Osher Lifelong Learning Institute, Winter 2025

Contemporary Economic Policy

Bradley University

Host: Jon Haveman, Ph.D.
National Economic Education Delegation

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Course Outline

- **Contemporary Economic Policy**
  - Week 1 (2/5): Economic Update (Jon Haveman, NEED)
  - Week 2 (2/12): Economic Mobility (Kathryn Wilson, Kent State University)
  - **Week 3 (2/19): Federal Debt and Deficits (Geoffrey Woglom, Amherst College)**
  - Week 4 (2/26): Tariffs and Their Effects (Alan Deardorff UMichigan)

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Submitting Questions

- **Submit questions in the chat or by raising your digital hand.**
  - I will try to handle them as they come up.
- **We will do a verbal Q&A once the material has been presented.**
- **Slides will be available from the NEED website tonight. (https://needelegation.org/delivered_presentations.php).**

Available NEED Topics Include:

- **Healthcare Economics**
- **US Economy**
- **Climate Change**
- **Economic Inequality**
- **Economic Mobility**
- **Trade and Globalization**
- **Minimum Wages**
- **Immigration Economics**
- **Housing Policy**
- **Federal Budgets**
- **Federal Debt**
- **Black-White Wealth Gap**
- **Autonomous Vehicles**
- **US Social Policy**

The US Federal Debt

Geoffrey Woglom,
Professor of Economics
Amherst College, emeritus
February 19, 2025

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Credits and Disclaimer

- **This slide deck was created by:**
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  - Geoffrey Woglom, Amherst College, Emeritus
- **This slide deck was reviewed by:**
  - Olivier Blanchard, Peterson Institute for International Economics
  - John H. Cochrane, Stanford University
- **Disclaimer**
  - NEED presentations are designed to be nonpartisan.
  - It is, however, inevitable that presenters will be asked for and offer their own views.
  - Such views are those of the presenters and not necessarily those of the National Economic Education Delegation (NEED).

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Outline

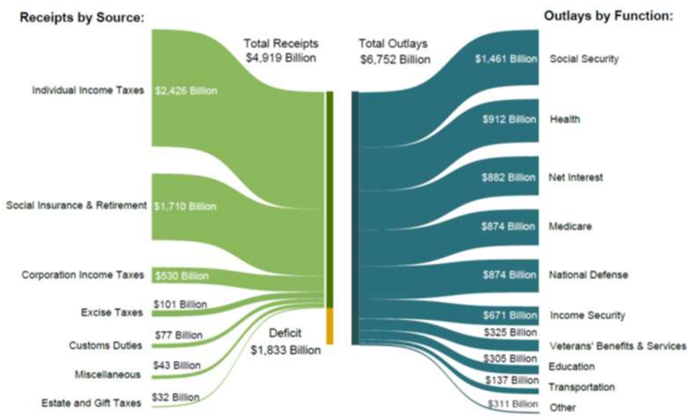
- **Definitions, Basic Data and Historical Data.**
- **Traditional Economic Analysis of the Costs of the Debt**
- **Recent Congressional Budget Office (CBO) analysis of the Cost of the Debt.**
- **Citizens Guide to Debt Issues**

Basic Definitions

- **Fiscal year Deficit = Total Outlays Less Revenues between Oct to September.**
- **The deficit paid for by government borrowing: (net) issue of new government bonds.**
  - In 2024, the government issued $28.5 trillion in new Treasuries (https://treasurydirect.gov/auctions/) to finance a $2 trillion deficit.
- **The accumulated value of past borrowing is the total government debt.**

The Federal Budget in FY2024 (ended 9/30)

