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RESTRUCTURING UNITED STATES GOVERNMENT DEBT: PRIVATE RIGHTS, PUBLIC VALUES, AND THE CONSTITUTION

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ABSTRACT

Mainstream policy discussions take as given that the United States will and must pay its debts in full and on time, and that restructuring is legally and politically impossible. In our judgment, this assumption is unwarranted. Far from being unthinkable, under some circumstances restructuring the debt of the United States would merit serious consideration, and these circumstances may well be fast approaching. We diverge from the standard wisdom for two reasons. First, we doubt that payments on treasury obligations will necessarily take precedence over what the electorate sees as more pressing needs, including national security and price stability. In particular, we suspect voters may balk if told that holders of United States debt securities have ironclad priority over Social Security claimants and others with well-settled expectations of government benefits. Second, we think it wrong to equate restructuring with catastrophe. While we do not dismiss out of hand the dangers of not paying creditors in full and on time, we believe that—perhaps counterintuitively—the American constitutional framework could prove an asset rather than

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a liability when it comes to handling severe financial stress. Our conclusion on this point follows from the insight that the very dispersals of power that can fuel gridlock can also serve to enable the United States to offer credible assurances that its new financial structure will be stable going forward.

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INTRODUCTION

This Article argues that the time has come to consider the (once) unthinkable idea that the United States government could restructure its finances.[1] A debt restructuring could come about through

1. *See* Robert Jenkins, *Think the Unthinkable on U.S. Debt*, *in* SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? 86, 86–87 (Bureau of Int'l Settlements ed., 2013) (finding that whether the United States will "request a bailout" and what "writedown of US debt will be needed to restore sustainability to its fiscal accounts" are "not questions being asked today" but are "worth contemplating"); *see also* Charles W. Mooney, Jr., *United States Sovereign Debt: A Thought Experiment on*

negotiations with creditors who agree to altered terms or result from an outright refusal by the United States to meet its obligations.[2] What is more, we suggest that a debt restructuring would not spell inevitable doom for the United States. In fact, if handled with skill—which we stress is a big "if"—it could even help lay the foundation for a stronger, more prosperous nation.

We do not advance these claims lightly. We recognize this line of thought lies outside the bounds of mainstream discussions of fiscal policy, which take as a starting point that while taxes and spending (including spending on Social Security, Medicare, and other entitlement programs) are up for readjustment, the United States must pay its debts in full and on time or suffer disaster.[3]

Default and Restructuring, *in* IS U.S. GOVERNMENT DEBT DIFFERENT? 169, 169–70 (Franklin Allen et al. eds., 2012) (undertaking a "thought experiment" on the "default and restructuring" of U.S. sovereign debt while expressing the view "that such a restructuring would make sense only in extremely dire economic circumstances").

2. *See* Mooney, *supra* note 1, at 170. This Article's analysis is grounded on the premise that a debt restructuring would follow such a refusal. *Cf.* Herschel I. Grossman & John B. Van Huyck, *Sovereign Debt as a Contingent Claim: Excusable Default, Repudiation, and Reputation*, 78 AM. ECON. REV. 1088, 1088 (1988) (explaining why, in a world with rational debtors and creditors, sovereign debt tends to be restructured rather than repudiated). Debt restructurings of sovereign nations commonly involve reductions of the principal amount owed, reductions of interest rates, changes in maturity dates or some combination of these approaches. *See* Lee Buchheit et al., *The Restructuring Process*, *in* SOVEREIGN DEBT: A GUIDE FOR ECONOMISTS AND PRACTITIONERS 328, 343 (S. Ali Abbas et al. eds., 2019).

3. *See, e.g.*, WILLIAM G. GALE, FISCAL THERAPY: CURING AMERICA'S DEBT ADDICTION AND INVESTING IN THE FUTURE 1, 64–65 (2019) (maintaining that "[a]ddressing the [federal government's] debt challenge will require both slowing the spending trajectory and raising taxes" and arguing that debt default could result in such "unmitigated disaster" that "we should do everything we can to ensure that we never have one"); EDWARD D. KLEINBARD, WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY xxi–xxii (2015) (advancing fiscal reform proposals and characterizing debt default as "a tactic" so "cataclysmic in its implications that only a modern Nero would contemplate it"); MICHAEL D. TANNER, GOING FOR BROKE: DEFICITS, DEBT, AND THE ENTITLEMENT CRISIS 11 (2015) (concluding that, in large part because "all money borrowed today must be repaid eventually—with interest," the United States must make fundamental changes to its major entitlement programs); Roger C. Altman & Richard N. Haass, *American Profligacy and American Power: The Consequences of Fiscal Irresponsibility*, 89(6) FOREIGN AFFAIRS 25, 33–34 (2010) (maintaining "the only sound approach" to the "debt addiction" that imperils America's national security and international standing is "a mix of spending reductions and tax increases"); Leonard E. Burman et al., *Catastrophic Budget Failure*, 63 NAT'L TAX J. 561, 581 (2010) (strongly endorsing spending cuts, "especially for entitlements," and revenue increases to "stabilize" and "eventually reduce debt as a share of the economy"); *see also* ERSKINE B. BOWLES & ALAN K. SIMPSON, A BIPARTISAN PATH FORWARD TO SECURING AMERICA'S FUTURE

But it is precisely these assumptions that we think deserve a hard look. The harsh reality is that with total United States government debt of $22.72 trillion as of September 30, 2019, and projected to rise to unprecedented levels by 2049,[4] a "fiscal gap"[5] that is a growing chasm, and a volatile international climate, the United States might not be able

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8–9 (2013) (calling for "[s]erious [t]ax and [e]ntitlement [r]eforms" along with significant spending cuts to "[p]rotect the [f]ull [f]aith and [c]redit of the U.S. [g]overnment").

4. *Debt to the Penny*, TRANSPARENCY.TREASURY.GOV, https://www.transparency.treasury.gov/dataset/debt-to-the-penny/table-view [https://perma.cc/QBP5-KRBT] (last visited Feb. 3, 2020). This number includes $5.91 trillion of intragovernmental holdings, which consist, for the most part, of special United States debt securities held by government controlled "trust funds" and retirement funds, most prominently the Social Security Trust Fund and Federal Disability Insurance Trust Fund. *Id.* The United States Treasury emphasizes another figure, termed "debt held by the public," which omits intragovernmental holdings while (somewhat confusingly) counting obligations held by the Federal Reserve. U.S. DEP'T OF THE TREASURY, FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT FY 2018, at 19–20 (2019) [hereinafter U.S. FINANCIAL REPORT FY 2018]. Many discussions of the national debt use this smaller "debt held by the public" amount, which stands at $16.80 trillion as of September 30, 2019. *Debt to the Penny*, *supra*. Unless otherwise specified, in this Article, "public debt" or "national debt" means the total of "debt held by the public" and intragovernmental holdings. We include intragovernmental holdings in our debt figures because they represent important promises of the U.S. government to beneficiaries of key social insurance programs and are not available for other government purposes, including debt service and repayment. *See also* CONGRESSIONAL BUDGET OFFICE, THE 2019 LONG-TERM BUDGET OUTLOOK 5 (2019) ("If current laws generally remained unchanged, growing budget deficits would boost federal debt drastically over the next 30 years [to a] . . . level of debt [that] would be the highest in the nation's history by far [and] . . . on track to increase even more.").

5. *See The Coming Crisis: America's Dangerous Debt: Hearing Before the S. Comm. on the Budget*, 114th Cong. 356 (2015) (statement of Laurence J. Kotlikoff, Professor of Economics, Boston University) (defining the "infinite horizon fiscal gap" as equal to the present value of all projected future expenditures less the present value of all projected future receipts); *see also* U.S. FINANCIAL REPORT FY 2018, *supra* note 4, at 7 (defining the "75-year fiscal gap" as a measure of "how much primary deficits must be reduced over the next 75 years in order to make fiscal policy sustainable," and reporting "[t]hat [the] estimated fiscal gap for 2018 is 4.1 percent of GDP (compared to 2.0 percent for 2017)"); Alan J. Auerbach et al., *The Federal Budget Outlook: We Are Not Winning*, TAX NOTES 617, 621–22 (2018) (explaining that "[t]he fiscal gap is an accounting measure that is intended to reflect the long-term budgetary status of the government" by answering "the question: to start a policy change in a given year and reach a given debt-to-GDP target in a given future year, what is the size of the annual, constant-share-of-GDP increase in taxes or reductions in noninterest expenditures (or combination of the two) that would be required, holding projected economic performance unchanged?").

to keep all its promises, even if it wants to. That means that some of the commitments the United States has taken on may be reduced or even jettisoned altogether, and it is far from clear—at least to us—that payments on treasury obligations must be accorded the highest level of protection. The United States, after all, is a democracy, and voters may see more pressing needs for government expenditures than interest and principal payments on the national debt. In particular, we suspect that if push comes to shove voters will balk if told that holders of United States debt securities enjoy ironclad priority over Social Security claimants and others with well-settled expectations of government benefits. It is also highly plausible—again, at least to us—that citizens will regard national security and price stability as higher priorities than paying the nation's creditors.

If we are correct in our suppositions about the American electorate, it makes sense to ask what consequences would follow from not treating the national debt as sacrosanct. The normal inside the beltway wisdom holds that failure to pay United States government creditors would be "unconstitutional"[6] and certain—or nearly so—to destroy the nation's credit.[7] We take a different view. While we do not dismiss out of hand the dangers of borrowing and not repaying funds in full, we believe the United States Constitution does not bar debt restructuring and that our constitutional system could even turn out to be an asset when it comes to preparing for, withstanding, and flourishing in the wake of severe financial stress. Our conclusions are rooted in the insight that the very dispersals of power that can make it hard to get things done under the American constitutional system also enable the United States to give credible assurances that its revised financial structure will be a durable one.[8] As evidence of our position,

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6. *See* GALE, *supra* note 3, at 64; *see also* D. ANDREW AUSTIN & KENNETH R. THOMAS, CONG. RESEARCH SERV., CLEARING THE AIR ON THE DEBT LIMIT 8 (2017) ("There is little doubt that Congress has an obligation to pay its debts under a variety of constitutional provisions, including the Borrowing Clause, the Due Process Clause, and theories of vested contractual rights. The failure of the government to pay its debts would also appear to violate the Public Debt Clause."); Neil H. Buchanan & Michael C. Dorf, *How to Choose the Least Unconstitutional Option: Lessons for the President (and Others) from the Debt Ceiling Standoff*, 112 COLUM. L. REV. 1175, 1179 (2012) (asserting that failure to pay "bondholders, contractors, employees, and other persons entitled to money under federal law" would violate the Fourteenth Amendment's Public Debt Clause).

7. *See, e.g.*, KLEINBARD, *supra* note 3, at 159–69.

8. *Cf.* JON ELSTER, ULYSSES UNBOUND: STUDIES IN RATIONALITY, PRECOMMITMENT AND CONSTRAINTS 142–49 (2000) (exploring the challenges nations face in making commitments to engage in fiscal restraint in the future and suggesting that such commitments are more credible "when power is divided between the

we observe that the United States has successfully restructured its finances twice already: once in the 1790s under Alexander Hamilton's debt repayment scheme and again at the start of the New Deal when it abrogated the gold clauses in its debt instruments.[9]

To be clear, we do not argue that in an ideal world the United States would renege on its obligations. We hope—fervently—that those who insist that concerns over the nation's exploding budget deficits are overblown turn out to be right,[10] that gloomy predictions of sluggish future economic growth will prove wrong,[11] that technological and institutional innovations will lighten the federal government's health care cost burden,[12] and that a peaceful world will allow the United States to cut military spending. But hope is not a strategy. In view of the financial position of the United States, it is prudent to think through contingencies. That is what this Article aims to do.

In no way do we suggest that restructuring United States government debt would address all the nation's financial challenges. But the fact that restructuring would not fully "solve the fiscal problem in the United States"[13] is no reason to reject it out of hand. Our aim is to explain why debt restructuring belongs on the menu of potential

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executive, an independent judiciary, and a democratically elected legislature"); Julia D. Mahoney, *Kelo's Legacy: Eminent Domain and the Future of Property Rights*, 2005 SUP. CT. REV. 103–33 (2006) [hereinafter *Kelo's Legacy*] (describing how a constitutional system with multiple veto points over reconfigurations of ownership claims can promote the security of property rights). *See also* Barry R. Weingast, *Constitutions as Governance Structures: The Political Foundations of Secure Markets*, 149 J. INSTITUTIONAL & THEORETICAL ECON. 286, 305–06 (1993).

9. *See infra* notes 44–51, 71–96 and accompanying text.

10. *See, e.g.*, Jason Furman & Lawrence H. Summers, *Who's Afraid of Budget Deficits? How Washington Should End Its Debt Obsession*, FOREIGN AFFAIRS, https://www.foreignaffairs.com/articles/2019-01-27/whos-afraid-budget-deficits [https://perma.cc/2SQU-SBNJ] (last visited Jan. 3, 2020).

11. *See, e.g.*, ROBERT J. GORDON, THE RISE AND FALL OF AMERICAN GROWTH: THE U.S. STANDARD OF LIVING SINCE THE CIVIL WAR 642 (2016) (concluding that the "headwinds" faced by the United States economy "are sufficiently strong to leave virtually no room for growth over the next 25 years in median disposable real income per person").

12. *See* Rebecca S. Eisenberg & W. Nicholson Price, II, *Promoting Healthcare Innovation on the Demand Side*, 4 J.L. & BIOSCIENCES 3, 3 (2017) (detailing how technological and institutional innovations in the healthcare sector can reduce costs).

13. GALE, *supra* note 3, at 64.

approaches to America's financial predicament and thus to expand the set of policy options under serious discussion.[14]

The remainder of this Article is organized as follows. Part I explains how the United States has run up a massive national debt while also granting trillions more dollars of claims (both explicit and implicit) on future productivity.[15] Part I also details how the United States has effectively restructured its debt on two separate occasions.[16] Part II lays out the benefits of expanding the set of policy options to include debt restructuring.[17] In brief, we argue that to do so is to recognize reality, given that it is highly plausible that voters will prefer debt restructuring to cuts in benefits, inadequate national or international security, or significant inflation. We also explain why the United States Constitution is not a bar to all restructurings of public debt. Part III turns to the question of how the United States might better equip itself for the road ahead and offers some ideas for institutional and regulatory reforms.[18] We emphasize that failing to recognize that United States government debt, which holds a position at the very core of the financial system,[19] is not risk-free carries risks of its own.

