

FOREIGN AFFAIRS

SEPTEMBER/OCTOBER 2025 • VOLUME 104 • NUMBER 5

America's Coming Crash

—
Will Washington's Debt Addiction
Spark the Next Global Crisis?

KENNETH S. ROGOFF

America's Coming Crash

Will Washington's Debt Addiction Spark the Next Global Crisis?

KENNETH S. ROGOFF

For much of the past quarter century, the rest of the world has looked in wonder at the United States' ability to borrow its way out of trouble. Again and again, under both Democratic and Republican administrations, the government has used debt more vigorously than almost any other country to fight wars, global recessions, pandemics, and financial crises. Even as U.S. public debt rapidly climbed from one plateau to the next—net debt is now nearing 100 percent of national income—creditors at home and abroad showed no signs of debt fatigue. For years after the 2008–9 global financial crisis, interest rates on Treasury debt were ultralow, and a great many economists came to believe that they would remain so into the distant future. Thus, running government deficits—fresh borrowing—seemed a veritable free lunch. Even though debt-to-income levels jumped radically

KENNETH S. ROGOFF is Professor of Economics at Harvard University and a Senior Fellow at the Council on Foreign Relations. He was Chief Economist at the International Monetary Fund from 2001 to 2003 and is the author of *Our Dollar, Your Problem: An Insider's View of Seven Turbulent Decades of Global Finance, and the Road Ahead*.



after each crisis, there was no apparent need to save up for the next one. Given the dollar's reputation as the world's premier safe and liquid asset, global bond market investors would always be happy to digest another huge pile of dollar debt, especially in a crisis situation in which uncertainty was high and safe assets were in short supply.

The past few years have cast serious doubt on those assumptions. For starters, bond markets have become far less submissive, and long-term interest rates have risen sharply on ten- and 30-year

A once-in-a-century U.S. debt crisis no longer seems far-fetched.

U.S. Treasury bonds. For a big debtor like the United States—the gross U.S. debt is now nearly \$37 trillion, roughly as large as that of all the other major advanced economies combined—these higher rates can really hurt. When the average rate paid rises by one percent, that translates to \$370 billion more in annual interest payments the government

must make. In fiscal year 2024, the United States spent \$850 billion on defense—more than any other country—but it spent an even larger sum, \$880 billion, on interest payments. As of May 2025, all the major credit-rating agencies had downgraded U.S. debt, and there is a growing perception among banks and foreign governments that hold trillions of dollars in U.S. debt that the country's fiscal policy may be going off the rails. The increasing unlikelihood that the ultralow borrowing rates of the 2010s will come back any time soon has made the situation all the more dangerous.

There is no magic fix. U.S. President Donald Trump's efforts to place the blame for high rates on the Federal Reserve Board are deeply misleading. The Federal Reserve controls the overnight borrowing rate, but longer-term rates are set by vast global markets. If the Fed sets the overnight rate too low and markets expect inflation to rise, long-term rates will also rise. After all, unexpectedly high inflation is effectively a form of partial default, since investors get repaid in dollars whose purchasing power has been debased; if they come to expect high inflation, they will naturally require a higher return to compensate. One of the main reasons governments have an independent central bank is precisely to reassure investors that inflation will remain tame and thereby keep long-term interest rates low. If the Trump administration (or any other administration) moves to undermine the Fed's independence, that would ultimately raise government borrowing costs, not lower them.

Skepticism about the safety of holding Treasury debt has led to related doubts about the U.S. dollar. For decades, the dollar's status as the global reserve currency has conferred lower interest rates on U.S. borrowing, reducing them by perhaps one-half to one percent. But with the United States taking on such extraordinary levels of debt, the dollar no longer looks unassailable, particularly amid other uncertainty about U.S. policy. In the near term, global central banks and foreign investors may decide to limit their total holdings of U.S. dollars. Over the medium and longer term, the dollar could lose market share to the Chinese yuan, the euro, and even cryptocurrency. Either way, foreign demand for U.S. debt will shrink, putting further upward pressure on U.S. interest rates and making the math of digging out of the debt hole still more daunting.

