EconoFact Chats: On Debt, Fiscal Crises, and AI
Greg Mankiw, Harvard University
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Michael Klein
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.

Michael Klein
Well, welcome everybody to this EconoFact Chats webinar. I'm really pleased to have Greg Mankiw with us today. Greg is the Robert M. Beren Professor of Economics at Harvard University. He's a very prolific writer, and a regular participant in academic and policy debates. His really well-regarded research covers a wide range of issues, including price adjustment, which is a vital issue in macroeconomics, consumer behavior, financial markets, monetary and fiscal policy, and economic growth. He's published in really top journals. And he's also, importantly, I think, written for the wider public in places like The New York Times, The Wall Street Journal, and The Washington Post. Also, Greg has written two of the leading textbooks in economics. His macroeconomics textbook, which really changed the way a lot of people, myself included, taught macroeconomics by including a lot on economic growth, which had been ignored in textbooks before that. And then his introductory textbook, Principles of Economics, which has sold over 4 million copies, and has been translated into 20 different languages. Also, Greg has had an important role in public service. He has been an advisor to the Congressional Budget Office and the Federal Reserve Banks of Boston and New York. And also, he was the chair of the President's Council of Economic Advisors from 2003 to 2005 under President George W. Bush. So Greg, thanks very much for joining us today, on this webinar for our premium subscribers.

Greg Mankiw
Oh, it's nice to be with you Michael.

Michael Klein
So, Greg, I want to start off by referring to a lecture you gave this summer. At the National Bureau of Economic Research, there's the Martin Feldstein Lecture, which is one of the most prestigious lectures that people can be asked to give, and you focused on the ballooning U.S. government debt. And one of the things you talked about was the different ways that the debt could be resolved. You mentioned there could be faster growth, there could be higher taxes, there could be spending cuts, there could be monetization of the debt, where the Treasury is buying the debt, and that's increasing the money supply and inflation, and also repudiation of the debt. What combination of these would you favor, and which of these do you think are the most likely to come about?

Greg Mankiw
Well, the one I unambiguously favor, if I could choose, would be faster growth. It's always great to grow your way out of a problem. And it's certainly true that no matter how much debt you have, if your income goes up fast enough, then that's not a problem. So, I think there are people who think that we can grow

fast enough, and maybe it's true, but it's probably not prudent to assume that we can. There are people who look at AI and think we're on the verge of some technological revolution where growth is going to go well beyond what we've experienced historically. I'm skeptical about that. I'm skeptical, even though we'll go back to the sort of high growth rates we experienced from World War II to 1972 or so. I've personally been more convinced by the work of Bob Gordon on the rise and fall of American growth, and the work of Nick Bloom and Chad Jones that ideas are getting harder to find. So, I suspect…when I project the future, the CBO's probably right. That kind of more normal productivity growth is what we should expect. But in population growth, it will surely be below what we have experienced historically. So, I think the high growth scenario is my preferred outcome, but it's, I think, not something we can count on, and probably not the most likely. Among the things we could actually choose, I think that most likely is going to be higher taxes. In part because I think monetization and high inflation is very costly and very unpopular. I think defaults is very costly, and would not prove very popular. And so that gives us very little…that gives us either cutting spending or raising taxes. And I think there are certainly things that I think we should cut spending on, but fundamentally, what's really causing the problem is the growth of entitlements over time, and people don't really want to cut back on things like Social Security and Medicare. I mean, Medicaid is being cut back in the Trump administration, but that's not enough to put us on a sustainable path. So, given that people basically want the social safety net we have, and maybe they even want a little more than we have, I think ultimately it's going to have to come down to higher taxes. So I think the most likely outcome is that my children and my grandchildren will face higher taxes during their lifetimes than I faced during mine.

Michael Klein
One of the things about monetization is that people might not recognize it. You know, Keynes has this famous quote about the German hyperinflation, that not one man in a million would understand what's going on, and the hyperinflation was a consequence of fiscal problems. With the president leaning on the central bank, and perhaps having the opportunity to appoint new members of the central bank, do you think that there's going to be a greater likelihood of this monetization of the deficit? And would, in fact, more than one person in a million recognize what's going on?

