Testimony of Douglas Elmendorf
December 11, 2024
House Budget Committee Hearing on "Sounding the Alarm: Pathways and Possible Solutions to the U.S. Fiscal Crisis"

Good morning, Chairman Arrington, Ranking Member Boyle, and Members of the Committee. It is good to be back with the Budget Committee, and I appreciate the invitation to testify today.

I am pleased that the Committee is hosting this hearing about the need for significant changes in the federal budget. Let me make three points.

<u>First, current federal policies regarding spending and revenue are almost certainly unsustainable.</u>

Federal debt is now roughly equal to the nation's annual output, or GDP (gross domestic product). That is nearly the highest level in our history and almost three times the level in 2007 before the global financial crisis.

More importantly, the Congressional Budget Office's projections based on current law show debt rising continuously relative to GDP in the years ahead (see figure 1). As debt rises, interest rates tend to rise, so interest payments by the federal government will keep rise. Those trends cannot continue indefinitely. And although one can imagine scenarios in which those patterns go away by themselves, those scenarios are highly unlikely. Therefore, policies will need to be changed.

<u>My second point is that we are not in a fiscal crisis now, and changes do not need to be made urgently—but acting sooner rather than later would be valuable and prudent.</u>

A key sign of a fiscal crisis would be interest rates rising well above their typical levels. We have not seen that. For example, even with the increase in interest rates over the past few years, the yield on the 10-year Treasury note remains lower now than at almost any time between 1990 and 2007 (see figure 2).

But although we are not in a crisis now, delaying action has significant costs. The accumulation of debt crowds out capital investment, which holds down wages and pushes up interest rates relative to what would happen otherwise. In addition, the accumulation of debt limits the government's ability to borrow when truly needed to respond to problems in

the future. And the accumulation of debt increases the risk that we will face a fiscal crisis, in which investors are unwilling to hold Treasury securities at reasonable interest rates.

<u>My third point is that putting fiscal policy on a sustainable path should include both tax increases and spending reductions.</u>

Stabilizing the ratio of debt to GDP at its current level for the next 30 years would require policy changes totaling a little more than 2 percent of GDP each year, which amounts to about $600 billion today. If the expiring provisions of the 2017 tax cut were extended with no "pay-for"s, the fiscal hole would be much deeper.

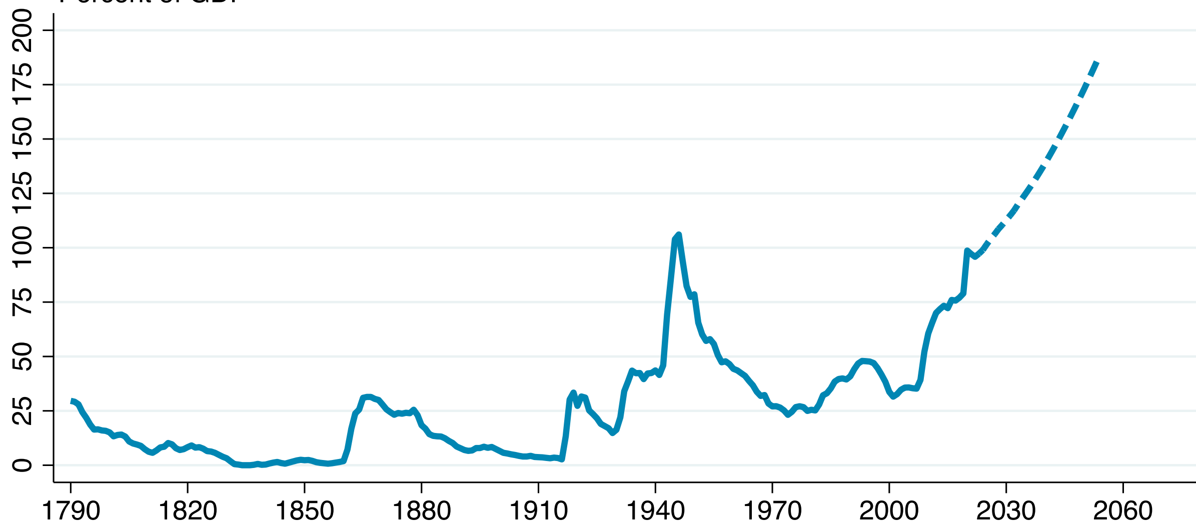
Cutting spending that much would require large cuts to popular and important government benefits and programs, and raising taxes that much would require large tax increases for many people. The only realistic way forward is through a combination of those changes.

