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WHY WE SHOULD NEVER PAY DOWN THE NATIONAL DEBT

*Neil H. Buchanan**

I. INTRODUCTION

The Great Recession of 2008 and its aftermath—with persistently high unemployment,¹ grinding poverty, ruinous state and local government budget cuts, and the continued risk of renewed distress in the housing and financial markets, both at home and abroad²—have led to a completely predictable and temporary increase in the federal government’s annual budget deficit, and a concomitant rise in the national debt. Because of broad misunderstandings and biases regarding the nature of public debt, there have been loud calls to bring the federal government’s budget into some measure of balance.³

Because politicians are often no more knowledgeable than is the public at large about the issues raised by federal deficits and debt, their calls for “financial responsibility” are often confused and contradictory, with politicians simultaneously calling for both balanced budgets—which would simply freeze the level of federal debt at its current levels—and for paying down the national debt—which can only be accomplished by running annual federal budget surpluses.⁴ Typically, no reasons are offered to justify paying down the national debt, other than simple repetitions of vague, content-free sound bites, such as the insistence that we must protect “our

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¹ James Marschall Borbely, *U.S. Labor Market in 2008: Economy in Recession*, MONTHLY LAB. REV., Mar. 2009, at 3, 3, available at <http://www.bls.gov/opub/mlr/2009/03/art1full.pdf> (“The increase in the unemployment rate in 2008 was larger than that experienced during the 2001 recession and was the largest fourth-quarter-to-fourth-quarter increase since 1982.”).

² Bob Willis, *U.S. Recession Worst Since Great Depression, Revised Data Show*, BLOOMBERG (Aug. 1, 2009), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aNivTjr852TI>.

³ See, e.g., Jennifer Steinhauer, *Republicans, Fresh from Debt Battle, Set Sights on Balanced Budget Amendment*, N.Y. TIMES, Aug. 5, 2011, at A10 (describing a GOP-led effort to amend the U.S. Constitution to require a balanced budget).

⁴ See, e.g., Jackie Calmes & Jennifer Steinhauer, *Bipartisan Plan for Budget Deal Buys President*, N.Y. TIMES, July 20, 2011, at A11.

children and grandchildren” from the supposedly damaging effects of federal borrowing.⁵

In this article, I will describe the accounting concepts underlying federal budget deficits and the national debt, as a prelude to explaining the possible costs *and benefits* of increasing the national debt. I will then argue that, rather than agreeing to decrease the national debt, we should instead commit to a long-term plan to allow the federal debt to rise in a controlled fashion, using the borrowed funds to truly protect the interests of future generations. I will argue further that paying down the national debt would destabilize financial markets, by removing an essential source of risk-free financing that is used in nearly all major private-sector financial transactions, and that is the basis of sound financial planning for households and businesses alike.

Although it is understandable that people are confused by a subject as technical and complicated as federal budgeting, it is disturbing that this confusion is being reflected—and even amplified—in the national political debate. Fiscal responsibility is not a simple matter of refusing to borrow money. For families, businesses, and especially governments, borrowing money is often the most responsible path to future prosperity.

II. THE FISCAL BATTLES OF 2011 AND 2012

It has been more than a year since the mid-term elections of 2010, when control of the House of Representatives changed from the Democrats to the Republicans, and the Democrats’ majority in the United States Senate shrank by six seats.⁶ The driving electoral force behind those Republican gains was the so-called Tea Party movement, which repackaged longstanding conservative opposition to government intervention in the economy into an aggressive attack on all federal spending.⁷

The new House majority wasted little time in asserting its influence over policy, initiating four high-pitched battles over taxes and spending in the year after the elections:

⁵ See Neil H. Buchanan, *What Do We Owe Future Generations?*, 77 GEO. WASH. L. REV. 1237, 1239 (2009).

⁶ Chris Cillizza, *Election 2010: Republicans Net 60 House Seats, 6 Senate Seats and 7 Governorships*, WASH. POST, Nov. 3, 2010, <http://voices.washingtonpost.com/thefix/morning-fix/2010-election-republican-score.html>.

⁷ See, e.g., *Timeline: Rise of the Tea Party Movement*, CNN POLITICS (Nov. 2, 2010), <http://www.cnn.com/2010/POLITICS/11/02/timeline.tea.party/index.html> (detailing the rise of the Tea Party from late 2008 until the 2010 elections).