Already, the Trump administration has hinted at more drastic actions to deal with mounting debt payments, should gaining control of the Fed not be enough. The so-called Mar-a-Lago Accord, a strategy put forward in November 2024 by Stephen Miran, now head of Trump's Council of Economic Advisers, suggests that the United States could selectively default on its payments to the foreign central banks and treasuries that hold trillions of U.S. dollars. Whether or not the proposal was ever taken seriously, its very existence has rattled global investors, and it is not likely to be forgotten. A clause proposed for the huge tax and spending bill that was passed by the U.S. Congress in July would have given the president discretion to impose a 20 percent tax on select foreign investors. Although that provision was removed from the final bill, it stands as a warning of what might come if the U.S. government finds itself under budget duress.

With long-term interest rates up sharply, public debt nearing its post-World War II peak, foreign investors becoming more skittish, and politicians showing little appetite for reining in fresh borrowing, the possibility of a once-in-a-century U.S. debt crisis no longer seems far-fetched. Debt and financial crisis tend to occur precisely when a country's fiscal situation is already precarious, its interest rates are high, its political situation is paralyzed, and a shock catches policymakers on the back foot. The United States already checks the first three boxes; all that is missing is the shock. Even if the country avoids an outright debt crisis, a sharp erosion of confidence in its creditworthiness would have profound consequences. It is urgent for policymakers to recognize how and why these scenarios could unfold

and what tools the government has to respond to them. In the long term, a severe debt or, more likely, an inflationary spiral could send the economy into a lost decade, drastically weakening the dollar's position as the dominant global currency and undermining American power.

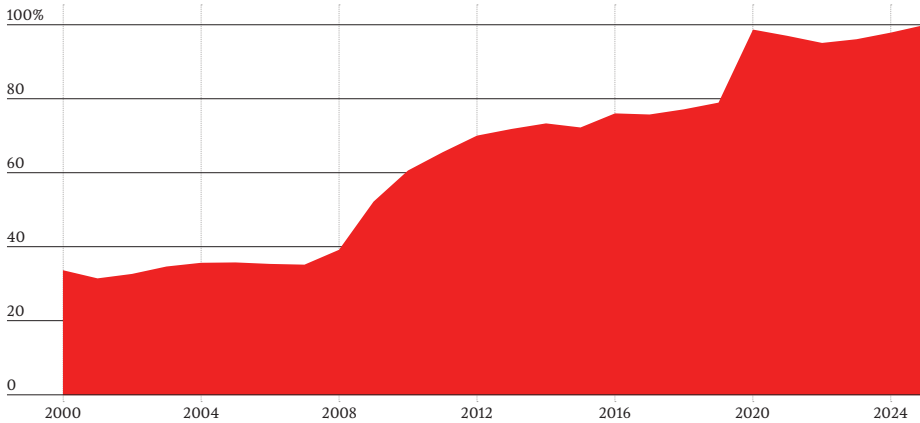
THEIR MONEY, OUR GAIN

It is crucial to understand that the Trump administration's economic policies are an accelerant, rather than the fundamental cause, of the United States' debt problem. The story really begins with President Ronald Reagan in the 1980s, an era of deficit spending in which the U.S. debt-to-GDP ratio was about a third of what it is today. As Vice President Dick Cheney said during the first George W. Bush administration, "Reagan proved deficits don't matter." It is an assumption that both parties appear to have taken to heart in the twenty-first century, despite far more worrying debt burdens. In fiscal year 2024, for example, the Biden administration ran a budget deficit of \$1.8 trillion, or 6.4 percent of GDP. Except for the global financial crisis and the first year of the pandemic, that was a peacetime record, slightly exceeding the 6.1 percent of the previous year. President Joe Biden's deficits would have been larger still but for determined resistance from two centrist Democratic senators who bid down some of the administration's most expansive spending bills.

During his 2024 presidential campaign, Trump pilloried Biden for his administration's massive deficit spending. Yet in his second term in office, Trump has embraced similarly large deficits—six to seven percent of GDP for the rest of the decade, according to independent forecasts produced by the Congressional Budget Office and the Committee for a Responsible Federal Budget. The latter has projected that, by 2054, the U.S. debt-to-GDP ratio will reach 172 percent—or an even higher 190 percent if the bill's provisions become permanent. Trump and his economic advisers claim that such forecasts are overly pessimistic—that the projections for growth are far too low and those for interest rates far too high. Higher growth will bring in larger future tax receipts; lower interest rates mean the debt will be less costly to service. If Team Trump is right, both factors will actually lower deficits and tilt the trajectory of debt to income downward. Whereas in January 2025, the CBO projected an annual growth rate of 1.8 percent over the next decade, the administration has put the figure at 2.8 percent. The difference is significant: if the U.S. economy is

IN THE RED

U.S. net public debt as percent of GDP



Source: Congressional Budget Office. Data as of January 2025.

growing at 1.8 percent annually, it will double in size (and presumably tax revenues) every 39 years. At 2.8 percent, it would double every 25 years. For Trump, assuming that kind of rapid growth has made it easier to finance a lot of budget giveaways.

