

# *Osher Lifelong Learning Institute, Summer 2024* **Contemporary Economic Policy**

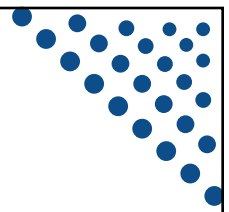
OLLI – University of California  
June, 2024

Jon Haveman, Ph.D.  
National Economic Education Delegation



NATIONAL ECONOMIC  
EDUCATION DELEGATION

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

# Course Outline

## • Contemporary Economic Policy

- Week 1 (6/4): US Economic Update (Jon Haveman, NEED)
- Week 2 (6/11): Economics of Immigration
- **Week 3 (6/18): Federal Debt**
- Week 4 (6/25): Taxes: Rebellion, Rascals, and Revenue

3



# The US Federal Debt

June 18, 2024

Jon Haveman, Ph.D.  
NEED



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).



5

## Outline

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



6

# First: A Budget Review

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		
<b>Total</b>	<b>\$4,898</b>	<b>Total</b>	<b>\$6,271</b>

Budget Deficit: \$1,375 Billion

8

# But There is More to The Budget!

## Estimated Outlays, Revenues, and Tax Expenditures in 2023

Percentage of GDP



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

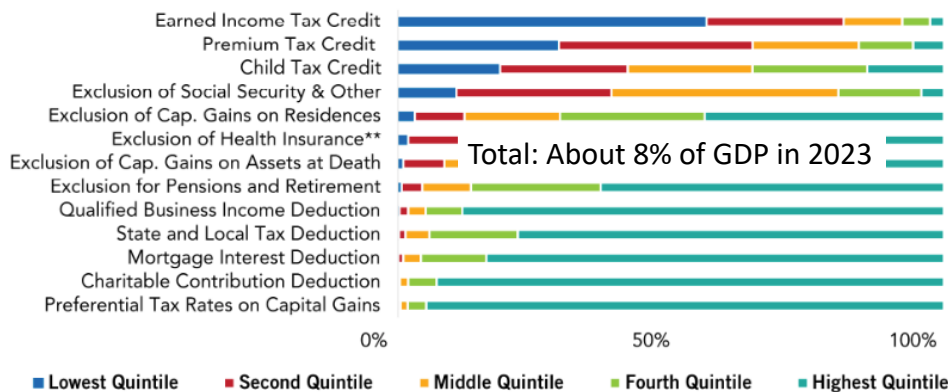
9

9

# What Are Tax Expenditures?

SHARE OF MAJOR TAX EXPENDITURES\* (%)

All Major Expenditures



SOURCE: Congressional Budget Office, *The Distribution of Major Tax Expenditures in 2019*, October 2021.



Source: [https://www.pgpf.org/Chart-Archive/0199\\_distribution\\_tax\\_expenditures](https://www.pgpf.org/Chart-Archive/0199_distribution_tax_expenditures)

10

10



# And Now: The Debt

 NATIONAL ECONOMIC EDUCATION DELEGATION

11

11



## WHAT IS THE NATIONAL DEBT TODAY?

**\$34,684,998,349,899**

 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**

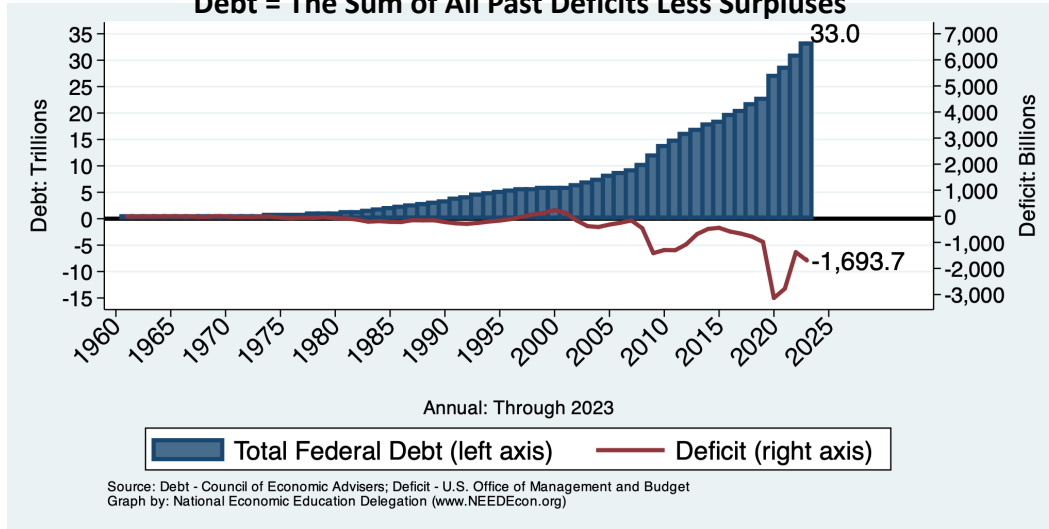
- **Debt:** The accumulation of debt over time.
  - The sum of all past deficits and surpluses.



13

# Debt vs. Deficit

Debt = The Sum of All Past Deficits Less Surpluses



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 deficits.
  - These are driven by Medicare and Social Security spending.
- The longer we postpone action, the greater the probability of a “fiscal crisis.”



15

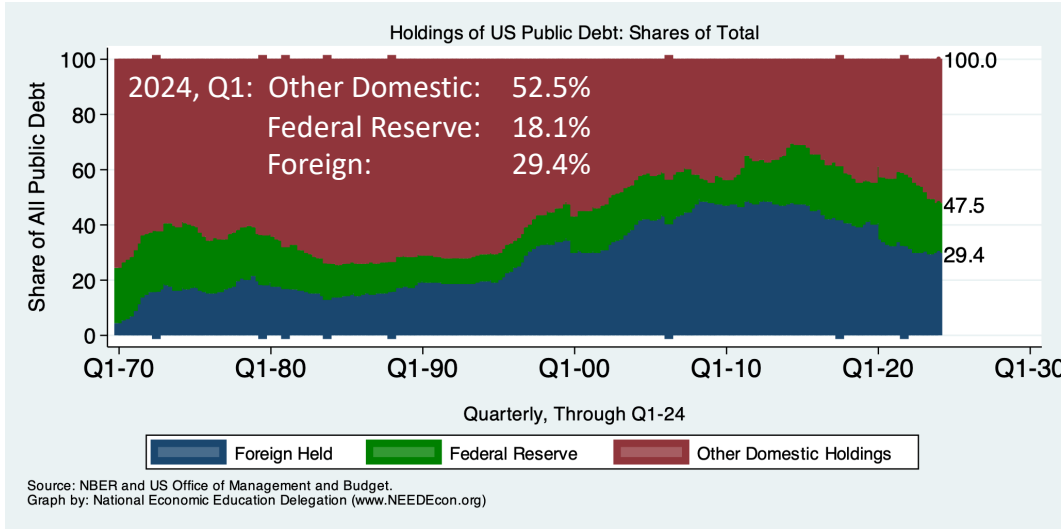
## How Does the US Government Borrow?