(1) In December 2010, before newly-elected members of Congress had even been sworn into office, Republican leaders in both houses threatened to allow taxes to rise across the board—allowing the so-called Bush Tax Cuts to expire as a whole—rather than agreeing to President Obama's proposal to allow taxes on the top 2% of taxpayers to return to their pre-2001 levels (while leaving tax liabilities unchanged for the bottom 98% of all taxpayers). As a result, President Obama and the Democratic leadership in Congress agreed to extend the Bush Tax Cuts for all income levels for two years, with taxes now scheduled to revert to Clinton-era levels at midnight on December 31, 2012, unless Congress acts again to extend the current rates or otherwise amends the tax code. As part of that agreement, Congress also enacted a payroll tax cut, and it extended benefits for the long-term unemployed.⁸

(2) In March 2011, as a temporary budget extension expired, the new Congress passed a budget for the remainder of the 2011 fiscal year, following a standoff that threatened to precipitate a partial shutdown of the federal government. That budget required cuts in spending, with no tax increases, to reduce deficits over a multi-year period.⁹

(3) In August 2011, after an acrimonious debate over raising the debt ceiling statute, President Obama signed a law that reduced spending by \$1.2 trillion over ten years.¹⁰ The new law also mandated that a special committee of Congress propose up to \$1.5 trillion in further combined spending cuts and tax increases, or—when that committee failed to offer a proposal meeting that target—that an additional \$1.2 trillion in spending be cut.¹¹

(4) In December 2011, as the first year of the 112th Congress came to an end, the parties failed to agree on a plan to extend unemployment benefits and to continue the payroll tax cut that had been enacted a year earlier.¹² The parties ultimately agreed on a compromise in February 2012 that would extend the benefits beyond the looming presidential election.¹³

⁸ See David M. Herszenhorn & Jackie Calmes, *Tax Deal Suggests New Path for Obama*, N.Y. TIMES, Dec. 7, 2010, at A1, available at http://www.nytimes.com/2010/12/07/us/politics/07cong.html?_r=1&scp=1&sq=December%20Obama%20democrats%20agree%20to%20extend%20bush%20tax%20cuts&st=cse.

⁹ Carl Hulse, *House Advances Budget and Cuts \$4 Billion*, N.Y. TIMES, Mar. 2, 2011, at A16, available at <http://www.nytimes.com/2011/03/02/us/politics/02budget.html?scp=1&sq=March%202011%20congress%20passes%20budget%20to%20avoid%20government%20shut-down&st=cse>.

¹⁰ Alan Silverleib & Tom Cohen, *House Approves Debt Ceiling Bill*, CNN MONEY (Aug. 2, 2011), available at http://money.cnn.com/2011/08/01/news/economy/debt_ceiling_vote.cnnw/index.htm.

¹¹ *Id.*

¹² Paul Kane & David Nakamura, *Congressional Negotiators Reach Tentative Deal on Payroll Tax*,

In each of those highly intense battles, partisans argued about the appropriate size and timing of deficit reduction. Nearly everyone involved agreed that long-term deficits must be reduced, but there was little hope of consensus about how to achieve that goal.¹⁴ Republicans refused to consider tax increases of any kind, while Democrats generally favored a combination of spending cuts with some increases in taxes on wealthier citizens.¹⁵

One surprising aspect of the political debate over the federal budget was the emergence of prominent voices calling for the complete elimination of the national debt.¹⁶ Although such arguments have been offered from the fringes of the political debate for decades, the year 2011 for the first time saw major political figures seriously discussing a goal of zero debt for the federal government.¹⁷ For example, Kentucky Senator Rand Paul voted against the Republican-sponsored March 2011 budget bill because that budget did not put the country on a path to pay down the national debt fast enough.¹⁸

The new political reality in the United States, therefore, includes a movement to pay off the national debt.¹⁹ Even short of that goal, however, nearly everyone agrees that government spending must be reduced, perhaps dramatically.²⁰ Such proposals could have disastrous effects on the economy. To understand why, it is essential first to explain some basic accounting principles that apply to the federal budget.

Unemployment Benefits, WASH. POST, Feb. 14, 2012, at A02, available at http://www.washingtonpost.com/politics/obama-renews-pressure-for-payroll-tax-cut-even-as-gop-leaders-agree-to-compromise/2012/02/14/gIQAyZEbDR_story.html.

¹³ *Id.*

¹⁴ Rosalind S. Helderman, *Bipartisan Group of Senators Urges Super Committee to Go Big*, WASH. POST (Sept. 15 2011, 1:44 PM), http://www.washingtonpost.com/blogs/2chambers/post/bipartisan-group-of-senators-urges-super-committee-to-go-big/2011/09/15/gIQASAbwUK_blog.html.

¹⁵ Paul Krugman, Op-Ed., *Failure Is Good*, N.Y. TIMES, Nov. 18, 2011, at A33.

¹⁶ Jeff Cox, *Republican Budget Plan to Eliminate National Debt: Ryan*, CNBC (Apr. 5, 2011), http://www.cnbc.com/id/42429728/Republican_Budget_Plan_to_Eliminate_National_Debt_Ryan.