There is a substantive basis for the Trump administration's growth projections, although it has little to do with the claimed benefits of the "big, beautiful bill" passed in July. Many prominent technology experts firmly believe that as long as the government stays out of the way, artificial intelligence companies will achieve Artificial General Intelligence, meaning AI models that can equal or outperform human experts at a wide variety of complex cognitive tasks, within ten years, leading to explosive productivity growth. Indeed, the progress of AI research has been breathtaking, and there are strong reasons for assuming that AI's effect on the economy will be profound. But in the medium term, widespread adoption of AI could be hindered by multiple bottlenecks, including outsize energy requirements, data regulations, and legal liabilities. Moreover, as AI allows companies in some sectors to lay off scores of workers, public discontent could encourage populist politicians to push through policies that—along with aggressive limits on legal immigration, cuts in funding for scientific research, and the chaotic tariff war that are already underway—could dramatically slow the effects of AI on growth.

Regardless of when and how the AI revolution unfolds, it's possible that another major economic shock may not be far off. During the COVID-19 pandemic, a short-lived recession and the large-scale government response to it added debt roughly equivalent to 15 percent of GDP; in the case of the global financial crisis, the debt added was closer to 30 percent of GDP. It seems reasonable to assume that another shock approaching this magnitude—a cyberwar or even a full-blown military conflict, a climate catastrophe, or another financial crisis or pandemic—will come in the next five to seven years. One might view the more modest CBO growth projections as realistically balancing the odds that the economy could see fantastic growth, most likely driven by AI, with the odds of a new shock.

How fast the U.S. debt level grows will also depend on the interest rate. The CBO has estimated that the government will have to pay an average interest rate of 3.6 percent through 2055. (This average takes into account that the government borrows at both short- and long-term maturities.) Here, too, the Trump administration views the CBO as far too pessimistic. The president seems to believe that the economy can go back to the extremely low interest rates of his first term, when they averaged less than half the current rates and there was only very modest inflation. It is hard otherwise to understand why he would be pressing for the Fed to cut its short-term policy interest rates by as much as three percentage points.

Trump's view should not be dismissed out of hand. Several members of the Federal Open Market Committee, which periodically reports where it believes the Fed's short-term policy rate will land in a couple of years, see much lower rates as the central scenario. Yet with the 30-year Treasury bill rate near five percent as of late July, market indicators do not signal that a sharp drop in long-term rates is coming. If they remain at or near this level, there are real risks to continuing to push up the debt, especially when the biggest crisis in the U.S. economy for now is a political one.

MAGIC MOUNTAIN

Washington's failure to deal with its runaway debt problem is in part the result of misguided (or at least oversold) economic theories that took hold over the last two decades. Throughout most of modern history, it was thought that prudent government debt management involved bringing down the ratio of debt to GDP during quiescent

periods of growth in order to store fiscal ammunition for the next crisis. In the 1800s, the United Kingdom used debt to fight one war after another, taking advantage of the time in between to repair its finances. Likewise, although the U.S. debt-to-GDP ratio was very high during World War II, it quickly declined in the years that followed; since the United States had just fought two world wars, policymakers feared there might be yet another. To pay for the Korean War, the Eisenhower administration famously raised taxes instead of relying mainly on debt. But in the years following the global financial crisis, the persistent very low interest rates that took hold caused a number of leading economists to question this orthodoxy.

