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Economic Risks of More Demand-Inducing Deficit Spending

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The Costs of Inaction: Economic Risks from Housing Unaffordability

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Chair Whitehouse, Ranking Member Grassley, and distinguished members of the Committee, thank you for the opportunity to testify before you today. It is an honor to appear before this body to discuss such an important topic.

My name is Jack Salmon, and I am the Director of Policy Research at the Philanthropy Roundtable. Philanthropy Roundtable is a mission-driven organization which aims to foster excellence in philanthropy, protect philanthropic freedom and help donors advance liberty, opportunity and personal responsibility. A strong private sector, supported by a free enterprise system, is the bedrock for the creation of the private wealth that makes philanthropy possible.

In my remarks today I will talk about the bigger picture, considering our nations fiscal condition, and why worsening this condition through yet more spending would be harmful to the long-term well-being of all Americans. I will also highlight the fact that the often-overlooked charitable sector is rising to the challenge of addressing homelessness and housing affordability.

Proposals from the Harris campaign include plans such as a $25,000 downpayment for first time home buyers, which will add $224 billion in new deficit spending.[1] Attempts to address housing affordability by further subsidizing demand will be counterproductive and make housing affordability worse. But more than this, such policies ignore the broader economic challenges we face, particularly the nation's deteriorating fiscal situation.

The nation's fiscal situation has never been worse. Debt held by the public is currently 100 percent of GDP and is forecast to reach 166 percent by 2054.[2] If economic growth is slower or interest rates are higher than baseline models forecast, then public debt could reach 217 percent of GDP over the coming 30 years. Debt held by the public is now more than $28 trillion, while total public debt outstanding is over $35 trillion.

[1] William McBride et al. Kamala Harris Tax Plan Ideas: Details and Analysis. The Tax Foundation. September 10, 2024. https://taxfoundation.org/research/all/federal/kamala-harris-tax-plan-2024/

[2] Congressional Budget Office (CBO). The Long-Term Budget Outlook: 2024 to 2054. March 20, 2024. https://www.cbo.gov/publication/59711

The Harm of Public Debt Crowd Out

As our debt burden has continued to grow unabated, rising interest rates have spiked the cost of servicing the debt. Three years ago, interest costs consumed 1.5 percent of the economy—today this figure is around 3.3 percent.[3] In fiscal year 2024, if you combined all federal transport spending, federal education spending, and all veterans' benefits & services, it still wouldn't come close to the level of spending committed to paying interest on the debt.[4] This means that policymakers have less fiscal space to commit spending towards their policy priorities.

But more than public spending crowd out, a higher public debt burden diminishes the economic growth potential of our broader economy. A survey of 65 academic articles published since 2010 find a broad economic consensus: that high levels of public debt have a negative impact on economic growth.[5] Specifically, countries with public debt ratios above a level around 80 percent of GDP experience significant deleterious impacts on growth rates. This should be especially concerning for those who claim to care about Americans at the lower end of the income distribution. Lower rates of economic growth mean less revenue potential for governments to support those who need it most, but it also means less job creation, lower wage growth, and diminished living standards.[6]

Government Spending Crowds Out Private Sector Investments

When advocating for more spending, this administration has often made the case that more spending on new and expanded programs is an investment in future growth. However, such claims are misleading as unfettered growth in government spending crowds out private sector investments.

Many policymakers predicate such ideas on the economic assumption of large fiscal spending multipliers. A 2019 study by economist Valerie Ramey reviewed the estimates of studies with strong methodological approaches to find a range of estimates for spending multipliers. She finds that the bulk of estimates for average spending multipliers lie in a fairly narrow range of 0.6 to 1.0.[7] When accounting for the future tax

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[3] Treasury.gov. Average Interest Rates on U.S. Treasury Securities. https://fiscaldata.treasury.gov/datasets/average-interest-rates-treasury-securities/average-interest-rates-on-u-s-treasury-securities

[4] U.S. Department of the Treasury. Monthly Treasury Statement. September 12, 2024. https://www.fiscal.treasury.gov/reports-statements/mts/current.html

[5] Jack Salmon. The Impact of Public Debt on Economic Growth. Cato Journal. 2021. *I have since updated the list from 40 studies to 65 studies (unpublished).

