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To Control National Debt, Congress Needs to Tackle Entitlements

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For most individuals, maxing out one's credit card is usually a sign of a spending problem—but not if you're Congress. For the first time in history, the national debt has hit \$12 trillion, and it will soon exceed the \$12.1 trillion maximum amount of debt allowed by law. Yet Congress needs only to vote to give itself a higher credit limit to keep spending. An increase is inevitable because the government must fund current programs and make interest payments on existing debt, but this time will likely be the single greatest one-time increase in history, with initial estimates ranging between \$1 trillion and \$1.5 trillion.

Such red ink is unsustainable over the long-term, which is why this increase should compel Congress to control spending. The main drivers of spending now and in the future are Medicare, Medicaid, and Social Security, and Congress ought to recognize that it is time to fundamentally reform these programs as it takes a shameful vote to saddle future generations with more debt.

Why Does Debt Matter? When Congress raises the debt limit, it ups its ability to issue two kinds of debt that each have different economic consequences. The first type is debt held by the public, which is the total of all past budget deficits plus interest and is owned by individuals, corporations, and foreign governments. The second part is debt held by the government, which represents money that was borrowed by the government from surpluses in the Social Security trust fund and other accounts and spent by other government entities.

The public debt, which makes up \$7.6 trillion of the \$12 trillion total debt subject to limit,¹ has the greatest economic significance for two key reasons. First, government must pay interest expenses on it to avoid default. In fiscal year 2009, interest payments on the public debt were \$202 billion, or roughly 1.4 percent of gross domestic product (GDP).² The larger these interest payments become, the less budgetary flexibility Congress and the President have to fund other spending priorities.

Second, publicly held debt has a direct effect on credit markets. Treasury securities must be sold to finance the federal deficit, which reached a record \$1.4 trillion this year, and these securities compete with private securities for buyers and reduce national savings.³ As the money available for private investment is diminished by government borrowing, private investment decreases, leading to lower productivity, wages, and economic growth.⁴

Debt held by the government, which stands at \$4.4 trillion, can be thought of as future debt whose economic consequences will not be felt for some time. Because government debt is issued from one part of the government to another, it is effectively an accounting mechanism that has no impact on current credit markets.

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However, eventually the government will have to repay debt it has loaned itself. For instance, the Social Security trust fund, which is the largest financier of inter-government debt, contains IOUs that will need to be repaid beginning in 2016. Unless other spending is cut to fund repayment, new publicly held debt would have to be issued at that time, resulting in a dollar-for-dollar shift from government to public debt.

This shifting of government debt to public debt would not, by itself, cause the total stock of debt to change. However, as the new public debt accrues interest, the compounding would cause the public debt to rise significantly.

It's All Downhill from Here. The recession and excessive spending have caused the debt held by the public to grow sharply to 56 percent of the economy, topping the historical average of 36 percent. Publicly held debt must not grow faster than the economy if it is to be sustainable; otherwise the demand on capital markets would be so severe that private and foreign lenders would stop buying U.S. securities. Yet the U.S. is rapidly headed in that direction.

Credit rating agencies have recently signaled that current and projected deficit levels threaten America's AAA credit rating.⁵ But as early as a year ago, Moody's warned that Social Security, Medicare, and Medicaid expenditures posed a severe threat to ratings over the long term.⁶

Such warnings have not gone unnoticed by major U.S. lenders, particularly China, which holds more than \$1 trillion of U.S. debt and whose citizens have even laughed at Treasury Secretary Tim Geithner for claiming that their investments in treasury securities are "safe."⁷

This new \$1 trillion debt increase will certainly capture the attention of creditors and taxpayers.

No One Said This Would Be Easy. Americans are rightly intolerant of congressional profligacy, and this monumental increase in the debt limit will demonstrate Congress's poor record of fiscal restraint. To avoid scrutiny, congressional leadership will likely try to sneak the debt limit increase into a "must-pass" measure, such as a continuing budget resolution or the defense appropriations bill.⁸

Such parliamentary gamesmanship would tie the hands of those Members who want to have a full debate about this ruinous spending. Instead, Congress should recognize its past overspending mistakes and take a standalone vote on the increase.

