



Osher Lifelong Learning Institute, Winter 2022
Contemporary Economic Policy

University of Southern Maine

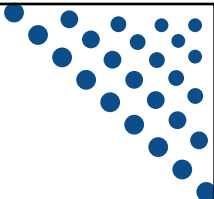
Ryan Herzog, Ph.D.
Gonzaga University



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National Economic Education Delegation

- **Vision**
 - One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.
- **Mission**
 - NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States.
- **NEED Presentations**
 - Are **nonpartisan** and intended to reflect the consensus of the economics profession.



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Credits and Disclaimer

- **This slide deck was authored by:**
 - Geoffrey Woglom, Jon Haveman,
- **This slide deck was reviewed by:**
 - Jon Haveman
- **Disclaimer**
 - NEED presentations are designed to be nonpartisan.
 - It is, however, inevitable that the presenter will be asked for and will provide their own views.
 - Such views are those of the presenter and not necessarily those of the National Economic Education Delegation (NEED).



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Course Outline

- **Contemporary Economic Policy**
 - Week 1 (1/11): US Economy & Coronavirus Economics
 - **Week 2 (1/18): Federal Debt (Ryan Herzog, Gonzaga University)**
 - Week 3 (1/25): Economics of Immigration (Jennifer Alix-Garcia, Oregon St.)
 - Week 4 (2/1): Health Economics (Me)
 - Week 5 (2/8): Minimum Wage (Me)
 - Week 6 (2/15): Cryptocurrencies (Geoffrey Woglom, Amherst College)



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Who Are We?

- **Honorary Board: 54 members**

- 2 Fed Chairs: Janet Yellen, Ben Bernanke
- 6 Chairs Council of Economic Advisers
 - o Furman (D), Rosen (R), Bernanke (R), Yellen (D), Tyson (D), Goolsbee (D)
- 3 Nobel Prize Winners
 - o Akerlof, Smith, Maskin

- **Delegates: 600+ members**

- At all levels of academia and some in government service
- All have a Ph.D. in economics
- Crowdsource slide decks
- Give presentations

- **Global Partners: 45 Ph.D. Economists**

- Aid in slide deck development



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US Government Debt



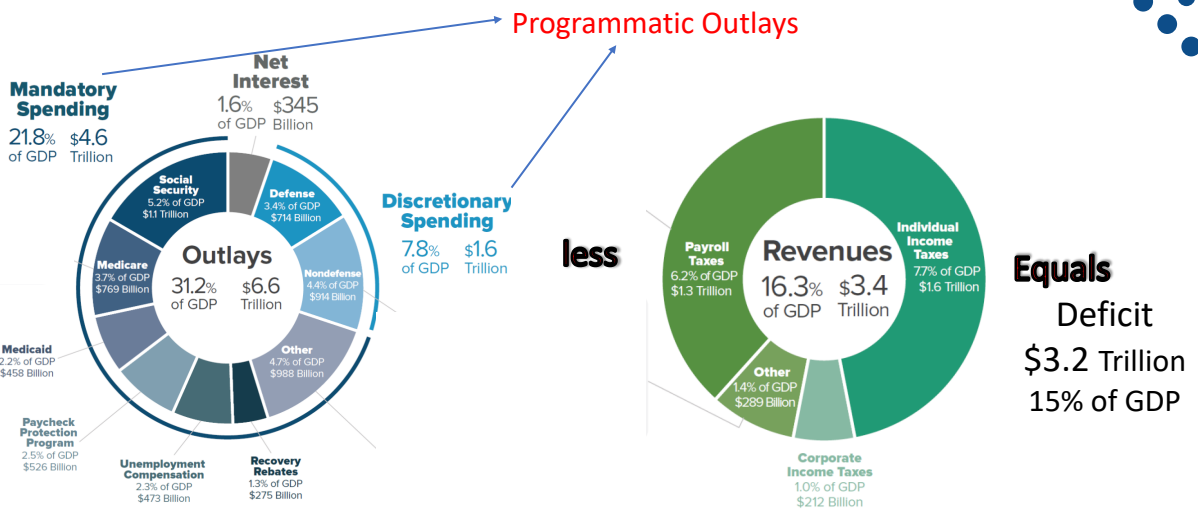
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A Fun Website

