Written by **Bob Adelmann** on June 7, 2010

National Debt at Tipping Point?

The Wall Street Journal took another look at the $13 trillion national debt written about here last week and announced that, according to a study by economists Carmen Reinhart and Kenneth Rogoff, the economy has now reached the tipping point, the Reinhart-Rogoff Line, better known as the point of no return.

"Once a developed nation's debt crosses it, its annual growth [tends to be much] lower." The best estimate is that, once that point is reached, the GDP will be reduced by one-third, with little chance of regaining normal economic output for the foreseeable future.

In their book, *This Time Is Different*, Reinhart and Rogoff state:

> Highly leveraged economies, particularly those in which continual rollover of short-term debt is sustained only by confidence in relatively illiquid underlying assets, seldom survive … particularly if leverage continues to grow….
>
> This time may seem different, but … a deeper look shows it is not.

In their recent working paper "Growth In a Time of Debt," Reinhart and Rogoff expanded on their conclusion: "Our main finding is that … high debt/GDP levels (90 percent and above) are associated with notably lower growth outcomes…. Seldom do [such] countries simply 'grow' their way out of deep debt burdens."

Noting that at $13 trillion, the debt/GDP ratio for the United States is at 88 percent and climbing, this will sooner or later cause interest rates to rise as lenders demand a higher return for taking on the higher risk of either inflation or outright default. They say that countries that are counting on short-term financing to continue at presently low interest rates are setting themselves up for "very sudden and 'unexpected' financial crises."

As noted by Jeanne Sahadi at CNNMoney.com, "Letting U.S. debt grow unabated is often framed as an unforgivable burden to heap on one's grandchildren. But there are plenty of reasons today's parents [should] be concerned for themselves." As the debt mounts higher, more and more capital is drawn out of the private economy to service that debt, which reduces the output, and the consequent tax revenues, of the economy. Inevitably, interest rates continue to climb to the point where all of those revenues are used just to service the debt. The analogy of paying the minimum on one's credit cards is apt, but not complete. If less than the minimum is paid, the debt on the credit card continues to mount. At some point, then, the debt is called, and bankruptcy results.

At that point, history shows that a country that faces such a debt crisis can only resolve it through inflating the currency (thus paying the debt through reduced purchasing power of the currency), draconian reductions in welfare payments, or outright default. Default would end the flow of subsidies and checks currently pouring out of the Treasury, including Social Security and Medicare. The end result, in any event, would be a sharp and painful reduction to the citizens' standards of living.

According to Maya MacGuineas, president of the Committee for a Responsible Federal Budget, this could happen within the next few years. Sahadi adds, however, that "Congress won't act until a true crisis is on the U.S. doorstep — for two reasons. The first is the sharp partisan divide. The second is that no politician likes to run on promises to implement difficult and unpopular measures."

Syracuse University professor Len Burman wrote recently, "Like the proverbial frog that fails to jump out of the soup pot as the temperature slowly rises, Americans seem terrifyingly unwilling to act until the pain of debt can no longer be ignored. As the frog learns in its final moments, by then, it's too late."

It's appropriate to note that making tea involves hot water, and the Tea Partiers recognize that only by turning up the heat on their elected Representatives to start the painful process of forcing the government to live within its constitutional means can the country step back from that point of no return.