Osher Lifelong Learning Institute, Fall 2023

Contemporary Economic Policy

Santa Clara University, CA
Sep-Oct, 2023

Jon Haveman, Ph.D.
National Economic Education Delegation

NATIONAL ECONOMIC EDUCATION DELEGATION

1

1

Available NEED Topics Include:

- US Economy
- Healthcare Economics
- 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
- Healthcare Economics

NATIONAL ECONOMIC EDUCATION DELEGATION

2

2

Course Outline

- **Contemporary Economic Policy**
  - Week 1 (9/21): US Economic Update (Jon Haveman, NEED)
  - Week 2 (9/28): US Federal Budget (Jon Haveman)
  - Week 3 (10/5): Monetary Policy (Geoffrey Woglom, Amherst College)
  - **Week 4 (10/12): Federal Debt (Jon Haveman)**

NATIONAL ECONOMIC EDUCATION DELEGATION

3

3

The US Federal Debt

OLLI – Santa Clara University
October 12, 2023

Jon Haveman, Ph.D.
NEED

NATIONAL ECONOMIC EDUCATION DELEGATION

4

4

Credits and Disclaimer

- **This slide deck was created by:**
  - Jon Haveman, Executive Director, NEED
  - Geoffrey Woglom, Amherst College, Emeritus
- **This slide deck was reviewed by:**
  - Olivier Blanchard, Brookings Institution
- **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).

Outline

- **First: A Budget Review**
- **And Now: The Debt**
- **Important Points About the Debt**
- **How to Think About the Debt**
- **Summary**

First: A Budget Review

NATIONAL ECONOMIC EDUCATION DELEGATION

7

7

What Does the US Govt. Budget Look Like?

2022 Budget Summary (in billions)

Revenue			Outlays	
Income Taxes	$2,632		Mandatory	$4,134
Payroll Taxes	$1,484		Discretionary	$1,661
Corporate Taxes	$425		Interest	$475
Other	$356			
Total	$4,897		Total	$6,270

Budget Deficit: $1,373 Billion

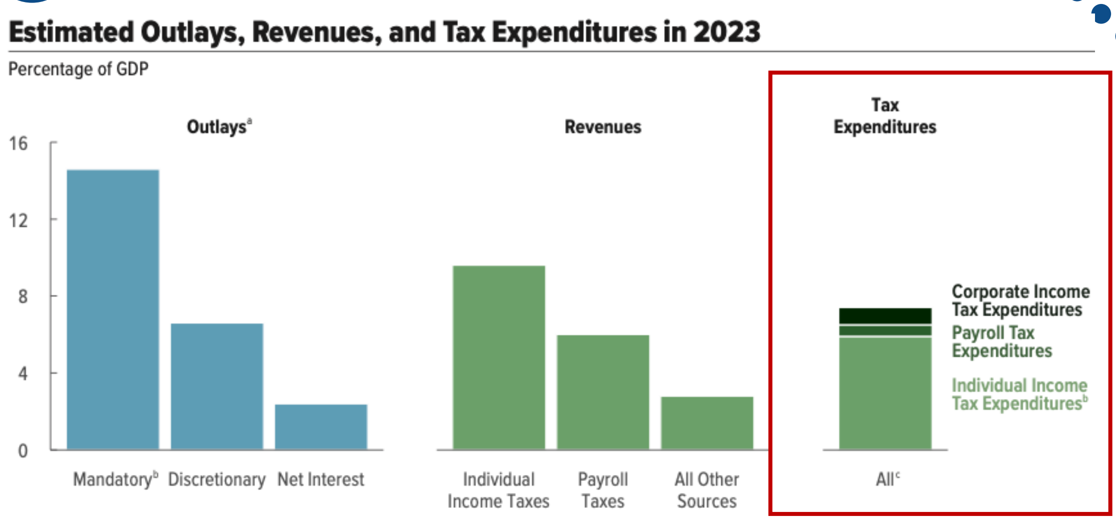
NATIONAL ECONOMIC EDUCATION DELEGATION

8

https://www.cbo.gov/publication/58888

8

But There is More to The Budget!



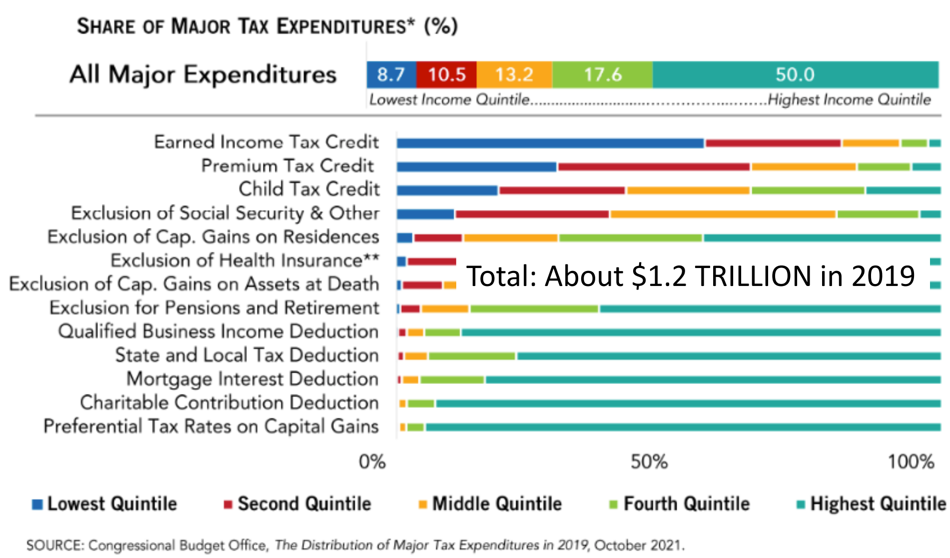
NATIONAL ECONOMIC EDUCATION DELEGATION

9

Source: https://www.cbo.gov/system/files/2023-02/58848-Outlook.pdf

9

What Are Tax Expenditures?



NATIONAL ECONOMIC EDUCATION DELEGATION

10

Source: https://www.pgpf.org/Chart-Archive/0199_distribution_tax_expenditures

10

And Now: The Debt

NATIONAL ECONOMIC
EDUCATION DELEGATION

11

11

WHAT IS THE NATIONAL DEBT TODAY?

$33,511,725,769,188

NATIONAL ECONOMIC
EDUCATION DELEGATION

12

12

Of Debt, Deficits, and Surpluses

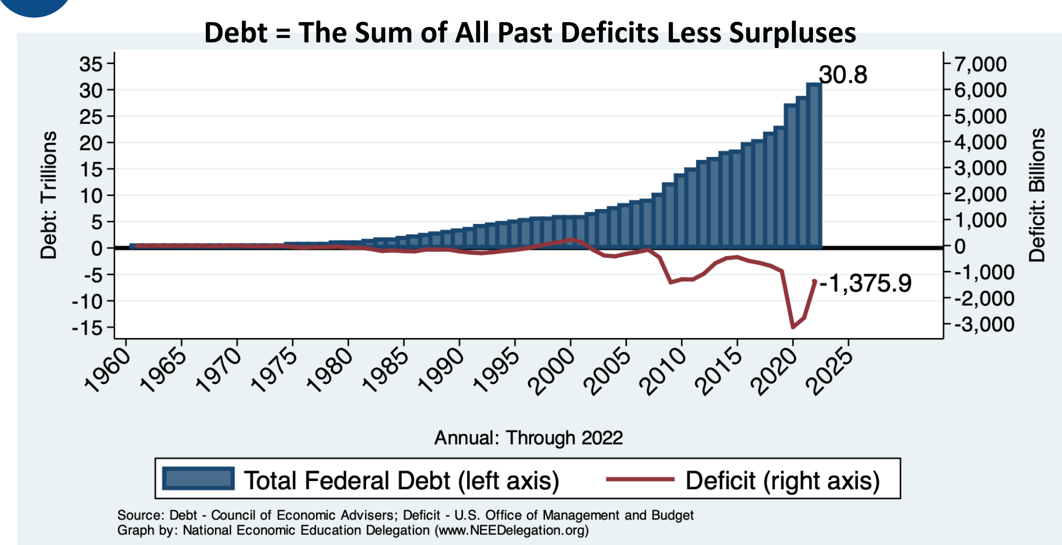
- **FLOW**
  - ***Deficit***: The excess of outlays over revenues in a year.
  - ***Surplus***: The excess of revenues over outlays in a year.
- **STOCK**
  - ***Debt***: The accumulation of debt over time.
    - The sum of all past deficits and surpluses.

NATIONAL ECONOMIC EDUCATION DELEGATION

13

13

Debt vs. Deficit



NATIONAL ECONOMIC EDUCATION DELEGATION

14

14

Major Takeaways: Talking Points

- **The debt is not currently a significant problem.**
- **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.**~~
- **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."**

NATIONAL ECONOMIC EDUCATION DELEGATION

15

15

How Does the US Government Borrow?

