

THE **NEW** BAZAAR

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DEBT AND DEFICITS: TIME TO WORRY?

MARTHA GIMBEL ON HOW THEY ALREADY AFFECT US

CARDIFF GARCIA: Hey everyone, Cardiff here. This is *The New Bazaar*. It is really hard to get normal people to care about the government's deficit or the national debt. For example, ask yourself if the following numbers mean anything at all to you.

The total US national debt right now is about [\\$31 trillion](#). That is the money that the government owes to holders of US Treasuries. That's now roughly 100% of US GDP, and it has not been that high since right after World War II. And it is projected to keep growing.

The amount of interest that the government pays on all that debt as a share of GDP is now [more than 3%](#), [double](#) what it was just five years ago, and that too is projected to keep growing. Both numbers are growing because the US runs a deficit every year. It spends more than it receives in taxes. Those deficits have been huge in recent years.

Now, did you care at all about anything I just said? I ask you again because you should. A lot. It is already affecting you even if you don't realize it.

So says today's guest, my friend Martha Gimbel, the executive director of the Yale Budget Lab and a former guest on *The New Bazaar*. The debt, the deficit, where they're going, and above all, why you should care. All coming up.

Martha Gimbel, welcome back to *The New Bazaar*.

MARTHA GIMBEL: Thank you for having me.

CARDIFF: You are, in addition to being an economist, a human person as well.

MARTHA: Sadly.

CARDIFF: Not all economists are. (CHUCKLES) Exactly.

MARTHA: Yeah, I mean sometimes.

CARDIFF: (CHUCKLES) Most of the time.

MARTHA: Yeah.

CARDIFF: I bring it up because you have both a professional reason for analyzing the debt and deficits — you're the head of the Yale Budget Lab — but also a personal one. You've got an almost two-year-old kid and you also have a minus one-month-old. You've got a baby in the ov — no, not a baby in the oven, a bun in the oven.

MARTHA: Yeah, let's not put the baby in the oven. (LAUGHS)

CARDIFF: We have with us today, child murderer Martha Gimbel.

MARTHA: (LAUGHS)

CARDIFF: So when people talk about the deficit and the national debt, a lot of times the way they frame it is like, we have to take care of this because we can't leave it to our children and our grandchildren to pay it back. You have kids, young kids. So do you think about it that way? Is that the right framing or is that kind of a wrong way to think about the deficit and the debt?

MARTHA: I don't think about it that way, which may be that I'm a bad mother or a bad economist.

CARDIFF: (LAUGHS) That's what we're driving at here.

MARTHA: Yeah, exactly. The thing that I have been thinking a lot about recently is that a lot of the times when we talk about debt and deficits, it's this kind of boogeyman in the room of like, you've got to take care of your debt and deficits or eventually the fiscal crisis will come and get you. And to be clear, I would prefer that the fiscal crisis not come and get us. That seems very stressful.

CARDIFF: Right.

MARTHA: But I think one of the things that we've been trying to really emphasize at Budget Lab is that this kind of deficit spending and building up of debt stocks the way we have has economic consequences now, which is another

way of saying, I don't worry about debt and deficits because I'm not worried about my children. I'm worried about me, and how this is affecting me today.

CARDIFF: Yeah. The thing that always bothered me about this framing is that it has gone on for so long. You can go back to the '70s and find articles that say, a politician saying, "Oh, we got to take care of the debt and deficits because our grandkids, we can't leave it to them. It'll be a huge problem for them."

Well, their grandkids are now grandparents, and paying off the government's debt has not yet become an issue. There hasn't been some crazy fiscal crisis, like you've said, where everybody's freaked out about the government's ability to pay off its debt or to pay the interest on the debt and so forth. This is about how we have arranged our society and how we've arranged the government's finances and so forth, but framing things that way, I think often turns it into this very emotional thing and it makes it hard to just assess it rationally.

You know what I mean?

MARTHA: Well, and it's also hard because there's a little bit of, I think, the boy who cried wolf on this topic. For your point, people have been saying, "We're going to have an issue when the debt-to-GDP ratio crosses X percent." And then we cross X percent and things seem kind of fine. And then people go like, "No, no, no. It's actually like, wait till we hit Y, that's going to be really bad." And then we cross Y and things still seem kind of fine.

And so I think there's been too much of hanging our hats on specific points that seem scary or specific amounts of debt, and there's a broader conversation, right? The US government is not a household. It is not the case that it has to spend less than it takes in. It thinks about things on a much longer timeframe. It can borrow money in order to make very long-term investments. It wants to spend money. For instance, when there's a recession, you want to have a countercyclical response.

The issue is that you can keep justifying all of those things and then eventually things just kind of creep up and creep up and creep up, and you can get to a point where, one, you are increasing the risk of a fiscal crisis, though there are various things holding that back, which we can discuss, but that you're also driving up interest rates in a way that's affecting all of us.

CARDIFF: Right now?

MARTHA: Right now.

CARDIFF: Yeah. We're definitely going to talk about that, but I like the way you're describing it there in part because it does get at this thing, which is that we don't actually have a concrete idea of just how much debt ends up triggering a massive fiscal crisis, but it doesn't mean that there aren't things that happen along the way.

So you mentioned the fact that a lot of economists in the past, a lot of people generally have said, "Well, there might be this point in time at which this becomes very dangerous." From the other direction, there've also been a lot of people who have said it will never become a problem, that the US is huge. It's got a powerful economy, it borrows in its own currency. And so yeah, you can worry about some immediate issues like if you spend too much right now, you'll get inflation, but there can never be an actual fiscal crisis.

And that also, I think, tends to be a dangerous way of thinking, right?

MARTHA: Yeah. I mean, part of the thing that's been really protective for the United States is it's kind of like a mafia-esque environment in some ways. What are you going to do? Lend to the Eurozone, really? Okay, go lend to New Zealand. Have fun with that.

We are the, I mean, not even 800-pound gorilla, three-ton. Can gorillas be three tons? Let's go with three tons. I don't know.

CARDIFF: Three tons? Probably not, but three tons is like a car. Are gorillas... No, I don't think—

MARTHA: Anyway. But we're something very... We're the blue whale. We're the blue whale in the ocean.

CARDIFF: I'll buy that.

MARTHA: Yeah.

CARDIFF: Gorillas are big and strong and scary, even if they don't weigh literally three tons, by the way. (CHUCKLES)

MARTHA: Yeah. There's a lot. Whatever it is, we are that in the room.

Treasuries underpin a lot of the global financial system. We have a relatively stable government. We've never defaulted on our debt, all of these various things. And so we occupy this kind of special place in the ecosystem that other countries don't, and so they're more vulnerable than we are.

Now, on the other hand, I think one thing to keep in mind is that we didn't always occupy that place in the ecosystem. It used to be the UK, or Great Britain, or whatever we were supposed to call it in 1899, right? And they eventually lost it to us. My apologies to the English.

CARDIFF: Not me. No apologies at all.

MARTHA: (LAUGHS)

CARDIFF: Come for it if you want, but no way.

MARTHA: Yeah, exactly. Got to keep it together, guys.

There was a lot of angst from economists in England at the time going like, "Ooh, wait a minute, this is looking bad for us. What if people move away from the pound and people move away from our debt?" And they did. They moved to the United States because it was more appealing. It was more economically dynamic, et cetera.

