**EconoFact Chats: Long Run Fiscal Solvency and Its Consequences**

**Wendy Edelberg and Ben Harris, The Brookings Institution**

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**Michael Klein**
I'm Michael Klein, executive editor of EconoFact, a nonpartisan, 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.

**Michael Klein**
The federal debt held by the public is almost as big as annual national income, a situation unprecedented in peacetime. The Trump administration has been cutting spending, but the amounts of discretionary spending that can be pared is small relative to the size of the annual deficit, and these cuts would not contribute much to shrinking the debt. The Tax Cut and Jobs Act enacted in the first Trump administration increased the deficit and the debt. If its provisions, that are set to expire this year, are extended by Congress, it would add an estimated $5 trillion to the debt over the next decade. People may be concerned in a somewhat abstract way about the solvency of the government, but many people are more concerned now with their own retirement solvency, as the stock market has declined since the beginning of the year, affecting their retirement accounts. And people in the administration have discussed cutting Social Security. To discuss long-run financial solvency of both the government and individuals, I'm very pleased to welcome to EconoFact Chats, Wendy Edelberg and Ben Harris. Wendy and Ben are both affiliated with the Brookings Institution. Wendy is the director of the Hamilton Project and a Senior Fellow in Economic Studies. She was Chief Economist at the Congressional Budget Office, Executive Director of the Financial Crisis Inquiry Commission, served on the Council of Economic Advisers and worked at the Federal Reserve Board. Ben is the Vice President and Director of Economic Studies at the Brookings Institution. He was Assistant Secretary for Economic Policy and Chief Economist at the Treasury Department in the Biden administration. He also served as the Chief Economist and Economic Advisor to the Vice President of the United States, and as a Senior Economist with the Council of Economic Advisers during the Obama administration, and as a Senior Economist with the US House of Representatives Budget Committee. Wendy and Ben, welcome to EconoFact chats.

**Wendy Edelberg**
Thanks for having us.

**Ben Harris**
Thank you.

**Michael Klein**
Let's start off by discussing the federal debt. The federal debt represents the government's

accumulated deficits. It's useful to break down the deficit as the sum of expenditures minus revenues, the so-called primary deficit, plus the interest payments on past debt. First of all, what's the size of the federal debt? And why is this typically expressed as a percentage of national income, or GDP?

**Wendy Edelberg**
So we express it as a ratio, because, indeed, if I told you the numbers, the trillions of dollars that actually comprise the publicly held amount of federal debt, it's kind of a meaningless number. Like, I could tell you that it's 50 trillion [inaudible] and like, what would that mean? Like, or I could tell you that you could stack up pennies to the moon and back 800 times. And what would that mean? So instead, it is most useful, it's most informative if we think of how big the federal debt is relative to some benchmark that we think is a useful comparison, and one that is commonly used is the size of the economy. So in that sense, debt held by the public at the end of 2024 was 98%. Now to be clear, there's nothing magical about 100%. It's not like when debt is greater than the size of the economy, like something breaks, but 98% of GDP just gives you a sense of how big it is relative to the overall economy.

**Michael Klein**
Well, as you mentioned Wendy, the debt-to-GDP ratio is now around 98%. It's risen from about 36% before the 2008 economic and financial crisis. What are the sources of this increase — more spending, lower taxes, higher interest costs, or some combination of all three?

**Ben Harris**
So I think some historical perspective here is helpful. We came out of World War II as a country with a debt-to-GDP ratio of around 106%, and then for several decades, we saw the debt-to-GDP ratio fall. We had pretty rapid economic growth, which helped, but we also had a different perspective when it came to budgeting. So in many of the decades, many of the years following World War II, we ran primary surpluses, which meant, if you take out the money we spent for paying service on the debt, the government was roughly in balance, and as a result, between 1950 and 1980 the debt-to-GDP ratio fell from 106% to around 25%. So then we get to 1980. President Reagan gets elected on a platform of tax cuts, puts in place fairly sweeping cuts, and then we start to see the debt-to-GDP ratio start rising. We get to the Clinton administration. We have the penetration of the internet. We see a boost in productivity. Debt goes down. And then we get to 2000. And in 2000, President Bush came into office and introduced sweeping tax cuts in 2001 and 2003. We had the wars in Iraq, and we start to see the debt-to-GDP ratio start to rise slowly again. We get to the great financial crisis. We introduce big tax cuts, big breaks for families, given the magnitude of that crisis, and we saw the debt-to-GDP ratio start rising even faster than we'd seen at any time since World War II. And then we get to 2017. President Trump comes into office, enacts the TCJA, which was a permanent tax cut in the corporate tax rate, plus temporary tax cuts for households. And the debt-to-GDP ratio starts rising again, slowly, and then, of course, we get COVID, and it spikes. So it's very difficult to decompose exactly why the debt-to-GDP ratio has risen. You have to kind of pick the exact year. You have to think through the counterfactual. In general, I think a fair

