



Fear the Spending, Not the Debt

September 23, 2019

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Never underestimate the ability of politicians to mess up a good thing. They're certainly trying in Washington, D.C.

Unfortunately, many people are concerned about the wrong thing. Nice even numbers fascinate people, and through the first eleven months of this fiscal year (October 2018 through August 2019), the U.S. budget deficit was over \$1 trillion (\$1.067 trillion to be exact), up 19% versus the same eleven months the year before. The government usually runs a surplus in September, so the budget deficit for full Fiscal Year 2019 should come in at roughly \$950 billion – that's close enough to \$1 trillion for government work.

Meanwhile, the public debt is at a record high \$22.5 trillion, and the Congressional Budget Office projects roughly \$1 trillion annual deficits as far as the eye can see. So, it's easy to understand why so many are concerned. Some even think the US is headed for bankruptcy. And, unlike with Greece, there's no one big enough to bail-out the US.

Here's what they're missing: in spite of record debt, the net interest on the debt should finish the year at 1.8% of GDP. For perspective, that's lower than it ever was from 1980 through 2001, during which it averaged 2.7% of GDP – and some of those years saw budget surpluses.

Moreover, net interest relative to GDP is unlikely to rise dramatically anytime soon. Imagine we wake up tomorrow morning and Treasury yields are miraculously at 4.0% across the entire yield curve, from short-term securities to long. That would be well above the 2.5% average interest rate taxpayers already pay on all marketable Treasury debt outstanding, including the securities issued many years ago.

Moving from 2.5% to 4.0% is a 60% increase in interest costs, which also means that, once we roll-over enough debt, the interest burden relative to GDP would rise by 60%, as well. But a 60% increase from 1.8% of GDP, would put us at 2.9%, very close to the long-term average in the 1980s and 1990s. And, interest rates aren't going to 4% in the real world anytime soon, plus it takes time for the debt to rollover.

The Treasury Department could use the current era of low long-term interest rates to lengthen the maturity of the debt. The best idea we've seen is for the Treasury to issue perpetual inflation-indexed

debt and then step aside and let the private sector slice and dice these instruments into bespoke securities. The market could create everything from plain vanilla 10-year Treasury notes, to 50-year zero-coupon debt, to debt instruments that don't pay interest for the first twelve and a half years and then pay every six months after that.

But here's another reason not to fear the current debt of \$22.5 trillion: the assets of all US households combined are \$129.7 trillion. Yes, they have debts worth \$16.2 trillion, but that still leaves a net worth of \$113.5 trillion.

Now let's imagine households paid off not only their own debts but the federal government's, as well. That would have left them with \$91.4 trillion in mid-2019. That's about 4.3 times GDP. From the early 1950s through the mid-1990s, this ratio – *the net worth households would have after paying off their debt and the national debt* – hovered between 2.8 and 3.3 times GDP. Now it's near a record high.

None of this means US fiscal policy is in a good place; it's just that the debt is manageable, we're not going bankrupt. The real fiscal problem is the level of spending and the need to fix entitlements: Social Security, Medicare, Medicaid, and "Obamacare." If we don't fix these programs, then in the next few decades the federal government will be spending relative to GDP in a normal year as much as it was spending at the peak of the crisis after the last recession. And when all we hear about is the deficit, it takes away the focus on spending and lets politicians sell the idea that it's all excessively low taxes that cause it, even though tax collections are at an all-time high.

The problem is that out of control spending gradually erodes the character of the American people. It pushes citizens toward dependence on government checks for their income, rather than their own efforts. In a democracy, we want our fellow citizens to know the value of hard work, shrewd investment, and entrepreneurship. Having too many people living off taxpayers is no way to conserve those traits.

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