The Debt Deniers’ Fantasy

By Michael Tanner January 30, 2013 12:00 A.M.

It’s not quite on a par with 9/11 truthers or Obama birthers, but recently a number of liberal commentators have descended into the fever swamps of denialism by rejecting the most basic facts about our debt and deficit. Mind you, they are not arguing about the best policies to reduce the debt — taxe hikes vs. spending cuts — but actually denying that the problem exists at all.

Paul Krugman, for example, pronounces the debt problem “mostly solved.” Matt Yglesias of *Slate* asks, “What sovereign debt crisis? There certainly isn’t one in the United States.” Bruce Bartlett, every liberal economist’s favorite former conservative, adds that “our long-term budget situation is not nearly as severe as even many budget experts believe.”

Bolstered by a study from the left-wing Center on Budget and Policy Priorities, the debt deniers claim that a combination of economic growth, tax hikes, and projected (but not yet realized) spending reductions have already significantly reduced deficits. They argue that a mere $1.2 trillion in additional tax hikes over the next ten years, and the resulting savings on interest, would enable us to “stabilize” our debt at a mere 73 percent of GDP by 2022.

Now there’s something to get excited about: stabilizing our debt at an amount equal to nearly three-quarters of the value of all goods and services produced in this country each year. Yippee!

But even if you think that’s good news, it’s not really the truth. The 73 percent figure actually represents only that portion of the federal government’s debt classified as “debt held by the public,” primarily those U.S. government securities that are owned by individuals, corporations, and other entities outside the federal government itself. Debt

held by the public currently totals roughly $11.6 trillion and is expected to rise to roughly $19.1 trillion by 2022.

Left out of this analysis, however, is roughly $4.9 trillion in "intragovernmental" debt, which consists of the debts that the federal government owes to itself, through more than 100 government trust funds, revolving accounts, and special accounts, such as the Social Security and Medicare Trust Funds (worth $2.7 trillion and $344 billion respectively). The combination of debt held by the public and intergovernmental debt yields our current $16.4 trillion in total red ink.

The debt deniers justify ignoring intragovernmental debt on the grounds that only debt held by the public competes with investment in the nongovernmental sector. Moreover, while interest on debt held by the public is paid in cash and creates a burden on current taxpayers, intragovernmental-debt holdings typically do not require cash payments from the current budget and don't present a burden on today's economy.

Intragovernmental debt can also be considered somewhat "softer" than debt held by the public, since the government can control when and whether trust-fund debt is paid through, for example, alterations to the Social Security benefit formula.

But the federal government, and deficit doves, cannot simply write off intragovernmental debt as inconsequential. As opponents of Social Security reform often argue when asserting the program's solvency, the securities held by the Social Security Trust Fund are backed "by the full faith and credit of the U.S. government." Eventually the securities held by the various trust funds and other accounts will have to be redeemed, just as if intragovernmental debt were debt held by the public. No matter how you treat intragovernmental debt today, repaying it should be included in any projection of future government spending.

Therefore, a fair accounting of our debt should include both that held by the public and intragovernmental debt. By that accounting, we currently owe 102 percent of GDP, and by 2022 our national debt will be 118 percent of GDP.

Moreover, by cutting off the trend line in 2022, the debt deniers ignore the enormous unfunded liabilities of Social Security and Medicare, the costs of which will kick in

mostly beyond this limited budget window. According to Social Security's board of trustees, the discounted present value (the amount that would have to be set aside today, earning 3 percent interest, in order to pay future shortfalls forever) of that program's unfunded liabilities is more than $20.5 trillion. And, according to the most optimistic estimates by the Obama administration itself, the discounted present value of Medicare's unfunded liabilities is more than $42 trillion. And that is an estimate that assumes Obamacare actually reduces health-care costs.

True, those obligations represent the "softest" form of debt. But "soft" does not mean debt that can be completely dismissed. According to generally accepted accounting principles (GAAP), by which private corporations abide, promises to pay future benefits are generally categorized as debt. After all, those benefit payments are called for under current law, and it would take congressional action to change them. Unless and until Congress reforms Social Security and Medicare, those obligations exist, but debt deniers are especially vehement in their opposition to precisely such reform. By their very failure to reform Social Security and Medicare, the deniers harden the program's future liabilities.

If we include all this debt — public debt, intragovernmental debt, and unfunded liabilities — we currently owe at least $79 trillion, 500 percent of GDP, and perhaps as much as $127 trillion, 800 percent of GDP.

That said, these future liabilities will be paid not out of today's but out of future economic production, which will inevitably be larger. Measurements of the discounted present value of future liabilities are extremely sensitive to assumptions about future interest/discount rates. Therefore, a better way to calculate the true size of the national debt might be to measure the share of a country's future GDP that will be required to finance that debt. By this measure, the United States faces a debt equal to an additional 9 percent of its future GDP forever.

However, this may underestimate the tax burden required to pay the debt, because a country's tax base is only a fraction of its GDP. Accordingly, the tax increases required to pay the debt would need to be much larger as a percentage of the current tax base than as a percentage of GDP. For example, the payroll-tax base equals slightly less than one-

half of GDP, implying that the 15.3 percent U.S. payroll-tax rate would have to be more than doubled to pay our debt. Similarly, the income-tax base is roughly 36 percent of GDP, meaning that revenue from income taxes would have to more than double, requiring massive rate increases just to pay what we owe.

Taxes at such levels would almost certainly depress both investment and consumption, substantially slowing economic growth.

Indeed, the debt is likely reducing economic growth already. The International Monetary Fund looked at the relationship between debt and economic growth, concluding that, from 1890 to 2000, countries with high debt levels have consistently experienced slower economic growth than those with low debt levels. Similarly, economists Carmen Reinhart and Kenneth Rogoff concluded that countries with debt totaling more than 90 percent of GDP have median growth rates one percentage point lower than countries with lower debt levels, and average growth rates nearly four points lower. The slow economic growth that the United States has seen coming out of the recession is likely due in part to our high levels of government debt.

Perhaps this was all thought up by President Obama's Muslim Kenyan overlords to hide the Mossad's role in 9/11, but I sort of doubt it. The debt deniers' argument is about as unrealistic.