobridge can be found [here](#).

Now, let me be very clear. Federal spending is indeed higher today than what it used to be in the late 1990's and early 2000's. But it has grown more slowly than expected. Some growth was always expected as the population ages and more Americans retire and rely on Social Security, Medicare and Medicaid. But the actual increase has been smaller than expected, not larger. We are spending less today on those three bedrock commitments to America's seniors than what we thought we would have to spend two decades ago, or even a decade ago.

Healthcare spending growth in particular has slowed dramatically compared to what was predicted a dozen years ago. In its 2012 projection, the CBO expected that federal spending on Medicare, Medicaid and the Affordable Care Act would average 7.3 percentage points of GDP over the ten-year period from 2024 to 2033. Now, the CBO expects that spending to average just 5.9 percent of GDP. That difference of 1.4 percent of GDP is equivalent to \$4.7 trillion in savings over the next decade.

Those trillions of dollars in savings from lower-than-expected healthcare spending will, however, be more than wiped out by trillions of dollars in lower tax revenues, the result of repeated tax cuts. Over the next 10 years, the CBO now expects the federal tax code to generate an average of 17.7 percent of GDP in revenue, and that assumes the expiring provisions of the 2017 tax cuts do, indeed expire or that any extensions are fully offset with new revenue. That is fully 4.5 percentage points of GDP lower than what the CBO projected the tax code would generate over that period had the Bush tax cuts not been extended. Those 4.5 points of GDP are equal to \$15 trillion over the next 10 years.

So, we may be spending \$5 trillion less on healthcare than expected over the next decade, but we're also essentially "spending" \$15 trillion more on tax cuts, roughly half of which is going to the richest 5 percent of households. And that is why the debt is on an upward trajectory, rather than downward.

When I look at that debt trajectory, I see risk. The magnitude of that risk is uncertain, yes, and that should make us cautious about taking drastic actions. But by employing a "risk management" approach we can see that there are prudent steps we can take now without causing unnecessary harm, such as investing in ways that we know support shared growth and prosperity. And we can certainly begin to reverse the revenue losses that are the primary contributor to our fiscal risks by asking the wealthy and corporations to pay more in taxes.

Thank you, and I look forward to taking your questions.