Special Commentary — June 24, 2025

Can the U.S. Grow Its Way Out of the National Debt Problem?

Summary

- **The outlook for the federal budget deficit and national debt is daunting.** At present, the U.S. federal budget deficit is nearly double the long-run average and unusually large for an economy that is not in a recession or engaged in a major war.
- **Reducing the budget deficit via tax increases and/or spending cuts has proved politically difficult.** Political developments in Washington, D.C. have time and again shown that meaningful deficit reduction is a challenging undertaking.
- **Could we grow our way out of the debt problem?** Perhaps the least painful solution to the long-run debt situation would be faster economic growth. Both public and private sector forecasters generally believe real GDP growth will average roughly 2% over the long run, but what if they are wrong? What would the long-run fiscal outlook look like if the U.S. economy grows faster or slower than 2%?
- **We model three different economic scenarios for the next 10 years to derive a plausible range of outcomes for the budget deficit and national debt.**
    - In all three scenarios, we assume the House version of the One Big Beautiful Bill Act (OBBBA) becomes law, temporary OBBBA provisions are made permanent, and tariff rates decline after the Trump presidency but remain higher than they were pre-2025.
    - Baseline scenario (2.1% real GDP growth and an average interest rate on the national debt of 3.7%): The federal budget deficit widens from its current value of 6.4% of GDP to roughly 8% by 2034. The debt-to-GDP ratio rises from 98% to 126%, surpassing the all-time high of 106% reached during World War II.
    - "Pessimistic" scenario (1.6% real GDP growth and an average interest rate on the national debt of 4.0%): The budget deficit as a share of GDP hits 10% by 2034, and the debt-to-GDP ratio surges to 140%.
    - "Optimistic" scenario (2.6% real GDP growth and an average interest rate on the national debt of 3.4%): The federal budget deficit remains roughly unchanged at 6.5%. The debt-to-GDP ratio continues to climb, hitting 114% in 2034, but the pace of the rise is much more gradual than in the other scenarios.
- **The key takeaway, in our view, is that it will take a very meaningful acceleration in real GDP over a long period of time to "solve" the unsustainable trajectory of the nation's public finances absent structural changes in revenues or outlays.** To stabilize the debt-to-GDP ratio around 100%, it would likely require real GDP growth of more than 3% annually for the foreseeable future, all else equal.
- Perhaps generative AI and other new technologies will lead to an economic boom that yields GDP growth rates this high. But, we would remind readers of additional downside risks to the fiscal outlook that we did not incorporate. For example, there may be unexpected developments, such as wars or natural disasters, that prompt Congress to step in with more spending than is incorporated into our projections.
- Ultimately, even if real GDP growth is somewhat faster than the consensus forecast in the years ahead, we think it will still take a reduction in the primary budget deficit via higher taxes, lower spending or some combination of the two to reduce the federal budget deficit back to a more sustainable 3% of GDP.

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The U.S. Fiscal Outlook: Economic Scenario Analysis

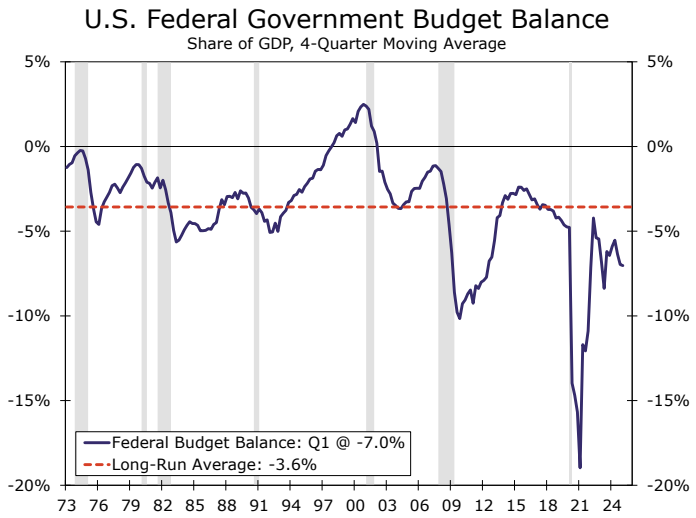
What is the 10-year outlook for budget deficits and the national debt under various economic assumptions?