[6] For employment effects see: Steven Kapsos. The Employment Intensity of Growth: Trends and Macroeconomic Determinants. Labor Markets in Asia. Palgrave Macmillan, London. 2006. https://link.springer.com/chapter/10.1057/9780230627383_4 ; For effects on living standards see: John V.C. Nye. Standards of Living and Modern Economic Growth. Econlib. https://www.econlib.org/library/Enc/StandardsofLivingandModernEconomicGrowth.html

[7] Valerie A. Ramey. Ten Years after the Financial Crisis: What Have We Learned from the Renaissance in Fiscal Research? Journal of Economic Perspectives 33, no. 2 (2019): 89–114.

increases required to fund the additional spending, the economists Robert Barro and Charles Redlick find that the multiplier likely turns negative.[8]

Not only does the empirical literature demonstrate that government spending crowds out private investment, but a review of the multiplier literature in relation to the fiscal position also reveals a significant negative relationship.[9] As debt levels continue to grow, the multiplier effect of additional government spending will continue to fall, meaning the negative crowd out effects of additional government spending will worsen over time.

Irresponsible Spending Inflates Away Our Living Standards

Another way in which our spiraling debt burden diminishes living standards is through inducing spikes in inflation. In recent years we experienced the largest spike in inflation in 4 decades. Prices today are 20 percent higher than in January 2021, while the cost of shelter is 23 percent higher.[10]

The scale and size of fiscal stimulus spending in 2021 was far in excess of the projected output gap. For example, the American Rescue Plan (ARP) distributed $1.9 trillion in stimulus spending to close an output gap that the Congressional Budget Office projected to be $700 billion through 2023.[11] At the time, economists from across the political spectrum warned policymakers about going too big with this level of stimulus spending. Larry Summers warned that it would cause inflationary pressures to mount, while Jason Furman noted that ARP was "too big for the moment".

An academic article published last year found that the ARP fiscal stimulus raised peak inflation by 3.1 percentage points, from 5.5 percent to 8.6 percent.[12] The authors noted, that due to unfunded spending, especially ARPA, it may take until 2025 for inflation to retrench to 2 percent target.

A recent study by European Central Bank economists concluded that the "evidence largely corresponds to the period when the pandemic fiscal packages were adopted and suggests that these transfers had long-lasting effects on inflation and contribute to explaining the persistence of core services inflation".[13]

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[8] Robert Barro and Charles Redlick. Macroeconomic Effects From Government Purchases and Taxes. The Quarterly Journal of Economics. Vol 126 (1), February 2011, pp 51–102.

[9] Veronique de Rugy and Jack Salmon. Declining Fiscal Multipliers and Inflationary Risks in the Shadow of Public Debt. Mercatus Center at George Mason University. August, 2022. https://www.mercatus.org/research/policy-briefs/declining-fiscal-multipliers-and-inflationary-risks-shadow-public-debt#:~:text=As%20debt%20levels%20continue%20to,risk%20for%20future%20economic%20crises.

[10] Bureau of Labor Statistics. Consumer Price Index. https://www.bls.gov/news.release/cpi.nr0.htm

[11] Congressional Budget Office (CBO). An Overview of the Economic Outlook: 2021 to 2031. February 1, 2021. https://www.cbo.gov/publication/56965

[12] Bianchi et al. A Fiscal Theory of Persistent Inflation. The Quarterly Journal of Economics. Vol 138 (4), November, 2023, pp 2127–2179.

[13] Maria Grazia Attinasi and Paola Di Casola. Post-pandemic US inflation: A tale of fiscal and monetary policy. Center for Economic Policy Research. September 17, 2024. https://cepr.org/voxeu/columns/post-pandemic-us-inflation-tale-fiscal-and-monetary-policy

As economists at the Federal Reserve Bank of Dallas pointed out in research published last year, high inflation disproportionally hurts low-income households the most.[14] When prices increase, middle-income households often adjust by opting for lower-cost goods and switching to generic brands. Low-income households, however, lack this flexibility, as they are often already purchasing the least expensive options available.

Proposals by policymakers to further induce demand will only worsen the cost-of-living crisis that American families are already dealing with.

