HEARING ON HIDDEN COST: THE TRUE PRICE OF FEDERAL DEBT TO AMERICAN TAXPAYERS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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United States House Committee on
Ways & Means
CHAIRMAN JASON SMITH

FOR IMMEDIATE RELEASE CONTACT: 202-225-3625
November 29, 2023
No. OS-04

Chairman Smith and Oversight Subcommittee Chairman Schweikert Announce Subcommittee Hearing on Hidden Cost: The True Price of Federal Debt to American Taxpayers

House Committee on Ways and Means Chairman Jason Smith (MO-08) and Oversight Subcommittee Chairman David Schweikert (AZ-01) announced today that the Subcommittee on Oversight will hold a hearing to examine the drivers of the rapidly rising cost to service federal debt and U.S. debt management practices. The hearing will take place on **Wednesday, December 6, 2023, at 10:00 AM in 1100 Longworth House Office Building.**

Members of the public may view the hearing via live webcast available at https://waysandmeans.house.gov. The webcast will not be available until the hearing starts.

In view of the limited time available to hear the witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record can do so here: WMSubmission@mail.house.gov.

Please ATTACH your submission as a Microsoft Word document in compliance with the formatting requirements listed below, **by the close of business on Wednesday, December 20, 2023**. For questions, or if you encounter technical problems, please call (202) 225-3625.

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The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission but reserves the right to format it according to guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Please indicate the title of the hearing as the subject line in your submission. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

ACCOMMODATIONS:

The Committee seeks to make its facilities accessible to persons with disabilities. If you require accommodations, please call 202-225-3625 or request via email to WMSubmission@mail.house.gov in advance of the event (four business days' notice is requested). Questions regarding accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the Committee website at http://www.waysandmeans.house.gov/.

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HIDDEN COST: THE TRUE PRICE OF FEDERAL DEBT TO AMERICAN TAXPAYERS

WEDNESDAY, DECEMBER 6, 2023

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The subcommittee met, pursuant to call, at 10:02 a.m., in Room 1100, Longworth House Office Building, Hon. David Schweikert [chairman of the subcommittee] presiding.

Chairman SCHWEIKERT. Good morning. The subcommittee will come to order.

I will let you, my good friend, ranking member, grab his seat.

All set?

Good morning. Today's oversight hearing is focused on the Treasury markets. Our jurisdiction in the Ways and Means Committee is the initial issuances from Treasury. As many of those have focused on the rapidly rising costs, so some of our economists in our office basically say we are moving just back to normal. But either way, gross interest this year will be a trillion dollars, making it the second highest cost in U.S. Government, you know, over Medicare and over defense.

The other thing I am also going to ask us to focus on is, if we lay out history, those of us remember, was it 2014, we had certain stresses; 2020, the repo market stresses; even the bond auction we touched on a little while ago, 6 weeks ago. Are these stressors to be concerned about or should we be pleased that the markets actually worked themselves out?

We have had the issue where the Federal Reserve, during two of those, actually sort of stepped in and participated. Is that something also we should be paying attention to?

As we move forward, the seriousness of this market, the seriousness of U.S. sovereigns in the world, the place it plays in U.S. and the world economy I think is not completely understood by Members of Congress, that, in many ways, this is the lubricant that makes much of the world economy work.

I am hoping, through this subcommittee hearing, we start to educate staff, members ourselves, and the seriousness—this is not a game, that the communication, the seriousness, the adult-like understanding that movements in this market can actually have cascade effects, and that is why we are hunting for stability.

And with that, my ranking member, Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman.

A little bit of history. You don't mind history, do you?

Chairman SCHWEIKERT. When it is accurate.

Mr. PASCRELL. Oh, of course.

President Clinton left office in 2001, running our last budget surplus.

So far, so good?

Chairman SCHWEIKERT. Republican Congress.

Mr. PASCRELL. Then came two decades of tax cuts for the wealthy, which blew holes in our budget big enough for Godzilla to waltz through. Without the Bush tax cuts and the Trump tax cuts, revenues today would be on track to keep up with spending indefinitely, and the debt ratio would be declining. Even your charts would show that.

Mr. SCHWEIKERT. No, they wouldn't.

Mr. PASCRELL. You are saying that the debt ratio would not be declining——

Chairman SCHWEIKERT. Yeah.

Mr. PASCRELL [continuing]. If that was done?

Chairman SCHWEIKERT. And this—Mr. Ranking Member, if you told me this was your opening, I would have brought the charts to show.

Mr. PASCRELL. Oh, okay. Bring them back the next time.

Chairman SCHWEIKERT. I will.

Mr. PASCRELL. Let us be clear about the greatest danger to our Nation's economic health, because that is where we are heading.

Where are the threats coming from to block America from paying its bills? Because we have got to pay our bills.

And you would agree to that, I think.

We have seen devastating consequences every time we have introduced default, threatened default—sorry—lowered credit ratings, skyrocketing borrowing costs, crippled job growth, and tumbling consumer confidence.

Fitch downgraded America's credit rating to AA+ in August. Last month, Moody's moved America's ratings from stable to negative. Both changes are directly caused by default threats.

Over and over, we have seen our economy held hostage over a budget shortfall the other side caused in the first place. During the last episode, the ransom demands included defunding the IRS to shield wealthy tax cheats. I thought we were over that. Obviously, we weren't, because we took that money—some of that money and used it to pay to help our allies in Israel.

This is funding Democrats passed to close the tax gap and reduce the deficit. After we narrowly averted a catastrophic default, the House Republicans shamelessly returned to the single issue that unites your party, it seems to me: tax cuts for the wealthy.

Fully extending tax scams would add another $3.5 trillion to the deficit. This is bigger than Mt. Everest. Rather than continuing to push extreme proposals, we need to come together to start governing. It will mean both sides, not just one. I know that. I know we stand ready, but I am not holding my breath.

I yield back.

Chairman SCHWEIKERT. Thank you, Mr. Pascrell.

I can't express my level of disappointment in your opening statement. We should have brought our charts that, in the first 30 months, there was $4.8 trillion voted out by the Democratic Congress, substantially—what is that, three times the cost of the tax reform.

But, once again, the hearing was supposed to be focused on Treasury markets, liquidity, price stability. And where does it lead us?

Grant—and is it Driessen?

Mr. DRIESSEN. It is Driessen.

Chairman SCHWEIKERT. Driessen.

Mr. DRIESSEN. Yeah.

Mr. Schweikert [continuing]. Driessen is a specialist in public finance at the Congressional Research Service. Thank you for coming.

Kent Summers?

Mr. SMETTERS. Smetters.

Chairman SCHWEIKERT. Smetters is a professor of business economics and public policy at the University of Pennsylvania Wharton School. Outstanding.

Bobby Kogan is senior director of Federal Budget Policy at the Center for American Progress. Thank you for joining us.

Michael—and help me on the last name.

Mr. FAULKENDER. Faulkender.

Chairman SCHWEIKERT. Faulkender? Okay. I should have gotten it—is a dean professor of finance at the University of Maryland Robert H. Smith School of Business. Thank you for joining us today.

And your written statements will be made part of the hearing record, and you each have 5 minutes to deliver your oral remarks.

Doctor.

STATEMENT OF GRANT DRIESSEN, PHD, SPECIALIST IN PUBLIC FINANCE, CONGRESSIONAL RESEARCH SERVICE

Mr. DRIESSEN. Chairman Schweikert, Ranking Member Pascrell, and members of the subcommittee, my name is Grant Driessen, and I am a specialist in public finance at the Congressional Research Service. Thank you for inviting me to testify——

Chairman SCHWEIKERT. Can you pull the mic closer?

Mr. DRIESSEN. Yeah. I never think it is——

Chairman SCHWEIKERT. The room has poor acoustics.

Mr. DRIESSEN. Yep. Yep. Every time, I will make that mistake.

Thank you for inviting me today to testify on behalf of CRS. As requested, I will provide background on Federal debt management, briefly summarize current practices, and discuss developments and policy issues in light of recent budget and economic outcomes and projections.

Congress now holds the authority to issue debt on behalf of the United States through the power granted in Article I, section 8 of the Constitution. While this power was delegated to the Treasury in 1789, Congress retains control over spending through the budget and appropriations process, revenue levels through tax legislation, and total borrowing through the statutory debt limit.

If spending exceeds revenues, Treasury determines what type of debt instruments are used to finance the borrowing necessary to fulfill all obligations. Treasury aims to fulfill the government's borrowing needs at the lowest cost over time, while also acting predictably in maintaining sufficient liquidity for financial—or Federal financial operations.

Beyond financing the government, Federal debt management also affects global markets due to the influential role of the United States in the world economy.

Federal debt management has more influence on future budget and economic performance in the current high-debt, high-deficit environment. Persistently large deficits have led to significant increases in Federal debt in recent decades, with heightened increases during the Great Recession and pandemic, but also with steady or increasing real debt in other, more normal economic periods.

Debt held by the public was $26.8 trillion at the end of November of 2023, or about 98 percent of gross domestic products, GDP. As the stock of real debt and average Federal interest rates rise, budget forecasts project that net interest payments will grow faster than both the general economy and other Federal spending and revenues.

CBO's long-term baseline projects that, under current law and average economic conditions, net interest payments will grow from 2.5 percent of GDP in fiscal year 2023 to 6.7 percent of GDP in the fiscal year 2053. That 2053 figure is larger than projections of either total discretionary spending or Social Security spending.

The Federal Government currently issues debt through several instruments, including Treasury bills, notes, and bonds, with maturities varying from several weeks to 30 years. These Federal securities are issued through an auction process. Auctions and their offering amounts are scheduled and announced in advance of the auction date.

The Federal Reserve, or Fed, works with Treasury's Office of Debt Management, acting as their fiscal agent. Because they are also backed by the full faith and credit of the United States Government, Treasury securities are often seen as one of the safest investments available, which significantly lowers Federal net interest costs relative to other investment vehicles.

Federal securities are owned by both individuals and institutions, domestic and foreign. In June of 2023, Federal Reserve banks were estimated to hold about 20 percent of Federal debt held by the public, other domestic entities were estimated to own another 50 percent, and the remaining 30 percent or so was attributed to foreign entities.

Longer term securities generally command higher interest rates compared to shorter term securities because investors demand greater compensation for incurring risk over a longer period of time.

Generally, a strong economy or high inflation will be accompanied by high interest rates, which may make the prioritization of short-term issuances more attractive. This, however, could lead to more volatile and uncertain yearly interest payments as Treasury would have to enter the market more often. It involves a degree of uncertainty over future market behavior.

During periods of economic downturn and low interest rates, Treasury may decide to prioritize instruments with longer maturities to take advantage of lower borrowing costs, though such periods may also present an elevated need for predictable behavior and higher levels of liquidity to respond to economic turbulence. Interest rates can shift suddenly throughout the business cycle, underscoring the value of a flexible portfolio.

Developments in recent years presented new challenges for Federal debt management. Treasury responded to an uncharacteristically long period of low interest rates between the mid-2000s through the peak of the COVID pandemic by relying more heavily on debt instruments with a longer maturity period, locking in the low interest rates experienced at that time.

Interest rates have subsequently increased in the past couple of years, and Treasury securities faced an inverted yield curve with shorter term debt instruments having higher rates of interest than longer term ones for much of 2022 and 2023. These shifts further complicate the strategic choices for Federal debt moving forward.

Thank you for the opportunity to testify today. I look forward to any questions that you may have.

[The statement of Mr. Driessen follows:]

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TESTIMONY

Statement of

Grant A. Driessen
Acting Section Research Manager

Before

Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives

Hearing on

"Hidden Cost: The True Price of Federal Debt to American Taxpayers"

December 6, 2023

Congressional Research Service
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Chairman Schweikert, Ranking Member Pascrell, and members of the Subcommittee, my name is Grant Driessen, and I am a Specialist in Public Finance at the Congressional Research Service (CRS). Thank you for inviting me to testify today on behalf of CRS.

As requested, I will provide background on the federal debt management process, briefly summarize the debt instruments currently in use, and discuss developments and policy issues in debt management practices in light of recent economic performance.

An Overview of Debt Management Practices

Congress holds the authority to issue debt on behalf of the United States through power granted in Article I, Section 8 of the Constitution. While this power was delegated to the Secretary of the Treasury in 1789, Congress retains ultimate control over spending through the budget and appropriations process, revenue levels through tax legislation, and total borrowing through the statutory debt limit. If spending exceeds revenues, Treasury determines what type of debt instruments are used to finance the borrowing necessary to fulfill all obligations. 31 U.S.C. Chapter 31 provides much of the statutory detail on how debt management duties are divided between Congress and Treasury.

The primary objective of Treasury's debt management strategy is to fulfill the government's borrowing needs at the lowest cost over time. Beyond financing the federal government, the success of Treasury's debt management strategy also affects global markets due to the influential role of the United States in the world economy. Treasury adheres to three debt management principles: (1) to issue debt in a regular and predictable pattern, (2) to provide transparency in the decision-making process, and (3) to seek continuous improvements in the auction process.[1] Adoption of this strategy is intended to help maximize government contributions to growth and efficiency in both the domestic and global capital markets.

Development of modern debt management dates to the passage of the Second Liberty Bond Act of 1917. As amended, that legislation designated the Treasury Secretary as the principal authority to determine the types of issues, terms, and techniques most appropriate to manage public debt. Before this measure, interest rates and maturity periods of bonds were set by legislation and congressional authority.[2] Further refinements in debt management policy came when Treasury established the Bureau of Public Debt within the Office of Fiscal Service in June 1940. In the late 1980s, the Office of Debt Management (ODM), formerly known as the Office of Market Finance, became the central office responsible for the decision-making behind Treasury's borrowings. The Bureau of the Public Debt and the Financial Management Service (FMS) merged in 2012 to form the Bureau of the Fiscal Service. The Bureau of the Fiscal Service now oversees the operational aspects of the federal government borrowing process, accounts for and services federal debt, and provides reimbursable support services to federal agencies under the authority of the Treasury Franchise Fund.[3] It also conducts auctions of Treasury securities to allow individuals, institutions, and financial professionals to invest in Treasury bills, notes, bonds, inflation-protected securities (TIPS), and floating rate notes (FRNs).

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[1] U.S. Department of the Treasury, Office of Domestic Finance, Overview of U.S. Treasury Debt Management, available at http://www.treasury.gov/about/organizational-structure/offices/Pages/-Debt-Management.aspx.

[2] Tilford C. Gaines, *Techniques of Treasury Debt Management* (New York: The Free Press of Glencoe, 1962), pp. 19, 21, 154.

[3] The Treasury Franchise Fund provides common administrative support services to other parts of Treasury as well as other government agencies on a competitive and fully cost-reimbursable basis. The collection of delinquent debt owed to the U.S. government is collected by the Financial Management Service. Department of the Treasury, Bureau of the Fiscal Service, *Treasury Franchise Fund, FY2023 President's Budget,* available at https://home.treasury.gov/system/files/266/19.-TFF-FY-2023-CJ.pdf.

The Federal Reserve (Fed) works alongside the Treasury in the debt management process, acting as Treasury's fiscal agent. The Fed was created in 1913 to maintain stability in the banking sector following a time of financial panic. For the first several decades of its existence, the Fed worked closely with Treasury to implement fiscal policy goals. Since the early 1950s, however, the Fed has operated independently from Treasury and uses its open market operations to manage the amount of money and credit in the economy via monetary policy. The Fed also provides banking services to the federal government by maintaining deposit accounts for Treasury, paying U.S. government checks drawn on the Treasury, assisting in the debt auction process, and issuing and redeeming savings bonds and other government securities.[4]

How Treasury Sells Debt

Auction Process

Auctions are the cornerstone of Treasury's debt management strategy.[5] Auctions and their offering amounts are scheduled and announced in advance of the auction date. Bidders in Treasury auctions may be either foreign or domestic and individual or institutional investors, or federal, state, or local government entities. Treasury securities can be purchased via a web-based account using the department's Treasury Direct system. Purchases of Treasury bills, notes, bonds, TIPS, floating rate notes, and savings bonds can be made through this system.

The yield-to-maturity, interest coupon rate, and the discount (or premium) on a Treasury security are key to understanding the auction process. The yield-to-maturity rate is the rate of return anticipated on a security if it is held until the maturity date and is what is specified by a competitive bidder at the auction. The interest coupon rate is set at the highest yield level, in increments of one-eighth of one percent, which does not result in a price greater than 100% of principal.[6] If the price of a Treasury security, as determined at auction, is less than the face value of the security, then the security may be described as purchased at a discount. If the price exceeds the value of the security, it is described as purchased at a premium. Thus, the coupon rate and discount (or premium) jointly determine the yield to maturity.

Auction bids for Treasury securities may be submitted as noncompetitive or competitive. With a noncompetitive bid, a bidder agrees to accept the discount rate (or yield) determined at auction and is guaranteed to receive the full amount of the bid. With a competitive bid, a bidder specifies the yield that is acceptable.[7] A bid may be accepted in a full or partial amount if the rate specified is less than or equal to, respectively, the discount rate set by the auction.

Once the auction closes, all noncompetitive bids are accepted and competitive bids are ranked based on yield, from lowest to highest. Competitive bids are accepted, starting at the lowest yield, until the offering amount has been exhausted. The highest accepted yield becomes the "stop." A competitive bid will not be accepted if the rate specified in the bid is higher than the yield set at the auction. Though interest

[4] History of the Federal Reserve, available at http://www.federalreserveeducation.org/about-the-fed/history/. For more information, see CRS In Focus IF10054, *Introduction to Financial Services: The Federal Reserve*, by Marc Labonte.

[5] Though auctions were the main component of the new strategy, Treasury had tried to institute an auction-based system in 1935 and 1963. Both of these earlier attempts failed.

[6] There are no coupon rates for Treasury bills, as Treasury bills are sold on a discount basis.

[7] For bills and TIPS auctions, the bids are offered in terms of a discount rate rather than a yield.

payments received by successful bidders may vary based on the yield specified in their auction bids, all securities in an auction are sold for a single price, computed based on the "stop" yield.[8]

Marketable Securities

Most of the debt sold by the federal government is marketable, meaning that securities are sold via the auction process and can be resold on the secondary market. Currently, Treasury offers five types of marketable securities: Treasury bills, notes, bonds, inflation protected securities (TIPS), and floating rate notes (FRNs). Treasury holds roughly 300 public auctions per year.[9] If Treasury borrowing requirements or financing policy decisions change, the types of securities, the length of maturity periods, and offering amounts could be altered.[10]

Treasury Bills

Treasury bills (T-bills) are short-term securities that mature in one year or less. T-bills are sold at a discount from their face value. The interest rate determines the discount from face value and the price paid at auction. When the bill reaches maturity, the investor receives the face value. T-bills are currently being offered with maturities of 4, 13, 26, and 52 weeks. Auctions for T-bills take place weekly on Tuesdays (4-week bills) and Mondays (13- and 26-week bills). Every 4 weeks, 52-week bills are auctioned on Tuesdays as well. The timing from the announcement of the auction, to its execution, to issuance of the purchased security is generally between 7 and 10 days.[11]

Treasury Notes

Treasury notes are interest-bearing securities, offered in multiples of $100, currently being offered in 2-, 3-, 5-, 7-, and 10-year fixed maturities. The relationship between yield to maturity and the interest rate determines the price at auction. If the yield-to-maturity is greater than/equal to/less than the interest rate, the price will be less than/equal to/greater than par (face) value. Treasury notes pay interest on a semi-annual basis and the investor receives the face value when the note matures. Treasury notes are currently being auctioned on a monthly basis (2-, 3-, 5-, and 7-year notes) and quarterly (10-year notes).[12]

Treasury Bonds

Treasury bonds are interest-bearing securities, offered in multiples of $100, with maturities of 20 and 30 years. The price, yield, and interest rate of a Treasury bond are determined at auction in the same way as a

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8 Garbade, Kenneth D. and Jeffrey F. Ingber, *The Treasury Auction Process: Objectives, Structure, and Recent Adaptations*, FRBNY Current Issues in Economics and Finance, February 2005, pp. 2-3.

9 U.S. Department of the Treasury, Treasury Auctions, available at https://home.treasury.gov/services/treasury-auctions.

10 Cash management bills are occasionally offered in order to meet short- and medium-term cash needs as determined by Treasury. These bills mature on dates determined by Treasury based on need, generally a few days from issue. Occasionally, Treasury also offers reopenings of previous auctions where additional amounts of a previously issued security are sold at the same coupon interest rate and maturity, but with a different issue date and price.

11 U.S. Department of the Treasury, Treasury Bills, available at http://www.treasurydirect.gov/instit/marketables/tbills/tbills.htm.

12 Initial offerings of 10-year notes are currently auctioned in February, May, August, and November. Each initial offer is followed by two reopenings of the same issue in January, March, April, June, July, September, October, and December. In a security reopening, the U.S. Treasury issues additional amounts of a previously issued security. The reopened security has the same maturity date and interest payment date as the original security, but has a different issue date and usually a different price. U.S. Department of the Treasury, Treasury Notes, available at http://www.treasurydirect.gov/instit/marketables/tnotes/tnotes.htm.

Treasury note. Treasury bonds pay interest on a semi-annual basis and investors receive face value when the bond matures. Treasury bonds are currently auctioned quarterly.[13]

Treasury Inflation-Protected Securities (TIPS)

Treasury Inflation-Protected Securities (TIPS) are interest-bearing securities that protect investors from inflation, and have been offered since 1997. TIPS are offered in multiples of $100, with maturity periods of 5, 10, and 30 years. The TIPS principal adjusts based on the movements in the consumer price index (CPI-urban, non-seasonally-adjusted) with a three-month lag. The adjustments in the principal of the security form the basis for the interest payments, paid semiannually at a fixed rate. If inflation/deflation occurs, the interest payment increases/decreases. However, when a TIPS matures, the investor is paid the inflation-adjusted principal or original principal, whichever is greater. TIPS are currently being offered either annually (30-year) or biannually (5-year and 10-year).[14]

Treasury Floating Rate Notes (FRNs)

Treasury began issuing Floating Rate Notes (FRNs) in January 2014. FRNs are sold in increments of $100, and have a 2-year maturity period. The interest rate on FRNs is tied to the discount rate for 13-week Treasury bills. This relationship protects investors from the effects of a rise in interest rates, in exchange for offerings at lower yields than fixed-rate debt instruments with equivalent maturity periods. Auctions for FRNs take place at the end of each month.[15]

Nonmarketable Securities

Nonmarketable debt is composed of approximately 2% of publicly held debt and nearly all intragovernmental debt. Publicly held debt that is nonmarketable is primarily the state and local government series and savings bonds.[16] Intragovernmental debt is largely composed of debt owed by Treasury to the Social Security, Civil Service Retirement and Disability, Military Retirement, and Medicare trust funds.[17]

The main purpose of publicly held nonmarketable debt is to protect the bearers from market risk. The state and local government series was created in 1972 to restrict state and local governments from earning arbitrage profits by investing any tax-exempt bond proceeds in investments that may generate higher yields, thereby risking the returns. This program sells Treasury securities to state and local governments to help them comply with this requirement. Savings bonds provide a means for the small investor to participate in government financing. Savings bonds have been sold continuously since 1935 when they were introduced to encourage broad public participation in government financing by making federal bonds available in small denominations.[18]

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[13] Initial offerings of 30-year bonds are currently auctioned in February, May, August, and November. Each initial offer is followed by two reopenings in the two months following the initial auction. U.S. Department of the Treasury, Treasury Bonds, available at http://www.treasurydirect.gov/instit/marketables/tbonds/tbonds.htm.

[14] U.S. Department of the Treasury, Treasury Inflation-Protected Securities, available at http://www.treasurydirect.gov/instit/marketables/tips/tips.htm.

[15] U.S. Department of the Treasury, Floating Rate Notes (FRNs) In Depth, available at https://www.treasurydirect.gov/indiv/research/indepth/frns/res_frn.htm.

[16] U.S. Department of the Treasury, Bureau of the Fiscal Service, *Monthly Statement of Public Debt*, April 2022, Tables I, available at https://www.treasurydirect.gov/govt/reports/pd/mspd/2022/opds042022.pdf.

[17] U.S. Department of the Treasury, Bureau of the Fiscal Service, *Monthly Treasury Statement*, July 2016, Table 6 – Schedule D, available at https://fiscal.treasury.gov/files/reports-statements/mts/mts0422.pdf.

[18] Such offerings of Treasury securities dated back to 1776. Between 1776 and 1935, these securities were marketable and

U.S. government trust funds, which compose intragovernmental debt, contain revenues designated by law for a specific purpose. When revenues in the trust funds exceed benefit payments, the unspent monies must remain in the trust fund for future use. However, this excess cash is transferred to the Treasury's General Fund and is used to finance other activities which fall outside the specific purpose of the trust fund. In exchange, the trust fund is issued a Treasury "special issue" security to be redeemed at face value at any time in the future when the funds are needed.[19] Special issue securities are available only to trust funds and are designated as nonmarketable, earning interest on a semi-annual basis. The interest rate is determined by formula, based on the average yield of certain marketable securities.[20] Securities of this type protect the trust fund investments from market fluctuations.

Role of Federal Reserve

The Federal Reserve serves as Treasury's fiscal agent. In this role, it is responsible for the primary dealer relationships which are used not only for Treasury auctions but other open market operations to conduct monetary policy. In addition, the Federal Reserve plays an important role in the operational aspects of the auction process and payments mechanism. The Federal Reserve is not responsible for making debt issuance decisions—this responsibility rests solely within Treasury's ODM to ensure the independence of the two institutions.

In addition, the Fed is a holder of Treasury securities. It is involved in the purchase and resale of these securities to the secondary market through its open market operations. Its holdings of Treasury securities amounted to nearly $4.8 trillion as of November 2023.[21] Any profits earned by the Fed through the sale of Treasury securities and other activities are remitted to Treasury and recorded as revenues in the federal budget.[22] The Federal Reserve banks also act as fiscal agents and depositories for Treasury accounts by accepting deposits of federal taxes and other federal agency receipts and processing checks and electronic payments drawn on the account.

Managing Federal Financial Flows

The Treasury Secretary manages revenue, works to improve public credit, and provides for on-time revenue collection and payment of debts.[23] If federal government finances are not well managed, financial stability and economic growth could be at risk. Throughout the year, the fiscal balance held by Treasury can fluctuate significantly as a result of higher or lower revenue collections or issuance of more or less debt during certain periods. As a result, Treasury must ensure that adequate funds are available, either via revenue streams or borrowing, to finance obligations. In order to finance the government's obligations

subjected the investor to market fluctuation. Particularly during World War I, small investors incurred significant losses if they were forced to sell their bonds prior to maturity.

[19] The trust funds now hold only special issues, but they have held public issues in the past.

[20] The specifications for securities issued to each type of trust fund are listed in separate places in the *U.S. Code*. Specifications for the Social Security Trust Fund can be found at 42 U.S.C. §401. Specifications for the Civil Service Retirement and Disability Fund can be found at 5 U.S.C. §8348.

[21] Federal Reserve, St. Louis Branch, "U.S. Treasury securities held by the Federal Reserve: All Maturities," available at https://research.stlouisfed.org/fred2/series/TREAST. Currency, not Treasury securities, is the Fed's primary liability. Treasury securities are assets to the Fed.

[22] For more information on the Fed's activities, see CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

[23] U.S. Department of the Treasury, available at http://www.treasury.gov/about/role-of-treasury/Pages/default.aspx.

while minimizing borrowing costs, Treasury must accurately project what cash requirements will be needed on a daily basis to cover government payments, especially given these variations.[24]

The total amount of debt issued over the fiscal year depends in large part on the decisions made by Congress and the priorities it chooses in its annual budget and appropriations process. Recently, Treasury has issued increasing amounts of debt as a result of the government response to the most recent economic downturn, along with other budgetary initiatives. Over the longer term, these priorities could change and decisions on how to finance the promises to retirees for healthcare and other benefits may increase the demands on Treasury's debt issuance. Treasury's financing needs generally follow a predictable seasonal pattern in response to changes in the level of public debt. Growth in public debt is typically lowest in April, due to the filing of individual income tax returns and payment of any unpaid taxes during that month, and highest in September, as a result of the need to meet obligations due at the end of the fiscal year.

How Much Debt is Outstanding?

Gross federal debt is composed of debt held by the public and intragovernmental debt. Debt held by the public—issued through the Bureau of the Fiscal Service—is the total amount the federal government has borrowed from the public and remains outstanding. This measure is generally considered to be the most relevant in macroeconomic terms because it is the amount of debt sold in credit markets. Intragovernmental debt is the amount owed by the federal government to other federal agencies, primarily in the Social Security, Medicare, and Civil Service Retirement and Disability trust funds, to be paid by Treasury.[25]

Although nominal debt levels have steadily risen in the postwar period, debt measured as a percentage of GDP declined precipitously for several decades following its peak at 118% in 1946 until it reached 32% by 1981. Real debt levels have subsequently undergone significant increases in the past several decades. At the end of FY2022, total debt was 123% of GDP, and debt held by the public equaled 97% of GDP. The FY2020 debt totals of 128% of GDP for total debt and 100% of GDP for debt held by the public represented the highest levels for each category since FY1940 and FY1947, respectively. The debt shifts in response to the COVID-19 pandemic and the 2007-2009 Great Recession represent the largest increases since the end of World War II.

