The US Federal Debt

Money Talks

05/16/2022

Scott Baier, Ph.D.

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National Economic Education Delegation

- **Vision**
  - Someday, 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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- **This slide deck was created by:**
  - Jon Haveman, Executive Director, NEED
  - Geoffrey Woglom, Amherst College, Emeritus
  - Scott Baier, Clemson 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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US Government Debt

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Of Debt, Deficits, and Surpluses

- **FLOW**
  - ***Deficit***: The excess of outlays over revenues in a year.
  - ***Surplus***: The excess of revenues over outlays in a 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			
Total	$3,420		Total	$6,552

Budget Deficit: $3,132

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

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What Does the US Govt. Budget Look Like?

2019 Budget Summary (in billions)

Revenue			Outlays	
Income Taxes	$1,718		Mandatory	$2,735
Payroll Taxes	$1,243		Discretionary	$1,336
Corporate Taxes	$230		Interest	$376
Other	$271			
Total	$3,462		Total	$4,447

Budget Deficit: $984 Billion

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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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US Government Deficits Over Time

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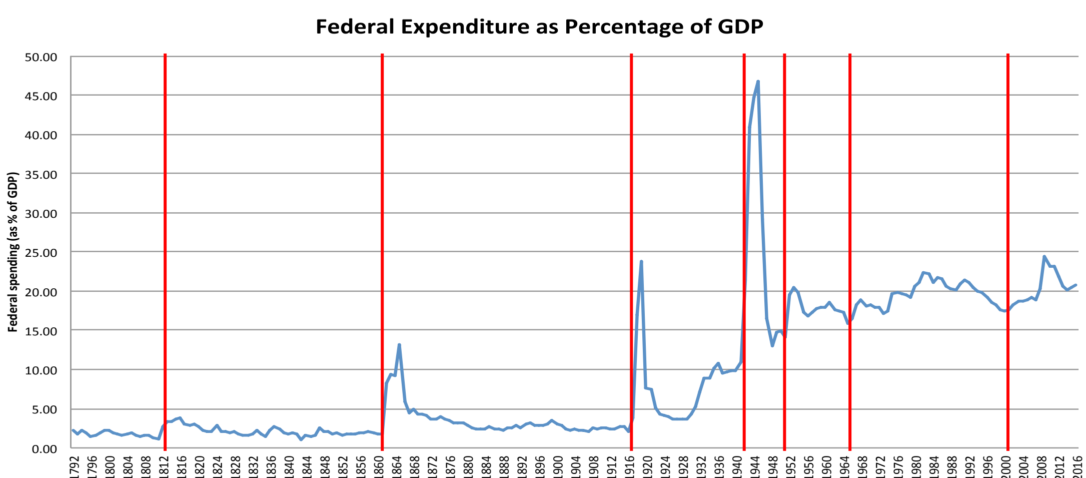
Figure 1: Federal Expenditures



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

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Figure 2: Federal Revenue

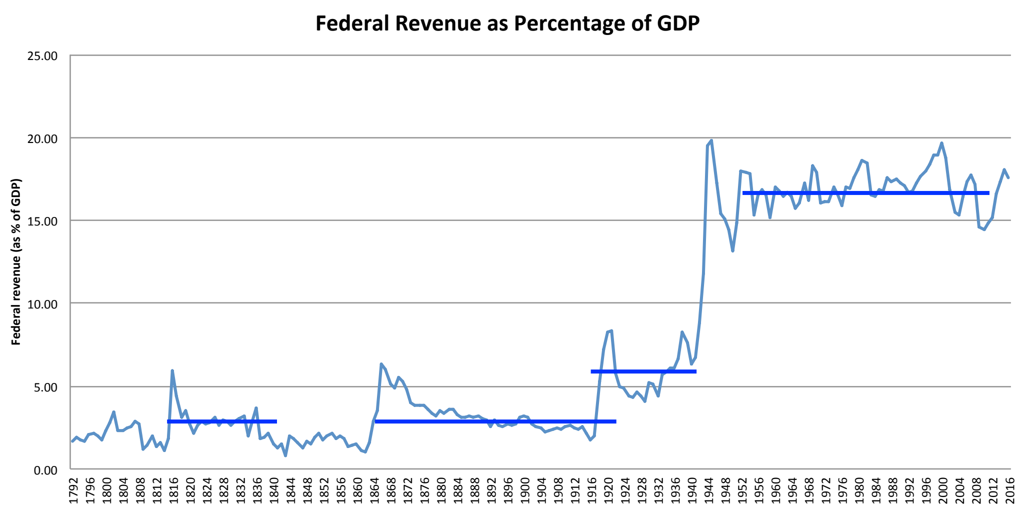

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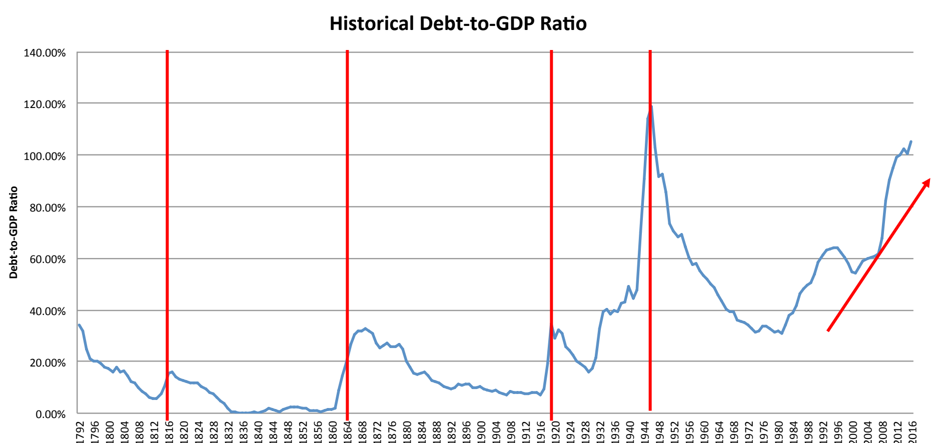
Figure 3: Debt-to-GDP



Source: usgovernmentrevenue.com

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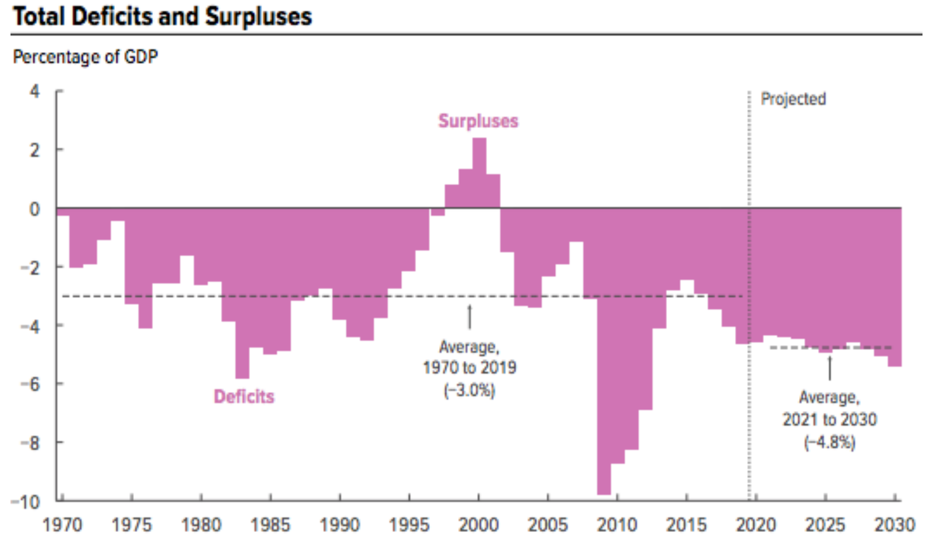
A Future of Deficits



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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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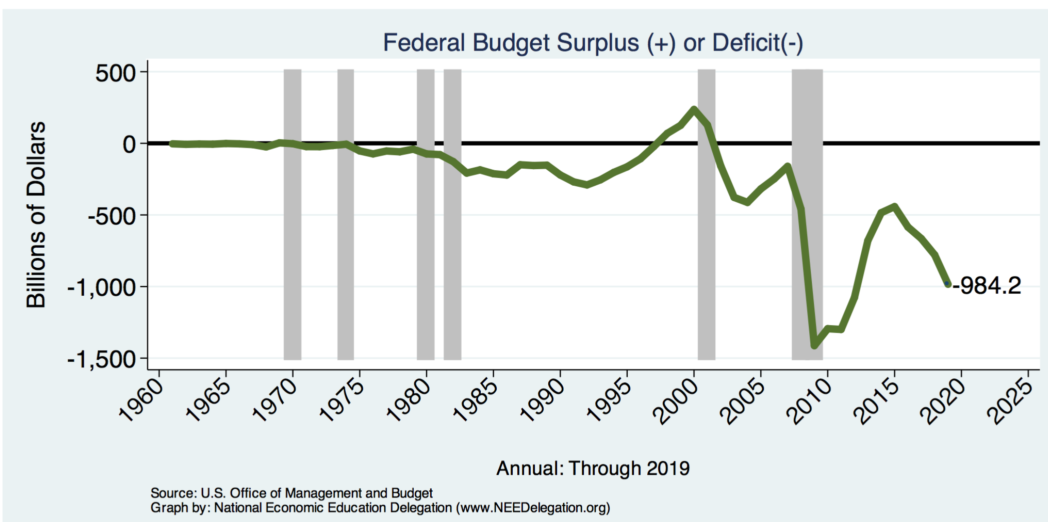
A History of Persistent Deficits



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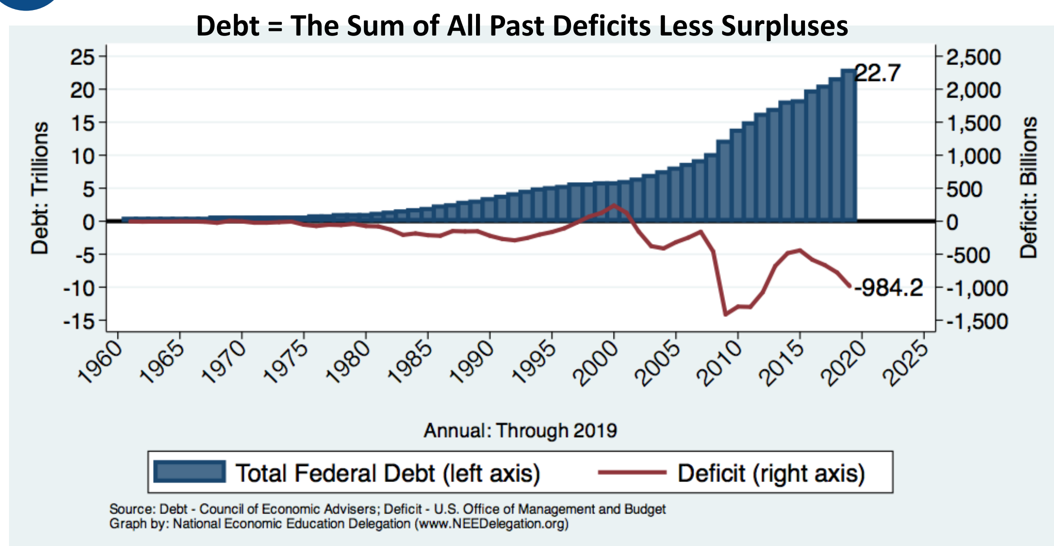
Debt vs. Deficit



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How Does the US Government Borrow?

- **It issues debt.**
  - Treasury marketable securities:
    - Treasury bills, notes, and bonds
    - TIPS: Treasury inflation-protected securities
    - Savings bonds
- **Who buys the debt?**
  - Other federal agencies
  - Individuals and businesses
  - State and local governments
  - Foreign government and individuals
  - Federal Reserve

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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
- **Intragovernment debt is (important) bookkeeping.**
  - This debt **DOES NOT** crowd out private investment.
- **Debt held by the public**
  - This debt **MIGHT** crowd out private investment.
- **Most analyses of debt focus on federal debt held by the public.**

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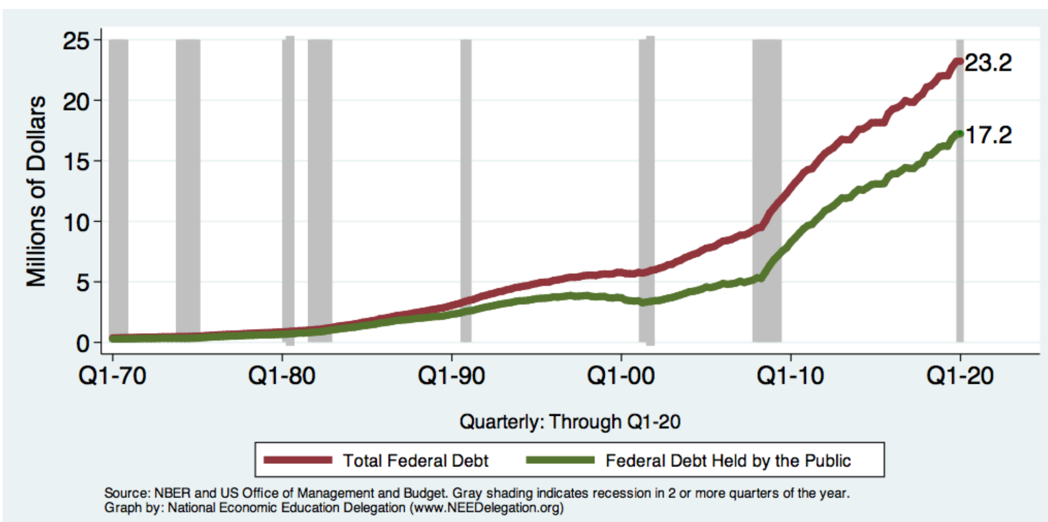
Two Measures of the Debt



