

# American Politics and Its Debt Issue

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## Abstract

*The purpose of this paper is to shed some light on the on-going debate about the United States' debt level and how U.S. lawmakers are attempting to resolve it. On the surface, it seems like they are not working together to resolve the issue, but further complicating it with various tactics, such as the government shutdown. That raises the question, "why is this the case?" to which the answer can be found through the understanding of the American political system and the way it was founded. It should be noted that many leading economists have questioned the very idea as to why we are making a big deal about the U.S. debt issue and assert that the U.S. does not have a debt crisis to begin with, and the issue is simply made up for political reasons. Many leading economists have a position on this argument and they strongly believe that their position is the correct one. The objective of this paper is to highlight those views as well as share its own view on the important topic while keeping an eye on why the U.S. political system functions the way it does.*

*Keywords:* U.S. Debt Level, Debt Crisis, American political system, Dollar Dilemma, Debt Dilemma, Global Financial Crisis

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## 1. Introduction

The tremendous growth of the U.S. economy after World War II and the role it plays in the global market has positioned it in a prominent place in the world stage. As it grew economically and militarily, U.S. influence across the globe increased through its active participation in NATO, United Nations, IMF, and World Bank. Many would argue that the United States also has enjoyed a place of prominence in part due to the dollar being the established reserve currency. The United States dollar has reigned dominant in international finances for a number of decades as the de facto reserve currency. Hence, for the past fifty years or so, the U.S. economy was truly an economic superpower and it has asserted its influence around the globe. It was always one of the first nations to “rush to the aid” of other nations or willing to fight for what it stands for. Similarly, in 2008 it was willing to create liquidity in the global financial market place by risking the U.S. dollar stability because the U.S. president believed that was the best thing to do for the U.S. and the global market. For some, its decision to supply the world market with additional dollars is credited for reducing the global recession, while for others this was not a prudent decision.

## 2. U.S. Political System and its Challenges

As a result of these decisions, the U.S. has created a large debt in its books. Also, the U.S. Congress usually increases the debt limit each year so that the U.S. government can borrow additional money by selling U.S. treasuries to fill the deficit between the revenue and expenditure. Recently, however, the U.S. Congress has not automatically increased the limit, resulting in the past government shut downs. The most recent shutdown in 2013 was attributed to the U.S. Congress not agreeing to increase the debt limit because one party (Republicans) was very much opposed to the idea of increasing the debt ceiling without the U.S. President countering that with some spending cuts. The last time the U.S. government was shut down was in 1996.

Consequently, the question in some people’s mind is why the U.S. political system is so broken to the point where the U.S. president is ineffective against the wishes of one party in the U.S. Congress. Why can’t he simply override their wishes and do whatever he pleases? The answer to these questions lie, in part, with the U.S. constitution, which was designed so that no one branch of government can do whatever they want without the blessing of the others. Let’s look at the structure of the U.S. government to further understand this. First, we must recognize that the United States has three branches of government: the legislative, the executive, and the judicial. Each of these branches has a distinct and essential role in the function of the government, and was established in Articles 1 (legislative), 2 (executive), and 3 (judicial) of the U.S. Constitution. The legislative branch consists of the Senate (one hundred senators) and the House of Representatives (four hundred and thirty-five representatives). The legislative branch, as a whole, is charged with passing the nation’s laws and allocating funds for the running of the federal government as well as providing assistance to the fifty U.S. states. The executive branch consists of the president, vice-president, and fifteen cabinet-level departments (for instance, the Interior Department). The judicial branch consists of the U.S. Supreme court and lower federal courts.

The U.S. political system was deliberately designed to ensure a system of checks and balances so that no single person or entity would have a monopoly on power. For example, the ability of the U.S. Congress to pass bills into laws is checked by the President’s ability to veto passed bills, but this is balanced by the ability of Congress to override that veto with a two-thirds majority. In addition, Congress can further limit the President’s power by refusing to confirm his appointees, controlling funding for executive actions, or even removing the President through impeachment. Meanwhile, the Supreme Court

has the authority and power to declare laws or executive actions unconstitutional, but Congress can amend the constitution to override their decision while the president can appoint different judges. Finally, Congress has far reaching powers to investigate both the executive branch and judicial branch, further balancing the system. While this complex system of checks and balances may seem counter-productive to some from the outside, it serves an important function in preventing absolute abuses of power in any branch.

