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**THESIS**

**BLOOD AND TREASURE: THE U.S. DEBT AND ITS  
IMPLICATIONS FOR NATIONAL DEFENSE AND  
SECURITY**

by

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December 2012

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**BLOOD AND TREASURE: THE U.S. DEBT AND ITS IMPLICATIONS FOR  
NATIONAL DEFENSE AND SECURITY**

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## ABSTRACT

Is the current budget and debt of the United States a concern to its national defense? Does debt held by foreign nations, particularly China, give them soft power over the United States? The current national deficit is more than \$1.3 trillion dollars each year with the national public debt just over \$16 trillion. Congress and the greater civilian population are calling for dramatic cuts to the Department of Defense in order to balance the budget—but the issue is more complicated. Accounting for only 3.7 percent of the FY2012 budget, reducing the DoD will reduce capabilities within the military but only reduce the deficit by a mere \$50 billion a year—less than five percent of the overall deficit.

By law, the government must fund such entitlements as Social Security, Medicare, and Medicaid, totaling almost \$2.2 trillion (and increasing) per year. The government's receipts amount to \$2.5 trillion per year, leaving only \$300 billion for “discretionary” spending. This sum is inadequate to the demands upon it. For example, Department of Defense (DoD) alone currently has an annual base budget of just more than \$700 billion. In other words, the national budget cannot balance without changes in law that would reduce outlays for entitlements. Entitlements account for 10 percent of the current federal budget—and are expected to engulf the entire federal budget within the next 40 years. Only if Congress changes the laws in regards to entitlements—and not simply the DoD budget—will the federal deficit ever extinguish. But with the DoD taking the brunt of budget cut rhetoric, the fate of the defense lies with the current national debt.

This study will examine the aspects of the U.S. national debt and how that debt influences the power of the military, the relationship with the rising Chinese, and the nation's ability to protect itself financially.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

ADM	Admiral (Navy)
BCA	Budget Control Act of 2011
CBO	Congressional Budget Office
CCP	Chinese Communist Party
CRS	Congressional Research Service
DDG	Guided Missile Destroyer
DoD	Department of Defense
DoS	Department of State
FY	Fiscal Year
GDP	Gross Domestic Product
LHA	Landing Helicopter Assault
LTCOL	Lieutenant Colonel (U.S. Army)
LSD	Dock Landing Ship
MFN	Most-Favored-Nation
NATO	North Atlantic Treaty Organization
NSS	National Security Strategy
OCO	Overseas Contingency Operations
QDR	Quadrennial Defense Review
RMB	Renminbi
S & ED	Strategic and Economic Dialogue
TVA	Tennessee Valley Authority
WWII	World War II

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## **I. BLOOD AND TREASURE: THE U.S. DEBT AND ITS IMPLICATIONS FOR NATIONAL DEFENSE AND SECURITY**

Is the current budget and debt of the United States a blessing or a concern to its national defense? Does debt held by foreign nations, particularly China, give exogenous actors soft power over the United States?

The implications of the national debt for the national defense are unparalleled. The current national deficit is more than \$1.3 trillion dollars each year. In May 2012, the national debt passed the statutory debt ceiling of \$14.29 trillion (currently the national public debt stands at just over \$16 trillion). By law, the government must fund such entitlements as Social Security, Medicare, and Medicaid, to the tune of almost \$2.2 trillion (and increasing) per year. The government's receipts amount to \$2.5 trillion per year, leaving only \$300 billion for "discretionary" spending. This sum is inadequate to the demands upon it. For example, the Department of Defense (DoD) alone currently has an annual budget of just more than \$700 billion. Thus, the national budget cannot balance without changes in law that would reduce outlays for entitlements, although some strands of popular current speech seem to take the stance that the DoD budget is the sole reason for the runaway national debt.<sup>1</sup> Is the debt that is incurred by the United States for the defense of the country the main issue, and is the interest that the United States pays on the debt worth the capabilities it currently enjoys?

Needless to say, the situation of the U.S. national deficit and debt has grave implications for the DoD and consequently for national defense. Current defense obligations in the United States are rebalancing toward the Asia-Pacific and Middle East regions, with a goal of remaining capable of defeating one enemy in a major combat operation while denying another enemy its objectives, and protecting new capabilities

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<sup>1</sup> Office of Management and Budget, "Fiscal Year 2013 Budget of the United States Government." <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf>; U.S. National Debt Clock: Real Time. Accessed 15 October 2012. <http://www.usdebtclock.org/>.

and investments.<sup>2</sup> The global asymmetrical threat has not disappeared, and other geo-strategic threats, notably China's potential superpower ambitions, are poised to gather force.

Beyond China's increase in military strength, China also holds \$1.17 trillion in U.S. debt, which may limit the political and military response of the United States toward the Chinese.<sup>3</sup> Will the national debt that is held by foreign countries be able to be used as leverage in political forums (soft power)? Will the United States have the funds available for its military to combat enemies with conventional forces or asymmetrical threats, or will the political rhetoric blaming the national debt almost solely on the DoD's budget gain speed and reduce the fiscal capability of the DoD to impotence? This study examines how that debt influences the power of the military, the relationship with the rising Chinese, and the nation's ability to protect itself financially and militarily.

#### **A. GOVERNMENT RESPONSE TO FINANCIAL CRISIS**

In the throes of a financial crisis, what is a government's optimal response to ensure national defense and security? During the Revolutionary War, the U.S. government undertook massive debt, by contemporary measures, in order to pursue its independence from Great Britain.<sup>4</sup> Amid such actions, the debate about whether national debt was a blessing or a curse took shape. The same contentions concerning governmental public debt are being debated again today. In the interim, however, national debt acquired positive connotations as the intellectual views of borrowing, credit and debt changed. In the interwar period of 1920–1940, John Maynard Keynes, in *Economic Consequences of the Peace*, argued that when the European authorities denied Germany the chance to borrow money and rebuild its economy, the countries in power in

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<sup>2</sup> Department of Defense, "Defense Budget Priorities and Choices," Washington, DC: GPO, January 2012, 5–9.

<sup>3</sup> U.S. Department of the Treasury/Federal Reserve Board, "Major Foreign Holders of Treasury Securities," 15 May 2012. <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>.

<sup>4</sup> The debt of the United States is estimated to have been ~\$75 million in nominal dollars in 1790, or about \$1.2 billion in real dollars–2012. This debt equals about 32% debt-to-GDP ratio. (Bureau of Public Debt, accessed on 12 November, 2012. <http://www.publicdebt.treas.gov/history/history.htm>).

essence created a situation that forced the rise of a Nazi Germany. Keynes also famously argued that a certain amount of deficit spending was the hallmark of a healthy economy and a responsible government. In a word, Keynesianism represented a license to incur *some* national debt, and debt spent on national defense is money well spent.<sup>5</sup>

Helping to recover the Great Depression, President Roosevelt's New Deal was suffused with a Keynesian philosophy. The government attempted to boost a sluggish economy by injecting money into the system in hopes that the investment would equal jobs, and that jobs would equal spending—both creating more money and helping the nation to recover from economic hard times. Such stimulus consequently led to an increased national debt (the highest debt-to-GDP arriving at 122 percentage). The corollary idea, however, held that economic growth over the long term would obviate any ill effects of the short-term deficit.

Ultimately, the goal should be a balanced national budget—but therein lies the rub. Although the government has, in the past, created plans to eliminate these debts, politicians today have failed to do so. In no small part, deficit spending is attractive in the short term of individual election cycles because, whether it's "pork-barrel spending" or more legitimate infusions of federal dollars, national-level spending often tracks with local-level prosperity. Therefore, breaking the debt habit very likely will entail short-term political consequences—costs that current politicians are unwilling to accept—and could even lead to a larger recession than the one the United States is currently coming out of. Looking at the path ahead, in *Debtor Nation* Louis Hyman argues that the inputs from government that shock the system into investment are, indeed, the proper way to come out of recession. A short-term increase in national debt is acceptable, considering the long-term betterment of society. This calculus is especially relevant right now, amid the aftermath of the global economic crisis. In some aspects, the large DoD budget is today's economic input into society. However, long term planning has failed to be acknowledged by the current administration and Congress.

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<sup>5</sup> Robert L. Heilbroner, *The Worldly Philosophers: The Lives, Times, and Ideas of the Great Economic Thinkers*, New York: Simon and Schuster, 1961, 240–244

Will politicians come together and decide that the fate of the country is more important than individuals getting reelected or continuing the fight between Democrats and Republicans in order to provide financial stability to national defense? With a lack of trust for each side, the government has been at a standstill over possible remedies. The Republicans have argued that if they move first and agree that taxes must be increased, then the Democrats would not need to lower expenditures. The reverse is also true. If the Democrats reduced spending on entitlements, then the current tax rates would allow for a balanced budget. Truly, though, there is only one way out for the U.S. government: both an increase in taxes and a decrease in expenditures needs to happen for the annual deficit and the accumulated debt to be reduced. However, nothing in government will change until all other options are impracticable.

One member of the Continental Congress was quoted as saying: "Do you think, gentlemen, that I will consent to load my constituents with taxes, when we can send to our printer and get a wagon load of money, one quire of which will pay for the whole?"<sup>6</sup> The same argument is made by the government today: Why bother fixing the problem and imposing greater hardship upon those who vote when the United States can simply borrow money from its citizens and other governments?

As other countries will lend to the United States without end and at levels of interest that are below any serious repercussions, the U.S. government has not felt the need to balance the budget. It will only be when American citizens and other governments are either unwilling to lend to the United States or the rates at which they loan are unbearable that the U.S. government will actually act on balancing the budget. The United States has the ability to correct the deficit and subsequently the national debt, it just needs the desire or motivation to do so.

## **B. WHAT IS THE THREAT?**

In respect to national defense, the rise of China poses the potential problem of a multi-polar world, where the United States is not the only global hegemon. China will

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<sup>6</sup> *The Order of the Founders and Patriots of America*, accessed on 10 October 2012.  
<http://www.founderspatriots.org/articles/continental.htm>.

remain Communist and will continue to enlarge its military.<sup>7</sup> China, then, might be emboldened to act aggressively, striking while the proverbial iron is hot and the United States may not have the budgetary chops to fight back on a full scale. Economically, however, the nightmare scenario starts with China dumping its holdings of U.S. debt assets, triggering a debilitating recession in the U.S. market. With a sudden liquidation of U.S. assets, the dollar could nose-dive in value and cause an even bigger recession for the U.S. economy than the 2008–2009 recession precipitated.<sup>8</sup>

At the same time, however, the Chinese and the U.S. economies are intertwined now more than ever. As the leading purchaser of Chinese exports, a decrease in the United States' purchase power would drastically affect the internal ambitions of the Chinese government. Adversarial actions by the Chinese government towards the United States will have greater (or at least equal) negative consequences upon the Chinese economy. The potential for China having or exercising undue influence on U.S. policy is more than campaign-trail histrionics.

As the United States is the leading purchaser of Chinese exports, a poor U.S. economy would mean poor exporting for the Chinese—so poor as to deter China from making good on any threat.<sup>9</sup> So as long as Beijing has the same intentions of internal growth and acts rationally, the United States may have less to worry about than the current presidential candidates suggest.

### **C. THE DEFENSE ASPECT**

As a primary responsibility of the government for the defense and security of its citizens, the military will remain an important aspect of national policy. After all, “providing for the common defense” represents one of the explicitly enumerated reasons for founding this country in the form it took in 1776, or, more precisely, upon the

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<sup>7</sup> Department of Defense, *Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2012*, Washington, D.C.: GPO, May, 2012, IV.

<sup>8</sup> *China Scope*, “How China Deals with the U.S. Strategy to Contain China,” 4. <http://chinascope.org/main/content/view/3291/92>.

<sup>9</sup> Tyler J. Moore, “China's Security Perspective” (master's thesis, Naval Postgraduate School, 2011), 31. <http://edocs.nps.edu/npspubs/scholarly/theses/2011/June/11Jun%5FMoore.pdf>.

promulgation of the Constitution in 1787. The 20th century has been all about American preeminence, which presupposes American prosperity, at least to the extent that the United States has paid to make its superiority stick.

Today, however, there is room in the budget for the United States to be somewhat less mighty as our current forces are positioned to be. Michael E. O’Hanlon, in *Budgeting for Hard Power*, contends that the threat to U.S. military might is overblown. With the highest GDP level of any country coupled with the most military expenditures (combined with the fact that most other leading nations in military expenditure are our allies), even if the U.S. government cut military funds, there is still room in the budget that would allow for a successful retention of global authority. Currently, U.S. military expenditure represents 41 percent of world-wide defense spending; indeed, NATO and other allies, including the United States, account for some 80 percent of the world’s defense spending.<sup>10</sup> Commonsense dictates that the U.S. military can afford to have a reduced budget and still maintain its global dominance—perhaps a “mere” 25 percent of the global total would suffice?

With this very accurate and compelling argument, O’Hanlon reminds his readers that the economic downturn is not specific to the United States. Because all nations are included in the recession, a decrease in the U.S. military is most likely to be mirrored in other countries. The United States must take advantage of the opportunity and save money now, reduce its debt ratio, and ensure the availability of monies for a future military if war seems imminent. If the United States chooses to reduce its defense spending, relying on international cooperation would make global security more credible.

Especially in this, an election year, critical voices charge that the claims of national security on the national budget are disproportionate. Without question, the bottom-line defense budget figures are high. But with a national deficit almost twice the entire defense budget, just cutting the DoD’s budget will not solve the deficit crisis.<sup>11</sup> It

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<sup>10</sup> Stephanie Blenckner, “Background paper on SIPRI military expenditure data, 2011,” Stockholm International Peace Research Institute, 17 April, 2012.