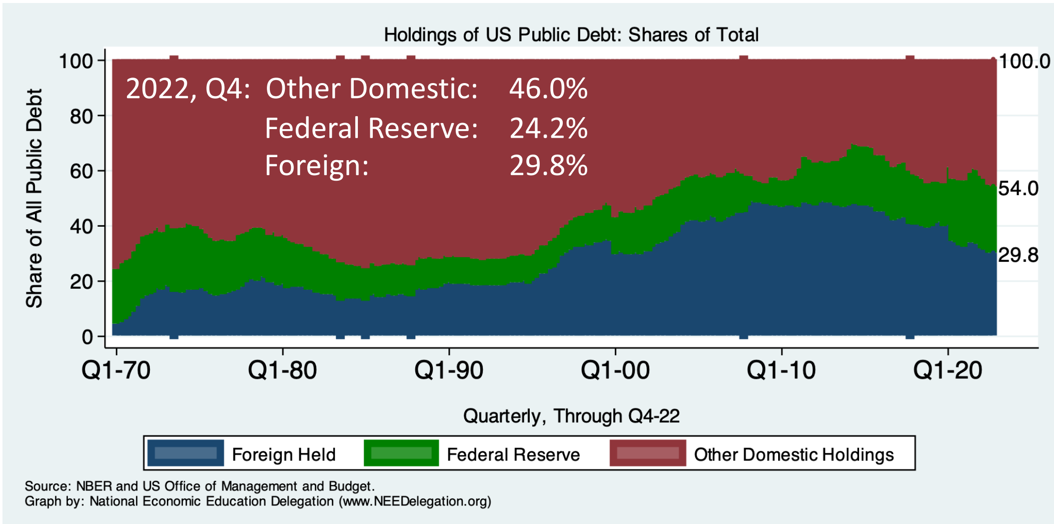
- **It issues debt.**
  - Treasury marketable securities:
    - Treasury bills, notes, and bonds
    - TIPS: Treasury inflation-protected securities
    - Savings bonds
- **Who buys the debt?**
  - Other federal agencies
  - Individuals and businesses
  - State and local governments
  - Foreign government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

NATIONAL ECONOMIC EDUCATION DELEGATION

16

16

Trends in US Debt Holdings Over Time

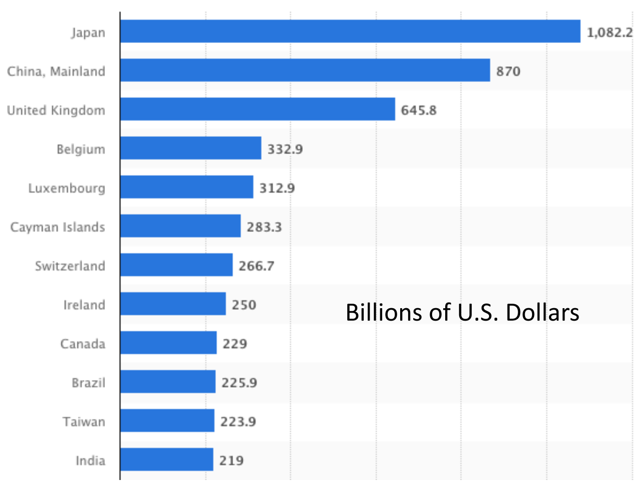


NATIONAL ECONOMIC EDUCATION DELEGATION

17

17

Who Holds Debt to Foreigners, 11/22



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

NATIONAL ECONOMIC EDUCATION DELEGATION

18

Source: https://www.statista.com/statistics/246420/major-foreign-holders-of-us-treasury-debt/

18

Why Do Foreign Investors Buy US Treasuries?

- **Market for Treasuries is the deepest, most liquid capital market in the world.**
- **The US economy has a history of political and economic stability.**
- **The dollar is the largest international reserve currency.**
  - Most trade transactions (e.g., oil) are quoted in dollars.
  - With some exceptions, foreign citizens borrow in dollars.

NATIONAL ECONOMIC EDUCATION DELEGATION

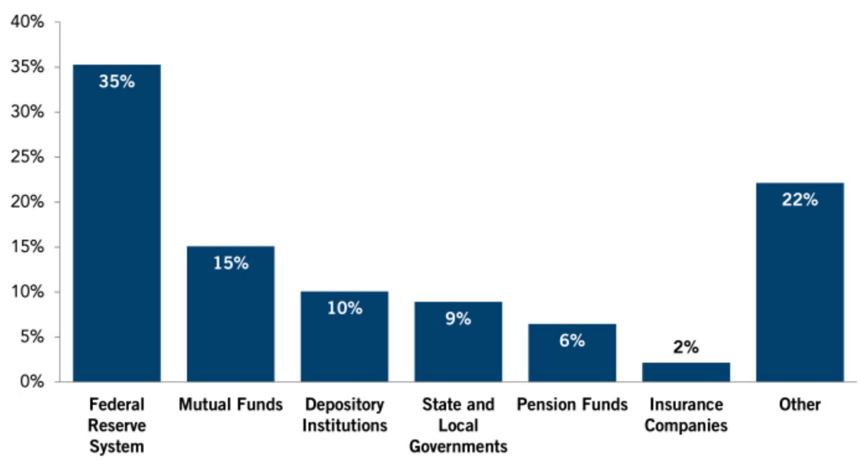
19

19

PETER G. PETERSON FOUNDATION

The Federal Reserve owns about 40 percent of domestically held debt

Percent of Debt Held by the Public Owned by Domestic Creditors



SOURCE: U.S. Department of the Treasury, *Treasury Bulletin*, March 2023.
NOTES: Data are through September 2022. The Other category is made up of U.S. Savings Bonds and Other Investors.

PGPF.ORG

NATIONAL ECONOMIC EDUCATION DELEGATION

20

20

Important Points:

- Not all debt is created equal.
- What is the right measure of the debt?

NATIONAL ECONOMIC EDUCATION DELEGATION

21

21

Not All Debt Is Created Equal

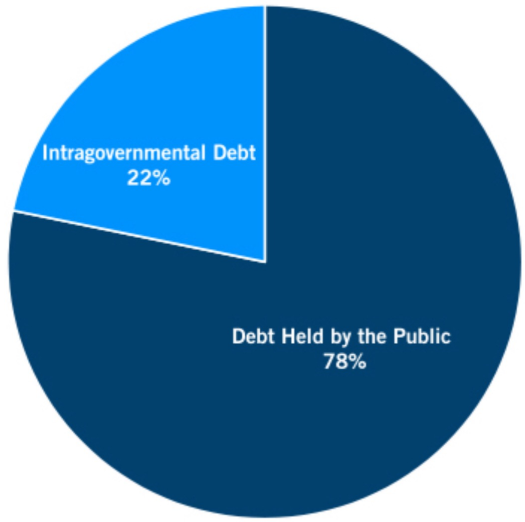
- **Some debt can reduce the availability of investment funds to other borrowers.**
  - Often referred to as "crowding out" private investment.
- **Intragovernmental debt is (important) bookkeeping.**
  - This debt **DOES NOT** crowd out private investment.
- **Debt held by the public.**
  - This debt **MIGHT** crowd out private investment.
- **Most analyses of debt focus on federal debt held by the public.**