I. HOW WE GOT HERE: WAR, ENTITLEMENTS, AND GOVERNMENT GUARANTEES (EXPLICIT AND IMPLICIT)

Alarm over United States government debt is as old as the nation.[20] For most of the country's history, the general practice of the

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14. *See* Julia D. Mahoney, *The Struggle for America's "Fiscal Soul"*, THE NEW RAMBLER (Jan. 4, 2016), https://newramblerreview.com/book-reviews/political-science/the-struggle-for-america-s-fiscal-soul [https://perma.cc/3FSW-CJNE] (arguing that the repeated failures of proposed fiscal reform packages made up of tax hikes and spending cuts indicate a need to expand the "menu of options under consideration" for putting the United States "back on a responsible financial track").

15. *See infra* Part I.

16. *See id.*

17. *See infra* Part II.

18. *See infra* Part III.

19. *See* Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143, 1147–48 (2017); *see also* Anna Gelpern, *About Government Debt . . . Who Knows?*, 13 CAP. MKTS. L.J. 321, 321 (2018) (characterizing government debt as "a public institution that binds its constituents in a multigenerational political project" as well as "a public asset at the core of banking, capital markets, and payment systems").

20. *See* JAMES D. SAVAGE, BALANCED BUDGETS & AMERICAN POLITICS 1 (1988) (documenting the "central role" the "idea of balancing the federal government's budget has played" from "the earliest days of the republic").

federal government was to borrow heavily only if necessary to respond to grave national emergencies—which generally meant war—and to reduce or eliminate the debts incurred once the danger had passed.[21] In recent decades, this vigilance over America's creditworthiness has broken down and today there is no longer a robust bipartisan consensus in favor of fiscal restraint.[22] Instead, massive budget deficits have become the norm,[23] and the American public shows little alarm about the situation.[24]

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21. *See* BILL WHITE, AMERICA'S FISCAL CONSTITUTION: ITS TRIUMPH AND COLLAPSE ix (2014) (characterizing these "well-defined principles" as an "unwritten fiscal constitution"); William A. Niskanen, *The Case for a New Fiscal Constitution*, 6 J. ECON. PERSP. 13, 13–14 (1992).

22. *See* Bill White, *The Evolution of America's Fiscal Constitution*, *in* THE OXFORD HANDBOOK OF THE U.S. CONSTITUTION 321, 336 (Mark Tushnet et al. eds., 2015) (detailing how in the early twenty-first century, "leaders in each major political party adopted spending policies largely independent of their tax policies," with the result that "[c]onservatives no longer insisted on taxation so that the public would be truly aware of the cost of government, while progressives no longer sought to sustain the social safety net by limiting benefits to available tax revenues"); *see also* Michael Doran, *Legislative Enrichment and Federal Fiscal Policy*, 81 J.L. & CONTEMP. PROBS. 27, 49–58 (2018) (explaining how federal fiscal policy is now "entrenched" against deficit reduction).

23. *See* Binyamin Appelbaum, *Federal Debt Is Rising. Concern Is Not.*, N.Y. TIMES (Feb. 15, 2019), https://www.nytimes.com/2019/02/15/us/politics/national-debt-trump.html [https://perma.cc/JM4G-4YR9] (reporting that "neither political party appears to be making a priority of debt reduction"); Brian Riedl, *Why Washington Won't Address Soaring Deficits*, THE HILL (June 18, 2019), https://thehill.com/opinion/finance/448897-why-washington-wont-address-soaring-deficits [https://perma.cc/G9R6-YZ7G] ("Seemingly no one cares about budget deficits anymore. . . . The cost of paying interest on [the nation's] debt is projected to become the largest federal expenditure within a few decades, consuming one-third of all federal taxes.").

24. *See* J. Baxter Oliphant, *Fewer Americans View Deficit Reduction as a Top Priority as the Nation's Red Ink Increases*, PEW RES. CTR. (Feb. 20, 2019), https://www.pewresearch.org/fact-tank/2019/02/20/fewer-americans-view-deficit-reduction-as-a-top-priority-as-the-nations-red-ink-increases/ [https://perma.cc/2C8N-NDKK] (reporting the results of a Pew Research Center survey that found public concern about federal budget deficits decreasing even as such budget deficits have grown); *see also* Bill Bergman, *A True Portrait of America's Finances: Analyzing the Federal Government's Fiscal Year 2018 Financial Statements*, CPA J. (May 2019), https://www.cpajournal.com/2019/05/24/a-true-portrait-of-americas-finances/ [https://perma.cc/78FP-WREV] (describing the "public reaction" of "deafening silence" to the "bad news" on deficits contained in the most recent United States government financial report).

A. Road to Ruin or Public Blessing? National Debt and the Creation of the American Republic

At the time of the founding, Americans needed only look east across the Atlantic for signs that profligacy could bring low even the greatest power. Spain, the dominant empire of the sixteenth century, had fallen into steep decline after serially defaulting on loans from its European bankers and, by the end of the eighteenth century, had been reduced to bit player status on the world stage.[25] France's repeated failures to pay its loans on schedule had constrained its access to credit, fueling a fiscal crisis in 1788 that in turn sparked the French Revolution.[26] And while Great Britain had managed to avoid default in the eighteenth century,[27] in many quarters its burgeoning debt was viewed as a grave threat to public morals and honest government.[28]

Among the sharpest critics of public debt were two thinkers well known to the founders, David Hume and Adam Smith. "[E]ither the nation must destroy public credit, or public credit will destroy the nation," wrote Hume in 1752.[29] Hume went on to catalogue the "many disadvantages" of public debt, which in his account include the "great encouragement to an useless and unactive life" of "idle people" who live off interest payments; taxes "levied to pay the interest on these debts," causing "an oppression of the poorer sort"; and the rendering of the "public, in a manner, tributary" to the foreigners who "possess a great share of our national funds," a state of affairs that "may in time

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25. *See* MAURICIO DRELICHMAN & HANS-JOACHIM VOTH, LENDING TO THE BORROWER FROM HELL: DEBT, TAXES AND DEFAULT IN THE AGE OF PHILIP II 244 (2014).

26. *See* Thomas J. Sargent & Francois R. Velde, *Macroeconomic Features of the French Revolution*, 103 J. POL. ECON. 474, 477 (1995); *see also* MICHAEL SONENSCHER, BEFORE THE DELUGE: PUBLIC DEBT, INEQUALITY, AND THE INTELLECTUAL ORIGINS OF THE FRENCH REVOLUTION (2007). *See generally* HERBERT E. SLOAN, PRINCIPLE AND INTEREST: THOMAS JEFFERSON AND THE PROBLEM OF DEBT (1995) (positing that France's financial problems in the 1780s were aggravated by the United States' unpaid war debt).

27. *See* JOHN BREWER, THE SINEWS OF POWER: WAR, MONEY AND THE ENGLISH STATE, 1688–1793 88–134 (1990).

28. *See* ISAAC KRAMNICK, BOLINGBROKE AND HIS CIRCLE: THE POLITICS OF NOSTALGIA IN THE AGE OF WALPOLE 43–44 (1992); THOMAS K. MCCRAW, THE FOUNDERS AND FINANCE: HOW HAMILTON, GALLATIN, AND OTHER IMMIGRANTS FORGED A NEW ECONOMY 93, 103 (2012); GORDON S. WOOD, THE CREATION OF THE AMERICAN REPUBLIC 1776–1787 32–36 (1969).

29. DAVID HUME, *Of Public Credit*, *in* TREATISES ON SEVERAL SUBJECTS: ESSAYS, MORAL, POLITICAL, AND LITERARY 344, 356 (1752).

occasion the transport of our people and our industry."[30] Smith sounded a similar cautionary note in the final chapter of his 1776 work *The Wealth of Nations*: "When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid."[31]

The early historical record of the United States is replete with similar expressions of hostility toward public debt and its perceived tendency to corrupt public officials and enrich manipulators—as distinct from makers—of wealth.[32] Yet debt's perils were not the whole story. Having borrowed heavily at home and abroad to win its independence, in a sense the young United States owed its very existence to debt. And it was not lost on Americans that Britain's near limitless access to capital markets had given it a powerful edge in the Revolutionary War.[33] Future Secretary of the Treasury Alexander Hamilton made the case for prudent use of public credit in a 1781 letter to Robert Morris, the merchant and financial impresario then serving as the nation's first (and last) Superintendent of Finance: "A national debt if it is not excessive will be to us a national blessing," enabling the new nation to fund armed conflict and creating a "necessity for keeping up taxation to a degree which without being oppressive, will be a spur to industry."[34] Hamilton's sophisticated grasp of the possibilities of public debt was consonant with emerging attitudes toward commerce and private debt in late eighteenth-century America.[35]

Both Hamilton and Morris thought the national government needed more revenue to service public debt and establish sound credit. But under the Articles of Confederation, individual states could—and did—refuse to go along. A discouraged Morris quit his post in 1784,

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30. *Id.* at 348, 350.

31. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 396 (1776).

32. *See* MCCRAW, *supra* note 28, at 93, 103, 333; *see also* FORREST MCDONALD, NOVUS ORDO SECLORUM: THE INTELLECTUAL ORIGINS OF THE CONSTITUTION 93–94, 115–19 (1985).

33. *See* RON CHERNOW, WASHINGTON: A LIFE 620 (2010); STANLEY ELKINS & ERIC MCKITRICK, THE AGE OF FEDERALISM 117 (1993) (noting that Hamilton was "intensely aware of the advantages" of sound public credit and of the fact "that the principal weakness of the Revolutionary government had been its inability to raise money").

34. Letter from Alexander Hamilton, Lieutenant Colonel, Cont'l Army, to Robert Morris, Superintendent of Fin., U.S. (Apr. 30, 1781).

35. *See generally* BRUCE MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2002).

and throughout the 1780s, the United States remained in default on most of its interest-bearing debt.[36] In addition, the market value of the paper currency—commonly called "Continental" dollars—issued by the Continental Congress plunged.[37] The nation's shambolic finances were a major impetus for the 1787 Philadelphia Convention that led to a new Constitution,[38] one that "realigned incentives and authorities" so as to empower the central government to control its finances.[39] Interestingly, the new Constitution did not explicitly forbid defaults on the nation's debt.[40] Article VI simply states, "All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation."[41] More stringent provisions, including one providing that Congress "shall discharge the debts & fulfill the engagements" of the United States, were considered at the Constitutional Convention but not adopted.[42]

Once ratified, the new Constitution made possible a quick reversal of the nation's fortunes. In just three years—from 1790 to 1792—the United States laid the financial foundations for a secure, prosperous nation in place of one that was for all practical purposes bankrupt.[43] Crucial for this newfound stability was the failure to pay in full the obligations taken on to fight and win independence from Great Britain. This point deserves emphasis, for the claim that the

36. *See* Farley Grubb, *The Net Worth of the US Federal Government, 1784-1802*, 97 AM. ECON. REV. 280, 280–81 (2007).

37. *See generally* Farley Grubb, *The Continental Dollar: How Much Was Really Issued?*, 68 J. ECON. HIST. 283 (2008).

38. *See* MICHAEL J. KLARMAN, THE FRAMER'S COUP: THE MAKING OF THE UNITED STATES CONSTITUTION 69, 69 (2016); *see also* Sonia Mittal et al., *The Constitutional Choices of 1787 and Their Consequences*, *in* FOUNDING CHOICES: AMERICAN ECONOMIC POLICY IN THE 1790S 25, 27–28 (Douglas A. Irwin & Richard Sylla eds., 2011).

39. Thomas J. Sargent, *Nobel Lecture: United States Then, Europe Now*, 120 J. POL. ECON. 1, 12–13 (2012).

40. *See* Michael W. McConnell, *Origins of the Fiscal Constitution*, *in* IS U.S. GOVERNMENT DEBT DIFFERENT?, *supra* note 1, at 45, 49.

41. U.S. CONST. art. VI.

42. 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787 377 (Max Farrand ed., 1911); *see also* MAX M. EDLING, A HERCULES IN THE CRADLE: WAR, MONEY AND THE AMERICAN STATE, 1783–1867 42–43 (2014) (reporting that some delegates at the Constitutional Convention "countered that 'shall' was too strong a word" as the "new government might not have the means to pay off the debt").

43. *See* Richard Sylla, *Financial Foundations: Public Credit, the National Bank, and Securities Markets*, *in* FOUNDING CHOICES: AMERICAN ECONOMIC POLICY IN THE 1790S, *supra* note 38, at 59.

United States of America has always honored all its commitments in full exerts a powerful hold on the public imagination. In truth, the founders were nothing if not pragmatic and accepted that the principle of making good on all pledges must bow to circumstance. As Alexander Hamilton wrote in his First Report on the Public Credit, delivered to Congress on January 9, 1790:

> Every breach of the public engagements, whether from choice or necessity, is, in different degrees, hurtful to public credit. When such a necessity does truly exist, the evils of it are only to be palliated by a scrupulous attention, on the part of the Government, *to carry the violation no further than the necessity absolutely requires, and to manifest, if the nature of the case admit of it, a sincere disposition to make reparation whenever circumstances shall permit*.[44]

Hardest hit were the owners of the approximately $80 million (in face value) of "Continentals" that remained outstanding as of 1789.[45] Hamilton's restructuring plan "harshly discriminated against" holders of these instruments.[46] Although allowed to swap their paper dollars for interest-bearing debt or specie, the ratio at which they could do so was a punishing 100 to one.[47]

Owners of the interest-bearing national debt of approximately $79 million (which included roughly $25 million of state debt assumed by the federal government) fared far better.[48] But even those creditors were not, for the most part, made whole.[49] Foreign creditors (who held a total of roughly $11.7 million of the debt) by and large got more than domestic ones, with the French receiving about 80% of what they were

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44. ALEXANDER HAMILTON, FIRST REPORT ON THE PUBLIC CREDIT (1790) (emphasis added).

45. *See* George J. Hall & Thomas J. Sargent, *Fiscal Discriminations in Three Wars* 7, 10 (Nat'l Bureau of Econ. Research, Working Paper No. 19008, 2013).

46. *Id.* at 2.

47. *See* Grubb, *supra* note 36, at 280; *see also* Hall & Sargent, *supra* note 45, at 10–12.