- 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 governments and individuals
  - Federal Reserve



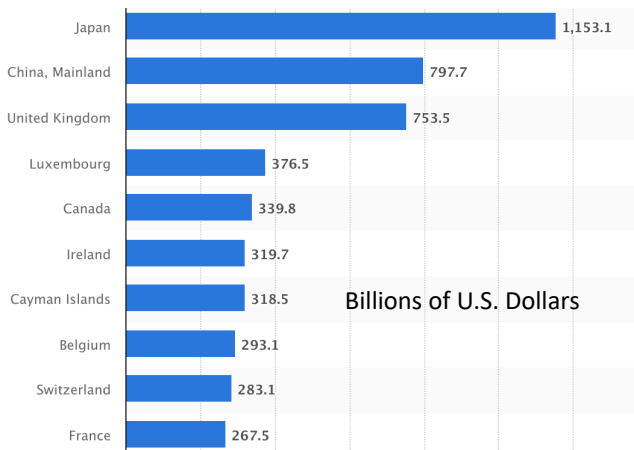
16

## Trends in US Debt Holdings Over Time



17

## Who Holds Debt to Foreigners, Jan. 2024



Foreign ownership is relatively recent  
 – in 1990 foreign ownership was less than 20%  
 – peaked at 40+%  
 – now is 29.4%

18

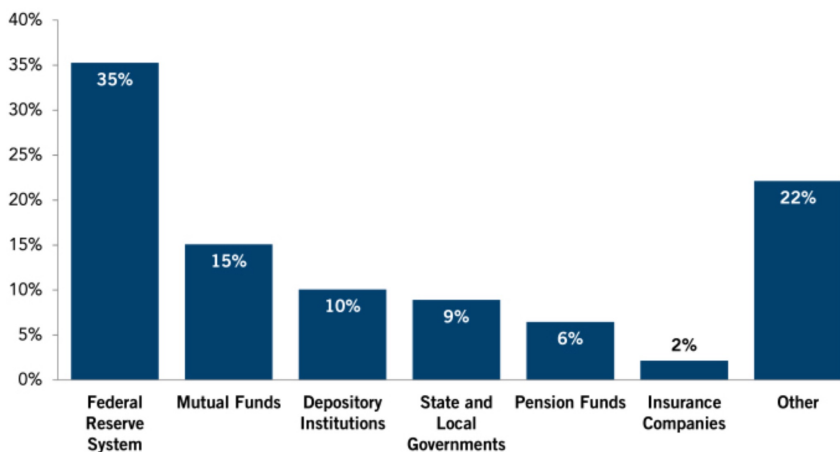
## Why Do Foreign Investors Buy US Treasuries?

- **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.
  - 88% of international transactions involve the dollar.
  - With some exceptions, foreign governments borrow in dollars.

19

The Federal Reserve owns about 35 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.

© 2023 Peter G. Peterson Foundation

PGPF.ORG

20

## Important Points:

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



21

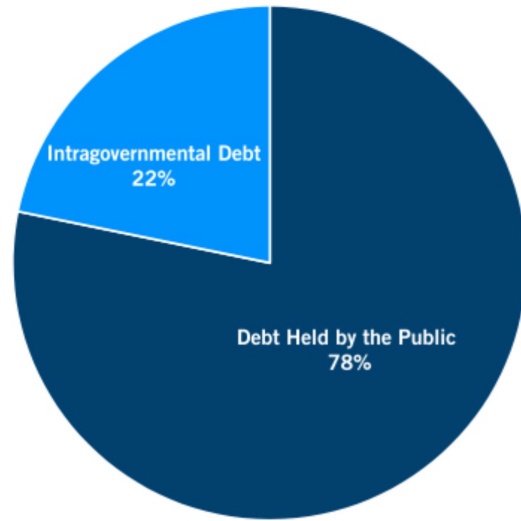
## Not All Debt Is Created Equal

- **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.**



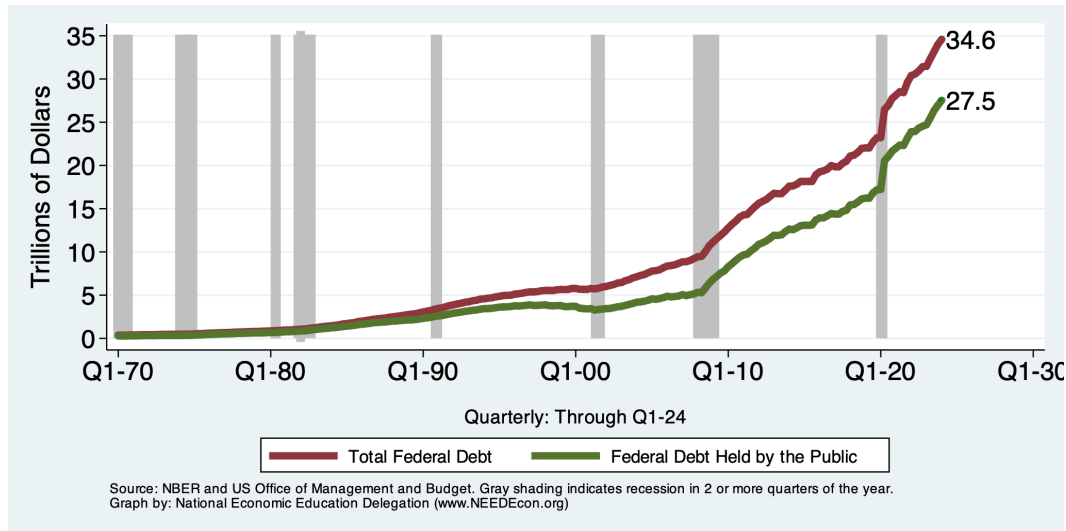
22

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



23

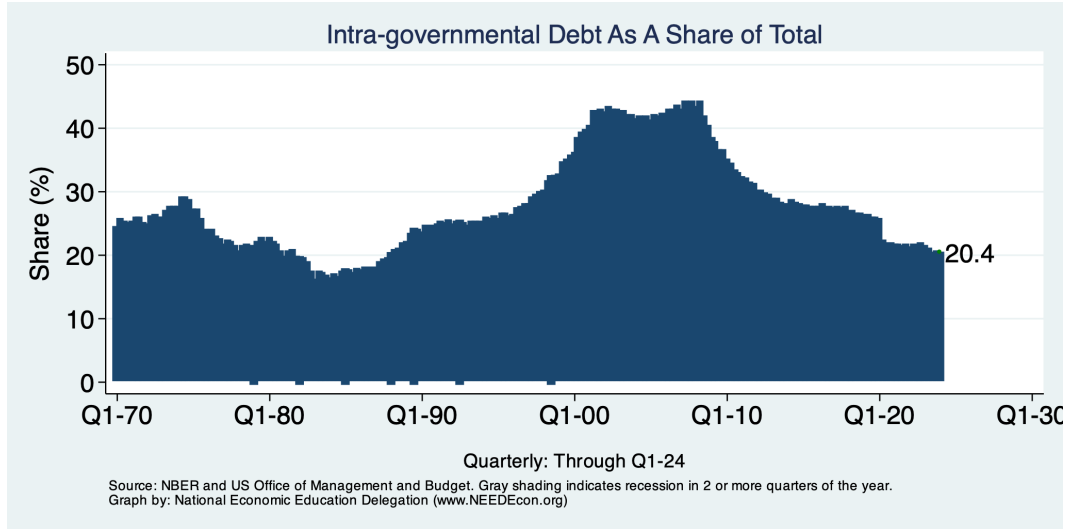
## Two Measures of the Debt



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.NEEDecon.org](http://www.NEEDecon.org))