Rent Control Will Further Reduce the Supply of Affordable Rentals

President Biden has advocated imposing a 5 percent cap on rent increases—a policy position that has also been endorsed by Vice President Harris. Price controls are incredibly market distorting, in fact, a recent weighted survey of 44 economics found that 99 percent agree with the statement that widespread use of price controls creates substantial economic distortions.[15] A second survey of 45 economists carried out in July found 85 percent disagreed with the notion that rent caps would make middle-income Americans better off, while just 2% agreed.[16]

It isn't just the opinions of economic experts that find price controls to be ineffective and market distorting. A meta-analysis of 112 empirical studies published in the Journal of Housing Economics earlier this year found that rent controls lead to lower supply of rental units, less new housing, and lower quality of existing rental units.[17]

A textbook study on the impact of rent controls on markets can be found by reviewing the experience of Argentina in recent years. In 2020, the Argentine government imposed rent price controls with the aim of increasing economic security. As a result, an estimated 45 percent of landlords stopped renting and instead sold their properties, while others moved to short-term rentals.[18] This led to a significant shortage of rental properties and an unprecedented spike in rental prices.

Prices are signals that convey important information about supply, demand, and scarcity. Attempts to control or impose arbitrary caps on prices distort these signals and make shortages worse.

Private Philanthropy is Rising to the Challenge

[14] Aparna Jayashankar and Anthony Murphy. High inflation disproportionately hurts low-income households. Federal Reserve Bank of Dallas. January 10, 2023. https://www.dallasfed.org/research/economics/2023/0110

[15] Kent Clark Center (University of Chicago). Election Economic Policy Ideas. September 10, 2024. https://www.kentclarkcenter.org/surveys/election-economic-policy-ideas/

[16] Kent Clark Center (University of Chicago). National Rent Caps. July 23, 2024. https://www.kentclarkcenter.org/surveys/national-rent-caps/

[17] Kholodilin, Konstantin A. "Rent control effects through the lens of empirical research: An almost complete review of the literature." Journal of Housing Economics 63 (2024).

[18] Jacobo, Alejandro D., and Konstantin A. Kholodilin. "One hundred years of rent control in Argentina: much ado about nothing." Journal of Housing and the Built Environment 37, no. 4 (2022), 1923-1970.

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Most people know someone who has been impacted by either the homeless crisis or who struggle to find affordable housing. While government often attempts to fix social problems with a one-sized-fits-all approach, charities around the country have been doing inspiring work alleviating homelessness by addressing the underlying causes such as mental health, employment, and addiction recovery.

For example, Texas based organization, Mobile Loaves and Fishes, shows the strength of charities rising to the occasion to support their communities.[19] Their volunteers help the homeless by providing meals, housing, and income opportunities to help those in crisis get back on their feet. Residents in the Community First! Village have an opportunity to earn income via different onsite programs, instead of getting stuck in the never-ending cycle of poverty and homelessness.

Another example is Step Denver, a Colorado-based organization that works men through a Steps for Success program based on four pillars: sobriety, work, accountability, and community.[20] The goal of the program is to help men end the cycle of addiction and become productive members of society. The program appears to be working. According to their statistics, 82% of alumni are currently employed and 89% live in stable housing. The program has done so well, they have plans to expand to Colorado Springs, Phoenix, Albuquerque, and other cities.

Finding a solution isn't simply about providing affordable housing. It's about adequately addressing what created the problem in the first place. And it starts with community-based programs that connect individuals with a strong support system and really gets to the root of the problem, whether it be addiction, employment, or mental health issues.

Rather than subsiding demand through increased government spending and redistribution, policymakers should focus on policies that induce economic growth, not more public debt. Policymakers should also focus on alleviating regulatory burdens that stifle the much-needed supply of new housing across the country.

Private philanthropy is already rising to the challenge of alleviating homelessness and affordable housing crises, but their work is undermined when government pursues anti-growth policies. Policymakers should refrain from adding to the public debt burden that continues to be a serious drag on our nation's economic potential.

Thank you.

[19] Mobile Leaves and Fishes. https://mlf.org/
[20] Step Denver. https://stepdenver.org/program-overview/