There are two main parties in the U.S. political system – the Republicans and the Democrats. The Democrats, including the current President, believe that continually taking on more debt is a more responsible course of action at the present time, because the global economy is still in the recovery stage from the global financial crisis of 2008. They believe that debt accumulation is necessary to steer the global economy from a bigger disaster (severe recession). The Republicans, on the other hand, are insisting the U.S. government should control its debt accumulation by cutting spending as well as putting a freeze in any new spending. They also believe that these actions will not create any economic disaster, as argued by some Democrats. It is obvious that both sides believe that they are correct and that the other side must be stopped at any cost.

Within the Republican Party, a political movement began in 2009 with a focus on fiscal conservatism. This movement, commonly known as the Tea Party movement, is considered conservative as well as libertarian, favoring decreased taxes as well as decreased spending by the government. They are against funding for the Affordable Care Act and against raising the U.S. debt ceiling. This party has created some discomfort within the Republican Party, with recent comments from the Republican Senate majority leader criticizing them for undermining his agenda. He added they are working against the interest of the Republican Party (Kane and O’Keefe, 2013). Hence, the Tea Partiers are definitely creating additional strain between the Republicans and the Democrats. Although the Tea Party group has been strong especially in 2012, their support has eroded since then. According to a recent poll, fewer Americans now describe themselves as supporters of the Tea Party movement than they did at the height of the movement in 2010, or even at the start of 2012. Recent polls show fifty one percent view it unfavorable, the lowest since the start of the movement (Gallup poll, Dec. 11, 2013).

The distrust and extreme positions of the two parties are definitely making it harder for any true bipartisan compromise bills, although, more recently, they agreed to cross the party lines to approve a two-year budget outline that would reduce the “chance of another government shutdown and end the cycle of crisis budgeting” that has been taking place in Washington DC for the last three years (Kane and O’Keefe, 2013).

## *2.1. Tables*

Many have argued that the current U.S. debt level is too high and, if left unchecked, will create havoc in the U.S. and the global economy, while others do not believe that is the case. Historically, since its independence, the U.S. has been in debt at one time or another. The revolutionary war itself created a debt of \$75 million, while the Civil War also created a debt of \$2.7 billion in 1864. After 1865, the U.S. ran deficits in eleven of the forty seven years, having surpluses in the other thirty six years. In the twentieth century, more debt followed after World War I, after the creations of social programs to fight the Great Depression of 1929 and continued to increase by the build-up to World War II. By 1950, it continued to increase to \$260 billion. From 1950 to 1980, the debt grew from \$260 billion to \$909 billion and then to \$3.2 trillion by 1990. In the next ten years, it increased to \$5.6 trillion and then from 2001 to 2007 in

went up to \$8.9 trillion. Finally, it increased further to stand at about \$17.5 trillion at the end of 2013 (Office of Management Budget, 2013 and Bureau of Public Debt, 2013). Although the actual dollar value of the debt has been increasing, the more important measure is the percentage of the debt-to-GDP ratio. From Table I below, we notice-that right after World War II, the debt-to-GDP ratio was over 90%, and the U.S. crossed that threshold in 2010 and it is estimated to increase further in the near future. The reason to use the 90% as the yardstick as Rogoff and Reinhart (2010) argue that when debt exceeds 90% of GDP, the growth of the economy will plummet, although that did not happen in the case of the U.S. While others have shared their doubts if Rogoff and Reinhart's premise is correct at all, some have indicated that the reason it does not apply to the U.S. economy is due to its sheer size and because its currency (dollar) is used as the international sovereign currency (International Economy, 2013). Logically, the next question is whether the debt-to-GDP ratio matters. Sadly, there is no consensus on that argument, but many suggest that the U.S. must control spending and increase its revenue. Unfortunately, the U.S. government often manages to spend more than it takes in. The last time the federal government had a balanced budget was between 1997 and 2001. Since then, however, its deficit has been growing steadily. For instance, in 2010, the biggest expenditure was healthcare (Medicare and Medicaid) at \$793 billion; together they made up 23 percent of the budget. Next came Social Security at \$701 billion or 20 percent. Following that was defense spending at \$698 billion and 20 percent of the budget, according to Congressional Budget office. On the revenue end, individual tax is the largest component, followed by the deficit (borrowing). Fast forward to 2012, the health bill was 23.7% and projected to be 25% in 2014.

