



## Should We Fear the National Debt?

 [westwoodgroup.com/weeklyblog/should-we-fear-the-national-debt/](https://westwoodgroup.com/weeklyblog/should-we-fear-the-national-debt/)

Investors and voters frequently discuss fears of the growing national debt and the possible negative and destabilizing effects on the financial markets in the future. It is a valid concern, and it can be a confusing issue, as a government budget deficit is not the same thing as a personal budget deficit. If a family consistently spends more than they earn, then that lack of fiscal responsibility will eventually create large financial problems and stress. However, a government budget deficit is a different animal and there are varying schools of thought regarding the benefits or ills that a large national debt could create. There are three current views on the benefits and detriments of deficit spending and increasing government debt, and they fall under these three theories:

### **Theory One — Iceberg, Right Ahead**

The U.S. government continues to run large budget deficits, spending far more money than it collects in tax revenues. The large and growing national debt of \$21 trillion, currently at an all-time high, will lead to spiraling government interest payments on those liabilities in the future. This interest burden will use up an increasingly large amount of available tax revenue and will crowd out funds needed for crucial programs and the national defense. The large debt will lead to declining confidence in the U.S. position as the most economically stable country in the world and will diminish both the dollar's standing as the world's reserve currency and its bonds as the safe-haven store of value for global investors.

The constant printing of new money to pay for budget deficit spending will cause rampant inflation, like what was seen in Germany's Weimar Republic in the early 1920s, when it took a wheelbarrow full of cash to buy a loaf of bread. Spiraling inflation will cause economic and societal unrest and lead to economic hardship and financial crises for U.S. businesses and consumers.

This theory is based on fears from financial crises of the past, and a desire to not repeat them. I would note that the hyperinflation in Post-World War 1 Germany was the result of large war debts, and war reparation payments to the victors of the war after its conclusion. With a crippled German economy, the government found it extremely difficult to pay back its war debt and to afford these annual reparation payments, and continuously inflated their currency to pay the debt in the years following the war. This hyperinflation, therefore, was the result of a unique set of circumstances at a point in history, rather than a common failure of monetary policy.

### **Theory Two — We Spend a Lot, but We Make a Lot**

The U.S. national debt is currently \$21 trillion, but our economy is very large and continues to grow every year. Comparing the current debt to the debt 20 years ago is not a fair comparison, as the total economic output of the U.S. economy is much larger today. In addition, the amount of interest that the U.S. pays on its debt remains low as a percentage of GDP, so although our total interest burden is large, it is not historically cumbersome when compared to the size of our economy. If Bill Gates went to the mall and charged \$1 million to his credit card, that amount is obviously a lot of money. However, relative to his net worth and his resources, that level of spending is very manageable.

U.S. government securities still have very low yields and are considered the safe-haven asset of the world's financial markets, so intelligent global investors clearly do not see these large U.S. government budget deficits as a concern. If foreign investors begin to sell U.S. bonds en masse, thereby driving up yields and displaying a decline in confidence in the U.S. financial system, then we need to worry. However, there is no sign of this loss of confidence today, as government bond yields remain very low and there is continued global demand to lend us money.

This theory is based on current conditions in the financial markets, continued low yields on U.S. bonds and the world's unwavering confidence in U.S. assets.

### **Theory Three – Don't Worry, Be Happy**

A new macroeconomic theory has gained public attention over the past few years called Modern Monetary Theory, or MMT. The principal tenet of MMT contends that if a country can print a sovereign currency as the U.S. can, it has a wide degree of freedom in conducting its fiscal and monetary policy. This freedom implies that government spending is never constrained by the revenue it receives in taxes, it is only limited by inflation. The theory contends that a country such as the U.S., which can create and utilize dollars, can continue to run yearly budget deficits as it can just print more money to pay for the deficit spending. We borrow in dollars, so we can always pay our debts because we can always print more money.

This prodigious printing of new money will not necessarily create runaway inflation (the Fed's printing of dollars has not increased inflation at all over the past 10 years, for instance). Therefore, deficit spending should only be curtailed when it results in harmfully high levels of inflation, but not before then. MMT disciples believe that to have use of a currency that a government can simply print more of without visible inflation, and to not use that power to spend extra money to help cure society's ills and spur economic growth, would be cruel and unproductive. If our government can print money without causing inflation, why would we not do that? This theory effectively frees up politicians to spend as much money as they want without raising an equivalent amount of tax revenue, as we can always print more money to pay for the new spending.

MMT is a relatively new economic school of thought, but you will be hearing more about it in the coming years, or even in the 2020 election debate. Some candidates seem to be in favor of its tenets, even if they are not familiar with the MMT theory yet.

In summary, the range of opinions on the state of the national debt is wide and the debate on the merits of each of these three arguments will continue as long as well-meaning folks worry about the economic and financial future of the United States.

The information contained herein represents the views of Westwood Wealth Management at a specific point in time and is based on information believed to be reliable. No representation or warranty is made concerning the accuracy or completeness of any data compiled herein. Any statements non-factual in nature constitute only current opinion, which is subject to change. Any statements concerning financial market trends are based on current market conditions, which will fluctuate. Past performance is not indicative of future results. All information provided herein is for informational purposes only and is not intended to be, and should not be interpreted as, an offer, solicitation, or recommendation to buy or sell or otherwise invest in any of the securities/sectors/countries that may be mentioned.