Study finds national debt 'tipping point' that slows economic growth

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Researchers from North Carolina State University have identified a "tipping point" for national debt - the point at which national debt levels begin to have an adverse effect on economic growth. The findings could influence economic policy discussions globally, and will be distributed at the upcoming meeting of the International Monetary Fund (IMF) and World Bank Group.

“If a country’s public debt reaches 77 percent of its gross domestic product (GDP), bad things start to happen,” says Dr. Mehmet Caner, professor of economics at NC State and co-author of the study. “There is a tipping point for national debt, and if you exceed that point the amount of debt will have a linear relationship to declines in economic growth. The more debt you have, the slower your GDP will grow.

“For example,” Caner says, “if a country’s GDP is growing at a rate of three percent annually, and it increases its debt from 80 percent to 90 percent, its economic growth will shrink the following year to 2.8 percent.”

However, the researchers say it is important to note that the tipping point - a debt level of 77 percent or more - was developed based on an analysis of the debt of 100 countries over 30 years. “That tipping point could be higher or lower for any specific nation, based on the nation’s wealth,” says Tom Grennes, a professor of economics at NC State and co-author of the study. For example, the researchers found that countries with emerging economies and lower per-capita incomes, such as China and

Guatemala, had a tipping point of 64 percent. That means those countries can sustain less debt before it begins to curtail their economic growth.

"The United States has not exceeded the tipping point yet," Grennes says. "During our sample period of 1980-2008, U.S. debt was 61 percent of GDP. But we do need to think about this as we move forward, and this research will help national and international leaders make informed, long-term economic decisions."

Caner agrees, saying, "You do not want to pile on the debt forever. Some debt can be good - if you start at a low level of debt and increase it slightly, there is a positive effect on GDP growth. But you do not want to exceed the threshold of 77 percent for an extended period of time."

A paper describing the study, "Finding the Tipping Point: When Sovereign Debt Turns Bad," was co-authored by Fritzi Koehler-Geib of the World Bank. The paper will be published in October in a World Bank volume titled *Sovereign Debt and the Financial Crisis*. The book will be distributed at the annual meeting of the IMF and World Bank, being held in Washington, D.C., Oct. 8-10.

More information: Authors: Mehmet Caner, Thomas Grennes, North Carolina State University; Fritzi Koehler-Geib, World Bank; Published: Forthcoming, *Sovereign Debt and the Financial Crisis*, published by the World Bank.

Provided by North Carolina State University

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