¹⁷ *Id.*

¹⁸ Susan Ferrechio, *Senate Rejects Budget Plans 9 Days Before Deadline*, WASH. EXAMINER, Mar. 9, 2011, <http://washingtonexaminer.com/politics/congress/2011/03/senate-rejects-budget-plans-9-days-deadline/111459>.

¹⁹ See, e.g., Richard Cowan & David Alexander, *Republicans Take Gamble with 2012 Budget Proposal*, REUTERS (Apr. 5, 2011), <http://us.mobile.reuters.com/article/politicsNews/idUSTRE7343MJ20110405>.

²⁰ See Felix Salmon, *A Bipartisan Proposal For More Government Spending*, REUTERS (Nov. 11, 2011), <http://blogs.reuters.com/felix-salmon/2011/11/11/a-bipartisan-proposal-for-more-government-spending/> (describing a proposal to reduce the long-term growth of federal spending).

III. DEFICITS AND DEBT

When a government borrows money, it creates both deficits and debt. Although many people (including far too many politicians) use those terms interchangeably, they are wholly different concepts. The federal government's budget deficit (also called the fiscal deficit, or the cash-flow deficit) represents the new borrowing that the United States Treasury must undertake in a given year, equal to the amount by which government spending exceeds tax revenues collected during the year.²¹ The debt, by contrast, is the total amount of money that the government owes to all of its lenders at any given time.²² The debt, therefore, is equal to the sum of "all previous deficits (less previous annual surpluses), plus accumulated interest on the money borrowed."²³

The government borrows money by selling Treasury bonds,²⁴ which are legal contracts obligating the government to pay principal and interest to lenders under specified terms.²⁵ Businesses, households, state and local governments, and foreign governments voluntarily lend money to the United States government by buying its bonds.²⁶

In addition, the federal government's debt is partly held internally, with some federal agencies holding Treasury bonds on their books as assets.²⁷ The most important of these agencies is the Social Security Administration, which accounts for its accumulated annual budget surpluses by holding Treasuries, thereby lending its annual surpluses to the rest of the federal government.²⁸ This means that the total federal debt is only partly held by

²¹ Neil H. Buchanan, *Good Deficits: Protecting the Public Interest from Deficit Hysteria*, 31 VA. TAX REV. 75, 83 (2011).

²² *Id.*

²³ *Id.*

²⁴ The debt securities issued by the Treasury are collectively referred to as bonds, even though the term "bond" technically only applies to 10-year securities, with medium term securities called "notes," and short-term securities (with maturities of one year or less) called "bills." In this article, I will follow the convention of referring to all Treasury securities as bonds, or as Treasuries.

²⁵ For example, 10-year Treasury bonds pay a fixed interest rate every six months until they mature. *Treasury Bonds*, TREASURYDIRECT (Apr. 7, 2011), http://www.treasurydirect.gov/indiv/products/prod_tbonds_glance.htm.

²⁶ *Id.*

²⁷ *Ownership of Federal Debt*, U.S. GOV'T ACCOUNTABILITY OFFICE, <http://www.gao.gov/special.pubs/longterm/debt/ownership.html> (last visited Apr. 17, 2012).

²⁸ Kathy Ruffing, *Social Security Does Not Need a "Bailout"*, CTR. ON BUDGET & POLICY PRIORITIES (Aug. 24, 2010), <http://www.cbpp.org/cms/index.cfm?fa=view&id=3104>.

parties that are not part of the federal government, creating a distinction between the total federal debt and the “debt held by the public.”²⁹

In the 2011 fiscal year, the federal budget deficit was approximately \$1.3 trillion dollars, or about 9% of Gross Domestic Product (GDP, the broadest measure of the country’s annual income).³⁰ This relatively large amount of new net borrowing was largely driven by the high unemployment and depressed output of the still-weak economy, which depressed tax receipts and temporarily increased income support payments. In March 2012, gross federal debt was approximately \$15.5 trillion, while the debt held by the public (which includes all lenders, foreign and domestic, as well as the Federal Reserve System), was approximately \$10.8 trillion,³¹ or about 70% of GDP.

Because deficits are responsive to the state of the economy, economists find it useful to define a measure of the deficit that is independent of changes in national income. The “cyclically-adjusted deficit,” sometimes called the standardized-employment deficit, measures the difference between the levels of spending and revenues that would exist if the economy were operating at full capacity.³² In 2012, if the economy had been healthy, the deficit would have been approximately \$630 billion, or a bit more than 4% of GDP, which is more than one-third lower than the projected level of the cash-flow deficit projected for this year.³³

IV. SHOULD WE WORRY ABOUT DEFICITS AND DEBT?

With deficits temporarily at historically high levels, and with the national debt higher than it has been since the decade immediately following World War II, many economists and politicians have become alarmed that such borrowing might inflict damage on the overall economy.³⁴ There are two defensible concerns about the dangers of federal

²⁹ See *The Debt to the Penny and Who Holds It*, TREASURYDIRECT (Feb. 21, 2012), <http://www.treasurydirect.gov/NP/BPDLogin?application=np>.

