

New Model Federalist No. 5 – On the National Debt

That a national debt is beneficial if maintained at a moderate level – That excessive debt leads to high taxation – That unexpected events can combine with indebtedness to prompt a vicious cycle – That establishing priorities for public spending is the simplest way to manage public debt – That priority ought to be given to defense, diplomacy, infrastructure, research, exploration, and conservation – That discipline ought to be restored to the management of public funds allocated for national defense – That provision for defense and diplomacy accomplishes the same ends – That provision for infrastructure and research is an investment in the future of the Republic

Persuaded as the Secretary is, that the proper funding of the present debt, will render it a national blessing: Yet he is so far from acceding to the position, in the latitude in which it is sometimes laid down, that “public debts are public benefits,” a position inviting to prodigality, and liable to dangerous abuse, that he ardently wishes to see it incorporated, as a fundamental maxim, in the system of public credit of the United States, that the creation of debt should always be accompanied with the means of extinguishment. This he regards as the true secret for rendering public credit immortal. —Alexander Hamilton, First Report on Public Credit, January 9th, 1790.

In our previous essay, we advocated simplification of federal laws and reduction of the bureaucracy that has accompanied them. We now move our focus to the fuel that gives motion to the vast machinery of government: the public funds. These funds are, in the final reckoning, provided for through taxation, but in the interim they are provided for by government borrowing. This borrowing is the basis of the public debt, known commonly as the national debt.¹ Many of the great questions of state, therefore, regard spending, taxation, and debt. Since the turn of the present century, however, our Republic has failed to reckon with these fiscal matters in a prudent manner. One party calls incessantly for more federal spending; the other vies blindly for severe reduction of taxes; both approaches inexorably and irresponsibly expand the national debt, which is now strained by the expense of two wars and the retirement of the Baby Boomer generation.² Such reckless stoking of the furnace exposes our Union to the caprices of chance and renders it vulnerable to the challenges of its rivals. An errant spark could cause its engine to melt down.

Accepting, as we do, that a well-funded national debt can be in the national interest, so long as it is accompanied by what Mr. Hamilton described as a “means of extinguishment,” to be employed if the growth of the debt outstrips the growth of the economy; that excessive taxation impedes prosperity; that taxation is nonetheless necessary for provision of public goods; and that some public support is warranted to our fellow citizens who, due to twists of fortune, are unable financially to support themselves; we endeavor in the next two essays to present a new approach to taxation and spending, in keeping with the federal structure of our Republic, which shall reinforce the partial sovereignty of the several States, accord choice to citizens, reduce waste, and moderate the national debt. We begin, in this one, with a discussion of the public debt and the rightful priorities for government spending in the discretionary portion of the federal budget.

¹ Whereas the ‘deficit’ refers to the amount the government borrows in a single year; i.e., the shortfall between that year’s budget and government revenue. The public (or national) debt refers to the sum total of money that the government owes, accumulated over the course of many years of deficits, and incorporating interest.

² “To relieve the present exigency is always the object which principally interests those immediately concerned in the administration of public affairs. The future liberation of the public revenue, they leave to the care of posterity.” Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 3.

We follow, in the next, with a discussion of the mandatory portion of that budget and of the form and manner of taxation at the federal and state levels of government.

National debt must, like a flame, be considered an essential tool but also a dangerous one, should it escape the control of its user. No sensible person would urge his or her family to forego the use of fire and thus shiver in the cold and dark; so ought no sensible leader to advise his or her fellow citizens to forswear a public debt entirely. Well-funded national debts, which began to be employed by Western nations during the dawning years of the Enlightenment, allow countries that use them to acquire more than they otherwise would have the means to. Just as most private citizens must borrow in order to have, at one time, the capital necessary for purchasing a home, so must governments borrow in order to maintain world-class armies and fleets, and to provide public goods for their citizens.³ And just as the debt that a citizen incurs to purchase a home can, in the long term, prove a profitable investment as the home rises in value, so can government realize long-term gain by borrowing funds to invest, for instance, in infrastructure, wherein the resulting economic growth comes to outweigh the debt incurred. Governments, moreover, have advantages in borrowing that private citizens lack: they exist for several lifetimes, and they have a degree of influence over the market from which they borrow.

