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THE LIMITS OF DEBT REDUCTION

Why the Government Can't Pay It All Off

A popular argument against tax reduction is that Federal surpluses should instead be used to pay off the Government's debt. But in fact, the Government could not pay off all its publically held debt in the foreseeable future regardless of how much money might be available for it.

"Part of it [the debt] – including some long-term bonds and savings bonds – will not be available for redemption," says the Congressional Budget Office [CBO] in its January publication, *The Budget and Economic Outlook: Fiscal Years 2002-2011*. "Therefore, in any given year, some debt will remain outstanding and incur interest costs, regardless of the size of the surplus." Indeed, even though the next decade's surpluses will exceed the debt by almost $2.5 trillion (assuming current-law spending and tax trends were left unchanged) the Government in 2011 still would have $818 billion in debt left to pay, CBO says.

This "debt held by the public" – amounts owed to parties outside the Federal Government, including private investors and State and local governments – increased from 1969 through 1997, as the Treasury sold bonds to finance chronic deficit spending. The debt peaked at $3.8 trillion in 1997, the year Congress passed, and the President signed, the Balanced Budget Act. When the Government began running surpluses the next year, it started retiring some of its debt. By the end of fiscal year 2001, debt held by the public is expected to have fallen by $625 billion, to $3.1 trillion.

The Government will be able to continue paying down debt until about the middle of the decade – and then will encounter debt that cannot reasonably be redeemed before it matures. Most of this unredeemable debt consists of 30-year Treasury bonds; some is in savings bonds or nonmarketable securities issued to State and local governments. *This debt could not be reduced further in the next decade even if larger tax surpluses were available.*

In fact – although most agree the Government should continue reducing its debt as much as possible – the current surplus projections introduce another, more challenging, prospect: what to do with the leftover funds that cannot be used for debt reduction? These amounts, which CBO calls "uncommitted funds," are expected to begin accruing by mid-decade, and could reach $3.2 trillion by 2011 under current spending and tax projections. This money will have to go somewhere – and the Government would have little choice but to invest it in nonfederal (i.e. private) assets.

House Majority Leader Richard K. Armey has warned this could have serious political consequences. "In no time, the Federal Government would use its vast new economic influence to advance any number of politically correct causes," he wrote in a February 6 memo to Members. "It would forever change the relationship between the Government and our people."

From an economic perspective, Federal Reserve Chairman Alan Greenspan cautions that the political pressure connected with such investments would risk "sub-optimal performance" by capital markets, a less efficient economy, and weaker growth in living standards. As a result, Chairman Greenspan calls this "the critical longer-term fiscal policy issue" facing Congress and the administration.

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