Treasury also estimates who owns federal securities. Because marketable Treasury securities can be and are often sold on the secondary market, ownership will change over time. As of December 2022, the latest period for which full estimates are available, gross debt totaled $31.4 trillion, including $12.4 trillion in the Federal Reserve and Intragovernmental Holdings. U.S. savings bonds accounted for $0.2 trillion in federal debt, and foreign and international holdings accounted for $7.3 trillion. The remainder of the debt was held in depository institutions (i.e., commercial banks), pension funds, insurance companies, mutual funds, state and local governments, and other investors (i.e., individuals and corporations).[26]

The Office of International Affairs provides figures on the amount of debt held by foreigners through the Treasury International Capital System (TIC).[27] The TIC data reflect estimates of who holds Treasury

[24] U.S. Department of the Treasury, *Treasury: Strategic Plan, 2022-2026*, available at https://home.treasury.gov/system/files/266/TreasuryStrategicPlan-FY2022-2026.pdf.

[25] For additional analysis of federal debt levels, see CRS Report R44383, *Deficits, Debt, and the Economy: An Introduction*, by Grant A. Driessen.

[26] U.S. Department of the Treasury, Bureau of the Fiscal Service, *Treasury Bulletin*, September 2023, Table OFS-2, available at https://www.fiscal.treasury.gov/fsreports/rpt/treasBulletin/current.htm. For more information about foreign ownership of Treasury securities, see CRS Report RS22331, *Foreign Holdings of Federal Debt*, by Marc Labonte and Ben Leubsdorf.

[27] Data on major foreign holders of Treasury securities by country is available at http://www.treas.gov/tic/ticsec2.shtml#ussecs.

securities in a given period, which may be different from who purchased these securities at auction. As of September 2023, TIC data showed a total of $7.6 trillion in debt held by foreigners (with governmental and private holdings roughly equivalent), or 29% of all debt held by the public.[28] Japan ($1.1 trillion in total holdings), mainland China ($0.8 trillion) and the United Kingdom ($0.7 trillion) were the countries with the largest federal debt holdings. The percentage of publicly held debt owned by foreigners increased from below 10% before the 1970s to over 50% in 2008, but has gradually declined in recent years.[29]

Factors Affecting Supply and Demand for Treasury Securities

Investors examine several key factors when deciding whether they should purchase Treasury securities. As with all types of investments, price, expected return, and risk play a role in this process. Treasury securities provide a known stream of income and offer greater liquidity than other types of fixed-income securities. Prices are determined by investors who place a value on Treasury securities based on the characteristics of safety and liquidity afforded by this investment option.[30] Because they are also backed by the full faith and credit of the United States, they are often seen as one of the safest investments available.

Yield Curve

The yield curve shows the relationship between the interest rate (cost of borrowing) and the maturity of debt (i.e., U.S. Treasury securities) at a given time. In other words, the yield represents the rate of return an investor would earn if a security was held to maturity. The yield curve typically changes on a daily basis as interest rates move. Generally, yield curves are upward sloping (i.e., the longer the maturity, the higher the yield), with diminishing rates of increase over time.

Two opposing forces affect the slope and shape of the yield curve. First, investors must be compensated for choosing to invest now even though they may be able to achieve higher interest rates if they invested at a future point in time. This pushes interest rates up. Opposing this increase in interest rates is the fact that the longer the period to maturity, the greater the likelihood that interest rates will fall. This increases the risk to the lender (i.e., Treasury), as they could save on interest costs if they decided to wait before borrowing money. Generally speaking, the first effect will outweigh the second, leading to an upward sloping yield curve. An upward sloping yield curve also illustrates expectations for future economic growth and rising short-term interest rates. A downward-sloping (or "inverted") curve implies that investors expect short-term interest rates to rise above long-term rates.[31] Downward-sloping yield curves have frequently, but not always, occurred before recessions.[32]

[28] U.S. Department of the Treasury, "Major Foreign Holders of Treasury Securities," November 2023, available at https://ticdata.treasury.gov/resource-center/data-chart-center/tic/Documents/slt_table5.html.

[29] For more information on foreign federal debt ownership, see CRS Report RS22331, *Foreign Holdings of Federal Debt*, by Marc Labonte and Ben Leubsdorf.

[30] Dupont, Dominique and Brian Sack, *The Treasury Securities Market: Overview and Recent Developments*, Federal Reserve Board, Federal Reserve Bulletin, December 1999, pp. 792-793, available at http://www.federalreserve.gov/pubs/bulletin/1999/1299lead.pdf.

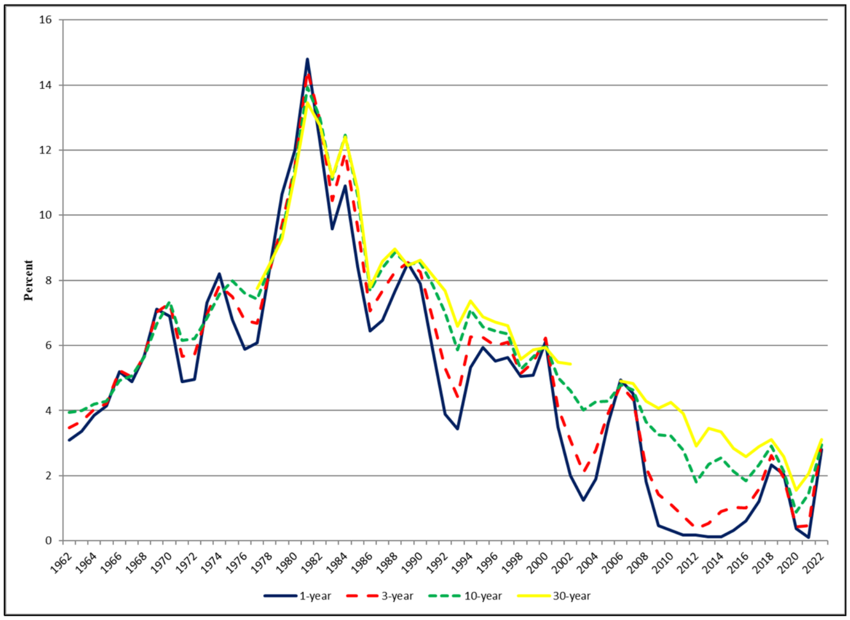
[31] Federal Reserve Bank of San Francisco, *What is a yield curve, and how do you read them? How has the yield curve moved over the past 25 years?* July 2004, available at http://www.frbsf.org/education/activities/drecon/answerxml.cfm?selectedurl=/2004/0407.html.

[32] For more information, see CRS Report RS22371, *The Pattern of Interest Rates: Does It Signal an Impending Recession?*, by Marc Labonte and Gail E. Makinen. Out of print. Available to congressional clients upon request.

As of November 24, 2023, Treasury securities exhibited a slightly downward sloping nominal yield curve and a relatively flat real yield curve. These values reflect a flattening of each yield curve in late 2023, and follow a number of shifts in the Treasury yield curves in recent years, with inversions in 2019 and 2022 and a return to the typical upward sloping shape for the yield curves in 2021. Market analysis of the 2023 yield curve flattening is mixed, highlighting the uncertainty surrounding yield curve shifts and general economic performance.[33]

Figure 1. Selected Treasury Nominal Constant Maturity Rates

Annual rates, 1962-2022



Source: Federal Reserve Board, Federal Reserve Statistical Release, H.15 Selected Interest Rates, U.S. Government Securities – Annual Series, available at http://www.federalreserve.gov/releases/h15/data.htm.

Notes: Treasury began issuing 30-year Treasury securities in February 1977 and did not issue these securities between February 18, 2002, and February 9, 2006. The Office of Debt Management also calculates constant maturity rates for securities with other maturity periods in addition to calculating rates for inflation-indexed securities (i.e., TIPS).

Figure shows the Treasury constant maturity rates for selected maturities since 1962. Rates on securities with different maturities generally track each other, as securities with similar maturity periods

[33] Illan, Ivan, "What a Flattening Yield Curve Means for Future Fiscal Fitness," October 19, 2023, Forbes, available at https://www.forbes.com/sites/forbesfinancecouncil/2023/10/19/what-a-flattening-yield-curve-means-for-future-fiscal-fitness/?sh=604087ce2607; and Barbusica, Davide, and Carolina Mandl, "US Treasury yield curve shifts could be set-up for Jackson Hole unwind," August 25, 2023, Reuters, available at https://www.reuters.com/markets/us/us-treasury-yield-curve-shifts-could-be-set-up-jackson-hole-unwind-2023-08-24/.

tend to have similar rates because they offer fixed interest payments over essentially the same period of time.[34] Given that securities with longer maturities tend to reflect expectations about the future path of the interest rates of short-term securities, short-term rates generally provide a picture of the path of their longer-term counterparts.

The maturity rates of both long-term and short-term Treasury securities declined significantly after peaking in the early 1980s. Increases in the maturity rates of short-term securities from 2004 through 2007 were followed by sharp declines in rates during and after the economic recession of 2007-2009. Nominal rates of all Treasury securities declined from 2010 to 2019, with a much more pronounced decline among securities with shorter maturity lengths. The economic fallout from the COVID-19 pandemic again led to a swift decline in interest rates, though rates of all securities picked up considerably in 2021 and 2022, with Treasury rates at the end of 2022 looking roughly similar to values in 2018. The spread between the 30-year and 1-year security interest rates was 0.3% in 2022, smaller than the 1.3% average spread since the creation of the 30-year security in 1977. In a recent statement, the Federal Open Market Committee expressed a commitment to lowering inflation to levels closer to their 2% long-term target, while maintaining the target range for the federal funds rate at 5.25%-5.50%.[35]

Determining Maturity Mix

Newly issued Treasury securities, sold to finance the operations of the federal government, are offered at a mix of maturities in order to satisfy the provisions of the regular and predictable debt management strategy and to minimize interest payments over time. The profile of securities is also important due to its influence on liquidity. In addition, Treasury must make sure that it has adequate cash balances available to pay federal obligations.[36]

Longer-term securities generally command higher interest rates compared to shorter-term securities because investors demand greater compensation for incurring risk over a longer period of time. Generally, a strong economy or higher inflation will be accompanied by higher interest rates. If Treasury issues long-term debt during this time, they are committing to paying higher interest rates for a longer period and may thus decide to prioritize short-term security issuances. However, this leads to uncertainties over the longer term, since the interest rate will likely change. This, however, may lead to more volatile and uncertain yearly interest payments because Treasury has to enter the market more often, and involves a degree of uncertainty over future market behavior. During periods of economic downturn and low interest rates, Treasury may decide to prioritize instruments with longer maturities to take advantage of lower borrowing costs, though such periods may also present an elevated need for predictable behavior and higher levels of liquidity.

Since 1974, the average maturity period of Treasury securities reached its minimum point in FY1976 at 31 months and its peak in FY2000 at 75 months. The average maturity length of Treasury securities has generally increased in recent decades, with swift declines in the maturity period during the Great Recession and COVID-19 pandemic followed by maturity period increases in subsequent years. The average maturity period of Treasury securities was 68 months in 2022, its highest total since 2001.

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[34] Dupont, Dominique and Brian Sack, *The Treasury Securities Market: Overview and Recent Developments*, Federal Reserve Board, Federal Reserve Bulletin, December 1999, pp. 793-794, available at http://www.federalreserve.gov/pubs/bulletin/1999/1299lead.pdf.

[35] Federal Reserve Bank, Board of Governors of the Federal Reserve System, press release, May 2022, available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504a.htm. Changes in the federal funds rate affect other interest rate levels, and represent one of the Fed's primary methods of implementing desired changes in monetary policy.

[36] Requirements and guidance for Treasury cash balances can be found in the federal code, including 31 U.S.C. §323.

Mr. SCHWEIKERT. Thank you.

STATEMENT OF KENT SMETTERS, PHD, PROFESSOR OF BUSINESS ECONOMICS AND PUBLIC POLICY, UNIVERSITY OF PENNSYLVANIA'S WHARTON SCHOOL

Mr. SMETTERS. Good morning, Chairman Schweikert, Ranking Member Pascrell, and other members of the——

Chairman SCHWEIKERT. Once again, pull the mike very close.

Mr. SMETTERS. Okay.

Mr. SCHWEIKERT. The room has very difficult acoustics.

Mr. SMETTERS. All right. I am a professor at the Wharton School, the faculty director of the Penn Wharton Budget Model, and research associate at the NBER. After receiving my Ph.D. in economics from Harvard in 1995, I worked at CBO for several years before heading to Wharton, and then later Stanford, and also was—served a brief appointment under Treasury Secretary O'Neill during the early days of the Bush administration. My remarks today are my own.

I previously submitted written remarks, had a few typos. I apologize about those, hopefully corrected. In there, I discuss some more technical issues related to the Treasury auctions, international holdings, and related items there. I am happy to answer those types of questions a little bit later on.

I want to use my brief remarks today to really talk three major points. The first one is, without major changes in the U.S. fiscal policy, we estimate at the Penn Wharton Budget Model that the U.S. Treasury debt will be unable to roll over its accumulated debt in about 20 years. Put differently, the U.S. Government will have to default, either explicitly or implicitly, through monetization as inflation of that debt. And that time span shortens if capital markets get spooked and believe that the U.S. policy will never create fiscal balance.

Specifically, what we estimate is that the debt-GDP ratio will hit about 190 percent by 2050, now likely even earlier. And unlike Japan, we just don't have the national savings to support that high level of debt.

So if we ask the question, what size of policy change would it be required to create fiscal balance, that is just enough money to be able to make spending promises as well as just interest payments. It would require either an immediate and permanent increase in all Federal tax revenue of 40 percent, an immediate or permanent decrease in all spending by 30 percent, or some combination of the two.

The second point is that, even if Congress did stabilize the debt-GDP ratio but waited a couple decades to do it, it would have serious macroeconomic costs. GDP would be about 8 percent lower than it otherwise would have been, wages would be about 4 percent lower, and borrowing rates would be about 150 basis points higher.

And so far, that is actually the good news, because these calculations assume that capital markets are patient, that they believe something will happen, Congress will take big action within a couple decades.

We certainly have a range of options that we can consider at this point, and we have posted some of those at the Penn Wharton

Budget Model, both on the more liberal and conservative side, a whole range. But the point is that simple options are not going to work. Simply saying we are going to limit tax increases on those making $400,000 and above, that is not going to come even close to covering the shortfall. Same thing with promises to cut spending otherwise unspecified. That is not going to do anything either.

The third issue that I want to emphasize is that we can't really get distracted with side discussions here. Yes, one could always find some type of fiscal programs that pay for themselves, that they—even with higher deficits. But the truth be told, those are pretty uncommon. They don't scale very well.

The more important issue here is that the blame game is just also irrelevant as well. We can argue until we are blue in the face whether it is because of tax cuts, spending increases. I could make an argument for both, just simply based on the baseline. Both baselines are—in terms of—we really wouldn't let the AMT increase the amount of tax collection over time. Same thing with real bracket created by debts—that is often baked into people's baseline, and that is just not realistic. Congress would never have had that happen.

Same thing with Social Security. Technically speaking, Social Security is not ever insolvent, because cuts are going to happen automatically if Congress does nothing, but no one takes that seriously as a baseline either. And so baselines can certainly change people's views on things.

But the more important thing is it—the blame game doesn't accomplish anything. It really doesn't tell us where to go from here forward. Even if I believed it was 100 percent due to tax cuts or 100 percent due to spending increases, the world today is completely different. It doesn't tell us the next best step. And so I think, instead, we need to really focus on what is the next best step going forward regardless of the blame game.

And debt crises are the most serious of economic crises, because they lower the government's ability to pay while also increasing costs.

Thank you.

[The statement of Mr. Smetters follows:]

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THE JOSEPH AND RUTH BOETTNER PROFESSOR
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TESTIMONY OF KENT SMETTERS
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS,
OVERSIGHT SUBCOMMITEE

Good morning, Chairman Schweikert, Ranking Member Pascrell, and Members of the Subcommittee on Oversight. Thank you for the opportunity to discuss the United States Treasury debt market, including potential opportunities to improve its administrative efficiency.

I. Background

U.S. fixed-income securities comprise about 40 percent of the $140 trillion global supply. Half of those U.S. securities are issued by the U.S. Treasury. Among the G4 (US, UK, Europe, and Japan), the United States now supplies half of all risk-free securities, a sharp increase during the past 25 years (Figure 1). Moreover, the historical apparent ability to cheaply rollover this debt and to cheaply borrow more in future appears to be over. Capital markets are currently projecting that that U.S. and European borrowing rates will not reverse anytime soon (Figure 2).

At its most basic level, annual deficits reflect spending above tax revenue, and total debt is just the accumulation of past annual deficits. But the topic then gets more complicated.

Debt Held by the Public. Although the current *gross* federal debt stands at around $33 trillion, over $6 trillion takes the form of the government holding its own debt in the form of trust funds and similar balance sheet items. The *debt held by the public* is around $26 trillion, a figure that economists generally view as more meaningful as it must be financed in domestic and international capital markets, thereby "crowding out" some private capital formation over time.

As discussed in Section II, the debt held by the public is projected to increase substantially over time under current law, reaching unsustainable levels within two decades.

Foreign holdings. The level of foreign holdings of debt by the public has fallen over the past five years, from around 40 percent to 30 percent today.[1] This fall, which was mostly previously projected by the Penn Wharton Budget Model more than four years ago,[2] is consistent with the increase in trade tariffs over time. Economic softening in China has also contributed.[3] Overall, the decrease in international demand for U.S. securities requires the U.S Treasury to sell securities at lower prices to produce larger returns to buyers. Unlike key technologies and other sourcing for the critical infrastructure, economists generally see no gain from "reshoring" the demand for U.S. debt. Even though countries like Japan have a level of national debt relative to

[1] See Treasury tic data: https://home.treasury.gov/data/treasury-international-capital-tic-system-home-page/tic-forms-instructions/securities-b-portfolio-holdings-of-us-and-foreign-securities
[2] https://budgetmodel.wharton.upenn.edu/issues/2019/7/24/the-trade-war-trade-off-short-term-gains-then-long-term-losses
[3] Some Chinese holdings are custodied in offshore accounts outside of the United States or China.

their GDP more than 200 percent, Japan still has a substantially larger national gross saving rate than the United States, with some of those savings invested in U.S. Treasuries.

Auction Design and Debt Mix. U.S. Treasury auctions take the "first-price" or "Dutch" form. In theory, such auctions are susceptible to "bid shading" with bids placed below a bidder's true "reservation price" representing the bidder's willingness to pay for those securities. In practice, Treasury auctions are the world's largest. The numerous bidders in the primary market and its liquid secondary market render the exact auction design unimportant within reason. Instead, the U.S. Treasury focuses more of its attention on the *mixture* of debt instruments (bonds, notes, and bills) that it will auction to cover U.S. federal deficits.[4] See Section III.

II. Challenges

The U.S. Treasury faces a significant future challenge:

Point #1: Without major changes to current U.S. fiscal policy, Penn Wharton Budget Model (PWBM) projects that the U.S. Treasury debt will be unable to rollover its accumulated debt in about 20 years. Put differently, the U.S. government will have to default explicitly, by not making interest payments, or default implicitly, through debt monetization (inflation), or some combination. This timespan shortens if capital markets start to believe that U.S. policy will never create fiscal imbalance.

As shown in Figure 3, PWBM projects that federal debt will increase to around 190 percent of GDP by 2050 under current policy. To put this a different way, having just enough federal tax revenue to cover future spending and interest payments on the debt would require (Figure 4):

- An immediate and permanent increase in all federal tax revenue of 40 percent, or,
- An immediate and permanent increase in all federal spending by 30 percent, or,
- Some combination of both.

Moreover, our recent work estimates that if real borrowing rates continue to persist for longer periods of time, the 190 percent ratio will be reached within 20 years.[5] At that ratio, we estimate that there is no price at which the United States Treasury will be able to rollover or sell its debt. While Japan currently has a debt-GDP ratio more than 200 percent, Japan also has a gross national savings rate that is substantially larger than that of the United States.

This 190 percent threshold holds even if we assume, quite unrealistically, that: (i) *all* future increases in public debt after 2023 are invested in *public* capital; (ii) public capital serves as a *complement* to private capital; and, (iii) the initial return to public capital net of its own depreciation rate is currently 400 basis points above the net return to private capital, an estimate at the upper bound found in the data related to public infrastructure.[6] To be sure, there are

[4] Besides duration, that mixture includes real (TIPS) and nominal securities. I-Bonds can be purchased at the TreasuryDirect.gov website, with annual purchase caps on direct purchase or using a tax refund.
[5] https://budgetmodel.wharton.upenn.edu/issues/2023/10/6/when-does-federal-debt-reach-unsustainable-levels
[6] See overview and references here: https://budgetmodel.wharton.upenn.edu/issues/2021/6/15/economic-effects-of-infrastructure-investment. For public capital to have such a high marginal return, it must be sufficiently scarce.

smaller public investments that can produce larger returns. For example, PWBM has shown that pre-K education subsidies or vouchers could even "pay for itself", once long-term macroeconomic effects are considered, provided that such subsidies are sufficiently narrow and means tested, thereby avoiding inframarginal giveaways to households who would have otherwise purchased pre-K education.[7] Still, there are very few spending programs with large returns that scale to absorb the increase in public debt that we project over the next 20 years. And, in reality, a large portion of that future debt is to support immediate consumption rather than making investments in public capital or in the future workforce.

Moreover, growing public debt does not rule out reforms that are financed. For example, PWBM shown that shifting healthcare away from an employer-based system toward a portable-premium supported system (with Medicaid subsidizing premiums at lower income) could increase health care coverage while lowering total costs.[8] While this reform reduces debt, it still does not avoid the need to make large changes adjustments to avoid an exploding debt path.

In sum, policy discussions should not distract from the likely demise of the U.S. economy---rendering such policy changes pointless anyway---without *material* changes to curb debt growth.

Point #2: Administratively, a well-functioning U.S. Treasury market does *not* attempt to simply minimize contemporaneous interest payments to free up money for other uses.

In practice, when determining the optimal mix of U.S. Treasury securities to auction, the U.S. Treasury places some weight on providing risk-free liquidity at different durations. However, most consideration includes attempting to minimize interest payments on debt. For example, during my brief tenure at the U.S. Treasury Administration (2001 – 2002) under President George W. Bush, we eliminated the auction on new 30-year bonds, despite knowing that such action would create considerable disruption for liability accounting within ERISA defined-benefit plans. I believed then, and continue to believe today, that this action was shortsighted.

If the goal were really to reduce interest payments, the government could shift more debt financing to the overnight repro market, with immense rollover risk. Weighted average duration would then be measured in hours instead of in years. To be even more cheeky, the government would expect to pay *negative* interest---that is, get paid to float debt---if it first invested its proceeds into cryptocurrency, biotechnology stocks and other risky assets. Of course, these ideas are absurd, but so is the idea of trying to minimize debt interest payments more generally.

Point #3: The U.S. Treasury could improve economic efficiency if the U.S. Treasury committed to eventually auction only longer-dated securities instead of trying to optimize Treasury security duration mix against contemporaneous market prices.

In practice, the U.S. Treasury optimizes its debt duration mixture against financial market demand (and, hence, prices) at various durations. But markets simultaneously optimize its

But as its stock increases, its marginal product falls while its total depreciation cost increases even with a fixed cost of depreciation per unit. Eventually, that higher depreciation cost must be covered with distorting taxes.

[7] https://budgetmodel.wharton.upenn.edu/issues/2021/8/23/economic-effects-preschool-and-childcare-programs

[8] https://budgetmodel.wharton.upenn.edu/issues/2020/1/30/medicare-for-all-background

demand at different durations against the U.S. Treasury, including making guesses about future Treasury auction mixes. This two-sided interaction is often *incorrectly* viewed as "competition".

Textbook microeconomics teaches that competition exists between multiple sellers or between multiple bidders. Of course, many markets (e.g., agriculture) manifest competition between multiple sellers who offer products in the presence of multiple bidders. Either way, well-defined markets generally produce "equilibrium" prices at a point in time. More of the "gains from trade" ("surplus") accrues to the less competitive side of a market, either to suppliers or demanders.

It is generally incorrect to view "competition" as happening between a single seller and buyers. In fact, it is possible that such "competition" produces a "hysteresis loop" where an equilibrium never emerges. That could be the case, for example, if the U.S. Treasury adaptively changes its mixture of securities at auction based on recent auction outcomes while buyers adaptively change their projections in response. Or one or *more* equilibrium(s) could emerge.[9]

More importantly, even if an equilibrium exists and is unique---which is actually unclear in the data[10]---efforts by the U.S. Treasury to try to reduce short-term interest payments by changing is optimal mixture of debt instruments generally produces inefficient uncertainty for buyers.[11] Instead, it is more efficient for the U.S. Treasury to mostly focus on producing securities that private markets cannot manufacture, i.e., long-dated risk-free contracts like the 30-year bond. The private market can easily strip and repackage these securities---with minimal counterparty risk using standard custodial relationships---to create intermediate durations, even short durations. This operation would be mundane, competitive, and scalable at low cost.

At first blush, it would seem that markets might demand steep discounts for the 30-year bond. (Indeed, just recently, 30-year bonds appeared to sell cheap, causing the U.S. Treasury to shift toward shorter duration.) But that is only because capital markets have already created multiyear commitments around the existing Treasury mixture and predictions about the future mixture. Moving gradually to a single, predictable long-dated debt contract would reduce supply side uncertainty. It would eventually reduce risk premiums, especially if constructed properly to include rollover risk. It would also simplify rather than complicate existing derivative markets.

Point #4: However, such a commitment by Treasury is generally not "time consistent" under current budget scoring conventions.

If Treasury committed to move gradually toward long-dated bonds, it would eventually notice that private markets were repackaging shorter duration debt at lower rates. That outcome is

[9] For the mathematically inclined, this two-sided competition can produce a differential equation system that is stable (e.g., a linearized version has eigenvalues within the unit circle) or unstable.

[10] https://home.treasury.gov/system/files/221/TreasuryPresentationToTBACQ12021.pdf, p. 21. There have been substantial variations in the weighted average duration over outstanding (not just new) securities. Average duration is naturally procyclical as investors seek safety for shorter-term investments during economic contractions. Still, the evidence is consistent with existence of a single equilibrium, multiple equilibria or no equilibria.

[11] This point holds even if the presence of "tax smoothing" arguments. There are models that attempt to predict optimal weighted average duration based on related economic outcomes. While the "Taylor Rule" approach works for a range of applications including monetary policy, it is not stable for determining the optimal debt mixture. Consistently, many of these papers do not report any statistical significance.

efficient. Treasury would then have a short-term incentive to start floating shorter duration debt again to reduce interest payments, as rewarded by current budget scoring conventions. Such a pivot would produce longer-term rollover risk, not captured by current scoring conventions. Any stated commitment to issuing only long-term debt, therefore, is not "time consistent."

III. Opportunities

Point #5: The U.S. Congress could disincentivize the U.S. Treasury from trying to exploit lower contemporaneous short-term interest payments by expanding the 1990 Credit Reform Act to require scoring agencies to report federal interest payments using the 30-year bond yields regardless of the actual security mixture picked by the U.S. Treasury.[12]

To be sure, the Federal Credit Reform Act of 1990 is far from comprehensive.[13] But such a rule change would be consistent with it and other existing rules (e.g., SFFAS 7, Paragraph 313) that attempt to avoid budget gaming associated with debt, including origination and termination.

Point #6: There are a range of different tax changes and spending cuts that could stabilize the debt-GDP ratio at least at its current value.

Figure 5 projects the macroeconomic effects if federal debt is allowed to increase to 180 percent of GDP over the next 30 years. These estimates understate the actual projected path of debt over time, both in magnitude and speed, due to a key technical reason. In a nutshell, an even more aggressive debt path using less favorable policy instruments crashes the economy. There is then no price where the U.S. Treasury can roll over its debt once economic factors are considered.

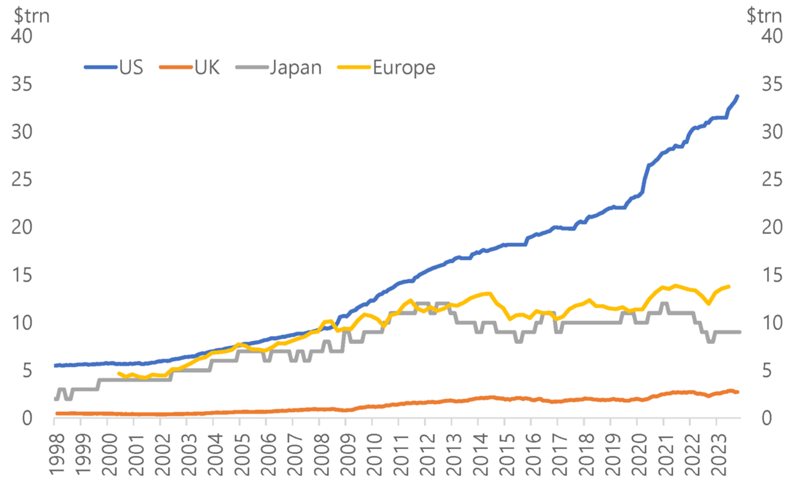
Even with this favorable bias: GDP is projected to fall by around 8 percent, wages fall by 4 percent and the risk-free rate (borrowing costs) would be permanently 150 basis points higher.