<sup>11</sup> <http://www.globalsecurity.org/military/world/spending.htm>.

certainly will not enhance national security. As such, budget reformers—whose intentions are good and timely—must take a strategic view, in every sense, of their task. Cuts are necessary, but not blind or emotion-led cuts, and not only from the DoD.

#### **D. THE PATH AHEAD**

Robert D. Hormats in *The Price of Liberty*, contends that “absence of a sound, long-term financial strategy could bring about a deterioration that... ‘leads to the downward spiral of slower growth, heavier taxes, deepening domestic splits over spending priorities and a weakening capacity to bear the burdens of defense.’”<sup>12</sup>

LTCOL Eugene A. Klann, in a thesis for the U.S. Army War College in 1992, examined the efficacy of curbing U.S. expenditures so as to “reduce its public debt in order to retain its position of global leadership into the 21<sup>st</sup> century.”<sup>13</sup> Klann predicted that the “inevitable impact of the debt on national security will be continued economic stagnation, dramatic defense cuts and significantly reduced global influence.” The debt has risen from \$4 trillion in 1992 to its current level in excess of \$16 trillion, suggesting that Klann’s predictions may indeed come true. As such, entitlements must be restructured, taxes increased, and all spending reduced, including the exaggerated DoD budget since 9/11.

The answer is NOT simply indiscriminate cuts in defense spending, however. If foreign lending comes to an end, the government of the United States will be forced to correct the policies that have ended with a \$16 trillion debt. The DoD and entitlements budgetary means will definitely be reduced. Although the United States is faced with budgetary restrictions, so is the rest of the world. Misery loves company, especially where economics are concerned: that is, it is essential to see the budget as relative to other nations—and in its international context. In *The Post-American World*, Fareed Zakaria claims that the United States will maintain its position within the world by

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<sup>12</sup> Robert D Hormats, *The Price for Liberty: Paying for America’s Wars*, New York: Henry Holt and Company, 2007, 298.

<sup>13</sup> Eugene A Klann, “Security Implications of the National Debt of the United States,” (Thesis, U.S. Army War College, 1992), ii, DTIC.

seeking positive and reciprocal relations with China and by returning to a time of partnership with conducting world affairs. Such a policy boils down to sharing the wealth—voluntarily or not. The United States needs to rely more on the allies it has cultivated over the last 70 years since the end of World War II.

Taken together, these facets will allow the United States to spend its money on military defense and critical infrastructure protection, as opposed to interest payments to other countries. As these actions are not popular at the polls, however, it will take a national event or crises to occur before Congress actually does something to fix the debt and ensure future capabilities.

## II. WHAT HAPPENED TO ALL THAT MONEY?<sup>14</sup>

From waging war to “priming the pump” of the economy, the government can use the ability to borrow as a means of success in war and to stabilize the economy. The ability to borrow money at other times, however, is how the United States has amassed such an astonishing amount of public debt. For most of the history of the United States, the government’s public debt was only increased in times of war (with the exception of Roosevelt and the “New Deal”). Within the last two decades, however, the increasingly expensive health care along with other entitlements have played an effect on the national debt and they will only continue to increase that effect if the laws are not changed.

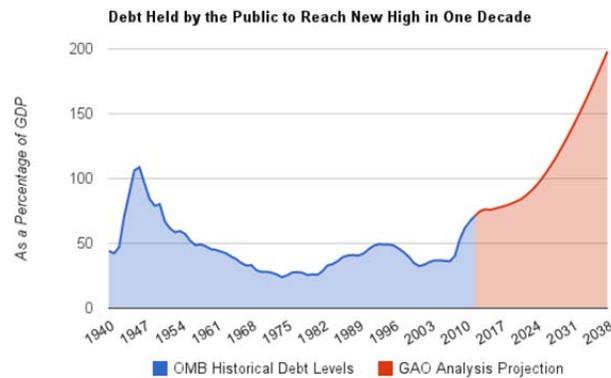


Figure 1. Debt held by public to reach new high in one decade- From: The Concord Coalition, *Projected Debt*. (OMB Historical Tables 2011 and GAO Analysis Fall 2011) Accessed on 15 October 2012.

<http://www.concordcoalition.org/issues/indicators/projected-debt>.

### A. RECENT DEBT ACTIVITY

Since fiscal year 1999, the debt has risen 286 percent, from \$5.6 trillion to \$16.02 trillion as of October 2012.<sup>15</sup> A major reason the debt has ballooned so high is the government has run a deficit in the budget since FY2002; since FY2009 this deficit has

<sup>14</sup> *Ocean’s Eleven*, Directed by Steve Soderbergh, 2001; Century City, Los Angeles, CA: United Artist, 2001. DVD.

<sup>15</sup> [http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt\\_histo4.htm](http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo4.htm).

run \$1 trillion or more annually, the first trillion-dollar deficit in U.S. history. The current debt to GDP is approaching the all-time high of WWII (122 percent) at almost 105 percent, as of October 2012. As the annual deficits continue to raise the national debt, the likelihood of the United States being able to pay off the debt decreases every year as the funds able to pay off the debt get dwarfed in size compared to the debt accumulated.

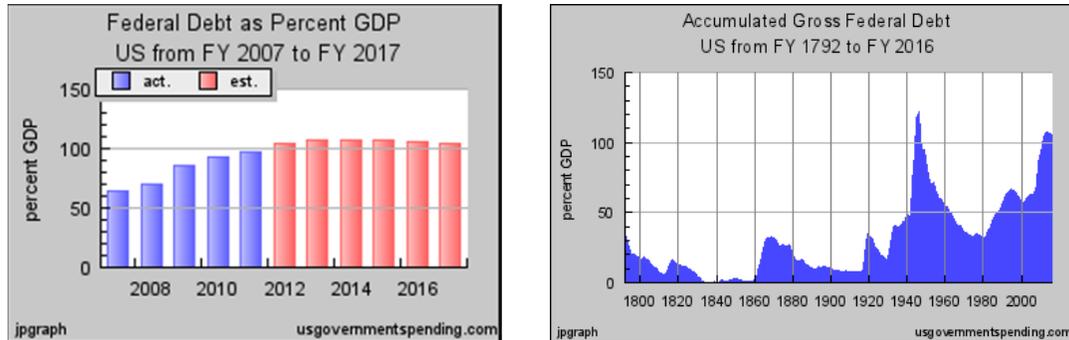


Figure 2. Federal debt as percentage of GDP- US from FY 2007 to FY 2017- From: compiled by Christopher Chantrill, *Debt in Percentage GDP*. Accessed on 6 November 2012. [http://www.usgovernmentsspending.com/federal\\_debt\\_chart.html](http://www.usgovernmentsspending.com/federal_debt_chart.html); Accumulated gross federal debt- US from FY 1792 to FY 2016- From: compiled by Christopher Chantrill, *Two Centuries of Government Debt*. Accessed on 6 November 2012. [http://www.usfederalbudget.us/debt\\_deficit\\_history](http://www.usfederalbudget.us/debt_deficit_history).

On 2 August 2011, the President signed the Budget Control Act of 2011 (BCA, P.L. 112-25), increasing the statutory debt ceiling and including measures to reduce the budget deficit by reducing outlays. The BCA is supposed to reduce the federal deficit by \$2 trillion dollars. Before anyone gets excited: This two trillion is over the span of 10 years—just over \$200 billion per year. With a current deficit of \$1.3 trillion, saving \$200 billion is similar to putting a Band-Aid on a severed artery; sure, some bleeding stops, but the problem really has not been addressed. Furthermore, President Obama’s FY2013 budget proposal eliminates the automatic spending reduction for all 10 years, but is supposed to supplant them with his own ideas of trimming the fat.<sup>16</sup>

<sup>16</sup> Mindy R. Levit, “The Budget Control Act of 2011: The Effects on Spending and the Budget Deficit When the Automatic Spending Cuts Are Implemented,” Congressional Research Service, 23 April 2012, 1.

The BCA was designed to reduce spending between FY2012–FY2021 by limiting the amount of spending through the annual appropriations process for the next 10 years. The problem with the BCA is twofold. First, the limits can be adjusted at any time; Second, only discretionary spending is affected.<sup>17</sup> There are six items that are contained within the allowable adjustments: “(1) changes in concepts and definitions; (2) appropriations designated as emergency requirements; (3) appropriations designated for Overseas Contingency Operations/Global War on Terrorism (such as for military activities in Afghanistan); (4) appropriations for continuing disability reviews and redeterminations; (5) appropriations for controlling health care fraud and abuse; and (6) appropriations designated as disaster relief.”<sup>18</sup> Restated, everything that the government has spent extra money on that has caused the debt to almost triple within the last decade is not subject to the BCA.<sup>19</sup> The idea of a Budget *Control* Act is simply a misnomer.

After the failure of the Joint Select Committee on Deficit Reduction (composed equally of Senators and Representatives from both sides), the automatic BCA reductions are simply a way for Congress to present something to the public. According to the CBO, the “combination of the Budget Control Act’s caps and automatic spending reduction process would reduce defense discretionary outlays by \$15 billion in FY2012 and \$812 billion over 10 years (an average of \$81 billion per year), and non-defense discretionary outlays by \$12 billion in FY2012 and \$714 billion over 10 years (about \$71 billion per year—parenthesis mine).”<sup>20</sup> These numbers, however, do not account for

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<sup>17</sup> Discretionary spending only accounts for 1/3 of the national budget, with over ½ of that consisting of the DoD budget.

<sup>18</sup> Levit, “The Budget Control Act of 2011,” 2.

<sup>19</sup> Within the last decade, the government has spent an estimated \$5 trillion on the war on terror since 9/11, over \$110 billion on Hurricane Katrina relief, and close to \$1 trillion in relief since the 2008/9 economic recession (the Obama administration committed \$110 billion to the car industry, the federal Troubled Asset Relief Program, established to prop up failing financial institutions, exposed taxpayers to \$700 billion in obligations (though the actual cost so far is just \$66 billion), and last year, Congress approved a \$787 billion stimulus bill for the nation’s economy).  
<http://www.csmonitor.com/Commentary/Opinion/2010/0827/Hurricane-Katrina-Five-years-on-New-Orleans-s-problems-have-gone-national>.

<sup>20</sup> Levit, “The Budget Control Act of 2011,” 3.

any of the allowable adjustments within the BCA. So, most likely, the numbers will be vastly different in the next 10 years. Also:

the \$2 trillion in deficit reduction relative to the baseline continued in the BCA does not mean that the total federal debt will decrease by \$2 trillion relative to today's levels. Rather, it means that the projected cumulative deficit over the FY2012-FY2021 period will be about \$2 trillion less than it otherwise would have been if the BCAA had not been enacted. Since the budget is projected to remain in deficit after the BCA, the publicly held debt will continue to rise in dollar terms each year, from \$10.1 trillion in FY2011 to \$14.7 trillion in FY2021 under the current law baseline.<sup>21</sup>

## **B. WHAT IS THE FEDERAL DEBT**

The federal debt is the accumulated sum of the annual deficits of the government. Debt is typically measured by the amount owed versus the amount of a country's GDP. The government's debts are labeled as either debt held by the public or intra-governmental debt (debt held in governmental accounts). Debt held by the public is amassed when the government borrows money from such entities as foreign governments, state and local governments, the Federal Reserve System, foreign banks, and private investors. Total domestic debt is nearly \$5 trillion dollars while countries such as China and Japan hold over \$1 trillion each, respectively. Intra-governmental debt, on the other hand, consists of assets held by one part of the government that are borrowed against to pay liabilities from another part of the government. Examples of these accounts are Social Security, DoD military retirement, and civil service.<sup>22</sup>

The larger the nation's economy, the more debt that nation can assume without a negative effect. "For a given amount of debt, the larger the potential tax base is, the less of a burden on the economy the interest payments on that loan will be."<sup>23</sup> For the United States, having a large debt such as the current \$16 trillion dollar debt is less a concern

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<sup>21</sup> Ibid., 15.

<sup>22</sup> Andrew D. Austin, "Overview of the Federal Debt," Congressional Research Service, 11 May 2011, CRS-2, 21.

<sup>23</sup> Brian W. Cashell, "The Federal Government Debt: Its Size and Economic Significance," Congressional Research Service, 1 March 2005, CRS-2.

than Greece's \$461.4 billion.<sup>24</sup> The reason is that the United States has the ability in revenue to pay off the debt if certain fiscal policies were put into place. Greece, on the other hand, has no ability to pay its current debt. In addition, nations are typically less concerned about debt owed to its own public, and more wary of taking on debts owed to other nations. Japan has an extremely high debt to GDP ratio of 200 percent, yet the government owes a great part of this debt to its own citizens.

Debt held by the public burdens today's economy as it pulls money away from the economy in order to service the debt. As the debt increases, it also causes upward pressure on the interest rates and further increases to burden to society. Also, the interest on the debt is not directly influenced by the government and creates an uncontrollable restraint on government policy. Instead of placing current burdens on society, intra-governmental debt negatively affects tomorrow's society. When such trust funds as Social Security come due, the government will then have to borrow from the public in order to meet payments.<sup>25</sup> Ultimately, the U.S. government is choosing to defer the real problem of debt to future politicians; they are passing the buck. By continuing to spend in excess to maintain political appeal, politicians are only making greater the ramifications of higher interest payments and diminished social entitlements in the future.

### **C. ECONOMIC SIGNIFICANCE OF THE NATIONAL DEBT**

In the short term, annual budget deficits increase the public debt, which then affects the economic output. As the government borrows more money, typically the interest on the debt increases, which increases the national interest rate. As this happens, companies that want to borrow money to increase production will be put off by the high interest rates at which they must borrow; in turn, constrained private investment in physical capital sets limits on the country's future growth potential. In the long term, as U.S. debt is currently being financed by foreign investors, the money spent on interest,

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<sup>24</sup> Greece National Debt Clock, accessed on 13 September 2012. <http://nationaldebtclocks.com/greece.htm>. Conversion from Euros to dollars done at the current exchange of 1 U.S. dollar = 0.7745 euros.

