Statement of Bruce Bartlett
Before the Senate Budget Committee
February 25, 2015

Thank you for the opportunity to testify this morning on "The Coming Crisis: America's Dangerous Debt."

I should state up front that I don't necessarily agree with the premise of this hearing. I don't think there is a debt crisis looming in the near or medium term on the basis of present or foreseeable policies, or that the national debt is per se dangerous.

Let me briefly make a few points about the debt that I seldom see in popular discussions of this topic.

1. ***The nominal debt is irrelevant***. By this I mean the dollar figure, which, as this is written, is $18,138,241,907.59. That's a lot of money and it scares people. It makes them accept policies that may not only be unnecessary, but harmful. Cutting spending in a recession is clearly counterproductive and I think that the cuts that have been enacted over the last several years were unwise and slowed growth in the economy. The fact that the U.S. economy is doing marginally better than some in Europe is because they cut spending even more than we did.

2. ***The debt is a stock, not a flow***. To determine whether the debt is "excessive" we have to compare it to something that approximates ability to pay. Typically, we look at the debt as a share of the gross domestic product. But this is not a proper comparison; we are comparing apples and oranges. To get an apples-to-apples comparison, we should compare the debt to the federal government's assets. The comparable figure to GDP would be interest on the debt. Presently, net interest is 1.3 percent of GDP, well down from 3.2 percent in 1992. CBO currently estimates that this percentage will rise in coming years to 3 percent of GDP in 2025. This is due primarily to a projected rise in interest rates, rather than a rise in debt. This problem could be mitigated if the Treasury issued more long-term debt now while interest rates are low.

3. ***Budget conventions grossly overstate the interest cost***. The reason is that the budget treats the Federal Reserve as part of the public rather than part of the government. Presently, the Fed owns $2.5 trillion of Treasury securities, on which it receives interest from the Treasury.[1] But the Fed pays almost all of it back to the Treasury. In 2014, Treasury paid the Fed $116 billion in interest. After subtracting various costs, the Fed returned $99 billion to the Treasury.[2] This amount should be subtracted from the federal government's interest expense, just as we do with interest paid on trust funds. Instead, the Fed's payment to the Treasury is treated as a miscellaneous receipt.[3]

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[1] http://www.federalreserve.gov/releases/h41/current/h41.htm#h41tab1.
[2] http://www.federalreserve.gov/newsevents/press/other/20150109a.htm.
[3] Bruce Bartlett, "Fiscal Effects of the Federal Reserve," *Tax Notes* (January 23, 2012): 471-2.

4. ***Tax cuts increase the debt***. This may seem like an obvious point, but some of my conservative friends often act as though this is not the case. According to the Congressional Budget Office, tax cuts enacted between 2001 and 2011 added close to $3 trillion to the national debt.[4]

Changes in CBO's Baseline Projections, 2001-2011

Change in Surplus	**Billions of dollars**
Economic Growth and Tax Relief Reconciliation Act of 2001	-1,256
Jobs and Growth Tax Relief Reconciliation Act of 2002	-328
Working Families Tax Relief Act of 2004	-121
Economic Stimulus Act of 2008	-106
American Recovery and Reinvestment Act of 2009 (tax provisions)	-253
Tax Act of 2010	-354
Other	-461
Subtotal of legislated tax changes	-2,879
Subtotal of economic and technical effect on revenues	-3,484
Total revenue change	-6,363
Discretionary spending	-2,947
Mandatory spending	-1,403
Net interest	-1,376
Subtotal of legislated spending changes	-5,726
Subtotal of economic and technical effect on spending	+87
Total spending change	-5,638
Projected surplus as of January 2001	+5,891
Actual deficit	-6,111
Total fiscal change	-12,002

5. ***Capital investments are appropriately financed by borrowing***. There is an unfortunate tendency to treat all government spending as if it is consumption. Economists will commonly subtract the deficit from national saving to determine net saving. But of course, the federal government makes unambiguous investments in physical, technological and human capital that provide benefits for future citizens as well as those today. It would be highly desirable to clearly separate capital expenditures from operating expenses in the budget.[5] It is penny-wise/pound-foolish to cut infrastructure investments. Those who note that the states have balanced budget requirements and favor one for the federal government never call attention to the fact that such requirements apply only to state operating budgets, not capital budgets.[6]

6. ***Those that fear the burden of the debt on future generations always forget that future generations inherit the assets as well***. In the case of the national debt, it is true that future generations will inherit the obligation to continue paying interest, but they also inherit the bonds