characterization is the debt-to-GDP ratio is rising because A) We have increased spending on Social Security and Medicare and an aging population. B) We have a bit of an addiction to tax cuts, particularly under Republican administrations. And C) and — this may be controversial — we have a commitment to the economy that we're going to interject federal resources in times of economic downturns, and we're going to do so without really asking questions about fiscal sustainability. So, the bulk of the debt that's been taken on since 2007 has happened during the great financial crisis and during COVID. And to be clear, it is smart economic policy to interject federal resources when we're in the middle of a downturn. But many of these programs could be better. And so, when I was in the Biden administration, and we're thinking through the American Recovery Act, you know, we were a bit hamstrung by having these counter-cyclical policies. And by that, I mean policies that are used to address a downturn in the economy. We were hamstrung in the sense that we didn't have really well-designed programs. So unemployment insurance. Just to give one example — unemployment insurance — we had to give this really crude fixed unemployment insurance. We gave, like, an extra $600 per person. Now ideally, you would have been a bit more precise in the way that you gave money to unemployed workers. You would have had maybe a more precise formula based on their level of earnings. But we were dealing with unemployment systems that were running on software that was decades old. And so anyway, the point here is to say, I think the big drivers of the debt over the past 20 years or so are an aging population and increased Social Security and Medicare costs, an addiction to tax cuts, and big spending in times of economic downturns.

**Michael Klein**
Yeah, Maurice Obstfeld and I — did an EconoFact memo about the decline of the debt-to-GDP ratio in the wake of World War II, which is really very striking. And then we have a lot of stuff during COVID about the spending. And in fact, just as you're mentioning, Ben, about the unemployment insurance — I guess, as you're sort of alluding to – it's kind of hard when you're fighting a fire to keep the couch from getting ruined by water. And so, during that time, you know, you're doing all you could to keep the economy from cratering, but as you suggest, it also contributed to the debt. So, going from the past to the present and future, how much latitude is there for reducing government spending if we take off the table things that can't be changed, like interest payments on the debt — or shouldn't be changed, perhaps — or programs that have broad bipartisan support, like military spending and perhaps Social Security?

**Wendy Edelberg**
Well, you've basically described nearly all of the spending that the federal government does, which just, you know, on the face of it, will mean you haven't much left over. Social Security accounts for one and a half trillion dollars of the $6.8 trillion that we spent last year, just to give you a sense of how big the footprint is, just of Social Security alone. Healthcare spending is also huge. We seem to really value the spending that the federal government does in the healthcare space. And, you know, unless we're going to do something wildly irresponsible with regards to the financial system, we're going to continue paying interest. So roughly speaking, what that leaves you is the discretionary spending that you mostly hear Congress fighting about, and that is only a slice of the

spending. And then what you really hear is, like, fights over things like USAID. You alluded at the beginning to Trump cutting spending. Maybe your listeners are thinking, oh, right, like what DODGE is doing with USAID — these spending cuts where, you know, less money has been sent over to USAID – I should note as a little asterisk, contradicting the will of Congress and how they've appropriated money to go [inaudible] USAID – that's in the single of billions. So what we often argue about are these trivial, diminutive, de minimis amounts.

**Michael Klein**
So given this, I imagine the fiscal picture isn't likely to improve without drastic changes.

**Ben Harris**
I think it's a matter of degree. I think that the goal for Congress should be, when we're not in the middle of a recession, to run a primary surplus. And so, looking at Congressional Budget Office projections, we're around 2% of GDP, and if you were willing to split that between a combination of moderate tax increases and moderate spending cuts, it doesn't have to blow up the entire system to get to a place where we're running primary surpluses. This isn't saying that it wouldn't be painful, but we're talking about potentially raising the corporate tax rate some, having better tax administration, increasing the Social Security retirement age gradually over time. These are pretty moderate tax increases that can get you close to surplus pretty quickly.

