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Reload the gun ahead of next crisis

From Mr Daniel J Aronoff.

Sir, Edward Luce points out that US federal government debt is not projected to increase appreciably over the coming decade (“Simpson and Bowles are wrong on US debt”, July 15). He acknowledges that: “Without any change in the near term, Medicare could swallow up all of the federal budget by the 2040s” but he argues that concern over the issue should be tempered because “that is some way off” and, in any event, the US political system is unlikely to address risks that only arise in the distant future. I quite agree but there is another issue that has not been given the prominence it deserves in the debate over debt and deficits.

There is a trade-off between current debt levels and the ability of government to respond to emergencies such as war or depression. Higher debt affords less flexibility to respond to events by increasing spending. During the second world war, US debt increased from 42 per cent of gross domestic product in 1940, the year prior to US involvement, to a peak of nearly 109 per cent of GDP in 1946. During the recent financial crisis, US debt rose from 36 per cent of GDP in 2007, the year prior to the onset of the crisis, to 77 per cent currently. Nobody forecasts a significant decline in US debt under current policies.

So, if the US encounters an emergency sometime in the future on a scale commensurate with the second world war or the recent financial crisis, and if it were to respond by increasing debt by a commensurate amount, federal debt would need to increase to 118-144 per cent of GDP. It should be quite clear that attaining the upper end of this spectrum may not be feasible and that a level of debt that lies within the range heightens the risk of a government debt crisis.

Put another way, one argument for taking steps to reduce debt (as a percentage of GDP) is to reload the gun in readiness for a future crisis. While it may be premature to begin deficit reduction today, it should under no circumstances be delayed for as long as a decade.

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Simpson and Bowles are wrong about the US debt

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