

# The US Deficit and Debt

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National Education Education Delegation (NEED)



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## Of Debt, Deficits, and Surpluses

### • FLOW

- **Deficit:** When government expenses exceed revenues in a single year.
- **Surplus:** The excess of revenues over expenses in a single year.

### • STOCK

- **Debt:** The accumulation of debt over time.
  - The sum of all past deficits and surpluses.



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# What Does the U.S. Gov't Budget Look Like?

## Fiscal 2020 Budget Summary

Budget Deficit:

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Source: Congressional Budget Office, *Monthly Budget Review*, Nov 2020

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# What Does the U.S. Gov't Budget Look Like?

## Fiscal 2020 Budget Summary

Revenue	Billions		Outlays	Billions
Income Taxes	\$1,609		Mandatory	\$2,315
Payroll Taxes	\$1,310		Discretionary	\$3,850
Corporate Taxes	\$212		Interest	\$387
Other	\$289			
<b>Total</b>	<b>\$3,420</b>		<b>Total</b>	<b>\$6,552</b>

Budget Deficit: **\$3,132**

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Source: Congressional Budget Office, *Monthly Budget Review*, Nov 2020

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# What Does the U.S. Gov't Budget Look Like?

## 2018 Budget Summary

Revenue	Billions	Expenditures	Billions
Income Taxes	\$1,684	Mandatory	\$2,520
Payroll Taxes	\$1,171	Discretionary	\$1,263
Corporate Taxes	\$205	Interest	\$325
Other	\$270		
Note the large difference in Discretionary Spending: \$3,850 in 2020 and \$1,263 in 2018			
Total	\$3,329	Total	\$4,108

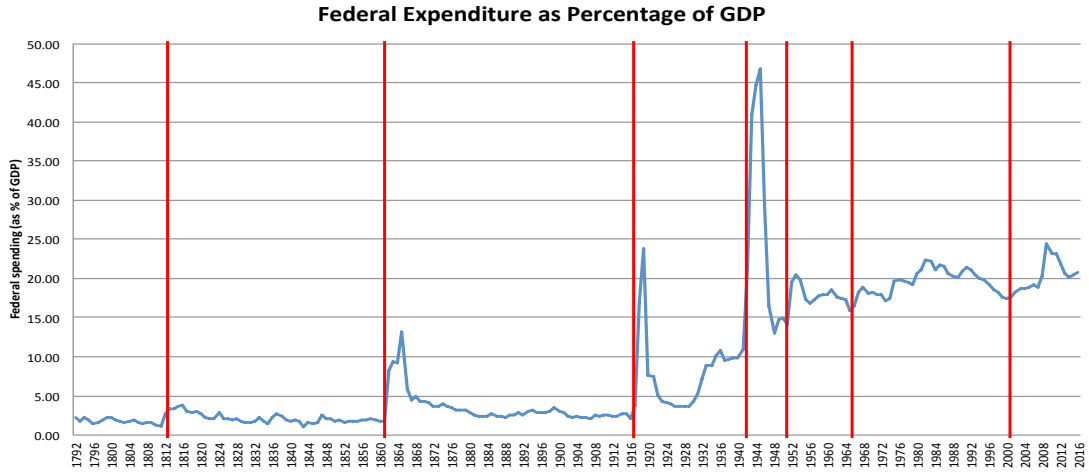
Budget Deficit **\$779 Billion**

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# US Government Deficits Over Time

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# Figure 1: Federal Expenditures

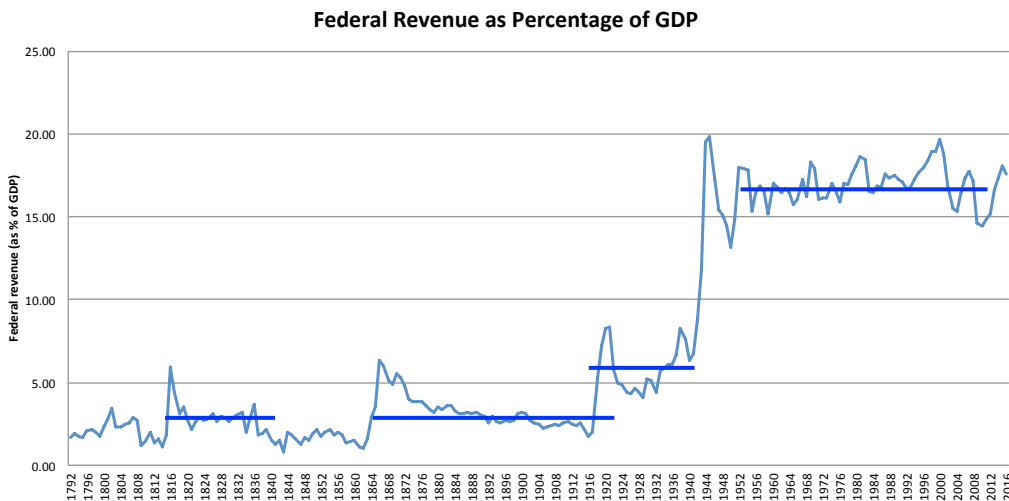


Appropriate to measure the "size" of the Federal Government relative to the size of the economy



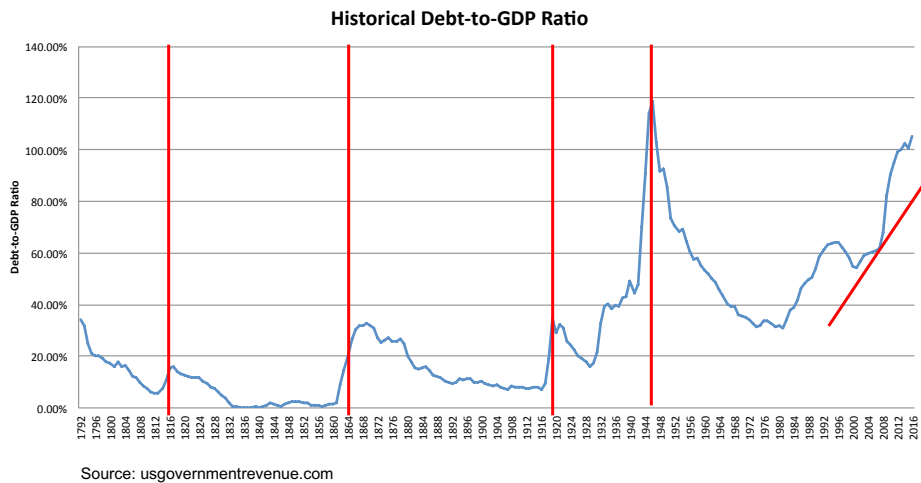
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# Figure 2: Federal Revenue



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## Figure 3: Debt-to-GDP



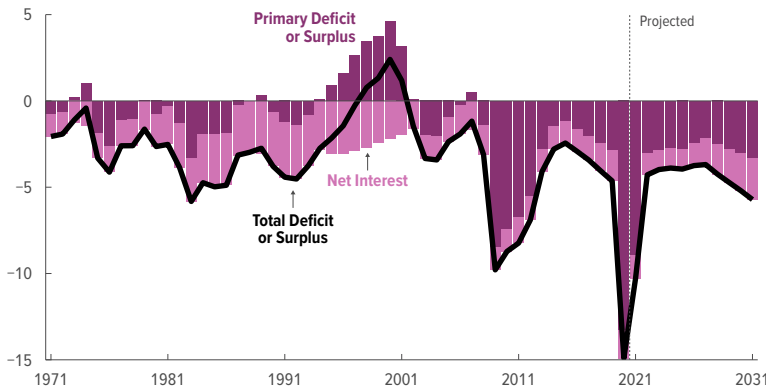
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## Recent Past and Forecasted Future of Deficits

### Total Deficits and Surpluses

Percentage of GDP



In CBO's projections, both total deficits and primary deficits shrink as a percentage of GDP for the next few years and then generally increase thereafter. Total deficits grow more rapidly than primary deficits near the end of the projection period because of rising interest costs.

CBO projection does not include the American rescue plan

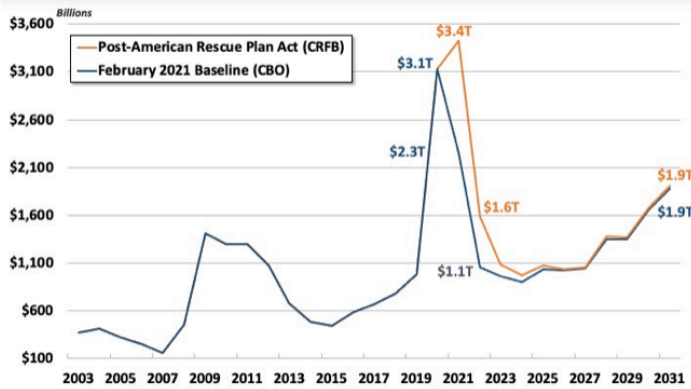
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Source: Congressional Budget Office, Additional Information About the Budget Outlook: 2021 to 2031

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# Recent Past and Forecasted Future of Deficits

## This Year's Deficit Will Eclipse Last Year's



Measured as a share of the economy, the deficit will total 15.6 percent of GDP this year and average 4.7 percent over the coming decade.

As a share of GDP, the 2021 deficit will be the fourth highest in history, eclipsed only by three years of borrowing to fight World War II.

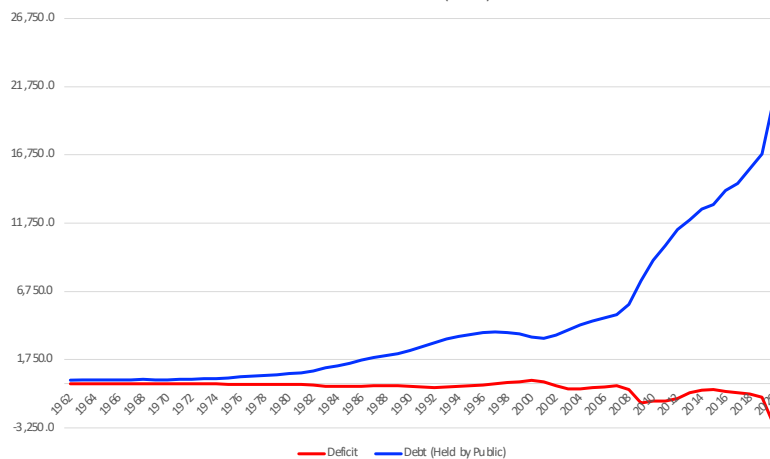
Source: Congressional Budget Office and CRFB calculations. These figures do not account for economic feedback effects.



