Making Sense of It All

BY ROBERT KLEINSCHMIDT ON *MAY 9, 2025*

Let us stipulate at the outset that the single most pressing and dangerous problem facing the U.S. is its gargantuan National Debt and its ability to service it now and in the future. Failure to solve this issue renders all other concerns trivial including, China, Ukraine, Gaza, Climate Change, Illegal Immigration, Demographic Collapse, etc. A bankrupt or insolvent U.S., or one gripped by hyperinflation caused by trying to avoid it, changes ***everything***.

So, it pays to assess all of the new Administration's policies in the context of this overriding problem. Does the President agree? That's hard to tell, but Elon Musk certainly seems to understand the magnitude.

The Trump Administration hit the ground running in its first one hundred days, the first two thirds of which were marked by their swift pace and broad scope of activity, but the final third was dominated by the confusing zig-zagging tariff policy.

While the tariff policy roll out might have been better handled, the Administration's goal to reorder the world trade system remains a primary objective. Why? And how does it help solve the big problem?

Too Much of a Good Thing

The extant global trading order, in which the U.S. had few import restrictions while the rest of the world had many, was put in place after World War II with the primary objective of renewing the devastated economies of Europe and Japan. It worked well for many years. The strength of American consumer spending drove imports to new levels and helped our former adversaries and allies get back on their feet. The U.S. ran manageable, unalarming trade deficits during this period. U.S. industry thrived, for the most part, largely unthreatened by foreign competition.

All this changed with the oil price shock of the 1970s, which dramatically altered the playing field. In 1970 oil sold at $1.35 per barrel, but by 1980 the price was $35 per barrel (roughly $134 per barrel in today's dollars)[1]. Having gone from the world's largest producer of oil to a net importer, the U.S. saw its trade deficit explode.

"So what?" argued Milton Friedman. "They send us oil we send them pieces of paper." He was right about that, as he was about so many things, but even he couldn't anticipate the long-term effects of what was expected to be a short-term phenomenon. The recycling of Petrodollars back into U.S. Treasuries became the preferred use of the Middle East's newfound wealth. From 1970 to 1980 the national debt nearly tripled, financed significantly by petrodollars. Monetary policy accommodated the higher oil prices, unleashing a period of inflation that took a decade to subside.

Deficit spending funded in large part by foreign nations' trade surpluses (the Arab countries in the 1970s and 1980s, Japan in the 1980s and early 1990s, and China in the early years of the 21st century) continued apace. Easy access to low-cost debt, coupled with a long period of declining interest rates meant that there was no fiscal penalty and great political benefit to ever-increasing deficit spending and the ever-expanding social welfare state.

Debt went up and interest payments went down(!) or stayed roughly flat for more than three decades, until the 2021 blowout in government spending (the classically misnamed American Recovery Act) after the economy had already started a strong recovery from the Covid lockdowns. This extra and unnecessary **$1.9 trillion** in Federal spending (fully accommodated by the Federal Reserve) reignited the inflation menace that had been dormant for so long and ended the decades long period of interest rate decline. Suddenly, the cost of carrying all this extra national debt ($36 trillion now vs $300 billion some fifty years ago, an increase of 120 fold) exploded, exceeding $1 trillion per year and rising, accounting for more than half of annual federal borrowing.

Clearly this profligate spending and soaring debt are serious problems and an unsustainable situation, but how can tariffs solve them? They cannot, not by themselves, but they are a stealth tax to be paid both by U.S. consumers and foreign producers in some yet-to-be-determined proportion. Increased government revenues from this source can offset reduced revenues in others and will need to, since an income tax cut bill is coming. ("The Big Beautiful Bill").

Team America: World Police

The U.S. military budget spending, which is more than $900 billion, is about forty per cent of all military spending in the world. This is double that of the European NATO members, three times that of China, and twenty times that of Japan, South Korea or Israel[2].