And, that is the good news! These calculations also assume that financial markets believe that the U.S. Congress would then invoke a *major* policy change in 30 years to prevent the debt-GDP ratio from climbing even more. Before then, if financial markets no longer believe that such an action will occur, interest rates will skyrocket, and the economy will unravel even sooner.

Fortunately, there are still a range of options to consider. Penn Wharton Budget Model has recently posted a range of policy ideas, spanning from traditionally "liberal" to traditionally "conversative" packages.[14] Penn Wharton Budget Model will be releasing a longer and more comprehensive list of policy package ideas over time. However, our estimates already point to a starting point: simple solutions are not sufficient. Just increasing taxes on households with incomes above $400,000 will not raise nearly enough revenue and could negatively impact the economy. Similarly, claims to reduce "wasteful" (but otherwise unspecified) spending will result in no scored cost saving, essentially guaranteeing economic demise along the current debt path.

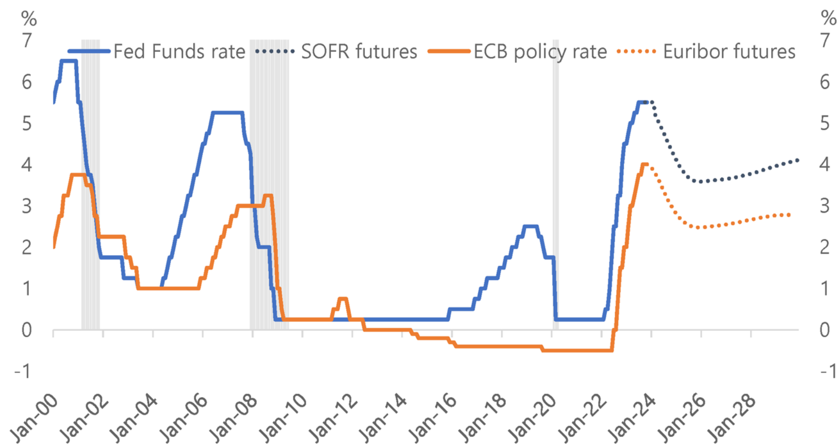
[12] If there were concerns about short-term gaming by Treasury, the actual rule could simply require that the highest rate is used along the term structure issued by Treasury.
[13] Bazelon and Smetters, "Discounting Inside the Washington D.C. Beltway" Journal of Economic Perspectives, 1999.
[14] https://budgetmodel.wharton.upenn.edu/issues/2023/9/29/stabilize-federal-debt-economic-growth

Figure 1: G4 Government Securities Outstanding



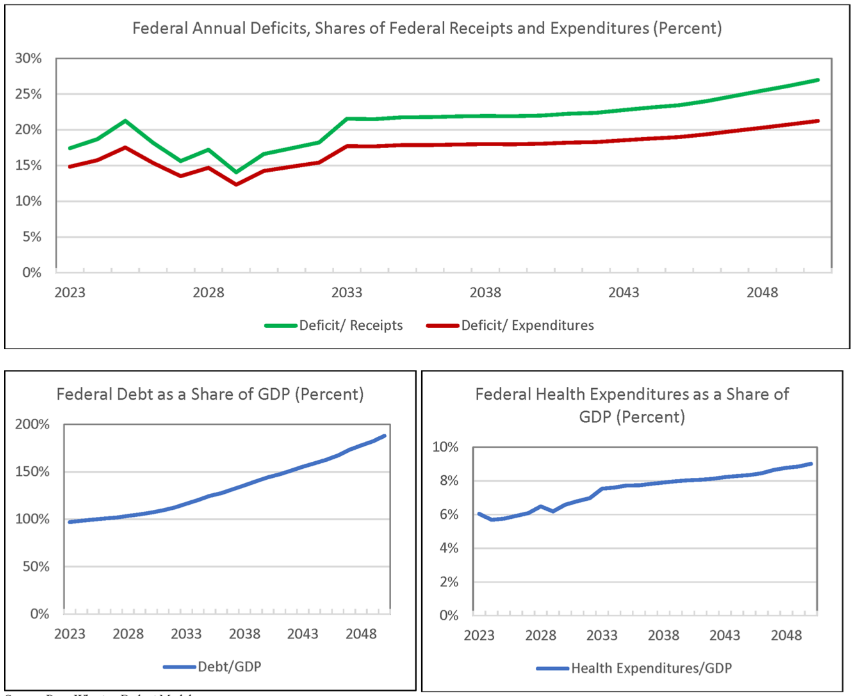
Source: Bloomberg, Haver Analytics. Apollo Chief Economist. Note: US includes total Treasuries outstanding, UK includes Gibs outstanding, Japan includes JGBs and T-bills outstanding, and Europe includes General and Central Government debt securities of the Euro area outstanding.

Figure 2: Fed Fund Futures



Source: Bloomberg, Apollo Chief Economist

Figures 3a, b, c: Federal Flows



Source: Penn Wharton Budget Model

Figures 4a, b: Fiscal Imbalances

	Next 75 Years			
	Federal fiscal imbalance (present values* in billions of constant 2023 dollars)			
	Assets(+)/Debt(-)**	Receipts	Expenditures	Fiscal imbalance
(Asset(+)/Debt)***	-30,838			-30,838
Social Security	2,943	79,860	-107,679	-24,876
Medicare Part A	197	25,638	-47,865	-22,031
Other Programs	3,441	220,376	-163,857	59,959
Discretionary		824	-103,054	-102,230
Total	-24,257	326,698	-422,455	120,015
PDVGDP	1,906,871			

	Next 75 Years			
	Federal fiscal imbalance (as percent of the present value of GDP:)			
	Assets(+)/Debt(-)	Receipts (+)	Expenditures(-)	Fiscal imbalance
(Asset(+)/Debt)	-1.6			-1.6
Social Security	0.2	4.2	-5.6	-1.3
Medicare Part A	0.0	1.3	-2.5	-1.2
Other Programs	0.2	11.6	-8.6	3.1
Discretionary		0.0	-5.4	-5.4
Total	-1.3	17.1	-22.2	6.3
Ratios	1,906,871	36.7	28.4	

* Present values are calculated at a discount rate of 4.4 percent
** Intragovernmental Debt for Social Security, Medicare, and Others Programs
*** Gross Federal Debt

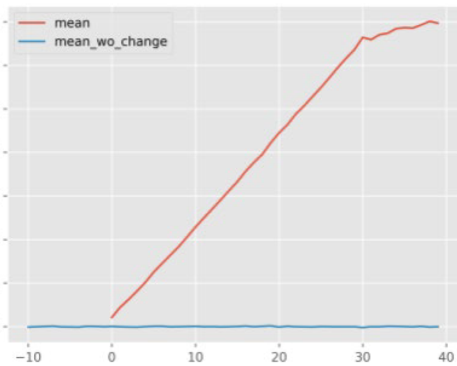
	Perpetuity			
	Federal fiscal imbalance (present values* in billions of constant 2023 dollars)			
	Assets(+) / Debt(-)**	Receipts	Expenditures	Fiscal imbalance
(Asset(+)/Debt)***	-30,837.6			-30,837.6
Social Security	2,943.1	161,333.1	-236,592.6	-72,316.4
Medicare Part A	196.6	51,033.3	-113,290.0	-62,060.1
Other Programs	3,441.0	451,606.3	-359,251.0	95,796.4
Discretionary		1,593.8	-200,257.7	-198,663.9
Total	-24,256.8	665,566.5	-909,391.2	268,081.6
PDVGDP	3,770,834.3			

	Perpetuity			
	Federal fiscal imbalance (as percent of the present value of GDP:)			
	Assets(+) / Debt(-)	Receipts (+)	Expenditures(-)	Fiscal imbalance
(Asset(+)/Debt)	-0.8			-0.8
Social Security	0.1	4.3	-6.3	-1.9
Medicare Part A	0.0	1.4	-3.0	-1.6
Other Programs	0.1	12.0	-9.5	2.5
Discretionary		0.0	-5.3	-5.3
Total	-0.6	17.7	-24.1	7.1
Ratios	3,770,834	40.3	29.5	

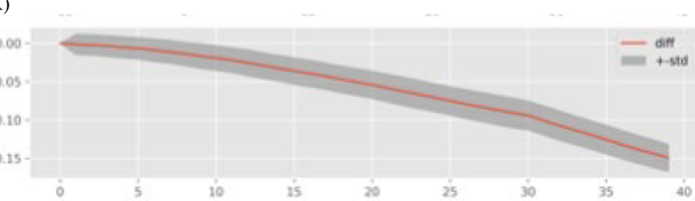
Source: Penn Wharton Budget Model

Figures 5 (various): Economic Effects of Debt Increase from 100 to 180 percent.

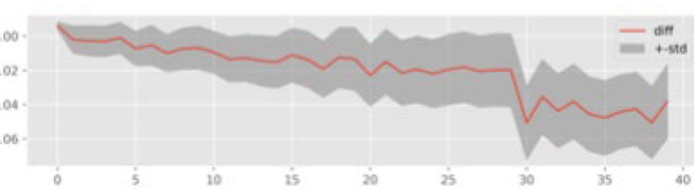
Debt-GDP Ratio (Experiment)[15]



Capital (K)



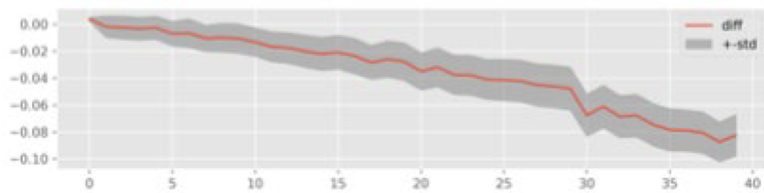
Labor (L)



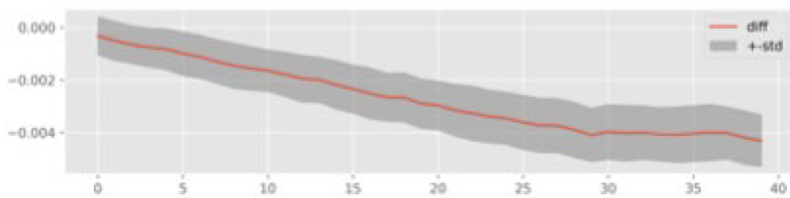
Note: mean change in paths in orange with confidence intervals the gray band area.

[15] Experiment: Decrease in linear wage tax rate for 30 years that produces a debt increase. At year 30, wage tax cut turned off and linear wage tax used to make higher interest payments on debt.

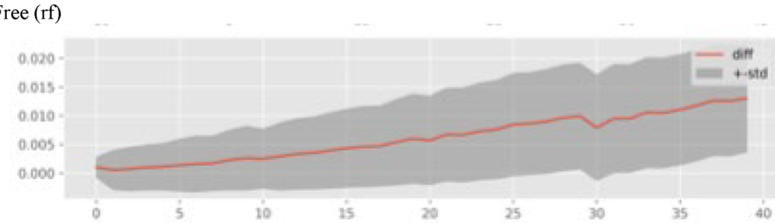
GDP (Y)



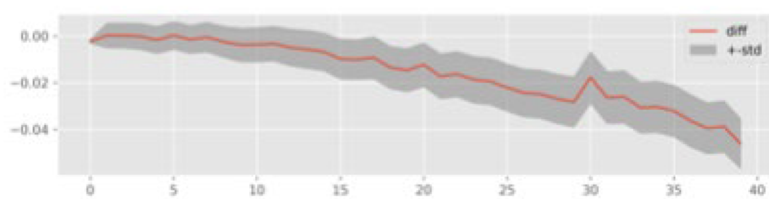
Equity Premium (ep)



Risk Free (rf)



Wages (wage)



Source: Yebiao Jin and Kent Smetters, University of Pennsylvania. Computations from Jin's PhD dissertation under the direction of Smetters.

Chairman SCHWEIKERT. Thank you, Doctor.

Mr. Kogan.

STATEMENT OF BOBBY KOGAN, SENIOR DIRECTOR, FEDERAL BUDGET POLICY, CENTER FOR AMERICAN PROGRESS

Mr. KOGAN. Chairman Schweikert, Ranking Member Pascrell, members of the subcommittee, thank you for inviting me to testify.

Today I intend to make two points. The first is that, without the Bush tax cuts, their bipartisan extensions, and the Trump tax cuts, the ratio of debt-to-GDP would be declining indefinitely. The second is that our current rising debt ratio is due entirely to these tax cuts and not to spending increases.

But when I say spending, I mean primary or noninterest spending. And every mention of revenue, spending deficits, debt, I mean those amounts as a percent of GDP.

Okay. So, recently, Fitch downgraded the United States credit rating, and Moody's put us on the negative watch. While each cited the long-term fiscal outlook in the last—the long-term fiscal outlook, in the last 3 years, each year, the long-term outlook was better than the year before. Importantly, however, they each cited recent Republican-led debt limit brinksmanship.

A default is the only true worry on our Nation's ability to repay bondholders.

This hearing is about debt service, and debt service is a product of debt and the interest rate, which is largely a function of primary deficits. I am going to tell you how we went from having primary surpluses to primary deficits.

According to CBO, primary deficits are on track to shrink to roughly 3.3 percent of GDP over 30 years, high enough to cause the debt to rise indefinitely. The common refrain that you hear is that rising debt is due to rising spending. Revenues have been roughly flat for decades, and while spending was also roughly flat until recently, demographic changes and rising healthcare costs are now pushing it up. These facts are true.

Our intuitions might reasonably tell us that if revenues are flat and spending is rising, then the one that is changing must be to blame, but I am going to tell you why our intuitions are wrong.

In CBO's long-term projections earlier this century, spending was projected to continue rising. But despite this, CBO routinely projected long-term debt stability with revenues keeping up with rising spending, not due to tax increases but to our Tax Code bringing in more as Americans prospered. That prosperity results in both higher revenue collection and higher real after-tax income for the people whose incomes are growing. It is a win-win.

In other words, we used to have a tax system that would fully keep pace with rising spending. And then the Bush tax cuts were enacted and expanded, and then, on a bipartisan basis, eventually made largely permanent in 2013.

Under CBO and OMB's baseline construction, temporary changes in tax law are soon to end as scheduled. 2012 was, therefore, the last year in which CBO's projections reflected the Bush tax cuts expiring. Yes, these projections showed rising spending, but they also showed revenues exceeding spending indefinitely with debt declining indefinitely. But ever since the Bush tax cuts were made permanent, CBO has showed revenues lower than spending and has projected debt to rise indefinitely. And since then, the Trump tax cuts have further reduced revenue.

Without the Bush tax cuts, their bipartisan extensions, and the Trump tax cuts, debt would be declining indefinitely regardless of your AMT assumptions.

Now, two points explain this. The first employs a concept called the fiscal gap, which measures how much primary deficit reduction is required to stabilize the debt. The 30-year fiscal gap is currently 1.7 percent of GDP, which means that, on average, primary deficits over 30 years would need to be 1.7 percent of GDP lower to stabilize the debt. The size of the Bush tax cuts, their extensions, and the Trump tax cuts under current law is larger than that. And, therefore, mathematically and unequivocally, without those tax cuts, debt would be declining, not rising.

But the second is why spending is not to blame even though it is rising. And I have—I have behind me—I have a graph up that I am going to make reference to.

So as I said, CBO's 2012 long-term debt project—long-term outlook was the last time that debt was projected to decline indefinitely. And relative to CBO's 2012 projection, current spending projections are down, not up.

On the graph, the darker dashed line is lower than the lighter dashed line. In short, if you were trying to explain how we got from CBO's 2012 projection of declining debt to our current projections of rising debt, changes in spending have decreased the future path, not increased them. But changes in revenue have declined significantly more than spending.

The darker solid line is far lower than the lighter solid line. Changes in revenue are, therefore, entirely responsible for going from declining debt to ever-growing debt. But importantly, a disproportionate share of the benefits of these tax cuts accrued to very rich Americans, highly profitable corporations, and wealthy heirs.

Any discussion of how to address the deficits caused by these tax cuts should first look to the source. And, importantly, in any attempt to address the possibility that debt service could crowd out future investments, we must not cut our actual investments in the future.

Thank you.

[The statement of Mr. Kogan follows:]

Bobby Kogan[i]
Senior Director of Federal Budget Policy, Center for American Progress
Testimony Before the House Ways and Means Subcommittee on Oversight
Hearing on "Hidden Cost: The True Price of Federal Debt to American Taxpayers"
December 6, 2023

Chairman Schweikert, Ranking Member Pascrell, Members of the Subcommittee, thank you very much for inviting me to testify before you.

I am currently the senior director of Federal Budget Policy at the Center for American Progress, working to ensure the federal budget prioritizes policies that help the most vulnerable people. Prior to joining American Progress, I served in the Biden-Harris White House as adviser to the director of the Office of Management and Budget, where I assisted with the American Rescue Plan and the Inflation Reduction Act, as well as the president's budget requests, budget concepts, and budget scorekeeping.

Today, I hope to leave you with two main points.

First: without the Bush tax cuts, their extensions, and the Trump tax cuts, which gave a disproportionate share of their benefit to the rich, the ratio of debt to gross domestic product (GDP) would be declining indefinitely[ii], regardless of your Alternative Minimum Tax (AMT) assumptions.[iii]

Second: our current rising debt ratio is due entirely to these tax cuts, not spending increases.[iv]

This testimony will focus on stabilization of the ratio of debt as a percent of the gross domestic product because debt is a non-issue if GDP grows faster. All else being equal, a shrinking debt-to-GDP ratio means a shrinking interest-to-GDP ratio. In other words, the cost of financing our debt would shrink as a percent of GDP if the debt itself shrank as a percent of GDP.

This testimony will also focus on "primary" spending and "primary" deficits – that is, spending and deficits not counting interest payments – for two reasons. The policy reason is that interest costs result from the federal debt, which grows with the annual deficit – and the annual deficit is a function of this year's revenues, this year's program spending, and interest on outstanding debt. In short, interest is just as much a result of tax policy as spending policy.

The analytical reason is that budgeteers look at the trajectory of debt (and deficits) relative to the size of the economy – i.e., at the ratio of debt to GDP. As explained by Professor Alan Auerbach in the 1990s[v], the calculation of the trajectory of the debt ratio depends on four factors: the primary deficit as a percent of GDP, the starting level of the debt as a percent of GDP, the Treasury's interest rate, and the GDP growth rate. His algebra shows, for example, that if the Treasury's interest rate equals the GDP growth rate, then a primary deficit of zero will keep the debt ratio constant even though the total budget, including interest, is running a deficit. That's why the Congressional Budget Office (CBO) focuses on the primary deficit when considering the trajectory of debt.[vi]

In August, Fitch Ratings downgraded the United States's credit rating to AA+[vii], and in November Moody's Investors Service, while it retained the AAA rating, changed the United States' outlook to negative.[viii] While each cited our long-term fiscal outlook, the fiscal outlook in recent years has not deteriorated. In fact, the long-term debt outlook this year was lower than the year before, which was lower than the year before that, which was roughly the same as the year before that.[ix] Importantly, however, they each cited House Republican-led debt limit brinksmanship.

A default, not our fiscal trajectory, is the only true worry for our nation's ability to repay bondholders.

In any given year, the deficit is the difference between our total spending and our revenue. In fiscal year 2023, it was $1.7 trillion, or 6.3 percent of GDP.[x] Our debt net of financial assets is the cumulative total net deficit over time. By the end of 2023, it was roughly $24 trillion, or 90 percent of GDP.[xi]

Interest, or debt service, is the net cost of financing that debt. It is driven by the size of the debt and the interest rate on servicing that debt. While temporarily higher or temporarily lower interest rates can affect debt in the medium term, they have little effect on our long-term trajectory since that debt will eventually roll over at a different interest rate.

The U.S. Treasury does not seek to minimize debt service payments because it instead seeks stability of our financial markets. The mix of Treasuries the government issues for its debt finances our debt, but the Treasury is careful to not create too much or too little demand for Treasuries of different durations, which as a whole capitalize our financial system.[xii]

Because of this, focus on debt service is best pointed towards the long-term trajectory of our primary deficits, as well as the relationship between growth and interest rates.

This hearing is about debt service. And debt service is just a product of debt and the interest rate[xiii], with debt being largely a function of primary deficits. So I'm going to tell you how we went from primary surpluses to primary deficits.

The Long-Term Debt Ratio Used To Be Stable, Despite Rising Spending

According to CBO's June 2023 long-term budget outlook, primary deficits are on track to shrink from their current level of roughly 3.8 percent of GDP, down to 3.3 percent of GDP over the next 30 years, on a downward trajectory in the long term.[xiv] These high primary deficits are projected to cause debt as a percent of GDP to rise every year in CBO's 30-year baseline.[xv]

The common refrain that you will hear and unfortunately that I expect to hear today is that our long-term rising debt ratio is due to spending that grows faster than GDP. After all, relative to GDP, revenues have been roughly flat since the 1960s.[xvi] And while primary spending was also roughly flat as a percent of GDP until recently, demographic changes and rising health care costs are now pushing up primary spending.[xvii] These facts are true. And they also appeal to our natural intuitions. One might reasonably think that, because debt stabilization is primarily a factor of our primary spending compared with our revenue, and one of those has stayed the same while the other has changed, the one changing must be to blame for the rising debt ratio.

But our natural intuitions are wrong, as my testimony today will show.

Earlier in the 21st century, demographic changes were looming, and health care costs were growing – in fact, at a faster pace than they are today.[xviii] CBO in its long-term budget outlooks projected primary spending to rise as a percent of GDP. Despite this, CBO's forecasts showed long-term debt stability for decades into the future, because revenues were projected to keep up with this rising spending due to real economic growth moving a portion of taxable incomes into higher tax brackets[xix] – not due to tax increases, but due to our tax code bringing in more as our country and the people in it prospered; that prosperity results in both higher revenue collection and higher real after-tax income for the people whose incomes are growing.[xx] It's a win-win. In other words, we had a tax system that, as it stood, would fully keep pace with rising spending.

The Passage Of The Bush Tax Cuts, Their Bipartisan Extensions, And The Trump Tax Cuts

And then the Bush tax cuts were enacted and expanded.

Under the rules of reconciliation, the fast-track budget process tool used to enact most of the Bush tax cuts, a title of the reconciliation bill may not cause long-term deficits in any year outside the budget window, which is almost always 10 years.[xxi] Because of this, Congress sunset the Bush tax cuts at the end of 10 years. On a bipartisan basis, these tax cuts were extended for two years in 2010 and then largely made permanent in the beginning of 2013[xxii], two days after they had expired.[xxiii]

Under the law setting forth baseline construction, which CBO and the Office of Management and Budget strive to follow, temporary changes in tax law are assumed to end as scheduled or go into effect as scheduled.[xxiv] In practice, what this meant is that CBO's projections showed the Bush tax cuts ending on schedule, with the tax code then reverting to prior law. 2012 was therefore the last year in which CBO's projections reflected the Bush tax cuts expiring.[xxv] In the long-term budget outlook produced that year, CBO projected primary spending rising over the long run, just as it had in previous projections.[xxvi] Importantly, CBO showed revenues exceeding that primary spending for all 65 years of its extended baseline.[xxvii] With these primary surpluses continuing indefinitely, CBO showed debt as a percent of GDP declining indefinitely.[xxviii] This forecast changed when the Bush tax cuts were made permanent. Ever since then, CBO has forecast that revenues would be lower than primary spending and has projected debt to rise indefinitely as a percent of GDP.[xxix] And since then, budget reconciliation has been used to further reduce revenues with the enactment of the Trump tax cuts in 2017.[xxx]

In total, the Bush tax cuts, their bipartisan extensions, and Trump tax cuts have cost $10 trillion to date and their cost will increase enough over time to account for the entire long-term growth in the debt ratio. In other words, without the Bush tax cuts, their extensions, and the Trump tax cuts, debt would be declining as a percent of the economy indefinitely.[xxxi]

Why Tax Cuts, Not Spending, Are Responsible For The Rising Debt Ratio

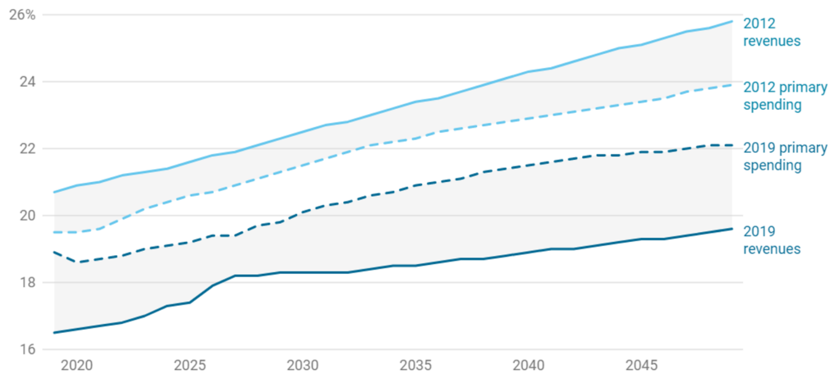
There are two ways to explain my conclusion. The first employs a concept called the fiscal gap, which measures how much primary deficit reduction is required to stabilize the debt over any given period of years. The current fiscal gap over 30 years is roughly 1.7 percent of GDP[xxxii], meaning primary deficits over 30 years would need to be an average of 1.7 percent of GDP lower for debt as a percent of GDP in 2053 to be the same level as it is now.[xxxiii] The size of the Bush tax cuts, their extensions, and the Trump tax cuts under current law is larger than that,[xxxiv] regardless of your AMT assumptions.[xxxv] Because their cost is larger than the fiscal gap, what this means is that, mathematically and unequivocally, without those tax cuts, debt would be declining as a percent of GDP.

To the second argument, a person might reasonably ask whether increased spending bears some responsibility for increased debt as a percent of the economy. The answer is no. In 2012, before most of the Bush tax cuts were made permanent, CBO projected that debt as a percent of GDP would decline indefinitely.[xxxvi] That's the last time CBO made that projection. And relative to those projections, current primary spending projections are down, not up.

While it's true that primary spending as a percent of GDP is rising year over year, primary spending has declined relative to the last projections that showed a stable debt ratio. As illustrated in the figure below, the darker blue dashed line is below the lighter blue dashed line. That means that, if you were trying to explain how we got from the 2012 projections of a debt ratio declining indefinitely to current projections of a debt ratio increasing indefinitely, changes in spending have decreased the debt. However, relative to 2012 projections, revenues have declined roughly three-and-a-half times as much as primary spending has. The darker blue solid line is significantly below the lighter blue solid line – a much bigger difference than the space between the dashed lines. So, it's the changes in revenue that are therefore entirely responsible for our ever-growing debt as a percent of the economy.[xxxvii]

Both revenues and spending are lower than earlier projections, meaning low revenues are responsible for persistent primary deficits

2012 and 2019 Congressional Budget Office projections of annual revenues and primary spending as a percentage of gross domestic product



Hover or click to see values.

Notes: 2019 was the last year in which the Congressional Budget Office produced long-term budget outlooks that contained data without macrodynamic feedback, which are essential to fiscal gap analysis. Therefore, the 2019 outlook is the most recent comparison possible. This analysis assumes that the temporary portions of the Trump tax cuts expire as specified in current law. "Primary spending" means spending excluding interest costs. Primary, not total, deficits are one of the three factors that determine whether debt will be stable as a percentage of gross domestic product.

Source: Congressional Budget Office, "The 2012 Long-Term Budget Outlook" (Washington: 2012), available at https://www.cbo.gov/publication/43288; Congressional Budget Office, "The 2019 Long-Term Budget Outlook" (Washington: 2019), available at https://www.cbo.gov/publication/55331.

Chart: Center for American Progress

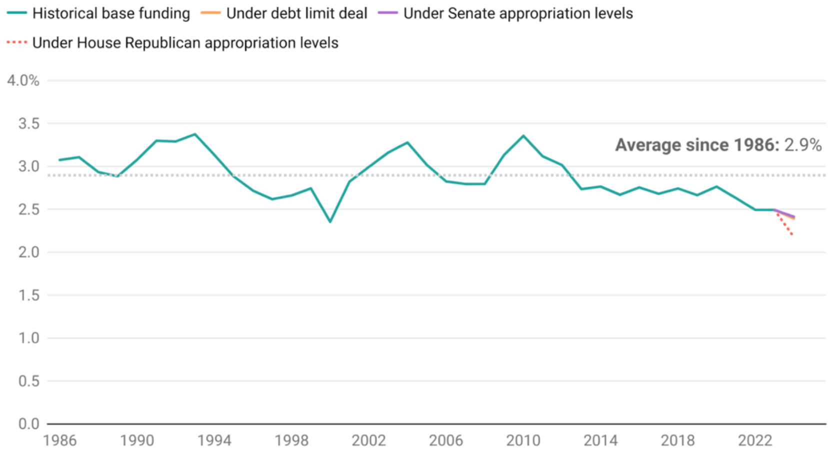
Importantly, a disproportionate share of the benefits from the Bush tax cuts, their extensions, and the Trump tax cuts accrued to very rich Americans, profitable corporations, and wealthy heirs.[xxxviii] Any discussion of how to address the deficits caused by these tax cuts should look first to the source.