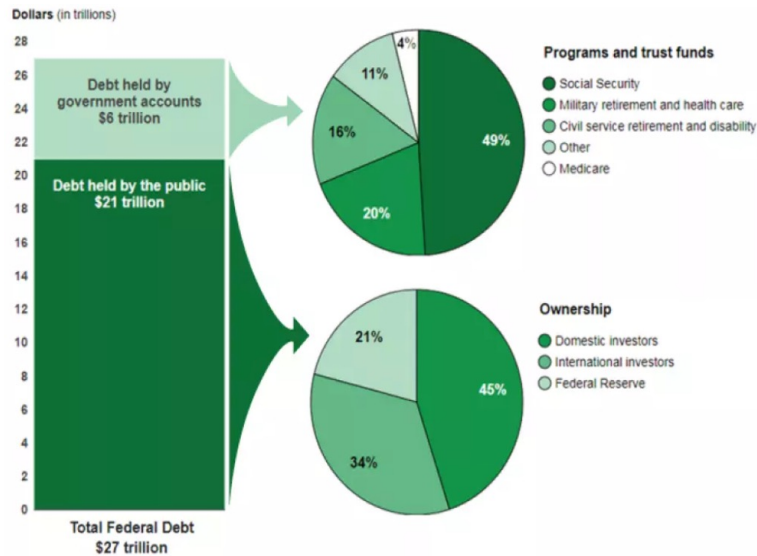
24

## Trends in Intragovernmental Debt



25

## A Breakdown of Total Federal Debt, 2020



26

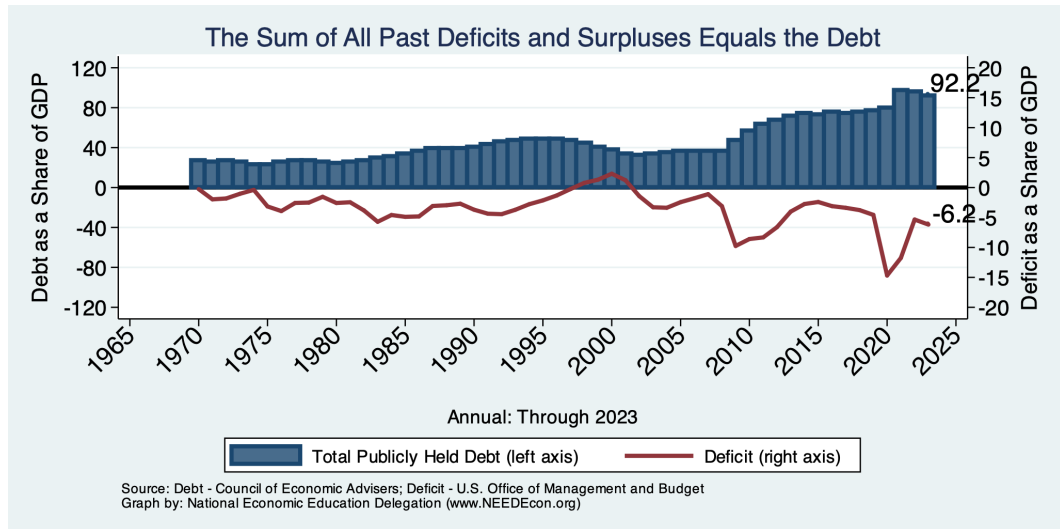
# The All-Important *Relative* Debt

- 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	\$27.5 Trillion	97.4%
Greece	\$0.215 Trillion	170%

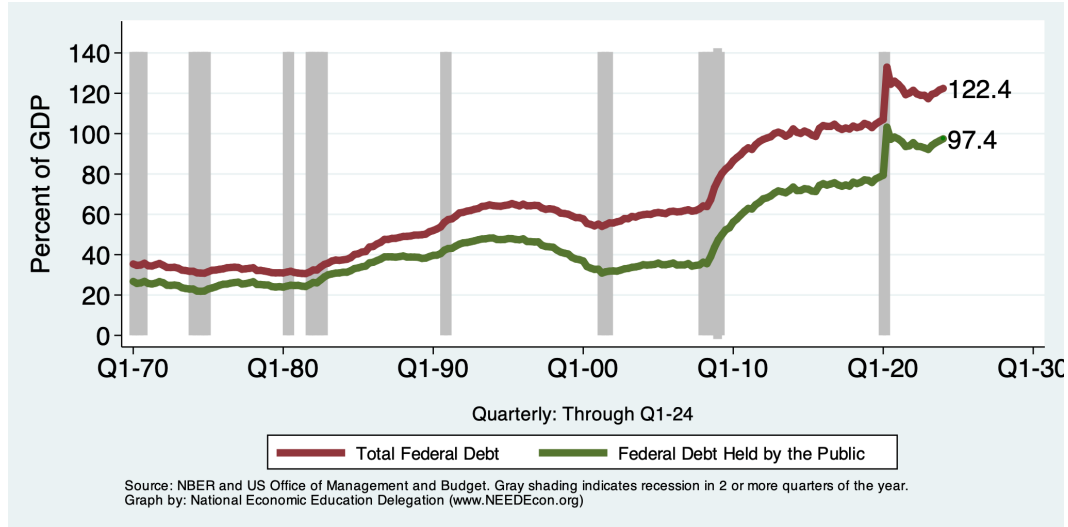
27

# Relative Debt and Deficit



28

## Two Measures of RELATIVE Debt



29

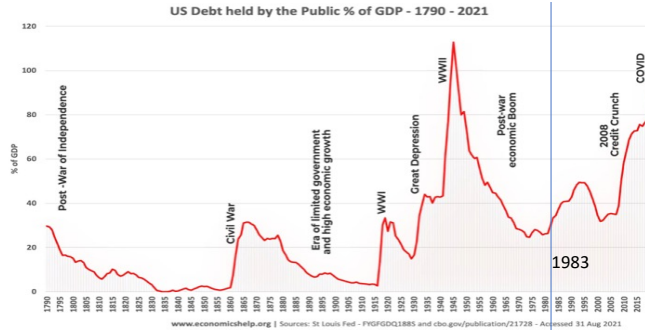
## Two Measures of the Deficit

- (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.



30

# Key Points About US Relative Debt



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

31

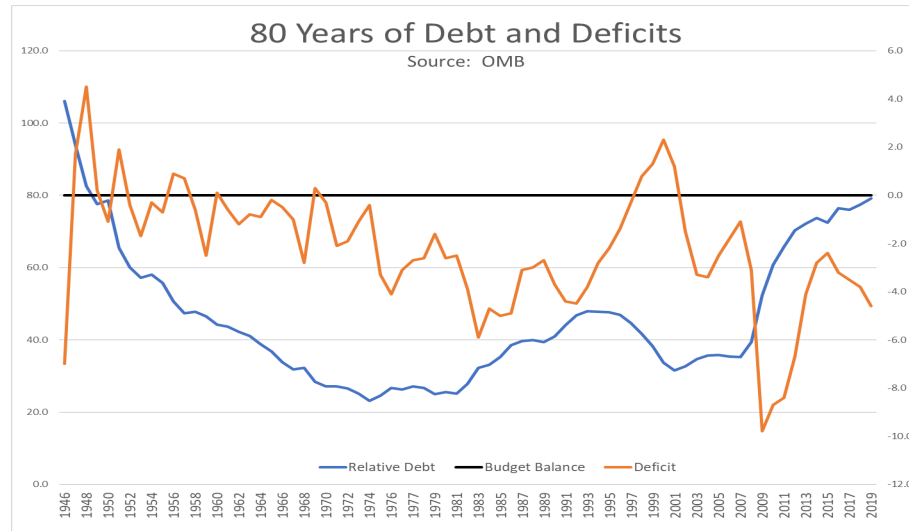
# Debt Dynamics

## • Surprising (?) Facts

- From 1945 to 1979, relative debt fell from 110% of GDP to 25% of GDP.
- During this period, the federal budget was in surplus only 8/35 years!

32

## The Post-WWII Fall in Relative Debt



33

## Debt Dynamics

### • Surprising (?) Facts

- From 1945 to 1979, relative debt fell from 110% of GDP to 25% of GDP.
- During this period, the federal budget was in surplus only 8/35 years!