**Michael Klein**
And in fact, that's what Keynes said. You know, Keynes is viewed as the father of counter-cyclical spending — so when you're in a downturn, the government spends. But he also advocated, when the economy is doing well, you should be running, as you're suggesting, Ben, a primary surplus.

**Wendy Edelberg**
I want to jump in and offer just a quick, broader frame of how we should think about this…which is, we would do well as a country to figure out what we want our federal government to do and what we value, and then do the incredibly radical thing of figuring out how to pay for it. It's actually that simple.

**Michael Klein**
Which is sort of what households have to do as well, right, Wendy?

**Wendy Edelberg**
Yeah, I am loath to use the metaphor of a household too much to think about a government budget, because the federal government really is different in so many ways from a household. We don't actually have to balance our budget each year, but we do have to work backwards from: We want our federal government to do X, Y, and Z. That should drive, like, okay, if we value that, let's figure out how to raise money to pay for it.

**Michael Klein**
So if we're talking about very large and perhaps increasing debt, what would be the adverse effects of such a large debt burden on the performance of the economy?

**Wendy Edelberg**
There's lots of research that I find very compelling that shows that more federal borrowing, all else equal, crowds out private sector activity. And the reason that that happens is that private lenders — so if you hold treasury bonds somewhere in your portfolio, or even if the pension that you're going to get holds treasury bonds as they invest that money before giving it to you when you retire — that makes you a lender to the federal government. And the more the federal government is in that market and borrowing and trying to get those funds, the less is available to lend to the private sector. So the more federal government we have, all else equal — that's carrying a lot of weight there — the smaller of an economy we're going to have. Now, I don't want to overstate this. These aren't huge effects, but they are there.

**Michael Klein**
People also say that the public debt is a tax that we're putting on our grandchildren. Would you agree with this characterization?

**Ben Harris**
Yeah, I think that that's a fair characterization. So, as Wendy just said, she explained how deficits lead to a smaller economy in the future. And just to quickly put a number on it, in a paper that Wendy and I did with Louise Sheiner at the Brookings Institution, we pointed out…look, this means that if we run these deficits and we see higher debt over time, that will mean less income in the future. And a reasonable question is, well, how much? And so, if we stabilize our debt-to-GDP, then we can expect between now and 2055 that the average income per person will be $129,000. If we allow debt to increase, as the CBO projects, it'll be $123,000. So that is to say, in 2055, what is the tax on our grandchildren? The tax on our grandchildren from running all this debt is around $6,000 per year, every year. And whether that's big or small is in the eye of the beholder, but it's still a tax, you know, and it's still substantial.

**Michael Klein**
But it doesn’t fall evenly on all people in the population. I mean, if you're holding Treasury debt, you or your descendants will get the revenues from that. But people who don't have that kind of wealth — they're going to have money that they're, you know, paying in the future to pay off the debt, but they don't have the benefit of having the assets, right?

**Ben Harris**
Yeah. I mean, it depends on how you ask the question. So you say, okay, well, we don't want to have our grandchildren inherit that $6,000-a-year annual tax from running higher debt, so we want to go ahead and stabilize the debt-to-GDP ratio. It depends on how you do that. So if you go ahead and increase taxes on capital, which have been falling for quite some time, you know, then you're saying that upper-income taxpayers are going to

be the ones that bear the cost of stabilizing that debt. If you instead say, look, we want to go ahead and raise the Social Security age at which people start receiving benefits, then it's a whole different calculus. So, if the question is, if you want to stabilize the debt, how do you do it — you know, that really depends on who will pay and who won't.

**Michael Klein**
There's also a concern — or maybe even a fear — that the size of the debt would spark a crisis. Why would this happen and what would its consequences look like?

