US Fiscal Health
Is There Life After Debt?

Even before the COVID-19 pandemic of 2020, the United States faced the most serious fiscal threat in its modern history. The economic devastation wrought by the outbreak has made the problem far worse. Despite the very serious threat to US fiscal health, this issue does not rank among the top five for American voters in the 2020 election campaign.¹

CED addresses the direct impact of the pandemic elsewhere in this series. This CED Solutions Brief will explain why even the prepandemic threat must be a public policy priority.

The United States was born with a legacy war debt, and no mature public institutions to manage it. However, our nation found its footing, in large part through a public pronouncement that it would honor that debt. On several occasions since, we have accumulated substantial debt. However, in every instance that debt has resulted from the costs of a war, and once that war ended, the debt quickly subsided (Figure 1, page 3).²

For the last 40 years, however, the public debt has been mounting in a time largely of peace, when we have had only smaller military engagements.³ The debt jumped sharply during the global financial crisis of 2007–2009 and has continued to grow faster than our nation’s collective income (our gross domestic product, or GDP), even during the continued economic expansion over the last 10 years. This vicious spiral in good economic times is unprecedented.

But this current and ongoing US fiscal challenge, which existed before the pandemic, is new and different in several dimensions beyond just its broadest historical outlines. Past war-related episodes of threatening debt and deficits have certainly required forbearance from gratifying tax cuts and spending increases. But in each of those instances, once wartime military expenditures ended, the inertia of budgetary forces—the “baseline” of customary public expenditures and revenues—naturally brought the deficit down.
Reform the US health care system. Health care costs are growing unsustainably, bloating the public debt, inhibiting business hiring, and eroding household incomes, especially for low- and moderate-wage workers. The US needs to implement cost-responsible consumer choice among competing private health care plans to cover all Americans and incentivize all providers and plans to deliver quality, affordable care. The same general approach can control costs in Medicare, through expansion of the successful Medicare Advantage program.

Reform the US income tax. Revenues today are running lower than the average of the last 70 years, including years of recession, and significantly lower than they were when the budget was last in balance. Even the best plan to right the incentives in the health care system will take years to rebuild the market and reduce costs. Greater revenues will be needed to slow the unsustainable growth of the federal debt. A better tax system after the general model of the Tax Reform Act of 1986 will eliminate tax preferences, including for capital income, and reduce tax rates across all income brackets. The earned income tax credit should apply more broadly to enhance work incentives for low- and moderate-wage workers. If the revenue gain from such tax reform is insufficient, as CED has predicted, an additional value-added tax (VAT) would be needed.

Refinance Social Security. After health care, Social Security is the largest cost driver in the budget because of the aging of the population. At the same time, Social Security is a lifeline for seniors who have earned low wages over their lifetimes, and for widows and divorced older women, especially those who worked in the home or had only intermittent spells in the workforce. A revitalized Social Security program would recognize the improved status of longer-lived healthy seniors while providing greater protections for the least well-off.

The remainder of the budget. The long-term pressure on the budget is heavily concentrated in health care and Social Security. However, the budget problem is so large, and programs focusing on seniors so slow to change, that savings must be found in other entitlement programs and annual appropriations. Still, the public and elected policymakers must be realistic, and be informed that the miscellaneous programs in the budget are small, are not growing rapidly, and cannot supply all the savings needed to head off the rising federal debt. Diligent budgeting must provide for our national defense in a hostile world and for the education, research, and infrastructure necessary to support a growing economy.

