How the United States landed in a debt 'danger zone'

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The interaction of public and private debt in the United States reduced economic growth about 0.43 percentage points per year between 2009 and 2014, a new study suggests.

In addition, growth declined an additional 0.40 percent due solely to high levels of private debt, taking into account public debt.

Overall, the results suggest debt dragged U.S. growth down by at least

0.83 percentage points in this time period.

"The effect that debt is having on our economic growth is much larger than we expected. We were surprised," said Mehmet Caner, co-author of the study and professor of economics at The Ohio State University.

The nation's GDP (Gross Domestic Product) grew 4.1 percent in the most recent quarter, but Caner said growth would have been even larger without the current level of debt.

"We should be worried," he said.

Most economists have examined how one type of debt—either public or private—affects economic growth. But this study is one of the first to show that the interaction of the two should be a real concern, Caner said.

"We were able to quantify the effects of this debt interaction and it is kind of scary."

Caner and his colleagues used data from 29 advanced countries (members of the Organisation for Economic Co-operation and Development, or OECD) from 1995 to 2014 to see how debt was related to economic growth. They found that when both public and private debt were relatively low, their interaction could stimulate economic growth.

Even when debt rises, increases in public debt can be offset by decreases in private debt, or vice versa. But if they are both at relatively high levels and increasing at the same time, their interaction can be particularly harmful for growth, results showed.

The study found that the interaction of public and private debt reaches a "danger zone" when it goes above 100 and 137 percent of the nation's GDP for public and private debt respectively.

The researchers calculated that 12 of the 29 countries studied—including the United States—were in this danger zone during the time of the study. The U.S. public-private debt interaction was at 203 percent in the 2009-2014 period.

If debt was reducing U.S. growth by around 1 percentage point a year—as this study suggests—that may explain a large portion of why growth went from 3.3 percent per year before the Great Recession (2007-2009) to about 2.2 percent since the recession.

"Since 2014, both public and private debt ratios in the U.S. have increased, indicating that debt has become an even greater obstacle to growth," Caner said.

Not all kinds of private debt had the same effects, the study found. Results showed that household debt had a much more negative effect than corporate debt.

The reason may be that corporate debt generally goes to more productive uses compared to household spending, such as investments in plants and machinery.

Why is the interaction between private and public debt important for economic growth?

Caner said one reason might be that the government guarantees much private debt, including mortgages and school loans.

"Greater private default often means greater public debt," he said.

These results suggest that Congress should work to control public debt, as many commentators and political groups have suggested, Caner said.

"The other implication is that agencies responsible for regulating private debt should not ignore the interaction between public and private debt, especially mortgage debt," he said.

More information: Mehmet Caner et al. Partners in Debt: An Endogenous Nonlinear Analysis of Interaction of Public and Private Debt on Growth, *SSRN Electronic Journal* (2018). DOI: 10.2139/ssrn.3186077

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