<sup>25</sup> Government Accountability Office, "Financial Audit: Bureau of the Public Debt's Fiscal Years 2011 and 2010 Schedules of Federal Debt," Washington, D.C.: GPO, November, 2011, 1-3.

dividend, and rent payments is not spent domestically. The outflow of the dollar does not necessarily mean that the standard of living will decrease, but may mean that the future standard of living may not be as high as it could have been.<sup>26</sup> If the government was able to put the \$454 billion dollars of interest payments into the country's infrastructure—such as roads, schools, national parks—the citizens' wellbeing would be increased, as opposed to simply continually paying money for past goods.<sup>27</sup>

Ultimately, the risk of the national debt is small if there is a market for U.S. securities. With a continual increase in annual deficits and public debt, though, U.S. securities may decrease in perceived value. If this happens, the purchasing of governmental debt by public parties may wane, causing a problem for the government with regards to the annual deficit. If the U.S. government found itself unable to borrow money to balance the fiscal budget, Capitol Hill would actually have to make certain concessions and balance the budget on its own. Cutting programs is not how politicians get reelected. For them it is better to pass the buck and maintain current positions than to do what is difficult but right for the nation.

#### **D. THE IMPORTANCE OF INTEREST**

Interest plays a major factor in the amount of debt the nation has and the amount of money that the U.S. government spends on servicing the debt. In January, 2011, the CBO (Congressional Budget Office) estimated that “a 1-point increase in interest rates above baseline projection levels would increase federal net interest costs by \$15 billion in FY2011 and \$438 billion over the FY2012–FY2016 budget windows.”<sup>28</sup>

Higher interest rates not only place a burden on the government's fiscal responsibility, they also have a direct impact upon society and business. As interest rates increase, it is less likely that businesses will borrow money for improvements and expansions as the amount of money that will be required to pay back will be higher due

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<sup>26</sup> Cashell, “The Federal Government Debt,” CRS-3–4.

<sup>27</sup> GAO, “Financial Audit,” 14.

<sup>28</sup> Austin, “Overview,” 14.

to those higher interest rates. This crowding out of private business means that there is less corporate taxes and less wages being earned, in turn less income taxes, and the government will have to borrow more money to pay for the annual deficit (assuming all else stays equal and the government remains in a deficit).

If the budget does get in balance minus the interest, the growth rate of the debt would equal the interest rate. The interest rate gets interesting when one considers that debt-to-GDP is the primary means of assessing the truth about a nation's debt. When the interest rate is higher than the GDP growth rate, then the national debt increases every year. But if the interest rate is less than the GDP growth rate, then as a percentage of the GDP, the debt actually goes down.<sup>29</sup> This effect is however, only a numbers game. The debt does not actually go down, rather the debt as a percentage to GDP decreases.

In an example, let us assume that a country's GDP is \$100 billion and that same country's debt is also \$100 billion (100-percent-debt-to-GDP ratio). If this nation's interest on the debt is 4 percent, at the end of the year, the nation would now owe \$104 billion (assuming the fiscal year budget was in balance, of course). If the same nation's GDP went from \$100 billion to \$110 billion the next year, the interest rate increase of \$4 billion would be offset by the larger increase in GDP of the same year. In sum, the debt increased \$4 billion but the debt as a percentage of GDP actually decreases. (Debt-to-GDP ratio is now 95 percent in this example.)

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<sup>29</sup> Debt decrease with a higher GDP than interest rate assumes that the government has been able to balance the budget and that there is no yearly deficit that is increasing the deficit on its own.

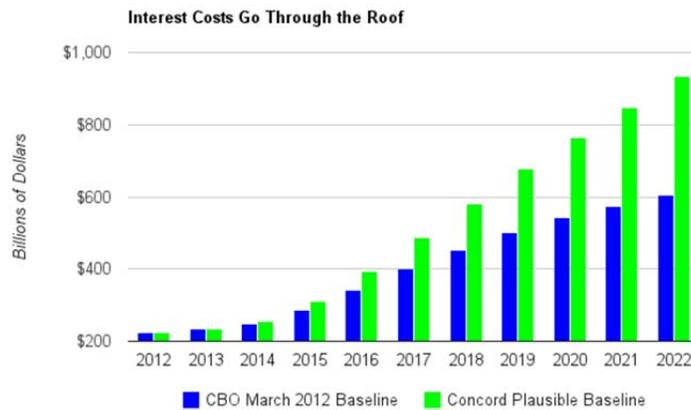


Figure 3. Interest on US national debt in next decade- From: The Concord Coalition, *Projected Interest Costs*, (Congressional Budget Office, March, 2012). Accessed on 6 November 2012.

<http://www.concordcoalition.org/issues/indicators/projected-interest-costs>.

## E. REACHING THE DEBT CEILING

The Second Bond Act of 1917 was enacted by Congress and created a debt limit in order for Congress to “exercise its constitutional prerogatives to control the federal government’s fiscal outcomes.”<sup>30</sup> “The debt limit is the total amount of money that the United States government is authorized to borrow to meet its existing legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and other payments.”<sup>31</sup> The debt limit also mandates that if the debt limit is to be raised, then the President and Congress must accompany the raise with some measure to reduce the deficit. This requirement is an attempt to ensure that lawmakers revisit the budget and fiscal policy every time the debt limit must be increased. The current national deficit is more than \$1.3 trillion dollars each year, and in May 2012, the national debt passed the statutory debt ceiling of \$14.29 trillion (arriving at almost \$15.7 trillion). In only 31 years, the debt as a percentage of gross domestic product has

<sup>30</sup> Mindy R. Levit, “Reaching the Debt Limit: Background and Potential Effects of Government Operations,” Congressional Research Service, 31 May 2012, 2.

<sup>31</sup> U.S. Department of the Treasury, “Debt Limit: Myth v. Fact.” <http://www.treasury.gov/initiatives/Documents/Debt%20Limit%20Myth%20v%20Fact%20FINAL.pdf>.

climbed from 32.5 percent to its current levels of nearly 105 percent (as the national GDP is \$15.2 trillion).<sup>32</sup> The federal government's statutory debt limit is \$16.394 trillion as of 27 January 2012.

As a report of the Congressional Budget Office stated, "By itself, setting a limit on the debt is an ineffective means of controlling deficits because the decisions that necessitate borrowing are made through other legislative actions. By the time an increase in the debt ceiling comes up for approval, it is too late to avoid paying the government's pending bills without incurring serious negative consequences."<sup>33</sup> A debt limit is in essence an artificial protection, giving lip service to the problem but not actually addressing the root causes. Major budgetary reform has never accompanied a debt ceiling limit increase as was originally intended.

"Failing to increase the debt limit would have catastrophic economic consequences. It would cause the government to default on its legal obligations ... that would precipitate another financial crisis and threaten the jobs and savings of everyday Americans ... just as the country is recovering from the recent recession."<sup>34</sup> If the U.S. government were to default on its loans, the rest of the financial world would lose faith in the ability of the United States to pay back its debts and an even bigger crisis than the 2008 economic downturn could become reality.<sup>35</sup> Treasury Secretary Timothy Geithner, in a letter to Congress concerning the impending default if Congress did not raise the debt ceiling, stated that "default would have prolonged and far-reaching negative consequences on the safe-haven status of Treasuries and the dollar's dominant role in the

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<sup>32</sup> U.S. Debt Clock, accessed on 18 October 2012. <http://www.usdebtclock.org/>; Mindy R. Levit, "The Federal Debt: An Analysis of Movements from World War II to the Present," Congressional Research Service, 17 September 2010.

<sup>33</sup> U.S. Congressional Budget Office, *Federal Debt and Interest Costs*, December, 2010, 23. <http://www.cbo.gov/ftpdocs/119xx/doc11999/12-14-federaldebt.pdf>.

<sup>34</sup> U.S. Treasury, "Myth v. Fact." <http://www.treasury.gov/initiatives/Documents/Debt%20Limit%20Myth%20v%20Fact%20FINAL.pdf>.

<sup>35</sup> Ibid.

international financial system, causing further increases in interest rates and reducing the willingness of investors here and around the world to invest in the United States.”<sup>36</sup>

By Congress failing to increase the debt limit, “the government would have to stop, limit, or delay payments on a broad range of legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and many other commitments.”<sup>37</sup> If Congress wants to avoid defaulting on its debt and avoid an even larger recession than that of 2008-2009, increasing the debt limit as the debt approaches the ceiling is not only inevitable, it is a must. Since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit.<sup>38</sup>

Although raising the debt limit creates the ability for the government to pay its bills, and even though it requires the President and Congress to revisit the budget and potential ways to reduce the deficit, little has been done to actually correct the means by which the deficit required more borrowing. The only way for the government to avoid having to raise the debt limit would be for Congress to pass a budget that was able to pay for all its outlays. A novel idea!

Assuming that the current law of automatic discretionary spending cuts goes into effect, the government will still incur an additional \$402 billion in debt in FY2013, spending \$1.22 trillion on discretionary programs and \$2.12 trillion on mandatory programs. Predicting that the federal debt limit will be reached by the middle of FY2013, without a debt ceiling increase, “roughly two-thirds of all discretionary spending in the second half of the fiscal year would have to be eliminated in order to cover borrowing needs.”<sup>39</sup> If attempting to cover the \$402 billion by revenues instead of program cuts, the government would have to raise the tax percentage up 27 percent. These reductions

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<sup>36</sup> Treasury Secretary Geithner letter, 6 January 2011, 4.

<sup>37</sup> U.S. Treasury, “Myth v. Fact.”  
<http://www.treasury.gov/initiatives/Documents/Debt%20Limit%20Myth%20v%20Fact%20FINAL.pdf>.

<sup>38</sup> U.S. Department of the Treasury, “Debt Limit.”  
<http://www.treasury.gov/initiatives/pages/debtlimit.aspx>.

<sup>39</sup> Levit, “Reaching the Debt Limit,” 15.

come in addition to the BCA cuts that are already scheduled to become effective when the United States reaches the much-touted “cliff” on 1 January 2013.<sup>40</sup>

Historically, the automatic spending reductions have been changed or repelled by subsequent laws, so there is no guarantee that the current BCA laws will actually be enacted. If the same pattern of repelling the cuts occurs again (through President Obama’s current policy and FY2013 budget proposals), the debt subject to limit is projected to reach \$25.94 trillion at the end of FY2022.<sup>41</sup> This debt level equates to almost \$1 trillion each year in deficit. Also, this increase in national debt almost quintuples the national debt from \$5.66 trillion at the turn of the century. Although the deficit obviously must be reduced, in the meantime, Congress must continue to raise the debt ceiling to avoid defaulting on its current obligations and causing an even bigger catastrophe.

#### **F. DEFAULTING ON THE DEBT**

If the government is unable to find purchasers for its annual deficit, then two things could happen. First, the government may actually have to balance the annual budget. There will be no more running into the red and having other nations step in with debt purchasing. The other—less desirable—is that the government would default on its payments. Default essentially means that the government failed to make on-time payments when those payments were due. Defaulting does not necessarily mean the U.S. government is unable to pay the loan, it simply means that the government was unable to pay the required amount at the required time.

Default comes with myriad problems: Most noticeably, interest rates would rise and the country’s credit rating would fall. Both these problems directly affect the amount of money required to service the current debt as well as the ability to accumulate more debt in the future should there be a need (such as another war or a natural disaster similar to Hurricane Katrina or most recently Hurricane Sandy). If the United States’ credit

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<sup>40</sup> Ibid., 15–16.

<sup>41</sup> Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2013, The Budget*, Table S-15. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/tables.pdf>.

rating were to fall and interest rates went up even only one percent, then from the example earlier of a \$100 billion dollar national debt, the next year that debt would not be \$105 billion. One percent can make a big difference when such big numbers are involved. Seeing as how the U.S. government pays \$454 billion in interest each year, the one percent interest is now compounded four-and-a-half times, adding multiple billions of dollars to the interest payments.

One alternative that the government may have instead of defaulting on its debts would be for the Federal Reserve to simply print more money. Although this is an easy fix for being able to pay the creditors, it becomes problematic as the added currency will increase inflation. When inflation increases so too does the interest on the debt, consequently leading to more money the government owes its debtors. So although a short-term solution, simply printing more money creates an even longer-term problem.

#### **G. WHO OWNS THE DEBT?**

The U.S. government is the largest holder of its own public debt. Much of this debt is held within trust funds such as Social Security. The Federal Reserve holds a large portion of the federal debt as well, buying and selling Treasury securities in order to impact the growth rate in the money stock. Many private and foreign entities purchase U.S. debt as a means to balance a portfolio. Because U.S. debt is backed in full faith by the U.S. government, the debt is perceived as a safe risk. Also, as the debt is the closest thing to cash (being that it is extremely liquid asset), it can be converted to cash quickly.<sup>42</sup> As of May 2012, the largest foreign holders of US debt are China and Japan, which each hold about \$1.2 trillion worth. Overall, debt held by foreign nations comes to nearly \$5.3 trillion dollars, about one-third of the national debt.<sup>43</sup>

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<sup>42</sup> Cashell, "The Federal Government Debt," CRS-4.

<sup>43</sup> <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>.

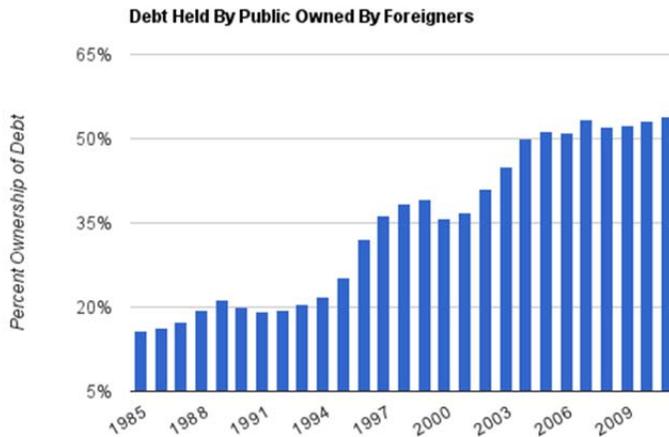


Figure 4. US debt held by foreigners- From: The Concord Coalition, *Debt Owned by Foreigners*, (United States Treasury Department, Treasury Bulletin, Table OFS-2, December 2011). Accessed on 6 November 2012. <http://www.concordcoalition.org/issues/indicators/debt-owned-foreigners>.