| Table I: U.S. Debt and Debt as a Percentage of GDP (Selective Years from 1940-2017) |                                     |                       |           |                                     |                       |
|-------------------------------------------------------------------------------------|-------------------------------------|-----------------------|-----------|-------------------------------------|-----------------------|
| Year                                                                                | Gross Federal Debt<br>(in millions) | Debt as a<br>% of GDP | Year      | Gross Federal Debt<br>(in millions) | Debt as a<br>% of GDP |
| 1940                                                                                | 50,696                              | 52.4                  | 2008      | 9,986,082                           | 69.7                  |
| 1945                                                                                | 260,123                             | 117.5                 | 2009      | 11,875,851                          | 85.2                  |
| 1946                                                                                | 270,991                             | 121.7                 | 2010      | 13,528,807                          | 94.2                  |
| 1947                                                                                | 257,149                             | 110.3                 | 2011      | 14,764,222                          | 98.7                  |
| 1951                                                                                | 255,288                             | 79.7                  | 2012 Est. | 16,350,885                          | 104.8                 |
| 1974                                                                                | 483,893                             | 33.6                  | 2013 Est. | 17,547,936                          | 107.4                 |
| 1987                                                                                | 2,345,956                           | 50.4                  | 2014 Est. | 18,499,909                          | 107.8                 |
| 1992                                                                                | 4,001,787                           | 64.1                  | 2015 Est. | 19,426,503                          | 106.9                 |
| 2001                                                                                | 5,769,881                           | 56.4                  | 2016 Est. | 20,391,198                          | 105.9                 |

Source: Office of Management and Budget, Table 7.1 (2013)

On the revenue side, in 2012, individual tax receipts was 32% of the budget but the President believes that it will be 46% in his proposed budget for 2014 (United States Treasury Department, Treasury Bulletin, Table OFS-1, June 2013 and Office of Management Budget, 2013).

On the other hand, the U.S. is in a unique position because of its currency – the U.S. dollar – as it serves as the main international currency of choice after World War II. It remains at the heart of the international monetary and financial system and thus the U.S. has to worry not only about the U.S. market, but also the global market. This unique situation of either promoting dollar stability or dollar liquidity is called the “Triffin Dilemma” introduced by Robert Triffin in 1960; it is defined as the choice the U.S. must prioritize between dollar stability and dollar liquidity (Triffin, 1960). In essence, if the U.S. decides to promote dollar stability, then the U.S. should run budget surpluses and the Federal Reserve should keep interest rates high, refraining from any quantitative easing. Hence, austerity is the key word. The risk is that this action by the U.S. during a recessionary period may further deteriorate the already fragile global economy. If the U.S. decides to promote to dollar liquidity, then the U.S. must increase the dollar supply and run deficits and this in turn should promote economic growth and stability. On the downside, this could lead to higher inflation in the U.S. and destabilize and depreciate the dollar. Fortunately, in 2013 inflation is almost non-existent, which, for many economists, means that too many dollars in the market is not a concern at the present time.