³⁰ *The Federal Budget Deficit for 2011 — \$1.3 Trillion*, CONG. BUDGET OFFICE (Oct. 7, 2011), <http://www.cbo.gov/publication/42532>.

³¹ TREASURYDIRECT, *supra* note 29 (reporting the nation’s total public debt outstanding at \$15.52 trillion as of early March 2012; \$10.77 trillion of this amount was held by the public).

³² Buchanan, *supra* note 21, at 85.

³³ Letter from Douglas W. Elmendorf, Dir., Cong. Budget Office, to Chris Van Hollen, Ranking Member, Comm. on the Budget (Oct. 4, 2011), available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/10-04-Portion_of_Deficit_Due_to_Cyclical_Weakness.pdf.

³⁴ Frank James, *U.S 2011 Deficit Picture Bleak; Worse May Follow: CBO*, NPR (Jan. 26, 2012, 1:02 PM), <http://www.npr.org/blogs/itsallpolitics/2011/01/26/133240383/u-s-2011-deficit-picture-bleak-worse-may-follow-cbo>.

borrowing: one is based on the possible effects on financial markets;³⁵ the other is based on the diversion of economic resources to unproductive ends.

If the government's total debt were to become large enough, it could become impossible for the government to repay all of its debts. Because lenders care about whether their loans will be repaid, they monitor the government's long-term borrowing needs to ensure that the day will never come when the government must either default on its bonds or (if the government fulfills its debt obligations by issuing more currency) reduce the value of its debts by increasing the rate of inflation.³⁶ When the government appears to be moving toward unsustainable debt levels over time, lenders will demand higher interest payments in return for their continued willingness to lend.³⁷ On the other hand, when the government's long-term borrowing needs appear stable and manageable, lenders do not require such additional compensation.

All of these considerations, however, are based on decades-long forecasts of the federal government's borrowing needs. If, because of a deep recession, the government suddenly needed to borrow large sums of money (but its borrowing needs would return to normal levels when the economy recovered), then lenders would have no reason to worry about the long-term path of the debt. It is only when borrowing patterns—in both good times and bad—appear to be surpassing the long-term ability of the government to repay its debts that the financial markets should become concerned enough to change their behavior.³⁸

This means that concerns about the high levels of deficits in the aftermath of the 2008 recession are fundamentally misplaced. Even a decade or more of unusually high deficits should not be enough to cause financial markets to refuse to finance the federal government's borrowing needs. The danger is that financial markets will become convinced that the *long-term*, permanent debt situation will pass the point of no return. Even if that were to happen, however, all would not necessarily be lost. If the markets reacted in an orderly fashion, interest rates would rise, and the

³⁵ See Francis E. Warnock, *How Dangerous Is U.S. Government Debt? The Risk of a Sudden Spike in U.S. Interest Rates*, COUNCIL ON FOREIGN RELATIONS (June 2010), <http://www.cfr.org/financial-crises/dangerous-us-government-debt/p22408>.

³⁶ Matthew Jaffe, *Debt Ceiling: What US Government Default Would Mean For You*, ABC NEWS (July 12, 2011), http://abcnews.go.com/Politics/debt-ceiling-us-governmentdefault/story?id=14047647#Tyb_n-OXQjc.

³⁷ See CONG. BUDGET OFFICE, ECONOMIC AND BUDGET ISSUE BRIEF: FEDERAL DEBT AND THE RISK OF A FEDERAL CRISIS 1 (2010), available at http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/116xx/doc11659/07-27_debt_fiscalcrisis_brief.pdf.

³⁸ *Id.*

government could respond in a timely way to the warning signal that those increased interest rates would provide. The greatest worry, however, is that financial markets would not react in such a tidy way, but rather would spin out of control in a sudden, chaotic overreaction to some unforeseen triggering event (or even to the mere perception that something important has happened). Once such a cascade of events was under way, the entire financial system would be at risk, with disastrous consequences for the economy.³⁹ In that catastrophic situation, even well-run businesses would find it impossible to obtain financing for the most ordinary purposes, thereby freezing the economy and putting millions of people out of work.⁴⁰

This grim possibility—that financial markets will become so concerned about the government’s long-term unwillingness to finance its operations that the entire economic system is suddenly brought to a halt—can only become a reality if market participants come to believe that the government’s long-term borrowing will become unmanageable.⁴¹ Based on available forecasts of the federal government’s likely spending and taxing levels, only health care costs pose a serious danger of creating the kind of systemic crisis that could bring down the economic system.⁴² The remainder of the federal government’s finances, including Social Security payments during the retirement years of the Baby Boom generation, is entirely under control, with no indication that long-term borrowing needs would approach anything close to unsustainable levels.⁴³

Moreover, if the worst-case forecasts of spiraling health care costs turn out to be true, there is nothing that could be done elsewhere in the budget to avert catastrophe.⁴⁴ The best long-term path would include increased taxes

³⁹ See Philip Aldrick & Emma Rowley, *What Happens If the US Defaults?*, TELEGRAPH (July 25, 2011), <http://www.telegraph.co.uk/finance/financialcrisis/8659658/What-happens-if-the-US-defaults.html>.