Source: Committee for a Responsible Federal Budget Deficit

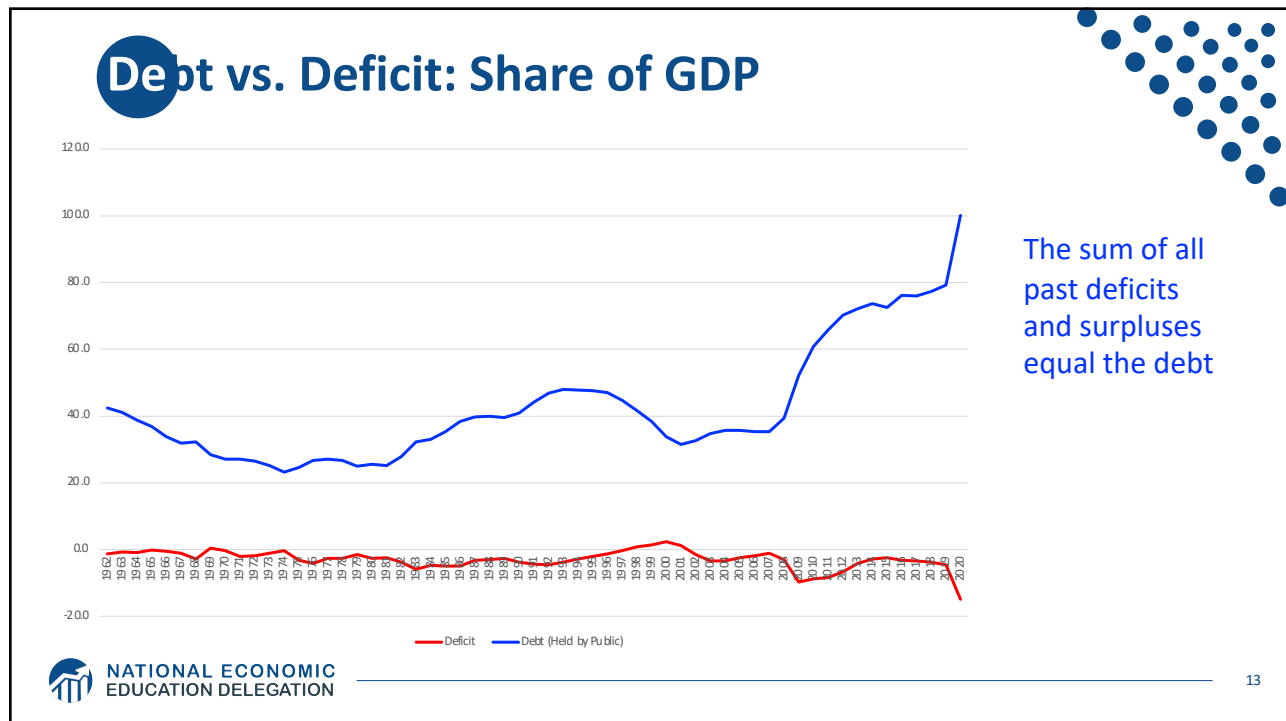
# Debt vs. Deficit

Debt and Deficits (Total)



The sum of all past deficits and surpluses equal the debt





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## Not All Debt Is Created Equal

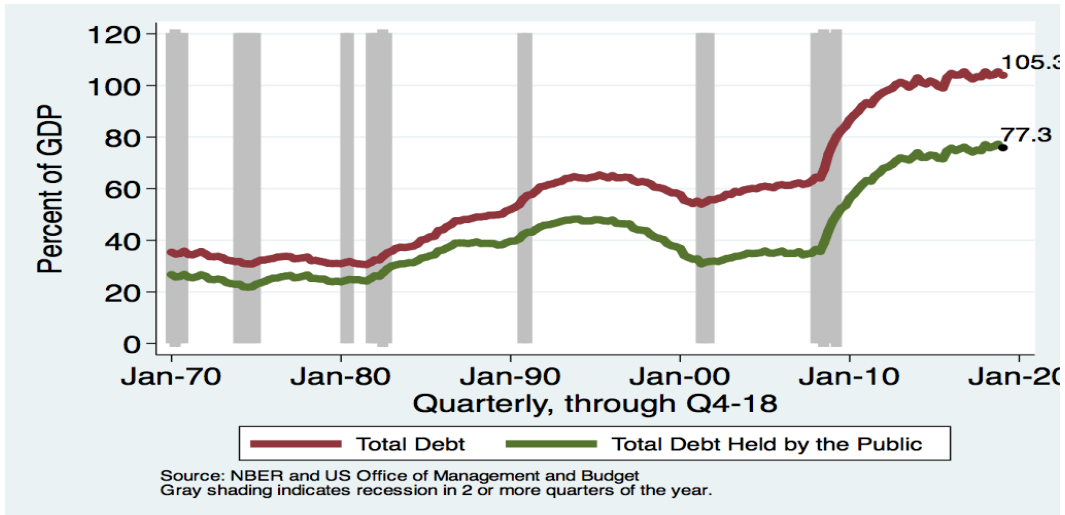
- **Some debt can reduce the availability of investment funds to other borrowers.**
  - Often referred to as “crowding out” private investment
- **Intra-governmental debt is important bookkeeping.**
  - This debt **DOES NOT** crowd out private investment.
- **Debt held by the public**
  - This debt **MAY** crowd out private investment.
- **Most analyses of debt focus on the federal debt held by the public.**

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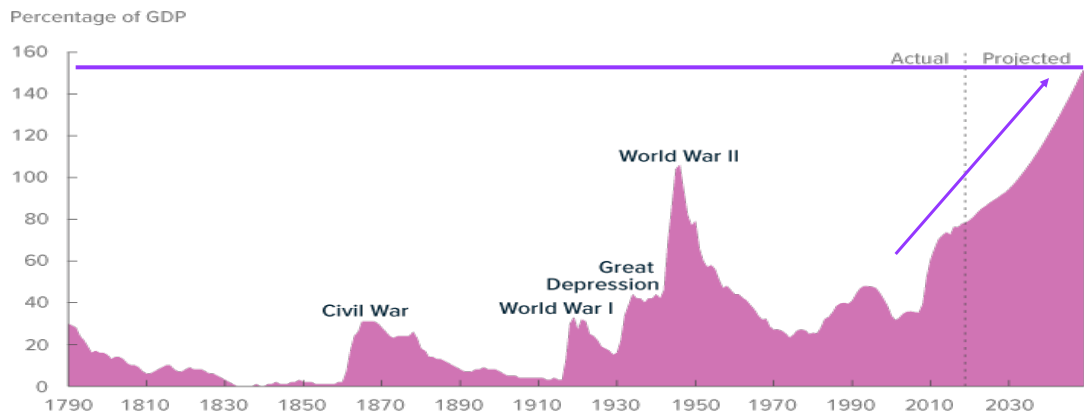
## Two Measures of the Debt



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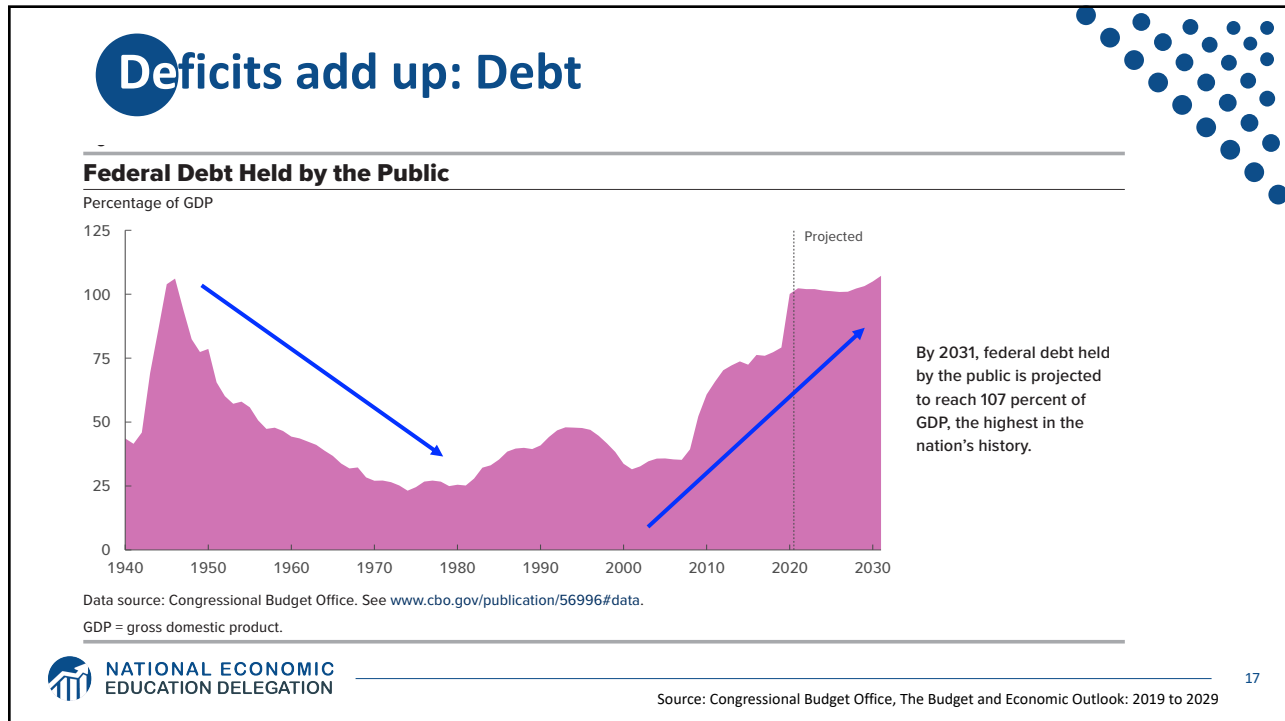
## Deficits add up: Debt

### Federal Debt Held by the Public

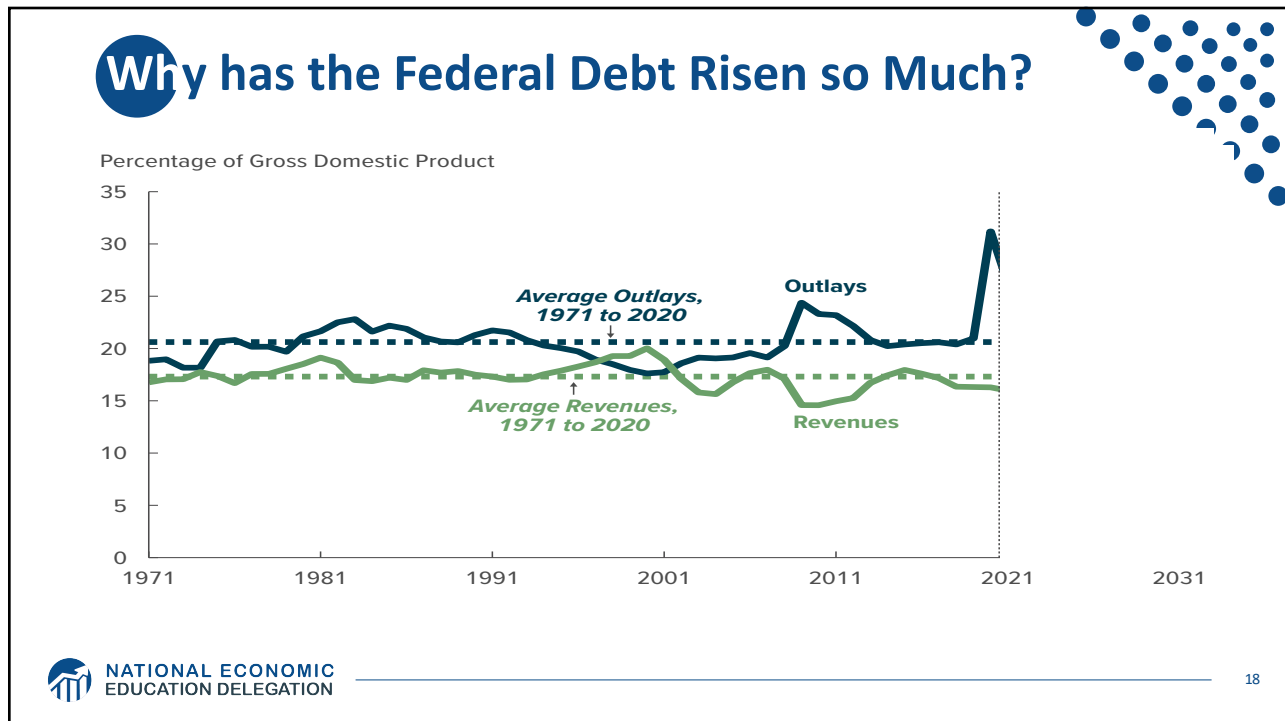


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# Why has the Federal Debt Risen so Much?