Because this will be a difficult vote, many in Congress may be inclined to increase the limit by an amount large enough to avoid another increase before their next election, but such evasion should not be tolerated by taxpayers. Any increase this year should also be no larger than what is required to fund necessary spending.

Time for Serious Action. To avoid perpetual trillion-dollar debt limit increases, Members of Congress

1. U.S. Department of the Treasury, "Debt to the Penny and Who Holds It," at <http://www.treasurydirect.gov/NP/BPDLogin?application=np> (November 25, 2009).
2. Congressional Budget Office, "Monthly Budget Review," November 6, 2009, at <http://www.cbo.gov/ftpdocs/107xx/doc10708/11-9-09MBR.pdf> (November 17, 2009).
3. *Ibid.*
4. See J. D. Foster, "Keynesian Fiscal Stimulus Policies Stimulate Debt—Not the Economy," Heritage Foundation Backgrounder No. 2302, July 27, 2009, at <http://www.heritage.org/Research/Economy/bg2302.cfm>.
5. Lita Epstein, "Moody's Warning on the U.S. Credit Rating: A Bit of Payback?," *Daily Finance*, Oct. 22, 2009, at <http://www.dailyfinance.com/2009/10/22/moodys-warning-on-the-u-s-credit-rating-a-bit-of-payback> (November 23, 2009).
6. Reuters, "Moody's: U.S. Rating Could Be Pressured in Long Term," January 10, 2008, at <http://www.reuters.com/article/bondsNews/idUSN1017237120080110> (November 23, 2009).
7. Reuters, "Geithner Tells China Its Dollar Assets Are Safe," June 1, 2009, at <http://www.reuters.com/article/companyNewsAndPR/idUSPEK14475620090601> (November 25, 2009).
8. In fact, the last time the debt limit was increased was with the passage of the Troubled Assets Relief Program, which occurred during a time of economic crisis.

should also finally address the long-term entitlement-driven budget problem. Adding to today's deeply troubling spending-driven public debt levels, the Congressional Budget Office estimates that as Social Security IOUs are redeemed and rising health care costs drive up expenditures for Medicare and Medicaid, the publicly held debt will exceed 320 percent of GDP by 2050. Net interest expense by that time will increase nearly tenfold from today's level of 1.4 percent of GDP to 13.5 percent.⁹

One way to address this issue would be to establish a commission to address entitlement reform as part of an agreement to increase the debt limit. A growing number of Members—led by Budget Committee Chairman Kent Conrad (D–ND) and ranking member Judd Gregg (R–NH) in the Senate and Representatives Frank Wolf (R–VA) and Jim Cooper (D–TN) in the House—are calling for a vote that would require exactly that.

An effective commission would require that Congress restrain entitlement growth by placing the programs on long-term budgets, which would prevent the national debt from growing on autopilot. Congress should also rethink the entire notion of what debt “matters” and include a measure of the

long-term entitlement obligations—equal to about \$44 trillion (net present value)—in the federal budget. Indeed, it is impossible to have an honest conversation about a \$1 trillion debt increase without an acknowledgement of future debt as well.¹⁰

Do It for the Kids. Today's \$12 trillion debt is small compared to the debt that future generations stand to inherit from unchecked entitlement spending. Congress should build budget controls to spare them this crushing and immoral burden. Reforming entitlement programs, which are the main drivers of government spending and borrowing, should be front and center in this effort.

Failure to act will guarantee that future Congresses will have to raise the debt limit many more times and that future generations will pay the price. Responsible fiscal stewardship requires hard choices. Congress must prove it is up to the task by debating the issue on its own merit and taking this hard vote without the subterfuge of burying it in “must-pass” legislation.

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9. Congressional Budget Office, “The Long-Term Budget Outlook,” June 2009, at <http://www.cbo.gov/ftpdocs/102xx/doc10297/06-25-LTBO.pdf> (November 23, 2009). Figures are drawn from CBO's Alternative Fiscal Scenario.

10. See Stuart M. Butler, “Bipartisan Entitlement Commission Needed to Control Spending and Debt,” Heritage Foundation WebMemo No. 2698, November 16, 2009, at <http://www.heritage.org/Research/Budget/wm2698.cfm>.