The long-run fiscal outlook in the United States remains front and center for investors, businesses, policymakers and concerned citizens everywhere. At present, the federal budget deficit is in the range of 6%-7% of GDP, a fiscal gap that is nearly double the long-run average and unusually large for an economy that is not in a recession or engaged in a major war (Figure 1). The stock of debt, as measured by the debt-to-GDP ratio, is nearly 100%, the highest it has been since World War II, and it is set to grow larger in the coming years unless the annual budget deficit is reined in (Figure 2).

The new administration and Congress have elevated the debate about the path forward for U.S. fiscal policy. We have written elsewhere about the impact on the economic and fiscal outlook from the Republican reconciliation bill and the Trump administration's new tariffs. Many other analysts and economists also have written on the economic impact of the bill, and their thinking has been generally similar to ours: a short-run boost to economic growth from deficit-financed tax cuts, with a more muted economic growth impact over the longer-run.[1]

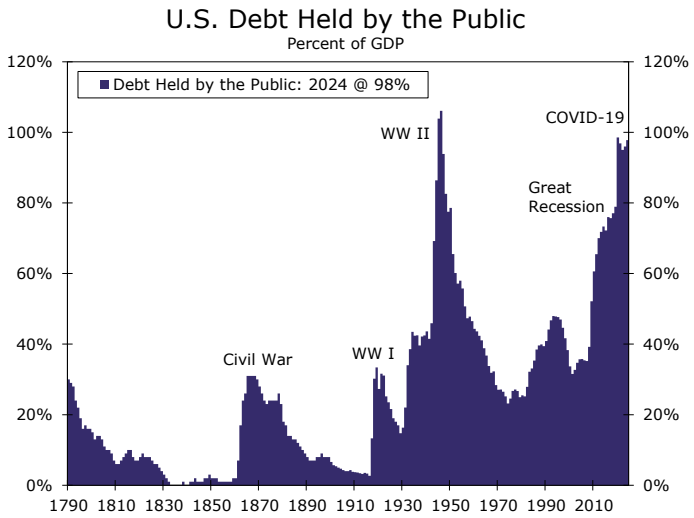
In this report, we are not as interested in the specific impact of the Republican reconciliation bill, known as the One Big Beautiful Bill Act (OBBBA). Rather, we seek to explore a different question: what is the 10-year outlook for budget deficits and the national debt under various economic assumptions?

Figure 1



Source: U.S. Department of the Treasury, U.S. Department of Commerce and Wells Fargo Economics

Figure 2



Source: Congressional Budget Office and Wells Fargo Economics

For simplicity's sake, most budget forecasters typically assume that current laws governing taxes and spending generally remain in place.

Forecasting budget deficits and debt over long periods of time is no easy task, but modeling them generally boils down to two key kinds of variables. First, the forecaster must make assumptions about future policies. What will tax rates on households and businesses be? How much will the federal government spend on national defense, infrastructure and retirement benefits? The tricky part of this exercise is that at any time Congress can change the law, making assumptions about future policies tenuous. For simplicity's sake, most budget forecasters typically assume that current laws governing taxes and spending generally remain in place. For example, if a government program or tax cut is slated under current law to expire in a few years, the forecaster generally assumes that this expiration takes place as scheduled. If a government program is not slated to change under existing law, it is left unchanged in the projection. This practice, often called a "current law" baseline, is the approach typically used by the Congressional Budget Office (CBO), Congress' in-house budget referee.

The second kind of key input into the budget deficit forecast is economic variables. Projections for economic growth, inflation, interest rates, demographics and a host of factors can influence the fiscal outlook. Perhaps no single variable is more important than economic growth. An economy growing at a robust clip in the years ahead would help narrow the budget deficit, all else equal, while an economy with a sluggish growth rate would further compound the long-run budget gap. A larger and faster growing economy generates more tax revenues for the federal government as well as increases the size of the denominator in the deficit/debt-to-GDP ratios.

