Osher Lifelong Learning Institute, Spring 2025

Contemporary Economic Policy

University of Connecticut

Host: Geoffrey Woglom, Ph.D.
Director, National Economic Education Delegation

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
- US Social Policy

Course Outline

- **Contemporary Economic Policy**
  - Week 1 (4/10): Climate Change Economics (Sara Jacobson, Williams College)
  - Week 2 (4/17): Tariffs and Their Effects (Geoffrey Woglom, Amherst College)
  - Week 3 (4/24): Economics of Immigration (Robert Gitter, Ohio Wesleyan)
  - Week 4 (5/1): The New Inequality (Geoffrey Woglom, Amherst College)
  - **Week 5 (5/8): Federal Debt and Deficits (Geoffrey Woglom, Amherst College)**

Submitting Questions

- **Submit questions by raising your virtual hand or in the chat 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://needecon.org/delivered_presentations.php**

The US Federal Debt

Geoffrey Woglom,
Professor of Economics
Amherst College, emeritus
May 8, 2025

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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.**
- **Debt, Trade Deficits and Tariffs**
- **Citizen's Guide to Budget Reconciliation.**

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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.**

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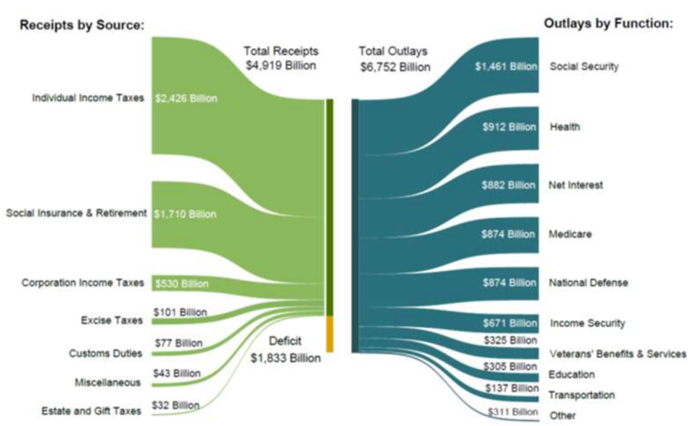
The Federal Budget in FY2024 (ended 9/30)

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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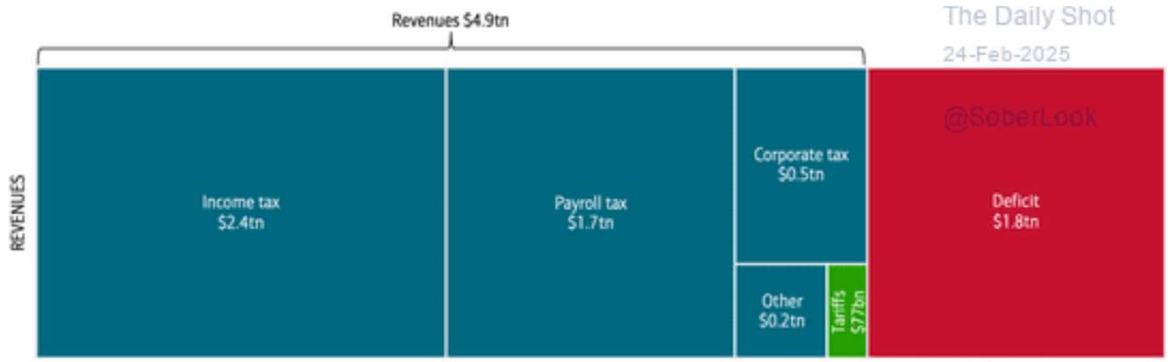
Source: Monthly Treasury Report, 9/2024

Where Do the Federal Dollars Come from?



Inc Tax, 49%
SS+Medicare Tax, 35%
Corp Tax, 10%

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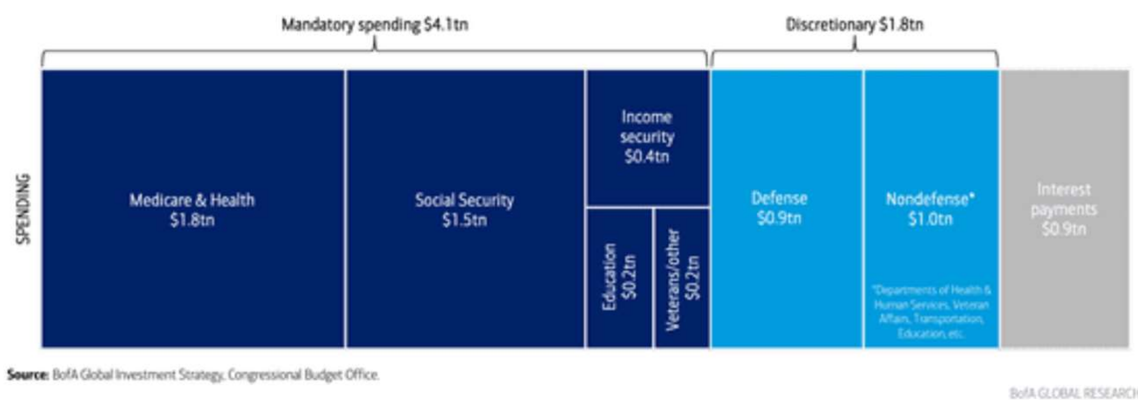
Where Do Federal Dollars Go?



