

Attention! Deficits Disorder

by [Addison Wiggin](#)

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"To contract new debts is not the way to pay old ones."

~ George Washington, letter, April 7, 1799

If the history of United States federal budgets – and the debts that grow out of them – tells us anything, it is this: the dollar's in it up to its eyeballs. Today's level of debt and continuing deficit spending is only the visible portion of that problem; beneath the surface we face an unavoidable day of reckoning for our great national past-time: spending money.

Long before Lord Keynes opened his mouth in the 30s, the attitude in Washington, and among academics, has been that we don't really have to ever repay debt. It can be carried indefinitely for future generations to worry about. Most people today would claim that debt "doesn't matter" or even that it is a wise policy to spend more than you bring in. The mind boggles.

Early on in U.S. history, Americans learned from British ancestors that empires could be built on a foundation of debt – and continued indefinitely. In the early part of the 18th century, Sir Robert Walpole introduced an innovative system for financing Britain's colonial expansion and ever-growing military might.

Government, Walpole demonstrated, is able to create a revenue stream by issuing bonds and other debt instruments. The interest is paid regularly and eventually, upon maturity, the face value is paid off – and for every maturing bond, a new one is issued. This simple means for the expansion of revenue through debt was the venue by which Britain built

its empire, from the 1720s through the next 100 years. Among those who observed this phenomenon of "endless debt financing" was the first Secretary of the Treasury of the United States, Alexander Hamilton.

In the early days of the American nation, a host of fiscal problems faced Hamilton and the other Founders. The War for Independence left a large debt; there was no unified currency and each state issued its own money; the currency itself was of dubious value and inflation made it difficult to imagine how the young nation would even survive.

Hamilton's view was that growth and expansion would be possible with the use of debt. "Hamilton's rationale for a perpetual public debt included his belief that it would help keep up taxes and preserve the collection apparatus," writes Scott Trask on the Mises.org site, "He believed Americans inclined toward laziness and needed to be taxed to prod them to work harder."

Not everyone agreed.

Thomas Jefferson argued: "It was unjust and unrepugnant for one generation of a nation to encumber the next with the obligation to discharge the debts of the first. After all, the following generation cannot have given their consent to decisions made by their fathers, nor will they have necessarily benefited from the deficit expenditures."

During the 19th century, American debt did not grow substantially. When he began his presidential term, Jefferson had an \$83 million debt, mostly left over from the costs of the war. During his term, Jefferson reduced the debt to \$37 million even after spending \$15 million on the Louisiana Purchase.

In Madison's term of office, the ill-fated War of 1812 ran the national debt up to \$127 million by 1816. Monroe and John Quincy Adams were both able to reduce the debt during their terms of office and by 1829 the debt had fallen to \$58 million. And then, during Andrew Jackson's presidency, the national debt was entirely paid off. For the first time in its history (and the last) the United States had no national debt.

Over the next decade, the country ran up \$46 million in new debt and by 1848 it rose to \$63 million. However, in all fairness, one advantage of this was that the Mexican War resulted in U.S. expansion all the way to the Pacific and the acquisition of the entire southwest and California.

Under the Pierce administration, the debt was paid down to \$28 million; but it never got that low again.

The Civil War exploded the national debt up to \$2.8 billion, or 100 times higher than it had been in 1857. Per capita debt in 1860 was \$2 per capita; at the end of 1865, it was \$75. The temporary tax measures in place during the war were repealed and, by the end of the 19th century, the debt had been reduced to \$1.2 billion, less than half of its 1865 level.

Given the vast expansion of U.S. territory and the wars the country fought to create and then hold together the United States, this does not seem a large debt level. In fact, in its first 110 years of history, the United States had shown its ability to fund expansion while reducing debt over time. And this was accomplished without an income tax. In fact, in 1869 and again in 1895, the Supreme Court ruled federal income taxes unconstitutional.

The story was quite different in the 20th century. By the end of World War I, the national debt had risen to \$26 billion. Even though the debt level had been reduced over the next decade, the Great Depression caused further deficit spending and FDR's New Deal tripled debt levels up to \$72 billion.

World War II created even higher debt levels. By 1945, the country owed \$260 billion – small by today's standards, but gargantuan in its time. But one outgrowth of that war was a new one, the Cold War. Military spending took the national debt up to \$930 billion by 1980 and under Reagan's administration, it rose to a staggering \$2.7 trillion. In Clinton's eight years, the debt tripled to \$6.9 trillion. Estimates as of 2005 are that the debt will reach \$10 trillion by 2008.

In other words, the national debt is growing exponentially. We may blame the War on Terror, the inheritance of the Cold War, or the new international market and its competitive forces, or a combination of these realities. In any event, it is clear that the levels of debt reach new records, virtually on a month-to-month basis.

We make a distinction in reviewing all of this history, between debt levels and deficit spending. Many people are confused about the differences here and some, even experts, use "debt" and "deficit" interchangeably.

A "debt" is the amount of money owed. A "deficit" is the shortfall in a current budget. For example, if we begin the year with a \$6 trillion national debt, and in the following year we spend \$1 trillion more than we bring in, we are running a deficit of \$1 trillion. At the end of the year, that deficit will increase the debt to \$7 trillion.

Why does the government need to spend more than it takes in? After all, in most of the 19th century there were no income taxes (except during the Civil War). And the debts the nation incurred were paid down time and again. Even by 1900, the debt level was manageable...not so today. And since 1980, the debt has exploded to levels that are inconceivable.

If a currency reflects a nation's economic health, as the quaint classical economists believed, the current bull run in the dollar is but a correction in a long-term bear market and an opportunity to sell.

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Addison Wiggin [[send him mail](#)] is the author, with Bill Bonner, of [Financial Reckoning Day: Surviving The Soft Depression of The 21st Century](#). This article is taken from his soon-to-be released new book, [The Demise of the Dollar...and Why It's Great for Your Investments](#).



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