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Can an AI Productivity Boom Strengthen USA Inc.?

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In our February 2026 client letter, ***Regimes Are Changing***, we asked readers to think about the United States as a very large and very successful company—"USA Inc." The analogy remains useful. Like any company, the country has an income statement, a balance sheet, productive assets, competitive advantages, obligations, and a need to invest for future growth.

USA Inc. enters this period with extraordinary strengths.

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It operates at unmatched scale, has the world's deepest capital markets, issues, the primary global reserve currency, and remains home to many of the world's most innovative and profitable companies. It also benefits from abundant energy and agricultural resources, leading universities, a skilled workforce, strong institutions, and an ability to attract capital and talent from around the world. Few enterprises possess a comparable collection of assets or a greater capacity to adapt when change becomes necessary.

The principal risk is the balance sheet. Federal debt held by the public is now near the size of the economy, annual deficits remain large even outside recession, and higher interest rates are steadily repricing the government's obligations. In 2025, federal interest outlays absorbed approximately 18.5% of federal receipts. Under the Congressional Budget Office's February 2026 baseline, net interest could consume roughly 26% of receipts by 2036—more than one out of every four dollars collected by the federal government.

The immediate danger is not that USA Inc. lacks the resources to meet its obligations. The danger is that debt and interest expense consume a growing share of its income, leaving less capital available for defense, infrastructure, research, energy systems, and other investments needed to strengthen the enterprise. Because the debt must be continually refinanced, debt issued at lower interest rates is being replaced with debt issued at higher rates, raising the government's financing cost. Persistent deficits then add to the amount that must be financed, causing interest expense to compound even faster.

If USA Inc. were a public company, its board would not respond by focusing only on the debt balance. It would also examine the cost structure, capital allocation, asset productivity, and the ability of the enterprise to grow revenue faster than its obligations. The federal government must restrain spending and reform the long-term drivers of the deficit. But the most constructive way to improve the fiscal outlook is to increase the output generated from each hour of work and each dollar of capital. **That is why productivity matters.**

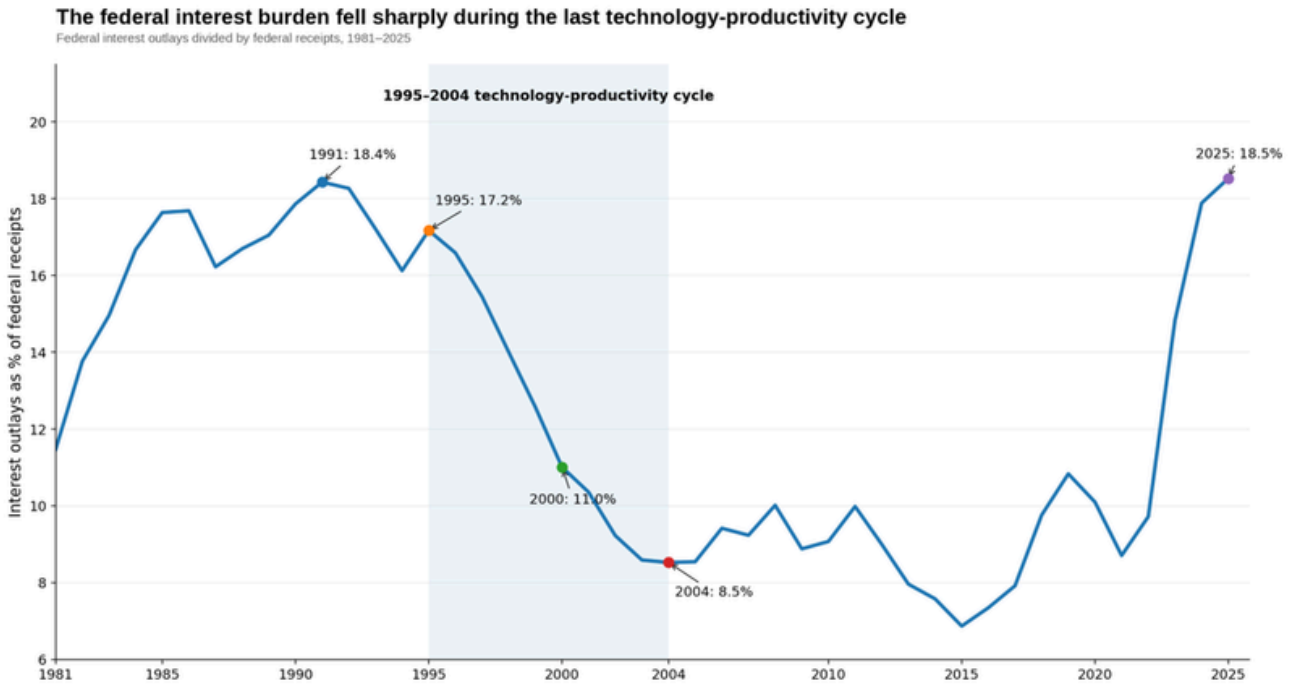
Artificial intelligence provides the United States an opportunity to raise that productive capacity. But realizing that opportunity will require elected officials, the managers of USA Inc., to work collectively to pursue growth policies that benefit all stakeholders, rather than engage in political brawls, fearmongering, and policy obstruction. This is not an argument that AI will solve the federal debt problem. It will not. Nor should stronger revenue growth be treated as permission to create new obligations. The more important point is that productivity can expand real output, wages, profits, and the tax base without requiring an equivalent increase in inflation. Fiscal consolidation in an economy growing 3%–4% in real terms is far less painful than the same adjustment in an economy growing closer to 2%.

