Introduction: Sailing Off the Charts

The finances of the US government are sailing off the charts. According to the current projections of the Congressional Budget Office (CBO)—which are inherently optimistic because of constraints that the law imposes on the estimating process and will surely worsen with the most recent developments—the federal government’s debt burden (the debt owed to the public, expressed as a percentage of the nation’s gross domestic product, or GDP) will rise to equal its highest level in history within 10 years and then will continue to rise with no end in sight (see Figure 1). The three costly crises the nation has faced in the last 15 years—the financial crisis, the pandemic, and the war in Ukraine—demonstrate that this nation must be fiscally prepared to be a true world leader. It must not continue to teeter over the edge of financial stability. A brief assessment of the risks will explain why.

Before this century, the largest expansions of the public debt occurred in war. The last time the nation’s debt burden was so high, the American people had just emerged from the trial of World War II. Although the nation’s past at that time was bloody, its future was bright. The troops came home to work in factories quickly converted from wartime to peacetime production, using unparalleled new technology. US workers had been fully employed in the war effort but had been forced by wartime shortages and rationing to save the bounty they earned, so their balance sheets were flush and their expectations for a richer life were high when those restrictions were lifted. The US was the only advanced nation that remained unscathed, and so was the prime supplier to the world. The federal government had borrowed enormous sums but did so to defend our freedom; when the war was won, peacetime life resumed—with an economic and commercial boom that was a total reversal from the Great Depression.
Today, the nation faces the same debt burden as it did three-quarters of a century ago at the end of World War II, but its economic and fiscal outlook is far bleaker. For one thing, instead of the returning troops swelling the labor force, a rapidly growing pool of retirees claiming Social Security—and even more tellingly, Medicare benefits—drain it. Compounding the unfavorable long-term growth fundamentals is an aging population generally (which the US shares with many other developed countries, notably China) and trends toward lower birth rates. Indeed, by 2031 there will only be 3 working-age people (ages 15-64) per retired person (ages 65 and over) and by 2041 just 2.8. These ratios are compared to 3.7 in 2011 and 5.4 in 2001. But beyond the shrinking number of people to support the tax base required for offsetting the expanding annual federal budget deficits and mounting public debt, the majority of American families have virtually no net wealth and are already at their limits of affordable consumption—and so cannot fuel an economic boom like that of the postwar years.

The US economy is still the largest, most important, and most innovative economy in the world and still regularly outperforms its peers in Europe and Japan. But although US technology remains unparalleled, other nations nip at our heels; we are not the world’s unchallenged economic colossus as we were in the 1950s and 1960s. And all of those post-World War II economic advantages only compounded enormous federal budget savings from spending reductions from military demobilization. Defense spending fell from 37 percent of GDP in 1944 and 1945 to less than 5 percent from 1948 to 1950 and remained below 10 percent even after the Korean conflict and the most intense years of the Cold War. This drop-off provided enormous, rapid, and essentially painless deficit...
reduction. Today, as the world cannot yet determine the full impact of the war in Ukraine, US defense spending is surely at an irreducible minimum. Thus, although the nation quickly outgrew its debt following World War II, the debt today is well placed to grow much faster than the nation’s economy.

And unlike the debt that the nation incurred in World War II to defend our freedom, today we have no such excuse. Yes, the nation was forced to respond to the 2008-2009 financial crisis, and to the 2020 pandemic that besets us still. But the federal budget was well on its way to perdition even before those setbacks, with long-range projections of debt rising toward infinity almost every year over the last 40, and policymakers have not yet begun to build the consensus to respond to either the preexisting debt or the substantial emergency additions to it.

Though increased spending on infrastructure, education, social welfare, and the environment may be wise, and rising deficits would naturally result in such times of crisis, we cannot borrow ceaselessly without real harm. Americans can and should expect leaders to address both the nation’s challenges and its fiscal health.

So what danger, precisely, does this exponential debt growth pose? Why does debt matter? And what should we do about it?

**Insights for what’s ahead**

Debt can erode economic growth and sap prosperity and living standards over a period of years, demoralizing the populace and demeaning the nation in the world community. Rising debt service costs will prevent the federal government (and state and local governments) from meeting the nation’s most fundamental needs—law and order, adequate infrastructure, and public health, not to mention the national defense.

