Discuss the arguments that the national debt is a burden. In what ways and under what circumstances can the national debt be a burden? Would it be a burden primarily to future generations?

1. Existing households give up current consumption goods to give the government control over more resources by purchasing bonds (voluntarily). This burden is on people at the time of the deficit.

2. Money borrowed from foreigners can create future leakages (interest and principle payments), which can be a burden IF the money borrowed is not invested wisely. If the money we borrow from foreigners is invested in improvements in transportation, communication, education and training, the greater productivity and economic growth in the future may more than compensate for the future leakages.

3. Government borrowing may “crowd out” (discourage) private investment if it forces interest rates higher. This is usually only a problem if the government has a budget deficit during the expansion or peak phases of the business cycle (a period of relatively full employment for resources). Most macroeconomic theories agree that there is no reason for government to have large deficits when the economy is at or near full employment.

If the government borrows (sells bonds) during a recession, interest rates may not rise. Even if interest rates rise due to government borrowing during a recession, higher interest rates do not discourage investment because investment is already discouraged by excess capacity and unemployment of capital! I am a firm owner and three of my five plants are shut down due to the recession. Interest rates have very little influence on my investment decisions. I am NOT going to build a sixth plant, no matter how low interest rates fall. Rising interest rates will NOT discourage me from building a sixth plant. So “crowding out” is not a problem during recessions and should not occur during expansions if the government is fiscally responsible.

4. If the Federal Reserve helps the U.S. Treasury finance a deficit by buying the bonds it is selling, the resulting increase in the money supply may be inflationary. Still the “burden” of inflation is usually felt within a few years of the deficit, not on future generations.

5. If, over the long run, the national debt grows faster than the rate of growth of real GDP, the government may find it difficult to meet its payments of interest and principle by raising taxes.

6. Other points:
   - The national debt is smaller than the private debt (owed by households and firms), and it is growing more slowly.
   - The national debt is mostly internal (owed to American citizens, American firms, and the Federal Reserve who hold U.S. government bonds), while the private debt is mostly external to the borrower. Internal debts are less “burdensome” than external debts.
   - As a percentage of GDP, the U.S. national debt declined from 1945 to 1980.
   - Government does not always distinguish between spending on capital versus spending on current goods and services, though they have a very different effect on future generations.
   - The national debt never has to be repaid. It can be refinanced as it becomes due (print new bonds, sell them, pay off the old bonds). Firms and households also rollover debt in this manner.

Discuss the advantages of having a national debt. How is the national debt useful?

1. Having a national debt makes discretionary fiscal policies easier to implement. Otherwise, all discretionary fiscal policies would have to be balanced-budget policies, which involve much greater changes in both government spending and taxes to achieve the same effect.
2. Having a national debt makes it possible to use automatic stabilizers (nondiscretionary fiscal policies) to stabilize the economy and reduce the severity of the business cycle.
3. Having a national debt makes it possible for the Federal Reserve to use open-market operations, the most powerful, most commonly used, and most important tool of monetary policy.
4. U.S. government bonds are important low-risk assets for households (especially low-income households who want a higher return than they can get from banks but who cannot afford the risk of the stock market).