Recall that nearly half of all federal spending goes to Social Security, Medicare, and interest payments on the debt (see figure 3); few Members of Congress have called for cutting spending in those areas. Many Members seem to want more spending on defense and border security rather than less. Some people have proposed cutting Medicaid, but I hope they realize that Medicaid covers almost half of nursing home bills in the country and that Medicaid benefits for children not only help those kids now but also boost their earnings and tax payments when they grow up. In addition, cutting federal spending on infrastructure and research would hinder economic progress, and cutting benefits for lower- and middle-income Americans would hurt those who have been struggling the most in the economy. So, cutting spending efficiently and fairly is difficult.

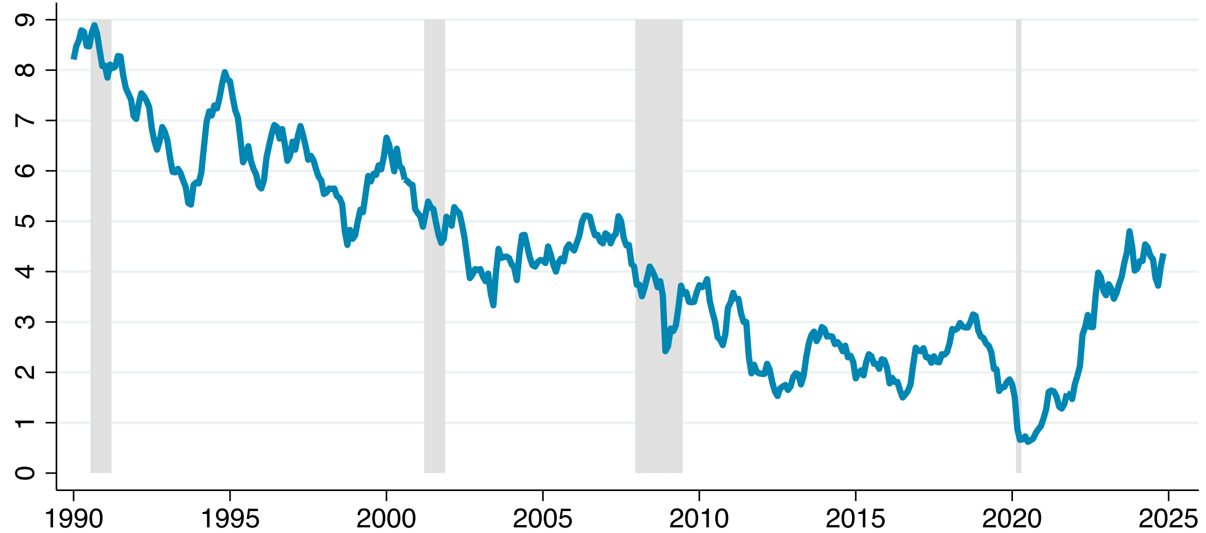
Meanwhile, of course, most people do not want to pay more taxes, and taxes can discourage work, saving, and investment, which also hinders economic progress. So, raising taxes efficiently and fairly is difficult. But I want to point out that federal tax revenue this year is estimated by CBO to equal 17.0 percent of GDP—which happens to be exactly the same percentage as in 1962, the year I was born, and when far fewer Americans were collecting Social Security and Medicare did not yet exist (see figure 4).

All told, these considerations show why the only realistic way forward is to both scale back spending and increase taxes.

Let me close by thanking you for your commitment to managing the federal budget in a prudent manner on behalf of all Americans. I look forward to your questions.