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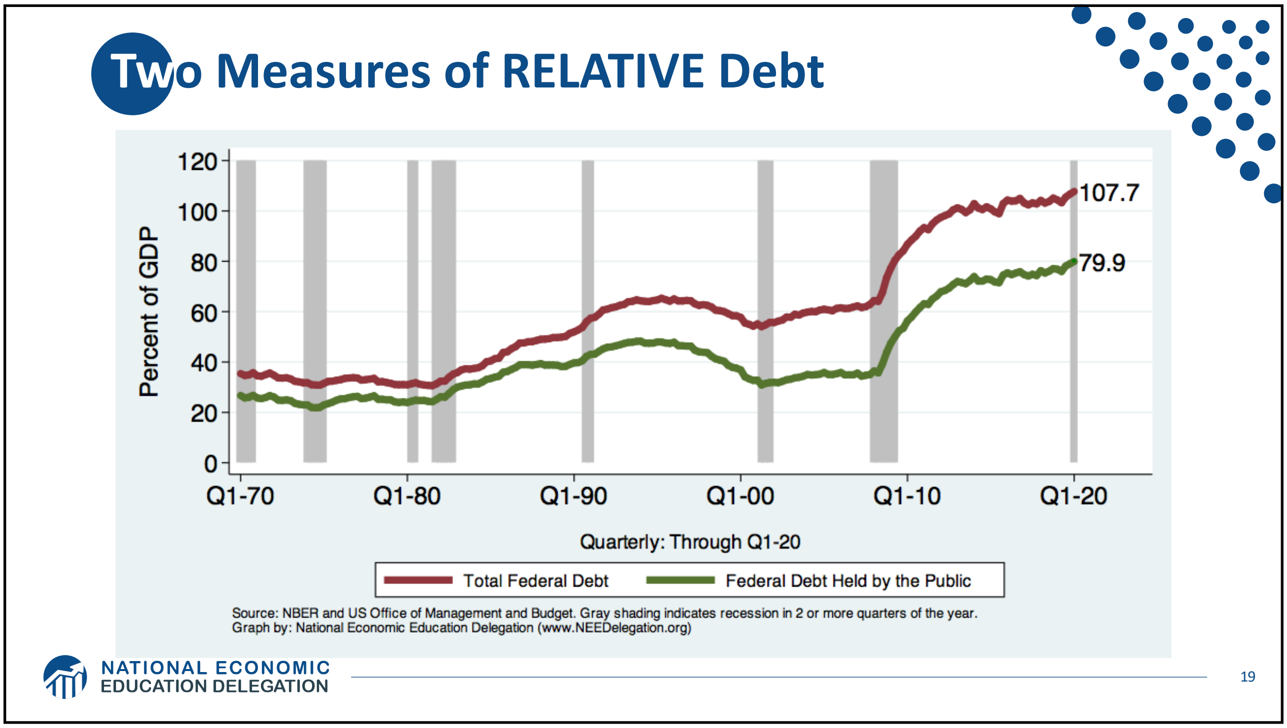
Two Measures of RELATIVE Debt
120
100
80
60
40
20
0
Percent of GDP
Q1-70
Q1-80
Q1-90
Q1-00
Q1-10
Q1-20
107.7
79.9
Quarterly: Through Q1-20
Total Federal Debt
Federal Debt Held by the Public
Source: NBER and US Office of Management and Budget. Gray shading indicates recession in 2 or more quarters of the year.
Graph by: National Economic Education Delegation (www.NEEDelegation.org)
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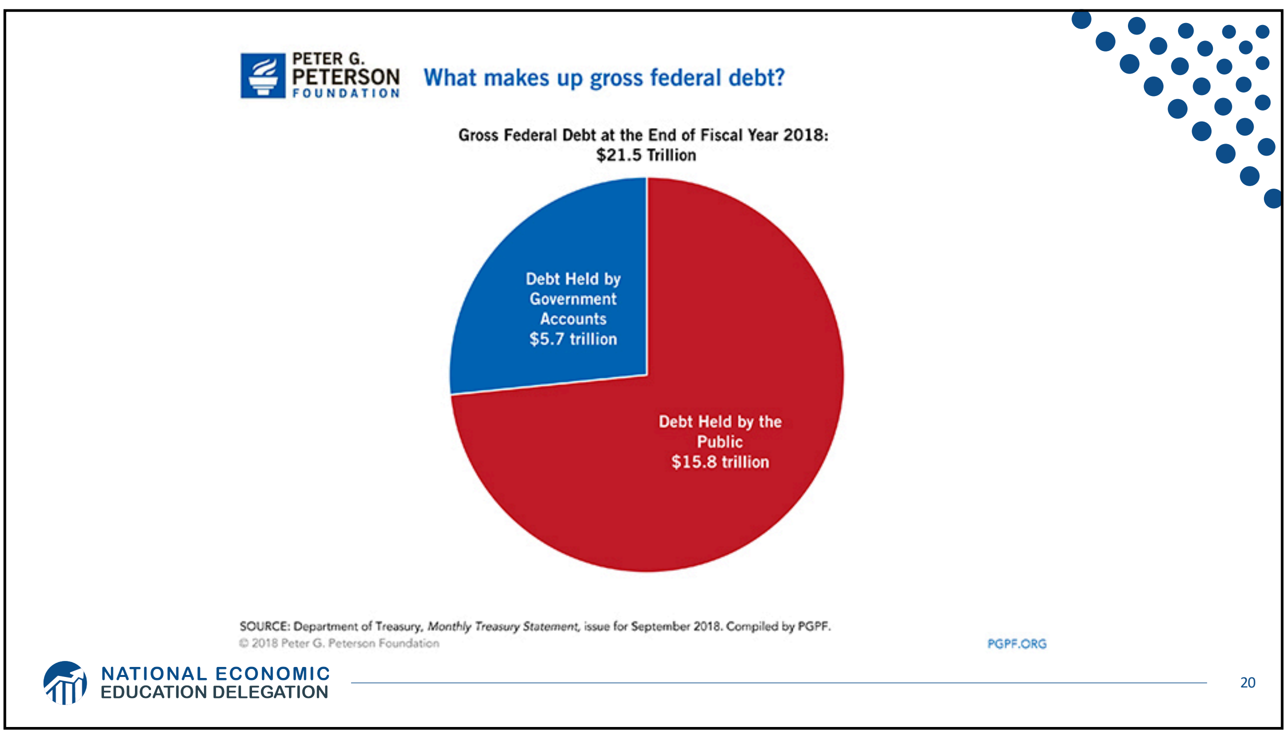
PETER G.
PETERSON
FOUNDATION
What makes up gross federal debt?
Gross Federal Debt at the End of Fiscal Year 2018:
$21.5 Trillion
Debt Held by
Government
Accounts
$5.7 trillion
Debt Held by the
Public
$15.8 trillion
SOURCE: Department of Treasury, Monthly Treasury Statement, issue for September 2018. Compiled by PGPF.
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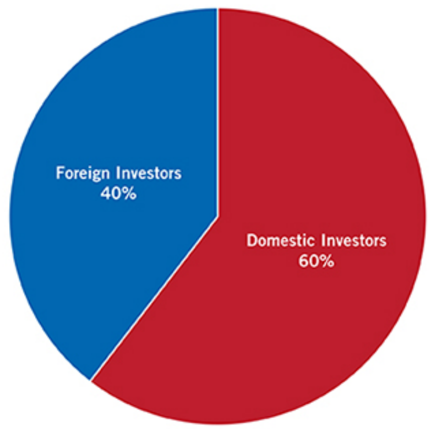
Foreign investors own over one-third of all U.S. public debt



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

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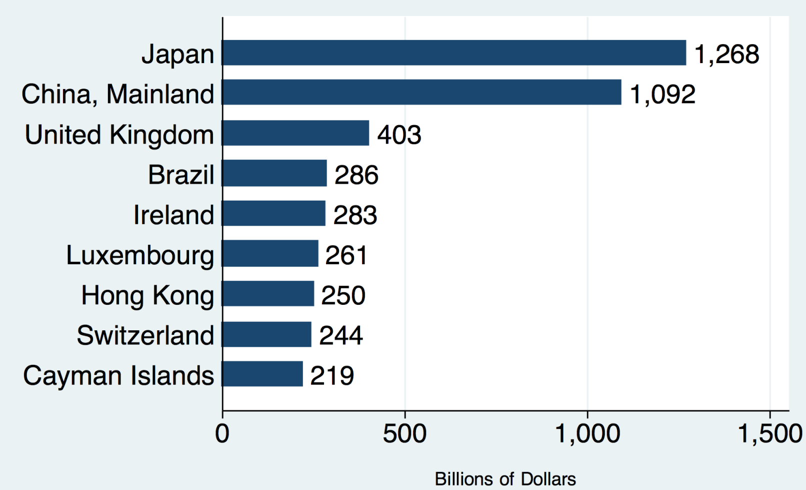
Who Holds Debt to Foreigners



Source: US Department of the Treasury, April 2020
Graph by: National Economic Education Delegation (www.NEEDelegation.org)

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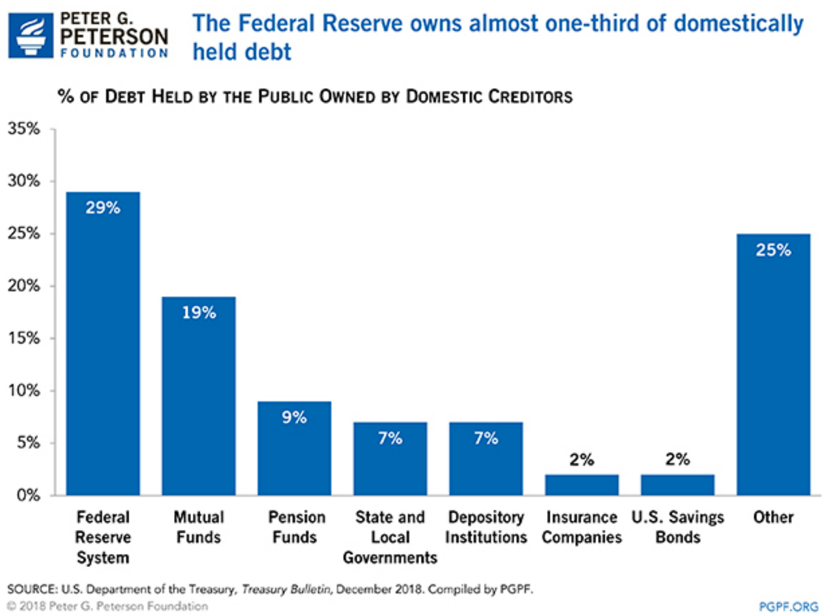

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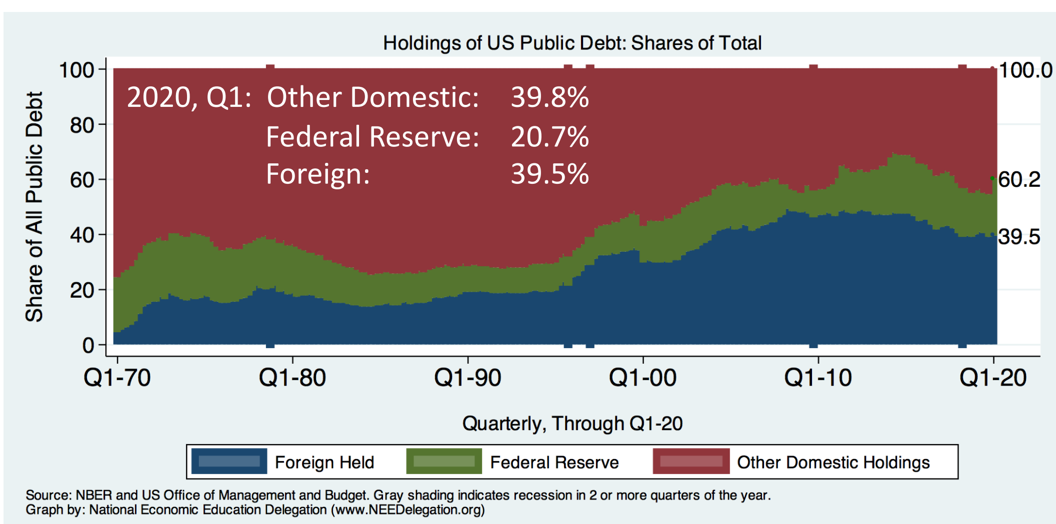
Trends in US Debt Over Time



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Key Points About US Relative Debt

1. **Prior to 1983, relative debt rose purposefully (wars and recessions) and then fell.**
2. **Relative debt peaked during World War II, followed by a long decline.**
3. **Relative debt has been and is expected to rise for the next 30 years w/o a strategic purpose.**

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Debt Dynamics

- **Surprising (?) Facts**
  - From 1945 to 1979, relative debt fell from 100% of GDP to 25% of GDP.
  - During this period, the federal budget was in surplus only once, in 1969.
- **Relative debt is a fraction: Debt/GDP; fractions fall if:**
  - The ***numerator*** falls (budget surplus)
  - The ***denominator*** rises (nominal GDP growth)
  - The ***denominator*** grows faster than the ***numerator***

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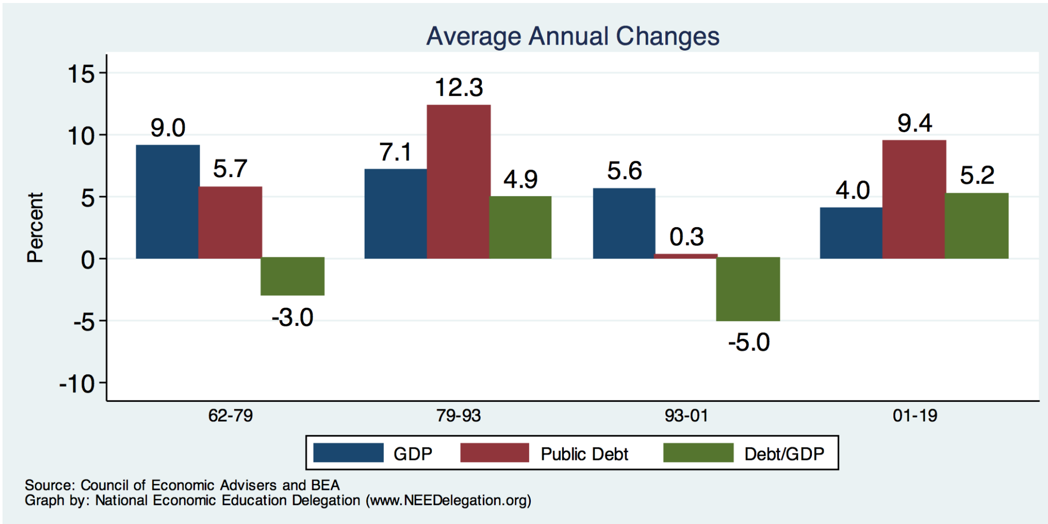
The Arithmetic of Changes in Relative Debt



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Why has the Federal Debt Risen so Much?