The thing right now is that there's no alternative, right? Joking aside, the Eurozone has various issues. People have concerns about entrusting money to China, and people will sometimes come up with some examples of like, "Well, you could send your money to Switzerland." Yes, you can. We've seen already some outflows to Switzerland, but there's only so much money that Switzerland can absorb.

One thing that the US gives to capital markets is we issue a lot of debt and we can absorb their money.

CARDIFF: Often described as a big, deep, and liquid market. If you sent literally all the world's money to Switzerland, interest rates would tank and then there'd be no point in sending anything.

Yeah, I get it. One issue that people bring up as well is that, well, what if a lot of the Treasuries end up being bought by foreign institutions, foreign individuals? And so I was looking up the statistics here. I went to the [Congressional Research Service](#). In 2008, right around the time of the financial crisis, a little more than half of Treasuries were owned by foreigners. Now that share has been cut roughly in half. Most Treasuries are owned by other Americans.

So I often think of it as — well, not just me, a lot of people point this out — it is Americans owing money to each other and that maybe that staves off the risk of a crisis as well because this is kind of an internal, partly an internal issue.

What do you think about that?

MARTHA: Maybe. I mean, the other issue is that individual investors can in some ways be more fickle than other governments. They're going to want to send their money to where they can get higher returns. And so if you're relying on the goodwill of the American people—

CARDIFF: Not goodwill, but it's not a problem if we're paying more and more interest on the debt each year. Well, that interest is going to other Americans, so then they're making that money. You see what I mean?

MARTHA: Yeah. I mean, you're getting these very cyclical—

CARDIFF: Circular kind of things.

MARTHA: Circular kind of arguments. The thing that I'm kind of trying to point out is if people worry about the debt and investors having a knee-jerk response all of a sudden going like, "Oh, wait a minute, it's time to panic. I want to sell off." And then that causes a problem in Treasury markets. It is likely that is more likely to happen with a bunch of individual investors than a bunch of big governments that may be more concerned about the impacts of dumping the debt versus one individual investor who wants to throw all of their money into Microsoft debt or something like that.

CARDIFF: You just published [a piece in *The Atlantic*](#) and the argument you're making is that deficits have gotten high enough, the debt has gotten high enough now, that it has already started to affect people's standard of living, people's ability to pay certain things. Take us through the argument.

MARTHA: Yeah. So I think this is kind of one of those stealth things that's driving up costs for people that they don't really see.

So one of the things that economists have looked at is the impact of this kind of rising debt load, deficit spending, on interest rates. And one of the things that it does is it drives up interest rates because of something that economists call crowding out.

Basically, yes, we have these deep, liquid capital markets, but there's still only so much money that is willing to lend. And so when you increase the amount of money that the federal government is having to borrow, that means that you, me, whoever's listening to this podcast, if we want to take on debt for getting a mortgage, buying a car, starting a small business, we have to compete with more

and more Treasuries for that private money. And the way you compete is you offer higher interest rates.

And so basically it drives up interest rates for everyone.

CARDIFF: You also did some calculations on how it would affect people's mortgage payments, auto loan payments, and small business loan payments. And here's what you write: the borrowing costs for mortgage payments have gone up by about 2,500 bucks a year, or \$76,000 over the life of the loan. That's a lot. And you base it on decisions that have been made in roughly the last 10 years, right?

MARTHA: Yeah. So this is off of [work done by Abhi Gupta](#), who's with us at the Budget Lab. And what he did was look at basically decisions that Congress made to spend since 2015 and looked at how much, if you were going to buy an apartment or a mortgage today, how much that has driven up costs.

The 2,500 number is for the average mortgage that people are taking out, so around \$400,000. If you want, you can go to the [Budget Lab website](#) and plug in your own mortgage and see how much it is costing you.

I did that and then I screamed very loudly.

CARDIFF: (LAUGHS) Wait, tell us the number.

MARTHA: No, I'm absolutely not telling you the number because then people can back out the cost of the house.

CARDIFF: All right, fine. Was it above the \$2,500-a-year average position?

MARTHA: I live in the District of Columbia, so the average cost of housing here is higher than—

CARDIFF: But that's a meaningful difference, and part of what you're trying to assess here is the extent to which the political decisions of the last 10 years — and I take it that the big ones are what, the big Tax Cuts and Jobs Act of 2017 and then some of the COVID spending as well.

MARTHA: Yeah, exactly.

I think that this gets at a really important part of this entire discussion, which is you talk with people about debt and deficits at cocktail parties — or at least I do, because I'm an economist.

CARDIFF: (CHUCKLES) Do you really?

MARTHA: I do.

CARDIFF: I try to drag it out of people at non-economist things. But what do you tell people at cocktail parties?

MARTHA: So I am an economist, so what I tell them is it depends.

But I think the other thing, if you're talking to people and you're trying to say, "We're at this point, interest rates are really high, we need to take this problem seriously," and they'll go, "Yes, 100%, what can we do about that?" And you'll name six different policies, which may or may not be good ideas, and people will immediately be like, "Oh, we couldn't possibly do that. We should deficit spend on that."

And so you end up with this situation where people are always willing to deficit spend on something that they think is a good idea, but the things that other people want to do, those people should have to pay for.

My thing I can always borrow money for, but your thing you have to pay for. And if you compound that over years, no one ever pays for anything.

CARDIFF: You worked at the Council of Economic Advisers under President Biden and I think under President Obama as well.

MARTHA: Under both. Yeah.

CARDIFF: Curious to know, do you get flack from the left when you bring up the crowd-out issue? Because there's a lot of—

MARTHA: (LAUGHS)

CARDIFF: No, really, because there's a lot of, like, "It's not a real thing. It doesn't kick in and we can definitely spend money. Oh, now you're telling us we can't spend on this, but we can spend it on tax cuts, stuff like that." A real effort to sort of deny that crowding out's a thing. I'm just kind of curious what kind of flack you've gotten.

MARTHA: So yes, but I think in general, everyone just loves deficit spending now.

I mean, I was testifying before Congress and I was trying to make the point that these various tax cuts had cost us a lot of money. We lost revenue because of all of the different tax cuts we've been doing, and someone said, "Well, we had to do that because otherwise the tax rates would've risen and that would've been bad and people would've had to pay higher taxes."

I'm like, "That is true, right? Because we passed these tax cuts, people are paying less in taxes than they would have otherwise." That is true. It's also true that that has costs.

And people in general, this sort of goes back to the thing of people just don't want to pay for their favorite policy. They just want to have dessert, and I get that. I also just want to have dessert, but there are costs to only having dessert, and so you kind of have to figure that out.

But also, if you're proposing a policy, everyone always loves the policy, but no one ever loves the pay-for.

CARDIFF: So as head of the Yale Budget Lab, are you like the least popular person at any of these cocktail parties because you're the one saying that, sorry, your tax cuts add to the deficit. Sorry, your spending plans add to the deficit. And when you're like, "Here's what reduces the deficit," everyone's like, "Get the hell out of here. I'm not going to do that."

MARTHA: And to be clear, you can reduce the deficit in ways that I think many of us would think would be a bad idea. So for instance, one quote-unquote solution is to just totally get rid of Social Security. Then we have solved our deficit problem. I don't think most people think that that's a good idea.