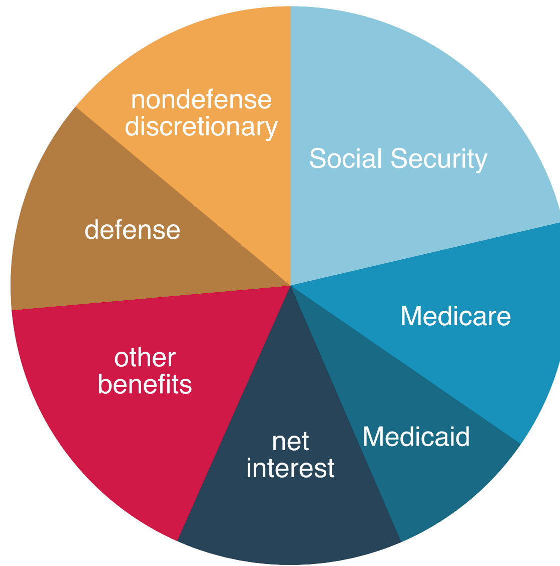
Source: Author's calculations and supplementary data files for Congressional Budget Office *Budget and Economic Outlook* documents (Jan. 2020, Feb. 2024, Mar. 2024, Jun. 2024).
Note: Solid line is history; dashed line is projection under current law. Projection equals CBO's June 2024 10-year projection for 2024-2034. For 2035-2054, CBO's March 2024 long-term projection was adjusted to be consistent with the June 2024 revisions to the 10-year projection.



Source: Federal Reserve Board (via FRED).
Note: Shaded areas correspond to recessions. Last data point: November 2024.

Figure 3
Federal Spending by Category in 2024

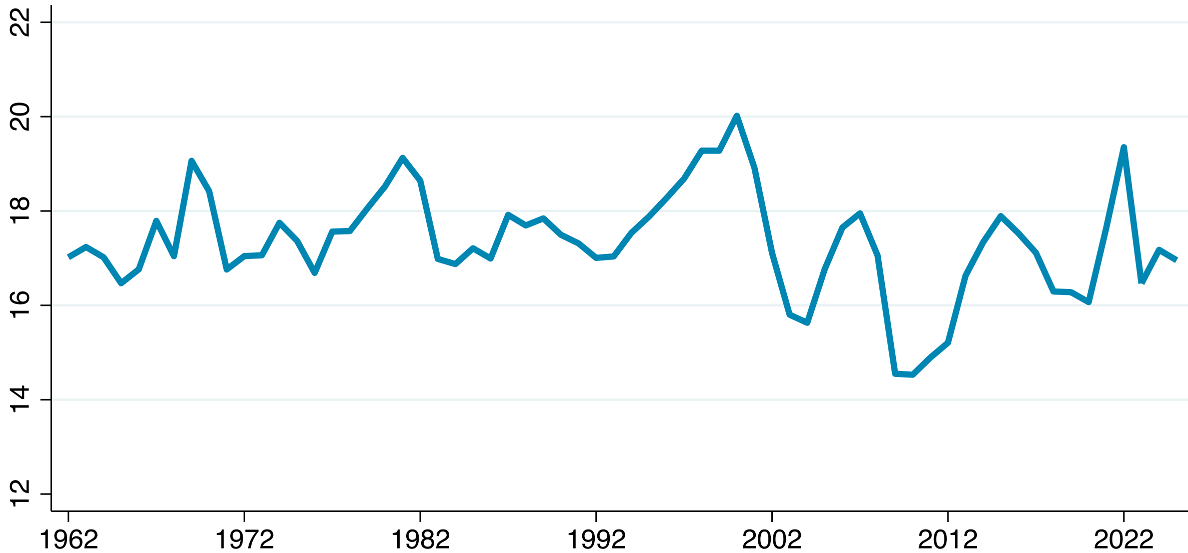
Share of total spending



Source: Congresssional Budget Office, *An Update to the Budget and Economic Outlook: 2024 to 2034*.

Figure 4
Federal Revenue

Percent of GDP



Source: Supplementary data files for Congressional Budget Office *Budget and Economic Outlook* documents (Feb. 2024, Jun. 2024).
Note: CBO projections for 2024 and 2025. Last data point: 2025.