Balancing the Federal Budget

human capital debt safety net reform trade-off deficit GDP priorities spending Medicare mandatory budget Social Security revenue health care governance discretionary baby boomers economic growth infrastructure

ESSENTIAL DILEMMA

When, if ever, should the nation prioritize balancing the federal budget?

INTRODUCTION

> Government spending must stop growing. The government, like every Hoosier [Indiana] household, must be required to balance its checkbook and stop living on a credit card.
>
> —Congressman Todd Rokita (2012)

> National income will be greater tomorrow than it is today because Government has had the courage to borrow idle capital and put it and idle labor to work. . . . Our national debt after all is an internal debt owed not only by the Nation but to the Nation. If our children have to pay interest on it they will pay that interest to themselves. A reasonable internal debt will not impoverish our children or put the Nation into bankruptcy.
>
> —President Franklin D. Roosevelt, May 22, 1939 (Peters & Woolley, n.d.)

> I have long argued that paying down the national debt is beneficial for the economy: it keeps interest rates lower than they otherwise would be and frees savings to finance increases in the capital stock, thereby boosting productivity and real incomes.
>
> —Federal Reserve Board Chairman Alan Greenspan, April 27, 2001 (Federal Reserve Board, 2001)

On September 4, 2011, the Gainesville, Florida, Tea Party launched an Internet meme by claiming to simplify the Congressional debate over raising the debt ceiling. They claimed that simply removing 8 zeroes from the federal government's expenditures, revenues, deficit, outstanding debt, and proposed budget cuts would facilitate easy comparison to a household budget, and reveal a shocking lack of discipline and foresight on the part of policymakers (Newsom, 2011).

How valid is this comparison? On the one hand, a comparison between the management of a household budget and management of the federal budget is tempting. It is a rhetorical device that pundits and politicians use when they are advocating fiscal restraint because it is a frame of reference voters will understand. On the other hand, the analogy breaks down in at least one important way. Whereas households must borrow money from unforgiving, outside sources (banks, for example), the government has more flexibility because much of what it borrows, it borrows from itself. In fact, economists argue that some level of debt can be good for the economy, particularly if the money borrowed finances investments in future productivity. Traditional economists believe the government should not play a role in stimulating the economy, but those who accept the theories of economist John Maynard Keynes believe that using borrowed money for short-term deficit spending can help to stimulate the economy when it is not doing well.

This proposition introduces several other important questions: Which investments ensure future economic growth? (In household terms: Would borrowing to go on an expensive vacation have the same effect on future income as borrowing to go to college?) What is the distinction between the short term and long term? Is there a limit to how much debt the government should have, and are we approaching it? If so, what are the consequences of too much debt in the long term? Get the answers right, and a targeted economic stimulus will help the economy recover and bolster the long-term outlook. Get it wrong, and one of two things could happen: On the one hand, balancing the budget too soon in an austerity approach could cripple an economic recovery; on the other hand, failing to plan for the long term and borrowing too much to fund wasteful and inefficient projects could send interest rates and inflation skyrocketing. This, in turn, would curb investment, hurt consumer confidence, and reduce prospects for future economic growth.

The key takeaway? It's not simple. Balancing the budget is not inherently "good," and debt and deficits are not inherently "bad" (nor is the reverse true). In summary, the value of balancing the budget versus running deficits and incurring debt for the short or long term depends on (1) the type or purpose of the debt, (2) the time frame of the proposed borrowing, and (3) the total size of the debt. In this lesson, students will wrestle with this complex challenge by using evidence and adopting a range of perspectives. In this 2-day lesson, students will not be expected to reach a definitive conclusion on how to weigh the competing imperatives of managing the budget. They will, however, use the tools of economics to propose criteria for evaluating when debt is "good" in the short term and long term. Just as importantly, they will develop questions that will take them to a deeper understanding of these complex issues.

Note: This lesson is rich in content. Students with a background in the topic will have success with a 2-day experience because some portions (for example, the mini-lesson) can be abbreviated or omitted. For students new to the topic, 3 to 4 days will make the experience more rewarding.