Putting aside U.S. politics, many argue that what the U.S. did since the global financial crisis of 2008 was the right thing to do for the global economy. In fact, many go further to say that the U.S. should have done more (Widmaier, 2013). Widmaier added that the U.S. economic policy, since the global financial crisis, is the correct prescription for the global economy and that the global economy has more to lose with a shortage of dollar than from a surplus. Others argue that the U.S. has misused its reserve currency status to benefit the U.S. economy at the expense of its currency holders. They argue that by moving away from a sole international reserve currency, we should consider other currencies in place of the dollar. While there are studies that have looked at the feasibility of the Euro, Yen, or the Renminbi, all of them have come to the conclusion that none of these currencies have what it takes to be the international currency [See Greenwood (2011); Horton, Leavell and Maniam (2013); Huang and Lynch (2013); Lo (2013); Prasad and Lei (2013); and Wilson, Rady and Maniam (2012)]. Others such as Lorenzo Bini Smaghi, former member of the executive board of European Central Bank, suggested a creation of a global central bank and the issuance of a new supranational currency which is floated against national currencies.

Until we have a better solution, the U.S. dollar has to serve this purpose of providing liquidity for the global market to promoting growth with the risk of running large deficits. What it means for the U.S. economy in the long run is that budget deficits increased during the recession of the early 1990s, again reaching 3.4% of GDP in 1992, but then turned to surpluses from 1997 until 2001. The best forecasts available today show deficits increasing far into the future. Deficits add to the federal debt, which is expected to increase as a percentage of GDP. The Congressional Budget Office’s most realistic projection shows federal debt exceeding 110% of GDP, the level reached for a very short time at the end of World War II, by the year 2023, and then continuing to increase after that. By some estimates, the ratio reaches nearly 190% by 2035.

### **3. What Should the U.S. Do?**

Although the Rogoff-Reinhart thesis, that “growth plummets when debt exceeds 90% of GDP”, may not apply to the U.S. at the current level, we cannot leave the U.S. debt-to-GDP ratio continue to increase at such an alarming rate in the long run.

As Peter Schiff, CEO and Chief Global Strategist of Euro Pacific Capital puts it, “unfortunately our debts don't leave us much in the way of choices. We can choose to pay now or try to pay later. But the longer we wait the steeper the bill and more importantly be bigger the uncertainty.” It is argued by many that the U.S. is going into uncharted territory by letting the debt level increase too much because it's implication on the U.S. economy and the dollar will be negative in the long run. The U.S. is very unique compared to other economies like Argentina, Greece, Italy, Spain, and Portugal, who all went to debt crisis in the last decade, but most of their debt were denominated in other currencies (either dollar or Euro) which made them vulnerable because they simply cannot print money to make their payments, whereas the U.S. can.

Between the two arguments, that sovereign debt accumulation is not harmful to the economy versus high debt-to-GDP ratios, which can create serious problems in the long run, the tendency is to lean towards the latter view. In other words, this means the U.S. must look at reducing the projected fiscal deficit and its debt-to-GDP ratio slowly without pushing the U.S. economy into a recession and, more importantly, keeping an eye on its impact on the global economy. This implies a credible commitment by both parties in Washington D.C. to reduce future outlays and increase tax revenue. In order to reduce future outlays, U.S. Congress must reform social security and federal government health programs, i.e. Medicaid and Medicare, as well as other entitlement programs. On the other side, in order to increase future revenues, the U.S. Congress must reform the tax laws to close tax loopholes and find ways to encourage investments by firms. They must make a conscious effort to invest in pro-growth policies.

### **4. Concluding Remarks**

Many people are frustrated because, in their opinion, the U.S. Congress is not moving forward quickly enough to resolve this issue. Unfortunately, they fail to recognize that is a very complicated issue that requires a delicate balance between spending cuts versus increasing revenue as well as other important structural reforms. Some view the Democrats as a party that is not willing to offer any plans to reduce the current debt and their unwillingness to cut entitlement programs. Others view the Republicans as a party that is willing to increase tax rates but not willing to negotiate because of the Tea party members. Washington lawmakers seem to forget that in order to move forward to reducing the U.S. debt-to-GDP ratio, all aspects of debt reduction must be on the table for discussion. However, the idea that the more we borrow and spend today, the more we will suffer tomorrow when the bills become due is so basic, yet Washington is not willing to sit down and iron out a sensible solution for the long term. We will have to see if the politicians will ever “get it” and truly understand the words “compromise and partisanship” and together form a workable solution for this problem. Lately, there has been some progress in this front.

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