OP-ED COLUMNIST

Till Debt Does Its Part

By PAUL KRUGMAN
Published: August 27, 2009

So new budget projections show a cumulative deficit of $9 trillion over the next decade. According to many commentators, that's a terrifying number, requiring drastic action — in particular, of course, canceling efforts to boost the economy and calling off health care reform.

Fred R. Conrad/The New York Times
Paul Krugman

The truth is more complicated and less frightening. Right now deficits are actually helping the economy. In fact, deficits here and in other major economies saved the world from a much deeper slump. The longer-term outlook is worrying, but it's not catastrophic.

The only real reason for concern is political. The United States can deal with its debts if politicians of both parties are, in the end, willing to show at least a bit of maturity. Need I say more?

Let's start with the effects of this year's deficit.

There are two main reasons for the surge in red ink. First, the recession has led both to a sharp drop in tax receipts and to increased spending on unemployment insurance and other safety-net programs. Second, there have been large outlays on financial rescues. These are counted as part of the deficit, although the government is acquiring assets in the process and will eventually get at least part of its money back.

What this tells us is that right now it's good to run a deficit. Consider what would have happened if the U.S. government and its counterparts around the world had tried to balance their budgets as they did in the early 1930s. It's a scary thought. If governments had raised taxes or slashed spending in the face of the slump, if they had refused to rescue distressed financial institutions, we could all too easily have seen a full replay of the Great

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Depression.

As I said, deficits saved the world.

In fact, we would be better off if governments were willing to run even larger deficits over the next year or two. The official White House forecast shows a nation stuck in purgatory for a prolonged period, with high unemployment persisting for years. If that's at all correct — and I fear that it will be — we should be doing more, not less, to support the economy.

But what about all that debt we're incurring? That's a bad thing, but it's important to have some perspective. Economists normally assess the sustainability of debt by looking at the ratio of debt to G.D.P. And while $9 trillion is a huge sum, we also have a huge economy, which means that things aren't as scary as you might think.

Here's one way to look at it: We're looking at a rise in the debt/G.D.P. ratio of about 40 percentage points. The real interest on that additional debt (you want to subtract off inflation) will probably be around 1 percent of G.D.P., or 5 percent of federal revenue. That doesn't sound like an overwhelming burden.

Now, this assumes that the U.S. government's credit will remain good so that it's able to borrow at relatively low interest rates. So far, that's still true. Despite the prospect of big deficits, the government is able to borrow money long term at an interest rate of less than 3.5 percent, which is low by historical standards. People making bets with real money don't seem to be worried about U.S. solvency.

The numbers tell you why. According to the White House projections, by 2019, net federal debt will be around 70 percent of G.D.P. That's not good, but it's within a range that has historically proved manageable for advanced countries, even those with relatively weak governments. In the early 1990s, Belgium — which is deeply divided along linguistic lines — had a net debt of 118 percent of G.D.P., while Italy — which is, well, Italy — had a net debt of 114 percent of G.D.P. Neither faced a financial crisis.

So is there anything to worry about? Yes, but the dangers are political, not economic.

As I've said, those 10-year projections aren't as bad as you may have heard. Over the really long term, however, the U.S. government will have big problems unless it makes some major changes. In particular, it has to rein in the growth of Medicare and Medicaid spending.

That shouldn't be hard in the context of overall health care reform. After all, America spends far more on health care than other advanced countries, without better results, so we should be able to make our system more cost-efficient.

But that won't happen, of course, if even the most modest attempts to improve the system are successfully demagogued — by conservatives! — as efforts to "pull the plug on grandma."

So don't fret about this year's deficit; we actually need to run up federal debt right now and need to keep doing it until the economy is on a solid path to recovery. And the extra debt should be manageable. If we face a potential problem, it's not because the economy can't handle the extra debt. Instead, it's the politics, stupid.

A version of this article appeared in print on August 28, 2009, on

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