48. The $79 million figure is Hamilton's own and may be an overestimate. *See* E. JAMES FERGUSON, THE POWER OF THE PURSE: A HISTORY OF AMERICAN PUBLIC FINANCE, 1776–1790 330–32 (1961) (pegging the total par value at about $74 million and attributing Hamilton's larger figure to the challenges of obtaining accurate information about the state debts).

49. *See* Funding Act of 1790, ch. 34, 1 Stat. 138, 138–39 (1790); Peter M. Garber, *Alexander Hamilton's Market Based Debt Reduction Plan* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 3597, 1991) (observing that Hamilton's "prescription of full repayment of sovereign debt seems to have crumbled" under pressure).

owed and Dutch private creditors being paid in full.[50] Domestic debtholders were offered securities packages with market values well below face values, resulting in significant haircuts.[51] That domestic debtholders were so willing to exchange old debt for the packages offered is a testament to how low expectations of full repayment had fallen.

Having pulled off the unusual feat of right sizing its obligations while convincing the credit markets it was unlikely to repeat the behavior, the United States became zealous in its commitment to fiscal probity. By 1811, the national debt had fallen to $45 million, although the outbreak of the War of 1812 caused the national debt to soar again.[52] Logistical problems in military and financial matters plagued the national government throughout the conflict, and toward the war's end in late 1814, it suffered the serious embarrassment of having to put off payments to creditors in what a recent report from the Congressional Research Service terms "unambiguous examples of default."[53] But the payment delays were just that: delays, not restructuring or repudiation, and America was very soon back on a strong financial footing.[54] At no point during or after the War of 1812 did then President James Madison, members of his administration, or

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50. *See* Garber, *supra* note 49, at 37; Hall & Sargent, *supra* note 45, at 10 n.16.

51. *See* Garber, *supra* note 49, at 3 (concluding that "a large part of the face value" of the debt incurred by the national and state governments prior to the Constitution "was effectively written off"); *see also* EDLING, *supra* note 42, at 96 (noting that critics of Hamilton's debt restructuring proposals "inside and outside of Congress had no difficulty detecting a breach of contract" in the terms of the exchange and that Hamilton defended his approach on the grounds that the debt conversions would be voluntary); Sylla, *supra* note 43, at 72. *See generally* Donald F. Swanson & Anthony P. Trout, *Alexander Hamilton, Conversion and Debt Reduction*, 29 EXPLORATIONS ECON. HIST. 417 (1992) (providing an overview of Hamilton's proposed debt reduction plan).

52. GALE, *supra* note 3, at 36.

53. D. ANDREW AUSTIN, CONG. RESEARCH SERV., HAS THE U.S. GOVERNMENT EVER "DEFAULTED"? 6 (2016).

54. In 1977 and 1979, there occurred minor incidents that some characterize as technical defaults. *See* THOMAS E. MANN & NORMAN J. ORNSTEIN, IT'S EVEN WORSE THAN IT LOOKS: HOW THE AMERICAN CONSTITUTIONAL SYSTEM COLLIDED WITH THE NEW POLITICS OF EXTREMISM 6 (2013) (arguing that a technical default took place in 1977 when one temporary debt limit increase expired shortly before Congress enacted a new debt limit increase); Terry L. Zivney & Richard D. Marcus, *The Day the U.S. Defaulted on Treasury Bills*, 24 FIN. REV. 475, 475 (1989) (recounting a short and quickly rectified delay in 1979 in interest and principal payments to some small investors holding Treasury securities).

Congress contemplate not paying the nation's debts with dispatch and in full.

B. From the Jackson Administration to the Gold Clause Cases

A resurgence of federal revenues, together with popular enthusiasm for becoming "wholly" (that is, debt) free,[55] led to the elimination of the public debt in 1835 under President Andrew Jackson.[56] America's interlude of national debt freedom soon ended, but public debt remained low in relation to the size of the national economy until the Civil War.[57] Then it again exploded, soaring from $65 *million* in 1860 to $2.76 *billion* in 1866.[58] The aftermath of the Civil War followed the same path as that of the War of 1812, with public debt steadily reduced thanks to rapid economic growth that swelled federal revenues.[59] The commitment to repay the "sacred and inviolate"[60] debt incurred to save the union was enshrined in the Public Debt Clause of the Fourteenth Amendment, which provides: "The validity of the public debt of the United States . . . shall not be questioned."[61] The Public Debt Clause's inclusion in the Fourteenth Amendment was largely motivated by concerns that a coalition of

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55. CARL LANE, A NATION WHOLLY FREE: THE ELIMINATION OF THE NATIONAL DEBT IN THE AGE OF JACKSON 161 (2014) (explaining that to many Americans "[d]ebt meant dependence upon creditors, an obligation of the majority to a minority, a burden on the many to the advantage of a few").

56. *Id.* at 159. The national government's finances stood in stark contrast to those of some states, a number of which defaulted on debt in the 1840s after borrowing heavily for transportation and banking. *See* William B. English, *Understanding the Costs of Sovereign Default: American State Debts in the 1840's*, 86 AM. ECON. REV. 259, 259, 261 (1996) ("Between 1841 and 1843 eight states and one territory defaulted on their obligations, and by end of the decade four states and one territory had repudiated all or part of their debts."); Sargent, *supra* note 39, at 25 (noting that proposals for the federal government to assume state debts were considered but ultimately rejected); John Joseph Wallis, *Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842 to 1852*, 65 J. ECON. HIST. 211, 211 (2005).

57. *See* Richard Sylla, *US Government Debt Has Always Been Different*, *in* IS U.S. GOVERNMENT DEBT DIFFERENT?, *supra* note 1, at 1, 7.

58. *Id.*

59. *Id.*

60. CONG. GLOBE, 39th Cong., 1st Sess. 10 (1865).

61. U.S. CONST. amend. XIV, § 4.

southern Democrats and northerners might seek to refuse to pay the Civil War debt.[62]

The United States' 1917 entry into World War I marked yet another run up of public debt in war followed by a decline in peace.[63] But there the pattern ends, for the 1920s marks the final era of significant United States debt retirement.[64]

The Great Depression's severity paved the way for the "bold, persistent experimentation" of the New Deal.[65] What emerged may—with justification—be called a "new fiscal constitution."[66] Federal government spending increased dramatically,[67] and a federal system of old-age benefits, a program now commonly described as having "quasi-constitutional" status,[68] was established by the Social Security Act of 1935.[69] Keenly aware of the federal government's limited capacity to bear risk, President Franklin Roosevelt stressed that Social Security was designed with the "protection of the credit structure of the [United States]" in mind.[70]

Most dramatically, in early 1933 the United States went off the gold standard and in June 1933 abrogated the gold clauses in United

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62. *See* Stuart McCommas, Note, *Forgotten but Not Lost: The Original Public Meaning of Section 4 of the Fourteenth Amendment*, 99 VA. L. REV. 1291, 1294 (2013) (discussing why the amendment mentioned public debt).

63. *See* Sylla, *supra* note 57, at 7.

64. *Id.*

65. Franklin Delano Roosevelt, Governor, State of N.Y., Address at Oglethorpe University (May 22, 1932), *in* THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 639, 639 (1938).

66. Niskanen, *supra* note 21, at 13; *see also* J. Bradford DeLong, *Fiscal Policy in the Shadow of the Great Depression*, *in* THE DEFINING MOMENT: THE GREAT DEPRESSION AND THE AMERICAN ECONOMY IN THE TWENTIETH CENTURY 67, 83–84 (Michael D. Bordo et al. eds., 1998).

67. *See* GALE, *supra* note 3, at 39 ("Overall, the 1930s saw a substantial increase in the size of government. Federal spending more than doubled as a share of the economy, from less than 4 percent in 1930 to more than 9 percent in 1940.").

68. *See* WILLIAM N. ESKRIDGE JR. & JOHN FEREJOHN, A REPUBLIC OF STATUTES: THE NEW AMERICAN CONSTITUTION 83–85 (2010) (characterizing social security as integral to "basic rules of political participation and citizenship"); Gillian E. Metzger, *Administrative Constitutionalism*, 91 TEX. L. REV. 1897, 1899 (2013).

69. *See* Pub. L. No. 74-271, 49 Stat. 620 (1935).

70. Franklin D. Roosevelt, President, U.S., A Message to the Congress on Social Security (Jan. 17, 1935); *see also* ADVISORY COUNCIL ON SOCIAL SECURITY, FINAL REPORT (1938) ("[T]he fulfillment of the promises made to the wage earners included in the old age insurance system depends upon, more than anything else, the financial integrity of the Government."); Julian Zelizer, *The Forgotten Legacy of the New Deal: Fiscal Conservatism and the Roosevelt Administration 1933-1938*, 30 PRESIDENTIAL STUD. Q. 331, 331–58 (2000) (detailing the power wielded by fiscal conservatives in the Roosevelt administration).

States government debt instruments.[71] A steep reduction in the dollar's gold content followed in January 1934.[72] Financial historians have classified the U.S. government's actions as a "default,"[73] and in its 1935 decision *Perry v. United States*,[74] the Supreme Court agreed with a disaffected bondholder that the gold clause abrogation was not within the authority of Congress under the United States Constitution. Invoking the Borrowing Clause of Article I,[75] Chief Justice Hughes wrote for a five-justice majority of the Court:

> [T]he right to make binding contracts is a competence attaching to sovereignty. . . . The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the government, upon which in an extremity its very life may depend. The binding quality of the promise of the United States is one of the essences of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations.[76]

Justice Hughes also invoked the Fourteenth Amendment's Public Debt Clause. Although "this provision was undoubtedly inspired by the desire to put beyond question the obligations of the government issued during the Civil War," wrote Justice Hughes, "its language indicates a broader connotation."[77] He continued:

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71. *See* SEBASTIAN EDWARDS, AMERICAN DEFAULT: THE UNTOLD STORY OF FDR, THE SUPREME COURT, AND THE BATTLE OVER GOLD (2018); Kenneth W. Dam, *From the Gold Clause Cases to the Gold Commission: A Half-Century of American Monetary Law*, 50 U. CHI. L. REV. 504, 504, 512 (1983).

72. *See* Carmen M. Reinhart & Kenneth S. Rogoff, *Financial and Sovereign Debt: Some Lessons Learned and Those Forgotten*, *in* FINANCIAL CRISES: CAUSES, CONSEQUENCES, AND POLICY RESPONSES 141, 150 (S. Claessens et al. eds., 2014).

73. *See, e.g.*, CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009); Sebastian Edwards et al., *The U.S. Debt Restructuring of 1933: Consequences and Lessons* 1 (Nat'l Bureau of Econ. Res., Working Paper No. 21694, 2015) (stating that the "U.S. did restructure its debt unilaterally during the first administration of Franklin D. Roosevelt," imposing "a 41 percent loss on investors" in what "would become one of the largest transfers of wealth (from creditors to debtors) in the history of the world"); Randall S. Kroszner, *Is It Better to Forgive Than to Receive? Repudiation of the Gold Indexation Clause in Long-Term Debt During the Great Depression* 1 (Ctr. for Research in Sec. Prices, Working Paper No. 481, 1998).

74. 294 U.S. 330, 353 (1935).

75. U.S. CONST. art I, § 8, cl. 2 ("The Congress shall have Power to . . . borrow Money on the credit of the United States . . . .").

76. *Perry*, 294 U.S. at 353–54.

77. *Id.* at 354.

> We regard it as confirmatory of a fundamental principle which applies as well to the government bonds in question, and to others duly authorized by the Congress, as to those issued before the amendment was adopted. Nor can we perceive any reason for not considering the expression 'the validity of the public debt' as embracing whatever concerns the integrity of the public obligations.[78]

Yet the creditor victory in *Perry* came with an important twist, for the Court ruled that the "facts alleged by the" plaintiff bondholder "fail to show a cause of action for actual damages."[79] Wrote the majority: "Plaintiff has not shown, or attempted to show, that in relation to buying power he has sustained any loss whatever."[80] The Court's reasoning on this point hinged on the fact that because the federal government had shut down the gold market,[81] the gold clauses in its debt were for all practical purposes inoperable.[82]

Having shown no "actual damage," the majority opinion went on to pronounce, the aggrieved bondholder had no action in the Court of Claims, for the Court of Claims had no power over actions for nominal damages.[83] The "Delphic character" of the majority's reasoning,[84] together with post-oral argument press reports that in the event of a loss the government was prepared to push back hard against the Court,[85] has fueled speculation that the outcome in *Perry* was

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78. *Id.*

79. *Id.* at 358.

80. *Id.* at 357.

81. *See* Dam, *supra* note 71, at 510.

82. *See* Georg Vanberg & Mitu Gulati, *Financial Crises and Constitutional Compromise*, *in* CONSTITUTIONS IN TIMES OF FINANCIAL CRISIS 117, 135 (Tom Ginsburg et al. eds., 2019); Dam, *supra* note 71, at 517.

83. Henry M. Hart, Jr., *The Gold Clause in United States Bonds*, 48 HARV. L. REV. 1057, 1060 (1935); *see also Unconstitutional Abrogation of Gold Clause in Government Bonds—Damages*, 35 COLUM. L. REV. 441, 444 (1935); John Harrison, *New Property, Entrenchment, and the Fiscal Constitution*, in FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY (Elizabeth Garrett, et al. eds., 2008).

84. Hart, *supra* note 83, at 1058. Observed Hart of the Court's opinion in *Perry*: "Almost the only thing which it is possible to say with assurance is that the plaintiff in the particular suit did not recover." *Id.* at 1059. *See also* Dam, *supra* note 71, at 517 ("The reasoning [of the Court] on the lack of damages in *Perry* was convoluted and suspect . . . .").

