Fix the Debt

CHAIRMEN

JUDD GREGG

EDWARD RENDELL

FOUNDERS

ERSKINE BOWLES

AL SIMPSON

STEERING COMMITTEE

MICHAEL BLOOMBERG

PHIL BREDESEN

KENT CONRAD

DAVID COTE

PETE DOMENICI

VIC FAZIO

JIM MCCRERY

SAM NUNN

MICHAEL PETERSON

STEVEN RATTNER

ALICE RIVLIN

SCOTT SMITH

ANTONIO VILLARAIGOSA

ROBERT ZOELLICK

# Q&A: Everything You Need to Know About the National Debt

**How big is the debt?**

Currently, the national debt held by the public is about $14 trillion, which is around 77 percent of the country's economy, as measured by Gross Domestic Product (GDP). The gross debt, which includes money owed to other parts of the federal government, is slightly under $20 trillion, or roughly 105 percent of GDP.

Throughout history, the United States has normally maintained some amount of debt. However, with the exception of a brief period during and immediately after World War II, debt levels have never been as high as they are now. Without congressional action, debt levels will continue increasing.

**Why do we have a national debt?**

Particularly over the last 40 years, the federal government has generally spent more than it collected in revenue. When this occurs, the government must borrow money to cover the difference. The government borrows by selling securities such as Treasury bonds, then agreeing to pay bondholders back with interest. Over time, this borrowing accumulates into the national debt.


Source: Congressional Budget Office

1900 M Street, NW · Suite 850 · Washington, DC 20036 · (202) 596-3597 · www.fixthedebt.org

**What are the effects of a high national debt?**

The effects of the national debt on the economy are far from abstract. High levels of federal debt will cause:

- **Higher costs of living:** Large amounts of debt mean higher interest rates on everything from credit cards to mortgage loans.
- **Slower wage growth:** In normal economic times, every dollar an investor spends buying government debt is a dollar not invested elsewhere in the economy. That is, high debt "crowds out" more productive investments, leading to slower economic growth and lower wages.
- **Generational inequality**: By not making responsible debt choices, we are placing higher debt burdens on our children and threatening their standard of living and retirement.
- **Reduced fiscal flexibility:** Our debt levels doubled between 2008 and 2013 from 35 percent of GDP to over 70 percent, a result of and in response to the Great Recession. We can't afford another recession. With an already high debt, the government has less room to respond to future crises such as international events or economic downturns.
- **Fiscal crises:** Unchecked debt growth could eventually lead to a fiscal crisis, as recently occurred across Europe. At that point, investors in U.S. debt will demand higher returns, driving up interest payments, and leading to a debt situation spiraling out of control.

**How can we bring our debt levels down?**

Achieving meaningful debt reduction will require a comprehensive plan that addresses the major drivers of our debt. Reforming the tax code, slowing the growth of entitlement spending, and reducing other spending, and helping to grow the economy are all necessary to put debt on a downward path over the long term.