- **Expenditures:**
  - Social Security
  - Healthcare costs
  - Economic stimulus
    - In particular, during the Great Recession.
  - Foreign entanglements
- **Revenues**
  - Declining income tax revenues
    - Stagnant wages
    - Tax cuts
  - Social security
    - Declining revenues
  - Corporate income taxes

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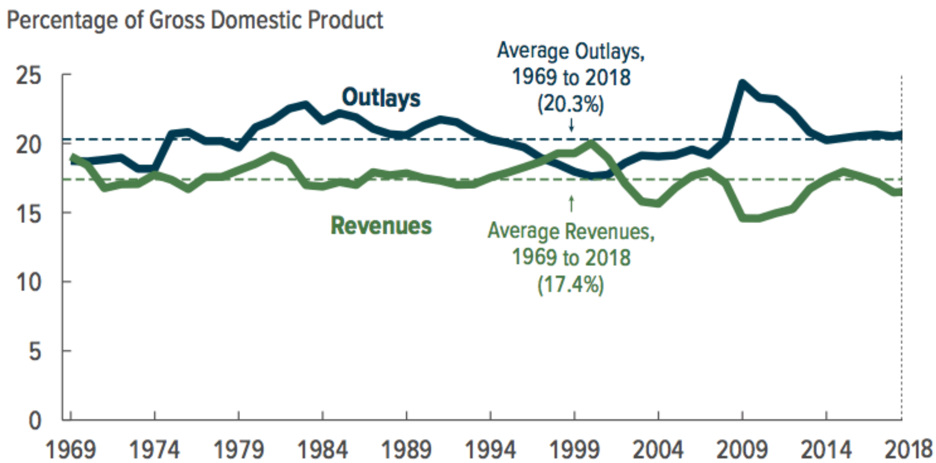
Why Has the Federal Debt Risen So Much?



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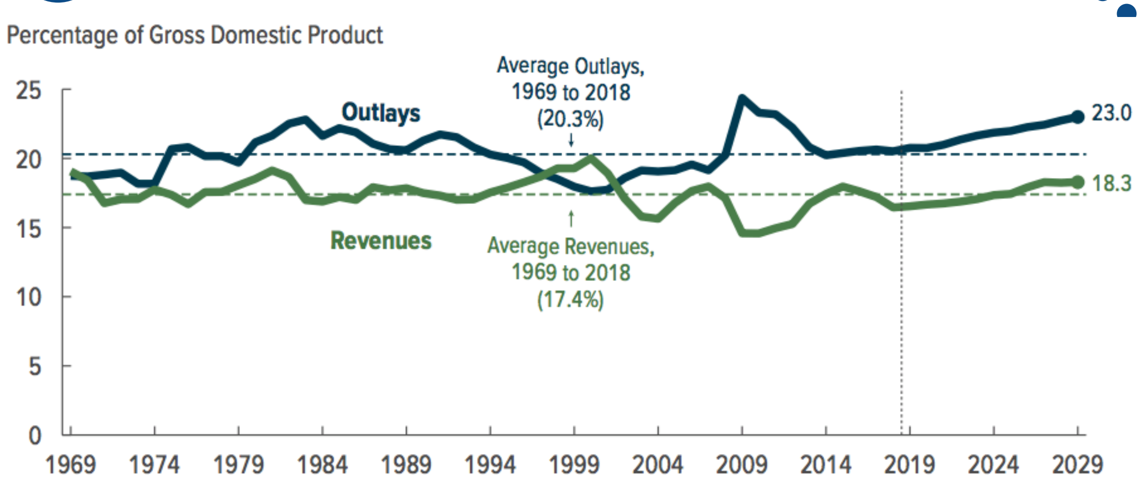

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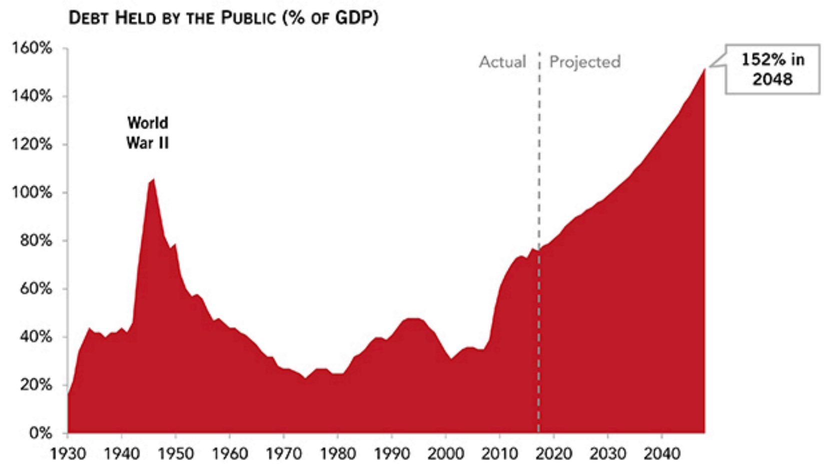
The national debt is on an unsustainable path



SOURCE: Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018. Compiled by PGPF.

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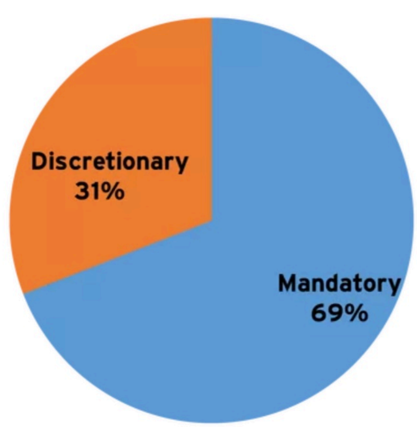
On What is the Money Spent? Complicated

COMPOSITION OF FEDERAL SPENDING (2018)



Source: Congressional Budget Office, Haver

Hutchins Center on Fiscal & Monetary Policy at BROOKINGS

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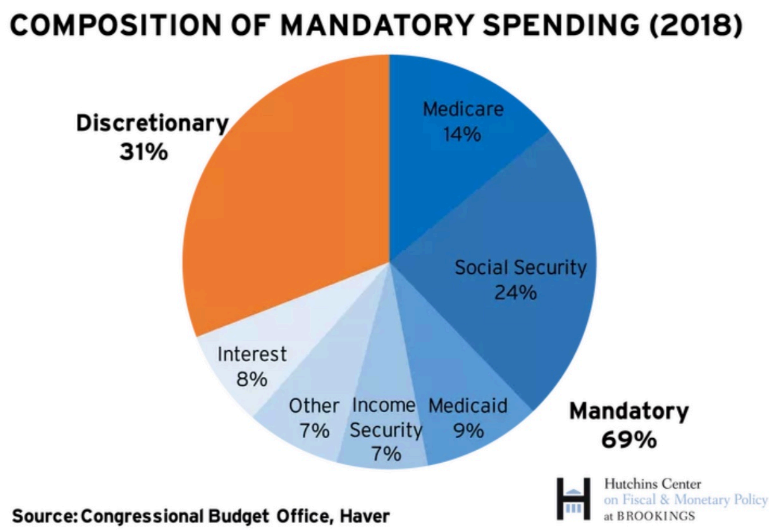
What is Mandatory Spending?



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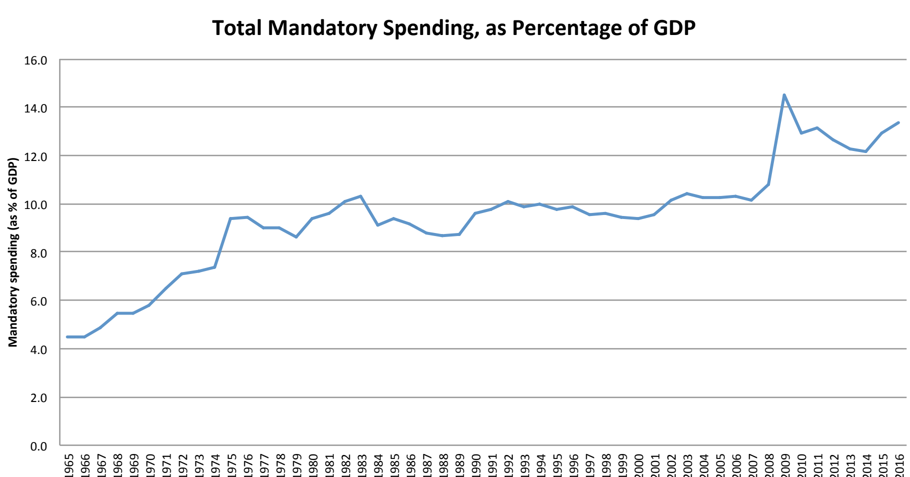
Mandatory Spending: Total Mandatory



Source: Congressional Budget Office (2017)

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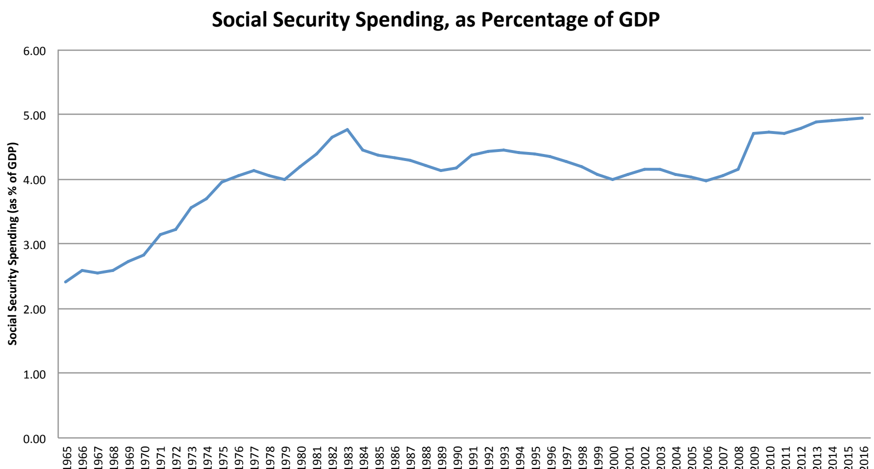
Mandatory Spending: Social Security Spending



Outlays 2018: $ 982 billion
Outlays 2029: $1,900 billion
6% annual growth rate

Source: Congressional Budget Office (2017)

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Mandatory Spending: Medicare (14%)

- **Part A: Hospital Insurance**
- **Part B: Physician, outpatient, home health, and other services.**
- **Part D: Subsidized access to pharmaceuticals.**

- **Part C: Medicare Advantage Plans – offered by private companies approved by Medicare.**
  - Medicare Advantage Plans may offer extra coverage, such as vision, hearing, dental, and/or health and wellness programs.

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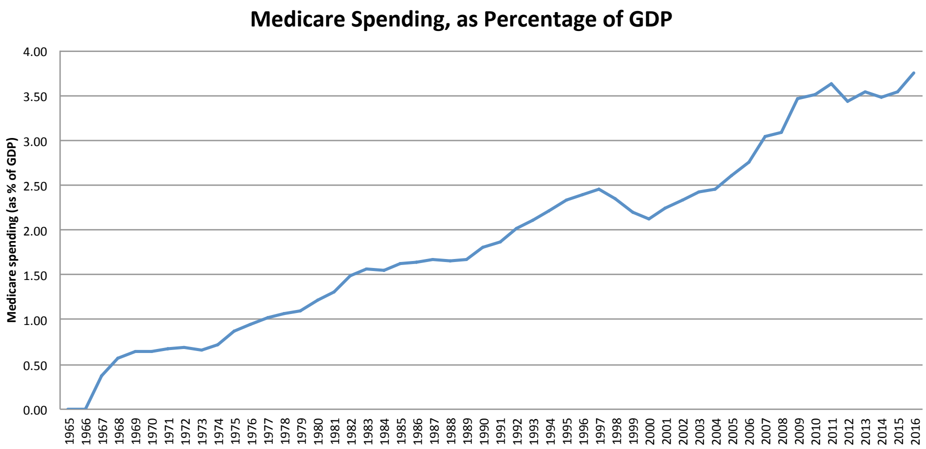
Mandatory Spending: Medicare Spending



Outlays 2018: $1,100 billion
Outlays 2029: $2,100 billion
Growth 6.8%

66% of the growth from rising health care costs and 33% from increased enrollments.

Source: Congressional Budget Office (2017)

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Medicare Finances in 2018

- **Part A:**
  - Income in 2018: $299 billion
  - Expenses in 2018: $297 billion
  - Surplus: $2.8 billion
- **Part B and Part D:**
  - Income in 2018: $406 billion
  - Expenses in 2018: $414 billion
  - Surplus: $-7.9 billion
- **Long term sustainability:**
  - Deficits began in 2016
  - For as far as the eye can see
  - Insolvent in 2026 with current parameters.

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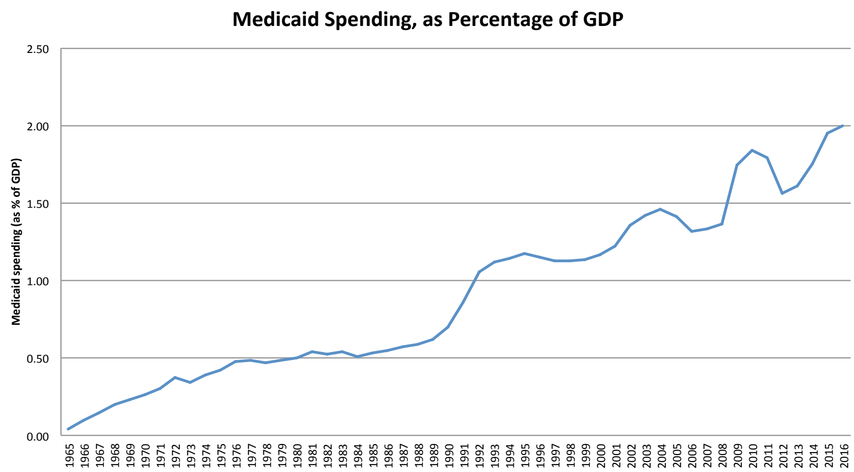
Mandatory Spending: Medicaid Spending



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Source: Congressional Budget Office (2017)

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Mandatory Spending: Medicaid (9%)

- **Medicaid provides medical insurance for those whose income and resources are insufficient to pay for health care.**
- **It is a program with costs shared with the states.**
- **Amount spent in 2017: $576.6 Billion**
  - Federal: 61.5% or $354.6 Billion
  - States: 38.5% $222.0 Billion
- **People served in 2017: 72 million (22% of Americans)**