85. *See, e.g.*, *Gold Policy Decided by Roosevelt*, L.A. TIMES, Feb. 4, 1935 (reporting that Roosevelt had decided "against restoration of the former gold value of the dollar, even if the Supreme Court should rule adversely to the government" and is "ready to put his hold on the people to the test if it becomes necessary"); Arthur Krock, *Roosevelt Speech Was Ready in Case He Lost on Gold*, N.Y. TIMES, Feb. 21, 1935.

driven by the Court's anxieties about its institutional standing and legitimacy.[86]

Critically, Justice Harlan Stone, who joined the majority opinion, distanced himself from the majority's constitutional analysis in a concurring opinion that was narrow in scope.[87] While agreeing that the plaintiff suffered "no damage because Congress, by the exercise of its power to regulate the currency, had made it impossible" for bondholders to "enjoy the benefits" of the promised gold payments,[88] Justice Stone took pains to insist he did "not join in so much" of the majority opinion

> as may be taken to suggest that the exercise of the sovereign power to borrow money on credit, which does not override the sovereign immunity from suit, may nevertheless preclude or impede the exercise of another sovereign power, to regulate the value of money; or to suggest that, although there is and can be no present cause of action upon the repudiated gold clause, its obligation is nevertheless, in some manner and to some extent not stated, superior to the power to regulate the currency which we now hold to be superior to the obligation of the bonds.[89]

Unsurprisingly, the gold clause abrogation provoked outrage, not least among the four dissenting Supreme Court Justices, who in an opinion by Justice McReynolds predicted "legal and moral chaos" would ensue.[90] "Just men regard repudiation . . . of citizens by their sovereign with abhorrence," thundered the dissent, adding for good measure that "we cannot believe the farseeing framers, who labored with hope of establishing justice and securing the blessings of liberty, intended that the expected government should have authority to annihilate its own obligations and destroy the very rights which they were endeavoring to protect."[91]

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86. *See* David Glick, *Conditional Strategic Retreat: The Court's Concession in the 1935 Gold Clause Cases*, 71 J. POL. 800, 814 (2009) (suggesting that "the Administration extracted a crucial policy victory by appealing to the strategic instincts that the Court originally evinced in *Marbury*"); Gerard N. Magliocca, *The* Gold Clause Cases *and Constitutional Necessity*, 64 FLA L. REV. 1243, 1243 (2012); *see also* Vanberg & Gulati, *supra* note 82, at 132 (suggesting that the Court's conduct in *Perry v. United States* "illustrates the paradigm of a weak [C]ourt capitulating in the face of government pressure").

87. *See* Perry v. United States, 294 U.S. 330, 358–61 (Stone, J., concurring).

88. *Id.* at 360.

89. *Id.* at 361.

90. Norman v. Balt. & O.R. Co., 294 U.S. 240, 361, 381 (1935) (McReynolds, J., dissenting).

91. *Id.* at 362; *see also Justice McReynold's Dissent in the Gold Clause Cases*, 18 TENN. L. REV. 768, 768 (1945) ("It is impossible fully to estimate the result

But the grim consequences foretold by the "Four Horsemen" never came to pass.[92] Although there were likely some adverse consequences for the United States,[93] reneging on its contractual obligations did not cut off its access to capital. The U.S. government was able to issue new debt without serious obstacle.[94] Indeed, some of the takers of the new debt were the very bondholders whose earlier debt had been involuntarily restructured.[95] That the United States emerged in such good shape lends credence to the conclusion that on balance the United States government's abrogation of the gold clauses in its debt did more good than harm in that the "benefits of eliminating debt overhang" exceeded the losses to creditors.[96]

C. After the New Deal: The Growth of the Entitlements State

A sharp rise in public debt during the Second World War was followed by a swift decline as more than a decade of pent-up consumer demand stoked a post-war economic boom. The next quarter century was a golden era for the U.S. economy, but as the 1960s came to an end, things began to look shaky. Inflation picked up speed, to the discomfiture of establishment economists, who had little to offer in the way of explanation, much less cure. And a change seemed to have come over an electorate that had long rejected significant budget deficits except in times of national crisis. With the new Medicare and Medicaid programs—established in 1965 as part of President Lyndon Johnson's Great Society initiatives—and ramp-ups in other social spending, the United States was now borrowing not just for war and other exigent purposes but to fund ambitious social welfare and insurance programs with long time horizons.[97] These spending

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of what has been done. The Constitution as many of us have understood it, the instrument that has meant so much to us, is gone.").

92. The Article's use of "Four Horsemen" refers to the three Justices who dissented alongside Justice McReynolds in the Gold Clause Cases. *See id.* at 768.

93. *See* Edwards et al., *supra* note 73, at 9 (summarizing evidence that some "investors may have turned to the highest-rated bonds issued by the strongest remaining sovereign borrowers" to the detriment of the United States).

94. *See id.* at 3 (finding that "controlling for key debt features" post-restructuring debt auctions were "just as oversubscribed" as before).

95. *See id.* (concluding "there is little evidence that holders of restructured Treasury debt 'voted with their feet' by stigmatizing new debt issues").

96. Kroszner, *supra* note 73, at 1.

97. *See* Daniel L. Thornton, *The U.S. Deficit/Debt Problem: A Longer-Run Perspective*, 94(6) FED. RES. BANK OF ST. LOUIS REV. 441, 445 (2012).

commitments, together with the absence of adequate taxes to pay for them, were a recipe for massive, ongoing deficits.

In 1977, James Buchanan and Richard Wagner wrote a book that documented the demise of the classic view among America's rulers that debt was generally bad and thus to be incurred only when necessary and paid off as soon as practicable.[98] They attributed the collapse of this traditional understanding to the usefulness of Keynesian economic policy for politicians eager to spend public money to win favor with their constituents and other groups without a corresponding increase in taxes.[99] Their forecast, which turned out to be right, was that public debt would rise inexorably unless something changed.[100]

While compelling, Buchanan and Wagner's thesis was not entirely persuasive. After all, Keynes's insight that not all deficits did harm had been part of public discourse for decades. Why, then, did it take politicians so long to figure out its potential to allow them to appeal to various interests without presenting voters with the full tab? There was no question, however, that Buchanan and Wagner's admonitions about the destruction that unchecked deficits could wreak were in tune with the worries of many voters. In 1980, the winner of the Presidential election was former California Governor Ronald Reagan, who on the campaign trail depicted budget deficits as a sign of government run amok.

In his first inaugural address, Reagan promised a new era of fiscal rectitude.[101] But what Reagan delivered—albeit with the assistance of a Democratic House of Representatives—were not balanced budgets but the largest deficits the United States had ever seen. These record deficits were in large part the consequence of tax

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98. JAMES M. BUCHANAN & RICHARD E. WAGNER, DEMOCRACY IN DEFICIT: THE POLITICAL LEGACY OF LORD KEYNES (1977) (documenting the demise of the view among American rulers that debt was generally bad).

99. *Id.* at 166 ("Politicians themselves have, for the most part, short time horizons. For most of them, each election presents a critical point, and the primary problem they face is getting past this hurdle. 'Tis better to run away today to be around to fight again another day' might well be the motto. This is not to say that politicians never look beyond the next election in choosing courses of action, but only that such short-term considerations dominate the actions of most of them. Such features are, of course, an inherent and necessary attribute of a democracy.").

100. *See id.* at 187–88 (recommending amending the United States Constitution to include a balanced budget amendment).

101. *See* Ronald W. Reagan, President, U.S., Inaugural Address (Jan. 20, 1981) ("For decades we have piled deficit upon deficit, mortgaging our future and our children's future for the temporary convenience of the present. To continue this long trend is to guarantee tremendous social, cultural, political, and economic upheavals.").

cuts aimed at lifting the economy out of a deep recession and increased defense spending justified as necessary to win the Cold War. Defenders of the Reagan legacy argue that while regrettable, the deficits made America stronger, richer, and safer. Whatever the deficits' merits, Reagan paid no obvious political price. He was reelected by a landslide in 1984, following his "Morning in America" campaign that drew voters' attention to the healthy economy and ignored the near doubling of the nation's debt since 1979.[102]

Deficits did decline enough during Reagan's three final years in office to allow him to claim that the country was "on track" to balance its budget,[103] but this claim turned out to be an example of his famous optimism at work. In fact, the deficit soared in George H.W. Bush's first and only term as President, reaching $290 billion in 1992.[104] The perils of government economic ineptitude loomed large in that year's presidential contest, as maverick third-party candidate Ross Perot won 19% of the popular vote with a campaign centered on the dangers of the "red ink of our national debt [and] the red tape of our government bureaucracy."[105]

Bill Clinton, the victor of the 1992 election, also ran on economic issues, emphasizing jobs and growth. At the start of his administration, there were indications that the Clinton presidency would feature heavy public investments in health and education. This did not happen. A strong belief that the market for United States

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102. Debt and deficits were a great enough worry to spur Congress to pass the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No.99-107, 99 Stat. 1037 (1985), at the start of Ronald Reagan's second term as President. Gramm-Rudman-Hollings was billed as a vehicle to end the federal budget deficit by 1991. *See* Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 CAL. L. REV. 593, 596 (1988). Whether this piece of innovative legislation would have achieved its ambitious goal must remain a matter of conjecture, for the Supreme Court invalidated the law the following year. *See id.* at 597–98. A revised version of the law, the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987, lacked teeth and was regarded as having only minor effects. *See id.* at 598–99.

103. Ronald W. Reagan, President, U.S., Radio Address to the Nation on the Federal Budget and Executive Salaries (Jan. 7, 1989) (stating that the United States is on track to balancing the budget). Reagan was never at ease with the tide of red ink that is one of his legacies, and in his farewell address, he listed the budget deficit as one of his "regrets." *See* Ronald W. Reagan, President, U.S., Farewell Address to the Nation (Jan. 11, 1989).

104. U.S. GEN. ACCOUNTING OFFICE, A COMPARISON OF FISCAL YEAR 1992 BUDGET ESTIMATES AND ACTUAL RESULTS 1 (1993).

105. Renee Loth, *Perot Campaign Unveils New Ads*, THE BOS. GLOBE, Oct. 8, 1992, at 22 (reporting that one of Perot's ads read: "In this new war, the enemy is not the red flag of communism but the red ink of our national debt").

Treasury securities would demand higher yields if government spending rose precipitously,[106] together with a resounding Republican victory in the 1994 midterm elections, pushed Clinton to the center on matters fiscal.

In Clinton's second term, as the economy flourished and the "dot com" boom crested, the federal budget actually ran a surplus for the four fiscal years 1998 to 2001. These surpluses had not been predicted, and their appearance allowed both Democrats (who held the Presidency) and Republicans (who controlled the House of Representatives) to claim the mantle of fiscal responsibility. But these "surpluses," far from indicating that America's governing class had repented of its spendthrift ways and embraced what Buchanan and Wagner called the "Old Time Fiscal Religion,"[107] were phantoms of the United States government's cash accounting practices.[108] During these years of "surplus," the national debt continued to grow.[109] And as the 1990s wore on, the nation's entitlements commitments looked increasingly unsustainable.[110]

When Clinton left office in January 2001, total public debt was $5.73 trillion.[111] Those figures now seem quaint. Since then, the federal government has broken new ground. Public debt reached $8.2 trillion by the end of 2005, $10.7 trillion by the end of 2008, and as of September 30, 2019, approaches $23 trillion.[112] These numbers are even more striking when viewed in relation to the size of the nation's economy.[113]

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106. *See* Ronald McKinnon, *Where Are the Bond Vigilantes?*, WALL ST. J. (Sept. 30, 2011), https://www.wsj.com/articles/SB10001424053111904332804576538363789127084 [https://perma.cc/LM5F-FUQ5] ("During the Clinton administration, interest rates served to discipline government spending. That vital check is missing.").

107. BUCHANAN & WAGNER, *supra* note 98, at 9.

108. *See* KLEINBARD, *supra* note 3, at 159 ("The budget of the United States is basically a cash flow statement . . . ."); *see also* Jason Delisle & Jason Richwine, *The Case for Fair-Value Accounting*, 21 NAT'L AFF. (2014).

109. *See* D. ANDREW AUSTIN, CONG. RESEARCH SERV., THE DEBT LIMIT: HISTORY AND RECENT INCREASES 13 (2015).

110. *See* DANIEL SHAVIRO, DO DEFICITS MATTER? 147–50 (1997) (detailing the long-range problems the United States faced due to its entitlements programs); *see also* CONG. BUDGET OFFICE, THE LONG-TERM BUDGET OUTLOOK: AN UPDATE 1 (Dec. 14, 1999).

111. *Debt to the Penny*, *supra* note 4.

112. *Id.*

113. *See* CONG. BUDGET OFFICE, THE 2019 LONG-TERM BUDGET OUTLOOK, *supra* note 4.

How did America's debt climb so high so fast? Among the causes most often invoked are the Bush Tax Cuts of 2001 and 2003, their extension in 2010 and further partial extension in 2012; Medicare Part D, a large new prescription drug entitlement with no identified funding source;[114] about $1 trillion for homeland security;[115] the invasions of Iraq and Afghanistan, followed by over a decade of protracted conflict and expensive rebuilding;[116] the close to one trillion dollar Stimulus program enacted in early 2009;[117] the Patient Protection and Affordable Care Act passed in 2010;[118] and the Tax Cuts and Jobs Act of 2017.[119] All these measures—or at least aspects of them—can be defended on grounds of national security, public welfare, and so forth. But it is hard to make the case that, taken as a whole, they add up to sustainable fiscal policy.

D. Where We Are Now

The official debt is but the tip of the iceberg when it comes to what American citizens and residents—not to mention the rest of the world—have been led to expect from the United States government.[120] Most salient are the "quasi-constitutional" old-age Social Security benefits that are the primary means of support for elderly individuals

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114. *See* BENJAMIN M. FRIEDMAN, THE MORAL CONSEQUENCES OF ECONOMIC GROWTH 419–20 (2005).

115. *See generally* TOM COBURN, A REVIEW OF THE DEPARTMENT OF HOMELAND SECURITY'S MISSIONS AND PERFORMANCE (2015) (estimating the Department of Homeland Security's various funding awards).

116. *See generally* SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN RECONSTRUCTION (SIGAR), QUARTERLY REPORT TO THE UNITED STATES CONGRESS (2014) (outlining government expenditures on Afghan economic development); SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION (SIGAR), LEARNING FROM IRAQ: A FINAL REPORT (2013) (outlining government expenditures on Iraqi economic development).

117. American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 504, 123 Stat. 115 (2009); *see also* MICHAEL GRUNWALD, THE NEW DEAL: THE HIDDEN STORY OF CHANGE IN THE OBAMA ERA (2013).

