Donald Trump and the “F” Word
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If there’s one belief that enjoys broad, bipartisan support, it is that the U.S. faces a debt crisis. Democrats and Republicans routinely bemoan America’s irresponsibility and immorality by claiming it is borrowing from the “bank of China” and leaving that debt for our children and grandchildren to repay. Donald Trump threats to challenge that paradigm by aggressively using the “f” word.

The “f” word is fiscal stimulus.

Through his proposed $1 trillion infrastructure plan, to be spent over 10 years, along with other spending and tax policies, Trump is tossing aside the notion that the federal government could face bankruptcy or an inability to service its debt. The question is how much stimulus we can afford.

Stephanie Kelton provided answers to that question as part of a panel discussion at the Harvard Law School on December 2. She is a professor at the University of Missouri in Kansas City, and previously served as chief economist for the Democrats on the U.S. Senate Budget Committee and as an economic advisor to the Sanders 2016 presidential campaign.

Kelton spoke only about Trump’s economic agenda and did not discuss (or endorse) any of his other proposals.

Deficits exploded after the financial crisis, Kelton said, and it quickly became a core topic of conversation, particularly as Spain, Greece, Ireland and other European countries experienced crises. Fiscal policy was not an option in the U.S. because of the perceived debt crisis, and our primary tools were monetary policy and the Fed, she said. The Fed did what it could, starting with interest rate cuts before turning to unconventional methods like quantitative easing, buying mortgage-backed securities and Treasury bonds, with the hope of driving down rates and creating consumer demand. It used “forward guidance” to encourage investors to take positions that would stimulate growth.

But none of this created the robust economic expansion that was needed. Since the financial crisis, GDP growth has averaged less than 2%. So while this is the longest recovery on record, it is also the slowest of the post-WWII era.

Ben Bernanke asked for help in the tentative language that Fed chairs are accustomed to using. In 2012 in testimony before Congress, he said “monetary policy is not a panacea and not the ideal tool.” He was saying, according to Kelton, that Congress needs to reach for the other lever – fiscal policy. She did not criticize his language, but one could rightfully ask why Bernanke didn’t pound his fists and plead directly for the policy actions that he knew were necessary to revive growth.

“Now there is a new sheriff in town,” Kelton said, who is ready to pull the fiscal-policy lever.

Trump gets it

One needn’t look far to see the prevailing wisdom regarding fiscal deficits. Consider this commentary What Should Trump Do?, by the highly respected analyst John Mauldin. Mauldin cites 160 instances of major countries “having to renegotiate their bonds because they had too much debt” and states that many of those incidents resulted in financial crises.

But the U.S. can never face such a crisis. Trump grasped this point and spoke about it in an interview with Maria Bartiromo in May. “This is the United States government,” he said. “First of all, you never have to default because you print the money. I hate to tell you. So there’s never a default.”

People went crazy when Trump made that statement, Kelton said. “It was as if Trump could not be trusted with the nuclear codes, much less with handling the federal debt.”

But, as Kelton pointed out, Trump is far from the first person to acknowledge that the U.S. cannot face insolvency. That point has been made by Warren Buffett and Alan Greenspan, among others.

Trump, Buffett and Greenspan are correct, according to Kelton. Too much debt could have its consequences, but it is not a
financial crisis along the lines of what Greece and other countries have faced. As a sovereign nation with complete control
over its currency, the U.S. can always make good on its debts, on time and in full – and that includes its Social Security,
Medicare and its other dollar-denominated obligations.

How much debt can we afford?

The question isn’t whether we have the financial resources but whether we have enough real resources to make the kinds
of investments that will make our economy as productive as it can be. Because, if we’re not producing enough real goods
and services, inflation will result.

But in the post-crisis period, the U.S. has had the opposite problem – an inability to create enough inflation – due to a lack
of aggregate demand. There’s no data that suggests how much federal debt would be inflationary, Kelton said. Indeed,
Japan has a debt-to-GDP ratio of 240% – more than twice as high as that of the U.S. – and it has experienced persistent
deflationary pressure, even as its debt has grown.

According to Kelton, the policy question is how to invest in a way that assures future productivity and a prosperous
economy without inflation. That debate has begun in a small way, as observers have pointed out that unemployment in the
construction industry is only 5.7% and there may not be enough workers to execute Trump’s infrastructure plans. That type
of calculation, she said, focuses on the raw materials and resources that are necessary to support infrastructure without
causing inflation, not on the false narrative of whether we face too much debt.

“The question isn’t how to pay for it,” she said, “but whether we have the resources to boost productivity.”

Nonetheless, analysts have pointed out that Trump’s proposed policies will increase deficits by 5.5%. The problem, Kelton
said, is that government is not like a household, which is constrained by debt limits and the amount of interest it pays.
Analysts insist that too much government borrowing “crowds out” private-sector borrowing or they cite the Reinhart-Rogoff
claim that the government can be punished by its creditors for excessive debt.

Kelton called those “zombie” ideas because they are impossible to kill. Most politicians don’t even try, she said, because it
is political suicide to do so.

Maybe it’s just semantics

“A budget deficit is a surplus that resides elsewhere in the economy,” Kelton said. “Evidence of over spending is inflation. A
deficit is just evidence of a net contribution or surplus that has been created in some other part of the economy.” Kelton
elaborated on this in a talk that I wrote about earlier this year.

Kelton had a tough time getting points like this across to members of Congress. She related one incident that she called
“shockingly disturbing.” After one hearing, she asked a senator a hypothetical question: If she could wave a magic wand
and make the debt disappear, would the senator want her to do that? The answer was an unequivocal “yes.”

She then asked, “What if I could use that same magic wand and make all the securities in the Treasury market disappear?”
The senator was dumbfounded, she said, and unsure about how to answer the question.

But the questions are identical – a point which neither the senator nor the audience at Harvard grasped without Kelton’s
explanation. The national debt is nothing more than the sum total of the outstanding Treasury securities. Indeed, those
who hold those securities call them their assets.

Maybe the whole problem is that we call it the “national debt,” she said. It would go a long way toward reducing global
anxiety if we called it a “national savings account.”