Programmatic Outlays = Mandatory + Discretionary

Paul Krugman, "The Federal government is basically an insurance company with an Army."
1.8+1.5+0.4+0.2+0.9= 4.8; 4.8/5.9=0.81=81%

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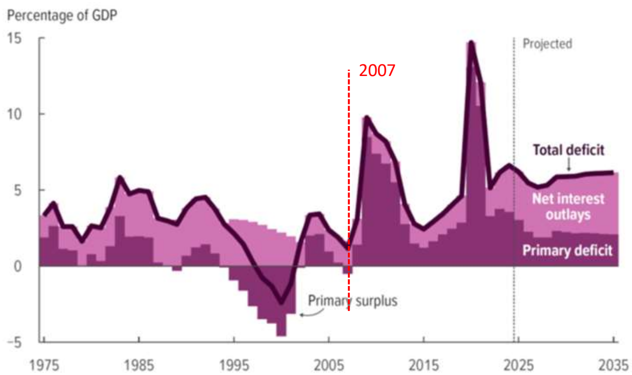
Past and Future of Deficits



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

Primary Deficit =
Programmatic Outlays less Taxes

E.g., 2007: 1.1 = (17.4+1.7) -18.0 =1.1
1.1 = (**17.4-18.0)+1.7** **=1.1**

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

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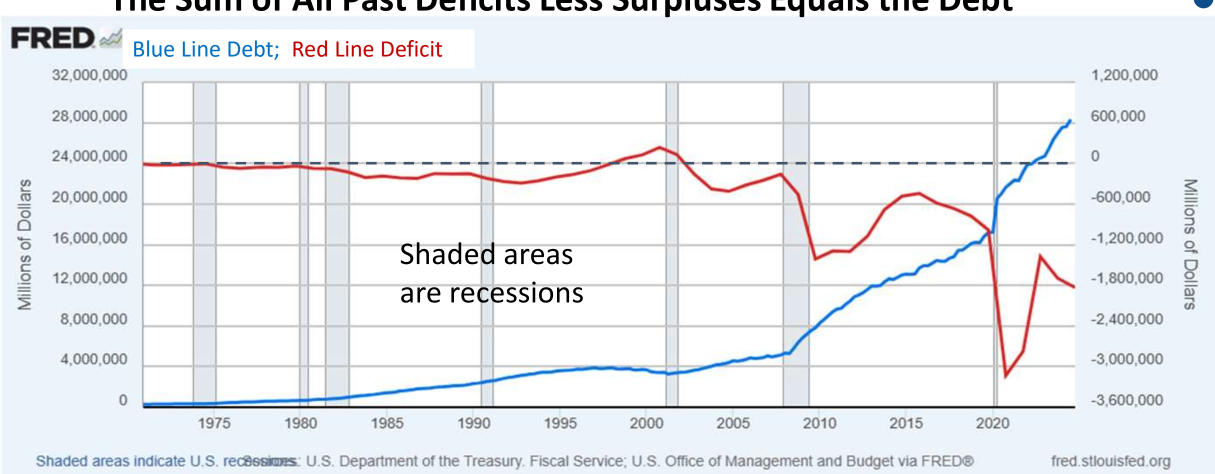
Debt vs. Deficit

The Sum of All Past Deficits Less Surpluses Equals the Debt



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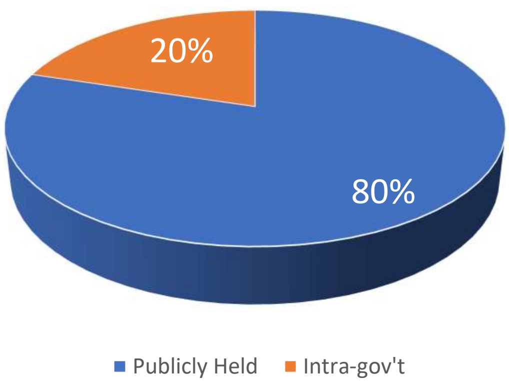
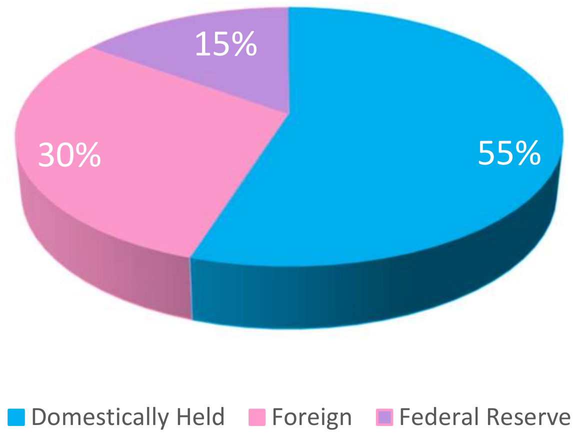
A Breakdown of the Total Federal Debt