## H. CONCLUSION

In only three decades, the government has gone from having a fairly low debt-to-GDP ratio (about 32 percent in 1980) to having a 1-to-1 ratio (currently just under 105 percent). In 2005, CRS reports were contending that at 2005 “current and projected levels, the debt poses few if any economic risks. Ultimately the risk of a very large, and rapidly growing, government debt is extremely high rates of inflation, as pressure would mount on the Federal Reserve to monetize the debt. But that would require so much more rapid growth in the debt than is currently expected, that it is virtually out of the realm of possibility.”<sup>44</sup> Now that the annual deficit is \$1.27 trillion, the outcomes look a little bleaker than only seven years ago.

Congress is quick to point to the fact that mandatory spending is not subject to BCA automatic reductions by law. So obviously there is nothing they can do if it is a law. However, when more money is needed, the laws that must be changed are quickly changed. The BCA itself requires automatic reductions unless “new legislation in

<sup>44</sup> Cashell, “The Federal Government Debt,” CRS-12.

enacted to eliminate or change the process before then.”<sup>45</sup> As already noted, President Obama has proposed to do just this. So for Congress, there really is no reason why the unchangeable laws cannot be changed. It seems to be simply a matter of votes at the booths. Taking away citizens’ entitlements has never been popular. Enacting the BCA that mandates automatic cuts shows action, even if the promise seems to be hollow. So the only cuts that seem to be on the table are discretionary spending, primarily the Department of Defense as it is the biggest recipient of discretionary spending.

Things are not necessarily as bleak as one might think. Federal spending is still capable of coming to a balance. Total revenue for the federal government equals \$2.5 trillion, only \$200 billion less than before the 2008 economic recession.<sup>46</sup> In order to balance the budget, Congress just needs to come to an agreement between the Democrats and the Republicans to raise receipts (taxes) and decrease outlays (entitlements mostly as the baby boomers approach retirement). If a balanced budget is actually the goal, then the BCA is not to be considered successful.

As contingency operations in Iraq are almost over and Afghanistan is approaching its withdrawal (majorly decreasing discretionary spending), mandatory spending under the BCA is predicted to grow from its current \$2.1 trillion to \$3.3 trillion in FY2021. No matter how much discretionary spending is reduced, the problem of the annual deficit and national debt will not become controllable until Congress is willing to put entitlements onto the chopping block; “unsustainably large budget deficits are projected to reappear, primarily driven by the assumption that health care costs will continue to grow faster than GDP.”<sup>47</sup> The reforms needed in Congress to bring the deficit and debt under control are not popular at the voting booth, and may even make the economy worse for a short while. But by waiting until out of office, current Congressman are simply leaving a tough choice to future politicians, choices that will become more difficult as the debt increases along with interest rates.

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<sup>45</sup> Levit, “The Budget Control Act of 2011,” 2.

<sup>46</sup> *Total Government Revenue*. <http://www.usgovernmentrevenue.com/total>.

<sup>47</sup> Levit, “The Budget Control Act of 2011,” 15.

The government's challenge of today is to deal with the economic recession. The policies of the current administration are expected to restore faith in the U.S. economy. Once the economy is back on track, however, the focus needs to shift to containing the rising budget. In order for the government to have the ability to provide economic stability or support overseas contingency operations, the government needs to be in a position to be able to borrow money. The current entitlement structure does not allow for wiggle room when future necessity abounds. The current laws concerning the costs of the health care system "are expected to cause government spending for its major health programs to grow faster than both the economy and federal revenues over the next 75 years."<sup>48</sup> The government was able to assume the War on Terror, emergency operations in relation natural disasters, Overseas Contingency Operations, and economic bailouts all within the last decade because previous administrations provided the ability to do so. If the current fiscal policies are not corrected, the government may not have the ability for such future actions.

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<sup>48</sup> Government Accountability Office, "A Citizen's Guide to the 2008 Financial Report of the United States Government." <http://www.gao.gov/financial/citizensguide2008.pdf>.

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### III. ECONOMIC ARGUMENTS OF THE STATE

War is expensive. History has already taught this lesson. Between 1689 and 1815, the winner of the seven Anglo-French wars was the state that could continue to supply its army through the use of credit. Often, the side that found itself low on resources would turn to an ally who was able to provide it monetary and personnel resources in order to keep itself in the fight. Victory, therefore, often came to the state that could muster the “greater capacity to maintain credit and to keep on raising supplies.”<sup>49</sup>

The sheer amount of money needed for war rose at an astronomical rate from the 16th century through the Napoleonic Wars. At a time when Europe was having a shortage of specie, from the average street vendor to nation states, vast networks of credit emerged that helped to resolve the trade imbalances—and allowed for the continued war-fighting capability. After all, most armies at the time were made up from mercenaries, who expected to be paid for their services, sometimes in advance. Thus, the best armies were extremely expensive. Raising taxes to pay for these wars was no longer tolerable to the citizens, who were increasingly aware of their own rights and prerogatives vis-à-vis the state. Borrowing now with long-term payoffs became the only way states could conduct war. The need for money and a means to transfer that money led to the financial revolution of the late seventeenth, early eighteenth century, generating a cutting-edge system of both banking and credit.<sup>50</sup>

A nation that is able to pay for its wars will be more successful in war. As Kennedy states, “military power rests upon adequate supplies of wealth, which in turn derive from a flourishing productive base, from healthy finances, and from superior technology.... All of the major shifts in the world’s *military-power* balances have followed alterations in the *productive* balances; and further, that the rising and falling of the various empires and states in the international system has been confirmed by the

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<sup>49</sup> Paul Kennedy, *The Rise and Fall of the Great Powers*, New York: Vintage Books, 1989, 76.

<sup>50</sup> *Ibid.*, 76–77.

outcomes of the major Great Powers wars, where victory has always gone to the side with the greatest material resources.”<sup>51</sup> In order for a great power to remain a great power, the state must continue to be able to afford to defend its position. The question, then, is what role, if any, debt may play.

#### **A. THE REVOLUTIONARY WAR AND UPSTART AMERICA**

During the Revolutionary War, the U.S. government undertook a massive debt (by contemporary measures) in order to pursue its independence from Great Britain. The debate about the efficacy of such a national debt arose almost immediately. Alexander Hamilton argued that if the national debt is not excessive, it would be a national blessing, as the building of credit will allow the country to borrow sums of money when needed, such as during a time of war. The action of accumulating new debt could ease the current tax burden on society and still allow for growth within the economy, ultimately spreading the obligation over numerous generations while not stifling the ability of the economy to grow in the near term. Furthermore, economic growth should take some of the edge off this debt-of-necessity over time.

In order for a country to gain prominence in the old world, that country had to be able to defend what it had. A military was essential and an economy that could support that military was absolutely crucial. After serving as aide-de-camp to Washington in the Revolutionary War, Hamilton was named Secretary of the Treasury, in effect putting him in charge of creating the means for financial success of the young country. Faced with major debts following the war with Great Britain, the United States verged on losing its hard-fought independence because it was unable to pay to govern its own territory. As is the lesson throughout history, money is a necessity for defense. Especially in an upstart nation that is unable to fund itself, the ability to borrow money is essential.

Hamilton understood that public credit was not only an absolute prerequisite to a successful military campaign, but also a “matter of high importance to the honor and

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<sup>51</sup> Ibid., 439.

prosperity of the United States.”<sup>52</sup> Hamilton, in his first report on public credit, goes on to say that “loans in times of public danger, especially from foreign war, are found an indispensable resource, even to the wealthiest of them”; further, he notes the “necessity for borrowing in particular emergencies cannot be doubted, so on the other, it is equally evident, that to be able to borrow upon *good terms* [emphasis original], it is essential that the credit of a nation should be well established.”

Thomas Jefferson argued the opposite about borrowing and accruing debt, insisting that it is immoral to put off one’s obligations and therefore burden a future people with the problems of today.<sup>53</sup> He went on to say:

The earth belongs to each of these generations during its course, fully and in its own right. The second generation receives it clear of the debts and encumbrances of the first, the third of the second, and so on. For if the first could charge it with a debt, then the earth would belong to the dead and not to the living generation. Then, no generation can contract debts greater than may be paid during the course of its own existence.<sup>54</sup>

Jefferson was adamant that government intrusion that burdened the unborn was disgraceful. Jefferson may have been prescient, however, in his assessment that politicians would find it easier to borrow money than to raise taxes among the voting populace, eventually leading to a national debt that has ballooned to exorbitant amounts.

Both Hamilton and Jefferson typified the arguments that continue today. Hamilton, coming from the north and wanting to bring big business to the forefront of the national economy, believed that it was the government’s job to regulate the market because market regulation is the means by which the government can ensure that the economy stays in balance. Jefferson, however, being from the agriculturally rich south, contended that less government intrusion was the only way forward. He insisted that the

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<sup>52</sup> U.S. Treasury Department, *The First Report on Public Credit by Alexander Hamilton (1797)*, Norton College. Last modified 10 May 2012.  
[http://www.wvnorton.com/college/history/archive/resources/documents/ch08\\_02.htm](http://www.wvnorton.com/college/history/archive/resources/documents/ch08_02.htm).

<sup>53</sup> Robert E. Wright, *One Nation Under Debt: Hamilton, Jefferson, and the History of What We Owe*, New York: McGraw Hill, 2008, 13.

<sup>54</sup> Thomas Jefferson to James Madison, 1789, ME 7:455, Papers 15:393.

market should be free to regulate itself and that putting undue burdens and hardships on small businesses for the sake of the larger economy was ill-fitting.

## **B. UNDERSTANDING ECONOMICS**

It is not enough to be able to borrow money for today's emergency or war; a nation must be able to borrow on terms that will afford the ability to repay those loans in the future. If money borrowed today will only exacerbate the situation tomorrow, then maybe in-deed Jefferson was correct when he wrote that "public debt is the greatest of all dangers to be feared."<sup>55</sup>

A couple of books lay out the foundations for an economic understanding, including Keynes' *Economic Consequences of the Peace* and Paul Kennedy's *The Rise and Fall of the Great Powers*. Given that economics is the life-blood of modern civilization, one can understand how indebtedness can quickly drain the life out of a country. As Kennedy states, balancing the costs of the military to ensure current security may indeed sacrifice the future capabilities of the nation's infrastructure to generate revenue.<sup>56</sup> In his conclusion, Kennedy states that it all comes down to a matter of governmental choice; should government choose the immediate security of a military but leave itself vulnerable to future economic collapse, or should it chose the long-term security of a prosperous economy but leave itself vulnerable to attack (in the case of the United States, attack by either China or terrorism, or both).<sup>57</sup>

Robert Heilbroner continues the discussion in *The Worldly Philosophers* of how wealth and savings affect a nation's ability to grow or decline economically. If people are prone to saving their earnings in a manner that does not promote growth (i.e., such as the cookie jar or the mattress), then the investment into new business and technology will not be available. This lack of investment will in turn produce a decrease in the growth of economy, ultimately leading to less available income capable of being saved. Without

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<sup>55</sup> Daniel B. Baker, Editor, *Political Quotations*, Detroit, 1990, 219.

<sup>56</sup> Kennedy, *The Rise and Fall*, 444–5.

<sup>57</sup> *Ibid.*, 539.

private investment, Heilbroner (via Keynes) argues that the government must step in and prime the pump, allowing for the growth of industry that generates savings that can be reapplied into society.<sup>58</sup>

What does economic security really mean? Simply having vast amounts of gold in reserve or having stockpiles of resources and factories to manipulate those resources is not economic security. In order to have a strong economy, a country must have income; income on the national level but more importantly on the individual level. National income in many respects is derived from the ability of individuals to make purchase and earn wages, thus adding to the taxable income. So when individuals prosper, the nation prospers. But prospering as an individual is not enough; a person must also put that prosperity to use in society. Money simply stuffed into a mattress does not reenter society in any usable fashion.

### **C. KEYNESIAN CIRCLES**

Every dollar a person makes is from money spent by someone else. The car mechanic makes money when another person spends his or her money to fix the car, the waitress makes money when people eat at the restaurant, and the department store associate makes money when someone buys a new shirt. All of these people who make a purchase also are providing money for the government when they pay the sales tax associated with the purchase. When the mechanic, waitress, and sales associate then get paid, they in turn are providing more money for the government when they pay their income tax. Once these people cash their paycheck, they in turn go into society and purchase goods and services, completing the circle of income entering back into society and strengthening that society.

When people hoard money and do not apply those wages and earnings back into society, that money does not become someone else's income or taxes to the government and in essence decreases the wealth of a nation. When businesses are unable to borrow money from the banks due to individuals maintaining their own funds, then businesses

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<sup>58</sup> Robert L. Heilbroner, *The Worldly Philosophers: The Lives, Times, and Ideas of the Great Economic Thinkers*, New York: Simon and Schuster, 1961, 224–44.

cannot expand. When businesses cannot expand, then the salary of those employees must decrease. The proper investment of money (such that someone else is able to borrow that money for entrepreneurship) is the aspect that has allowed the United States such economic growth since the mid-1800s. With the creation of the banks and the stock market, people are able to store their monies into an institution that is able to then allow other customers to borrow that money and increase their ability to make more money, employ more people, and pay more taxes.

