

[Transcript] The Daily / The Problem With a \$2 Trillion Deficit

From New York Times, I'm Michael Boboro.

This is The Daily.

On Friday, the U.S. government reported that over the past year, the federal deficit, the gap between what the U.S. spent and what it earned, doubled to nearly \$2 trillion.

That figure seems to validate the worries of congressional Republicans about government spending, which have been at the center of the messy fight over who should be House Speaker.

But as my colleague, Jim Tankersley, explains, the Republicans' plans won't come close to solving the problem.

It's Monday, October 23rd.

So Jim, \$2 trillion, we now know, is our deficit for just the last year.

And I'm not an economist.

That seems like a huge number, and I'd like you to put that into perspective.

It's a big deficit.

It's twice the size of the deficit last year, so a big jump.

It's only the third time in American history when we've had a \$2 trillion deficit, and the first two were in the depths of the pandemic.

We were in a really different economic place than we were those last \$2 trillion deficits.

We're not just reopening from the pandemic, we're back.

And usually, when an economy is growing rapidly, like our economy has been over the last year, deficits go down, but this one did not.

Now Jim, deficits are always a tricky subject.

Republicans talk about it now all the time.

In fact, they have put it at the center of this chaotic speakership fight that they're now having.

Yet, you have trained us through many long conversations to understand that deficits aren't necessarily that big of a deal.

So how much should we really care about this \$2 trillion number?

I think we should care a lot.

And people I know, smart people who I talk to for my stories, who have for a long time said, don't worry about deficits, don't worry too much about deficits, are starting to worry more.

And it's because of two big changes in circumstances, right?

We update our views based on the information that changes around us.

The first big change is that you don't normally run big deficits when the economy is growing, and so that's an alarm bell in itself.

Historically, when you get growth, what happens is that the government brings in more taxes, because people are earning more money and spending more money, and the deficit usually goes down, but not here.

But the second reason why a lot of economists worry about the deficit right now, when maybe they weren't even a few months ago, is how much it's costing the country all of a sudden to borrow all this money we need to cover the deficit.

Paying costs for the federal government have shot up in the last few months, and if they stay high, that is going to become this sort of feedback loop for deficits.

We pay a lot more on interest, and therefore we have to borrow more to pay the interest,

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and that could become a really bad cycle for the government and the economy.

You're describing a kind of financial double whammy that sounds very grim.

I want to get to the root causes of these two changed circumstances you're describing.

The fact that our deficit doubled despite a healthy economy, and the fact that our borrowing costs to make up for that deficit have grown so quickly.

So let's start with why our deficit got so big in the past year.

The biggest reason is the amount of tax revenue that we brought in last year as a country was just way down, down by like 9%.

Why was that?

Well, we cut a bunch of taxes over the last couple of decades.

That includes the Trump tax cuts, which passed in 2017, but we knew about those Trump tax cuts, we knew they were going to hold down revenues, and revenues still came in lower than forecasters expected.

And that was because of all sorts of weird little reasons.

Capital gains taxes, like what happens when you sell a stock, they went way down.

Tariffs revenue went down.

We just bought less stuff imported from other countries.

There were natural disasters all over the country that caused the IRS to change some tax filing deadlines for like people in California.

And so they didn't have to pay certain taxes before the end of the fiscal year.

All of that added up to this huge drop in tax revenues.

So the big thing that happened here is that we took in a heck of a lot less tax money than we did the year before.

But as we all know, deficits happen when our spending outstrips our tax revenue.

So I'm curious, did we spend a lot more, even as this tax revenue fell by, I think what you said, 9%.

It's not a secret we're spending a lot of money right now in this country.

For example, on the war in Ukraine, we're about to spend even more money on the war in Israel.

Is that a factor in this deficit?

Actually not a very big one.

Spending didn't actually go up very much last year, even with what we spent in Ukraine.

I know Republicans like to talk about this a lot, but this type of sort of emergency defense spending aid to foreign countries is mostly short term and it's not very big in the context of the overall budget and certainly not very big in the context of our long haul budget problems.

So spending didn't go up by nearly as much as tax revenues fell.

The big driver here is taxes.

It's that surprisingly big drop in tax revenue.

Okay.

Clearly we have a tax problem.

Now, Jim, walk us through this second big change you alluded to before that compounds this problem, the high cost of borrowing money to fill our deficit gap.

Okay.

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So when the government takes in less money in tax revenue than it needs to spend on government services, it has to borrow the money.