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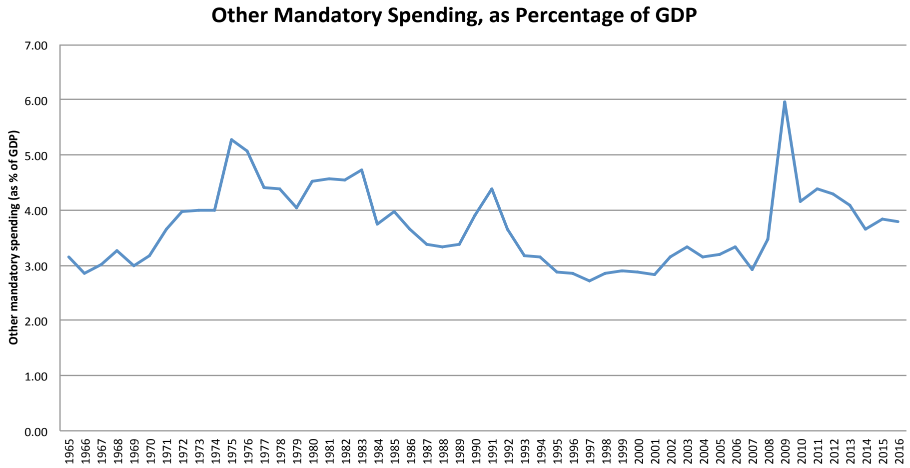
Mandatory Spending: Other



Source: Congressional Budget Office (2017)

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Mandatory Spending: Interest (8%)

- **Interest costs in 2018: $325 Billion**
  - 1.6% of GDP, or 8% of the Federal Budget
- **Forecast to increase to $928 Billion in 2029**
  - 3.0% of GDP, or 22% of the Federal budget

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Source: CBO, January 2019 Budget Projections

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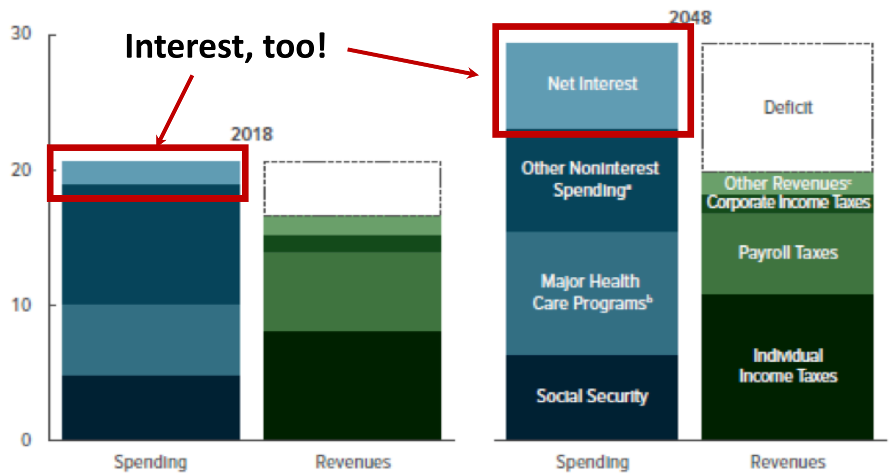
Spending to Grow Much Faster Than Revenue



Source: Congressional Budget Office.

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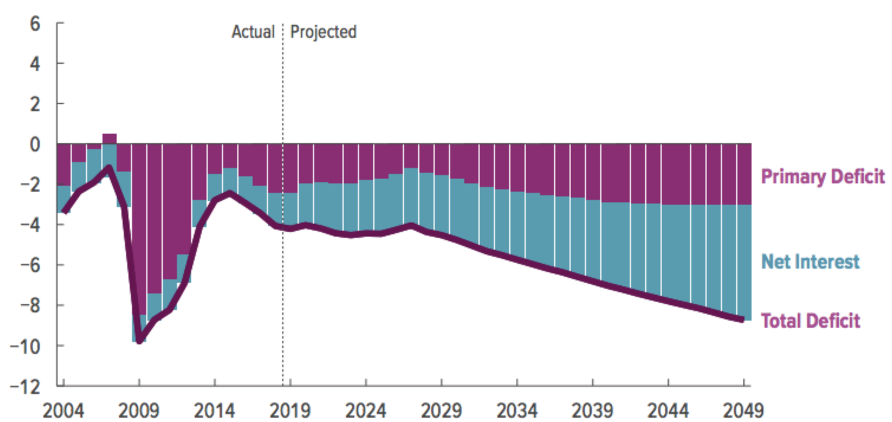
Interest Will Grow as a Share of the Deficit



Deficits grow from 4.2 percent of GDP in 2019 to 8.7 percent in 2049, driving up debt. Net spending for interest on debt accounts for most of the growth in total deficits.

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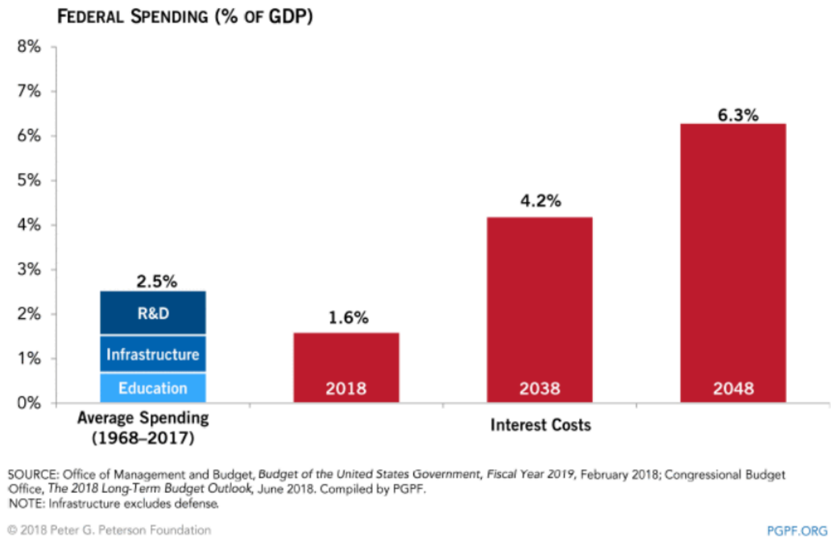
Interest Payments to Grow Significantly



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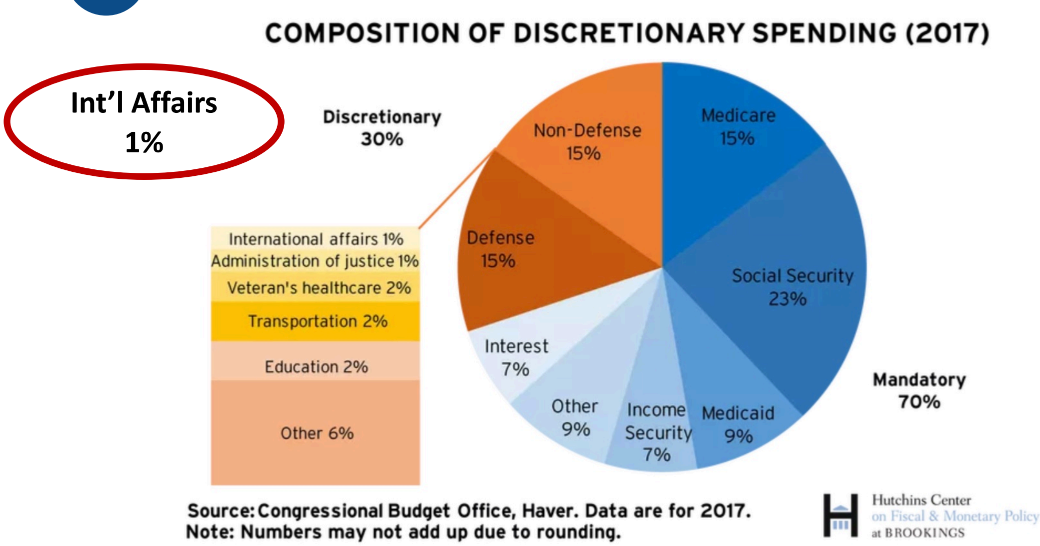
What is Discretionary Spending?



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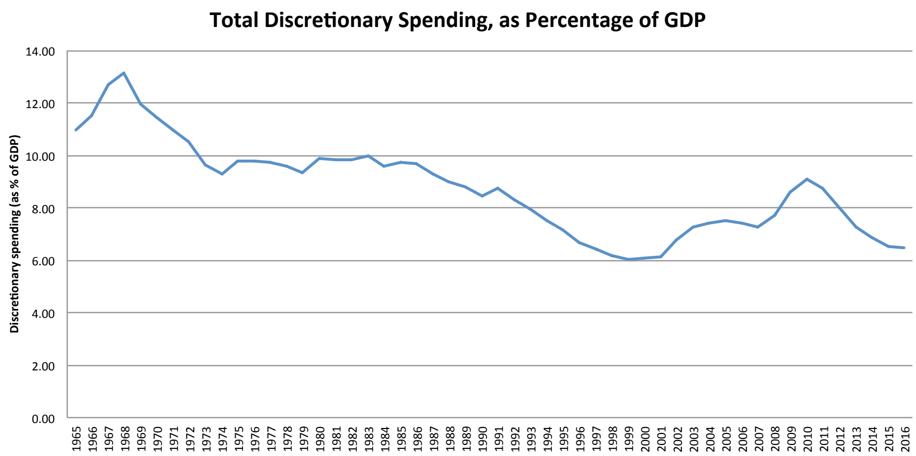
Discretionary Spending: Total



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Source: Congressional Budget Office (2017)

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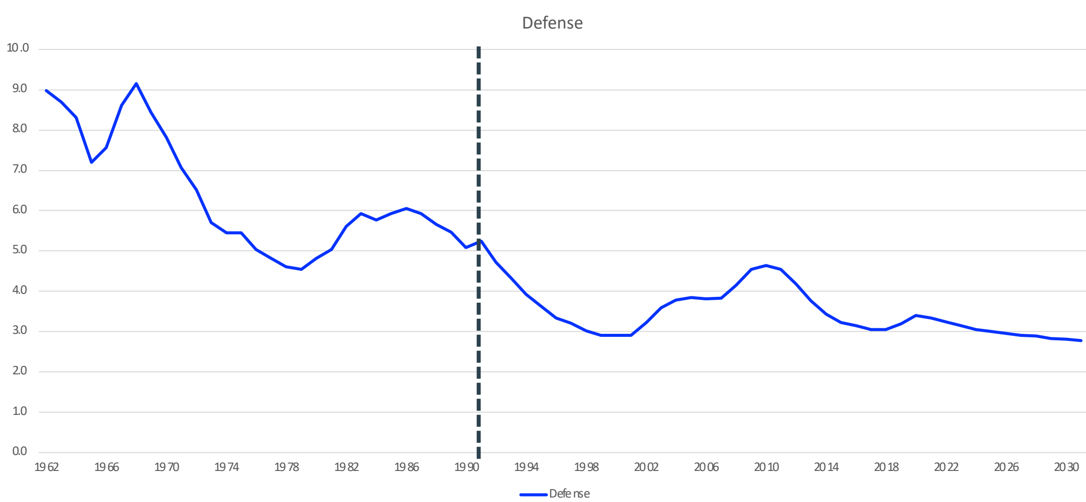
Discretionary Spending: Defense Spending



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Source: Congressional Budget Office (2017)

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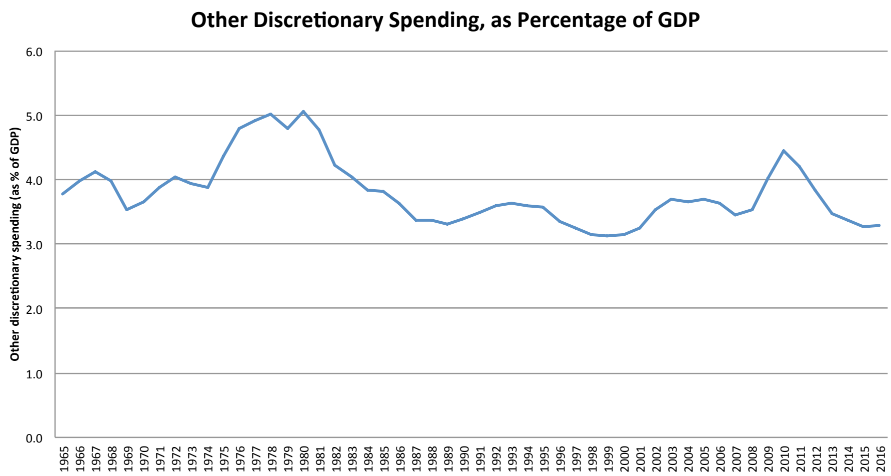
Discretionary Spending: Other



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Source: Congressional Budget Office (2017)

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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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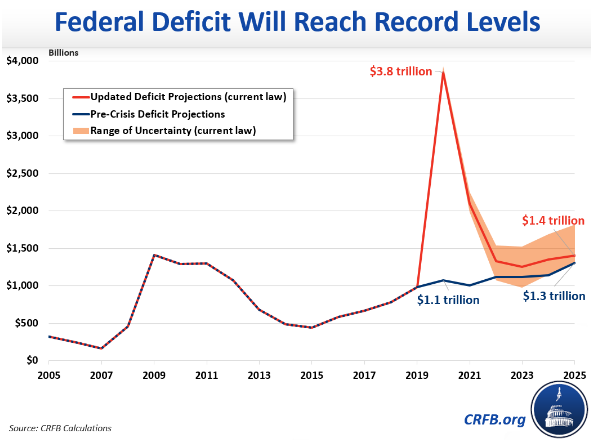
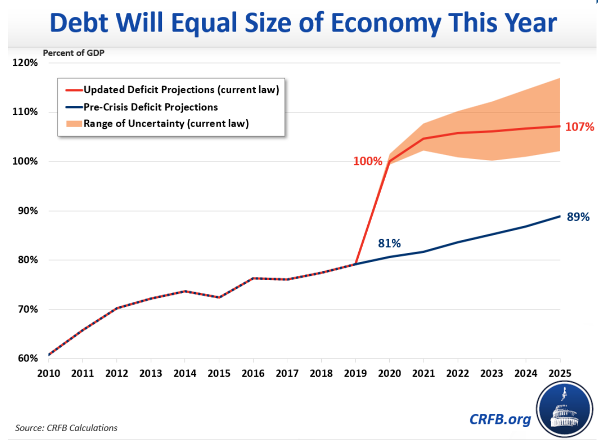
Very Large Deficit!