It is not the case also that you should just raise tax rates to 90% or slash social safety net spending to zero just to solve the deficit. All of these things have costs, all of these things have benefits. The problem is that when you're not talking about the costs of rising debt and these high deficits, you're leaving a part of the equation out.

And that's why I'm the least popular person at cocktail parties, right? Because I'm just like, "Well, it's these different things."

CARDIFF: You're such a charming person that I feel like you can get it back.

MARTHA: Sure. Let's go with that. (LAUGHS)

CARDIFF: You start talking about debt and deficits and then it's like, all right, bad start to this. Let's pivot to movies or something like that.

MARTHA: Yeah. Theater.

CARDIFF: Or theater.

I want to just be explicit about what the actual dangers are of rising deficits and the debt, right?

You've already kind of outlined one. You've already found that the danger has in fact become a reality, which is if interest rates are higher because people see that the debt and deficit are projected to rise, then that makes some costs higher for people, right? Starting a business, borrowing money for a car, borrowing money for a house and so forth. That's one, and that could continue. Those costs could get worse. Okay, that's one danger.

Another is you mentioned a fiscal crisis. Okay. How does that work exactly? The debt gets too high and then nobody wants to keep funding it, everyone runs away?

MARTHA: Yeah. I mean, one thing is I want to push back on "How's the fiscal crisis work? The debt gets too high."

The debt gets to a point where the markets say, "We out." And for different countries, that's going to be at different levels. So how much markets are going to let us borrow before they freak out is probably very different than how much they're going to let—

Oh man, I'm going to pick a random country and then people who actually follow sovereign debt crises in different countries—

CARDIFF: Oh, it's going to be so good. Ecuador? Go with Ecuador.

MARTHA: Great.

CARDIFF: Lots of sovereign debt crises.

MARTHA: Everyone who's going to yell, Cardiff picked Ecuador, so please yell at Cardiff about this.

CARDIFF: (LAUGHS)

MARTHA: And then at the same time, people point to Japan, which has incredibly high debt-to-GDP, and they go like, "Well, they have—"

CARDIFF: Interest rates have been low forever.

MARTHA: Right, they haven't had a fiscal crisis. I mean, Japan's having rising interest rates right now, but they're still low relative to everyone.

CARDIFF: I know, from such a low place. No, totally. But I take your point. Japan is always the counterexample. Well, the US has now 100% debt-to-GDP. It's like, well, Japan's way higher than that and they're fine. Who cares? Yeah, so go ahead.

MARTHA: Well, I was going to say, I mean, Japan is kind of an interesting example of this because sure, fine, who cares, but in some ways they've had a stagnant economy for some time, and we can debate a range of things there.

But one of the things that they do is they make, for instance, their insurance companies take on a lot of Japanese debt, and so they can strain their private sector in various ways around the management of their debt, which is then going to flow through to economic growth.

And it's also something I don't think US companies would generally be on board with if we were like, "The plan to handle the rising US debt is to make all of you buy it." They'd be like, "Wait a minute, this is not... We were going to buy SpaceX bonds. We don't want to do this."

CARDIFF: It sounds like what you're saying is that before you get to the point of markets saying, "We out" — fiscal crisis.

MARTHA: Yeah

CARDIFF: The new fiscal crisis phrase is "we out," by the way.

MARTHA: (LAUGHS)

CARDIFF: Before you get to that point, there are ways in which it can actually start influencing economic growth itself. And you just outlined a few, right? If these things get way worse, if the cost of a mortgage gets way too high, if the cost of auto loans, et cetera, et cetera, gets way too high, maybe some people actually end up being more likely to default on those loans.

But even then, you could see how more of their paycheck is taken out by that so they buy fewer other things, and that could affect economic growth itself, right? Is that what you're getting at here?

MARTHA: Yeah. I mean, there's also... So let's go back to the One Big Beautiful Bill Act, which was the very expensive tax cut bill—

CARDIFF: Passed last year.

MARTHA: Passed last year. And one of the things that we found, as did CBO, was that when you look over 10 years, the effect on growth is basically nil, which is, by the way, pretty impressive that you can throw trillions of dollars at the economy and not generate any economic growth.

It speaks to the fact that the economy doesn't really need additional deficit-financed spending right now. Part of the reason for that is rising interest rates, which crowd out private investment.

If you look over the longer run, which we did, what you find — and I should emphasize, this is modeling, this is all speculative, this is all forecast—

CARDIFF: These are estimates.

MARTHA: These are estimates, right?

CARDIFF: And a lot of it's contingent on what ends up happening.

MARTHA: Totally. Please don't come find me in 30 years and go, "Your exact estimate of this was off." For many reasons, not least of which is I plan on being retired.

CARDIFF: You won't be interested in it.

MARTHA: I will not care.

But what we found is that actually in the long run, you end up on a lower growth trajectory because of the compounding effects of those higher interest rates, and it just slows you down and you end up with lower living standards.

That doesn't require there to be a fiscal crisis. And it's not even that noticeable to people. If you move from 2.1% annual GDP growth to 1.9%, I don't think either you or I just sitting here would notice that year to year, right? Those numbers are pretty similar, but it compounds over time.

This is part of what you've seen in the UK, by the way, particularly post-Brexit, is that they've had these kinds of slower year-to-year growth. It's not that any one year has been particularly crazy, but it compounds over time and now they're looking around going, "Well, wait a minute, what happened? Where are our higher living standards that we thought were coming?"

CARDIFF: So there's slower growth.

MARTHA: Slower growth.

CARDIFF: Okay. There is, at some level, the possibility of a fiscal crisis?

MARTHA: Oh yeah.

CARDIFF: There is maybe inflation in the short run if there's too much sudden spending, right? That's part of it.

MARTHA: Yes.

CARDIFF: Okay. These are sort of the explicit dangers of rising deficits and debt.

I bring it up partly because for a very long time in the aftermath of the Great Financial Crisis in particular, and throughout the 2010s, people were trying to assess this all. They were trying to assess where does it get actually dangerous? Does it ever get actually dangerous?

There were heterodox economic theories, one of which, Modern Monetary Theory, says that essentially the one big constraint on higher fiscal spending, on higher debt, is inflation, but that otherwise, the likelihood of an actual crisis or these other crowd-out effects, very, very small, very limited.

I take it that's not your position.

MARTHA: No, but I think that this gets at part of why talking about these issues has been so hard for many of us, because many of us, for lack of a better phrasing, grew up as baby economic policy wonks at a time when it was legitimately the case that money was free.

We had really low interest rates after the Great Recession. The economy frankly needed some more stimulative spending. I think you saw some of that with the TCJA, that that did actually do some spurring of the economy in a way that was probably helpful in the short run.

CARDIFF: 2017 tax funding.

MARTHA: In 2017, right? That's not a statement about whether long-run tax cuts were a good idea, but in 2017, some additional stimulus probably made sense.

And so a lot of us kind of came up in this environment where proposing your favorite policy and not paying for it was actually the economically responsible thing to do. And now all of a sudden we're in a different environment. Interest rates are much higher. We have really low unemployment, but we still have these really, really high deficits, which is unusual. When you have 4.3% unemployment, you don't expect 6% deficits.

And so I think it's been hard for people to get their minds around the fact that the environment has changed. I, for one, am in mourning for the economic policy environment of 2014, 2015, when we just got to think about all the fun things all the time. I didn't have to worry about it.