House Republicans' Proposed Disinvestment in the Future

Instead, this chamber has called to cut investments in America's future. In June, President Biden signed into law the Fiscal Responsibility Act, which created budget caps in exchange for temporarily suspending the debt limit.[xxxix] Despite rhetoric to the contrary, non-defense discretionary funding excluding Veterans' Affairs medical care – hereafter referred to as NDD* – shrank as a percent of GDP during the first two years of the Biden administration.[xl] Further, the funding levels agreed to by former Speaker McCarthy and the White House are extremely tight and would lead to NDD* being $49 billion below last year's level, on a current services basis. As a percent of GDP, it would be the second lowest on record.[xli] Despite this, House Republican appropriators wrote bills that funded NDD* $58 billion below the deal, which would leave NDD* at its lowest level on record, going back more than 60 years.[xlii]

The House Republican appropriators' plan would cut nondefense discretionary funding, excluding Veterans Affairs medical care, to the lowest levels on record as a percentage of gross domestic product

Base nondefense discretionary budget authority



Hover or click to see values.

These figures reflect the "base" amounts under current congressional concepts, with two authors' adjustments: 1) They include $1 billion of additional emergency funding in 2023 for CHIPS and Science Act programs; and 2) They reflect additional nondefense discretionary funding offset by savings from CHIMPs (CHanges in Mandatory Programs). Due to data limitations, data prior to fiscal year 1991 do not use current congressional concepts of base amounts and instead show total amounts of nondefense discretionary funding excluding Veterans Affairs medical care. The authors used fiscal year 1986 as the starting year in this graph because it was the first year of coordinated bipartisan leadership attempts to constrain government spending. Nonetheless, the level proposed by House Republican appropriators would be the lowest on record as a percentage of gross domestic product.

Source: Authors' calculations using data from Congressional Budget Office, "Fiscal Year 2024, U.S. Senate" (Washington: 2023), available at https://www.cbo.gov/system/files/2023-08/FY2024-Senate-2023-07-27.pdf; Congressional Budget Office, "Fiscal Year 2024, U.S. House of Representatives" (Washington: 2023), available at https://www.cbo.gov/system/files/2023-08/FY2024-House-2023-07-27.pdf; Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033" (Washington: 2023), available at ; Richard Kogan, senior fellow, Center on Budget and Policy Priorities, personal communication with author via email and phone, 2023, on file with authors; Congressional Budget Office, personal communication with author via email and phone, 2014–2023, on file with authors; U.S. Office of Management and Budget, "Public Budget Database: Outlays," available at https://www.whitehouse.gov/omb/budget/supplemental-materials/ (last accessed August 2023); U.S. Office of Management and Budget, "Table 10.1—Gross Domestic Product and Deflators Used in the Historical Tables: 1940–2028," available at https://www.whitehouse.gov/omb/budget/historical-tables/ (last accessed August 2023); U.S. Office of Management and Budget, "Budget of the U.S. Government, Fiscal Year 2024" (Washington: 2023), available at https://www.whitehouse.gov/wp-content/uploads/2023/03/budget_fy2024.pdf; U.S. Office of Management and Budget, "FY 2017 President's Budget Briefing Book - Summary Tables" (Washington: 2016), on file with authors.

Chart: Center for American Progress

The cuts proposed to achieve this low level of funding are extreme, and they would leave the country less prepared for the future. To highlight just five, House Republican-led bills called to cut:

- Title I education grants, which support poor local public schools in every state, by nearly 80 percent[xliii]
- Money that ensures our drinking water is safe by 59 percent[xliv]
- Nutrition assistance for newborns[xlv]
- The National Institutes of Health's (NIH) cancer and stroke research[xlvi]
- Our most critical clean energy R&D program by 42 percent[xlvii]

These cuts would harm the American people, and they would harm our future.

In any attempt to address the possibility that debt service might crowd out future investments, we must not cut our actual investments for the future.

Thank you.

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[i] Huge thanks to Richard Kogan and David Kamin, and to my colleagues at American Progress, including Jean Ross, Jessica Vela, Lily Roberts, Emily Gee, Madeline Shepherd, Rose Khattar, Brendan Duke, Marc Jarsulic, and Christian Weller for helpful feedback and assistance.

[ii] Bobby Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," (Washington: Center for American Progress, 2023), available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.

[iii] The AMT serves to ensure Americans are unable to shrink their tax liability too much through deductions. When it was originally enacted, it was not indexed for inflation. Because of this, Congress habitually needed to enact an AMT patch so that it didn't apply to more Americans than intended. Before being permanently indexed in the American Taxpayer Relief Act of 2012, current law did not assume any future patches and thus showed higher revenues in the baseline relative to one that assumed an AMT patch. This calculation, that the Bush and Trump tax cuts were bigger than the fiscal gap, is true regardless of whether you work from a baseline that first assumed a permanent AMT patch. Author's calculations from Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/; Congressional Budget Office, "The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59233; Congressional Budget Office, "The Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2005), available at https://www.cbo.gov/publication/17558; "Revenue Impacts of the Fiscal Cliff Deal," Citizens for Tax Justice, January 3, 2013, available at https://ctj.sfo2.digitaloceanspaces.com/pdf/fiscalcliffdealrevenueimpacts.pdf.

[iv] Ibid.

[v] Alan J. Auerbach, "The U.S. Fiscal Problem: Where We Are, How We Got Here, and Where We're Going," NBER Macroeconomics Annual 9 (1994): 141–186, available at https://www.nber.org/system/files/chapters/c11009/c11009.pdf.

[vi] Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.

[vii] "Fitch Downgrades the United States' Long-Term Ratings to 'AA+' from 'AAA'; Outlook Stable," Fitch Ratings, August 1, 2023, available at https://www.fitchratings.com/research/sovereigns/fitch-downgrades-united-states-long-term-ratings-to-aa-from-aaa-outlook-stable-01-08-2023.

[viii] "Moody's changes outlook on United States' ratings to negative, affirms Aaa ratings," Moody's Investor Service, November 10, 2023, available at https://ratings.moodys.com/ratings-news/411110.

[ix] Congressional Budget Office, "The 2020 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2020), available at https://www.cbo.gov/publication/56516; Congressional Budget Office, "The 2021 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2021), available at https://www.cbo.gov/publication/56977; Congressional Budget Office, "The 2022 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2022), available at https://www.cbo.gov/publication/58340; and

Congressional Budget Office, "The 2023 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2023), available athttps://www.cbo.gov/publication/59331.

[x] Author's calculations from "Final Monthly Treasury Statement," U.S. Department of the Treasury Bureau of Fiscal Service, October 8, 2023, available at https://www.fiscal.treasury.gov/files/reports-statements/mts/mts0923.pdf and Bureau of Economic Analysis, "Table 1.1.5 Gross Domestic Product, National Income and Product Accounts," last accessed December 2023, available at https://apps.bea.gov/iTable/?reqid=19&step=2&isuri=1&categories=survey&_gl=1*ba3jvd*_ga*MTk5NzM0Nzk2My4xNjk0OTAzNzE0*_ga_J4698JNNFT*MTcwMTY1NDgyNC4xNi4xLjE3MDE2NTQ4MzAuMC4wLjA.#eyJhcHBpZCI6MTksInN0ZXBzIjpbMSwyLDMsM10sImRhdGEiOltbImNhdGVnb3JpZXMiLCJTdXJ2ZXkiXSxbIk5JUEFfVGFibGVfTGlzdCIsIjUiXSxbIkZpcnN0X1llYXIiLCIyMDIxIl0sWyJMYXN0X1llYXIiLCIyMDIzIl0sWyJTY2FsZSIsIi02Il0sWyJTZXJpZXMiLCJRIl1dfQ==.

[xi] Author's calculations from Fiscal Data, "Debt to the Penny," last accessed December 2023, available at https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny; Bureau of Economic Analysis, "Table 1.1.5 Gross Domestic Product, National Income and Product Accounts," last accessed December 2023, available at https://apps.bea.gov/iTable/?reqid=19&step=2&isuri=1&categories=survey&_gl=1*ba3jvd*_ga*MTk5NzM0Nzk2My4xNjk0OTAzNzE0*_ga_J4698JNNFT*MTcwMTY1NDgyNC4xNi4xLjE3MDE2NTQ4MzAuMC4wLjA.#eyJhcHBpZCI6MTksInN0ZXBzIjpbMSwyLDMsM10sImRhdGEiOltbImNhdGVnb3JpZXMiLCJTdXJ2ZXkiXSxbIk5JUEFfVGFibGVfTGlzdCIsIjUiXSxbIkZpcnN0X1llYXIiLCIyMDIxIl0sWyJMYXN0X1llYXIiLCIyMDIzIl0sWyJTY2FsZSIsIi02Il0sWyJTZXJpZXMiLCJRIl1dfQ==; and Congressional Budget Office, "An Update to the Budget Outlook: 2023 to 2033," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59159.

[xii] Amar Reganti, "This isn't a corporation: US Treasury's debt maturity management," Official Monetary Policy and Financial Institutions Forum, November 28, 2023, available at https://www.omfif.org/2023/11/this-isnt-a-corporation-us-treasurys-debt-maturity-management/.

[xiii] "Policy Basics: Deficits, Debt, and Interest," Center on Budget and Policy Priorities, July 29, 2022, available at https://www.cbpp.org/research/policy-basics-deficits-debt-and-interest.

[xiv] Congressional Budget Office, "The 2023 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59014.

[xv] Ibid.

[xvi] Ibid.

[xvii] Ibid.

[xviii] Congressional Budget Office, "The Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2000), available at https://www.cbo.gov/system/files/2018-10/12749-long-term-budget-outlook.pdf; Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033," available at https://www.cbo.gov/publication/58848.

[xix] Congressional Budget Office, "The 2012 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2012), available at https://www.cbo.gov/publication/43288.

[xx] Congressional Budget Office, "The 2022 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2022), available at https://www.cbo.gov/publication/58340.

[xxi] Richard Kogan and David Reich, "Introduction to Budget "Reconciliation"," May 6, 2022, available at https://www.cbpp.org/research/federal-budget/introduction-to-budget-reconciliation.

[xxii] Emily Horton, "The Legacy of the 2001 and 2003 "Bush" Tax Cuts," October 23, 2017, available at https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts.

[xxiii] 112th Congress, "American Taxpayer Relief Act of 2012," January 2, 2013, available at https://www.govinfo.gov/content/pkg/PLAW-112publ240/html/PLAW-112publ240.htm.

[xxiv] There is a special exception for excise taxes dedicated to trust funds. See, Committee on the Budget, U.S. House of Representatives, "A Compendium of Laws and Rules of the Congressional Budget Process," August 2015, available at https://www.govinfo.gov/content/pkg/CPRT-114HPRT96107/pdf/CPRT-114HPRT96107.pdf.

[xxv] Congressional Budget Office, "The 2012 Long-Term Budget Outlook," available at https://www.cbo.gov/publication/43288.

[xxvi] Ibid.

[xxvii] Ibid.
[xxviii] Ibid.
[xxix] Congressional Budget Office, "The 2013 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2013), available at https://www.cbo.gov/publication/44521; Congressional Budget Office, "The 2023 Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59014.
[xxx] Seth Hanlon, "Budget Reconciliation Is a Critical and Regularly Used Tool," February 5, 2021, available at https://www.americanprogressaction.org/article/budget-reconciliation-critical-regularly-used-tool/.
[xxxi] Under current law, the individual portion of the Trump tax cuts are assumed to expire on schedule. This calculation is definitionally true regardless of your assumption about the expiration of the Trump tax cuts. See Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.
[xxxii] Author's calculations from Congressional Budget Office, "The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59233.
[xxxiii] Technically, the fiscal gap is a present value calculation: it shows how much the present value of primary deficits would need to be reduced over a given period, measured as a percent of the present value of GDP over that period. Using present values accounts for the interest effect of the deficit reduction. Put differently, the fiscal gap shows the average level of discounted primary deficit reduction that's needed for the debt ratio at the end of the period to equal, rather than exceed, the debt ratio at the beginning of the period.
[xxxiv] Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.
[xxxv] The AMT serves to ensure Americans are unable to shrink their tax liability too much through deductions. When it was originally enacted, it was not indexed for inflation. Because of this, Congress habitually needed to enact an AMT patch so that it didn't apply to more Americans than intended. Before being permanently indexed in the American Taxpayer Relief Act of 2012, current law did not assume any future patches and thus showed higher revenues in the baseline relative to one that assumed an AMT patch. This calculation, that the Bush and Trump tax cuts were bigger than the fiscal gap, is true regardless of whether you work from a baseline that first assumed a permanent AMT patch. Author's calculations from Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/; Congressional Budget Office, "The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget," (Washington: Congressional Budget Office, 2023), available at https://www.cbo.gov/publication/59233, Congressional Budget Office, "The Long-Term Budget Outlook," (Washington: Congressional Budget Office, 2005), available at https://www.cbo.gov/publication/17558; "Revenue Impacts of the Fiscal Cliff Deal," Citizens for Tax Justice, January 3, 2013, available at https://ctj.sfo2.digitaloceanspaces.com/pdf/fiscalcliffdealrevenueimpacts.pdf.
[xxxvi] Congressional Budget Office, "The 2012 Long-Term Budget Outlook," available at https://www.cbo.gov/publication/43288.
[xxxvii] Kogan, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio," available at https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.
[xxxviii] Horton, "The Legacy of the 2001 and 2003 "Bush" Tax Cuts," available at https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts; Tax Policy Center, "Analysis of the Tax Cuts and Jobs Act," May 8, 2020, available at https://www.taxpolicycenter.org/feature/analysis-tax-cuts-and-jobs-act.
[xxxix] Bobby Kogan and Jean Ross, "House Republican Appropriations Proposal Breaks the Debt Limit Deal," Center for American Progress, September 6, 2023, available at https://www.americanprogress.org/article/house-republican-appropriations-proposal-breaks-the-debt-limit-deal/.
[xl] Ibid.
[xli] Ibid.
[xlii] Ibid.
[xliii] Ibid.

[xliv] This bill was passed through the House of Representatives 213-203. A total 212 House Republicans voted for the bill and 3 House Republicans voted against the bill. One House Democrat voted for the bill, and 200 House Democrats voted against the bill. Author's calculations from 118th Congress, "H.R. 4821 - Department of the Interior, Environment, and Related Agencies Appropriations Act, 2024," last accessed December 2023, available at https://www.congress.gov/bill/118th-congress/house-bill/4821 and 117th Congress, "H.R. 2617 - Consolidated Appropriations Act, 2023," December 23, 2022, available at https://www.congress.gov/bill/117th-congress/house-bill/2617.

[xlv] Bobby Kogan and Jean Ross, "House Republican Appropriations Proposal Breaks the Debt Limit Deal," Center for American Progress, September 6, 2023, available at https://www.americanprogress.org/article/house-republican-appropriations-proposal-breaks-the-debt-limit-deal/.

[xlvi] Ibid.

[xlvii] This figure reflects the House-passed fiscal year 2024 Energy and Water appropriations bill, which included additional cuts to the Office of Energy Efficiency and Renewable Energy beyond those in the version passed out of committee. Author's calculations from 118th Congress, "H.R. 4394 - Energy and Water Development and Related Agencies Appropriations Act, 2024," last accessed December 2023, available at https://www.congress.gov/bill/118th-congress/house-bill/4394 and 117th Congress, "H.R. 2617 - Consolidated Appropriations Act, 2023," December 23, 2022, available at https://www.congress.gov/bill/117th-congress/house-bill/2617.

Chairman SCHWEIKERT. Dr. Faulkender.

STATEMENT OF MICHAEL FAULKENDER, PHD, DEAN'S PROFESSOR OF FINANCE, UNIVERSITY OF MARYLAND ROBERT H. SMITH SCHOOL OF BUSINESS

Mr. FAULKENDER. Chairman Schweikert, Ranking Member Pascrell, members of the subcommittee, thank you for the opportunity to testify today on the costs to the American people arising from increased Federal debt service. I have been a finance professor for more than 20 years and had the privilege of serving as the assistant secretary for Economic Policy at the Department of Treasury from 2019 to 2021.

In fiscal year 2018, outstanding public debt was just under $16 trillion. Cost of servicing that debt totaled $351 billion. By the end of fiscal 2023, public debt had risen to more than $26 trillion. Debt service increased to $666 billion.

So while the cost—while the debt outstanding has risen 67 percent, the cost of servicing that debt has risen 90 percent, the result of the higher interest rates were seen recently.

Even before COVID hit, our Nation was on an unsustainable fiscal path. While the CARES Act was necessary to mitigate the economic harm from the pandemic, that spending was entirely debt financed. Spending has not returned to its pre-COVID levels. According to CBO, as was just said, government spending will continue to rise, consuming 23 to 25 percent of national output each of the next 10 years compared to the last 50 years of just 21 percent. Revenue forecasts are at 18 percent of national output, which are above where revenues have been for the last 50 years at 17.4 percent.

This permanent spending increase means debt as a percentage of GDP will rise unsustainably. A financial report of the U.S. Government forecasts that if this current policy were extended over the next 75 years, it would result in a debt-to-GDP ratio of 566 percent, compared to just 78 percent 5 years ago.

Debt service costs are the result of both the amount of debt outstanding and the interest rate environment. One might think that minimizing interest costs is accomplished by simply issuing the maturity with the lowest yield. However, it depends upon the time horizon over which one is minimizing debt service costs.

In 2020, interest rates on 1-year bonds were less than 10 basis points, while coupon rates on the 10-year were at 0.625 and, on the 30, were as low as 1.25 percent. If one were merely looking to minimize debt service costs in 2020, one might think Treasury should have only issued short-term debt. Instead, the Secretary increased the quantity of long-term debt in 2020 that was issued. While that marginally raised debt service costs, the American people today benefit from the fact that we issued, quote, higher-cost debt because, today, Treasury is still just paying 62 basis points on the 10 years that were issued at the time rather than the 4 to 5 percent that they would be rolled over at today.

Significant academic work on the term structure of interest rates of debt issuances at different maturities find it to be upward sloping because, as was mentioned, investors bear greater risk on long-term bonds. One might, therefore, conclude that interest costs would be minimized by issuing just short-term debt. However, the bonds issued in 2020 demonstrate that there may be market conditions where Treasury will reduce long-term borrowing costs by issuing long-term bonds.

As the chairman mentioned, recently, long-term bond auctions have shown less demand than normal, particularly from international buyers. The central banks of both Japan and China have been reducing their ownership of U.S. Treasuries, likely reflecting that investors are growing more concerned about our Nation's long-term fiscal stewardship.

Whether we should pull back on issuing long-term Treasury bonds depends on whether government policy succeeds in reining in the recent 40-year high inflation. Reductions in budget deficits, deregulatory unleashing of the American economy would bring down inflation more effectively than the Federal Reserve merely raising interest rates.

Issuing short-term debt that can be rolled over at lower bond yields would reduce long-term debt service costs. If, instead, we continue running unsustainable budget deficits and disincentivizing output, locking in today's interest rates might best mitigate the potential costs of having to roll over debt at even higher interest rates.

I know that some have expressed concern that foreign holdings of U.S. Treasuries are problematic for Americans. I would differentiate Chinese holdings in technology firms who provide inputs into sensitive national security tools or the purchases of farmland near military facilities as different than holdings in U.S. Government debt.

I believe we should welcome lower Treasury borrowing costs arising from foreign countries wanting to invest in our Nation's future, provided that those investments don't sacrifice defensive capabilities.

I believe we net benefit from being the world's reserve currency. In addition to lowering borrowing costs, it facilitates implementation of our National Security Strategy to monitor arms dealing, drug trafficking, and other illicit activities. Further, it facilitates using sanctions as an economic tool to punish bad actors, enhancing potential military and diplomatic activities.

The impact on the American people of higher debt service costs extends beyond future tax rates. Rising interest costs will likely crowd out funding for other government services. Additionally, mortgage rates paid by American home buyers directly result from the long-term borrowing rates for the U.S. Government.

I believe the best way for us to improve access to home ownership for young people is to get interest rates back down, which means the fiscal and regulatory policy need to assist the Federal Reserve in bringing down inflation.

I look forward to answering your questions.

[The statement of Mr. Faulkender follows:]

Chairman Schweikert, Ranking Member Pascrell, and Members of the Subcommittee,

Thank you for the opportunity to testify today on the costs to the American people arising from the significantly increasing burden of federal debt service. I have been a finance professor for more than twenty years and had the privilege of serving as the Assistant Secretary for Economic Policy at the Department of Treasury from 2019 to 2021. In that role, I worked on the economic projections included with the administration's budget submission and oversaw the Trustees processes on behalf of Secretary Mnuchin. During the pandemic, I was part of the Secretary's team who negotiated the CARES Act and was the senior Treasury official responsible for implementing the Paycheck Protection Program.

During my first week at Treasury, the Secretary asked me to oversee finalizing the Financial Report of the U.S. Government for 2018. According to the projections in that report, by the end of the 75-year forecast period, U.S. government debt would represent 530 percent of Gross Domestic Product, compared with just 78 percent in 2018. Even prior to the spending that was necessary at the depths of the pandemic, the U.S. fiscal situation was not sustainable. Despite historically low interest rates, rising deficits were projected to cause outstanding debt to escalate. For that reason, we modified the Executive Summary of the 2018 report to no longer have the second section called "Where We Are Headed" (as it was called in the 2017 report) and we instead renamed the second section "An Unsustainable Fiscal Path". We also added language in that section to read, "The projections in this Financial Report show that current policy is not sustainable. These projections assume that current policy will continue indefinitely, and are, therefore, neither forecasts nor predictions. Nevertheless, policy changes must be enacted so that financial outcomes will be different than those projected."

In 2020, the COVID-19 pandemic hit and Congress on a bipartisan basis worked closely with the Trump Administration to fund the CARES Act and mitigate the economic harm that might have otherwise resulted. However, all of that spending was deficit financed, making the unsustainable nature of the fiscal situation that we outlined in the 2018 report even more acute. Since CARES, trillions more in deficit spending has been enacted. Debt held by the public has risen from $15.75 trillion at the end of fiscal year 2018 to $26.24 trillion at the end of fiscal year 2023. The most recent version of the report (issued in February of this year) has retained our title for the second section of the Executive Summary - "An Unsustainable Fiscal Path" - and now forecasts a debt to GDP ratio at the end of the 75-year forecast period of 566 percent. As a result, the rating agency Fitch downgraded the US government's bond rating from AAA to AA+ earlier this year and last month, Moody's outlook for the US government's credit rating changed from stable to negative.

Debt services costs are not just a function of the amount of debt outstanding; they are also determined by the interest rate environment when Treasury is borrowing money and the decision of the mix of debt securities that are issued. The overall interest rate Treasury will pay this fiscal year is partially based on the currently high interest rates for the new and rolling over of debt that will be issued this year. It is also impacted by the interest rates at which outstanding long-term bonds were issued in the past. As Treasury issues debt with maturities as short as one month to as long as 30 years, debt service costs this fiscal year are a weighted average of the interest rates of the last 30 years.

In fiscal year 2018, debt service costs on outstanding public debt totaled $351 billion. By fiscal year 2023, that number had risen to $666 billion. In other words, debt outstanding has risen 67 percent since 2018 but the cost of servicing the debt has risen 90 percent. Debt service costs have increased faster than outstanding debt because the recent level of interest rates has been the highest we have seen in a couple of decades.

The Treasury Department is tasked with minimizing expected interest costs on servicing the federal debt. That is primarily done through the selection of the maturity of the debt securities that they issue. One might think that such an objective is accomplished by simply issuing the maturity that currently has the lowest yield. However, that depends on the time horizon over which one is looking to minimize debt service costs. For instance, in 2020, interest rates on 1-year bonds were at about 0.1 percent while coupon rates on the ten-year bond got as low as 0.625 percent. If one were merely looking to minimize debt service costs in 2020, one might think Treasury should have only issued short-term debt. Instead, the Secretary increased the quantity of long-term debt that was issued.[1] While that marginally raised debt service costs in fiscal year 2020, the American people are benefiting today from having issued `higher cost' debt in 2020 because that outstanding principal has an annual interest cost of just 0.625 percent instead of the current four to five percent rates prevalent today.

There is significant academic work on the interest rates that we observe on debt issuances of different maturities, a topic called the term structure. This literature generally models the long-term interest rate as a function of expectations on where short-term interest rates are likely going to be in the future plus a risk premium, called the term premium.[2] The term premium is extra yield investors require to compensate them for potential losses on Treasury bonds, and is higher with increased risk of such losses. For investors, long-term debt is risky because it is not known what the future path of interest rates will be, which creates the potential for bondholders to actually lose money if they buy Treasury bonds and have to sell them before they mature. For example, 10-year Treasury bonds issued in 2020 are currently trading at twenty percent below their issue price, meaning that if holders of those bonds sold them now, they would take losses of twenty percent. Some of the thirty-year bonds issued during 2020 are trading at 50 cents on the dollar.

The result is that historically, the term premium is positive, and the term structure is upward sloping. Investor-required compensation for those potential losses is why long-term bonds generally have higher yields than short-term bonds. That may lead one to conclude that interest costs would be minimized by issuing short-term bonds. However, the bonds issued in 2020 demonstrate that there are market conditions where Treasury will reduce long-term borrowing

[1] Note that the percentage of debt that was long-term fell because the quantity of debt being raised was extraordinary.

[2] Risk-free bonds may also carry a convenience yield that as van Binsbergen, Diamond, and Grotteria (2022) explain "reflects the ease with which they can be traded by uninformed agents, posted as collateral, satisfy regulatory capital requirements, or perform other roles similar to that of money."

costs by issuing long-term bonds. Ultimately, this means the Treasury Secretary is speculating on the future path of interest rates.

To facilitate their work identifying the mix of maturities to issue, Treasury meets quarterly with the Treasury Borrowing Advisory Committee (TBAC). Members of the committee provide the Secretary and the Treasury team with their assessment of current market conditions and advise on the demand for bond issuances of various lengths.

The reason that demand for varying maturities exists is because different investors have a range of time horizon objectives. For example, pension funds are investing money received from employers today to fund retirement payments decades in the future. Similarly, most whole life insurance contracts will not be exercised for decades, and those companies likewise benefit from investing in long-term securities in the interim. Other investors desire short or intermediate term investments because of the timeframe on when they anticipate using the funds. Some of the largest buyers of Treasury bonds are foreign reserve banks who likewise have varying time horizons on their holdings. The input from TBAC helps the debt management team update the mix of maturities at which they estimate that they can most efficiently fund the maturing debt that will be rolled over and issue new debt to finance persistent budget deficits.

One challenge the bond market has recently faced is that long-term bond auctions have shown less demand than normal, particularly from international buyers. The result is that the interest rates at which Treasury was able to borrow at the auctions were significantly higher than secondary market yields would have suggested, raising debt service costs for the American people. The central banks of both Japan and China have been reducing their ownership of US Treasuries. While part of this may be the recent strength of the dollar making dollar denominated securities less attractive, it is also a reflection that investors are growing more concerned about our nation's long-term fiscal stewardship. Additionally, the Chinese Communist Party (CCP) has been making efforts to reduce the portion of Chinese trade conducted in dollars, which would also decrease the transactional motivation for holding dollar-based assets. A sustained decrease in foreign holdings of U.S. Treasuries would be concerning if it is resulting from a view that the future of our economy is not as strong as it once was.

Given the significant reduction in demand for extended maturity government bonds and despite the fact that yields on long-term bonds are currently lower than the yields on short-term bills, Treasury announced last month that their issuance of long-term bonds would be lower than the market anticipated. Whether we should pull back on issuing more long-term Treasury bonds depends upon whether government policy succeeds in reigning in the 40-year inflation that we have incurred recently. Reductions in budget deficits and the unleashing of the American economy through deregulation would bring down inflation more effectively than Federal Reserve interest rate policy. If that were to occur, issuing short-term debt that can be rolled over at the lower bond yields will result in reducing long-term debt service costs. If on the other hand, we continue running unsustainable budget deficits while reducing potential output through excessive government intervention, locking in today's interest rates for years to come would best curtail ongoing interest costs and mitigate potential risks of having to rollover our debt at even higher interest rates.

