Tom Weisskopf talk on U.S. AUSTERITY POLICIES (Ann Arbor, MI, 4/23/2013)

0. <u>Introduction: an onslaught of fiscal and debt struggles</u> over the past 3 years

2010: The "National Commission on Fiscal Responsibility and Reform" (Simpson-Bowles)

2011: The Raising-The-Debt-Limit crisis, which generated the sequester plan
to scare Congress into making alternative cuts in Federal Gov't spending

2012: The "Fiscal Cliff" negotiations – postponing the sequester to March 2013, preserving the Bush tax cuts except on very high incomes, and ending the payroll tax cut

2013: Congress agrees to let the sequester reduce Fed'l spending by up to $85 b. in FY 2013

What is the driving force behind all this worry about spending & debt?

-- it's what has been aptly labeled the "GREAT AUSTERITY WAR"

1. <u>Why such determination to push AUSTERITY ?</u>

-- Ostensibly because of the <u>fear of rising US national debt</u>, stoked by DEFICIT SCOLDS (not just Republicans, but Simpson-Bowles, Peter Peterson, et al.; also at times Obama)

The national DEBT – at any given time – is the sum of all past annual federal budget DEFICITS (e.g., excesses of Fed'l Gov't. spending over revenues, minus any Fed'l budget surpluses).

So the DEBT goes up with budget DEFICITS and comes down with budget SURPLUSES.

[SHOW GRAPH 1: US GOV'T SURPLUS or DEFICIT/GDP from 1900-2023 – p.7]

As you can see, in most years there have been deficits, hence increases in US national debt.

- especially large deficits during the World Wars
- surpluses only in the 1920s, 1950s, and late 1990s

Conventional wisdom holds that the gov't should <u>balance its budget</u>, not raise national debt.

"We must live within our means." -- Obama (in 2011)

"We have a moral responsibility not to spend more than we take in." -- Romney (in 2012)

N.B.: Obama finally changed his tune in 2012, but the Republican stranglehold on Congress (via majority in House, filibuster in Senate) has kept THE AUSTERITY WAR going.

2. Do DEFICITS and growing DEBT really matter ?

The deficit scolds argue that "The U.S. national debt at the end of 2012 was 16+ trillion dollars -- more than $50,000 per citizen. We will have to pay off that debt, so each of us is really $50,000 poorer than we realize."

Wrong! No country ever pays off all of its national debt, because carrying that debt can cause a problem only if the burden on taxpayers to SERVICE THE DEBT becomes too onerous.

That burden in any year depends on the amount that must be paid out by the Fed. Gov't to service the national debt RELATIVE TO the size of the national economy –

i.e., DEBT service payments)/GDP.

Now bear with me for a few minutes as I mention some figures…

DEBT service payments are the product of

(1) the part of the national <u>debt held by lenders outside of</u> the US Gov't
– i.e., by private US. citizens, foreign citizens & gov'ts, and the Federal Reserve System,

and (2) the <u>average interest rate</u> paid by the US Gov't on the outstanding debt.

Consider the year 2012:

US GDP and US total national DEBT were roughly $16 trillion.

But roughly $5 trillion of the debt was held by the SocSecSyst. & other parts of the Fed'l Gov't.

This $5 trillion did not impose any repayment burden on taxpayers; the gov't in effect repaid itself to service it. So the burdensome part of the U.S. national DEBT amounted to about $11 trillion <u>~ 70% of GDP</u>.

At the average interest rate of a little over 2% in 2012, <u>US debt service payments</u> came to roughly a quarter trillion $, which <u>was just 1.5% of US GDP</u>.

This <u>is a lighter debt service burden than in almost any of the last 30 years</u>, when the burden averaged 2.5%.

And it constitutes just under 6% of total US Federal Gov't spending – the lowest figure since the end of World War II!

3. A brief look at long-term trends in US Fed'l Gov't DEFICITS and DEBT

[SHOW GRAPH 2: US GOV'T SURPLUS or DEFICIT/GDP from 1980-2023 – p.8]

In almost all years since 1980 there have been US Federal Gov't deficits;
only in the late 1990s – President Clinton's 2nd term – were there surpluses.

Note how the deficit/GDP ratio shot up in 2009, at the onset of the Great Recession.

Gov't deficits were high under Obama from 2009-12, mainly because of the economic crisis – which automatically reduced Fed'l Gov't revenues and raised Fed'l Gov't spending.

Also, the Obama STIMULUS legislation – designed to boost economic growth – cut taxes and raised Fed'l Gov't expenditures in 2009 and 2010, helping to limit the depth of the crisis.