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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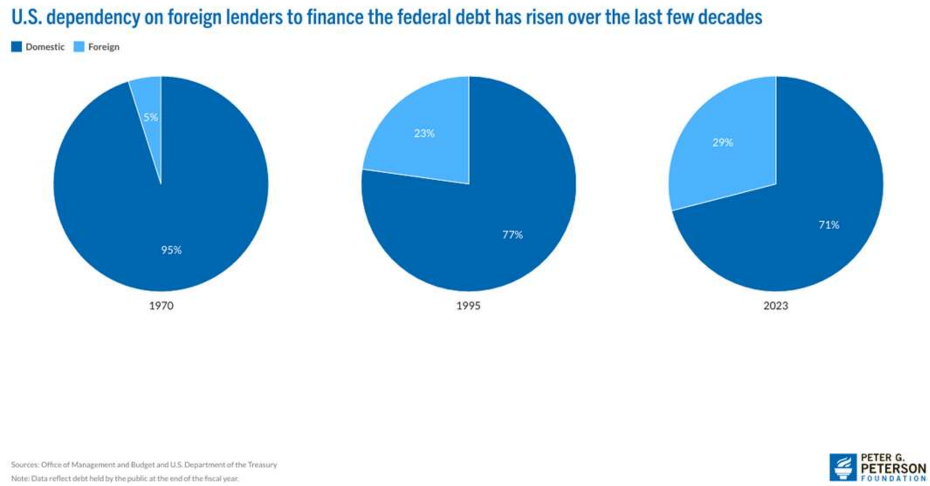
Source: U.S. Department of the Treasury

PETER G. PETERSON

The Growing Importance of Foreign Held Debt



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.

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

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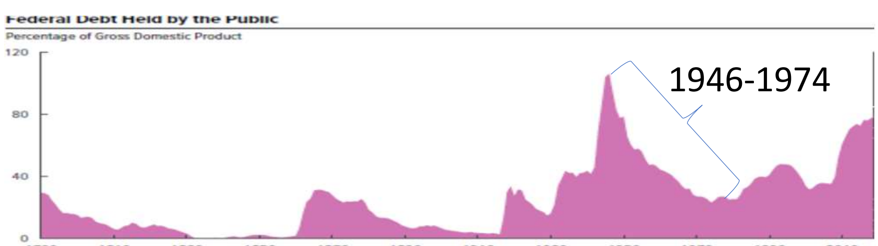
Key Points About the U.S. Relative Debt



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

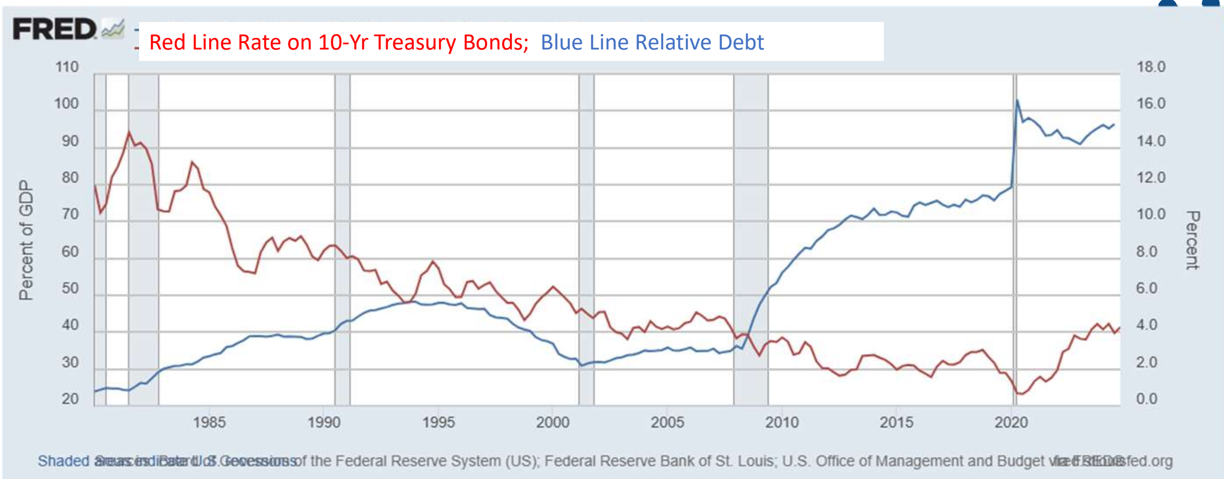
- The relative debt fell *in spite of* deficits in 21 of the 29 years, with the debt increasing by 42%. How?
- 1946-1974, deficits caused the debt to grow, but not as fast as the economy was growing.
- While the debt grew by 42%, GDP (nominal) grew by 550%

You don't need a surplus to reduce the *relative* debt:
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?



