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Sure Cure for the Debt Problem: Economic Growth

By CATHERINE RAMPELL

NOT so long ago, the National Debt Clock, perched above the Avenue of the Americas, a block east of Times Square, was running backward.

It seems remarkable now, with all the End Times talk of debt ceilings and default, but it was only 11 years ago that the owners of that electronic totem, the Durst family, simply pulled the plug. The clock, a fixture since 1989, went dark after the federal government ended its 2000 fiscal year with a record \$236.4 billion budget surplus.

Today, well — you know. We face the largest budget deficit the nation has ever known: \$1.6 trillion, the equivalent of about 11 percent of our economy. And, whatever Washington does, many economists say the situation will grow only worse, particularly as Americans age and [Medicare](#) costs spiral higher.

But there is, in theory, a happy solution to our debt troubles. It's called economic growth. No need to raise taxes or cut programs. Just get the economy growing the way it used to.

Good luck with that. Growth is in short supply these days, as new, [dismal numbers underscored](#) on Friday. Revised data showed that the [recession](#) took an even bigger bite of the economy than we thought. And economists are sizing up the risks of another recession.

“The basic issue is that the U.S. is on an unsustainable fiscal track,” says Dean Maki, the chief United States economist at Barclays Capital. “From that point, none of the choices are fun.” The most obvious choices, Mr. Maki says, are to reduce spending (ouch), raise taxes (yuck), let inflation run (gasp) or default (thud).

We wouldn't need any of that if we could restore economic growth. If that happened, Americans would become richer and pay more taxes. Et voilà! — we'd pay down the debt painlessly.

Crazy as that might sound, particularly given Friday's figures, the possibility isn't some economic equivalent of that nice big farm where your childhood dog Skip was sent to run free. There are precedents.

Before its economy crashed, Ireland was a star of this sort of debt reduction. In the 1980s, Ireland's debt dwarfed its economy. Over the next two decades, though, that debt shrank to about a quarter of gross domestic product, largely because the economy went gangbusters.

“Ireland went from being, you know, the emerging market in a European context, to a very dynamic economy,” says Carmen Reinhart, a senior fellow at the Peterson Institute for International Economics and co-author of “This Time Is Different,” a history of debt crises.

The United States has done the same in the past, too. After World War II, gross federal debt reached **122 percent** of G.D.P., the highest ratio on record. But over the next 40 years, it fell to about 33 percent. That wasn't because some blue-ribbon panel prescribed austerity; it was because the American economy became much, much richer.

The same happened during the prosperous 1990s, which began with deficits and ended with surpluses. Former President Bill Clinton is often credited for that turnabout, as he engineered higher tax rates. But most economists attribute the surplus years primarily to extraordinarily rapid growth.

It would be lovely to repeat that experience today, and send our federal debt off to that farm with Skip.

But the structure of America's federal spending is different now than it was in, say, the immediate postwar decades. Back then, growth helped to erase the debt. But remember that in the 1950s, the United States didn't have Medicare. The population was younger, and Americans didn't live as long.

Given the health spending obligations we face, and the debt overhang we're already dealing with, growth rates would have to acquire something like **Ludicrous Speed**, as in the movie "Spaceballs," to keep up. And, near term, even modest speed is unlikely.

Usually after a recession, growth snaps back quickly and the economy makes up for ground lost — and then some. That's not the case this time, at least so far. In the 60 years before the Great Recession, the economy expanded at an average annual rate of 3.5 percent. In the second quarter of this year, it grew at less than half of that pace, putting us further and further behind where we would be if the economy were functioning normally.

These doldrums won't last forever, but many predict that economic growth to come will be somewhat slower than it was before the recession, for many of the same reasons that our debt is growing so quickly — the aging of the population, for instance.

While it may be difficult or impossible to grow our way out of debt, the G.D.P. figures announced on Friday suggest that we could quite possibly shrink our way into bankruptcy. The austerity measures that Congress is debating would almost certainly slow growth further. That, in turn, might actually worsen the debt problem — the exact opposite of what their proponents suggest.

Economists agree that in the long run, fiscal discipline is good for growth. When the budget is in order, the country isn't weighed down by the burden of paying down burgeoning entitlements. Companies can worry less about being surprised by, say, higher taxes, and proceed to hire new workers. More manageable federal debt also helps to keep interest rates low, which is generally good for growth. And, again, what's good for growth is generally good for the debt.

The problem is that reducing spending or raising taxes just now would hurt the already fragile

economy. Another recession would not only be painful for ordinary Americans but would actually worsen the debt problem by reducing tax revenue.

Don't believe it? Consider this: Of the \$12.7 trillion in additional federal debt that was accumulated over the last decade, about a third came from the souring economy.

Back in [the Great Depression](#), Washington tightened its belt with disastrous results. Congress severely reduced spending in 1937, plunging the economy back into the hole. Ultimately, that meant even more federal borrowing.

Today, Wall Street is worried that the United States will lose its AAA rating, whatever happens in Washington. Last week's sign of the apocalypse: While we were moping about the debt mess in Washington, Uruguay — Uruguay! — was putting its fiscal house in order. Standard & Poor's, which has been threatening to cut the United States' credit rating, raised its assessment of Uruguay.

Granted, it's still a junkyard BB+. But it makes you wonder: If Montevideo can get its act together, why can't Washington?

In a perfect world, Washington might lay out plans to reduce spending or cut taxes in the future, giving us a collective heads-up, and then phase in those measures a few years from now — when, hopefully, the economy is on a firmer footing.

The problem, of course, is credibility, which the ratings agencies have demanded. Would Washington follow through? Congress has promised fiscal discipline for decades, only to undo its promises before the reckoning. Fiscal discipline is painful, unpopular and, in today's Washington, as elusive as the prosperity we once had.

William Easterly, a development economist at New York University, notes that countries that undertake fiscal consolidation in the midst of a crisis — like the one Washington is in right now — tend to be penny-wise and pound-foolish.

For example, during the debt crises of the 1980s in Latin America, many countries in that region cut back on easy targets, like telecommunications and transportation. Those decisions later impeded those countries' ability to function and to collect the tax revenue they needed to keep current with their creditors. Britain likewise axed spending on transportation maintenance and operations in the 1980s, which led to much more expensive repairs to roadways and other infrastructure later.

ON the other hand, the paragon of thoughtful, growth-minded fiscal consolidation is Canada, according to Paolo Mauro, a division chief at the International Monetary Fund and editor of "Chipping Away at Public Debt: Sources of Failure and Keys to Success in Fiscal Adjustment."

Rather than making decisions under the gun, Canada in 1994 undertook a comprehensive, McKinsey-style review of all of its federal spending over the course of a year to determine "where they were getting value for their money, rather than just doing across-the-board cuts," Mr. Mauro says.

Policy makers telegraphed their conclusions and medium-term plans for reform, and subsequently pared down Canada's debt level from one of the highest in the Group of Seven to the lowest. Since Canada cut federal fat judiciously, it reduced its debt without much harm to growth.

American policy makers might learn a thing or two from Canada's patient, hysteria-free pruning, at least once another clock — the counting down to an American downgrade or default — stops ticking.



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