But rising public debt will afflict the private sector as well. The federal government’s security auctions have a de facto, implicit first claim on financial resources in the economy. Financing of productive private business investment must make do with what is left over. And in the face of rapidly rising public debt and tightening in the markets, economic and financial expectations will become less “anchored.” Investors and the media already ponder whether the federal government will resort to hyperinflation to escape the debt. Under such uncertainty, private-sector decision makers—especially at small, potentially innovative firms—fear to undertake long-term investment and risk-taking that might extend beyond a future major financial inflection point—to the detriment of economic dynamism and innovation, US world leadership, and longer-term growth of living standards.
RECOMMENDATIONS

The nation needs leaders of both parties who recognize the peril and are willing to work together in the nation’s interest. Responsibility for difficult decisions must be shared.

Reform health care. The operating part of the budget builds up the debt in the first place. And the largest and fastest-growing operating part of the budget is health care, driven by both population aging and—more importantly—the rising cost of delivering care. The nation’s health care system needs fundamental restructuring, with cost-responsible consumer choice among competing private health plans to cover all Americans and align incentives so that quality, affordable care is in the interests of patients and providers alike.

Reform Social Security. Social Security’s cost is growing because of the same population aging. It must strengthen the safety net for low-wage workers with intermittent careers, but then rein in costs with gradual reductions in benefits for the most-affluent workers, and with broader coverage of the payroll tax for workers with higher wages and with generous currently nontaxed fringe benefits.

Exercise oversight in a rigorous budget process. The remainder of the spending side of the budget is less problematic on its own but must contribute savings to make room for the irreversible and unavoidable costs from population aging. All domestic and defense programs need rigorous comparison of costs and benefits. Congress must execute a complete appropriations process, providing full oversight of every executive agency. Similarly, the nation needs an annual budget resolution that takes a holistic view of the debt problem and reinvigorates the reconciliation process for its intended purpose of deficit reduction. If our elected policymakers will not take on this burden themselves, the nation will need to turn to a fully empowered commission of experts to carry that load.

Increase revenues. In addition to spending restraint, the budget problem necessitates greater revenues. The nation’s demographics are inescapable. Revenue collections that were inadequate with a younger population and relatively more working Americans during the earlier post-World War II years will by no means be sufficient for the older population with relatively more retired Americans in the coming decades of the 21st century. Historical episodes of income tax reform consistent with principles of fairness, efficiency, and simplicity have been conducive to economic growth and budget improvement. If income tax reform on these terms does not yield sufficient revenues, policymakers should consider additional sources consistent with these principles and with continuing budget discipline.

Pay for any new initiatives. Any legislation in response to the continuing coronavirus pandemic must be fully paid for, and gimmick free; the economy does not need any further economic stimulus, but it does need investment—in the public health, to protect against a renewed pandemic outbreak, or another pathogen months or years down the road; and in the nation’s infrastructure, its business capacity and technology, and the skills of its workforce.
The Dangers and Damage of Debt

Debt can be a catastrophic illness leading to an economic and financial implosion (as bankruptcies and failed sovereign governments from time immemorial have demonstrated). But it can also be a wasting disease. It can stunt economic growth and sap prosperity and living standards, leading to an erosion that demoralizes the populace and demeans the nation in the world community. In the instance of a global leader such as the US, which has set standards for worldwide commercial and geopolitical behavior to the benefit of all nations over the last century and more, such deterioration could be especially costly, leaving a leadership vacuum among nations. And though it would almost certainly lead to a catastrophic financial crisis, it would do so only eventually—while too many decision makers comfort themselves that the absence of immediate chaos in the markets is adequate testimony that all is well. In other words, debt is often thought of as a wolf lurking just outside the door; but even in the absence of the wolf, debt can be the termites in the timbers, which in the end are just as deadly. As Mike in Ernest Hemingway’s The Sun Also Rises answered the question, “How did you go bankrupt?”: “Two ways... Gradually, then suddenly.”

Of course, we cannot know precisely the timing and the consequences of excessive debt for this nation at this time. The world is constantly changing, and so we have never seen this world before, and we have never seen such complex and intertwined trade and financial technology relationships. But some regularities will likely repeat themselves, especially in the “erosion” phase of the process—like the “whimper” from T.S. Eliot’s poem “The Hollow Men.” The eventual “implosion”—the poetic “bang”—will be closer to unique for the issuer of the world’s reserve currency.

Attack the pandemic debt. And finally, CED continues to urge policymakers to take on the “pandemic debt” (the direct economic cost plus the cost of the recovery legislation), both as a first step toward an overall debt solution, and to demonstrate the nation’s determination to restore fiscal responsibility. We propose consolidating the pandemic debt in a single separate financial entity (probably organized as a public corporation) and financing it with fixed-rate bonds with a maturity longer than the current 30-year Treasury bonds. This public corporation must have the sole claim on a dedicated revenue source as a commitment to fiscal responsibility. The financial markets would accept low interest rates on these bonds, which should be retired by the time they mature. This step would be perhaps the greatest signal of credibility that the nation could send quickly and convincingly to the financial markets.

