

Federal Deficits Debate

“To everything there is a season, and a time to every purpose under heaven.”

--Ecclesiastes 3:1

Now – our economy still very weak
--unemployment still almost 8%

We need higher federal budget deficits

Later – when economy at full-employment

We should reduce deficits

There are two major issues tonight:

1. Can federal deficits produce jobs, cure today's unemployment?
2. Even if deficits can help, is the resulting national debt a terrible problem?

Our economy is still really bad

GNP is at \$16 trillion; at full capacity it would be \$17 trillion

Unemployment peaked at 10%

Now down to 7.6% but seems stalled

12 million+ people unemployed

This is a terrible human tragedy

Ending this tragic situation soon should
guide our decisions

Question 1: Can federal deficits produce jobs, cure today's unemployment?

Answer: absolutely yes!

Deficits produce spending (“demand”), either by cutting taxes or increasing spending, or both

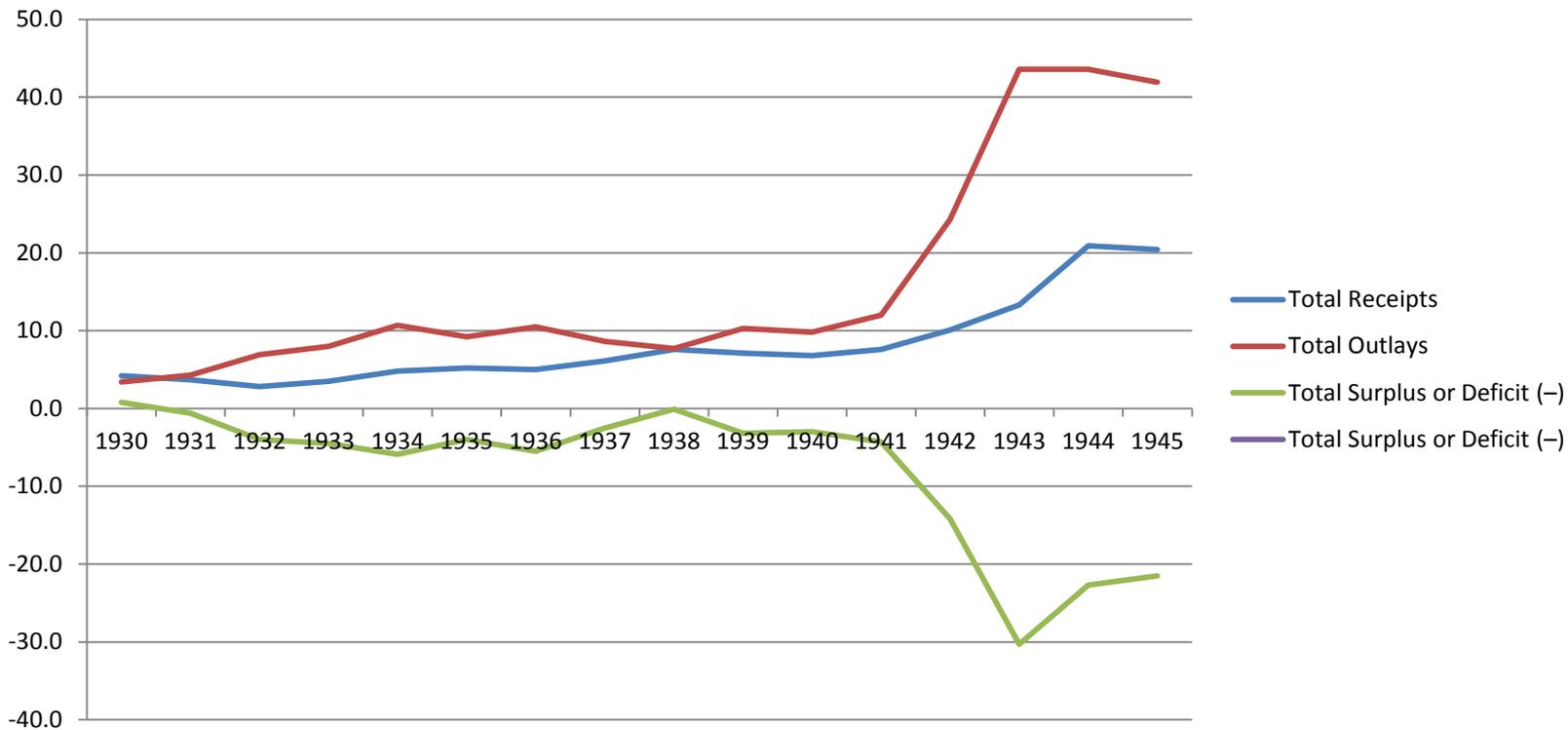
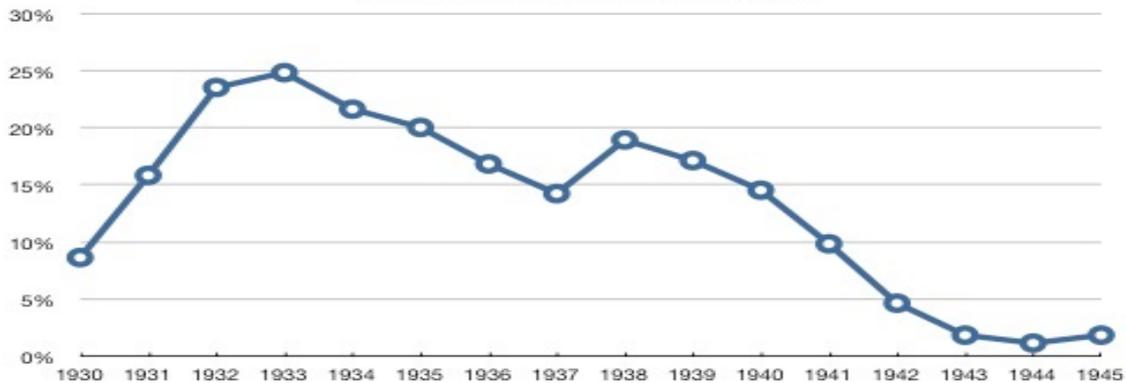
When there is excess capacity, like now, increased demand increases output and employment