**Wendy Edelberg**
So the size of the debt is $28 trillion. That sounds like a frightening amount of money. And then when you look at what is projected to happen to debt, even under current law, where the low tax rates that were put in place under the Tax Cut and Jobs Act expire and tax rates rise, the amount of debt continues rising, and it rises as a share of GDP, without bound. And that sounds really scary. And so people start thinking, surely there's some inextricable link between the size of federal borrowing and the inevitability of a fiscal crisis. And in the same paper that Ben talked about — that Ben and Louise and I wrote — we tried to take that really seriously and think through: How do you get from rising federal debt to a fiscal crisis? What are the channels that get you from one to the other? And we come to the conclusion that it really isn't the grindingly higher amount of federal debt, day in and day out, that is actually in any sense going to spark a fiscal crisis. And let's think about a fiscal crisis like interest rates jump by three percentage points, and they stay three percentage points higher for as far as the eye can see. Like, that would be bad. And, in fact, stop worrying so much about how bad that would be for our cost of borrowing, and start worrying about what that would mean for the financial system. Like, it would be bad. But what leads to that? One way that you can just know on the face of it that it can't just be borrowing rising ever higher day by day, is that if indeed the Tax Cut and Jobs Act were completely extended and we raised that projection of debt as a share of GDP just along the lines of what you said at the beginning, where you said that that would cost an additional almost $5 trillion – if we fully extended the Tax Cut and Jobs Act over the next 10 years, made it permanent — my guess is that financial markets would largely shrug their shoulders, and maybe interest rates would go up a little bit — tenths. How can it be that rising federal borrowing will inextricably, just inevitably, lead to a crisis, if financial markets could just absorb such a huge wallop of higher debt? And the fact is, I think it's because rising debt – what it really does is it just makes our economy smaller. But this is not to say we shouldn't worry about the risk of a fiscal crisis. I am very worried about the risk of a fiscal crisis. I just don't think it comes from debt rising year after year.

**Michael Klein**
In fact, you have a New York Times editorial where you say a crisis would arise out of government mismanagement of the economy, rather than the debt. What did you mean by that?

**Wendy Edelberg**
So think of it as just political malpractice. What is the new piece of information that financial markets could get at some point where they then lose confidence in the value of the treasuries that they're holding? It has to be some new piece of information. And one possible new piece of information could be that the federal government has decided that all foreign holders of treasuries have to pay a so-called user fee, take a haircut, pay an extra charge for the privilege of owning treasuries. That is basically a partial default, and that is described actually in the so-called 'Mar-a-Lago Accord' that's being shopped around within the Trump administration. That would be a new piece of information where financial markets might say, this is not a default-free, risk-free security that I am holding, and I am now quite worried about it. You can imagine a world where not only do they decide, we're going to fully extend the Tax Cut and Jobs Act, but you know what, we're not going to tax tips, we're not going to tax Social Security benefits, we're not going to tax overtime. And I don't think the new piece of information that financial markets would learn if all of that seemed to be on track to happening would be — I don't think the new piece of information is, "Whoa, debt's going to rise." Because debt's going to rise. That's not the new piece of information. The new piece of information is: policymakers are not serious people, and no one's driving the bus.

**Ben Harris**
Yeah, if I can just say something really quick, Michael — which is that 25 years ago, the Congressional Budget Office said we'll pay off all of our debt within 10 years. Instead, we have debt which is larger than the size of our economy. So, what we're learning is that financial markets are perfectly fine with us taking on ever-larger debt. What they're probably not fine with is the suggestion that they might not get paid on those bonds.

**Michael Klein**
And we saw something like that in Britain under Liz Truss and under her very short prime-ministership, where the budget that came out — it wasn't so much that it was a big deficit — it was that it wasn't serious. And so, we saw this crash, and she ended up being, I guess, the shortest-term prime minister but for somebody who died a week or two after taking over.

**Wendy Edelberg**
That is 100% — you know, it's an excellent example to think through this point. And what was really important about this episode is when they saw financial markets respond and freak out, policymakers pivoted. They said, "Oops, sorry, take back." What I am worried about — like, that's a bad week, a bad month. What I'm worried about is the scenario that policymakers do something equally stupid, or even stupider, in the United States, but in the face of some terrible response from financial markets, they dig in. And they say, "No, no, no, we really mean it. We're committed to this completely asinine policy."

**Michael Klein**
It's like when — I guess it was, who was it — the head of the Treasury at the beginning of the Great Depression said, "liquidate everything" rather than respond appropriately.

And of course, the Great Depression became worse and worse and worse up until Roosevelt, and then he had to declare a bank holiday to close the banks to keep the runs from keeping going. So turning from fiscal solvency of the government to that of individuals — Ben, you co-authored a 2023 book, *The Retirement Challenge: What's Wrong with America's System and a Sensible Way to Fix It.* Briefly, what is wrong with the American retirement system?

