

Deconstructing the DOGE narrative about government debt

The fear of US public debt, often exaggerated by policymakers, overlooks fundamental economic realities. Instead of focusing on debt reduction, the priority should be ensuring government expenditures enhance productive capacity to sustain economic growth

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MARCH 10, 2025 / 08:59 IST

Highlights

- *Government debt represents accumulated private sector savings, not an impending financial crisis*
- *Since the U.S. issues debt in its own currency, it can always roll over liabilities without defaulting*
- *Running surpluses reduces private sector assets, potentially leading to recessions*
- *Unlike households, the government settles debts using its own liabilities, making insolvency impossible*
- *Instead of cutting expenditures out of debt concerns, governance should prioritize investments that expand economic capacity while controlling inflation*

For several months now, Elon Musk, Chief of the Department for Government Efficiency (DOGE) set up by the Trump administration has been repeatedly warning that the US “headed for bankruptcy super-fast” on account of its huge public debt that now exceeds \$36 trillion or almost 125% of its GDP. To underscore the desperation of the situation, this figure is often conveyed in more personal terms: each citizen of the US would have to pay up more than \$100,000 to resolve the US public debt! The solution to problem: deregulation or streamlining government operations, and expenditure cuts. While these may control the growth in public debt, it will not *reduce* existing debt *per se*. The only definitive solution is to run budget surpluses, the consequences of which could paradoxically increase the debt.

We must begin deconstructing DOGE with the basic question, what is public debt? We assume that the US government issues its own fiat currency (inconvertible into gold or silver) – the dollar. To understand the essence of public debt we assume there is no banking system. The US government in order to draw resources from the private sector for the creation of public goods, spends dollars – its financial liabilities or promissory note – into existence. A portion of these dollars (financial liabilities) are extinguished by way of taxes when they are returned to the government. The amount of dollars remaining in the economy accumulates over the years into public debt.

The government may also want to ensure that people are not tempted to spend all the dollar bills (liquid cash) they hold as it may lead to inflation. An interest bearing bond may be issued to mop up some of this liquid cash. It is important to note that taxes cannot be paid and debt cannot be issued before the government spends dollars into existence as both must be settled in dollars, and dollars only. Moreover, both cash and securities are financial liabilities of the government. When a bond matures (akin to a fixed deposit), it can be settled in cash, which is nothing but a non-interest-bearing financial liability akin to money held in a current account. Since US debt will be repaid in its own financial liabilities, the US government cannot go bankrupt. Default on debt happens only when the government chooses to do so.

How can the government reduce its accumulated financial liabilities or debt? The only solution is to tax people more than the government spends, i.e. run a budget surplus so that people are forced to draw down their cash holdings and/or liquidate their savings held in government securities. From the private sector's point of view, government issued cash and bonds are financial assets, or in other words, public debt is nothing but private sector savings accumulated over the years. Destroying private sector assets through budget surpluses will reduce their spending while increasing their propensity to save from current income resulting in a contraction of the economy – a recession or even a depression – that may ultimately result in a larger budget deficit as tax collections fall and expenditure (say, on social security) rises.

It is difficult to comprehend why fear mongers over US debt do look at glaring facts. Japan, for instance, had a yen-denominated (its own sovereign fiat currency) debt to GDP ratio of 250%, more than double the US'. In spite of this, interest rates remained at near zero for several years. And most importantly, Japan never defaulted on its debt. Another fact that Americans seem to have forgotten (conveniently) is the consequences of Bill Clinton's budget surpluses between the late 1990s and early 2000s; the personal savings rate tanked while household debt surged, which has been [argued](#) to be the precursor to the Great Recession of 2008.

One of the most common arguments used against public debt is the government-household (or corporate) analogy. The [Adam Smith Institute](#), a pro free-market, neoliberal think-tank, claims that this analogy "is an absolutely great way to describe government debt ... Yes, obviously, a government can print money. But so can a household. Getting the pub to run a tab is money printing – debt creation ..." However, and herein lies the key difference, while a household can run a tab when it's time to make a final settlement, it has to do so not with its own liability but with the financial liabilities of the government (currency) whereas the government simply settles its liabilities with its own liability – the debt can be rolled over *ad infinitum*. If you walk into the Fed with a \$100-dollar bill and ask them to settle their liability (promissory note), they will give you a new one or perhaps 20 x 5 new notes.

The household analogy, however, applies to sovereign debt denominated in a foreign currency. For instance, if Sri Lanka runs out of dollars, it cannot issue dollars to settle the debt – it can therefore go bankrupt in dollars. In such situations it issues its own debt (Sri Lankan rupees or LKR) to buy dollars in the market, depreciating the LKR, importing inflation that often times triggers hyperinflation. This problem does not arise for the US as most of its debt held by foreigners (30% of total debt) is dollar-denominated. If a foreign central bank asks for settlement of US treasuries, the Fed would transfer the amount from their securities account to their deposit account held at the Fed, i.e. similar to liquidating a fixed deposit at the bank, which entails transferring the amount from the FD account to a current (or deposit) account.

If the US government cannot go bankrupt from its debt, does this mean that wasteful expenditures are justifiable? Absolutely not. Economic efficiency means that all expenditures are allocated to their most valuable uses and waste is eliminated. This is important but should be driven by the fear of the debt *per se*; instead, wasteful expenditures must be seen as inflationary. When the government spends it adds purchasing power in the hands of the private sector, when it taxes it drains out this purchasing power so that the deficit is the net purchasing power (or aggregate demand) injected into the economy. If these expenditures do not add, directly or indirectly, to the productive capacity of the economy (aggregate supply), the result will be inflation. As long as aggregate supply and demand move in tandem, deficits and debt are never a problem.

In reality, it is difficult to ascertain which expenditures add to productive capacity and how much? For instance, building a museum might be considered wasteful or inefficient expenditures but are they really? In their contribution to preserving a country's heritage it can be argued that they contribute to nation-building that ultimately adds (indirectly perhaps) to the productivity of its citizens.

The choice of expenditures is undeniably difficult to make: should the US (or for that matter, any country) spend on a museum, a Mars mission, a high-speed rail network, primary healthcare facilities and/or public housing? Rather than pursue deficit and debt numbers, and laying off workers, it would be more efficient if DOGE focuses on "governance", or in other words, how government expenditures could best raise US productive capacity so that the economy continues to grow with an acceptable rate of inflation.

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