- **Brookings Institute**
- The Fiscal Ship - <https://fiscalship.org>

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The Federal Budget in 2020



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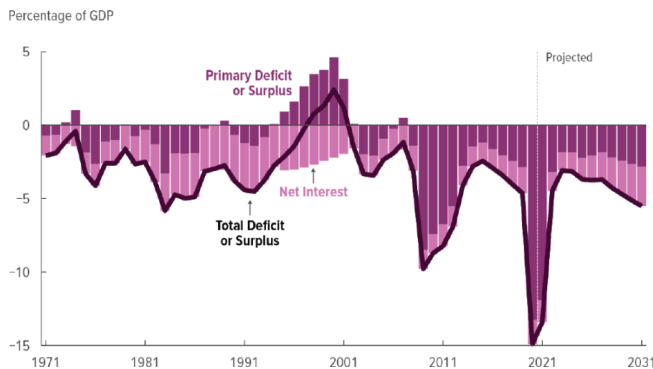
Fiscal 2021 (no fancy graphics yet)

- Deficit, 2.8t (12.4% of GDP) = Outlays, 6.8t – Receipts, 4.0t
- \$250b more outlays; \$600b more in taxes.

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Past and Future of Deficits

Total Deficits, Primary Deficits, and Net Interest



Useful Deficit Decompositions:

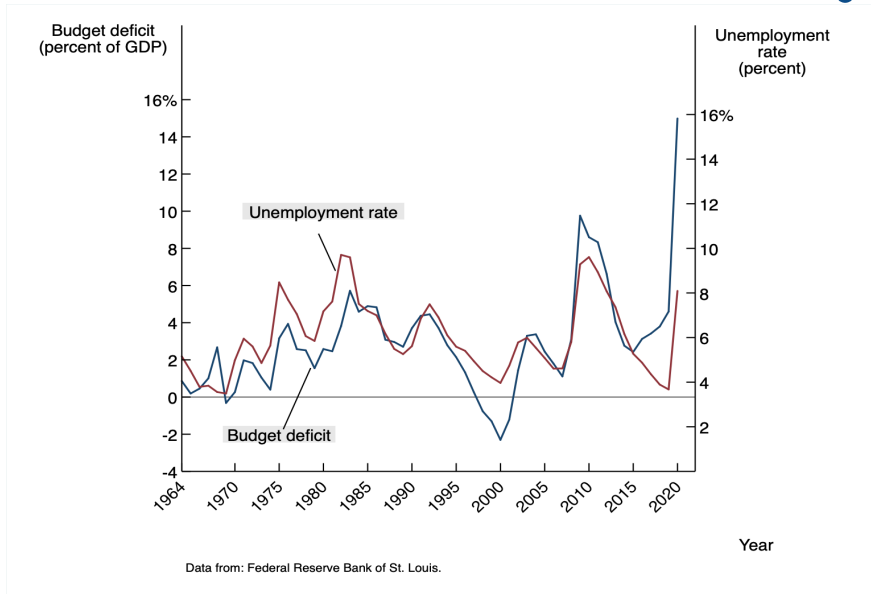
$$\text{Total Deficit} = (\text{Spending on Programs} + \text{Interest Expense}) - \text{Revenue}$$

$$= (\text{Programmatic Outlays} - \text{Revenue}) + \text{Interest Expense}$$

$$= \text{Primary Deficit} + \text{Net Interest}$$

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Deficits and Recessions



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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