The nation’s budget problem is large and worsening. It will not fix itself. But very soon, this nation will have no choice but to fix it—because debt does matter.
The common element of historical episodes of excessive debt is the damage from the cost of servicing it. Public debt service crowds out both public and private investment and maintenance; that is what slows economic growth, as labor has less and lower-quality capital with which to work because of reduced research & development (and also lesser skills because of the crowding out of human investment in education, training, nutrition, and health).

Some will argue that the US is immune from that wasting disease because interest rates have remained extraordinarily low since the financial crisis of more than a decade ago, and therefore surely will remain low forever—and will keep public debt service cost (and the cost of capital to private investors) low as well. But that is too much to assume. Apart from the earliest stages of economic recovery, first from the financial crisis and later from the pandemic, growth has remained sluggish, and that flaccid demand (along with the accommodative Federal Reserve policy to revive it) has allowed interest rates—and inflation—to remain low. After more than a decade of low interest rates and low inflation, as the economy expands in early 2022, the nation is seeing that faster growth and tighter labor markets can yield faster inflation and higher interest rates, already higher than economic projections of just months ago, and their upper limits are far from certain.

After almost two decades of low interest rates concealing the magnitude of the rapidly accumulating debt, many people seem to have lost their perspective on the potential of rising debt service to swell the federal budget. The public debt has become so large that it has enormous leverage over the budget. In 1980, the debt was only about 25 percent of GDP. As late as 2000, it was only 33 percent, and at that time it was falling. Today, the debt is about 100 percent of GDP—three to four times higher. Therefore, even at average interest rates half of what they were, the cost of debt service will be 1-1/2 to 2 times what it was relative to the size of the economy in those earlier years. And as the debt continues to grow faster than the economy, and there is every reason to believe that it will, the cost of debt service will grow exponentially—even without higher interest rates. If interest rates respond to higher debt as they have in other countries and in the past, only the sky is the limit.

The CBO’s projections, shown above in Figure 1, illustrate the alarming prospect of debt growing along the path dictated by current budget policy—which in fact assumes that numerous temporary tax cuts, including those enacted in 2017 and enjoyed by a wide range of moderate-income Americans (i.e., voters), are allowed to expire—as they surely will not. (The budget law requires that CBO make that assumption in the formal baseline.) But even assuming that unlikely eventuality, the public debt will equal its highest historical level by 2031, and then will double from that extreme level by 2051, just 30 years from now. Those levels might seem only abstractions, numbers so large that they boggle the mind. But logic and experience scream out that serious concern is well warranted. Despite its unprecedented level of debt at the end of World War II, this nation, preoccupied with demobilization and saving huge sums from reduced defense spending, was able to maintain its fiscal and financial equilibrium. The nation today cannot presume that the same outsized debt burden will quickly melt away. Furthermore, in a more general sense, the debt in Figure 1 is sailing off the edge of the map, out of the zone where we know from experience we are probably safe into an area where we have no experience
at all. (In fact, the experience of other nations indicates that there is grave danger off of the top of that chart.)

**Rising Debt and the Public Sector**

Another perspective on the damage that this rising debt can do would line up those debt service dollars against a more familiar yardstick. Debt service will soon become the fastest-growing major component of the budget, and before the end of the projection period (in 2051) it will become the largest major item in the budget in absolute terms. It may be informative to see just what that means. Figure 2 shows all of the major components of the budget and compares them to the projected level of revenues. By 2051, the federal government’s debt service obligations will have grown so large that all of the projected revenue will not be sufficient to pay for debt service, Social Security, and Medicare. The federal government will have to borrow to pay for part of Medicare, all of the health care costs other than Medicare (such as Medicaid and the health care programs for veterans), and everything else that the federal government does—defense and domestic. Obviously, this path is not sustainable and will not happen. It also is not consistent with a nation that meets its population’s most fundamental needs—law and order, adequate infrastructure, and public health, not to mention the national defense. The resulting deficits are so large that they will be forestalled only by a combination of painful cuts in defense and domestic appropriated programs, Medicare and Social

![Figure 2: Interest Cost Crowds Out National Priorities](https://www.cbo.gov/publication/56977)

**Figure 2**

*Interest Cost Crowds Out National Priorities*

Sources: Congressional Budget Office, www.cbo.gov/publication/56977; author’s analysis
Security—and increases in taxes and other sources of revenue. Those adjustments can be made sooner and in an orderly way so that they can be smaller and less painful, or the nation can procrastinate, such that those cuts will be forced in the face of a crisis and will be more abrupt, less carefully chosen and planned, and more harmful to the American people.