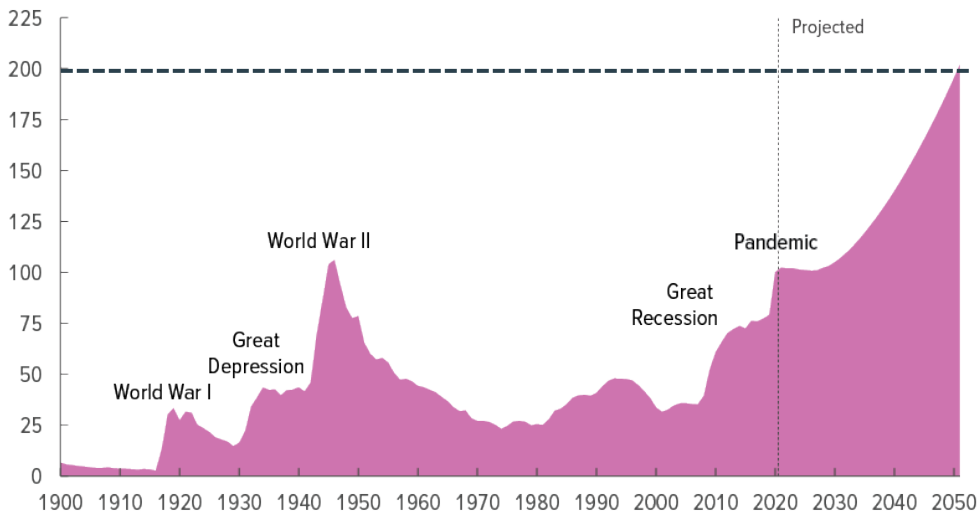
## • Expenditures:

- Social Security
- Healthcare costs
- Economic stimulus
  - o In particular, during the Great Recession.
- Foreign entanglements

## • Revenues

- Declining income tax revenues
  - o Stagnant wages
  - o Tax cuts
- Social security
  - o Declining revenues
- Corporate income taxes

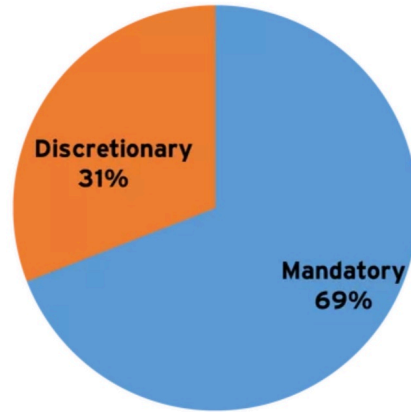
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# On What is the Money Spent? Complicated

## COMPOSITION OF FEDERAL SPENDING (2018)



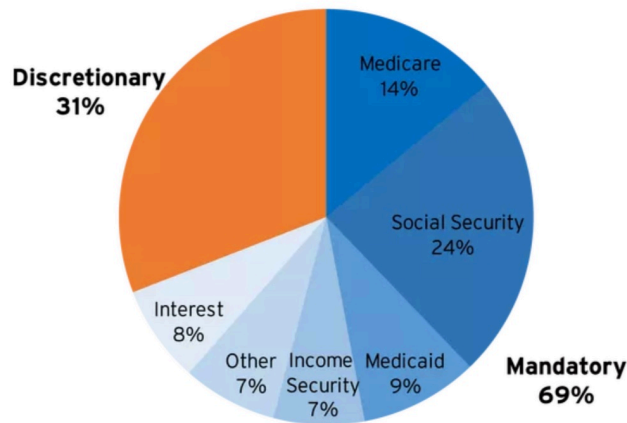
Source: Congressional Budget Office, Haver

Hutchins Center on Fiscal & Monetary Policy at BROOKINGS

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# What is Mandatory Spending?

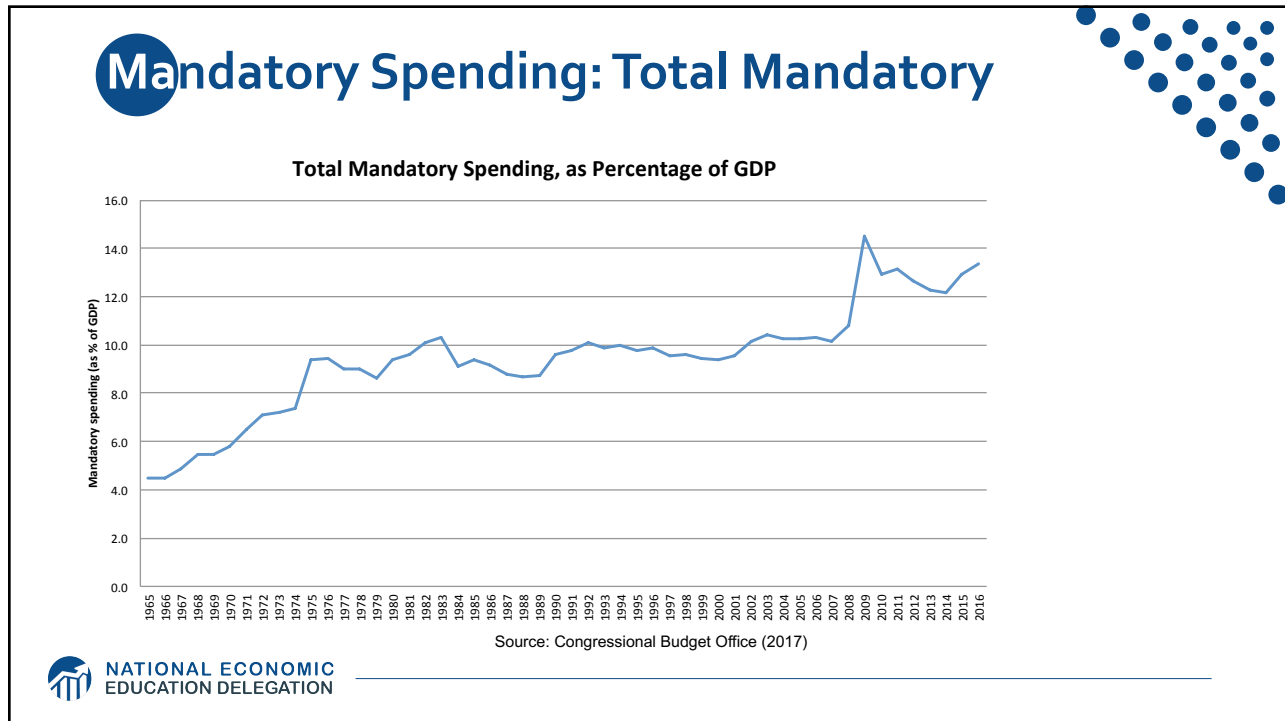
## COMPOSITION OF MANDATORY SPENDING (2018)



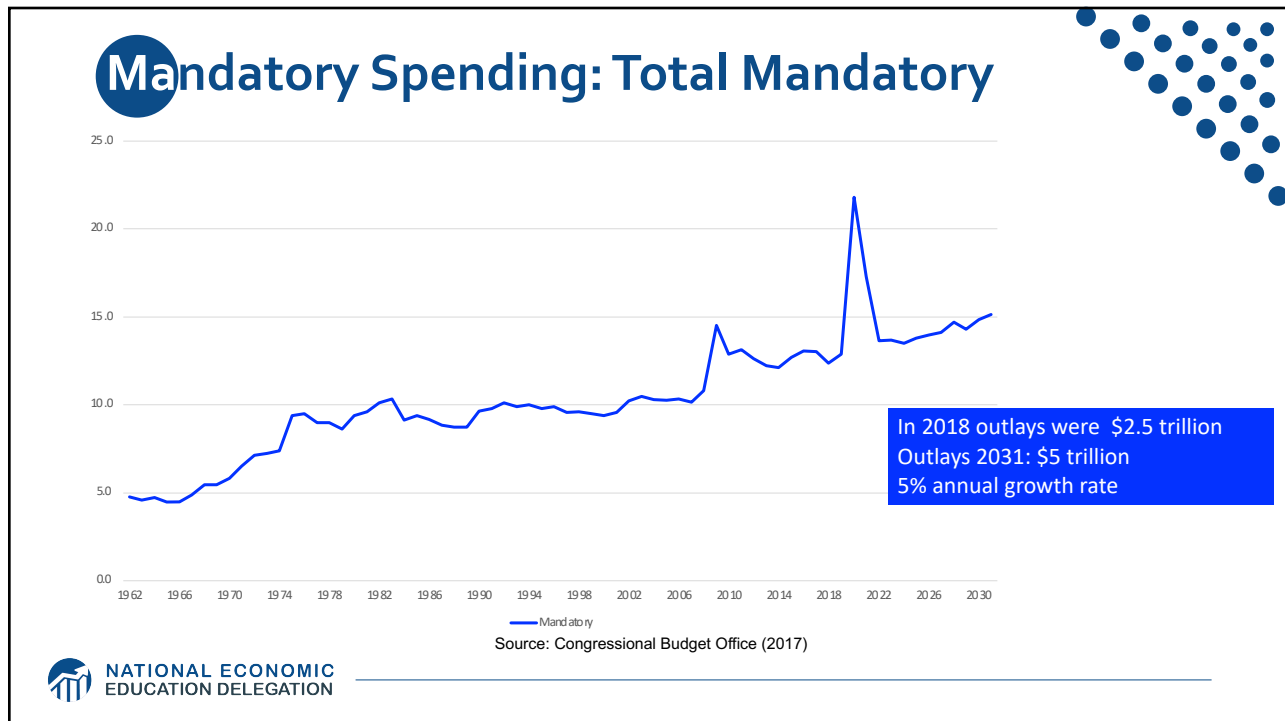
Source: Congressional Budget Office, Haver