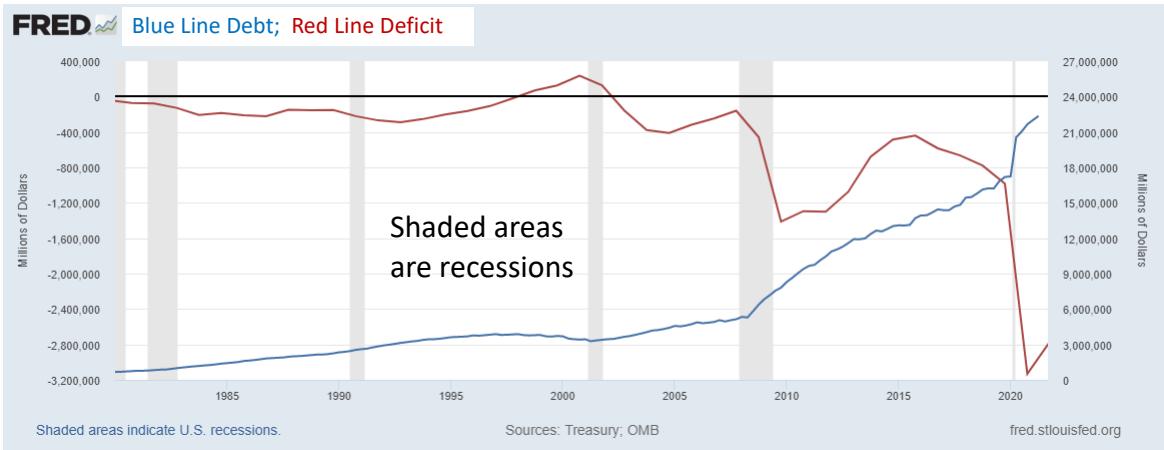
- **Debt:** The accumulation of debt over time.
 - The sum of all past deficits and surpluses.



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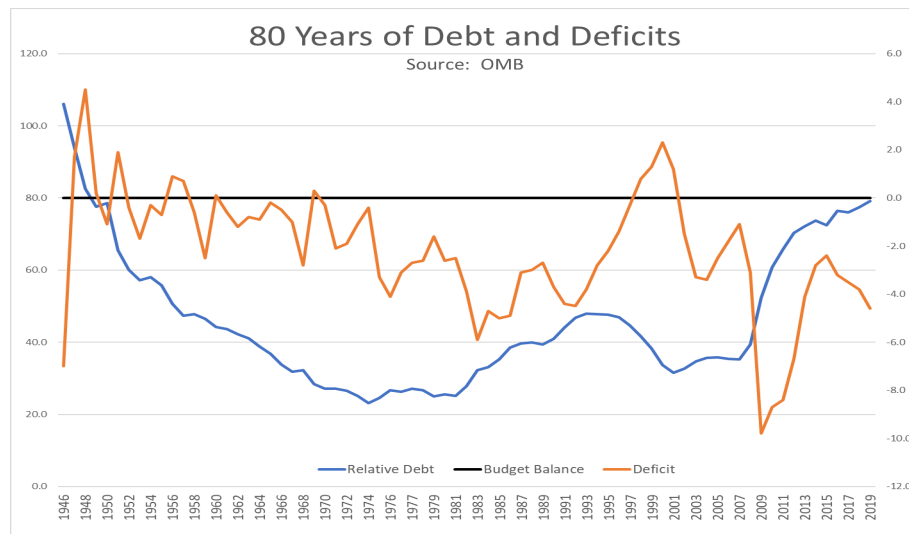
Debt vs. Deficit

The Sum of All Past Deficits Less Surpluses Equals the Debt



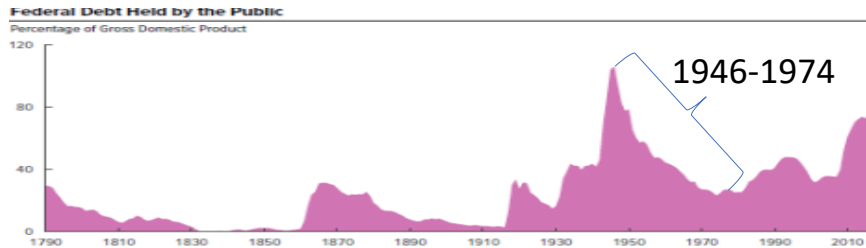
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The Post-WWII Fall in Relative Debt



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Key Points About the U.S. Relative Debt



1. Relative debt peaked during WWII (106%) - followed by a steady decline until the 1980s.
2. Prior to 1983, relative debt rose purposefully (wars, recessions, public investment) and then fell.
3. What can we learn from the 46-74 period, where the relative debt fell continuously?