In his influential theory of secular stagnation, the former U.S. Treasury Secretary Lawrence Summers posited that real (inflation-adjusted) interest rates would stay low indefinitely because of factors such as adverse demographics, low productivity growth, and chronically weak global demand. Others, such as the economist Paul Krugman and Olivier Blanchard, the former chief economist of the International Monetary Fund, suggested that the secular stagnation cloud had a silver lining in that reliably low rates allow the government to use fiscal policy aggressively without worrying too much about the cost. Normal economic growth would continually swell tax revenues by more than enough to cover glacially rising interest bills on the national debt, the thinking went, at least on average over time. Indeed, so rosy was the interest-rate picture in the 2010s that some economists, including proponents of modern monetary theory, argued that there would be little risk to running larger deficits even when the economy was growing briskly. In this view, which was embraced by progressive politicians such as Representative Alexandria Ocasio-Cortez and Senator Bernie Sanders, deficit spending was a low-cost means of paying for social investment, including ambitious climate protections and policies to reduce inequality.

To be fair, Democrats were hardly in universal agreement about any debt-driven approach. Even as he ran outside deficits to pay for progressive priorities, Biden made clear that over the long run, he hoped to meet the cost by raising taxes, and he might have done so with a larger Democratic majority in the Senate. By contrast, Republican administrations continued to espouse the idea that budget deficits did

An inflationary spiral could send the economy into a lost decade.

not matter if they were used to pay for tax cuts, since higher growth would turn the deficits into surpluses over time. Although this claim was widely understood to be overstated, the general view, including on Wall Street, was that ultralow interest rates would save the day even if the extra growth from tax cuts proved insufficient.

As debt debates became highly politicized, economists who questioned the lower-rates-forever orthodoxy were shunned or ignored. Yet anyone looking at the long history of interest-rate fluctuations would have recognized that a return to higher rates was a distinct, indeed likely, possibility. Consider the interest rate on ten-year inflation-indexed U.S. Treasury bonds, which are often used as a measure of the real interest rate in the economy. The rate fell by roughly three percentage points between September 2007 and September 2012, a collapse that can hardly be explained by slow-moving trends such as demographic decline and falling productivity. A far more plausible explanation was the prolonged effects of the global financial crisis and its aftermath. As with other past financial crises, these effects would eventually end, and one might reasonably have guessed that the era of ultralow interest rates would end as well.

True, some of the factors that contributed to very low interest rates are still present today, including aging populations in most advanced countries. But there are plenty of reasons to think that long-term interest rates will remain higher well into the future. Foremost, government debt is exploding globally, putting upward pressure on U.S. rates in a world of integrated capital markets. For example, the average net debt-to-GDP ratio for the G-7 countries has grown from 55 percent in 2006 to 95 percent today. In fact, the United States is not even the worst offender: Japan's net debt-to-GDP ratio is 134 percent (its gross public debt is a staggering 235 percent of GDP). For Italy, the ratio is 127 percent; France, 108 percent; and the United States, 98 percent. Other upward pressures on interest rates include the rise in many countries of populist parties, which are pushing for more domestic spending; AI's voracious appetite for electricity, which generates a huge demand for investment that has to be financed; tariff wars and the fracturing of global trade, which are forcing companies to invest in reshoring, with massive borrowing; and the ever-growing cost of adapting to climate change and responding to climate disasters. Although some economists, taking note of these trends, have begun to reconsider the seductive assumptions of the 2010s, there is little sign that Washington has. And

with high interest rates, already vertiginous levels of debt, political upheaval, and challenges to Fed independence, there is now a real risk that a fresh economic shock could precipitate a broader collapse.

THE GREAT RECESSION

How and when a debt crisis in the United States could unfold is now the \$37 trillion question. In one scenario, the trigger will be a collapse of confidence by investors in U.S. Treasuries—a “crack in the bond market,” as Jamie Dimon, the CEO of JPMorgan Chase, warned in May—meaning a sudden spike in interest rates that revealed a larger problem. This is not as hyperbolic as it may sound; debt crises often build up steam quietly for what seems like forever before erupting unexpectedly. Alternatively, investors’ growing fears about the safety of their money could cause a gradual rise in Treasury bond yields over many months or even years.

Rising interest rates do not in themselves constitute a crisis. But if driven by debt concerns, they will push down stock and housing prices, make business investment more challenging, and raise the cost of servicing government debt. If this process unfolded slowly, the government would have time to react. If it doesn’t do so forcefully—typically, by closing the current budget deficit and credibly committing to fiscal rectitude—markets would smell blood, interest rates would go up even more, and the government would need to make even bigger adjustments to steady the ship. As long as the country remained stuck in this high-interest debt purgatory, business and consumer confidence would be low and growth would stall. The usual U.S. solution of running a giant deficit would likely backfire and lead to even higher interest rates. To escape this situation without crushing austerity measures, the government would almost certainly reach for heterodox options that are today more usually associated with emerging markets.