This scenario, which surely would frighten the financial markets and eviscerate the public sector, assumes arithmetically that somehow investors in Treasury securities remain totally calm and that interest rates remain at historically low rates. Because the economy is assumed to grow at its full capacity for the foreseeable future, interest rates (using the 10-Year Treasury Note rate for purposes of this illustration) are expected to drift upward from their levels today, but only to reach levels that prior to the financial crisis (and the pandemic that followed) would have been considered quite low (see the base case in Figure 3 below).

Which raises the questions: How sensitive is this projection to the level of interest rates? What if interest rates were slightly higher? CBO suggests an alternative to their base case scenario, in which the effective interest rate on the outstanding debt increases by 0.05 percent (five basis points) per year. Figure 3 illustrates such a path for the 10-Year Treasury Note (labeled as “higher rates”); after 30 years of such a slow increase, the rate
is still at a level that was considered low in the late 1990s, when the budget was in surplus and the Treasury was actually buying rather than selling bonds.

The budgetary outcome that results from this alternative projection takes the base case that was merely unthinkable and makes it totally unimaginable. The debt held by the public would reach 260 percent of GDP, rather than the 202 percent in the baseline; instead of approximately doubling from 2031 to 2051, it would increase by about 150 percent. The implications for inflation and the dollar (and for further increases in interest rates themselves) are beyond contemplation.

Still, looking up at those two debt trajectories from ground level, they may not appear all that different. But looking at the implied budget deficits relative to the levels of spending in the current budget, the potential impact of this massive increase becomes clearer. As shown in Figure 4, just this modest, five-basis-point-per-year increase in interest rates would send debt service cost through the ceiling, almost literally. By the end of the projection period in 2051, net interest cost would grow so large that all of current-law government revenues could barely pay for it. The federal government would have to borrow to pay for virtually all of its operations—all of spending for all operating programs. By the end of the projection period in 2051, total revenues would pay for interest on the debt plus about half of the cost of Social Security, and nothing more—none of Medicare, national defense, veterans programs, or anything else. And that total

![Figure 4](chart.png)
of spending will reach almost an incomprehensible 40 percent of the nation’s entire GDP. Which of the nation’s highest priorities will Congress and the president choose to throw over the side to slow the growth of the public debt and its debt service costs? The sizes of the reductions (and of the tax increase) that would be necessary should this scenario be allowed to unfold are so large that speculation is purely idle; the public would not be served by the federal government in any recognizable semblance of the past.

Importantly, this crowding out of public priorities because of the growth of the federal government’s debt is by no means restricted to the federal government. Prepandemic (in 2019), state governments received more than 31 percent of their revenue from federal government grants; local governments received more than 39 percent from the federal government and state government combined, with much of the money from state government grants likely being passed through from the federal government. (In 2020, the latest year for which data are available, the pandemic response raised the federal grant share of state revenue to 39 percent.) Trouble flows downhill; if the federal government’s finances are impaired by its buildup of debt, typical state and local government functions, including (but not limited to) education and police protection, will suffer as well.

The moral of the story is that the public debt has become so large that it now has enormous leverage on the overall budget. The cost of servicing the debt will overwhelm the federal budget even if interest rates remain historically low. Any upward movement of interest rates will make the needed substantial reductions of spending, and equally substantial increases of revenues, far worse than they would be under the baseline projections. And given the power of compound interest, each increment of increase in interest rates will be far more destructive than the last, and therefore can be expected to roil the financial markets even more—in an ever-worsening vicious cycle.

**Grasping at Straws**

When confronted with such a painful prospect, a natural human reaction is to reach for a miracle. One scenario for such a miracle is faster economic growth. However, the baseline growth scenario is already optimistic, and even faster growth is unlikely.

Wishful thinkers look at the faster rates of economic growth that the nation enjoyed during the 1950s and 1960s and presume that we can merely “do the same thing we did before” to “grow our way out” of the problem. But even beyond the onetime stimulants to economic growth that the nation enjoyed in the aftermath of World War II (explained above), the wishful thinkers do not understand that the rate of economic growth is the sum of the rates of workforce growth and productivity growth—output grows by the number of hours that Americans work, compounded by the growth of how much they produce for each hour. And unfortunately, slower future US workforce growth has been baked into the demographic cake for generations.