118. Pub. L. No. 111-148, 124 Stat. 119 (2010).

119. Pub. L. No. 115-97, 131 Stat. 2054 (2017).

120. *See* James D. Hamilton, *Off-Balance-Sheet Federal Liabilities* 1 (Nat'l Bureau of Econ. Res., Working Paper No. 19253, 2013); *see also* Howell E. Jackson, *Counting the Ways: The Structure of Federal Spending*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY, *supra* note 83, at 185, 188; Julia D. Mahoney, *America's Exceptional Safety Net*, 40 HARV. J.L. & PUB. POL'Y 33, 38 (2017).

in the bottom half of the income distribution.[121] Many Americans plan to draw on these benefits heavily in retirement.[122] It is true that a portion of expected future Social Security outlays are funded in the sense that a special class of Treasury debt has been put aside for them,[123] but these holdings fall far short of the actuarially expected outlay, meaning that Social Security is significantly underfunded.[124]

Also looming large are the U.S. government's promises to cover retiree health care needs, largely through its Medicare program. As with Social Security benefits, beneficiaries' expectations have a moral component because of the common belief that through dedicated taxes collected over their working lives they have already paid for what they will receive.[125] Other big ticket items include the federal government's share of Medicaid and the Children's Health Insurance Program (CHIP), two means-tested programs that are linchpins of the nation's social safety net, and approximately $8 trillion of obligations for pension and retiree health care benefits of federal government employees, both military and civilian.[126]

No discussion of United States government finances is complete without mentioning its role as insurer. Some of these commitments,

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121. *See* James M. Poterba, *Retirement Security in an Aging Society* 44 (Nat'l Bureau of Econ. Research, Working Paper No. 19930, 2014) (detailing "[t]he importance of Social Security for those in the lower income range" and concluding that "changes in the benefits associated with this program, for this group, would be likely to translate directly into living standards"); *see also* David N. Weil, *Capital and Wealth in the 21st Century* 12 (Nat'l Bureau of Econ. Research, Working Paper No. 20919, 2015); Dirk Cotton, *Are Social Security Benefits a Bond?*, SEEKING ALPHA (Nov. 10, 2014), https://seekingalpha.com/article/2666875-are-social-security-benefits-a-bond [https://perma.cc/N78R-D7CV] (estimating that "for most American households, the present value of Social Security benefits is the largest component of the household's wealth, followed by home equity and then retirement savings").

122. *See* Frank Newport, *Young, Old in US Plan on Relying More on Social Security*, GALLUP.ORG (May 25, 2017), http://www.gallup.com/poll/211085/nonretirees-rely-social-security.aspx [https://perma.cc/4EFC-2SPQ] (reporting that since the start of this century "non-retired Americans have become somewhat more likely to say Social Security will be a 'major source' of income in their retirement").

123. *See supra* note 4 and accompanying text.

124. *See* BD. OF TRS. OF THE FED. OLD-AGE & SURVIVORS INS. & FED. DISABILITY INS. TR. FUNDS, ANNUAL REPORT 22 (2019) ("Social Security's combined trust funds are projected to cover full payment of scheduled benefits on a timely basis until the trust fund reserves become depleted in 2035.").

125. Medicare, like Social Security, does have "trust funds" of sorts, but the most recent trustees report projects that these funds will be depleted a little more than a decade from now. *See* BDS. OF TRS. OF THE FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS, ANNUAL REPORT 2 (2019).

126. U.S. FINANCIAL REPORT FY 2018, *supra* note 4, at 19, 99–108.

including the deposit insurance provided by the Federal Deposit Insurance Corporation (FDIC) on roughly $7 trillion entrusted to financial institutions, are explicit obligations about which extensive public information is available.[127] Others can only be guessed at, including potentially hundreds of billions of dollars of backstops for private pensions.[128] In addition, many state and local governments face serious financial challenges, including huge pension funding shortfalls, stagnant revenues, and excessive debt loads,[129] and it is at least plausible that the federal government will end up assisting some of these entities.[130] Certain private firms may also enjoy implicit federal government backstops, as evidenced by the bailouts of the 2007–2009 financial crisis.[131]

Finally, the United States government has taken on the mantle of guarantor of world security and stability as well as its own national defense.[132] How much longer the United States will be able to fulfill

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127. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-19-295R, FINANCIAL AUDIT: FEDERAL DEPOSIT INSURANCE CORPORATION FUNDS' 2018 AND 2017 FINANCIAL STATEMENTS (2019).

128. *See* Alex Pollak, *Multi-Employer Pension Bailout Needs a Good Bank/Bad Bank Strategy*, REAL CLEAR MKTS. (July 10, 2019), https://www.realclearmarkets.com/articles/2019/07/10/multi-employer_pension_bailout_needs_a_good_bankbad_bank_strategy_103812.html [https://perma.cc/K7ZU-6LZ3] (reporting that "many multi-employer, union-sponsored pension plans are hopelessly insolvent," the "government's program that guarantees those pensions through the Pension Benefit Guaranty Corporation (PBGC)" has a "net worth of a negative $54 billion," and that "PBGC estimates the total unfunded pension liabilities of the multi-employer plans at $638 billion").

129. *See* Vincent S.J. Buccola, *The Logic and Limits of Municipal Bankruptcy*, 86 U. CHI. L. REV. 817, 818 (2019) ("Cities and towns across the country face debt burdens of a magnitude not seen since the Great Depression."); David A. Skeel, *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 HOUS. L. REV. 1063, 1064 (2013).

130. *See* MICHAEL S. GREVE, THE UPSIDE-DOWN CONSTITUTION 154 (2012) (observing that "[t]he New Deal and, on a grander scale, the Great Society blanketed vast areas of government with 'cooperative' fiscal transfer programs" and that in "recent experience, the long-standing precommitment against federal bailouts of state and local governments appears to have collapsed").

131. *See* ERIC A. POSNER, LAST RESORT: THE FINANCIAL CRISIS AND THE FUTURE OF BAILOUTS 2–3 (2018) (arguing that government bailouts of systemically important private firms are unavoidable in a complex economic system); Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 437, 439 (2011); Carmen M. Reinhart et al., *Public Debt Overhangs: Advanced-Economy Episodes Since 1800*, 26 J. ECON. PERSP. 69, 71–72 (2012) (describing how "the lines between public and private debt often become blurred in a crisis").

132. *See generally* G. JOHN IKENBERRY, LIBERAL LEVIATHAN: THE ORIGINS, CRISIS AND TRANSFORMATION OF THE AMERICAN WORLD ORDER (2012) (detailing the

this mission is an open question, but for now it is committed to maintaining and, if necessary, deploying a large and very expensive fighting force around the globe.[133]

To be sure, the United States government has considerable assets as well as liabilities.[134] These assets include roughly 640 million acres of land in the United States along with numerous structures affixed to those lands (such as dams, power plants, and space exploration facilities),[135] a U.S. government gold reserve,[136] and extensive carbon and other energy resources.[137] Also included in the "assets" of the United States are trillions of dollars of loan receivables of highly uncertain value,[138] most notably the federal government's troubled $1.4 trillion student loan portfolio.[139]

Sales or leases of some of these assets could provide relief from financial pressures for the United States, both in the short- and long-terms.[140] But the fact that the United States has substantial assets does not mean it cannot be in serious financial trouble. Even if the total value of the nation's assets dwarfs that of its liabilities—which there is grave reason to doubt, in no small part because the federal government's own 2018 balance sheet shows a negative net worth of

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United States' endeavor to provide global economic services and security); STEPHEN M. WALT, THE HELL OF GOOD INTENTIONS: AMERICA'S FOREIGN POLICY ELITES AND THE DECLINE OF U.S. PRIMACY (2018) (examining the United States' post-Cold War attempt to spread democratic and capitalist values globally).

133. *See* DANIEL EGEL ET AL., ESTIMATING THE VALUE OF OVERSEAS SECURITY COMMITMENTS 1 (2016).

134. *See* U.S. FINANCIAL REPORT FY 2018, *supra* note 4, at 4, 18 (2018).

135. *See id.* at 33.

136. *See* U.S. DEP'T OF TREASURY, STATUS REPORT OF U.S. GOVERNMENT GOLD RESERVE (2019) (showing that as of November 30, 2019, the United States government's gold reserve totaled 261.5 million troy ounces).

137. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-19-410, FEDERAL OIL AND GAS ROYALTIES: ADDITIONAL ACTIONS COULD IMPROVE ONRR'S ABILITY TO ASSESS ITS ROYALTY COLLECTION EFFORTS 5 (2019).

138. Michael Grunwald, *The (Real) Bank of America*, POLITICO, https://www.politico.com/magazine/story/2015/01/federal-loans-bank-of-america-113920_full.html [https://perma.cc/9BS8-A99W] (last visited Feb. 3, 2020) (describing a "bizarre" portfolio of government-held loans that "sprawl across 30 agencies at a dozen Cabinet departments, with no one responsible for managing" the portfolio, "evaluating its performance or [managing] its risks").

139. *See* CONG. RESEARCH SERV., A SNAPSHOT OF FEDERAL STUDENT LOAN DEBT (Feb. 4, 2019).

140. *See* Jim Millstein, *Burning the Furniture to Heat the House—The Potential Role of Asset Sales in Funding the Federal Government's Deficits*, *in* IS U.S. GOVERNMENT DEBT DIFFERENT?, *supra* note 1, at 151–52.

approximately $21.52 trillion[141]—many assets cannot be disposed of without endangering national security or significantly eroding the government's capacity to govern.

II. BEYOND TAX AND SPENDING REFORM: EXPANDING THE MENU

So far, the precipitous rise in United States government commitments has not led to a concomitant expansion in the set of options under consideration to deal with the situation. No matter how high the debt climbs or how massive the growth in entitlements, debates about what to do continue to revolve around tax increases and spending cuts, as well as to assume that all public debt obligations will be met.[142] In our judgment, to so limit the discussion is a mistake. There is no reason to regard debt restructuring as a sort of third rail, the merest contact with which must prove fatal to the nation. On the contrary, debt restructuring is a real possibility, if only because the electorate may favor receiving promised government benefits over repaying creditors. To add debt restructuring to the mix of options, in short, is not to court disaster but to accept reality.

A. Why Worry? Capital Markets Love the United States and It Borrows in Its Own Currency

A common rejoinder to alarm over the United States government's financial state is that there is no cause for fear right now.[143] After all, or so the argument goes, the United States borrows trillions of dollars each year at very low interest rates, definitive proof that the world's capital markets do not think it is in any trouble.[144] Given the eagerness of domestic and foreign creditors to lend the

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141. *See* U.S. FINANCIAL REPORT FY 2018, *supra* note 4, at 59

142. *See supra* notes 3–7 and accompanying text.

143. *See, e.g.*, Paul Krugman, *Who's Afraid of the Budget Deficit?*, N.Y. TIMES (Jan. 3, 2019), https://www.nytimes.com/2019/01/03/opinion/house-democrats-budget-deficit.html [https://perma.cc/VK4P-26LN] (arguing that "[d]eficit obsession was deeply destructive in the years that followed the global financial crisis" and that "there are things the government should be spending money on" at present, "like fixing our deteriorating infrastructure and helping children get education, health care and adequate nutrition").

144. *See, e.g.*, SIMON JOHNSON & JAMES KWAK, WHITE HOUSE BURNING: THE FOUNDING FATHERS, OUR NATIONAL DEBT AND WHY IT MATTERS TO YOU 7 (2012) ("The United States is the world's only true superpower . . . and its national survival is not in question. Nor does [its] Treasury have any trouble borrowing money. . . . Treasury bonds are used in financial markets as the very definition of a safe asset.").

United States money at very low interest rates, why fret now?[145] Fiscal restraint is a problem for the future.[146]

We disagree with this sentiment. The history of sovereign debt is replete with stories of nations that borrowed freely until suddenly they could not.[147] High profile recent examples include Greece, which in 2009 lost access to the financial markets following revelations it had been misstating its budget deficit figures for years,[148] and Argentina, which after being shut out of the financial markets in 2001 proceeded to engage in the largest sovereign debt default in history.[149] The blunt truth is that "it is hard to know how much debt any government can safely issue before risk premiums start rising in a dangerous manner."[150]

In the normal equilibrium, holders of short-term debts backed by illiquid but valuable assets expect to be repaid on demand and accordingly do not all demand to be repaid at once. Under such conditions, investors are generally content to roll over maturing debt. But, as many financial institutions discovered to their peril during the 2007–2008 financial crisis, the equilibrium can shift rapidly if

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145. *See, e.g.*, Stephanie Kelton, *How We Think About the Deficit Is Mostly Wrong*, N.Y. TIMES (Oct. 5, 2017), https://www.nytimes.com/2017/10/05/opinion/deficit-tax-cuts-trump.html [https://perma.cc/7YXA-8BRU] (arguing that "Americans are vulnerable to nationalist scare tactics that warn of the perils of relying on foreigners to pay our bills" while the "truth" is that there is "no reason to worry about China (or any other entity) refusing to finance our deficits"); *see also* Olivier Blanchard, *Public Debt and Low Interest Rates*, 109(4) AM. ECON. REV. 1197, 1198 (2019) (concluding that "the signal sent by low rates" on United States government bonds "is not only that debt may not have a substantial fiscal cost, but also that it may have limited welfare costs").

146. *Cf.* Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739, 759 (2002) (examining how current generations can create problems for future generations in the context of land preservation).

147. *See* REINHART & ROGOFF, *supra* note 73, at 174; Carmen Reinhart & Christoph Trebesch, *Sovereign Debt Relief and Its Aftermath*, 14 J. EUR. ECON. ASS'N 215, 216 (2016).

148. *See Explaining Greece's Debt Crisis*, N.Y. TIMES (June 17, 2016), https://www.nytimes.com/interactive/2016/business/international/greece-debt-crisis-euro.html [https://perma.cc/KXC2-7MGY].

149. *See* PIERRE VERDIER, GLOBAL BANKS ON TRIAL: U.S. PROSECUTIONS AND THE REMAKING OF INTERNATIONAL FINANCE (forthcoming March 2020); Eshe Nelson, *How Argentina Went from Selling 100 Year Bonds to an IMF Rescue in a Matter of Months*, QUARTZ (May 12, 2018), https://qz.com/1274875/how-argentina-went-from-selling-100-year-bonds-to-an-imf-rescue-in-a-matter-of-months/ [https://perma.cc/Z2C8-ZXVQ].