CARDIFF: Yeah. But not the economy of 2014, 2015.

MARTHA: No, there were pros and cons.

CARDIFF: Do you remember the big controversy over Reinhart and Rogoff?

MARTHA: I do, yes.

CARDIFF: I've been thinking about this recently. I was discussing this with a colleague of mine yesterday.

There was something interesting about it. And the background here for everybody is that Ken Rogoff and Carmen Reinhart are these two titans of economics, and they'd written this huge book on financial crises, the history of financial crises. And then they did some work on debt-to-GDP ratios.

And what they concluded was that at a debt-to-GDP ratio above 90%, economic growth would slow. And apparently what happened was that their study of past episodes where the debt-to-GDP ratio had gone above that had an Excel error that somebody caught, and it ended up leading to a reexamination of whether or not that whole "economic growth falls by X amount if the debt-to-GDP ratio goes above 90%" was correct.

I mean, they got slammed for it.

And the thing I was talking to my colleague about was, but the gist of their point, that above a certain debt-to-GDP ratio somewhere it could start affecting economic growth to some degree, seems not just right, but it seems like exactly what you just said.

MARTHA: Right.

CARDIFF: Right.

MARTHA: I mean, I think this gets at, leaving aside the whole specific way—

CARDIFF: Oh god, yeah, we're not going back. We're not going back to that!

MARTHA: Yeah. A little bit of what you and I were talking about at the beginning, which is that I think sometimes this conversation has gotten too anchored on specific numbers. Ninety percent. A hundred percent. I'm sure when we get to 110%, we'll have this conversation again.

And none of this is predictable. I should say none of this is precise. It is not the case that you can do an RCT for different countries of how much debt they take out and then see... That's just not how macroeconomics works. But you can kind of look historically at what has happened and these different associations and different shocks.

And it does seem like at certain points you get a slowdown from increased deficit spending. And I think that that is really important.

I also want to say, by the way, that it's also in these contexts really, really important to think about what you are deficit spending on. As money becomes more expensive, it's really important to consider whether or not the purchase the government is about to make makes sense, and the standard for that gets higher and higher and higher.

In the same way that I say in 2014, propose whatever you want, great. Money was cheap. Money is much less cheap now. And so the standard for deficit spending is much higher.

CARDIFF: I was looking at a graph earlier of household debt. I want to ask about the relationship between government debt and then household debt.

So on this graph of household debt, what it shows essentially is that as a share of the economy, it's actually been falling since 2008. It's fallen by quite a lot. It used to be something like, I don't know, around 100% of the economy. Now it's like

two-thirds, roughly. And it's happened at the same time that the government debt has climbed.

Should we feel pretty good about that, that one kind of debt has gone up while the other kind of debt as a share of the economy has fallen? Doesn't it mean that the private sector, if we have to raise taxes or something, can absorb some of that because it's in a good financial position, or a better financial position than the government is, or something like that? What is the relationship between those two?

MARTHA: Oh man, this is not something I've fully thought through because you'd also have to think about how corporate debt is fitting into all of this as well.

CARDIFF: Of course.

MARTHA: And I think also in all of this, it's really important to realize that we kind of sit in international debt markets. And so when you're thinking about financing US debt, yes, foreign governments buy less of it than they used to, but it's part of a worldwide thing.

If we're talking about room to raise tax rates, I think it's much more useful to kind of look at where we've been in the past compared to other countries. So right now, if you think of revenues as a percent of GDP, they're several percentage points below where they've been at various points in the past. They're certainly below where they are in various different OECD countries.

I think part of the question is actually a political one, which is on the revenue side, how much taxation are people willing to go for?

And this kind of goes back to if you get a bunch of real debt and deficit nerds in a room, they'll all start debating the CBO projections from 2000 and 2001, which showed over time—

Cardiff's nodding, he's like "Yeah."

CARDIFF: Another one of your cocktail parties.

MARTHA: Yeah!

CARDIFF: You got to invite me to these.

MARTHA: It's a great time.

CARDIFF: (CHUCKLES)

MARTHA: Which showed over time us basically paying off the national debt. I'm oversimplifying because actually what ends up happening is you still have some debt because it's longer-dated debt, so you keep it on the balance sheet, but you have savings that offset that debt. But just so that the budget nerds don't yell at me, just saying.

And there's a lot of arguments about how realistic those projections were. And part of that is an argument about whether or not the path for taxation in those reports was plausible, and basically whether or not Congress was going to let that path for taxation happen.

And I should say, Congress stepped in and said, "We don't like that path for taxation. We want to cut taxes." And the American people went, "Yeah, that sounds cool. We'd like lower taxes."

CARDIFF: Those are the Bush tax cuts of the 2000s.

MARTHA: The Bush tax cuts, which then got extended for almost everyone at the top under Obama. Then you had additional tax cuts under Trump One, and then you had obviously the tax cuts of last year in Trump Two.

Everybody loves to cut taxes.

CARDIFF: Everybody, in fairness, also loves to increase spending, right?

MARTHA: Again, because it's fun. It's fun.

And no one likes the ideas that will close the deficit. It's no one's idea of a good time.

And so there's two separate questions here, which is how much taxation can the country economically sustain? By which I mean, if we were taxing everyone at a 90% average tax rate, I think basically all economists would say that's going to substantially slow down economic activity and you're going to be way on the other side of the Laffer Curve, and you're not going to get as much revenue as you would if you had lower tax rates.

But then there's also the question of what we as a country are politically willing to do. And we certainly know the answer to the second, which is not pay very much in taxes, which doesn't mean that we couldn't economically sustain higher tax rates.

CARDIFF: When interest rates go up, as they have in recent years, how do we know to what extent it is from worries about the debt versus, I don't know, worries

about the credibility of being able to pay off the debt in the future versus expectations of more inflation or higher real economic growth, which can also drive them up?

When you do these models that say people are paying more on their mortgages because of the fiscal decisions that have been made by the government in the last 10 years, how do we disentangle all the other things that could also be contributing to it?

MARTHA: I mean, that is the million-dollar question. I should say that there are people on Wall Street who are paid substantially more money than I am—

CARDIFF: To also not know, right? (LAUGHS)

MARTHA: Well, yes. I mean, they're trying to disentangle all of this.

I should say our work very much relies on this paper from Laubach et al., whose name, I'm so sorry. I hope they are not listening. I'm sure I've just butchered it. That shows this relationship between debt-to-GDP and interest rates.

So we're doing these kinds of illustrative calculations. In the exact moment, I think it's really hard because a lot of these things end up happening together.

So let's go back to the One Big Beautiful Bill Act. How much of what's happened with interest rates since then is about concerns about deficit spending? How much of it is concerns about political stability? How much of it is a response to a stronger economy and spending on AI capex?

I think one of the things that is hard in these situations is that they never happen in isolation. Again, you never get that magical RCT. But what you can see is kind of these long-run patterns and patterns over time.

And so when you see numbers from my shop or from shops like mine, you really need to think of these as illustrative calculations, right? It is not an exact science to say like, "Oh, it's definitely exactly this number."

We are using kind of what we know from the academic literature to get at these illustrative calculations that are trying to illuminate for people some of the underlying dynamics that can end up swamped one way or the other by other macroeconomic impacts.

CARDIFF: Yeah. I appreciate that answer a lot, in part because I think the quest for precision can really lead people astray when it comes to this.