Inc Tax, 49%
SS Tax, 35%
Corp Tax, 11%



Mandatory: \$4.1tr, 61%
Discretion.: \$1.8tr, 27%
Net Interest, \$0.9tr, 13%

Deficit: 1.8 tr, 25%
6.4% of GDP

Programmatic Outlays = Mandatory + Discretionary

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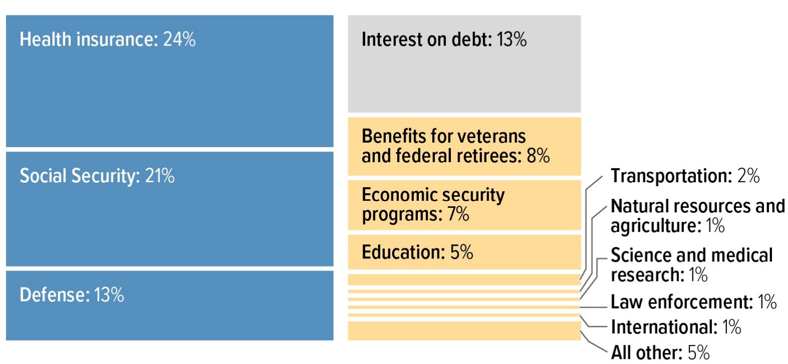
Source: Monthly Treasury Report, 9/2024

Where Do Federal Dollars Go?

The Majority of the Budget Goes for Health, Social Security, and Defense



Note: Figures differ from OMB's for technical reasons related to the shifting status of the Administration's 2022 student loan forgiveness policy and its effect in 2023. Percentages do not add to 100 due to rounding.

Source: 2023 figures from the Office of Management and Budget, March 11, 2024

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

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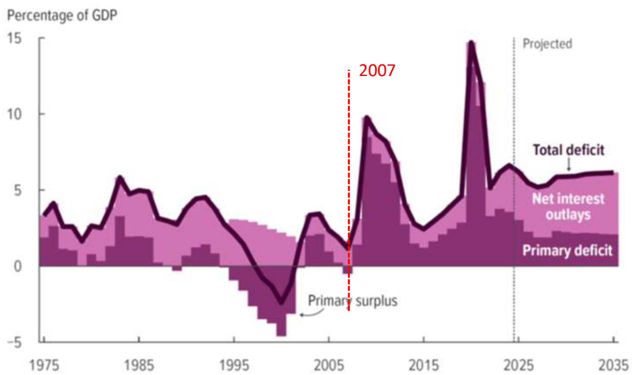
Past and Future of Deficits



Useful Deficit Decompositions:
Deficit=
Primary Deficit + Net Interest,

Primary Deficit =
Programmatic Outlays less Taxes

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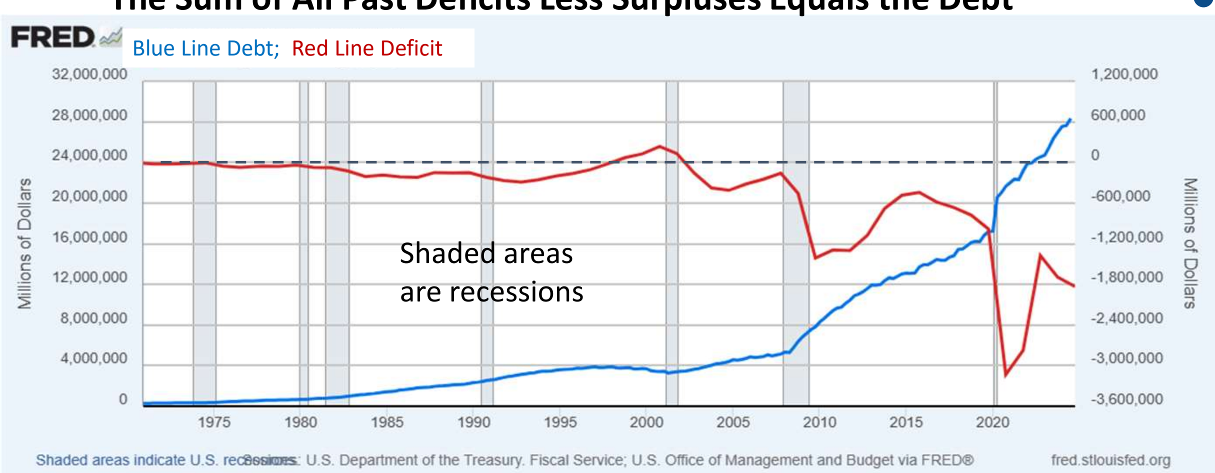
CBO, "The Budget and Economic Outlook," Jan 2025