Where the system breaks down is when there is a shock or scare to the system and money is then taken away from the banks and the stock market. People get uncomfortable with their money in limbo with these financial markets and withdrawals occur. Personal savings account withdrawals then limit the ability of corporations from borrowing money and growing business. With businesses expansion halted, the workers begin to think about their wages and job security and hold on to money in case they lose their job in the near future. By not spending their money, other people are then not earning new money, leading even more people to hold on to the money they have already made. As no money then changes hands, the government also loses money by the reduction of sales tax and income tax. This economic downward spiral continues as a county's "income [is] contracted, and what happens as its income [is] contracted was that its savings were squeezed out."<sup>59</sup> The lack of savings then continues the lack of money available for businesses to borrow which in turn continues the lack of income generated by the employees, which means less savings that is able to reenter into society. The circle continues and everyone loses.<sup>60</sup>

John Maynard Keynes would argue that when such a scenario plays out, there is no automatic righting-of-the-ship. In essence, an economy would stay at the bottom floor of the building with no way of raising the elevator to a higher floor. Such was the case from 1929 and into the 1930s. Due to the stock market crash, most people lost vast amounts of money, money they could not afford to lose. As the amount of money spent

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<sup>59</sup> Heilbroner, *The Worldly Philosophers*, 235.

<sup>60</sup> *Ibid.*, 230–232.

in society disappeared, so did corporate America and the jobs that went with it. As these jobs disappeared, the ability of people to spend money was almost non-existent. The spiral continued and the United States was worse off, economically, than any time in its recent history. It was not for the lack of gold, or the lack of factories, for these did not dry up overnight, but for the lack of spending within society that forced the economy into depression.

So how then does a society that is unable to earn money, get out of depression by spending money? Keynes contends that in order for the elevator to get off the ground floor, government spending must take up where private investment was unable. By injecting money into society, he hoped that this would “prime the pump” and begin the climb up from the bottom floor. Once businesses began to make money, they would put money back into the wages of the workers. As the workers began to earn wages again, they would be able to consume more products, in turn allowing the businesses to make more money and hire more workers. This upward spiral directly opposes the conditions that drive a nation to economic weakness.<sup>61</sup>

Contrary to Keynes, Friedrich Hayek asserts that the market is a free-flowing entity. If the market booms, then, Hayek reasons, a bust is necessary to right the market. If the government were to prime the proverbial pump, Hayek contends that there would also be a rise in inflation, leading to unemployment. As more and more money enters the system, inflation would continue to rise and the problem would only get worse. Only through a truly free market can the people adjust accordingly and enable the market to regain its own balance. This adjustment by the people equals more austerity, not more spending, as the natural, even logical, thing.

#### **D. ROOSEVELT’S NEW DEAL**

A Keynesian injection of money into society by the government does not only increase inflation. As the need for government intervention comes from the lack of society spending money, this also means that the government is not receiving money

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<sup>61</sup> Ibid., 240.

from income and sales tax. So for the government to increase its spending at a time of decreased receipts, the national debt is going to increase. Keynes contends that during the United States' Great Depression, "the need for investment of some sort was so imperative that almost anything was better than nothing."<sup>62</sup> Once in office, President Franklin Delano Roosevelt did just that. While "investment was the capricious element in the system, consumption provided the great floor of economic activity."<sup>63</sup> With programs that directly affected the nation's ability to spend money, from those unemployed to corporations, FDR led the way for the resumption of private business advancement.

President Roosevelt's New Deal was enacted with a Keynesian philosophy. He insisted that only the government was able to pull the economy up off the bottom floor. Roosevelt enacted an ambitious plan. In his first 100 days in office, the benchmark by which all current presidents are judged upon assuming office, he and Congress enacted the New Deal to "deliver *relief* to the unemployed and those in danger of losing farms and homes, *recovery* to agriculture and business, and *reform*, notable through the inception of the east Tennessee Valley Authority (TVA).<sup>64</sup> To fund the New Deal, government spending skyrocketed. Spending rose from \$697 million in 1916 to \$9 billion in 1936. In merely 20 years, government spending increased almost thirteen-fold; the national debt ballooned to unparalleled heights—rising from 20 percent GDP and reaching 70 percentage of GDP.<sup>65</sup>

Similar to the opposition of Hamilton by Jefferson, Roosevelt's ideas did not go unchallenged. Herbert Hoover, president before Roosevelt, argued that government

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<sup>62</sup> Ibid., 241.

<sup>63</sup> Ibid.

<sup>64</sup> <http://www.u-s-history.com/pages/h1851.html>. Italics in the original.

<sup>65</sup> "Total Government Debt since 1900," accessed on 11 November 2012. [Usgovernmentspending.com](http://Usgovernmentspending.com).

spending to provide jobs was not the way to success.<sup>66</sup> Such an extravagant amount of money that would be necessary to provide jobs and benefits to the citizens would sink the nation into debt through deficit spending and burden, through higher taxes, those who were still working and those who would work in the future. Hoover went on to say that the idea that borrowing your way out of hard fiscal times, once established, would be impossible to depose. Evident in today's government and economy, Hoover may have indeed been correct, but obviously only about the problem with runaway debt.

The government attempted to boost a sluggish economy by injecting money into the system in hopes that the investment would equal jobs, and jobs would equal spending; both creating more money and help the nation to recover from economic hard times. Such stimulus consequently led to an increased national debt. Only by the means of an economic boom after World War II did the United States begin to pay off the exorbitant national debt. Not taking this fact into consideration, politicians today have failed to come to an agreement on how the fiscal policy will balance and how the national debt will be repaid.

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<sup>66</sup> It must be noted that Herbert Hoover was very much partly to blame for the economic situation leading up to the Great Depression. "The Hoover term was just months old when the nation sustained the most ruinous business collapse in its history. The stock market crashed in the fall of 1929. On just one day, October 29, frantic traders sold off 16,400,000 shares of stock. At year's end, the government determined that investors in the market had lost some \$40 billion. Hoover's administration made a bad mistake when Congress, caving in to special interests, passed the Smoot-Hawley Tariff Act in 1930. The measure would hike up tariffs to prohibitively high levels. The president signed the bill into law over the objections of more than 1,000 economists. Every major trading nation protested against the law and many immediately retaliated by raising their tariffs. The impacts on international trade were catastrophic. This and other effects caused international trade to grind nearly to a standstill; the depression spread worldwide. Meanwhile, the president and business leaders tried to convince the citizenry that recovery from the Great Depression was imminent, but the nation's economic health steadily worsened. In spite of widespread hardship, Hoover maintained that federal relief was not necessary. Farm prices dropped to record lows and bitter farmers tried to ward off foreclosers with pitchforks. By the dawn of the next decade, 4,340,000 Americans were out of work. More than eight million were on the street a year later. Laid-off workers agitated for drastic government remedies. More than 32,000 other businesses went bankrupt and at least 5,000 banks failed. Wretched men, including veterans, looked for work, hawked apples on sidewalks, dined in soup kitchens, passed the time in shantytowns dubbed "Hooverilles," and some moved between them in railroad boxcars. It was a desperate time for families, starvation stalked the land, and a great drought ruined numerous farms, forcing mass migration." (<http://www.u-s-history.com/pages/h1569.html>)

## E. CONCLUSION

Kennedy synthesizes the problem well when he states:

Not for the first time in history, therefore, there looms today a tension between a nation's existence in an anarchic military-political world and its existence in a laissez-faire economic world; between on the one hand its search for strategic security, as represented by its investment in the latest weapon systems and in its large-scale diversion of national resources to the armed forces, and on the other hand its search for economic security, as represented by an enhanced national prosperity, which depends upon growth (which in turn flows from new methods of production and wealth creation), upon increased output, and upon flourishing internal and external demand- all of which may be damaged by excessive spending upon armaments. Precisely because a top-heavy military establishment may slow down the rate of economic growth and lead to a decline in the nation's share of world manufacturing output, and therefore wealth, and therefore power, the whole issue becomes one on the balancing the short-term security afforded by large defense forces against the longer-term security of rising production and income."<sup>67</sup>

Kennedy explains that it ultimately comes down to a matter of choice: the choice between ensuring military dominance in times of uncertainty, which would further burden society, or reducing the monetary allocation to defense and perhaps being vulnerable to outside influence. In essence, it is a choice between immediate military security and long-term economic security.<sup>68</sup>

Even with sustained growth, though, "without a balance between these competing demands of defense, consumption, and investment, a great power is unlikely to preserve its status for long."<sup>69</sup> The United States is currently at this juncture in history. It is a time where the choice between sustained economic growth, social needs, and the military are all vying for the same small pot of cash. Sacrificing one aspect of government requirements for the others may indeed be necessary for the greater good of society in the long run. Hamilton understood this point perhaps better than most in his time.

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<sup>67</sup> Kennedy, *The Rise and Fall*, 444–445.

<sup>68</sup> *Ibid.*, 539–540.

<sup>69</sup> *Ibid.*, 446.

Although views of debt, credit, borrowing, and deficit spending changed over the course of U.S. history, the disagreement between Hamilton and Jefferson has not been resolved, but simply evolved into Keynes versus Hayek or Democrats versus Republicans. The government must be able to switch its approach when the situation calls for it. Hamilton stated that public credit is essential to:

justify and preserve their confidence; to promote the increasing respectability of the American name; to answer the calls of justice; to restore landed property to its due value; to furnish new resources both to agriculture and commerce; to cement more closely the union of the states; to add to their security against foreign attack; to establish public order on the basis of an upright and liberal polity. These are the great and invaluable ends to be secured, by a proper and adequate provision, at the present period, for the support of public credit.<sup>70</sup>

The United States' current situation calls for a Jeffersonian approach of taking care of today's needs and paying off the current national debt in order to ensure a Hamiltonian ability to borrow large sums of money if a future war or emergency so prescribes.

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<sup>70</sup> U.S. Treasury Department, *The First Report*,  
[http://www.wwnorton.com/college/history/archive/resources/documents/ch08\\_02.htm](http://www.wwnorton.com/college/history/archive/resources/documents/ch08_02.htm).

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## IV. THE THREAT

Is the United States more susceptible now to financial persuasion than it was during the 2008–2009 financial meltdown? After this crisis, the United States government pumped billions of dollars into the domestic economy in order to stop it from lapsing into a full-on depression. The billions of dollars came in the form of debt—debt purchased—in large part—by the Chinese. China’s amount of U.S. debt holdings has risen from \$164 billion in 2005 to almost \$1.2 trillion in May 2012.<sup>71</sup> With the massive accumulation of U.S. dollars, China may very well have some influence over U.S. international decision-making and may very well be able to precipitate a financial crisis in the United States should China take certain options. This aspect of the current U.S. debt puts a whole different spin on the blessing-or-curse calculus.

### A. U.S.-CHINA TRADE

The U.S.-China trade has increased dramatically since the 1979 bilateral trade agreement signed between the two countries. Helped along by the most-favored-nation (MFN) treaty in 1980 and China’s accession to the World Trade Organization in 2001, trade between the two nations has risen from a paltry \$2 billion dollars annually to just over \$500 billion in 2011. China currently ranks as the U.S.’s second largest trading partner—behind only Canada—and the largest source of U.S. imports. With China’s political focus on internal development and raising the national living standard, the trade between the two nations is only expected to increase.<sup>72</sup>

The United States purchases about 30 percent of Chinese exports, making a change in the RMB or the dollar very significant for both sides. If the RMB rises in value, the extraordinary export market that feeds the Chinese economic growth would be in jeopardy. “Between 1994 and July 2005, China pegged its currency...to the U.S. dollar at about 8.28 yuan to the dollar. In July 2005, China appreciated the yuan to the

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<sup>71</sup> Cashell, “The Federal Government Debt” CRS-6; <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>.

<sup>72</sup> Morrison, “China-U.S. Trade Issues,” 2.

dollar by 2.1 percent and moved to a ‘managed float,’ based on a basket of major foreign currencies, including the U.S. dollar. In order to maintain a target rate of exchange with the dollar (and other currencies), the Chinese government has maintained restrictions and controls over capital transactions and has made large-scale purchases of U.S. dollars (and dollar assets).<sup>73</sup> The Chinese government continues to intervene in order to maintain the yuan at an artificially low price. By maintaining the yuan at an artificially low exchange versus the dollar, the Chinese government has in essence maintained the trade imbalance by ensuring that Chinese goods are cheap when compared to U.S. imports—moving the trade deficit from \$10 billion dollars in 1990 to almost \$300 billion in 2011.<sup>74</sup> This fiscal policy ensures that China remains a creditor to the United States, but China must maintain the current export market in order to ensure a growing Chinese economy, not to apply pressure on the United States.

Any fiscal policy that the Chinese would choose to enact that would have a negative impact on the U.S. economy would also induce a negative impact on the world economy. With the United States being such a major aspect of international trade, “Chinese actions that destabilized the U.S. economy could diminish China’s standing as a ‘responsible stakeholder’ in the global economy.”<sup>75</sup> As China is overwhelmingly dependent on international trade, specifically its export market, poor relations with the trading world would go against China’s aspirations of internal growth.

## **B. BEIJING ECONOMIC OPTIONS AGAINST THE UNITED STATES**

“A large sell-off of Chinese Treasury securities holdings could negatively affect the U.S. economy, at least in the short-run. As a result, such a move could diminish U.S. demand for Chinese products and thus could lower China’s economic growth as well.”<sup>76</sup> A lower demand from the United States for Chinese products is the result of a large sell-off from the Chinese. As the dollar is dumped on the market, the demand for the dollar

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<sup>73</sup> Ibid., 40.

<sup>74</sup> Ibid., 2; Ibid., 40.

<sup>75</sup> Morrison, “China’s Holdings,” CRS-12.

