An Overview of the United States National Debt

There is much debate about raising the national debt ceiling in Washington, D.C. Some members of the Congress argue against raising the ceiling in spite of warning from the White House about the inability of the federal government to borrow money and grave consequences of debt default. In this article, I will provide an overview of the national debt, including the size of the debt, ownership of the debt, causes of debt accumulation, effects of debt accumulation, and the need for paying down the debt.

**How Large is National Debt?**

The U.S. national debt is the largest in the world. The U.S. National Debt Clock ([http://www.brillig.com/debt_clock/](http://www.brillig.com/debt_clock/)) showed the debt at more than $14.3 trillion on June 8, 2011. With the U.S. population of over 310.7 million, each resident’s share of the debt is $46,180. The national debt has continued to increase at an average of about $4.0 billion per day since September 28, 2007. President Bush (2001-2009) added $4.9 trillion to the debt. So far, President Obama has increased the debt by $1.6 trillion.

The national debt is now 95 percent of the Gross Domestic Product (GDP), which is a record high in the post World War II era. The Debt-GDP ratio actually declined from 56 percent in 1959 to 32 percent in 1979, but rose to 66 percent in 1994; it fell again to 61 percent in 1999, but climbed to a peak of 95 percent in the first quarter of 2011.
Interest payment on the national debt exceeded $300 billion in 2000-2005 and 2009 and surpassed $400 billion in 2006-2008 and 2010. So far in the fiscal year 2011, the U.S. government has paid $275 billion in interest to its lenders.

Who Owns National Debt?
The national debt is the sum of all outstanding debt owed by the federal government. Nearly two-thirds of the national debt is public debt ($9.7 trillion), which is money owed to households, businesses, and foreigners holding U.S. government bonds (i.e., Treasury Bills, Notes, and Bonds). Of the $4.3 trillion of the national debt held by foreigners, China and Japan own 47 percent for $2.0 trillion. Interestingly, China and Japan invest their surpluses in trade with the U.S. in government bonds to make interest income. They see the U.S. a safe investment environment in spite of relatively low rates of return paid on government bonds.

The rest of the national debt ($4.6 trillion) is owed to government trust funds that operate with sizable surpluses (e.g., Social Security Fund). Also, the Federal Reserve System (the Fed) keeps a large holding of U.S. government bonds to implement policies of keeping interest rate low or bringing inflation rates under control. The Fed also buys additional securities to accommodate expansionary policies of the federal government.

What Causes National Debt to Accumulate?
The national debt is an accumulation of federal budget deficits. Year after year, the federal tax revenues fall short of public spending with the difference borrowed through sale of new government bonds. In the short run, the economy benefits from deficit spending as more jobs and incomes are created, resulting in faster economic growth. However, the government would have to allocate more money in its deficient budget to interest payment on national debt. This added interest expense boost up the budget deficit, resulting in increased government borrowing.

On an annual basis, a budget deficit is not a major concern. The U.S. economy, the world's largest, has always paid back its debt. However, as the debt continues to
accumulate, eventually some lenders would demand their money back plus interest. Failure to do so could cause such an unprecedented panic that could be potentially devastating to the global economy. This possibility coupled with massive deficit-spending policies of the federal government is forcing the Congress to worry about a growing deficit and try to keep the national debt within reasonable limits.

The most recent budget forecast from the Office of Management and Budget showed the fiscal year 2011 budget deficit at $1.3 trillion, the difference between $3.9 trillion in spending and $2.6 trillion in tax revenue. Although this deficit is huge, it is less than the $1.6 trillion deficit in 2010, and the $1.4 trillion deficit in 2009. Such a large budget deficits are due to (1) reduced income tax revenues from a deep and long recession and the ensuing jobless recovery; (2) massive war and security spending; (3) colossal spending to pay for the stimulus, bailout, and recovery packages; and (4) various tax cut measures including The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and the Alternative Minimum Tax patch.

**What are Effects of National Debt?**

The deficit-debt vicious circle promises future economic problems. Over the next twenty years when the Baby Boomers retire, borrowed Social Security funds must be paid back to provide them with benefits. Since the government has already spent the money, additional resources are needed to repay intergovernmental loans. In doing so, the federal government can raise taxes, reduce benefits, push the retirement age to 70 years, and curtail benefits to younger and high-income retirees.

Moreover, many foreign countries holding U.S. debt (e.g., China, Japan, Brazil) are now investing heavily in their own economies and seeking higher rates of return on their holdings of foreign government bonds. Foreign investors are likely to reduce their demands for U.S. government bonds. Under this condition, the U.S. government would have to compete more vigorously for private savings, increasing interest rates and slowing economic growth. Furthermore, such a decline of the demand for government bonds would place downward pressures on the dollar as dollar-denominated securities become less desirable. As the dollar declines, foreign holders are paid back in currency that is worth less, which further diminishes the demand for U.S. government bonds.

Additionally, the Fed’s policy of buying more U.S. government bonds to keep interest rates low would lead to increased spending in the economy and accelerating inflation. The federal government not having sufficient resources to invest in essential public goods such as education, infrastructure, and environment would slow the pace of economic development and reduce the quality of life.

**What Must be Done?**

The U.S. financial market is a safe heaven for investors and the U.S. government is best known for meeting its debt obligations. The unlikely possibility of “monetary default”
(i.e., the failure to pay principal or interest promptly when due) will create an unprecedented shockwave in the global financial system. The government unable to pay back its debt would lose credit worthiness. In addition, the government’s inability to borrow money to pay for its excess expenditures would make spending cuts and tax hikes the only viable options.

Members of the Congress are likely to raise the debt ceiling before the deadline of August 2, 2011. In the meantime, they are seeking compromises on a comprehensive spending reduction plans. The White House plans to reduce the deficit beginning 2012. The Office of Management and Budget forecasts a deficit of at least $700 billion a year through the fiscal year 2020. Still, some members of the Congress see this deficit reduction plan insufficient.

Increased spending was needed to move the economy out of recession. It may even be needed again to prevent a double-dip recession. Deficit spending is not needed beyond economic stimulus. With tax hikes being politically unpopular, cutbacks in wasteful spending and reductions in war expenditures would help reduce the federal deficit. Savings from deficit reduction plans must be allocated entirely to paying down the national debt.

Sources:
