Debt Denial Is a Threat to America

By Desmond Lachman

Do deficits matter? Between Republican tax cuts and Democratic spending proposals, U.S. lawmakers act as if the answer is no. Lately, academic economists have echoed the sentiment, advocating large, unfunded infrastructure spending programs—the main thrust of former International Monetary Fund chief economist Olivier Blanchard's recent presidential address to the American Economic Association. "Put bluntly," Mr. Blanchard said, "public debt may have no fiscal cost."

This view, known as modern monetary theory, rests on false premises. One is that the U.S. government will likely be able to borrow at low rates indefinitely. Another is that so long as the U.S. nominal growth rate is greater than the rate at which its government borrows, America can always grow its way out of debt problems.

Never mind that amid full employment and low interest rates, according to the IMF the U.S. has a general budget deficit of more than 5% of gross domestic product, and the general government debt level exceeds 100% of GDP. Even if the government borrowing rate were to stay low, the public-debt-to-GDP ratio would still increase indefinitely. Growth is no panacea.

Say we accept that nominal U.S. growth continues to exceed government borrowing costs by 1 percentage point. Starting from America's high debt level, the budget deficit excluding interest payments would need to be less than 1% of GDP to stabilize the public debt ratio. At

'Modern monetary theory' rests on dangerous, false premises. The U.S. won't grow its way out of the red.

the peak of the business cycle, the U.S. general government deficit excluding interest payments is already around 3.5% of GDP. Even under ideal conditions—full employment and low interest rates forever—the public debt ratio would increase indefinitely.

If the U.S. experiences a recession at any point, the budget deficit would swell as tax revenues decline. Unfunded increases in infrastructure spending—as proposed by Mr. Blanchard and other leading academics—or an expansion in social spending under a future Democratic president, or even increased military spending in a war, would also boost the deficit. Those eventualities would put the public-debt ratio on an even steeper upward curve.

The premise that government borrowing costs will stay low indefinitely, even if the budget deficit remains high, is questionable, especially now that the Federal Reserve is shrinking demand for Treasurys by reducing the size of its holdings—while a ballooning budget deficit is increasing the supply.

It's more likely that investors, particularly from overseas, will demand higher government bond yields to compensate for the elevated inflation or default risk they see from an ever-increasing public debt ratio. This would be made worse if larger budget deficits put downward pressure on the dollar by increasing the size of the U.S. trade deficit.

One must hope that the drift in the U.S. economic-policy debate toward fiscal laxity is a passing phase. If not, we are well on the path to fiscal ruin.

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Notable & Quotable

Rep. Tulsi Gabbard (D., Hawaii), writing in the Hill, Jan. 8:

While I oppose the nomination of Brian Buescher to the U.S. District Court in Nebraska, I stand strongly against those who are fomenting religious bigotry, citing as disqualifiers Buescher's Catholicism and his affiliation with the Knights of Columbus. . . . No American should be told that his or her public service is unwelcome because "the dogma lives loudly within you" as Sen. Dianne Feinstein (D-Calif.) said to Amy Coney Barrett. . . . While I absolutely believe in the separation of church and state as a necessity to the health of our nation, no American should be asked to renounce his or her faith or membership in a faith-based, service organization in order to hold public office.