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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
- **World has(d?) an insatiable demand for safe US assets.**

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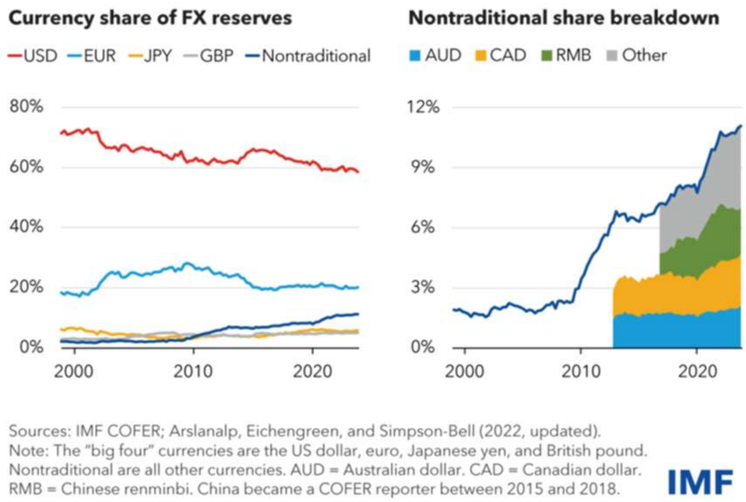
Demand for Dollars by Central Banks



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

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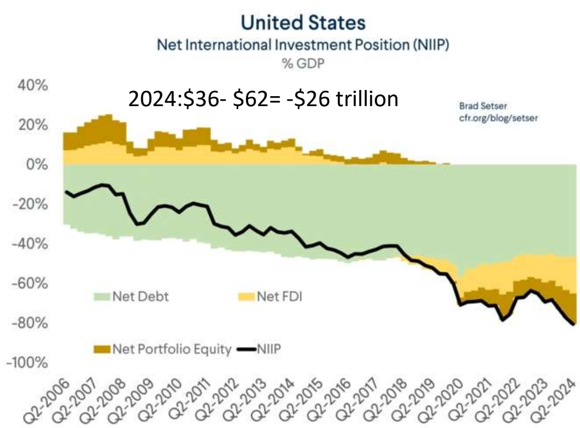
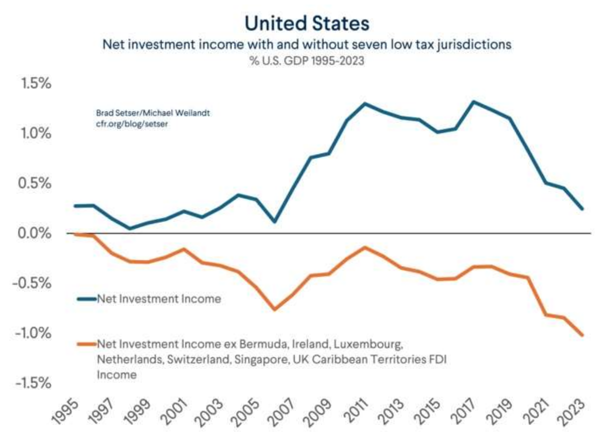
Reflections of "Privilege"

Includes over $1 trillion in US currency,
45% of total

2024:$36- $62= -$26 trillion





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https://www.cfr.org/blog/us-income-balance-puzzle

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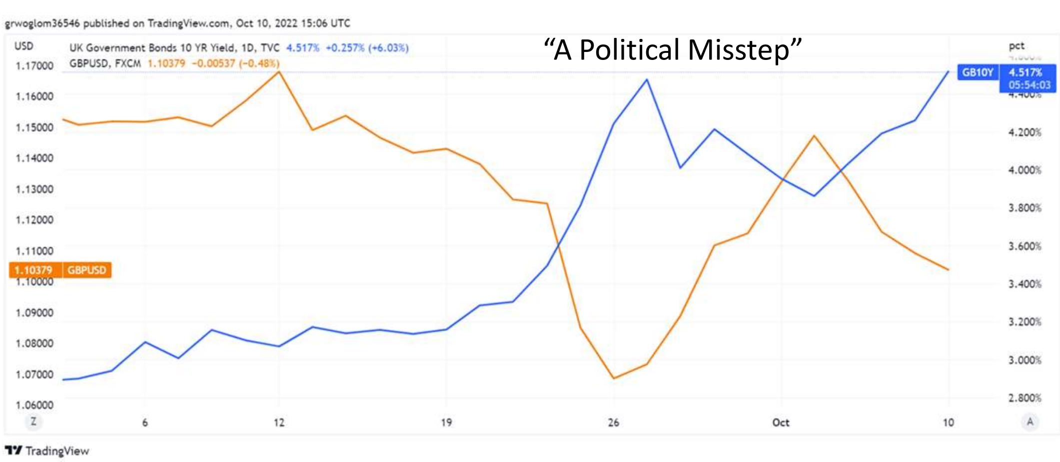
CBO on the Costs of "High and Rising Debt"

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.

