Debate Brief · The National Debt
February 2019

Resolved: The United States federal government should make reducing the national debt a fiscal priority.

"Faster growth and returns on public investment yield higher tax revenues, and a 5% to 6% return is more than enough to offset temporary increases in the national debt."
–Economist Joseph Stiglitz, 2010

"I'm not saying that we shouldn't worry about debt at all, because there may be future contingencies when real interest rates rise and debt becomes an issue. But debt is way, way down on the list of things to worry about – absolutely trivial compared with, say, crumbling infrastructure, which should be fixed without worrying about paying as you go."
–Economist Paul Krugman, 2018

"The real goal should be reduced government spending, rather than balanced budgets achieved by ever rising tax rates to cover ever rising spending." –Economist Thomas Sowell, 2012

"One of the chief dangers to the success of popular government is that it will throw away self-restraint and self-control and adopt laws, which being without sound economic foundation, bring on such a financial distress as to result in want, misery, disorder, and the dissolution of society." —President Calvin Coolidge, 1926

ABOUT THE COOLIDGE FOUNDATION

The Calvin Coolidge Presidential Foundation is the official foundation dedicated to preserving and promoting the legacy of America's 30th president, Calvin Coolidge, who served in office from August 1923 to March 1929. These values include civility, bipartisanship, and restraint in government, including wise budgeting. The Foundation was formed in 1960 by a group of Coolidge enthusiasts, including John Coolidge, the president's son. It maintains offices at the president's birthplace in Plymouth Notch, Vermont, and in Washington, D.C. The Foundation seeks to increase Americans' understanding of President Coolidge and the values he promoted.

BACKGROUND

An important responsibility of the federal government each year is to create and pass a budget for the upcoming year. The budget is a detailed spending plan that designates how much money will be spent on each of the numerous programs and functions of the government. Everything from Medicare and retiree benefits to the military and our space program needs to be accounted for somewhere. Although the President can submit ideas and recommendations in the form of a budget proposal, Congress is the government body that is officially in charge of coming up with the budget. Only it has the power to collect taxes, borrow money, and come up with spending bills that appropriate money for various purposes.

For every dollar that the federal government plans to spend in a given year's budget, it must collect a dollar in taxes or borrow a dollar from a lender. During the 2018 fiscal year, the federal government spent $4.11 trillion and collected $3.33 trillion, resulting in a deficit of approximately $780 billion (about 3.9 percent of GDP).[1] The deficit from 2018 gets added to all the other deficits that were run in other years, and is referred to as the national debt. The national debt currently stands at about $21 trillion, which is the largest it has ever been.

The National Debt

The national debt, or federal debt, does not only grow from the accumulation of deficits. It also grows because lenders charge *interest*, which is the money that must be repaid over and above the *principal* amount. Interest payments provide the incentive for lenders to loan money to debtors in the first place. If the government borrows $1 at a 3 percent interest rate, it doesn't just have to pay back the $1. It has to pay back roughly $1.03—or maybe even a little more, depending on the exact terms of the loan. This past year, the federal government spent about $371 billion on interest alone. (For comparison, the entire Defense Department budget for the same year was about $599 billion.)

The question of how much money to spend, and thus whether to run a deficit or a surplus, is a perennial debate in government. Some people worry that the practice of chronically spending more than we collect puts us too far into debt and will hinder economic growth. They point out that the more debt we have, the more expensive new debt becomes as lenders demand higher interest rates to compensate for the risk that the government might not be able to pay its bills. They also note that paying back government debt is only possible through the collection of taxes which, all else equal, hinder economic growth by taking money out of the hands of individuals and businesses. For those concerned with budgetary shortfalls, the national debt is too big and reducing it ought to be a priority.

Other people do not worry as much about annual deficits contributing to a large national debt. They point out that as long as a nation has a stable and effective government and a productive

[1] Fiscal Year 2018 Budget, Congressional Budget Office. December 2018.

economy, it is possible to service (i.e., pay the interest on, and therefore maintain) a high level of debt. For them, the national debt is not too big and reducing it need not be a priority.

Economic Growth

A big part of the debate about whether to focus on reducing debt is the question of whether doing so will hurt or help the economy.

Some economists believe that government spending can stimulate the economy to grow. This is sometimes called a Keynesian view, after the 20th century British economist John Maynard Keynes. They argue that increasing government expenditure puts money back into the economy, creating jobs and increasing demand. Of course, greater government spending (more money going out) and lower taxes (less money coming in) can quickly mean budgetary shortfalls, and thus the growth of government debt, but many Keynesian economists would argue that the short run benefits of growth outweigh the long term costs of debt. They might quote Keynes who famously once said, "In the long run, we are all dead."

Other economists argue that while lower taxes and greater government spending tend to boost Gross Domestic Product (GDP) in the short run, the associated budgetary shortfalls simply kick the can down the road and impose costs in the long run. They argue that deficit spending is simply a tax on future generations, since the money will someday have to be paid back through taxes. They are skeptical that government spending for the sake of economic growth is a good thing. They argue that growth as a result of government expenditure is often distortionary and unsustainable because it comes from the government spending other people's money rather than from consumers making their own fiscal decisions. Historically, they cite periods such as the 1920s and 1990s when economic growth accompanied balanced federal budgets.

Does Reducing Debt Come at the Expense of Economic Growth?

Some scholars, such as Reinhart and Rogoff, have argued that it is possible to pursue a policy of debt reduction while also enjoying economic growth.[2] In the 1920s, the government reduced the national debt and experienced strong growth. Over the decade, from 1920 to 1929, GDP grew by 43 percent while the federal debt was simultaneously decreased by 30 percent. Even with reduced government expenditure, economic growth was exceptional.

Contrast this with the 1930s. From 1930 to 1939, GDP grew by 20 percent—less than half the rate of the 1920s—despite the national debt increasing by 150 percent.[3] If debt reduction and economic growth are truly at odds with each other, how can we explain the high growth and debt reduction of the 1920s and the low growth and debt explosion of the 1930s?

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[2] Carmen Reinhart and Kenneth Rogoff, "Growth in a Time of Debt" NBER Working Paper No. 15639. Issued in January 2010, Revised in December 2011.

[3] Author's calculations, based on data from the United States Census Bureau.

THE COOLIDGE CONNECTION

Of all the presidents in the history of the debt discussion, the one who took debt most seriously, and did the most about it is our thirtieth president, Calvin Coolidge. President Coolidge was famously attentive to budgeting and wary of excessive debt. He believed that the federal budget ought to be kept in balance, that tax rates should be low and reasonable, and that the best way to achieve economic growth is to "let those who earn money keep more of it for themselves and give less of it to the government."[4]

In the time that he was president (from 1923 to 1929), Coolidge managed to cut taxes, reduce government spending, *and* reduce the national debt by about 30 percent, all while overseeing a booming economy.[5] Growth was palpable during this period with GDP rising 3.5 percent per year, and unemployment was a mere 1.8 percent, the lowest it had been in a century.[6,7] Some economists who were skeptical of Coolidge's approach had argued that cutting government spending would threaten the economy. Other economists had argued that the dual goals of cutting taxes and reducing the national debt were incompatible. Year after year, however, Coolidge's policies produced these economically healthy results.

For Coolidge, prudent governing started with responsible spending. "Economy in the cost of government is inseparable from reduction in taxes. We cannot have the latter without the former."[8] Good peacetime governing meant running budgets in balance or at a surplus, not a deficit, and it meant paying down the national debt if possible.

After Coolidge left office, fortunes changed for many Americans. The 1930s brought the Great Depression, which economists agree had many causes, and few having to do with the growth and innovation of the 1920s. The depression was made worse, not better, by the tariffs enacted by President Hoover (which slowed trade), and the taxes enacted by President Roosevelt (which hurt employment). In the 1930s, public spending rose, and the previously shrinking national debt reversed course and resumed its climb. By 1941, the U.S. had entered World War II, the nation's resources and economy became thoroughly transformed in support of the war effort.

Now almost 95 years since Coolidge's assumption of the Presidency, what do you think the most prudent approach is in government budgeting? Was Coolidge correct in viewing reducing the national debt as a priority? Was he right in viewing debt reduction as compatible with growth, and not contrary to it? Or were Coolidge's views somehow particular to his time and circumstances, and not directly applicable to today's world?

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[4] Calvin Coolidge, "Address of the President at the Meeting of the Business Organization of Government, June 22, 1925, Washington, D.C.," Commerce Papers, File Treasury Department, Bureau of the Budget.
[5] Shlaes, Amity. *Coolidge*. Harper Perennial, 2014.
[6] Furchtgott-Roth, Diana. "Calvin Coolidge transformed the economy—can we?" Marketwatch, November 8, 2013.
[7] Powell, Jim. "Two Of The All-Time Greatest Successes In Cutting Taxes And Spending" Forbes, August 10, 2011.
[8] Hendrickson, John. "Budget and Tax Lessons from President Calvin Coolidge" Coolidge Foundation. December 10, 2014.

KEY TERMS

Overview for Fiscal Year 2018

Total Federal Outlays: $4.11 trillion
Total Federal Receipts: $3.33 trillion
Federal Deficit: $779 billion (3.9 percent of GDP)
Total Federal Debt: $21.46 trillion

Source: U.S. Department of the Treasury, Monthly Report, September 2018

Federal budget – The federal budget is the annual spending plan for the United States government. Not unlike the budget that a family or a business might have, it has two main components: revenue (sometimes called receipts) and spending (sometimes called outlays). Revenue is the money that the government takes in, and spending is the money that the government spends on various agencies, programs, and financial obligations. It is often said that the budget represents the priorities of the government.

Surplus – The amount by which revenues exceed expenditures in the federal budget.

Deficit – The amount by which expenditures exceed revenues in the federal budget.

Balanced budget – A budget in which total revenues and total expenditures are equal in a fiscal year. A balanced budget creates neither a surplus nor a deficit. Sometimes people talk about passing a balanced budget amendment. A balanced budget amendment would amend the U.S. Constitution to require that the federal government spend no more than it takes in.

Fiscal Year – The fiscal year is the period used by governments and companies for the purposes of accounting and budgeting. A fiscal year can be the same as a calendar year (i.e., January 1 to December 31), or it can be different. The fiscal year of the United States federal government begins on October 1 of one year and ends on September 30 of the following year.

Mandatory spending – Expenditures where the amount that is to be spent is stipulated by a specific law (i.e., by an appropriation made by Congress). Because these expenditures are set by law, they are more difficult to increase or decrease, and are thus said to be "mandatory." Examples include spending related to programs such as Social Security, Medicare, and Medicaid.

Discretionary spending – Expenditures where the amount is decided and/or renewed annually as part of the budget process. Because the amounts to be spent are not stipulated by law, these expenditures are easier to increase or decrease, and are thus said to be "discretionary." Examples include military spending and the funding of executive departments (e.g., the Department of Energy) and federal agencies (e.g., the Federal Communications Commission).

Tax – A payment that an individual or company is required to make to the government. Taxes are the main revenue source of the federal government.

Revenues – Revenues are funds that flow to the government (specifically the U.S. Treasury). The main categories of revenues are individual and corporate income taxes, payroll taxes, excise taxes (i.e., taxes on specific goods such as gasoline), customs duties (i.e., taxes on imported goods), and user fees. The government can also borrow money, but any money that it borrows it eventually has to pay back, with interest.

National debt (or Federal debt) – The national debt is the debt held by the federal government. It is the sum of all past federal budget deficits, minus what the federal government has repaid. As of 2018, the national debt is approximately $21 trillion.

Debt ceiling – The United States debt ceiling is a legislative limit set by Congress on the amount of debt the federal government allows itself to hold. The debt ceiling constrains the executive branch from spending more than legislative branch believes is appropriate.

Interest – Money paid to a lender for the use of money, or for delaying the repayment of a debt. The interest rate is the rate or percentage of the loan (e.g., 3 percent or 9 percent) that is charged periodically (e.g., monthly, annually) over the duration of a loan.

Sequestration – A term for an automatic, across-the-board cut in discretionary spending. It is triggered if Congress approves spending that exceeds the cap. Under sequestration, all executive departments and federal agencies would be required to cut their budgets by some percentage (e.g., 3 percent or 5 percent) for the coming year.

Gross Domestic Product (GDP) – The total market value of all finished goods and services produced within a country's borders during a specific period of time (usually one year). When economists talk about economic growth, they often are referring to the rate at which gross domestic product increases or decreases.

Debt overhang – When an organization has so much existing debt that it cannot easily borrow more money, even when new borrowing is a good investment and would pay for itself. This can occur with governments, corporations, or any other type of organization that is allowed to borrow money. As a convention, economists sometimes use 90 percent of GDP as the threshold for whether a nation is in the condition of debt overhang.

Congressional Budget Office (CBO) – A non-partisan agency formed in 1974 that produces independent analyses of policy proposals and spending plans to help Congress arrive at a budget. CBO "scores" (i.e., estimates the costs of) the policies and programs that legislators design. It does not come up with its own policy recommendations or ideas for spending.

AFFIRMATIVE ARGUMENTS

> *"[I regard] a good budget as among the noblest monuments of virtue." –Calvin Coolidge*

1. We should reduce the debt because excessive debt hinders economic growth.

> A 2010 study found that when national debt rises above 90 percent of GDP, economic growth tends to be 1.2 percent lower.

When a government takes on too much debt, economic activity slows. A large amount of debt makes lenders worry that the government might not be able to repay its loans, so lenders start to demand higher interest rates on new loans. When interest rates rise, the cost of borrowing money becomes very expensive for the government. With high interest rates, the purpose to which the government is putting that borrowed money needs to be very important for it to be worth it for the government to keep borrowing.

To stop interest rates from rising indefinitely (or to avoid the situation in which lenders stop being willing to lend the government money at all), the government has to collect money from taxpayers in order to pay down its debt obligations. Individuals and businesses are the main taxpayers in the United States. The more money that they are required to pay in taxes, the less money they have to invest in the economy. It is individuals and businesses who are the drivers of economic growth, through their entrepreneurial activities such as producing goods and services, building offices and factories, and so on.

In a seminal study on the relationship between debt and growth, economists Carmen Reinhart and Kenneth Rogoff found that when a nation's debt level rises above 90 percent of its GDP, that nation's economic growth tends to be 1.2 percent lower (2.3 percent versus 3.5 percent).[9] The authors also found that the effects of having high national debt can affect a country for many years—"in 20 out of 26 cases of debt overhang… the period of reduced growth lasted a quarter-century, substantially reducing GDP and living standards."

2. The interest we currently pay on the debt is high, and future interest rates are unpredictable.

In fiscal year 2018, the federal government spent approximately $371 billion just to pay the interest on the national debt. Paying off the interest does not reduce the principal amount of the loan—it is the sheer cost of carrying that debt. The more we pay in interest, the less we have available to spend on infrastructure, social programs, education, scientific research, and

[9] Carmen Reinhart and Kenneth Rogoff, "Growth in a Time of Debt" NBER Working Paper No. 15639. Issued in January 2010, Revised in December 2011.

other things.[10] Looking at it another way, it is money that the government would not have needed to collect in the first place and could have remained in the pockets of private individuals and businesses.

As expensive as the interest on the national debt is right now, that is with relatively low interest rates of less than 4 percent. At times in our nation's history, interest rates have risen far above current levels, even reaching above 10 percent in late 1970s and early 1980s.[11] Rapid increases in the debt ratio can make lenders nervous and can lead to rapid increases in interest rates.[12] If the national debt is too high, there is risk that interest rates will rise, future debt will become more expensive, and an ever larger portion of the federal budget has to go toward paying off the interest on the debt.

> The CBO projects that by 2020, interest payments on the national debt will surpass Medicaid spending, defense spending by 2023, and all non-defense discretionary spending by 2025.

Currently the interest on the debt consumes about 8.3 percent of the federal budget.[13] It is the fastest growing part of the budget. As the Congressional Budget Office's own projections show, government spending on national debt interest will exceed Medicaid spending by 2020, defense spending by 2023, and all non-defense discretionary spending by 2025.[14] If the national debt is not paid down, interest alone will cost us nearly $1 trillion dollars per year by 2028.[15]

3. It is wrong to make future generations pay for today's spending choices.

By spending more than we have today and promising to pay our lenders back later, we are passing the bill of our current choices along to future generations. This is unfair and wrong. Children, who do not participate in the political process, have little to no say in these choices, yet they will be responsible for the cost.

Younger generations are already weighed down with the mistakes of previous generations. Policy decisions in education, housing, and healthcare have already created intergenerational inequities in which many of today's young people make less money and enjoy less independence than their parents did at the same age.[16] Carrying a high national debt that necessitates high interest payments imposes even more pain on these future taxpayers.[17] Nobody disputes that as a legal matter, Congress has the power and authority to make such

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[10] Puentes, Robert. "Why Infrastructure Matters: Rotten Roads, Bum Economy" Brookings Institution. January 20, 2015.
[11] Interest Rates, Discount Rate for the United States. Federal Reserve Economic Data (FRED). June 1, 2017.
[12] Foster, J.D. "The Many Real Dangers of a Soaring Debt" The Heritage Foundation. June 18, 2013.
[13] The Budget and Economic Outlook: 2018 to 2028. Congressional Budget Office. April 2018.
[14] Ibid.
[15] Ibid.
[16] Chetty, et al. "The Fading American Dream: Trends in Absolute Income Mobility Since 1940" NBER Working Paper No. 22910, Issued in December 2016, Revised in March 2017.
[17] Edwards, Chris. Testimony to Committee on the Budget United States House of Representatives. June 17, 2015.

spending decisions, but in terms of evaluating what is ethical behavior, saddling future generations with the bill for today's lavish expenditures should offend our moral sensibilities.

4. **The higher the debt, the less able the government is to respond to unexpected situations, national security needs, and economic downturns.**

Unforeseen events are inevitable. Geopolitical events, war, terrorism, economic recessions, natural disasters, and other incidents can all stress the economy. Maintaining a high level of national debt is risky enough when times are good. It could be outright devastating when the next emergency hits.

In times of crisis, it is important that government policymakers have the flexibility to be able to respond appropriately. For example, following the terror attacks of September 11, 2001, the United States unexpectedly needed to increase military spending again, committing nearly $2 trillion to the War on Terror between 2001 and 2017. The relative fiscal health at the time of those events at least made it possible for government officials to evaluate their options and choose how to respond. By contrast, following the debt crisis experienced by Greece starting in 2009, Greek officials had few options and Greeks were forced to accept strict austerity measures, leading to impoverishment, the loss of income, and social instability.[18]

If America is deeply in debt, then its strength and leadership abroad will be undermined. Other countries will sense our weakness. As Kenneth Lieberthal and Michael O'Hanlon from the Brookings Institution explain,

> *"If this perception becomes more widespread, and the case that we are in decline becomes more persuasive, countries will begin to take actions that reflect their skepticism about America's future. Allies and friends will doubt our commitment and may pursue nuclear weapons for their own security, for example; adversaries will sense opportunity and be less restrained in throwing around their weight in their own neighborhoods. … Major war will become more likely."*[19]

Reducing national debt is therefore not just a priority for economic reasons, but for national security reasons, too.

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[18] Galbraith, James K. "The Greece Bailout's Legacy of Immiseration" *The Atlantic*. August 20, 2018.
[19] Kenneth Lieberthal and Michael O'Hanlon, "The Real National Security Threat: America's Debt" Brookings Institution. July 10, 2012.

5. **The debt could end America's status as a world leader.**

In the past, America always enjoyed a great protection: the protection of being the world's reserve currency (or "anchor currency"). As long as the dollar was king, America was king among other nations, even if it was experiencing high unemployment and large debts. To this day, foreigners help us cover our debt. Roughly 31 percent of debt is held by people or countries outside the United States.[20]

> Roughly 31 percent of the U.S. national debt is held by people or countries outside the United States.

Today, however, there are new challenges to nations currencies, such as cryptocurrencies like the bitcoin. If America is mired in debt, the world may decide to trade in different currencies, newer currencies, or a combination of other currencies and cryptocurrencies. Then the United States, like other nations, will have to compete for investors in its currencies, and give the world's investors more of a return. That means raising interest rates, which will hurt all American borrowers, from students to families that have taken out mortgages on their homes. America's general status will decline, which will have implications for international security.

6. **High national debt lowers confidence and can result in lower savings and income.**

If the national debt becomes too high, people will lose confidence in the ability of the government to pay its obligations. This will cause the value of outstanding government bonds to fall, which affect the savings of individuals who own these bonds in their retirement portfolios.

High national debt can also hurt people's income by hurting the companies that they work for. As the CBO notes, "Because wages are determined mainly by workers' productivity, the reduction in investment would reduce wages as well, lessening people's incentive to work."[21] The CBO projects the national debt will cause the average four-person family to lose $4,000 in income per year by 2028, $8,000 in income by 2038, and $16,000 in income by 2048. If this were allowed to occur, it would result in economic stagnation rather than growth.

> The CBO projects the national debt will cause the average four-person family to lose $4,000 in income per year by 2028, $8,000 in income by 2038, and $16,000 in income by 2048.

According to the CBO, "Stagnating wages and growing disparities in income and wealth are very concerning trends. The federal government should not allow budget imbalances to harm American citizens."[22]

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[20] "The depth and breadth of the federal debt" Federal Reserve Economic Data (FRED). March 2, 2017.
[21] "The 2014 Long-Term Budget Outlook" Congressional Budget Office. July 15, 2014.
[22] Ibid.

7. **Economic growth is currently relatively strong. Now is not the time for the government to engage in more stimulus spending if its means further running up the national debt.**

   Responsible stewardship of almost any fund, private or public, typically entails some sort of saving during abundant times so that one can continue to meet one's obligations during lean times. State governments, for instance, use reserve funds called "Rainy Day Funds" to manage unexpected shortfalls and cover unplanned expenditures.[23] In a similar way, when the national economy is strong, such as it is at present, the federal government does not need to continue to stimulate the economy if it comes at the cost of large deficits.

   There is no need at present to boost consumer spending (i.e., "aggregate demand"). Rather than engaging in stimulus, the government in good times should pay down the national debt. The federal government does not maintain a rainy day fund, but paying down the debt when economic growth is strong is the next best thing.

[23] "States Make More Progress Rebuilding Rainy Day Funds" Pew Trusts. August 29, 2018.

NEGATIVE ARGUMENTS

> *"Reducing government spending is a risk not worth taking." –Joseph Stiglitz*

1. **Rather than reducing the debt, we should focus on growing the economy so that the debt can be more easily managed and eventually paid off.**

Many people assume that the only way to improve the federal debt situation is to raise taxes and cut spending, but a country's debt-to-GDP ratio consists of both a numerator *and* a denominator. If the goal is to have a better debt-to-GDP ratio, it is just as valid to seek to increase GDP as it is to decrease debt. If the economy (i.e., GDP) grows faster than the debt, the debt does not look so ominous and does not pose such a big threat.

> If the US economy experienced 4 percent GDP growth each year for ten years, the government would collect more than $3 trillion in tax revenues.

Countries with higher GDP will have an easier time paying off their national debt because they have a wider revenue stream to draw from. This means that countries with higher GDP can afford to borrow more than countries with lower GDP. In 2013, economist Ike Brannon estimated that if the US economy experienced 4 percent GDP growth each year for ten years, the government would collect more than $3 trillion in tax revenues, which would contribute to a 30 percent reduction in the ten year budget deficit. [24] In other words, if we prioritize growth, then the government will bring in more in taxes and future deficits will be smaller.

According to a 2015 report from the International Monetary Fund, "the distortive cost of policies to deliberately pay down the debt is likely to exceed the crisis-insurance benefit from lower debt." Instead of paying down the debt, the IMF authors argue, "debt-to-GDP ratios should be reduced organically through growth, or opportunistically when less distortionary sources of revenue are available."[25]

Rather than hurting the economy, deficit spending can be a good thing for overall debt-to-GDP health, as long as it helps the economy keep growing. As economist John Maynard Keynes argued, deficit spending raises aggregate demand and increases consumption. When individuals are reluctant to spend their savings, the government can step in and purchase goods that might otherwise go unsold or hire labor that might otherwise go unused.[26] This smooths the economy—especially in times of uncertainty—and keeps the private sector booming.

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[24] Brannon, Ike. "What 4% Growth Would Mean for America" George W. Bush Presidential Center. March 21, 2013.
[25] Ostry, et al. "When Should Public Debt Be Reduced?" International Monetary Fund. June 2015.
[26] Keynes, John Maynard. *General Theory of Employment, Interest and Money* (1936)

2. Running a surplus to pay off the debt would require the government to raise taxes.

If the U.S. federal government makes reducing the national debt a priority, then it must find a way to run a budget surplus. Since Congress has limited flexibility in cutting spending, that leaves tax increases as the main way to make sure that receipts exceed expenditures.

Some countries, such as Sweden, Finland, and Germany, manage their debt in part by having high tax rates. High taxes help Germany, for example, maintain a relatively low debt-to-GDP ratio of about 43 percent.[27] However, the problem with raising taxes and keeping them high for many years in a row is that eventually this takes money out of the hands of individuals and businesses, hurting economic growth.[28] In the early 1930s, President Herbert Hoover attempted to continue Coolidge's emphasis on debt control, but because was not as disciplined in managing spending, he opted to raise taxes dramatically. This played a role in depressing the economy.

> "Each tax reduction has been followed by a revival of business. If there is one thing above all others that will stimulate business it is tax reduction. If the Government takes less, private business can have more. If constructive economy in Federal expenditure can be assured it will be a stimulation to enterprise and investment."
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> –Calvin Coolidge, 1925

The negative effect on economic growth could be greater than the benefit that we get from reducing the debt. According to the Keynesian school of economics, running a budget surplus to pay down the debt would hurt the economy, since people would have less money with which to buy goods and services.[29] If the Keynesian view is true, then making debt reduction a priority is a bad strategy.

3. Using debt to improve our standard of living isn't a bad thing—it is a healthy thing.

Businesses borrow money to acquire new equipment and build new factories. Individuals borrow money to purchase large-ticket items such as cars and homes. These uses of debt are generally considered wise. Debt enables businesses to stay competitive and increase production. It enables workers to get to work in the morning, and to afford to live close to a good employer.

> Debt can be a good thing for a country. It smooths the effects of expenditures out over time.

As for a company, so also for our government. The borrowing of money by the government to pay for such things as social programs and infrastructure can be a good thing. Often American households are portrayed as victims of the national debt, but in fact we benefit from it by enjoying a higher standard of living in the present.

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[27] Bofinger, Peter. "German Example Shows Way Out of Debt Crisis" Spiegel. August 12, 2011.
[28] Ferrara, Peter. "Should we pay off the debt?" Heritage Foundation. October 2000.
[29] Ibid.

If we did not make use of debt, investments in large and expensive projects such as infrastructure (e.g., roads, bridges, dams) would be considerably more disruptive. Taxes would dramatically rise and fall with each new project. The International Monetary Fund praises the use of public debt in part because it "smooth[s] the taxes necessary to finance lumpy government expenditures."[30]

4. What matters for public financing is not the level of debt but our ability to service it.

Although it is true that many countries today have high debt-to-GDP ratios compared to the past, this is not necessarily a cause for concern. As long as a country is able to fund itself at low interest rates, taking money out of the economy to deliberately pay down the debt as part of a concerted policy of debt reduction is not necessarily the wisest course of action.

At $21 trillion, the national debt can sound scary to the average person, but that's because as individuals we do not routinely deal with numbers on this scale. Our GDP is roughly the same size as the debt (the national debt is about 102 percent of GDP). This puts the country in roughly the same financial position as a hypothetical family that makes $75,000 in income and owes a total of $76,500 on, say, a home mortgage and a car loan. The monthly payments on those two items will be easily payable ("serviceable") with the earners' after-tax monthly income. This hypothetical family is not in a financial crisis.

The nation's debt-to-GDP ratio of 102 percent is even less alarming when compared to what the typical household's debt-to-income ratio would be, if we calculated such a statistic. The average U.S. household has outstanding mortgage debt of $168,000 and an income of about $55,000.[31] This would be a debt ratio of about 305 percent, and although some families genuinely are in financial hardship, few would say that most American families are in a state of financial crisis because most families can still service their debt.

> The average interest rate paid on federal debt has been 3 percent for over 10 years.

Some people fear a "debt spiral"—a situation in which deficits lead to higher debt, which lead to higher interest payments, which in turn lead to higher debt in a vicious cycle. However, the average interest rate paid on the federal debt has been under 3 percent (i.e., low and relatively stable) for over 10 years—not high or trending upward as the debt spiral theorists fear. Our strong economic performance has held this threat at bay. As economist Paul Krugman notes, "[a] debt spiral can only happen if the interest rate on the debt is higher than the economy's growth rate."[32]

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[30] Ostry, et al. "When Should Public Debt Be Reduced?" International Monetary Fund. June 2015.
[31] Tepper, Taylor. "5 Things Most People Don't Understand About the National Debt" *Time Magazine*. April 2016.
[32] Krugman, Paul. "On the Debt Non-Spiral" *New York Times*. September 11, 2018.

5. Much of the national debt is money that we owe to ourselves.

Contrary to popular belief, debt does not represent money that we have "stolen" from future generations. When it comes to debt, one person's debt is another person's asset.[33] When one person borrows money and begins making interest payments on it, it becomes an income stream for the lender. Because much of the government's debt is owned by American institutions (and thus American families through bonds and other investments), much of the national debt simply represents money that we owe to ourselves.[34]

If debt is money that we owe to ourselves, then it does not necessarily make us poorer to have a lot of it, and nor does it make us richer to pay it off.[35] Reducing the national debt is in some ways a neutral action—it eliminates the loan on the borrower's side of the ledger but also eliminates the income-producing asset on the lender's side of the ledger.

It may make sense for some individuals or companies to reduce their debt, but if everyone tries to reduce their debt simultaneously—the term for which is "deleveraging"—it could have negative effects on the economy. During the recession in 2009, former Chair of the Federal Reserve Janet Yellen warned about the threat of deleveraging:

> *"Consumers are pulling back on purchases, especially on durable goods, to build their savings. Businesses are cancelling planned investments and laying off workers to preserve cash. And, financial institutions are shrinking assets to bolster capital and improve their chances of weathering the current storm. Once again, Minsky understood this dynamic. He spoke of the paradox of deleveraging, in which precautions that may be smart for individuals and firms—and indeed essential to return the economy to a normal state—nevertheless magnify the distress of the economy as a whole."*[36]

As Paul Krugman writes, "Why is deleveraging a problem? Because my spending is your income, and your spending is my income, so if everyone slashes spending at the same time, incomes go down around the world."[37]

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[33] Fatas, Antonio. "Those Mountains of Debt (And Assets)" *Antonio Fatas Blog*. February 5, 2015.
[34] Ibid.
[35] Krugman, Paul. "Nobody Understands Debt" *New York Times*, February 9, 2015.
[36] Yellen, Janet. "A Minsky Meltdown: Lessons for Central Bankers" Federal Reserve Bank of San Francisco. April 16, 2009.
[37] Krugman, Paul. "Nobody Understands Debt" *New York Times*, February 9, 2015.

6. **Focusing on reducing the debt could push the economy into deflation or depression.**

   If the U.S. government were to pursue a policy of reducing the debt rather than encouraging growth, the economy could experience deflation. Deflation occurs when there is a contraction of the money supply and prices fall. Although falling prices might sound good for the consumer who is in the market for a new television or computer, it is actually a dangerous economic condition for two reasons: 1) that same consumer may also see his wages fall, and 2) savvy consumers who see that prices are falling might delay making purchases, which can worsen the economic slowdown (a case of a "self-fulfilling prophecy").

   Not only does deflation contribute to economic slowdown, it means that Americans have to pay back interest on our debt using more valuable dollars (because if prices have fallen, then a given amount of dollars can buy more goods and services). As Krugman notes, "Efforts to reduce debt end up pushing the economy into deflation and depression."[38]

7. **Interest rates are currently low. The government should take advantage of this and encourage as much growth as possible before borrowing becomes more expensive.**

   By historical standards, current interest rates are extremely low. Although nobody knows exactly when they will again rise, it is likely that at some point in the near future they will at least increase, if not fully return to historic averages. Therefore, now is the time for the government to attempt to stimulate as much growth as possible. If we wait and interest rates to rise, stimulus spending will cease to be an option, as it will simply become too expensive.

   Overseas investors still believe that the U.S. government is highly creditworthy, which means that the federal government can still borrow to make much-needed investments (such as investments in infrastructure) that will keep our productive resources strong.[39] As long as the cost of borrowing is low and the borrowed money can be put to a use with a greater return on investment than the cost, the government should continue spending to encourage growth.

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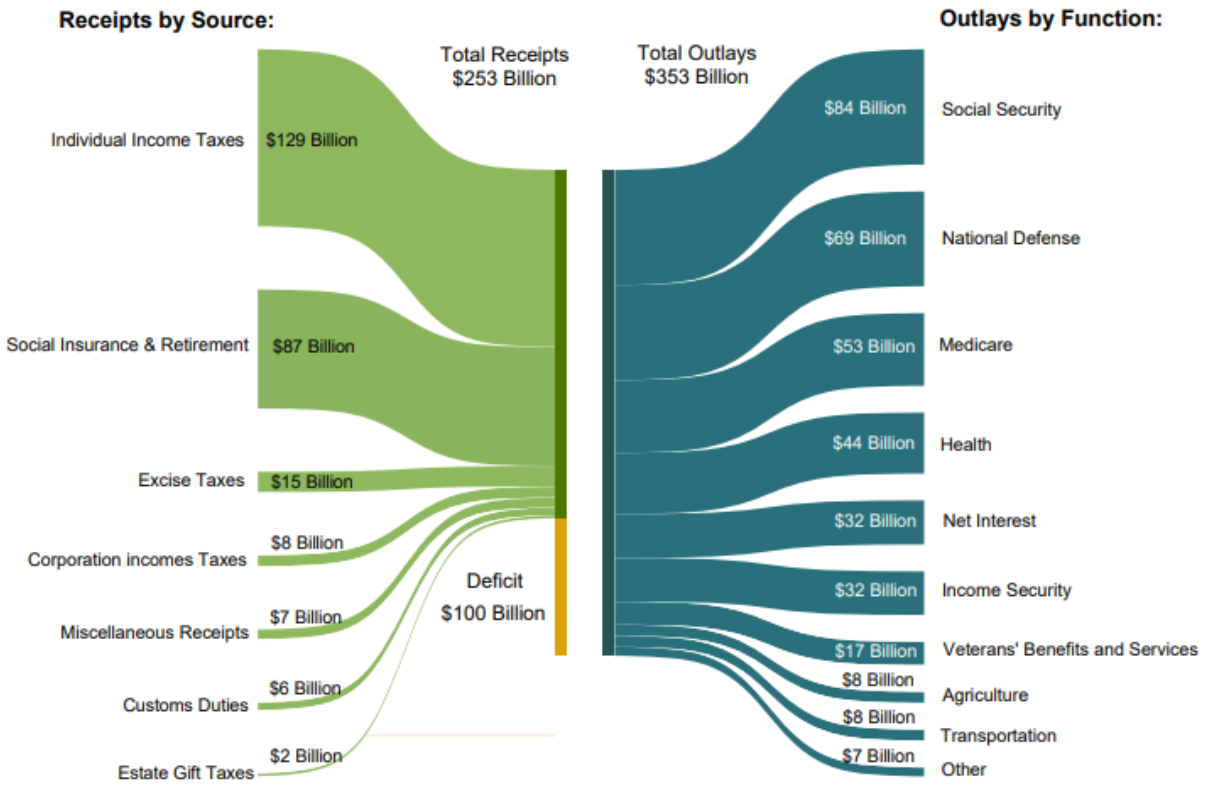
[38] Ibid.

[39] Wolverson, Roya. "Is More Fiscal Stimulus Needed?" Council on Foreign Relations. July 14, 2010.

APPENDIX A. Receipts, Outlays, and Surplus/Deficit for October 2018

The federal government has many sources of revenues (receipts) and many different expenditures (outlays). The figure below shows where the money comes from and where it goes for a typical month. Note that this depicts the receipts and outlays for just one month.

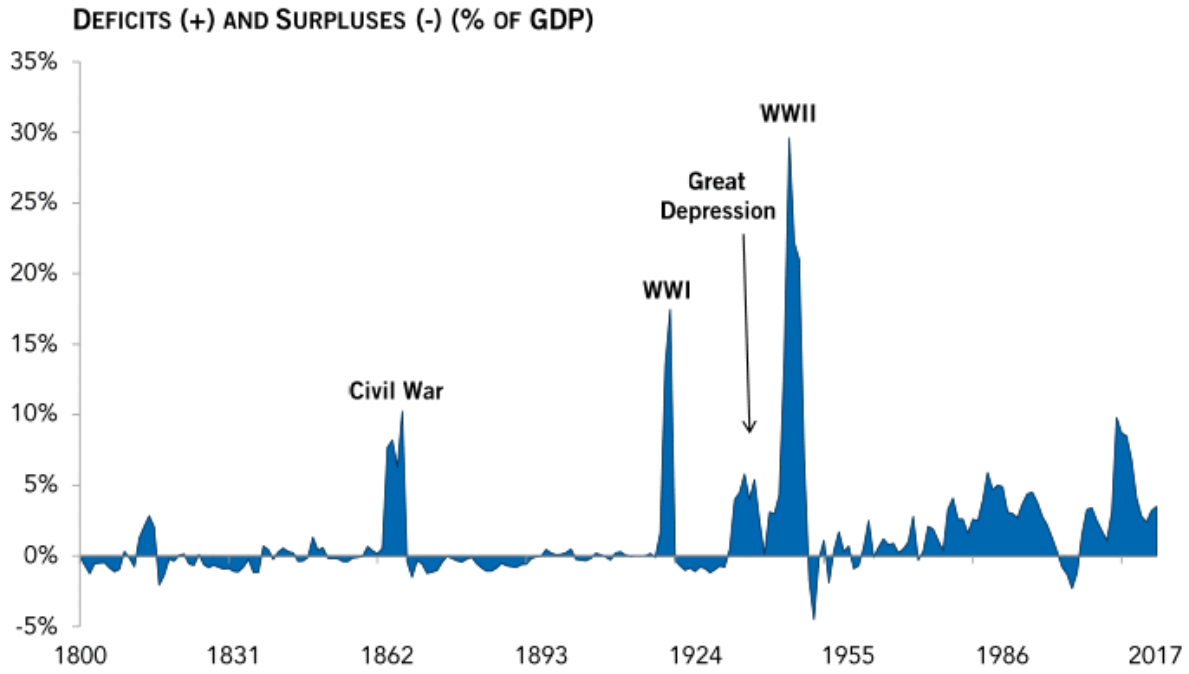


Source: Monthly Treasury Statement. U.S. Department of the Treasury. October 2018.

APPENDIX B: Historical Deficits and Surpluses

Over most of U.S. history, surpluses have been more common than deficits. In the first 125 years of the country's history, surpluses occurred in more than two-thirds of the years. Large deficits were limited mainly to war times and times of extreme economic depression.

More recently, however, deficits have been more common. In the last 50 years, there have been 46 years of deficits and only four years of surpluses (1998 to 2001).

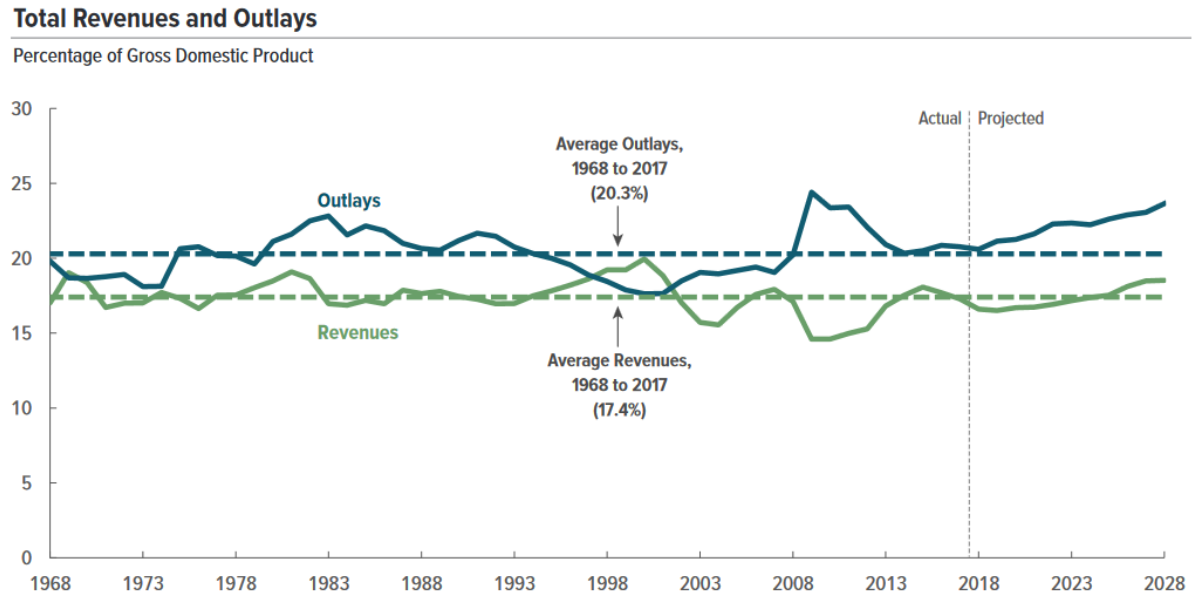


Source: Data from the Office of Management and Budget. Graph from "Federal Deficits and Surpluses, 1800 to Present" Peter Peterson Foundation. March 22, 2018.

APPENDIX C: Looking at Revenues and Outlays Separately

Since there is currently no requirement that total revenues and total outlays be the same (i.e., balanced), those two variables can follow different paths. The graph below shows revenues and outlays separately. Wherever outlays exceed revenues, the government is running a deficit. Wherever revenues exceed outlays, the government is running a surplus.

It is common for economists and budget analysts to make projections about where these variables will go in the future based on current trends. Projections by the Congressional Budget Office (CBO) indicate that if current laws remain unchanged, deficits will rise over the next decade, driving up federal debt. Based on current policies and conditions, the CBO projects moderate economic growth during this period.

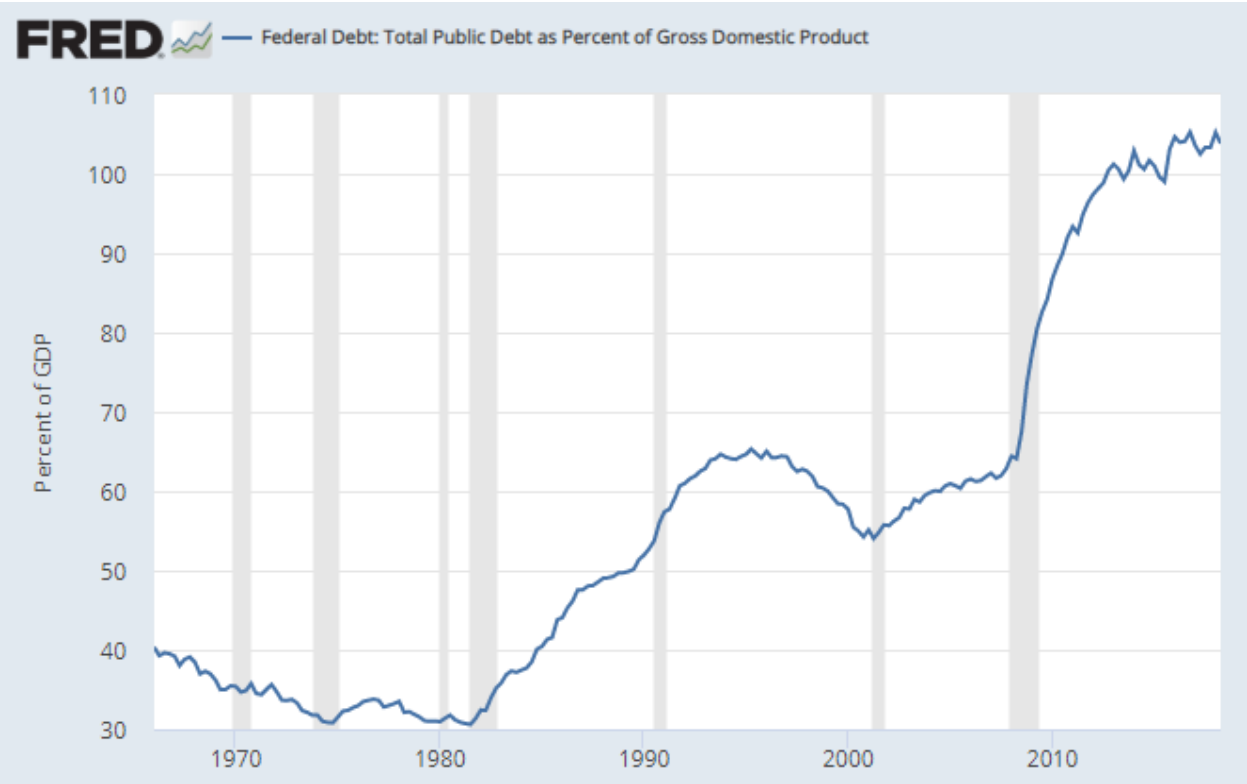


Source: [The Budget and Economic Outlook](). Congressional Budget Office. January 2017.

APPENDIX D: Federal Debt as a Percent of Gross Domestic Product

The graph below shows the federal debt as a share of Gross Domestic Product (GDP). In the 1970s and early 1980s, the federal debt was below 40 percent of GDP. In recent years, the federal debt has climbed to over 100 percent of GDP, which is to say that the amount we owe is as large as the total of what we create in an entire year.

To appreciate how unusual this is, consider that when Europe unified back in the 1990s, the Maastricht Treaty criteria stipulated that a country could not have a debt-to-GDP ratio of greater than 60 percent in order to be a member.[40]



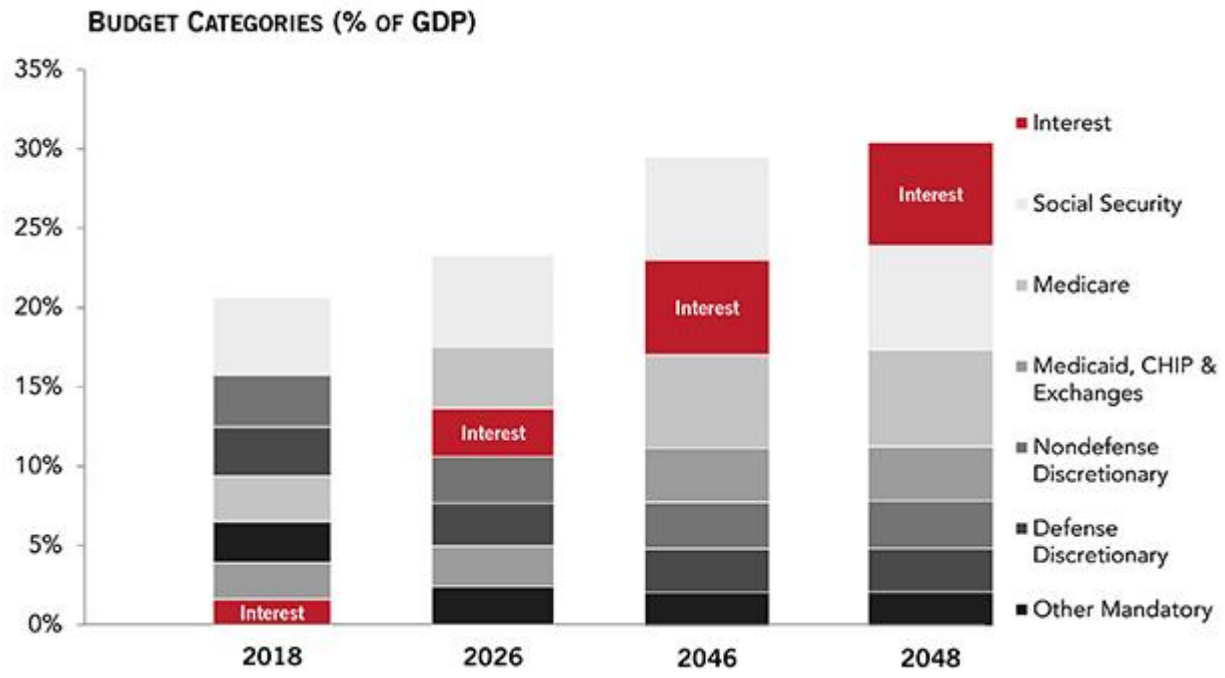
Note: Shaded areas indicate U.S. recessions.

Source: Federal Reserve Economic Data (FRED). Created by Federal Reserve Bank of St. Louis, February 2017.

[40] "Progress Towards Convergence" European Monetary Institute. November 1995.

APPENDIX E. Projected Growth of Various Budget Categories

Interest expenses are the fastest growing category of the federal budget. By 2026, interest expense will be the third largest budgetary item. By 2046, it will be the second largest budgetary item. By 2048, it will be the largest budgetary item.



Note: Medicare spending net of premiums and payments to the states.

Source: Data from the Congressional Budget Office, "The 2018 Long-Term Budget Outlook" Peter Peterson Foundation. March 22, 2018.