It makes it hard to talk about this topic, but also psychologically we know that people grasp for certainty, right? They reach for it. They attach themselves to it. So they want a number like, "At 90% debt-to-GDP, we're all screwed." They want that.

And I find that it can be a little bit frustrating to tell people, "Well, we don't actually know. We have this understanding of how all these forces work that's pretty good, but we don't actually know with precision the exact points at which one thing can lead to another or what's influencing what."

Which makes conversations about this topic super hard, but that's a much more honest way to approach it than to say, well, you said those people on Wall Street who get paid a crapload of money to give you very precise numbers — they don't know either. They're full of shit. Okay, not all of them, but many of them.

MARTHA: (LAUGHS)

CARDIFF: They can come for me. I don't care. They can come for me.

MARTHA: I was about to say (LAUGHS)

CARDIFF: You like to do the thing with, "Come for Cardiff." Go ahead.

MARTHA: (LAUGHS) Come for Cardiff, guys.

CARDIFF: The Ecuadorians are coming for me already, so it's fine. All right.

MARTHA: Come for Cardiff, yeah.

No, but I mean, I think there's another example of this, not to get us off topic, but that you and I have talked about a lot, which is the impact of AI on the job market.

And you had ChatGPT released in November 2022. There's a lot of other things that have happened to the labor market since November 2022. We've had rising interest rates. We've had huge shifts in immigration. We've had a big push on deficits. There's a bunch of things that have been going on.

And so, trying to precisely pull out, it's definitely this thing with 100% certainty, and we can all go home and never think about it again, I think, is just hard in the real world.

CARDIFF: Have you heard the phrase that the US government is an insurance company with an army attached?

MARTHA: Yes.

CARDIFF: Something like that.

So I was looking at [a breakdown](#) of what the US government spends money on. This is from early last year from the Center on Budget and Policy Priorities. So some of the numbers might have changed a little bit, but I think this is pretty close.

Here's what they found. So if you think about it as three different things, okay?

Number one is healthcare-related spending. This is things like Medicare, Medicaid, to a smaller extent, I think the Affordable Care Act subsidies, things like that. That all adds up to 25% of the budget, of what the US spends its money on.

Another 21% goes to Social Security. So right there, you're already at like 46%. It's projected to keep going higher, up to half or whatever. That's a lot.

And then defense spending is roughly another 13%. I think that is projected to go higher for sure after the events of the past year.

So right there, you have something close to 60% of everything. And again, especially the parts that are related to the country getting older, so the healthcare spending, Social Security, et cetera, those parts are really projected to keep going.

That leaves room for only a smaller share of the budget to actually tinker with, like, "Oh, we're going to spend less on this versus that."

The spending that's built in, okay, the entitlement spending and so forth, that part's going to go up unless you make changes to the law that say, "We're going to change how these things pay out."

How do you process that, especially the way it's going to end up affecting deficits in the future and the rise of the debt in the future?

MARTHA: I mean, I think this gets at the point of, in this environment, we really need to think about what we are deficit spending on. And frankly, even if we get to the point where we can get people to raise more revenue, what we're spending that additional revenue on.

One of the things we talk about a lot at Budget Lab is we know, for instance, that returns to spending on children are higher than returns to spending on the elderly. It doesn't mean we should spend no money on the elderly, but if we invest in education for a four-year-old, just mechanically, they have more years to pay taxes.

CARDIFF: By returns, what do you mean?

MARTHA: Yeah, I mean, both higher economic growth and also then more revenue that we get from that, so both.

And so in the United States right now — and I'm going to get this exact number wrong — but we spend about six times on people over 65 than what we do on children. And people need to think about if that's where we want our money going.

And to be clear, the answer may be like, yes. Yes, we do.

But we can raise more revenue than we are raising right now, but we can't raise infinite more revenue than we are raising right now. And we do need to start thinking about deficits. We do need to start thinking about debt. And there are other things that people want to invest in.

And I think people need to think about where it actually makes sense to increase spending or decrease spending because we don't have infinite money. We do not have an infinite money machine.

CARDIFF: Let me do a rapid-fire thing with you because you suggested some other ideas that might work in that *Atlantic* piece.

I'm just going to run through them, each one, and just list it off, and then you tell us why it's such a good idea.

MARTHA: Well, I want to be clear. These were not meant to be the good ideas. These were meant to be ideas that people have put out there that we could discuss, kind of thing.

CARDIFF: That would work to either raise more revenues or spend less.

MARTHA: Yeah, exactly.

CARDIFF: Okay. Better funding for the IRS.

MARTHA: Yeah. I mean, better funding for the IRS, I think, is one of the ones that makes budget wonks totally crazy because what they're doing is getting tax revenue that we were supposed to get already, and that people were not paying. Pay your taxes, people.

Spending on the IRS is actually also one of the few areas that, quote unquote, pays for itself. Everyone always thinks that they're — sorry, you said rapid fire. I'm not going rapid fire on this, but—

CARDIFF: That's alright. This one's good. This one's good.

MARTHA: So people will often talk about this policy will pay for itself. And that is usually not the case because, mechanically, we only get 17% of GDP as revenue. And so basically what that means is in order for a policy to pay for itself, it needs to generate seven times as much economic activity as it costs in order to pay for itself. That is a crazy high bar.

Most policies, even if from a societal perspective they pay off, don't generate that much revenue. But funding the IRS does. The returns to it are quite, quite high. And it's not about raising new revenue. It's not about passing new laws. This is just about money that people owe us.

CARDIFF: It helps them, I guess, in one sense, catch tax cheaters if they have better funding, but it also helps them just find taxes that people maybe even inadvertently didn't pay that they were supposed to pay, that kind of thing. Not popular for obvious reasons, by the way.

MARTHA: Yeah. I mean, to be fair, people don't like funding the IRS. When people know that if you're going to commit tax fraud, the IRS is more likely to find you, they're also just more likely not to commit tax fraud, which then also raises the amount of money that we bring in.

If people think that if they commit tax fraud, there probably won't be any consequences for them because the IRS isn't going to find them, why are you paying taxes like a sucker?

Again, please pay your taxes.

CARDIFF: Pay your taxes, folks. Raising the retirement age.

MARTHA: Yeah. I mean, so this is one — we're going to get into the ones where people are going to have a lot of emotions.

CARDIFF: That's why I can't wait.

To be clear, you're not saying these are good or bad ideas. You're saying these are ideas that would help bend the deficit back in a healthier direction.

MARTHA: Yeah. And I mean, frankly, part of the reason I wanted to include some of them is because I think people will read the piece and be like, "Yeah, I agree with this. I agree with this. I agree with this." And then start getting to some of the ways that we could deal with this and go, "Oh no, but we can't do that." Which is exactly the point, right?

Raising the retirement age: we live longer than we used to. Yay, us. That also means we pay out Social Security benefits for longer. And so if you raise the retirement age, you mechanically have fewer years of paying out benefits.

CARDIFF: The argument on this one usually goes that the people who tend to live longer are also the ones who need those Social Security checks the least. Correct? They tend to be better-off folks who've saved a lot more money throughout their lives, and that people who work lower-paying blue-collar jobs tend to live shorter lives.

And so you're essentially raising their retirement age. You're cutting off a stream of funding specifically for people who would need it the most. But again, it would cut spending.