Austerity for its own sake thus has little value, and holds a nation below its true potential. Nor is the public debt of these United States yet in crisis: the U.S. Government has, since Mr. Hamilton's time, diligently paid its obligations incurred from interest on the public debt, and still does so today; private persons and foreign states thus remain content to lend to our Republic at a manageable cost.⁴ Our Union, furthermore, holds a unique position in the world economy, which dampens the incentive for foreign lenders to abruptly call in its debts to them. The U.S. dollar is the world's foremost reserve currency, such that many foreign assets held by creditor nations are denominated in dollars. Should those countries prompt a crisis of payment for the U.S. Treasury, and thereupon a fall in value of the dollar, they would prompt a fall in their own wealth. It is rare that any country would act against its own interest in such a way; thus has the United States remained so far on solid financial footing despite two decades of profligacy in its expenditure.⁵

That our Republic has benefitted from its public debt so far, however, ought not to lull it into complacency; it should not fall asleep by the fire. All debts must eventually be paid, and taxation is the eventual form of payment for all public debt.⁶ This maxim holds true even for that portion of the national debt which is serviced, in effect, for perpetuity; that is, where government pays the interest on the debt at recurring periods while leaving the principal untouched. As the volume of debt accumulates, so does the volume of interest; more government revenue must then be dedicated to servicing the interest, and so the volume of taxation steadily increases.

³ "That exigencies are to be expected to occur, in the affairs of nations, in which there will be a necessity for borrowing. That loans in times of public danger, especially from foreign war, are found an indispensable resource, even to the wealthiest of them." Alexander Hamilton, *First Report on Public Credit*.

⁴ 10-year U.S. Treasury bond yields have in the past decade averaged between 2-3%, less, in fact, than the decades preceding it; this represents the confidence the world reposes in the full faith and credit of the U.S. government. The data may be found on the Treasury's website, under "Daily Treasury Long Term Rate Data" in its Resource Center.

⁵ The same logic, of course, applies to the domestic portion of the debt; domestic bondholders, by virtue of residing in the United States, mostly hold their wealth in dollars and thus would be similarly averse to devaluation.

⁶ "When funding [of debt], besides, has made a certain progress, the multiplication of taxes which it brings along with it sometimes impairs as much the ability of private people to accumulate even in time of peace, as the other system [of saving] would in time of war." Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 3.

Were the national economy to grow faster than the national debt, it is true, then revenue may increase without the need for an increased rate of taxation.⁷ That is often the premise upon which the deceptive species of policy known as the unfunded tax cut and its cousin, the unfunded spending increase, are proposed; but it is a risky gamble. It relies on a prediction of the future, yet the future is difficult to predict. Any unexpected shock, any unforeseen stumble, might slow the economy. If that occurs, the government faces a dilemma. It may restore the higher tax rate, but doing so might slow the economy further, which compounds its difficulties. Or it may double down on its bet by borrowing more funds to service the debt. Doing so throws the public on the mercy of its creditors; at some point, if the prospect of repayment appears remote, and especially if an inviting alternative presents itself, the creditors shall demand more to lend less. Additional borrowing thereby becomes unaffordable; the existing debt must still be serviced; the burden of servicing debt raises taxation, which slows the economy; and reduction in economic growth adds to the difficulty of servicing debt, creating a vicious cycle that may cripple the greatest nations.

History offers a cautionary tale. At the turn of the past century, Great Britain occupied a position similar to that held by these United States today. It had, by means of a longstanding and well-serviced national debt, grown its economy to prosperity, accumulated formidable military might, and extended its influence to all corners of the world. Its banks sat at the center of world finance and its currency led the world onto the gold standard, which gave it value in transactions across the globe. Other nations had little incentive to harm Britain's economy; Britain had little reason to ponder the need for a means of extinguishment to accompany its growing debt.

Then war came. Twice Britain was cast into the center of world war, and each struggle, though it ended with victory, increased the British public debt to a level far beyond the ability of the British government to control.⁸ When war subsided, Great Britain found that it was no longer the world's indispensable economy. These United States had grown to take that role; New York came to overshadow London. The rest of the world thus no longer had reason to be lenient with British debt, and so for several decades the people of Britain faced hardship as their government repaid its dues. The British authorities rationed food until 1954; the British Empire collapsed; the British economy did not return fully to life until the 1980s; and when Britain did recover by the century's end, it retained but a shadow of the might and influence it possessed at the start of it.

The expansion of the national debt was not the sole cause of Great Britain's fall from wealth and power,⁹ but that it played a key part cannot be denied. Long accustomed to a benign public debt, Britain did not prepare for events that would overwhelm its ability to fund the debt, nor for the possibility that another power might take its place at the world's economic center.¹⁰

⁷ Given that tax rates are proportional to income and profit; a strong economy brings higher incomes and profits, and thus more tax revenue, even when the tax rate remains constant.

⁸ "In Great Britain, from the time that we had first recourse to the ruinous expedient of perpetual funding, the reduction of the public debt in time of peace, has never borne any proportion to its accumulation in time of war." Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 3.