What Is the Outlook for Long-Run Economic Growth?

Over the long run, economic growth is determined by the ability to sustainably increase total output.

In the short run, aggregate spending drives economic growth. It is from the demand side that economists derived the well-known equation C+I+G+NX=GDP. Although economists measure the economy in this way, over the long run, growth is driven by the supply side of the economy—an economy's capacity to produce output (i.e., goods and services). This is a somewhat tricky concept that is best illustrated by an extreme example. If tomorrow all U.S. consumers went out and drained their savings accounts completely to buy goods and services, real GDP growth would surge. However, this surge would not increase the U.S. economy's productive capacity, and the boom in economic activity would quickly peter out. To generate more output, the U.S. economy would need more workers, more equipment and/or more efficiency.

Economists typically refer to an economy's sustainable long-run growth rate as its "potential" GDP growth rate. Over the long run, economic growth is determined by the ability to sustainably increase total output. Total output generally can be grown in two ways: more hours worked or more output per hour worked. So, when most economists attempt to derive an estimate for potential GDP growth, they do so by forecasting the growth in the labor force (a proxy for hours worked) and labor productivity (i.e., output per hour worked).[2]

The table below summarizes a variety of projections for longer run real GDP growth from a mix of public and private sector forecasters. As shown in the table, most forecasts are clustered at or slightly below 2%. But why are forecasters so anchored to 2%? After all, the average real GDP growth rate over the past 50 years is 2.7%.

Figure 3

Long-Run GDP Growth Estimates

Forecaster	Annual GDP % Change
Wells Fargo Economics	2.1%
New York Fed Survey of Market Expectations (Median)	2.0%
Blue Chip Economic Indicators (Median)	2.0%
Philly Fed Survey of Professional Forecasters (Median)*	2.0%
Congressional Budget Office**	2.0%
FOMC (Median)	1.8%

*Federal Reserve Bank of Philadelphia Survey of Professional Forecasters median real GDP growth forecast for 2028

**CBO's current 10-year baseline projection includes a 1.8% annual growth rate (rather than allowing economic growth to converge to its potential rate of 2.0%) to account for the historical output gap.

Source: Wells Fargo Economics

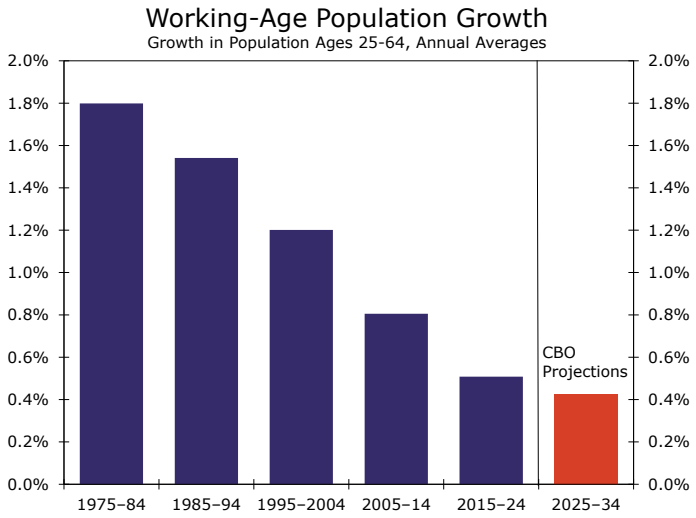
One of the biggest headwinds to faster economic growth over the long run is tepid growth in the labor force.

One of the biggest headwinds to faster U.S. economic growth over the long run is tepid growth in the labor force. The aging of the population and declining fertility rates have led to a significant slowdown in growth of the working-age population, and, by extension, growth in the labor force (Figure 4). At present, the U.S. fertility rate is about 1.6 children per woman, below the roughly 2.1 needed to maintain the size of the population through births alone. The fertility rate has been declining for two decades, and most economists have no reason to expect it will rebound suddenly in the years ahead.