The budget process. As budget experts have long noted, “The process is not the problem; the problem is the problem.” Rules cannot substitute for political will. However, elected policymakers have not sat down together and addressed the problem. The CED has suggested that initial negotiations center on a simple and unavoidable question: What level of debt, expressed as a percentage of GDP, is too high to be acceptable? (An 85 percent of GDP maximum exclusive of pandemic costs surely would not be too strict.) With that question negotiated and answered, our elected leaders will themselves have demonstrated that they must agree on a plan that will stop the growth of the debt before it reaches that limit. The PAYGO budget process was successful when it was enacted in 1990, 1993, and 1997, yielding budget surpluses from 1998 through 2001. It can be modified to require future pay-as-you-go savings to overcome the current rising baseline deficits. Through such a system, our elected policymakers can mandate the savings that they must achieve. And in this time of stagnant incomes and inequality, this process must be open, transparent, and responsive to the least well-off.
The degree of restraint needed to reach that baseline increased from episode to episode over time, but even in the latest fiscal challenge (in the early 1990s), once firm remedial steps were taken, time came to be our friend.

That is not the case today. Even before the pandemic and the financial crisis, the federal budget had begun to slowly deteriorate from year to year. Now, that deterioration is accelerating. This time, the budget problem will not solve itself. It will take serious action, beyond the scope of past remedies, to turn the rising debt tide. And there are risks—of low but nontrivial probability—that the problem could worsen quickly and uncontrollably. Prudent public stewards must face up to this issue before it gradually or suddenly threatens the solvency of the United States.

**DIMENSIONS OF THE PROBLEM**

The nation’s large annual deficits are piling up debt faster than the economy is growing. It is as though a family’s home mortgage balance were rising faster than its income. This cannot continue indefinitely.4

According to the January prepandemic outlook of the Congressional Budget Office (CBO), the federal budget deficit was projected to rise from $0.984 trillion in fiscal year 2019 to $1.742 trillion in fiscal year 2030—from 4.6 percent to 5.4 percent of GDP.5 Those excessive deficits would drive the public debt to rise from 79.2 percent to 98.3 percent of GDP, which would be the highest level since 1946, in the immediate aftermath of World War II, which in turn was the highest in the nation’s history.6 In fact, it would take a 10-year deficit reduction...
package of about $4.2 trillion—more than 1.5 percent of GDP, and very nearly the largest ever by that measure—just to keep the ratio of debt to GDP below 85 percent within that 10-year prepandemic budget window.

**COSTS AND RISKS**

Such an extreme debt burden outside of a world war (or civil war) would be totally unprecedented. It would carry multiple costs and risks. These continuing deficits would have to be financed by borrowing from abroad. With certainty, such immense borrowing would detract from the US’ own already troubling, mediocre rate of productive, domestically financed business investment, making our nation poorer in the long run. As a mature, developed nation, we cannot collectively borrow our way to prosperity and world leadership.

Equally concerning is the risk that financial markets will someday refuse to lend to a nation whose public debt is so extraordinarily burdensome. Foreign lenders could come to question our ability or will to tax ourselves sufficiently to service such a growing debt. To be sure, there has as yet been no such reaction; interest rates on US Treasury securities are quite low by historical standards. One controversial point of view is that a nation that supplies the world’s reserve currency, and therefore can borrow in its own currency, can simply pump out more and more paper, and will never be subject to discipline.

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**Figure 2**

US interest rates grew after years of stability, 1953–1986

Source: U.S. Department of the Treasury
by international financial markets. Another line of reasoning to the same practical conclusion—that “debt doesn’t matter”—is that US interest rates are so low, and will remain so low, that the federal government can service far more debt than was thought feasible in the past.

The United States must not become so blasé; the downside is far too steep. Continuously rising debt will certainly erode the nation’s wealth, reduce investment, and hobble productivity growth. Furthermore, the growing debt-service burden will demand increasingly higher taxes, which will breed resentment among taxpayers and reduce the federal government’s ability to supply needed services, including but not limited to the education, infrastructure, and research that help the economy grow. The latest CBO deficit and debt projections, which show such a growing debt burden, have already assumed interest rates well below any sustained levels prior to the financial crisis.

Advocates of tolerating the current high deficits often claim that today’s economy is permanently changed, and inflation and interest rates will remain low forever. That is a high-stakes bet. Figures 2 and 3 (page 4 and below) show that inflation and interest rates stayed low in the 1950s and early 1960s for far longer than they have since the global financial crisis of 2007–2008, but nonetheless spiked upward for almost two decades.