Okay. Next one is reducing Social Security benefits for high earners, which goes in the opposite direction of the last one.

MARTHA: Yeah. I mean, we all pay into Social Security, and we all get Social Security benefits as long as we've paid in. Even people who quote unquote may not need them.

So if you worked as a high-paid lawyer for many, many years and you built up large 401(k)s to support you in your retirement, you're still getting Social Security benefits. And so there's a certain amount of money that we are paying out to people who, quote unquote, don't need it.

I should say the argument against this one is that Social Security is a program we all benefit from and that we all, quote unquote, pay into, and that that's part of why it has been so popular and has had the sustainability of the program.

CARDIFF: Yeah. It's been politically sustainable because of that universal nature of it.

MARTHA: Yeah.

CARDIFF: Reforming Medicare Advantage.

MARTHA: This is one where I am not as much of an expert, I should say, but if you talk to people on the healthcare side, there's various ways that Medicare Advantage bills for various things that is much more expensive than it needs to be, I think is the way to put it, and that we could save a lot of money by reforming how billing works there.

I should say in the healthcare space, there's always a discussion of the ways that we could save on waste, fraud, and abuse. One person's waste, fraud, and abuse is someone else's paycheck. And I think that that is a really important thing to keep in mind with all of this.

It's very easy for me to say like, "Oh, there's a lot of overcharging that goes on in Medicare Advantage. We should get rid of that." And there are a lot of people listening to this who benefit from that who are going, "What are you talking about? I charge fairly, and I should be able to continue to charge those rates."

So I'm going to continue arguing against myself because I think it's important.

CARDIFF: That is the point of this. That these are parts of... I think what you're doing by arguing with yourself is showing how the arguments that a lot of other people have with each other end up making it so hard to actually address the issue, right?

MARTHA: Correct.

CARDIFF: Yeah. Last one is removing the tax exemption on employer-provided health insurance.

MARTHA: This is a policy that only the budget wonks love, but the budget wonks love it.

So right now, when you get health insurance through your employer, it's not taxed. And so if one person is paid \$70,000 in wages and gets \$20,000 in healthcare benefits, and someone else is paid \$50,000 in wages and gets \$40,000 in healthcare benefits, their total compensation is the same, right? They're each making \$90,000.

But the person who gets paid \$70,000 in wages pays more in taxes than the person who gets paid \$50,000 in wages, and that doesn't seem fair.

And there's a lot of arguments among economists about the ways in which this drives all of us to get health insurance through our employers in ways that may be inefficient if we're thinking about broader healthcare reform in the United States.

Again, I'm not a healthcare economist. Healthcare economists, please do not come for me.

CARDIFF: Come for Cardiff.

MARTHA: Come for Cardiff! Everyone just come for Cardiff.

CARDIFF: Everybody just come for Cardiff. That's the theme here.
(CHUCKLES)

MARTHA: But again, this is one where I think healthcare is really sensitive for people, and this is a tax increase on people. This is a benefit that currently is not taxed. And if we start taxing it, people are going to be paying more in taxes, which, per our previous conversation—

CARDIFF: No, your argument's very interesting there because the first thing that came to mind to me was, well, if you tax something more, you get less of the thing. So maybe you'll get less employer-provided healthcare coverage. That's one possibility.

But it sounds like you're also saying that the incentive to break down somebody's compensation by salary versus healthcare also is skewed by the fact that it is a tax benefit right now. And so you might undo some of that as well.

Okay.

MARTHA: I mean, this is a thing also that came up a lot in the context of the ACA and the Cadillac tax on very expensive healthcare benefits.

And I think one of the things that people sometimes wonder about with healthcare costs in the United States is that they're subsidized in various ways because the healthcare benefit is not taxed. So you can provide these very, very fancy healthcare benefits to people that aren't taxed, so you don't have the same cost to the worker. So they're like, "Great, this is fancy healthcare for me. Love this."

And then they can consume a lot of healthcare, which may or may not be a good idea.

CARDIFF: You mentioned earlier that the thing you want the government spending money on is stuff that brings later returns. So, for example, you mentioned investing in children. I think investing in public research and development also tends to have a big payoff down the line.

MARTHA: Yup

CARDIFF: Let me throw one more at you that doesn't even really involve the government spending money. Actually, it's like a win-win all across the board.

MARTHA: I'm 90% certain I know where this is going and I'm excited.

CARDIFF: Oh, go ahead and guess.

MARTHA: Immigration.

CARDIFF: High-skilled immigration, specifically.

So this is something that obviously, at the Economic Innovation Group where I work, and which this podcast belongs to, this is one of our big policy pushes.

And the argument there is that if you were to bring in way more high-skilled immigrants, these are people who by definition make a bunch of money, which you can tax right away, of course, because that's their income. They pay income taxes. And the direct fiscal benefits of that over time, if you bring in enough, could be in the hundreds of billions of dollars.

But also, the indirect benefits might be even bigger. These are people who, a lot of times, yeah, they're hugely innovative, and they work for companies, but they also start companies. You could end up just getting a few of these guys to start massive companies or run huge companies, and at that point, the growth effects are enormous.

I don't think this is very popular amongst policy wonks or budget wonks or whatever. It's weird that this has been such a big omission.

You spend a lot of time around them. What is going on? Why not?

MARTHA: So I will disagree with you a little bit. I actually think that this is a thing that people have been bringing up and have been — it's that Trump cope — people are talking about it more and more these days.

And so I think, particularly in the context of the wild swings in immigration policy we've had over the last couple of years, people have been really focusing on the fiscal and economic benefits of higher immigration, especially because, me aside, we've had this declining fertility rate in the United States, which is also impacting the long-run both economic and debt trajectory for the United States.

I should say at Budget Lab, Abhi Gupta, which is a name that you all have heard me say multiple times on this podcast — everyone follow Abhi on Twitter and read his work.

CARDIFF: We're going to link to Abhi's work in the show notes for this episode. For sure.

MARTHA: Yeah.

Did these calculations about lower immigration and how this flows through to lower productivity because of fewer startups? Immigrants are more likely to start new businesses.

And one of the points that he made in that piece was we've had this decline in immigration over the last couple of years—

No. How long have we? A year and a half?

CARDIFF: Yeah, I think it's been something like that. For sure, the curtailment of legal immigration last year was quite aggressive. And it's starting to show up in the numbers now.

MARTHA: Yeah, exactly.

And so part of the point that he makes is that it's not just immigrants, it's also the children of immigrants. And so we've had this kind of hit to productivity and business dynamism that is almost certainly going to carry through even if, in 2029, we magically change immigration policy all at once, that this period of time where we've really restricted immigration is going to have long-run productivity impacts.

CARDIFF: Yeah. So let's do that.

I don't think the mood is right right now, politically, I mean. I think the national mood is because high-skilled immigration at least is very, very popular. I don't know. This drives me nuts that this is not more in the zeitgeist.

MARTHA: I mean, this gets at—

Bobby Kogan at the Center for American Progress had [a piece](#) just out today. I shouldn't say today because who knows when this podcast will be released, but on—

CARDIFF: Today, June 23rd.

MARTHA: Yeah, exactly.

It was Jared Bernstein, who served in the Biden administration, talking about how he's thinking about debt and deficits right now and making many of the points that we have made right here.