From the late 1960s through the 1980s, the outsized US baby boom generation entered the labor force and raised economic growth; over the same period, women of the baby boom and other generations also joined the workforce in larger than previous numbers, to the same effect. However, with the baby boomers now retiring and with women’s workforce participation at a plateau not much different from men’s, labor force growth is
a mere fraction of that of decades past. (See Figure 5.) Faster immigration is needed and would ameliorate but could not possibly fully offset that constraint; raising labor force growth from the current 0.3 percent per year to the roughly 2.0 percent of the 1950s–80s would require that the number of additional immigrant workers each year approximately quintuple. Therefore, total US economic growth faster than projected over the long-term budget outlook can be achieved only through productivity growth well beyond the historical norm, which is most unlikely. Private-sector businesses already struggle every day to eke out the smallest increments to their efficiency; there is no silver bullet in public policy to achieve quantum increases in productivity. Education and workforce training are crucial but are also difficult and slow. Even startling advances in digital technology often add much more to consumer well-being or enjoyment than they do to taxable incomes.

Furthermore, faster economic growth tends to increase interest rates. When the economy grows more rapidly, entrepreneurs see opportunities and are willing to bid interest rates up to borrow the funds they need to finance their new investments. The resulting higher rates will wipe out a significant share of the deficit reduction from higher government revenues and outlay savings that otherwise would result from faster growth. This is one more reason why prudent stewardship would require limiting the federal government’s debt. (Another reason being protection against the costs of all manner of contingencies, such as natural disasters or threats to our national security.)

![Average Annual Growth Rate of Real Potential GDP](source: Congressional Budget Office www.cbo.gov/publication/56977)
Without prompt action, the federal government will not be able to fulfill its public functions, from national security to national parks. The budget shortfall will be so large that neither the most-profound nor the most-mundane public services will be immune from the fallout. Risking that dangerous situation on speculative policy solutions would go beyond imprudence to recklessness.

But emaciation of the public sector is not the full extent of the ill effects of unchecked budget deterioration. The consequences of inaction will afflict the private sector as well as the public, leaving the economy crippled.

**Crippling Private-Sector Growth**

The federal government has a de facto, implicit first claim on financial resources in the economy. This is so because the Treasury sells its securities at auction; those securities do not need to pass through a rating process, and they always sell in the full planned amount. The private sector, to finance its investment and therefore to generate growth and jobs, must fight over the scraps left after the Treasury soaks up its irrefusable demands for credit. Businesses that are large enough to sell their own securities must satisfy rating authorities and the markets to achieve a successful placement. Smaller businesses must satisfy venture capitalists, private equity firms, banks, or other intermediaries. (Individuals, like small businesses, must pass muster with banks or other institutions to borrow for their consumption of durable and other goods and services.)

The more credit the federal government demands of the financial markets, the less financing will be left for the private sector. In much of the extraordinary time of the last 15 years, the Federal Reserve made credit more readily available than it otherwise would have been. Now that the economy and the labor market have achieved nearly full recovery, that period is coming to an end, and past presumptions that the private sector will have easy credit will no longer be operative. Ironically, the more rapidly the economy recovers, and the more private borrowers step forward for credit, the tighter financial markets will be; interest rates will rise, and the federal budget will recover much less during faster growth than it did in similar episodes in the past, precisely because the public debt has grown so massively.

In the face of rapidly rising public debt and tightening in the markets, economic and financial expectations will become less “anchored.” The range of possible near- and medium-term outcomes for interest rates, inflation, and federal budget deficits will become progressively greater. As the public debt has grown and fiscal policymakers have failed to act to forestall it, all manner of financial and news sources have already begun to discuss hyperinflation as a potential policy tool to deal with the debt. Merely the prospect of such an unprecedented turn will be unsettling to the economy. The greater the uncertainty, the lesser the willingness of private-sector decision makers to undertake long-term commitments involving investment and risk-taking, because these commitments might extend beyond a future major financial inflection point.

One troubling consequence of such uncertainty would be an even stronger constraint on the availability of financing for new, small, potentially innovative businesses. Large, established businesses that have widely accepted product or service lines and that can access the long-term markets on their own will be reliable places for
investors to put their money. They will be the first to get credit. In contrast, smaller businesses that are struggling to establish new technologies and new product lines, and whose timelines to turn the corner and realize profits are uncertain, typically must borrow through intermediaries, using shorter-term loans bearing higher interest rates. In uncertain times, with a wide range of possible interest rates just months down the road, lenders such as private equity and venture capital funds would likely discount highly the prospects of a new firm. Many financial intermediaries will greatly reduce their exposure to risky ventures, leaving innovators without funding opportunities. Thus, an early consequence of a buildup of public debt would be investment hunkering down in the safe, slower-growth part of the business sector—to the detriment of economic dynamism and innovation, US world leadership, and longer-term growth of living standards. We have already seen evidence of such tendencies—with vigorous investment and innovation when the federal budget deficit was declining in the 1990s, but reduced rates of new business formation in the aftermath of the financial crisis and in the pandemic.