⁴⁰ See Loren Berlin, *How the Debt Ceiling Issue Will Hit Ordinary Americans in the Wallet*, AOL (June 4, 2011), <http://www.dailyfinance.com/2011/06/04/how-the-debt-ceiling-issue-will-hit-ordinary-americans-in-the-wa/>.

⁴¹ Buchanan, *supra* note 21, at 89.

⁴² See, e.g., Susan A. Channick, *Taming the Beast of Healthcare Costs: Why Medicare Reform Alone Is Not Enough*, 21 ANNALS HEALTH L. 63, 71 (2012) (“The problem is quite clear and undisputed: healthcare costs are rising at a level that is simply unsustainable both in the private sector . . . and in the public sector . . .”).

⁴³ While the Social Security system is hardly perfect, there is an abundance of workable responses to any financing shortfalls that might arise over the next few decades. See, e.g., Peter H. Schuck, *The Golden Age of Retiring and Its Discontents*, 18 ELDER L.J. 25, 64–69 (2010).

⁴⁴ See Channick, *supra* note 42, at 70 (“Rising healthcare costs pose an economic threat in all sectors, not just the public sector. The conundrum of health care costs is illustrated by this year’s 7% plus rise in costs to \$19,393 for a family of four covered by a preferred provider organization in an otherwise almost zero inflation economy. The Milliman Medical Index (‘MMI’) reports that in 2002,

on the wealthiest Americans,⁴⁵ which would allow the government to finance the rest of its operations easily for decades to come. Even so, without serious progress to bring health care cost inflation under control, nothing else matters. The possibility of a financial catastrophe being triggered by a government financial meltdown, therefore, is ultimately based entirely on health care costs. We must control health care spending, or face dire consequences.⁴⁶

Beyond the possibility of financial collapse, the second legitimate concern about federal borrowing is that it will “crowd out” productive investment that private businesses would otherwise have undertaken.⁴⁷ When the government uses economic resources (workers, raw materials, and so on) that private businesses would otherwise have used, we potentially reduce the long-term growth rate of the economy. This is the plausible basis for concerns that government borrowing might reduce the size of the economy that we bequeath to future generations of Americans.

It is important to remember, however, that the government can sometimes use economic resources in more productive ways than those resources would have been used by private businesses. When the government engages in productive investment, such as building the infrastructure that allows private commerce to flourish, that spending more

American families had healthcare costs of \$9,235, and those costs have now doubled in fewer than nine years. Although the MMI tracks health care costs in the private sector, the same factors that drive costs in the private sector should be at play in the public sector as well.”); *Medicare Fraud: A \$60 Billion Crime*, CBS NEWS (Sept. 5, 2010), <http://www.cbsnews.com/stories/2009/10/23/60minutes/main5414390.shtml?tag=currentVideoInfo;videoMetaInfo> (“President Obama says rising costs are driving huge federal budget deficits that imperil our future, and that there is enough waste and fraud in the system to pay for health care reform if it was eliminated.”).

⁴⁵ See Linda M. Beale, *Funding Healthcare Reform: A Surtax on the Wealthy?*, ATAXINGMATTER (July 7, 2009), <http://ataxingmatter.blogspot.com/2009/07/funding-health-care-reform-surtax-on-wealthy.html> (“From my perspective, I think a surtax on the highest incomes — in fact, a progressive surtax of 3% up to half a million, 4% above that to \$2 million, 5% between \$2 and \$5 million, and 6% on \$5 million and up, and 7% on \$10 million and up, 8% on \$20 million and up, with a maximum surcharge of 10% on incomes of \$50 million or more — makes a heck of a lot of sense.”). House Democrats introduced a proposal in July 2009 to increase taxes on the wealthy in order to pay for rising healthcare costs. See David M. Herszenhorn, *Leaders in House Seek to Tax Rich for Health Plan*, N.Y. TIMES, July 11, 2009, at A1, available at http://www.nytimes.com/2009/07/11/health/policy/11health.html?_r=2&scp=2&sq=tax&st=cse. However, the proposal did not become law.

⁴⁶ Channick, *supra* note 42, at 65 (“[W]ithout changes in spending, deficits will continue to rise and contribute to the growth of the federal debt, which by 2020 will have reached 90 percent of GDP. By 2025, the CBO has projected that federal revenue will be able to finance only interest payments on Medicare, Medicaid, and Social Security with expenses from all other sectors financed with borrowed money.”).

