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The Politics of Debt: A Plea for Fiscal Responsibility

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Politicians often bicker over what to *spend* money on—e.g., tax cuts or entitlements—but they rarely raise the discussion on where to *save* money. The consequence of neglecting fiscal realities is evident. Interest rate payments are currently the fastest-growing public expenditure of the United States.[1] National debt is at a record high, in part due to COVID-related stimulus packages, but contrary to other periods of debt spikes, national debt is currently on track to grow indefinitely.[2]

If your son or daughter had a spending behavior in their twenties that was largely financed by loans, and they spent 10 percent of their income paying off interest rates, and this would rise to 20 percent in their thirties and then to 40 percent in their fifties, you would not be late to explain the insanity of your dear child's spending behavior. Yet this is the path that America is on, as each child born today literally inherits almost $50,000 in national debt.[3]

Even though all sectors have legitimate demands—from improving health care to strengthening national security or funding new green technologies—the simple fact is that we will not be able to afford this in the future if the current reckless fiscal behavior of the government continues.

Some may infer that, contrary to people, the state never dies. Therefore, the government can simply issue new debt to pay of current interest payments. But this is shortsighted, as we are already seeing the consequences of debt today, in terms of rising interest payment expenditures. Others may point to tax cuts as the golden solution, as they claim that tax cuts finance themselves through higher growth. Although this argument may work in theory, there are few empirical examples of this indeed being the case.[4]

Last, some point to the historically low interest rates to say that debt isn't the same problem that it used to be. But this logic should run the other way: there is no guarantee that interest rates will remain low, which is why this is the time to pay off public debt before it runs out of control. The interest rate is in fact the great unknown, which raises the importance of action on public debt now. For if the interest rate returns to normal levels, the problem will explode.

There are no easy answers. The state must either raise revenue or lower expenditures to pay off—or simply stop—the current trajectory of public debt. Raising awareness of the importance of debt is hard. Contrary to public spending and the needs of now, the interest of the future is poorly represented. When cutting spending on schools or health care, public outcry is immediate. When raising taxes, private interests are instantaneously mobilized in the great lobbies of the Capitol. But luckily, history provides us with examples of the necessary examples to show that we are not trapped on a certain path, and that politicians indeed have agency and incentives to reduce public debt.

Denmark: From the Edge of the Abyss to Negative Debt

Two days after leaving his post in the administration in 1979, Minister of Finance Knud Heinesen warned that Denmark was at the "edge of the abyss."[5] Due to wild public expenditures in the 1970s, which were mostly driven by the governing center-left party, the Danish public debt had exploded.[6] Unemployment was also at record levels, which strengthened the chilling effect of the words of the departing minister of finance. He made the public realize that action was needed immediately to save the Danish state from bankruptcy. The present was bad, and the future was bound to be worse.

When Conservative leader Poul Schlüter became prime minister in 1982, he took immediate action to reduce public debt. The budget came under control, and to this day Schlüter's cabinet is the longest-sitting Danish government in postwar history. When the Social Democrats regained power in 1993, they adopted the same fiscal discipline.[7] This was done by strengthening the Ministry of Finance, which was given considerable autonomy. This institutionalized a fiscal responsible entity to control the cost of the welfare state via continuous reforms of the entitlement system.

Although the governments of the 1980s and 1990s met with some resistance in their efforts to strengthen the Danish economy, they managed to create a new responsible fiscal consensus from which Denmark still profits today. In periods of the 2000s and 2010s, Denmark's public debt was in fact *negative*.[8] Today, discussions revolve around the Danish economy being *too sustainable*, i.e., the state should be able to take in more short-term debt.[9]

Denmark has succeeded in gaining bipartisan support for fiscal responsibility, despite having a large welfare state. The traumatic experience of the 1970s is still salient among voters today, which creates continued support for responsible policy, to ensure the long-term welfare of Danish citizens.

It was not a given that Denmark would manage to repair the sinking hull and steer on to long-term stability. One must simply look to its European peers to see how the problem has spun out of control since the 1970s. The PIGS countries (Portugal, Italy, Greece, and Spain), who entered the financial crisis with high debt levels and subsequently met massive economic challenges, may perhaps serve as the most terrifying example. This highlights the agency of political leaders. Irresponsible political leadership has burdened southern European citizens with high interest rates and debt, while the Danish state has ample room to borrow money in periods of crisis, which was particularly timely under the economic shock created by COVID-19.

From Abstraction to Action: Possible Policy Paths for the United States

The need for action is clear, which is why policy makers in the United States should direct their attention towards how to reduce public debt. Concretely, debt reduction requires a budget surplus on the primary balance. The primary balance is the difference between government revenues and government spending. Put simply, the government must either raise revenues or lower expenditures. The problem has grown to a size where action on both is necessary.

On spending, the second-fastest growing expenditure (after interest rate payments) is entitlements. The policy goal here is to freeze the growth of public expenditures while still providing public support to those in greatest need.