NATIONAL ECONOMIC EDUCATION DELEGATION

22

22

U.S. Publicly Held Debt, December 31, 2022



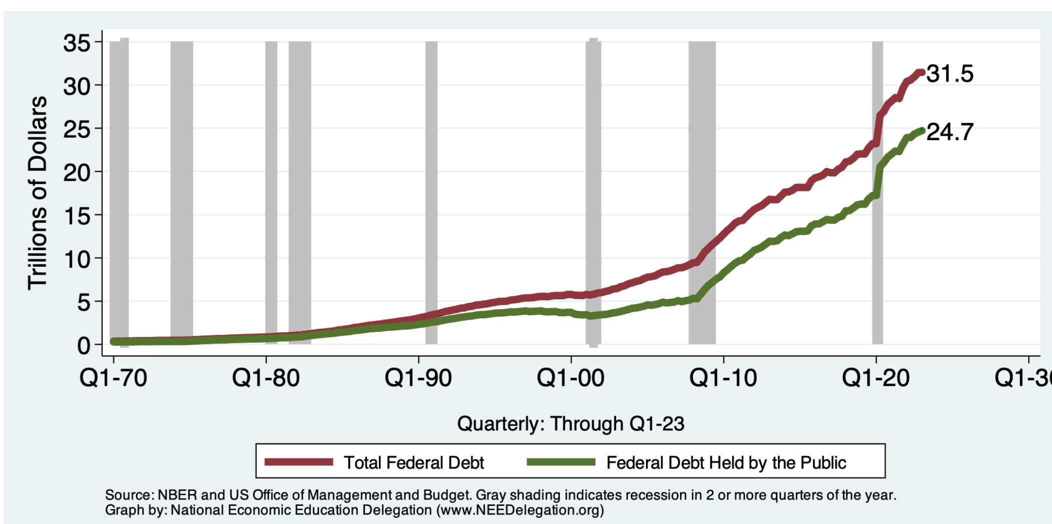
NATIONAL ECONOMIC EDUCATION DELEGATION

23

Source: PGPF.org

23

Two Measures of the Debt

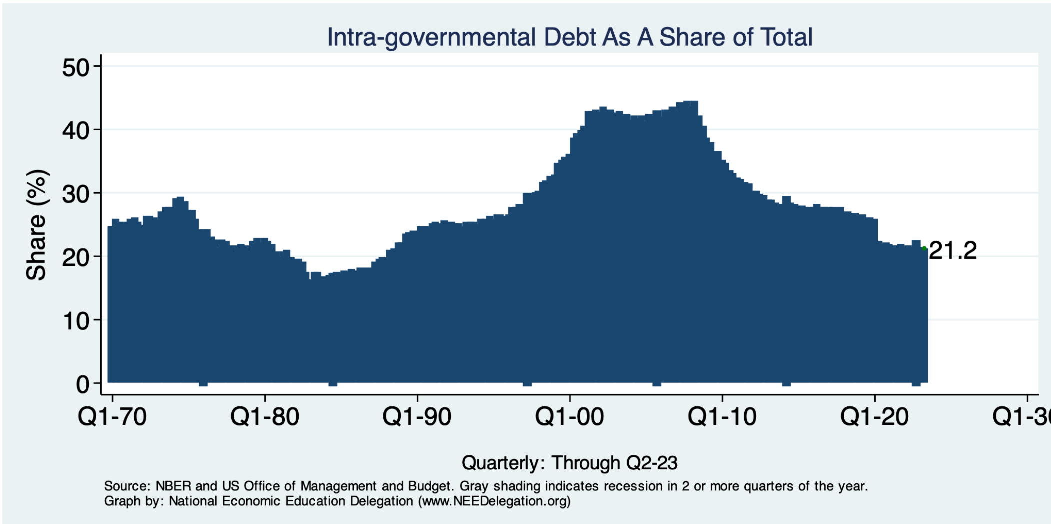


NATIONAL ECONOMIC EDUCATION DELEGATION

24

24

Trends in Intragovernmental Debt

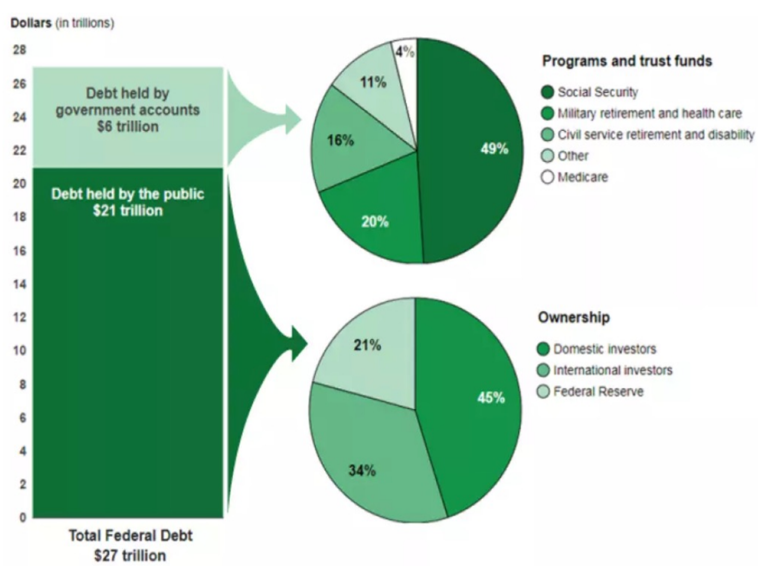


NATIONAL ECONOMIC EDUCATION DELEGATION

25

25

A Breakdown of Total Federal Debt, 2020



NATIONAL ECONOMIC EDUCATION DELEGATION

26

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

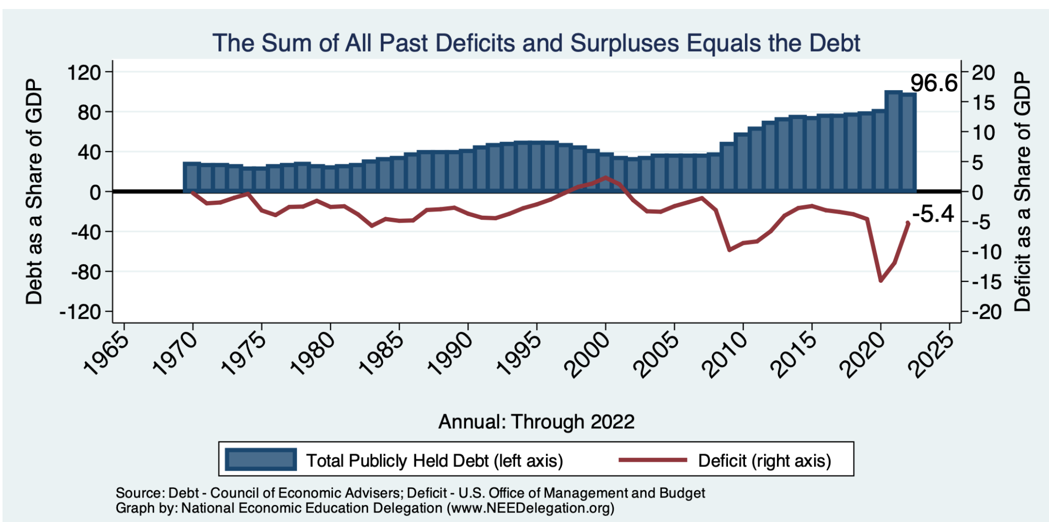
26

The All-Important *Relative* Debt

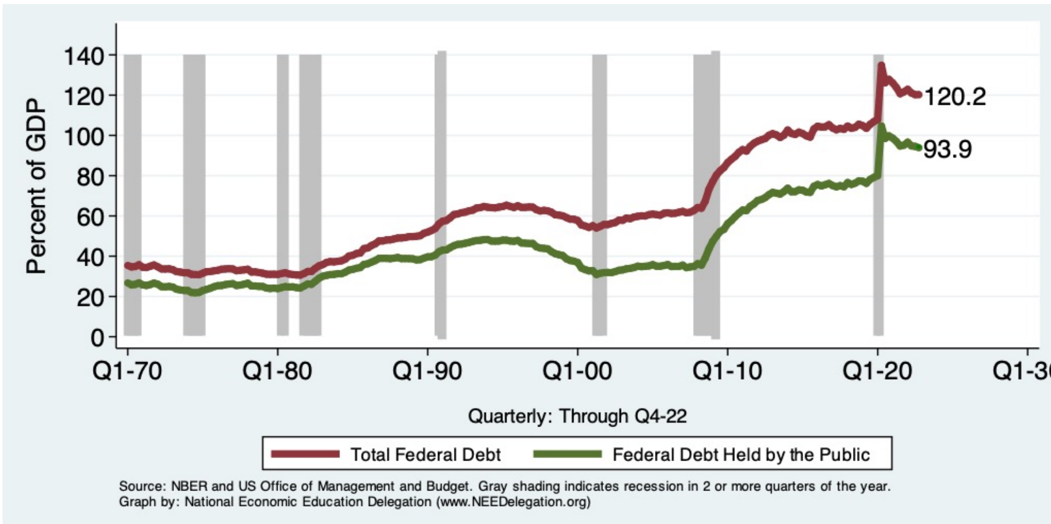
- **CBO analyzes the debt *relative* to GDP because:**
  - To the extent that debt and deficits have burdens, these burdens depend on the size of the debt ***relative*** to the size of the economy.

	Total Public Debt	Relative Debt Debt/GDP
United States	$24.5 Trillion	93.3%
Greece	$0.215 Trillion	170%

Relative Debt and Deficit



Two Measures of RELATIVE Debt

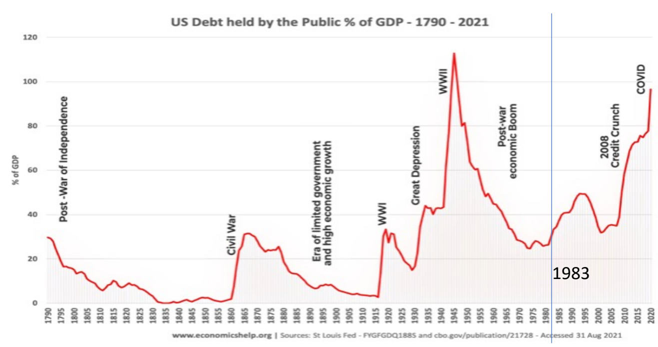


NATIONAL ECONOMIC
EDUCATION DELEGATION

29

29

Key Points About US Relative Debt



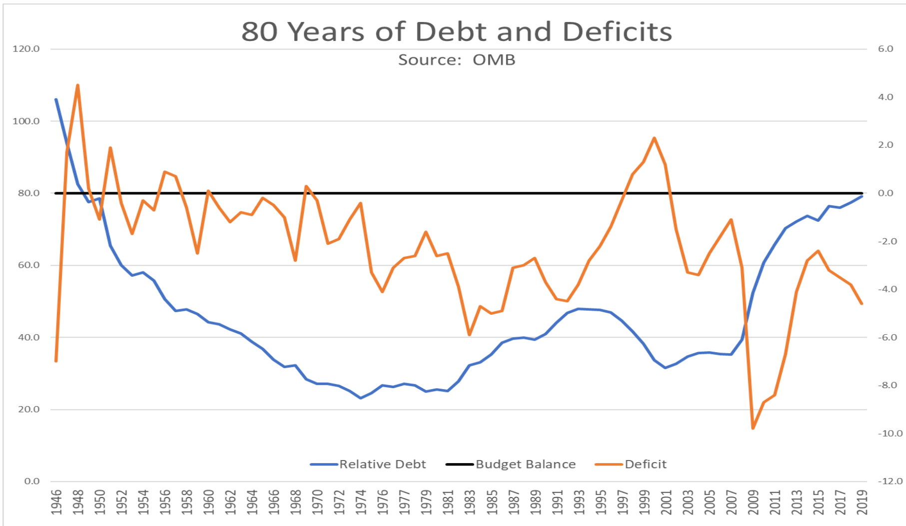
1. **Prior to 1983, relative debt rose purposefully (wars and recessions) and then fell.**
2. **Relative debt peaked during World War II, followed by a long decline.**
3. **Relative debt has been and is expected to rise for the next 30 years w/o a strategic purpose.**

NATIONAL ECONOMIC
EDUCATION DELEGATION

30

30

The Post-WWII Fall in Relative Debt



NATIONAL ECONOMIC EDUCATION DELEGATION 31

31

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 8/35 years!
- **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***
    - ***GDP growth is greater than the interest rate on borrowing.***
    - ***CAN still run deficits and reduce the relative debt.***