Debt vs. Deficit

The Sum of All Past Deficits Less Surpluses Equals the Debt



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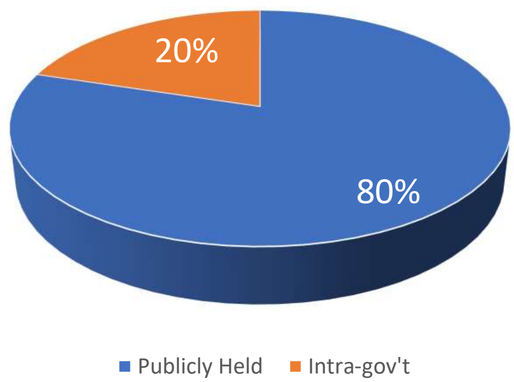
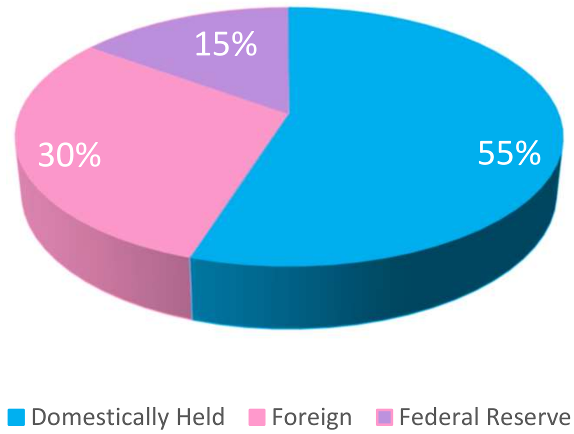
A Breakdown of the Total Federal Debt

Total Public Debt: $36.1 tr, 12/1



Publicly Held Debt: $28.8 tr, 12/1



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Ownership of $27 trillion Publicly Held Debt (12/23)

US Savings Bonds, $120 billion

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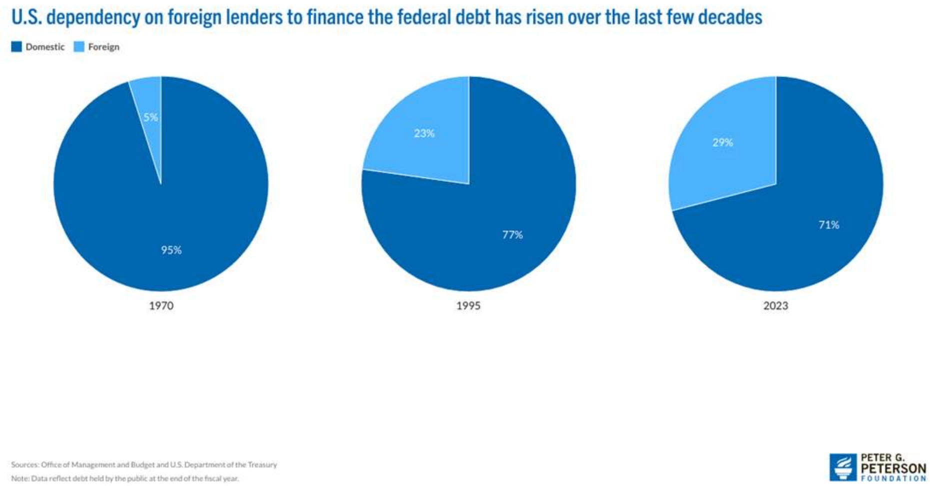
Source: U.S. Department of the Treasury

PETER G. PETERSON

The Growing Importance of Foreign Held Debt



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Not All Debt Is Created Equal

Intra-governmental debt is important bookkeeping.

- This debt **DOES NOT** require funding on credit markets

- **Debt held by the public**
  - This debt is funded by borrowing on credit markets and competes with private funding.
- **Most analyses focus on the publicly held debt *relative* to GDP because:**
  - To the extent that debt and deficits have burdens these burdens depend on the size of the debt ***relative*** to the size of the economy.