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https://www.crfb.org/blogs/budget-projections-debt-will-exceed-size-economy-year

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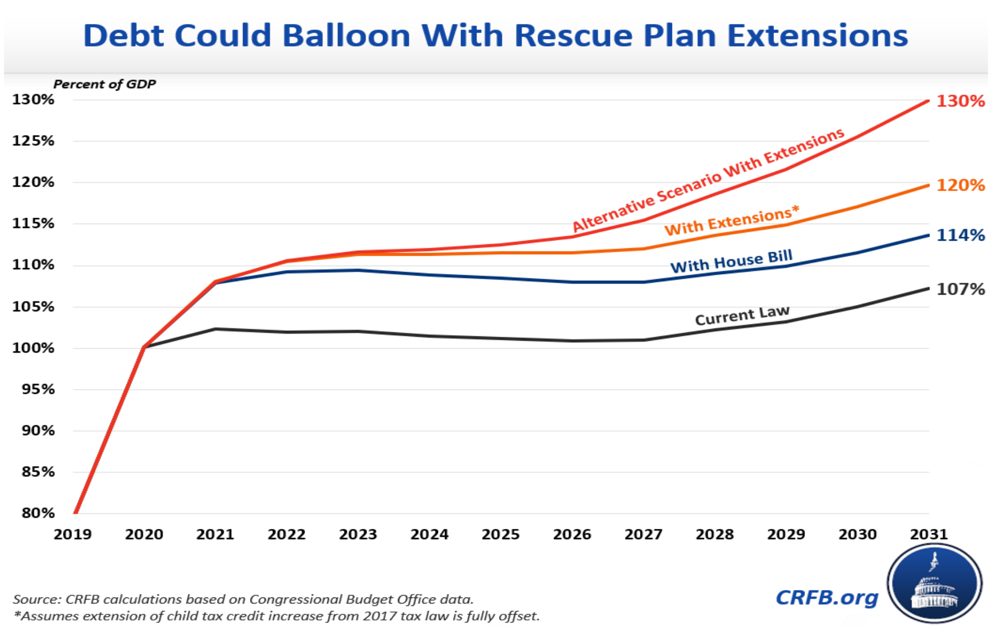

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How to Think About the Debt

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Perspectives on Increased Debt

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

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Not All Borrowing Is Bad!

- **Two good reasons to borrow:**
  1. During a temporary crisis
     1. Recession
     2. War
     3. Pandemic
  2. Productive public investment
     1. Infrastructure
     2. Education

- **These deficits do not permanently increase relative debt.**
  - Great Depression, WWII
  - Public investment expands GDP and tax revenue

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Is The Debt a Problem Today? (Pre-COVID 19)

- **Currently borrow about $100 billion each month with little difficulty.**
- **Very little evidence of ”crowding out.”**
- **Interest rates are very low, less than 1% on 10-year notes.**

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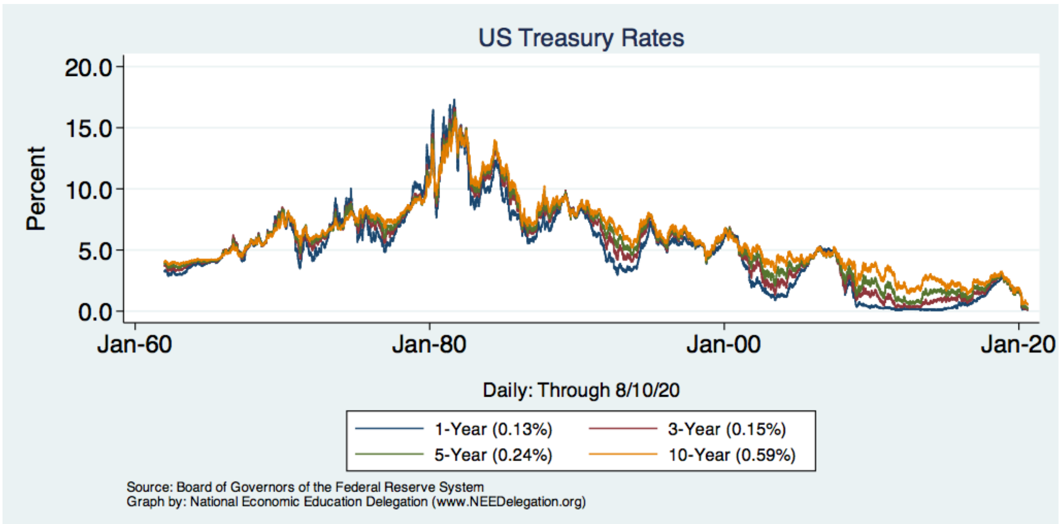
Interest Rates Are Historically Low



So, Why Worry About it?

- **If debt become too high:**
  - Investors might start questioning the creditworthiness of the US government.
    - Problem: Nobody knows how high is too high.
  - It becomes more difficult to borrow in times of crisis.
    - War, severe recession
    - "Fiscal space"
      - Impossible to measure how much we have.
      - Clearly, we have less now than in 2007.
  - Could start to crowd out investment by consumers and businesses.
    - Not currently a problem.
  - Could be inflationary.

So, Why Worry About It?

- **If debt continues to grow:**
  - Interest payments will grow with it.
    - 8% of spending in 2018.
    - 22% of spending in 2048.
    - Less room for using the budget for policy priorities.
    - 40% of payments go to other countries.
  - The longer we wait to address it, the harder and more disruptive addressing it will be.
  - Interest rates might increase.

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Inflation

Source: BLS

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Economists' Views on the Debt Evolve

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Traditional View: Four True Costs

- **Crowding out:**
  - The Treasury's borrowing needs compete with private borrowers, so debt and deficits raise interest rates.
- **Higher interest rates lead to foreign capital inflows or foreign borrowing.**
  - With foreign borrowing, some of the interest on the debt goes to foreign countries.
- **Larger primary surpluses are needed to stabilize the relative debt.**
  - The larger the relative debt, the bigger the needed primary surplus.
  - Thus, higher taxes or programmatic outlays must be reduced.
- **Government bias toward higher inflation**
  - GDP grows if either prices rise or real output rises.

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Source: CBO, Federal Debt: A Primer, March 2020 pp.24-5

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Maybe Debt Isn't a Problem After All: MMT

- **Stephanie Kelton provided a prominent and recent exposition of modern monetary theory in a *NY Times* op-ed on June 6, 2020:**
  - "Learn to Love Trillion-Dollar Deficits."
- **Modern monetary theory**
  - US Treasury borrows in its own currency and therefore cannot default.
    - As opposed to countries, such as Greece, which borrow in euros.
  - Example: How did we "find the money" for the recent increase in the deficit of about $1.9 trillion?
    - Answer: The Fed purchased $1.7 trillion = 89% of financing
  - More generally, MMT argues that we can always find the money to increase federal spending.

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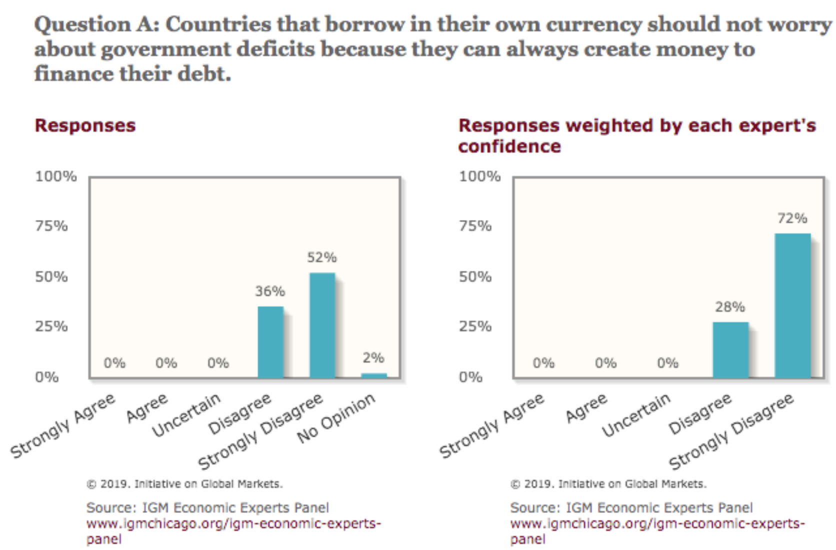
General Sense on Modern Monetary Theory



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The Key: Stabilization of Relative Debt

- **Stabilization of relative debt might forestall the consequences of chronic deficits.**
- **Problem: The US federal debt is in no way stable.**
- **W/O stability, interest rates might rise, causing crowding out of:**
  - policy priorities
  - domestic investment
- **Budget surpluses are not necessary, but budget control is.**

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What Is a Fiscal Crisis?

- **Increased perception of risk in government debt.**
- **Potential manifestations:**
  - Sudden major increase in interest rates
  - Plunging exchange rates
- **Why?**
  - Increased expectation of default
- **Potential results:**
  - Dramatic budget reforms may be quickly necessary to stave off actual default.
  - Recession from declines in:
    - investment (interest rates)
    - consumption (interest rates)
    - Government spending
  - Higher interest bill on existing debt

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Bottom Line: We Need to Worry about the Debt

1. Interest rates will not stay this low forever.
2. A fiscal crisis should be avoided at all costs.
3. Stabilizing relative debt would substantially reduce the possibility of a crisis.
4. The good news is we might be able to stabilize relative debt without a primary surplus.

But (after the pandemic is over) we must substantially reduce primary deficits.

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Major Takeaways: Talking Points

- The current trajectory of federal debt is unsustainable.
- Given the historically low interest rates, we can afford to wait until after the crisis to act.
  - How long will interest rates stay low?
- After the crisis, we must enact plans to reduce the future (primary) deficits.
  - These are driven by Medicare and Social Security spending.
- The longer we postpone action, the greater the probability of a "fiscal crisis."

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Takeways

- **After the pandemic, some combination of spending cuts and tax increases must be enacted.**
- **The particular combination of spending cuts and revenue increases is a political question.**
- **But high debt levels should not deter:**
  - Productive infrastructure investment.
  - Fiscal responses to crises.
- **Given the fiscal challenges of an aging population and climate change, it is better to do this sooner rather than later.**

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Fiscal Crisis, or a Run on the Dollar

- **With an exploding relative debt, what happens if foreigners lose confidence in the stability of the dollar?**
- **CBO (*Federal Debt: A Primer*, March 2020):**

  because the United States currently benefits from the dollar's position as the world's reserve currency and because the federal government borrows in dollars, a financial crisis—similar to those that befell Argentina, Greece, or Ireland—is less likely in the United States.

  Although no one can predict whether or when a fiscal crisis might occur or how it would unfold, the risk is almost certainly increased by high and rising federal debt.

- **Crises of confidence, in addition to being unpredictable, happen very quickly.**

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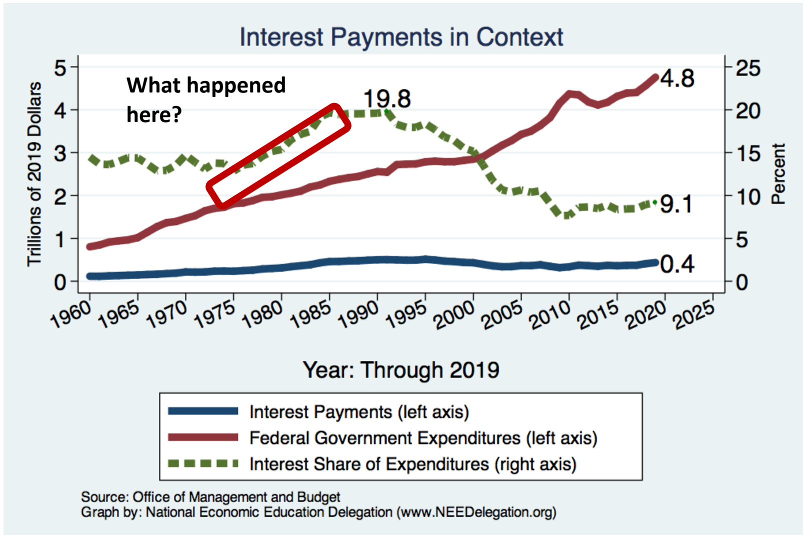
History: A Cautionary Tale of Interest Rates?



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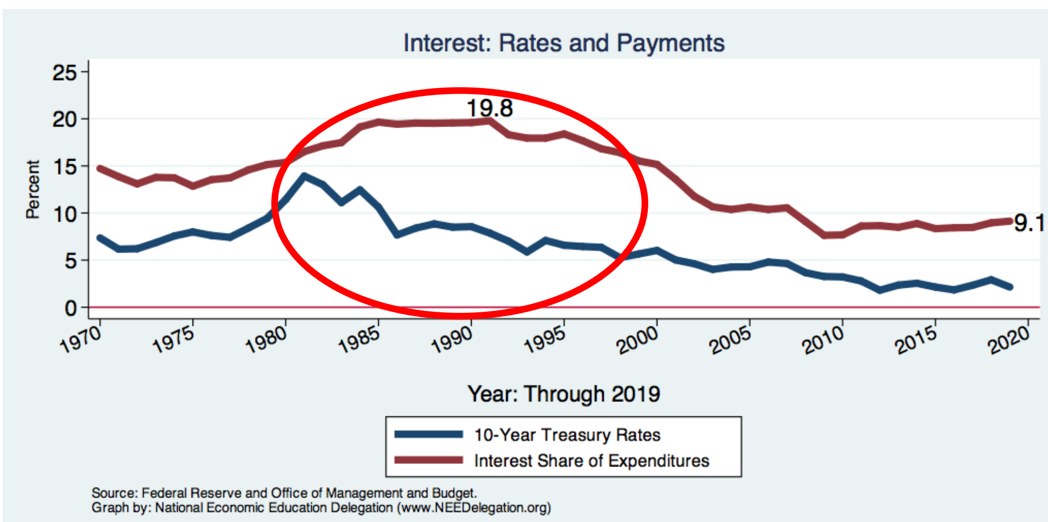
Interest Payments and Interest Rates



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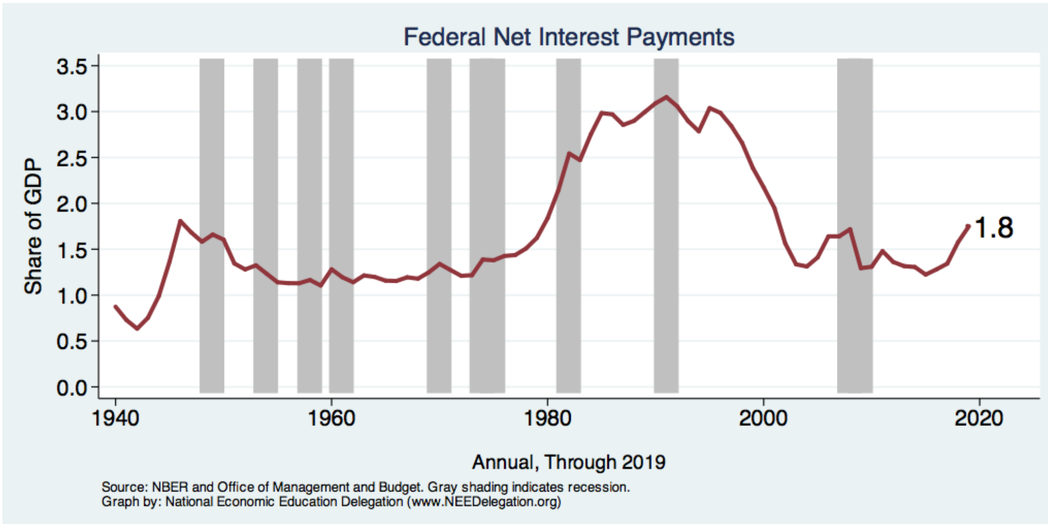
Rising Interest Expenses?