NATIONAL ECONOMIC EDUCATION DELEGATION 32

32

An Almost Free Lunch

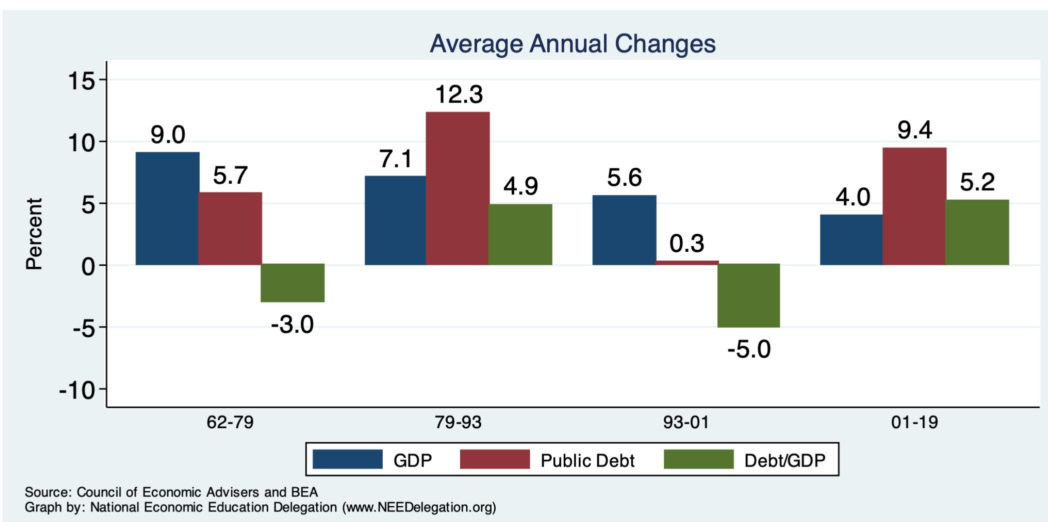
- If the interest rate is *less* than the growth rate of GDP, then the contribution from the primary budget can be positive, hence…
- Debt to GDP can be stabilized with a (small) primary ***deficit***.

NATIONAL ECONOMIC EDUCATION DELEGATION

33

33

The Arithmetic of Changes in Relative Debt



NATIONAL ECONOMIC EDUCATION DELEGATION

34

34

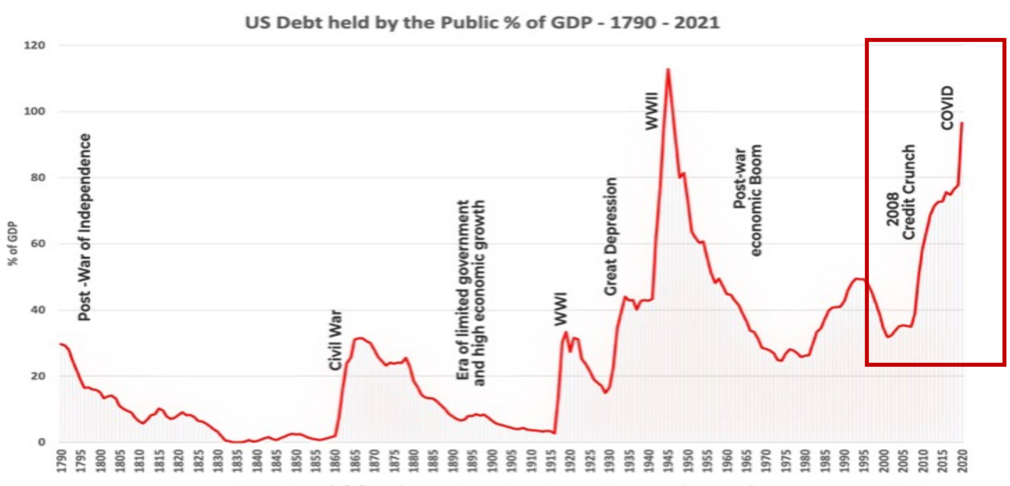
Is Stabilizing Relative Debt Good Enough?

- **This means that the absolute level of the debt would continue to increase.**
- **Yes, it is probably good enough.**
  - It is a reflection of the economy's ability to support the debt.
  - Stability will avoid bond market scares.
- **More on this later.**

NATIONAL ECONOMIC EDUCATION DELEGATION 35

35

But Let's Think About Today

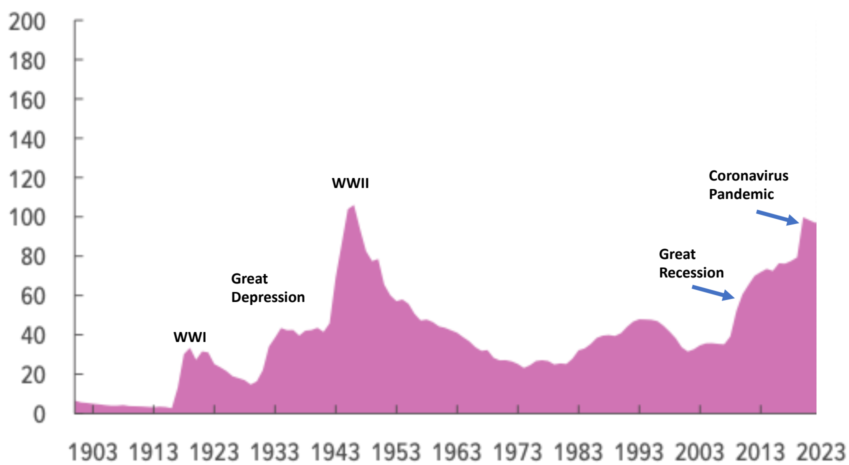


NATIONAL ECONOMIC EDUCATION DELEGATION 36

36

But Let's Think About Today

Federal Debt Held by the Public, 1900 to 2053
Percentage of Gross Domestic Product



NATIONAL ECONOMIC EDUCATION DELEGATION

37

37

Why Has the Federal Debt Risen So Much?

- **Expenditures UP:**
  - Social Security
  - Health-care costs
  - Economic stimulus
    - **In particular, during the Great Recession & COVID.**
  - Military engagements overseas

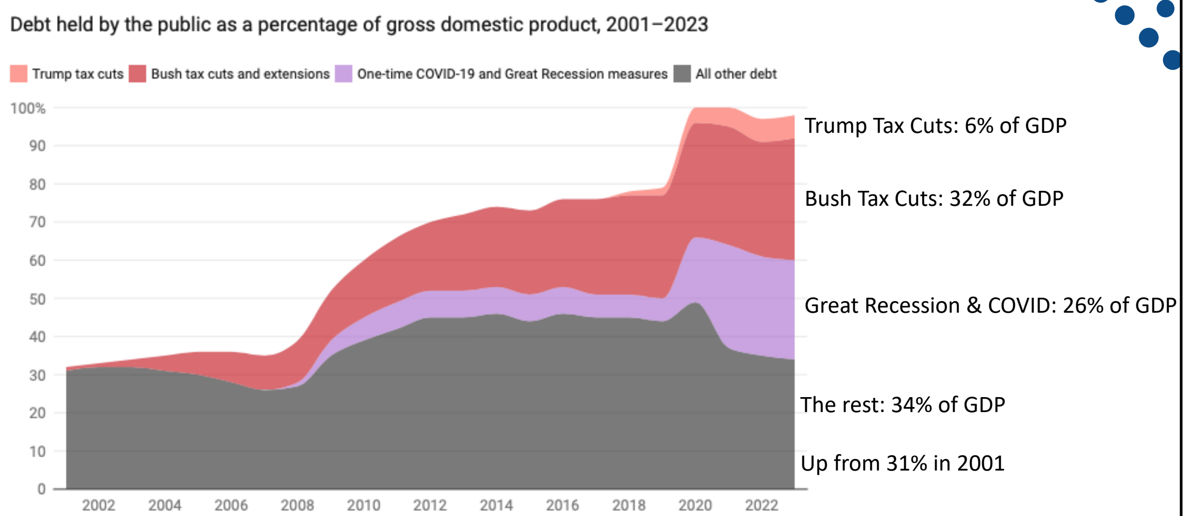
- **Revenues DOWN:**
  - Declining income tax revenues
    - Stagnant wages
    - **Tax cuts**
  - Social security
    - Declining revenues

NATIONAL ECONOMIC EDUCATION DELEGATION

38

38

Tax Cuts Have Driven The Debt Increases



NATIONAL ECONOMIC EDUCATION DELEGATION

39

39

Thinking About Today….

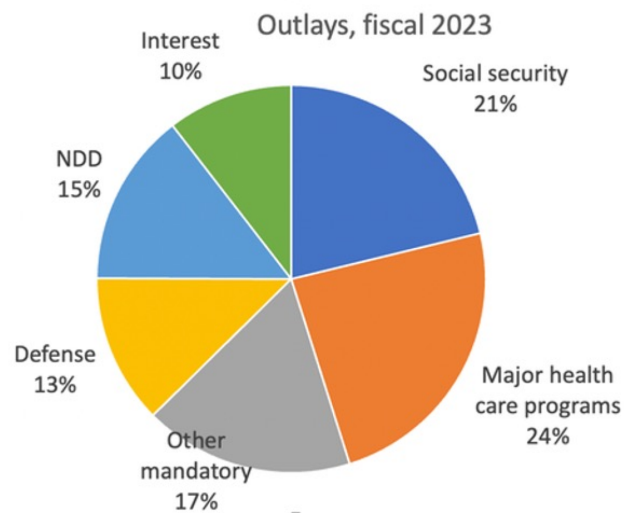
- **Do we have:**
  - A spending problem?
  - A revenue problem?
  - Both?