Figure 3
US inflation accelerated after years of stability, 1953–1986

Source: U.S. Bureau of Labor Statistics
after international conflict and oil market disruptions starting in the late 1960s. The fiscal miscalculation with respect to financing the Vietnam War led to large deficits and startled financial markets. It was followed by the Middle East oil embargo, which drove inflation even higher. Admittedly, today’s large deficits have not yet had that effect. But today’s debt is already almost triple the size of that of the late 1960s relative to GDP. Allowing these deficits to run is tantamount to placing an enormous bet on the proposition that interest rates will never rise. History does not encourage prudent policy leaders to place such a bet, nor does careful analysis. Interest rates one percentage point higher than projected—still below historical averages—would add more than $1 trillion to the public debt over 10 years.\textsuperscript{11}

Policymakers should not assume or hope that today’s low interest rates will solve the problem for them. They should instead attack the problem, knowing that financial markets that see true fiscal discipline will be much more likely to help by holding interest rates lower than they otherwise would be.\textsuperscript{12}

**THE CAUSES**

The budget deficit is the difference between spending and revenue. Some believe that the problem lies solely with one or the other. Dispassionate analysis can yield a more useful answer.

In fiscal year 2019, when the budget deficit was 4.6 percent of GDP, total revenues were 16.3 percent of GDP. On average from 1950 through 2019 (including recession years, when revenues are typically low), revenues averaged 17.3 percent of GDP. Over the most recent period (1998–2001) when the budget was balanced, revenues averaged 19.4 percent of GDP. This strongly suggests that insufficient revenues are part of the problem.

The CBO long-range projections on the spending side provide an equally compelling clue. In the latest prepandemic projections covering 2019 through 2049, as the deficit continues to grow faster than the economy from which it must be financed, total programmatic (that is, noninterest) spending—not including health care—is expected to decline by 0.4 percent of GDP. More than all of the net growth in federal program spending comes from health care—and the great bulk of that growth comes from Medicare. That growth, 3.0 percentage points of GDP from Medicare and 1.0 percentage points from all other health programs, is substantial and unsustainable. Thus, in arithmetic terms, the unavoidable conclusion is that most of the federal government’s long-run budget problem, beyond lower-than-historical-average revenues, is driven by health care costs.

The growth in Medicare spending comes in a conceptual, accounting sense from two sources. One is the growth in the cost of health care services for the average beneficiary. The other is the number of beneficiaries who must be served. The first source is at least potentially remediable; in fact, to avoid an eventual debt explosion, the nation must find more efficient ways to deliver quality health care to all Americans.\textsuperscript{13} However, the second part of the problem, the aging of America’s population (and the consequent increase in the number of Medicare beneficiaries), will continue worsening for the remainder of this decade and beyond.\textsuperscript{14}
This demographic challenge of an aging population itself consists of three parts. The most obvious part is the maturing of the oversize baby-boom generation, which will add disproportionately to the Medicare population for the rest of this decade. The second part is the increasing longevity of all Americans on average, of which a greater proportion will be of Medicare-eligible age and in need of more services to maintain their health. The third is that even the Medicare population itself is aging, with proportionately more of the elderly in their older years (using an arbitrary classification, more of those 65 and older are 85 and older) and therefore needing more care.

That demographic challenge is beyond our control. Policymakers can (and must) grapple with the monster of the rapidly rising cost of administering health care. But they cannot change the aging of the population. In fact, as we learn how to deliver better health care, Americans will live still longer, and having more older Americans, taken by itself, may well add to costs. Furthermore, the nation’s challenging demographics add to Social Security costs in addition to increasing the costs of health care. Social Security’s contribution to the long-term budget problem is much less than that of health care, but it is a rising cost nonetheless, and it compounds the already bedeviling budget challenge.