The Debt and Interest Problem

The fiscal position has become more sensitive to interest rates because public debt is much larger than in prior cycles. In 1991, interest outlays consumed 18.4% of federal receipts while debt held by the public was approximately 44% of GDP. In 2025, the interest burden returned to roughly the same level, but public debt approached 98% of GDP. The similar interest burden therefore masks a debt level more than twice as large relative to the economy.

Higher interest rates create a difficult feedback loop. Larger interest payments widen the deficit, requiring more Treasury issuance, often at higher yields. Those yields then raise future refinancing costs, while elevated government borrowing competes with private investment and places upward pressure on other borrowing costs.

The following chart shows the result. From 1994-2004 the federal interest burden fell steadily through the technology-productivity expansion as stronger growth and fiscal restraint increased receipts and reduced borrowing needs. Lower market rates gradually reduced refinancing costs. By 2004, interest outlays had fallen to 8.5% of receipts. The burden has since returned to 18.5%, but now supports a debt level more than twice as large relative to GDP.



Source: U.S. Office of Management and Budget; Federal Reserve Bank of St. Louis (FRED). Interest as a share of receipts is calculated as federal interest outlays divided by federal receipts. The shaded period marks the 1995–2004 technology-productivity cycle.

The interest burden therefore matters more than the headline debt level alone. The danger develops when interest expense persistently grows faster than receipts, consuming a rising share of the budget and leaving less flexibility to invest in the future or respond to the next recession, war, or financial disruption.

The Traditional Ways Governments Reduce Debt

Historically, governments have dealt with excessive debt in a limited number of ways: default or restructuring, inflation, higher taxes or lower spending, keeping borrowing costs artificially low, or growing the economy faster than the debt. None is painless.

Default would be extraordinarily damaging to the United States and the global financial system. Inflation reduces the real value of debt, but it also reduces purchasing power and eventually raises borrowing costs. Spending cuts and tax increases can improve government finances, but if taken too far they can weaken economic growth. Keeping borrowing costs below inflation can reduce the real interest burden over time, but it penalizes savers and distorts capital allocation.

That leaves one particularly important part of the solution: growth. If the economy and federal revenues can grow faster than the debt, the burden becomes more manageable. With the labor force expected to grow slowly, productivity—producing more from each hour of work—becomes especially important.

Why Productivity Changes the Arithmetic

Productivity is often discussed as an abstract economic statistic. Its practical meaning is straightforward: when workers and businesses produce more from the same amount of labor, equipment, energy, and time, real income rises.

Higher productivity can lower company costs, support margins, and create room for higher wages. It also expands taxable incomes and profits and increases the size of the economy against which the debt is measured.

The inflation benefit is equally important. If hourly compensation rises 4% while productivity rises only 1.5%, unit labor costs increase approximately 2.5%. If productivity rises 3.5%, the same wage increase produces unit labor-cost growth of only about 0.5%. At 4% productivity, wages can rise 4% with essentially no increase in labor cost per unit of output.

Productivity does not eliminate inflation. Housing, energy, tariffs, imported goods, regulation, and profit margins still matter. But it gives the Federal Reserve more room to accommodate growth and wage gains without assuming they must generate inflation.