Greg Mankiw
I think it is a real possibility, and it worries me. When you do polls of professional economists, they're nearly unanimous that we need an independent central bank, and it's in part because we watch experiences like the German hyperinflation, or other experiences of high inflation, when the central bank becomes too closely aligned with the fiscal authority. When fiscal problems arise, it's too easy for the fiscal authority to turn to the central bank and say, solve my problems by printing money. And solving problems by printing money works only for a very short period of time, because very quickly that money turns into very high inflation. And so, when I see President Trump politicizing the Fed, putting pressure on Jerome Powell, trying to get Lisa Cook fired, putting his own people in there that obviously are in favor of much more expansionary monetary policy, and seem to be and are still seem very politicized, and the fact that Stephen Miran is still keeping his position at the Council of Economic Advisors while he's at the Fed, which is a very strange outcome. So the whole politicization of this institution is very dangerous. And if high inflation starts creeping up, which I think is not an implausible scenario if monetary policy gets too beholden to fiscal policy, it's probably not the case that the president would say, 'Oh, sorry, I'm wrong, we need tighter monetary policy, we need a more independent central bank.' The public reaction

to high inflation is usually counterproductive. I mean, you saw this when inflation rose during President Biden's term, where people were talking about how corporate greed was the problem. You saw this during Richard Nixon, when they imposed wage-price controls. Given, sort of, President Trump's authoritarian instincts, if inflation started creeping up, I wouldn't be at all surprised if he tries to do it, via the wage-price controls that we saw during Nixon, because that's kind of the authoritarian answer to high inflation. Doesn't work, except for in the short run. But, you know, you can see it happening, and I do worry about it as a possible risk going forward.

Michael Klein
In your Feldstein lecture, you talk about a day of reckoning with regard to the ballooning fiscal debt. What would a day of reckoning look like?

Greg Mankiw
First it would look like political dysfunction, where the two parties can't get together. We have that right now. We have the political dysfunction. The government is shut down. Nobody thinks that's a smart way to handle fiscal policy. But because the two parties can't agree on spending priorities or taxing priorities, they're basically playing this game of chicken that's going to have really quite adverse effects. It would be a combination of the political dysfunction, together with people starting to think that the interest on the debt is something that can be negotiated. And I mean, nobody right now is saying…

Michael Klein
That's repudiation then, right?

Greg Mankiw
Yeah, exactly, exactly. It's repudiation. What's going to be happening over time is the debt relative to GDP starts rising. Debt service, as a percentage of the budget, is going to keep rising. At some point, people are going to say, 'Well, gee, that's something we really need to look hard at.' And when bondholders start realizing that's something that is up to negotiation, that's when, all of a sudden, people are going to say, I don't really trust government bonds anymore, and all of a sudden, the United States starts looking like Argentina, or Greece, or one of these other countries that have defaulted on the debt. Is this impossible? I want to read you a quote, Michael, that I quote in the Feldstein lecture, but this is from Donald Trump. When he was a candidate in 2016. So I'm going to read this verbatim. I'm not going to try to do Donald Trump's voice, I can't do that.

Michael Klein
Thank you for that, Greg.

Greg Mankiw
But I will read you the answer verbatim. So anyway, Donald Trump is a candidate in 2016. He's asked by a journalist about how he'd deal with the national debt, and here's what he says. This really does sound like him if you listen to the words, "I'm the king of debt, I'm great with debt, nobody knows debt better than me. I've made a fortune by using debt. And if things don't work out, I renegotiate the debt. I mean, that's a smart thing, not a stupid thing." I love that. That really is phrased like Donald Trump would say something. And then the journalist says, "Well, how do you renegotiate the debt?" And Candidate Trump

says, “You go back, and you say, hey, guess what? The economy crashed. I’m going to give you back half.”

Michael Klein
Yeah, well, he famously went bankrupt any number of times.

Greg Mankiw
Exactly, exactly. So you know, imagine if the President, in the middle of a government shutdown, in the middle of political dysfunction, said that now.

Michael Klein
Yeah.