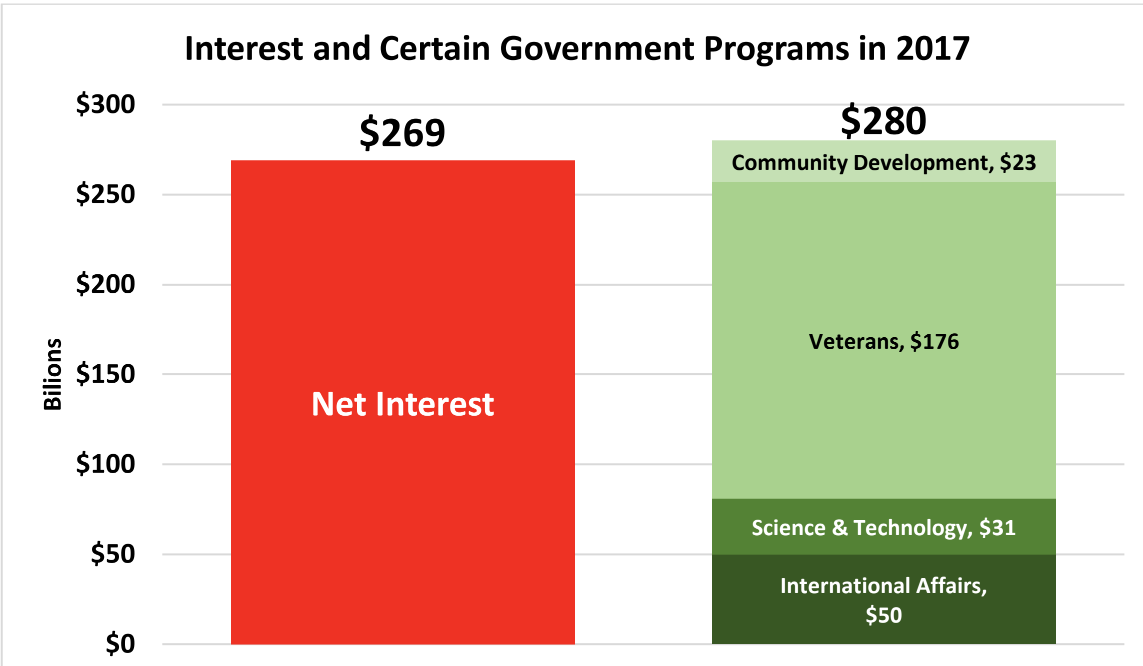
**Why act sooner rather than later?**

Acting now to address our growing debt has numerous advantages. The sooner we act, the easier it will be to make changes. If we act now, changes can be phased in gradually so they are less disruptive. Because of compound interest, acting sooner means we can reduce debt to a sustainable level with a smaller amount of savings. For example, if we start now, we would need spending cuts and/or tax increases equaling 3.1 percent of the economy to bring the debt gradually down to historical levels in the next 30 years. Waiting 5 years, however, would require adjustments of 3.7 percent of GDP and waiting 10 years would require 4.6 percent. Waiting has real costs.

The sooner we act, the sooner we will receive the dividends of debt reduction such as faster economic growth, faster wage growth, and increased fiscal flexibility to address priorities. A smart mix of deficit reduction can also lower income inequality.

**How much do we pay in interest?**

Interest on the debt is now and is projected to continue being the fastest growing area of federal spending in the coming years, outpacing even Medicare or Social Security. In 2017, the U.S. spent $269 billion, or 7 percent of the federal budget, paying for interest on the debt.