150. Peter Boone & Simon Johnson, *Forty Years of Leverage: What Have We Learned About Sovereign Debt?*, 104 AM. ECON. REV. 266, 268 (2014).

expectations change.[151] When trouble materializes for debtor nations, it tends to follow a pattern: the unlucky country is heavily indebted but has no current problems borrowing money, until suddenly and without significant warning, it does.[152] This point is a crucial one, for what at first blush appear to be temporary glitches in access to credit can quickly snowball into solvency threats.[153]

"Rollover risk" is a serious worry.[154] Although the U.S. government issues debt with a range of maturities, it relies heavily on short-term instruments with maturities under ten years. Because short-term interest rates are generally less than long-term rates, relying on short-term debt can reduce interest cost. But there is no free lunch: this strategy increases the risk that at any one point in time the government will be unable to sell enough bills to pay off the maturing bills and thus be thrown into default.[155] Alternatively, lenders might demand such a high nominal interest rate as to guarantee that interest payments and other spending commitments (including entitlements payments) could not both be honored. At present, over 65% of the federal government's annual cash outflows are rollovers of maturing debt with the proceeds of newly-issued debt.[156] Deprive the U.S.

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151. *See* MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION 103 (2016).

152. *See* Nina Karnaukh et al., *The Dark Side of Foreign Exchange Liquidity*, VOX (Sept. 10, 2015), https://voxeu.org/article/dark-side-foreign-exchange-liquidity [https://perma.cc/P96X-TGE5] (noting that nominal domestic-currency interest rates shot up nearly overnight during the Asian financial crisis of 1997 and the "Black Wednesday" crisis of 1992).

153. *See* Zhiguo He & Wei Xiong, *Rollover Risk and Credit Risk*, 67(2) J. FIN. 391, 392–93, 397–98, 401–02 (2012).

154. *See* Peter R. Fisher, *Thoughts on Debt Sustainability*, *in* IS U.S. GOVERNMENT DEBT DIFFERENT?, *supra* note 1, at 87, 99 ("If you ask Treasury or finance ministry officials responsible for debt management 'What keeps you up at night?' the only candid reply will be: the risk of not being able to rollover their debt at the next auction. . . . [D]ebt sustainability is about rollover risk: the risk that demand at an auction will drop precipitously from recent, prior auctions.").

155. *See* Steven L. Schwarcz, *Rollover Risk: Ideating a U.S. Debt Default*, 55 B.C. L. REV. 1, 4–7 (2014).

156. *See* U.S. DEP'T OF THE TREASURY, TREASURY DAILY STATEMENT tbl.2 (2019). The following numbers are from the Treasury Daily Statement ("TDS") of September 30, 2019, the end of the U.S. 2019 fiscal year. During the fiscal year 2019, ending September 30, 2019, the Federal Government had cash receipts of $15.99 trillion (TDS Table II, Total Deposits). *Id.* Of this amount, $11.92 trillion (TDS Table II Public Debt Cash issues from Table III-B) or 75% came from borrowing and $4.07 trillion (TDS Table II, Total Deposits Minus Debt Deposits) or 25% came from taxes and other revenue sources. *Id.* During the fiscal year 2019, the Federal Government had cash expenditures of $15.99 trillion (TDS Table II, Total Withdrawals), of which $10.96 trillion or 69% was for redemption of outstanding debt (Public Debt Cash

government of the latter, and it could not possibly pay the former and still have enough left over to pay Social Security, Medicare, and Medicaid benefits, let alone the remainder of its budgeted expenditures.

Of course, America's status as the safest refuge for capital may ensure uninterrupted access to whatever funds are desired for the indefinite future. But although it is true that in times of trouble investors have often fled to the relative safety of United States treasury securities, there is no guarantee they will view these instruments as safe no matter how large the amount of outstanding debt and no matter how frequently it has to be refunded.[157] The U.S. Treasury market has been hailed a "marvel of modern finance,"[158] but it is not a marvel without limits. In addition, the United States could lose its vaunted position as the safest refuge for capital not by its own reckless conduct but through effective competition from rivals who seek to displace it. And in thinking about how things could go wrong for the United States, it is also worth noting that a significant amount of the debt held by the public is owned by what the Department of the Treasury

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Redemption from Table III-B), and $5.03 trillion (TDS Table II, Total Withdrawals Minus Public Debt Redemption Withdrawals) or 31% was for the other expenses of the government. *Id.* As of September 30, 2019, the total debt of the U.S. government was $22.72 trillion. *Id.* at tbl.3(C). Treasury Daily Statements both current and archived back to January 7, 1998, are available online. BUREAU OF THE FISCAL SERV., https://www.fiscal.treasury.gov [https://perma.cc/CFX5-P6B6] (last visited Feb. 3, 2020) (supplying Treasury Daily Statements both current and archived back to January 7, 1998). Earlier Treasury Daily Statements are available in print. The Treasury Daily Statement implements the mandate of the United States Constitution that "a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." U.S. CONST. art. I, § 9. The Treasury Daily Statement is one of the longstanding practices of the Department of the Treasury that implements a policy of financial transparency and has helped to support financial market demand for United States debt instruments.

157. *See* Francis Warnock, *How Dangerous Is U.S. Government Debt?*, 2 CAP. FLOWS Q. 1, 1 (2010) ("The dollar's status as the world's reserve currency has become a facet of U.S. power, allowing the United States to borrow effortlessly and sustain large debt-financed military commitments. Capital has tended to flood into the United States especially readily during moments of geopolitical stress, ensuring that the nation has had the financial wherewithal to conduct an assertive foreign policy precisely at moments when crises demanded it. But the capital inflows associated with the dollar's reserve-currency status have created a vulnerability, too, opening the door to a foreign sell-off of U.S. securities that could drive up U.S. interest rates and render the nation's formidable stock of debt far more expensive to service.").

158. KENNETH D. GARBADE, BIRTH OF A MARKET: THE U.S. TREASURY SECURITIES MARKET FROM THE GREAT WAR TO THE GREAT DEPRESSION 1 (2012).

classifies as "foreign holders."[159] It is possible some could reduce their holdings or even stop buying altogether for strategic reasons.[160]

One response is to say that because Treasury debt is denominated in U.S. dollars, which the Federal Reserve can create in unlimited amounts, the United States will never have to default. Creditors will always expect repayment, and there will accordingly never be a run on Treasury debt. The same logic suggests that the substantial Treasury debt held by the Fed is not a true debt: if it is not repaid, the Fed can meet its obligations to the rest of the banking system by creating currency. This line of reasoning was most famously articulated by now President Donald J. Trump during his 2016 presidential campaign, when he clarified an earlier statement widely interpreted as indicating that he believed debt default was an option for the United States.[161] Said Trump: "This is the United States government. First of all, you never have to default because you print the money. . . . So there's never a default."[162]

As a formal matter this is true, but as a practical matter the difference between formal default and rampant inflation is merely

159. *Major Foreign Holders of Treasury Securities*, U.S. DEP'T OF THE TREASURY (Nov. 18, 2019), https://ticdata.treasury.gov/Publish/mfh.txt [https://perma.cc/D7VN-PDRH] (explaining that the largest concentrations of these securities are in the hands of China and Japan, each of which holds roughly $1.1 trillion worth, and that among other "foreign holders" with substantial amount of federal debt are Brazil, the United Kingdom, and Ireland).

160. *See* Warnock, *supra* note 157, at 1, 6.

161. *See* Binyamin Appelbaum, *Trump's Idea to Cut National Debt: Get Creditors to Accept Less*, N.Y. TIMES (May 6, 2016), https://nyti.ms/1Trr97k [https://perma.cc/637X-CXJW].

162. Nick Gass, *Trump: U.S. Can Never Default Because It Prints Money*, POLITICO (May 9, 2016), https://www.politico.com/story/2016/05/trump-no-debt-default-222957 [https://perma.cc/QLR5-J8EH]; *see also* John Carney, *Trump Says the U.S. Will Never Have to Default Because It Prints the Money*, WALL ST. J. (May 9, 2016), https://blogs.wsj.com/moneybeat/2016/05/09/donald-trump-says-the-u-s-will-never-default-because-it-prints-the-money/ [https://perma.cc/P27P-CNZ5]. This statement was not Trump's final word on the subject. In a television appearance the following month, Trump remarked that as President, were the U.S. economy to crash, he would negotiate with the nation's creditors: "[Y]ou go back and you say, 'hey, guess what? The economy just crashed. I'm going to give you back half.'" *See "Trump recession"? Presumptive GOP Nominee Fires Back at Clinton*, CBS NEWS (June 22, 2016), http://www.cbsnews.com/news/2016-race-donald-trump-responds-to-hillary-clintons-attack-on-his-economic-proposals [https://perma.cc/GJY4-3QYK]; *see also* Russell Berman, *Donald Trump Brings Back the Talk of Default*, ATLANTIC (June 22, 2016), https://www.theatlantic.com/politics/archive/2016/06/donald-trump-brings-back-the-default-talk/488270/ [https://perma.cc/7TY9-Y6ER] (characterizing Trump's statements in the CBS News This Morning interview as "much more of a musing than an actual plan").

semantic. Take the extreme case in which the Federal Reserve prints so much money that a dollar is worth next to nothing. Paying debts in worthless computer entries is default in all but form. Moreover, the strategy could have consequences even more dire than those of a formal default. It would destroy confidence not merely in Treasury debt, but in the dollar. It is even possible that lenders will begin treating the United States as they do some other profligate nations and refuse to lend us money in our own domestic currency. Less severe inflation poses less severe problems, but also does not retire debt as effectively.

All in all, the short-term gain of retiring debt with newly created dollars could be more than offset by long-term economic harm. While the U.S. central bank can create as many dollars as it wishes, it cannot obligate the markets to continue to supply the same amount of goods and services in return for those dollars. Voters might well react negatively to policies that carry substantial risks of significant inflation, for inflation can entail tremendous social costs, including misallocations of resources, tax distortions, and arbitrary wealth redistributions.[163] When and under what circumstances voters would prefer inflation to debt restructuring is of course a matter of conjecture. But there is no reason to think that citizens will always see inflation as the lesser evil.

B. Why Debt Restructuring Belongs On the Table

Another perspective on the federal government's finances holds that while the nation is in serious danger of "macroeconomic carnage" and "catastrophic budget failure" as it continues to rack up large debts,[164] crisis can (and should) be averted through the traditional, familiar policy prescriptions of tax reform and adjustments to government expenditures.[165] This conviction lies at the core of a

163. *See* N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 640–46 (8th ed. 2016).

164. Burman et al., *supra* note 3, at 562 (concluding that the "tax and spending trajectories" contained in a then-recent Congressional Budget Office report could lead to "macroeconomic carnage" so grisly as to merit the label "catastrophic budget failure").

165. *See id.* at 581 (arguing that the solution for avoiding economic meltdown is "relatively straightforward: cut spending, especially for entitlements, and raise revenues to stabilize and eventually reduce debt as a share of the economy").

number of well-wrought proposals crafted by respected experts over the past decade or so.[166]

Yet for all their virtues, these proposals have two things in common. First, none have been adopted, and there is no indication that any of these or similar policies has any significant chance of being put into operation any time soon. And second, all are grounded in an undefended and, in our judgment, indefensible assumption that principal and interest payments on treasury securities must always take precedence over all other United States government commitments.

We are deeply skeptical of the notion that debtholders enjoy *de facto* and *de jure* absolute priority over all other potential claimants. While it is true that conventional wisdom has long held that social security and other entitlements promises do not bind the federal government with the same force as does its formal debt, legal authority on this point is scant.[167] Perhaps more important, the wealth represented by social security and other strong, well-settled expectations of government transfers is vast and the number of Americans who rely on the payment streams from that wealth is very large.[168] Voters consider, and for decades have been encouraged by politicians to consider, Social Security, Medicare, and other entitlements as a form of household wealth as dependable and secure as a savings account. For that reason, one can easily envision holders of United States government debt losing a political showdown with entitlements claimants. This is particularly so if the United States were to consider a restructuring plan that discriminates between domestic and foreign holders of its debt. Early twenty-first century voters might not feel a sense of moral obligation to the nation's creditors, particularly foreign ones.

Nor does the United States Constitution compel the federal government to put its "formal debt" creditors first, whatever the cost

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166. *See, e.g.*, BOWLES & SIMPSON, *supra* note 3, at 8–9; PETE DOMINICI & ALICE RIVLIN, BIPARTISAN POLICY CTR., DOMENICI-RIVLIN DEBT REDUCTION TASK FORCE PLAN 2.0 (2011).

167. *See* John Harrison, *New Property, Entrenchment, and the Fiscal Constitution*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY, *supra* note 83, at 401, 401–03.

168. *See* Weil, *supra* note 121, at 18 (describing how in the late twentieth and early twenty-first centuries "new types of wealth," including "transfer wealth, have come to constitute a very significant fraction of wealth"); *see also* EDWARD N. WOLFF, A CENTURY OF WEALTH IN AMERICA 311–66 (2017) (calculating the magnitude and distribution of the wealth represented by expectations of social security benefits).

to the nation.[169] That is not to say that any and all measures carried out under the banner of debt restructuring are sure to pass constitutional muster. Far from it, for protections for private property and contract rights are key components of the American constitutional system,[170] and were of great importance to the founding generation.[171] But the relationship between private rights and public values is a complex one.[172] Federal, state, and local governments continually exercise power in ways that have profound effects on the value and character of property and contract rights. Not surprisingly, questions of where the boundary lies between permissible and impermissible government actions justified as furthering the public interest are often very difficult ones.[173]

Nothing in the Constitution as originally ratified forbids debt restructuring. Indeed, the historical record shows that delegates to the 1787 Philadelphia Convention considered including language explicitly precluding federal government debt defaults but chose not to do so.[174] And while the Fifth Amendment—added to the Constitution in 1791 as part of the Bill of Rights[175]—provides in

169. *Cf.* Ann Woolhandler & Michael G. Collins, *Overcoming Sovereign Immunity: Causes of Action for Enforcing the Constitution*, *in* THE CAMBRIDGE COMPANION TO THE CONSTITUTION 165, 184 (Karen Orren & John W. Compton eds., 2018) (tracing the history of government immunity from suits by private parties, and observing that "sovereign immunity doctrine has retained its core treasury-protective function, with its continuing prohibitions on suits for collection of sovereign debt and for retrospective monetary relief that runs against the state treasury").

170. *See* RICHARD A. EPSTEIN, THE CLASSICAL LIBERAL CONSTITUTION: THE UNCERTAIN QUEST FOR LIMITED GOVERNMENT 303–80 (2014); Jedediah Purdy, *Property in the United States Constitution*, *in* THE OXFORD HANDBOOK OF THE U.S. CONSTITUTION, *supra* note 22, at 501, 501–20; James Y. Stern, *Property's Constitution*, 101 CAL. L. REV. 277, 277–78 (2013).