<sup>76</sup> Ibid., CRS-1.

would diminish, requiring a larger interest rate return on the dollar in order to attract more investors. As the interest increases on the dollar, the dollar itself will depreciate. As the dollar depreciates, the exports to other countries from the United States become cheaper for those countries and the imports from other countries into the United States becomes more expensive. The trade imbalance would eventually correct itself and the U.S. economy would be no worse for wear in the long run.<sup>7778</sup>

“Given China’s economic dependency on a stable and growing U.S. economy, and its substantial holdings of U.S. securities, any attempt to try to sell a large share of those holdings would likely damage both the U.S. and Chinese economies. Such a move could also cause the U.S. dollar to sharply depreciate against global currencies, which could reduce the value of China’s remaining holdings of U.S. dollar assets.”<sup>79</sup> Also, as China only holds approximately eight percent of total U.S. public debt, any sell-off of U.S. securities by the Chinese is not likely to cause a global chain reaction. Plus, while the Chinese currency is pegged to the dollar, the Chinese government “has little choice but to purchase U.S. dollar assets in order to maintain that peg.”<sup>80</sup>

The magnitude of any Chinese sell-off, however, would depend on how quickly dollar assets were sold off. A slow sell-off may actually aid the United States as the balancing of the trade deficit may offset the depreciation of the dollar.<sup>81</sup> A rapid sell-off, though, may be more troublesome to the U.S. economy if such action triggered a bigger global panic on the dollar. Although monies within private sector investments are more likely to shift at a moment’s notice, China only holds about 8 percent of U.S. securities,

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<sup>77</sup> Ibid., CRS-9.

<sup>78</sup> An example for a slow decline actually increasing the bottom line is when Japan decreased its U.S. Treasury holdings between August 2004 and September 2007. Although Japan’s U.S. assets dropped from \$699.4 billion to \$582.2 billion, the impact on the American economy seems negligible.

<sup>79</sup> Morrison, “China-U.S. Trade Issues,” 17.

<sup>80</sup> Ibid.; Morrison, “China’s Holdings,” CRS-1.

<sup>81</sup> “Historical experience seems to bear this out—the dollar declined by about 40 percent in real terms and the trade deficit declined continually in the late 1980s, from 2.8 percent of GDP in 1986 to nearly zero during the early 1990s. Yet economic growth was strong throughout the late 1980s.” Morrison, “China’s Holdings,” CRS-10.

with most of the remaining assets held by allies. There is a possibility that the remaining assets would not be sold off and that China will have liquidated its U.S. assets and be left with nowhere else to put its extra capital. A rapid sell-off would still deflate the dollar (although maybe not to a catastrophic value) and the “resources may not be able to shift quickly enough from interest-sensitive sectors to export sectors to make this transition fluid.”<sup>82</sup>

The Federal Reserve is advantageous in helping fend off this type of rapid attack on the dollar. By manipulating short-term interest rates, the Federal Reserve is able to lessen the impact on the U.S. economy. In 2007, Federal Reserve Chairman Ben Bernanke stated that due to the small amount of U.S. Treasury holdings by foreign countries, the U.S. credit market would be able to absorb any change in foreign security assets.<sup>83</sup> It is worth asking that since the recession in 2008 and subsequent bailouts by the U.S. government, does the Federal Reserve still have the same capacity?

“Although the low U.S. savings rate is a problem, the U.S. current account deficit and high levels of foreign capital flows to the United States are also reflections of the strength of the U.S. economy and its attractiveness as a destination for foreign investment, and therefore discount the likelihood that foreign investors will suddenly shift their capital elsewhere.”<sup>84</sup> With the trouble of the Euro in recent years and uncertainty over Japan and its almost 200 percent debt-to-GDP ratio (along with the strong animosity between China and Japan), the dollar is really the only reliable security within the world. A win by default is still that, a win. The dollar will remain the only currency substantial enough for conservative Chinese businessman to put their money into. China, in essence, “is trapped into a cycle of buying our Treasury bonds. No matter what any ratings agency says, no other bond market is as big or as safe.”<sup>85</sup>

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<sup>82</sup> Ibid.

<sup>83</sup> Ibid., CRS-11.

<sup>84</sup> Ibid., CRS-13.

<sup>85</sup> Fareed Zakaria, “China’s Not Doing Us a Favor,” *Global Public Square Blog*, 14 August 2011. [http://globalpublicsquare.blogs.cnn.com/2011/08/14/why-china-needs-u-s/?hpt=hp\\_c1](http://globalpublicsquare.blogs.cnn.com/2011/08/14/why-china-needs-u-s/?hpt=hp_c1); Edmund Downie, “You call Greece a crisis? Try the U.S., says China,” *Foreign Policy Blog*, 1 July 2011. [http://blog.foreignpolicy.com/posts/2011/06/30/you\\_call\\_greece\\_a\\_crisis\\_try\\_the\\_us\\_says\\_china](http://blog.foreignpolicy.com/posts/2011/06/30/you_call_greece_a_crisis_try_the_us_says_china).

### C. CHINA GROWTH STRATEGY

China is hungry for success and this might well be a key reason for its enduring rise. In the twentieth century, after hundreds of years of poverty, the country went through imperial collapse, civil war, and revolution only to find itself in Mao's hellish version of communism. It lost 38 million people in the Great Leap Forward, a brutal experiment in collectivization. Then it burrowed itself deeper in isolation and destroyed its entire professional and academic class during the Cultural Revolution. Unlike India, which would be proud of its democracy despite slow economic growth, China by the 1970s was bereft of any reason to raise its head high. Then came Deng's reforms. Today, China's leaders, businessmen, and people in general have one desire in common: they want to keep moving ahead. They are unlikely to cast aside casually three decades of relative stability and prosperity.<sup>86</sup>

With a country still bereft with poverty, the only immediate direction the Chinese nation is agreed on is internal development. Many nations, however, "view China's rise in economic wealth and military might as a source of suspicion and concern primarily due to its lack of transparency in clearly stating the goals and objectives of its 'peaceful rise' and the rationale and extent of its military build-up."<sup>87</sup> "With the exception of anything related to Taiwan, Beijing tends to avoid picking a fight with other governments. The focus remains on growth."<sup>88</sup> Chinese economic growth is also the same thing that feeds political stability for the Chinese Communist Party (CCP).<sup>89</sup> Over the last few decades China has consistently pursued objectives that developed the internal infrastructure of its country and simply maintained CCP control. Beijing depends heavily on the good relations with other countries to continue the unprecedented nearly 10 percent annual growth rate. Bringing to bear their economic might would only derail their national goals of self-improvement.<sup>90</sup>

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<sup>86</sup> Zakaria, *The Post-American World*, 104.

<sup>87</sup> Donald H. Myers, "China: Prosperity, Wealth, and Implications for the U.S. National Military Strategy," Thesis, U.S. Army War College, 2010, 2.

<sup>88</sup> Zakaria, *The Post-American World*, 105.

<sup>89</sup> Morrison, "China's Holdings," CRS-11-12.

<sup>90</sup> Department of Defense, *Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2012*, Washington, DC: GPO, May, 2012, 2.

Another example of China's focus on internal betterment was exuded during *The Rise of the Great Nations*, a television show that aired in China during the early 2000s that covered the rise of nine great powers.<sup>91</sup> The basic premise of the series lay in the idea that a nation's rise to great power status came in the form of economics, not military might. In the final episode, the series ends with "a declaration that, in the new world, a nation can sustain its competitive edge only if it has the knowledge and technological capacity to keep innovating. In short, the path to power is through markets, not empires."<sup>92</sup> In essence, the Chinese government was propagating to its citizens the simple fact that only through economic might can China become a global power.

#### **D. ECONOMIC COOPERATION**

Since September 2006, China and the United States have engaged in economic dialogue meant to "discuss long-term strategic challenges, rather than seeking immediate solutions to the issues of the day' in order to provide a stronger foundation for pursuing concrete results through existing bilateral economic dialogues."<sup>93</sup> Subsequently named the U.S.-China Strategic and Economic Dialogue (S&ED), the process "brings together top economic officials from both sides, as well as U.S. cabinet officials and Chinese heads of ministries, on a regular basis, which enables both sides to identify their major positions and priorities on various issues and to develop long-term working relationships."<sup>94</sup>

In the first session of the newly named S&ED, Secretary of the Treasury Timothy Geithner stated: "Recognizing that cooperation between China and the United States will remain vital not only to the well-being of our two nations but also the health of the global economy, we agree to undertake policies to bring about sustainable, balanced global growth once economic recovery is firmly in place."<sup>95</sup> The same idea conveys to the

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<sup>91</sup> Zakaria, *The Post-American World*, 106–107.

<sup>92</sup> *Ibid.*, 108.

<sup>93</sup> Morrison, "China-U.S. Trade Issues," 43.

<sup>94</sup> *Ibid.*

<sup>95</sup> *Ibid.*

military relationship between the two countries, also. ADM Keating stated that “how China emerges in its relationship with the United States is not solely up to them. It is a shared responsibility in terms of how the United States initiates and works cooperatively with them.”<sup>96</sup>

The argument that China will not act irrationally only prevails if the current status quo remains unchanged; if China can continue to grow internally through its exports, then China has more to lose by dumping dollar assets. If, however, China’s CCP begins to lose control over the country due to a population unhappy about a lack of growth rate or an increase in the standard of living, China may very well use any means necessary to make the United States its enemy, focusing attention outside the country, rather than inwards at the national leadership.

There may already be evidence that China has tested the ability to sink the U.S. economy. Kevin Freeman’s book *Secret Weapon* argues that the market crash of 2008 was not brought about by mismanagement of the housing market, but by purposefully manipulating the market.<sup>97</sup> Coupled with numerous cyber-attacks and theft of intelligence, China could be performing dry runs and gaining intelligence on every occasion for the upcoming real attack.

As this scenario appears to be nowhere in the near future, the best the United States can hope for is that Congress is able to circumvent any Chinese mal-intentions in the future by getting its own fiscal house in order and taking Chinese economic warfare off the table.<sup>98</sup>

## **E. THE CHINESE MILITARY ASPECT**

Even with China concerned predominantly with a peaceful economic rise that leads to the betterment of its civilian lives, one cannot rule out the enormous growth in

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<sup>96</sup> Admiral Timothy J. Keating, Commander, U.S. Pacific Command, “Remarks at the Center for Strategic and International Studies Military Forum,” Washington, DC, 15 September 2009.

<sup>97</sup> Kevin Freeman, *Secret Weapon: How Economic Terrorism Brought Down the U.S.. Stock Market and Why it can Happen Again*, Washington, D.C.: Regnery Publishing Inc., 2012, 61.

<sup>98</sup> JR Nyquist, “When the China Bubble Bursts,” *Financial Sense*, 6 September 2011.

the Chinese military. Although the Chinese government insists that its military growth is for the purpose of winning local wars—presumably this means towards Taiwan—the military strength is still something that the United States must take notice of. As China continues to develop contingency plans aimed at deterring Taiwan and denying third-party intervention—a third party that could only be the United States—it is essential that as the Chinese military continues to grow, the United States maintains its own capability.<sup>99</sup>

In March 2012, Beijing announced that an increase of 11.2 percent in military spending would increase Beijing’s annual military spending to \$106 billion. However, China’s military budget is not totaled as the U.S. military’s is. If one adds categories of expenditures that the United States uses to compile its DoD budget, such as foreign procurement, then China’s military expenditure increases to \$120–180 billion. Even these numbers are considered to be lower than actual due to China’s “poor accounting transparency and its still incomplete transition from a command economy.”<sup>100</sup> Taken altogether, China’s steady increase of its military budget has given it capabilities that would rival the United States, at least in the close proximity of mainland China.

The PLA Air Force is increasing its capabilities for off-shore reconnaissance and offensive/defensive operations. In 2011, China flight-tested its first generation-five stealth fighter aircraft. China has also increased its capabilities in long-range transportation and logistics, adding further to the threat toward U.S. assets. The PLA Navy has made significant strides in its fleet upgrade. Aimed at achieving sea superiority within the first island chain, China has acquired “attack submarines, multi-mission surface combatants, and fourth-generation aircraft.”<sup>101</sup> The Chinese ground forces have also made strides in becoming a more formidable opponent. Increasing force-on-force training—increasing China’s combat experience—while adding tools such as simulator trainers and command tools, will help to battle harden the ground forces by 2020.

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<sup>99</sup> Department of Defense, *Annual Report to Congress: Military and Security Developments Involving the People’s Republic of China 2012*, Washington, DC: GPO, May, 2012, 3–6.

<sup>100</sup> *Ibid.*, 6.

<sup>101</sup> *Ibid.*, 7.

Coupled with the increases in physical forces, China is also “the world’s most active and persistent perpetrators of economic [and technological] espionage,” and is expected to remain such over the next decade.<sup>102</sup> If Taiwan is the battlefield for China, then why does China need stealth aircraft and long-range transportation assets couple with high-tech espionage capabilities?

Although the current mission of China only calls for defense of china within the first island chain and the ability for anti-access/area denial, these newly acquired assets will allow China to expand its area of control farther away from the mainland of China within the next 10–15 years. So even though China lacks any real soft power over the United States, in 20 years the military might of China may make the economic aspect irrelevant as China continues to increase the overall capacity and capability of the PLA. By focusing solely on the deficit and allowing the military to take the brunt of the budget cuts, the United States may make itself irrelevant in the Pacific in the coming years.

## **F. CONCLUSION**

“For now, the forces of integration have triumphed, in both Beijing and Washington. The Chinese-American economic relationship is one of mutual dependence. China needs the American market to sell its goods; the United States needs China to finance its debt—it’s globalization’s equivalent of the nuclear age’s Mutual Assured Destruction.”<sup>103</sup> In August 2011, Vice President Biden stated that “a rising China will fuel economic growth and prosperity and it will bring to the fore a new partner with whom we can meet global challenges together.”<sup>104</sup> President Obama examines the point that just because the United States does not currently have an adversary, does not mean one must be created. He claimed that “the [U.S-China] relationship has not been without disagreement and difficulty. But the notion that we must be adversaries is not predestined.”<sup>105</sup>

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<sup>102</sup> Ibid., 10.

