## The Strategic Implications of the U.S. Debt

***Testimony before the Senate Foreign Relations Committee***

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Chairman Corker, Ranking Member Cardin, and fellow members of the Senate Foreign Relations Committee. My name is Neera Tanden, and I'm the president of the Center for American Progress. I want to thank you for the opportunity to testify before you today.

CAP is an independent, nonpartisan educational institute dedicated to improving the lives of all Americans through progressive ideas and action. At CAP, we believe that a robust middle class is vitally important to growing a stronger and more prosperous economy. That's one of our core priorities, and I know it's a priority of every member of this committee.

I appreciate the opportunity to speak to you on such a critical topic: how America's economic success is critical to maintaining our unmatched international standing. Indeed, I could not agree more that it is a central part of our international strength. Where I may have a different focus is the source of that strength. I believe that the strength of our middle class has long been the key to our international appeal. The American middle class is not only the engine of our nation's economic growth – it's a symbol of our ideals, a promise that – no matter what you look like or where you come from – if you work hard and play by the rules, you have a fair shot at success.

Indeed, America has served as the world's brightest beacon of economic opportunity. Immigrants from every country – including my own parents – have come to our shores in search of a better future for themselves and their families.

Today, we're failing to fulfill that promise for too many American families. While our national debt is a long-term problem that we can and should tackle, the struggles of our middle class and those trying to get into it is an urgent problem – and, I believe, the proper concern of this committee and Congress.

### Introduction and background

The U.S. economy is a vital source of our international power and influence. A strong economy is one that fully utilizes its resources and makes critical investments to increase prosperity for all of its citizens.

In the aftermath of the financial crisis, the U.S. and our allies were pushed to the economic brink, suffering massive losses in jobs, revenue, private investment, and ultimately, growth. Faced with these challenges, our countries had two options: invest in our economy to spur recovery, or enact harsh austerity measures that would shrink growth and burden working families.

The Obama administration acted swiftly to combat this sharp decline in demand with fiscal stimulus, and prevented the U.S. economy from sliding into an even deeper recession – and quite possibly a second Great Depression. The interventions taken by this administration saved entire industries and sectors of the U.S. economy from collapse.

In fact, our recovery has outpaced some of our allies who chose to implement harmful austerity measures.[1] In 2015, the U.S. was the fastest growing G-7 country (Canada, France, Germany, Italy, Japan UK, US), and the International Monetary Fund projects that we will continue to lead G7 growth in 2016 and 2017.[2] While countries in the European Union grew at an average rate of 1.5 percent in 2015, the U.S. economy grew 2.5 percent and is projected to continue to grow a half a percent faster than other advanced economies. Indeed, Federal Reserve Chair Janet Yellen noted last week that while the outlook for the U.S. economy is favorable, its biggest threat is a weak global economy dragging down manufacturing and net exports.[3]

Despite the limits placed on U.S. investment in the recovery, much progress has been made. Millions of jobs have been created, unemployment has fallen dramatically, and long-term debt projections have improved as well.[4] And projections for growth in federal health care spending are down under the Affordable Care Act, even as we addressed a major national challenge by expanding health insurance to millions of uninsured Americans. In fact, the Congressional Budget Office recently published data showing that the total estimated federal spending for major health care programs in fiscal year 2016 will be lower than the FY 2016 projection the office published in January 2009.[5]

While the recovery from the recession remains incomplete, there is no evidence that the U.S. government debt is currently creating obstacles to further economic growth. To the contrary, many economists argue that now is the time to invest significantly in infrastructure, research and development, education, and other productivity-enhancing investments that will boost demand

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[1] Paul Krugman, "The Austerity Delusion," *The Guardian,* April 29, 2015, available at http://www.theguardian.com/business/ng-interactive/2015/apr/29/the-austerity-delusion.

[2] International Monetary Fund, "World Economic Outlook" (2016), available at http://www.imf.org/external/pubs/ft/weo/2016/update/01/#footT1.

[3] Janet Yellen, "The Outlook, Uncertainty, and Monetary Policy," March 29, 2016, available at https://www.federalreserve.gov/newsevents/speech/yellen20160329a.htm.

[4] Richard Kogan, Paul N. Van de Water, and Cecile Murray, "CBPP Projections Show Long-Term Budget Outlook Has Improved Significantly Since 2010 But Remains Challenging" (Washington: Center on Budget and Policy Priorities, 2015), available at http://www.cbpp.org/research/federal-budget/cbpp-projections-show-long-term-budget-outlook-has-improved-significantly.

[5] Harry Stein, "The Obama Health Care Legacy: More Coverage and Less Spending" (Washington: Center for American Progress, 2016), available at https://www.americanprogress.org/issues/economy/news/2016/03/25/134074/the-obama-health-care-legacy-more-coverage-and-less-spending/.

and produce long-term economic returns. That is because despite our broad economic growth rate, a clear problem remains weak demand. And weak demand is in part a product of stagnant wages. Between 2001 and 2015, our economy's productivity grew about two percent a year. During that same time period, real wages for most workers grew less than one percent per year. Despite the Great Recession, our economy has managed to grow, but the benefits of growth haven't reached most workers.[6]

**Using National Debt for National Strength**

The United States is the strongest nation in the world. And when it comes to our economic and national security, we cannot afford to let false assumptions distort our choices.