KEY TERMS

The following terms and concepts are used in this lesson and appear in the online glossary:

Budget, Debt, Debt-to-GDP ratio, Deficit, Discretionary programs, Expenditure, Gross domestic product, Investment, Mandatory programs, Revenue, Surplus, Trade-off

STUDENTS WILL UNDERSTAND

- Budgeting requires weighing substantial trade-offs among the benefits of government spending, the costs of taxation and debt, and the opportunity cost of pursuing some programs at the expense of others.
- Decisions about budgets require weighing these trade-offs in light of our national values and priorities, but they must also be informed by an economic analysis of their costs and benefits.
- Costs and benefits of debt can vary based on the time frame of the analysis and the reasons for incurring the debt.

STUDENTS WILL BE ABLE TO

- Ask good questions and make inferences.
- Analyze graphs, tables, and charts.
- Support positions with evidence.

RELATED CURRICULUM STANDARDS

Common Core State Standards (CCSS) Initiative[1]

CCSS.ELA-Literacy.RI.9-10.8. Delineate and evaluate the argument and specific claims in a text, assessing whether the reasoning is valid and the evidence is relevant and sufficient; identify false statements and fallacious reasoning.

CCSS.ELA-Literacy.RI.11-12.7. Integrate and evaluate multiple sources of information presented in different media or formats (e.g., visually, quantitatively) as well as in words in order to address a question or solve a problem.

CCSS.ELA-Literacy.RH.9-10.6. Compare the point of view of two or more authors for how they treat the same or similar topics, including which details they include and emphasize in their respective accounts.

The College, Career, and Civic Life (C3) Framework for Social Studies State Standards[2]

D2.Eco.2.9-12. Use marginal benefits and marginal costs to construct an argument for or against an approach or solution to an economic issue.

D2.Eco.13.9-12. Explain why advancements in technology and investments in capital goods and human capital increase economic growth and standards of living.

1. National Governors Association Center for Best Practices, Council of Chief State School Officers. *Common Core State Standards*. Washington, DC. Copyright 2010.
2. National Council for the Social Studies (NCSS). *The College, Career, and Civic Life (C3) Framework for Social Studies State Standards: Guidance for Enhancing the Rigor of K-12 Civics, Economics, Geography, and History*. Silver Spring, MD. Copyright 2013.

Council for Economic Education's Voluntary National Content Standards in Economics[3]

Content Standard 15: Economic Growth. Investment in factories, machinery, new technology, and in the health, education, and training of people stimulates economic growth and can raise future standards of living.

Content Standard 16: Role of Government and Market Failure. There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also have direct or indirect effects on people's incomes.

Content Standard 20: Fiscal and Monetary Policy. Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

LIST OF LESSON RESOURCES

The following resources are used in this lesson and can be downloaded online:

1. Cartoon: "Budget Crunch"
2. Background on the Debt
3. Balancing the Budget in the Short Term
4. Balancing the Budget in the Long Term
5. Criteria, Questions, and Evidence for Evaluating Budget Proposals

3. Council for Economic Education. *Voluntary National Content Standards in Economics*. New York, NY. Copyright 2010.

DAY 1 of 2

ENTRY

Cartoon: "Budget Crunch"

Distribute **Resource 1**, the "Budget Crunch" political cartoon. Give students a few minutes to look over the cartoon and make observations and inferences. If students become stuck or are confused about the meaning of the cartoon, prompt them with the following:

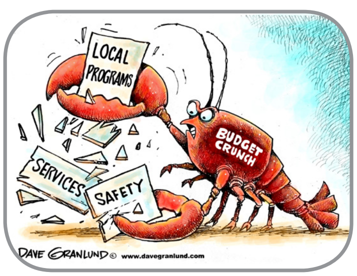
- What in the cartoon are you familiar with or have you seen before? In what context?

  [Student answers will vary. They will likely be familiar with some of the items being "crunched" by the lobster. They may also have heard of budget cuts in the news, possibly including local budget cuts that may affect their school or community.]

- What terms, images, or connections in the cartoon are new to you or are used in an unfamiliar context?

  [Again, student answers will vary. Students may not be sure what the phrase "budget crunch" refers to, or what specific local programs are being "crunched." Inform them that, although the metaphor in the cartoon could make sense in other contexts, for the purposes of this lesson, the budget crunch in question refers to the challenge of balancing the federal budget. The local programs depicted in the cartoon are those programs run by state and local governments that receive some federal funding, such as public schools or housing.]