Greg Mankiw
And, suppose you were serious. Well, that would really scare the heck out of the bond market. Now, would he ever say such a thing? Well he’s done a lot of things that people thought were unthinkable. Right? Of the one thing that he’s good at doing, it’s sort of expanding the Overton Window—the range of things that we can talk about. So, is that completely out of the question? I don’t think so. I think that’d be really quite dangerous, but talk like that would be the beginning of a bond crisis, where the bond vigilantes come in, and we have some sort of crisis. At some point people stop showing up at Treasury auctions, and we have a crisis. And I wrote about this some years ago in The New York Times, and I talked about the United States getting an IMF bailout, but that’ll only be after the IMF moves its headquarters to Beijing. And what would an IMF bailout of the United States look like? It would be like old IMF bailouts, it would be a lot of conditionality, and they’d say, ‘look, we can make a short-term loan if you do if you make some sensible fiscal policy,’ and a sensible fiscal policy would probably involve sizable tax increases. One can imagine a scenario in which we sort of sit down rationally and say we have a long-term fiscal imbalance, let's rationally think about what the solution to this is, and gradually phase in a bunch of sensible policies. Watching the political dysfunction, I don’t think that a more deliberate, sensible way of doing it is what’s going to happen. I think the changes are going to have to happen in the midst of a crisis. That’s probably going to involve the bond vigilantes coming in and holding the policymakers’ feet to the fire.

Michael Klein
So, I want to ask two questions related to that. One is that we’ve seen the dollar plunge by over 10% already this year, and gold prices have shot up, by more than 30%, it’s now over $4,000 an ounce, and Treasury yields are going up as well. So, do you think this is a harbinger of the kinds of concerns that you’re talking about?

Greg Mankiw
Well, those would certainly be the directional moves that you’d see in that kind of event. I mean, I think that what we’ve seen now is kind of modest compared to a true debt crisis. I think we’d see much bigger things, but directionally, yes, I think that’s the kind of thing you’re seeing. And so the people moving into gold…I mean, I’ve not looked at the data myself, but I understand a lot of central banks have been moving their reserves into gold, too, so it’s not just private investors. Some of the central banks are

thinking, ‘Huh, maybe dollar reserves aren’t the best thing for us to hold, we need to hold some other things, too.’ And so that’s the kind of thinking that would happen, but I think what you’d see is basically more extreme versions of what we’ve seen in the past year.

Michael Klein
And we’ve seen an example of that, right, with the UK under Liz Truss. Where they delivered a budget that seemed, kind of not at all tethered to reality. And Truss lasted 3 or 4 weeks, and there was kind of this crisis in the UK. Is that a model of what could happen in the United States?

Greg Mankiw
I think it could. I think the rest of the world somehow trusts us more than they trust other countries. We are a reserve currency. They come out, they somehow think that the United States will eventually do the right thing. I mean, there’s this famous Winston Churchill quote that goes, roughly, ‘Americans can always be counted on doing the right thing, after they have exhausted all the alternatives.’ Well, right now, if you look at the budgetary debate and the government shutdown, we’re basically in the process of exhausting the alternatives. And will we eventually do the right thing? I hope so. But if we don’t, that’s when the bond vigilantes come in and basically do what they did in the UK. And once that happens, policymakers will have really no choice. I mean, policymakers can move quickly when they have to. Most fiscal policy happens very slowly, but if you think of what happened during the pandemic, when it was a true crisis, they did lots of stuff really fast. It was kind of miraculous how quickly a lot of the fiscal policy occurred during the pandemic. Similarly, in the case of fiscal policy with the vigilantes coming in, you know, they could pass a plausible budget quickly if they needed to. Nobody has any interest in doing it right now.

Michael Klein
And in 2008, of course, they acted very quickly as well in the fall of 2008.

Greg Mankiw
Yes.

Michael Klein
One of our attendees asks. What ratios or trigger points are there that would signal the U.S. economy is crossing the boundaries of debt sustainability?

Greg Mankiw
You know, I don’t think we have a trigger point, because I think a lot of this is psychological. It’s almost like, at what point do the investors start saying, the United States is more like Greece than I thought. And I don’t think it’s a magic number. Sometimes people have pointed out certain debt-to-GDP ratios, other people have sort of said when debt service starts exceeding defense spending, that’s like a magic point. I don’t actually think there’s a magic point. I think this thing is so psychological that it’s very hard to predict. When I first wrote about these risks, it was in a New York Times article. It was written about 15 years ago, I guess it was 14 years ago, exactly, because I put it when a debt crisis would occur. And it was a fun article. It’s an article I wrote for The New York Times in the form of a speech that a president would give in the middle of a debt crisis.

