Fiscal Policy Analysis in the Current Environment

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U.S. Federal Net Debt-GDP Ratio

Actual

March 2001 Projections

End of Fiscal Year

Percent of GDP
U.S. Federal Net Debt-GDP Ratio

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March 2001 Projections

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Percent of GDP

2001 2002 2003 2004 2005 2006 2007 2008 2009
U.S. Federal Net Debt-GDP Ratio

Actual

March 2001 Projections

End of Fiscal Year

Percent of GDP

60 –

50 –

40 –

30 –

20 –

10 –

0 –

-10 –
U.S. Federal Net Debt-GDP Ratio

Actual

March 2001 Projections

Percent of GDP

End of Fiscal Year
U.S. Federal Net Debt-GDP Ratio

End of Fiscal Year
September 2009 Projections
U.S. Federal Net Debt-GDP Ratio

Percent of GDP

End of Fiscal Year

September 2009 Projections
Implications for Fiscal Policy Analysis
1. No Worries About the Fed
Having No Debt to Buy
2. Automatic Stabilizers will Grow in Strength
3. Expectations Really Matter
4. Responses to Policy Shocks Will Vary Because of Budget
5. Current Debt-GDP Ratio is Largely Uninformative
6. Some Very Unpleasant Monetarist Arithmetic
Government Intertemporal Budget Constraint

\[ B_t = \sum_{s=t+1}^{\infty} \left( \frac{1 + r}{1 + g} \right)^{-(s-t)} S_s^p \]
• US federal debt: $ 12.3 trillion
  – Publicly held: 7.8 trillion
  – Bills + TIPS: 2.4 trillion

• Total federal fiscal imbalance:
  – Through 2085: $ 53 trillion (6.9% of GDP)
  – Through $\infty$: 126 trillion (8.7% of GDP)

• Entitlement programs are indexed either explicitly (Social Security) or implicitly (Medicare, Medicaid)
7. What is Debt? What is Fiscal Policy?
8. Government Spending ≠ Government Purchases
Federal Spending Components

- Medicare + Medicaid + Social Security
- All Discretionary Spending (including Defense)

Fiscal Year

Percent of GDP
9. Macroeconomic Effects Depend a Lot on Composition
10. Would Fiscal Rules Help?
Conclusions