America will have to reckon with all that debt

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Michael Strain The writer is an FT contributing editor and director of economic policy studies at the American Enterprise Institute

The US hit a milestone this year. The size of the national debt eclipsed annual economic output. The ratio of debt to GDP is over 100 per cent for the first time since 1946, when the US had been borrowing to finance military spending during the second world war.

Today, debt service is the third-largest category of federal spending, behind only social security and Medicare — and, remarkably, ahead of national defence.

In Washington, analysts and politicians alike seem increasingly resigned to the idea that the only way the government will engage in fiscal consolidation is in the aftermath of a bond market crisis. But I am more optimistic that the normal democratic process could yet lead to deficit reduction.

Many discount this possibility because the last truly successful effort to reduce the deficit occurred as long ago as 1993, when the political environment was much more amenable to productive compromise. Commentators contrast this success with the failure of the $4tn "grand bargain" deficitreduction effort in 2011, led by President Barack Obama and Republican House Speaker John Boehner. They argue that the rise of more adversarial and performative politics is to blame.

Of course, politics and policymaking have deteriorated since the 1990s. But it is important not to overstate this. After all, Bill Clinton's 1993 deficit reduction act passed without a single Republican vote. A more compelling explanation is the decline in interest rates. During the 1980s, Americans lived through a period when the 10-year Treasury yield nearly hit 16 per cent. By the end of that decade, it was typically 8 to 9 per cent. In the 1980s, high rates made it harder for households to buy homes and automobiles and for businesses to invest.

The American people, through the normal democratic process, made it clear to elected leaders that a solution was needed. In the 1992 presidential contest, the candidates were pressed by the voters to reduce the budget deficit further. In a debate the month before the election, a voter asked the three candidates (Clinton, George HW Bush and Ross Perot): "How has the national debt personally affected each of your lives?" She then explained how the national debt had personally affected her: "I know people who cannot afford to pay the mortgage on their homes, their car payment."

Despite the statesmanship shown two decades later by Obama and Boehner, voters were not then feeling pressure from high rates. Unlike in 1993, too many rank-and-file members of Congress questioned what they would gain from raising their constituents' taxes and cutting their benefits when the 10-year yield was only 3 per cent.

But over the past three years, the 10-year yield has been higher than at any point since the 2008 global financial crisis — and, if you look hard enough, you can see some green shoots sprouting for the cause of fiscal consolidation.

For example, the unaffordability of housing was a clear issue in the 2024 presidential election, and has only grown in political salience since. Interest rates on 30-year fixed-rate mortgages are currently around 6.5 per cent, more than twice as high as they were as recently as 2021. In the 2028 elections, I expect some candidates to link fiscal irresponsibility to the high cost of housing.

More generally, as voters' concern about the cost of living grows, political competition will push presidential candidates in 2028 to promise solutions, including fiscal consolidation. Again, there are green shoots. In the wake of this week's CPI report, which showed inflation hitting a three-year high in May, Florida governor and potential GOP presidential hopeful Ron DeSantis explicitly linked "massive deficits" to high prices, arguing: "When Congress borrows trillions and runs massive deficits, it is still an effective tax increase — it just comes in the form of higher prices."

This is not a call for complacency. Responsible policymakers should be planning today for the moment when the democratic process pressures politicians to cut the deficit. And even if many voters are demanding fiscal consolidation, cutting spending on social security and Medicare and raising taxes will be politically challenging, requiring stronger leadership in Congress and the White House than the nation has had over the past decade.

But the endgame is more straightforward than many think. When enough voters feel more economic pain from deficit increases than deficit reduction, more politicians will opt for reduction.