The Debt Crisis: Any Role For Fiscal Policy?

Thomas R. Saving
Director, Private Enterprise Research Center
Jeff Montgomery Professor of Economics
Texas A&M University
Immediate Past Public Trustee: SS and Medicare Trust Funds
Social Security Deficits in 2011$
CBO Projected Increase in Federal Health Care Spending
Percent of GDP

Percent of GDP

Year:
- 2010
- 2015
- 2020
- 2025
- 2030
- 2035
- 2040
- 2045
- 2050
- 2055
- 2060
- 2065
- 2070
- 2075
- 2080

Graph showing the projected increase in federal health care spending as a percent of GDP from 2010 to 2080.
U.S. Entitlement Debts
Trillions Current Dollars

Federal: 5.7
Social Security: 18.8
Medicare: 88.9
Total Primary Federal Spending as a Percent of GDP 1970-2080

Total Primary Federal Spending as a Percent of GDP 1970-2080

Total Primary Federal Spending as a Percent of GDP 1970-2080

Percent of GDP

Total Primary Federal Spending as a Percent of GDP 1970-2080

Total Primary Federal Spending
2000 Noninterest Spending
Percent of GDP 2000-2080

Medicare Drives the Bus
The Future of Senior Health Care

- General Revenues
- Payroll Taxes
- Premiums
- Out-of-Pocket

% of GDP

2010 2015 2020 2025 2030 2035 2040 2045 2050 2055 2060 2065 2070 2075 2080
The Real Burden of the Debt

• James Buchanan and understanding the burden of sovereign debt.
  – Corporate debt versus country debt
  – Consumption debt versus investment debt
• Internally or externally held: Does it matter?
• Does the interest rate matter?
Publicly Held Government Debt
2011 - Economist

% GDP

Canada  France  Germany  Greece  Ireland  Italy  Japan  Portugal  Spain  UK  United States
Future Entitlement Debt

% GDP

-% GDP

France | Germany | Greece | Ireland | Italy | Portugal | Spain | UK | United States

Private Enterprise Research Center
Texas A&M University
Government Revenue % GDP
2010

Canada  France  Germany  Greece  Ireland  Italy  Japan  Portugal  Spain  UK  United States

% GDP
Sovereign Plus Entitlement Debt
\% GDP

France, Germany, Greece, Ireland, Italy, Portugal, Spain, UK, United States
Sovereign Plus Entitlement Debt
% Central Government Revenue

France  Germany  Greece  Ireland  Italy  Portugal  Spain  UK  United States
External Debt Growth and Productivity
Japan 1990-2009

% Change per-capita GDP
% Change external debt

Private Enterprise Research Center
Texas A&M University
The Valuation of Future Debt
Interest Rates and Term to Maturity
U.S Government Bonds and TIPS

November 18, 2011
Inflation Required for Return Equivalence
U.S Government Bonds and TIPS

November 18, 2011

Implied Inflation

<table>
<thead>
<tr>
<th>Years</th>
<th>Implied Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>1.75</td>
</tr>
<tr>
<td>7</td>
<td>2.00</td>
</tr>
<tr>
<td>10</td>
<td>2.25</td>
</tr>
<tr>
<td>20</td>
<td>2.50</td>
</tr>
<tr>
<td>30</td>
<td>2.75</td>
</tr>
</tbody>
</table>
Debt Projections
Net Interest as a Percent of GDP

% of GDP


CBO 2011 Baseline

2012 Budget
A Tale of Three Budgets
Spending as a share of GDP, 2000-2021

Sources: Congressional Budget Office, House Budget Committee, and author’s estimates based on April 13 White House fact sheet

Source: John Taylor, WSJ, April 21, 2011
Implications for Federal Debt
Debt Projections under Various Fiscal Reform Plans (% of GDP)
The Bottom Line

• Public debt, both marketable debt and promises to citizens, crowds out capital investment.
• The almost unprecedented increase in the ability of the population to move resources to the future using debt rather than capital could result in a significant reduction in the rate of economic growth in the coming decades.
• Without a solution to entitlements there is no fiscal policy way out of this gloomy future.