Just as with the postwar trade arrangements, this Pax Americana global security regime was necessary to restore postwar order. And, like trade, it was largely successful. But also like the trade order, it has long outlived its usefulness, at least since the collapse of the Soviet Union, some thirty-five years ago. This also appears to be the view of the Trump Administration. One of their major goals is to reorder these security arrangements so that U.S. allies will pick up a far larger portion of the overall security expense, while the U.S. stands guard on a much smaller proportion of the globe.

In principle this major policy switch could well enable the U.S. to reduce its defense budget meaningfully over time and contribute to deficit reduction. If so, that would open the door to some entitlement reform which has always been blocked by the demand, among many others, to reduce the military budget. It is common sense that social entitlements, particularly Social Security, Medicare and Medicaid, which represent two-thirds of the Federal budget, must be reformed if the budget is to be brought back in balance.

Bringing it All Back Home

Another campaign promise, and a key goal of the Trump Administration, is to bring industry back to the U.S. This has been sold as a national security issue as well as a jobs issue. While the one may be true, the other is questionable. In the 21st Century, modern factories will be AI and robotic driven like never before, so it is doubtful that many new jobs will be created, even if the ones that are will pay higher wages. Nor is it likely that communities decimated by global competition over the past three decades will be revived by reshoring. Revival of these areas may be possible for other reasons, like cost of living or quality of life, but it is unlikely that they will be the sites of the new factories which will require better infrastructure and a higher educated workforce than these former factory towns can provide.

In theory, however, bringing more industry back into the U.S. should generate additional tax revenues to address the budget issue.

Where Did Everybody Go?

Illegal immigration has been perceived by the electorate as a major issue, and the Trump Administration campaigned heavily on it. The problems at the southern border have swiftly been solved, but the deportation exercise has only just begun. Already, it has hit a number of snags which will take time to work out. Notwithstanding the effort to remove illegal immigrants from our shores, the country will continue to need additional legal immigrants to man the huge number of service and other industries that already rely on them. Managing immigration, rather than preventing it, is the more pressing challenge. Foreign workers pay taxes, unemployed foreigners who gain access to the social welfare system increase spending.

With a declining birth rate here, (as well as in the rest of the developed world) importing a work force that is dwindling due to aging is key to economic growth without which deficit reduction is unlikely, if not impossible.

One Trick Pony?

All of these policy goals, to a greater or lesser extent, address the budget issue. But tariffs which have dominated the news cycle cannot solve the problem on their own. Indeed, there are better policies to accomplish these same goals. A much lower corporate income tax would surely entice more reshoring of industry, as would a wholesale rationalization of the regulatory regime. Temporary work permits would go a long way to solve the immigration/worker shortage problem. Shrinking overseas military presence in countries that no longer need it and modernizing defense procurement objectives by substituting low-cost unmanned weapon systems should help reduce the defense budget. The DOGE mentality, if it permeates the government, could have long term beneficial impact. Import licenses imposed on foreigners who want access to our markets –the so-called Walmart model – based on the level of sales, could be an alternative to the blunt instrument of universal tariffs.

However, none of these can prevent the looming disaster of unserviceable national debt.

Bond Vigilantes

Budget discipline is a necessary condition, but it is not a sufficient one. Only low interest rates can prevent the carrying cost of the national debt from spiraling out of control and only budget control can give the bond market the confidence to keep rates low. With debt servicing costs already more than $1 trillion dollars, the last thing the country can afford is the return of the bond vigilantes that sank the budget some fifty years ago. The swift reversal of tariff policy when the bond market moved in the wrong direction suggests that the Trump Administration understands this.

It is a high stakes game. Will interest rates cooperate? We'd best hope so.

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[1] https://en.wikipedia.org/wiki/1973_oil_crisis

[2] https://www.sipri.org/media/press-release/2025/unprecedented-rise-global-military-expenditure-european-and-middle-east-spending-surges