

Understanding the National Debt Presentation Handout

- Deficit spending occurs the government spends more money than it makes in revenue. Each year that deficit spending occurs, the deficit is added to the national debt. Deficit spending is financed via the sale of bonds. Bonds have a fixed interest rate and maturity and can be purchased by anyone, including local governments, individuals, firms, and other nations.
- Federal debt began to fund the Revolutionary War, and has been used since then to varying degrees, including being paid off in 1835. The debt usually spikes during war and recessions due to funding the conflict and stimulating the economy respectively. A large portion of the federal debt goes to fund entitlement programs, national defense, and interest payments on the debt.
- The issue is that the current debt has tripled since 2000 and now exceeds GDP. Additionally, recent budgets are tending towards larger deficits and interest payments have doubled in the last 5 years. Traditional analysis of the debt indicates future living standards will decrease due to lower national savings, reduced private investment, higher interest rates, and GDP shrinkage. Interest payments are increasing exponentially and may create a debt spiral as the government borrows more to pay off the interest. Over time this could lead to heavy market contractions and potentially a depression.
- An economic recession would result in higher interest rates and a contraction in GDP, hurting consumers in real terms. Additionally, the associated increase in unemployment rates would exert pressure on the market and lead to instability.
- The classical view on the federal budget is averse to deficits, seeing them as directly injurious to growth. This is supported by the notion that public spending crowds out private spending. Criticism of the classical viewpoints to effects of deficit spending during economic downturns as a means to stimulate the economy, as well as correcting for market failures and externalities.
- The Keynesian view rejects the effect of crowding out, and instead supports public investment as a stimulant in the economy. This view has been criticized by Ricardian economists under the notion that investors adjust their spending preferences, defeating the purpose of stimulus spending. Additionally, higher interest rates under deficit spending would make credit more expensive for everyone.
- A relatively new perspective, Modern Monetary Theory focuses on the role of the US as an issuer of its own currency, stating that any level of debt can be paid off by printing it. Criticisms of this method point out that large-scale introductions of

additional currency into the market would trigger inflation and an economic meltdown.

- Under Modern Monetary Theory, the federal debt is not a problem to be solved. Under Keynesian economics, high rates of GDP growth, adjusted deficit spending based on market performance, and a focus on low inflation and interest rates will keep the debt manageable. Classical economists hold that small deficits, budget surpluses, and balanced budgets can be used to greatly reduce the debt growth rate.