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Panel warns of perils of ballooning debt

David M. Dickson

The nation's ballooning debt will inevitably limit America's future wealth by reducing the size o: the economy and the growth of its capital stock, while increasing the nation's dependence on foreign creditors, according to a new survey by a panel of top fiscal policy experts.

A report issued Wednesday by the National Academy of Sciences (NAS) and the National Academy of Public Administration warned that, unless policies are changed, the cost of financing the government's rapidly expanding debt will rise sharply, especially after today's relatively rock-bottom rates return to historical levels. This cost will cut into funds to finance other government programs, the report, "Choosing the Nation's Fiscal Future," concluded.

Moreover, as debt continues to increase, foreign and domestic investors may lose confidence in the U.S. economy, according to the analysis prepared by the NAS' 21-member Committee on the Fiscal Future of the United States. The committee includes three former directors of the Congressional Budget Office (CBO) — June O'Neill, co-chairman Rudolph Penner and Robert Reischauer.

This loss of confidence would likely force interest rates higher, reduce domestic investment and push down the value of the dollar, setting off a vicious cycle that could threaten the long-term economic stability of the nation.

"Our committee members have varying political backgrounds and views, but we all agree that future economic prosperity is at grave risk if our nation does not change its fiscal course," said John Palmer, a former trustee for Medicare and Social Security who co-chaired the committee.

The greatest concern, the panel said, is the rapid growth in spending for Medicare and Medicaid, the federal health programs for the elderly and the poor.

In order for the economy to recover from the recent deep recession, the committee recommends that corrective action be taken by fiscal 2012, which begins in October 2011.

The report outlines four scenarios to achieve its recommended debt-to-GDP goal of 60 percent. They range from a low-spending, low-tax program to a high-spending, high-tax option.

The debt-to-GDP ratio, which was 33 percent in 2001, jumped from 41 percent at the end of fiscal 2008 to 53 percent at the end of fiscal 2009. The CBO estimated last year that President Obama's 10-year budget blueprint would raise the debt-to-GDP level to 82 percent by fiscal 2019.

The Peterson-Pew Commission on Budget Reform recently projected that publicly-held debt would reach 100 percent of the GDP by 2022 and 200 percent in 2038, based on current trends.

The Center on Budget and Policy Priorities (CBPP), a liberal think tank, agrees that the debt-to-GDP ratio must be stabilized, but took issue with the NAS target.

"Sixty percent is overly ambitious," said James Horney, the CBPP's director of Federal Fiscal Policy. He added that beginning corrective action in 2011 was also unlikely to be politically feasible.

Chris Edwards, director of Tax Policy Studies at the libertarian Cato Institute, argued that the larger-government options outlined by the NAS posed greater dangers to the nation's economic health than the smaller-government path.

"If tax rates were to rise as under the larger-government options, GDP would likely shrink, and higher tax rates [than envisioned] would be needed to generate the revenue required to stabilize federal debt," he said.