

William G. Gale and Peter R. Orszag

“Budget Deficits, National Saving, and Interest Rates”

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This paper provides new evidence that sustained federal budget deficits reduce national saving and raise interest rates by economically and statistically significant amounts. Using a series of consumption function and Euler equation specifications that nest Ricardian and non-Ricardian models, we obtain evidence of non-Ricardian behavior in aggregate consumption. Our preferred estimates suggest that an increase in the federal deficit equal to 1 percent of GDP reduces national saving by 0.5 to 0.8 percent of GDP. Consistent with several recent studies, we also find that projected deficits affect forward long-term interest rates. For each percent of GDP that the projected unified deficit rises, forward long-term interest rates rise by 25 to 35 basis points, and for each percent of GDP that the projected primary deficit rises, forward interest rates by 40 to 70 basis points.

JEL classification codes: E0, H0.