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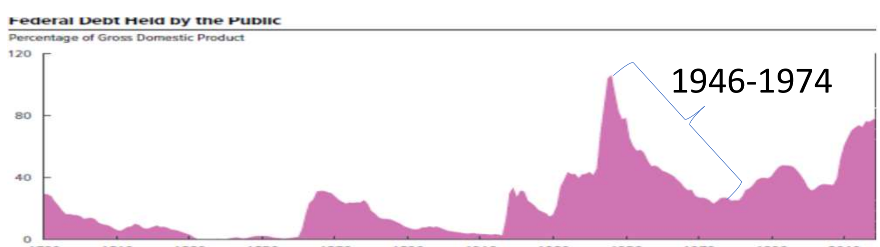
CBO: Budget Analysts in Chief

- **The Congressional Budget Office was founded in 1974 to provide Congress with information about the budgetary implications of legislation.**
- **Two kinds of Reports**
  - Cost Estimates or "Scoring"
    - H.R. 5409, Safeguarding American Farms from Foreign Influence Act
    - Build Back Better Scoring.
- **Projections of Debt and Deficits – The Budget and Economic Outlook: 2025 to 2035,**
  - https://www.cbo.gov/publication/60870

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, recessions, public investment) and then fell.**
3. **What can we learn from the 46-74 period, where the relative debt fell continuously?**

Debt Dynamics

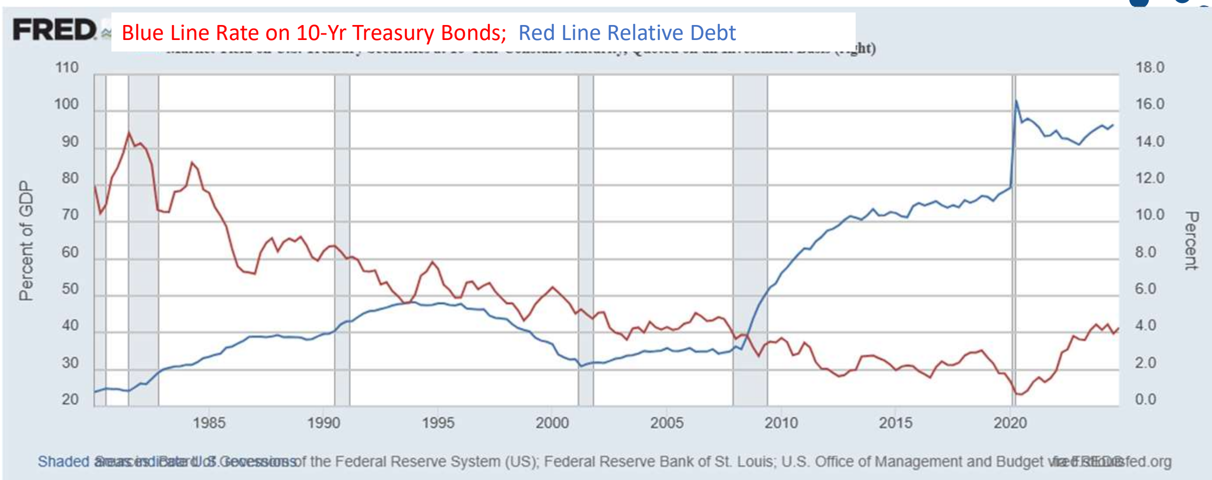
- The relative debt fell *in spite of* deficits in 21 of the 29 years, with the debt increasing by 42%. How?
- 1946-1974, deficits caused the debt to grow, but not as fast as the economy was growing.
- While the debt grew by 42%, GDP (nominal) grew by 550%

You don't need a surplus to reduce the *relative* debt:
You just need GDP to grow faster than the debt

Traditional View: Debt and Deficits Raise Interest Rates

1. Crowding Out via higher interest rates:
    1. Private: less investment and over time leads to a smaller capital stock and reduced future output.
    2. Government: primary surplus needed to stabilize the debt is larger; i.e., less programmatic outlays or higher taxes
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.