Hutchins Center on Fiscal & Monetary Policy at BROOKINGS

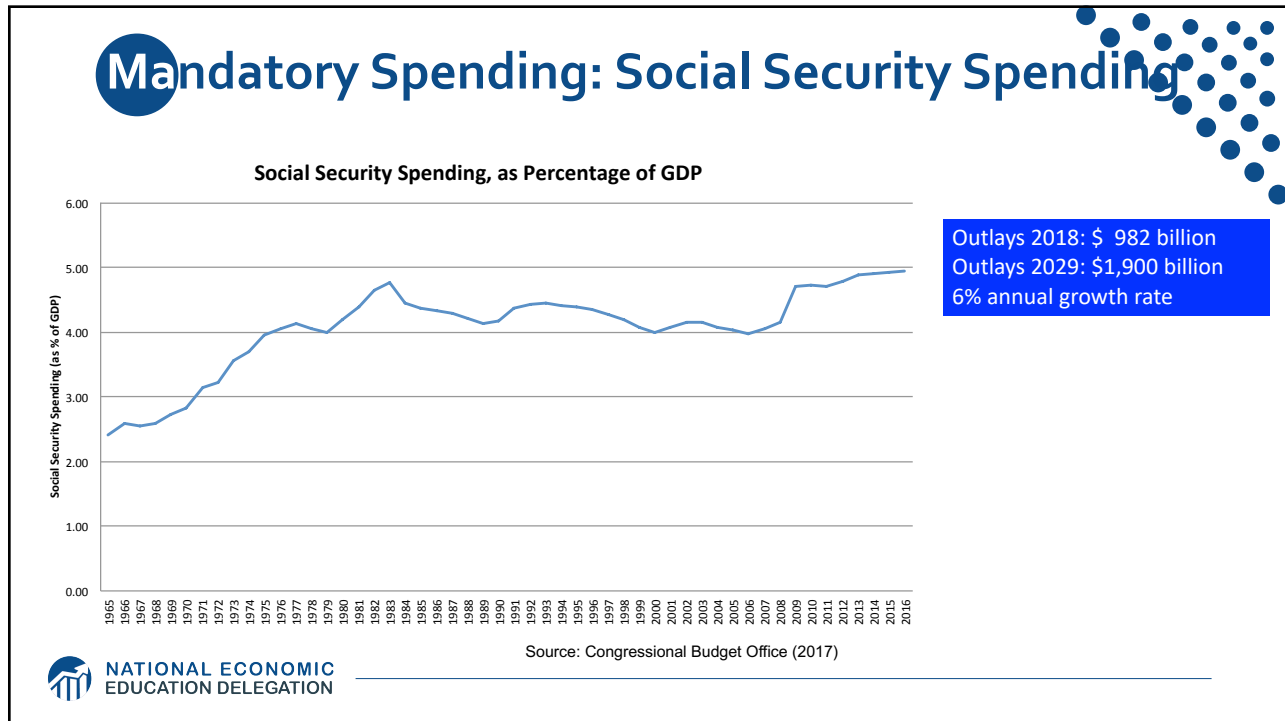
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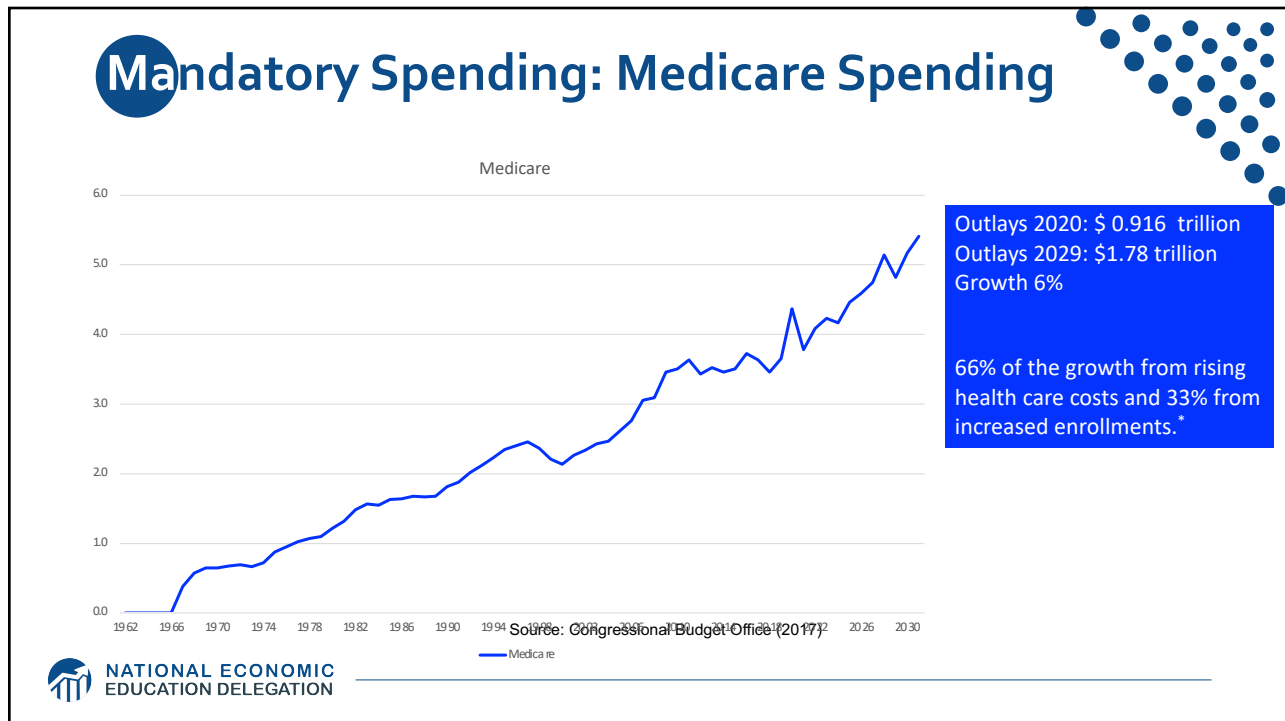
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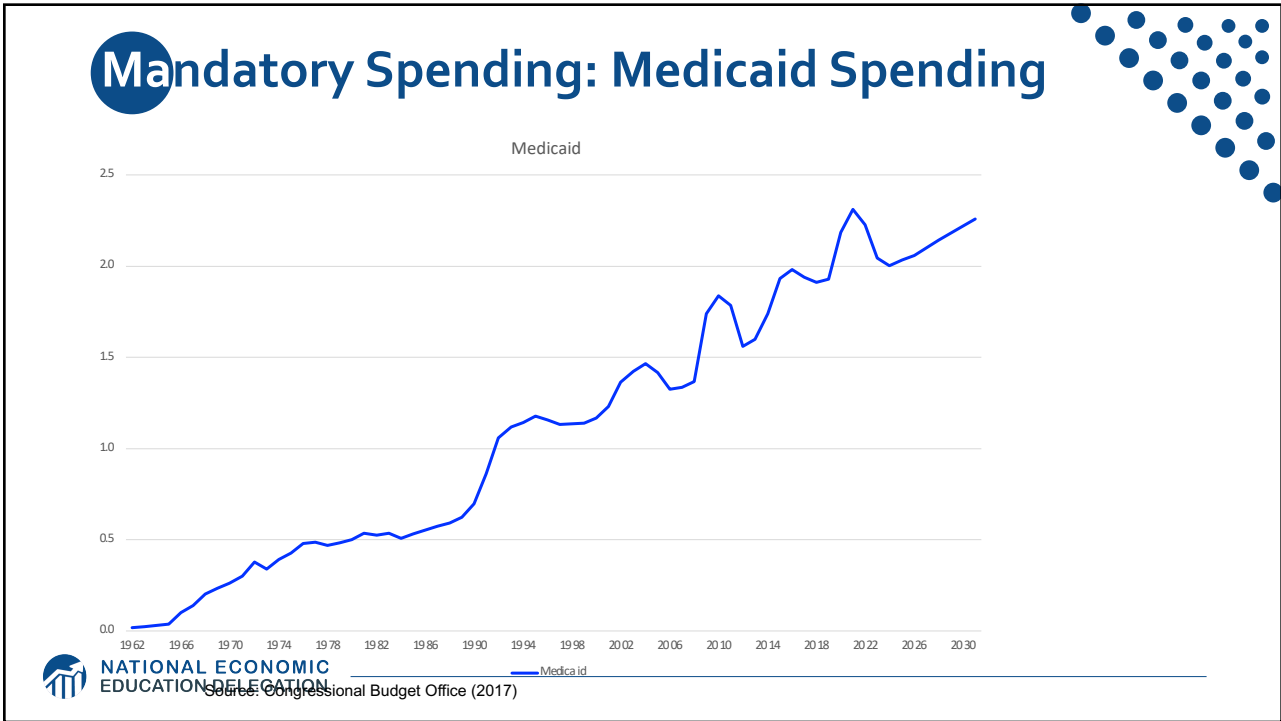
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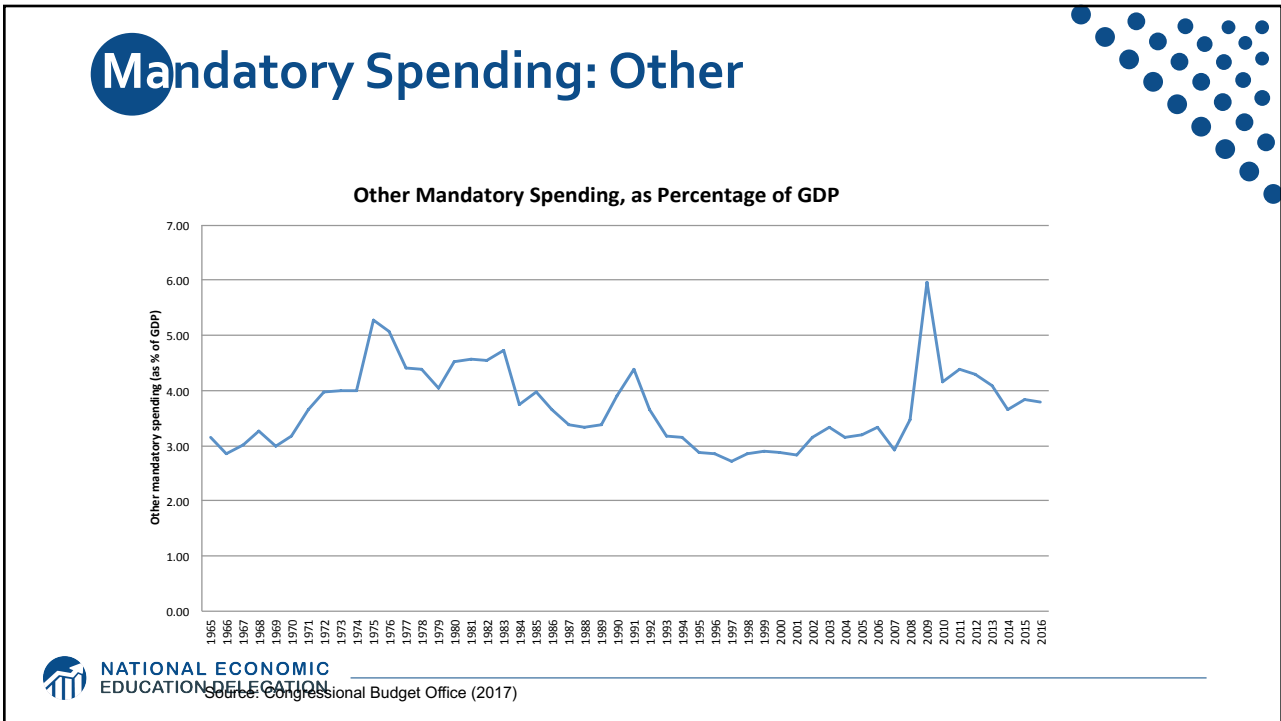
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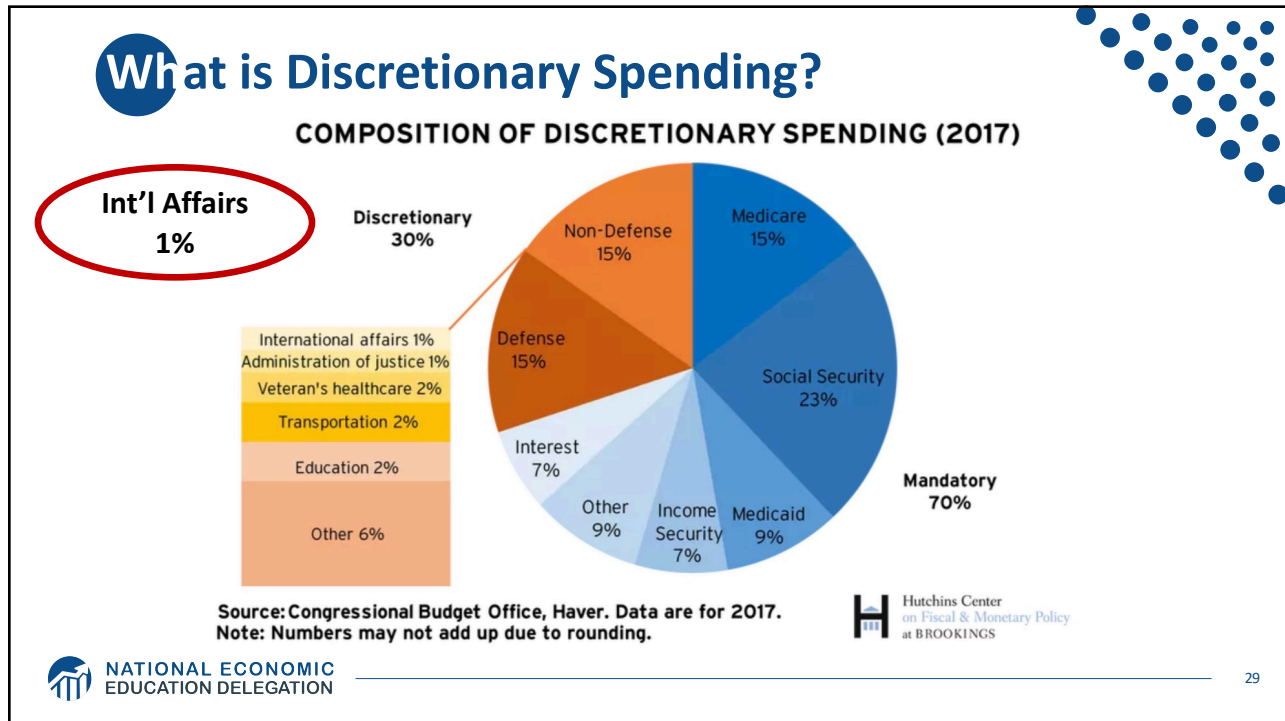