For one, the United States could default outright (in the legal sense) on its debt. It has done so before. In 1933, President Franklin Roosevelt abrogated the so-called gold clause for U.S. Treasury debt, which guaranteed creditors that they could choose to be paid in gold, instead of dollars, at \$20.67 per ounce. The next year, the conversion rate of dollars to gold was set at \$35 per ounce, sharply devaluing the currency. In a highly controversial case, the Supreme Court ruled in 1935 that Roosevelt’s abrogation of the gold clause in public debt

was indeed a default. But under enormous political pressure from the president, the court simultaneously ruled that creditors were not entitled to compensation because no harm had been done. Really? For foreign central banks across the world that had been holding U.S. Treasury bonds on the assumption that they were as good as gold, the 1933 default was quite painful.

Given that the United States can print dollars rather than refuse to honor its debt, a far simpler option is to use high inflation to achieve a partial default. Of course, the independence of the Fed poses a significant obstacle to this, but not an insurmountable one in a true crisis. The Fed's independence is not mandated by the Constitution, and the president has many ways to induce it to lower interest rates. The first, clearly, is to appoint a chair who believes it will be in the national interest to radically cut interest rates, even if that creates inflation. This solution, however, has limits, starting with the fact that Fed chairs serve for four years, and the Supreme Court has indicated, in a May ruling, that the president cannot fire them over policy differences. Moreover, the Fed chair leads the Open Market Committee, which consists of the seven Fed governors in Washington, the president of the Federal Reserve Bank of New York, and four rotating representatives of the 11 other regional Federal Reserve Banks. These positions typically rotate infrequently; a full term for a Fed governor is 14 years, and only one position is guaranteed to open up in 2026.

With the cooperation of Congress, however, the president can do much more. For example, Congress could empower the Treasury to dictate the Fed's short-term interest rate target during a national emergency, including a debt crisis. This is more or less what happened in World War II and its immediate aftermath. It could also pack the Federal Reserve Board with new members, as Roosevelt threatened to do with the Supreme Court in the 1930s. A battle of that scale between the Fed and the president would take the country into uncharted territory. But even if the Fed submits and cuts rates sharply, inflation is not the get-out-of-jail-free card some believe it to be. Whereas a truly massive bout of hyperinflation, such as what happened in Germany after World War I, would effectively wipe government debt off the books, it would wipe out the rest of the economy, as well: ask the citizens of Venezuela and Zimbabwe, who have suffered epic hyperinflation in this century. More plausibly, a few years of 1970s-style inflation—in 1979 inflation reached more than 14 percent per year in

the United States—would crater the value of long-term bonds but have less effect on short-term debt, which would have to be refinanced at higher interest rates. And such a prolonged spike would likely be very damaging to both the U.S. and the global economy.

One way to manage the effects of inflation is to use it in conjunction with financial repression. In this strategy, governments stuff public debt into the financial sector via banks, pension funds, and insurance companies, with the central bank typically buying massive quantities as well. By creating a vast captive market for public debt, the government can lower the interest rate it has to pay and significantly reduce the odds of any sudden flight from its bonds. Financial repression can be made more potent by restricting other assets people can hold or by imposing interest rate controls. This is not as exotic as it sounds: governments around the world have used financial repression for most of modern history. After World War II, governments leaned heavily on financial repression to help inflate their way out of massive public debts. Without financial repression, U.S. debt in relation to GDP would likely have continued to grow from 1945 to 1955; instead, it fell by more than 40 percent. In some countries, notably the United Kingdom, results were even more dramatic. Today, the strategy is especially widespread in emerging markets, but Europe used financial repression to hold the euro together during the European debt crisis, and Japan has used it on an even greater scale; the Bank of Japan alone holds Japanese government debt equal to nearly 100 percent of the country's income.