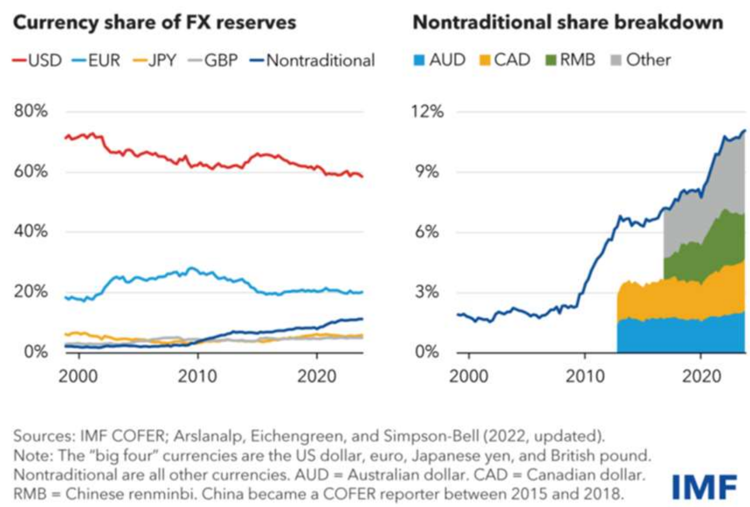
The Dog that Didn't Bark; Rising Interest Rates?



Why do Foreigners Buy US Treasuries?

- **Market for Treasuries is the deepest, most liquid and safest capital market in the world.**
- **US economy has a history of political and economic stability.**
- **We enjoy "An exorbitant privilege" (Valery Giscard d'Estaing): The dollar is the largest international reserve currency.**
  - Most trade transactions are quoted in dollars, e.g., oil.
  - With some exceptions, foreigners borrow in dollars. E.g., Yankee bonds

Demand for Dollars by Central Banks



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https://www.imf.org/en/Blogs/Articles/2024/06/11/dollar-dominance-in-the-international-reserve-system-an-update

CBO on the Costs of "High and Rising Debt"

1. The interest expense portion of the deficit will rise, including payments to foreigners.
2. Crowding out of private investment.
3. "The likelihood of a fiscal crisis in the United States would increase."
4. Slow erosion of confidence in the U.S. dollar as an international reserve currency leading to higher interest rates.
5. Policymaker constraint in using deficit-financed fiscal policy to respond to unforeseen events.

CBO, "Budget and Economic Outlook: 2022-2032," May 2022, pp15-16.

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Brookings on a Fiscal Crisis

In most … scenarios, it is likely within policymakers' power to avoid a crisis altogether, even given the projected increase in federal borrowing. In other words, a fiscal crisis is more likely to result from political missteps. These missteps include threats to default or efforts to undermine credibility of the Federal Reserve as well as enactment of policies that sharply increase deficits and thus raise the specter of strategic default.

Trump added: "It could be that a lot of those things don't count. In other words, that some of that stuff that we're finding is very fraudulent, therefore maybe we have less debt than we thought."

It was not clear whether Trump was referring to debt service or other government payments made by the Treasury Department.

https://www.brookings.edu/articles/what-are-the-risks-of-a-rising-federal-debt/

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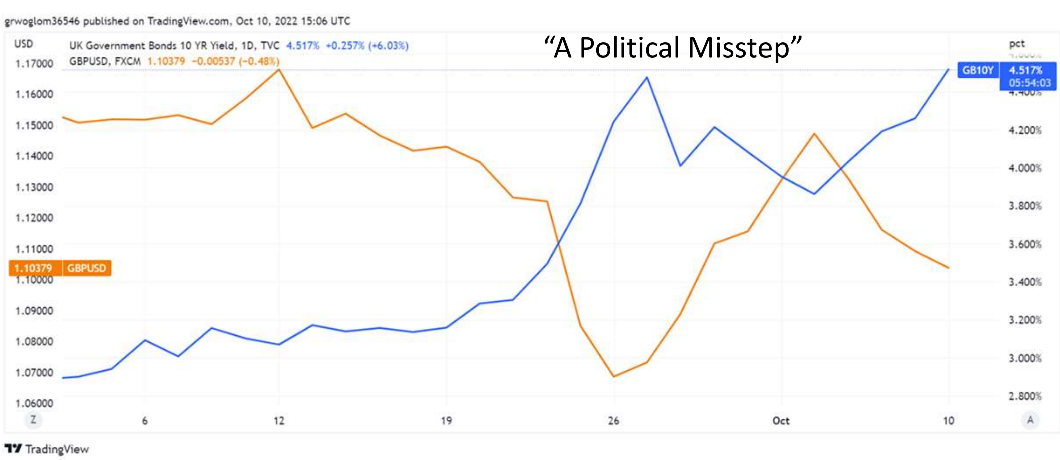
https://www.reuters.com/markets/us/trump-says-us-might-have-less-debt-than-thought-2025-02-09/

Fiscal Crisis Preview: UK & Liz Truss



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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 our 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.