The main policy proposal here is a comprehensive entitlement reform.[10] The first major expenditure is Social Security, which needs to refocus on its original intent of helping needy retirees instead of the entire population. One effort would therefore be to incentivize young workers to invest and save money for their own retirement. Second, the retirement age should be gradually increased, while experienced workers should be encouraged to keep working.[11] Last, benefits should be calculated in terms of price-indexing, instead of the current practice of wage-indexing.[12]

The Social Security system was successfully brought back to balance in 1983, which a new reform initiative could aspire to do.[13] Another positive example from Denmark is the 2006 bipartisan deal that determined the pension age would gradually rise as life expectancy increases. In other words, disciplining federal expenditures on Social Security doesn't mean dismantling care for the elderly; on the contrary, it is about securing the long-term health of these programs.

Regarding Medicaid, the objective is to reduce costs while ensuring that citizens still have access to good health care. The first reform would therefore be to limit Medicaid to help citizens struck by catastrophic events, while promoting private insurance.[14] To further enable people to choose freely, the opportunity to establish and use a health savings account should be liberalized.[15] This will encourage competition in the health sector and reverse the trend of ever-growing medical expenses of the most expensive health care system in the world.[16]

On the revenue side, action is needed. While the argument that tax cuts are self-financing as they stimulate growth is weakly backed by empirical evidence, it is true that sustaining growth is pivotal. Otherwise, we may risk falling into a negative spiral of a stagnant economy paying off a growing debt. The economy needs to continue to grow to alleviate the pain of cutting spending, to ultimately reduce public debt.

Therefore, targeted taxes against the rich or large corporations may be appealing for some, but these are exactly the most growth-damaging taxes on the market. Instead, we should focus on a broad widening of the tax base. One way to accomplish this is to reorient the tax system toward consumption rather than income.[17] This policy would have a much smaller negative effect on the incentive to work than would a regular income tax.

The risk of raising taxes to ameliorate the debt is if the federal government uses its improved tax base to increase spending, which would worsen the problem. That is why we must think in several policy areas at the same time in order to reduce debt. As former secretary of state George P. Shultz puts it:

> For progress [on controlling public spending] ramming through a new law or executive order is not success. […] The real governance challenge is

> in getting the balance of the American people on board with the overall need and general direction from the start.[18]

In other words, it doesn't suffice to present smart policy proposals; we also need an "edge of the abyss" moment for the public to appreciate that this is the decisive problem of our era. Therefore, we must think of ways to raise awareness on this issue, as well as what politicians and other stakeholders stand to gain by taking this topic seriously.

The Politics of Debt

Although the problem of debt seems clear, the path to alleviate it seems less so. Some claim that we are trapped in bad incentives, as current generations simply tax future generations as the latter are unrepresented and unorganized.[19] With this perspective, the issue of debt simply is locked in a negative spiral, until interest rate payments rise to a level where they can't be ignored anymore.

On the other hand, we can also see political incentives to reduce debt. To take the Danish example, the fiscal irresponsibility of the Social Democratic government in the 1970s led to a loss of credibility in Social Democratic leadership. The Conservative government managed to insert new fiscal norms, which the following Social Democratic government adopted and even developed these norms further.

Today, the reference point to the 1970s versus the 1980s persists in Denmark. If the government starts acting fiscally irresponsible, experts can with some success refer to the 1970s and the need to maintain fiscal discipline. Therefore, to reduce federal debt, a "balanced budget amendment" or an "unbalanced budget amendment" isn't necessary per se.[20] What is necessary instead is a bipartisan effort to change the fiscal behavior of federal government.

As motivation for why it's important to be the first party to reach this realization, both major political parties should try to think in the long term. If either succeeds in being the party that today sounds the dangers of growing debt, then when this problem indeed develops in a near foreseeable future it will be able to refer to its initial warning and gain credibility.

America needs a new fiscal consensus. Matters of budget are the precondition for any policy proposal, and if inaction persists, the financing of current and future policies will steadily be eaten away by interest rates. Let's act now to reduce fiscal spending and raise revenue, to secure future generations the same possibilities that we have been bestowed.

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Endnotes

[1] Committee for a Responsible Federal Budget (CRFB), "Interest Payments in the Federal Budget."
[2] CRFB, "The Nation's Upcoming Fiscal Challenges."
[3] CRFB, "Why Should We Worry About the National Debt?"
[4] CRFB, "Tax Cuts Don't Pay for Themselves."
[5] Jørgen Goul Andersen, "From the Edge of the Abyss to Bonanza—and Beyond."
[6] Per Ulstrup Johansen and Mikael Trier, *Danmarks økonomi siden 1980* (Denmark's economy since 1980).
[7] Andersen, *Edge of the Abyss*.
[8] Johansen and Trier, *Danmarks økonomi*.
[9] *Det Økonomiske Råd* (Danish Economic Councils), *Dansk Økonomi* (Danish economy).
[10] George P. Shultz, "Spending."
[11] John F. Cogan, "Entitlements and the Budget."
[12] Cogan, "Entitlements and the Budget"; and Shultz, "Spending."
[13] Shultz, "Spending."
[14] Scott W. Atlas, "Transformational Health Care Reform."
[15] Scott W. Atlas, "Health Savings Accounts."
[16] Organisation for Economic Co-operation and Development, "Health Expenditure and Financing."
[17] Michael J. Boskin, "A Blueprint for Tax Reform."
[18] Shultz, "Spending."
[19] See, for example, James M. Buchanan, "Confessions of a Burden Monger."
[20] James M. Buchanan, "The Balanced Budget Amendment"; Alex Tabarrok, "An Unbalanced Budget Amendment."

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