THE CONSEQUENCES

Past episodes of rising debt in the US arose mostly because of the costs of all-out war. Once the war spending ended, the budget could recover if the tax law were left untouched and spending grew roughly with inflation (that is, was left unchanged in terms of purchasing power). Today’s debt boom is different, in that it arises because of rising “baseline” peacetime spending, which unlike the costs of war, will not go away on its own. The economy has not grown and will not grow fast enough to outrun this spending, given that the spending is driven by this unprecedented and irremediable demographic wave, and the retirement of the baby-boom generation itself is slowing the growth of the labor force and therefore economic growth. This demographics-induced slowdown of labor force growth reduces the growth of economic output by at least one full percentage point per year, and probably more, as illustrated in Figure 4 (page 8).

Therefore, the solution to the US fiscal problem must be unlike any such past episode. The task is not merely to hold policymakers to the baseline, but rather to bend the baseline downward. And with the inevitably rising costs for US health care and Social Security because of the aging of the population, the deficit will not return to a sustainable trajectory without revenues that are higher, as a percentage of the GDP, than has been the case historically. Our nation’s need for national security, care for our veterans, education, research, infrastructure, and the administration of our justice and revenue systems will not decrease, and beyond those functions there is very little of the federal government left either to wither away or be cut. So demographics will push federal spending up, and while we struggle to slow that trajectory, revenues must keep pace to prevent the debt from rising out of control.
Even after the pandemic ends, and even assuming that the debt from the pandemic response is managed as CED suggests in a separate brief, large-scale, essential budget deficit reduction will be exceedingly difficult. The federal budget is way out of bounds. Large spending cuts, including savings from reform of the health care system, will impose costs on the beneficiaries of those programs but are unavoidable. It will be imperative for the process of fixing the budget to be open and transparent, and that its fairness be clear and beyond doubt.

THE CENTRAL ROLE OF HEALTH CARE

Rising health care costs are at the root of the long-term budget problem. They are also pernicious with respect to slow wage growth and inequality. Response to the pandemic will add to costs, and the pandemic has exposed the underlying health care cost problem; but the problem preexisted the pandemic and will continue after it is gone.

Most Americans probably instinctively judge their financial well-being by the bottom-line amounts on their paychecks. For those who have employer-provided health insurance, that bottom line is net of both the employer’s and the employee’s premium contributions, in whatever proportions the cost is divided between the two. And many people probably build into their personal “baselines” that they have insurance to provide health care;

Figure 4
Slowing labor force growth will constrain future economic growth

![Graph showing labor force growth and economic projection](source: CBO's January 2020 report The Budget and Economic Outlook: 2020 to 2030 (Figure 2-6))
they assess their well-being on their wages after paying for health insurance, both through their employers’ contributions and the deductions from their own paychecks. As health insurance has become more expensive, it has formed a growing wedge between workers’ total compensation and the cash that they take home (as Figure 5 illustrates).\textsuperscript{20} People surely do not believe that they are better off this year because they have a more expensive health insurance policy that provides the same benefits as last year.

In 2019, according to the Kaiser Family Foundation, the average cost of a family insurance policy was $20,576; at firms with predominantly lower-wage workers, premiums averaged $17,633, probably for policies with less complete coverage.\textsuperscript{21} In 2018, according to the Census Bureau, the median family income was $61,937—not that far above the cost of an insurance policy.\textsuperscript{22} But consider that the cost of health insurance bears very little relation to income. Thus, the cost of health insurance is much more like a “head tax”—a fixed-dollar assessment on each person or family—than it is a free consumer choice to buy more or less of some item according to the purchaser’s circumstance. That cost falls much more heavily on those of modest means. It aggravates the popular perception of stagnant incomes, and of inequality.

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**Figure 5**

*Growing employer health costs constrain cash wages*

March 1980 = 100, not seasonally adjusted

- **Total compensation**
- **Wages & salaries**

Source: U.S. Bureau of Labor Statistics
Thus, health care must be made more affordable not only to protect public and business budgets but also to unburden family budgets and reduce the corrosive sense of stagnant living standards and inequality that afflicts our national community.