⁴⁷ See Buchanan, *supra* note 21, at 88; Paul Krugman, *Wrong and Right*, N.Y. TIMES (Aug. 4, 2011, 8:18 AM), <http://krugman.blogspot.com/2011/08/04/wrong-and-right/>.

than pays for itself.⁴⁸ For example, the best recent economic research indicates that each dollar spent to prevent students from dropping out of school before receiving their high school diplomas results in a return to the government of between \$1.45 to \$3.55, saving approximately \$90 billion for each year that the government succeeds in halving dropout rates from current levels.⁴⁹

Therefore, the concern about reducing investment, and thus harming future living standards, does not justify across-the-board reductions in government spending. Instead, it calls for increases in spending on programs—including early-childhood nutrition programs, as well as government support for basic scientific research—that offer handsome long-term payoffs. Moreover, given that the private sector—both during the current downturn and in the longer term—has not fully utilized the available capital that is already in existence,⁵⁰ it is difficult to argue that the government's short- or long-term borrowing patterns are actually compromising future growth.

If we decide, therefore, that we should alter our policies to promote greater investment to enhance future economic growth, then the answer is not to try to reduce the deficit or the debt, but to spend wisely. The most important investments continue to be in the area of education, at all levels. We provide for future generations by giving them the knowledge and skills to provide for themselves.⁵¹

With these considerations in mind, economists have devised a budget rule that maximizes long-term economic growth, dubbing it the “Golden Rule.”⁵² Under the Golden Rule, the federal government would borrow money to finance its spending on productive investments, and it would collect enough taxes to cover its other spending, including interest payments on the debt, on a cyclically-adjusted basis—that is, after allowing

⁴⁸ See, e.g., Buchanan, *supra* note 21, at 109; Neil H. Buchanan, *Is It Sometimes Good to Run Budget Deficits? If So, Should We Admit It (Out Loud)?*, 26 VA. TAX REV. 325, 345 (2006).

⁴⁹ Henry M. Levin & Cecilia E. Rouse, Op-Ed., *The True Cost of High School Dropouts*, N.Y. TIMES, Jan. 26, 2012, at A31, available at <http://www.nytimes.com/2012/01/26/opinion/the-true-cost-of-high-school-dropouts.html?ref=opinion>.

⁵⁰ See Brett Fawley & Luciana Juvenal, *Why Health Care Matters and The Current Debt Does Not*, REGIONAL ECONOMIST, Oct. 2011, at 4, 4–5.

⁵¹ Perversely, however, in 2011–12, states' funding of higher education fell by an average of 7.6%. Doug Lederman, *State Support Slumps Again*, INSIDE HIGHER ED (Jan. 23, 2012), <http://www.insidehighered.com/news/2012/01/23/state-funds-higher-education-fell-76-2011>. Federal spending, supported by borrowed funds, should have made up the difference.

⁵² See Buchanan, *supra* note 21, at 112–14.

for increased deficits during economic downturns.⁵³ If the government were to adopt the Golden Rule in its budgeting, then total national debt would rise every year in dollar terms, but the economy overall would grow more quickly, allowing the ratio of debt to GDP to fall over time. This would not only guarantee that future generations would enjoy higher living standards, but it would also prevent the financial markets from ever collapsing out of fear that the federal government's finances would become permanently out of balance.

V. SHOULD WE PAY DOWN THE DEBT?

In short, the best pro-growth budget policy would always see the federal government running a deficit, which means that the debt would grow in a controlled and sustainable way over time. Balancing the budget on an annual basis would be unnecessary, and running annual surpluses to pay down accumulated national debt would actually be counter-productive. When there are short-run economic problems, the government should respond by temporarily increasing annual deficits,⁵⁴ and the resulting return to economic prosperity would allow the overall increase in the national debt to be financed without needing to pay down that debt.

Notably, none of the arguments against deficits and debt include a coherent theory about the proper level of the annual deficit or of the overall debt. There is no level of the federal deficit or debt that would be "just low enough" to avoid a spontaneous meltdown of the financial markets, under any available economic theory.⁵⁵ Similarly, even if federal borrowing does crowd out private investment, there is no theoretical basis to say how much crowding out is acceptable. For example, when the European Union set up its guidelines for borrowing by its member governments, it imposed a limit of 3% of GDP for annual deficits, and 60% of GDP for overall debt held by the public.⁵⁶ Those numbers, however, have no basis in theory or evidence.⁵⁷ Only the Golden Rule actually offers a principled method to

⁵³ See Gordon Brown, Chancellor of the Exchequer, Great Britain, Budget Speech (July 2, 1997), available at <http://www.pnewswire.co.uk/cgi/news/release?id=54997>.

