THE NATIONAL DEBT IS SOOOOOOO BIG

Posts in this series

Chapter 3 of Stephanie Kelton's *The Deficit Myth* addresses the National Debt. It's a very big number, and politicians use it to terrorize voters. Kelton tells a story about Senator Mike Enzi, R-WY, complaining about a CBO budget outlook report, saying it should put in the zeros instead of using the word "trillion". And that's how seriously we should take the problem. Remember what we learned in the last post: money is a debt on the books of the US government, but it's also an asset in the hands of a currency user. That means that the National Debt tells us how much we collectively have received in assets from the Treasury.

Kelton says that fear of the National Debt is shared by everyone in and near government across the ideological spectrum, politicians, staffers, wonks and think-tankers. When she was Chief Economist for Bernie Sanders on the Senate Finance Committee, Kelton questioned the myth.

> One of the most eye-opening things I learned came from a game I would play with members of the committee (or their staffers). I did this dozens of times, and I always got the same incredible reaction. I'd start by asking them to imagine that they had discovered a magic wand with the power to eliminate the entire national debt with one flick of the wrist. Then I'd ask, "Would you wave the wand?" Without hesitation, they all wanted the debt gone. After establishing an unflinching desire to wipe the slate

> clean, I’d ask a seemingly different question: “Suppose that wand had the power to rid the world of Treasuries. Would you wave it?” The question drew puzzled looks, furrowed brows, and pensive expressions. Eventually, everyone would decide against waving the wand. P. 77. [1]

Wiping out the National Debt means eliminating Treasuries, and that exposed the contradiction at the heart of the myth of the Very Scary Debt. We can’t get rid of Treasuries! But the raw number scares voters so many people continued to rant about the National Debt. They never asked why voters were scared, or questioned their role in creating that fear.

Intuitively, if deficits aren’t a problem unless they cause inflation, then the national debt isn’t a problem unless it causes inflation. In the same way interest on the national debt isn’t a problem unless it causes inflation. Kelton acknowledges that there may be limits on the size of the national debt, usually discussed in terms of the ratio between the national debt and the GNP. The US is nowhere near the size of the debt to GNP ratio of Japan, for example, so there’s no immediate problem. Assuming there is some limit, Kelton turns to the various ways we could eliminate the national debt.

One way would be to run government budget surpluses, as we did when Bill Clinton was President. We could easily do that by raising taxes on the rich and their corporations, slowly depleting their total wealth. That’s a good idea on its own terms, because it would reduce their political and economic power. Kelton says that in the past when the government has run surpluses for several years the result was depressions. I would add that if we did raise taxes we’d be destroyed in the shrieks of the rich saying that their money was being used to pay for social programs like Social Security.

Or, the Fed could get rid of all of the

Treasuries with just a few clicks on a keyboard, by reducing the number in the Treasury Securities account and increasing the numbers in the bank account of the holders of the Treasury securites. Economists call this monetizing the debt.

Or, we could do it by continuing to spend as we see fit subject to the inflation constraint, but stop issuing new Treasuries. As the old ones mature, the Fed pays them by crediting the accounts of the holders with green dollars. We could stop that at any time we reached a level of debt that wouldn't frighten even the most fearful Americans. or at some higher level. [2]

Once getting rid of Treasuries would have caused a problem, because the Fed used the market in Treasuries to control interest rates. That is no longer the only control mechanism available to the Fed. [3] But then what? Kelton discusses an article by Eric Lonergan, an economist and fund manager. Lonergan asks what would happen if Japan monetized all its bonds. I quote his analysis in full:

> First, let's go through the balance sheet effects: 1. The government now has no debt. 2. The value of the Japanese private sector's assets is unchanged – they used to hold JGBs [Japanese Government Bonds], now they hold the same value in cash. So overnight, the government's debt is eliminated, and the private sector's net wealth is unchanged.
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> The income effects are also interesting: 1. The government's budget position improves. 2. The income of the private sector falls because bonds paying interest have been replaced with cash holding none.
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> So what happens to the economy?
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> Most people tend to say, "hyperinflation", but that makes little sense. Why on earth would the Japanese

> household sector rush out and buy things when their interest income has fallen, their wealth is unchanged, and they are used to falling prices. The private sector already has a high wealth to GDP ratio and are spending less than they produce (which is precisely why the government runs a deficit).
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> The Yen might weaken because the yield on overseas assets has risen relative to Japanese assets, but this spread is hardly offering much compensation for exchange rate risk. My conclusion is that nothing would change in Japan if you had 100% monetization of the stock of JGBs!

The takeaway is that getting rid of Japanese government debt wouldn't affect the economy at least in the short term. Two possible problems: a) less spending because bond income disappears from the economy; and b) weakening of currency in international markets because there are higher return available on the bonds of other countries. In the case of the US, we can add that cash previously held as Treasuries suddenly isn't producing any return, so its owners look elsewhere for returns. That might mean an increased purchases of assets by foreigners; purchase of the debt of other countries; or something else. But that's not all bad, and I don't know enough to work it out.

Kelton accepts Lonergan's logic. Paying off US Treasury Securities is possible and likely would have minimal short-term effects. Late in the Clinton Administration the US ran budget surpluses, to the point that White House economists prepared a draft report title*d Life After Debt*. Here's a discussion by David Kestenbaum of Planet Money. This report got labeled PRELIMINARY AND CLOSE HOLD OFFICIAL USE ONLY", and Planet Money got it through FOIA. Then the Republicans cut taxes for the rich, with the usual pennies for the rest of us, so the problem evaporated.

In sum, the national debt isn't a problem as long as it doesn't lead to inflation. A lesser constraint might be the impact on the value of the dollar, which might affect international trade in unpredictable ways.

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[1] This is a good example of Kelton's style. As you can see, it's clear, simple, and direct English prose, the highest praise my high school English teacher, Brother Daniel, ever bestowed.

[2] Here's a recent tweet from Scott Fullwiler, an MMT economist:

> The core point is it should be done by the [Central Bank]—there's no reason why the appropriate (for mkt conditions) change in risk-free, liquid securities should equal size of govt debt/surplus, & no reason for appropriate maturity structure to be same as what cost-minimizing [Treasury] chooses.

[3] For example, the Fed began to pay interest on the reserves commercial banks are required to keep at the Fed. There is a full explanation starting at P. 117.

[4] There are, of course, distributional issues for both Treasury Securities and for the interest they pay. This is a normative issue best dealt with by politicians, and not economists. One consideration is that many people benefit indirectly from interest on Treasuries through money market funds, investments by pension plans and direct purchase, because Treasuries are absolutely safe.