RECOMMENDATIONS
The Committee for Economic Development of The Conference Board (CED) has addressed each of the major segments of the budget problem and has issued detailed recommendations.23 To summarize the key points:

Reform the US health care system. As emphasized above, health care costs are growing unsustainably, bloating the public debt, inhibiting business hiring, and eroding household incomes, especially for low- and moderate-wage workers. The US needs to implement cost-responsible consumer choice among competing private health care plans to cover all Americans and incentivize all providers and plans to deliver quality, affordable care.24 The same general approach can control costs in Medicare, through expansion of the successful Medicare Advantage program.25

Reform the US income tax. Revenues today are running lower than the average of the last 70 years, including years of recession, and significantly lower than they were when the budget was last in balance. Even the best plan to right the incentives in the health care system will take years to rebuild the market and reduce costs. Greater revenues will be needed to slow the unsustainable growth of the federal debt. A better tax system after the general model of the Tax Reform Act of 1986 will eliminate tax preferences, including those for capital income, and reduce tax rates across all income brackets. The earned income tax credit should apply more broadly to enhance work incentives for low- and moderate-wage workers.26 If the revenue gain from such tax reform is insufficient, as CED has predicted, an additional value-added tax (VAT) would be needed.27

Refinance Social Security. After health care, Social Security is the largest cost driver in the budget because of the aging of the population. At the same time, Social Security is a lifeline for seniors who have earned low wages over their lifetimes, and for widows and divorced older women, especially those who worked in the home or had only intermittent spells in the workforce. A revitalized Social Security program would recognize the improved status of longer-lived, healthy seniors while providing greater protections for the least well-off.28

The remainder of the budget. The long-term pressure on the budget is heavily concentrated in health care and Social Security. However, the budget problem is so large, and programs focusing on seniors so difficult to change quickly, that savings must be found in other entitlement programs and annual appropriations. Still, the public and elected policymakers must be realistic, and be informed that the miscellaneous programs in the budget are small, are not growing rapidly, and cannot supply all the savings needed to head off the rising federal debt. Diligent budgeting must provide for our national defense in a hostile world and for the education, research, and infrastructure necessary to support a growing economy.
The budget process. As budget experts have long noted, “The process is not the problem; the problem is the problem.” Rules cannot substitute for political will. However, elected policymakers have not sat down together and addressed the problem. The CED has suggested that initial negotiations center on a simple and unavoidable question: What level of debt, expressed as a percentage of GDP, is too high to be acceptable? (After segregating the debt caused by the pandemic response, as CED recommends, the 85 percent of GDP maximum suggested earlier surely would not be too strict, and would be attainable with prompt action.) With that question negotiated and answered, our elected leaders will themselves have demonstrated that they must agree on a plan that will stop the growth of the debt before it reaches that limit. The PAYGO budget process was successful when it was enacted in 1990, 1993, and 1997, yielding budget surpluses from 1998 through 2001. It can be modified to require future pay-as-you-go savings to overcome the current rising baseline deficits. Through such a system, our elected policymakers can mandate the savings that they must achieve. And in this time of stagnant incomes and inequality, this process must be open, transparent, and responsive to the least well-off.

The federal budget today is out of control. It will unquestionably erode our standards of living, and its unprecedented deficits and accumulated debt threaten our economic stability. Our leaders must step forward and lead, or our nation will cease to be a world leader.
Endnotes


2 “The Budget and Economic Outlook: 2020 to 2030,” Congressional Budget Office, January 2020. Figure 1-4, p. 11, illustrates this vividly. Some might see the Great Depression as an exception to this generalization, but in the historical scale of the lifetime of the Republic, the Depression was followed quickly by the far greater debt buildup of World War II.