The 1990s Provide the Best Recent Example

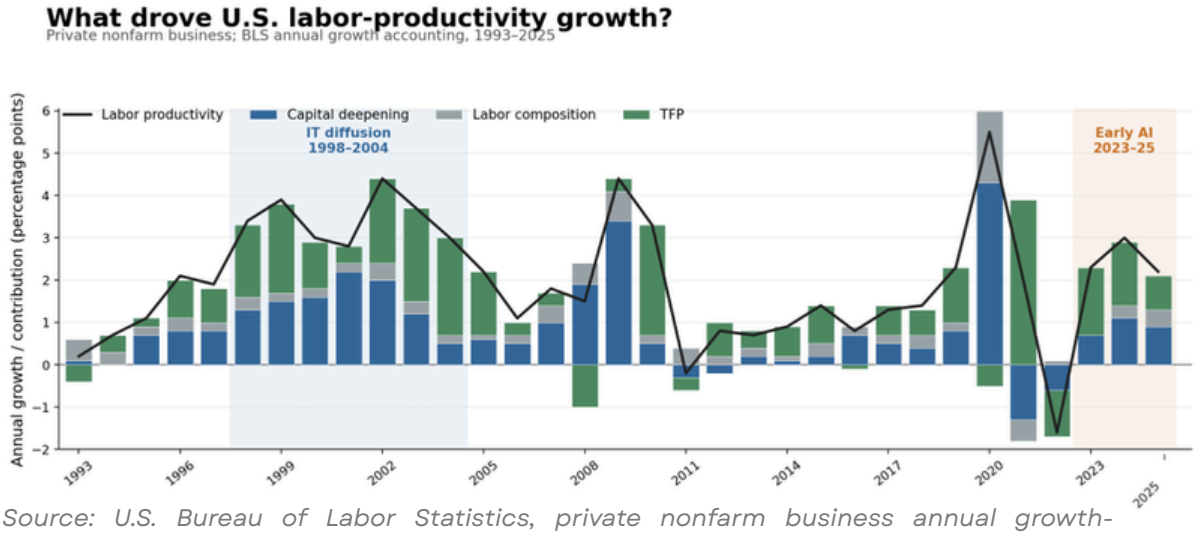
The productivity acceleration from 1990 through 2004 was not driven by a single invention. It reflected the widespread adoption of personal computers, enterprise networking, software, databases, and ultimately the internet. Businesses first invested in the technology. The larger gains arrived as it became cheaper and easier to deploy—and as companies redesigned inventory management, procurement, supply chains, customer relationships, and internal communication around it. Productivity therefore spread well beyond the technology sector.

Private nonfarm business labor productivity accelerated from 1.6% annual growth in 1990–95 to 2.9% in 1995–2000. During the broader 1998–2004 diffusion period, productivity averaged approximately 3.46%. Real GDP grew about 4.1% annually from 1995 through 2000 while inflation remained comparatively restrained.

The cycle also began from a considerably higher interest-rate base. The 10-year Treasury yield averaged more than 8% in 1990, and fed funds rates were also well above current levels. Productivity did not lower rates by itself. Inflation restraint, deficit reduction, slower federal borrowing, and confidence in the fiscal outlook all mattered. But stronger productivity allowed the economy and tax base to grow without a comparable rise in inflation, helping both short- and long-term rates decline.

The expansion also survived meaningful energy-price pressure. Oil prices spiked during the 1990–91 Gulf crisis and rose sharply again near the end of the decade. Productivity did not eliminate those higher costs, but it offset part of them by reducing the labor, capital, and time required to produce each unit of output. That is an important precedent as electricity, natural-gas, fuel, and infrastructure costs place pressure on inflation and margins today.

The source of the productivity gains matters as much as the headline number. Some of the improvement came from giving workers better technology and equipment. But companies also became better at combining people, technology, and capital. That tells us the gains eventually went beyond simply buying new technology—they changed how businesses actually operated.



Source: U.S. Bureau of Labor Statistics, private nonfarm business annual growth-accounting data. The shaded periods identify the 1998 to 2004 IT diffusion cycle and the early AI period from 2023 to 2025. Components may not sum exactly because of rounding.

The fiscal improvement was striking. Interest outlays fell from 18.4% of federal receipts in 1991 to 11.0% in 2000 and 8.5% in 2004. Deficit reduction, spending restraint, strong tax receipts, lower debt issuance, and falling interest rates all mattered. Productivity supplied the growth that made restraint easier to sustain, allowing receipts and the economy to compound faster while slowing debt accumulation and future interest expense.