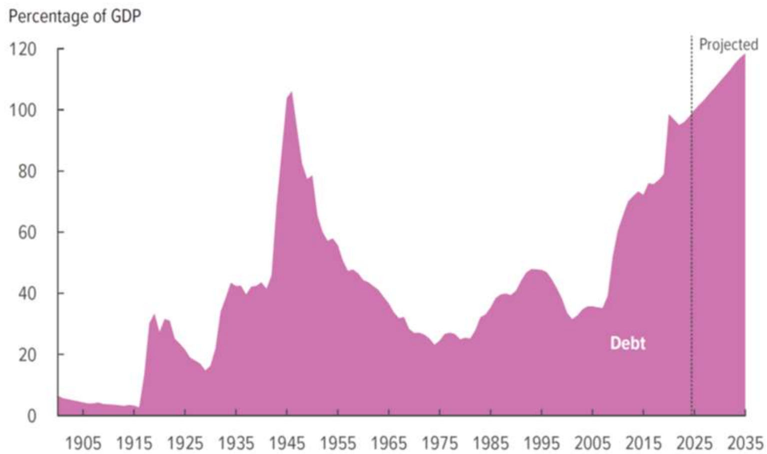
Could the Fed Bail us Out?

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

Bottom Line: We Need to Worry about the Debt

1. **Economist don't really know why they fell to such low levels over the past 20 years. What will they be in the next 20?**
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 is this Problem Impossible?



By 2054, CBO publicly-held debt will rise to 166% of GDP

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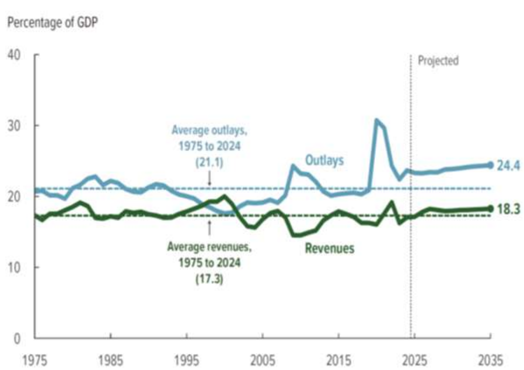
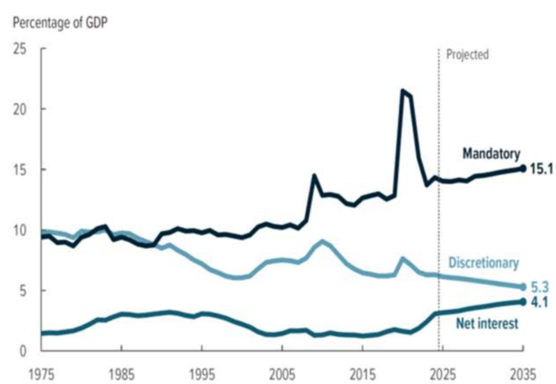
CBO, "The Budget and Economic Outlook," Jan 2025

The Blueprint for a Crisis?





But, these are "projections," not forecasts!