Some have expressed concern that foreign holdings of US securities are problematic for Americans. In my view, the desire of foreign individuals and governments to hold Treasury debt reveals that investment in the United States offers financial safety at a competitive rate of return. This is a beneficial outcome and reflects ongoing economic strength. I would differentiate CCP holdings in technology firms who provide inputs into sensitive national security tools or farmland near military facilities from holdings in government debt. We should welcome lower borrowing costs on US Treasury borrowings arising from foreign countries wanting to invest in our nation's future, provided that those investments do not sacrifice our defensive capabilities. We net benefit from being the dominant reserve currency for the world. In addition to lowering borrowing costs of the both the US government and American households, being the world's reserve currency facilitates implementation of our national security strategy as we are in a superior position to monitor money flows around the world that may be funding arms dealing, drug trafficking, and other elicit activities. Further, it facilitates using sanctions as an economic tool to punish bad actors, enhancing potential military and diplomatic actions.

The impact on the American people of higher debt service costs is not limited to merely the potential for higher future taxes to cover these growing expenditures. Growing interest costs have the potential to crowd out funding for other government services. Additionally, mortgage rates paid by American home buyers directly result from long-term borrowing rates for the U.S. government. Since January 2021, 30-year fixed mortgage rates have risen from an average of 2.77% to 7.22%. This translates to a monthly principal and interest payment on a $250,000 mortgage rising from just over $1000 per month to $1700. The best way for us to improve access to home ownership for young people is to get interest rates back down, which means deploying fiscal and regulatory policies in ways that result in lower inflation and therefore lower interest rates. We should stop relying entirely on the Federal Reserve to curb the inflation that has crushed household budgets over the last three years.

Thank you for including me in today's important discussion and I look forward to answering your questions.

Chairman SCHWEIKERT. Thank you, Doctor.

As chairman's prerogative and an idiosyncrasy, I will go last in my questions. Think of it as batting cleanup.

Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Chairman Schweikert, for holding this hearing.

There is no question that the greatest economic and national security threat we face is our long-term debt and deficit. We can point fingers and argue all day long about whether it is a revenue or a spending issue, but one thing is clear, there is only one thing that will fix the problem, and that is a bipartisan, bicameral solution where everybody comes to the table.

Our national debt has increased more than $6 trillion just in the past few years alone. The United States is currently—our debt stands at $33.8 trillion in debt. And as we know, the primary objectives of the Treasury's debt management strategy is to issue debt in a regular and predictable manner, to provide transparency in the decision making process, and to seek continuous improvements to the auction process.

So, Mr. Smetters, I will start with you. Do you believe the Treasury's current debt management strategy is meeting these objectives?

Mr. SMETTERS. The auction design is, I think, fairly efficient. It is a very large market. The secondary market is very liquid. From an economist's perspective of we are going to start all over again, I actually would have the U.S. Treasury mostly focus on long-term debt issuance, even if it means a higher interest rate that is paid.

And the reason why we currently have the situation that we have is that we have debt markets who are making bets against what they think Treasury will issue in the future, Treasury making bets against the debt market, and that is not competition; that is just an incredible source of uncertainty. Instead, Treasury should focus on what it actually does.

So it is a big bias currently in the budget right now, where it rewards Treasury for lowering the expected costs, freeing up money for other things, but it doesn't penalize for anything like rollover risk that comes associated with that shorter term cost. I would remove that budget bias. I have an idea in my written remarks to do that.

But the real value that Treasury brings is the thing that private markets cannot bring, and that is the long-term, risk-free asset.

Mr. FITZPATRICK. Thank you.

Mr. Faulkender, as I understand it, the Treasury's debt servicing strategy not only impacts private investment income growth and things like mortgage rates, but also impacts the Federal Government's ability to spend on other policies and programs. Is this correct, number one?

To put it another way, how does the dramatic increase in debt servicing costs impact the Federal Government's ability to spend money on other policies and programs?

Mr. FAULKENDER. So, yes, it is correct, in that the Treasury rate serves as the base rate for most, if not all, world—you know, global financial transactions. When we think about pricing out the interest rates, we would see on whether it is mortgage securities, whether it is on car loans, but even international bond issuances, the Treasury rate serves as a base reference rate that is used.

And so while I would not—while I wouldn't argue we should push towards entirely long-term, I think it is beneficial that we have—that Treasury issues the whole spectrum of interest rates to provide those base rates for a variety of transactions, and I think that their work with the Treasury Borrowing Advisory Committee to get guidance on where there are clientele effects or gaps in the maturity structure is beneficial.

Mr. FITZPATRICK. Thank you.

I yield back, Mr. Chairman.

Mr. SCHWEIKERT. Thank you, Mr. Fitzpatrick.

Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman.

Mr. Kogan, we have had a front-row seat in the last couple years as America's credit has been endangered. We have only escaped fiscal calamity by the skin of our teeth, listening to all of our great speakers here today.

So, over a decade ago, our committee heard testimony from the former IMF chief economist who said the impacts of default would be 10 times worse than the Great Recession. That is what he said 10 years ago.

Can you detail what a default would mean for everyday Americans, as quickly as possible?

Mr. KOGAN. Sure. So there are two points I want to make on that, Congressman. Appreciate the question.

The first is on the credit side, and then the other is on the government side.

Mr. PASCRELL. Right.

Mr. KOGAN. So as my fellow panelist was saying, the entire financial system is capitalized through the U.S. Treasury market, and so any single transaction that involves credit would be more expensive. The whole point is that, if the government says it is going to pay you a certain amount in a certain time, you believe it. But if we are in default, that is no longer the case.

And so home loans, auto loans, anything that involves credit is more expensive. But even if you are just buying from a business and you are not doing any credit, if the business is involved in the credit market and that is more expensive, then now the business costs are up. So any kind of purchase from an individual is more expensive. So that is on the credit side.

And on the government side, the government is not allowed to issue new debt, which means it has to dramatically pull back its spending as we are no longer allowed to run deficits, and that means that any of the benefits that the American people rely on are no longer assured to come on time in the full amount—veterans benefits and disability compensation, child care, Medicaid payments to the States, you name it—those are all no longer guaranteed. So it would be cataclysmic for the country and for the world that also relies on the global financial market.

Mr. PASCRELL. And I think you would agree with me that, when we look back historically, both parties are at fault in getting to the red line, some more appreciably at different times, obviously.

But in 2011 and 2013, in 2015, in 2023, this was driven by the Congress.

The debt extortion—I use that word strongly—has led to devastating consequences. Our Treasury debt has long been the world's safest asset, historically, but default extortion has lowered credit ratings and created higher borrowing costs. You guys have referred to that.

Can you explain how even threatening a default on our debt impacts our Nation's economy and the ability of the Federal Government to maintain a stable market for Treasury securities?

Do you understand my question? Am I clear?

Mr. KOGAN. Yes, Congressman. So absolutely, as we said, the entire—the entire financial market is capitalized by these Treasuries. So if you are no longer certain—even if we don't default, if you now have in the back of your mind that we might default, then, especially for the longer term bonds, you are going to want to price in some uncertainty. And that is going to raise up—that is going to raise rates.

Now, it is not going to be cataclysmic in the way that the actual default would be, but that raises the bar and cost in the margin of everything. So it is—if you want to talk about government waste, that is pure government waste. It is uncertainty out of nothing that raises borrowing costs both for the government and for everyday Americans.

Mr. PASCRELL. Thank you.

The deficit fell by a record $1.7 trillion during President Biden's first 2 years. The President has a plan to reduce deficits—have you seen that plan—by nearly $3 trillion over the next decade.

We have been focused on looking and protecting Social Security, Medicare. Members on both sides have different views of that.

Can you explain why spending programs like Social Security and Medicare are not primarily responsible for our deficit? Why is it necessary to increase revenue and close the tax gap to reduce the deficit?

Mr. KOGAN. Thank you, Congressman. So taking the second part of your question first, the tax gap for anyone listening who is unfamiliar, it is the difference between the amount that is legally owed under law and the amount that we take in. So the tax gap is the mixture of people cheating on their taxes and then accidentally paying the wrong amount. It is estimated to be over $600 billion a year. Again, that is how much we don't take in that we are supposed to.

That is bigger than the fiscal gap. So if tomorrow—obviously, you actually—it is impossible to recoup all of it, and then you actually have to spend money to get it. But if tomorrow everyone started voluntarily paying the correct amount and not making mistakes, that would be enough to change our fiscal trajectory to having debt decline indefinitely. So it is an incredibly important source.

The fiscal gap is 1.7 percent of GDP, and it is bigger than 1.7 percent of GDP. So, therefore, it is just a mathematical truth; that will be enough to have debt declining indefinitely. It is a great source of revenue to have people pay the taxes that they already owe.

As to the first question for why it is spending—so why it is not spending, again——

Mr. SCHWEIKERT. Yeah.

Mr. PASCRELL. Let him finish his answer.

Chairman SCHWEIKERT. No, no, no. Let you finish, and then we can get——

Mr. KOGAN. Okay. Sorry. As to the first part of your question, it is just—as I said in my testimony, these two tax gaps are bigger than the fiscal gap, so regardless of whether—where you kind of want to place blame, like, we can—we mathematically know that they are enough to stabilize debt. And then the question about why we think that that is more fair than spending, it is just that spending is down and not up.

Chairman SCHWEIKERT. And for management of the room, we are just going to start doing two to one just because the ratio is—Mr. Steube.

Mr. STEUBE. Thank you, Mr. Chairman.

When I was elected to Congress only 5 years ago, the debt was $21 trillion. Today, it is almost $33 trillion. So in 5 years, we have put $13 trillion on the debt, and it is a staggering number that seems almost incomprehensible, especially to those in my district.

When I try to explain that Washington has a spending problem and we are not addressing and balancing our budget, I come from the State of Florida, where we are required by constitution to balance our budget every single year. And so the legislature is very good about making sure that we are operating like you would operate your family or operate your business and not getting ourselves into the incomprehensible levels of debt that we have gotten our country into.

Unless Congress gets serious about our spending problem, the consequences of Congress' failure to govern responsibly will have a disastrous impact on lives of several generations of Americans.

It is true that deficit spending is nothing new. With only a few exceptions over the past several decades, the Federal Government spends more money than it receives every year. Since we do not actually have the money to pay for our spending, the government borrows money by issuing debt in the form of Treasury bills, notes, and bonds.

In just the past few years, the amount we are forced to borrow has grown dramatically. The national debt increased by almost $2.5 trillion just in this past year alone. Despite Congress' best efforts to bury its collective head in the sand, the bill will ultimately come due.

The interest payments on our existing debt are growing at an unsustainable rate. In fiscal year 2023, Federal net interest payments skyrocketed up to $659 billion, a 40 percent increase from just the prior year. Debt servicing costs will soon be the second largest line item for Federal spending, which will put it ahead of Medicare and defense spending.

In recent months, both Fitch Ratings and Moody's downgraded their credit ratings on the government due to the large fiscal deficits and rising interest rates. We have been able to issue debt on favorable terms in the past because investors viewed them as a low-risk investment. Unfortunately, our bad decisions are catching up with us, and the market is starting to notice.

We got away with spending like this for too long because interest rates were historically low. However, rates are on the rise, and our government does not appear to be ready for the consequences. Politicians from both sides of the aisle share blame for our addiction to spending money we do not have, and we are just now beginning to bear the consequences.

Mr. Faulkender, I will start with you. Given the dramatic increase in debt servicing costs that we are experiencing, shouldn't this encourage Congress to tighten our belt instead of borrowing more money at a higher rate?

Mr. FAULKENDER. Certainly, yes. We definitely need to tighten our belts.

Mr. STEUBE. Your testimony points out that demand for Treasury securities at long-term bond auctions has declined. Why is that?

Mr. FAULKENDER. That is correct. So if we look at the last couple—there was a 10-year auction and a 7-year auction recently where there was less demand, particularly from international buyers, and so the prime dealers who participate, they had to soak up more of the issuances than they normally would have to.

Mr. STEUBE. Well, and you said two. What—like, what are the implications for that on the taxpayer?

Mr. FAULKENDER. So the implications are that yields, therefore, are going to be higher. The auction outcome at which the issuance actually goes through results in a higher yield, which means that interest payments are higher than what they were expected to be.

Mr. STEUBE. So, in the last exchange with Mr. Pascrell, Mr. Kogan was talking about, if we were able to magically get $600 billion of people to pay what they are supposed to pay, do you guys have any response to that or do you have a difference of opinion on that issue?

Mr. FAULKENDER. Well, I think there are two parts, right. There is the tax gap, and then there is also had we not engaged in some of the tax cuts. If that were the case—remember that the Tax Cuts and Jobs Act, for instance, made the Tax Code more progressive, not less. And so, you are talking about a time of an affordability crisis for many American households, and the argument seems to be if only middle-class taxpayers were paying more taxes.

Mr. STEUBE. Mr. Smetters.

Mr. SMETTERS. So even if we collected all the uncollected tax revenue, it is not going to come close to——

Chairman SCHWEIKERT. Can you move closer to your microphone?

Mr. SMETTERS [continuing]. It is still not going to balance the budget. It is simply the numbers aren't there. That is a big hypothetical if we can even get a lot of that money.

I mean, the bottom line here is, you know, taxes have come—revenues come down, spending has gone up. And both sides are really to blame. In particular, if you just look at spending for fiscal year 2023, it is about $600 billion, $700 billion more than you would have guessed just by trending the line pre-COVID. So, both are happening.

Mr. STEUBE. Do you have anything to add to that in the remaining time I have?

Mr. DRIESSEN. Yeah. So, you know, I think $600 billion would be helpful if we could kind of improve that on that side of the ledger. And I think, while I think some of the numbers that we have been throwing out are quite pessimistic, one thing I would want to communicate is, the sooner we act, even if it is only partially acting, the better, whether it is on the revenue reside or on the spending side.

I think, you know, it would not get rid of the deficit entirely. Collecting $600 billion more in revenue every year would probably go some way to improving our debt trajectory, though how much is kind of uncertain.

Mr. STEUBE. Thank you.

I yield back.

Chairman SCHWEIKERT. Thank you, Mr. Steube.

Ms. Tenney.

Ms. TENNEY. Thank you, Mr. Chairman, and thank you to the witnesses for your expertise. We greatly appreciate it.

I just want to first say, one of the reasons we are here today is Ways and Means has sole House jurisdiction over the Federal debt and to fulfill this committee's duty to ensure that existing Federal debt is being managed at the lowest cost to the American taxpayer. Part of this means ensuring that the American people have more transparency surrounding the Treasury's debt management practices.

So, with that being said, Mr. Driessen, it is my understanding that the Treasury has discretion over the debt management process. Is this correct? And, if so, where does this discretion derive from?

Mr. DRIESSEN. Yeah. Treasury does have a relatively broad discretion within—to manage Federal debt. So, there is a lot of places in statute where that is provided. One of the big places is 31 U.S.C. in the 3100s. And so, you know, Congress can certainly make changes to what sort of powers they delegate to Treasury, but there is a lot of power with the Treasury Secretary and more generally——

Ms. TENNEY. So, rulemaking also under the Code of Federal Regulations, I see, has happened over the years as well?

Mr. DRIESSEN. Yes. Yes.

Ms. TENNEY. So do you know, since that time of that statute, like, when is the most recent modification that this statute—well, to the statute that was made that is impacting the ability of the Treasury, either——

Mr. DRIESSEN. Yeah.

Ms. TENNEY [continuing]. For better or worse, to manage our debt?

Mr. DRIESSEN. Sure. So I think the most observers would say it is kind of the last significant changes made to those portions of the Code were several decades ago. I think there were large changes in the 1970s and 1980s, largely to make the process a little bit more predictable and transparent.

There have been some small changes since then, 2010 and others, but I think significant, you are talking several decades.

Ms. TENNEY. Still significant ability to manage the debt?

Mr. DRIESSEN. Right. Exactly.

Ms. TENNEY. Thank you so much.

As many know, the United States has benefited from historically favorable credit ratings, allowing the Federal Government to issue Treasuries on relatively favorable terms. However, as funding deficits and projected debt-to-GDP ratios have grown over time, the country's credit rating has not.

For example, on August 1, 2023, Fitch Ratings downgraded the country's long-term foreign currency issuer default rating from AAA to AA+, which was the first time a ratings firm lowered its assessment of the U.S. Government's ability to pay its debt on time since 2011.

Mr. Faulkender, can you please describe the relationship between Treasury's debt issuance strategy and credit ratings?

Mr. FAULKENDER. Sure. So all bond issuances have to be rated in order for many mutual funds and different fund families to hold them, and so Treasury—there is—the rating agencies differently model out governments, corporates, utilities, and financials, and then they set a rating on the likelihood of being repaid.

Treasury meets with the three major rating agencies each year to discuss the fiscal outlook and to give—and from that information they obtain, the rating agencies then provide a rating that is, as has been said by my panelists, the foundational interest rates that are provided in global financial markets.

Ms. TENNEY. Well, let's bring this home. How does this affect American families, the bottom line there?

Mr. FAULKENDER. So, the higher the borrowing costs for the U.S. Government, the higher the borrowing costs for nearly every other form of credit for the American people. So, it is not just that they are going to pay higher taxes in the future to support higher interest costs, but any borrowing they are doing in their own household is going to be higher if U.S. Treasury rates are higher because their bond rating is lower.

Ms. TENNEY. Thank you.

So, quickly, since—I will stick with you, Mr. Faulkender. You may recall a slide that Mr. Kogan shared earlier today during his testimony which argued that revenue and spending are both lower than earlier projections, suggesting that low revenues are responsible for the persistent primary deficits.

So, what are your thoughts on this, and do you agree with Mr. Kogan's proposal?

Mr. FAULKENDER. Well, again, the revenue forecast relied upon current law extending in ways that it is not clear Congress actually would have. So, we suffered, for instance, from what is known as bracket creep, which is that, as people made more money, a higher portion of their income was then thrown into a higher tax bracket.

In order to have those CBO projections continue, you would have had to assume that Congress would not have fixed that. Likewise, as we know, the alternative minimum tax, for instance, was implemented to capture a couple of millionaires that weren't paying very much in Federal income taxes, and yet by the—into the 2000s, you had, you know, a few million taxpayers being hit by the AMT, and so Congress came in and modified it because it extended beyond what its original objective was.

One has to presume that Congress would not have made those fixes that American households would be paying about 25 percent higher taxes today.

Ms. TENNEY. Well, let me ask you this: Aren't a lot of these things static numbers? Isn't there a lot of growth that happened because of the Tax Cuts and Jobs Act?

Mr. FAULKENDER. So that is the other piece, is that you have to presume that we would have continued to have the growth output we had. We saw higher growth rates following the Tax Cuts and Jobs Act. There is some recent academic work that shows that. It is hard to argue that we would have had the same economic output and the same spending levels had tax rates been significant—substantial.

Ms. TENNEY. So, historically, where are we with revenues today?

Mr. FAULKENDER. Revenues is a percent of GDP, which is, I think, the best way to look at it. In 2022, for instance, we are about fourth highest on record.

Ms. TENNEY. Thank you.

My time has expired. Thank you, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Ms. Tenney.

Ms. Chu.

Ms. CHU. Mr. Kogan, I want to address an accusation leveled against Treasury Secretary Janet Yellen alleging that she committed the biggest blunder in the Department's history by not refinancing the public debt when interest rates were historically low. This accusation assumes that the Treasury could have easily auctioned trillions of dollars in long-term securities at a very low interest rate on the bond market.

Of course, the Secretary cannot compel investors to purchase the securities at Treasury auctions. And, in fact, former Treasury Secretary Mnuchin explored the idea of refinancing the debt this way under the Trump administration and found that there was no viable market for these bonds.

So, we already know that there is no quick fix to reduce debt servicing costs. The reality remains that Republicans' commitment to cutting taxes for the wealthy and corporations is the reason for the country's rising debt ratio.

So, Mr. Kogan, can you talk more about the issues with this proposed simple fix for reducing debt servicing? Why did Secretary Mnuchin find that this option was not viable when he studied it in 2019?

Mr. KOGAN. Thank you for the question, Congresswoman. Yeah. Precisely as you said, you cannot induce demand—you cannot force people to buy stuff. But even if you—it is even deeper than that, because even if you could compel people to buy at the rate you want, the Treasury deliberately tries to diversify, you know, how it is doing the bond market. It deliberately wants to make sure that there is not too much demand for certain kind of Treasuries, too little demand. It has a vested interest in making sure that the entire market is stable, and that is far more important than kind of winning a little bit in the margin. Maybe you could do a little bit in the margin, but the stability is the most important thing.

And then I would be remiss if I didn't point out, even if you then did do this and you were able to—you were able to lock in really low rates for a lot of the debt, that has nothing—that has very little to do with kind of the long-term trajectory. Eventually that debt rolls over, and then you are right back where you started. Yes, you kind of gained a little bit by getting the benefit from lower stuff, but the long-term issue is driven by the fact that revenues are lower than primary spending, not that, you know, we locked in interest a little bit higher or a little bit lower. And that is kind of the big issue. And as I said, that is caused by these tax cuts.

Ms. CHU. Mr. Kogan, unfortunately there are far too many tax loopholes that benefit the wealthy in our Tax Code, and I am working with Senator Sheldon Whitehouse, chair of the Senate Budget Committee, on legislation to close one of those harmful loopholes in the Tax Code.

Normally, the wealthy are subject to capital gains taxes when they sell appreciated assets like stock. But if those assets are instead donated to a 501(c)(4), the donor pays no capital gains taxes at all, even if the organization sells the assets immediately after receiving the donation.

This loophole effectively gives a public subsidy to the wealthy for engaging in political activity like lobbying and seriously reduces tax revenue. For example, earlier this year, billionaire Barre Seid donated $1.6 billion in stock to a rightwing nonprofit organization that engages in political activity, avoiding a tax bill of up to $400 million.

So, Mr. Kogan, can you talk about the impact of closing tax loopholes like this one? Can Congress improve our fiscal condition by ensuring that the wealthy pay their fair share?

Mr. KOGAN. Thank you, Congresswoman. Yeah, making sure that the—kind of these forms of capital are not getting preferential treatment is an important way of—both of kind of increasing equity in society and also in terms of helping the Federal Government.

I think the estimate is that more than half of capital gains have never been taxed and will never be taxed. You get the full buildup, and then the example you give, they get to pass it over, and then the basis is reset. And so, then, if they sell it immediately, there is no gains, right. It is another way in which—yeah, in the case of Mr. Seid, most of the gains from his business will never be taxed, and that is a major problem that has huge effects on our Federal outlook.

The one thing I want to say, so the President proposed a tax plan that would be only above 4—only bring in revenue above folks making 400K in profitable businesses. That itself is—his proposal is almost enough by itself just to stabilize our long-term outlook. It is slightly below the fiscal gap. If you did a little bit more, that will be enough. This is a major, major, major source of revenue.

Ms. CHU. And, in fact, earlier, somebody on the other side of the aisle said that despite our $688 billion in the tax gap, that how could we magically pay for this? But is there a way to pay for it?

And let's talk about IRS funding.

Mr. KOGAN. Sure. So the tax gap, as I say, it is bigger than the fiscal gap. So you cannot get it all. You have to spend money to get it. That ends up, you know, netting down the costs and, regardless, you won't be able to get it all. But it is a major source of lost revenue of people simply cheating on their taxes or kind of mispaying.

As I said, if we could get it all—we can't, but if we could get it all, that would be enough not to balance the budget but to stabilize our debt ratio.

Ms. CHU. Thank you. I yield back.

Chairman SCHWEIKERT. Thank you, Ms. Chu.

Mrs. Fischbach?

Mrs. FISCHBACH. Sorry. Had to find my button.

Thank you, Mr. Chair.

Dr. Faulkender, I——

Chairman SCHWEIKERT. Mrs. Fischbach, can you get close to your mic?

Mrs. FISCHBACH. I can't, actually. The chair is too big. I will lean in.

Chairman SCHWEIKERT. Just scream.

Mrs. FISCHBACH. Okay. I will lean in.

And thank you very much.

But I know that Congresswoman Tenney kind of was—led up to some of this, but maybe you could describe the impact that the higher Treasury yields have on the American family in layman's terms. So, what is it really doing to the American family budget?

Mr. FAULKENDER. Sure. So, let's think about—the mortgage rate that the American person—that the American household pays on their 30-year mortgage is going to be priced off of a 10-year Treasury bond. So, think about where 10-year Treasury bond yields were back in the 2020, 2021 timeframe. They were around 1 percent. And so, therefore, you were able to get households to get 30-year mortgages at around 3 percent. There is going to be a gap because there is, of course—the Federal Government is going to be a higher quality credit than an individual household, and so there is a spread that households pay.

Today, the 10-year bond is closer to 4, 4.5 percent, and so you have got mortgage rates closer to 7 percent. Again, as the 10-year Treasury yield went up, so did the borrowing rate for households.

Now, this has enormous problems because, for instance, a $250,000 mortgage on a house back in early 2021 would have about a thousand dollars a month in a principal and interest payment. At today's interest rates, that would be closer to $1,700 per month.

That doesn't just make home ownership less affordable for people newly looking to purchase a home, but it also means that people are somewhat trapped in their existing homes. So, imagine for a moment that, you know, you got married and your spouse and you bought a house, but you were looking to maybe move to a different school district or get a larger home when it was—when the kids were of school age.

Right now, if you move, you don't get to take your mortgage rate with you. And so that means that, if you move, you lose the 3 percent mortgage rate that you had when you refinanced back in 2020, and now you are possibly going into a 7, 7.5. And that makes it nearly unaffordable for many not just to start home ownership, but then continue on the path that we normally think about families engaging in.

Mrs. FISCHBACH. Thank you very much.

And, you know, can you maybe talk about some of that in comparison to what is going to happen with the economic growth?

Mr. FAULKENDER. Sure. Oh, my. Okay.

Mrs. FISCHBACH. See, you get up close and it scares you.

Mr. FAULKENDER. I barely moved.

Mrs. FISCHBACH. That is what is going on with me.

Mr. FAULKENDER. So the other thing, though, it does is there is something called labor mobility, which also, because we have locked people into their houses, it makes it more difficult for people then to move if—so let's say that a new work opportunity arose in another town, again, it is now significantly more expensive for somebody to move and take that alternative job because, again, you don't get to take your mortgage rate with you.

Also, purchases of automobiles, any kind of purchase that consumers are making on credit is now that much larger. Small business loans are now higher interest rates. So that is going to curtail the type of investment we see. And that is why we have seen, for instance, that the number of pending home sales is at 20-year lows. So there is reductions in a variety of economic—of industries as a result of this higher interest rate environment.

Mrs. FISCHBACH. Thank you very much. I appreciate it. And it really is important, I think, that the American people understand, you know, how this really is affecting and their inability to purchase a home and to purchase the cars.

And I appreciate the effect that you mentioned, the labor mobility issue too, because there are lots of other job offers going around and it makes it difficult. So thank you, and thank you all for being here. I appreciate it.

And with that, I yield back, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Mrs. Fischbach.

Ms. Van Duyne.

Ms. VAN DUYNE. Thank you very much.

The reality is Biden inflation is driving our national debt to unprecedented levels, not only burdening future generations but also actively punishing working families and forcing people across the country to choose between putting food on the table and paying for things like rent. The American people are suffering and tightening their budget right now. The Federal Government should be doing the same thing. The last few years of spending levels weren't just unsustainable, they were reckless and unfair to future generations who will be forced to foot the bill.

To borrow from my friend, the Budget Committee chairman, we didn't get into this massive amount of debt overnight and we won't get out of it overnight, but we cannot get ourselves out of this mess just by cutting spending. But through sound tax policy, we can and need to grow our way out of this.

I am looking forward to the Tax Subcommittee hearing later today, which we will look at the successes of TCJA, which brought in record revenues and created unprecedented growth. And this is our Tax Cut and Jobs Act, as all of you are familiar.

I have got a question for Mr. Smetters. Since 2021, we have seen the Federal debt balloon by more than $6 trillion all the way up to an unprecedented $33.8 trillion. This debt not only strains the Federal Government's ability to service the debt, but also costs American families and taxpayers tremendously through increased mortgage rates, car loan rates, and every other day necessities.

Mr. Smetters, what can Congress do to help mitigate the cost of servicing this extremely high debt for American taxpayers?

Mr. SMETTERS. The main thing it can do is simply reduce the deficits over time, and that is either through more revenue, less spending, or a combination of both, and that would lower interest payments that are required to be paid on that debt.

And, you know, there is a lot focused on these ratings, but keep in mind, ratings really focus on technical default or the failure of the government to pay. Markets are much more concerned about potential for monetization of future debt and through higher inflation, and that is not going to be captured in ratings at all. So there is much more scare out there than is captured by ratings alone.

Ms. VAN DUYNE. I appreciate that.

Mr. Faulkender, in fiscal year 2023 alone, debt increase soared to $659 billion, a nearly 40 percent increase from fiscal year 2022. And on top of that, within a few years, debt service costs alone are expected to become the second largest Federal Government outlay only behind Social Security.

So is there anything the Treasury can or should be implementing in this debt servicing and management strategy to help mitigate costs for the American people?