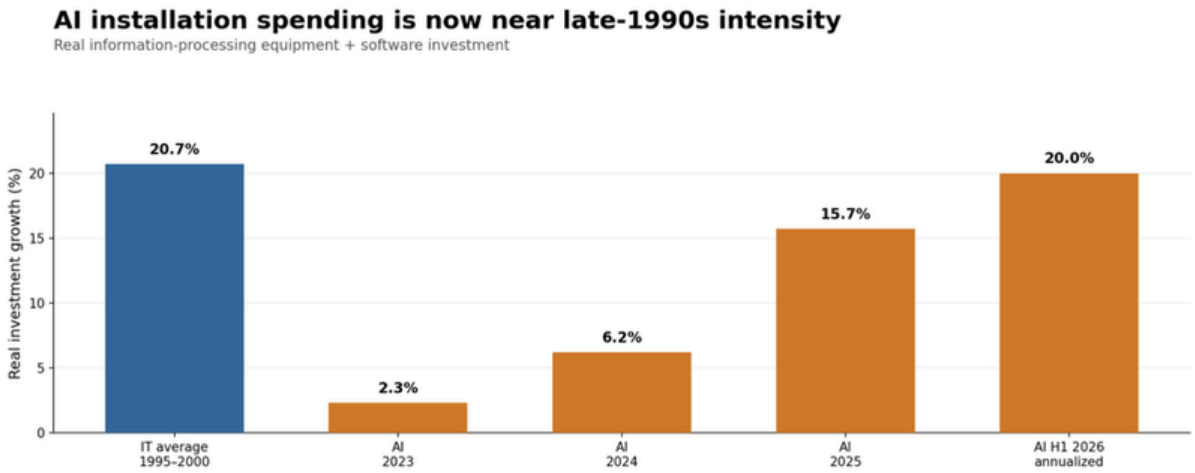
AI May Be Starting a Similar Cycle

The current AI cycle is not yet comparable to the mature technology boom of the late 1990s. Though, it has moved through a recognizable sequence: first building the models and infrastructure, then testing the technology inside enterprises, and now beginning to place AI inside production workflows.

Artificial intelligence has the potential to follow the same pattern across an even larger share of the economy. The technologies of the 1990s transformed how information was stored, processed, and moved. AI can also improve how information is interpreted, decisions are made, and work is performed. Its reach extends beyond knowledge work into robotics, industrial automation, autonomous systems, and AI-enabled machinery. Broad adoption across digital and physical operations creates a credible opportunity to match—or potentially exceed—the productivity gains achieved from 1990 through 2004.

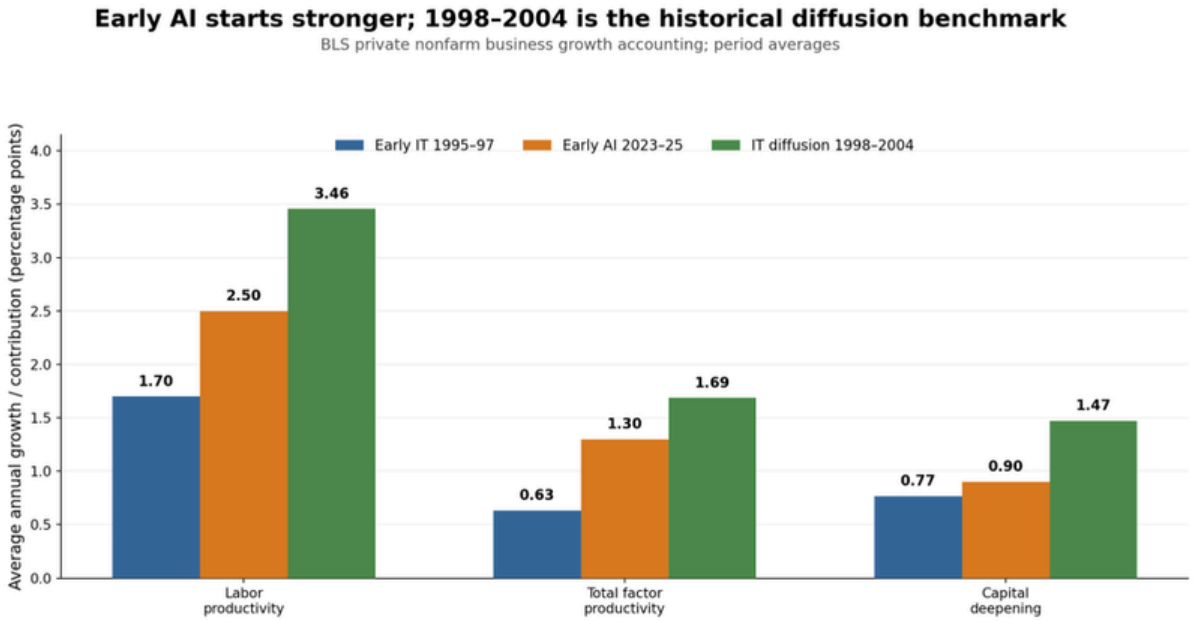
The first phase concentrated on training large language models and building the infrastructure to support them. Hyperscalers and model developers constructed data centers and purchased GPUs, memory, servers, storage, and high-speed networking. This created the supply of intelligence, but did not prove that most businesses could use it profitably.