Michael Klein
Right. I remember that, yeah.

Greg Mankiw
This is so the President can read, explaining what's going on. And I put this speech to be 15 years ahead, so it was 2026. And when that came out, I got a very nice email from Alice Rivlin the very great policy economist, and founding director of the Congressional Budget Office. And Alice said, 'great article in the New York Times, but I don't think we can wait 15 years. I think the crisis is going to hit us in the next 5.' So she was much more pessimistic than I was. And obviously, she was wrong, because we've now gone 14 years. And I'm not predicting that the next we only have one year left, because maybe we have another 15 years, I don't know. But I do think that it could be a ways away, and then when it happens, it's going to happen quickly.

Michael Klein
Yeah, your colleagues, Ken Rogoff and Carmen Reinhart had this very well-publicized idea that once it crosses 100% of GDP, then it's kind of like the floodgates open. But, you know, we're at that point now, or we were very recently, but again, I guess you're, you know, I would agree that it seems like you don't really know, but once it starts, it's really bad. So Rudy Dornbusch, your former teacher, said something like, 'crises come about slower than you might think, and then occur faster than you can imagine.'

Greg Mankiw
That's right. I think that's exactly right. A related quote is from Ernest Hemingway in one of his books, one of his novels, a character is asked, 'how did you go bankrupt?' And the character replies, 'two ways. Gradually, and then suddenly.' And so we're now in the gradual stage, but when you get past the gradual stage, the next stage is the sudden stage.

Michael Klein
So, linked to that, we are seeing some indicators. On the other hand, the stock market has been booming. I mean, not in the last 2 or 3 days. We're recording this on October 15th. But up until the end of last week, it was doing really well. My wife asked me about that, and I said, I don't know. And maybe your wife, Deborah, asks you about that as well. What do you answer?

Greg Mankiw
Well, I don't know is usually a very good answer to that question, so I applaud you, because we usually don't know, but it does seem like right now there's a tremendous enthusiasm for artificial intelligence. And if you look at the stocks that are particularly booming, it's either the AI stocks, or the things that are obviously very closely adjacent to it, producing the semiconductors. Taiwan Semiconductor, NVIDIA, those stocks have really been doing extremely well. So, there seems to be a tremendous enthusiasm for that. I do wonder about whether it's a little bit like 1999, where there was a tremendous enthusiasm for the internet, and all the dot-com stocks went way up. And one thing we learned after 1999 was two things. One is, the internet was a big deal, but that doesn't mean buying stocks at the peak was a good deal. And I kind of worry that this AI boom may be similar, in that AI is going to be a big change for the economy, but that doesn't mean buying these stocks at very high valuations today is necessarily a good deal. Having said that, I'm not, like, selling short anything. I think your first answer is, 'we don't know,' is really a

good answer for economists, and I'm a big believer in buy and hold and diversification. So in my personal portfolio, I'm basically 60% stocks, 40% bonds, a few small percentages in alternatives, it's a handful, including a little bit of gold, by the way, which I'm this is my best performing asset right now, a teeny bit in gold, which I wrote about in The New York Times a while ago, about how gold is a diversifier. But, so I have not changed my portfolio allocation, but I do look at it and worry that the stock market may have gotten a little ahead of itself.

Michael Klein
Well, you alluded to a point that is another question from an attendee. This person asks, why don't you think the AI wave will provide a surge in productivity growth? Aren't we already hearing about how corporate America is moving aggressively to take advantage of this new technology? So I guess you hedge that a little bit, but do you think AI is going to be something that will be a game changer?