<sup>103</sup> Zakaria, *The Post-American World*, 124.

<sup>104</sup> DoD, *Annual Report to Congress*, 12.

<sup>105</sup> Ibid., 13.

With China's ability of internal nation-building stemming mostly from its capability to export goods on the global market, the reliance on positive global interactions is vital. With an economy that is still considered poor on the global scale, China's leadership—the CCP—is dependent on the overall increase in the standard of living to continue in good standing with its 1.3 billion citizens. If China were to take measures that would negatively impact the United States—its largest exporter—or the dollar, China may be subject to global repercussions as the United States and the world economies would likely take a nose dive. With China being as dependent upon the trade imbalance and the monetary standing of the United States, and with the United States being equally dependent on China's for its continued purchase of U.S. Treasury assets, the symbiotic nature of the relationship deems that the U.S. debt is indeed a blessing to the continued well-being of the United States (and China). The sheer nature and impact of globalization will dictate a lack of global, hegemonic conflict in the near future.

A war between global powers seems less likely (at least within the next two decades). But as China continues to grow its military, the United States cannot afford to rest on its laurels and allow China to surpass the United States in military might. As the debt actually maintains the current status quo, to reduce the debt would actually leave the country less secure in two ways: one, reducing the national public debt would require the DoD budget to be reduced which equates to the military defense capability being reduced, leaving the door open for a future China; two, reducing the national debt, specifically the debt held by China, reduces the financial pressures that comes with the sheer amount of U.S. debt holdings that China maintains—in essence reducing the deterrent effect of China losing massive amounts of money should the dollar or the U.S. economy tank.

## V. AN EASTER BUNNY MILITARY

The national debt is indeed an outward blessing concerning China and its potential impact of soft power, but how does the growing national debt internally impact the nature of the U.S. military and its ability to defend the country? With the symbiotic nature of the Chinese—United States debtor/creditor relationship—the U.S. military is positioned to be a scapegoat in national political rhetoric in the election year concerning ways to reduce the national deficit. The military has already taken measures to streamline operations. Coupled with the budgetary reductions of the BCA, anything more in regards to sequestration could hollow out the military force and leave the nation vulnerable to future attacks, in essence, a hollow chocolate Easter Bunny—although it looks big and is packaged nicely, a bite lacks any real substance.

### A. TRIMMING THE EXCESS

Then-Defense Secretary Robert Gates began the process of streamlining the Department of Defense a couple years before the mandatory budget tightening of the BCA took effect. Trimming the budget associated with simple wasteful processes, the Department of Defense already has cut \$60 billion out of the defense budget by simple better business practices.<sup>106</sup> Also, by abolishing under-developing programs and programs that ran significantly over budget, such as the Air Force's F-22, the Navy's DDG-1000 and the Marine Corps' Future Combat System, Secretary Gates was able to fund programs that are still battle-field necessary or on track to pay dividends in the future.<sup>107</sup>

In addition to acquisition and waste reductions, personnel and asset reductions are also in process. The Army and Marine Corps will be drawing down its total end strength as the war in Iraq is finished and the war in Afghanistan is coming to a close. Now that the wars are over, the budget calls for a reduction-in-force of 80,000 Army personnel and

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<sup>106</sup> DoD, *Annual Report to Congress* 3.

<sup>107</sup> U.S. Government, "Quadrennial Defense Review Report," Washington, DC: GPO, 2010, xi.

20,000 Marine Corps respectively.<sup>108</sup> The Army drawdown has a ripple effect as the Air Force no longer needs to maintain its high volume of airlift capability—reducing budget requirements even further—by eliminating six of the 60 Air Force tactical air squadrons and one training squadron. The same reduction is felt by the Navy with regards to transporters. Some combat logistical and fleet support ships will also be retired to reduce budget needs.<sup>109</sup>

Having thoroughly examined the budget for any waste and irrelevance, the diligent defense budgeters have claimed that there is now “no room for modification.”<sup>110</sup> The DoD continues to insist that any more budget reductions simply would be a pill too big to swallow.

## **B. PROLONGING THE DEBT ISSUE**

One aspect of current budget cuts that will impose constraints on the future military is the idea that in order to save money in today’s budget, Congress can simply extend acquisitions over a longer period of time. Such acquisitions as a Landing Helicopter Assault (LHA), a Virginia class submarine, and replacement Dock Landing Ships (LSDs) have been moved to subsequent years. By adjusting purchasing time tables, however, the DoD accomplishes the budget reduction this year but adds to the problem in subsequent years. As older weapon systems become in need of repairs and replacements, the military will be busy replenishing items that should have been replaced in years past.<sup>111</sup> Ultimately, the idea of moving acquisitions from the current year to later years means that more drastic cuts must come in the future. In essence, the future administration will have to make today’s cuts and tomorrow’s cuts at the same time.

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<sup>108</sup> DoD, “Defense Budget Priorities,” 11.

<sup>109</sup> Leon E. Panetta, “Statement of Fiscal 2013 Budget,” Pentagon Press Briefing Room, 26 January, 2012, 2.

<sup>110</sup> DoD, “Defense Budget Priorities,” 3.

<sup>111</sup> *Ibid.*, 6.

Congress, attempting to curtail a budget crisis today by cutting the DoD budget, is only exacerbating the situation tomorrow—a similar consequence of paying interest today on debt accumulated yesterday.

### C. KEEPING PERSPECTIVE

It is important to keep things in perspective when discussing the U.S. defense budget. The United States' military expenditure in 2005 “totaled \$495 billion in nominal dollars out of a global total of \$1.207 billion—or 41 percent of the world’s total.”<sup>112</sup> As we moved into the next decade, U.S. expenditure on the military is still 41 percent of the world military expenditure.<sup>113</sup> China, which spent 10 percent of what the United States spent in 2005, is only up to 20 percent in 2012. When adding China’s total military expenditure with any other potential adversary—such as Russia, Iran, or North Korea—the total military expenditure is estimated at around \$220 billion. This statistic reveals that the most likely potential enemy states only equal about 31 percent of the U.S. military expenditure.

By itself, this is only half of the story. When adding the U.S. military expenditure with that of the U.S. allies, which round out the top ten countries with the highest military expenditure, potential enemy military expenditure drops to an estimated 22 percent.<sup>114</sup> These numbers only equate if the United States continue to adequately supply its military.

Also maintaining military capability perspective means that one must acknowledge the sheer size of the U.S. military, specifically the Navy, and its capabilities. It is not sufficient to examine just the tonnage numbers when assessing threats; one must also examine the quality of the tonnage. As Secretary Gates stated in a

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<sup>112</sup> O’Hanlon, *Budgeting for Hard Power*, 23.

<sup>113</sup> Blenckner, “Background paper on SIPRI.” The SIPRI military expenditure project was initiated in 1967 to study developments in world military expenditure. Military expenditure is an indicator of the economic resources devoted to military purposes. There is no direct relationship between the level of military expenditure and output in terms of military resources, military activities or military capability. Military expenditure is an input measure and military output depends on several factors other than its financing. However, analyzed in its economic and political context, the level and trend in military expenditure can provide information not only on the cost of military activities but also about their extent and change over time, which can have an impact on military capability or reflect military intentions.

<sup>114</sup> *Ibid.*; O’Hanlon, *Budgeting for Hard Power*, 23.

speech in 2008, the U.S. Navy “in terms of tonnage... is larger than the next 13 navies combined—and 11 of those 13 navies are allies or partners [of the United States].” He went on to say: “No other navy has anything comparable to the reach or combat power of a single American Carrier Strike Group.”<sup>115</sup> The United States currently has 11 carrier strike groups capable of world power projection. So although the United States Navy is vastly superior to potential enemies, the task of deterrence is dependent on lop-sided numbers that prevent enemies from believing a war with the United States could be won. With the size of budget reductions today, and even worse, the potential budget cuts due to sequestration, the Navy and the military as a whole may not maintain the dominance that grants overwhelming superiority and the peace that the U.S. citizens currently maintain. As China continues to increase its military might, the United States must continue to budget its military is it wants to remain in a position of power within the Pacific Rim.

#### **D. REMAINING STRONG AND CAPABLE**

In the publication “Defense Budget Priorities and Choices,” the DoD states that reaching BCA reductions will be difficult but attainable. The document goes on to affirm that with the BCA reductions, the defense budget level will actually increase.<sup>116</sup> The President himself has declared that the military will remain strong and funded. In a speech on defense strategic guidance on 5 January 2012, President Obama confirmed that over the next 10 years, the growth of the military may not be as dramatic as the 10 years after 9/11, but the fact is the military budget will still grow. The President’s base defense budget request for FY2012 was \$553.7 billion. This budget request amounts to a 3-percent real increase in spending potential over FY2011.<sup>117</sup>

The President reinforced the security and defense of the United States by contending that the military budget continues to be larger than the next 10 countries *combined*. Secretary of Defense Leon Panetta went on to say that even with the BCA

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<sup>115</sup> Robert M. Gates, “National Defense University,” speech given in Washington, DC on 29 September 2008. Accessed on 12 May 2012, <http://www.defense.gov/speeches/speech.aspx?speechid=1279>.

<sup>116</sup> DoD, “Defense Budget Priorities,” 1.

<sup>117</sup> Towell, “Defense,” 20.

requirements, he does not foresee the need to decide between “national security and fiscal responsibility.”<sup>118</sup> The separation of leadership concerning balancing the deficit and reducing the military budget seems to just be political sport. Although the current political position of the president is to maintain the strongest military in the world, eventually, everything comes down to money. If the U.S. citizens continue to be told that the annual deficit is largely the result of the DoD budget, eventually political pressure may force politicians to act differently in the future.

Even with the best intentions of Congress and the president (and presidential candidates), eventually a decline in budgetary means will dictate a hollow “Easter Bunny” military if the national deficit is not corrected early. It is one thing to speak of reducing the DoD’s budget as political sport, it is another thing to blindly cut the defense capabilities in a manner that ultimately will not even resolve the original issue of national indebtedness, but will have an enormous impact on national defense and security. By getting ahold of the budget now, the pressure felt by politicians—who understand the necessity of the strength of the military—will be diminished and the capabilities for defense and security will be maintained.

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<sup>118</sup> U.S. Government, “2012 Defense Strategic Guidance,” Inside Defense, last modified 12 May 2012. <http://insidedefense.com.libproxy.nps.edu/201201052386447/defense-plus/text-document/2012-defense-strategic-guidance/menu-id-77.html>.

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## VI. THE WAY AHEAD

Thomas Paine, a very vocal proponent of independence, agreed with Hamilton that a national debt could be a blessing. In his pamphlet *Common Sense*, Paine contended that Americans need not worry about a national debt; there currently was not one, but there also was no Navy either. Britain, on the other hand, had a huge debt and a huge Navy to go with it. He continued that if the Americans went into debt—not for the consumption of goods but for the ability to finance a Navy and win independence—the money borrowed would be well worth the money paid back.<sup>119</sup> It is on this message that today’s politicians have grown foggy. In time of war it may be a blessing, maybe even a necessity, to borrow money. However, money borrowed in time of peace is more than irresponsible, and the U.S. government’s level of irresponsibility has increased rather quickly in recent years.

As the terror attacks on 11 September 2001 recede in time and memory, and as the results of the financial crises of 2008–2009 become more entrenched in everyday experience, funding for the U.S. military has become a much more controversial topic. With politicians and the general public only interested in the bottom line budget and unwilling to reduce the entitlements enjoyed by the greater public, the one percent of the U.S. citizens that make up the military are feeling the erroneously strong push to reduce the size of the Department of Defense.

Cutting the defense budget will not ultimately save the government from a large deficit, and may actually reduce the amount of money pumped into the economy. The idea that cutting the defense budget is the key to financial success is even more inaccurate when one looks at how much the defense budget actually accounts for in the federal budget. Defense spending is already near historical lows. During the Vietnam Conflict, the Defense as a percentage of GDP was 8.9 percent. Through the Reagan administration, that rate dropped to 6 percent. Under President Bush, the defense budget

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<sup>119</sup> Robert E. Wright, *One Nation Under Debt: Hamilton, Jefferson, and the History of What We Owe*, New York: McGraw Hill, 2008, 47.

was 4.6 percent of GDP. Today, the base defense budget has dropped even further to 3.7 percent, and if the current planned budget cuts go into effect, that number sinks to 3 percent. So with the rise in entitlements (Social Security alone went from 2.5 percent in 1965 to 10 percent now, and is expected to engulf the entire budget in less than 40 years), lowering the defense budget will not fix the problem of the growing national debt.<sup>120</sup> Moreover, singling out the military to bear the brunt of the budget cuts, particularly in the heat of an election year, will have similarly ill effects on the national defense and security.

Although China's ownership of the national debt has decreased from 12 percent of the total U.S. public debt to 10 percent of the public debt, it is more a concern of how much debt the United States maintains rather than who holds the debt. But by other countries increasing their holdings of U.S. dollar assets, it reduces their currency value and in essence increases their exports—mainly to the United States who is the largest global importer—and increases their own country's economic growth.<sup>121</sup> So unless Congress makes tough decisions to fix its current free-borrowing mentality, other countries will continue to buy our debt and the United States will continue to pay interest to other countries rather than putting that money into its own economy and the military.

#### **A. GLOBAL PARTNERSHIPS**

Although the United States remains currently the only country capable of projecting power across the globe, the decrease in budget capacity will reduce the force structure and require alternative options within the global theater. With the reduction in forces, the United States is required to build on global partnerships and continue the practices of the Iraq War and the most recent reliance on international relations that prevailed during the Libyan conflict. President Obama reiterated this commitment to international cooperation in the National Security Strategy when he stated that “we are joining with allies and partners around the world to build their capacity to promote

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<sup>120</sup> Matthew Spalding, “The Price of Liberty: Providing for the Common Defense,” The Heritage Foundation, no. 12-0, 1 May 2012, 2.