But one of the things that he said when he released it was like, "Look, if you locked me and Jessica Riedl, who's at Brookings, who's sort of a more moderate conservative; Mark Goldwein, who's at the Committee for a Responsible Federal Budget, who's also more of a debt and deficit hawk than Bobby is—"

CARDIFF: All really good chartmakers, by the way.

MARTHA: All— look at [the charts](#).

CARDIFF: Excellent, excellent wonks.

MARTHA: Look at their charts, guys.

And he's like, "If you lock all of us in a room, we could come up with something."

And I think that this sort of gets at the broader point. You've got wonks on the left, you've got wonks on the right, you've got wonks in the center. People have various disagreements about where they would focus, but if you locked all of us in a room, we could come up with a solution for all the things we were just talking about, which would almost certainly include higher immigration.

So much of this is about political will. And it's about the fact that, going back to where we started, a lot of the costs of this are hidden. There's no line on your mortgage statement that says X basis points of your mortgage rate are because we have a debt-to-GDP ratio of X percent.

The effects are kind of pernicious, and that makes it harder.

CARDIFF: I want to float a couple of ideas that are out in public right now and just get your thoughts on them.

MARTHA: Oh, fun.

CARDIFF: Tax-based ideas.

So one is — and this primarily comes, I think, from politicians who are Democrats — is that nobody who earns below a certain amount of money should pay income taxes at all.

And it's generated kind of an interesting discussion, even within the left, by the way—

Or within the left/center-left, whatever, where some people would say, okay, that sounds good. If people who are super rich end up not paying their fair share in taxes — I'm using other people's phrasing here — then we should make it easier for people who don't make as much money to also pay less in taxes.

Versus other people who say, look, we need broad-based taxation, not just for debt and deficit reasons, but also because it signals something about societal participation.

What do you think about this idea?

MARTHA: Weirdly, I think this gets back to the thing we were talking about with IRS enforcement, which is that I think people have this feeling right now that taxation isn't fair and that people at the top, or people — whomever — are not "paying their fair share."

And then what that flows into is, "So why should I? Why should the barista have to pay taxes if"— name your favorite villain here

CARDIFF: If Warren Buffett doesn't pay any.

MARTHA: Right, exactly.

CARDIFF: I get it.

MARTHA: And I think it is really important to think about things we can do to simplify and make the tax code fairer because it makes people feel like we all have a share in this, which, by the way, we do.

And if you think about the tax cuts that have happened since 2000, we often talk about how they have disproportionately benefited the rich, the wealthy, the high-income, the 1%, pick your favorite classification here.

It is also the case that if you are listening to this, you almost certainly got a tax cut from those. They were broad tax cuts. They were just tilted heavily towards the top.

And so I think that there has been this movement towards, "Those people aren't paying. Why should I have to pay? Someone else can pay."

And that just doesn't work. We all kind of have to pay in. And we can argue about how much people individually have to pay in and what's the right amount and how do we distribute that, et cetera, et cetera.

But it is not the case that we can balance the entire federal budget on the backs of Elon Musk, Jeff Bezos, Bill Gates — I don't know, name other billionaires here.

CARDIFF: Speaking of them, this is another idea that's been floated, which is a wealth tax, and specifically a wealth tax on billionaires.

This, I think, has gotten a lot of debate in California in particular.

MARTHA: Yeah.

CARDIFF: With worries on the one side that it might lead to a lot of billionaires just straight-up leaving the state, and to the extent they're going to pay state taxes, they would pay it somewhere else or not pay any if they move to Texas, I guess, right? I don't know.

MARTHA: (LAUGHS)

CARDIFF: Well, you know what I mean.

MARTHA: By the way—

CARDIFF: And then others saying, "No, that's not true, and we'll get a lot of money, this will actually lead to a lot of money."

And again, a lot of times, the argument that gets floated is these guys are finding loopholes and ways around paying taxes anyway, so this would be a straightforward way to get money out of them.

Anyways, what were you going to say? I cut you off.

MARTHA: Oh, I was just going to say, people often point to states with no income tax, and I just want to point out that those states often have higher sales taxes or property taxes.

CARDIFF: Property taxes, yeah.

MARTHA: Because you have to get the revenue from somewhere, guys.

And so I think it's important to say that sometimes even when we think about, like, "Oh, this magic land where we don't have to pay taxes," you still have to pay taxes. It just looks different.

CARDIFF: They'll get it from you somewhere.

MARTHA: They're going to get it, guys. Yeah.

So, first on wealth taxes, I do think it is important to note that it seems very unlikely that you can have an argument about whether or not they are constitutional. It seems very likely that this current Supreme Court would say that they are not constitutional.

So if you're thinking about things that can raise revenue at the federal level, that seems like a dead end to me.

If you're thinking about the state level, you've already seen capital be relatively responsive to this. There's been a lot of reporting about billionaires switching where their family offices are in response to the prospect of this legislation.

Capital taxation in general is a huge problem. We don't do it very well. Some of that is because capital is harder to tax than labor.

So you and I each get paid by our employer. We get a W-2. That W-2 gets handed over directly to the IRS.

CARDIFF: It's easy to withhold taxes from it, that kind of thing.

MARTHA: Yeah, exactly.

Capital, you can hold onto it. You haven't realized it. If you die, there's something called a stepped-up basis, where all of the amount that the stock is valued at that your inheritors would have to pay tax on if they realize it gets changed to what it was when you die.

So basically, if you haven't sold it and you've held onto it until you die, you don't have to pay capital gains on any of that.

CARDIFF: And also in some cases, if a founder starts a company and most of that founder's wealth is shares in the company, how do you tax that, and what kind of implications would it have for the ownership structure of the company and all that?

MARTHA: Yeah.

CARDIFF: Capital's trickier.

MARTHA: Capital's trickier. It is legitimately trickier.

I think it is something that is really important that we figure out. I also think it's something where we used to be much better at it, and then we let a bunch of loopholes creep back into the tax code.

And so my view is that we should be going after a lot of those first, partly because if you keep those in there, capital's just going to flow to wherever the loophole is because it can. It's very mobile in a way that labor income can't hide from taxes in the same way.

CARDIFF: Point out, by the way, that when it comes to capital taxation, though, if you end up having higher taxes on capital and they're badly designed, it can have some negative effects.

If you want to drive more investment in the economy, then lowering taxes on capital is one way it could happen. There's better and worse ways to tax capital. I want to be clear. But when we talk about this, it's not like we're talking about it in a vacuum.

Tax capital better. Just don't have loopholes.

In some cases, lower taxes on capital could be a good thing. It could spur some incentives that are beneficial to the economy. Isn't that right?

MARTHA: Yes. I mean, I think this also gets into we need to be really clear about places where there are benefits that we've seen, like tax credits for R&D, for instance, on the corporate side, as opposed to places where the benefits are much less clear.

So, for instance, one of the things my team has looked at is carried interest, which is this fun part of the tax code where basically people in private equity, venture capital get certain fees, they get to get taxed at capital gains as opposed to at earned-income labor rates.

And if you close that, there's substantial revenue there.

CARDIFF: Even that is a pretty small share of total investment throughout the country, right? That's not—

MARTHA: Well, but the people who benefit—

CARDIFF: I agree, it's unfair.

MARTHA: Again, I'm going to argue against myself, which is all I've done.

