Statement of
David R. Malpass
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Subcommittee on Children and Families
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Chairman Casey, Senator Tuberville, Members of the Subcommittee, thank you for the invitation to testify. People across the country and around the world have been hit hard by inflation. Children and families are particularly at risk due to high food, medical and energy prices and the generational setback in education from prolonged school closures during COVID.

As background, my career has been focused on economics, finance and development. My first job in Washington was in 1984 as a tax and trade economist with the Senate Budget Committee chaired by Senator Pete Domenici. From 1986-1993, I was an economic official at the Treasury and State Departments with Secretary James Baker and then worked on Wall Street from 1993-2016. From 2017-2023, I was privileged to serve as Treasury Undersecretary and then World Bank president.

My remarks today are focused on the cause and impact of high prices. They are continuing to put strain on children and families in the U.S. and around the world. Reversing the current stagflation will require a complete upheaval in economic policy to allow faster growth, greater private sector investment, more production, a conscious shift from excessive regulation to effective, much slower growth in government spending, a smaller, more focused Federal Reserve with revised models and tools, and a recovery in education, none of which is forthcoming in the current Administration. The election choice has made clear that there is another path: positive change by reducing harmful regulations, taxing much less than President Biden's proposals, shrinking the oversized government and Washington establishment, encouraging private sector growth, and defending the dollar. Markets are forward-looking, so the benefits would spread quickly through the economy. Prices and interest rates could decline relatively quickly, helping consumers make a comeback.

Stagflation and Reversal in Education

During my recent six years in public service, I participated actively in the G7, G20 and IMF discussions on economic policies and the outlook for inflation and interest rates. I focused my work as president of the World Bank on higher incomes, clean water and sufficient energy for people in developing countries. By 2021, the Covid lockdowns and school closures were causing severe reversals in living standards, especially for children and families. World Bank statistics on poverty, child nutrition, and literacy showed devastating declines in developing countries, reflecting deep trauma for poorer families.

Russia's February 24, 2022 invasion of Ukraine came immediately after the weak U.S. and NATO message I heard at the Munich Security Conference on February 18-20, 2022. Russia' invasion, on the heels of the abrupt U.S. withdrawal from Afghanistan in 2021, added major new obstacles to global growth. Among them, the invasion triggered an energy crisis in western

Europe, which was heavily dependent on Russian gas and oil despite harsh Reagan and Trump sanctions. Europe's leaders began buying up natural gas supplies worldwide that would otherwise have gone to developing countries. The resulting shortages of natural gas caused disruption of fertilizer, agriculture and electricity production. Government spending surged and inflation worsened. The prolonged war in Ukraine has strengthened Russia and China across the developing world.

By the World Bank's June 2022 Global Economic Prospects report, I warned of stagflation and an extended period of slow global growth.[1] I urged added production. "With inflation now running at multidecade highs in many countries and supply expected to grow slowly, there is a risk that inflation will remain higher for longer than currently anticipated… It's essential to boost the supply of key food and energy commodities. Markets look forward, so even mere announcements of future supply would help reduce prices and inflation expectations."

In remarks at the Brookings Institution on July 13, 2022[2] , I noted that much of the supply increase needed to come from the U.S. because it has the capital and resources to make rapid additions to world supplies:

"If the anti-inflationary policies that are now getting underway are primarily achieved through interest rate increases, it risks deepening the inequality that is so problematic in the world. Stagflation could worsen. It's exacerbated by shortages of the working capital needed for small businesses and supply chains. We have a system patently set up that diverts capital to the big players and not to the small players that provide this solution to the current inflation problem... The United States has the biggest ability in the world to expand production to counteract the global inflation underway. *Not enough steps are being taken to dramatically increase U.S. production of supplies that are in shortage.*"

Slow Growth, Explosion of Debt

Fast market-based non-inflationary growth is the critical underpinning of higher living standards. U.S. first quarter real GDP growth was only 1.4%. This is disappointingly slow, especially considering the huge injection of demand through government spending and debt. The non-government portion of the economy is barely growing. The explosion of government debt is costly not only because of debt service. Even more costly is the intergenerational transfer that supports the current government and its policies but uses up future resources.

The Congressional Budget Office economic projections shows only 2% real growth in 2024 and the same or less in the subsequent ten years. The generation of Americans coming of age then will be repaying trillions of dollars of debt without having benefited much from it. *Reversing the current stagflation will require a complete upheaval in economic policy to allow faster growth, greater private sector investment, more production, a conscious shift in regulation from*

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[1] World Bank Global-Economic-Prospects-June-2022-Foreword

[2] Brookings Institute July 2022 wbg president-david-malpass-on-the-state-of-the-global-economy/

excessive to effective, much slower growth in government spending, revised Federal Reserve models and tools, and a recovery in education, none of which is forthcoming in the current Administration.

I'd like to mention education briefly given this Committee's important remit. Children in the U.S. suffered a severe setback in learning during Covid, as they did many countries. The World Bank is deeply involved in education worldwide. This led to a major coordinated global call to action to overcome the Covid losses in education. I co-hosted and spoke at the September 2022 summit on Transforming Education to urge leaders to make changes in educational systems, among them to reopen more schools and focus on literacy and numeracy.[3] This focus is urgently needed if we are to recover some of the ground lost during the school closures and enable the generation that is expected to repay the explosion of government debt underway.