See how the deficit/GDP ratio has actually been declining since 2009, and
it is expected to level off over the next decade near the long-term average.

Now let's look at what's been happening to the US NATIONAL DEBT over time:

[SHOW GRAPH 3: US NATIONAL DEBT & DEBT/GDP from 1940-2010 – p.9]

(The blue line shows the most relevant debt/GDP ratio)
(The debt here is the debt requiring payments – debt to lenders outside the US Gov't itself)

The debt/GDP ratio spiked high during WW2, then declined fairly steadily until 1980,
then began to rise again as the Fed'l Gov't ran budget deficits (except in late 1990s).

The debt/GDP increases were greatest under Presidents Reagan & G.W. Bush – in both cases due to big tax cuts (mainly for the rich) and big increases in military spending (not needed)!

Budget SURPLUSES resulted in significantly declining DEBT only in the late Clinton years – thanks to strong economic growth in the late 90s (following tax increases in the early 90s).

Republicans allow national DEBT to rise, then demand that Democrats do something about it!

Since 2010 a fiscal policy of AUSTERITY has replaced the initial Obama STIMULUS, so US Gov't spending & public sector employment at all levels have been steadily declining – more than ever before (except at the Fed'l level right after WW2).

The DEFICIT SCOLDS who insist on cutting taxes, and cutting gov't spending even more,
are clearly not that interested in reducing the national DEBT, because a policy aimed at
that objective would call for higher taxes and faster economic growth.

What the AUSTERITY WAR does accomplish – and the real reason most of its proponents are waging it – is to "starve the beast" of government…at the national, state and local levels.

"Starving the beast" may be good news for the 1% whose taxes get lowered, but it's bad news for the economy and for most of us – since government provides indispensable services.

4. <u>Why DEFICIT spending – adding to US national DEBT – is actually desirable now</u>

When the US economy is in recession, priority should be given <u>to reducing unemployment and raising the rate of utilizationof productive capacity</u>, which will raise GDP and thereby also <u>help to reduce the burden of debt service payments</u>.

What is preventing this from happening now is not the growing national debt, but a lack of overall demand for the goods and services the economy is capable of producing.

The Fed'l Gov't is uniquely <u>well-placed to provide needed demand STIMULUS</u>, which it can do precisely by spending more than it taxes – for example, by distributing funds to state and local governments and public institutions so they don't have to keep shrinking their activities and laying off workers.

This means running a larger Fed'l budget deficit in the short run; but it makes it easier to manage the national debt in the long run.

For future generations of Americans there are <u>much bigger threats</u> than higher national debt.

For one thing, the threat posed by <u>global warming</u>, with consequent sea level rises and ever-greater intensity of storms and droughts, which will significantly reduce economic growth and impair the quality of life.

For another, the threat of <u>underfunded public infrastructure</u>

– all kinds of educational facilities, from pre-schools to research universities, as well as roads, bridges, airports, waterways, communications, etc.

The failure to keep investing in such public infrastructural facilties
will retard the capacity of the US economy to provide needed goods and services.

Bequeathing a higher national debt is far less of a problem for our children and grandchildren…

than bequeathing a world whose climate has been compromised by global warming

and a country whose infrastructure has deteriorated for lack of public investment.

5. But isn't there a real long-run DEBT problem ?

There are ultimately limits to the use of fiscal STIMULUS.

US taxpayers will suffer if the part of the national debt held outside the Fed'l Gov't rises to a level where the Gov't cannot borrow at a reasonable interest rate – as has happened in some European countries in recent years.

This tends to happen only when the ratio rises well above 100%. That is not going to be a problem for the US (with a ratio now of about 70%) – unless GDP growth slows significantly in the coming years, as it has in many European countries pursuing AUSTERITY policies.

In the long run the US Gov't will face a real debt problem if the rapid rate of growth of Medicare and Medicaid costs cannot be significantly slowed down.
(This is much more of a problem than the modestly rising costs of the Soc. Sec. System).

The real key to avoiding US DEBT problems: pursue fiscal STIMULUS now & AUSTERITY later – only when GDP is much closer to its potential and unemployment is way down.

The AUSTERITY needed then can be achieved by improving the US system of medical care – by far the most inefficient and costly among wealthy countries -- and by higher taxes on the rich.

6. What are the key US Gov't economic decision points looming ?

-- the next DEBT limit increase (this summer)

Will Obama be able to resist demands from Boehner to cut Fed'l Gov't spending by the amount of the DEBT limit hike?