Of course, there are other ways to increase the size of the labor force beyond a higher fertility rate. More immigration into the United States could increase the size of the labor force. But, as we discussed in a recent special report, greater immigration does not seem likely to be a tailwind to potential GDP growth in the years ahead.

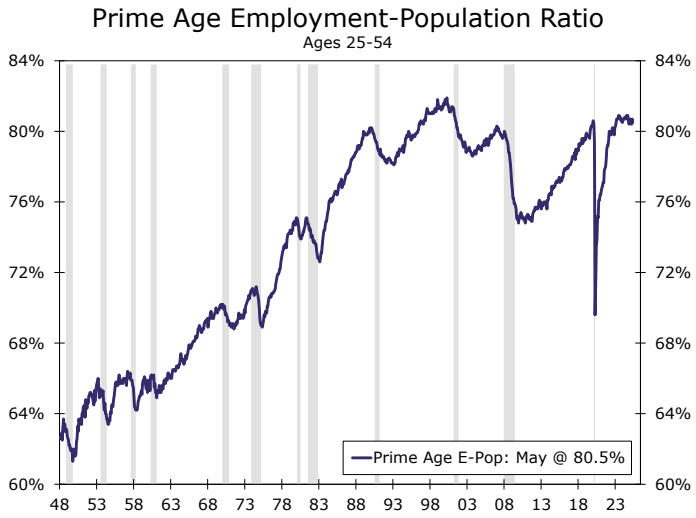
What about higher employment rates among those already inside the United States? Perhaps the answer is not increasing the pool of available workers but using the existing pool more intensely. The challenge here is that employment rates for working-age Americans are already near the all-time highs (Figure 5). Perhaps this can go a bit higher over time, but we are skeptical that it will increase dramatically in the way that prime-age employment rates did from the 1950s through the 1990s. In all likelihood, long-run real GDP growth in the United States, as well as many other countries around the world, will be hampered by slower labor force growth in the future than it experienced in the past.

Figure 4



Source: Congressional Budget Office and Wells Fargo Economics

Figure 5



Source: U.S. Department of Labor and Wells Fargo Economics

When it comes to the outlook for labor productivity growth, we think there are more reasons to be optimistic. The drivers of labor productivity growth can be divided into two factors: capital (e.g., the physical tools utilized by the workers) and total factor productivity (the intangibles that affect output per hour worked, such as education or new innovations). As Figure 6 illustrates, the past 10-20 years have seen below-average labor productivity growth. Output per hour worked in the nonfarm business sector has increased at a roughly 1.7% per annum rate over the past decade. That said, more recent years have been a bit better. Labor productivity growth has been 1.8% since the end of 2019, and since ChatGPT was released at the end of 2022, labor productivity growth has been 2.1% on an annualized basis.

The past 10-20 years have seen below average labor productivity growth.

We doubt the early innings of generative AI and other new technologies have played a major role in the perkier productivity numbers of late. But, with excitement building over continued new developments and wider adoption in the space, it strikes us as plausible that labor productivity growth may rise to at least a little bit above its long-run average in the coming years. This in turn would help boost real GDP growth even despite the headwinds from sluggish labor force growth. If realized, what would faster real GDP growth in the next decade mean for the fiscal outlook?

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Figure 6

Source: U.S. Department of Labor and Wells Fargo Economics

Faster Economic Growth Helps, but It Probably Will Not Solve the Debt Problem Alone