And in the broadest sense, times of financial stress encourage and reward financial manipulation. When the economy is growing, there is economic opportunity and profit waiting for those who provide a better product or service. When such opportunity is absent, money must find other ways to make money. Clearly, true economic growth benefits society much more, and financial uncertainty is inimical to solid growth.

**A Policy Road Map**

What can be done to halt our nation’s sickly slide into ever deepening debt and meet our budget priorities?

**Time to Face Up**

The nation cannot right its fiscal ship without leaders of both parties who recognize the peril and are willing to work together in the nation’s interest. Responsibility for difficult decisions must be shared to provide solutions on this difficult and important national problem; neither side will impose the pain alone.

Fiscal responsibility must again have a role in budget deliberations. Deficits and debt matter, and if uncontrolled they will eclipse the benefits of other budget initiatives. The answer to the multitude of challenges before the nation is to pay for them—set priorities and ensure there is revenue to meet those priorities—not through smoke and mirrors or budget gimmicks. This not only protects the nation from a fiscal crisis, it also makes the economy stronger and American lives better and more prosperous. The CBO and Penn Wharton Budget Model both have estimated that paying for new investments will do more to boost wages and income than borrowing to finance them.

Also, it is important to emphasize that spending more and more money on a problem does not always solve it. Reforms of current programs to ensure resources flow to
those that meet their objectives is as important, if not more important—whether it be education, health care, job training, or the rollout of infrastructure modernization.

Health Care
It is, of course, the operating (not the debt service) part of the budget that builds up the debt in the first place. And the largest and fastest growing operating part of the budget is health care.

As Figures 6 and 7 document, all of the net increase in federal noninterest spending as a percentage of GDP is accounted for by Medicare; the entire remainder of the operating budget is declining, not increasing, relative to our GDP. In other words, were it not for the growth of spending in Medicare, the budget problem would be much more easily managed; the budget deficit could be reduced by relatively limited changes in other spending or revenues, debt would not grow faster than the economy, and debt service cost would remain affordable. Instead, with health care costs growing so rapidly, the nation faces uncontrollable debt service costs and a potential debt crisis.

Figure 6
Noninterest Spending Is Driven by Medicare

Source: Congressional Budget Office, www.cbo.gov/publication/56977
### Medicare and Net Interest Are Sources of Increased Spending

<table>
<thead>
<tr>
<th>Source</th>
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<tr>
<td>Net Interest</td>
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<tr>
<td><strong>Total</strong></td>
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Source: Congressional Budget Office, www.cbo.gov/publication/56977

The causes of rising health care costs are fundamental and structural. The nation’s dysfunctional health care nonsystem features misaligned incentives, under which both patients and providers want more care to be delivered, with little concern about either cost or efficiency. Too many people are left out of the system at the same time as others receive unnecessary or low-value services. These same conditions afflict the federal government’s Medicare program, which is the primary source of pressure on the federal budget; as explained above, Medicare, more than any other federal activity, drives up the annual deficits and the accumulated debt, and debt service cost increases as a result. (The Medicare Trust Fund itself is projected to reach insolvency in 2026.) At the same time, the broader private system for the working-age population and their dependents strains the finances of businesses and households alike.

The nation’s health care system needs fundamental restructuring, going well beyond the changes made by the Affordable Care Act (ACA). CED has explained how, for Medicare and for the private health care system broadly, cost-responsible consumer choice among competing private health plans can cover all Americans and align incentives so that quality, affordable care is in the interest of patients and providers alike. If health plans and their providers must compete to enroll quality-conscious consumers who can save money by choosing a more-efficient plan, every part of the system will be driven by its own interest to generate value through process and service innovation. Economic incentives are known to drive better outcomes in virtually every sector of our economy—notably not including health care. If health cost growth can be slowed, the budget can be brought under control. But if health care costs continue to grow at their pace over the last half century, there is little that can be done to stop an overall budget explosion. Taxes literally cannot be raised fast enough to pay for projected health care costs.