The current buildout is approaching the intensity of the late-1990s installation cycle. Real investment in information-processing equipment and software grew 15.7% in 2025 and reached a 20.0% annualized pace in the first half of 2026, just below the 20.7% average during 1995–2000. That does not prove a productivity boom. It does, however, show that businesses are putting enough capital in place to make broad adoption possible.



Source: U.S. Bureau of Economic Analysis, real private fixed investment in information-processing equipment and software. H1 2026 growth is annualized from Q4 2025 to Q2 2026; the 1995–2000 bar is the average annual growth rate during the IT installation phase.

The early comparison is encouraging, although three years of data is not enough to establish a durable trend. Private nonfarm business productivity averaged approximately 2.5% during 2023–25, compared with 1.7% during the opening years of the information-technology cycle. These early gains appear to reflect businesses learning to use AI more effectively, while much of the 2025–26 investment wave has yet to appear in measured productivity.



Source: U.S. Bureau of Labor Statistics, private nonfarm business annual growth-accounting data; period averages calculated from annual observations. Early IT = 1995 to 1997; early AI = 2023 to 2025; IT diffusion = 1998 to 2004.

The second phase brought AI into the enterprise through copilots and pilot programs. Companies tested document drafting, research, software development, customer service, and other discrete tasks. These pilots allowed management teams to measure time saved, accuracy, employee acceptance, implementation cost, and output quality before committing more capital.

The third phase is now beginning: embedding AI inside production workflows. Claims processing, engineering, sales, supply chains, and manufacturing systems contain many connected steps. When AI performs several of those steps, directs equipment, routes exceptions to employees, and learns from outcomes, companies can produce more with the same labor and capital. That is the organizational change most likely to improve profitability and eventually appear in economy-wide productivity.

Company reports of productivity gains are useful, but selective. A more telling signal may be the breadth of enterprise spending on AI infrastructure and integration. Some projects will fail, but widespread spending on servers, storage, networking, cybersecurity, data preparation, software integration, and power suggests that a growing number of companies have seen meaningful benefits—or a credible path to them—inside their own operations.

The Next Test Is Broad Enterprise Absorption

Prior technology cycles show that organizational adoption takes years. Moving from model training to pilots and then to production workflows is not automatic. Companies still need clean data, redesigned processes, governance, security, employee training, and management systems capable of using the technology effectively.

This makes 2027–30 the first serious test of the AI productivity thesis. The question is whether AI spreads into ordinary production across enough companies and industries to raise company-wide output. The case strengthens if productivity remains above the post-2007 trend and businesses move from individual copilots to integrated workflows. It weakens if capital spending remains enormous while productivity falls back, adoption stalls, or time savings fail to translate into output.

What Different Productivity Outcomes Could Mean

The following scenarios are not forecasts. They are intended to show why relatively small changes in sustained productivity can produce large differences when compounded across a decade.

Sustained labor productivity	Potential real GDP growth	Unit labor-cost growth with 4% compensation	Illustrative 2035 debt to GDP
1.5%	~1.9%	~2.5%	118%
2.5%	~2.9%	~1.5%	105%
3.0%	~3.4%	~1.0%	99%
3.5%	~3.9%	~0.5%	93%
4.0%	~4.4%	~0.0%	87%

Source: Scenario calculations based on the Congressional Budget Office February 2026 baseline. Assumes labor-force growth of approximately 0.4 percent. Unit labor-cost growth is approximated as compensation growth minus labor-productivity growth. Debt outcomes are illustrative sensitivities derived by adjusting the CBO baseline for the effects of higher productivity on real economic output, federal receipts, and debt accumulation. They are not forecasts and do not incorporate every possible change in interest rates, spending, or fiscal policy.