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Covid-19 Update

- **CBO projections (as of 4/24) :**
  - The 2020 federal ***deficit*** will rise from $1 trillion to $3.7 trillion.
  - ***Relative debt:*** will rise from 80 percent to 101 percent of GDP.
- **FY 2019–2020 ends September 30.**

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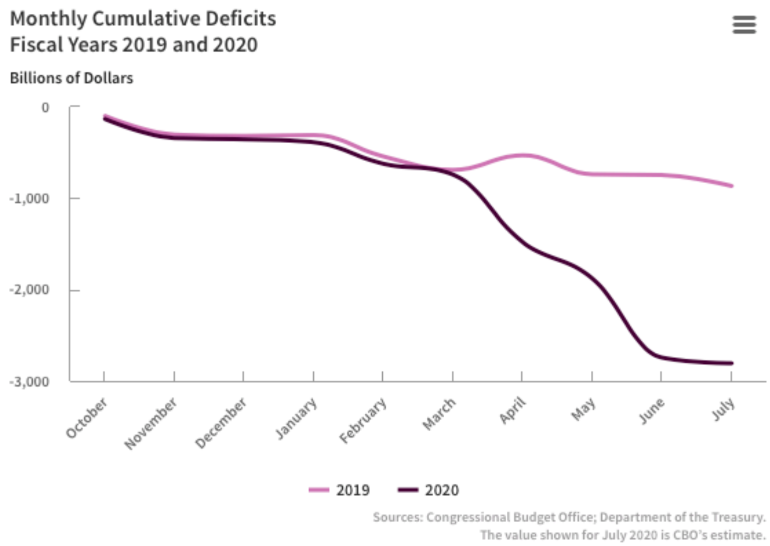
COVID-19's Impact on the Deficit – to July



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Source: https://www.cbo.gov/publication/56497

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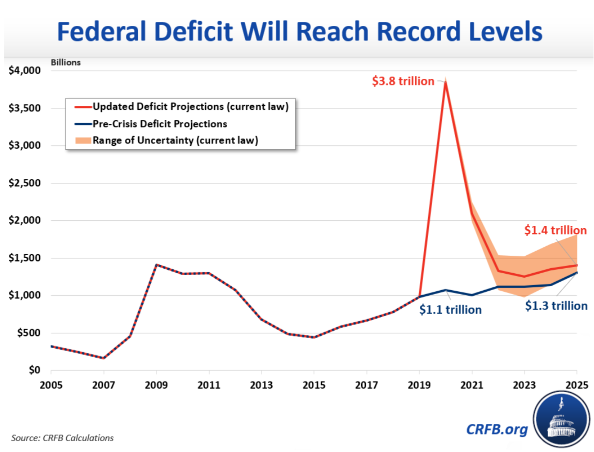
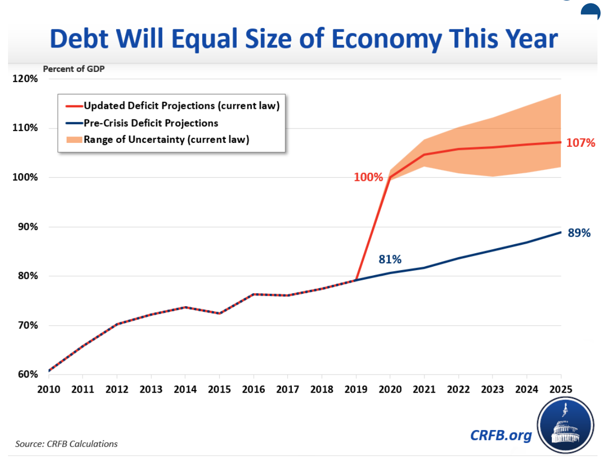
Very Large Deficit!





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https://www.crfb.org/blogs/budget-projections-debt-will-exceed-size-economy-year

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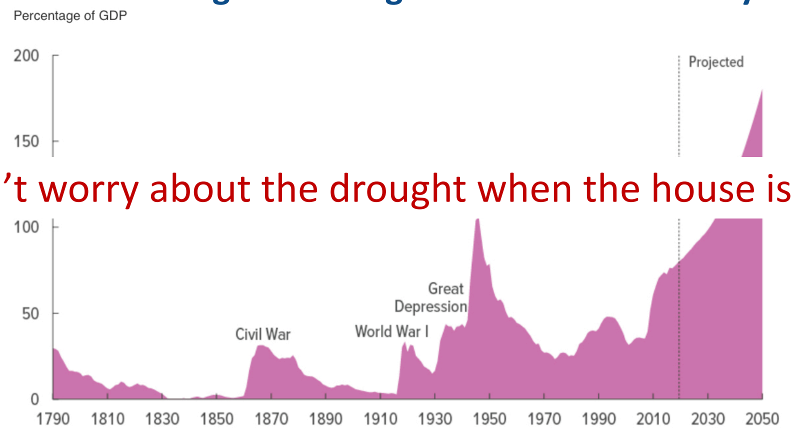
How Do We Pay for This?

- **Good News: Treasury interest rates are nearly 0.**
- **Bad News: The long-term budget outlook was already a mess.**



Don't worry about the drought when the house is on fire!

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CBO, "The Budget and Economic Outlook: 2020-2030," 1/2020

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Why Has the Federal Debt Risen So Much?

- **Expenditures:**
  - Social Security
  - Health-care costs
  - Economic stimulus
    - In particular, during the Great Recession.
  - Military engagements overseas
- **Revenues**
  - Declining income tax revenues
    - Stagnant wages
    - Tax cuts
  - Social security
    - Declining revenues
  - Corporate income taxes

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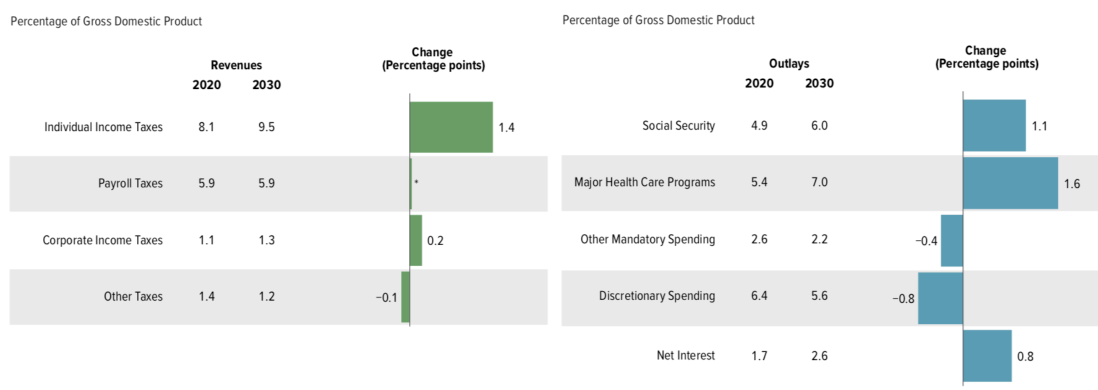
Growth in Outlays Exceeds Revenue



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Budget Consequences of an Aging Population

Contributions to the Federal Deficit: % of GDP

	2020	2031–2040	Change
Social Security	-0.4	-1.7	-1.3
Medicare	-1.7	-3.4	-1.7
Other	-2.5	-1.9	+0.6
Deficit	**-4.6**	**-7.0**	**-2.4**

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Bottom-Line Takeaways

- Herb Stein, an expert on fiscal policy and the chairman of the Council of Economic Advisors under Richard Nixon, is famous for observing: "If something cannot go on forever, it will stop." A rising and accelerating ratio of debt to GDP cannot go on forever.
- We have a choice largely between:
  1. Fiscal crisis.
  2. Reductions in the primary deficit.

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OK: Relative Debt Cannot Grow Forever, But

- Does it matter at what level we stabilize relative debt?
- Relative debt stops growing:
  - when the growth of debt is less the growth in GDP (on average).
- Arithmetic: growth rate of the debt equals the interest rate plus the effect of the primary surplus or deficit.
- The bigger the relative debt, the smaller the effect of the primary surplus or deficit.

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CBO on the Possibility of a Fiscal Crisis

- Moreover,
  - because the United States currently benefits from the dollar's position as the world's reserve currency and
  - because the federal government borrows in dollars,
  - a financial crisis—similar to those that befell Argentina, Greece, or Ireland—is less likely in the United States.
- Although no one can predict whether or when a fiscal crisis might occur or how it would unfold, the risk is almost certainly increased by high and rising debt.

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Source: CBO – Federal Debt: A Primer, March 2020

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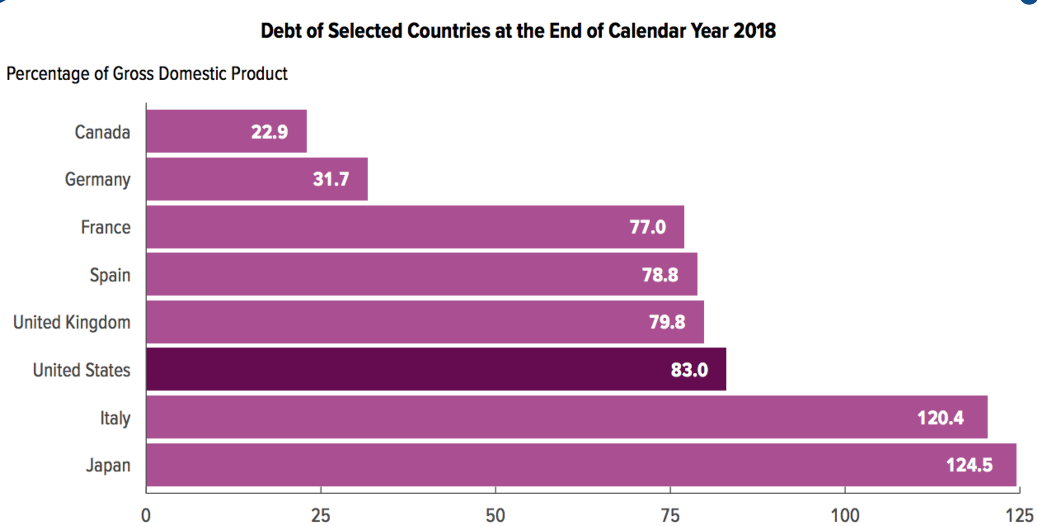
Other Countries Have Higher Debt Levels



Source: Congressional Budget Office, using data from the Organisation for Economic Co-operation and Development.

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Takeways (Continued)

- **After the virus is defeated, some combination of spending cuts and tax increases must be enacted.**
- **The particular combination of spending cuts and revenue increases is a political question.**
- **But high debt levels should not deter:**
  - Productive infrastructure investment.
  - Fiscal responses to crises.
- **Given the fiscal challenges of an aging population and climate change, it is better to do this sooner rather than later.**

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Bottom Line

- Question is not ***WHETHER*** the US 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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Are There Reasons to Wait?

- **Very little evidence of:**
  - Crowding out
  - Inflationary impact
- **Uncertainty about the future**
  - Economic growth might render action today unnecessary.
- **There are a great many investments to be made by the govt.**
  - Infrastructure
  - Education
  - Much, much more …

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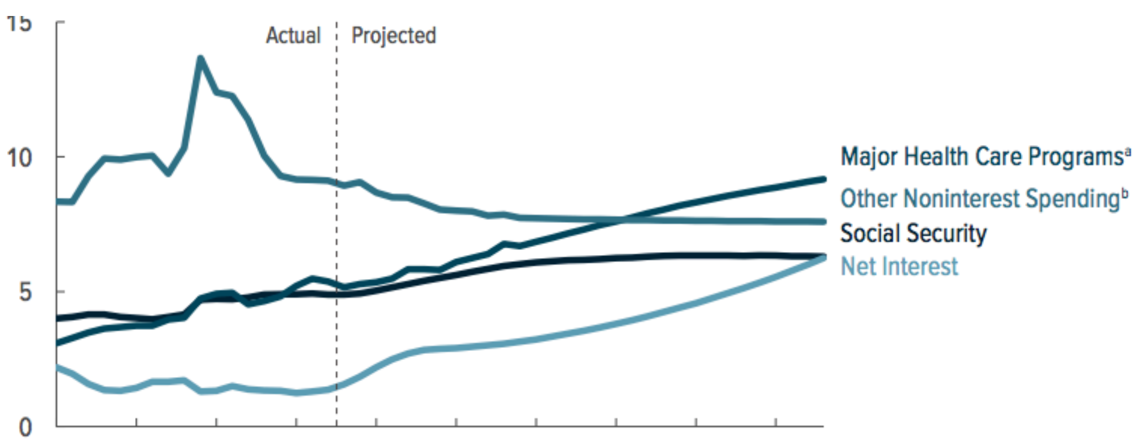
What Are the Primary Drivers Going Forward?



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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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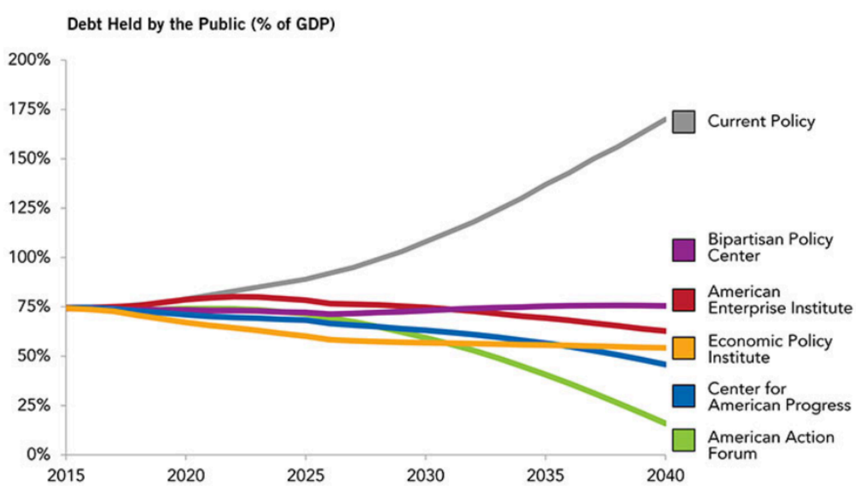
PETER G. PETERSON FOUNDATION

Solutions Initiative III: Projected Federal Debt through 2040



SOURCE: Peter G. Peterson Foundation, *Solutions Initiative III*, May 2015. See pgpf.org/solutions-initiative-iii for more details.
NOTE: Current policy is defined as the alternative fiscal scenario without economic feedback from CBO's *2014 Long-Term Budget Outlook*.