However, although health care costs are the primary source of the budget problem, they are not necessarily—in fact, they cannot be—the sole solution. Although the leading source of rising health care spending is the rapidly growing cost of services, further cost pressure comes from the growth of the Medicare (mostly the senior) population. The size of that group is preordained by past births. Furthermore, the Medicare population in and of itself is becoming on average older because of lengthening average life spans,
and older Medicare beneficiaries need more services and therefore are more expensive
to treat. Thus, even if the growth of the cost of each Medicare service could be reined
in to no more than the average economy-wide inflation rate, Medicare’s cost would still
grow relative to the size of the overall economy. Therefore, further budget spending
reduction will be needed.

Social Security

Social Security’s cost, also, is growing because of the same population aging, but not
so rapidly as Medicare’s cost because Social Security is not affected by the rising cost
of health services. At the same time, however, Social Security leaves important gaps in
the economic security of workers with interrupted employment histories (often women,
and often people who worked at low wages). After strengthening the safety net for such
intermittent workers, Social Security’s costs could be reined in with gradual reductions in
benefits for the most-affluent workers, and with broader coverage of the payroll tax for
workers with higher wages and with generous fringe benefits that are currently not taxed.
(The Social Security Trust Fund is also projected to reach insolvency in 2033.)

Annual Appropriations and Smaller Entitlement Programs

The remainder of the spending side of the ledger includes the cost of national security,
and of a large number of smaller domestic programs whose growth is projected to be
less rapid than that of Medicare or Social Security. Both because those programs are
smaller and because they are expected to grow more slowly, they cannot by themselves
solve the budget problem, but every dollar counts. Those programs can be divided
into the mandatory or “entitlement” programs, which are a part of continuing law and
remain in effect unless they are changed; and the annually appropriated defense and
domestic programs, which shut down at the end of the fiscal year if funds are not again
appropriated. All of those programs must be reviewed rigorously to ensure that their
benefits exceed their costs.

In recent years, Congress has rarely completed an actual appropriations process (culmi-
nating in the enactment of 12 separate appropriations bills), and it is during that process
that the most rigorous oversight needs to take place. Congress must again take this
annual appropriations process seriously and fulfill its obligation to undertake it. Even
though the appropriated programs are not at the core of the budget problem, it is hard
to imagine a long-term budget solution that does not involve responsible appropria-
tions. There is legitimate disagreement over whether the appropriations cycle should be
lengthened to two years. Some argue that Congress needs more time; others counter
that under a biennial cycle, Congress would simply procrastinate twice as long. Some
experts express concern that a two-year cycle would require more-frequent supplemental
appropriations because of unforeseen developments. Some believe that a two-year cycle
would allow more time for necessary oversight; others reply that Congress has enough
time today, but simply fails to do its job—and that a two-year cycle would at best result
in half as much oversight, just once every other year. Whatever process Congress might
choose, it should commit itself to execute that process—which it is not doing today.

Similarly, if there is to be any progress, Congress must again each year complete its
annual budget resolution, through which it can assess the budgetary situation in a holistic
way. It is in a budget resolution that Congress can initiate a reconciliation process to set targets for achieving savings in the entitlement portion of the budget. Deficit reduction, not tax cuts or increased spending, was reconciliation’s original intent. Some say that we have a budget problem because Congress has rarely in recent years completed a meaningful budget resolution; others say that Congress cannot bring itself to complete a serious budget resolution because the budget numbers are too terrifying to acknowledge on paper. The latter is surely closer to the truth, but again, once Congress determines to get serious about the budget problem, it should and must follow the budget process set forth in law. And if Congress and the president cannot take on both the substantive and the process issues in a timely fashion, they should constitute a successor to the National Commission on Fiscal Responsibility and Reform (the “Simpson-Bowles Commission”), or even a legislative body on the model of the “super committee,” with the strongest possible mandate to begin a serious national conversation on the debt and provide guidance and motivation.

Revenues
In addition to spending restraint, any long-term solution to the budget problem will require greater revenues. The nation’s demographics are inescapable. Life expectancy has increased with virtually every birth year over at least the last six decades, and over that time has increased by about nine years. The result has been a growing population of seniors collecting Social Security benefits, and demanding more, and more-expensive, health services under Medicare. Totally, in addition to general population aging, the oldest of the enlarged baby boom generation, those born in 1946, became eligible for actuarially reduced Social Security benefits in 2008, and for Medicare benefits in 2011; the youngest vintage, born in 1964, will begin collecting Social Security in just four years, in 2026, and Medicare in 2029. In contrast to this dramatic demographic shift, the federal government’s revenue collections have remained essentially static at about 17 percent of GDP (and are only about 16 percent now). Revenue collections that were inadequate with a younger population and relatively more working Americans during the earlier post-World War II years will by no means be sufficient for the older population with relatively more retired Americans in the coming decades of the 21st century.

