EconoFact Chats: Recent Trends in U.S. Debt
Mark Zandi, Moody's Analytics
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I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

There are problems that are acute and those that are chronic, but both are problems. A heart attack is addressed immediately, but people may ignore chronic high blood pressure and do so at their peril. Chronic and acute economic problems likewise get different amounts of attention. The government rallied to prevent a steep and protracted economic downturn at the outset of the COVID pandemic, but has failed to address the chronic problem of high and rising government debt. As with high blood pressure, we can ask similar questions of government debt. How did we get to this point? What are its threats? How can we treat the problem? To address these questions, I'm pleased to welcome to EconoFact Chat's Mark Zandi. Mark is Chief Economist at Moody's Analytics, where he directs economic research. He also serves on the board of directors of MGIC, the nation's largest private mortgage insurance company, and is the lead director of Reinvestment Fund, one of the nation's largest community development financial institutions, which makes investments in underserved communities. He is the author of Paying the Price, Ending the Great Recession in Beginning a New American Century, which provides an assessment of the monetary and fiscal policy responses to the Great Recession, and also Financial Shock, a 360-degree look at the subprime mortgage implosion and how to avoid the next financial crisis. Mark, welcome to EconoFact Chats.

Mark Zandi
Michael, so good to be with you. Thanks for the opportunity.

Michael Klein
Well, it's great to have you on. Mark, the federal government debt represents all the borrowing done by the government to cover shortfalls in its budget, as well as the interest payments on past debt. Where does the debt stand today, and how has it evolved over the last few decades?

Mark Zandi
It's high. The Congressional Budget Office, CBO, the nonpartisan agency that does the budgeting, puts the publicly traded debt to GDP ratio just under 100%. And for context, if you go back, say, 20, 25 years ago, it was 35%, 40%. Of course, the financial crisis was very costly, added significantly to the debt load. And then more recently, the pandemic and all the costs associated with that raised the debt load. But here we are at just under 100%.

Michael Klein
What were the sources of these increases? You mentioned the pandemic and the financial crisis. But debt reflects spending minus tax revenues. And at the start of the recession, like those in 2008 and 2020, government spending goes up in an effort to keep the economy from cratering,

and revenues go down with reduced growth and lower taxes. That's part of the story. But what about the nearly 20 percentage point rise between 2011 and the end of 2019?

Mark Zandi
Yeah, I think the pandemic and the financial crisis were the two key contributors. I think other big factors would include 9-11 and the resulting wars that we fought against terrorism. And then, of course, all the efforts we made in the Middle East, they were very costly. We've had some pretty large tax cuts in this period, the most recent being the TCGA Tax Cut and Jobs Act that was passed late 2017, early 2018. And that's added significantly to the deficit and debt. So a bunch of stuff. But I think most significantly, it's these two massive crises that require the government to step in and provide a lot of taxpayer support, both in terms of reduced taxes, but also in terms of increased spending. And of course, economy has also been on the soft side. That period you mentioned was a period of very slow growth. It was in the wake of the financial crisis and the economy was struggling to grow. And of course, when the economy is growing less quickly, that weighs on tax revenue and adds to government expense in terms of income support to folks that are not doing quite as well. So, there's no one reason for all of this. There's a bunch of reasons. But I'd put it at the top of the pandemic and the financial crisis.

Michael Klein
It's notable that you use the word required the government to step in. So, when we're talking about the threat of debt and deficits, we should also think, I suppose, about the fact that in the absence of those, the economy could have really cratered. So, it's not like this was done for reasons that weren't well supported, right?

Mark Zandi
Totally. I mean, in fact, we don't know the counterfactual here, obviously, but if the federal government had not stepped in in a very aggressive way in the financial crisis and in the pandemic, economy would probably have completely evaporated, take tax revenues with it. There's so-called automatic stabilizers in the budget that would kick in, unemployment insurance and other food assistance and other things that would be added to the cost. So our budget deficits and debt load would be even higher. So, it's a Hobson's choice. There's really no good choice here. We took the least bad choice.

Michael Klein
I guess we do have a counterfactual 1929 to 1933.

Mark Zandi
Ah, good point. Yeah, that's a great point. Ultimately, the government did step in. That's when Franklin Roosevelt became president in 1932. Was it 32? Yeah, 33 he took office, and that was the beginning of the turnaround. But before that, under Herbert Hoover, a very laissez-faire kind of approach, and that didn't work out so well.

Michael Klein
Right. Andrew Mellon, who was the secretary of the treasury at that time, said liquidate, liquidate, liquidate. And unfortunately, that's what happened. And the result wasn't what Mellon

had hoped that things would become more efficient. We just got into a worse and worse situation.