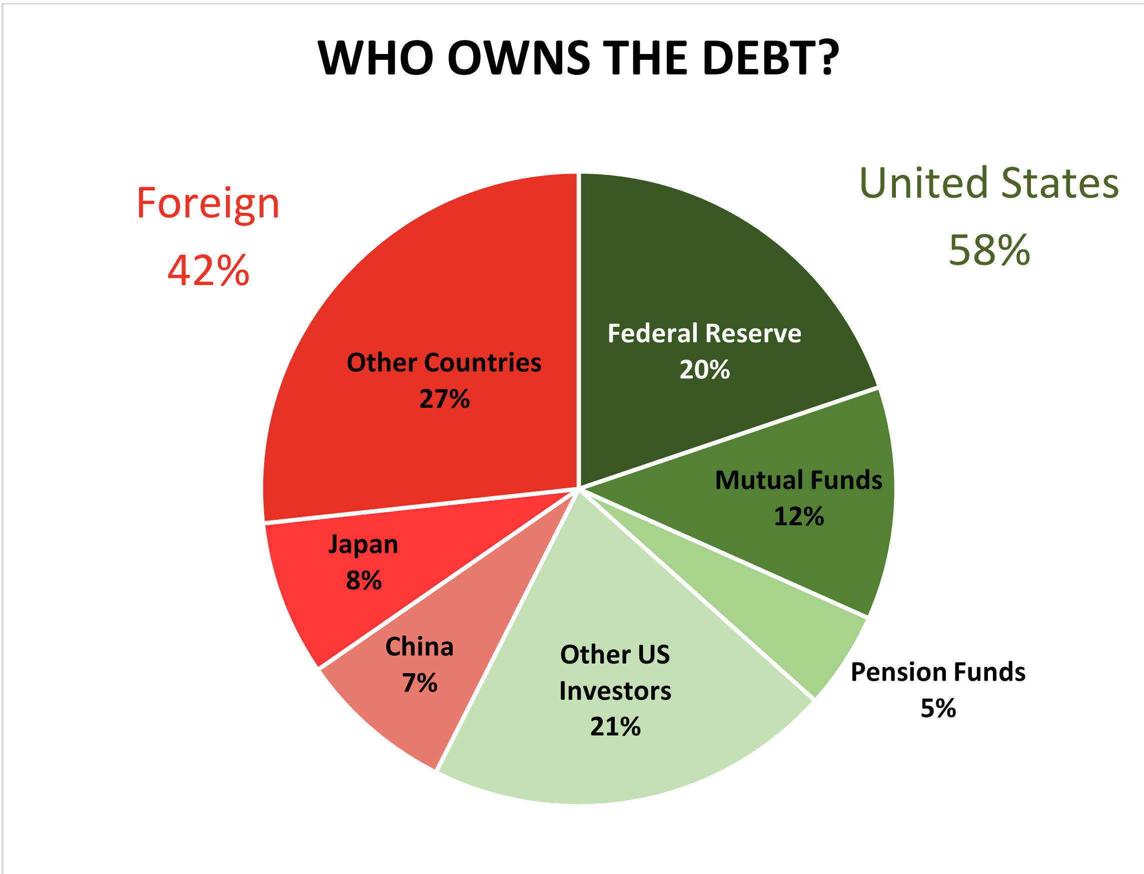



In recent years, interest rates have been at historic lows. As they return closer to normal levels, the amount the government spends on interest will rise substantially. The Congressional Budget Office projects the interest rate on ten-year Treasury bonds will climb from slightly over 2 percent today to 3.5 percent by 2020. As a result, interest payments will triple from $269 billion in 2017 to more than $800 billion in 2027. By 2030, interest will represent about 12 percent of the federal budget and continue to climb. This represents money that cannot be spent on other government priorities such as education, national defense, research or infrastructure.

If interest rates rise even higher, our payments will be even greater—a one percentage point increase costs the country an additional staggering $1.6 trillion over a decade. If interest rates returned to the record-high levels of the 1980s, the country would pay **$6 trillion** more in interest.

**To whom do we owe the national debt?**

While a majority of U.S. debt is held domestically, a sizable portion is held by foreign investors. Both foreign governments and foreign citizens purchase U.S. debt.




Debt Held by the Public, December 2016
Source: U.S. Treasury Department. Countries include purchases by that government and by investors with accounts in that country.

There are several reasons why U.S. debt is attractive to foreign investors. In times of economic turmoil, such as during the recent financial crisis and its aftermath, U.S. Treasury bonds are considered a safe investment. Foreign investors also hold U.S. Treasuries because they are highly *liquid* (easily converted to cash) and because they provide protection against fluctuating exchange rates.

China and Japan are the largest foreign owners of U.S. debt. In addition to the reasons already mentioned, these countries can influence their currency exchange rates through large purchases of U.S. debt. Altogether, in February 2017, about $6.1 trillion of U.S. debt was held by foreign investors.

**What has led to our current debt levels?**

The U.S. had budget surpluses from 1997-2000. Since then, tax cuts, spending on the wars in Iraq and Afghanistan, and overall increases in spending all added significantly to the national debt. The economic crisis and the response also substantially contributed. Falling income levels and rising unemployment meant lower revenue, while spending also automatically grew on social safety net programs—such as unemployment benefits and food stamps.

**What is driving our future debt path?**

Many of the drivers of our past debt are nearing resolution—the wars are winding down and the economy is recovering. Unfortunately, our future debt will grow if nothing is done, due to a different set of factors. These include:

- **Population Aging**: As the population grows older, spending on Social Security and Medicare will increase dramatically. Additionally, these older Americans will no longer be working and will pay fewer taxes, leading to lower revenues.
- **Rapid Health Care Cost Growth**: Federal health spending is currently equal to 5.5 percent of the economy. In 25 years, it is projected to rise to approximately 8.8 percent.
- **Growing Interest Costs**: As interest rates return to normal levels, the cost of interest payments on debt already borrowed will increase.
- **Insufficient Revenue**: The historical amount of revenue collected is not sufficient to afford record-high levels of retirees, health care spending, and interest. Our debt problems are so large they cannot be solved by either spending cuts or revenue increases alone.

**What is the appropriate level of debt?**

The historical average of our debt as a share of the economy is around 40 percent, slightly over half of current levels. It is not necessary to pay off the national debt entirely to restore our nation's fiscal health. In fact, incurring some national debt can be useful in responding quickly to unexpected events such as wars and recessions. However, current debt levels limit this flexibility. Our debt/GDP ratio should be placed on a clear downward path toward the historical average. The Peterson Pew Commission on Budget Reform recommended a medium-term goal of a 60% debt-to-GDP ratio.

**Do we have to balance the budget each year?**

While narrowing the gap between spending and revenue is important, it is not necessary to balance the budget each year to bring the debt under control. Because debt/GDP is the best measure of an economy's capacity to handle debt, as long as the economy is growing faster than debt, debt will fall relative to GDP.

Small deficits are acceptable. During a recession, larger deficits are often needed to allow the government to reduce the economic impacts of the downturn. However, to foster flexibility during recessions, deficits must fall back to low levels in periods of economic growth.

**What is the difference between deficits and debt?**

*Deficits* occur each year that federal spending exceeds revenues collected. Alternatively, when revenues exceed spending, the federal budget runs a *surplus*. When the federal government runs deficits for multiple years—as we have done with only a few exceptions in the last 40 years—the deficits plus the interest incurred on that borrowing accumulate into the *national debt*.