### • Relative debt is a fraction: $\text{Debt}/\text{GDP}$ ; 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.*

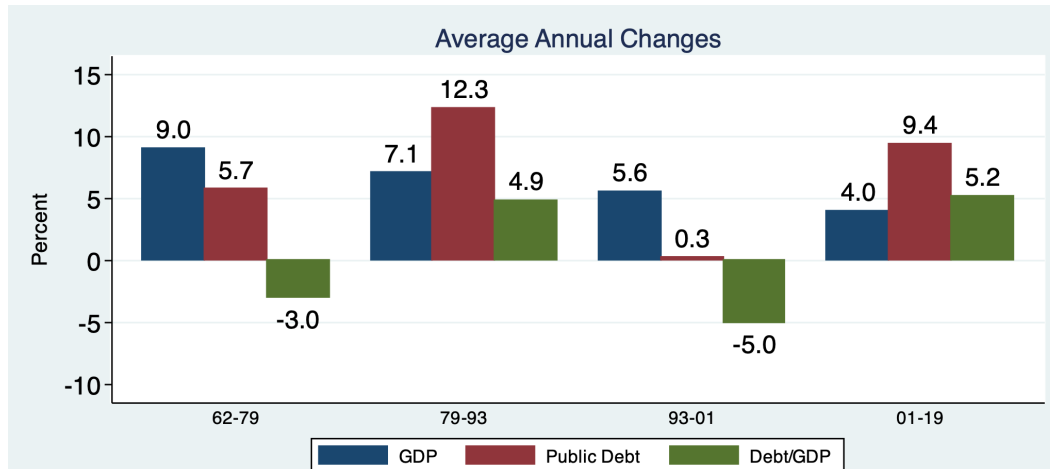
34

## 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*.

35

## The Arithmetic of Changes in Relative Debt



Source: Council of Economic Advisers and BEA  
 Graph by: National Economic Education Delegation ([www.NEEDelegation.org](http://www.NEEDelegation.org))

36

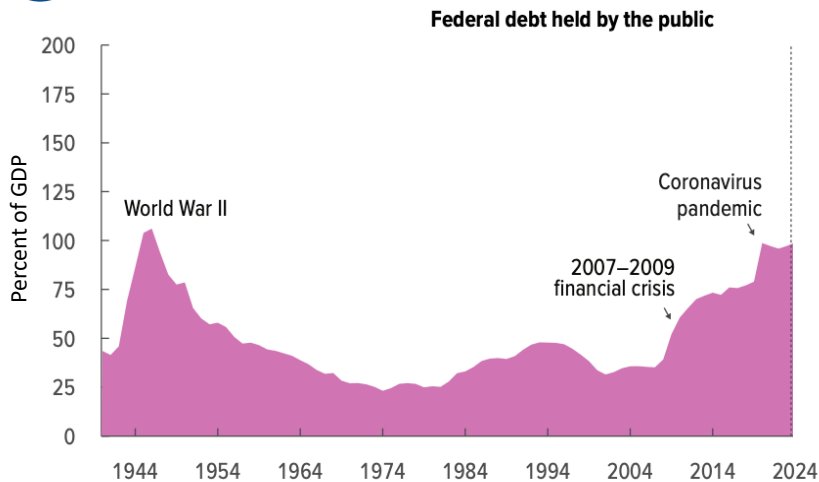
## Is Stabilizing Relative Debt Good Enough?

- This means that the absolute level of the debt would continue to increase.
- Yes, it probably is 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.



37

## But Let's Think About Today



Data source: Congressional Budget Office. See [www.cbo.gov/publication/59711#data](http://www.cbo.gov/publication/59711#data).



38

# 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

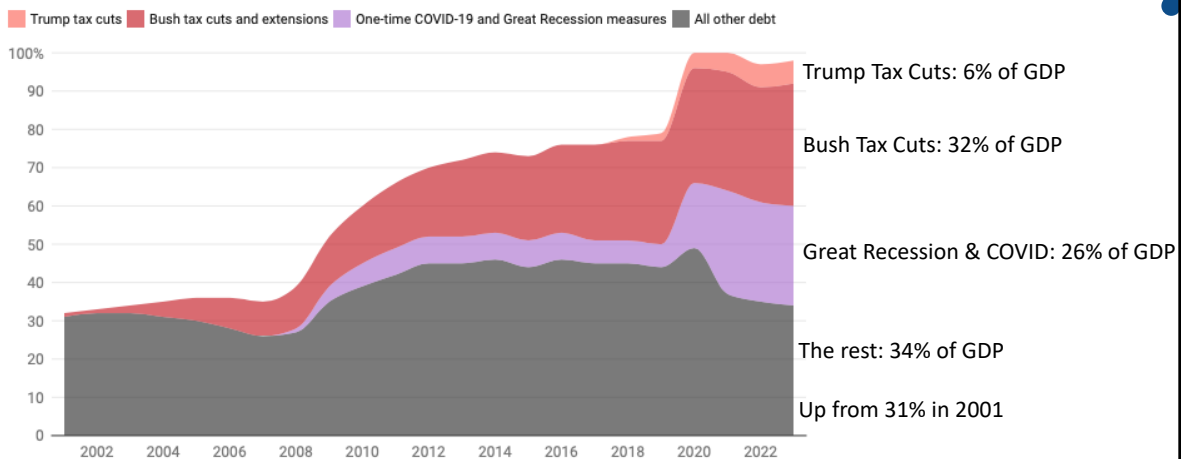
## • Revenues DOWN:

- Declining income tax revenues
  - Stagnant wages
  - Tax cuts
- Social security
  - Declining revenues

39

# Tax Cuts Have Driven The Debt Increases

Debt held by the public as a percentage of gross domestic product, 2001–2023



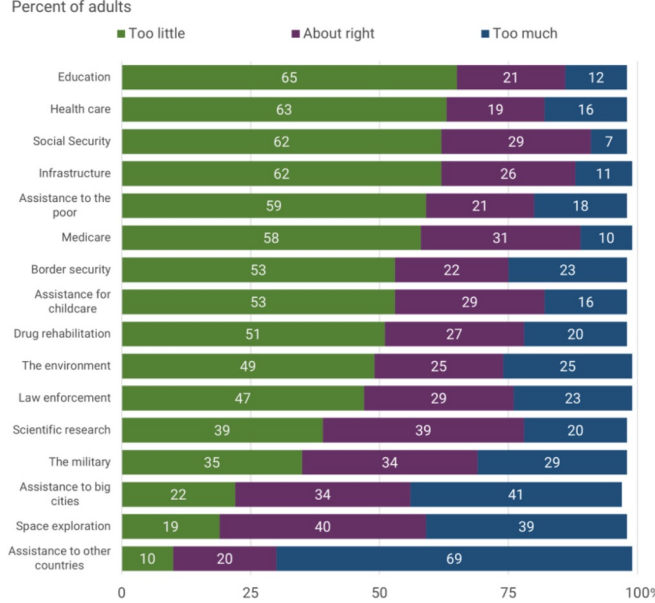
40

# Thinking About Today....

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

41

## Overall, the public is dissatisfied with the way the government is spending in key public policy areas.



There is very little enthusiasm for cutting anything.

42

## Thinking About Today....

- **Do we have:**
  - A spending problem?
  - A revenue problem?
  - Both?
  