Mark Zandi
Yeah. And of course, that was a global depression. And same with the financial crisis and the pandemic. These were global issues, not just US issues. So other governments around the world during the pandemic and financial crisis stepped up in a similar way. They didn't have the same resources as we did and couldn't step up to the same degree. But they followed the same policy script. And thank goodness, because governments around the world had all collectively really provided a backstop to businesses and to households. We'd be in a much worse position today. We wouldn't have, I feel quite confident in saying, we wouldn't have a 3.7% unemployment rate here at this point in time.

Michael Klein
So we talked about the past. Let's talk about the future a little bit. We have a recent EconoFact memo by Karen Dynan of Harvard about the federal debt. And she cites estimates from the Congressional Budget Office about the path of the debt in the future that are quite striking. Numbers that you also cite in a recent paper you wrote for the Peterson Foundation. What is the forecast for the debt in the future?

Mark Zandi
Yeah, Karen and I are on the same Economic Advisory Board for the CBO, because I see her every couple times a year, I think, at this board. And it's a really interesting group of economists that attempt to help out the CBO in terms of its forecasting, both on the economic side and budget side. And in the latest forecast, I said the debt to GDP, publicly traded debt to GDP is just under 100%. Under no change in policy, and of course, CBO's projections assume current policy, no change, or what's written into law, the debt to GDP ratio will be, and I'm speaking from memory, so this will be roughly right, not completely right, but 115% in 10 years from now. So just under 100 will be 115% 10 years from now. 180% debt to GDP 30 years from now. That's when the forecast ends, but you can do your own forecast. It's just straight up, and that's not sustainable. Something's got to give. We need to see some changes here in policy, tax, and spending.

Michael Klein
One of the factors that contributes to higher debt is higher interest rates. We have a really nice memo by Dan Bergstresser of Brandeis that discusses this. Interest rates have been very low for years, but they've spiked up more recently with higher inflation by the efforts by the Federal Reserve to bring inflation down. How important, in your view, are higher interest rates for the rising level of debt and the interest burden that is represented in debt?

Mark Zandi
That's important. It's critical. If you go back prior to the pandemic when rates were low, between the great financial crisis and the pandemic, inflation interest rates were very, very low. That takes a lot of pressure off of the government. If rates are below the kind of the nominal growth rate in the economy, much easier for the government to maintain a stable or falling debt to GDP ratio. But when interest rates rise, like they've had, they've now done over the past couple of years with

the Fed's efforts to quell inflation, and interest rates are above the nominal growth rate in the economy, things get pretty difficult pretty fast. Interest expense rise as a share of GDP or revenue that adds to the government's deficit and debt that causes interest rates to rise even more. You can get into this kind of self-reinforcing, very vicious negative cycle. That's when things break. Interest rates are critical to the debt dynamics that will play out here going forward.

Michael Klein
Another point that Karen talks about in her memo is the aging of the population. This also contributes to higher debt levels, right?

Mark Zandi
It does. I mean, the most significant line items in the budget in terms of outlay spending would be Social Security and Medicare. Medicaid's not too far behind. Of course, Social Security and Medicare are for folks that are older in their 60s, 70s, and beyond. Of course, our population is aging. The baby boom generation, my generation, is now firmly in their 60s and 70s and retiring very quickly. They're not going to be earning wages that get taxed and support a better fiscal situation, but are going to be calling upon Social Security and Medicare to help support them in their later years, and that does add significantly to the burden. This is one reason why immigration is so important to our economy in lots of different ways, but immigrants tend to be younger. They're working, entrepreneurial, productive, and that's really critical to making sure that it's essential that we have continued strong immigration to make sure that we don't get swamped by this demographic aging of the population that we're struggling with right now. One other quick point. Of course, this is an issue here in the United States. It's also an issue, and then some in many other parts of the world. In other parts of the world, because they don't have immigration like we do, like a Germany or a Japan or even a China, their demographic fiscal problems are even much more serious than our own.

Michael Klein
Yeah, we have a lot of memos about the role of immigration. So people talk about the dependency ratio, which is very much linked to this. Could you just quickly define what that means?

Mark Zandi
Yeah, it's the number of older Americans that are requiring additional support from the government, either through Social Security, Medicare, or other income support programs, and the younger population that's working and they're generating income, and that income is being taxed and producing the revenues to support the older population. So that dependency ratio is really critical to understanding this kind of demographic problem that we have, and it's only going to get worse going forward given the aging of the population.

Michael Klein
And the falling birth rates, right?

Mark Zandi
Yeah, that's a great point. I mean, fertility rates are down, and so it's not only the folks that are aging, it's the fact that we're just having fewer young people, fewer babies, and ultimately that means the number of people that are young and working isn't growing nearly as quickly.

Michael Klein
So these are some of the proximate causes of high debt and perhaps even higher debt in the future. Mark, what are the consequences of these high debt levels for the broader economy and for people's standards of living?