⁵⁴ See, e.g., Roger Bootle, *This Recession Demands That We Employ Logic and Spend Our Way out of It*, TELEGRAPH (Jan. 11, 2009), <http://www.telegraph.co.uk/finance/comment/rogerbootle/4218744/This-recession-demands-that-we-employ-logic-and-spend-our-way-out-of-it.html>.

⁵⁵ See Buchanan, *supra* note 21, at 82.

⁵⁶ C. Craig & M. Umemura, *Spending Caps and Debts Limits in the EU and Japan 1* (Harvard Law Sch. Fed. Budget Policy Seminar, Briefing Paper No. 31, 2005), available at http://www.law.harvard.edu/faculty/hjackson/SpendingCaps_31.pdf.

⁵⁷ It should also be noted that both numbers are well above zero.

determine the appropriate level of the annual deficit, and thus of the overall path of the national debt.

People's intuitive attraction to "balance," by contrast, appears to reflect little more than a desire to see zeroes on a balance sheet. A person who favors balancing the annual budget, which means that there would be "zero new borrowing" (neither increasing nor decreasing the debt in a given year), is thus drawn to a notion of balance that necessarily keeps the national debt at its current non-zero level in dollars. By contrast, a person who takes "neither a borrower nor a lender be"⁵⁸ as a literal guide for government finances will argue that the national debt should be zero—that is, that there should be no government bonds in existence at all. That, however, requires that the annual budget be *unbalanced*, with taxes exceeding spending.

As a matter of political realism, in fact, it is arguably unnecessary to ask whether we *should* pay down the national debt, because we almost certainly will never even try to do so, at least in a sustained fashion. This is because paying down the debt would involve collecting tax revenues each year in amounts far in excess of annual spending. The current \$10 trillion of national debt held by the public,⁵⁹ even if there were no interest to be paid on that debt, could be repaid over a twenty year period only by running annual budget surpluses of \$500 billion.⁶⁰ That would mean that, every year for twenty years, taxpayers would agree to pay \$500 billion more in taxes than they receive in government benefits. There is no reason to think that the public would agree to pay taxes at that rate, when they would know that cutting each year's taxes by \$500 billion would still leave the federal government with a balanced annual budget. The appeal of paying down the national debt would surely dim considerably in very short order.

Paying down the debt is not merely politically unimaginable, however; it would also be bad for the economy, now and in the future, because federal debt is an essential part of the nation's financial system.

The desire to pay down the debt is, in part, based on the common intuition that being in debt is undesirable. If it is bad for a family to be in

⁵⁸ WILLIAM SHAKESPEARE, *HAMLET* act 1, sc. 3.

⁵⁹ See TREASURYDIRECT, *supra* note 29.

⁶⁰ Just as there is no theory supporting the idea that the national debt should be zero, nor any other arbitrary level of borrowing, there is similarly no theory available to determine how quickly a nation should pay down its debt. In the example above, I use twenty years merely for illustrative purposes, demonstrating that even a multi-decade effort to pay down the debt would require large annual surpluses. Advocates of zero government debt, however, can offer no guidance to policy makers regarding whether the national debt should be paid down in five years, or ten years, or forty years, or one hundred years, or more. Any such choice would be wholly arbitrary.

debt, the thinking goes, then it must also be bad for a government to be in debt.⁶¹ This intuition, however, ignores that those who lend money quite properly view the bonds that they hold as important assets. No one is forced to lend money to the federal government, but lenders are currently willing to be paid historically low interest rates to do so.⁶² The federal government's bonds are a safe haven for investors.⁶³

Because of the broad appeal of holding government bonds—based on those bonds being backed by the government's full faith and credit⁶⁴—Treasury bonds are also easy to trade on secondary markets.⁶⁵ A lender need not wait until the bonds in her possession mature, because she can sell her bonds on large and transparent markets to others who are willing to hold the bonds as assets. These secondary markets are so large and well-regulated, in fact, that government bonds are used as the equivalent of cash in many large financial transactions. Anyone who wishes to turn a Treasury bond into cash can do so quite readily, making such bonds an important element of the financial system.

During the late 1990's, when large projected annual budget surpluses implied that the national debt would be paid down to zero in less than a decade, there was serious concern about the disappearance of Treasury bonds from the financial system.⁶⁶ There are no acceptable substitutes, because only Treasury bonds carry zero risk of default.⁶⁷ An internal

⁶¹ Buchanan, *supra* note 21, at 95. Of course, people do not really believe that it is a bad idea for families to be in debt, either. It is the essence of good financial planning to engage in responsible borrowing for various purposes, most notably taking out mortgages to finance home purchases, and using student loans to finance higher education; See Kelli B. Grant, *Being Debt-Free Isn't Always All It's Cracked up to Be*, SMARTMONEY (Jan. 24, 2007), <http://www.smartmoney.com/borrow/debt-strategies/being-debt-free-isnt-always-all-its-cracked-up-to-be-20695>.

