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Why There is Nothing Scary about the U.S. National Debt

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"Debt" is a four letter word often brandished to frighten the American public. That is surprising, because corporate bonds; federal, state, and local bonds; lines of credit; credit cards; and many other forms of debt are essential to the functioning of the modern economy. True, some debts prove to be "bad," and are not repaid. But our country, not to mention the global economy, would face a disastrous situation if debts were not frequently incurred and regularly repaid. In America, moreover, households and business firms borrow just as much as government; and the U.S. government has many people and organizations eager to lend to it.

Debt is just one side of a transaction. "Credit" is the same thing by a slightly nicer name, and credit has long been an everyday tool in both the private and public sectors. Every dollar of debt creates an asset of equal value. As headlines often remind us, each U.S. citizen owes a share of our currently $20 trillion public debt. But Americans also **own** approximately $14 trillion of that debt – as participants in Social Security, insurance policyholders, participants in pension funds, stockholders, or, more directly, by virtue of having purchased Treasury notes. "Treasuries" are very secure, and those not owned by Americans are held by foreign banks and governments that are glad for the chance to lend money, securely, to the United States.

Why Does the Federal Debt Seem Scary?

Why do some people think federal government indebtedness is the major problem America faces today? There are many answers to this question. Some have legitimate, though exaggerated, concerns about so much U.S. debt held by foreigners. Others are not really worried, but use scaremongering about the allegedly "out of control national debt" as a political weapon.

Public fears can also be aroused by antiquated ways of thinking about the nature of money. More than two centuries ago, the most trustworthy money consisted of precious metals. Among merchants, and between merchants and governments, credit and debt had long been used to settle transactions. But during financial panics, wise counsel recommended a "run to gold." Money was stuff, a physical thing, and there was apparently a finite amount of it.

But in our time, most monetary transactions don't involve the use of coins or even paper notes. Instead, we use electronic messages to buy things, pay employees or merchants, and settle debts. The mundane reality of electronic transfers is obvious for credit card users – and for U.S. Social Security recipients who, as of 2013, receive automatic deposits rather than checks each month.

Although we routinely experience electronic transfers free from coins and paper, many of our arguments about money and debt still refer to the pre-electronic world. "Where will the money come from?" ask concerned citizens and pontificating pundits. When faced with the thought that the federal government's expenditures are exceeding revenue collections people seem to be looking about for bags of coins or bills. The anxious search flows from a deep-rooted cultural sense that there is only so much money in the system – that we must hoard what we have, because the only way to get more would be by revving up the printing presses, unleashing disastrous inflation.

Credit Depends on Trust in Ability to Repay

Discussions about U.S. fiscal policy would improve if we talked about money/debt as more like electricity than physical stuff that passes from hand to hand or is lugged from vault to vault. For example, a household receives a monthly pay check by automatic deposit, with some funds withheld for payroll taxes and perhaps a pension contribution. A computer program does it all instantly, electronically increasing the household's bank balance and adding to balances at the pension fund and the U.S. Treasury, while subtracting from the employer’s account.

Similarly, when a household draws on a line of credit at a bank or credit union to buy a new living room set, the furniture dealer’s account is increased and the household’s decreased. Of course, each household faces limits in using lines of credit, arranging credit through a second mortgage, and so forth. We can liken such limits to circuit breakers that are tripped when there is too much usage. In this instance, “too much” is subjectively defined as an educated estimate lenders and borrowers make about the future ability of borrowers to repay on time and in full. How much can safely be lent or borrowed depends on uncertain forecasts – and even more on trust that borrowers will make every effort to meet their obligations.

Borrowing is not just something households routinely do. Businesses regularly take out loans, even the largest corporations. And governments also borrow for many good reasons. They borrow to meet short-term needs for liquidity; they borrow to cover unbudgeted shortfalls (for example, when tax revenues decline during an economic recession); and they borrow to pursue long-term goals (such as investing in infrastructure to make the economy more productive). Even state governments in the United States regularly borrow, despite the fact that they operate under constitutional rules requiring annual budgets to balance. Every kind of borrower – households, businesses, and governments – faces some level at which additional borrowing would “trip the circuit,” that is, potentially exceed their ability to repay in the eyes of potential lenders and objective observers. Expectations and trust are inherent to the process.

The U.S. Federal Government is Trusted and Can Borrow Cheaply

Right now, the U.S. government is far from hitting a circuit breaker – we know, because lenders are still eager to buy Treasuries and interest rates are not rising significantly. Congress could pass bills that cut taxes significantly in the future and if those bills were signed into law and if, at the same time, the Federal Reserve System worked to increase interest rates, then we might begin to approach a circuit breaker but at the moment we are not close.

The simple answer to “where will the money come from?” is that it comes from people who crave the chance to purchase U.S. Treasuries as a safe and secure investment in a world of great uncertainty. Eager lenders trust America’s economic prospects and ability to repay with interest for a long time to come. Trusted public debt can, in short, be a very good thing. When government spends and jobs are plentiful and businesses thrive, the economy grows and so do incomes. Private and governmental loans are made and repaid, and trust is abundant – setting the whole fruitful cycle in motion once again.