- **Not much support for it being a spending problem.**



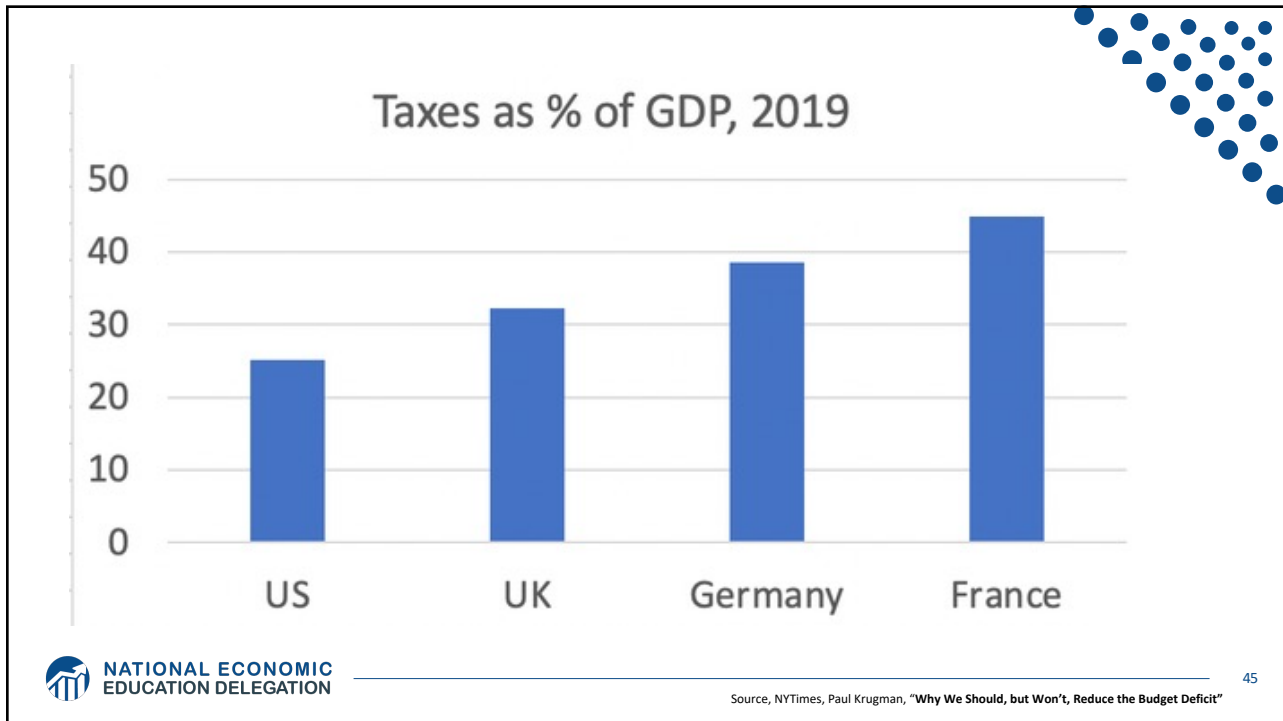
43

## How To Address the Debt?

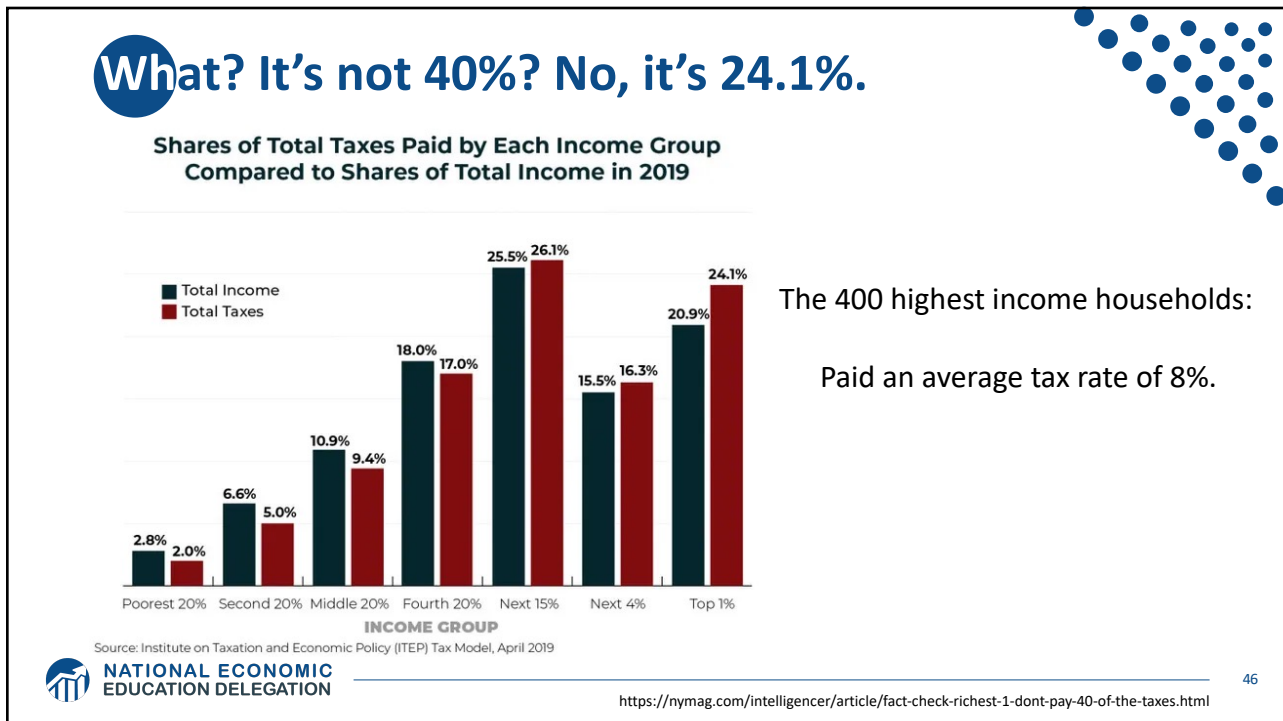
- **The question isn't taxes vs spending cuts.**
- **The question is:**
  - **Who should bear the burden of solving the problem?**
    - Spending cuts will mean primarily lower-income households.
    - Tax increases will mean primarily high-income households.
    - Soc Sec benefit cuts (age limit, actual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