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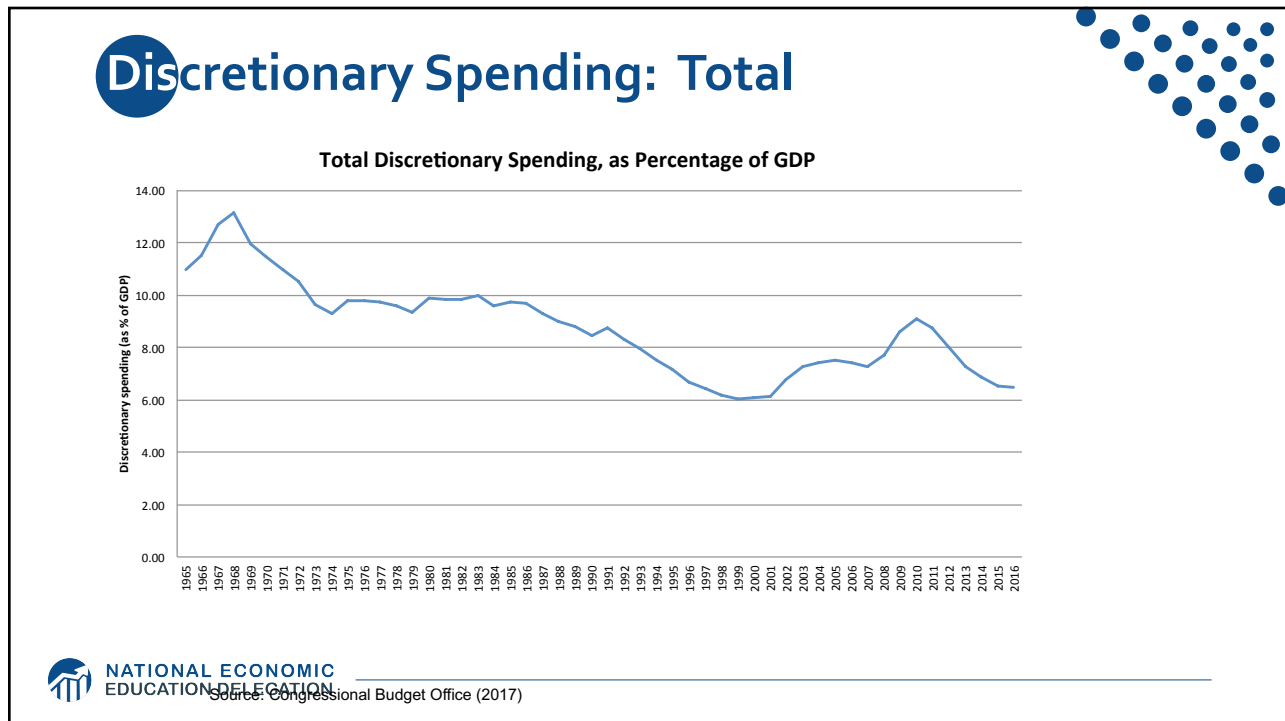
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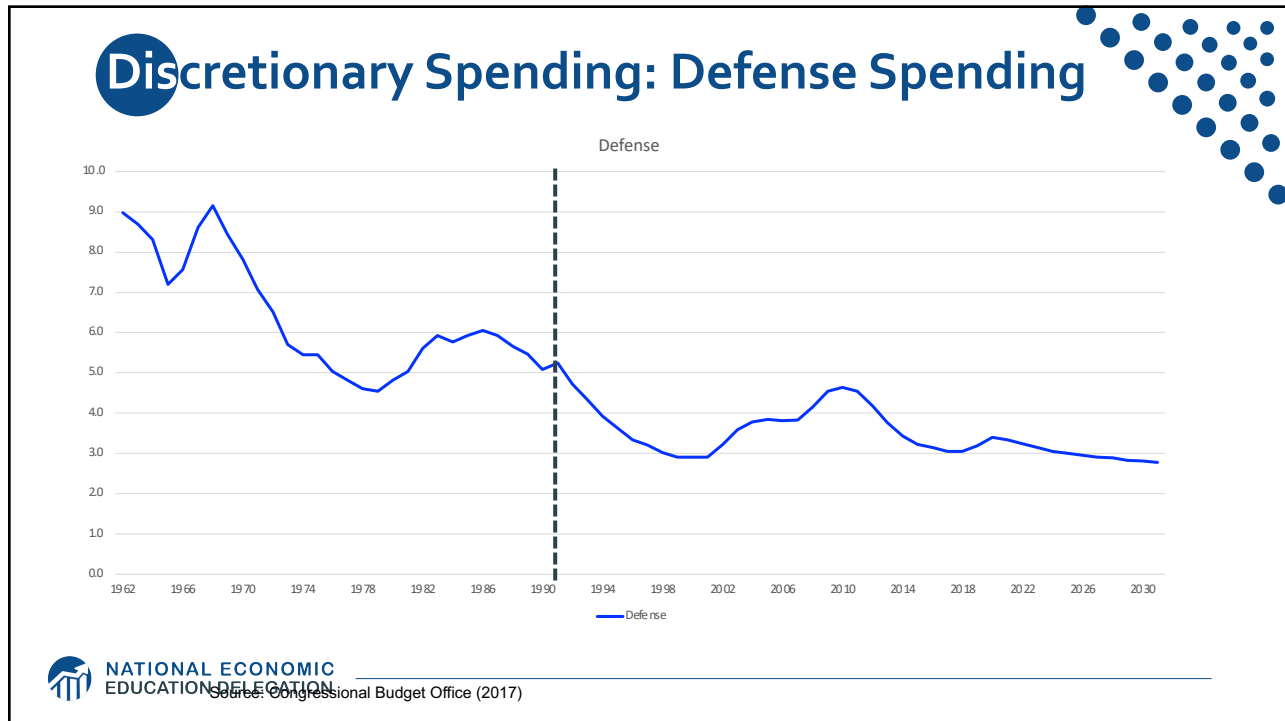
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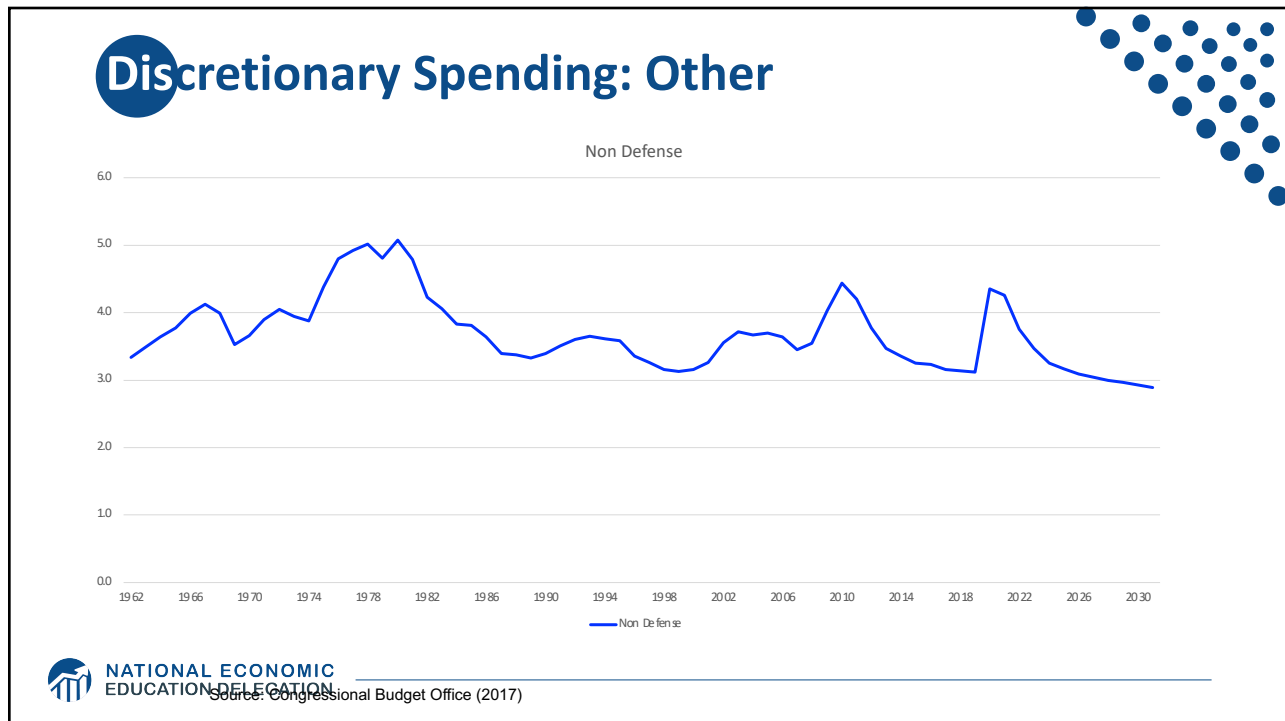
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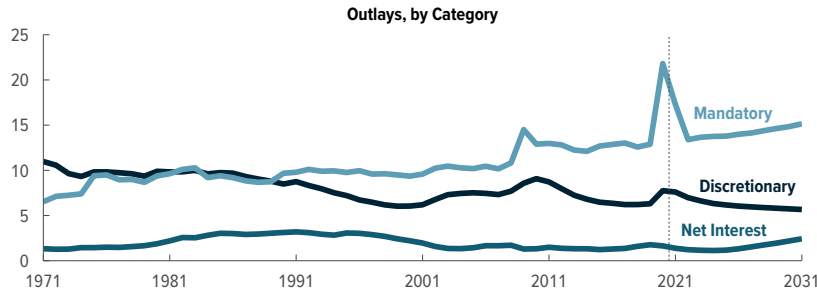
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## Mandatory Spending Dominates Forecasts