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[4] http://www.cbo.gov/sites/default/files/06-07-ChangesSince2001Baseline.pdf.
[5] There was a commission to study this idea in 1999: http://clinton3.nara.gov/pcscb/report.html.
[6] Thomas A. Garrett, "State Balanced-Budget and Debt Rules," Federal Reserve Bank of St. Louis (2011).

on which that interest is paid. While relatively few individuals may own Treasury securities, vast amounts are owned indirectly by pension funds and insurance companies for which they are a vital asset with which they will pay benefits to future generations. If the national debt were entirely owned by Americans, we would literally owe it to ourselves; there would be no burden in the aggregate.

7. ***The burden of debt owned by foreigners is not a problem as long as it is denominated in dollars***. In every single case where a nation has gotten into debt trouble, such as Greece or Argentina, it has been because they sold bonds denominated in currencies they cannot control. Their problem wasn't so much that they couldn't service the debt as that they lacked the means to make or refinance principal payments when due. This cannot happen to any country that only sells bonds denominated in its own currency. In the early days of the Republic borrowers needed gold to service foreign debts. This is the principal reason why the Founding Fathers were opposed to government borrowing. In recent history, the U.S. has borrowed in foreign currencies only once back in the Carter Administration.[7]

8. ***The debt limit is a dreadful way to try and constrain the growth of debt***. It manifestly does not work and creates unnecessary risk in financial markets when it is not raised in a timely manner. It should be abolished.[8] Since Congress is unlikely to do this, I have long urged the president to utilize his power under section 4 of the 14th Amendment to the Constitution to invalidate the debt limit. The legislative history of this provision makes clear that its purpose was to prevent Congress from holding the debt hostage to a political agenda.[9]

9. ***Analogies between a family's debt and the federal government's are totally invalid***. There are two key reasons. Humans die and their books must be balanced at death, with all debts paid, passed along or written off. But the federal government lives forever; there is never a point at which its books must be balanced as a matter of principle. Second, if families get into debt trouble they cannot legislate higher revenues for themselves; the federal government can. The ultimate guarantor of the debt is the federal government's taxing power and secondarily its power to print money. Absent a problem with the debt limit, which is a technical legal problem, not an economic one, the federal government cannot default; families can and do.

10. ***There is no relationship whatsoever between the deficit and inflation***. Historically, inflation has been the number one reason to oppose deficit spending, which is the annual increment to the debt. The history of the last several decades is sufficient reason to dismiss this argument. Indeed, the biggest problem facing the world economy today is deflation, most obviously in commodity markets, but in consumer prices as well. Recent research suggests that an aging society will tend

[7] B. Dianne Pauls, "U.S. Exchange Rate Policy: Bretton Woods to Present," *Federal Reserve Bulletin* (November 1990): 902.
[8] I testified to this effect before the Senate Finance Committee on February 14, 2002.
[9] Bruce Bartlett, "The Dangers of Debt Limit Brinksmanship," *Tax Notes* (September 30, 2013).

to be deflationary, which may be a cause of secular stagnation.[10] Forecasters expect continued low inflation for the foreseeable future.[11]

11. ***The supply of private saving is vital to determining whether the debt is sapping economic growth***. As I noted earlier, many economists assume that the deficit is negative saving and insofar as net national saving is a key determinant of growth, they believe deficits could crowd private borrowers out of financial markets and reduce investment, which would reduce growth.[12] This may have been the case in the 1970s, but today the economy is awash with saving, as shown by the low level of interest rates. Also, saving can be imported if domestic saving is insufficient to finance domestic investment. Historically, U.S. foreign investment has approximately matched foreign investment in the U.S., including Treasury securities, and the U.S. has long gotten a higher return on its foreign investments than foreigners have gotten on their investments in the U.S.

12. ***To a large extent, the burden of the debt is a function of the efficiency of the tax system***. Since the true burden of the debt is the interest cost, it stands to reason that the revenue needed to pay it is critical to determining how burdensome that is. All tax systems impose what economists call a "deadweight" cost over and above the tax itself. If this deadweight cost is reduced by a tax reform that improves tax efficiency then the burden of the debt is reduced.[13] Of course, to the extent that tax policy can improve economic growth that will also reduce the burden of the debt.[14]

13. ***There is no 90 percent of GDP threshold for debt that must be avoided at all cost***. This was the popular interpretation of a famous paper by the economists Carmen Reinhart and Kenneth Rogoff.[15] However, recent research and correction for coding errors in the Reinhart-Rogoff paper now show no threshold effect.[16] This is not to say that debt never reduces growth, only that it depends on circumstances, such as the trajectory of debt and other factors.