44



45

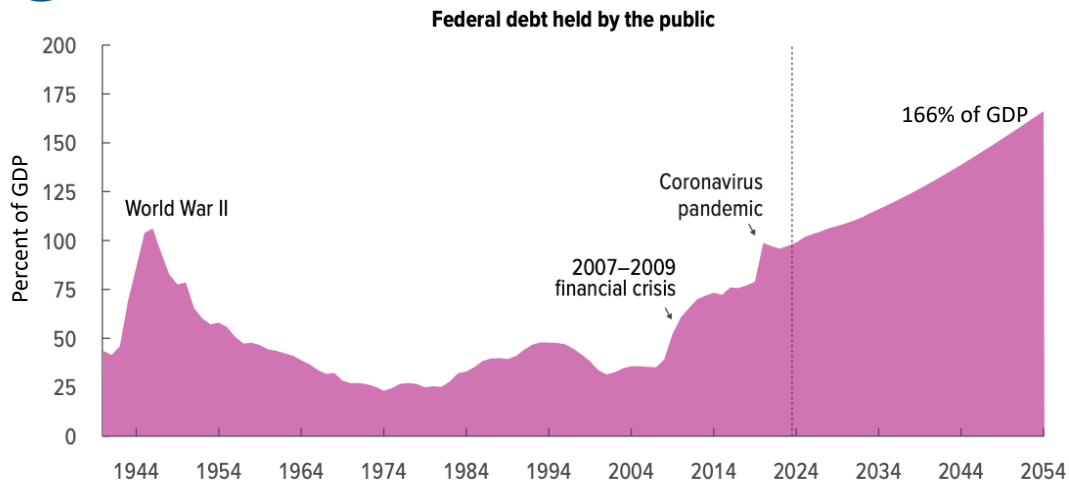


46

# Can't Stop...Thinking About Tomorrow

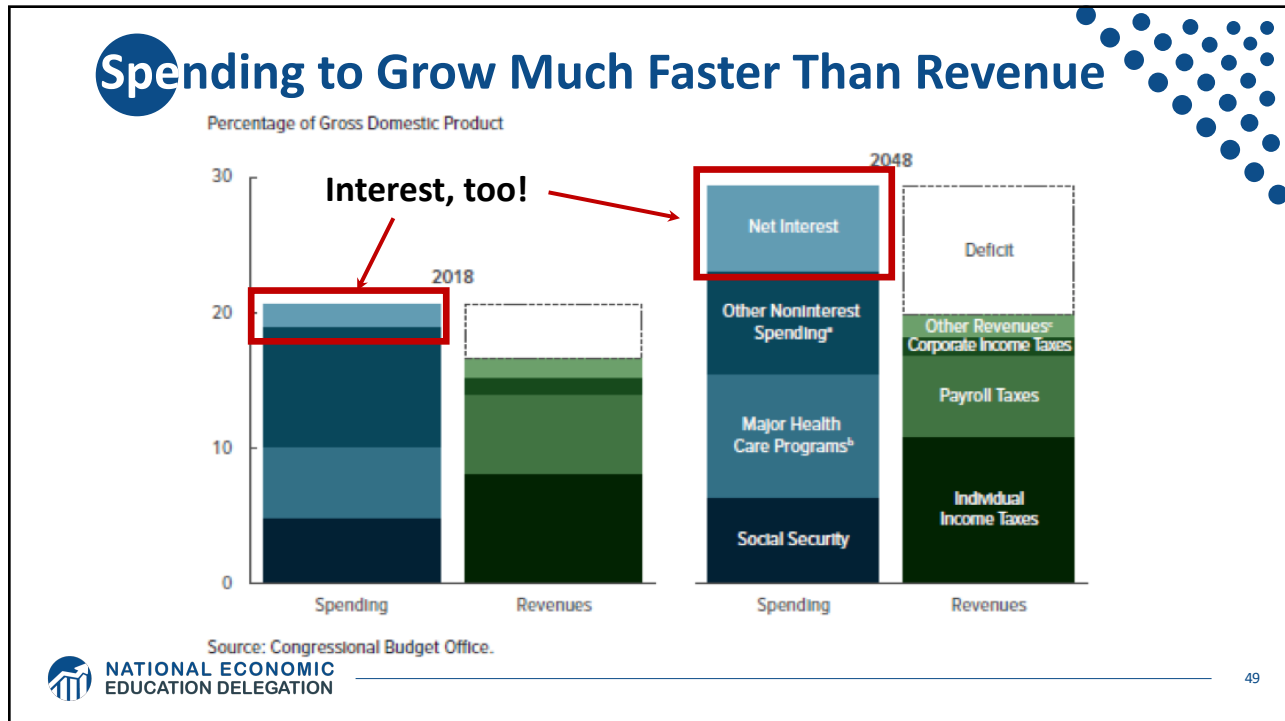
47

## Now Let's Think About Today and the Future

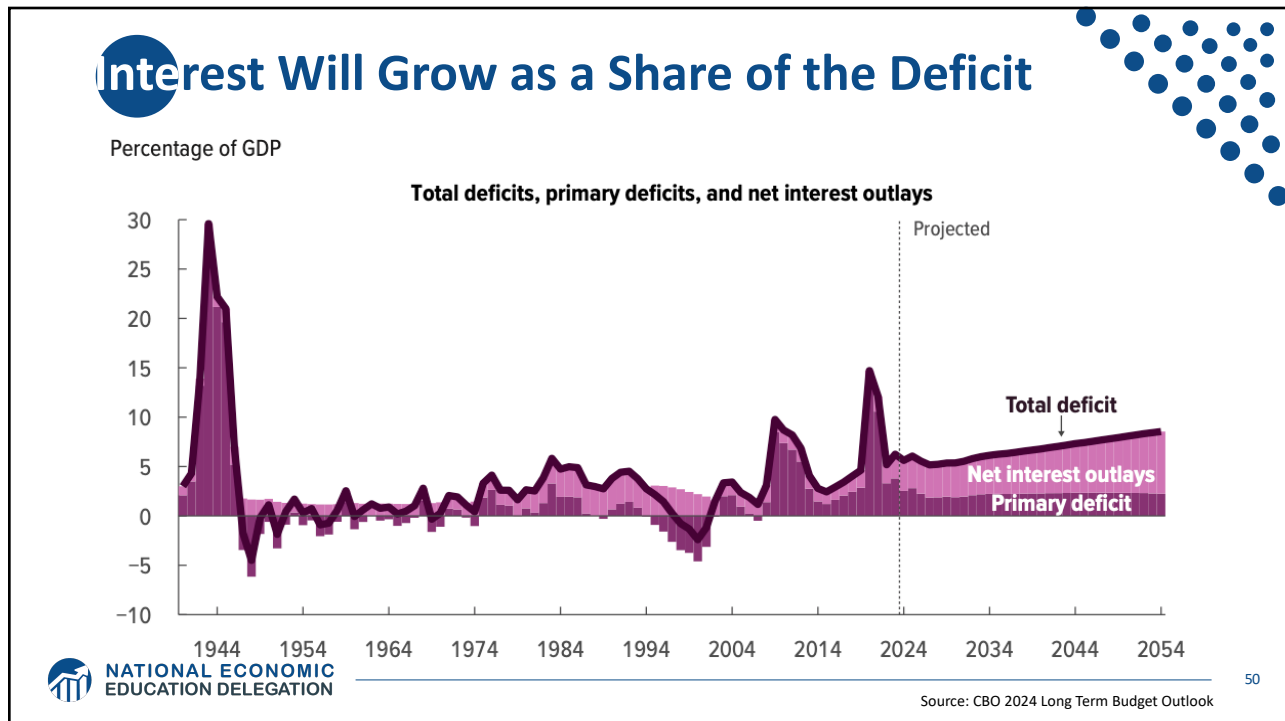


Data source: Congressional Budget Office. See [www.cbo.gov/publication/59711#data](http://www.cbo.gov/publication/59711#data).