After students have made observations and listed the things with which they are familiar and unfamiliar, lead a discussion about the cartoon's message, the issue it identifies, and why the issue is important. This discussion will depend on prior knowledge the students bring to this topic, or content the teacher introduces. Use the following prompts if these points do not emerge during the discussion:



See Resource 1 online

- What is the likely cause of the "budget crunch"?

  [The budget crunch is caused by the desire or need to balance the budget; if the expenditures, such as those required by the programs represented in the cartoon, exceed revenues, then the budget is out of balance and the government must borrow money to cover the difference. This gap between expenditure and revenue is referred to as the deficit. Although there is broad consensus among economists and politicians about the long-term consequences of unsustainable debt, there is much more controversy about the short-term consequences of debt. Widespread concern about those consequences has been generated by political activists and politicians advocating for increased revenue, reduced spending, or both, to balance the budget in as few as 5 years.]

- What are the possible costs or consequences of the budget crunch?

  [The cartoonist might be using the lobster claws as a metaphor for the way in which attempts to balance the budget must squeeze (or chop off) funding for individual programs. With scarce resources, not everything can be funded at the level advocates for a program might desire. Legislators charged with taking responsibility for the overall budget will have to make choices. In economic terms, this means that trade-offs must be made, opportunity costs understood, and next-best alternatives accepted.]

- What point of view does the cartoonist have on the need to reduce deficit spending?

  [It might be safe to assume that the cartoonist favors treating deficit spending as a near-term problem that must be solved, or he would have depicted pressure from a competing imperative to continue or even increase short-term deficit spending to boost the productivity of a sluggish economy. The choice of lobster claws as a metaphor also implies that the cartoonist may favor spending cuts over tax increases as a method for balancing the budget.]

Mini-Lesson: Federal Budget Basics

Present a brief mini-lesson to introduce or review the basic concepts and vocabulary of the federal budget. The concepts introduced here are developed in much further detail in the other economics and civics lessons in this curriculum, as well as through the game Fiscal Ship and its accompanying resources, available at http://fiscalship.org/.

Emphasize the following concepts and key points in the mini-lesson:

– The amount of money the government takes in each year (largely through individual or corporate taxation) is known as ***revenue***. The amount it spends is known as ***expenditures***. When revenue equals expenditures, the budget is balanced. If the government takes in more money than it spends, it has a surplus. If it spends more money than it takes in, it must borrow to make up the difference. That difference is known as the deficit.

– The accumulated deficit over many years is known as the ***debt***. One measure of the health of the economy is the debt-to-GDP ratio. The gross domestic product (GDP) is a measure of total production in the economy in a year. The theory behind using the ratio is that, as the economy grows, the government's ability to pay back its debt improves, so any absolute level of debt becomes less significant.

– The federal government cannot raise unlimited amounts of money because taxation itself has direct and indirect costs and consequences. This limit on resources is called ***scarcity*** because the federal government, like any other budgetary unit (an individual, a family, a company), has an unlimited number of ways in which it might use its limited resources. Scarcity means that balancing the budget requires making choices, and choices always involve trade-offs. The same money can't be spent twice. A choice has two costs—the direct cost of the choice and the "cost" of giving up something. The cost of giving up something is called an ***opportunity cost***—the cost of a missed chance to get the second-best alternative, the second choice.

- Some federal programs have long-term legal or contractual obligations, and thus are difficult or impossible to cut in the short term. Spending money on these programs is not a choice. These are known as mandatory programs, and include Social Security and Medicare. Required spending on mandatory programs limits how much money Congress can choose to allocate to discretionary programs, for which Congress does have funding power.

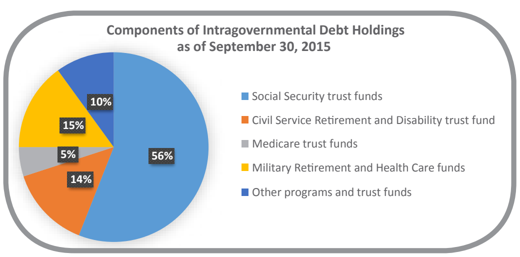
- Revenue, whether raised through taxation or borrowing, is limited, so Congress and the President must make difficult and interdependent decisions when they build the federal budget. Choosing to spend money on one program means there is less opportunity to spend money on another program. Congress and the President must decide (1) which programs to fund and at what level, (2) whether to raise or lower taxes, and (3) whether to borrow money instead of (or, in addition to) raising taxes. These choices all have economic consequences. Those consequences are the focus of this lesson.