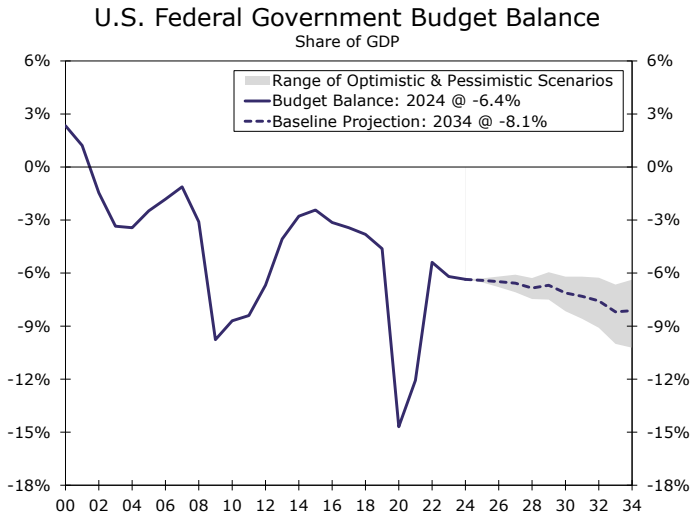
First, we need to make some policy assumptions about taxes and spending over the next decade. We have tried to make them as realistic as possible, although we readily acknowledge that numerous other combinations and permutations are possible. Generally speaking, we use a current law baseline for this analysis. The policy adjustments that we have made are 1) Republicans' reconciliation bill (OBBBA) becomes law, 2) the temporary tax cuts and spending increases in OBBBA are extended past 2028/2029 (e.g., no tax on tips/overtime income/etc., are eventually made permanent), 3) there is a 15% average effective tariff rate throughout President Trump's first term and a 6% average effective tariff rate thereafter and 4) discretionary spending holds steady at 6% of GDP over the long run. Finally, it assumes 2.1% real GDP growth, 2% inflation and an average interest rate on the national debt of 3.7% over the next 10 years, up from the current rate of 3.4%.

To better illustrate the range of possible fiscal outcomes in the years ahead, we have modeled an "optimistic" scenario and a "pessimistic" scenario for the deficit- and debt-to-GDP ratios (Figures 7 and 8). In the "optimistic" scenario, we assume real GDP growth averages 2.6% and the average interest rate on the national debt is just 3.4% over the next decade. In the "pessimistic" scenario, real GDP growth is just 1.6% on average over the next decade, while the average interest rate on the national debt is 4.0%. In a standard economic model, one would typically assume that economic growth and interest rates would move together, all else equal. But, given that many factors can influence the level of interest rates other than just economic growth, and in the spirit of generating one genuinely optimistic scenario and one pessimistic scenario, we have leaned on the scale a bit more via interest rate assumptions.

In the baseline projection, the federal budget deficit steadily widens from its present value of 6.4% of GDP to roughly 8% by 2034.

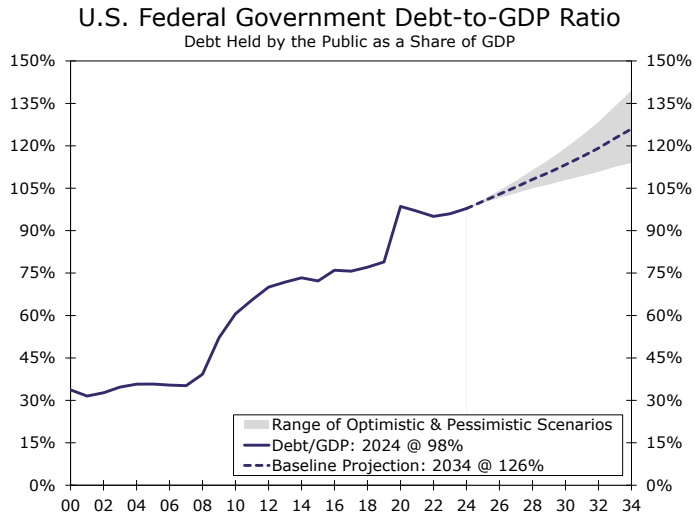
Figure 7 illustrates the range of fiscal outcomes that these three scenarios produce. In the baseline projection, the federal budget deficit steadily widens from its present value of 6.4% of GDP to roughly 8% by 2034. The debt-to-GDP ratio rises from 98% to 126%, surpassing the all-time high of 106% reached during World War II. In the pessimistic scenario, budget deficits as a share of GDP hit 10% by 2034, and the debt-to-GDP ratio surges to 140%. In the optimistic scenario, the federal budget deficit as a share of the economy remains roughly unchanged from current levels in the years ahead. The debt-to-GDP ratio continues to climb, hitting 114% in 2034, but the pace of the rise is much more gradual and less exponential than in the other scenarios.