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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



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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:

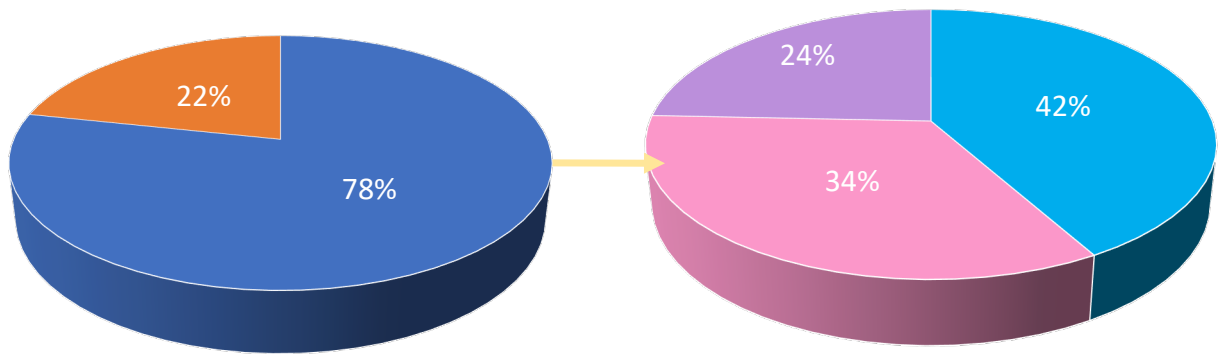
- The **numerator** falls (budget surplus)
- The **denominator** rises (nominal GDP growth)
- The **denominator grows** faster than the **numerator**

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A Breakdown of the Total Federal Debt

Total Public Debt, 9/30, \$28.4 tr

Publicly Held Debt, 9/30/, \$22.3 tr



Publicly Held Intra-gov't

Domestically Held Foreign Federal Reserve

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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 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.



How Does the US Government Borrow?