171. *See* Renee Lettow Lerner, *Enlightenment Economics and the Framing of the U.S. Constitution*, 35 HARV. J.L. & PUB. POL'Y 37, 40 (2012) (noting that the inclusion of the Contracts Clause and the Takings Clause in the Constitution provides "evidence of the importance to the Framers of upholding contracts and protecting private property from government interference").

172. *See* David Singh Grewal, *The Legal Constitution of Capitalism*, *in* AFTER PIKETTY: THE AGENDA FOR ECONOMICS AND INEQUALITY 471, 484–85 (Heather Boushey et al. eds., 2017); David Blankfein-Tabachnik & Kevin A. Kordana, *Kaplow and Shavell and the Priority of Income Taxation and Transfer*, 69 HASTINGS L.J. 1, 4 (2017).

173. *See Kelo's Legacy*, *supra* note 8; Stern, *supra* note 170.

174. *See* McConnell, *supra* note 40, at 49–50 and accompanying text.

175. *See* NOAH FELDMAN, THE THREE LIVES OF JAMES MADISON: GENIUS, PARTISAN, PRESIDENT 245–85 (2017); JACK N. RAKOVE, THE ANNOTATED U.S. CONSTITUTION AND DECLARATION OF INDEPENDENCE 232–34 (2009).

pertinent part that "[n]o person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation,"[176] there is no indication this language was intended to have or understood as having any bearing on the federal government's capacity to carry out debt restructuring activities.[177]

As for the Fourteenth Amendment, added to the Constitution in the wake of the Civil War, it is true that some interpret the text of the Amendment's Public Debt Clause as a blanket prohibition on the federal government's failing to make its debt payments.[178] But even some experts sympathetic to such an interpretation admit there are other plausible readings of the Public Debt Clause.[179] Critically, that interpretation of the apposite language is not the most logical one. The Public Debt Clause provides that the "validity of the public debt of the United States, authorized by law, including debts incurred for payments of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned,"[180] but failing to pay a debt in full and on time is not at all the same thing as questioning that debt's validity. Adjustment and even full discharge of debt obligations is part and parcel of a sophisticated commercial society,[181] and debtors can (and frequently do) seek adjustments or discharges without claiming the debt at issue is in any way not valid. This occurs with regularity in the area of international sovereign debt restructuring, where nations that seek to renegotiate their obligations generally do not deny that the debt was lawfully incurred.[182]

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176. U.S. CONST. amend. V.

177. *See* Gary Lawson, *Take the Fifth…Please! The Original Insignificance of the Fifth Amendment's Due Process of Law Clause*, 2017 BYU L. REV. 611, 643 (2017); Ryan C. Williams, *The One and Only Substantive Due Process Clause*, 120 YALE L.J. 408, 420–21 (2010).

178. *See, e.g.*, Michael B. Abramowicz, *Train Wrecks, Budget Deficits, and the Entitlements Explosion: Exploring the Implications of the Fourteenth Amendment's Public Debt Clause* 5 (Geo. Wash. Univ. Legal Studies, Working Paper No. 575, 2011) (advocating a broad reading of the Public Debt Clause and arguing that "[t]he most obvious consequence of taking the Clause seriously would be that a government failure to make debt payments . . . would be unconstitutional").

179. *See, e.g.*, Buchanan & Dorf, *supra* note 6, at 1191–92 (detailing alternative and narrower readings).

180. U.S. CONST. amend. XIV, § 4.

181. *See* DOUGLAS BAIRD, ELEMENTS OF BANKRUPTCY 32 (Robert C. Clark et al. eds., 6th ed. 2014); Richard M. Hynes & Steven D. Walt, *Inequality and Equity in Bankruptcy Reorganization*, 66 U. KAN. L. REV. 875, 875 (2018).

182. *See* ODETTE LIENAU, RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE 1 (2014); VERDIER, *supra* note

Turning to judicial precedent, the leading United States Supreme Court case—in fact, the only case—on federal government debt restructuring is *Perry v. United States*.[183] While it is possible to argue *Perry* stands for the proposition that the Constitution prevents the federal government from restructuring its debt in any way,[184] that is a heavy burden to place on an eighty-four-year-old, highly cryptic opinion for a bare majority of the Supreme Court, particularly when one of the five-man majority indicated in a concurring opinion he did not embrace the majority's constitutional analysis.[185] Perhaps more importantly, the denouement of *Perry*—when the Court found the complaining debtholder had suffered no damage and thus sidestepped a potential confrontation with Congress and the Executive branch—belies the notion that the Constitution must necessarily operate as a hard constraint.

Again, we do not argue the Constitution is silent or irrelevant when it comes to restructurings of federal government debt. On the contrary, we believe the Constitution and constitutional doctrine would be of the utmost importance in determining whether and to what extent specific debt restructuring proposals are lawful. Our claim is that the common assertion that debt restructuring is somehow off the table because it is inimical to the American constitutional system is not well-grounded in constitutional text, history, structure, or precedent.

III. PREPARING TO RESTRUCTURE

If only for planning purposes, it is prudent to recognize that the United States may fall far short of its commitments. Should that time come, the United States will need to overhaul its formal debt, its social insurance and welfare programs, or both. For the system to work up to its potential, however, it needs adequate preparation. The panicked official responses to the events of 2007–2009,[186] which came on the

149. Rare exceptions to this practice occur when successor regimes claim debt incurred by predecessor regimes is "odious" and thus not binding on a nation. *See* G. Mitu Gulati et al., *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1203 (2007).

183. *See supra* Part I.B.

184. *See, e.g.*, Josh Hazan, *Unconstitutional Debt Ceilings*, 103 GEO. L.J. ONLINE 29, 29 (2014); Zachary K. Ostro, *In Debt We Trust: The Unconstitutionality of Defaulting on American Financial Obligations, and the Political Implications of Their Perpetual Validity*, 51 HARV. J. ON LEGIS. 241, 241 (2014).

185. *See supra* at notes 87–89 and accompanying text.

186. *See generally* BEN S. BERNANKE, THE COURAGE TO ACT: A MEMOIR OF A CRISIS AND ITS AFTERMATH (2015) (documenting the experience of the 2008 financial

heels of years of denying that so serious a financial crisis could occur,[187] illustrate the virtues of thinking ahead. So do the examples of the 2011 and 2013 showdowns over the debt ceiling in which—or so the then incumbent Secretaries of the Treasury claimed—the United States teetered on the brink of catastrophe.[188]

To date, there is no sign that federal government officials have any appetite for thinking seriously about restructuring as an option.[189] Their failure to do so is readily explainable: to contemplate default would be to admit tacitly that United States debt securities are not in fact risk-free. This admission would be an awkward one, given that "large swaths" of the nation's—and the world's—financial infrastructure are built on the idea that obligations of the United States government carry no risk.[190] But this continual refusal to face reality may exact a heavy cost. A financial system not grounded in the delusion that U.S government debt carries no default risk could be a more stable one.

We believe academics have a useful role to play in deliberations about conflicts between private rights and public exigencies, as they are subject to fewer constraints than most political and government

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crisis from the perspective of the chairman of the Federal Reserve); HENRY A. PAULSON, JR., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 1 (2010) (cataloguing the events of the 2008 financial crisis).

187. *See* Julia D. Mahoney, *Takings, Legitimacy, and Emergency Action: Lessons from the Financial Crisis of 2008*, 23 GEO. MASON L. REV. 299, 301–02 (2016).

188. *See* Press Release, U.S. Dep't of the Treasury, Testimony of Secretary Lew Before the Senate Finance Committee on the Debt Limit (Oct. 10, 2013) (on file with the author) (warning of "potentially catastrophic impacts of default, including credit market disruptions, a significant loss in the value of the dollar, markedly elevated U.S. interest rates, negative spillover effects to the global economy, and real risk of a financial crisis and recession that could echo the events of 2008 or worse"); Timothy F. Geithner, *Meet the Press Transcript for July 10, 2011*, NBC NEWS (July 10, 2011), http://www.nbcnews.com/id/43672884/ns/meet_the_press-transcripts/t/meet-press-transcript-july/ [https://perma.cc/2CTK-BAT8].

189. *See* Mooney, *supra* note 1, at 3 ("[I]t is possible that behind closed doors at the Department of the Treasury and within the Federal Reserve System (Fed) the relevant issues have been pondered and analyzed in depth. . . . But I suspect that no such investigations have taken place. The statements and behavior of Treasury and the Fed during the period of 2007 to 2009 appear to reflect a classic case of denial. Exploring a U.S. default or restructuring would be very much out of their institutional character.").

190. Donald B. Marron, Inst. Fellow & Dir. of Econ. Policy Initiatives, The Urban Inst., The Costs of Debt Limit Brinksmanship: Testimony Before the Joint Economic Committee (Sept. 18, 2013) (detailing the "unique and vital role" Treasury securities play in financial markets).

actors in terms of what they can say in public about the nation's finances.[191] In that spirit, we turn to how the United States can get into better shape to weather economic and financial storms.

A. The Short Term: Reducing the Risk of a Rollover Crisis

To enhance the capacity of the United States to respond to shocks with calm and dispatch, we suggest that the federal government take two steps. The first is to increase the duration of the outstanding debt, preferably through the issuance of perpetual instruments, thus reducing the amount of debt that has to be continuously rolled over and mitigating the immediate effect of higher interest rates. The second is to set up a liquidity fund to be available in the event of a financial disruption, thus giving the government breathing room to fund its operations for a period of time without resorting to the debt markets.

1. *Extension of Debt Duration*

The first of our suggestions is to extend the duration of the outstanding debt.[192] Extending the duration would reduce the daily

191. *Cf.* Howell E. Jackson, *The 2011 Debt Ceiling Impasse Revisited*, *in* IS U.S. GOVERNMENT DEBT DIFFERENT?, *supra* note 1, at 55, 67.

192. A discussion of the optimal duration of United States Treasury debt can be found in THE $13 TRILLION QUESTION: HOW AMERICA MANAGES ITS DEBT (David Wessel ed., 2016) [hereinafter THE $13 TRILLION QUESTION]. THE $13 TRILLION QUESTION features two papers addressing optimal debt duration. One, by Robin Greenwood, Samuel G. Hanson, Joshua S. Rudolph, and Lawrence H. Summers, argues for a shorter duration. *See* Greenwood et al., *The Optimal Maturity of Government Debt*, *in* THE $13 TRILLION QUESTION 1, 1–27. The other argues for a longer duration. *See* John H. Cochrane, *A New Structure for U.S. Federal Debt*, *in* THE $13 TRILLION QUESTION 91, 91–139. Both papers implicitly assume that the risk of a rollover crisis is so minute that it has no relevance to the analysis. *See* Cochrane, at 91–139; Greenwood et al., at 1–27. The "$13 Trillion" of the title is the amount of U.S. Treasury debt held by the public in the fall of 2015, when the papers were presented at a conference held at the Hutchins Center on Fiscal & Monetary Policy, which is part of the Brookings Institution. *See* Lawrence H. Summers, *This $13 Trillion Question Is More Important than Ever*, WASH. POST (Nov. 10, 2015), https://www.washingtonpost.com/news/wonk/wp/2015/11/10/larry-summers-this-13-trillion-question-is-more-important-than-ever/ [https://perma.cc/987X-2KZW] (describing the conference). As of September 30, 2019, less than four years later, this "$13 Trillion" debt held by the public figure had increased to $16.80 Trillion. *The Debt to the Penny and Who Holds It*, TREASURY DIRECT, https://www.treasurydirect.gov/govt/reports/pd/pd_debttothepenny.htm [https://perma.cc/GBS4-3HF2] (last visited Feb. 3, 2020).

financing requirements of the United States government. That in turn would ease the adjustment shock when and if the United States government is unable to continue to roll over its debt. The quickest way to extend the duration of United States government debt is for the Treasury to issue perpetual bonds, along the lines of the now largely forgotten "consols" once issued by the government of the United Kingdom.[193]

Extending the duration of the outstanding debt has other advantages. It would lock in the present relatively low interest rates. A perpetual bond could be issued in large quantities, creating a single class of U.S. Treasury bond which would have greater liquidity than any presently outstanding issue. Admittedly, the Treasury staff and the Treasury Bond Advisory Committee (known as TBAC) appear to be hesitant to change any of the present practices in the U.S. Treasury market. This is shown by the resistance to the idea put forward by Secretary of the Treasury Steven Mnuchin that the Treasury should issue 50 years bonds (30 years is presently the maximum maturity that the Treasury uses).[194]

A large market of United States government perpetuals with identical terms would create a liquid trading market in United States obligations that would provide a highly useful barometer of the financial health of the United States. Although the market in United States government obligations is often described as the largest and most liquid in the world, its liquidity is undermined by the fact that it

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193. *See* Jan Tore Klovland, *Pitfalls in the Estimation of the Yield on British Consols, 1850-1914*, 54 J. ECON. HIST. 164, 165 (1994) ("For many decades before World War I the price of Consols was the single most important asset price in the world economy."). Corporations (and a number of governments) have been issuing bonds with maturities of fifty years or more. U.S. corporations are not in a position to consider a perpetual bond because under income tax rules the interest on a perpetual bond is not deductible. The income tax rules have no impact on the government choice. Private corporations, of course, issue a type of perpetual security in the form of common stock. *See* Mooney, *supra* note 1, at 12, 15 (proposing "Prosperity Shares" to be "structured to provide periodic payments to the holder that reflect in some fashion the growth of the U.S. economy and positive increases in the fiscal health of the U.S.").

194. *See* Kate Davidson and Daniel Kruger, *Treasury Exploring New Debt Products, Including 20-Year Bond*, WALL ST. J., https://www.wsj.com/articles/treasury-exploring-new-debt-products-including-20-year-bond-11572438976 [https://perma.cc/5CUJ-8BN4] (last updated Oct. 30, 2019) (reporting that the Treasury Department said "it was considering several possible new debt products as officials seek to find more ways to attract investment as budget analysts expect years of continued growth in federal budget deficits," including "adding new bonds with maturities of 20- and 50-years").

consists of hundreds of different issues with different maturities, coupon rates, and so on. An outstanding issue of, for instance, $4 trillion of 4% U.S. perpetuals would create an easily tradeable and shortable public market whose value would be based on investors' beliefs about U.S. financial stability and likely future U.S. interest rates. This would be similar to the role corporate equity markets play in providing public information about the performance of company managements.