NATIONAL ECONOMIC EDUCATION DELEGATION

40

40

An Insurance Company with An Army



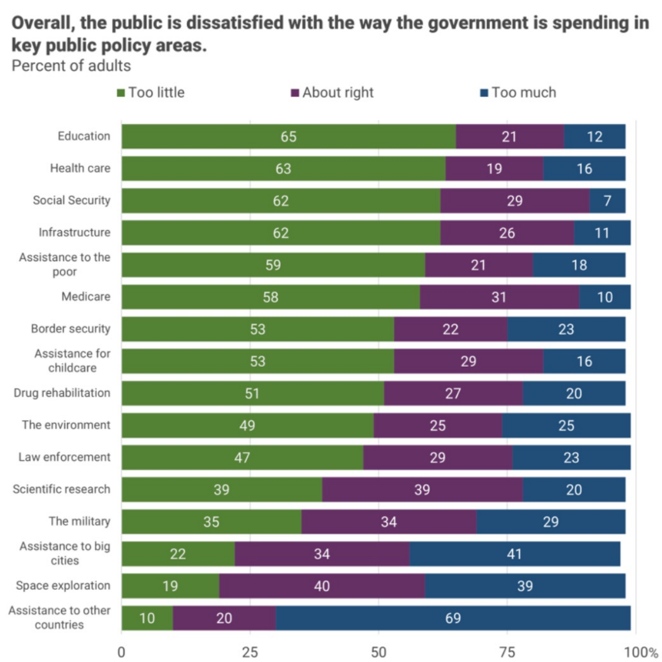
NATIONAL ECONOMIC EDUCATION DELEGATION

41

Source, NYTimes, Paul Krugman, " **Why We Should, but Won't, Reduce the Budget Deficit"**

41

There is very little enthusiasm for cutting anything.

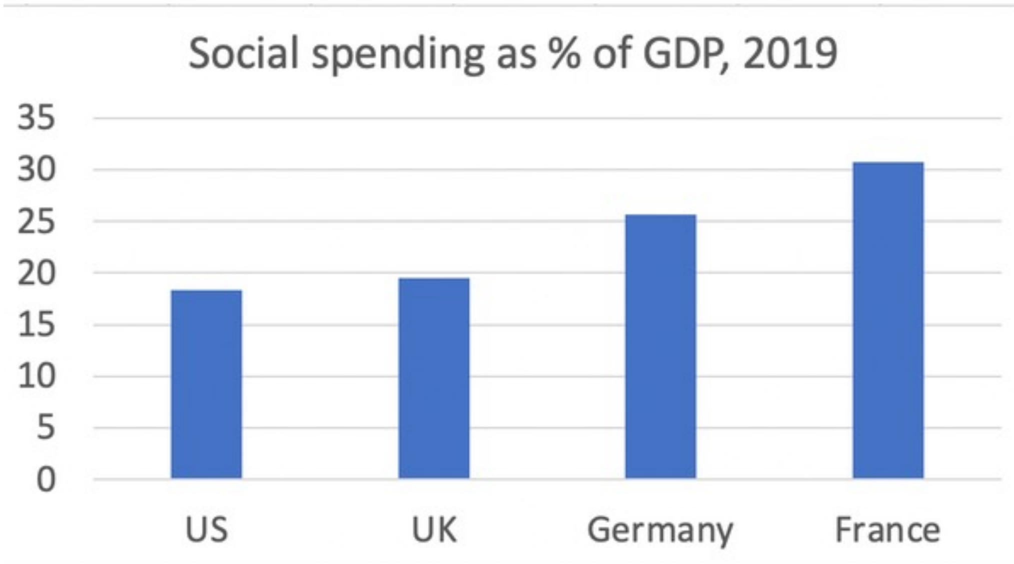


NATIONAL ECONOMIC EDUCATION DELEGATION

42

Source, NYTimes, Paul Krugman, "**Why We Should, but Won't, Reduce the Budget Deficit"**

42

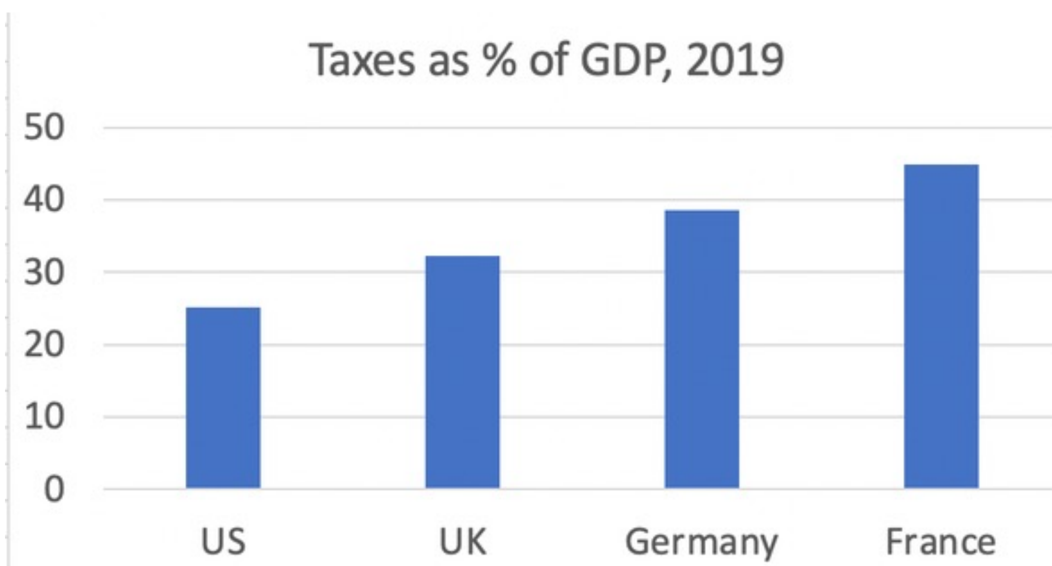


NATIONAL ECONOMIC EDUCATION DELEGATION

43

Source, NYTimes, Paul Krugman, **"Why We Should, but Won't, Reduce the Budget Deficit"**

43



NATIONAL ECONOMIC EDUCATION DELEGATION

44

Source, NYTimes, Paul Krugman, **"Why We Should, but Won't, Reduce the Budget Deficit"**

44

Thinking About Today….

- **Do we have:**
  - A spending problem?
  - A revenue problem?
  - Both?