Figure 7



Source: Congressional Budget Office and Wells Fargo Economics

Figure 8



Source: Congressional Budget Office and Wells Fargo Economics

The key takeaway from this analysis, in our view, is that it will take a very meaningful acceleration in real GDP over a long period of time to "solve" the unsustainable trajectory of the nation's public finances absent structural changes in revenues or outlays. It is undeniable that faster real GDP growth of, say, 2.6% rather than 1.8% would go a long way toward keeping the problem more manageable. But, to stabilize the debt-to-GDP ratio around 100%, it would likely take real GDP growth of more than 3% annually for the foreseeable future, all else equal.

To stabilize the debt-to-GDP ratio around 100%, it would likely take real GDP growth of more than 3% annually for the foreseeable future, all else equal.

It is not to say that this is impossible. The mid-1990s through early 2000s saw a surge in labor productivity growth as advancements in computer technology and widespread adoption of the internet led to tremendous technological change and an economic boom. Perhaps generative AI and its related technologies will lead to similar economic outcomes. If so, one could argue that this would create a better fiscal outcome than even our "optimistic" scenario. But, we would remind readers that there are additional downside risks to the fiscal outlook that we did not consider. For example, there could be a major recession that occurs at some point in the next decade that reduces economic growth and weakens public finances. There may be other unexpected developments, such as wars or natural disasters, that prompt Congress to step in with more emergency spending than is incorporated into our policy baseline. In the extreme, factors such as these could create a public debt outcome that is even worse than our pessimistic scenario.

The consequences of ever-growing public debt are real. A survey of the research literature suggests that each percentage point increase in the debt-to-GDP ratio increases long-term rates by two to three bps.[3] Applying this rule of thumb to our scenario analysis indicates that the "pessimistic" scenario would produce higher long-term interest rates via the public debt channel of 52-78 bps compared to the "optimistic" scenario. Large structural budget deficits and high debt may constrain future policymakers' ability to act in an emergency, and in an extreme scenario could lead to a fiscal crisis.

Even if real GDP growth is somewhat faster than the consensus forecast in the years ahead, we think it will still take higher taxes, lower spending or some combination of the two to reduce the federal budget deficit back to a more sustainable 3% of GDP.

Ultimately, even if real GDP growth is somewhat faster than the consensus forecast in the years ahead, we think it will still take a reduction in the primary budget deficit via higher taxes, lower spending or some combination of the two to reduce the federal budget deficit back to a more sustainable 3% of GDP. Faster economic growth would help, but unless it is as strong or even stronger than the peak of the late 1990s internet boom, it probably would not be enough to put the U.S. public debt on a sustainable trajectory.

Endnotes

1 – For example, interested readers can see the Tax Foundation's (June 6, 2025) "'Big Beautiful Bill' House GOP Tax Plan: Preliminary Details and Analysis"; American Enterprise Institute's (June 12, 2025) "A Preliminary Macroeconomic Analysis of the 'One Big Beautiful Bill Act'"; The Budget Lab at Yale's (June 6, 2025) "Long-term Impacts of the One Big Beautiful Bill Act"; Penn Wharton's Budget Model's (May 23, 2025) "The House-Passed Reconciliation Bill: Budget, Economic, and Distributional Effects"; and CBO's (June 17, 2025) "H.R. 1, One Big Beautiful Bill Act (Dynamic Estimate)." (Return)

2 – A full review of potential GDP growth and its determinants is beyond the purview of this report. We would point interested readers to our series on potential GDP growth published last year. (Return)

3 – Gambler, Edward and John Seliski. March 2019. "The Effect of Government Debt on Interest Rates." Congressional Budget Office, Working Paper 2019-01; Plante, Michael, Alexander Richter and Sarah Zubiary. April 2025. "Revisiting the Interest Rate Effects of Federal Debt." Federal Reserve Bank of Dallas, Working Paper 2513. (Return)

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