2. *Dedicated Liquidity Fund*

Our second suggestion is the establishment of a liquidity fund, available for government operations if a disruption should occur. There is already in existence an Exchange Stabilization Fund, controlled by the Secretary of the Treasury, which in the past has been deployed for purposes such as addressing the Mexican financial crisis in the 1990s.[195] At present, the Exchange Stabilization fund totals only about $90 billion, less than the nation's weekly borrowings.[196] What we propose would provide a far larger cushion.

The resources available to the Secretary of the Treasury to deal with a disruption in the United States' access to credit markets have been the subject of public discussion in connection with the recent controversies over debt ceiling increases.[197] In normal times, the debt limit is for practical purposes something of a paper tiger. This paper tiger exists because the Treasury Secretary can take advantage of the statutory definition of the outstanding debt in the debt-limit statute.[198]

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195. *See* Anna J. Schwarz, *From Obscurity to Notoriety: A Biography of the Exchange Stabilization Fund* (Nat'l. Bureau of Econ. Research, Working Paper No. 5699, 1996).

196. *See* U.S. DEP'T OF TREASURY, OFFICE OF INSPECTOR GENERAL, AUDIT OF THE EXCHANGE STABILIZATION FUND'S FINANCIAL STATEMENTS FOR FISCAL YEARS 2019 AND 2018 (2019).

197. *See, e.g.*, Kellie Lunney, *As Government Hits Debt Ceiling, Treasury Taps Federal Pensions*, THE FISCAL TIMES (March 16, 2015), http://www.thefiscaltimes.com/2015/03/16/Government-Hits-Debt-Ceiling-Treasury-Taps-Federal-Pensions [https://perma.cc/KV5K-PKSR].

198. The basic debt limit statute is codified at 31 U.S.C. § 3101 as supplemented by 31 U.S.C. § 3101(A), which provides an expedited procedure for Congressional approval of a recommended debt ceiling increase. These codified provisions are further supplemented by uncodified joint resolutions and Congressional practices. Both major political parties apparently found the continuing controversies over the debt ceiling embarrassing, and the debt ceiling was suspended through the current Presidential election cycle with bipartisan relief in Public Law No. 116-37, which became law on August 2, 2019.

That statute counts as outstanding debt the debt instruments required to be held in the social security and other trust funds, particularly funds that back retirement promises to federal employees.[199] However, the statute governing the Civil Service Retirement and Disability Fund provides that the Secretary can suspend required contributions to the Fund (partly derived from deductions in Civil Service employees paychecks) "if such additional investment could not be made without causing the public debt to exceed the public debt limit."[200] These funds must be made whole by the Secretary once the debt-ceiling crisis is resolved.[201] This enables the Secretary to divert this cash to other cash needs.

Another subsection of the same section provides that the Secretary can "sell or redeem . . . invested assets of the Fund before maturity" in order to prevent the public debt of the United States from exceeding the debt limit.[202] This ability to sell will only be helpful as long as the financial markets are receptive to the Secretary's sale.

If the Secretary were unable to borrow from global financial markets on satisfactory terms, due either to legal impediments or to a lack of demand, and after exhausting the Exchange Stabilization Fund, the Treasury Secretary might turn to his friends at the Federal Reserve. However, the Federal Reserve is statutorily barred from buying United States debt directly from the Treasury.[203] And even if it were allowed to buy treasury securities directly, the information that the Federal Reserve was now the buyer of last resort, paying for its purchases with newly printed dollars, could destabilize the markets, driving up interest rates, and along with it, the interest costs of the federal government.

What about asset sales? Could the United States sell part of its gold stores and use the proceeds to fund the operations of the government? One problem is that the Secretary would find it difficult to sell this much gold quickly at the current market price. This difficulty is in part because the United States, although a major owner

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199. *See* CONGRESSIONAL RESEARCH SERVICE, THE DEBT LIMIT SINCE 2011, R4338 [UPDATED AUGUST 29, 2019] 5 (2019).

200. 5 U.S.C. §8348 (j)(1); *see also* DEP'T OF THE TREASURY, DESCRIPTION OF THE EXTRAORDINARY MEASURES (2012) (detailing the extraordinary measures available to the Treasury Secretary); GRANT DRIESSEN & JOSEPH HUGHES, CRS INSIGHT, "EXTRAORDINARY MEASURES" AND THE DEBT LIMIT (2019).

201. 5 U.S.C. § 8348(j)(2) & (3).

202. 5 U.S.C. § 8348(k)(1). The Secretary does not appear to have made use of this power. *See also* DEP'T OF THE TREASURY, DESCRIPTION OF THE EXTRAORDINARY MEASURES, *supra* note 200; DRIESSEN & HUGHES, *supra* note 200.

203. *See* 12 U.S.C. § 355 (2018).

of gold, has not been supportive of a deep and liquid market in gold. A further question is what the impact of selling the U.S. gold holdings would be on the credibility of its currency. Although contemporary macroeconomics teaches that the United States and other modern economies have a system of fiat money and that any gold backing is irrelevant,[204] it is possible that news that the Treasury has found it necessary to sell its gold would have an impact on the financial markets. If so, the benefits obtained by selling the gold could be outweighed by the impact that the announcement of the sale would have on the economic prospects of the United States.[205]

Could the United States sell off some land? The United States has immense real assets, with ownership of one-third of the land mass of the nation.[206] The problem is that the bulk of these assets are encumbered by statutory requirements and fast sales would be hard without Congressional cooperation, which might not be forthcoming.

It is the inadequacy of these alternatives that leads us to suggest a liquidity fund that the Secretary can access in the event of a financial disruption. The long existence of the Exchange Stabilization Fund shows that the idea that the Secretary of the Treasury needs access to discretionary funds to deal with unexpected events is well-accepted.

The creation of a larger liquidity fund involves two important issues that would need to be addressed. First, how would the fund be governed? Second, in what form would the Fund hold its assets?

As to the first question, we suggest having the Secretary of the Treasury manage the fund. Perhaps this is because we are unwisely admiring of the great traditions of the U.S. Treasury dating back to Alexander Hamilton and Albert Gallatin, and the tradition of able staffing and fiscal rectitude they created. It does seem that the modern

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204. *See* N. GREGORY MANKIW, MACROECONOMICS 81 (7th ed. 2009) (explaining that "money that has no intrinsic value is called fiat money because it is established as money by government decree, or fiat" and that "fiat money is the norm in most economies today").

205. On August 24, 2012, Eric M. Thorson, Inspector General, Department of the Treasury, responded to questions asked by Senator Orrin G. Hatch in a letter of January 18, 2012, about the debt ceiling crisis of July 2011. *See* U.S. DEP'T OF TREASURY, OIG-CA-12-006, REQUEST FOR INFORMATION REGARDING THE DEBT CEILING ISSUES OF 2011 (2012). Thorson's response contained the following passage: "Treasury officials rejected the option of selling the nation's gold to meet payment obligations because selling gold would undercut confidence in the U.S. both here and abroad, and would be destabilizing to the world financial system." *Id.* at 4. Apparently, the treasury officials are not confident that everyone has internalized the teaching of contemporary macroeconomics that contemporary money is simply fiat money.

206. *See supra* notes 134–37 and accompanying text.

Secretaries of the Treasury have a lesser role, and Congress might well decide that such a fund should be under the control of a separate board. It would make sense to specify the conditions under which the Fund would be accessible. A statute could specify, for instance, that the funds would only be available after the Secretary (or the Board) certifies that no other source of short-term cash is available to the government.

With respect to the form of asset holdings: the U.S. government now keeps its operating funds in an account at the Federal Reserve Bank of New York. The problem with using the Federal Reserve Bank of New York for this purpose is that the assets of the Federal Reserve Banks, including the Federal Reserve Bank of New York, consist of U.S. Treasuries or GSE debt implicitly guaranteed by the United States. A disruption of the U.S. Treasury's ability to borrow would create solvency issues for the Reserve Banks (because the U.S. Treasury instruments would fall in value) just as the Treasury needed access to its funds. Consequently, we suggest that the liquidity fund could hold diversified liquid assets denominated in the major currencies, other than U.S. Treasuries and GSEs.[207]

B. The Longer Term: Preparing to Restructure

That a restructuring of U.S. government debt would not necessarily trigger catastrophe for the United States does not, of course, mean that catastrophe is not a possible outcome. We acknowledge the concern that a constitutional structure that disperses power could compound the country's problems in times of grave financial challenges. After all, divided authority can lead to unproductive, wasteful expenditures of energy, with the upshot that nothing gets done until a crisis occurs, and then what does get done is bad. We understand this line of thought and admit that the United States system has not always responded well to crises.[208] We also recognize that we live in an age when some question the value of the United States constitutional system and whether it retains any of the

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207. *See* U.S. DEP'T OF TREASURY, EXCHANGE STABILIZATION FUND STATEMENT OF FINANCIAL POSITION AS OF MAY 31, 2019 (2019) (elucidating that at the present time, the Exchange Stabilization Fund holds a substantial position in U.S. Treasuries as well as positions in IMF SDR's, and Euro and Yen denominated securities).

208. *See, e.g.*, PAUL G. MAHONEY, WASTING A CRISIS: WHY SECURITIES REGULATION FAILS 11 (2015); PHILIP A. WALLACH, TO THE EDGE: LEGALITY, LEGITIMACY AND THE RESPONSES TO THE 2008 FINANCIAL CRISIS 1 (2015).

usefulness it may once have had.[209] Gridlock and obstructionism, or so a commonly advanced argument goes, have rendered the American constitutional system incapable of functioning in anything akin to its original form.[210]

But to focus only on how bad things are when politics gets bitter is to ignore one of the American system's great advantages: what emerges from its often messy, cumbersome workings tends to have legitimacy and can generally be relied upon. That is precisely what occurred in both the Founding era and in the 1930s. In both instances, the federal government's treatment of its creditors generated intense controversy, in large part due to the profound tensions that arose between forging a viable financial structure for the nation and respecting contract and property rights. Yet the United States was able to navigate these choppy waters and emerge with the access to capital markets it needed. These events highlight that the very constitutional structure that can make it hard to get things done can also enable credible commitments that the nation will not become a serial defaulter on the order of Argentina or other problem nation sovereign debtors.

To realize the full potential of the United States constitutional system, it is crucial to understand its strengths and vulnerabilities. With respect to government debt, what the Constitution provides is a framework that creates space for crafting creative solutions to problems, not a rigid advance directive that sets out with specificity how government actors must respond in times of grave difficulty.[211] The demonstrated benefits of the flexibility that is built into the constitutional design is reason to be skeptical of the value of legislative proposals designed to prioritize interest and principal payments on treasury securities over other United States government commitments.[212]

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209. *See, e.g.*, SANFORD LEVINSON, FRAMED: AMERICA'S 51 CONSTITUTIONS AND THE CRISIS OF GOVERNANCE 1 (2012); Louis Michael Seidman, *The Secret History of Constitutional Skepticism: A Recovery and Preliminary Evaluation*, 17 U. PA. J. CONST. L. 1, 1–5 (2014).

210. *See, e.g.*, MANN & ORNSTEIN, *supra* note 54, at 7; Richard L. Revesz, *Congress and the Executive: Challenging the Anti-Regulatory Narrative*, 2018 MICH. ST. L. REV. 795, 796–97 (2018).

211. *See* Kenneth W. Dam, *The American Fiscal Constitution*, 44 U. CHI. L. REV. 271, 273–74 (1977) (describing the Constitution's "stable yet evolving structure" and speculating that the "modesty and lack of specificity" of the constitutional provisions relating to fiscal matters "account for its durability").

212. *See, e.g.*, Full Faith and Credit Act, H.R. 807, 113th Cong. (2013); *see also* Mitu Gulati et al., *When Governments Promise to Prioritize Public Debt, Do*

Another feature of the United States constitutional system that merits attention is Congress's "power of the purse."[213] The Constitution entrusts Congress with primary responsibility for the nation's finances, including the powers to tax, spend, and appropriate funds.[214] Increasingly, however, divisions of the federal government are drawing on non-appropriated funds for general operations.[215] It is worth considering what the ramifications of this shift may be for United States government preparedness for severe financial stress.

CONCLUSION

If something cannot go on forever, it will not. This Article's analysis has been premised on the distinct possibility that the United States government's current fiscal path is unsustainable, meaning that in the future *something* will have to change. That something might, of course, be cuts to social security obligations, defense spending, or a host of other government initiatives. Or it might be steps to increase revenue through changes in taxation. Or it might be strategies of financial repression to force purchases of government debt. But big government programs have proven stubbornly resistant to reform, taxes difficult to increase, and financial repression diverts scarce capital from its most productive use. This leads us to think it is only prudent to consider the prospect that at a time of great financial stress voters and politicians will conclude that the best course of action, all things considered, includes restructuring Treasury debt.

We hope this Article has demonstrated the central benefit of thinking about the previously unthinkable: we can then prepare for it. Our two concrete proposals—a lengthening of debt duration,

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Markets Care? 3–4 (Graduate Inst. of Int'l & Dev. Studies, Working Paper No. HEIDWP07-2019, 2019).

213. Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1344 (1988).

214. *See* U.S. CONST. art. I, § 8 (providing Congress with power to "lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States" and "to borrow Money on the credit of the United States"); *id.* art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law . . . ."); *see also* Christopher C. DeMuth, Sr. & Michael S. Greve, *Agency Finance in the Age of Executive Government*, 24 GEO. MASON L. REV. 555, 555 (2017) (stating that the "written Constitution is unequivocal, indeed emphatic, in committing fiscal powers to Congress and in withholding them from the executive, the better to safeguard the separation of powers").

215. *See* DeMuth, Sr. & Greve, *supra* note 214, at 555 (describing and analyzing this development).

including through the issuance of perpetual debt instruments, and the creation of a liquidity fund—are designed to provide breathing space so that the nation can better withstand financial shocks, including the disruption that would result from a debt rollover crisis. We have also provided an initial take on the constitutional questions that would need resolution at the time of a restructuring. While much remains uncertain, we think it clear that our constitutional system provides ample powers for the government to address the nation's challenges and that the Constitution would not operate as a hard constraint on restructuring the nation's debt.

A restructuring of United States government debt would likely prove painful, and not just to holders of Treasury securities. But any action must be compared to feasible alternatives. The standard responses to a full-blown debt crisis are currency debasement, messy default, or (relatively) orderly restructuring. We have argued that restructuring might well prove to be the least damaging of the three, in large part because our constitutional system has the capacity to make credible a United States government commitment not to engage in serial debt default going forward.