Inflation/Production Crisis

I'm also deeply concerned by high prices and regulatory obstacles. They are closely connected to the explosion of government debt and production shortfalls. In a market system, prices are a response to supply and demand. Complex regulations discourage investment and production, boosting prices and putting key infrastructure such as canals, locks, pipelines and the electricity grid at risk. Many sectors of energy production are constrained either by existing regulations or the fear of new regulations such as the attempted ban on liquified natural gas (LNG) exports. The regulatory freeze is particularly problematic for U.S. mining and energy production, key drivers of economic growth. To compete effectively, the U.S. needs more energy, not less. Production of nuclear power and other non-intermittent sources of electricity need to be accelerated dramatically to add to baseload as we work to strengthen and protect the electricity grid.

At the end of 2020, U.S. CPI inflation was 1.4% year-over-year. It rose sharply during the year due mostly to supply chain problems and a huge expansion of government spending. If the spending had been one-time, I think markets would have adjusted, and the Federal Reserve would have been on firmer ground in treating inflation as transitory. However, during 2021-2022, a multitude of large spending bills combined with regulatory constraints on production made clear to markets that demand would remain above supply. Inflation expectations rose, demand increased more than supply, and prices rose. CPI-U inflation reached 7% by the end of 2021 and peaked at 9.1% in June 2022.

From the standpoint of children and families, this result is devastating. Inflation and the policies causing it chew up anyone with limited disposable income. It is making housing unaffordable, especially for the young, via rent increases, high mortgage rates and the Administration's war on appliances. It will take years of better policies to reverse the damage to discretionary income.

[3] Wbg-president-at-unga-77, Sept. 2022, the-global-challenge-of-addressing-the-learning-crisis

Out of control spending. Misallocation of capital.

It is hard to fully comprehend the size of the expansion of the government in recent years. I've called it "uncharted territory" but that doesn't go far enough. Spending growth is out of control. Combined with costly regulations, it causes inflation. I've advocated strongly for new checks and balances that make spending increases harder when debt levels are too high. Outlays were running roughly $4.2 trillion per year prior to Covid. They jumped to $6.7 trillion in FY20 and FY21 and are now expected to be maintained at roughly $7 trillion per year, then rise to $8 trillion yearly later in the decade.[4] This sustained surge in spending causes businesses to invest and hire less. It is the epitome of irresponsible macroeconomic policy.

CBO's June baseline showed $85 trillion ten-year outlays in FY25-34 and $63 trillion in revenues, adding $22 trillion to the national debt. These are incredibly large numbers, and it is worth noting that actual spending is often well above the baseline due to add-ons, over-runs and new spending priorities. One example: The peace dividend that the U.S. enjoyed in the 1990s ended due to U.S. weakness abroad and needs to be replaced by stronger and more effective growth in defense spending not included in the baseline.

The rapid escalation of U.S. national debt is creating huge problems globally. I described these in detail while at the World Bank. In a speech at the Churchill Symposium in Zurich[5], I described the problem:

> "On the fiscal side, governments borrowed heavily from savers around the world to support consumption, leaving shortages of capital for growth and investment, especially in developing countries. Almost all the fiscal stimulus went to benefit people in advanced economies, often people with incomes well above the median. On the monetary side, the major central banks moved further away from monetarism. Some entirely removed the reserve requirement on banks, adopting a post-monetarist framework in which central banks both regulate and allocate capital, rather than controlling the money supply through bank reserves.… From an inequality standpoint, this framework misallocates capital, favoring those with higher net worth at the expense of broad-based growth."

In an October 2022 speech[6] at Stanford's Stanford Institute for Economic Policy Research (SIEPR), I explained:

> "The increase in fiscal and monetary policy accommodation has fed primarily into asset prices in advanced economies. This supports the wealthy who hold these assets, rather

[4] https://www.cbo.gov/system/files/2024-06/60039-Outlook-2024.pdf

[5] Churchill symposium remarks-May 2022 by-wbg-president-malpass-to-the-europe-institute-at-university-of-zurich

[6] The-crisis-facing-development-SIEPR speech-by-wbg-president-malpass-Sept 2022

than the bulk of the population, at a moment of nearly unprecedented inequality. Growth in median income has lagged with only a few exceptions; for developing countries, capital inflows mostly supported government spending and asset portfolios, with little showing up in foreign direct investment or gross fixed capital formation.

"To unwind this imbalance would require clear communication that increased production is a policy goal as is a market-oriented flow of capital to development. With inflation high, several tools are available beyond interest rate hikes: first, create the conditions for supply to increase in response to price increases; markets are forward looking, so even the announcement of future supply by private investors and governments would help; second, in the advanced economies, reduce the size of government current spending and improve efficiency by targeting it more on the poor and vulnerable; this would reduce non-productive demand and leave more space for global capital markets to fund investment, taking pressure off inflation; and third, reduce the maturity of the central banks' current and future bond holdings; this would send a signal to markets that capital can flow to other assets such as the short-term floating rate capital needed by smaller businesses to increase global output."