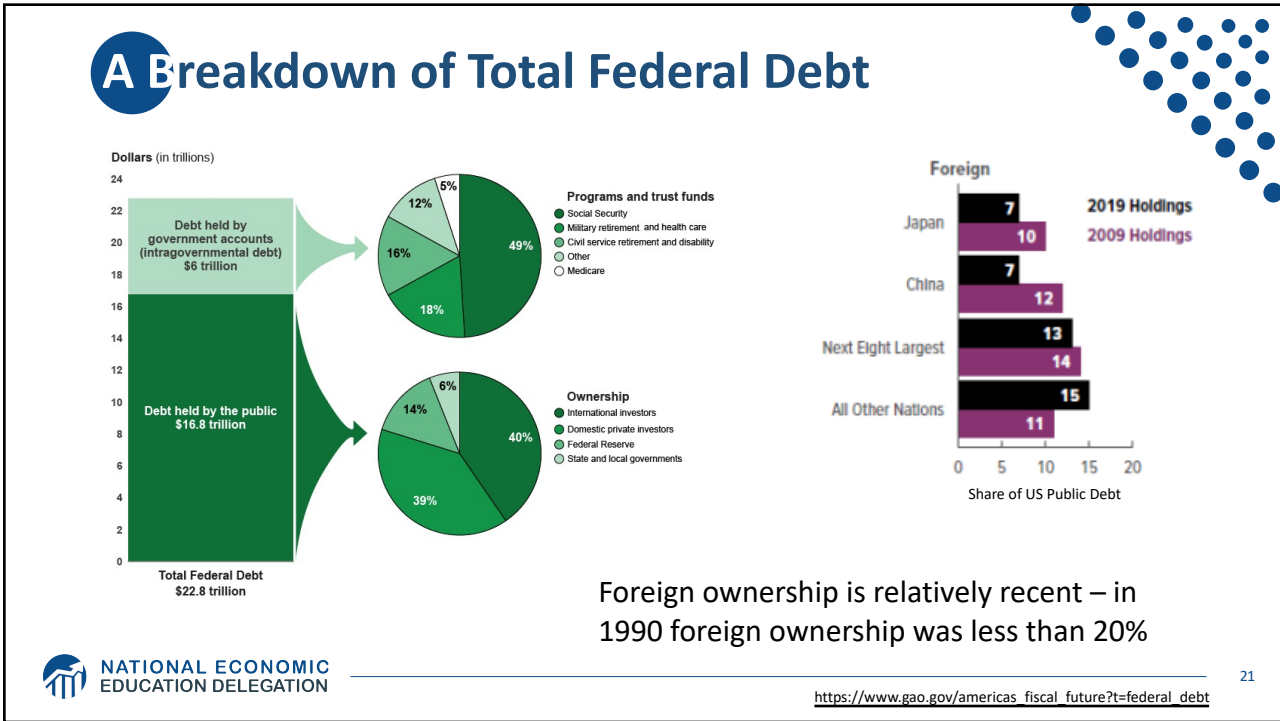
- **It issues debt.**

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

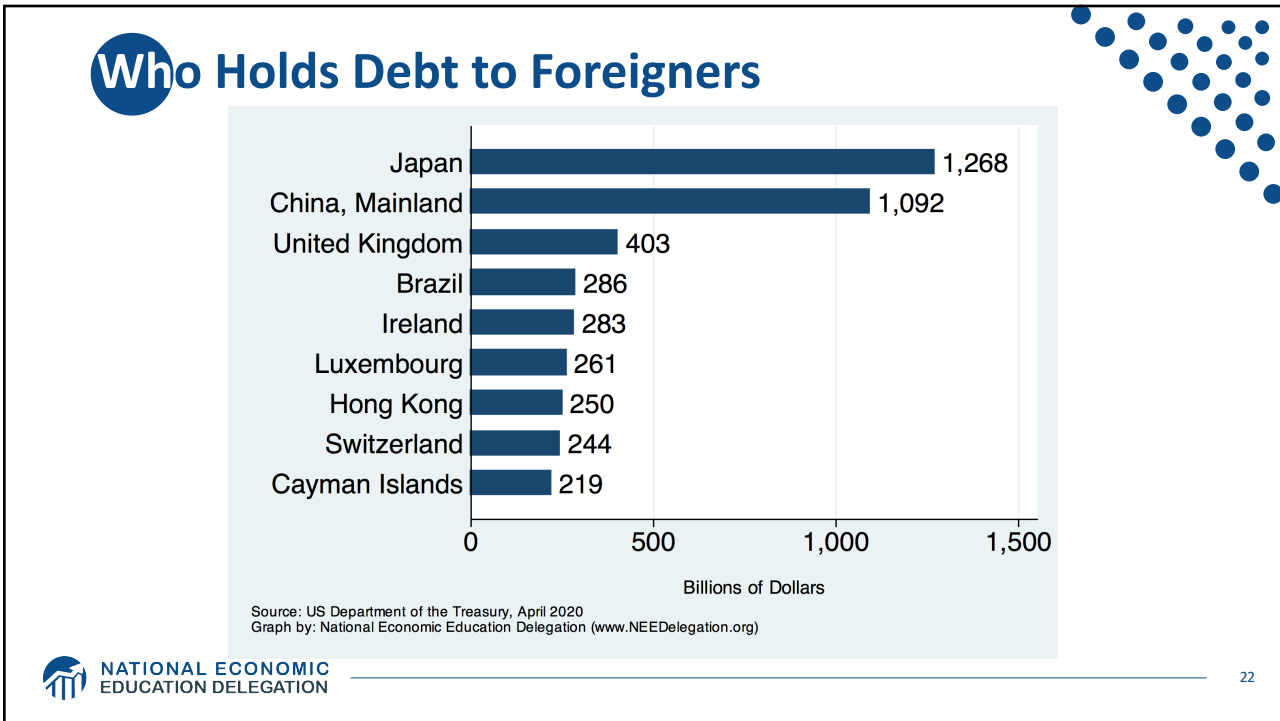
- **Who buys the debt?**

- Other federal agencies
- Individuals and businesses
- State and local governments
- Foreign government and individuals
- Federal Reserve