Each category of spending drops in the near term. In later years, rising spending for Social Security and the major health care programs boosts mandatory outlays, and net interest costs increase as interest rates rise.

Data source: Congressional Budget Office. See [www.cbo.gov/publication/56996#data](http://www.cbo.gov/publication/56996#data).

When October 1 (the first day of the fiscal year) falls on a weekend, certain payments that would have ordinarily been made on that day are instead made at the end of September and thus are shifted into the previous fiscal year. All outlay projections presented here have been adjusted to exclude the effects of those timing shifts. Historical amounts have been adjusted as far back as the available data will allow.

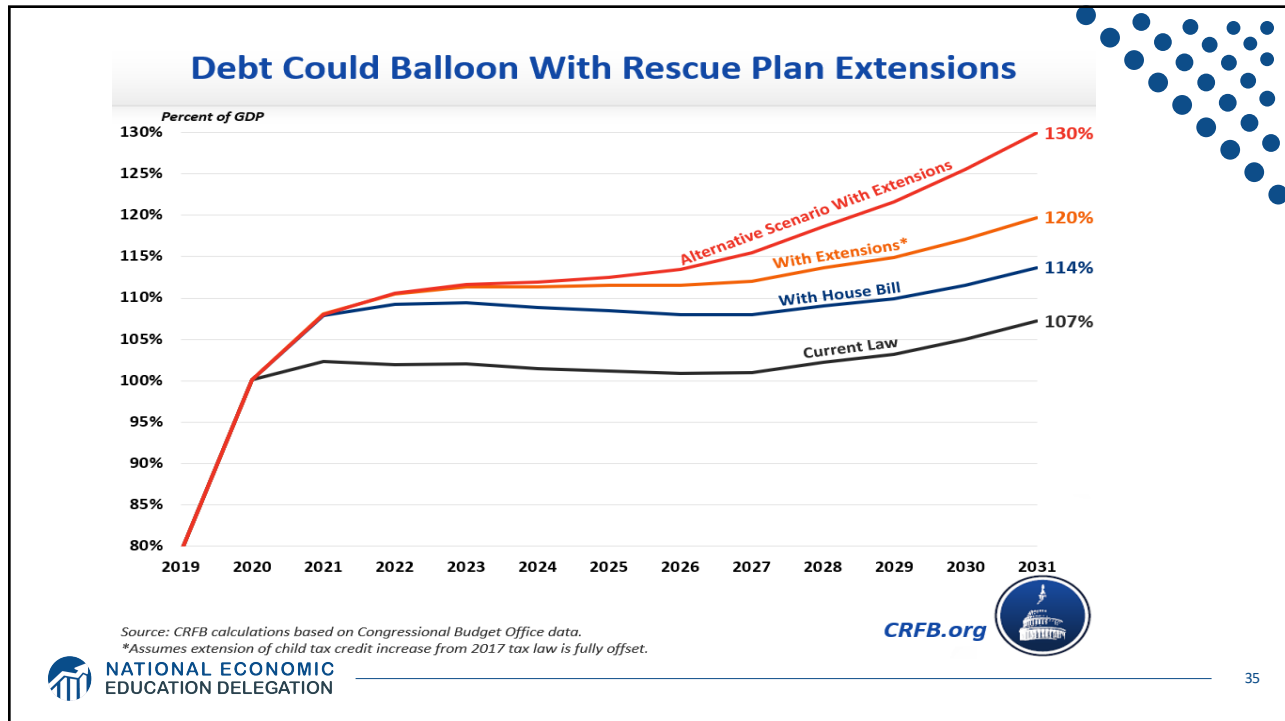
GDP = gross domestic product.

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## Debt and Deficit and the Pandemic

- The long run drivers of the debt and deficit are social security, Medicare and Medicaid spending.
- Discretionary spending has been declining as a share of GDP.
- Most likely, the American Rescue Plan will not have a long run impact on the debt....unless

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## Key Points About the U.S. Relative Debt

1. Relative debt peaked during WWII (106%) - followed by a steady decline until the 1980s.
2. Prior to 1983, relative debt rose purposefully (wars and recessions) and then fell.
3. Recently, relative debt has been and is expected to continue to rise for the next 30 years w/o strategic purpose.

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## Traditional View: Debt and Deficits Raise Interest Rates

1. **Crowding Out:** Higher interest rates lead to less investment and over time to a smaller capital stock and reduced future output.
2. **Foreign Borrowing:** Higher interest rates lead to foreign capital inflows or foreign borrowing. With foreign borrowing, some of our GDP is paid to foreigners as interest.



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## Olivier Blanchard's Presidential Address to the AEA 1/2019

**"If the future is like the past [with low interest rates],...the issuance of debt without a later increase in taxes may well be feasible. Put bluntly, public debt may have no fiscal cost."**

**But,**

**"My purpose...is not to argue for more public debt, especially in the current political environment. It is to have a richer discussion of the costs of debt...than is currently the case."**



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## What's the story here? How is it (almost) free

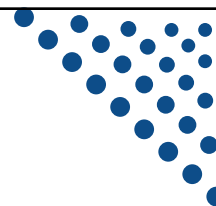
- Suppose that the government increases the debt by another \$5 trillion and this increases the debt to 125 percent of GDP.
- With an interest rate of one percent then the debt grows by one percent.
- However, if GDP grows by two percent the debt to GDP ratio falls by one percent.
- If this happens over time, it is like we did not spend it at all and we return to the same level.
- In order for this to work, interest rates have to stay low and GDP growth needs to be higher than interest.



## But why must the relative debt be stabilized

- For practical purposes, the US cannot default on its debt, but...
- International investors, however, can still lose if the exchange value of the dollar falls.
- Remember, foreign holdings of the public debt amount to 40 percent of the total





- In CBO's assessment, the debt-to-GDP ratio has no set tipping point at which a crisis becomes likely or imminent; nor is there an identifiable set point at which interest costs as a percentage of GDP become unsustainable.
- The risk of a fiscal crisis in the near term is not currently apparent in financial markets, even though the pandemic and the government's response to it have increased the federal deficit; there is still great uncertainty about the speed and scope of a recovery.

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## What would a Fiscal Crisis Look Like?

### Foreigners lose confidence in the dollar and sell Treasuries in exchange for assets denominated in their own currency,

1. Sale of Treasuries raises interest rates, worsening or fiscal outlook.
2. Trading of Foreign for US assets lowers US exchange rate.
  - a. Raising the price of imports thereby increasing inflation.
  - b. Lowering the foreign currency returns on all US assets, exacerbating 1.

### Could the Fed Bail us Out?

1. It could buy Treasuries and prevent the rise in interest rates.
2. Insufficient foreign assets to prevent the fall in the exchange rate,

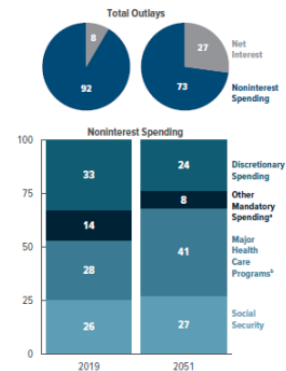
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# Bottom Line: We Need to Worry about the Debt

1. Interest rates may not stay this low forever.
2. A fiscal crisis should be avoided at all costs.
3. The good news is we may be able to stabilize the relative debt without a running a surplus.

But, we must substantially reduce deficits after the pandemic: CBO (9/2020) suggests deficits in 2025 be reduced from 5 to 2.5 percent of GDP, but it won't be easy

Figure 6.  
Composition of Federal Outlays  
Percent



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# Thank you!

## Any Questions?

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Contact NEED: [NEEDelegation@gmail.com](mailto:NEEDelegation@gmail.com)

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# How Does the U.S. Government Borrow?

- **It issues debt**

- Treasury marketable securities:
  - o Treasury bills, notes, and bonds
  - o TIPS: Treasury inflation-protected securities

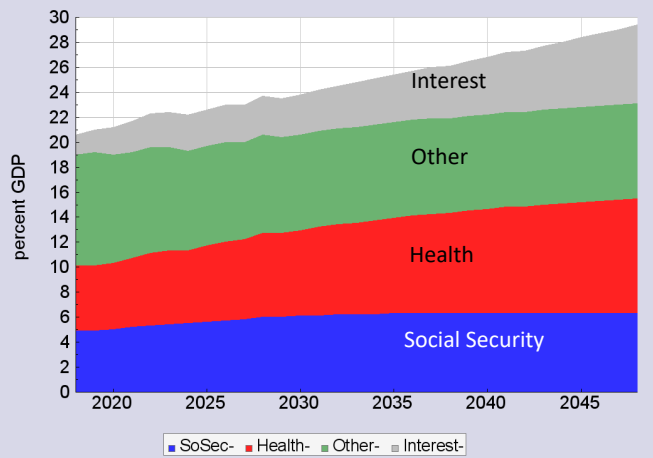
- **Who buys the debt?**

- Other federal government agencies
- Individuals and businesses
- State and local governments
- People, businesses, and governments from other countries.

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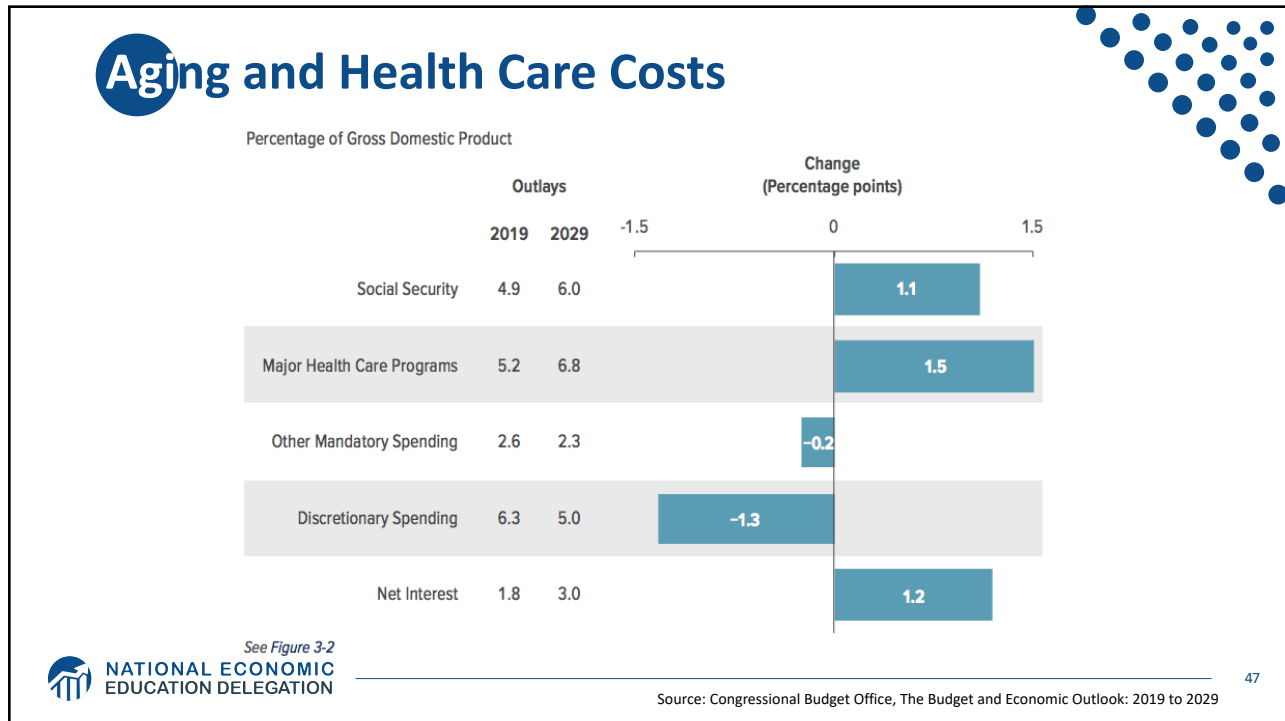
# Forecast Spending

CBO Long Term Outlook for Federal Spending 2018  
US from FY 2018 to FY 2048

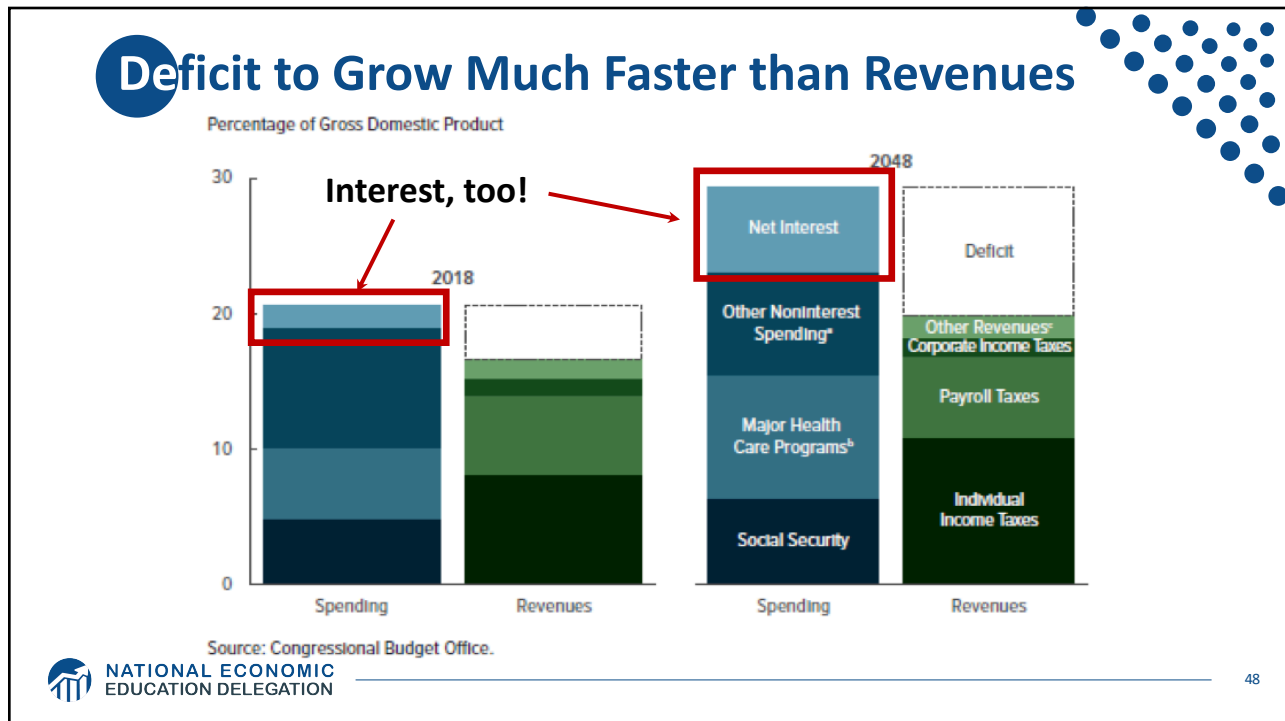


What trends do you see?