Mr. FAULKENDER. I think the most important thing Treasury can do, as Kent just mentioned, is work to reduce the budget deficit. So, for instance, we saw Treasury issue rules regarding the electric vehicle tax credits that were much more generous than they needed to have been. We have seen, for instance, just earlier this week, there was an article in The Wall Street Journal about Treasury opening up COVID money for States that, instead, could be reprogrammed towards other activities.

Anything we can do to bring down the budget deficit would lower our future debt service costs.

Ms. VAN DUYNE. I appreciate that.

And, Mr. Kogan, in your testimony, you said that our current rising debt ratio is due entirely to both Bush and Trump tax cuts, not spending increases. Can you honestly sit here and justify the current spending levels that we have seen over the last few years?

Mr. KOGAN. Thank you for the question, Congresswoman. Yes, I can. I think, you know, the important thing for us to figure out as a society is what we want our government to look like, and then we should figure out how to make sure we have——

Ms. VAN DUYNE. Well, we know what our government looks like. I am asking you not what the government looks like. I am asking you, can you sit here, look me in the eye, and justify the spending levels that we have seen since the Biden administration took over, when you are complaining that it is all the Bush and tax cuts—Bush and Trump tax cuts that caused it, even though we have seen record amounts of increased revenue as a direct result of things like the TCJA?

Mr. KOGAN. Thank you for the question. So I would make three points on this. The first is that we had the strongest recovery in the world among G7 countries. That is a really, really important thing. I am glad that we are serious about the COVID response.

Ms. VAN DUYNE. So you are glad that we are at $33.8 trillion debt. It is a good thing.

Mr. KOGAN. I am glad that we did not have an economic calamity. I am glad that we responded correctly.

Ms. VAN DUYNE. But do you not think that it is short term and that we will potentially have that when you are looking at $33.8 trillion in debt?

Mr. KOGAN. The stock of debt is different from the long-term trajectory. So what the recession spending did was we pushed up the stock of debt, but that has little effect on the long-term trajectory of our debt ratio. We are starting from a higher level.

Ms. VAN DUYNE. We are going to be at a point where the second largest Federal Government outline is going to be servicing that debt. That is long term.

Mr. KOGAN. Right. But the long-term debt ratio is driven by the flows in the future, rather than——

Ms. VAN DUYNE. Thank you. I yield back.

Chairman SCHWEIKERT. Thank you, Ms. Van Duyne.

I want to get to Mr. Schneider, because he has another place he belongs right now.

Mr. SCHNEIDER. Thank you very much. And I thank the witnesses. A lot of good things here.

Let me start with just a question for Mr. Kogan. In the opening remarks, it was noted that we had a balanced budget in 1999 with a Democratic President, Republican House. What was the—do any of you know the spending or the revenue—I am sorry, the revenue side as a percentage of GDP in 1999?

Mr. KOGAN. I don't have 1999, but the highest that we got was 20 percent of GDP. Yeah.

Mr. SCHNEIDER. Right. It was actually 19.6, to be precise. And by the way, I will agree with my Republican colleagues, we all rightly should be concerned about our level of debt. I think we are talking about it. $33 trillion is a massive number and, as you said, Mr. Kogan, it is not sustainable if we stay on the current trajectory. We have to take specific action.

Dr. Smetters, you made a comment just a moment ago. It is not just the drop of our ratings with the credit agencies; it is if there is a loss of confidence. One of the things I believe the credit agencies noted in the ratings cut is that it is the failure of Congress to take the necessary steps to show that we are serious about that.

Do you think that was a fair assessment of Fitch and others?

Mr. SMETTERS. Sir, do keep in mind Fitch is really focused on the narrow question of whether payments will be made.

Mr. SCHNEIDER. But S&P took that position when they did it a number of years ago. Do you think others are looking at us and saying, if Congress can't act, there are reasons to be concerned about United States' future fiscal trajectory?

Mr. SMETTERS. Absolutely. Once capital markets believe that fiscal balance will not happen, you will see a big unraveling.

Mr. SCHNEIDER. And, Mr. Kogan, maybe you know this. Our discretionary spending, is it significantly higher than it was in 1999, when the two lines crossed at 19.6 and 20 percent?

Mr. KOGAN. No. Our recent kind of post-Budget Control Act levels are significantly below average in the post-1986 kind of world. And, in fact, nondefense discretionary minus the VA shrank this year from the previous year, which itself shrank from the previous year. We have kind of a semistable, somewhat shrinking trend for NDD.

Mr. SCHNEIDER. So, if I follow your logic, going back to when we had things in balance at roughly, let's call it, 20 percent for sake of argument, revenues and spending both end at 20 percent of GDP. Our revenues today are what percent?

Mr. KOGAN. We are down to 16.5, not among the highest ever but, instead, the lowest ever in good economic times.

Mr. SCHNEIDER. Wait. I thought we were at record. Is 16.5 less than 20 percent?

Mr. KOGAN. Significantly less, Congressman.

Mr. SCHNEIDER. Okay. So let me stick on this for a moment. Because if the revenues are lower, there are a number of reasons that might be. One is, as you have noted, the tax cuts in previous administrations. The other one also noted is this tax gap, and that is something I have been very much focused on.

You said we can't get all of it. I think one of the reasons you expressed that was because there is going to have to spend money to get it. Compliance is a key piece of this.

What would happen if we cut the investment that the administration has asked for and Congress approved in increasing our compliance? What is likely to happen to the tax gap?

Mr. KOGAN. It absolutely will increase. It will send a signal to would-be tax cheats that, not only is the United States not serious about going after tax cheats, but that even if we—in the one time where it looked like we were going to get serious, that there was massive mobility against doing it. So I believe it would increase lack of compliance.

Mr. SCHNEIDER. Okay. So, if there is a greater tax gap and there is a greater need to try to get to a place where we are bending the curve and reducing our deficits, who is the burden going to fall upon?

Mr. KOGAN. I am sorry. Could you please repeat the question?

Mr. SCHNEIDER. I guess it is a leading question. I will ask it even more leading. If we signal to the tax cheats that it is open season, if we let the tax gap expand because the IRS doesn't have the ability to enforce the laws on the books, doesn't that put a greater burden on law-abiding taxpayers?

Mr. KOGAN. That is right. Thank you, Congressman. Yeah, it is a deeply unfair thing for the super majority of us who pay our taxes. Democrats, Republicans, Independents, nonvoters, most of us pay our taxes. To give special preference to tax cheats is bad for fairness, and it is bad for America, and it is bad for our Federal coffers.

Mr. SCHNEIDER. Maybe not just calling them tax cheats, but freeloaders and free riders, people who are taking advantage of those who obey the law, because there are too many people in this body, in Congress, who are trying to eliminate the ability to go after those tax cheats and make sure that we are doing what we can to serve those who are honoring the law.

With that, I yield back.

Chairman SCHWEIKERT. Thank you, Mr. Schneider. And I appreciate your patience. I know you needed to run on us.

Mr. Feenstra.

Mr. FEENSTRA. Thank you, Mr. Chair. Thank you for holding this hearing.

I want to thank each of our witnesses for your testimonies today. I think each of you made it very clear that we are in some very serious times with our debt, and it is on the backs of our children and grandchildren. And if we don't act, there are going to be severe ramifications. We have also just heard about the 10-year yield, how that affects families and businesses. And when it comes to loans on houses, cars, operational loans for businesses, this is real.

But I want to talk about more macroeconomics and the risks that are out there. And one thing that is not talked about is, when you start having all this spending, when you are having all these treasuries being sold, you are flooding the market with treasuries, in effect, it affects private investment, literally affects private investment. And that is what I want to talk about.

Dr. Faulkender or Mr. Faulkender, can you expand on this, that how would the private enterprise and the private sector, private investment be affected by all this flooding of paper on the market?

Mr. FAULKENDER. Sure. So the reason that firms are going to engage in the private investments is because spending money today is going to generate better outcomes in the future. But because it is now going to be more expensive to move that money from the future back to today in terms of the higher interest rate environment, that is going to make incremental investments less valuable. They are not going to look as strong. And so you are going to see companies——

Mr. FEENSTRA. Less competitive.

Mr. FAULKENDER. Less competitive, less beneficial to engage in that investment. And that means companies are going to pull back on the kind of infrastructure investment and facilities and equipment investments and intellectual property.

Ultimately, real wage growth comes from matching capital with labor. And if we reduce the incentives on businesses to allocate capital to match with that labor, you are reducing real wage growth, and that reduces income for future Americans.

Mr. FEENSTRA. Exactly right. And that is my greatest fear. I mean, we can talk about the interest rates and all this stuff, but there is this big macro effect that is going to affect so many other things, especially when it comes to GDP. And I want to talk to Mr. Smetters about that.

Staying on the topic of macroeconomics, you stated in your testimony that if Federal debt is allowed to increase to 180 percent of GDP over the next 30 years, the economic consequences would be severe. GDP would fall to around 8 percent. Wages would fall by 4 percent. Interest rates would go up by 1.5 percent.

I want you just to discuss the scenario further, and what timeframe do you see? I mean, this is big stuff. This is really serious stuff. I want your thoughts, Doctor.

Mr. SMETTERS. Yes. In fact, this is the good news, because that is the most optimistic that we could actually project our framework. And in particular, because of this crowding out effect that was just described of the reduction in investment, it is going to shrink the capital that is available, and it is going to reduce GDP relative to where it otherwise would have been at about 8 percent.

Literally, we cannot solve the model after that point. There is just not enough national saving. A lot of times people make a comparison against Japan. It is just not right for many reasons.

And so this is the most optimistic that we can even get with the model. If capital markets really believe that Congress is not going to take action, everything unravels even faster.

Mr. FEENSTRA. Yeah. So, Dr. Faulkender, I want to go back to you then. On that same front, right, if you look at the global world and where we stand with the European Union and all this stuff, if we continue to slide down this path of lowering our GDP and continue with, you know, flooding the bond market with paper, what does this do to the rest of the world? What does this do to our dollar?

Mr. FAULKENDER. So traditionally, the strength of our economy and the strength of our ability to engage in foreign policy, engage in our national security is a result of the strength of our underlying economy. So if we reduce our growth rate, that reduces our ability to, for instance, maintain our status as the world's reserve currency.

Mr. FEENSTRA. That is right.

Mr. FAULKENDER. The world's reserved currency, as I mentioned in my opening remarks, facilitates our ability to engage in sanctions, on the national security. It allows us to monitor illicit financing, drug dealing, arms dealing around the world.

All of those activities are endangered if we don't get our fiscal house in order. And if we continue down this path, it would jeopardize our status as the world's reserve currency.

Mr. FEENSTRA. I want to thank you for those comments. I mean, this is catastrophic not only to our Nation but around the world and what it does to our U.S. dollar. And that is why we have got to get our arms around this.

And I thank the chairman for putting this together, as it is so critical. So I look forward to figuring out a fix. I hope you guys are all involved in trying to understand what a fix looks like.

With that, I yield back.

Chairman SCHWEIKERT. Thank you, Mr. Feenstra.

Ms. Malliotakis.

Ms. MALLIOTAKIS. Thank you very much, Mr. Chairman.

The national debt has skyrocketed by more than $6 trillion over the last 2 years and is now nearing $34 trillion, and that represents over $100,000 in debt for every American man, woman, and child.

The current fiscal trajectory is unsustainable, and American families are already feeling the financial hit through higher interest rates on mortgages, cars, and other goods and services financed in the economy. Servicing this debt has crowded out other government spending and forced the government to prioritize interest payments at the expense of American families.

As early as next year, paying off the interest on the debt alone could become the second largest Federal outlay after Social Security, more than Medicare and defense outlays at a time when Medicare part A is predicted to be insolvent by 2031.

There has been a lot of discussion today about what happens if we continue on this current trajectory, but I want to shift to the circumstances around who holds our debt, specifically foreign and international holdings, which now accounts for $7.3 trillion. And this includes foreign adversaries like Communist China, which holds roughly $800 billion in America's debt.

I will turn to you, Mr. Smetters, first. Many believe that the risk could be mitigated by addressing foreign countries' role in bidding for and ultimately owning our national debt. Can you please speak more about the role that foreign adversaries and other nations play in our debt servicing process, and is it beneficial, and what are the challenges?

Mr. SMETTERS. Sure. So as testimony given earlier pointed out, there is a really big difference between China buying our debt versus them investing in our critical infrastructure and things like that. Right now, if anything, they are giving us a subsidy so we can build up our critical infrastructure. The international component of that is, if anything, right now a good thing for us, and it is not really a major risk.

Ms. MALLIOTAKIS. Okay. Does anybody else want to comment on that point? You guys all look tired.

Mr. FAULKENDER. I would just say I agree.

Ms. MALLIOTAKIS. Okay. You agree. Great.

I would like to turn—I would like you guys to expand a little more. I mean, you have brought up some really important points as it relates to keeping America's dollar as the reserve currency. And I want to just give an opportunity for you to expand on some of the other benefits that it is for the American taxpayer.

Mr. DRIESSEN. I think it actively lowers our net interest costs. I think estimates range on exactly how much that is worth, but I have seen things around, you know, 25 basis points in terms of the interest rates that Treasury is phasing. That is quite large when you kind of map it out in terms of Federal cost per year if we were to cede the reserve currency to someone else.

Mr. FAULKENDER. I would just add that being the world's reserve currency facilitates our sanctions activity. It facilitates capital flows not just to the Federal Government but to American businesses and companies as well as households. And then it also enables us to monitor illicit transactions, so everything from sex trafficking to arms dealing to drug trafficking.

The fact that dollar denominated securities pervade the global financial system means that financial institutions around the world willingly participate in our oversight of these transactions, and that is enabled by the fact that we have the world's reserve currency.

Ms. MALLIOTAKIS. And how threatened do you think this is right now, the U.S. debt and the impact it could have on us being the reserve currency?

Mr. FAULKENDER. I had the privilege of testifying to the Financial Services Committee about this a couple of months ago, and I think our view is there are kind of three factors at play. You want to maintain a regulatory environment such that we have the most liquid, transparent markets in the world; second, you want to be a strong financial steward such that reserve banks want to hold your assets denominated in your currency; and then, third, you want to make sure that you don't abuse your position as the reserve currency when it comes to engaging in unilateral sanctions or unilateral punishments that abuse that position. And so maintaining those three things, I think, are essential to maintaining status as a reserve currency.

Ms. MALLIOTAKIS. Thirty seconds left if anyone else wants to add.

Mr. SMETTERS. The biggest threat for the U.S. economy is still the longer term. So certainly we could maintain a reserve currency, but if financial markets get nervous about our willingness to monetize that debt, which is the last channel, that is what has to happen mathematically if we don't close this imbalance, then that is when the financial markets are going to demand a much higher return, and this whole thing could literally unravel.

Ms. MALLIOTAKIS. Well, thank you very much.

And thank you, Mr. Chairman, for your commitment in getting our fiscal house in order.

Chairman SCHWEIKERT. Thank you, Ms. Malliotakis.

Ms. DelBene.

Ms. DELBENE. Thank you, Mr. Chairman, and thanks to all our witnesses for being with us today.

Mr. Kogan, I wanted to give you an opportunity to respond to an earlier question about the impact the Bush and Trump tax cuts had on the Federal debt, and I would love to hear your view on what that is and—well, let's start there.

Mr. KOGAN. Thank you for the question, Congresswoman. I think the right way to look at kind of the long term is this concept called the fiscal gap. It measures how much primary or noninterest deficit reduction you need to go from having debt beyond its upward trajectory as a percent of GDP to being stable as a percent of GDP, not balanced budgets, not flat debt, but debt as a percent of GDP stable. And the most recent estimate using CBO numbers is 1.7 percent of GDP.

The size of the Bush and Trump tax cuts under current law is bigger than that. So that means, even if you want to say, well, you could blame other things as well, regardless of where you want to place the blame, that just means that they are big enough that if you hadn't done them or if you undid them today, that debt would be stable as a percent of GDP. And that is kind of the starting point.

I then think that it is right to focus on them because our spending trajectories—our long-term spending trajectories are down, not up. So we used to have a system where revenues and spending would keep pace, regardless of your assumptions about AMT. Now we don't. Since then, both revenue and spending are down. So it doesn't make sense to me to blame spending if our long-term trajectories are actually down instead of up.

Ms. DELBENE. And sometimes the investments we make, make a big difference on the long term. Child poverty costs our country a trillion dollars a year in lost productivity, crime, health disparities.

And so how can programs like the enhanced Child Tax Credit that increase children's opportunities for success and help rebuild the middle class, how can those benefit long-term economic growth?

Mr. KOGAN. Thank you for the question, Congresswoman. So I think there is broad agreement investing in children is a very wise thing to do. You see higher birth rates. You see higher graduation rates. You see higher wages. You see, therefore, more money into the Federal Government. You see lower crime rates. You see lower recidivism rates.

And then at the same time, you see the moral benefit of millions of children lifted out of poverty. There is strong agreement. In fact, CBO just released a working paper a couple weeks ago that showed that their estimate was that, even if you didn't offset it, enrolling children in Medicaid on a net present value basis paid for half of itself, and that if you did then offset it, then it was a two-to-one return. So there is strong, strong agreement that investing in children is a very wise thing to do, even aside from the moral imperative.

Ms. DELBENE. And not investing has a cost. As I said earlier, child poverty costs us a trillion dollars a year. Sometimes if we don't invest, it actually costs us more money over the long run, which I think has been left out of this conversation a little bit.

In your testimony, you discuss how earlier in the 21st century CBO forecasted long-term debt stability despite its initial outlook projecting primary spending to rise as a percentage of GDP.

I wondered if you can speak to the role our tax system played in CBO's calculation of long-term debt stability and what has changed since then.

Mr. KOGAN. Thank you, Congresswoman. Yeah. So in the CBO baseline, they assume bracket creep. I think some of my fellow panelists are against that concept. I don't think it is a bad thing that needs to be fixed. If I get a raise that outpaces inflation, then more of my income is taxed at a higher rate. That is the natural part of a progressive tax system. That is not a bad thing.

And so regardless of whether you then went in and changed your AMT assumptions, we used to have a tax system where our revenue was going to grow to match our spending. And that is kind of the most important part. Since then, we have done these tax cuts. They not only lowered the level, they not only did a level increase, but they also flattened the Tax Code. The jump from one tax bracket to the next tax bracket is smaller than it used to be and kind of the income bands in some places have changed. That leads to less bracket creep than there used to be and, therefore, less kind of natural—natural income gains from the real wage gains when Americans get them.

So those two components led to our revenue no longer keeping pace with our spending and, in fact, no longer growing quite as much when we have a good economy. We used to see, when the economy was great, revenues shot way up. Now they shoot up some. The fact that we have this economy and have revenues down at 16.5 percent of GDP, that shouldn't happen.

Ms. DELBENE. Thank you.

I yield back, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Ms. DelBene.

Ms. Moore.

Ms. MOORE. Thank you, Mr. Chairman.

I want to thank all of the witnesses for appearing. This is certainly a master class, and one of the great privileges of being a member is to have such expertise here.

I just want to clear some things up. I think, Mr. Kogan, you just shared with the committee an explanation of what constitutes a fiscal gap, and you said that the 1.7 percent fiscal gap of GDP, that the tax cuts from Bush and Trump exceed that.

One of the things that I really want to clear up is whether or not we regard tax cuts as spending. We seem to not think that providing trillions of dollars of tax cuts to the wealthiest 1 percent of Americans, that somehow that is not spending.

Can you help me understand why that distinction is made? Maybe I understand why it is made, but is that not calculated as a part of spending?

Mr. KOGAN. Thank you, Congresswoman. In terms of how the NIPA tables might show it, you know, they are going to classify it for the reason that you want. But to the point of your question, it is a cost regardless of how you are classifying it. It is the deficit or the primary deficit. It is just the difference between how much you are taking in and how much you are putting out.

And so one way to change that is to change how much you are putting in or taking out, and another way is how much you are taking in. And so these are true costs that are borne by the American taxpayer.

Ms. MOORE. So, when we reduced the tax bill down to 21 percent, that was a loss of revenue and it was spending. Am I correct?

Mr. KOGAN. I would say the way that it shows up in spending is with the future interest payments. We have to pay the—we have to bear the interest payments that then come from these tax cuts.

Ms. MOORE. Okay. So you assert in your testimony that both revenues and spending are lower than earlier projections, meaning low revenues are responsible for persistent primary deficits. So we hear all the time that spending is going up, up, up, up, up. And we have many worthy things that we need to spend on, you know, healthcare costs and, you know, defense.

So, your statement really contradicts people's notion of what is causing these deficits. Can you explain that statement?

So, actually, we are not spending as much as we used to. Those projections are lower, but the revenues are lower. Can you explain that?

Mr. KOGAN. Thank you, Congresswoman. So spending is going up, but it is going up at a slower pace than we used to project it to be. And so I think people focus that this year was higher than the previous year which, you know, aside from blips, is that is roughly the trend is the upward trajectory.

But the reason that I don't think that that is the right—I mean, that is basically driven by demographic changes and excess cost growth. And so mostly what is going on is it costs more to do the same. It is not like profligate spending. It is that it costs more to take care of our seniors than it did before. And that is okay, because we used to have a tax system that would keep pace with that. The problem is we now no longer have a tax system that would keep pace with it.

Ms. MOORE. Just very quickly, you know, I wrote down here, D equals S minus R, deficits equals spending minus revenues. Can you just sort of explain that for the record?

Mr. KOGAN. Yes, Congresswoman. So the annual deficit is the difference between how much we spend in total. You take all of our program spending—Medicare, Medicaid, Social Security, SNAP—and then also the interest. You take all of that spending and then you look at how much we bring in in Federal tax revenue, and the difference between those is the deficit.

Ms. MOORE. So when we talk about having high deficits, we are talking about having a lot lower revenue?

Mr. KOGAN. That is right, Congresswoman.

Ms. MOORE. Okay. So in my remaining time, I just want to associate myself with the comments, particularly of Ms. DelBene, with regard to the Child Tax Credit and the investments that we make in children.

Would you agree that that should not just be regarded as spending but should be regarded as investments, you know, just as, similarly, Republicans like to associate tax cuts as investments?

Mr. KOGAN. I think we can all agree that putting money for our children in the future is a wise investment. It is moral and, as I say, some of the benefits then redound to the Federal taxpayer.

Ms. MOORE. Thank you so much.

And thank you for your indulgence, Mr. Chair. I would yield back.

Chairman SCHWEIKERT. Thank you, Ms. Moore.

Dr. Murphy.

Mr. MURPHY. Thank you, Mr. Chairman. And thank you for having this conference.

And thank you all. I appreciate the expertise you all bring.

I am just a dumb surgeon, so I am just going to have to approach this in a little bit different regard. I think if you look at what our biggest challenge is in the future, really, it will be healthcare spending. And let me say why I feel that way.

1965 began with the Great Society programs with Medicare. At that age, you thought life expectancy was 70. You were going to live 5 years. Now we pushed it to 80, 2 or 3 percent live to 90. But there was never any type of calculation ever put in that system at that time to account for what would be growth in longevity. Nothing.

And so now we are chasing the fact that we are adding 10,000 Americans a day to the Medicare rolls, but there was never any chase about that. And now the fact we are living to 80, not 70, there was never any planning done with that. And so we are hitting the cliff because of that.

And as for what we are doing with child tax credits, also with the Great Society programs we began rewarding, actually punishing the nuclear family. So if you look in the State of North Carolina now, 52 percent of the births in North Carolina are on Medicaid. I see these patients, okay? I see them face-to-face. And I see the 16-year-old mothers. I see the 22-year-old mothers having children. They are Medicaid.

And all of a sudden, these poor children—and they are poor children because they are being raised by children themselves—are now the government's problem. These are, again, problems that have been caused by policies put into effect with the Great Society programs.

So now we have this huge massive occurrence. Mr. Kogan, this is fact. We now have this massive occurrence, more and more people on Medicare because, hey, great, technological advances that have occurred that are allowing us to live longer, which are more expensive. So now we are paying more and more for people on healthcare, which is great, but we never thought of changing the formula as we are going along.

And anybody now who wants to reform the formula, oh, we all want to cut Medicare. We want to do this. We don't want to do that. No, the numbers, just like you guys are pointing out with our deficit, the numbers just don't work. And so as we move along this curve, we have to do something with mandatory spending.

And we talk about this great recovery during the Biden administration. The great recovery was because you absolutely extinguished America. And instead of 100 widgets a day, we were only allowed to produce 40 widgets a day. And the framework was put in during the Trump era for this great continued recovery to occur.

I will agree with my Democratic colleagues, everybody who should pay taxes should pay taxes, period point-blank. I have no issue with that whatsoever. But our revenues are at record levels now. So it can't be just blamed on one side of this. This is a blend. This is an absolute blend.

One question that I love to ask, some of my social media, let's just say, favorite people are all espousing the modern monetary theory that none of this really matters, we can just keep printing money, and all the debt doesn't even matter at all.

I just wondered if each of you could just spend 2 seconds, really. Does debt matter? Is modern monetary theory actually a thing or is it just a stupid pie in the sky idea? How does that fit in relation to what is happening with our debt?

Mr. SMETTERS. I don't think anybody here would endorse modern monetary theory.

Mr. MURPHY. I am so glad to hear that. Debt does matter, correct?

Mr. SMETTERS. Yes.

Mr. MURPHY. It does. It is critical. And modern monetary theory was a great thing with unicorns and rainbows and pie in the sky and we could just keep printing money. It is not the case. It is not the case. Our national debt does matter, and it is actually truly a matter of national security.

So, you know, what would I ask—I heard one person say one time, just because of this debt, what happened if we just devalued our currency? What would that look like?

Mr. FAULKENDER. You would lose world reserve currency status, and then we would have all of the national security problems that we discussed previously of not being able to monitor illicit financial activity, nor be able to use sanctions.

Mr. MURPHY. Right. It would just absolutely undermine our economy and our national stature, correct?

Mr. FAULKENDER. Yes. And in addition to the national security issues, you would raise borrowing rates for every household.

Mr. MURPHY. And you know what, this may be heresy, but a Republican said that. And I just put my head in my hands.

This committee usually is fairly bipartisan. Math doesn't take any politics with this. And so we see how critically important this issue is. Yes, we need to collect our revenues, but yes, we need to cut our spending, and yes, we actually need to stop paying people not to work.

Thank you. With that, I will yield back, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Dr. Murphy.

Before I recognize Mr. Beyer, will you explain to us how AI is going to help us stabilize spending?

Mr. BEYER. I couldn't do that in my 5 minutes, but we are working on it.

Chairman SCHWEIKERT. But I know you are working on it.

Mr. BEYER. Mr. Chairman, Ranking Member, thank you for doing this.

Dr. MURPHY, I would suggest there are no dumb surgeons. And thank you for shouting out——

Mr. MURPHY. I must disagree.

Mr. BEYER [continuing]. MMT. I think Herb Stein said years ago, if something is too good to be true, it is not true. That is exactly where we are. And also, thank you for going through the increase in our social services over the years—Social Security, Medicare, Medicaid—and how that has completely changed what we spend money on in the Federal Government. It is very different from when I was a child.

The challenge is that it seems like the American people love most of those things, which is why it has been so difficult to cut back on them. Even President Trump has said, don't you guys go touching Social Security, because he knows that this is—so then the question is, how do we pay for it? How do we begin to balance what the American public has come to expect from government?

By the way, Mr. Chairman, I do completely share your concerns that our budget deficit at $33 trillion must be a very high priority. But we look at it—and thank you, Mr. Kogan, for all of your purposing.

One of the things that is missing as we look at this budget and cutting spending in a lot of different ways is, what is the fiscal effect of the disinvestment in our people? I mean, how much growth comes from the fact that we are putting money into our children, into education, into social services, and what happens when we slash that back?

Mr. KOGAN. Thank you for the question, Congressman. So five things that I mentioned in my written testimony that I didn't have room for in my spoken testimony. I wanted to highlight some of the cuts that were proposed by this body in this Chamber, right?

So the idea was, oh, well, we need to reduce our spending, and that is the great way to help the future. And in going about trying to write the appropriations bills that would find the spending cuts, this Chamber called for an 80 percent cut to Title I education grants, which helps poor public schools in every State. Called for a 59 percent cut to the Federal program that helps make sure our drinking water is safe across the country. It called to cut our NIH cancer and stroke research. You know, across the board, these were kind of cuts to the future.

And I would just say, as you are saying, these sorts of cuts are fundamentally shortsighted. You might lower a Federal dollar here or there, but then you wouldn't have the redounding effects in the future that are critical to us kind of being competitive in the future.

Mr. BEYER. Thank you.

You know, again, historically, I remember I used to prepare a little family's businesses taxes in the seventies and eighties, and the first $50,000 is a relatively low rate, and then it jumped up to 78 percent. So, I think both our personal and our corporate tax rates were much more progressive in the fifties, sixties, seventies.

How did that affect our GDP growth?

Mr. KOGAN. We had strong and robust GDP growth in the fifties and sixties.

Mr. BEYER. Thanks very much.

Dr. Faulkender, is there any plausible method of closing the fiscal gap that doesn't involve generating new revenues?