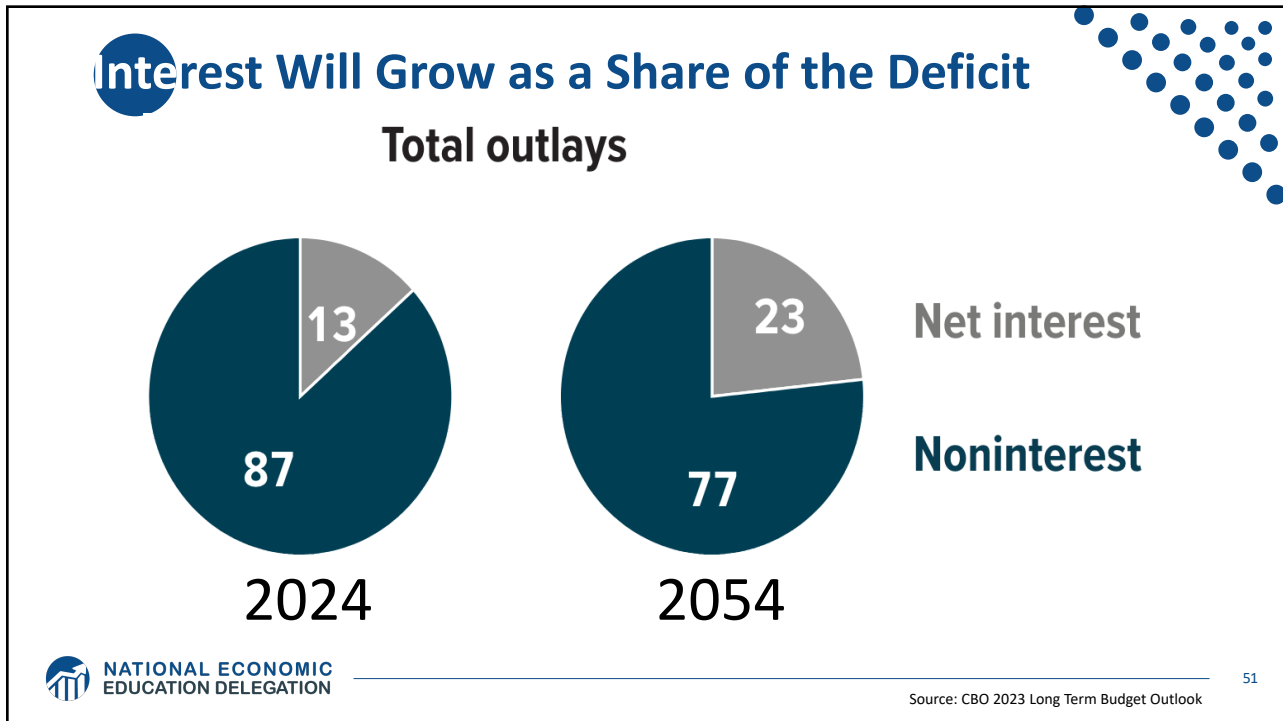
48



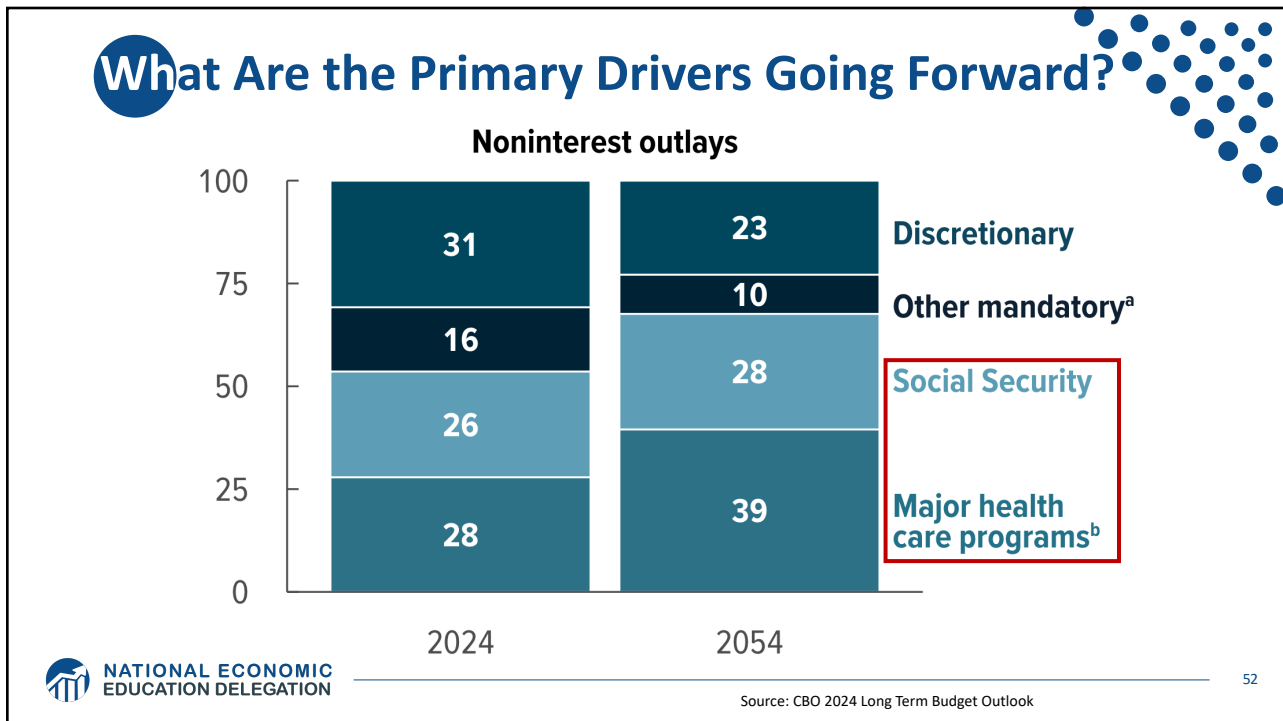
49



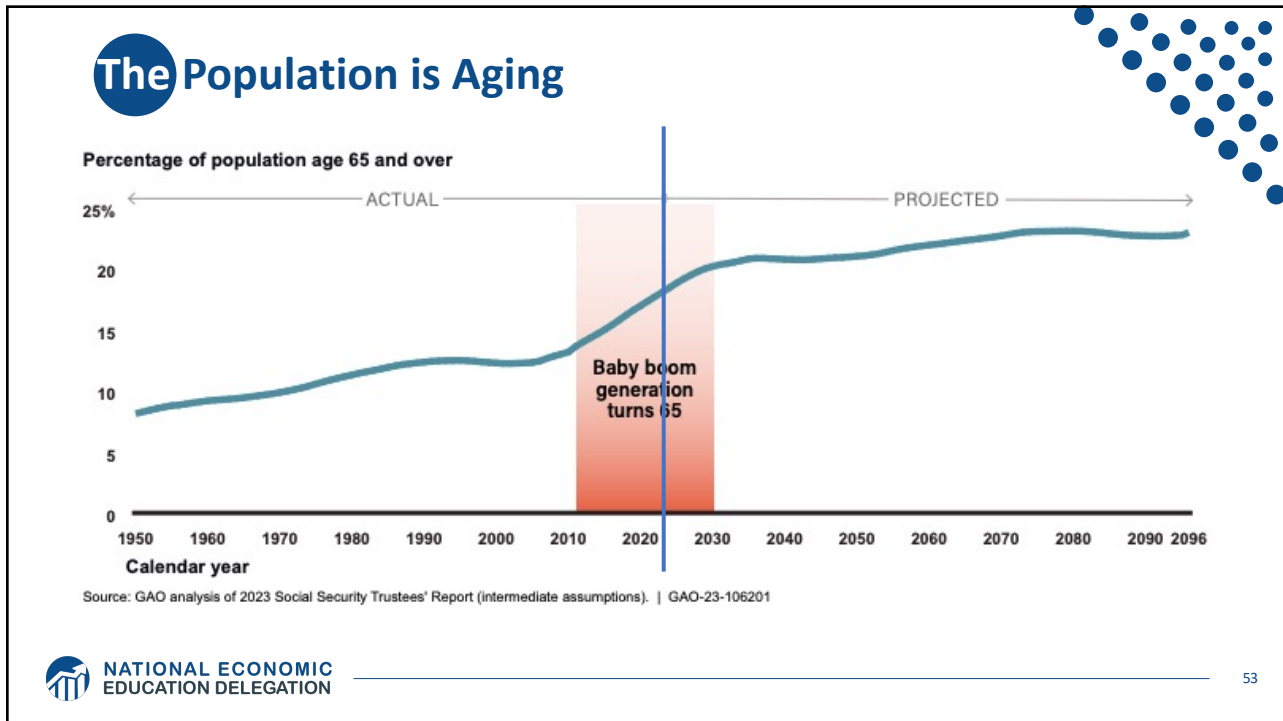
50



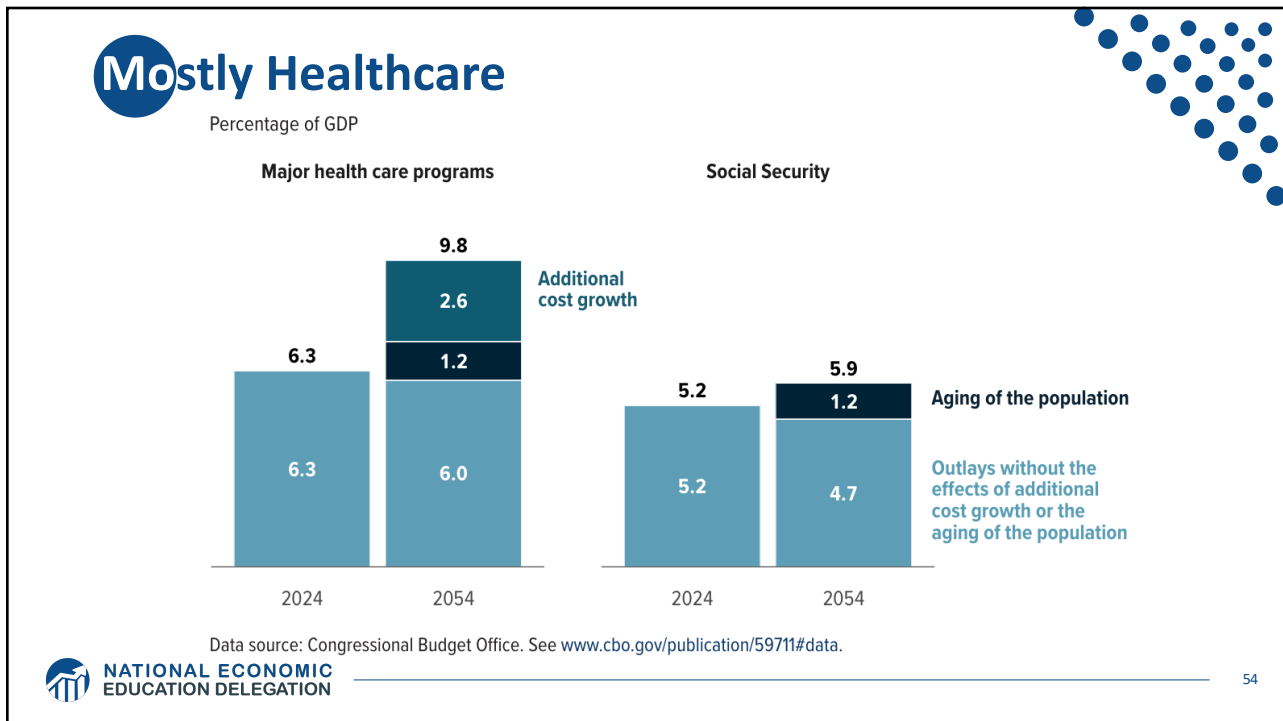
51



52



53



54

# How to Think About the Debt



55

## Perspectives on Increased Debt

- **Does debt impose a burden on future generations?**
  - Does it inevitably have to be paid off? No!
- **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.



56

## 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



## 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.**



## So, Why Worry About it?

### • If debt becomes too high:

- Investors might start questioning the creditworthiness of the US government.
  - o Problem: Nobody knows how high is too high.
- It becomes more difficult to borrow in times of crisis.
  - o War, severe recession
  - o “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.
  - o Not currently a problem. No idea if/when it might become one.
- Could be inflationary.



## So, Why Worry About It?

### • If debt continues to grow:

- Interest payments will grow with it.
  - o 13% of spending in 2024.
  - o 23% of spending in 2054.
  - o Less room for using the budget for policy priorities.
  - o 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



61

## 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.**



62

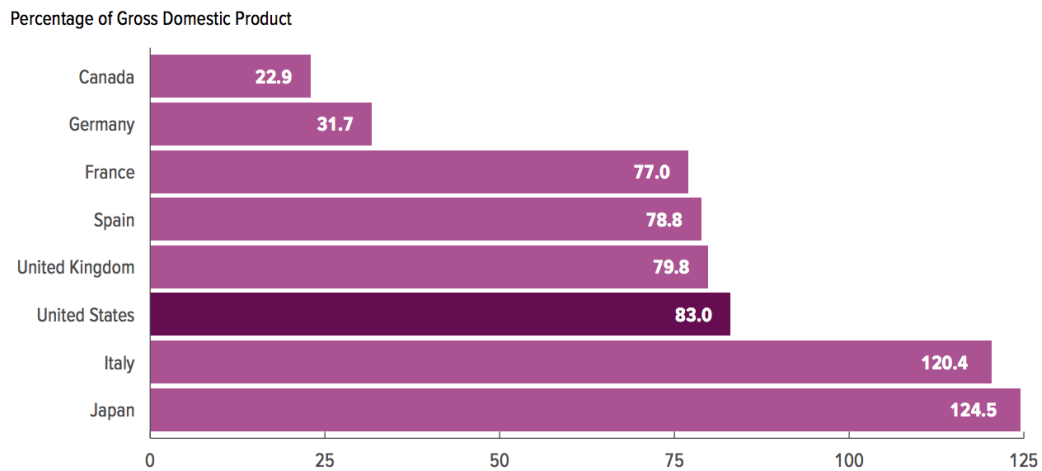
## What Is a Fiscal Crisis?

- **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

63

## Other Countries Have Higher Debt Levels

Debt of Selected Countries at the End of Calendar Year 2018



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

64

# Summary



65

