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The Economist: Can we borrow our way out of debt?

By Tucker Hart Adams and Tom Binnings

A few weeks ago the White House and Republicans reached a compromise to extend the 2001 and 2003 tax cuts and to extend unemployment benefits to households whose benefits are running out. It reminded us of a cartoon we saw recently that shows a person saying to his banker, “I want to borrow money so I can get out of debt.“

Prior to 1960, almost all additions to the national debt came from borrowing during times of war. The Revolutionary War, Civil War and WWI required the United States to borrow about 30 percent of Gross Domestic Product.

WWII took the level of government borrowing to 70 percent of GDP over the five years of the war. In contrast, the Depression resulted in debt amounting to 28 percent of GDP from 1929 to 1940. Reagan’s determination to bring the Cold War to an end and to implement tax cuts resulted in borrowing an additional 16 percent. The Bush tax cuts and War on Terror added 5 percent between 2001 and mid-2008.

Thus far, the Great Recession has added just under 26 percent to borrowing in 2 ½ years. Of the 26 percent of GDP we have borrowed, just over 11 percent ($1.6 trillion) was loaned by the Federal Reserve System - in essence by printing money.

We have been running a deficit of roughly 10 percent of GDP per year for two years - resulting in borrowing more money to cover the deficit. Based upon long-term forecasts of the Congressional Budget Office, the demands of the baby boomer population will increase Federal spending by 6 percent of GDP per year. Our current experience is giving us a little glimpse of the future, raising troublesome questions about the long-term sustainability of our current fiscal course.

So how far can we go? Well, the private markets essentially cut off Greece and Iceland in 2009 and 2010 when their debt was 113 percent of GDP. On the other hand, Japan's government borrowing has been approaching 200 percent of GDP, but its high savings rate allows it to borrow most of the money from itself.

The United States economy is not strictly comparable to these "pioneers on the high debt frontiers." But if we accept that borrowing is likely to be cut off at somewhere between 113 percent and 200 percent of GDP, we might have a decade of borrowing capacity left under current levels of deficit spending. Under a different set of assumptions, which includes the extension of the 2001 and 2003 tax cuts, the Congressional Budget Office puts the nation's debt at 109 percent of GDP in 2025. This will be a new all-time high - occurring just as the average baby boomer is 70 years old.

To make matters worse, as the debt as a percent of GDP grows, our ability to respond to international conflicts and our national defense becomes hamstrung, as does our flexibility to provide for our aging population and future economic crises. Interest rates (the price of credit) will increase as investors become less willing to hold our debt, making investment and economic growth more difficult.

In the end something will give. The president called on Congress to set aside partisanship and work together to solve the nation's problems. It's one thing to argue over "Don't Ask Don't Tell" and such for decades. But when the plane is running out of fuel, political brinkmanship is destructive.

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