Mr. FAULKENDER. Certainly. We could bring spending down significantly, and that would also close the fiscal gap.

Mr. BEYER. Let me put it back to—in the real world, is there any way, given the political realities of the American public and the American public's expectations, is there any way to do this without generating new revenue?

Mr. FAULKENDER. Yes. In the real world, we could bring spending down to the 2021 percent that it has been historically of GDP.

Mr. BEYER. But our revenues are at 16 percent right now. Doesn't that leave us a gap of——

Mr. FAULKENDER. Last year's revenues were much lower. If you look at 2022's revenues, they were at 19.5 percent of GDP. So I don't think we want to cherry-pick a single number.

Mr. BEYER. Well, that is a cherry-picked number, though, if you look back over the many years. And that is a number driven by all the investments we have made, the money we doled out as part of the pandemic, the CARES Act, et cetera, which is why it surged in that 1 year. That is certainly not where it was in the years right after the TCJA.

In any case, I have a couple seconds left, which I would love to yield to my friend Ms. Moore.

Ms. MOORE. Thank you so much, Mr. Chairman.

I just want to say that I just basically resent us bringing up the old tropes about paying people not to work. We are not paying people not to work.

I guess I would like to ask you, Mr. Kogan. I mean, would it be fair to say that our social services programs, like Medicare and Medicaid, are taking care of old people, disabled people, kids? Most of the people who are on food stamps work. And that is an old welfare queen trope that these moneys are going to people of bad character. Is that correct?

Mr. KOGAN. I completely agree with your assertion, Congresswoman. The idea that this money is immoral—is wrong, is poorly spent, is really disgusting.

Ms. MOORE. Thank you so much for that.

And I yield back. I yield back to Mr. Beyer.

Mr. BEYER. And I yield back.

Chairman SCHWEIKERT. Thank you for yielding back.

All right. Now for the lightning round. Oh, how could I possibly forget Lloyd, you know? So you don't want to take your time so I can just go?

Mr. SMUCKER. Mr. Chairman, you can do whatever you want.

Chairman SCHWEIKERT. No, go ahead, Lloyd. And I apologize.

Mr. SMUCKER. Well, I do appreciate, Mr. Chairman, the opportunity to participate in this hearing.

I think this is a really important topic. I know this is a topic you have been interested in for a long time, but I think it is difficult for the American public or even Members of Congress to understand the weight of what we are dealing with here.

And I think particularly, Mr. Smetters, what you have described, what could occur here, what will occur here, according to your testimony, over the next 20 years if we don't change course, is really—it is a five-alarm fire. It is cataclysmic.

History has plenty of examples of countries and empires that have risen, have maintained their dominance in the world for a long period of time, and then essentially have overextended themselves. And we, I would say, are potentially at the brink of that occurring here. And it could be a slow decline, where rising interest rates are affecting the economic conditions, or it could be catastrophic, which I think, Mr. Smetters, you have alluded to.

A sovereign debt crisis will occur when the capital markets—when investors no longer are willing to hold the U.S. dollar because they believe the government has the inability to pay or doesn't have the will to put ourselves on the right path to be able to pay.

And, Mr. Faulkender, you have talked about the softening. I don't know if I am misstating what you are saying, but certainly a few weeks ago we saw a softening of purchases and the demand, which potentially is probably driving up interest rates now. But, you know, if that trend continues, whether it is individuals or institutions or foreign countries that are no longer willing to hold our debt, we are in real trouble, are we not? I mean, am I overstating the condition that we are in now?

I see. Go ahead.

Mr. SMETTERS. So debt crises historically are the worst of all crises. If you look back at COVID, look back at 2008, how did we deal with those crises? We issued more debt. We were able to use debt to cover those crises.

But when the crisis is caused by debt itself, there is not much you can do at that point. And we have seen many societies completely reordered as a result of debt crises. Those societies cannot handle economic hits.

Not to be dramatic about it, but think about the Nazi Party, 1928. They only got 2.6 percent of the vote. Then 1929 happens. A complete reordering of society in the face of large——

Mr. SMUCKER. And we have seen the failure of nations. You know, and it is why I appreciate Mr. Pascrell's earlier comments that, I think, we have to come together as Members, regardless of party, and understand the situation that we are in. We have to accept responsibility. I think both parties, as Mr. Pascrell said, have led to the situation that we are in now.

Mr. KOGAN, I know that you have in your testimony been—you have been intent on blaming Republicans. Could you agree with me that both parties have brought us to where we are today?

Mr. KOGAN. My testimony was clear it was a bipartisan extension of the Bush tax cuts was an instrumental part of it.

Mr. SMUCKER. Do you feel like both parties contributed to the situation that we are in today?

Mr. KOGAN. I mean, it was a bipartisan bill. So yeah, both parties were involved.

Mr. SMUCKER. Besides the bill, would you say?

Mr. KOGAN. I think—I mean, I think——

Mr. SMUCKER. I will stop there. And the reason I put you on the spot is because I think it is really important that we have to get beyond blaming one another for where we are. And it is why I support a debt commission, which I think is critical to us to change the trajectory going forward.

We really need to come together and understand that this is far beyond blaming one another. It is far beyond politics. This is something, we are talking about the future of the country for future generations. And so it is critical that we act on this now.

So I hope, Mr. Kogan, that we can get past just blaming a particular party. And that is why I appreciated Mr. Pascrell's comments.

But one of the things I want to say as well, I don't think the American public really understands the situation that we are in now. And I have been looking, particularly if we do a debt commission, I think the role of the commission is going to be to help the public understand where we are and knowing that we are going to have to make tough decisions and everything should be on the table.

But in a very brief amount of time, I haven't seen a lot of work done out there in regards to past examples in history of what has happened and sort of looking at our current situation relative to that. And I would be very interested in hearing from any of you on where we could go to help to explain to the American people what happens if we don't address this.

Maybe, Mr. Smetters, I will start with you on that.

Mr. SMETTERS. Sure. I mean, the impact on the economy, the American people, the wages, the borrowing rates are all going to be very negatively affected. And there are lots of examples in Asia, in Latin America, in Europe where this has happened.

And there has been bipartisanship certainly in the past. That is what 1986 was all about. You know, the joke before 1986 was paying. One reason why these high rates didn't really matter is because paying your taxes was a civil obligation, just not a legal one before 1986. There were so many different ways to dodge those taxes.

But in 1986, incredible bipartisanship to—and most economists agreed with that approach. And so I think there are examples that you can point to.

Mr. SMUCKER. Thank you. I am out of time. Thank you, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Lloyd.

Chairman Arrington.

Mr. ARRINGTON. Thank you, Mr. Chairman, for your passion and concern about what I believe is the most significant threat to the United States and one that, if left unaddressed, in probably nearer term than we think will cause not only significant but irreparable harm that will impact interest across the political spectrum, by the way.

For those who care about climate and want more climate spending programs, safety nets, entitlements, or for those of us who think that the job of the Federal Government is mainly to keep us safe and free and most everything else is delegated to the States and the people, we still have to put a military on the battlefield such that protects our freedom and security interests. All of that is in jeopardy, as well as America's leadership in the world, if we slip into a sovereign debt crisis.

So I want to focus on how things are being managed at this point with respect to Treasury bonds and the issuance of debt and especially the rise in interest expensing, which some people think is the key measure of when we start to trip the wire and we start seeing a chilling effect, if not worse, in the Treasury bond market.

I just talked to an economist literally before coming to this hearing who said the 14 percent interest per revenue, Treasury revenue, tax revenue, is a tipping point where you start to see the effects in the Treasury bond market. And that hasn't been hit in over 30 years, but we are now over that.

And then this gentleman mentioned the two significant—he said the most significant events in his 27-year career as an economist and a policy adviser, which is the August and November Treasury Debt Issuance Advisory Committee saying, wait a minute, we are $250 billion short of the money we need to service the debt—that is significant—and we need a whopping $1.6 trillion in debt in the fourth quarter of this year and first quarter of next year.

The bottom line is, we are entering into this vicious cycle, and the interest and debt are going from unsustainable to completely running away from us.

Now, the Treasury Advisory Group and the Treasury Department has started issuing shorter term debt rather than longer term, like 80 percent more. That hasn't happened in recent history if not modern history. And that means the yield, they call it an inverted yield, where we are getting higher interest rates. And the tradeoff is keeping the economy propped up versus the cost to the taxpayer, and I would suggest future taxpayers, and the cost to generations of Americans who will pay a higher price for our widening deficits and mounting debt.

Help me understand that dynamic, the shift to short-term Treasury issuance versus long term with higher yields, lower cost. What are the implications of that?

Maybe, Dr. Smetters, you can start, but I welcome any input. And for the remainder of the 1 minute, I will yield to our witnesses.

Mr. SMETTERS. Sure. And I will try to be then brief. The cycle that you mentioned is exactly the right word. In particular, you could issue enough debt that interest rates become high enough that you actually now have to issue even more debt and interest rates would go up even more. There is no market clearing that happens anymore. You can literally have an economic collapse that way.

And what you mention about moving to shorter term, it looks in the short term like, hey, that is a win. We are taking advantage of lower rates. The problem is that you now take on more rollover risk. And that is not being costed and priced into the budget, and that is really a budget bias right now. We reward you for the lower expected interest rates. There is no pricing on the credit reform or anything like that for the rollover risk.

Mr. ARRINGTON. But the rates for the 10-year Treasury are now five and a quarter.

Mr. SMETTERS. Right.

Mr. ARRINGTON. So we are actually paying more——

Mr. SMETTERS. Even then, yeah.

Mr. ARRINGTON [continuing]. For the 10-year Treasury. Why the shift, this extreme shift to the shorter term Treasury to issue debt? Anybody else have any thoughts about that?

Mr. FAULKENDER. What the TBAC has told Treasury is that there are not sufficient buyers out there for the longer duration stuff. You can go ahead and find additional buyers for the shorter term stuff.

To add to what you said earlier, one of the issues that the economic literature has shown is, once you get above 90 percent debt to GDP—so you were talking about debt service to revenue. Another one is aggregate debt to the size of your—once you get above 90 percent, that is where fiscal crises, debt crises start to occur.

We are above that. The belief in the literature is that we can go above that because we are the world's reserve currency, but there is no test—nobody out there can model where it is. And so as Kent just said, you know, 20 years from now, at best, we get into that permanent spiral that you can't recover from.

Now, in terms of the maturity mix, we currently have an inverted curve. So 1 years are higher than 10 years. We would be cheaper issuing tens in the short run. Normally, tens are going to cost you more than one. The reason is that most people think interest rates are going to come down.

So it is okay to issue short. If, indeed, interest rates do come down, we may actually end up with lower debt service costs. But those debt service costs will not be lower if rates don't come down because we don't get the budget under control.

Mr. ARRINGTON. Listen, I think—thank you for that. Not sufficient buyers of U.S. Treasury treasuries. That is a very explosive statement when you are thinking about slipping into a sovereign debt crisis.

Again, I think there is this false sense of security that, as the world's reserve currency, we will just forever be able to act like we are all modern monetary theorists and spend and borrow and print with no significant consequence. It doesn't sound like that is the case.

Thank you, Mr. Chairman.

Chairman SCHWEIKERT. Thank you, Jodey.

All right. And I saved myself partially because I want to spend a little time doing sort of technical, so I am going to—and listen up, because you have actually come close to this.

Dr. Faulkender, what does a failed bond auction look like? A failed bond, an undersubscribed bond auction, what does it end up to ultimately look like.

Mr. FAULKENDER. Well, ultimately what happens is that the primary dealers who are part of the Treasury Borrowing Advisory Committee have to step in and take on the portion that was not subscribed, and it ends up being at higher yields. And ultimately what could happen is that those participants choose not to be in future auctions.

So because they are obligated to take on the portion that is not subscribed, they may very well withdraw from future auctions, and that creates additional problems in the future when we have got to re—when we have got to issue more debt.

Chairman SCHWEIKERT. So what is the ultimate definition of undersubscribed? I mean, we had a 10-year recently that 24 percent was taken by the primary dealers, which, you know, that is double what we would have seen traditionally.

Mr. FAULKENDER. Right. So I don't know that there is a formal—it is going to be a historical reference that it is—you are asking the primary dealers to come in and take a much larger portion than they are normally taking, and they may not themselves have set aside sufficient capital in order to fill all of that need.

Chairman SCHWEIKERT. That was actually what I was looking for, is, at what point does the piping, let's call it the plumbing, our primary dealer network not have enough cash on the books? If they had to take 50 percent of an issuance, is that more cash than they have? And at that point, have we hit a black swan where interest rates pop to bring in new capital? I am trying to understand our fragility, to use a sort of pop culture economic term.

Mr. FAULKENDER. I don't know that I would say there is a specific number, because I don't want to ever give the impression that we can march right up to that number, right. And so it does depend upon how much capital is available, what are the other things that they are funding, what does their reserve status look like. And that is going to change over time as to how much just excess capital the primary dealers have available in reserve to step in for these kind of contingencies. That is not something that, for instance, there is N dollars necessarily set aside that I can give you a specific number such that you think that they can march up to just below that and be okay.

Chairman SCHWEIKERT. Dr. Smetters, you have been bouncing your head up and down on this one.

Mr. SMETTERS. Yeah. I completely agree with that. There is no magic number. To take that example, even at the current values right now, if all of a sudden the primary dealers really believe that Congress is either going to spend it wildly or tax very little going forward, if they just lose confidence even at current values, things could unwind.

And so it is really about their expectations of the future rather than a given auction. If they are confident in Congress going forward, they are able to raise the capital. If they are not confident in Congress going forward, the capital markets are not going to give them the capital.

Chairman SCHWEIKERT. Okay. I was going to go this way, but could we spend 30 seconds, does anyone have an expertise on, you are a broker-dealer. You actually are in contract functionally with Treasury to be a market maker in the first takedown. How do you raise your own capital?

Mr. SMETTERS. Well, that is really costly capital, because that is equity capital that you would have to raise in order to meet your obligations. And so that could cause great dilution of the primary dealer. It would not be the case that they can just go out and engage and leverage themselves, because this is a very much more challenging market to do that. And that is why it is—once they get spooked, that is going to be a serious problem.

Chairman SCHWEIKERT. You see, and that is something I don't believe Members of Congress and even many who actually write about this area understand is they have to actually raise the capital. They often have certain relationships. I promised we weren't going to talk too much about repo, so we will stay away from, you know, some of the swaps and the pledges.

Do any of you see any potential stressors—I am agnostic on these because I haven't read enough—on the SEC wanting to go—and this is sort of for the secondary market—to sort of a single trading platform, or I will also ask you to speak to Treasury's plan to basically look at some of older issuances that are thin and repurchase them and add that to current capacity.

Do any of those make differences in the breadth of markets on capital or are those just grounding errors in the plumbing? Anyone that feels they have an expertise on either of these weird issues.

Mr. SMETTERS. Sure. I mean, I view Treasury as a current idea of, I call it operation twist with a twist. I mean, they have done some——

Chairman SCHWEIKERT. Yeah, but you don't game it, I mean.

Mr. SMETTERS. That is right. That is right. And so I don't think it is going to be a first order event. I think but it does point to a much broader problem, and that is markets are making bets against Treasury, Treasury are making bets against the market. It is that two-sided betting that is actually inefficient.

Treasury could over time create more consistency in supply and really focus and eventually reduce risk premiums if they made the maturity structure much more predictable and really focusing on what they can actually provide that capital markets cannot, and that is long-term risk-free assets.

Chairman SCHWEIKERT. But hasn't one of the problems been on Treasury's long-term funding outlooks is some of the spending bills, discussions of tax extenders, where they are suddenly, like we had in, you know, fourth quarter and even first quarter of this fiscal year, we were way off?

Mr. SMETTERS. Right. I mean, the projections were incredibly off. And this is a problem why I say the blame game is not that useful, because it doesn't tell us the best path forward.

You know, if we even think about the Bush era, remember their Medicare part D, the long-term effect of that was even bigger than the tax cuts there. I mean, it all comes down to your baseline and what you incorporate as your baseline.

I don't think looking back is the way to go. I think it is really about our best decisions going forward, whether it is investing in children or other things is independent of all that.

Chairman SCHWEIKERT. All right. And it is not heresy, because the math is the math. CBO, OMB, even a couple of your groups, if you actually look at the numbers, basically say from today through the next 30 years, 100 percent of the future borrowing is basically demographics and interest. Okay?

So we can spend—which broke my heart, and I have already shared with my friend here. Our staff sometimes live in a partisan bubble, but that is what they know. This hearing wasn't about—because I have plenty of charts, and so when you do the dynamic effects, some of the things you said drove me nuts, but that is the game we do here.

What I want to know is, from today forward, what do we do policy wise, or should we just stay the hell away from it? Stability, price efficiency. Price efficiency, stability, and if you have suggestions there.

And then my weird question—they get weirder—have any of you ever seen—Professor Shiller 10 years ago wrote an article about something he called a Trill, which was almost selling an equity interest that actually would be sympathetic to receipts going up, you got a little bit more. It is sympathetic if receipts went down, you got a little bit less. And that way you had an instrument that was a sympathetic bond where often what we have here is sometimes those bonds, you know, are countercyclical.

Should Congress dive into, what do we do for stability, what do we do for liquidity? And should we also be looking at some alternative debt management instruments?

Let's start at one end. What would you do?

Mr. DRIESSEN. Yeah, I mean, I think the biggest thing I would say is that I think there are different management approaches that could be considered, and I think Treasury is looking at those. Some of my colleagues have presented, you know, encouraging to kind of look at longer term instruments, which I think has some value.

Chairman SCHWEIKERT. And I know I am interrupting. Going back to Treasury Secretary Lew, because he and I had a wonderful argument years ago about wanting to sell super bonds, and it was basically to get beyond our demographic bubble.

Mr. DRIESSEN. Yeah.

Chairman SCHWEIKERT. He fussed back to me that there wasn't an appetite. And I said, you haven't really looked. When you talk about longer term bonds, are you talking 40s, 60s?

Mr. DRIESSEN. Yeah. I mean, I think both Secretary Mnuchin and Secretary Yellen at least expressed a desire to look at 50-year bonds and 100-year bonds. They do have the discretion to do that, as we talked about earlier. There was some feedback that there wasn't sufficient demand at that point.

I do think that, you know, it is going to be kind of a circular loop there where, you know, if you are looking at longer term, providing longer term supply, there is also going to be a demand issue. And all of that is going to kind of feed back to what the market views as the long-term debt trajectory.

So it really is going to go back to how do we bring down the deficits and how do we stabilize debt. That would probably help in terms of stoking demand for some of those longer-term vehicles that might help in the way that my colleague suggested.

Chairman SCHWEIKERT. Okay. Because there is the powerful argument that type of bond actually has a certain credit enhancement because of U.S. demographics. You know, you get beyond some of the cost structure, but that is——

Mr. DRIESSEN. Sure, sure.

Chairman SCHWEIKERT. Doctor?

Mr. SMETTERS. Yes. No, I agree with this. I mean, one of the problems that I have when people look at the current market and they talk about demand, that demand is all based on what they think Treasury is going to do in the future. They are trying to make forecasts. If Treasury created a much more predictable environment, then the private market could actually create this shorter term duration asset.

So, for example, in theory, economists would say, what textbook says, is that the government really just has to produce something similar to the asset you just talked about that is called a console. It just is an infinitely lived bond that pays interest rate forever. The U.K. has had some of these things.

Chairman SCHWEIKERT. So a perpetual.

Mr. SMETTERS. That is right, or perpetuals. And the private market, if they knew there was a constant supply of that, they can create all the intermediate durations—the repackaging is actually very simple—without counterparty risk. That is something that easy custodial relationships can deal with.

But the problem is that we—sometimes people call the supply and demand side of the Treasury market competition. That is just wrong. We can actually have no equilibrium when Treasury is trying to optimize against the bond buyers and bond buyers are trying to optimize against the Treasury.

I think the goal is that the Treasury, at least over time—because current contracts are written around what was issued in the last few years—over time Treasury should get to a longer term maturity, ideally quite a bit longer, and let the private market be the one who dices up and creates the more intermediate securities. Right now, the budget scoring process, though, really favors much shorter term issuance, because the rollover risk is simply not priced in.

Chairman SCHWEIKERT. That is helpful. That is helpful.

Mr. Kogan, what would you do in that sort of—would you offer alternative instruments? What would you do?

Mr. KOGAN. I think—I mean, I—I agree with what has been said previous, that I think there—I think you can look into trying to do stuff in the margin. I know in the Clinton administration they did a little bit at the margin. But I think you run the risk, if you kind of are messing with the bond market too much, of having unintended consequences.

I think the long run, interest is a product of debt, and so the right thing to do is to look at the long-run trajectory of our primary deficit.

Chairman SCHWEIKERT. Okay. Dr. Faulkender?

Mr. FAULKENDER. I was at Treasury when Secretary Mnuchin asked the TBAC to look at 50s. I was surprised that they came back and said that there wouldn't be sufficient demand for them, simply because, as people are living longer, both pension plans and insurance companies, it seems to me, would have even more need for locking in interest rates over 50-year time periods. And yet TBAC did come back and say there wouldn't be sufficient demand for them. I do worry that if we can't even issue 10s and 7s, as to whether or not there would be demand for 50s, particularly from our international potential purchasers.

In terms of other structures, I like TIPS, if for no other reason—the Treasury inflation protected securities—if for no other reason they get the right incentives, so interest costs to the U.S. Government are lower in low-inflation environments, higher in higher inflation environments.

One worries about whether the market would actually take the wrong signal if we start saying we are going to pay you more when the economy is doing well and pay you less when the economy is doing poorly. Is that going to be a signal that we think the economy is going to do badly?

So I think there is some perverse signaling that maybe we are——

Chairman SCHWEIKERT. But there is possibly alignment of incentives?

Mr. FAULKENDER. It is—yeah. So I like the idea of encouraging, you know, and having the American people have—I mean, there are already plenty of instruments, though, where people can share in an improving economy. You know, generally the stock market, more broadly. Usually, Treasury securities have served as a hedge.

I think what you are saying—and I would have to give it more thought and go look at Professor Shiller's paper—as to whether or not there really is need for yet another security that already provides upside in good economies.

Chairman SCHWEIKERT. Okay. But how do you feel, though, about the discussion in a perpetual?

Mr. FAULKENDER. Again, we would need to establish—I like longer term ones. There have been some corporate bonds issued with 100-year——

Chairman SCHWEIKERT. Oh, yeah.

Mr. FAULKENDER [continuing]. Maturities on them.

Chairman SCHWEIKERT. Apple did 60s last year.

Mr. FAULKENDER. Yeah. Yeah. So that was why I was a little surprised by the conclusion of the TBAC, because if AA and AAA companies can issue at 100 years, why can't Treasury find a sustainable market for 50s? I thought that market should have been there because, as I mentioned before, it seems like there is natural hedging demand from life insurance companies and pension plans.

Chairman SCHWEIKERT. All right. Gentlemen, thank you. I am probably going to send you all a note asking for a little bit more of your thoughts, and I know you have been incredibly generous to do this.

And part of the argument in sort of my place here in Congress is trying to make the argument that, you know, demographics is our destiny. Demographics is debt. Work through it. It is why, as we were here talking, we were talking about what could we do to disrupt the price of delivering health services, because Medicare is the primary unfunded liability in our society. And we are very uncomfortable talking about that, because most of what we talk about is financing of Medicare, not the actual cost of keeping someone healthy.

But with that, I have a powerful interest on are there some things we should do in our debt markets that show that we are going to try to reach beyond the demographic bubble?

You know, as I pointed out, I have a 17-month-old little boy we have adopted sitting in the back, and the math says, when he is functionally just become an adult, U.S. tax rates almost have to double just to maintain baseline services.

It is no longer, though, about the next generation. I will argue it is about all of our retirements now if the stressors continue, and I am terrified of a black swan. So I want to communicate to markets that stability, liquidity, and that we are paying attention.

So with that, I am going to bring this hearing to a close. I will— oh, you wanted to give me the script.

Please be advised that members have 2 weeks to submit written questions to be answered later in writing. Those questions and your answers will be made part of the formal hearing record.

And with that, I really, really appreciate your time.

And to Mr. Pascrell, thank you for letting me chat on your ear and try to be really annoying.

And with that, the hearing is over.

[Whereupon, at 12:13 p.m., the subcommittee was adjourned.]

MEMBER QUESTIONS FOR THE RECORD

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Congress of the United States
House of Representatives
Washington, DC 20515–0301

COMMITTEE ON
WAYS AND MEANS

JOINT ECONOMIC
COMMITTEE

December 20, 2023

Grant Driessen
Specialist in Public Finance
Congressional Research Service
101 Independence Avenue SE
Washington, DC 20540

Dear Mr. Driessen:

Please see below for questions for the record following your testimony to the U.S. House Committee on Ways and Means on December 6, 2023.

Q: Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?

Q: As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?

Q: Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Please elaborate on your answer, and feel free to include what sources you have seen that support your answer if helpful. We appreciate any additional details and information you can provide.

Sincerely,

David Schweikert
Chairman
Subcommittee on Oversight

Congressional Research Service
Informing the legislative debate since 1914

MEMORANDUM January 3, 2024

Subject: **Committee on Ways and Means Questions for the Record**

From: Grant A. Driessen, Acting Section Research Manager, gdriessen@crs.loc.gov, 7-7757

This memorandum was prepared to enable distribution to more than one congressional office.

This memorandum responds to the questions below, which were asked following the December 6, 2023 House Ways and Means Oversight Subcommittee Hearing entitled "Hidden Cost: The True Price of Federal Debt to American Taxpayers":

- **Q:** Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?
- **Q:** As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?
- **Q:** Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for (1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and (2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

CRS is available to provide further assistance regarding these questions.

Background on Primary Dealers of Treasury Securities

Primary dealers are securities brokers and dealers who are registered to operate in the market for U.S. government securities (e.g., "Treasuries") and that have a trading relationship with the Federal Reserve Bank of New York (New York Fed).[1] Primary dealers are the largest purchasers of Treasuries sold to the public at auction.[2] In many cases, purchases by primary dealers are later sold on the secondary or "when-issued" markets. The Federal Reserve (Fed) may also purchase, hold, and resell federal securities as part of its market operations. Along with the primary dealers and the Fed, individual investors, other dealers and brokers, private pension and retirement funds, insurance companies, investment funds, and foreign investors (private citizens and government entities) also purchase Treasury securities through the auction process and on the secondary market.

[1] A list of current primary dealers can be found at http://www.newyorkfed.org/markets/pridealers_listing.html.

[2] Purchases by primary dealers can be found at http://www.treasurydirect.gov/instit/annceresult/auctdata/auctdata_stat.htm.

Primary dealers also work closely with the Fed to execute its monetary policy in addition to their role in the auction process. They are expected to maintain trading relationships with the Fed's trading desk and provide market information and analysis that may be useful to the Fed in the formulation and implementation of monetary policy.

Questions for the Record

Q: Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?

Primary dealers are large and reputable companies regulated by the Securities and Exchange Commission, typically as broker-dealers. As such, they would be expected to have sophisticated internal risk management tools in place that would prevent them from bidding on a security that they are unable to finance. As with any credit market, markets for federal securities have an inherent nonzero risk of an inability to fulfill contractual obligations to pay. Because primary dealers in practice represent some of the largest entities in worldwide markets, they are exposed to a variety of risks across the financial system. As late as mid-2008, for instance, the list of primary dealers included three financial entities (Countrywide Securities Corporation, Lehman Brothers Inc., and Bear Stearns Companies, Inc.) who encountered significant financial difficulty during the ensuing Great Recession. Some of the components of the primary dealer system, however—including the ability to make markets for Treasury securities and, in certain cases, access to credit from the Federal Reserve—may reduce the likelihood of a transaction failure in the primary federal securities market. More specifically, the risk of a primary dealer being unable to pay for Treasury securities purchased at auction may be mitigated by the following factors:

- When-issued markets allow primary dealers to provide for a market for their federal security purchases before they are actually purchased. Once an auction is announced by Treasury, dealers and market participants start trading securities on a "when-issued" basis, meaning that once a security is purchased and issued, it will be immediately resold to the secondary market purchaser. Because trading starts in the secondary market before the actual auction takes place, "when-issued" market participants effectively determine the yield or discount rate of Treasury securities based on what they are willing to pay.[3]
- Repurchase (repo) markets, one of the largest and most liquid lending markets, may also assist in alleviating liquidity concerns for primary dealers. In the repo market, transactions take place between two parties who exchange Treasury securities, often on a very short-term basis, for cash. The company or dealer pays the investor an agreed upon rate of interest for use of the funds with the expectation that the Treasury security will be repurchased at the mutually agreed upon future date. This process provides the company or dealer with the liquidity needed to meet immediate obligations. In 2021, the Fed created a standing repo facility that primary dealers can access at any time, should repo financing become unavailable in private markets.
- In cases where adverse economic or financial conditions increase market or liquidity pressures on all or many primary dealers, the Fed may intervene to ensure that auctions for federal securities run smoothly. The Fed used its emergency lending authority provided through the Federal Reserve Act by creating short-term Primary Dealer Credit

[3] Garbade, Kenneth D. and Jeffrey F. Ingber, *The Treasury Auction Process: Objectives, Structure, and Recent Adaptations*, FRBNY Current Issues in Economics and Finance, February 2005, p. 2.