Since the global financial crisis, the United States has also pursued some financial repression through financial regulations and Federal Reserve purchases of long-term Treasury bonds. In a pinch, it could do much more. Financial repression is particularly effective in a high-inflation environment, in which, ordinarily, markets would drive up interest rates on government debt. On the other hand, repression negatively affects long-term growth by absorbing bank financing that could be going to the innovative firms in the private sector. The use of financial repression to deal with high debt is hardly the only reason for Japan's miserable growth record over the past few decades, but it is certainly a leading one.

No country has been able to sustain a dominant currency without also being a superpower.

As the Japanese experience has shown, financial repression would offer no panacea to the United States. It really only works on domestic savers and financial institutions that cannot easily avoid the implicit tax on their savings and income. If Washington used it in a large-scale way, foreign investors, who now hold close to a third of the U.S. debt, would try to flee, and it would not be easy to stop them without engaging in outright default. Moreover, the United States is highly dependent on its financial sector to drive its exceptionally innovative economy. And just as the costs of inflation fall most heavily on lower-income individuals, so, too, do the effects of financial repression, since the wealthy have workarounds.

Alongside default, austerity, inflation, and financial repression, a prospective new option for dealing with high debt is emerging, whose costs and benefits are not yet fully understood. This involves a form of cryptocurrency called dollar stablecoins. Unlike conventional cryptocurrency such as Bitcoin, whose dollar value fluctuates wildly, stablecoins are pegged to the dollar, typically at a value of one to one. New U.S. legislation passed by Congress in 2025 has attempted to provide a clear regulatory framework by requiring that U.S.-based dollar stablecoins hold a mix of Treasury debt and federally guaranteed bank deposits sufficient to (almost) pay off all coin holders in the event of a run. This requirement could potentially create a captive pool of stablecoins whose issuers hold large quantities of Treasury bills. To the extent that stablecoins compete for funds that might normally be allocated to banks, they provide a backdoor to routing bank deposits into Treasury debt. For now, it is unclear whether the new legislation will promote stability or undermine it, given a number of unresolved issues having to do with the risk of runs on stablecoins and how their circulation can be audited to prevent their use for criminal purposes or tax evasion.

In principle, the Federal Reserve can also issue its own stablecoin, or central bank digital currency. This, too, would compete with bank deposits and channel savings toward Treasury debt unless the funds were in turn used in lending to the private sector, a process that would create its own problems. A Fed digital currency would differ from stablecoins in other important ways. For one thing, it would, by design, be backed by the full faith and credit of the United States government, and presumably tracking its use would pose less of a concern. On the other hand, competitive private stablecoins would likely be far more innovative. Although none of the available options

for dealing with unsustainable debt are particularly attractive, it is nevertheless important that the government begin to contemplate them seriously. Not only does Washington need to be prepared for the next shock when it comes, but politicians and policymakers must also recognize what will happen if the government continues to assume that the United States can never have a debt crisis.

END OF AN EMPIRE

For too long, the status quo approach in Washington has been to ignore the massive debt problem and hope that a return to miraculous levels of growth and low interest rates will take care of it. But the United States is approaching the point at which the national debt could undermine not only the country's economic stability but also the things that have sustained its global power for so many decades, including the military spending that it has leveraged in many ways to maintain the dollar's formidable influence over the global financial system since World War II. Whether in the case of Spain in the sixteenth century, the Netherlands in the seventeenth century, or the United Kingdom in the nineteenth century, no country in modern history has been able to sustain a dominant currency without also being a superpower.

The United States may avoid a debt crisis, and Trumpian and progressive economists who count on growth dividends ultimately outweighing the interest costs of higher debt may turn out to be right. But the debt policy that both the Republican and the Democratic Parties have engaged in over the first quarter of the twenty-first century amounts to a huge wager on long odds, especially if the country wants to remain a dominant power for the rest of this century and beyond. Given the current trajectory of deficits, it has become much more difficult to sustain the belief that no matter how high U.S. debt gets, it will have no effect on the country's capacity to fight financial crises, pandemics, climate events, and wars. And it will certainly be a drag on the country's growth.

It is impossible to predict how and when a U.S. debt problem may erupt and what the consequences will be: unpalatable austerity, high inflation, financial repression, partial default, or a mix of these. There are strong reasons to assume that inflation will have a pronounced part, as it did during the 1970s. Regardless, a debt crisis will be destabilizing for the United States, the global economy, and the dollar's reserve status. Left unchecked, it could erode the country's position in the world. 🌐