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Is rising US public debt sustainable?

At $8.3 trillion, it breaks the legal limit, fueling a fiscal debate in Congress.

By Mark Trumbull | *Staff writer of The Christian Science Monitor*

Maybe the national debt clock was retired too soon.

Between 1989 and 2000, the electronic display near New York's Times Square tracked the rise of the nation's red ink until it reached $5.7 trillion. When it shut down, the federal budget was running a surplus.

Today, the national debt totals $8.3 trillion, a level that could force Congress this week to raise the debt ceiling for the fourth time in George W. Bush's presidency.

The prevote debate may be tinged by election-year rhetoric, but the underlying issue goes beyond partisan politics. The rising debt tally is a reminder, economists say, that the nation is on an unsustainable fiscal course.

The economic burden posed by the national debt, economists say, is more serious now than in 1980, when a $1 trillion figure stirred national anxiety.

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Today, the public debt is larger as a share of the American economy, more than half is held by foreigners, and the wave of baby-boomer retirements is no longer decades away.

"The situation now is really very different from the 1980s," says Alice Rivlin, former vice chair of the Federal Reserve. As the costs of programs such as Medicare rise, she says, "we can't go on into the next decade ... still running deficits as our major way of coping."

Economists don't have a simple formula for calculating how big a debt, as a share of America's gross domestic product (GDP), is sustainable. But many warn that devoting an ever-larger share of GDP to paying off interest on the debt is not healthy.

That could happen as government spending rises during the baby-boomer retirement wave. And the trend could be worsened if those who finance the debt - including foreign investors - start demanding higher interest rates due to the risk that the debt level will fuel US inflation.

"What we do know for sure is that in the next decade the upward pressure on federal spending is going to be very, very large," says Ms. Rivlin, who also worked as President Clinton's budget director and is now at the Brookings Institution. "It's not so much the aging of the population as the fact that spending on medical care has been rising faster than GDP."

In some cases in the past, the debt ceiling imposed by Congress has spurred lawmakers to restrain the growth of deficit spending that adds to the debt. Deficit-reduction plans coincided with debt-limit votes in 1990, 1993, and 1997.

The current $8.3 trillion total debt tally includes two types of debt: the kind owed to the public (including foreign lenders), and the kind owed from some government entities to others. In the strange accounting of Washington, the current surpluses run by the Social Security program add to the national debt.

The public debt is what's most worrisome. At $4.8 trillion, it is now a higher share of GDP than it was in 1980.

"The bigger our debt becomes, the bigger the 'risk premium' that foreigners are going to demand," in the form of higher interest rates, says Barry Eichengreen, an economist at the University of California, Berkeley. But if the president and Congress show signs of fiscal responsibility, "then foreigners will be reassured and the day of reckoning recedes."

The prospect of such a day of reckoning is among the arguments Democrats are employing as they fight for the high ground in midterm elections.

In a speech Saturday, Democratic National Committee Chairman Howard Dean cast the rising share of debt held by foreigners as a national security failure by the Bush administration.

More broadly, Democrats are tarring Bush as the president who squandered the Clinton-era track record of fiscal responsibility. War, tax cuts, and a prescription-drug benefit for Medicare recipients have spurred a return of deficits under Bush.

But some of the shifts, good and bad, relate to unforeseen events. Clinton benefited from a lower burden of defense spending, and from surging tax receipts during a record economic expansion. Bush has faced unforeseen costs of hurricanes and security.

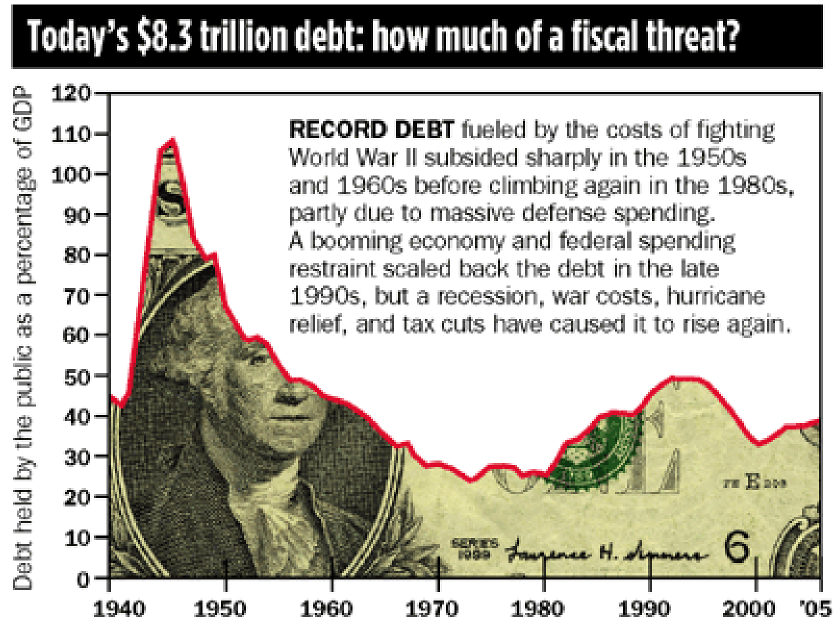
As a share of GDP, today's total public debt and the annual deficits look somewhat high, but not outrageous to many economists.

The European Union, for instance, expects member nations to hold deficits below 3 percent of GDP and debt below 60 percent of GDP. The US has reached the first target but not the second, using publicly held debt as the benchmark.

The bigger issue is how well America's fiscal health will hold up under the strain of costs associated with baby boomer retirements, which begin in just a few years. Taxes would have to be raised 50 percent to cover entitlement costs, says Glenn Hubbard, a former economic adviser to President Bush who is dean of the Columbia University business school.

Economists vary in their estimates of how the size of government affects economic growth. But the nonpartisan Congressional Budget Office warns that rising debt can harm the economy.

Within the range of possible budget paths forecast by the CBO, one scenario shows interest spending on government debt remaining at today's level of about 2 percent of GDP through 2050. But under a "high spending, low revenue" scenario, interest would cost 21 percent of GDP by 2050.



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