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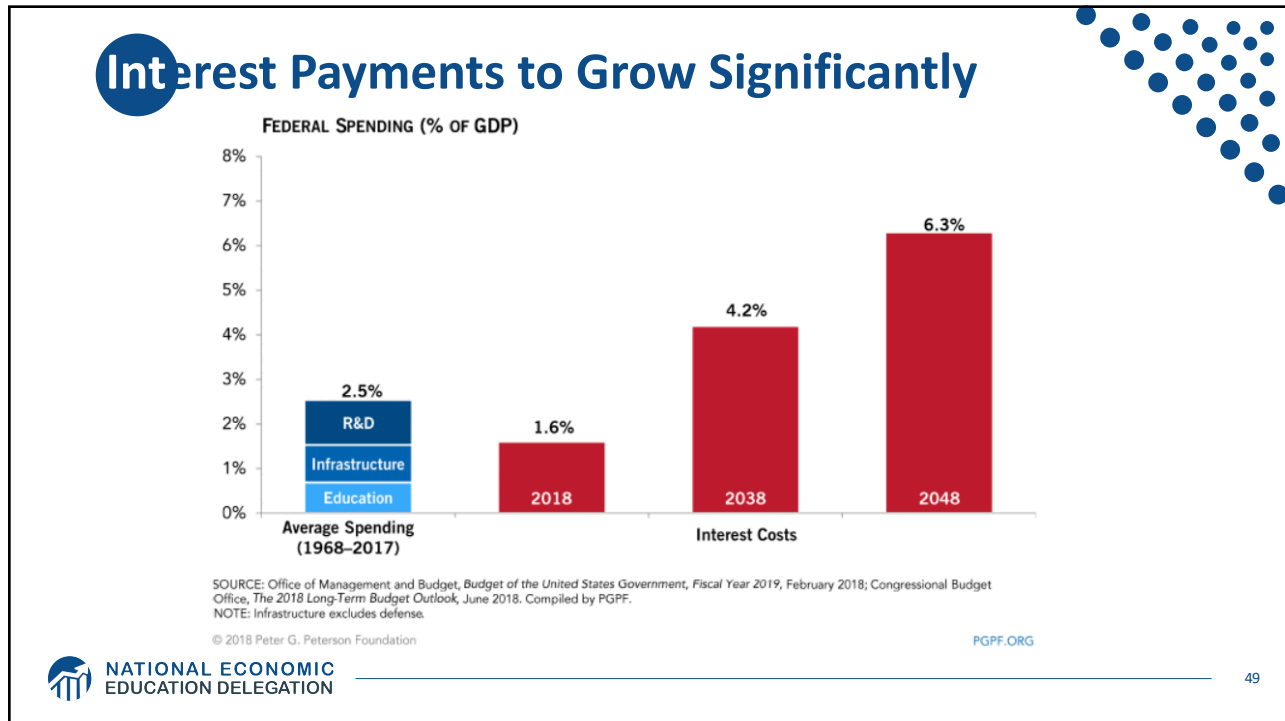


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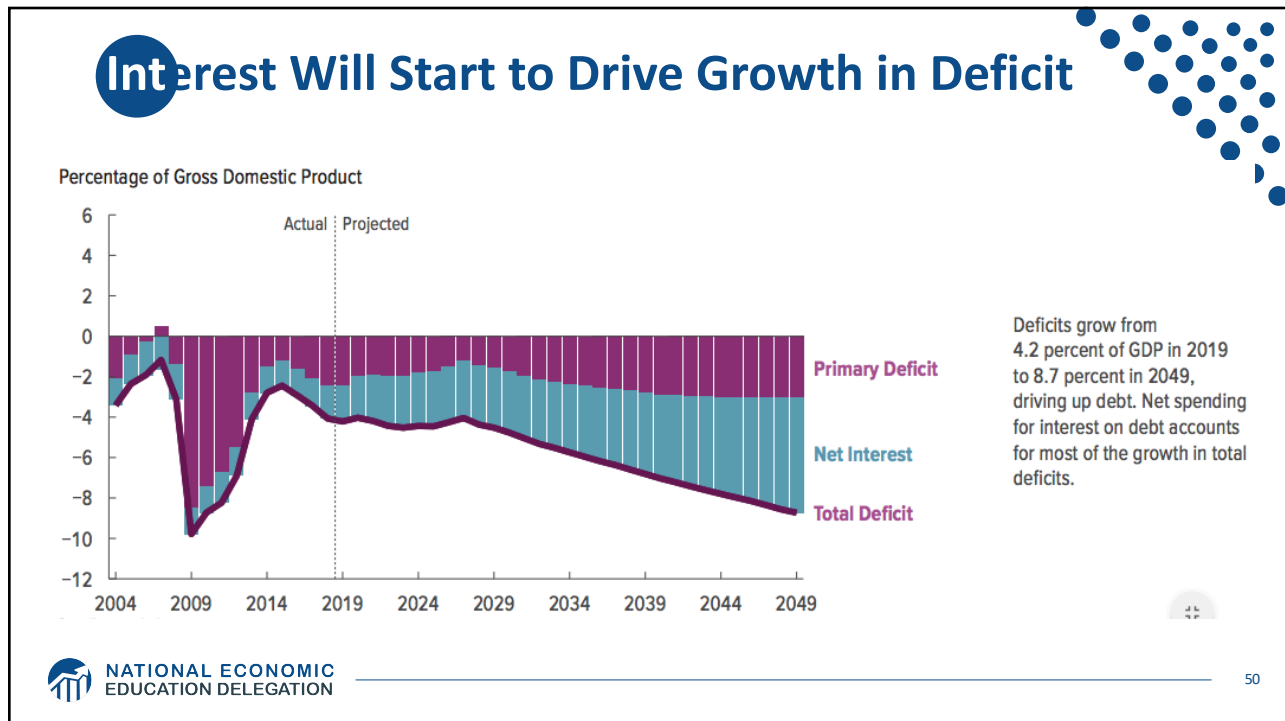


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## Perspectives on Increased Debt

- **Government borrowing crowds out private capital and investments.**
  - Weakened by ability to borrow from abroad.
- **Does debt impose a burden on future generations?**
  - Does it inevitably have to be paid off?
- **In time, it may start to crowd out other government spending.**
  - Diminishing policy priorities in the budget.
- **Is it reasonable to borrow at low interest rates for investments?**
  - For example, infrastructure.



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## Bottom Line

- Question is not **WHETHER** the U.S. will have to act...  
...but **WHEN**.
- Some combination of the following **WILL** be necessary:
  - Raising taxes
  - Cutting spending
  - Reining in health care costs



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## Proposals Do Exist

- **Simpson-Bowles**
- **Domenici-Rivlin Task Force**
- **Solutions Initiative – Peter G. Peterson Foundation**
  - American Action Forum
  - American Enterprise Institute
  - Bipartisan Policy Center
  - Center for American Progress
  - Economic Policy Institute



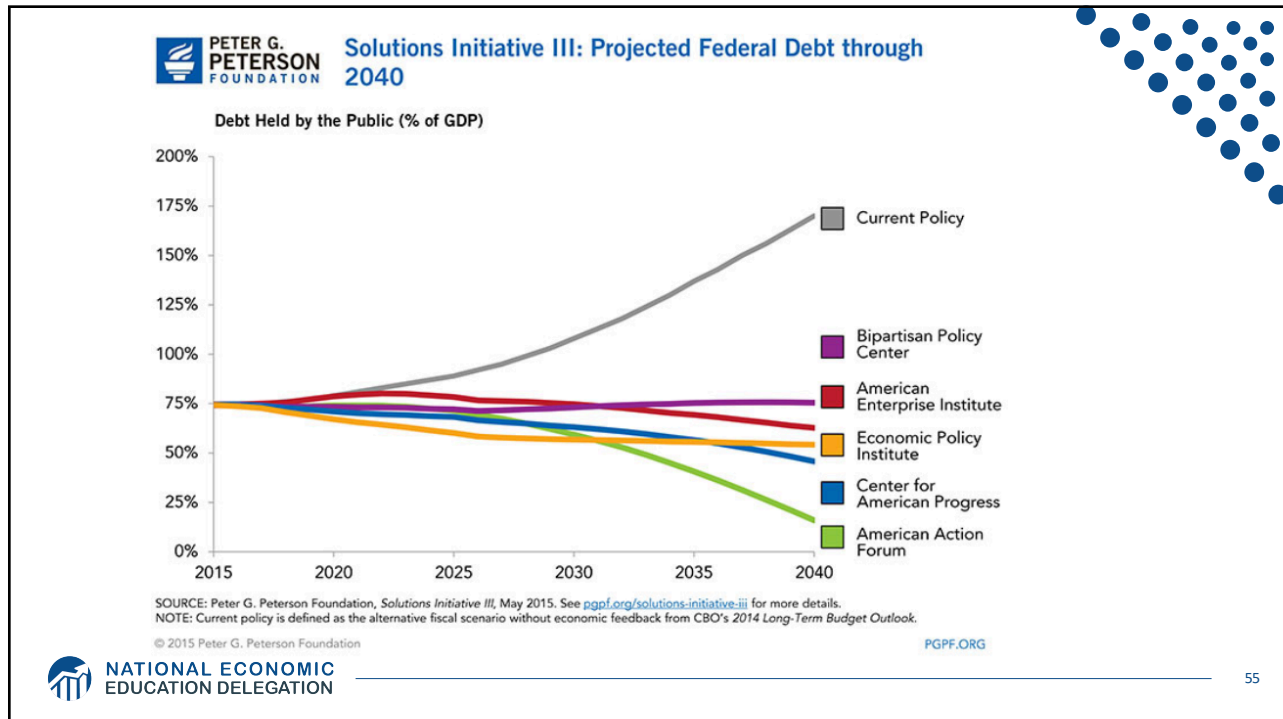
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## Another Category of Spending: Tax Expenditures

- **Description**
  - Social policies that are implemented and paid for through the tax code.
- **List of the largest tax breaks:**
  - Mortgage interest deduction
  - Retirement contributions
  - State and local taxes
  - Health insurance`
  - Low tax rates for Capital Gains
  - Child related tax credits
  - Charitable gifts
  - Lifetime Learning
- **Evidence of who they benefit**
  - Regressive



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## Are There Reasons to Wait?

- **Very little evidence of:**
  - Crowding out
  - Inflationary impact
- **Uncertainty about the future**
  - Economic growth may render action today unnecessary.
- **There are a great many investments to be made by the gov't.**
  - Infrastructure
  - Education
  - Much, much more...

