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A Short Primer on the National Debt

With a return to 1990s growth rates, the debt-to-GDP ratio could drop to 56.7%, about where it was in 2000, in just one decade.

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With the national debt certain to be a front-and-center issue in the 2012 campaign, it is important to understand the true measure of its size. That size seems to vary considerably in news reports. Some news organizations use the debt held by the public, others use total debt. Still others report total future liabilities of the federal government, without making clear what, exactly, that means.

So, a few definitions. The total national debt of the United States is the sum of all federal bills, notes and bonds that have been issued by the Treasury and not yet redeemed. The publicly held debt is the sum of the Treasury securities held by individuals, financial institutions and foreign governments. (That's not just the Chinese, by the way. Both Great Britain and Japan are also major holders of U.S. debt, as are many other countries in lesser amounts.)

The intra-governmental debt is the sum of Treasury bonds held by agencies of the federal government, principally the so-called Social Security Trust Fund. The liabilities equal the future pensions, health care, Social Security payments, etc., that are promised under current legislation.

But while the Treasury securities bear the full faith and credit of the United States and any failure to pay the interest or redeem the principal in a timely fashion would be a default, the liabilities are liabilities only so long as current law remains unchanged. If, for instance, Congress were to adjust the formula by which Social Security cost-of-living increases were calculated or change the age of eligibility, future federal liabilities would shrink by trillions of dollars instantly.

Should the intra-governmental debt be counted when discussing the national debt? I think the answer is yes. As the Social Security surplus disappears (it did, at least temporarily, in 2010) as the baby boomers increasingly retire, the Treasury will be asked to redeem more and more of these federal bonds.

Congress will then have three options: cut spending elsewhere, raise taxes, or borrow the money in the bond market, thus converting the intra-governmental debt into publicly held debt. The last of the three options is the only plausible one and so the intra-governmental debt should be counted as though it were publicly held debt, as that's exactly what it will be in the fullness of time.

In absolute numbers, the total public debt as of Aug. 11 was $9.924 trillion, and the intra-government debt was $4.666 trillion, for a total of $14.587 trillion. That's well over 300 million times the country's median household income. Stacked as dollar bills, it would reach 920,953 miles high, almost four times as far from Earth as the moon.

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But while these numbers are fun to play with, they don't mean much. It's the debt's size relative to gross domestic product that matters, just as personal debts must be measured against a person's income before they can be properly evaluated. The GDP of the United States was $15.003 trillion at the end of the first quarter in 2011. That makes the public debt equal to 66.1% of GDP and the intra-governmental debt 31.1%. Total debt is now 97.2% of GDP and climbing rapidly.

And it's the climbing rapidly part that is worrisome, not the debt's current size relative to GDP. Indeed, the debt has been substantially higher by that measure in earlier times. In 1946, in the immediate aftermath of World War II, it was 129.98% of GDP. But while the debt had increased enormously during the war (it had been 50% of a much smaller GDP in 1940), it did not increase substantially over the next 15 years. It was $269 billion in 1946 and $286 billion in 1960. The American economy grew so much in those years that the debt, while slightly up in absolute terms, was down to only 58% of GDP by 1960.

The debt grew to $370 billion in the next decade, but again economic growth (and, towards the end of the 1960s, inflation) continued to reduce it relative to GDP. In 1970 it was a mere 39%, the lowest it had been since the depths of the Great Depression. And while the debt nearly tripled in the 1970s (to $909 billion), the raging inflation of that decade caused the debt to continue to decline to 34.5% of GDP.

When the Federal Reserve under Paul Volcker broke the back of the 1970s inflation, the debt relative to GDP began to soar. Why? Because Washington continued to increase spending faster than government revenues increased (and revenues increased a whopping 99.4% in the 1980s thanks to the great boom that began in 1983). The debt was 58.15% of GDP in 1990, a full 24 percentage points above its 1980 low. It continued to increase dramatically in the early 1990s, reaching 68.91% of GDP in 1994.

But then a Republican Congress was swept into power that year, the first time the GOP controlled both houses of Congress since 1954, and President Clinton tacked sharply to the center. In the next six years, while revenues increased 61%, federal outlays increased only 22%. The years 1998-2000 actually showed the first surpluses in the federal budget in 30 years. And the debt, relative to GDP, declined between 1994 and 2000 to 57.3% from 68.91%.

That decline ended in 2001 following the collapse of the dot-com bubble and rising unemployment in the resulting recession. By 2003 the debt-to-GDP ratio had risen to 61.7%. Many blame the Bush tax cuts for adversely impacting federal revenues, causing the debt to spiral upwards. But that is just not true. Federal revenues declined by almost 12% in the early years of the decade, but when the tax cuts fully kicked in in 2003, the economy began to grow strongly again and federal revenues increased 44% in the next four years, while unemployment fell to 4.2% from 6.2%. Federal outlays in those four years increased by only 26.4%, and while the debt-to-GDP ratio increased to 64.8% by 2007, that was still well below what it had been in 1994.

Only with the severe recession that officially began in mid-2007 did the debt-to-GDP ratio begin to soar once more. It reached 67.7% by Oct. 1, 2008, near the end of the Bush administration. A year later, under President Obama, it was at 84.4%, a year later still 93.8%. It is headed quickly towards 100% and beyond without fundamental change in how Washington handles the public fisc.

But a president and a Congress committed to reforming Washington's ways face no insuperable problem getting the debt under control. No one expects the United States to pay off its debt (as we did in the administration of Andrew Jackson, the only time a major country has ever paid off its national debt). Even in a best-case scenario, the absolute size of the debt will not get smaller. But if we can summon the necessary political will, we can dramatically affect the measure of the debt burden that matters: the debt-to-GDP ratio.

Just do what we did after World War II, a period that saw its share of recessions and wars, both hot and cold: stop adding to the debt and let the growth of the GDP bring down the ratio.

If the country can experience GDP growth equal to what we had in the 1990s, the debt-to-GDP ratio would drop, in just a decade, to 56.7%, about where it was in 2000.

But that can only happen if the American electorate sends an unequivocal message in November 2012. Voters did exactly that in November 2010. Will they do it again?

Mr. Gordon is the author of numerous books, including "Hamilton's Blessing: The Extraordinary Life and Times of Our National Debt" (Walker, revised edition, 2010).