Fiscal Crisis Preview: Liz Truss & Head of Lettuce



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,

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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.**

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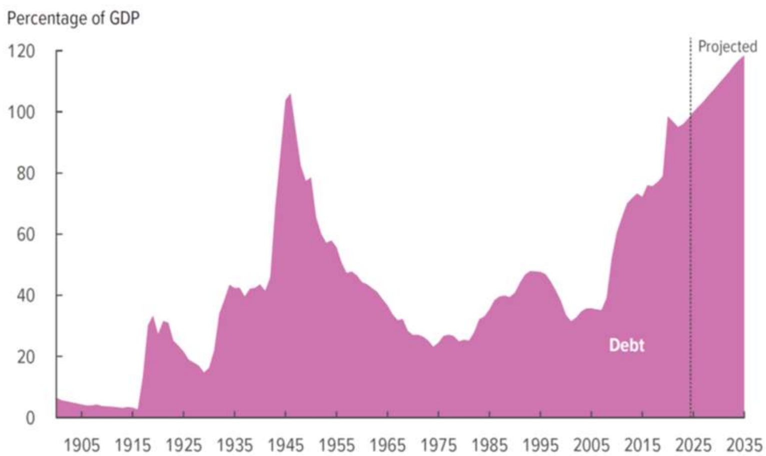
But is this Problem Impossible?



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

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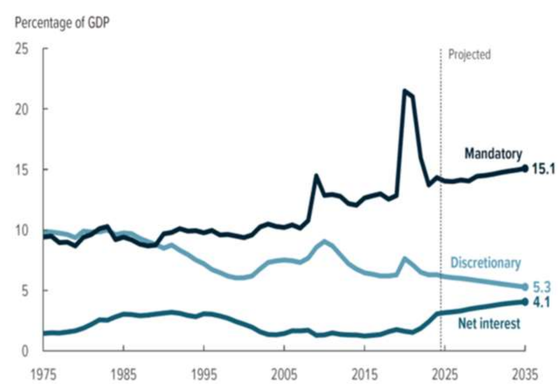
CBO, "The Budget and Economic Outlook," Jan 2025

The Blueprint for a Crisis?



But, these are "projections," not forecasts!

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

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

We need $700 billion ***per year*** to stabilize relative debt.

How about Revenue "Enhancement?"

Option 46—Revenues

Impose a Surtax on Individuals' Adjusted Gross Income

Billions of dollars	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	Total 2025–2029	Total 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

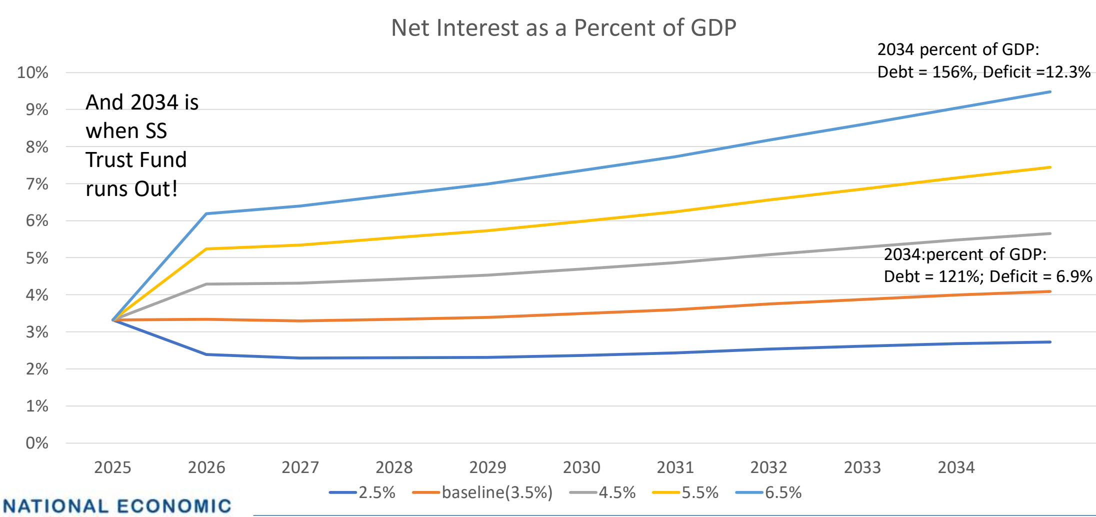
Change the Taxation of Assets Transferred at Death

Billions of dollars	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	Total 2025–2029	Total 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

