

Retiring National Debt: Bad Advice from a False Analogy  
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Many people, liberal and conservative, Democrat and Republican, have voiced their support for using projected federal surpluses to retire the national debt. At first glance, this proposal sounds like a paragon of sound government. It seems like a way finally to put government on a sound, business-like approach to its finances.

There are good reasons why families or businesses might go into debt. Some sudden calamity might necessitate a family's doing so. A business might find that it can earn more on borrowed funds than it must pay for those funds. Just as there are good reasons to incur debt, there are good reasons to retire debt. A business might determine that its interest costs are higher than the returns those borrowed funds can generate. If a business can find itself in this position, why can't a government?

It seems natural to draw an analogy between business debt and government debt. If it is good for a business to pay off its debt, it might be good for government as well. This analogy, however, is false. With business debt, the owners are indebted to someone else. Government debt, however, does not mean that citizens are indebted to someone else. Rather it means that some of them are indebted to others of them.

With respect to debt, a government is a financial intermediary. It is like a bank. A bank brings together people who supply credit and people who want to borrow, and it manages their accounts. A government does much the same,

save that the debtors become indebted through compulsion. In any case, a government is not indebted any more than a bank is indebted.

What we call government debt is simply the total volume of the credits that some people have extended to others. To the extent a government borrows, the people who buy the bonds are actually paying taxes for those whom otherwise would have paid higher taxes now. Higher future taxes are the means by which the forced debtors pay their government-intermediated creditors.

If debt represents a postponement of tax payments, paying off debt represents a sudden speeding up of those payments. Why would this be a good thing? And for whom would it be good? The alternative to paying off government debt is reducing taxes. Increased spending is not an alternative to reducing debt, because debt reduction is simply one form of spending. By paying down debt, politicians support higher spending over lower taxes.

Why would they do this? For one thing, politicians seem almost universally to resist calls for tax reduction. Even the recent tax reduction is phased in slowly and expires in ten years. Faced with a sudden increase in tax revenues, politicians seek typically to spend more rather than to tax less. Paying down the national debt sounds like a form of tax reduction, only with those reductions occurring in the future and not now. In truth, however, it is just another form of government expenditure. Paying down the national debt allows the government to keep its current tax rates in place, while creating the illusion that taxes are about to fall.

Suppose federal surpluses were dedicated to debt reduction, and that the debt was retired in 2013, as former President Clinton proposed in 2000. What

would happen then? One alternative would be to slash tax rates. The other alternative would be more spending. While we can only conjecture about what would happen in 2013, the evidence of history would surely counsel one to bet on more spending. Look at what happened to the massive peace dividend that was to accompany the end of the cold war a decade ago. Taxes were not lowered, they were raised, and several times. Some dividend!

Just what forms of spending might be increased if the national debt were retired would depend on conditions at that time. Increased tax revenues could be directed to social security and Medicare. Alternatively, government might establish itself as a giant lending enterprise. If this happened, government would almost surely use its creditor position to gain governmental entry into corporate boards throughout the land, leading to a socialization of investment that would surely please the founding members of the Fabian Society, even if it wouldn't quite suit Karl Marx.

We cannot know the particular details of history before their time. We can, however, be reasonably skeptical that the political clamor to retire the national debt represents a new, more prudent and frugal approach to the conduct of government. Retiring the national debt is not the first step in the transition to a smaller and leaner government. It is a tactic adopted to justify keeping tax rates where they are, while buying time to put together new coalitions to support new spending programs once the debt is retired.