Greg Mankiw
I think it's really quite a remarkable technology. The internet was a remarkable technology, too, but it's not the case that, you know, since the internet, the growth in productivity has been remarkable. We've never really gone back to a prolonged period that is equivalent to World War II to 1972. So yeah, I think it is going to be a game changer in many ways, but whether that's going to mean higher productivity growth than we've experienced historically, I don't know. It could be just the kind of productivity growth we're getting now. Bob Gordon is very convincing when he talks about early in the 20th century, we had these technologies that we now take for granted, like indoor plumbing and internal combustion engines and electrification. And so do I think AI is going to be as important as indoor plumbing or electrification? Maybe not. Maybe it'll be great, but not quite at that level of life-changing technology. I think it's going to change things. I should note, by the way, I've actually found AI kind of useful in my own life, because it's a much better search engine than just simply Google. I use Perplexity most often. Not only does Perplexity summarize what the internet thinks of stuff, and then gives you footnotes to it, so if you want to actually check whether it's right, and whether the source is credible or not, you can do that. So I actually found it, like, a super-duper search engine. I've also found that it's kind of one thing that will put some of my editors out of business, because I've put in some of my own writing, saying 'are any of these sentences unclear or verbose?' And it usually comes back with good suggestions. I mean, not every suggestion it has is good, but I'd say more than half of the suggestions it has, like, 'This sentence can be made shorter, or clearer…' I'd say more than half of the suggestions it gives me are worthwhile. This induces me to rewrite the passage. Let me tell you the freakiest thing I did. I wrote this short piece that came out recently in The Wall Street Journal, it's 250 words. They said, 'what do you think the economy's going to look like in 50 years?' And so they asked me and Daron Acemoglu and a few other people, and they published them all. And, I took—before I got that published—I took those 250 words I had put into Perplexity AI, and I said, 'Who do you think wrote this?' And it said, based on the sort of style of writing and the opinions expressed, I think it's probably Greg Mankiw. Which is just remarkable. It was very clear as an economist, because of the introductory paragraph, it's clear that it was an economist who was writing that, so that was not a hard guess. But it basically went out, and it compared these 250 words, with probably the several thousand economists that have written things and are writing them out on the internet, and sort of decided who it was closest to. And I ended up exactly right. It was remarkable.

Michael Klein
It might have been a combination of both what you were saying and the way in which you said it.

Greg Mankiw
That's right. No, no, it said that both it used both content and style in making that judgment. It definitely said that. And so I thought that was really quite remarkable.

Michael Klein
I interviewed Simon Johnson about technology…his book with Daron Acemoglu. And I made the point, and I'd like you to respond to that, that the generative AI could come up with something like a 60s-style sitcom, but it would never come up with The Sopranos or The Wire. They were breaking the mold. So, you know, it's sort of inductive reasoning. It says, okay, well, we saw 'Leave It to Beaver,' and we saw 'Father Knows Best,' so I can do something a lot like that. But they never come up with an idea of, you have this mobster who's going to a psychiatrist, and all the complexities of his life.

Greg Mankiw
Yeah, no, I think that's right. You know, I think that's very wise, Michael. And it's actually closely related to what I tell my students. I'm teaching a freshman seminar right now, and the students are writing essays for this course. There's a question of what do you tell students about the use of AI in doing assignments like this? And a fairly common approach faculty, I've learned, is that they say, 'oh, no, you're not allowed to use this, it's breaking the honor code, AI is off-limits, you have got to write it completely yourself.' And I thought that was kind of unrealistic, given the role that AI's going to play in our lives. And so what I told them is, I said, 'you can use the AI, but do not use it for your first draft.' Because if you ask it for a first draft, you're not going to get something very creative. It's just going to give you a rehash of what's already out there. Because it's basically based on the corpus of stuff it's learning on, and it's not all that creative, at least not the current generations of AI. So I said, what I recommend is, coming up with your first draft yourself, trying to come up with an idea yourself, and then ask it for suggestions on how to make the arguments clearer, or maybe what arguments might rebut your argument. So I said you're supposed to do the creative part yourself. Fine, use it as an editor, and maybe even as a sort of first draft discussant, but if you really want to do something creative for the class, and that's the purpose of the essay, was to come up with some creative ideas, don't expect AI to do it for you. And I haven't talked to them about how they are using it, but I do find the essays are, so far this semester, are better written than they have been in the past, because I think they put it through, and it's like the grammar check is actually quite good.

Michael Klein
So, Greg, I want to thank you very much for the work that you've done for EconoFact in the past by being on the podcast, and especially today for being in this webinar. Your insights are really valuable and help not only people not well-schooled in economics, but myself understand these issues much better. So thanks very much for joining me today.

Greg Mankiw
Oh, it's my pleasure, Michael. Good seeing you.

Michael Klein

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