PGPF.ORG

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There Are Other (Bad/Costly) Solutions

- **Financial repression**
  - Using regulation to force down interest rates.
- **Paying the interest by printing money.**
  - Risks inflation, hyper or otherwise.
- **Or defaulting on the debt.**
  - This will forever raise the cost of government borrowing.

Summary: The Debt

- **The jury is (sort of) out on the debt.**
- **Conventional wisdom is being challenged:**
  - Previously: inflationary and crowd out private investment
  - New assertion: these things don't matter for a country that can borrow in its own currency.
- **Upshot?**
  - This is a policy choice.
  - The cautious approach is to rein in the debt.
  - The cautious approach may lead to slower economic growth.

Summary

- **Debt: $22.9 Trillion**
  - Relative debt: 107% of GDP
  - Publicly held debt: 79% of GDP
- **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 180% in 2049 – pre-COVID-19 estimates.
  - Could exceed 100% of GDP by the end of 2020 and 200% by 2050.
- **Multiple ways to offset this growth.**
- **Growing interest payments can constrain budgets.**

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Summary: Address the Debt?

- **Risks:**
  - Inflation
  - Slower economic growth
    - Higher interest rates
    - Crowding out
  - Default
- **Reasons to wait:**
  - Interest rates are very low
  - Lots of important investments to make
  - Economic growth may take care of it

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Bottom-Line Takeaways

- **Relative debt must be stabilized, so it is imperative to reduce primary deficits after the virus has been defeated.**
- **Given the fiscal challenges of an aging population and climate change, it is better to do this sooner rather than later.**
- **But high debt levels should not deter:**
  - Productive infrastructure investment.
  - Fiscal responses to crises:
    - "When the house is on fire, you don't worry about being in a drought; you just put it out."

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Major Takeaways: Talking Points

- **The current trajectory for the federal debt is unsustainable.**
- **Given historically low interest rates, we can afford to wait until after the crisis to act.**
- **After the crisis, we must enact plans to reduce the future (primary) deficits.**
  - These are driven by Medicare and Social Security spending.
- **The longer we postpone action, the greater the probability of a "fiscal crisis."**

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Who Are We?

- **Honorary Board: 48 members**
  - 2 Fed chairs: Janet Yellen, Ben Bernanke
  - 6 chairs of the Council of Economic Advisers
    - Furman (D), Rosen (R), Bernanke (R), Yellen (D), Tyson (D), Goolsbee (D)
  - 3 Nobel Prize-winners
    - Akerlof, Smith, Maskin
- **Delegates: 500+ members**
  - At all levels of academia and some in government service
  - All have a PhD in economics
  - Crowdsource slide decks
  - Give presentations
- **Global Partners: 45 PhD Economists**
  - Aid in slide deck development

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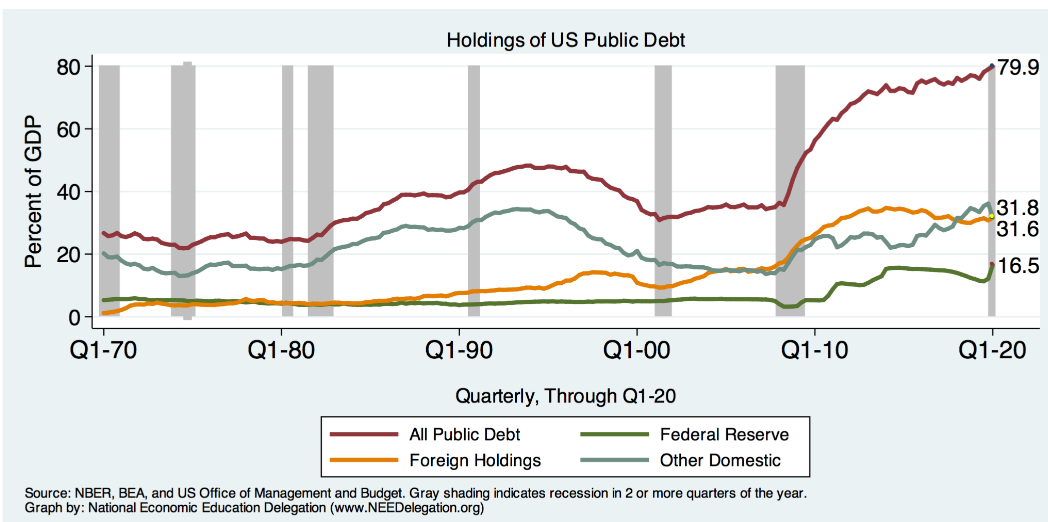
Summary: Who Holds US Public Debt?



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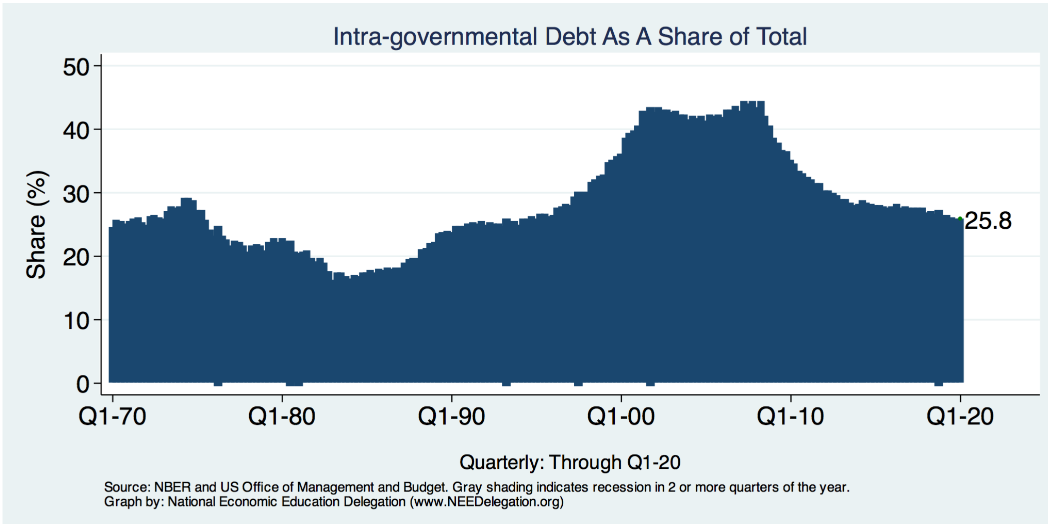
Trends in Intragovernment Debt



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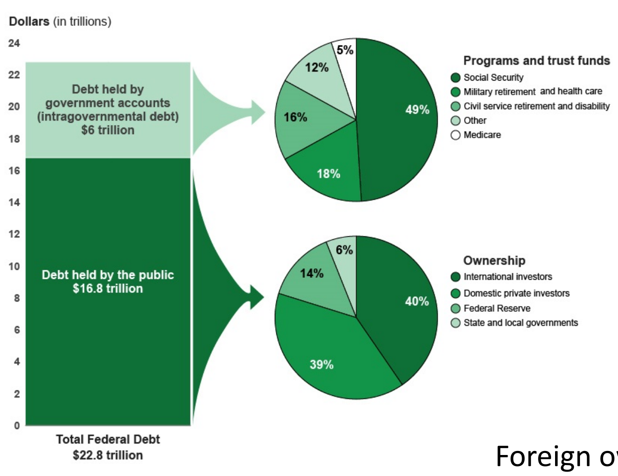
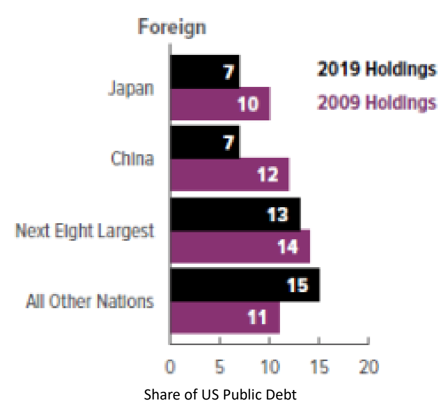
A Breakdown of Total Federal Debt





Foreign ownership is relatively recent – in 1990 foreign ownership was less than 20%

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https://www.gao.gov/americas_fiscal_future?t=federal_debt

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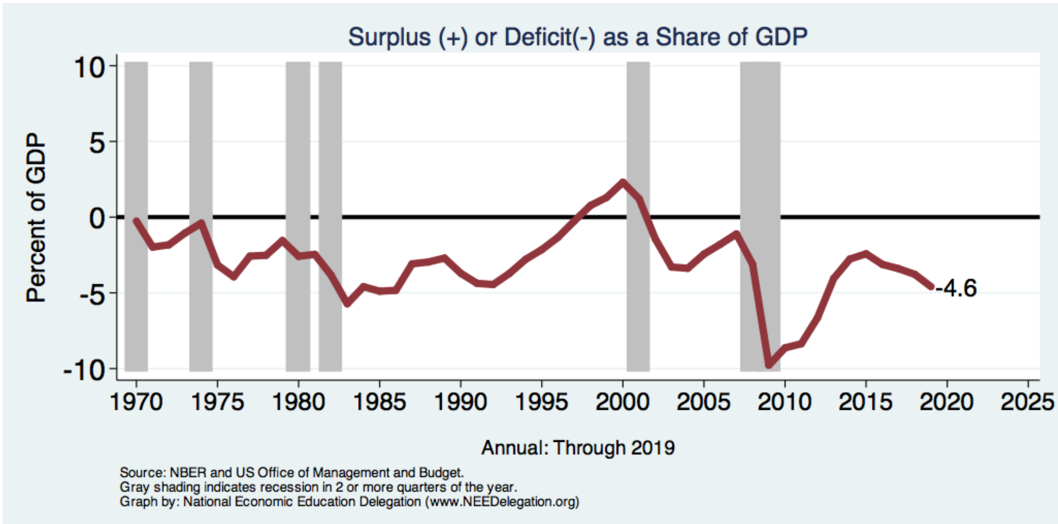
Deficits and Recessions



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Reagan's Experiment in Supply-Side Economics

- **Tax cuts were supposed to be "investments."**
  - Lower marginal tax rates, and people will work more/harder and save.
  - Higher GDP will raise tax revenue to pay for the deficit.
- **Sadly, in 1981-89, debt rises from 25% to 40%.**
  - For the first time, relative debt rises during a non-recessionary peacetime.
  - Reignites concern about debt and deficits.
- **Failed experiment?**

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Traditional View: Cost 1

- **Rising debt reduces investment.**
  - Deficits and debt raise aggregate demand.
    - Direct government spending.
    - Lower taxes lead households to spend more.
  - To offset this increase in demand, the Fed has to raise interest rates, reducing investment and future GDP.
  - By causing interest rates to rise:
    - debt and deficits *"crowd out" investment*.

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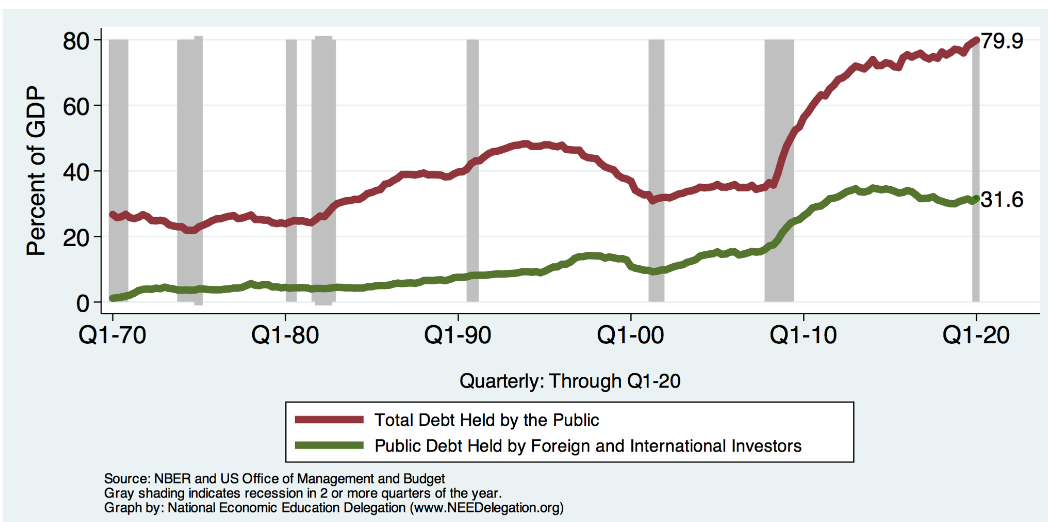
The International Appetite for US Treasuries



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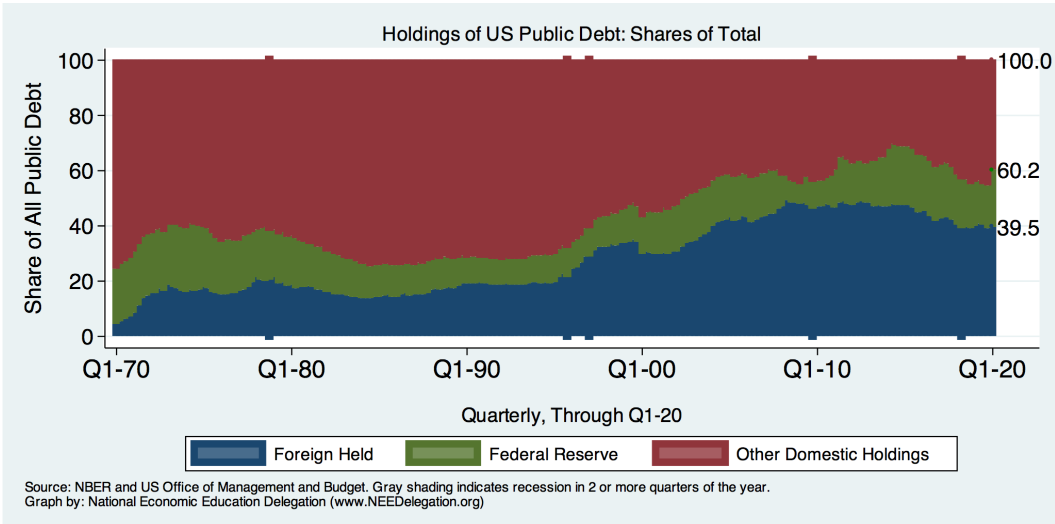
The International Appetite for US Treasuries