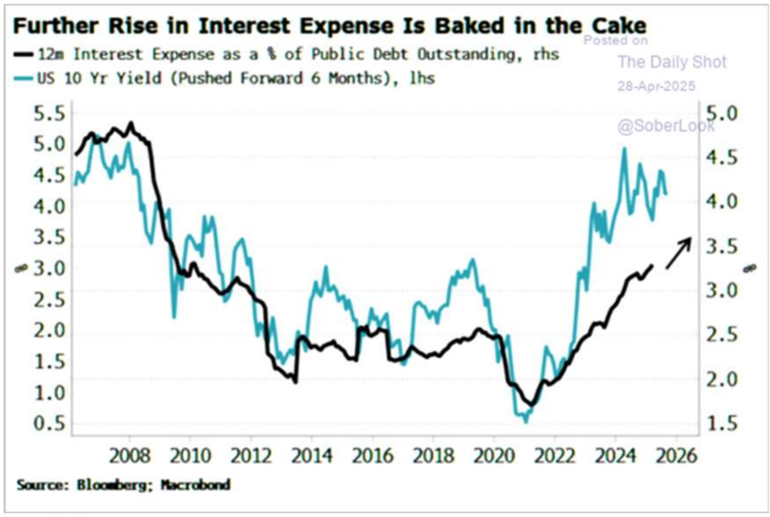
And, It Gets Worse

- **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



The Future of Interest on the Debt?



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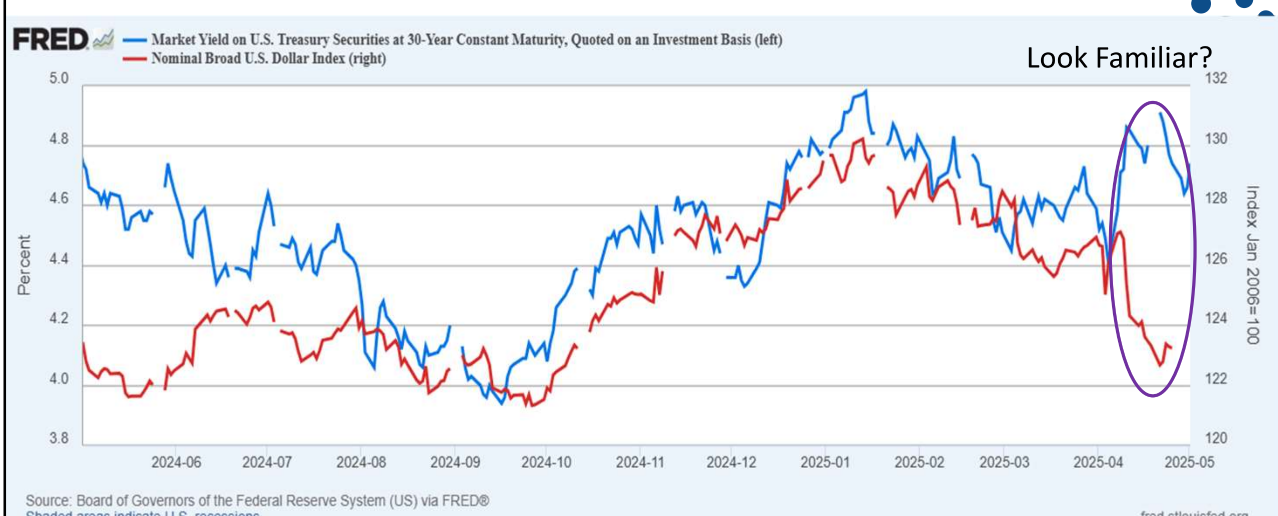
What About Those Gloomy Signals?



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Brookings on a Fiscal Crisis (2/12/2025)

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.

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

How Did We Get in This Mess?

- Partly, because of the "exorbitant" privilege combined with industrializing Asia.
- Japan, South Korea and China followed a similar playbook.
- Develop the industrial sector through subsidies and an "undervalued" currency.
- Sort of an "Infant Industry" argument.

How to Undervalue Your Currency

1. **Restrict domestic consumption to generate an increase in National saving and a trade surplus.**
2. **Normally a trade surplus would lead to an increase in the supply of dollars on foreign exchange markets and a fall in the value of the dollar (or rise in the value of US currency).**
3. **Offset the rise in the value of the your currency by buying US financial assets, e.g., US Treasury bonds. (which also helps to restrict domestic consumption).**

