JargonAlert

National Debt

BY DAVID VAN DEN BERG

When you hear debates about the fiscal health of the nation, it's important to put the rhetoric into context. Many observers worry about the amount of money that the U.S. government owes to its bondholders — the "national debt." But how the debt grew to its current size and the trend of federal expenditures are important matters to keep in mind when sorting out the arguments about the national debt.

When the federal government spends money, that money has to come from somewhere. Most government spending is financed by tax revenue. But the federal government usually spends more than it takes in, resulting in a budget deficit. So, to pay for expenses beyond the amount of taxes collected, the government borrows by selling Treasury securities — short-term "Treasury bills" or long-term "Treasury bonds" — to the general public. In short, unbalanced budgets drive an increase in the federal deficit which in turn is added to the total sum of the national debt.

America's total gross national debt is roughly $11 trillion today. Of that, about $6.8 trillion is the amount of debt held by the public. Of the two components that comprise the national debt, this is the one that is the most commonly reported. It includes all federal debt held by individuals, corporations, state or local governments, foreign governments and other entities outside the federal government. These numbers are reported by the Bureau of Public Debt of the U.S. Treasury Department. China and Japan are the largest foreign holders of this publicly held debt.

The rest, about $4.2 trillion, is held in intergovernmental accounts, like the respective trusts funds for Social Security, Medicare, and the retirement accounts for military and civil service personnel. The reason these trust funds hold Treasury securities is that the payroll tax which finances most of the spending on these programs generates more revenue than needed to pay for current services that the trust funds finance. Congress often borrows this surplus revenue for spending on other programs and issues Treasury securities to these trust funds in return.

These debt numbers might sound big, so it's important to put them in context. The national debt figures are typically measured as a percentage of gross domestic product (GDP), the primary measure of the nation's economic activity.

In the past, debt held by the public rose substantially during periods of war and, later, during periods of increased spending during economic downturns. The debt was 90 percent of GDP in the early 1950s, after World War II had ended and the Korean War was underway. By the 1970s, it was below 30 percent. It crept back up to 49 percent by 1996, but it has declined to about 41 percent in the last complete fiscal year (FY 2008). The decline after 1996 was due to a four-year period of budget surpluses that allowed the U.S. government to slowly pay off debt.

Currently, debt held by the public is about 47 percent of GDP. The total gross national debt is 74.6 percent of GDP. But that doesn't mean the full burden of the debt is borne by current taxpayers. The year-to-year burden of the national debt is the cost of paying the interest on the Treasury securities. Today, this "carrying cost" for the national debt is $249 billion, or 1.7 percent of GDP.

Economists and policymakers are divided about whether the current debt levels could have adverse consequences for economic growth or the country's future. Some are concerned that a growing debt burden will "crowd out" private investment — money that might have gone to other investments will instead go to purchasing safe Treasury bills. Others suggest that current debt levels are sustainable and point out that there is no correlation between interest rate changes on Treasury bonds and the present level of the national debt.

If history is any guide, government debt will always be with us. For starters, emergency military actions are unpredictable and have been funded by the issuance of debt throughout U.S. history. In addition, the purchase of Treasury securities is an important tool used by the Federal Reserve to conduct monetary policy.

The size of the gross national debt may be the least of our worries, however. An additional obligation that is not included in the national debt calculation is the future benefits that the U.S. government will pay to retirees in the years to come. The number of retirees — who receive their benefit payments out of current revenue — will soon dramatically outstrip the number of workers paying into the Social Security and Medicare system. This mismatch over time will result in trillions of dollars of "unfunded obligations" that will have to be financed by more Treasury debt, greater tax revenue, or cuts in benefits to retirees. Some argue that this implicit debt could have the potential to substantially dwarf the gross national debt and indeed harm the U.S. economy. **RF**

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