We learned this painfully in the Great Depression of 1929 – 1941

The guy who figured it out: British economist John Maynard Keynes (rhymes with “rains”)

But he also said, when the economy returns to normal, cut the deficits or even run a surplus.

U.S. Unemployment Rate, 1930-1945



N. Gregory Mankiw

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Brief Principles of
Macroeconomics



Sixth Edition

Did the “stimulus” induce more demand and thus lead to higher output and employment?
Of course!

Yes, the current recession led to trillion dollar deficits for the last four years from falling taxes and increasing social benefits

These deficits were not evil – they saved our economy and millions of jobs

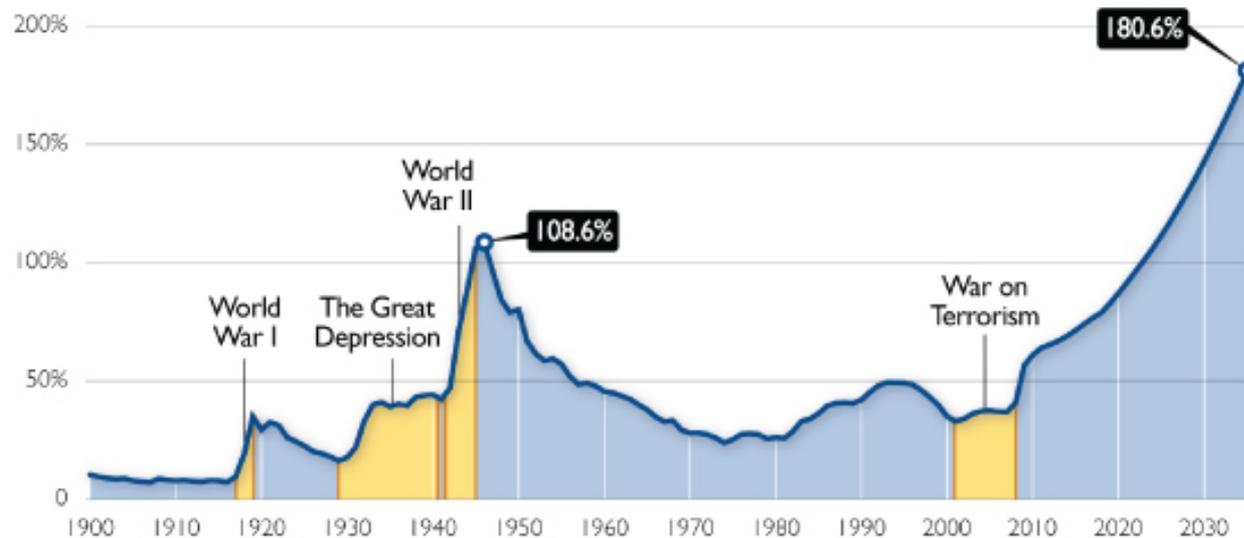
But, as Keynes emphasized, for everything there is a season:

When the economy is strong again, you want to reduce deficits to prevent higher interest rates and inflation

National Debt Set to Skyrocket

In the past, wars and the Great Depression contributed to rapid but temporary increases in the national debt. Over the next few decades, runaway spending on Social Security, Medicare, and Medicaid will drive the debt to unsustainable levels.