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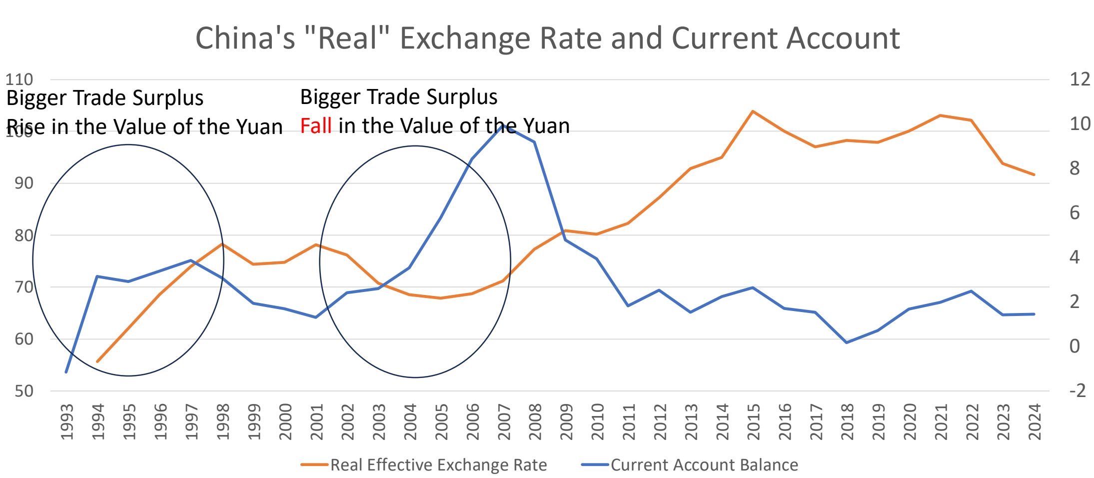
The Chinese Example



Chinese Consumption: 2000, 46.8% of GDP; 2010, 34.6%

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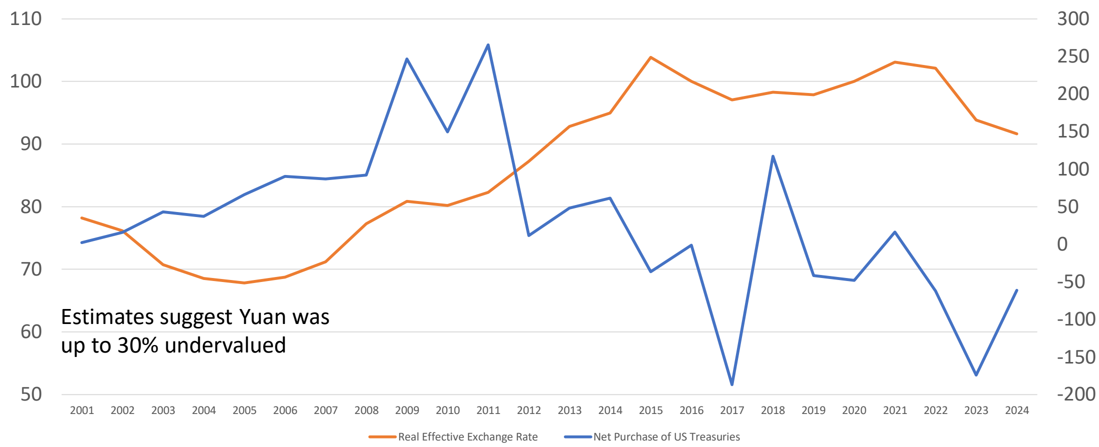
China's Net Purchase of US Treasury and the Yuan



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Why Didn't the US Respond?

- **Cheap Chinese goods kept US inflation low and benefited US consumers.**
- **Low US interest rates made the job of financing the deficit easier.**
- **Diplomatic reasons: "The US wants a prosperous China."**

- **Instead, the Fed cuts interest rate to raise domestic spending enough to accommodate growing imports, while maintaining domestic production.**
- **But manufacturing takes a big hit.**

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The Rise of a Heterodox Critic

- **Michael Pettis (based in a Chinese University!), *The Great Rebalancing,* 2013.**

In the *WSJ, April 30, 2025*

Letting other countries take the lead in manufacturing harms the American economy. The U.S. accommodates other countries' successful industrial policies by absorbing their negative consequences—namely, by absorbing global savings imbalances, running trade deficits and offshoring manufacturing.

U.S. leaders must adopt a strategic approach to industrial policy…and, more important, by reversing the U.S. role in absorbing global trade and capital imbalances.

But, How Would We Do This?

- **The "Mara Lago Accords":**
  - Tariffs
  - Discourage Capital inflows by
    - Forcing Foreigner governments to own 100-year Zero Coupon bonds.
    - Charging foreigners a fee for owning US Treasuries.

Sound Anything Like a Brookings Misstep?

How about "discouraging capital inflows" by cutting the deficit to decrease the need to borrow from foreigners!

Is that on the Congressional Agenda?

- **Sadly no.**
- **Two of "Trump's Three Steps to Economic Growth", Scott Besent, *WSJ*, 5/4/2025**

  First, renegotiating global trade. Tariffs are an effective tool for balancing international commerce. They reduce trade barriers in other countries, opening more markets to American producers while also bringing back thousands of manufacturing jobs.

  Second, making the 2017 Tax Cuts and Jobs Act permanent and adopting the president's new tax priorities: no tax on tips, overtime and Social Security.

What will be the effect of #2, on National Saving and the Trade Deficit?

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What about Entitlements?

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.

(There is a discussion of "reforming" Medicaid; about $600 billion in Federal spending last year.)

But there is no way this could get through the Senate Democrats, right?