- **Not much support for it being a spending problem.**

NATIONAL ECONOMIC EDUCATION DELEGATION

45

45

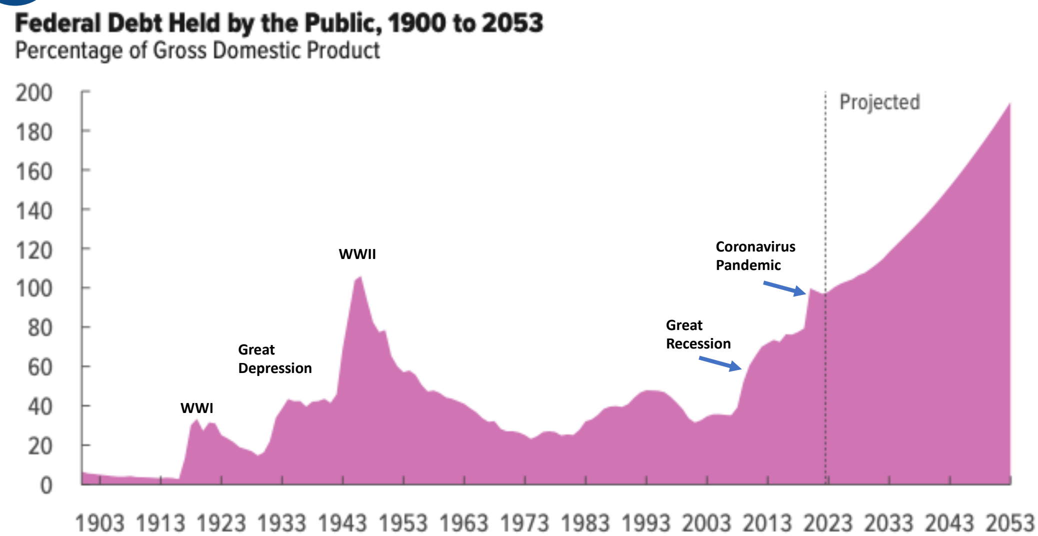
Can't Stop…Thinking About Tomorrow

NATIONAL ECONOMIC EDUCATION DELEGATION

46

46

Now Let's Think About Today and the Future

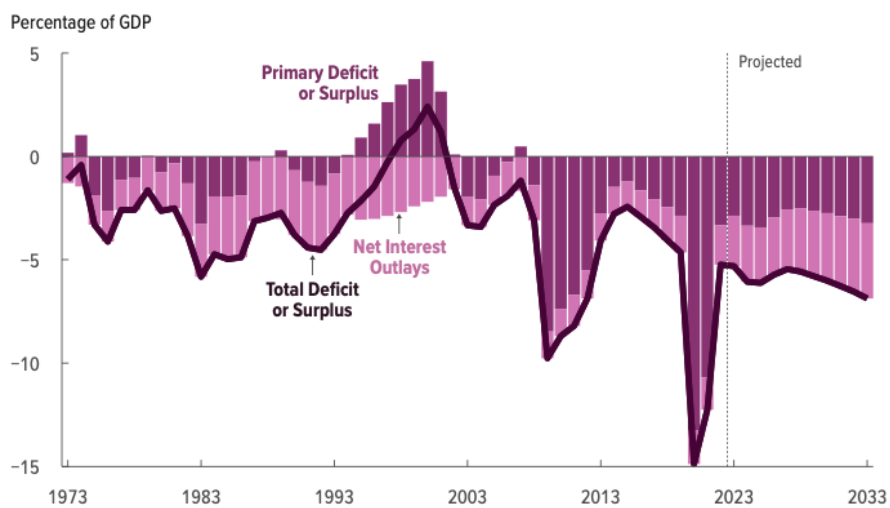


NATIONAL ECONOMIC EDUCATION DELEGATION

47

47

Rising Debt Levels Due to a Future of Deficits



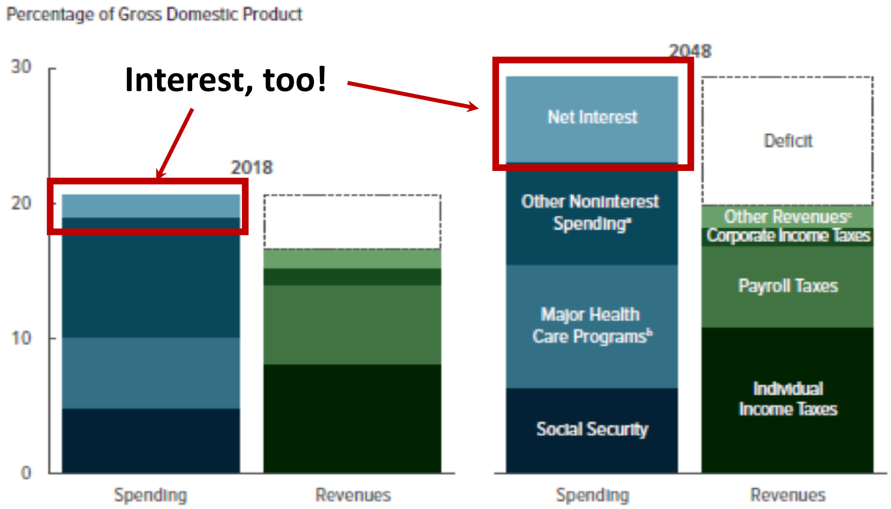
NATIONAL ECONOMIC EDUCATION DELEGATION

48

Source: Congressional Budget Office, The Budget and Economic Outlook: 2023 to 2033

48

Spending to Grow Much Faster Than Revenue



Source: Congressional Budget Office.

NATIONAL ECONOMIC EDUCATION DELEGATION 49

49

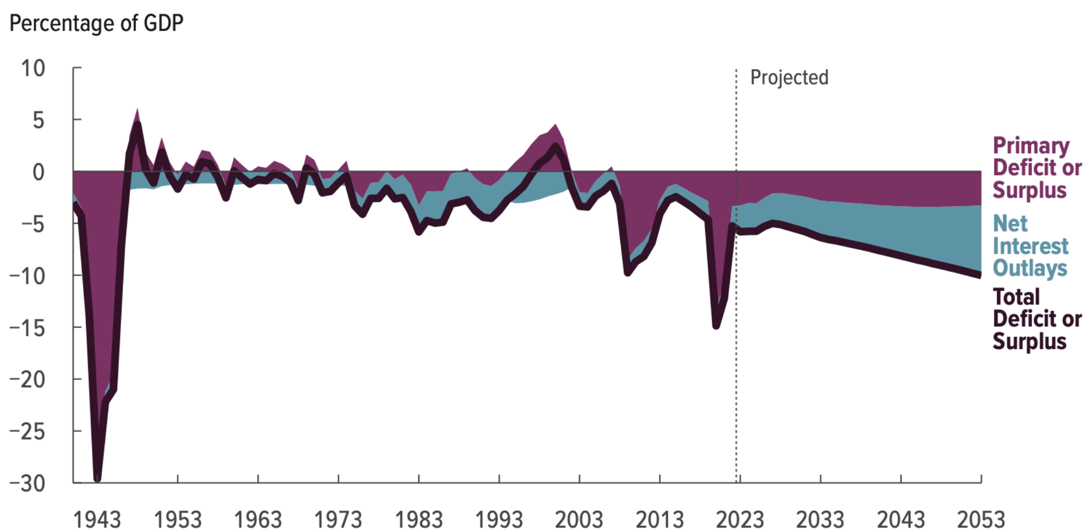
Two Measures of the Deficit

- **(1) Primary deficit = current programmatic outlays – revenues**
- **(2) Total deficit = primary deficit + interest**
- **Interest on the debt is**
  - The part of the total deficit that is due to past deficits.
- **This distinction becomes important for understanding:**
  - The future course of relative debt.
  - The costs borne by future generations because of the debt.

NATIONAL ECONOMIC EDUCATION DELEGATION 50

50

Interest Will Grow as a Share of the Deficit



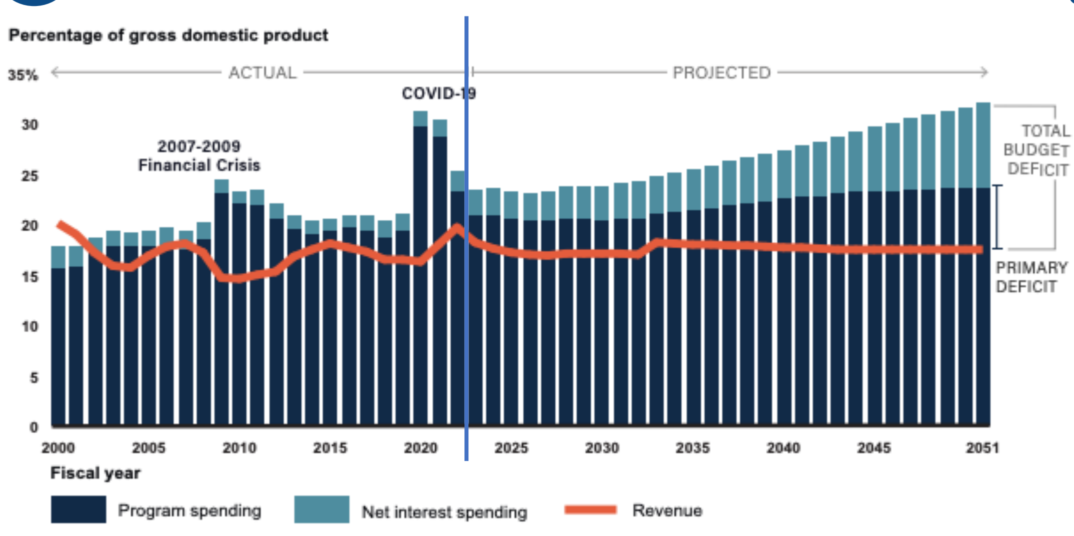
NATIONAL ECONOMIC EDUCATION DELEGATION

51

Source: CBO 2023 Long Term Budget Outlook

51

Interest Will Grow as a Share of the Deficit



NATIONAL ECONOMIC EDUCATION DELEGATION

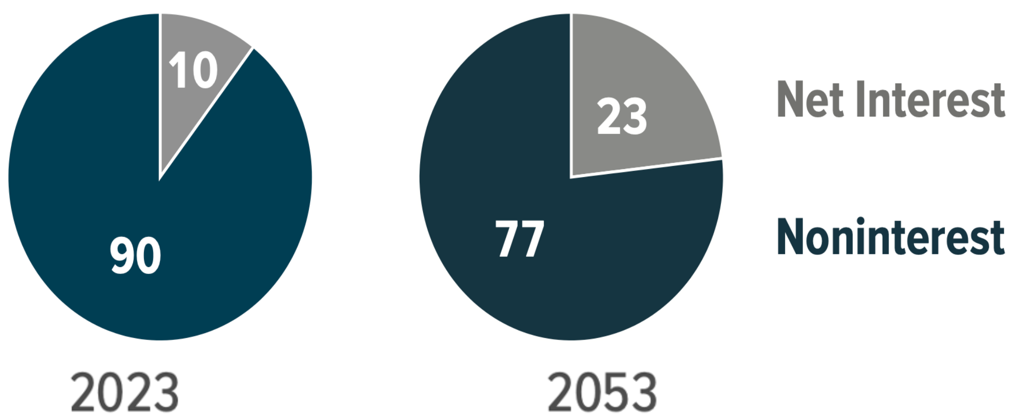
52

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

52

Interest Will Grow as a Share of the Deficit

Total Outlays



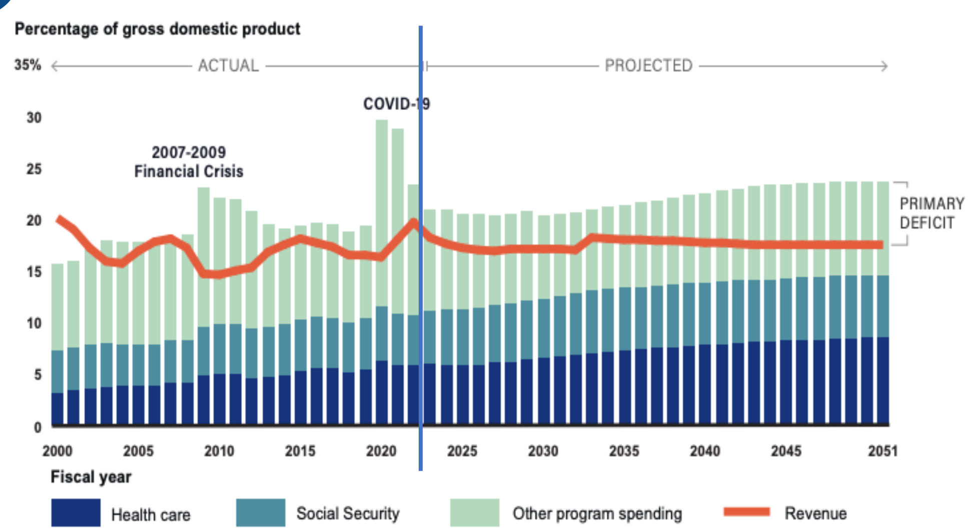
NATIONAL ECONOMIC EDUCATION DELEGATION

53

Source: CBO 2023 Long Term Budget Outlook

53

What Are the Primary Drivers Going Forward?



