Debt 101

What Is the 'National Debt' and Why Does It Matter?

We are, let's face it, a nation of debtors. As of December 2017, we citizens have a collective household debt of $13.15 trillion when you add up our national IOUs on mortgages, student loans, credit cards, and car loans. And that figure mounts with every passing quarter. Granted, we're no deadbeats—less than 5 percent of our overall debt is in delinquent status. Still, we are by and large pretty comfortable with being in the red. And, unfortunately, so is our government…and quite possibly to far worse effect.

The US government now owes much more than its citizens do collectively, with the government racking up the bill on health care, Social Security, the military, and the accumulated interest. Right now, our national debt is higher than the market value of everything we make and do in this country each year—our gross domestic product, or GDP. And while we would all grouse that our taxes are too damn high, the $3 trillion the IRS collects from us and our corporations, along with duties collected on incoming products, doesn't come anywhere near covering what the government spends. That's been pretty much the norm for a long time.

Does the Government Have a Deficit or a Debt?

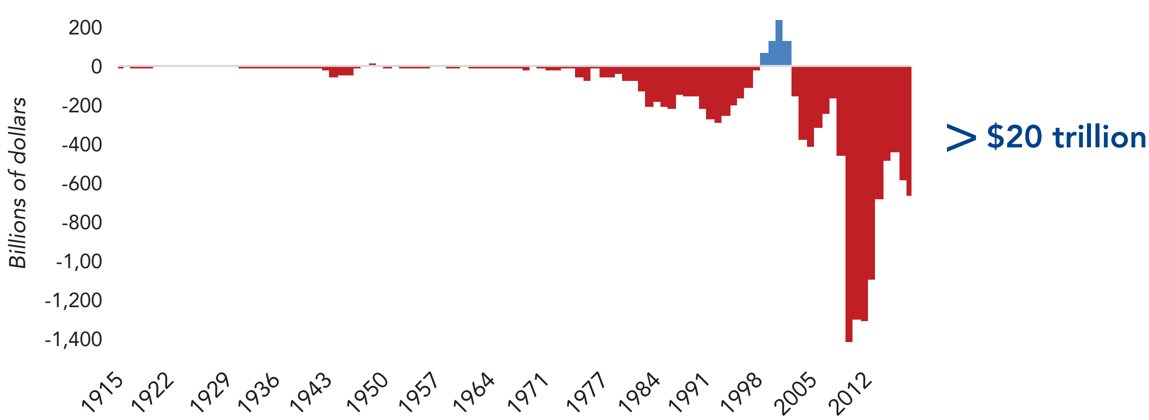
For some time now, it's had both. Every year, the government establishes a budget. The yearly shortfall between what the US government has available to spend and what it actually spends is the annual budget deficit, and the national debt is an accumulation of all past budget deficits.

It's taken a lot of past budget deficits to get to where we are now: the US government owes to the tune of $20 trillion, and that number is rising by the second.

Still, the US government maintains its creditworthiness for the many individuals and foreign nations that continue to buy our national debt—based largely on our country's reputation for repaying debts on time with interest.

Figure 1

The Sum of All Past Deficits Equals the Debt



Source: Office of Management and Budget (2018)

Where Does the US Get Its Loans?

Unlike us, the government doesn't borrow money on credit cards or go to the bank for a loan. Instead, the US Treasury issues bonds; essentially, individuals and groups agree to buy the government's debt in return for the money back by a given date, plus a market-determined interest rate. You and I could buy a US bond today; we'd be lending money to our country and, at the same time, profiting from our largesse once the interest is paid. After all, the US is considered one of the most fail-safe investments in the world—the government has always made good on its debts, which are backed by "the full faith and credit of the US government."

But what if that all changed? What if the world—and we Americans—ceased to have faith in the US government and stopped advancing it credit?

What Happens if the Debt Gets 'Too Big'—Whatever That Even Means?

Just how much debt is too much? It depends on investor psychology, such a notoriously irrational thing that even experts can't be sure. Though it's framed as a partisan talking point, "the national debt" is not a Republican or Democrat issue; it's a national issue that we should all keep in mind when casting our votes and determining our priorities.

Possible consequences of an unsustainable debt could be anything from **nothing happening at all** in the best case to **the end of US world leadership as we know it** in the worst. Russia, Iceland, and, most recently, Greece have all defaulted on their national debts. All experienced or continue to experience some form of severe economic hardship as a result. The US could be close behind if our government does not quickly turn its budgetary behavior around. Many economists consider the likely outcome as one of two possibilities: a "Whimper" or a "Bang."

The "Whimper" is a certain outcome of too much debt

To best picture the Whimper, think of the parable of the boiling frog: if a frog is placed suddenly into boiling water it will jump out, but if it is placed into tepid water that is slowly brought to a boil, it will not perceive the danger and will be boiled to its demise. In the "Whimper" scenario, the US is the frog, and the ever-rising debt is the tepid water coming to a boil. As some economists see it, the strain of repaying the debt would slowly erode the nation's economic strength and crowd out investments, which in turn would reduce US economic growth. Businesses would not be able to finance their essential investments. Social Security and Medicare beneficiaries would be in need of health care, and men and women in uniform would be left with too few resources. But the effect might be so gradual that it would not grasp anyone's attention until it was too late to rebound.

The “Bang” will happen if investors stop buying or holding government debt

This scenario would leave the US Treasury with bill collectors at the door and no cash to pay them. To maintain credibility, government leaders would have to raise cash fast by increasing taxes or cutting spending dramatically. Government leaders could try to pay their bills by printing more money, which would cause hyperinflation, but that would likely not motivate people, companies, or countries to buy more Treasury bonds. And it gets worse. Virtually every financial institution, including insurance companies and pension funds, holds Treasury securities as a safeguard investment. Those institutions would have to respond by cutting their spending on initiatives that employ American workers and help other organizations, thus having a huge impact on employees and clients alike.

How Can We Get Out of Debt?

As an individual, you have several options to pay down your debt: you can tighten your belt and spend less; you can get a new job that pays more, get a second job, or wait for an inheritance or a winning lottery ticket; you can dip into your savings or sell something of value. The US government can also choose one or a combination of routes: raise taxes, lower spending, or grow the economy. Which of these is most likely to work, and with what consequences?

Stay tuned for Part II with more detail on solutions to the ever-expanding debt problem.

Since its founding over 75 years ago, the Committee for Economic Development (CED) has recognized the importance of fiscal responsibility and has authored numerous pieces on causes and solutions to the problems now plaguing the US, most recently "This Way Down to a Debt Crisis" and "The Federal Budget Deficit and the Public Debt."

APRIL 2018

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