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

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

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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"**

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The Reconciliation Game in Action

	By Fiscal Year, in Billions of Dollars											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-2022	2018-2027
Total Estimated Changes in Revenues	**-144.3**	**-270.9**	**-257.0**	**-234.8**	**-199.6**	**-163.9**	**-148.9**	**-146.4**	**-61.5**	**-19.8**	**-1,107.0**	**-1,649.0**
Total Changes in Direct Spending												
Estimated Budget Authority	-8.6	9.1	1.8	-13.9	-21.8	-26.0	-28.8	-32.1	-21.1	-52.9	-33.3	-194.1
Impact on Deficit	**135.7**	**280.0**	**258.8**	**221.0**	**177.8**	**137.9**	**120.1**	**114.3**	**40.4**	**-33.1**	**1,073.7**	**1,454.9**

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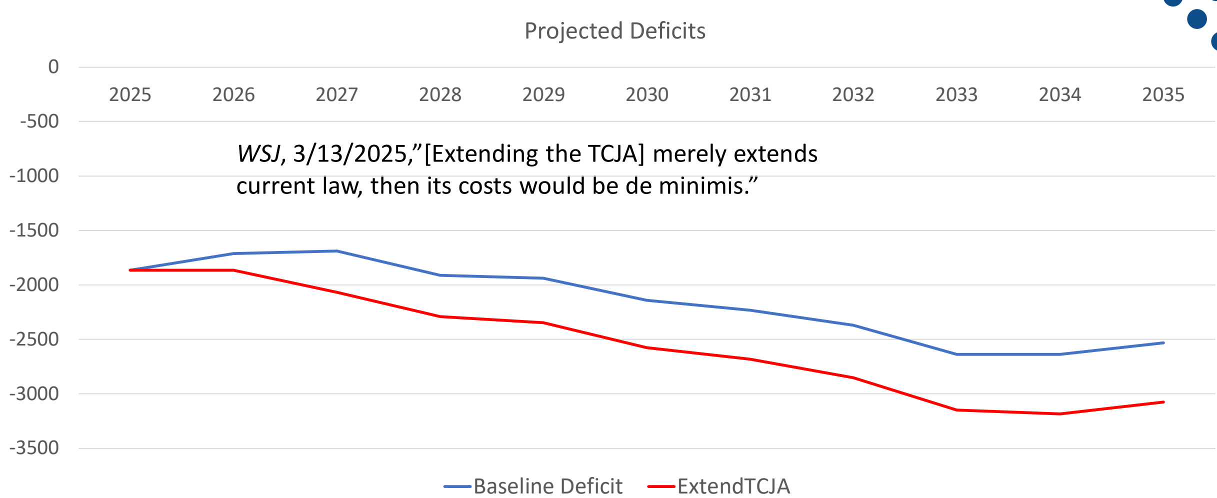
When is a Tax Cut, Not a Tax Cut?



WSJ, 3/13/2025,"[Extending the TCJA] merely extends current law, then its costs would be de minimis."

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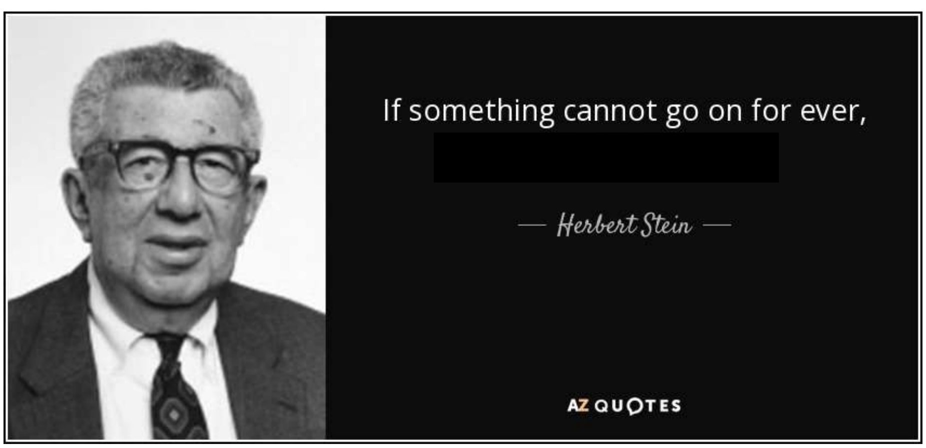
https://www.cbo.gov/publication/60114 https://www.cbo.gov/publication/61172

Consequences

- **Under the Current Baseline.**
  1. 2035 Deficit, $2.7 trillion (6.1% of GDP); Debt, $52.0 trillion (118%).
  2. Net Interest, $1.8 trillion.
- **Extend Just Income Tax Provisions of TCJA**
  1. 2035 Deficit, $3.1 trillion; Debt $53.7 trillion.
  2. Net Interest, $1.9 trillion
- **And, that is before "making room" for no taxes on overtime, social security, and tips!**
- ***Permanent* Tariffs could raise maybe $2trillion.**

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