Mark Zandi
Well, I think ultimately the most direct consequence ultimately is higher interest rates. I mean, if you're running large deficits that are adding to the debt load, you're issuing bonds to finance that, and investors, these are high quality, low, no risk treasury bonds, but at some point investors start to have their fill of the treasury bonds. They go, enough already, I've invested enough in these securities, and the deficits in debt remain large, and there's continued issuance of those bonds. Those investors start to say, hey, look, you're going to have to pay me a higher interest rate for me to buy this bond, and also to potentially compensate for the risk that down the road here that the government may not be in a position to make good on the promises to pay on that debt.

Michael Klein
So, my research area is international macroeconomics, and we think about a global world capital market, but the kind of factors that we've seen in the United States, as you mentioned, are happening all over the world. So, we're going to have higher real interest rates, not only in the United States, but everywhere, and we can't be bailed out by, for example, China buying U.S. treasury bonds the way they had in the past.

Mark Zandi
Yeah, no, absolutely. I mean, I think there's a lot of so-called sovereign debt that's being issued. Treasury bonds are the bonds of the U.S. sovereign, U.S. government, but governments all over the world are issuing a lot of bonds to finance their own large budget deficits and support their own high debt load, and this is evident across the globe, and global investors are beginning to wonder, well, you know, will governments be able to pay me back in a timely way and pay the interest on that debt when it's due? And, you know, adding to the concern is in many parts of the world, including here in the United States, there are some issues with regard to our politics, how fractured they are, what that might mean in terms of the willingness of lawmakers to come to terms to make good on their obligations to bondholders, the investors that are investing in this debt. So, for example, the drama over raising the debt limit. We have this anachronistic law in the United States that the government can't issue debt above a certain limit, so we hit that limit every so often, and we've got to raise it by law, and that's become a focal point for a lot of political brinkmanship. And so far, lawmakers have gotten it together, and increased the limit in time before not missing a debt payment and creating havoc, but, you know, who knows? And that's what investors are starting to ask themselves, who knows? And by so doing, they're saying, look, you know, there's risk here. You sold this to me, this bond, saying it's risk-free, but I'm not so sure, given all the things that are going on here, you're going to have to pay me, you, the U.S. government, you're going to have to pay me, the investor, a higher interest rate to compensate for

that risk, at least that perceived risk that I have. And so, you know, interest rates start moving higher here. And this is, again, this is not just a U.S. issue, this is a global issue. Governments around the world are issuing a lot of bonds.

Michael Klein
So, I started off introducing this talk by talking about chronic and acute conditions. So, the chronic consequence of the higher interest rates that you're mentioning is less capital formation, less growth in the economy, and so on. But there's also the acute problem that, for example, as you were saying, we could all of a sudden have a crisis where interest rates spike up because of a loss of confidence. But even perhaps less than that, but still important, would be a lack of what economists call fiscal space, that if there is another downturn with very high levels of debt, then it becomes difficult for the government to address the problems as they did in 2008 or in 2020. Can you speak to that a little bit?

Mark Zandi
Yeah, well, of course, you know, when things go bad, you know, typical bad would be kind of a recession, which we experienced at least in the last several decades, every, you know, six, seven years. Or when it goes really bad, you know, things go completely off the rails, e.g., the pandemic or the financial crisis, then, you know, the government needs to step in, you know, it steps in through its automatic stabilizers in the kind of a typical recession. But generally, those stabilizers aren't large enough, or at least lawmakers and the general electorate feel like this, it's not enough, the government has to pass legislation to come up and help out and step in and stem the bleeding, the economic bleeding. And, you know, that's incredibly costly to do. And the point is that if we're running these large deficits in the good times, like right now, the economy is doing well, we're producing lots of jobs, the unemployment rate is sub 4%, excellent conditions, and we're still running massive deficits and adding to the debt load, then you got to ask yourself, you know, are we going to be in a position, is the government going to be in a position to help out when things go bad again? And the question increasingly is maybe not. So we don't have that backstop, that collective backstop provided by the government, or that backstop is not nearly as strong. I mean, suppose we have another pandemic, you know, could the government step up in the same way that it did with the last pandemic? I mean, the last pandemic, US government provided 20, excuse me, $5 trillion worth of government support, I'm rounding, obviously, but $5 trillion, that's 25% of GDP, the debt to GDP ratio rose 25%. Could the government do the same thing next year if we got hit by another pandemic? That's, that's a reasonable question. I mean, probably, but, you know, increasingly, that's going to be more difficult to do the higher the debt load is. So there's lots of reasons to be nervous about, you know, rising deficits and big deficits and rising debt loads going forward. Higher interest rates is a corrosive on the economy. But, you know, it does limit the ability of the government to respond to things that the government has responded to in the past.