Source: Congressional Budget Office data and GAO simulation. | GAO-23-106201

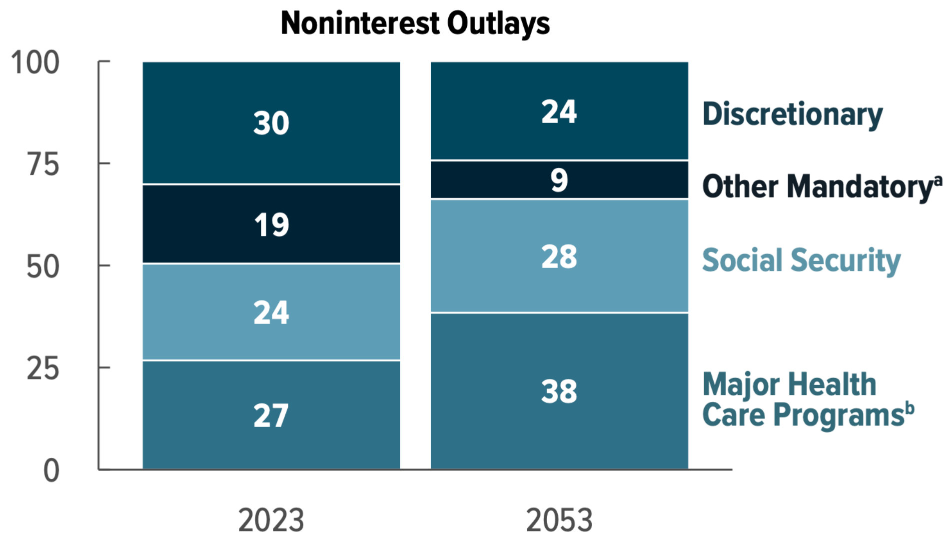
NATIONAL ECONOMIC EDUCATION DELEGATION

54

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

54

What Are the Primary Drivers Going Forward?



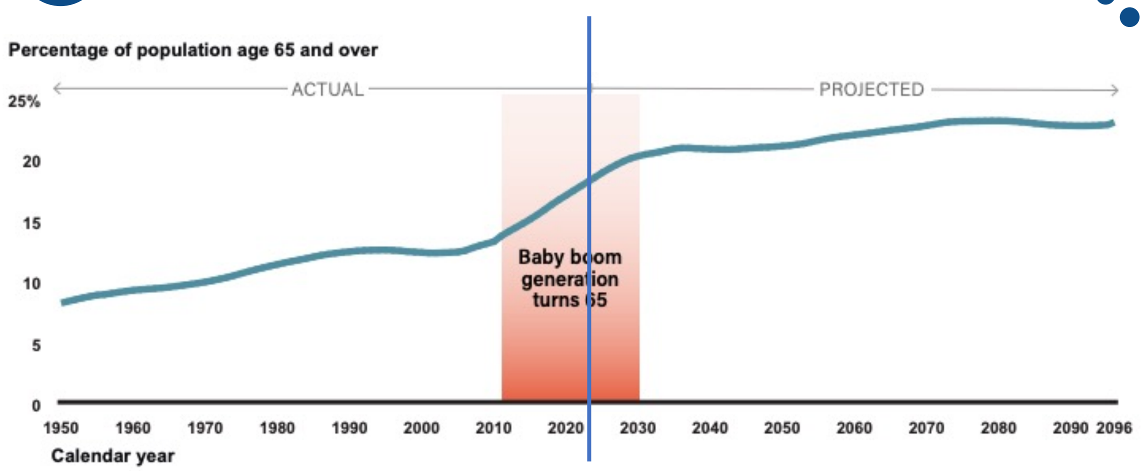
NATIONAL ECONOMIC EDUCATION DELEGATION

55

Source: CBO 2023 Long Term Budget Outlook

55

The Population is Aging



Source: GAO analysis of 2023 Social Security Trustees' Report (intermediate assumptions). | GAO-23-106201

NATIONAL ECONOMIC EDUCATION DELEGATION

56

56

How to Think About the Debt

NATIONAL ECONOMIC EDUCATION DELEGATION

57

57

Perspectives on Increased Debt

- **Does debt impose a burden on future generations?**
  - Does it inevitably have to be paid off?
- **Government borrowing crowds out private capital and investments.**
  - Weakened by the ability to borrow from other countries.
- **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.

NATIONAL ECONOMIC EDUCATION DELEGATION

58

58

Is The Debt a Problem Today?

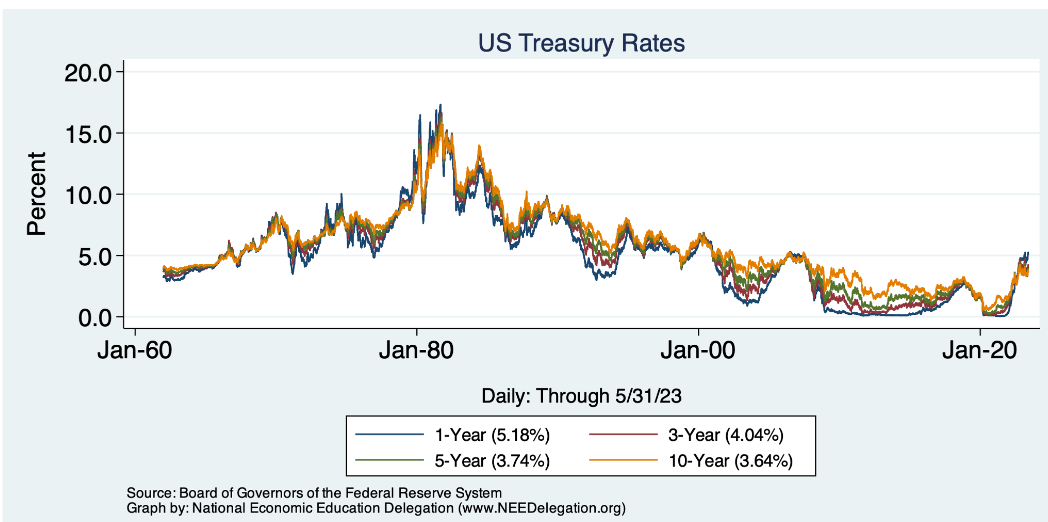
- Federal government borrows each month with little difficulty.
- Very little evidence of ”crowding out.”
- Interest rates are low, but rising – this is becoming a concern.
- So, no, other than the debt ceiling, it's not a problem today.

NATIONAL ECONOMIC EDUCATION DELEGATION

59

59

Interest Rates Are Historically Low, But Climbing



NATIONAL ECONOMIC EDUCATION DELEGATION

60

60

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

NATIONAL ECONOMIC EDUCATION DELEGATION

61

61

So, Why Worry About it?

- **If debt becomes 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. No idea if/when it might become one.
  - Could be inflationary.

NATIONAL ECONOMIC EDUCATION DELEGATION

62

62

So, Why Worry About It?

- **If debt continues to grow:**
  - Interest payments will grow with it.
    - 10% of spending in 2023.
    - 23% of spending in 2053.
    - Less room for using the budget for policy priorities.
    - 30% of payments go to other countries.
  - The longer we wait to address it, the harder and more disruptive addressing it will be.
  - Interest rates are increasing.

Growth in Relative Debt

- **Can be scary to….**
  - International investors
  - Bond markets

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.**

NATIONAL ECONOMIC EDUCATION DELEGATION

What Is a Fiscal Crisis?

- **Increased perception of risk in government debt.**
- **Potential manifestations:**
  - Sudden significant 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

NATIONAL ECONOMIC EDUCATION DELEGATION

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.

NATIONAL ECONOMIC EDUCATION DELEGATION

67

67

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.

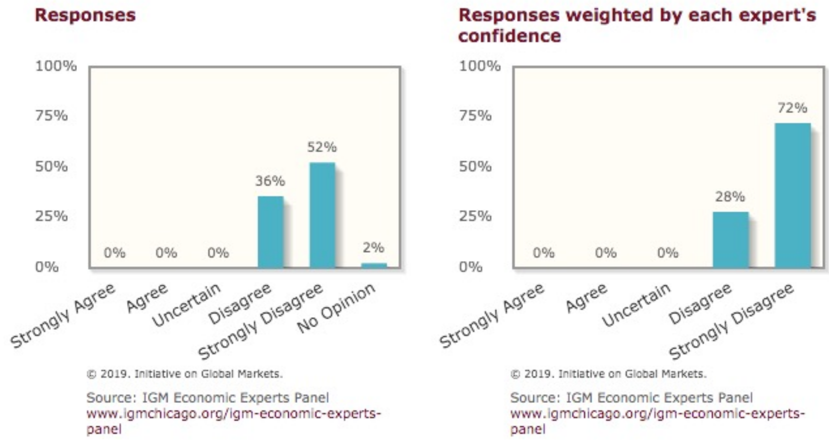
NATIONAL ECONOMIC EDUCATION DELEGATION

68

68

General Sense on Modern Monetary Theory

Question A: Countries that borrow in their own currency should not worry about government deficits because they can always create money to finance their debt.