Neither our allies nor our adversaries doubt American strength or leadership. Nor do financial markets treat the U.S. debt as anywhere close to an immediate concern. Some predicted that there would be a sharp reversal in the willingness of creditors to lend to the U.S. government by now. But this thinking assumes that lenders will lose confidence in the America's ability to repay its debts. Frankly, there is no empirical basis whatsoever for this belief.

Throughout the Great Recession and subsequent recovery, the market has yet to worry about a U.S. debt crisis – except for the manufactured crisis around the debt ceiling. We know this because both inflation and interest rates on Treasury bonds are at very low levels. This includes long-term Treasury interest rates and long-term inflation expectations. In fact, U.S. debt remains the world's safest investment.

Time and again, we have been told that the debt will spell economic doom in the form of high interest rates. And in the fiscal outlook from the Congressional Budget Office, one of the major reasons for increasing deficits in future years is that CBO assumes that interest rates on Treasury bonds will increase to more normal levels from their current lows.[7] But CBO has been predicting for years that Treasury interest rate increases were just around the corner. In February 2013, for example, CBO predicted that the interest rate on 10-year Treasury bonds would be 4.3 percent in 2016.[8] On April 4, 2016, this interest rate was actually 1.78 percent.[9]

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[6] Federal Reserve Economic Database, "Nonfarm Business Sector: Real Output Per Hour of All Persons,"; "Average Hourly Earnings of Production and Non-Supervisory Workers," available at https://research.stlouisfed.org/fred2/graph/?g=444i. Average hourly earnings were deflated with the Personal Consumption Expenditure Chain-Type Price Index.

[7] Congressional Budget Office, "Updated Budget Projections: 2016 to 2026" (2016), available at https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51384-MarchBaseline.pdf.

[8] Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2013 to 2023" (2013), available at https://www.cbo.gov/publication/43907.

[9] U.S. Department of the Treasury, "Daily Treasury Yield Curve Rates," available at https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.

The budget outlook has improved dramatically as a result of lower-than-expected interest rates.[10] That does not mean interest rates will not rise in the future, but we should not take it as a given that they will rise as quickly or as high as has been predicted. A small difference in interest rates can make an enormous difference in both economic growth and fiscal costs.

Moreover, we have heard claims that our debt-to-GDP ratio is a sign of impending crisis. This, too, does not square with the facts. In 2015, the U.S. debt-to-GDP ratio was about 74%. Many countries have sustained higher debt-to-GDP ratios without experiencing a debt crisis. Some countries, such as Russia and Iran, have much larger economic problems than the United States while also having lower debt-to-GDP ratios.[11] This ratio does not independently determine the health of an economy.

We should also remember that the U.S. dollar is the global reserve currency, our debt is financed in U.S. dollars, and we maintain sovereign control of our monetary and currency policy.

If there is a surplus of savings in the global economy—as many economists believe—that would explain why interest rates may remain low for a prolonged period of time. A high supply of savings without enough opportunities for productive investment would force savers to accept lower interest rates since they do not have better options to invest their money. This would also mean that we should increase public investment in order to put more of this surplus savings to productive use.[12]

When used to support smart policy choices, the national debt can improve our economy and enhance our national security. When used to support poor choices – like the Iraq War or massive tax cuts for the wealthiest Americans – it harms both our economy and national security.

The Center for American Progress recognizes that debt and deficits are a long term challenge we should take reasonable steps to address. By implementing balanced and gradual policies to address the nation's long-term fiscal challenges, we can prevent the need for more catastrophic measures and protect the integrity of vital programs like Social Security, Medicare, Medicaid, and SNAP that are fundamental to economic growth and middle-class prosperity. We have proposed eliminating the deficit by 2038. Our plans shows that it is possible to pursue progressive fiscal policies, preserve the basic social safety programs, and adequately fund defense, while maintaining a manageable level of debt. The CAP budget plan made significant

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[10] Harry Stein and Lauren Shapiro, "Does Washington Have a Spending Problem or a Revenue Problem?" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/budget/news/2015/05/07/112689/does-washington-have-a-spending-problem-or-a-revenue-problem/.

[11] Central Intelligence Agency, "Country Comparison: Public Debt" in "The World Factbook," available at https://www.cia.gov/library/publications/the-world-factbook/rankorder/2186rank.html.

[12] Lawrence H. Summers, "U.S. Economic Prospects: Secular Stagnation, Hysteresis, and the Zero Lower Bound," *Business Economics* 49 (2) (2014): 65-73, available at http://larrysummers.com/wp-content/uploads/2014/06/NABE-speech-Lawrence-H.-Summers1.pdf.

investments to strengthen the middle-class and grow the economy. It also gradually balanced the budget, primarily by enacting policies to slow the growth of health care costs and raise an adequate level of revenue to meet the needs of an aging population.[13] By FY 2040, our plan would reduce total outlays by 3.3% of GDP and increase total revenues by 3.7% of GDP, relative to the budget baseline from 2015. This would produce a budget surplus of 0.6% of GDP in FY 2040, which is more than enough to reduce the debt as a share of the economy.

