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The National Debt: Good or Bad?

Spending financed not by current tax receipts, but by borrowing or drawing upon past tax reserves. Is it a good idea? Why does the U.S. run a deficit? Since 1980 the deficit has grown very big. Some say its a bad thing, and predict possible doom, others say it is a safe and stable necessity to maintain a healthy economy.

In the beginning the Government only generated deficits during the War of 1812, the recession of 1837, the Civil War, the depression of the 1890s, and World War I. But, as soon as the war ended the deficit would be eliminated and the economy which was much larger than the amounted debt would quickly absorb it. But the Federal spending has grown over the years, especially starting in the 1930s in actual dollars and in proportion to the economy. President Roosevelt sought to use the full powers of his office to end the Great Depression. He and Congress greatly expanded Federal programs. Federal spending, which totaled less than $4 billion in 1931, went up to nearly $7 billion in 1934 and to over $8 billion in 1936. Then, U.S. entry into World War II sent annual Federal spending soaring to over $91 billion by 1944. Thus began the ever increasing debt of the United States. The last time the budget ran a surplus was in 1969 during Nixon’s presidency. Budget deficits have grown larger and more frequent in the last 50 years. In the 1980s it grew to record levels; when the Government cut income tax rates, greatly increased defense spending, and didn’t cut domestic spending enough to make up the difference. As a result, the national debt grew in size after 1980; growing from $709 billion to $3.6 trillion in 1990, only 10 years later.

What if the debt is not increasing as fast as we think it is? The dollar amount of the debt may increase but often times so does the amount of money to pay for the debt. If deficit spending eliminates non-productivity then its direct monetary cost will be offset if not surpassed by increased productivity. For example, in the 1980’s when the huge deficits were adding up the actual additions to the public capital or increased productivity were often as big, or bigger than the deficit. What if the government spends money on programs that do not increase its assets or productivity? For instance let’s take a Taco Bell. If the owner invests money to make a new Taco Bell 10 miles away from the other Taco Bell then he will probably increase sales and the company will regain what it spent on building the store. If the company spends money on building a Taco Bell across the street from the other Taco Bell the money is wasted because there is not as great need for one there; therefore it will not bring a lot of new customers. This example of frivolous spending is what makes a deficit dangerous. Then the governments net worth decreases putting it into serious debt.

Debt should not be a problem because we can just borrow more, right? This would be correct if we could borrow an unlimited amount of money, but it is not. At first the government borrowed internally from private sectors. The government did this by selling bonds to the private sectors essentially reallocating its own countries funds to spend on its country. This works fine in a recession, but when the country is at or near its full capability for production it cannot increase supply through investment of deficit dollars. Deficit dollars then translate into demand for goods that aren’t being produced. Inflation means there is more demand or money than there are goods this causes an increase in prices and drives down the worth of the dollar. This depreciation of the dollar counters the cost of the deficit but destroys the purchasing power of the dollar. Despite its dangers inflation is used to some extent to curb the debt. Crowding out is when the government is looking for the same capital that the business sector wants to invest.

What about allowing the government to run a deficit and avoid the negative aspects of inflation and crowding out. Borrowing from foreign sources is a very common practice. Attracted by high interest rates and stability, foreigners now buy huge amounts of U.S. national debt. Of course this cannot be the perfect solution otherwise no one would be concerned about the debt. The problem with borrowing from external sources is the lack of control the government has over foreign currency and debts. Internal debts can be paid with increased taxes, inflation, and other monetary controls the government has but external debts can extremely damaging to a country if it cannot buy enough of the foreign currency to pay the interest.

Running a deficit is apparently good for an economy that is operating inside its production possibilities curve but it can be damaging to an economy operating on the curve. A deficit managed properly has the effect of increasing demands. An economy inside its curve can increase supplies in reaction. An economy on the curve can increase demand but its supplies cannot increase causing prices to rise, or inflation. If there is no deficit and the curve shifts to the right then supplies will not increase and the country will no longer be operating on the curve. A deficit must be maintained to insure that the economy grows with its resources.

Is the U.S.’s current debt bad or good? The trick is finding out how large the deficit should be in order to allow for growth without waste. The U.S.’s deficit is bad at this point because the U.S. is close to its maximum production capabilities, and deficit money is being wasted. For example two of the largest portions of the budget: defense and social security. Defense spending produces little or nothing except in times of war. The way social security is managed creates a huge waste. As managed, social security is money spent to immobilize a large and fairly capable part of the work force. It encourages elderly people not to work by spending deficit money on them. Reducing productivity and increasing the debt at the same time. In its current state the U.S. should attempt to reduce its deficit but eliminating it is not necessary and could do more damage than good.

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