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2005: The International Dimension to Debt

- **Interest on foreign-held debt reduces US residents' welfare.**
  - Interest payments go to other countries.
- **When the Fed raises interest rates, the exchange rate of the dollar rises, causing:**
  1. Increases in the trade deficit
  2. Foreign borrowing.
- **Sharp increases in interest rates and the cost of imports raises the possibility of a fiscal crisis or a "run on the dollar."**

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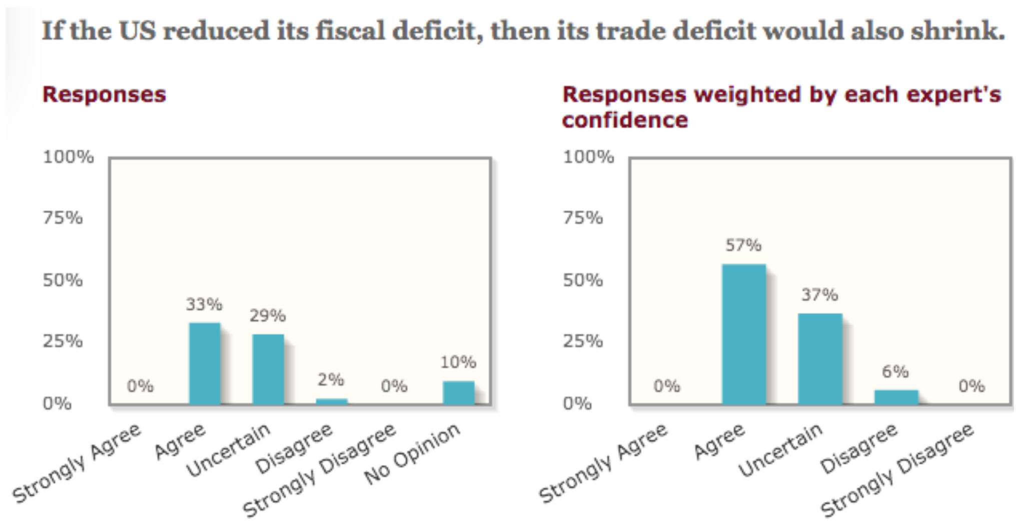
General Agreement Among Economists



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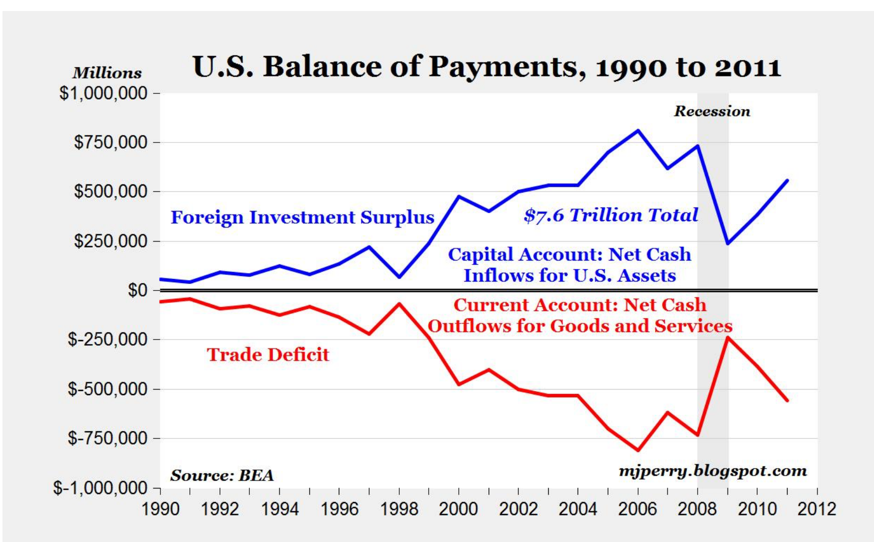
Trade and Investment Flows Balance Out



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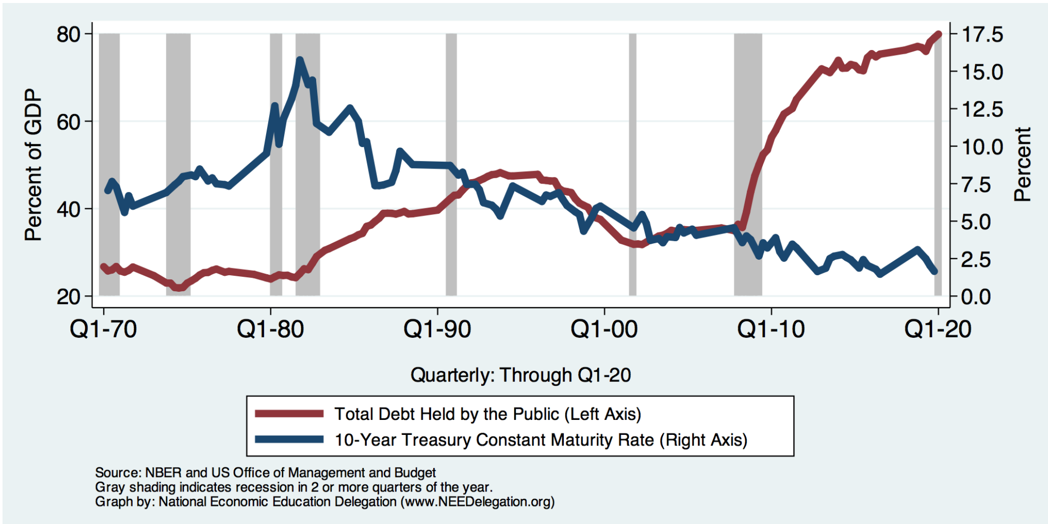
Costs 1–2: The Dog That Didn't Bark



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Traditional View: Cost 3

- **Rising debt reduces budgetary options.**
  - More debt means higher interest costs.
  - Therefore, greater relative debt:
    - requires a bigger primary surplus to stabilize the relative debt.
  - Larger primary surplus means either higher tax rates or less government spending:
    - *"crowding out" of outlays and/or tax cuts.*

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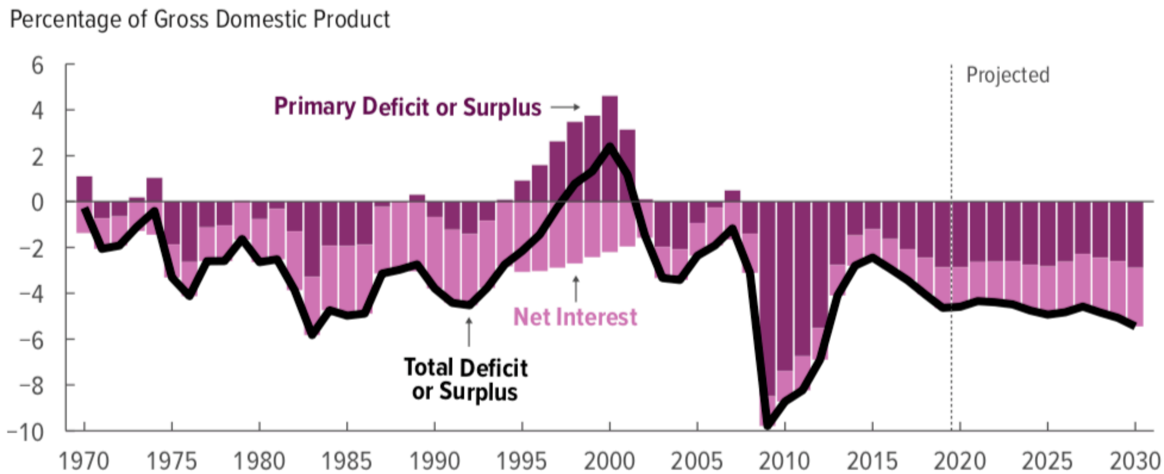
Cost 3: No Primary Surplus Since 2007!



This graph was done before Covid-19

Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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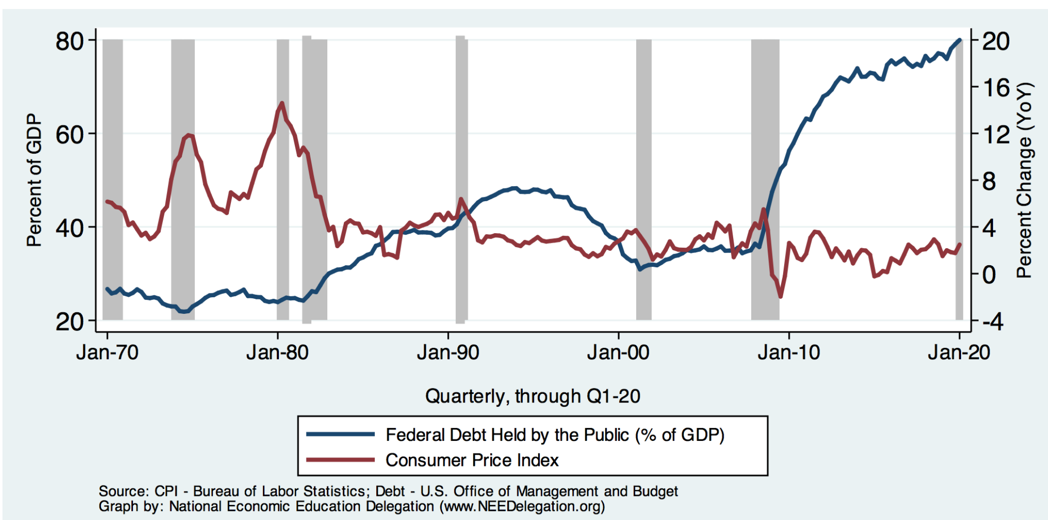
Cost 4: Anybody See Any Inflation?



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MMT's Free Lunch

- **The only limit on deficit spending is when it leads to too much spending, thereby increasing current inflation.**
- **Recognizing this fact, "could free policymakers not only to act boldly amid crises but also to invest boldly in times of more stability."**
  - First part, acting boldly, is important and likely true.
  - Second part, invest boldly, is suspect.

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A More Reasonable, But Still Optimistic View

Olivier Blanchard:

- Emeritus Professor at MIT
- Chief Economist at the IMF, 2008–2015
- President of the American Economic Association, 2018

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AEA Presidential Address, January 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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An Almost Free Lunch

- **If the interest rate is *less* than the growth rate of GDP, then the contribution from the primary budget can be positive, or**
- **Debt to GDP can be stabilized with a (small) primary *deficit*.**
- **Blanchard is not MMT (when the crisis is over)**
  1. Relative debt must be stabilized.
  2. Primary deficit must be reduced.
  3. But the level of debt at which we stabilize may not be crucial.

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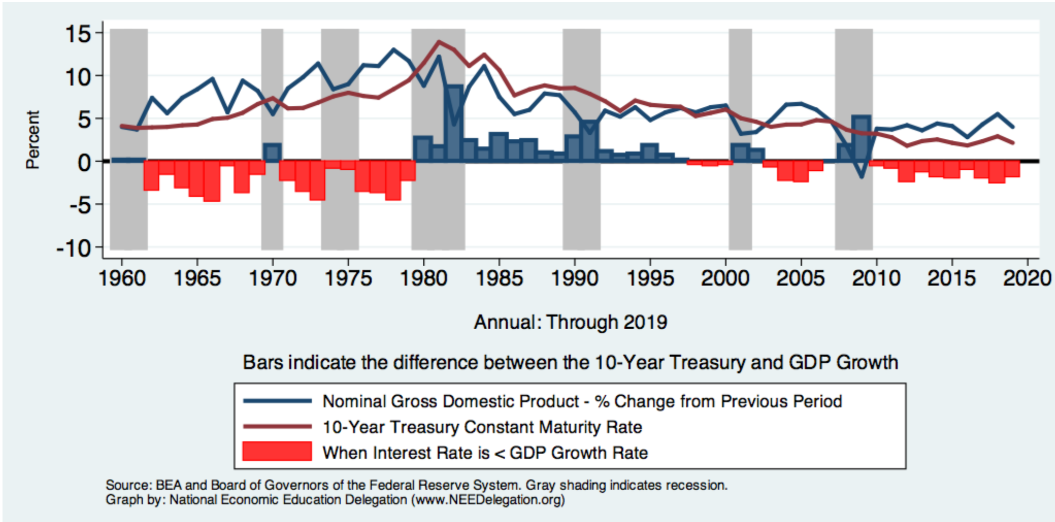
Evidence?



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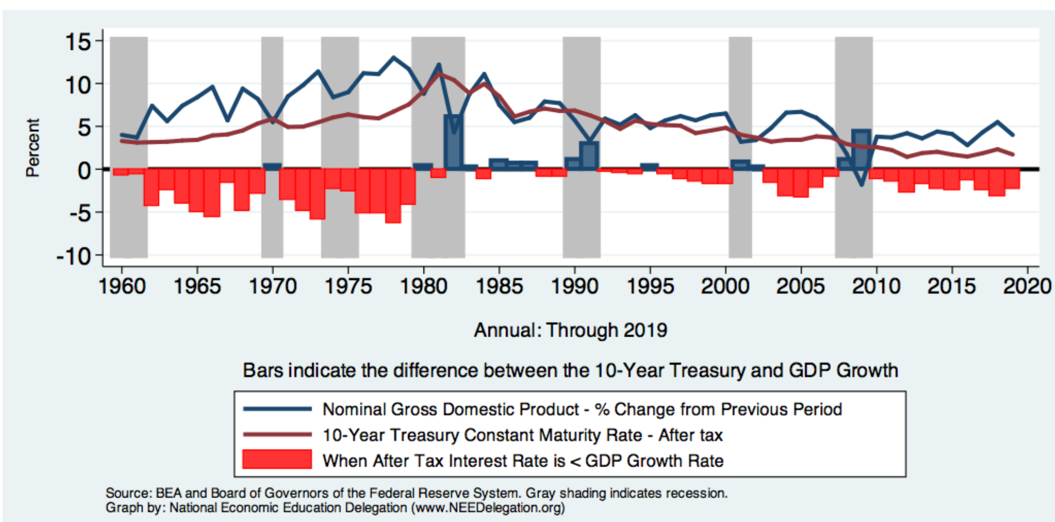
But Interest on the Debt Is Taxable



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Thank you!

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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: HR 6036 VA Family Leave Act of 2020
  - Projections of Debt and Deficits: The Budget and Economic Outlook, 2020 to 2030

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