Michael Klein
So, Dr. Zandi, we identified the problem. What about the cure? In your note for the Peterson Foundation, you talk about a few things. One, for example, is to raise the ceiling on earnings that are taxed for social security. And another is a carbon tax. Could you talk a little bit about each of these and why you see these as potential ways to address this problem?

Mark Zandi
Yeah, I, in my view, to address the long term fiscal problems of the nation, we need tax revenue and we need spending restraint, both. On the tax side, I do think it's reasonable to tax earnings, you know, above a certain level. Right now, there's a cap on the earnings that are taxed, and then anything above that is not taxed. But I would argue, you know-

Michael Klein
For social security, you mean?

Mark Zandi
For social security, yeah. The payroll tax, you know, so we could start taxing above some high level. So pick a number, $450,000 a year in earnings, tax that. And there's logic to it in that, you know, when social security was put on the planet, going back to Franklin Roosevelt's era, you know, a very large percent of earnings were taxed under the payroll tax. But over the decades, because of the skewing of the distribution of income, more income going to high income households rather than low, an increasing share of earnings are not being taxed, that are not being used to support the social security system. So let's just go back to the future and go back to where we were in the 30s and say, hey, let's work to get back to something like that and put the burden on folks that are high income, very high income, in, you know, the top couple, three, four percent of the income distribution. And that would put social security on solid financial ground and go a long way to addressing, you know, our broader fiscal issues. Now, I would also say on the carbon tax that, you know, that solves a lot of problems. It's, you know, it generates a lot of revenue. It taxes something that should be taxed because carbon is creating CO_2, it's creating temperature rise and exacerbating our climate risk issues, both in terms of physical, you know, and all the physical risks that it's creating. And by taxing carbon and raising the cost of carbon, you're going to address climate change as well and generate a lot of revenue. Now, there's a lot of nuances to it. You got to worry about regressivity, you know, because you don't want low-income households to suffer the burden of that. So, you got to worry about how to address that issue. And then there's questions about, you know, what about nations overseas? If you're taxing your businesses on carbon, aren't they at a competitive disadvantage against businesses in other parts of the world that don't tax carbon? But there's ways, very straightforward ways of addressing those concerns. And there you'll address a lot of the, you know, generate a lot of revenue, really go a long way to addressing the long-term fiscal problems and address the risk posed by climate change.

Michael Klein
We have quite a few memos on carbon taxation by my Tufts colleague, Gib Metcalf, who is really one of the leading experts on that. So, there are a lot of, as you mentioned, there are a lot of things that could be done. There's a political process that makes some doing a number of these things difficult. And one of the key proposals in your Peterson paper is the creation of a bipartisan fiscal commission to address these issues. And you mentioned the Simpson Bowles commission that was established during the Obama administration. Can you speak a little bit about what Simpson Bowles did, how effective it was in changing the discussion on policy, and what you see as the role of a new fiscal commission?

Mark Zandi
Yeah, I mean, Simpson Bowles got Democrats, Republicans, independents, together, people from Congress, the executive branch, and, you know, even some public, some citizens, you know, in different parts of the private sector. I think they had some union member members on the panel as well. So it was a, you know, a kind of a bipartisan group of folks that came together and worked to come up with proposals to try to address the fiscal situation. And, you know, back then, we thought it was a big deal. It's no, obviously, our problems are much greater today. And this is a bigger deal, you know, here as we sit today. Simpson Bowles was, I think, useful in that it got us talking and thinking about the hard choices we're going to have to make, the tradeoffs. And it got pretty close to, you know, the finish line. I mean, it was the idea was that Congress would have to vote up or down the proposal. And, you know, if it got voted through, then everything would be adopted in its totality. Kind of the logic was similar to used to close defense bases back in the day. We had a lot of defense bases that were not being used effectively, and it was hard to close them for political reasons and kind of use that same kind of strategy. And we got close. It didn't get across the finish line. It didn't succeed for lots of different reasons. And I'm not sure a bipartisan commission today would get anything across the finish line. But at this point, I think we just got to start talking again. You know, the political environment is so fractured, polarized. We're not talking at all. And, of course, that makes it impossible to address our long term fiscal issue. So it's just a baby step, you know, one step forward to get things moving. And hopefully, that baby step turns into a walk, a jog and a run, and we get something done here in the not too distant future.

Michael Klein
Well, we clearly have to get something done. And when we do or if we do, I think the insights that you bring to it will be very valuable through, for example, what you wrote for the Peterson Foundation, hopefully through this conversation as well. So I'd like to thank you, Mark, for joining me today and for sharing your insights on this really vital issue.

Mark Zandi
Well, thank you for the opportunity. It's obviously a very important issue. And I'm sure, you know, we're going to Michael, we're going to be talking about this for a long time to come. So it was a real pleasure. Thank you.

Michael Klein
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