And there's a way that it borrows the money.

It issues bonds, treasury bonds.

And when interest rates are low in the economy, which they have been for a really long time since the 2008 financial crisis, the cost of borrowing for the government is not very much.

It's able to sort of to go out, get a bunch of money, not have to worry about paying a lot more back.

And so the total interest costs that it's paying as part of its budget are low.

But now what's happened is the interest rate of a 10 year treasury bond has been hovering right around 5%, which is significantly higher than we've experienced in recent years.

If it stays at 5% for a long time, that means significantly higher interest costs for the government, which means it's going to need to borrow more money to pay those costs.

So basically it sounds like the government is facing the same financial scenario that everybody else in America is facing right now, which is higher interest rates on their loans to buy a car, to buy a house.

If you want to go buy a house right now, instead of paying 2%, 3%, which you did a decade ago, you're paying 5% or even more percent.

And it sucks.

Right.

It's really rough for the government's balance sheet.

That's a lot to be paying an interest at a time when you're going to have mounting interest costs and mounting deficits anyway.

Okay.

So just walk us through what the world looks like for a country with as much deficit as we have and a 5% interest rate cost of borrowing.

So last year, by the way, interest rates were not 5% for all of last year.

They were lower for a while than they jumped in recent months.

But last year, the federal government spent \$659 billion just to pay interest on the national debt, just for interest.

Wow.

And if rates stay at 5%, that number is going to go way up.

Right.

That's a tremendous amount of money to have to take out of the economy just to pay interest.

I'm thinking of all the good that money could do if we didn't have to spend it on interest on debt.

Perhaps it could be used to build a bridge, infrastructure, technology, childcare, whatever, something else that would benefit a lot of people.

So yeah, this is one of the worries about higher interest costs is that that interest cost starts to what's called crowd out other spending.

So maybe we can't build more bridges because we have to pay this interest.

Or maybe we have to reduce Medicaid benefits and healthcare to people who really need it.

The big worry is that if Congress doesn't want to get into this ongoing big spiral of

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bigger deficits and higher borrowing costs and more and more of the federal budget going to pay interest on the debt, lawmakers are going to have to make some pretty tough choices about taxes and spending.

And I don't know if you've been watching Congress lately, but they are not exactly really good right now at making tough choices.

Or any choices.

Or any choices.

But let alone truly tough choices.

Right.

Jim, we just agreed that it's a tough time in Washington to confront the financial challenges we're talking about.

I do want to pause to note that Republicans in their own very complicated and to many people dysfunctional way are talking a lot about deficits, spending and debt right now.

So I want to talk through that and make sense of how Republicans and in a few moments Democrats are thinking about the scale of the deficit in this moment and these higher borrowing costs.

Let's start with the Republicans.

Republicans have been warning for more than a decade that America's deficits were too high and that we needed to bring them down.

With the exception of when Republicans were president.

And that is an important thing to keep in mind here.

They passed a large tax cut under President Trump and deficits went up and they didn't complain in the way they are complaining now.

With some exceptions, there are some Republican fiscal hawks who have complained throughout in a bipartisan fashion.

But those Republicans who do talk about deficits and have sort of consistently over the years, what they're really talking about is reducing spending levels and the size of government.

They don't want to increase revenues.

They want to reduce the amount that the government is spending and what those Republicans who are clamoring about deficits are talking most about is a very particular type of spending, which is non-defense discretionary spending.

Just to find that.

It includes a bunch of things that are like fairly popular, national parks, the Department of Education and other things keeping the business of the government running day to day.

Pretty small in the context of a budget that also includes national security and large social programs like Social Security and Medicare.

And so here is the way that I think about it.

If the deficit is sort of a leak in the whole of our national budgetary boat that is growing over time, you could think of non-defense discretionary as the rain falling on the deck.

Not where the water is really coming into the boat.

There is water coming in.

It's not the big driver.

You could cut it to zero and still not solve the problem.

So you could stop the rain.

The whole is still going to be there.

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And I think if all you're focused on is these cuts that they would like to see in discretionary spending, you're not anywhere close to making a dent in the problem.

And the best sort of hope you would have as one of the advocates of that plan is that you've taken a meaningful first step.

But it is not a solution and they are not arguing over an actual way to change the course meaningfully of the national debt.

That's really helpful context.

So what about Democrats and President Biden?

How do they talk about these deficits and the borrowing costs and the threat of the two of them interacting in all the ways that everyone now fears?