The nation’s primary revenue source, the income tax on individuals and corporations, is challenged on many fronts. It is complex, it distorts taxpayer economic choices, it is perceived by many citizens to be unfair, and it does not provide sufficient revenue to meet the needs of the population. Like many other national institutions, it needs fundamental reform. Broad principles of taxation have been tested by time: Different sources of income should be taxed the same. Special treatment for different uses of income should be avoided. Work should be encouraged through supplements for low wages. The needs of families with children should be recognized. Reforms must adhere to our fundamental principles that tax rates should be progressive and should be as low as possible consistent with revenue needs; limiting incentives and subsidies in the tax law will help to keep tax rates low. Historical episodes of tax reform consistent with these principles have been conducive to economic growth and budget improvement. If income tax reform on these terms does not yield sufficient revenues, policymakers should consider additional sources consistent with these principles and with continuing budget discipline. And although income taxes are the primary source of revenue, combined they account for
only about 53 percent of the total. The social insurance payroll taxes contribute about 38 percent and must contribute part of the funds needed to make Social Security and Medicare financially sustainable.

The Continuing Pandemic: First, Do No Harm

Now, in 2022, Congress is considering legislation in response to the continuing coronavirus pandemic. Although the virus continues to threaten the public health, the US economy has recovered far beyond even the wildest hopes of the early days of the outbreak. The GDP has regained its pre-pandemic level, and the unemployment rate has registered below 4 percent. The economy clearly does not need any further economic stimulus. However, if Congress should pass further pandemic-response legislation, it should be fully paid for, with no future costs hidden by delayed effective dates or deceptive expirations that are not intended to take effect. Any public investments in such legislation must be high priorities, such as preparing for the next pandemic or crisis, that the nation finances by forgoing lower priorities of equal or greater cost. And as our elected representatives make those decisions, they should prepare to make further choices among priorities—including deficit reduction—at an early date.

Segregate, And Solve, The Pandemic’s Damage

CED continues to urge policymakers to take on the debt impact of the pandemic. With the economy all but fully recovered, we would estimate that this “pandemic debt” (the sum of the loss of revenue and increases in spending caused directly by the pandemic, and the cost of that policy response) would be about $6.5 trillion. Financing that one-time (perhaps once-in-a-lifetime) cost separately from the ongoing public debt makes sense, both as a first step toward an overall debt solution, and to demonstrate the nation’s determination to restore fiscal responsibility.

Interest rates are still very low, and the financial markets have shown themselves willing to consider very long-term securities. We believe that there is merit to consolidating all of the pandemic debt in a single separate financial entity (probably organized as a public corporation) and financing it with fixed-rate bonds with a 40- or even a 50-year maturity (or longer, even 100-year, if the markets will accept it)—longer than the 30-year Treasury bonds that are the longest the federal government sells today. With such a commitment to fiscal responsibility, we could expect that the financial markets would accept low interest rates on these bonds, and that the Federal Reserve would increase interest rates more slowly in light of the nation’s more responsible fiscal policy.

For credibility with the financial markets, the nation must set aside the additional, incremental funds to pay the interest bill pursuant to our core objective of financing the pandemic debt without increasing the total public deficit or debt. The bill for pandemic debt can be paid, effectively and credibly, only through the imposition of a dedicated tax. The public corporation that issues the bonds to cover the cost of recovery must have the sole claim on the additional revenues. With that tax so identified with the servicing of the pandemic debt, any change in use of the tax would be a clear violation of the nation’s commitment to service and retire the pandemic debt and so would most likely be subject to careful scrutiny.
The cost of servicing the pandemic debt, with the long-term, fixed-rate financing that we recommend, would be a fixed number of dollars each year. We recommend that the dedicated financing revenue source be calibrated to overproduce its target somewhat, not only for safety, but also to allow for gradual retirement of the pandemic debt. If the funding source grows with the economy over time, that would further aid in retiring the pandemic debt by the time the bonds mature. Once the pandemic debt is retired, the tax for servicing and retirement would sunset. This step would be perhaps the greatest signal of credibility that the nation could send quickly and convincingly to the financial markets.

Conclusion
The nation’s budget problem is large and worsening. It will not fix itself. Its consequences are potentially catastrophic, but they may not announce themselves through chaos in financial markets. Instead, there may be years of slow erosion of the nation’s economic strength, which will be felt in reduced prosperity and weakened leadership in a hostile world.

Policymakers will need to make difficult decisions about setting priorities, paying for them, addressing the nation’s heavy debt burden, and leading their constituents to accept them. Very soon, this nation will have no choice—because debt does matter.
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 postwar 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 2021 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.