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## Summary

- **Debt: \$22.9 Trillion**
- **Deficits drive growth in the debt.**
  - Likely greater than \$1 Trillion per year.
- **Publicly held debt matters most.**
  - Will grow from 78% of GDP today to 144% in 2049.
- **Multiple ways to offset this growth.**
- **Growing interest payments can be a real problem.**



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## Instruction on how to use the template



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## National Economic Education Delegation

### • Vision

- One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.

### • Mission

- NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States

### • NEED Presentations

- Are **nonpartisan** and intended to reflect the consensus of the economics profession



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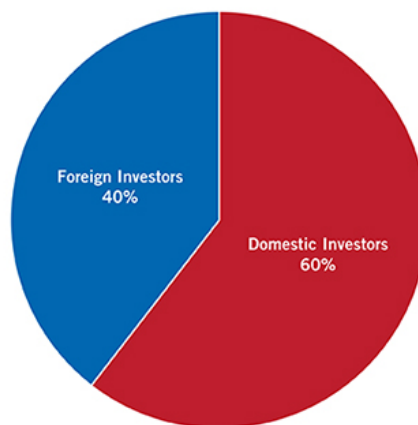
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PETER G.  
PETERSON  
FOUNDATION

Foreign investors own over one-third of all U.S. public debt



SOURCE: Department of the Treasury, *Monthly Treasury Statement*, issue for September 2018; and Department of Treasury, *Treasury Bulletin*, December 2018. Compiled by PGPF.  
© 2018 Peter G. Peterson Foundation

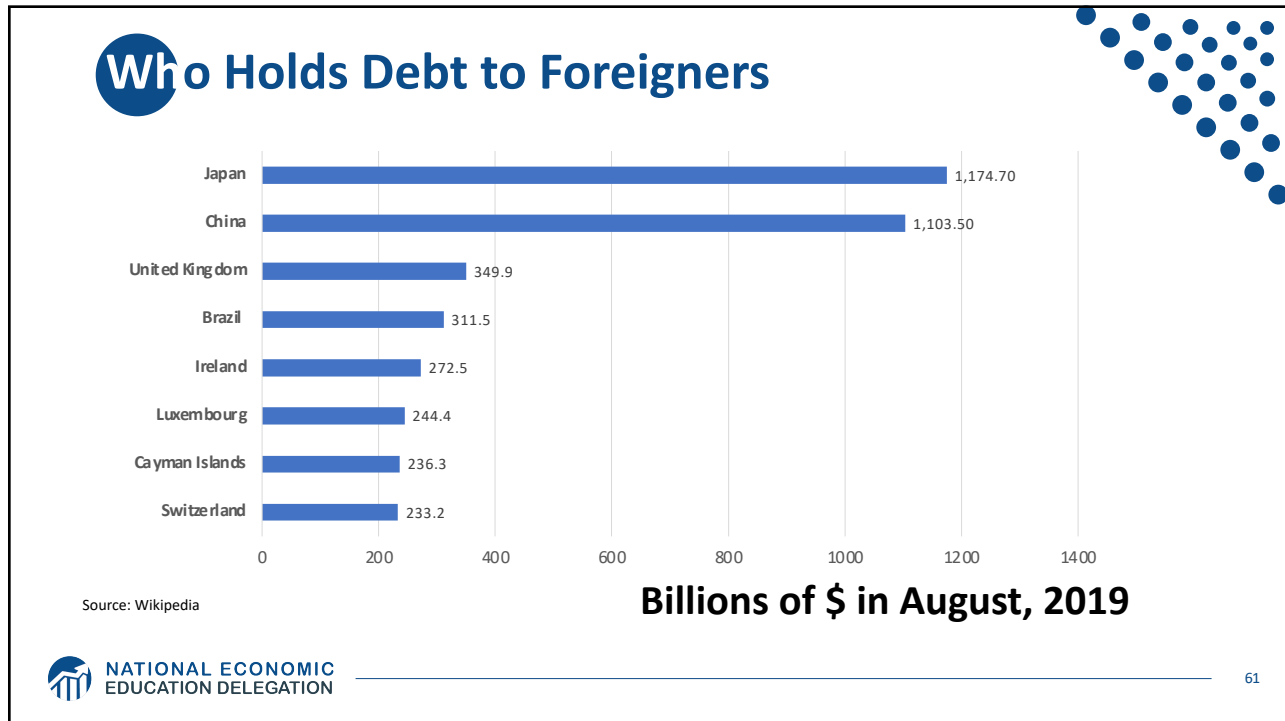
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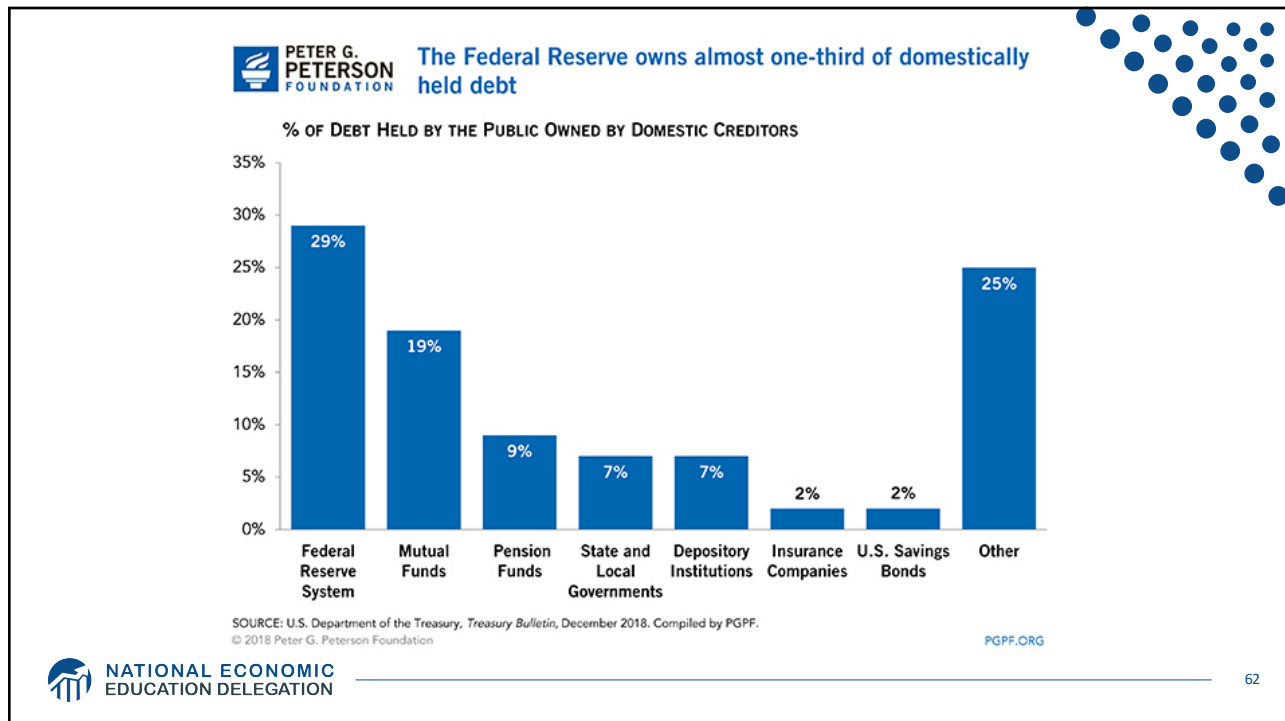
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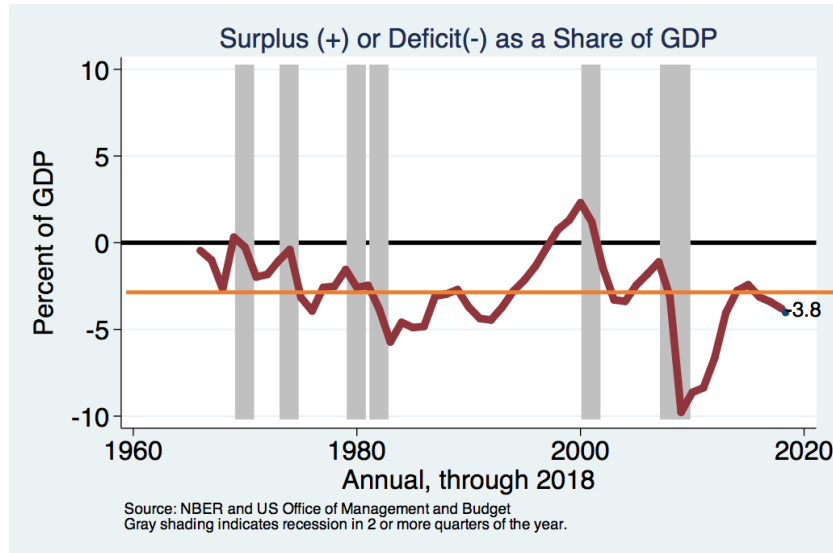


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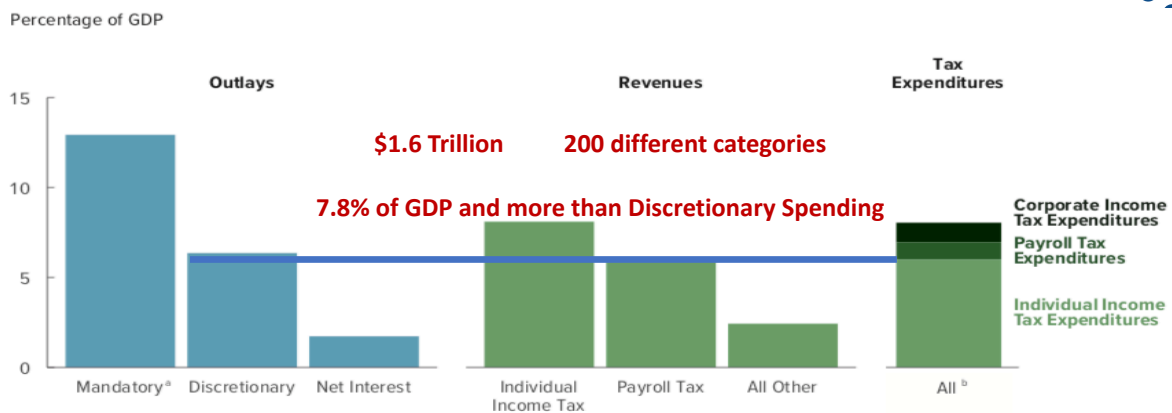
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## Deficits and Recessions



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## Tax Expenditures are Significant



Source: Congressional Budget Office, using estimates by the staff of the Joint Committee on Taxation.  
GDP = gross domestic product.

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# Tax Expenditures Tend to be Regressive

Percent Change in After-Tax Income due to Tax Expenditures, 2007 (with no AMT)*							
	Tax Exclusions	Lower capital gains and dividends rates	Itemized deductions	Above-the-line deductions	Non-refundable credits	Refundable credits	All provisions
Bottom 20 percent	0.54%	0.00%	0.02%	0.01%	0.05%	5.81%	6.97%
Second 20 percent	Income Group		Benefits			5.26%	8.89%
Middle 20 percent	Bottom 20%		7.0%			2.25%	7.25%
Fourth 20 percent						1.00%	7.28%
Top 20 percent	Top 20%		12.8%			0.25%	12.82%
Total Cost (no AMT)	\$326 billion	\$99 billion	\$153 billion	\$6.6 billion	\$11.3 billion	\$89 billion	\$746.7 billion
Total Cost (with AMT)	\$344 billion	\$96 billion	\$154 billion	\$6.4 billion	\$8.2 billion	\$89 billion	\$760.5 billion

Source: Center on Budget and Policy Priorities calculations based on TPC calculations of effect of eliminating tax expenditures.  
 \*Note: These figures take into account the interaction among individual tax expenditure provisions.