
Our Debt Won't Bankrupt Our Grandkids

By Editor Test *Thu, Oct 6, 2011*

Deficit hawks say that federal debts and deficits put our progeny in a hole. Indeed, they've said it for decades. But some economists, starting as far back as 75 years ago, have said that's poppycock. The latter may be right.

Challenging conventional wisdom is part of our mission at *Retirement Income Journal*, and few pieces of wisdom are more conventional than the supposition that adding more dollars to the national debt will impoverish our grandchildren.

This assumption has paralyzed the country. Fears of increasing the nation's annual budget deficit or the long-term national debt have emerged as urgent reasons for sawing off the limbs of Social Security and Medicare, on which virtually all retiring Baby Boomers will be sitting.

Politically, to be soft on the deficit today is arguably as suicidal as it was to be "soft on Communism" before 1989. No practical politician wants to be accused of saddling our grandchildren with the burden of paying back the federal debt.

But what if this assumption is false? What if it is counter-productive? What if it is based on a simplification or a misunderstanding of the nature of the debt of a sovereign nation with a fiat currency?

Though you rarely hear about their work, several economists have challenged this idea over the years, beginning at least as far back as the 1930s, during debates over the blessings or evils of the New Deal.

These economists believe that government expenditures on infrastructure and education (in the Great Recession) or soil conservation and rural electrification (as in the Great Depression) help the current economy (by employing people) as well as tomorrow's economy (by fortifying the nation's intellectual and physical capital).

Here, to start with a very recent example of this "heresy," is a quote from Cornell economist Robert Frank's latest book, *The Darwin Economy* (Princeton and Oxford, 2011):

"We're told that economic stimulus financed by borrowed money will increase the public debt and impoverish our grandchildren. And since most people don't want to impoverish their grandchildren, the discussion ends there. But prudent public investment does not impoverish our grandchildren at all. On the contrary, when the government borrows money at four percent and invests it in a project that yields 18 percent during an economic downturn, the effect is to not only to put people to work who have been otherwise sitting idle but also to enrich our grandchildren." (pp. 54-55)

Another example, in a similar vein, comes from Modern Monetary Theory proponent Warren Mosler's 2010 book, *The Seven Deadly Innocent Financial Frauds* (Valance Co., Inc.):

"... The idea of our children being somehow necessarily deprived of real goods and services in the

future because of what's called the national debt is nothing less than ridiculous.

... When I look at today's economy, it's screaming at me that the problem is that people don't have enough money to spend. It's not telling me they have too much spending power and are over-spending. Who would not agree?

Unemployment has doubled and GDP is more than 10% below where it would be if Congress wasn't over-taxing us and taking so much spending power away from us.

When we operate at less than our potential—at less than full employment—then we are depriving our children of the real goods and services we could be producing on their behalf.

Likewise, when we cut back on our support of higher education, we are depriving our children of the knowledge they'll need to be the very best they can be in their future. So also, when we cut back on basic research and space exploration, we are depriving our children of all the fruits of that labor that instead we are transferring to the unemployment lines."

This line of thinking pre-dates the current crisis. Back in 1961, when the federal debt as a percent of GDP had subsided (after the huge run-up during World War II) to about the same level as in 1937, Michigan State economist Abba Lerner, in his lucid and indispensable *Everybody's Business* (MSU Press), said this:

"Another argument—and this one is quite a tear-jerker—is that the national debt will be a burden on our grandchildren, and that it is immoral and heartless of us to allow posterity to pay for our profligacy. This is nothing but an echo of the original confusion. If the debt should be repaid by our grandchildren, it is hard to see who would be receiving the repayment except our grandchildren. There is, besides, the other question of whether or not the debt would in fact ever need to be repaid, and this applies just as much in our grandchildren's time as in the present." (pp. 108-109)

The earliest defense of this position that I could find was in Thurman W. Arnold's *The Folklore of Capitalism* (Yale, 1937), a book that gleefully tries to deconstruct our most cherished illusions about politics and economics:

"Belief in the inherent malevolence of government resulted in a fiscal fairyland in which the following propositions, absurd though they were from an organizational point of view, appeared to be fundamental truth:

1. If the government conserves our soil from floods and erosion in order to bequeath to posterity a more productive country, our children will be impoverished thereby and will have to pay for it through the nose.
2. If government builds a large number of productive public works which can be used by posterity, posterity will be worse off.
3. We cannot afford to put available labor to work because that would burden posterity.
4. We cannot distribute consumer's goods now on hand, because that would

burden posterity.

... Therefore, we do not improve our country, or conserve its resources, or utilize its labor, or run its productive plant to its maximum capacity—out of consideration for our grandchildren.” (pp. 311-312)

These authors are all Keynesians to one degree or another. They believe that government borrowing and spending during serious economic recessions or depressions is the best way to prevent both immediate and long-term damage to the economy and its participants. They don't merely believe that deficit spending will eventually pay for itself. More fundamentally, they tend to believe, as Lerner pointed out in the selection from *Everybody's Business*, that the federal debt may never need to be paid back at all.

This belief is, of course, sheer blasphemy for many—especially for those who like to compare the federal budget to a household budget and the United States to Greece. But, counterintuitive as the idea may seem, it may fit the facts better than conventional wisdom does.

In this view, U.S. Treasury debt is as much a mountain of assets—the savings of millions of Americans, Chinese and others throughout the world who transact in dollars—as it is a liability. It will be serviced, traded, redeemed as it matures and reissued over time, but it will never have to be cleared to zero, nor should it be.

If that's true, our current dilemma may not be as unsolvable as it seems.

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