CARDIFF: Good. That's the point of this.

MARTHA: Yeah.

The people who benefit from that would argue that that loophole does drive investment and does have returns when it comes to jobs and things like that.

I would argue the economic evidence is relatively weak on that, but you do kind of have to think through what the returns are from a revenue side relative to any slowdown of the economy or investment that you're going to get.

CARDIFF: I was talking to a colleague of mine, Adam Ozimek, chief economist, and he said somebody else said this, okay? I couldn't find out who, but the framing was interesting, right? The framing was interesting.

He said the phrase was something like, "Don't tax people getting rich, tax people just being rich." That's sort of a wiser way to go about it.

And the idea there is that you want people doing entrepreneurial things. You want people innovating.

MARTHA: Yes.

CARDIFF: You want people having avenues to getting rich, okay? Just kind of like staying rich and not doing anything. I mean, if you've earned it, I'm not saying make a rich person poor every time a person gets rich because that's the same thing as taxing getting rich, right?

But things, I don't know, on the inheritance side maybe, capital just sitting there doing nothing, I don't know. I don't know where that would lead to, but I thought the phrase was interesting, and I was kind of curious to get your thoughts on it.

MARTHA: I mean, this is one of the reasons why a lot of economists really like the idea of a consumption tax, particularly on goods that fancy people like.

Maybe we should tax Lamborghini purchases at a higher rate than purchases of — I guess we don't really have \$25,000 cars anymore — but cheaper cars.

But a consumption tax is something that kind of gets at Adam's point, right? As you are richer and you consume more, you're going to have to pay more for it.

CARDIFF: Let me be clear. This is not Adam's point. Adam thought the phrase was interesting, and he was like, "Oh, we should ask Martha about this."

MARTHA: Adam Ozimek is strongly endorsing a consumption tax, and once Ecuador is finished yelling at Cardiff, everyone else should go and yell at Adam.

CARDIFF: (LAUGHS) In that sense, I'm a pass-through entity, right?

MARTHA: (LAUGHS) Yeah, exactly.

CARDIFF: Come for me, and I'll just forward the email to Adam.

MARTHA: Yeah, that feels right.

CARDIFF: This is really about you, dude.

MARTHA: I should say there is a huge amount of debate about the distributional impacts of a consumption tax. Yes, it depends on how you structure it and how you think about how it affects the returns to capital. This is actually an area of active debate.

But one of the things that people worry about is poor people spend more of their income because they have to.

CARDIFF: Right. Because they don't make enough to save.

MARTHA: Right. Now, again, there's questions about how this reflects returns to various things and how it shakes out over the long run.

CARDIFF: Are you in on a consumption tax, or are you still thinking about it?

MARTHA: There are things that I like about a consumption tax, and this is the coward's way out, but it is actually true: I don't spend that much time thinking about it because I don't think that Congress is going to do it.

It's intellectually interesting to debate, and I think it has a lot of benefits, but if some politician came to me and said, "How should I think about closing the deficit?" I wouldn't list a consumption tax in the same way that I wouldn't list removing the tax exemption on employer-sponsored health insurance, leaving aside whether or not those are good ideas, because they're never getting passed.

CARDIFF: I think in fantasy land, though, I think I'm in for a consumption tax.

MARTHA: It has a lot of benefits to it.

CARDIFF: But also for transparency reasons, I feel like a consumption tax would be a lot easier just to tax literally at the point of consumption, at the point of purchase, than even an income tax, which can be relabeled as something else or whatever, right?

MARTHA: So this is going to lead to one of my favorite taxation stories.

CARDIFF: I can't believe—

MARTHA: (LAUGHES)

CARDIFF: We're like an hour and a half in this chat, and you've been withholding your favorite taxation story. Please go.

MARTHA: So the Maldives is an incredibly corrupt country, and if you are from the Maldives, you can come at me on this. This is absolutely— (CHUCKLES)

CARDIFF: Finally! You're going to catch smoke from one entity in this whole chat, and it's the Maldives.

MARTHA: And it's around corruption in the Maldives.

CARDIFF: Good.

MARTHA: And I can't remember when it was, but at some point they introduced a VAT, which is a form of consumption tax, and they found out — I'm going to get these numbers wrong, but I'm pretty sure this is right — that the economy was actually 20% bigger than they thought it was because everyone had just been evading taxes up the wazoo.

CARDIFF: (CHUCKLES) Evading income taxes.

MARTHA: Income taxes, right. But VATs, consumption taxes, are much harder to evade. That is a benefit that they have there.

And so that is a general benefit to them. They are easier to enforce. Tax evasion is much, much harder.

I mean, tariffs are a not-ideal version of a consumption tax, right? They are a tax on consumption from abroad, basically. But one of the reasons why countries in the

17th century did them, apart from the "we don't like Germany, so we're taxing their stuff" kind of thing, is because they didn't have the same kind of tax enforcement mechanisms that we do.

And it was really easy to be at the border and be like, "Ah, yes, I see you are bringing this whiskey into our country. Please pay us this amount."

So easier enforcement, I actually think, is a really, really important part in all of this.

And I think often when people are designing their ideal taxes, they start thinking about all these different edge cases that they worry about and start putting, like, "Okay, but if you fall into that category, then we won't tax you in this particular situation." And then you just end up with a really unmanageable tax code.

CARDIFF: Yeah. Any postmortem thoughts on DOGE? This is sort of a delayed question because I could have asked this a while ago, but it doesn't seem to have bent the deficit curve at all. I think it mainly just attacked foreign aid, which is what, less than 1% of the total budget? Right around there?

MARTHA: Yeah. It's interesting. There were a bunch of us, particularly — I mean, a lot of us. Jessica Riedl and I were yelling very loudly, but so were many others — saying, "This is going to make no difference. What are you doing? This is just going to cause a mess."

And yeah, it seems to have just caused a lot of mess, and I don't think has made any difference on the debt-deficit trajectory and seems to have made various government services a lot worse.

CARDIFF: And just nicely understatedly put.

MARTHA: Thank you. (CHUCKLES)

CARDIFF: That wasn't a compliment.

MARTHA: Yeah, yeah, yeah.

CARDIFF: Last question. If there's one thing about debt and deficits that you really would want to leave people with, especially if it's something that people just so often tend to misunderstand or don't pay enough attention to, what is it?

MARTHA: It's just that deficit spending does have costs. And that doesn't mean it's not the right way of financing your preferred policy, but that you have to think really carefully about those costs and whether or not the benefits outweigh them.

CARDIFF: Let's see. Ecuadorians, Wall Streeters, policy wonks—

MARTHA: Healthcare policy wonks specifically.

CARDIFF: Healthcare policy wonks specifically and vociferously are coming for me. Maldivian criminals are coming for you. That's it?

MARTHA: I think that's right. Although I want to—

CARDIFF: Is that the breakdown?

MARTHA: Yeah. I want to be very clear about this. I'm happy to fly to the Maldives and stay in a really fancy resort.

CARDIFF: Catch the smoke in person.

MARTHA: Right, exactly. I'm happy to make this sacrifice.

CARDIFF: And in any case, we both have Adam Ozimek's email address, so we can just forward all the complaints to him.

MARTHA: Adam Ozimek complaint department. Right, exactly.

CARDIFF: There we go. Martha, thanks so much.

MARTHA: Thank you for having me.