Facilities in both 2008[4] and 2020,[5] in each case with the stated purpose of easing liquidity pressure on primary dealers.[6]

- Although it has no regulatory jurisdiction over primary dealers, the New York Fed vets primary dealers to ensure that they are capable of acting as a reliable counterparty. Cases where there is increased strain or liquidity pressure on a specific financial entity may result in its removal as a primary dealer of federal securities. Financial entities are regularly added and removed from the list of primary dealers. The New York Fed maintains a public record of those modifications.[7]

Unforeseen risks are always present in financial markets. Even if a primary dealer has the financial means to purchase a security there are scenarios that would alter the discussion above. For example, a cybersecurity attack or other technological failure could cause normal market operations to fail. A scenario where a primary dealer is unable to pay for Treasury securities purchased at auction could also result in intervention from the Fed through its capacity as a lender of last resort.

Q: As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?

The New York Fed, with oversight from Treasury, is responsible for maintaining and modifying the requirements necessary to act as a primary dealer in Treasury auctions.[8] Federal law governs permissible actions for brokers and dealers of government securities.[9]

As of December 2023, the New York Fed listed the following capital reserve, cash reserve, and related requirements for primary dealers of federal securities:[10]

> "In order to be eligible as a primary dealer, a firm must:
>
> - Be either (1) a broker-dealer or government securities broker-dealer, registered with and supervised by the Securities and Exchange Commission (SEC) and approved as a member of the Financial Industry Regulatory Authority, Inc., and that has net regulatory capital of at least $50 million or (2) a state or federally chartered bank or savings association (or a state or federally licensed branch or agency of a foreign bank) that is subject to bank supervision, and that maintains at least $1 billion in Tier 1 capital.
> - Demonstrate a substantial presence as a market maker that provides two-way liquidity in U.S. government securities, particularly Treasury cash and repo operations, for at least one year prior to the application date;
>   - Maintain a share of Treasury market making activity of at least 0.25 percent."

[4] Board of Governors of the Federal Reserve System, "Primary Dealer Credit Facility," December 2010, available at https://www.federalreserve.gov/regreform/reform-pdcf.htm.

[5] Board of Governors of the Federal Reserve System, "Primary Dealer Credit Facility," June 2021, available at https://www.federalreserve.gov/monetarypolicy/pdcf.htm.

[6] For a broader discussion of the Fed's authority to intervene in economic crises, see CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

[7] Federal Reserve Bank of New York, "List of Primary Dealers: Additions and Removals," June 2023, available at https://www.newyorkfed.org/markets/primarydealers#additions-and-removals.

[8] Treasury and the New York Fed were responsible for the creation of the modern primary dealer system. For more on the history of primary dealers in the United States, see Garbade, Kenneth D., "The Early Years of the Primary Dealer System," *Federal Reserve Bank of New York Staff Reports*, no. 777, June 2016.

[9] Relevant statute for primary dealers of government securities includes 15 U.S.C. §78o–5.

[10] Federal Reserve Bank of New York, "Primary Dealers," available at https://www.newyorkfed.org/markets/primarydealers.

Many primary dealers are owned by U.S. bank holding companies (BHCs), which are corporations that own or control, or have controlling interest in one or more banks. BHCs are subject to capital and liquidity requirements on a consolidated basis and that are regularly examined by supervisors to ensure they are meeting those requirements.[11] Larger BHCs are subject to more stringent capital and liquidity requirements than smaller BHCs.[12] Other primary dealers are mostly owned by foreign banks, which depending on their legal structure, are either subject to U.S. or home-country capital and liquidity standards.

Q: Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for (1) primary dealers that are broker-dealers to maintain net regulatory capital of $50 million, and (2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

As noted above, primary dealers owned by BHCs and international banks face significantly more stringent capital and liquidity requirements than these guidelines used by the New York Fed solely to vet whether to accept a firm as a primary dealer. These capital and liquidity requirements are explicitly intended to ensure that a BHC can survive a financial market downturn, although the quantitative requirements are not tailored specifically to the risks faced by broker-dealers. For large BHCs, liquidity and capital stress tests are used to ensure the firms can continue to operate under a simulated liquidity crisis and severe financial downturn.

The capital requirements for primary dealers are not necessarily intended to serve as sufficient safeguards against all instances of market strain or liquidity pressures. This may be highlighted by the short-term Primary Dealer Credit Facilities put in place in 2008[13] and 2020.[14] The New York Fed may consider their potential effects in both safeguarding against adverse conditions and in the relative market presence of individual and collective primary dealers in Treasury auctions. Congress maintains authority to regulate primary dealers.

Many of the current primary dealer requirements date back to the early 1990s. These requirements stem from Treasury and Fed recommendations[15] in the wake of the discovery of an abnormally large position on Treasury two-year notes taken by Salomon Brothers Inc. in 1991.[16] The Fed can and does modify primary dealer requirements as part of its normal operations.[17] There are currently 24 primary dealers,

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[11] For more information, see CRS Report R47447, *Bank Capital Requirements: A Primer and Policy Issues*, by Andrew P. Scott and Marc Labonte.

[12] For more information, see CRS Report R47876, *Enhanced Prudential Regulation of Large Banks*, by Marc Labonte.

[13] Board of Governors of the Federal Reserve System, "Primary Dealer Credit Facility," December 2010, available at https://www.federalreserve.gov/regreform/reform-pdcf.htm.

[14] Board of Governors of the Federal Reserve System, "Primary Dealer Credit Facility," June 2021, available at https://www.federalreserve.gov/monetarypolicy/pdcf.htm.

[15] Department of Treasury, Securities and Exchange Commission, and Board of Governors of the Federal Reserve System, "Joint Report on the Government Securities Market," January 1992, available at https://home.treasury.gov/system/files/276/joint-report-on-the-government-securities-Market-1992.pdf.

[16] For a summary of the market effects of that activity, see Jegadeesh, Narasimhan, "Treasury Auction Bids and the Salomon Squeeze," *The Journal of Finance*, vol. 48, no. 4, September 1993.

[17] Federal Reserve Bank of New York, "FAQs About the New York Fed's Counterparty Framework for Market Operations," November 2016, available at https://www.newyorkfed.org/markets/counterparties/faq-counterparty-framework-for-market-operations.

slightly higher than the initial set of 18 primary dealers when the modern system was created in 1960 but lower than the peak of 46 primary dealers in 1988.[18]

[18] Federal Reserve Bank of New York, "List of Primary Dealers: Additions and Removals," June 2023, available at https://www.newyorkfed.org/markets/primarydealers#additions-and-removals.

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COMMITTEE ON
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JOINT ECONOMIC
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Congress of the United States
House of Representatives
Washington, DC 20515–0301

December 20, 2023

Kent Smetters, PhD
Professor of Business Economics and Public Policy
University of Pennsylvania
Wharton School
325 Vance Hall
3733 Spruce Street,
Philadelphia, PA 19104

Dear Dr. Smetters:

Please see below for questions for the record following your testimony to the U.S. House Committee on Ways and Means on December 6, 2023.

> **Q:** Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?
>
> **Q:** As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?
>
> **Q:** Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Please elaborate on your answer, and feel free to include what sources you have seen that support your answer if helpful. We appreciate any additional details and information you can provide.

Sincerely,

David Schweikert
Chairman
Subcommittee on Oversight

Kent Smetters
The Joseph and Ruth Boettner Professor
Faculty Director of Penn-Wharton Budget

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January 19, 2024

Representative David Schweikert
Chairman, Subcommittee on Oversight
Committee on Ways and Means
Congress of the United States
House of Representatives
Washington, DC 20515-0301

Dear Chairman Schweikert:

This letter is in response to your questions dated December 20, 2023, following the testimony provided on December 6, 2023. Thank you again for the opportunity to participate.

Question 1: Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?

Yes. Primary dealers are ultimately capitalized by financial markets. As documented in my testimony, the size of federal debt held by the public divided by the size of the economy (the "debt-GDP ratio") is projected to sharply increase over time under current law. If current law is allowed to continue unchanged, capital markets will demand an additional risk premium to compensate for additional "default risk." This risk can be either in the form of non-payment of interest payments (formal default) or in the form of inflation through debt monetization (informal default) where interest payments are formally made but in dollars with reduced purchasing power. The potential effects of formal default are obvious. However, since most U.S. Treasury issuance is nominally denominated and the U.S. controls its own money supply, debt monetization is the most likely path if policies under current law remain unchanged. Monetization can lead to a downward Treasury price spiral where, eventually, capital markets are no longer willing to capitalize dealers because there is no positive price that clears aggregate demand with total debt supply. There are many examples of this phenomenon happening historically outside the United States. The U.S. has historically avoided this price spiral, not because of its size, but because it has largely avoided exploding debt-GDP ratios in the past. For example, the runup in the debt-GDP ratio during World War II was temporary and followed by a sharp decline. In contrast, today the U.S. faces a climbing debt-GDP ratio that is unbounded under current law.

Question 2: As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?

Ultimately, dealers must have liquid capital reserves (see Question 3) plus "calls" on capital with minimal counterparty risk to meet the full supply of debt issued at auction. Historically, calls on capital have had minimal counterparty risk in this market. However, the 2007 - 2008 financial crisis has provided an important lesson on counterparty risk more generally.

Of course, the current two dozen primary dealers appear to have "deep pockets." But there is nothing firm. According to the Federal Reserve Bank of New York:

> "Primary dealers are trading counterparties of the New York Fed in its implementation of monetary policy. They are also expected to make markets for the New York Fed on behalf of its official accountholders as needed, and to bid on a pro-rata basis in all Treasury auctions at reasonably competitive prices."[1]

In other words, the NY Fed places "expectations" on its dealers. Dealers must also satisfy "any minimum capital or other standards that are set forth by their primary regulator" and "[p]rovide information as needed for the New York Fed's counterparty risk management and monitoring."[2] Actual required capital holdings are minimal (see Question 3 below).

Put bluntly, the current system is a mutually beneficial relationship, that is, until it is not for the primary dealers and their financial backers. Dealers can come and go. Since 2014 alone, three major primary dealers have left---Credit Suisse Securities (USA) LLC; Merrill Lynch, Pierce, Fenner & Smith Incorporated; and, RBS Securities Inc.---and five dealers have joined.

Q: Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

No, these capital requirements are not even remotely in the ballpark required to ensure all debt supply at auction will be purchased. However, sharply increasing these capital requirements could result in substantial risk premiums being paid by the government (lower prices), primary dealer pullout, and, even, financial market distress. Instead, Congress only has a single material lever: to not give capital markets any real reason to believe that direct or indirect defaults will happen. That requires Congress to fix the unsustainable debt path that exists under current law.

Very truly yours,

Kent Smetters

[1] https://www.newyorkfed.org/markets/primarydealers.html
[2] https://www.newyorkfed.org/markets/counterparties/policy-on-counterparties-for-market-operations

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COMMITTEE ON
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Congress of the United States
House of Representatives
Washington, DC 20515–0301

December 20, 2023

Bobby Kogan
Senior Director, Federal Budget Policy
Center for American Progress
1333 H Street, NW
Suite 100E
Washington, DC 20005

Dear Mr. Kogan:

Please see below for questions for the record following your testimony to the U.S. House Committee on Ways and Means on December 6, 2023.

> **Q:** Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?
>
> **Q:** As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?
>
> **Q:** Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Please elaborate on your answer, and feel free to include what sources you have seen that support your answer if helpful. We appreciate any additional details and information you can provide.

Sincerely,

David Schweikert
Chairman
Subcommittee on Oversight

MEMORANDUM

To:	The Honorable David Schweikert, Chairman of the House Ways and Means Subcommittee on Oversight
From:	Bobby Kogan, Senior Director of Federal Budget Policy, Center for American Progress
Re:	Questions for the record following December 06 hearing, “Hidden Cost: The True Price of Federal Debt to American Taxpayers”
Date:	January 04, 2023

Question #1

Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?

Answer #1

This question is sufficiently outside my area of expertise that I do not feel comfortable opining.

Question #2

As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?

Answer #2

This question is sufficiently outside my area of expertise that I do not feel comfortable opining.

Question #3

Should financial markets become strained and/or liquidity pressures on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Answer #3

This question is sufficiently outside my area of expertise that I do not feel comfortable opining.

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COMMITTEE ON
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Congress of the United States
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December 20, 2023

Michael Faulkender, PhD
Dean's Professor of Finance
University of Maryland
Robert H. Smith School of Business
2417 Van Munching Hall
College Park, MD 20742

Dear Dr. Faulkender:

Please see below for questions for the record following your testimony to the U.S. House Committee on Ways and Means on December 6, 2023.

> **Q:** Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?
>
> **Q:** As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?
>
> **Q:** Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Please elaborate on your answer, and feel free to include what sources you have seen that support your answer if helpful. We appreciate any additional details and information you can provide.

Sincerely,

David Schweikert
Chairman
Subcommittee on Oversight

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January 3, 2024

Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
1139 Longworth House Office Building
Washington, DC 20515

RE: Questions for the Record

Dear Chairman Schweikert:

Thank you for the opportunity to testify to your subcommittee on Wednesday, December 6, 2023 at the hearing entitled "Hidden Cost: The True Price of Federal Debt to American Taxpayers". Below are my responses to the questions you asked me to respond to for the record.

Question: Based on your experience, knowledge, and expertise, do you believe scenarios exist which would result in a primary dealer being unable to pay for the Treasury securities purchased at auction?

Response: I think it is unlikely a primary dealer would be unable to pay for US Treasury securities purchased at auction given the substantial capital and liquidity requirements imposed on the banking system, including primary dealers. However, there are some possible scenarios in which this might happen:

a. If indirect bidders (like foreign institutions) bidding through the primary dealer are unable or unwilling to pay for their awarded bonds in an auction, or the collateral they have posted to the primary dealer to finance their bid were to be insufficient, they may be unable to pay for the securities. In this case, the shortfall would have to be rather large relative to the size of the primary dealer's ability to absorb the bonds into its own inventory.
b. When there are violent swings in yields and primary dealers are underhedged in the duration exposure of their assets, leading to reduced liquidity and credit for the institution, as we saw with Silicon Valley Bank last spring. However, it would have to be on a greater scale than the swings we have seen recently.

Question: As a follow-up, what capital or cash reserves do primary dealers need to have on hand when bidding in Treasury securities auctions?

Response: I believe the current capital and liquidity requirements, detailed on the NY Fed's website, and the size requirements on being a primary dealer are sufficient to participate in Treasury auctions.

Question: Should financial markets become strained and/or liquidity pressure on primary dealers increase, are the current requirements for 1) primary dealers that are broker-dealers to maintain net regulatory capital of at least $50 million, and 2) primary dealers that are state or federally chartered bank or savings associations to maintain Tier 1 Capital of at least $1 billion, respectively, sufficient to meet potential instances of market strain and/or liquidity pressure?

Response: I believe so. Were the Treasury market significantly more volatile than what we have seen recently, I believe that many primary dealers would choose not to remain primary dealers rather than subject their capital to the losses that could accrue between when the bids are submitted at the auction and when they are able to sell them in the secondary market. I am more concerned by the potential that an insufficient number of financial institutions would be willing to be primary dealers than I am of those dealers exhausting their required capital and liquidity.

Please let me know if I might provide further assistance to the committee or any individual Members and their staff.

Sincerely,

Michael Faulkender

PUBLIC SUBMISSIONS FOR THE RECORD

Comments for the Record for the
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight
Hearing on Hidden Cost: The True Price of
Federal Debt to American Taxpayers
Wednesday, December 6, 2023 at 10:00 AM

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Chairman Schweikert and Ranking Member Pascrell, thank you for the opportunity to address this issue.

Less than full faith and credit

While my comments are usually frank, these will be on the brutal side. I will not be pulling punches, will share the raw politics of this situation and will be sharing my comments with the rating agencies.

Any downgrades we have had - and there have been two - did not come because the Democrats are spending out of control. It is because Republicans refuse to compromise until the last minute, with a significant portion of leadership not wanting to compromise at all. This unwillingness cost Mr. McCarthy his Speakership and likely drove John Boehner out of Congress.

Downgrades came for the same reason - brinkmanship on the debt limit in an attempt to force temporary tax cuts to be made permanent. The irresponsible strategy and the end goal alarm the bond markets because they indicate that one major party has no commitment to fiscal responsibility - play politics instead in fear of Grover Norquist - who no longer has skin in the game. Donald Trump took all of the radical oxygen away from the Republican fringe.

I am going to assume that leadership, especially among members of the Freedom Caucus, as well as their staffs are truly ignorant of how the national debt actually works. In short, it is the reason capitalism can exist at all. This is why, when the debt was paid off and the national bank was closed by Andrew Jackson, the economy collapsed.

Historic perspectives

In the 1960s, the debt from World War II was quickly being paid down. By the end of the decade, there was no federal debt to leverage other liquid investments. This eventually led to tax cuts, but President Reagan overshot the mark and then codified it in the 1986 tax reform. Presidents Bush and Clinton found the growing deficits unsustainable and adjusted tax reform at the margins. Doing so reduced the debt while fueling economic growth.

The Clinton cuts to capital gains taxes put too much money into the hands of speculators, which led to the tech boom and bust. It had nothing to do with technology and everything to do with IPOs. Even then, as budget balance was a real possibility, Alan Greenspan sounded the alarm about abolishing the debt. Many thought that this was to preserve the ability to maintain a fractional reserve currency, but the real motivation was to continue to provide the leverage on which capitalism depends.

The title of this hearing indicates that this history is new to the majority and staff. Either that or it is pandering to public ignorance. Regardless, please consider the current circumstances further.

Federal Debt Ownership

According to the Treasury Bulletin, the national debt is owned by the Federal Reserve System and its member banks (about a third), long term investment, insurance and retirement funds - both public and private - as well as Savings Bonds (another third). Using figures from the 2019 Federal Reserve Survey of Consumer Finance, I estimate that the top 10% of households own around 54% of these funds, with the bottom 90% owning the remainder (although the bottom three quintiles own essentially nothing - nor do they owe it - as will be described below.

The last third is owned by mutual and bond funds, as well as offshore investors. The top 10% of households own 77% of these funds. If the majority continues to dance on the edge of default, these are the investments that are at risk. The top 1% own the same percentages as of what the top 10% hold. This means that from the second to the tenth percentages own 25% of deposits retirement and mutual funds backed by Treasuries.

The top 1% hold one quarter of debt assets held through deposits and long-term investment funds and half of what is held by mutual and bond funds. There are better ways to increase interest rates for these borrowers than messing with the Full Faith and Credit of the United States, which is essentially what the Freedom Caucus led assault on the status quo is doing.

Let us add that of the debt held overseas, roughly two thirds are held by foreign governments who, by doing so, facilitate international capitalism - especially the import of consumer goods from Japan and China. Messing with these funds put WalMart shopping at risk, as well as the entire chain. Much of the remainder of foreign bond holdings are in the Caymans, Ireland, Switzerland and Luxembourg. In other words, they are held in tax shelters for very wealthy Republican donors.

These investors know exactly where their debt assets are being held. It seems as if members of the Freedom Caucus do not. Unless there is a plot to destroy capitalism that I have not yet heard about, we suggest that the debt limit be abolished and the 2018 tax cuts allowed to expire on schedule. This will restore the confidence of both rating agencies and investors at home and abroad.

Continuing on the current path, where a major portion of the Republican Party acts against the interests of investors and the nation at large and sustains unsustainable tax cuts could have drastic consequences. The entire economy could collapse again, but this time for real. If the Federal Reserve loses its international leverage because the debt has become worthless, there will be no bailouts for questionable investments in mortgage backed securities - investments that have shifted from owner-occupied housing to single-family rentals. The bill to ban hedge fund ownership of these properties will reduce risk overall, but will not save the nation from the risk of losing its good credit.

Who Owes the Debt?

Debt obligation is a function of income tax paid (FICA tax paid to create assets held in trust by the government, not debt obligation). The current factor is 19 dollars of debt owed for every dollar paid in tax.

Ownership of Social Security assets is realized when households are in the bottom quintiles who, at that time (because only 20% have income beside Social Security), own almost all FICA trust fund assets. The bottom quintiles hold more than their obligation.

The next three quintiles owe more than they own until we get to the top 0.1%. Because half of their income is earned through asset ownership taxed at preferred rates and their high share of ownership of debt, they break even. They own what they owe. In other words, when interest rates go up due to downgrades, their wealth expands in terms of debt owned compared to debt owed. This should guide how the debt should be reduced responsibly.

Please see the first attachment for more information on how debt is owned and owed. See the second attachment for our tax reform proposals that will responsibly bring down the federal debt.

Possible scenarios

It is now time to speculate on what may happen next. Let us assume rational actors who are capable of changing their behavior. Again, we will be pulling no punches.

Business as usual would be for an agreement between leadership, neo-liberal Republicans and neo-liberal Democrats to enact a reasonable set of spending bills, with the usual dissenters in the Freedom Caucus never coming around to do their duty as members of Congress in the majority party to keep government open.

A variation of that option is for those who have been voting with Democrats to simply switch parties, or at least enough of them to end the drama for the rest of this Congress.

Another change in leadership may, and probably will, occur when Roger Stone and his associates in the Willard Hotel War Room, including members of Congress who were part of the planning process, are indicted by Jack Smith. At this point, from the time these members resign or are expelled and until they are replaced by special elections, Minority Leader Hakim Jefferies becomes the Speaker and enacts a menu of tax, spending and budget process reforms.

The same variation is possible as above, which is for some number of current Republican members to permanently change parties - especially if they wish to remove the taint of having been in a party which had a majority of its members vote as if they had helped plan the Insurrection on January 7, 2021, because they realize that an elector bloodbath rivaling 1974 is likely.

The worst case scenario is Republican solidarity, allowing the debt to go into default and leading to permanent damage to the economy, including that portion of trade that occurs between China and the United States which is more akin to the internal operations of Wal-Mart. This would include the collapse of the Federal Reserve. If this occurs, it will be before the election, so that no Trumpian tyranny will result.

The least likely option is the challenge made in these comments - a return to bipartisanship without the kind of rhetoric used in naming this hearing - which has infected what was the status quo of this Committee. Under that option, Congress returns to business as usual and quietly passes the required legislation to keep the government running through the middle of 2025.

The fantasy option is for Jack Smith to do nothing related to Congress, with Trump returning to power with strong Republican majorities - strong enough so that he can turn aside any 14th Amendment challenges to taking office again. Anyone who thinks this is at all likely needs both psychiatric and legal advice.

The ideal option, which is also unlikely, is for bipartisanship to result in the reforms detailed in the second attachment. This would actually settle most controversy over taxes for the long-term, which is what makes it unlikely. A lot of money is spent on going back and forth on tax policy, sadly putting our nation at continued risk of financial collapse.

Thank you for the opportunity to address the committee. Please contact us for an in person briefing or to arrange for a public hearing.

Attachment - Debt Ownership as Class Warfare, March 20, 2023

Visibility into how the national debt, held by both the public and the government at the household level, sheds light on why Social Security, rather than payments for interest on the debt, are a concern of so many sponsored advocacy institutions across the political spectrum.

Direct household attribution can be made by calculating direct bond holdings, income provided by Social Security payments and secondary financial instruments backed with debt assets for each income quintile.

Responsibility to repay the debt is attributed based on personal income tax collection. Payroll taxes create an asset for the payer, so they are not included in the calculation of who owes the debt. Using 2019 tax data and the national debt as of COB February 15th, 2022. the ratio is $19 of debt owed for every dollar of income tax paid. Note well that the adjusted gross income of the bottom 80% is just over that garnered by the top 10%.

Percentiles	Millions of Returns	AGI	Income Tax	Debt	Federal Reserve and Bank Debt Assets	Long Term Investment Debt Assets	Mutual Fund and Bond Debt Assets	Social Security and Medicare Assets
Total with tax	104.01	11,210.1	1,581.4	30,040.3	6,806.6	3,276.5	6,419.1	3,186.5
Top .01%	0.02	659.0	163.2	3,100.2	820.6	378.8	2,519.8	0.0
.01% to 1%	7.26	1,427.9	185.6	3,526.6	1,736.9	844.4	1,652.5	10.2
1% to 10%	7.28	2,086.9	348.8	6,626.8	1,957.5	978.1	1,196.5	177.6
Top 10%	**9.00**	**4,602.44**	**987.23**	**18,754.0**	**4,515.0**	**2,201.4**	**5,368.8**	**187.8**
10% to 20%	13.08	1,788.34	200.3	3,805.1	921.5	644.9	583.2	463.7
Bottom 80%	81.92	4,829.22	393.6	7,476.6	1,370.1	430.3	467.2	2,534.9

The bottom 80% of taxpaying units hold few, if any, public debt assets in the form of Treasury Bonds or Securities or in accounts holding such assets and only take home one-third of adjusted gross income. Their main national debt assets are held on their behalf by the Government. They are owed more debt than they owe through taxes. The next 10% (the middle class), hold more in terms of long term investments and mutual fund and bond assets. They hold a bit under a fifth of social insurance assets.

The top 10% pay more than half of income taxes (the dividing line is about 97.5% - and has been for a while). Asset shares within the top 10% are estimated using the same breakdown as the entire population, that is, the top 1% hold 54% of Federal Reserve and Long Term Investment Assets and 77% of mutual funds and bonds as held by the top 10%. A similar fraction is used to estimate holdings by the top 0.01% - which is consistent with how much income they receive (note that I did not say earn.

This illustration shows who benefits the most from having a national debt, therefore who has the most to lose through default. The relative shares of debt ownership, however, are current as reflected in the 2019 Federal Reserve Survey.

Attachment - Tax Reform, Center for Fiscal Equity, March 24, 2023

Synergy: The President's Budget for 2024 proposes a 25% minimum tax on high incomes. Because most high income households make their money on capital gains, rather than salaries, an asset value added tax replacing capital gains taxes (both long and short term) would be set to that rate. The top rate for a subtraction VAT surtax on high incomes (wages, dividends and interest paid) would be set to 25%, as would the top rate for income surtaxes paid by very high income earners. Surtaxes collected by businesses would begin for any individual payee receiving $75,000 from any source at a 6.25% rate and top out at 25% at all such income over $375,000. At $450,000, individuals would pay an additional 6.25% on the next $75,000 with brackets increasing until a top rate of 25% on income over $750,000. This structure assures that no one games the system by changing how income is earned to lower their tax burden.

Individual payroll taxes. A floor of $20,000 would be instituted for paying these taxes, with a ceiling of $75,000. This lower ceiling reduces the amount of benefits received in retirement for higher income individuals. The logic of the $20,000 floor reflects full time work at a $10 per hour minimum wage offered by the Republican caucus in response to proposals for a $15 wage. The majority needs to take the deal. Doing so in relation to a floor on contributions makes adopting the minimum wage germane in the Senate for purposes of Reconciliation. The rate would be set at 6.25%.

Employer payroll taxes. Unless taxes are diverted to a personal retirement account holding voting and preferred stock in the employer, the employer levy would be replaced by a goods and receipts tax of 6.25%. Every worker who meets a minimum hour threshold would be credited for having paid into the system, regardless of wage level. All employees would be credited on an equal dollar basis, rather than as a match to their individual payroll tax. The tax rate would be adjusted to assure adequacy of benefits for all program beneficiaries.

High income Surtaxes. As above, taxes would be collected on all individual income taxes from salaries, income and dividends, which exclude business taxes filed separately, starting at $400,00 per year. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction.

Asset Value-Added Tax (A-VAT). A replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed. As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax free. These taxes will fund the same spending items as high income and subtraction VAT surtaxes. There will be no requirement to hold assets for a year to use this rate. This also implies that this tax will be levied on all eligible transactions.

The 3.8% ACA-SM tax will be repealed as a separate tax, with health care funding coming through a subtraction value added tax levied on all employment and other gross profit. The 25% rate is meant to be a permanent compromise, as above. Any changes to this rate would be used to adjust subtraction VAT surtax and high income surtax rates accordingly. This rate would be negotiated on a world-wide basis to prevent venue seeking for stock trading.

Subtraction Value-Added Tax (S-VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S-VAT is a vehicle for tax benefits, including

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S-VAT will not be border adjustable.

As above, S-VAT surtaxes are collected on all income distributed over $75,000, with a beginning rate of 6.25%. replace income tax levies collected on the first surtaxes in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I-VAT) Border adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S-VAT, then they would be funded by the I-VAT to take advantage of border adjustability.

I-VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S-VAT and I-VAT, however net income will be increased by the same percentage as the I-VAT. Inherited assets will be taxed under A-VAT when sold. Any inherited cash, or funds borrowed against the value of shares, will face the I-VAT when sold or the A-VAT if invested.

I-VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I-VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25% to 13%).

Carbon Added Tax (C-AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C-AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

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