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[10] P. Gajewski, "Is Ageing Deflationary? Some Evidence from OECD Countries," *Applied Economics Letters*, forthcoming; Mitsuru Katagiri, Hideki Konishi and Kozo Ueda, "Ageing and Deflation from a Fiscal Perspective," Federal Reserve Bank of Dallas (November 2014).
[11] "Low Inflation: More in the Pipeline," Goldman Sachs (February 20, 2015).
[12] Jonathan Huntley, "The Long-Run Effects of Federal Budget Deficits on National Saving and Private Domestic Investment," Congressional Budget Office (February 2014).
[13] Hans A. Holter, Dirk Krueger and Serhiy Stepanchuk, "How Does Tax Progressivity and Household Heterogeneity Affect Laffer Curves?" National Bureau of Economic Research Working Paper No. 20688 (November 2014).
[14] "Economic Growth and Tax Policy," Joint Committee on Taxation (February 20, 2015).
[15] Carmen M. Reinhart and Kenneth S. Rogoff, "Growth in a Time of Debt," *American Economic Review* (May 2010): 573-78.
[16] Thomas Herndon, Michael Ash and Robert Pollin, "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff," *Cambridge Journal of Economics* (March 2014): 257-79; Balázs Égert, "The 90% Public Debt Threshold: The Rise and Fall of a Stylized Fact," Organization for Economic Cooperation and Development (June 2013); Andrea Pescatori, Damiano Sandi and John Simon, "Debt and Growth: Is There a Magic Threshold?" International Monetary Fund (February 2014); Jurgen Amann and Paul Middleditch, "Revisiting Reinhart & Rogoff After the Crisis: A Time Series Perspective," University of Manchester (January 2015).

14. ***To the extent that we have a debt problem, the principal cause is unfunded wars, not benefits for the poor, elderly and disabled***. One can easily argue that the national debt is simply the cost of past wars adjusted for the associated interest expense plus postwar costs such as for veterans' benefits.[17] Thus far, the wars in Iraq, Afghanistan and other post-9/11 conflicts have added $1.6 trillion to the national debt.[18] Future costs for these operations are estimated at $4 trillion to $6 trillion.[19] Polls show that Americans blame wars more for our debt problems than domestic spending.[20] In my opinion, it is irresponsible to start wars without raising taxes so that all Americans are invested in the fighting.[21]

15. ***Generational accounting exaggerates the burden of debt***. Intergenerational accounting attempts to assess financial burdens through time, especially with a view to claiming that financial decisions taken in one generation can impose burdens on another. But this argument refuses to count as real assets the infrastructure and other national assets that the current generation will leave for future generations, and it does not understand that federal government debt never needs to be retired. In real terms, there obviously are no intergenerational transfers, except for the knowledge, the physical assets and the larger environment, which the present leaves to the future. The real goods produced in 2050 will be distributed to those alive in 2050, regardless of the public debt in existence at that time. Meanwhile, the U.S. government can always meet its payments when they come due.[22]

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[17] Gawon Yoon, "War and Peace: Explosive U.S. Public Debt, 1791-2009," ***Economics Letters*** (April 2012): 1-3.
[18] Amy Belasco, "The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations since 9/11," Congressional Research Service (December 8, 2014).
[19] Linda J. Bilmes, "The Financial Legacy of Iraq and Afghanistan: How Wartime Spending Decisions Will Constrain Future National Security Budgets," Kennedy School, Harvard University (March 2013).
[20] "More Blame Wars than Domestic Spending or Tax Cuts for Nation's Debt," Pew Research (June 7, 2011).
[21] Historically, taxes have always been raised to pay for wars. Only since 2003 has this norm been ignored. See Robert Hormats, *The Price of Liberty: Paying for America's Wars* (NY: Times Books, 2007).
[22] Kathy Ruffing, Paul N. Van de Water and Richard Kogan, "'Generational Accounting' Is Complex, Confusing and Uninformative," Center on Budget and Policy Priorities (February 6, 2014); Peter Diamond, "Generational Accounts and Generational Balance: An Assessment," ***National Tax Journal*** (December 1996): 597-607; "Who Pays What and When? An Assessment of Generational Accounting," Congressional Budget Office (November 1995).