3 From a purely budgetary perspective, the current Middle East conflict is not comparable to the previous wars highlighted in Figure 1. The most comparable, the Vietnam War, saw an increase in defense spending of 2.0 percent of GDP, from 7.2 percent in 1965 to 9.2 percent in 1968. The increase in defense spending in the current conflict was smaller, and from a lower base, rising from 2.9 percent of GDP in 2001 to 4.6 percent in 2009 and 2010, and back down to 3.1 percent in 2017 and 2018. The current Middle East conflict has carried on longer, and its human cost is undeniable, but it cannot be assigned responsibility for either the current higher US debt burden or the projected acceleration of US debt into the future. The Budget of the United States Government, Fiscal Year 2020, Historical Tables, Office of Management and Budget, Table 8.4.

4 Most parents want to leave their children with assets, not debt. Our nation does not face a day of reckoning in the same sense as a family does, but there are other costs to a rising debt burden. See: “Time to Face Up,” Committee for Economic Development (CED), April 26, 2018, summarized later in this document.


6 The Budget of the United States Government, Fiscal Year 2020, Historical Tables, Office of Management and Budget, Table 7.1

7 Nonresidential business fixed investment is now about 13 percent of GDP, less than the 14 percent of the late 1970s and the middle and late 1990s. Author’s own calculations based on data set from the Bureau of Economic Analysis.


10 CBO generally reduces its projected interest rates by about two-tenths of one percentage point relative to its previous forecast. Three-month Treasury bills average 2.3 percent over 2025–2030; 10-year Treasury notes average 3.0 percent. These rates are more than two percentage points below what was typical in the economic expansions of the 1990s and the pre–financial crisis 2000s. “The Budget and Economic Outlook: 2020 to 2030,” Congressional Budget Office, January 2020, Table 2-1, p. 30.


12 That is perhaps one of the most important lessons of the nation’s most recent episodes of balanced budgets in the late 1990s.


16 One additional challenge to health care policy is addressing the tragic shortening of life expectancies for some groups of the US population, including low-income persons and minorities.

17 People’s lives could be extended by delivering more—and more expensive—services, rather than the health care system saving money on net because the elderly are healthier. Better care may postpone the eventual expensive cardiac event, but in the interim those elderly might need expensive joint replacements or contract expensive cases of Alzheimer’s disease.

18 The cost of Social Security is projected to increase by 1.3 percent of GDP from 2019 through 2049 (compared to the total cost of health care of 4.0 percent of GDP and Medicare alone at 3.0 percent of GDP). All other federal programs not related to health care or Social Security are projected to decline in cost by 1.7 percent over that period.

19 “The Budget and Economic Outlook: 2020 to 2030,” Congressional Budget Office, January 2020, Figure 2-6, p. 47.

20 Figure 6 shows all employee benefits, but employer-paid health insurance is the largest and fastest-growing benefit item, even larger than the Social Security and Medicare payroll tax. “Employer Costs for Employee Compensation,” US Department of Labor, Bureau of Labor Statistics.


SUSTAINING CAPITALISM

Achieving prosperity for all Americans could not be more urgent. Although the United States remains the most prosperous nation on earth, millions of our citizens are losing faith in the American dream of upward mobility, and in American-style capitalism itself. This crisis of confidence has widened the divide afflicting American politics and cries out for reasoned solutions in the nation’s interest to provide prosperity for all Americans and make capitalism sustainable for generations to come. In 1942, the founders of the Committee for Economic Development (CED), our nation’s leading CEOs, took on the immense challenge of creating a rules-based post-war economic order. Their leadership and selfless efforts helped give the United States and the world the Marshall Plan, the Bretton Woods Agreement, and the Employment Act of 1946. The challenges to our economic principles and democratic institutions now are equally important. So, in the spirit of its founding, CED, the public policy center of The Conference Board, will release a series of 2020 Solutions Briefs. These briefs will address today’s critical issues, including health care, the future of work, education, technology and innovation, regulation, China and trade, infrastructure, inequality, and taxation.