Numerous bipartisan commissions have recognized that revenues are a necessary element of any responsible long-term budget plan.[14] Instead of signing pledges to oppose any increase in tax revenues, lawmakers must work together to pass a budget that bolsters the middle class and makes critical investments in our country's economic future.

With new revenue streams and smart investments in the engines of economic growth, we can gradually reduce our debt and ensure future security and stability.

## Make Critical Investments in Our Future

For the U.S. to maintain global leadership and ensure national security going forward, we must make smart choices in both foreign and domestic policy, including how to best use U.S. borrowing capacity.

The best ways to promote economic growth is through a strong and stable middle class with growing incomes. At a time when stagnant incomes remain a drag on the economy, we need some investments to foster shared prosperity. Growing the economy will not only ensure future security but reduce the debt burden in the long-run.

Much like a family seeking to buy a car or a house, debt should be viewed as tool to make productive investments today and finance their payment over many years, rather than in a single cash payment. The federal budget is not the same as a household budget, however, and our government has a greater capacity to borrow and finance urgent needs than a family or a business.  That is why it is essential to consider debt and deficits from the perspective of the entire economy and the entire nation.

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[13] Harry Stein and Alexandra Thornton, "Laying the Foundation for Inclusive Prosperity" (Washington: Center for American Progress, 2015), available at http://www.pgpf.org/sites/default/files/05122015_solutionsinitiative3_cap.pdf.

[14] The National Commission on Fiscal Responsibility and Reform, The Moment of Truth (The White House, 2010), available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf; The Debt Reduction Task Force, "Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System" (Washington: Bipartisan Policy Center, 2010), available at http://bipartisanpolicy.org/sites/default/files/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf.

The very foundation of U.S. economic strength and security is a vibrant middle class. In recent decades, the very existence of the American middle class has been threatened by growing inequality and a lack of broadly shared prosperity. With interest rates still near record lows and wage growth still weak. Now is the moment to make smart public investments to help restore a strong middle class, support future productivity growth, and enhance America's standing in the world.

Middle-class prosperity is not simply a consequence of economic growth – it is the engine of economic growth. In today's economy, strong and sustainable growth comes from the middle-class. A stronger middle-class makes for a more productive workforce and a more stable level of the consumer demand.

Stagnant wages and a lack of middle-class wealth also discourage business formation and contributed to a loss of 1 million entrepreneurs from 2002 to 2008, compared to the rate of business-owner households in the 1990s.[15] More equitable economic policies would grow the economy by helping more people fully participate as workers, consumers, and entrepreneurs. That means higher wages, which lawmakers can achieve by raising the minimum wage, expanding overtime pay, strengthening worker voice, preserving social safety programs, and investing in human capital so that American workers can compete for high-paying jobs in a global marketplace.

But national security can also be threatened by a loss of U.S. leadership economically and scientifically, including a failure to make key investments in infrastructure, education, innovation and scientific research. Leading the world in these fields is the hallmark of U.S. national power. And training the next generation of American leaders will be critical to maintaining American influence and respect abroad. In fact, it was the Council on Foreign Relations that commissioned a report in 2012 which argued that deficiencies in our education system constitute one of the nation's top national security threats. Even military leaders are concerned that underinvestment in today's young people undermines the military force of tomorrow.[16] Indeed many military and civilian defense leaders are also concerned about inadequate investment in diplomacy, development and economic statecraft. The United States needs to lead in the civilian and military tools of foreign policy to remain strong, advance our interests and protect our citizens.

To be sure, sustaining economic growth over the long-run also requires addressing long-term fiscal challenges – including an aging population, rising health care costs, and a tax code that collects too little revenue and includes far too many loopholes for the wealthy and well-connected. We must also confront the fact that a struggling middle class has not always reaped the benefits of economic growth. Growing inequality, corporate short-termism, insufficient power of workers, unfair foreign trade practices, and other structural economic challenges threaten our growth and broadly shared prosperity.

[15] Jennifer Erickson and Adam Hersh, "1 Million Missing Entrepreneurs" (Washington: Center for American Progress, 2015), available at https://cdn.americanprogress.org/wp-content/uploads/2015/05/InequalityEntrepreneurship-brief-5.19.pdf.

[16] Mission: Readiness, "About Us," available at https://www.missionreadiness.org/about-us/.

In short, we must ensure that the middle class enjoys the benefits of economic growth, women are able to participate equally in the economy, and young people have the opportunities to succeed without having to take on mountains of debt. That is all part of a strategy to ensure American success at home and in the world.

**Conclusion**

Our country faces significant economic and national security challenges. These are not far-off problems or possibilities. They are happening right now. Middle class families are struggling to get by on stagnant wages. Indeed, these are the most pressing challenges to our economic standing. That economic strength will help ensure America's global standing in the future.

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