DEBT AS A PERCENTAGE OF GDP



Source: Heritage Foundation compilations of data from U.S. Department of the Treasury, Institute for the Measurement of Worth (Alternative Fiscal Scenario), Congressional Budget Office, and White House Office of Management and Budget.

Debt and Deficits Chart 3 • 2010 Budget Chart Book heritage.org

For the U.S., reducing deficits after 2020 will mean reducing growth of American health care costs, which are outrageously high

Medicare and Medicaid just pay the private sector's outrageous costs

Europe spends half per person what we spend, for the same health outcomes

Back to Question 2: Even if deficits can help, is the resulting national debt a terrible problem?

Answer: not at the levels we are going to see.

Debt held by public now (\$12 trillion) is 77% of GDP. Even if we stimulate economy as I suggest, it won't top 100%, probably less than 90%

In the meantime, adding to the national debt is not imposing a “crushing burden on our children.”

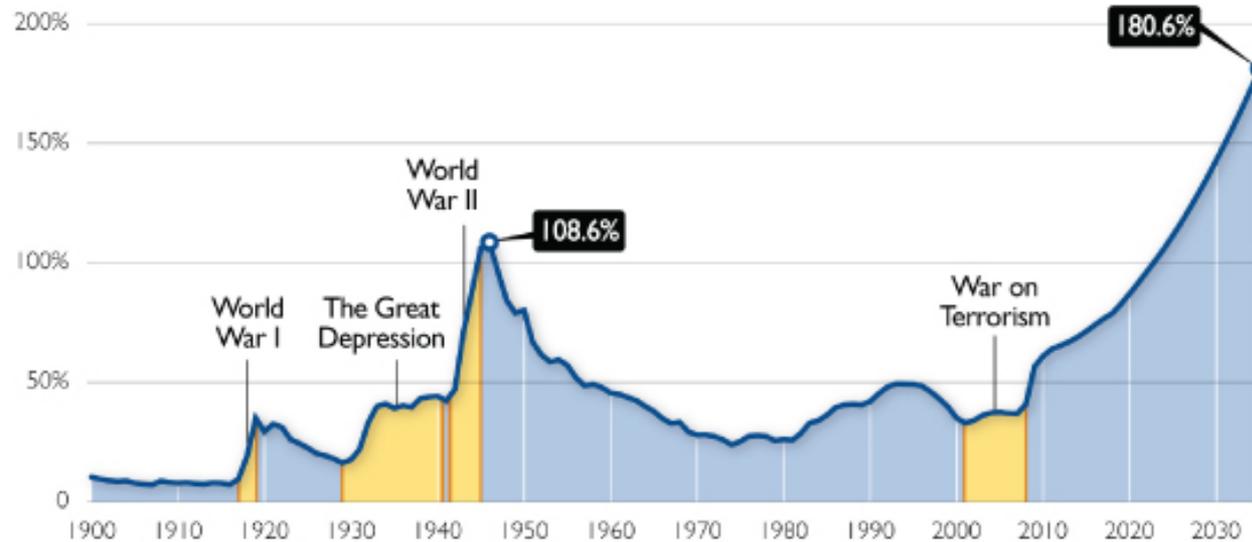
They will inherit many of the bonds and their government will make payments to them

Our post-World War II experience; we never paid down the huge World War II debt; the economy just outgrew it; our government taxes us but made the payments to us

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What about foreign ownership of half of our public debt today?

Foreigners own \$25 trillion in U.S. assets: \$5.5 trillion of government bonds; the rest in private assets like stocks and real estate

They get earnings from Americans on all these assets

If they own more government bonds they own fewer private assets

Where do foreigners get all these dollars to invest in the U.S.?

Because we buy \$500 billion more from them every year than they buy from us = a very significant “trade deficit”

some of that excess bound to be invested in U.S. Treasury securities