-- the FY 2014 budget (this fall)

What kind of budget will we get?

The Paul Ryan (severe AUSTERITY) Budget,

the Patty Murray (mild STIMULUS) budget, or

the Congressional Progressive Caucus "Back to Work" (strong STIMULUS) budget ?

Unless we can change the political climate, we're most likely to get a continuation of the status quo – medium AUSTERITY:

limited cuts in Social Security, Medicare & Medicaid funding;

bigger cuts in educational, research, social service and infrastructural funding.

WE'VE GOT TO DO BETTER !!!

Other issues for Q and A:

1. *Won't high levels of debt lead to runaway inflation and high interest rates?*

   It hasn't in Japan; and in the US the inflation rate has stayed below the Fed target of 2%, and the real interest rate has been zero or negative over the past 4 years – in spite of continual claims by deficit scolds that both rates would soon shoot up.

2. *Comment on the recent debate over the Rogoff-Reinhart study, which argued that countries with debt/GDP ratios over 90% would risk economic disaster – and must therefore pursue a policy of fiscal AUSTERITY to bring deficit and debt levels down*.

   Lots of problems with the study, even before recent UMass discovery of errors that biased results toward perils of debt/GDP > 90% – e.g., direction of causality in correlation of high debt and low growth.

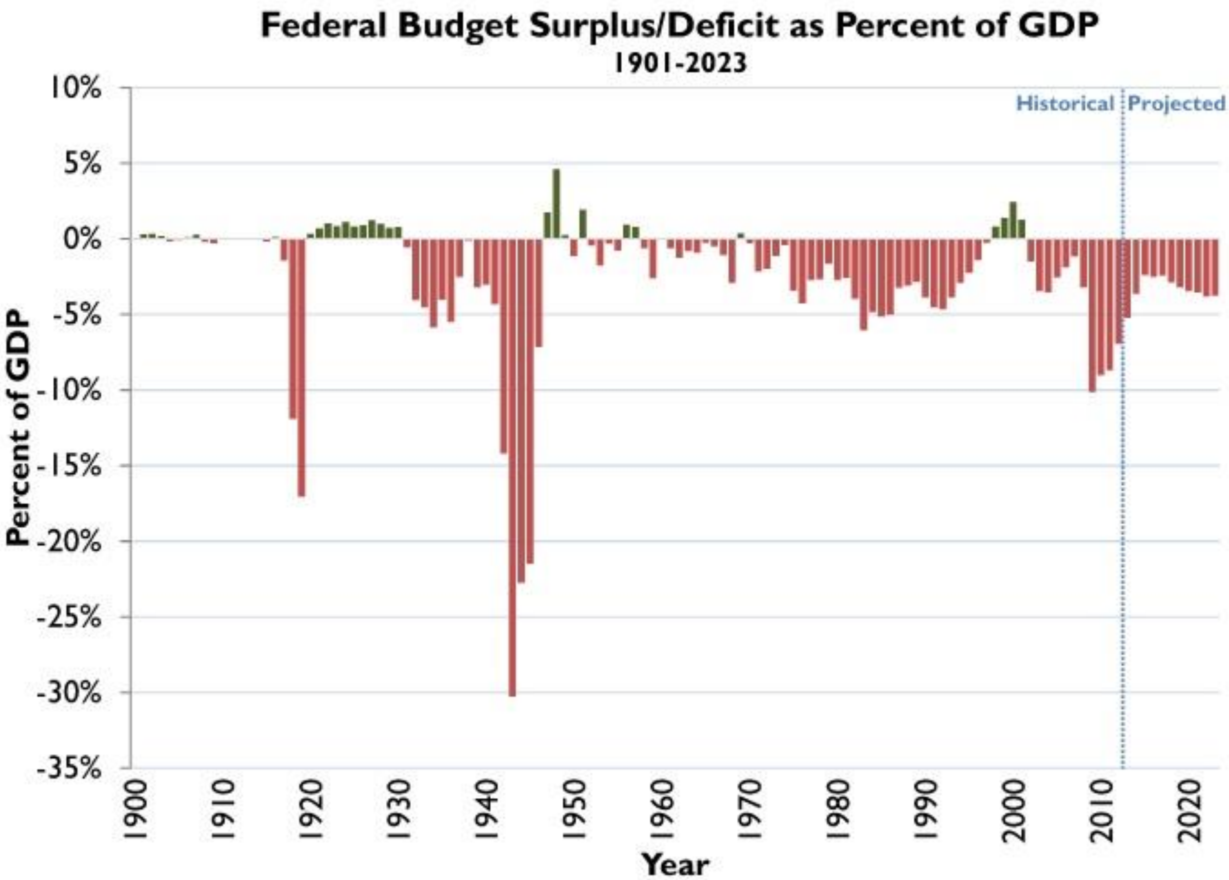
   The study was used to boost support pre-formed austerity policy much as reports of Saddam Hussain's acquisition of weapons of mass destruction were used to boost the case for war on Iraq.