If I'm being honest, I don't feel like Democrats as a party talk all that much about the deficit.

Yeah, the Biden administration has been really tough to pin down on this.

The president and his advisors won't tell you exactly what they think the ideal deficit number should be.

They just say they want it to be fiscally sustainable.

They're not trying to balance the budget over time.

None of their proposals have done that.

But they do think that we need more tax revenue over time to make that sustainability happen.

So what they've settled on is proposing deficit reduction with things they think voters will really like.

Like what?

That's mostly raising taxes on corporations and rich people.

In short, Democrats mostly want to reduce deficits by raising taxes at the top.

And Republicans entirely want to reduce the deficit by cutting spending.

You've already said that the Republican plan isn't really up to the scale of the problem.

Is the Democratic plan potentially the tax plan up to the scale of the problem?

Very few budget experts think that's possible entirely with tax increases on the rich and certainly the amount of tax increases that the president has proposed now is probably nowhere close to enough to actually stabilize the debt and deficits in a world where borrowing costs stay really high.

So what the world really needs is some sort of a Goldilocks solution that takes the Democrats' instincts perhaps to raise taxes and marries it to the Republican instincts to cut spending.

This is where we get into the real hard choices problem.

The sort of think tank industry around stabilizing the budget in Washington basically agrees that you need a mix of two things to stabilize deficits.

The first is some tax increases, which Republicans refuse to do.

And the second is a thing that President Biden has unilaterally ruled out.

All Democrats basically rule out.

And most Republicans also rule out, including former President Trump, which is reducing government spending on Social Security and Medicare.

The big entitlement programs, right?

Right.

And so that's what the fiscal hawks say, hey, we need to make some changes over time, we can raise some taxes, we can reduce some benefits, and that's the Goldilocks solution.

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But in this case, it's like everybody hates Goldilocks.

And so it's going to be a very difficult, I mean, it's just a very difficult conversation for Washington to even start having about the actual drivers of debt when seemingly tax increases are off the table and so are the big spending programs that are responsible for the big projected growth and spending in the years to come.

Well, when was the last time we got even close to this Goldilocks style solution?

Yeah.

So the last time we had a fiscal trajectory that got itself not just to stabilize deficits, but an actual balanced budget was this magical time you might remember, Michael, called the 1990s.

Oh, yes.

I was running because I thought we ought to change the direction of the country.

I was worried about the decline in middle class incomes, the growth of the underclass, an exploding deficit, a declining level of investment.

Bill Clinton was president, and first he and Democrats raised some taxes.

And then when Republicans took over the House of Representatives, Clinton worked with them and agreed on some spending cuts.

It seems to me that a lot of our problems are not particularly partisan in nature.

Clinton would make a point about this.

Having said that, I'd like to now bring the speaker on, let him say a word or two, and then we'll get on with your questions.

Mr. Speaker.

Early on, he even did a town hall with the Republican Speaker of the House, Newt Gingrich, to just talk about how they were going to bring down the deficit together.

I believe in this process, working with the president, with the House and the Senate, with the governors, I believe we can get to a balanced budget in a positive way, but it's got to be done exactly like here today.

So I hope, with your permission, the president and I will now have a dialogue with you and maybe-

And then we got a bunch of great economic growth, and all of that combined to actually balancing the budget for several years at the end of the 90s.

Right.

A truly balanced budget.

Same money coming in as went out.

Yes.

For the kids out there, it once happened.

It once happened.

And I think really, crucially, the sort of engine behind Clinton's efforts to do that was an actual economic theory that has now become associated with the guy who was his Treasury Secretary, Robert Rubin, Rubinomics.

And the idea of Rubinomics was, if you can reduce the deficit and maybe even balance the budget, then you can actually stoke more economic growth.

And you do that because lower deficits help to relieve pressure on interest rates.

They can help interest rates fall in the economy.

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And the idea being lower interest rates mean more people borrow money to buy houses or cars or whatever.

There's more economic activity.

You can get a growth bang for deficit reduction.

And that theory totally fell out of favor among Democrats in particular in the last couple of decades.

Why?

Because economic conditions changed.

Interest rates were low.

And there wasn't going to be much of a bang for deficit reduction in reducing rates that were basically zero across the economy.

But now that they're climbing again, now that that 10-year Treasury is back around 5%, you start to hear some whispers from some people around Washington about, could Rubinomics make a comeback?

