The National Debt

Your Name (First M. Last)

School or Institution Name (University at Place or Town, State)

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**Introduction:**

National debt also known as government debt and public debt is the debt owed by the government. It is divided into two categories that are internal debt and external debt. A period of general economic decline observed in the world market is known as a Great Recession. It results in a fall of tax collection, aggregate income, and employment level (Amadeo, n.d.). The government has two options, i.e., to decrease spending or increase borrowing. The fluctuation in national debt and its long term costs make the government to take wise decisions for eliminating the budget deficit.

**Theoretical Views on National Debt:**

Keynesian point of view on national debt is positive. They believe that it is beneficial to have current accounts deficit for boosting aggregate demand. Neo-Keynesian do not support this statement. They support fiscal policy. According to the neo-Keynesian, deficit in government spending should come into account only when monetary policy shows ineffectiveness and the nominal interest rate reaches to zero.

The Great Recession falls in IMF criteria in 2009 due to the decrease in world GDP per capita. According to US research agency, recession started in December 2007 and ended in June 2009 (“The Fiscal & Economic Impact of the National Debt,” n.d.). The cause of the Great Recession and the increase in National debt is due to the following main factors:

* **Shadow Banking System**: Failure of the system leads to the interrupted flow of credit to organizations and consumers.
* **Housing System**: Investment in housing construction decreased up to four percent. This decrease created the gap between GDP and consumption up to one trillion dollars.
* **Balance sheet recession**: Household debt was the result of the balance sheet recession.
* **Government policies**: Policymakers forced to contribute in tax lending standard and indebtedness even for those people who could not afford it.

**Long-Run Costs of National Debt:**

The Great Recession leads to a high national debt. Many countries face economic problems due to this increase. America national debt reaches to 21.97 trillion dollars. If the long-run challenges regarding fiscal issues remain unsolved, it can result in many negative consequences. Some of the major long-run costs of national debt are:

* **Investment:** With the increase in federal debt both the public and private investment will reduce. The government will increase its spending over costs which result in crowding out public investment. On the other hand, federal borrowing in the capital market will increase the interest rate which leads to the decrease in new private investment.
* **Economic Opportunities:** National debt has a negative impact on economic opportunities. National debt directly hits the interest rate, and due to high-interest rate opportunities of buying house, car, payment for education and training, demand for technology all will fall.
* **Fiscal Flexibility:** High national debt decreases the fiscal flexibility and government face difficulties in future like unpredicted challenges, natural disaster, recessions, and war.

**Elimination of budget deficit**:

Increase in tax increase and the decrease in transfer payment has a cost of budget elimination deficit. Transfer payment includes healthcare, Medicaid, and social security along with discretionary spending of different budgets like education, and defense, etc. With the increase in personal tax, deflation of economy starts which results in the low growth of the economy with the decrease in employment level. If the government decides to decrease the spending through fall in transfer payment, it would lead to the decrease in economy aggregate demand. The decrease in aggregate creates problems for people to obtain even the basic service of health care, Medicaid, and social security. Low spending on these services may cause low productivity in the economy. However, discretionary spending impact is critical in the long run. Discretionary spending is the primary investment of the government which is not easy to decrease rapidly if the government tries to do so. It will cause a negative impact on productivity and economic growth.

References

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The Fiscal & Economic Impact of the National Debt. (n.d.). Retrieved from https://www.pgpf.org/the-fiscal-and-economic-challenge/fiscal-and-economic-impact