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Why Should We Worry About the National Debt: Questions and Answers April 16, 2019

[“Why Should We Worry About the National Debt?”](#) describes six important ways that the growing national debt will affect the budget and the economy. Below, we answer specific questions frequently raised about the topic.

Isn't debt sustainable when the economy grows faster than interest rates?

Despite the fact economic growth rate is higher than government interest rates ($r < g$), debt remains on an unsustainable trajectory in the United States. Economist [Olivier Blanchard](#) and others have pointed out that governments can shrink their debt-to-GDP ratio while still borrowing to finance their interest payments when $r < g$. However, this only leads to a sustainable outcome if a government is running a primary balance (revenue equals non-interest spending) or a sufficiently modest primary deficit. The United States today is running a large and growing primary deficit. As a result, both debt and interest payments will continue to rise faster than the economy despite low interest rates. There is also no guarantee that the economic growth rate will remain higher than interest rates, particularly as rising debt puts downward pressure on growth and upward pressure on rates.

Do low interest rates mean deficits don't “crowd out” investment?

Evidence suggests that today's low interest rates are in spite of, not because of, high deficits and debt – and that deficits continue to “crowd out” investment. Two recent studies – [one](#) from Edward Gamber and John Seliski of the Congressional Budget Office and [another](#) from former Obama Administration economist Ernie Tedeschi – both find that higher deficits and debt continue to result in higher interest rates, as [past research](#) has indicated. Today's low interest rates, according to those studies, are the result of population aging, slower productivity growth, international demand for safe assets, and unconventional monetary policy. Debt continues to push interest rates up, crowding out productive investment and thus slowing economic growth.

Can we really have a fiscal crisis if the U.S. borrows in its own currency?

While it is highly unlikely that a government that borrows in its own currency will ever have to *default* on its debt, many other types of fiscal crises could occur because of unsustainably rising debt. One possibility is that a one-time spike in interest rates will trigger a mass sell-off of U.S. treasuries, leading to a global financial crisis. Other possibilities include an exchange rate crisis, an inflation crisis, or an austerity crisis, where massive austerity measures are needed to reduce debt obligations in the middle of an economic downturn. Such crises have happened before around the world and throughout history, including in countries that borrow in their own currency. The United States could also face a much subtler crisis, in which high and



rising debt leads to a slow erosion of U.S. growth and prosperity. As Federal Reserve Chairman Jerome Powell [has explained](#), “the idea that deficits don’t matter for countries that can borrow in their own currency I think is just wrong.”

Shouldn’t we borrow to finance new investments when interest rates are so low?

While smart public investments can grow the economy, studies from the [Congressional Budget Office](#), [the Penn Wharton Budget Model](#), and others have found that deficit-financing new investments is less pro-growth than offsetting their costs – and may even slow economic growth. With debt-financing, increased public investments would come at the cost of reducing private investments. This tradeoff may be sensible when interest rates are low and policymakers plan to pay for the investment over time, but most debt-financed investments would instead result in continuous rollover of the debt even as interest rates rise. With the debt already rising unsustainably, new borrowing for investment would come on top of substantial borrowing to finance consumption. While the budget deficit will total almost \$900 billion this year, federal (non-defense) investments total only about \$325 billion. It would be wiser for policymakers to reduce the share of current borrowing that goes toward consumption programs and divert those funds toward important investments. [Read more here.](#)

Shouldn’t we borrow to finance tax cuts, since they will ultimately grow the economy?

While thoughtful tax reform can help improve economic growth by promoting work and investment, there are few, if any, real-world cases in which [tax cuts will pay for themselves](#) – let alone reduce debt as a share of the economy. In order to be self-financing, every \$1 of tax cuts would need to generate \$4 to \$6 of economic growth, which is far in excess of what any model or past experience predicts. Debt-financed tax cuts are particularly unlikely to generate that level of growth, as higher debt serves as a drag on the economy. Improving the fiscal and economic situation will ultimately require more revenue, not less. [Read more here.](#)

Doesn’t Modern Monetary Theory say we don’t have to worry about debt?

The emergence of Modern Monetary Theory (MMT), a fringe economic theory that argues the government can and should print money to finance deficits, should not free us of debt concerns. Even under the ideal conception of MMT, debt continues to matter because deficits can drive high inflation. However, wholesale embracement of MMT would likely be disastrous. Giving Congress and the President the power to print money and the responsibility to raise taxes to manage price levels is a recipe for hyperinflation and economic disaster. Moreover, MMT has little bearing on the current consequences of debt, which are based on the economic institutions in place today, not those that MMT advocates believe should be in place.

The idea of MMT has been panned by [a variety of serious economists](#) on the left, right, and center including [former Treasury Secretary Larry Summers](#), [Nobel laureate Paul Krugman](#), [former International Monetary Fund Chief Economist Ken Rogoff](#), and [former Federal Reserve Bank of New York President Bill Dudley](#), among others. In [a recent survey of 42 top economists](#), none agreed with MMT. [Read more here.](#)



Don't the urgent challenges we face now demand we increase the debt to address them?

The country faces massive challenges and opportunities today and for the future, including those related to climate change, automation, the changing the nature of work, income inequality, rising health and education costs, and global threats from abroad. We may need proactive, creative public policies to address these challenges. However, fiscal imbalances are themselves a challenge we need to face. Expanding deficits to solve one problem just makes our fiscal problem worse; we're already at a point where debt and deficits are projected to rise indefinitely, regardless of any future actions policymakers take to confront urgent issues. Part of the solution will require paying for any new actions with offsetting tax increases or spending cuts. The other part will require addressing structural deficits with some combination of new revenue, mitigating long-term growth in entitlement programs like Social Security and Medicare, and both cutting and prioritizing other spending from consumption to investment.

Can't we address the debt by issuing longer-term bonds?

It may be wise to issue bonds with longer maturities – something the Treasury Department is already doing – but it will not solve our debt problem. The argument in favor of lengthening bond maturities is that it will reduce the “rollover risk” associated with existing debt, so a spike in interest rates would not lead to an immediate explosion of federal spending on interest payments. However, this lower risk comes at a cost: longer bond maturities tend to pay higher interest rates and thus are more expensive for the government. Without a plan to pay back the debt over the maturity period, longer-term bonds don't fundamentally change the debt situation; they just kick the can down the road. In addition, issuing bonds with longer maturities only protects past debt from rollover risk while leaving future borrowing (based on today's laws) vulnerable to increases in interest rates. It is also important to consider the economic and financial implications of bond maturities, not just the fiscal implications, because U.S. debt instruments provide important security to the global financial system.

Isn't faster economic growth the key to fixing our debt?

Economic growth is fundamental – not only for reducing deficits and increasing the country's capacity to hold debt, but also for improving job opportunities, increasing incomes, and expanding wealth. However, economic growth alone will not fix the debt. The economy would have to grow about twice as fast as projected in order to stabilize the debt at today's record-high levels over the next three decades. While faster economic growth would bring in more tax revenue, it would also lead to higher spending on Social Security and Medicare and push up interest rates and costs. As a result, current and projected deficits are simply too large to plausibly eliminate through growth. This is especially true if faster growth is achieved through more spending or lower taxes – those policies would expand, not reduce, the national debt.