Chapter 31+32 Notes: Deficit and Debt

**Fiscal Policy**
- Fiscal policy refers to the government’s policy on ___________________ and _____________________ and how they affect the flow of income in the economy.

**Expansionary Fiscal Policy**
- Expansionary fiscal policy:
  - Can be in the form of:

**Contractionary Fiscal Policy**
- Contractionary fiscal policy:
  - Can be in the form of:

**What about Transfer Payments?**
- A transfer payment is a payment that is given (or “transferred”) from the government to individuals who provide nothing in return (such as Social Security).
- What if the government decides to increase transfer payments?
  -

**What about Taxes?**
- What if the government decides to decrease taxes?
  -

**Discretionary Fiscal Policy**
- Discretionary fiscal policy
  - Estimated at $1.485 trillion for 2021 fiscal year
  - The largest discretionary spending category is national defense—which is more than 50% of the entire discretionary budget

**Nondiscretionary Spending**
- Nondiscretionary spending
The Federal Deficit and Debt

- **Budget surplus:**
  - The last surplus was between 1998-2001

- **Budget deficit:**

  - If the government increases spending without increasing taxes they will increases the annual deficit and the national debt

  - **Deficit spending:** when a government spends more than it collects in revenue for a given year
    - As a result, they forgo using these funds for other uses

Causes of Deficit

- **There are 4 main causes of deficit spending:**
  - National emergencies, such as wartime

- **Need for public goods and services**
• Stabilization of the economy
  - Government bailouts of 2008
  - Stimulus package of tax cuts in 2009

• Role of the government in society

Financing the Deficit
• When the government borrows money to fund the deficit it is affecting private investment
  - __________________________ discourages individuals and businesses from __________________________ money, which __________________________ their spending and __________________________ activities
  - Private __________________________ is __________________________ by __________________________ fiscal policy
    - Leads to a decrease in interest-sensitive private sector spending
    - In the long run this can lead to a decrease in economic growth

• Think back to the loanable funds market: If the government borrows money to cover its deficit, it increases demand for loanable funds and crowds out private investment as the real interest rate increases

Raising Money for Deficit Spending
• The government finances its deficit by selling bonds to private individuals and the Fed
  - The U.S. Treasury must sell new bonds to pay for a deficit and refinance previously issued bonds as they come due
    - Treasury bills (T bills) are short-term bonds that mature in less than one year
    - Treasury notes are bonds that mature between two and ten years
Treasury bonds are issued for 30 years

- To get people to buy/hold bonds, they need to be attractive
  - Ownership of the Debt
    - The U.S. debt is more than ________________________
    - See [http://www.usdebtclock.org/](http://www.usdebtclock.org/)
    - About 75% of the debt, which is held by the public
      - The government owes this to buyers of U.S. Treasury bills, notes, and bonds
      - The other 25% is owed to various government departments such as Social Security
    - China owns about $1.1 trillion of our debt
      - It keeps its currency the yuan weaker than the U.S. dollar to keep Chinese goods competitive
      - Remember, though, if China started selling a chunk of its U.S. debt the value of the dollar would be heavily impacted as would interest rates
    - Japan actually holds a little bit more of U.S. debt compared to China

Presidents Who Have Added the Most to the National Debt
- FDR: The Great Depression; New Deal; and World War II (1,048% increase in the debt level)
- Wilson: World War I (727% increase)
- Reagan: Reaganomics; defense spending (186% increase)
- George W. Bush: War on Terror; military spending; two recessions (101% increase)
- Obama: Great Recession; stimulus packages; tax cuts; defense spending; Obamacare (74% increase)

Debt Ceiling
- If the level of federal debt hits the debt ceiling, the government cannot legally borrow additional funds until Congress raises the debt ceiling (although this can be suspended by the president)

Automatic Stabilizers
- An automatic stabilizer is a built-in fiscal policy that work counter cyclically to stabilize the economy
  - It supports the economy during recessions and help prevent the economy from becoming overheated during expansionary periods
  - Examples: