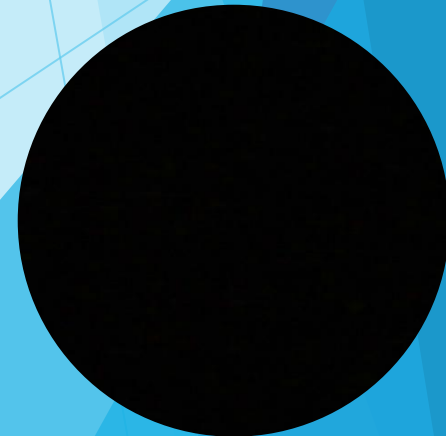


# Understanding the National Debt

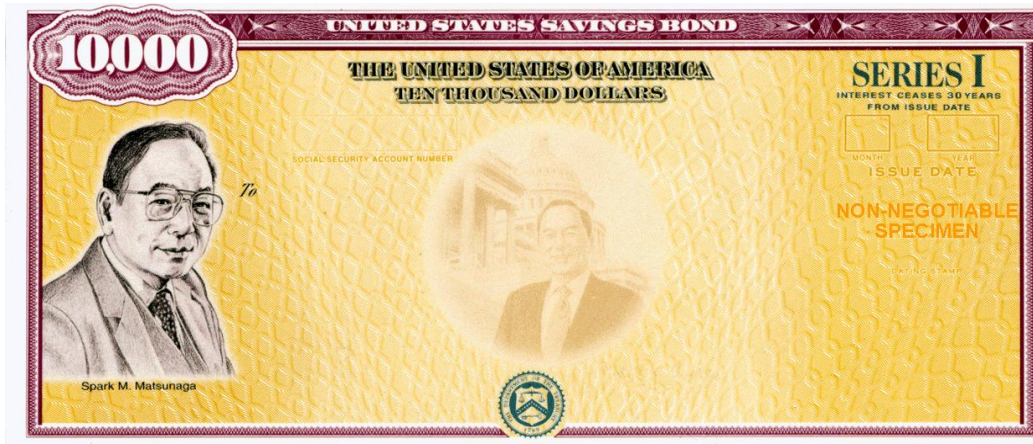
Impact and Solutions for Long-Term Stability

Matthew Sandell  
ECON 450  
Final Presentation  
Dr. Germán Izon



# What is National Debt?

- ▶ When the government needs to spend more money than it brings in as revenue, it engages in deficit spending
- ▶ The national debt is the total of all past deficit spending plus interest
- ▶ The federal government borrows money through the sale of treasury bonds
- ▶ Bonds have a fixed interest rate and maturity



# Who Owns the Debt?

A portion of the debt is intergovernmental

- Other departments of the federal government
- State and local governments

Individuals and firms

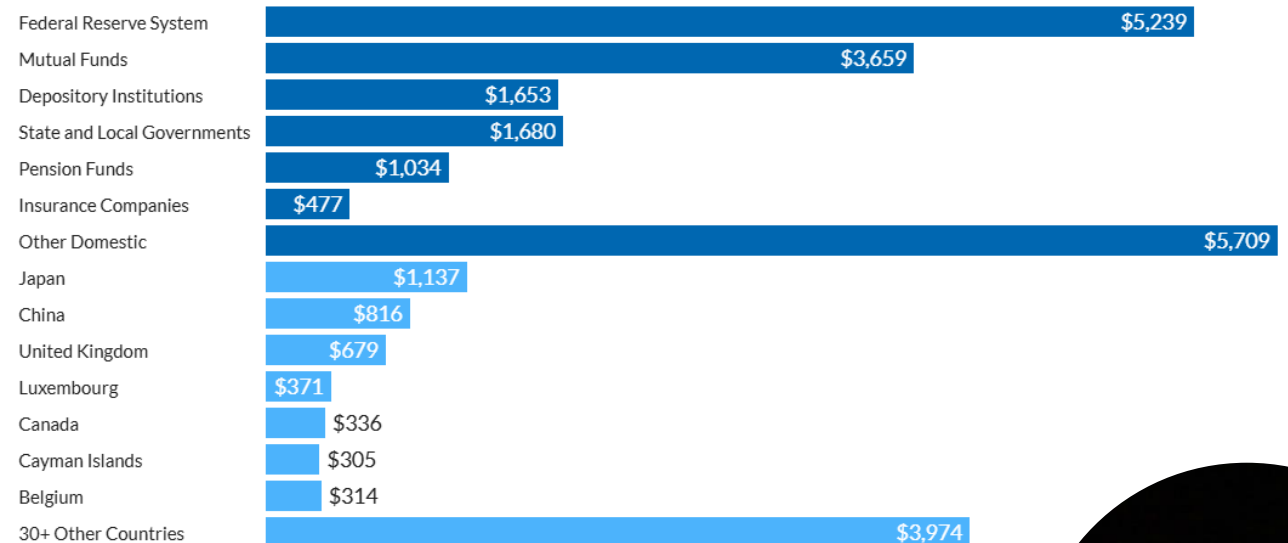
- Pension funds
- Direct purchasing from the government

Foreign governments

- Japan
- China

## Two-thirds of public debt is held by domestic holders

Composition of Debt Held by the Public (Billions of \$)



Source: U.S. Department of the Treasury • [Embed](#) • [Download image](#)

Note: Other Domestic includes owners of savings bonds. Data is through December 2023.

# A Brief History

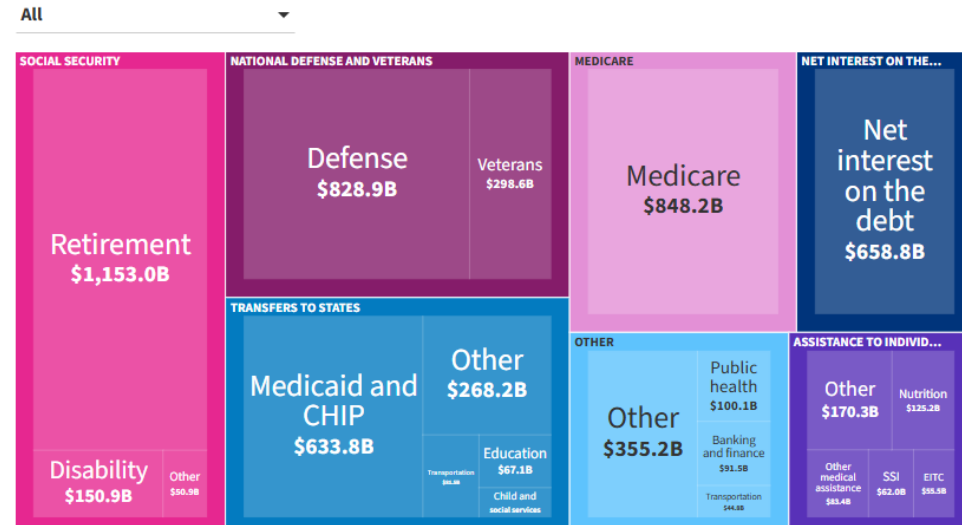
- ▶ Defined as “the price of liberty” by Alexander Hamilton, public debt in America began as a way to fund the Revolutionary War effort
- ▶ The nominal level of debt has fluctuated over time, including being fully paid off in 1835
- ▶ Debt usually spikes during war-time and recessions due to periods of high deficit spending
  - ▶ The Civil War
  - ▶ World War I and II
  - ▶ Great Depression
  - ▶ Great Recession

# Where Does the Money Go?

- Entitlement programs account for over 42% of total outlays
  - Social Security
  - Medicare
  - Medicaid
- National defense
- Interest on the debt

## Federal spending in FY 2023 totaled \$6.16 trillion.

Total US government spending by category, fiscal year 2023



Source: USAFacts aggregation of data from Office of Management and Budget, Census Bureau, Department of the Treasury, and Bureau of Economic Analysis

## U.S. National Debt Over the Last 100 Years

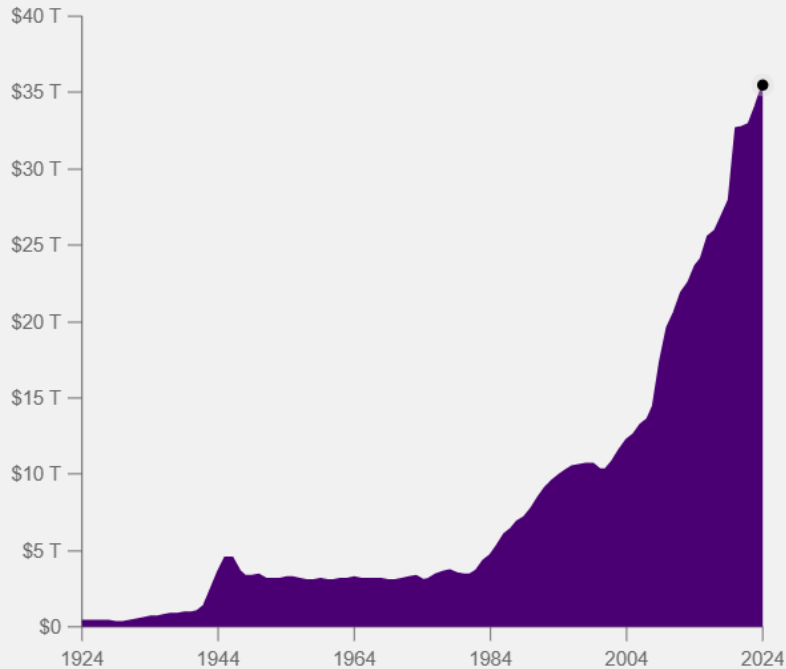
Inflation Adjusted - 2024 Dollars

**2024**

Fiscal Year

**\$35.46 T**

Total Debt



Visit the [Historical Debt Outstanding](#) dataset to explore and download this data. The inflation data is sourced from the [Bureau of Labor Statistics](#).

Last Updated: September 30, 2024

# The Problem

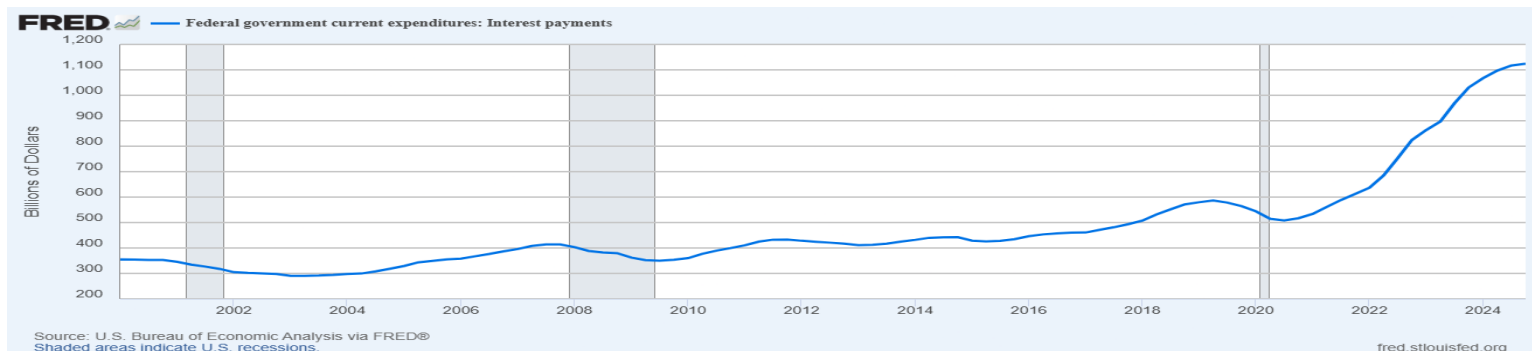
- The national debt now exceeds \$35 trillion
- Annual Gross Domestic Product (GDP) is just \$29 trillion
- Debt has tripled since 2000
- Recent budgets have been trending towards larger deficits
- Interest payments have doubled in the last 5 years

# Why Does Debt Matter?

- ▶ Continuing the current trend “will almost surely erode future living standards” (Edelberg et. al)
- ▶ Several effects could lead to this outcome
  - ▶ Lower national savings
  - ▶ Reduced private investment
  - ▶ Higher interest rates
  - ▶ GDP shrinkage

# Why Does Debt Matter?

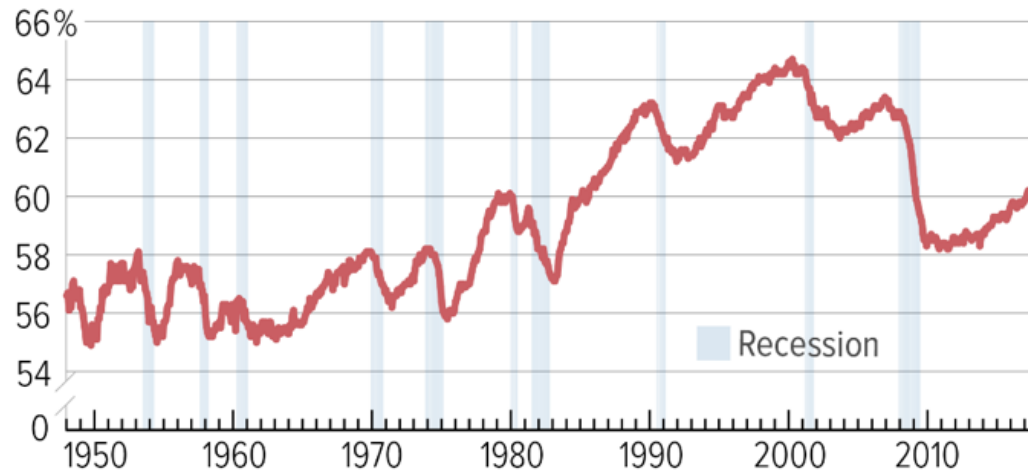
- As total debt increases, so does spending on the interest of the debt
- The Congressional Budget Office predicts net interest payments to exceed \$1 trillion by 2026 (CBO)
- Because the government is already in sustained deficit spending, additional interest payments will necessitate more borrowing to fund increased payments
- This vicious cycle could turn into a “debt spiral” where the government goes into more debt to pay off existing debt
- The long-term result of this runaway spending would likely be a heavy contraction in the market, with the potential for a depression



# Why Does Debt Matter?

## Share of Population With a Job Fell to Mid-1980s Levels

Share of population aged 16 and over with a job



Sources: Bureau of Labor Statistics and National Bureau of Economic Research

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- ▶ The long-term impacts of the debt situation hurt individuals as well
- ▶ Higher interest rates and GDP contractions make the average consumer financially worse off in real terms
  - ▶ Interest rates impact a wide range of purchases, from homes to cars to the use of credit
- ▶ Past recessions are always accompanied by drops in employment
- ▶ Layoffs destabilize personal and national economic conditions

# Perspectives on the Debt: Classical View



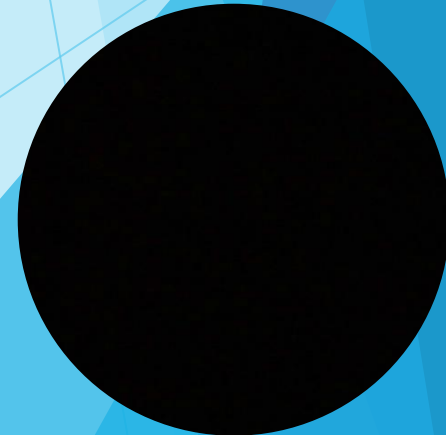
- ▶ Informed by classical economists such as Adam Smith and David Ricardo
- ▶ Focuses on balanced budgets, treating the federal budget like a household
- ▶ Holds the view that “the financing of public expenditures via borrowing is injurious to the economy and to its wealth-generating capacity” (Tsoulfidis)
- ▶ Classical economists typically support the idea of public spending “crowding out” private spending

# Criticism of Classical Economics

- ▶ The classical view tends towards avoiding budget deficits at all costs
  - ▶ Keynesian critics hold that budget deficits are powerful tools that can stimulate an economy during a downturn, most notably in the wake of the 2008 market crash (Investopedia)
  - ▶ Increased federal spending at a time when the taxable income declines due to market contractions creates large budget deficits, but is viewed by many modern economists as necessary to return to a state of vitality
- ▶ Contrasting with classical thought, deficit spending is viewed by some modern economists as a tool to correct for market failures and externalities, such as investing in infrastructure and education

# Perspectives on the Debt: Keynesian Economics

- ▶ Derived from the work of John Maynard Keynes and based on his theory of “socializing investment” (Yueh)
- ▶ Rather than supporting the theory of crowding-out, Keynesian economists view public investment as encouraging private consumption and therefore stimulating the economy
- ▶ Deficit spending is especially beneficial during times of low interest, when the cost of borrowing is low and the benefits to the economy are high



# Criticism of Keynesian Economics

- ▶ Classical Ricardian thought indicates that rational investors “do not increase current consumption that boosts growth” (Yueh)
  - ▶ Because investors know that the debt must at some point be paid off, they would tend towards saving for that time
  - ▶ This is antithetical to the point of high public spending under Keynes
- ▶ Sustained budget deficits over time could signal to investors to demand a higher interest rate (Yueh)
  - ▶ This would slow economic growth by making borrowing more expensive
  - ▶ Higher interest rates would cost the government more money for the same level of goods, and the possibility of a debt spiral could undermine investors confidence in government bonds

# Perspectives on the Debt: Modern Monetary Theory (MMT)



- ▶ A heterodox theory derived from New Keynesian economics that focuses on the importance of federal spending to sustain the market
- ▶ Modern Monetary Theory economists do not see the debt as an issue because the federal government is the issuer of its own currency, meaning it can print as much money as it needs to pay off the debt at any time
- ▶ MMT proponent Stephanie Kelton notes that while nations that do not issue their own currency can have unsustainable debt levels, America as a currency-issuer “can spend first and borrow later” (Kelton)

# Criticism of Modern Monetary Theory

- ▶ A common criticism of MMT is its treatment of inflation
  - ▶ Paying off large portions of the debt would introduce large sums of US dollars into the economy, devaluing the currency and triggering high inflation rates
  - ▶ The theory “does not credibly reveal more scope for deficit spending without inflation” according to former IMF economist Warren Coats (Cato)
  - ▶ Economist Stephen D. King disagrees with MMT theorists’ view that taxation isn’t necessary to fund the nation, calling inflation and taxes “two sides of the same coin”
  - ▶ On the future of the debt, King wrote that it will be paid either “in the form of higher taxes, more austerity, rising inflation or eventual default” (Financial Times)

# The Path Forward: MMT

- ▶ To Modern Monetary Theory economists, the federal debt is not a problem to be solved
- ▶ Deficit spending keeps the economy functioning smoothly by circulating currency through markets
- ▶ Taxation is used as a means for controlling the money supply and managing inflation

# The Path Forward: Keynesian view

- ▶ Keynesian economists support the use of deficit spending to support the economy, but utilize a nuanced approach
  - ▶ If the economy is sufficiently stimulated via spending, it can grow its way out of severe debt-to-GDP ratios
  - ▶ High deficit spending during downturns and decreased spending during upticks help control the pace of debt accumulation while also helping the economy
  - ▶ The Keynesian view sees high inflation and interest rates as leading to volatility in borrowing; therefore, focus is placed on keeping inflation rates low

# The Path Forward: Classical theory

- ▶ Classical economists see the debt as a looming problem to be solved
- ▶ Slowing the growth of the debt is vital
  - ▶ This can be achieved either through much smaller deficits
  - ▶ Budget surpluses would allow the federal government to begin repaying the debt
  - ▶ Balanced budgets can also be utilized either solely or in conjunction with a mix of surplus and deficit spending

# Is a debt crisis inevitable?

- ▶ A debt-related crisis is a possibility in the coming decades
- ▶ There is little immediate risk of a market crash related to the debt
- ▶ Mitigation steps can be taken to avoid a large-scale depression
  - ▶ Smaller budgets that are creatively structured to be effective and efficient
  - ▶ Working towards balanced budgets in strong markets and deficit spending in downturns
  - ▶ Stimulating GDP growth to effectively grow out of the debt
  - ▶ Maintaining inflation at a rate that encourages borrowing and growth but does not rapidly devalue the US Dollar

Thank You!