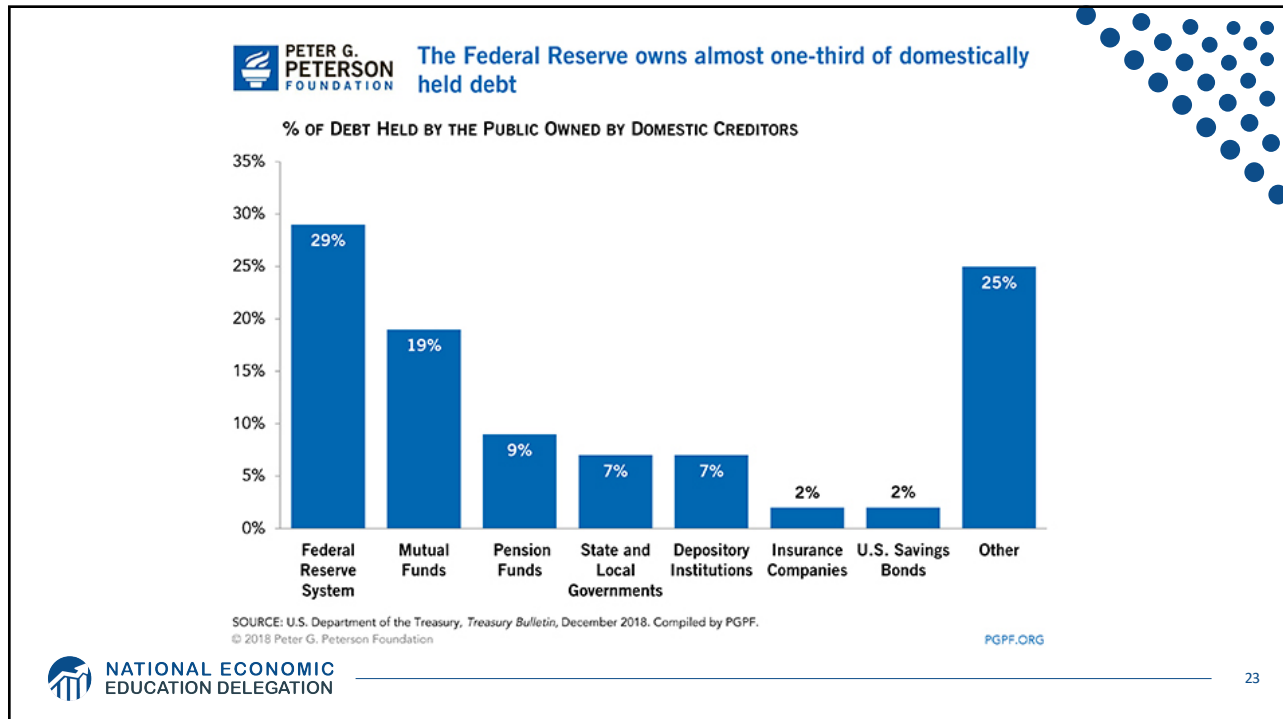




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Not All Debt Is Created Equal

- **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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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.**
- **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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Traditional Views of the Cost of the Debt

- **First a non-issue: There is no analogy between household and government debt.**
 - The government does not have to pay back the debt.
 - Retirees cash in maturing bonds which are financed with new bond issues sold to younger people.
 - Interest on the debt is essentially paid by the young to their parents
- **Economist View of the Debt circa 1980, very little cost because relative debt was falling. That changes in 1983.**