Could Democrats, Republicans work together to reduce the deficit and by bringing down the deficit, sort of stoke more growth.

And lower the cost of all that borrowing.

And lower the cost of all that borrowing, exactly.

And so I'm not saying we're there yet, but there is speculation that we may be nearing another one of these Rubinite moments where a reduced deficit could help grow the economy and create sort of a virtuous cycle where more growth helps bring down the deficit further in the future.

Right.

And government money is freed up to do the kinds of things we were talking about before, like maybe invest in childcare.

And if the government invests in childcare, maybe a parent who puts their kid in childcare opens a business and that business is a success and it generates more tax revenue, which we know from last year we need, that's the virtuous cycle you're talking about.

Lots of good things can happen.

That would be sort of the platonic ideal of the virtuous cycle there, or the Rubinite ideal of the virtuous cycle there, you might say.

But this is the part where I guess we have to be very honest that neither party, even if they decided one day that Rubinomics was the solution, seemed all that inclined to accept the version of economic events that would be required to pull it off, right?

Democrats don't want spending cuts, Republicans don't want tax increases, and Congress is split in this moment.

Yeah, it's basically impossible for me to imagine President Biden standing up giving a State of the Union speech and saying, we need trillions of dollars of new taxes on rich people and corporations in order to bring down the deficit.

We're not going to spend them on anything else, we're going to bring down the deficit.

And Republicans are plotting him and sending him a bill to do it.

I just don't think that's possible.

They have opposed tax increases as a party for a very long time and I don't think there's any chance they would go for something like that.

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In the same way, it's hard to imagine Democrats in Congress who, to be very clear, would like to raise taxes in order to spend that money on more programs like childcare.

It's hard to imagine them agreeing to even steeper cuts in spending from Republicans particularly ones that touch cherished programs like Social Security and Medicare.

That's not where they are as a party either.

And so you're at this moment where really it is very difficult to imagine either party adopting the other party's view of what vehicle is the right one to take to reducing the deficit.

Even if they could agree that reducing the deficit might be a good thing.

And so I think probably what you're really looking at is more economic disruption as possibly the only thing that could be a forcing agent by which I mean, if you think a 5% bond is bad, wait till it goes higher.

If borrowing costs go from five to six to seven to eight, you might see people's positions change a bit, but I don't even know then.

I really think that the fiscal problem is so wrapped up in the great political impasse that we are in in this country and the sort of inability of lawmakers to find common ground that it seems very difficult to imagine anything close to a resolution for this anytime soon.

Right. What you're really getting at is our political dysfunction begets our fiscal dysfunction and then our political dysfunction ensures that there's no solution for our fiscal dysfunction.

Yeah, I think that's exactly right.

And that is kind of the really difficult thing about fiscal debates, particularly in Washington today.

There are not easy low hanging fruits to pick that actually make a difference in these deficit issues and the ideas that smart people have on the table are at best Hail Marys to actual progress.

Well, Jim, thank you very much. We appreciate it.

Thank you, Michael.

We'll be right back.

Here's what else you need to know today. With an Israeli ground invasion imminent, Egypt opened its border to allow for humanitarian aid to enter Gaza for the first time since the war began. But with food and fuel cut off to the territory, Palestinian leaders called the initial convoy of 20 trucks entirely insufficient to meet the needs of the two million people inside of Gaza. The precise timing of an invasion remains unclear, but clashes between Israel and its Arab neighbors, Lebanon and Syria, intensified over the weekend, raising fears that the conflict could quickly widen beyond Gaza. In an effort to prevent that, the US said it was supplying Israel with new air defense systems that would allow it to repel missile attacks from its neighbors. Meanwhile, President Biden spoke with the two American hostages released by Hamas on Friday, a mother and daughter from Illinois who were visiting a kibbutz when they were kidnapped. Ann, at least 10 Republicans have announced they will run for Speaker of the House since Friday, when the party voted to reject its latest nominee, Representative Jim Jordan of Ohio.

As of today, the House has operated without a Speaker for the past 19 days, bringing much of the chamber's work to a halt. Today's episode was produced by Alec Stern, Eric Krupke, Summer Tamad, Jessica Chung, and Sydney Harper. It was edited by Mark George and Lisa Chow.

Contains original music by Marion Lazano and Alicia Beitu, and was engineered by Chris Wood.

Our theme music is by Jim Brunberg and Ben Leansverg of Wunderland.

That's it for the Daily. I, Michael Babarro, see you tomorrow.