## 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, healthcare costs 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.”**



66

## 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.”



## 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.**



## 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

69

69

## Thank you!

## Any Questions?

[www.NEEDEcon.org](http://www.NEEDEcon.org)

Jon Haveman, Ph.D.

Jon@NEEDEcon.org

Contact NEED: [info@NEEDEcon.org](mailto:info@NEEDEcon.org)

Submit a testimonial: [www.NEEDEcon.org/testimonials.php](http://www.NEEDEcon.org/testimonials.php)

Become a Friend of NEED: [www.NEEDEcon.org/friend.php](http://www.NEEDEcon.org/friend.php)



NATIONAL ECONOMIC  
EDUCATION DELEGATION

70

70

## 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.



71

## 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.

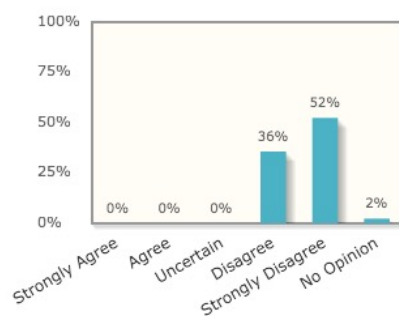


72

## 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.**

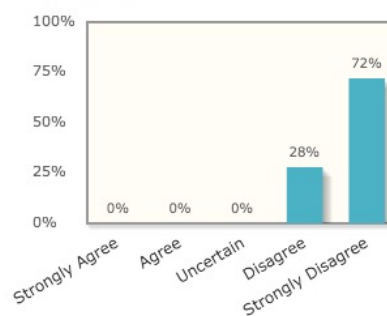
**Responses**



© 2019, Initiative on Global Markets.

Source: IGM Economic Experts Panel  
[www.igmchicago.org/igm-economic-experts-panel](http://www.igmchicago.org/igm-economic-experts-panel)

**Responses weighted by each expert's confidence**



© 2019, Initiative on Global Markets.

Source: IGM Economic Experts Panel  
[www.igmchicago.org/igm-economic-experts-panel](http://www.igmchicago.org/igm-economic-experts-panel)



NATIONAL ECONOMIC  
EDUCATION DELEGATION

73

73

## 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



NATIONAL ECONOMIC  
EDUCATION DELEGATION

74

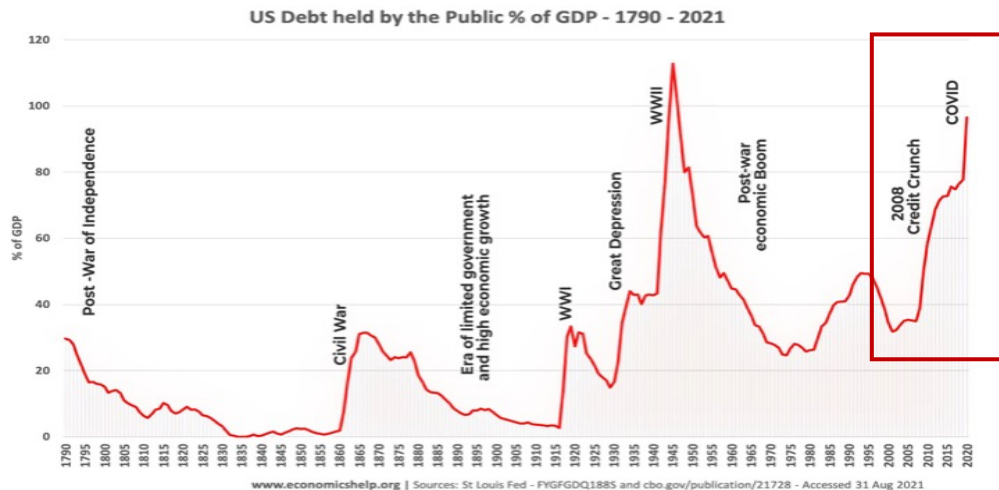
74

# 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.

75

# But Let's Think About Today



76