<sup>121</sup> Zachary A Goldfarb, “China less of a U.S. creditor as it becomes more of an election issue,” *The Washington Post*, 16 October 2012.

security, prosperity, and human dignity. And the growing capabilities of allies and partners, as demonstrated in the successful mission to protect the Libyan people, create new opportunities for burden sharing.”<sup>122</sup> Rebalancing the force can mean more than looking at our own military components.

The 2010 QDR emphasizes that “given the complex security environment and the range of missions, capabilities, and institutional reforms necessary to protect and advance U.S. interest, [it is] importance to revitalize defense relationships with allies and partners in key regions.”<sup>123</sup> The QDR goes on to say that “strong regional allies and partners are fundamental to meeting 21<sup>st</sup> century challenges successfully. Helping to build ally capacity can help prevent conflict from beginning or escalating, reducing the possibility that large and enduring deployments of U.S. or allied forces would be required.”<sup>124</sup>

The rise of China may very well never materialize to anything of concern for the United States economically. Militarily is another story, however. One country in particular that is definitely concerned with a Chinese rise is its neighbor to the west, India. As the world’s largest democracy (per population), India’s governmental doctrine is in contrast to that of China. It is no wonder that the United States has chosen to emphasize specific relationships within the Asian-Pacific as well as reinvesting “in a long-range strategic partnership with India,” the second largest population in Asia as well as the second fastest growing Asian economy.<sup>125</sup> There is strength in numbers.

Specifically noting the tough economic times, the National Security Strategy emphasizes the importance of NATO allies in a “‘Smart Defense’ approach to pool, share, and specialize capabilities as needed to meet 21<sup>st</sup> century challenges.”<sup>126</sup> The NSS continues by stating:

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<sup>122</sup> U.S. Government, “Sustaining U.S. Global Leadership: Priorities for 21st Century Defense,” Washington, DC: GPO, 2012.

<sup>123</sup> U.S. Government, “QDR Report,” 3.

<sup>124</sup> *Ibid.*, 10.

<sup>125</sup> U.S. Government, “Sustaining U.S. Global Leadership, 2.

<sup>126</sup> *Ibid.*, 3.

Building partnership capacity elsewhere in the world also remains important for sharing the costs and responsibilities of global leadership. Across the globe we will seek to be the security partner of choice, pursuing new partnerships with a growing number of nations- including those in Africa and Latin America- whose interest and viewpoints are merging into a common vision of freedom, stability, and prosperity. *Whenever possible, we will develop innovative, low-cost, and small-footprint approaches to achieve our security objectives, relying on exercises, rotational presence, and advisory capabilities.*<sup>127</sup>

The best the military can hope for in regards to Congressional funding is for Congress not to have to be concerned with funding military operations at all. Funding for the military needs to come from other nations that are benefitting from the U.S. military's capabilities. One example comes from the first Iraq War. Although the war was fought stupendously by U.S. forces, the funding came predominately from Kuwait, Saudi Arabia, Japan, Germany, and South Korea. Of the \$61 billion spent on the war, \$48 billion was repaid, in cash, by the above mentioned nations. Contributions other than cash, such as fuel and equipment, totaled nearly \$6 billion. Of the \$61 billion spent for the war, the United States was only fiscally responsible for a mere \$7 billion.<sup>128</sup> Even though the war was not originally planned to be a pass-the-hat type of operation, in the end, the ability of foreign funds makes this an invaluable lesson in how to handle overseas military operations; where more than one country benefits from military action, more than one country ought to pay for that military capability.

## **B. INTERNAL PARTNERSHIPS**

Not simply relying on other nations, the Department of Defense is expecting other national institutions such as United States Agency for International Development (USAID) and the Department of State (DoS) to take more of an active role in global security. The scaling down of the U.S. forces means that the military will no longer be sized to conduct war and then also remain as a rebuilding asset once the fighting has been terminated. What this means is not that the United States will ignore reconstruction, it

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<sup>127</sup> Ibid.

<sup>128</sup> Hormats, *The Price for Liberty*, 255.

means that the military plans to turn the rebuilding endeavor over to someone else. Presumably, this someone else would be the State Department, which is not set up to handle such a large task and is still limited by the same national fiscal policy.

The QDR emphasizes that the United States will rely on non-military means. Simply shifting responsibility from one agency to another, however, does not address the problem of the national deficit. Sure, the military looks like it is reducing its budget, but the matter at hand is still that the United States will be involved in nation building; the funds will simply come from another pot, ultimately not reducing the national debt.<sup>129</sup> This is similar to a wife spending money and the husband not being concerned because, well, *he* did not spend the money. The point is that the money was still spent and ultimately came out of the same pot, even if from a different account.

The 2011 National Military Strategy of the United States of America affirms the same reliance on partnerships. This strategy reemphasizes that the U.S. military is strongest when it is paired with other instruments of the state.<sup>130</sup> The idea of adding more government agencies to the same problem only exacerbates the problem of financial irresponsibility.

### **C. THE REAL FISCAL PROBLEM**

From Madison to Lincoln to Roosevelt to Reagan, all former Presidents and their Congressional members cut civilian programs, raised taxes, and performed the needed measures to help fund the wars they were involved with. During WWII, government revenue from taxes “increased more than three times to over 20 percent of GDP.”<sup>131</sup> When terrorism became real to the United States and President Bush subsequently declared a war on terror, the administration and Congress failed to act in the manner necessary during a time of war. With a cut in taxes, increased social welfare programs,

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<sup>129</sup> U.S. Government, “QDR Report,” 6.

<sup>130</sup> U.S. Government, “The National Military Strategy of the United States of America,” Washington, DC: GPO, 2011, 5.

<sup>131</sup> Institute for Economics and Peace, “Economic Consequences of War on the U.S. Economy,” 5. <http://economicsandpeace.org>.

and billions of dollars spent on Overseas Contingency Operations (OCO), the operations in Iraq and Afghanistan marked the first time in history that wars were financed completely by deficit spending.<sup>132</sup> Congress made no plan to balance its list of social entitlements with its commitment to protecting American citizens; Congress simply continued to spend money on domestic programs while increasing the military's budget almost two-fold.

Most of the current budget crises stems from the two parties in Congress not working together. In Defense Secretary Panetta's speech concerning the 2013 fiscal budget, he stated that in order to reduce the budget as required by the BCA, that:

Ultimately we will need the support and the partnership of Congress to implement this vision of the future military. Make no mistake, the savings we are proposing will impact all 50 states, and many districts across America. This will be a test of whether reducing the deficit is about talk or action. My hope is that when members understand the sacrifice involved in reducing the defense budget by half a trillion dollars, it will convince Congress to avoid sequestration, a further round of cuts that would inflict severe damage to our national defense for generations.<sup>133</sup>

Secretary Panetta confirmed the need for Congress to be willing to examine everything and make the correct, tough choice no matter whose district cuts fell upon in his defense strategic guidance speech. His third of four principles to help guide deliberation maintained that "savings must be achieved in a balanced manner, with everything on the table, including politically sensitive areas that will likely provoke opposition from parts of Congress, from industry and from advocacy groups. That's the nature of making hard choices."<sup>134</sup> These straight-forward statements by the Secretary of Defense detail exactly why the national deficit and debt has become such a problem—the unwillingness of Congressman to act in the manner most beneficial for the whole of the country.

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<sup>132</sup> Hormats, *The Price for Liberty*, XIX.

<sup>133</sup> Panetta, "Fiscal 2013 Budget," 5.

<sup>134</sup> *Inside Defense*, "2012 Defense Strategic Guidance," last modified 12 May 2012. <http://insidedefense.com.libproxy.nps.edu/201201052386447/defense-plus/text-document/2012-defense-strategic-guidance/menu-id-77.html>.

Historically, defense budgets have always decreased precipitously—and sometimes calamitously—as war came to an end. After the Vietnam era, defense spending decreased between 20 percent and 25 percent, for example. To decrease defense spending after war only makes sense. If war ends, the amounts of money spent on war should naturally decrease. But to decrease the military at such dramatic measures would leave the military in a hollow force structure as was the case post-Vietnam Conflict.

With the war in Iraq over and the war in Afghanistan drawing to a close, Congress has again looked at the military to reduce the budget. Then Defense Secretary Robert Gates stated that it was inevitable for cuts to come in defense as the government's belt gets tighter. He noted that it is not unprecedented for cuts of the current nature by saying, "What's being proposed by the President is nothing close to the dramatic cuts of the past. For example, defense spending in constant dollars declined by roughly a third between 1985 and 1998. What's being considered today, assuming all \$400 billion comes for DoD over 12 years, corresponds to a projected reduction of about 5% in constant dollars—or slightly less than keeping pace with inflation."<sup>135</sup>

Given this strength of the military, however, continued cuts are still possible. The problem is simply that continued cuts will only transform the national military into a hollow Easter Bunny. With a growing China and the everlasting possibility of asymmetrical warfare from nations or individuals, the military must remain strong to ensure global trade and peace. By the national debt increasing, it's creating a problem for the United States in which the military is taking the brunt of budget reductions leading to a less capable fighting force, and eventually everything in the government will be reduced as the debt is running away and entitlements are increasing at a similarly break-neck speed.

#### **D. THE BOTTOM LINE**

With the federal deficit coming down slightly from an all-time high, Congress and the greater civilian population are calling for dramatic cuts to the Department of Defense

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<sup>135</sup> Towell, "Defense," 19.

in order to balance the budget. The DoD as the sole means to balance the budget is a misnomer, however. Accounting for only 3.7 percent of the FY2012 budget, reducing the DoD will only reduce capabilities within the military, but reduce the deficit by a mere \$50 billion a year—the current requirement from the BCA of the military—equivalent to less than five percent of the overall deficit. Only if Congress changes the laws in regard to entitlements will the federal deficit ever extinguish. Congress, however, has not shown any real interest in fixing the deficit, merely empty rhetoric designed to blame someone else for the current predicament.

U.S. Senator Susan Collins, a member of the Senate Services Committee, Defense Appropriations Subcommittee, and the Senate Homeland Security Committee, summed up the problem of the budget completely when she stated:

The overwhelming bipartisan passage of this year's defense authorization bill came against the backdrop of a toxic partisan environment that has continued to get worse. This is not just my opinion: a Rand corporation study demonstrates that the amount of overlap between the most conservative Democrat and the most liberal Republican in the House has been decreasing since the 1960s. In the 110th Congress, the overlap in the House effectively disappeared, making it extremely difficult for centrist legislating to be successful. The ramifications of this culture were epitomized in the "Supercommittee's" failure to propose reforms that would place our fiscal trajectory on a sustainable course despite the urgent need to do so.

... As a person committed to seeking pragmatic solutions through compromise, it seemed to me that if ever there were a moment when Members of Congress would put aside their partisan politics for the greater good of the Nation, this would have been the time. Unfortunately, we now face automatic spending cuts that are slated to begin next year that would undoubtedly result in serious consequences for our national security. Sequestration remains the giant sword of Damocles hanging over our collective head...In the end, it all comes back to the budget, and the choices it forces us to make.<sup>136</sup>

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<sup>136</sup> Susan Collins, "Remarks to the Surface Navy Association Annual Symposium," *InsideDefense.com*.

11 January 2012. <http://insidedefense.com.libproxy.nps.edu/201201112386993/Defense-Plus/Text-Document/sen-collins-sna-symposium-speech/menu-id-77.html>.

“It is not enough to have a large number of troops, sound military strategy, and able generals to fight a war; the country also need[s] a sound financial strategy and skillful leaders at the Treasury and in Congress to ensure that the money [is] available to meet extraordinary military expenses.”<sup>137</sup> As President Obama stipulated in the National Security Strategy of 2012, “We must put our fiscal house in order... and renew our long-term economic strength,”<sup>138</sup> and in turn our military strength.

In the most recent quarter, the U.S. economy only grew at a rate of 2 percent. With the scheduled tax increases and budget cuts scheduled for January, the reduction in spending from the military—which is slated to receive the biggest proportion of the projected cuts—could have a drastic impact not only on defense but also on the economy. The CBO suggests that as much as a 4-percentage-point decrease in the economy could result from such Congressional decisions. Even the potential that such cuts and tax increases is going to happen is maintaining the economy in such a slow state of growth. The impact of this “fiscal cliff” is already having dire results.<sup>139</sup> If the economy reverts to a recession, will Congress only call for more cuts to the DoD and leave the country even more vulnerable?

As for now, the United States has little to fear about its national debt, at least outwardly. With no external competition for global hegemony, international cooperation in strategic locations, and economic integration throughout the globe, the current status quo is expected to remain in place. Not until something similar to 9/11 (which shook up the national intelligence system) occurs will Congress find it necessary to make significant changes to the current financial system. It is far more relevant to current Congressman to get re-elected than it is to balance a budget that will not affect them but future generations. The military will continue to be successfully budgeted according to national defense strategy and the national debt will continue to grow. The only immediate budgetary danger to the military appears to be if a politician is close to not getting

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<sup>137</sup> Hormats, *The Price for Liberty*, XIV.

<sup>138</sup> U.S. Government, “Sustaining U.S. Global Leadership,” 2012.

<sup>139</sup> *Washington Post*, *The*, “The Looming Fiscal Cliff,” 26 October 2012.

reelected and chooses to pursue the size of the military budget as his/her public rhetoric in order to influence the unaware voters who focus solely on the size of the defense budget rather than the real issue of runaway entitlements and lack of Congressional action. The budget does not need to be fixed to eliminate another country's soft-power leverage against the United States, but the deficit does need to be reduced to maintain a military force capable of overwhelming superiority in war.

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