In a Wall Street Journal article in May 2023[7], I focused attention on the problem that the U.S. government is materially slowing global growth by absorbing a huge portion of global capital and allocating the funds to government consumption rather than global investment, . The short maturities of U.S. debt add materially to the problem.

"As I near the end of my term as World Bank president, I'm discouraged by the lack of resolve and action. I worry that slow growth may persist for years. The world is digesting the huge buildup of government debt relative to gross domestic product, normalization of artificially low interest rates, and a system allocating capital away from small businesses and toward bond issuers, especially governments and the largest businesses. The result is reduced dynamism at home and fragility abroad...

"Solutions exist. First, markets are forward-looking, so credible government spending restraint would provide immediate encouragement to growth-oriented investment. Restraint that forces debt-to-GDP ratios to stabilize and then decline (without threatening default) would allow market-based capital flows to resume. Second, central banks should put more focus on policies that encourage currency stability and supply creation, not only demand destruction. They should give up their bond holdings and reduce their massive short-term debt. Combined with distortive credit regulation, current policies concentrate capital in narrow segments of the advanced economies and slow growth elsewhere. These policies need to be replaced to restart growth. This is discussed in international meetings but rejected in favor of the status quo. The world needs a range of strong policies that spur production to combat inflation. With no change, the likelihood is a long period of slow global growth and downward asset repricing. Capital will continue moving in the

[7] https://www.wsj.com/articles/the-world-economy-needs-to-get-its-growth-back-group-of-seven-developing-countries-debt-financing-yield-curve-private-sector-innovation-4113e720

wrong direction, toward a narrow group of "sinks"—governments, big corporate borrowers, excess consumption—rather than to small businesses, working capital and forward moving developing countries that could add to long-term global growth."

Risk of Slowdown and "More of the Same"

The outlook is no less concerning now. The most recent data showed CPI inflation of 3.3% over the 12 months through May. That's still well above the Federal Reserve's 2% target. Gasoline is averaging $3.50 per gallon, with the risk to the upside given the rising price of oil.

The government has so much short-term debt that high interest rates haven't been effective. The theory is that high rates will constrain credit, slowing the economy and allowing supply to catch up to demand. The reality is that Treasury and Federal Reserve interest payments are levitating the upper end of the economy, leaving prices high and millions of people, especially non-wealthy families with children, under heavy shortfalls in discretionary income.

The risk under current policies is continuation of the status quo as the economy weakens. It is digesting the prospect of years of high real interest rates and a deeply inverted yield curve, a scenario antithetical to private sector growth. Manufacturing data has been weak despite massive government injections. The May data showed an uptick in the unemployment rate and downward revisions to March and April job growth.

Commercial and industrial loans—the lifeblood that small businesses use to finance inventory and equipment growth—should have increased by more than $175 billion in 2023 to keep up with inflation and rising GDP. Instead they fell by $38 billion. Government hiring and subsidies have been one of the few supports for consumption growth in recent years, but that creates an unsustainable debt path.

Greater energy production would be especially valuable because it is a critical economic building block and a resource the U.S. has in abundance. If U.S. production had been encouraged in 2021 and 2022 instead of discouraged, I think inflation and interest rates could have peaked at substantially lower levels, allowing higher current living standards and a better growth outlook.

A supply-side approach based on increased production would bring inflation down and allow interest rate cuts while defending the dollar. That in turn would help homebuilding, infrastructure, small businesses and indebted consumers, all of which are struggling due to high short-term interest rates. This is the core of supply side economics and my fervor to see average people doing better around the world. Looking abroad, global growth needs to run at 5% to lift poorer families but has fallen to half that rate. Low investment rates spell continued weakness in growth and increasing pressure to migrate. Of course, conditions and challenges are different in the United States, but the common theme is for governments to allow markets to function and people to have the freedom, basic skills and opportunities to advance.

My June 26, 2024 Wall Street Journal article[8] addressed the election choice:

> "The Biden administration has argued against change. At first, it said inflation would be transitory. That idea was supported by the Federal Reserve, but like so many of the Fed's inflation models, it didn't pan out. The administration then blamed the supply chain, "shrinkflation," corporate greed and Donald Trump. Shrinkflation didn't work because the CPI takes smaller package size into account. The corporate-greed complaint wasn't supported by the data. An exhaustive Fed study last month disproved it: "Aggregate markups have stayed essentially flat since the start of the recovery."

The election cycle has made clear that there is another path: positive change by reducing harmful regulations, taxing much less than President Biden's proposals, encouraging private sector growth, and defending the dollar. Markets are forward-looking, so the benefits would spread quickly through the economy. Prices and interest rates could decline relatively quickly, helping consumers make a comeback.

Thank you for the opportunity to present a statement on these all-important topics. I look forward to your questions.

[8] https://www.wsj.com/articles/for-trump-as-for-clinton-its-still-the-economy-stupid-debate-spending-inflation-0a4a4afc