⁶² *Historical Treasury Rates*, U.S. DEP'T OF THE TREASURY, <http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-LongTerm-Rate-Data-Visualization.aspx> (last visited Apr. 17, 2012).

⁶³ *Treasury Bond Trading*, WLF NETWORK, <http://www.worldlinkfutures.com/bonds/tbondtr.htm> (last visited Apr. 17, 2012).

⁶⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 27.

⁶⁵ *Id.*

⁶⁶ Brad Plumer, *Imagining a World Without U.S. Debt*, WASH. POST (Oct. 21, 2011, 9:17 AM), http://www.washingtonpost.com/blogs/ezra-klein/post/imagining-a-world-without-us-debt/2011/10/21/gIQAG3iK3L_blog.html.

⁶⁷ Aswath Damodaran, *What Is the Riskfree Rate? A Search for the Basic Building Blocks 6* (Dec. 2008) (unpublished manuscript), available at <http://people.stern.nyu.edu/adamodar/pdfiles/papers/riskfreerate.pdf>. There is, in principle, no risk of default because (as noted above) the government can create the dollars necessary to pay each bond in full. The recent emergence of political gamesmanship regarding increasing the debt ceiling, described in Section II, has perversely created the possibility that the government might one day fail to honor its obligations. This risk of default is, however, entirely a function of that very political gamesmanship. Government bonds are as risk-free as our political system

government study documented the importance of having a large, deep, and growing pool of federal bonds to lubricate the financial system.⁶⁸

Admittedly, there is little theoretical guidance to indicate whether the financial system could survive with only \$8 trillion or \$9 trillion in Treasury bonds, rather than the current \$10 trillion—or, for that matter, whether it would be better still to have \$12 trillion or \$15 trillion worth of cash-equivalent government bonds in circulation. Even so, it is abundantly clear that the financial system has found important uses for all of the government's bonds in circulation today. Pension funds invest in Treasury bonds to eliminate the risk of losses, while guaranteeing small (but predictable) returns on investment, in support of a conservative investment strategy appropriate to their older clients.⁶⁹ Corporations hold Treasury bonds to use as cash in business transactions and to diversify their portfolios.⁷⁰ Families and individuals are also well-advised to include Treasuries as an essential part of a balanced portfolio. And because the Social Security system is able to put its surplus funds into Treasury bonds,⁷¹ it does not need to invest those funds in private companies—eliminating the unappealing idea of having the federal government own, or be a creditor to, private corporations.

As the economy grows over time, the demand for such securities will grow apace. If government bonds disappear entirely, or if their number becomes inadequate to support a deep and wide secondary market, then surely financial markets will be forced to find ways to adapt. Any such alternative, however, will be inferior to the real thing. Eliminating Treasury bonds for the sake of eliminating them would thus impose needless burdens on the financial markets.

VI. CONCLUSION

Repeated calls either to balance the federal budget on an annual basis, or to pay down all or part of the national debt, are based on little more than uninformed intuitions that there is something bad about borrowing money.

will allow them to be.

⁶⁸ See David Kestenbaum, *What If We Paid off The Debt? The Secret Government Report*, NPR (Oct. 20, 2011, 12:59 PM), <http://www.npr.org/blogs/money/2011/10/21/141510617/what-if-we-paid-off-the-debt-the-secret-government-report> (citing an unpublished government study entitled "Life After Debt").

⁶⁹ See IRA O. SCOTT, JR., *GOVERNMENT SECURITIES MARKET* 66 (1965).

⁷⁰ See *id.* at 67.

⁷¹ Kathy A. Ruffing, *Social Security Does Not Need a "Bailout"*, CTR. ON BUDGET & POLICY PRIORITIES (Aug. 24, 2010), <http://www.cbpp.org/cms/index.cfm?fa=view&id=3104>.

In fact, there is no convincing theory or evidence demonstrating that a government can enhance its citizens' economic prosperity by refusing to borrow money.

By contrast, because the federal government can undertake high-return investments (such as spending on education and infrastructure), the Golden Rule of government budgeting suggests that the federal government should run annual deficits to finance such long-term investments, while collecting sufficient tax revenues to pay for the rest of the government's operations each year. Following the Golden Rule will allow the government to avoid the financial panic that could arise from unchecked borrowing for non-investment projects, while also enhancing the living standards of future generations. Finally, the new debt that the government would issue to finance its public investments would become part of the essential pool of cash-equivalent Treasury securities on which the financial system relies.

In short, we should not only ignore calls to balance the budget or to pay down the national debt, but we should engage in a responsible plan to increase the national debt each year. Only by issuing debt to lubricate the financial system, and to support the economy's healthy growth, can we guarantee a prosperous future for current and future citizens of the United States.