⁹ Great consideration must be given to national independence movements which broke apart the British Empire; the United States, fortunately, faces no such risk to its territorial integrity today. Britain also suffered extensive physical damage during the world wars – a risk, which, if it finds itself in a major war, our Republic could also be exposed to.

¹⁰ "Great Britain seems to support with ease, a burden which, half a century ago, nobody believed her capable of supporting. Let us not, however, upon this account rashly conclude that she is capable of supporting any burden; nor even be too confident that she could support, without great distress, a burden a little greater than what has already been laid upon her." Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 3.

Our Republic ought to note the history of its predecessor. The retirement of the Baby Boomers looms large as an event that could increase its public debt to a height above its control, especially if paired with an unforeseen crisis such as war; and China is advancing as a rival economic power, predicted to overtake these United States in gross domestic product before the middle of this century.¹¹ China and the European Union, though with limited success so far, also aspire for their currencies to compete with the dollar as an international reserve. Our Union, in order to preserve its position, should thus ready a means of extinguishment, lest the flames of its national debt rise too high and too quickly to contain.

It is beyond the scope of this essay to examine the entire federal budget, and prescribe in detail a contingency plan to contain and reduce the public debt; such labor is best left to the two houses of Congress in whom that responsibility is vested. We advance instead the notion that the basic method of readying a means of extinguishment for the national debt is to establish certain priorities for federal spending; then, as the exigencies of state and the market demand, to reduce the public debt by diminishing spending in areas that are not accorded priority.¹² Moreover, we favor objects for spending that may be considered investments, and which thereby eventually recoup some of the sum they add to the public debt. Incurring debt for a subsidy, which is merely consumed, offers no such advantage. An individual who takes a loan to study medicine will, in the long run, be better off; one who does so only to lease a sports car will be the worse for wear. So, too, is it with governments that borrow for investments and those that borrow for subsidies.

In this essay, as indicated above, we limit our examination to the ‘discretionary’ portion of the federal budget, of which the greatest share, by far, is dedicated to those items considered necessary for the common defense. Defense is unmistakably within the proper purview of the federal government, both by the explicit provision of the Constitution and by common logic: the high principles for which this Republic stands will come to naught if these United States lack the means to defend themselves from foreign aggression. We thus endorse without qualm the notion that to be prepared for war is the best means of preserving peace, and liberty.

Yet we do not shrink from declaring that, in recent decades, the Department of Defense, in its management of public funds entrusted to it, has lacked the discipline which characterizes the profession of arms. Instead, it employs perverse and labyrinthine procedures, which render impossible the accounting of funds and encourage excessive and ill-considered spending, such that we are willing to wager that the amount spent wastefully by it exceeds the entire budgets of most other federal departments.¹³ Once the department fritters away its allocation in this manner, it marches to Congress with open hands, expecting to be given more without thought or scrutiny.

¹¹ Common estimates predict that China’s nominal gross domestic product (GDP) will overtake that of the United States in the 2030s. Others contend that, as China’s purchasing power parity (PPP) is now higher than the United States’, that China is already the world’s largest economy. There is not, however, full agreement on the subject.

¹² “That liberation [of public funds], it is evident, can never be brought about without either some very considerable augmentation of the public revenue, or some equally considerable reduction of the public expence.” Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 3.

¹³ For instance, as the future budgets of military units are cut if they do not spend the entirety of their present budget, units have every incentive to embark upon a wasteful spending spree at the end of each fiscal year, and no incentive to conserve public funds. It is unsurprising, therefore, that the DoD recently failed its first full audit since 1991; and it is also unsurprising, but greatly disheartening, that its public reaction to that event bordered upon apathy. “We failed the audit, but we never expected to pass it,” said the Deputy Secretary of Defense at the time, according to a news article on the subject. “Pentagon Fails Its First-Ever Audit, Official Says,” *Reuters*, Nov. 15, 2018.

This state of affairs is one that both parties have long indulged, but it is unacceptable in a Republic and must be curtailed. It shows contempt for the tax-paying citizen; it instills a sense of entitlement within the defense bureaucracy; and the inefficiency it breeds is counterproductive to military preparedness: small units are overloaded with expensive trinkets, but the Navy lacks ships.¹⁴ The Defense Department ought to receive funds based on military necessity, not merely in comparison to the previous year's budget; it ought to be held accountable through frequent external audits; and it must enact internal reforms that encourage conservation of public funds, rather than profligacy. Only once military discipline is applied to military spending should the citizens of these United States and their representatives in Congress be satisfied.