**Ben Harris**
So to start, I think it's important to acknowledge there's a lot right with the retirement system. We spend enormous money as a country ensuring that people have a comfortable retirement. That's not just Social Security and Medicare, but it's also roughly $250 billion a year in tax breaks to ensure that people have enough when they get to retirement age to supplement that Social Security. But I think there are two big flaws when it comes to the current retirement system. The first is that it's just so unequal, the way that we go ahead and administer those tax breaks for retirement saving. It's usually done through defined contribution plans, which are akin to 401(k)-like plans. Roughly 70% of that $250 billion in tax breaks we give every year, is given to the top 20% of Americans. If you designed a system from scratch, you would never design it to be so unequal. You'd give a lot more to middle-class families, to lower-income families. The 401(k) system arose largely by accident, and I think that the inequity is an unfortunate byproduct. So the first is that the saving system is really not set up optimally for middle-class families. The second problem is that we've developed all of this wealth — we have trillions of dollars in saving for retirement — we don't have good mechanisms for what I call 'decumulation,' so for helping people spend that down. The annuities markets we have in this country are really expensive and generally not very popular. We don't have great ways for people to access equity in their homes. So there are a lot of people who might have $400,000, $500,000, $600,000 in a home, but only $10,000 in a 401(k). And one big question is, well, shouldn't we have better avenues for people to access that housing wealth? Our long-term care markets are completely flawed. If I was teaching a business school class on insurance markets, I would use our long-term care market as an example of all the failures in markets. So, we don't have great ways for people taking all this money that they may have saved and turn that into security in retirement.

**Michael Klein**
The Social Security system was put in place in the 1930s, and it helped bring down elderly poverty dramatically. Is that system solvent today? And how important is it today for people's retirement?

**Ben Harris**
Social Security is the bedrock of American retirement. I mean, that feels like an uncontroversial statement. If we even saw moderate reductions in Social Security, there would be fairly severe impacts for lots of Americans, depending on how those cuts were administered. Your question — is the Social Security system solvent? So projections coming out of the Social Security Trustees show that in 2033, the Social Security program will no longer have the funds to make 100% payments on its promised benefits. And at that time, you'll have to see cuts to around 80% of the promised benefits. So no,

Social Security is not solvent over the long run. Now, I think the expectation is that that would be political suicide — imposing cuts on current retirees because the government failed to plan for something we've known about for decades. But that is to say, we don't really know what's going to happen when we reach the date where Social Security no longer has the funds to pay out its promised benefits. So like I said, the expectation is that Congress would continue funding it, but there is a long-term imbalance, and we need to fix that. And I just don't see the political will right now for any sort of resolution.

**Wendy Edelberg**
I think it's worth jumping in and saying that this is not because of anything nefarious that happened. I was learning about projections of insolvency of the Social Security Trust Fund when I was in college — many decades ago. This is simply demographics. We just — you know, the way we've set up our Social Security system, this was inevitably going to happen given demographics. And there are lots of ways we can fix it, but this isn't because anybody — you know…nobody embezzled the money. Just want to be clear.

**Ben Harris**
Oh yeah. Social Security is one of the best-administered government programs around, and there is lots of research to back that up. The size of the fix is big, though. So, for example, the latest Social Security Trustees Report said that if we want to fix it just through increasing the payroll tax, we'll have to increase the payroll tax rate every year indefinitely by about 3.3% of wages. Now that's a fairly sizable increase. Or we'll have to cut benefits by about 20%. And so, you know, the problem facing Congress to reach long-term solvency is pretty severe. My guess is that we'll get to 2030 or so, Congress will finally take some action to help address people's rising anxiety around Social Security, and will implement a series of moderate fixes to buy itself another decade. And hopefully, by 2040, we'll have a political system in place where you can reach bipartisan compromise — because this really needs to be bipartisan. We can go into the reasons why you can't do this through reconciliation. We really need a bipartisan fix for Social Security, and I just don't see the will of Congress to do that right now.

**Michael Klein**
Well, you mentioned demographics. We have some memos talking about the fact that the native-born working-age population is flat — it's not increasing. So, it really is depending upon immigration for the base that's providing the funds for Social Security — the pay-as-you-go system — to work. But that's a conversation for another day, and I want to thank both of you for joining me today about these really important issues and the insights that you bring to it, both from your background as economists, but also your work in government. So thanks very much for joining me for this episode of EconoFact Chats.

**Wendy Edelberg**
Thanks. It was great to talk.

**Ben Harris**
Thanks, Mike.

**Michael Klein**
This has been EconoFact Chats. To learn more about EconoFact and to see the work on our site, you can log into www.econofact.org. EconoFact is a publication of The Fletcher School at Tufts University. Thanks for listening.