Running Primary Deficits Forever in a Dynamically Efficient Economy Feasibility and Optimality

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Government debt can be rolled over forever without primary surpluses in some stochastic economies, including some economies that are dynamically efficient. In an overlapping-generations model with constant growth rate, g, of labor-augmenting productivity, and with shocks to the durability of capital, we show that along a balanced growth path, the maximum sustainable ratio of bonds to capital is attained when the riskfree interest rate, r[sub]f, equals g. Furthermore, this maximal ratio maximizes utility per capita along a balanced growth path and ensures that the economy is dynamically efficient.

**Url:**<https://www.nber.org/papers/w30554>