There are other items of high importance, and appropriate for federal expenditure, upon which we desire to place greater priority than is presently given. One is diplomacy, in particular the Department of State, which in recent times has been steadily deprived of funds even as its counterpart, Defense, has received ever-greater largesse. That Defense should have a larger share of the federal budget than State is ordinary and acceptable, for maintenance of armies and fleets requires vast expenditures in equipment and supplies; but it is neither ordinary nor acceptable that increases in defense spending should come at the expense of funds allocated to diplomacy.

Defense and diplomacy are but two sides of the same coin: they serve the same end of sustaining U.S. power abroad, thereby providing security and prosperity at home. A reduction in the diplomatic budget weakens the Republic in the same manner as a reduction in the defense budget; an increase correspondingly strengthens it. The provision of public funds for defense and diplomacy thus ought to rise and fall in tandem, guided by fiscal constraints and the dangers and opportunities that exist abroad. As an interim means of correcting the present imbalance, we propose that funds discovered, upon audit, to have been wastefully allocated by the Department of Defense be first re-apportioned to State, to the amount necessary for all U.S. embassies to perform the full extent of their duties, before being returned to the general fund. Such an approach in the short term would restore our Union's diplomatic capability without necessitating new taxation or additional debt. Thereafter, the proposed budgets for the Departments of State and Defense ought to be presented together to Congress under the title 'Defense and Diplomacy.'

Repair of national infrastructure is another clear and urgent priority, deserving of federal provision because it is important for both the national defense and commerce between the several States. A single levy of federal tax, for the purpose of repairing the decay caused by decades of neglect, ought to be considered, especially as the economic benefit to be expected from such a repair may eventually offset some or all of the cost in taxation. Thereafter a new plan ought to be conceived for the regular and continuous maintenance of interstate infrastructure, to be provided for by a re-apportionment of funds from items of lesser urgency in the present federal budget.

The provision of funds for research and development in science, technology, engineering, and medicine ought also to be accorded a high priority in the federal budget. Such development, akin to provisions for infrastructure, ought to be considered a profitable investment in fulfillment of the constitutional duty of Congress to provide for the general welfare and common defense of

¹⁴ "While the Navy is continuing to accept delivery of ships, it has received \$24 billion more in funding than originally planned but has 50 fewer ships in its inventory today, as compared to the goals it first established in its 2007 long-range shipbuilding plan." The Government Accountability Office, in a report titled "Navy Shipbuilding: Past Performance Provides Valuable Lessons for Future Investments," June 6, 2018.

the United States. Research in medicine provides security to the people of our Republic by better protecting them from the scourge of disease; research in science, technology, and engineering expands the Union's economic potential. Moreover, such research cannot be adequately provided for by private firms or the several States alone: as the returns of research are by their very nature uncertain, commercial entities are at times reluctant to assume the risks and costs of conducting experimentation on their own; nor are the States normally inclined to dedicate many resources to research that might benefit the country substantially, but any one State only marginally.¹⁵

There are two more items, related to infrastructure and research, which warrant priority in federal expenditure on account of the fact that they are achievable only by the Union, and that they tend greatly toward the general welfare of these United States. These are the exploration of outer space and the mitigation, halting, and reversal of the global warming phenomenon. Each ought to receive more emphasis and funding than it does at present; but which manner of funding them is most effective, we leave for further debate, our only stipulation being that it ought to be considered in the light of Mr. Hamilton's principle, that the national debt be increased only if it be accompanied by a means of extinguishment. The merits of these great tasks, and the means by which they might be accomplished, we shall discuss in detail in a later essay.

Such are the objects that we consider worthy of special priority in the provision of federal funds. In establishing our priorities, we do not imply that no other objects ought to receive funds from the government of these United States. We argue only that when the need to ready a means of extinguishment for the public debt requires a general reduction in federal expenditure, the objects designated above ought to be preserved to the greatest extent that circumstances allow, whereas other objects may have their provision reduced. We stress, too, that we propose these priorities only for the federal budget; the priorities of the several States do and should differ. We shall now, in our next essay, turn our attention to the mandatory portion of the federal budget, and confront the great questions associated with the provision of welfare contained within.

—U.S. Citizen

¹⁵ “The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expence to any individual or small number of individuals, and which it cannot therefore be expected that any individual or small number of individuals should erect or maintain.” Adam Smith, *The Wealth of Nations*, Bk. 5, Ch. 1. The granting of patents, which is also a constitutional duty of the federal government, sometimes solves this problem for private firms by giving them a financial incentive to bear the costs of research. But there must nevertheless be some prospect of profit for a patent to work, and not all public goods are profitable. Governments may also help to fund long-term research which may someday be profitable, but is in too early of a stage for private firms to realize the profit within the time they have available to produce a return on investment.