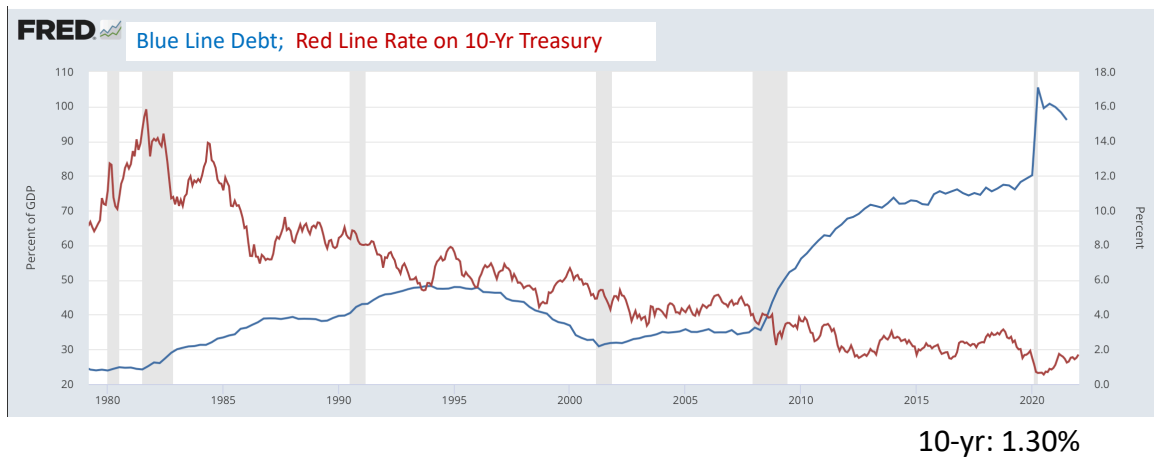


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Traditional View: Debt and Deficits Raise Interest Rates

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

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



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.

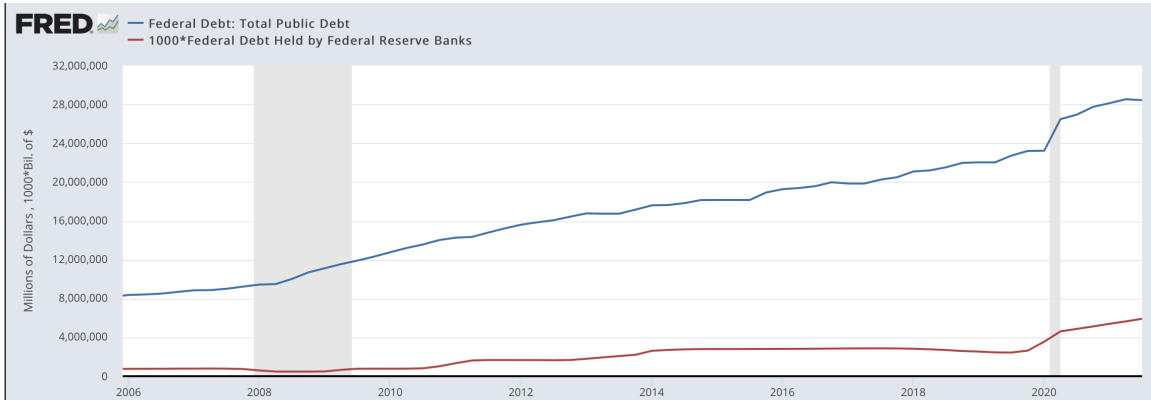
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MMT's Free Lunch

- **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.
- **The Trump experiment...**
 - From 2017q1 – 2019q4 (pre-Covid), public debt increased from \$19.8t to \$23.3t
 - An increase of \$3.5t
 - Federal Reserve holdings remained steady at \$2.8t

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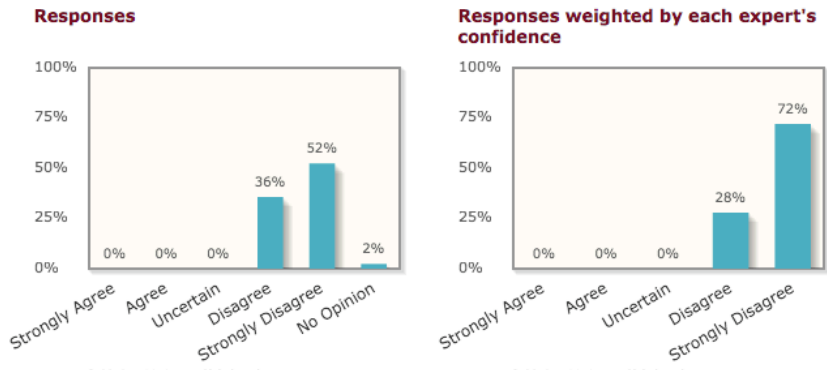
“Monetizing the Debt”



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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.



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

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

But,

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



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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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