Even the 2.5% productivity case would meaningfully improve on a 1.5% trend. At the historical 3.5% benchmark, potential real GDP growth could approach 4%, labor-cost pressure would fall for a given rate of wage growth, and federal revenues would compound faster. Stronger productivity may also keep real interest rates higher, so growth improves the government's capacity to manage the debt but does not replace fiscal discipline.

Geopolitics Raises the Value of Productivity

The fiscal challenge is developing as the United States is being asked to spend more on defense, energy security, supply-chain resilience, domestic manufacturing, and critical infrastructure. A less integrated and less predictable world requires redundant capacity and strategic inventories that improve national security but cost more than the globally optimized supply chains they replace.

AI-driven productivity can help absorb part of that cost. More efficient design, logistics, maintenance, manufacturing, intelligence analysis, cybersecurity, and energy management can raise the output generated from each dollar of capital and each hour of labor. It can also offset some of the inflation pressure from higher labor, energy, defense, and supply-chain costs. Productivity is therefore increasingly connected to industrial capacity and national security.

Investment Implications

If AI develops into a broad productivity cycle, the investment implications should extend well beyond the largest technology companies. **Phase 1**, the installation phase, supports providers of compute, semiconductors, memory, servers, networking, fiber, power equipment, cooling, and data-center infrastructure. **Phase 3**, the diffusion phase, should increasingly reward companies that use those tools to produce more, improve margins, shorten cycle times, and gain market share.

That distinction will become more important. **Capital spending identifies who is building the infrastructure. Workflow evidence identifies who is capturing the economic return.**

- Technology and infrastructure providers should benefit where demand is supported by real utilization, improving economics, and durable bottlenecks rather than spending alone.

- Industrial, financial, healthcare, energy, and service companies that reorganize high-volume workflows around AI may experience the most meaningful improvements in revenue per employee, operating margins, working capital, and return on invested capital.
- Companies unable to translate AI spending into measurable output may face rising depreciation, software, power, and financing costs without a corresponding earnings benefit.
- In fixed income, a stronger productivity cycle could improve corporate credit and federal revenue capacity, but also keep real rates higher. Income and security selection may therefore remain more important than relying on a large decline in long-term yields.
- Gold and other real assets remain useful hedges because the favorable productivity outcome is not guaranteed and fiscal discipline has not yet been demonstrated.

The Bottom Line Is This

The United States cannot painlessly inflate, tax, or cut its way out of the debt problem, nor can it rely on any one of those approaches alone. Each would impose meaningful costs on households, businesses, or financial markets. Nor can the country rely on AI to make difficult fiscal decisions unnecessary.

A productivity boom can still be squandered. The 1990s worked because stronger productivity coincided with deficit reduction and spending restraint. Congress therefore has two responsibilities: protect the conditions that allow productivity to spread—including reliable energy, infrastructure, workforce training, competitive capital markets, and sensible rules—and use the resulting growth dividend to narrow the primary deficit and address the long-term imbalance in mandatory spending. Growth without discipline can simply finance a larger government and a larger future debt burden.

Productivity can improve the available choices. If AI allows the economy to produce more from the same labor and capital, real growth can accelerate, wages can rise with less inflation pressure, and federal receipts can compound faster. That would make the debt easier to stabilize and reduce the spending and tax adjustments required.

The 1990s showed that productivity and restraint work together. Productivity enlarged the tax base, while fiscal restraint converted part of that growth into smaller deficits and less debt. Together, they reduced future interest expense and created more room for private investment.

The United States may now have another opportunity to follow that path. The infrastructure is being installed, and the early productivity evidence is encouraging. The next test is whether businesses can move from isolated AI tools to redesigned production systems at enough scale to lift the entire economy.

USA Inc. is not a failing enterprise. It remains one of the strongest economic franchises ever assembled, with unmatched capital markets, innovative companies, abundant resources, skilled workers, and an extraordinary capacity to adapt. Those strengths give the country the ability to manage its fiscal challenge, but they should not be mistaken for permission to ignore it. The central question is whether the United States can use its advantages to expand productive capacity faster than its debt and interest expense compound.

If it can, AI's most important contribution may not be a better chatbot or another technology product. It may be a larger and more productive economy–one capable of supporting higher real wages, greater industrial capacity, stronger national security, and a more manageable fiscal adjustment. Productivity can improve USA Inc.'s income statement. Only fiscal discipline can repair its balance sheet.

Selected Sources

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7. Brynjolfsson and coauthors, The Productivity J Curve; Oliner and Sichel, The Resurgence of Growth in the Late 1990s.

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