69

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

70

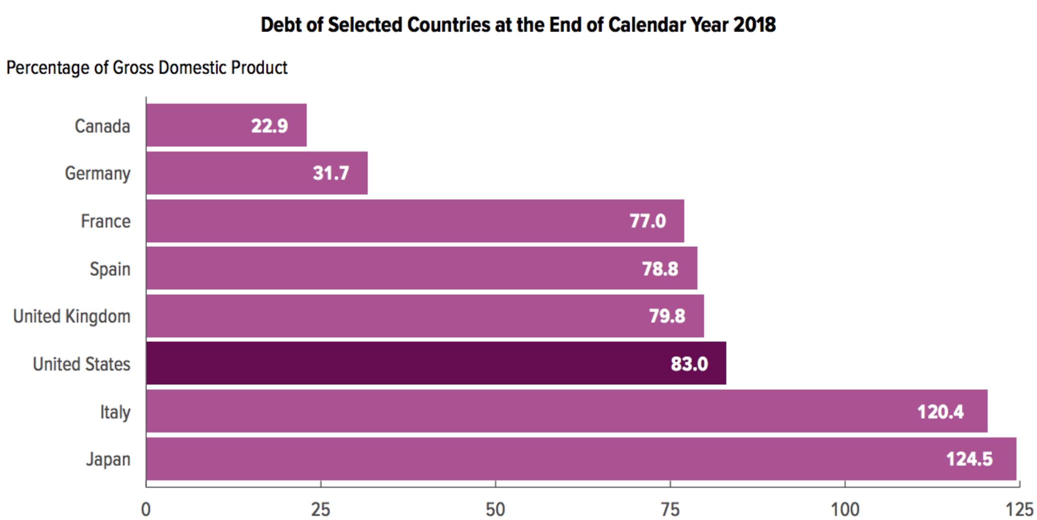
The Key: Stabilization of Relative Debt

- **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.**

NATIONAL ECONOMIC EDUCATION DELEGATION 71

71

Other Countries Have Higher Debt Levels



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

NATIONAL ECONOMIC EDUCATION DELEGATION 72

72

Summary

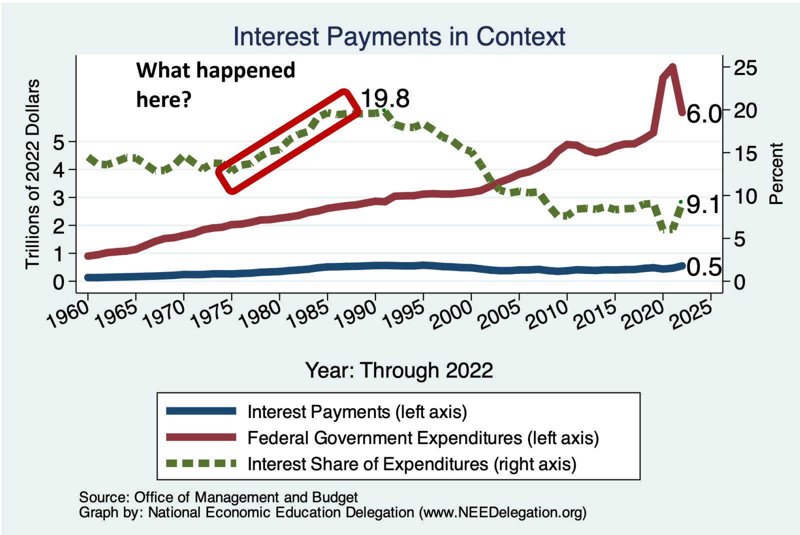
Bottom Line: We Need to Worry about the Debt

1. Interest rates are rising.
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 we must substantially reduce primary deficits.

We MUST MUST MUST continue raising the debt ceiling.

History: A Cautionary Tale of Interest Rates?

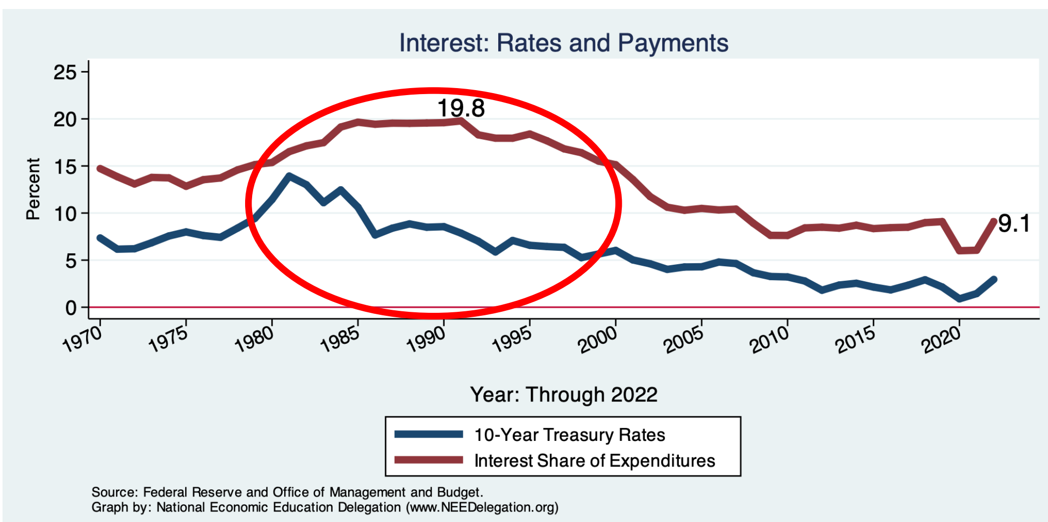


NATIONAL ECONOMIC EDUCATION DELEGATION

75

75

Interest Payments and Interest Rates



NATIONAL ECONOMIC EDUCATION DELEGATION

76

76

Bottom 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**

- **The longer we wait, the harder it will be!**

NATIONAL ECONOMIC
EDUCATION DELEGATION

77

77

Summary: Address the Debt?

- **Risks:**
  - Inflation
  - Slower economic growth
    - Higher interest rates
    - Crowding out
  - Default

- **Reasons to wait:**
  - Lots of important investments to make
  - Economic growth may take care of it

In my view: We should not wait another minute!

NATIONAL ECONOMIC
EDUCATION DELEGATION

78

78

How To Address the Debt?

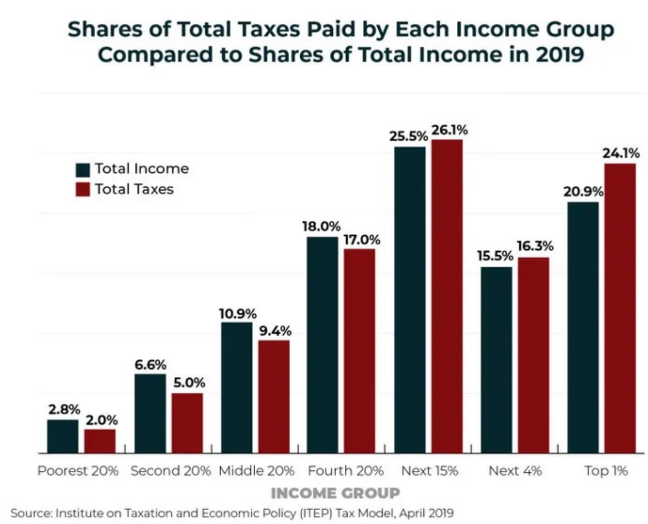
- **The question isn't taxes vs spending cuts.**
- **The question is:**
  - **Who should bear the burden of solving the problem?**
    - Spending cuts will mean primarily lower-income households.
    - Tax increases will mean primarily high-income households.
    - Soc Sec benefit cuts (age limit, actual payments, etc.) will mean primarily lower-income households.

NATIONAL ECONOMIC EDUCATION DELEGATION

79

79

What? It's not 40%? No, it's 24.1%.



The 400 highest income households:

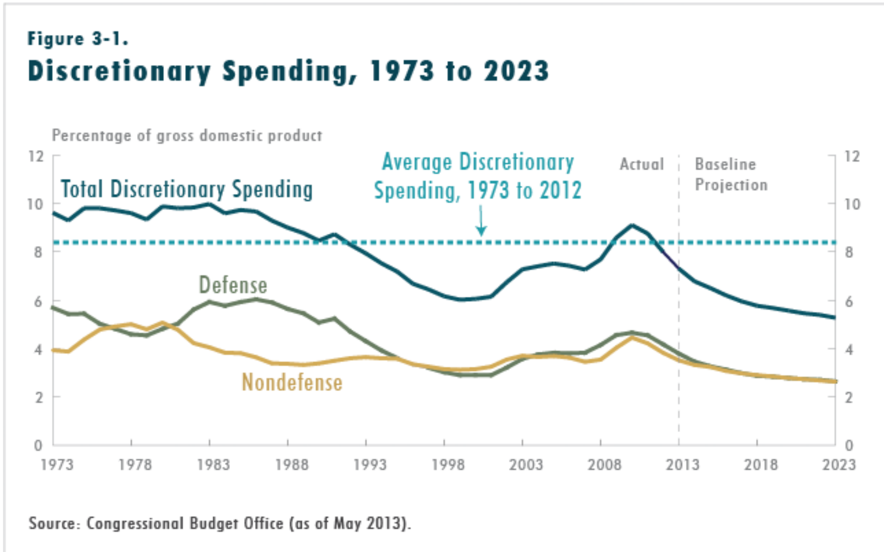
Paid an average tax rate of 8%.

NATIONAL ECONOMIC EDUCATION DELEGATION

80

https://nymag.com/intelligencer/article/fact-check-richest-1-dont-pay-40-of-the-taxes.html

80



NATIONAL ECONOMIC EDUCATION DELEGATION

81

https://www.cbo.gov/content/discretionary-spending-options

81

Bottom-Line Takeaways

- **Relative debt must be stabilized, so it is imperative to reduce primary deficits.**
- **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."

NATIONAL ECONOMIC EDUCATION DELEGATION

82

82

Major Takeaways: Talking Points

- **The debt is not currently a significant problem.**
- **The current trajectory for the federal debt is unsustainable.**
  - The primary drivers are an aging population and interest.
- **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."**

NATIONAL ECONOMIC EDUCATION DELEGATION

83

83

Thank you!

Any Questions?

www.NEEDEcon.org

Jon Haveman, Ph.D.
Jon@NEEDEcon.org

Contact NEED: info@NEEDEcon.org

Submit a testimonial: www.NEEDEcon.org/testimonials.php

Become a Friend of NEED: www.NEEDEcon.org/friend.php

NATIONAL ECONOMIC EDUCATION DELEGATION

84

84