   Now even the IMF is arguing that the AUSTERITY PUSH WENT TOO FAR, and that the US and Western European countries should pursue more of a STIMULUS POLICY to promote economic growth (and reduce debt problems in the long run).

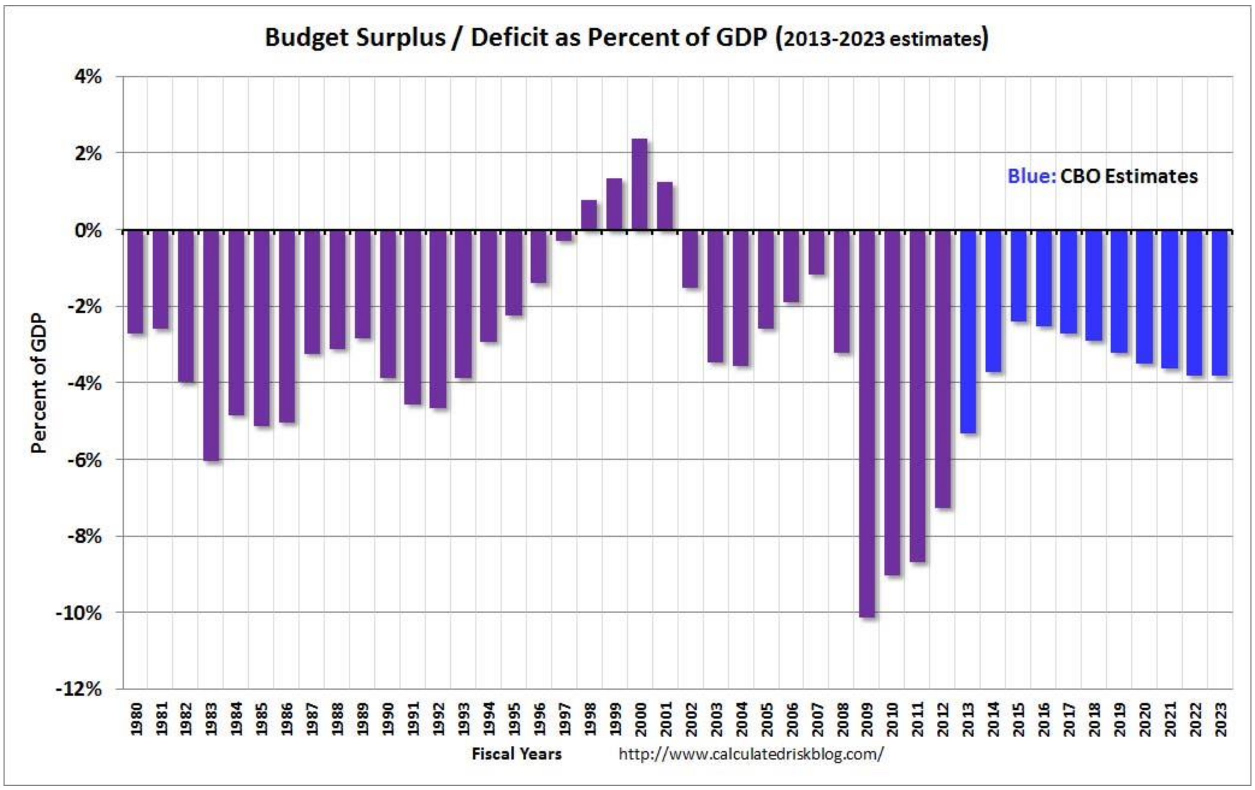
3. *Isn't half the national debt owed to US citizens, so there is no real cost to the economy?*

   True that the US citizen half of debt service payments comes and goes from US citizens. But there is a cost to the Fed'l Gov't's ability to finance needed programs, because both require tax revenues; taxes going to debt servicing could have been used for real needs.

GRAPH 1: US GOV'T SURPLUS or DEFICIT/GDP from 1900-2023



GRAPH 2: US GOV'T SURPLUS or DEFICIT/GDP from 1980-2023



GRAPH 3: US NATIONAL DEBT & DEBT/GDP from 1940-2010