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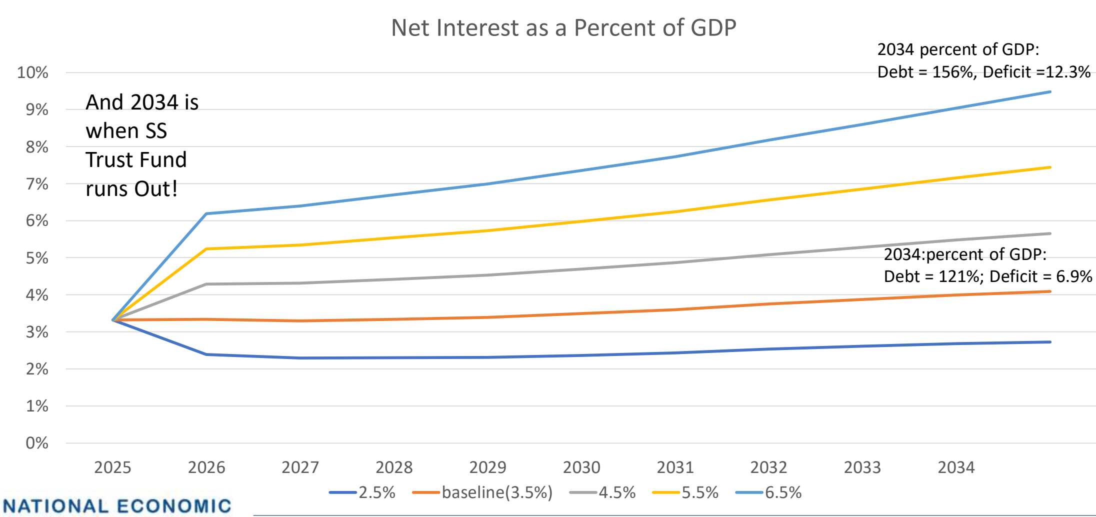
CBO, "The Budget and Economic Outlook," Jan 2025

And, It Gets Worse

- CBO Projections have to be based on forecasted future interest rates.
- Remember, nobody really understands why interest rates fell from 2000-2020.
- What if interest rates rise (and they have been)?

Pretty Bad



Citizen's Guide to "Budget Reconciliation."

- **Procedure successfully used 22 times since 1974 to avoid a Senate filibuster.**
- **Reconciliation can be used for changing taxes and spending (not Social Security) subject to the Byrd Rule.**
- **Byrd rule:**
  1. No extraneous provisions.
  2. No increase in the deficit after 10 year window.
- **Reconciliation games played by both parties:**
  1. BBB.
  2. 2017 Trump Tax Cut

Reconciliation and CBO Projections

- **For the CBO to be effective it must be perceived to be (and must be) nonpartisan.**
- **Therefore, CBO "baseline" projections and legislative scoring must not try to predict changes in legislation.**
- **Instead, CBO must analyze the data based on the current law as written (e.g., 2017 Personal Tax cuts expire this year).**
- **CBO is allowed to provide analyses of policy options. ("Options for Reducing the Deficit: 2025 to 2034," https://www.cbo.gov/publication/60557"**

Trump Fiscal Policies and the Deficit?

Needed Changes to stabilize relative Debt to 100% of GDP about $700b per year (https://www.cbo.gov/publication/60868)

1. **Extending TCJA tax cuts: CBO estimates about $3.7 trillion over 10 years.**
2. **Raise SALT limit to $20K; Eliminate taxes on tips and SS payments**
3. **Proposed tariffs: $1.5 trillion over 10 years.**
4. **Doge spending cuts, estimates now down to $1trillion ($55 *claimed* so far)**

https://www.cbo.gov/system/files/2024-12/60986-Expiring-Provisions-2017-Tax-Act.pdf

https://www.crfb.org/blogs/trumps-latest-tariff-plan-could-raise-15-trillion

Scott Bessent Part 1 and 2 of 3-3-3 Plan

1. **Raise real GDP growth to 3 percent per year,**
2. **Reduce the Budget Deficit to 3% (Cut the deficit by about $1 trillion)**

That will more than do it, but how?

My Personal Opinion: Disingenuous

Scott Bessent:

"These entitlements are massive. I think the next four years isn't the time to deal with them, that we've got to deal with the discretionary portion of the budget…then the next step is for a future administration to have the confidence to be able to deal with entitlements"

Total Discretionary Spending last fiscal year was $1.8 trillion.

https://www.foxbusiness.com/politics/treasury-secretary-nominee-scott-bessents-3-3-3-plan-what-know

CBO Spending Options

Table 1-1.

Projected Savings From Options for Reducing the Deficit

Billions of dollars

Option	Title	Savings, 2025–2034[a]
	Mandatory Spending	
1	Reduce Subsidies in the Crop Insurance Program	47
2	Raise Fannie Mae's and Freddie Mac's Guarantee Fees and Decrease Their Eligible Loan Limits	7 to 15
3	Eliminate the Add-On to Pell Grants, Which Is Funded With Mandatory Spending	44[b]
4	Establish Caps on Federal Spending for Medicaid	459 to 893
5	Limit State Taxes on Health Care Providers	48 to 612
6	Reduce Federal Medicaid Matching Rates	69 to 561
7	Increase the Premiums Paid for Medicare Part B	510
8	Reduce Medicare Advantage Benchmarks	489
	Discretionary Spending	
28	Reduce the Department of Defense's Annual Budget	959
29	Cap Increases in Basic Pay for Military Service Members	22[b]
30	Replace Some Military Personnel with Civilian Employees	17[b]
31	Stop Building Ford Class Aircraft Carriers	15
32	Cancel the Long-Range Standoff Weapon	15
33	Cancel the Army's Future Long-Range Assault Aircraft	11
34	Reduce the Size of the Bomber Force by Retiring the B-1B	6
35	Reduce the Size of the Fighter Force by Retiring the F-22	29
36	Reduce the Basic Allowance for Housing to 80 Percent of Average Housing Costs	17[b]
37	Reduce Funding for International Affairs Programs	187

Remember we need $700 billion ***per year***

How about Revenue "Enhancement?"

Option 46—Revenues

Impose a Surtax on Individuals' Adjusted Gross Income

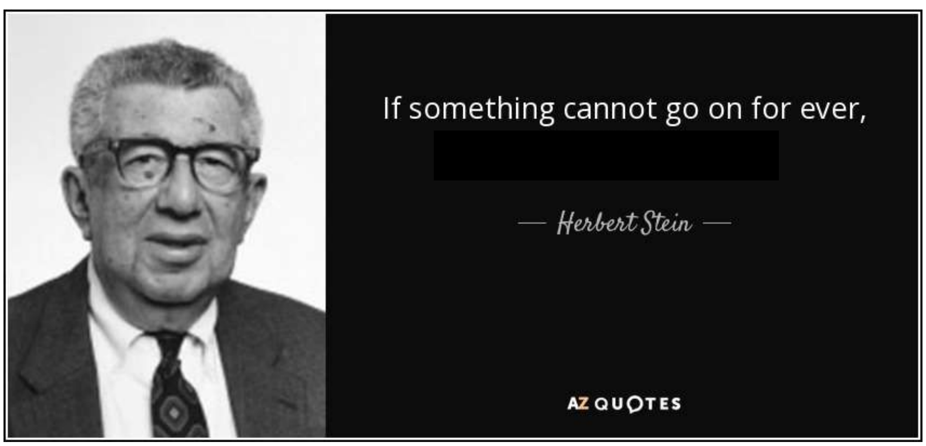
											Total	
Billions of dollars	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2025–2029	2025–2034
Decrease (-) in the deficit												
Impose a surtax of 1 percentage point on AGI above $20,000 for single filers and $40,000 for joint filers	-70.7	-124.4	-131.3	-139.0	-145.2	-151.7	-158.6	-165.9	-173.1	-180.4	-610.6	-1,440.1
Impose a surtax of 2 percentage points on AGI above $100,000 for single filers and $200,000 for joint filers	-49.5	-89.1	-94.2	-101.2	-105.8	-110.8	-116.3	-122.1	-127.9	-133.9	-439.8	-1,051.0

Option 51—Revenues

Change the Taxation of Assets Transferred at Death

											Total	
Billions of dollars	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2025–2029	2025–2034
Decrease (-) in the deficit												
Enact carryover basis for assets held until death	-1.0	-7.5	-11.5	-15.1	-18.6	-21.9	-25.1	-28.5	-32.0	-35.6	-53.7	-196.9
Include accrued capital gains in the last income tax return of decedents	-9.1	-48.7	-46.8	-48.8	-51.9	-55.8	-60.5	-65.8	-71.4	-77.3	-205.3	-536.1

The Wit and Wisdom of Herb Stein



And, what will be the damage when it stops!

Your Turn

https://needecon.org/

grwoglom@amherst.edu

My Website:

https://sites.google.com/view/macro-current-issues/debt