LESSON STRATEGIES AND ACTIVITIES

Context on the Debt

Distribute **Resource 2**, Background on the Debt. Instruct students to read the graphs, first individually and then with a partner. Their aim should be to come to a consensus on the most important points these documents include about the debt and determine what additional questions these facts raise.

As a class, review the documents, as well as students' conclusions and questions. Make sure students understand the distinction between "debt held by the public" and debt that one part of the U.S. government owes to another. Explain that the former is bonds and other securities purchased by entities besides the U.S. federal government, including individuals, corporations, and the governments of other countries. Debt held by government accounts is debt the government owes itself; for example, the federal government has borrowed from the Social Security Trust Fund because that fund has accumulated surpluses. Clarify for students that the individuals, corporations, foreign governments, and/or trust funds that loan the U.S. government money do so as an investment, as a way to earn money. They expect to receive their money back with interest. Lead a class discussion on what these facts and figures may tell us about balancing the budget. Use the following prompts as a guide:



See Resource 2 online

▶ What are some of the main features of the debt of the U.S. government?

[Student observations will vary, but may include some or all of the following: most debt is held by the public; of the debt held by the public, the largest portion (but not the majority) is held by foreign governments, with the next largest portion held by private investors. Of the money the government has borrowed from itself, most of that debt is held by the Social Security Trust Fund.]

- What is the reaction of students to these numbers? What questions do they have as a result of considering them?

  [Student responses may vary; they may see these numbers as quite large, but may want more context to determine how large they really are and what the practical consequences may be. Encourage students to further develop questions about the debt (for example, on the significance of the difference between money the government owes to itself and money the government owes to others—"the public"). Some of these questions will be addressed by this lesson and others will be part of the lesson assessment to encourage further inquiry.]

- What would be some of the potential benefits of balancing the budget? Conversely, what are some of the costs of not balancing the budget?

  [This is an opportunity to push student inference beyond the scope of Resource 2 or to introduce additional material. Benefits may include less reliance on international investments, smaller debt as a percentage of GDP, a smaller portion of the budget devoted to interest on the debt, and the increased flexibility to borrow in the future. Based on the political cartoon in Resource 1 and the information on money the government is borrowing from itself, students will realize that balancing the budget may have opportunity costs, including programs that cannot be funded and the costs of taxation. They might note that, if the government issues less debt (i.e., borrows less by selling fewer bonds), large investors like the Social Security Trust Fund will actually have fewer safe investment opportunities.]

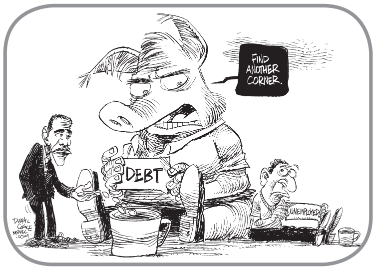
- How has the debt changed over time? What might have driven these changes?

  [Debt held by the public as a percentage of GDP remained below 50% until the Great Depression. It was generally quite low, although it started high in 1790 and spiked in the 1860s and late 1910s, indicating that the primary driver of debt until that time was war. World War II led to a massive spike in the debt held by the public as a percentage of GDP, which gradually declined through about 1970. Since then, it has increased slightly, particularly in the late 1970s and late 2000s. One reason for increases could be economic downturns in the late 1970s and late 2000s, which lowered the GDP growth rate and, as a consequence, tax revenues—thus increasing debt held by the public as a percentage of GDP. In addition, the cost of military buildup at the end of the Cold War (in the 1980s) increased the need for deficit spending. Declines in the debt held by the public as a percentage of GDP (during the 1990s, for example) were a consequence of faster economic growth and, with that faster growth, increased tax revenues. The debt held by the public is projected to continue to increase in the foreseeable future, although updated projections as of 2016 indicate that it will not rise as quickly as was feared in 2010.]

Given these numbers, students may become alarmed and may be quite inclined to support a balanced budget, or even a budget with large surpluses to reduce the debt. Remind students that, based on the Entry activity, balancing the budget or raising a surplus will have costs as well. Ask students to think about the circumstances (if any) under which the budget should be balanced, and when, if ever, some debt might be good. Determining when the government should prioritize balancing the budget, given the costs and benefits of doing so compared to alternatives, and when, if ever, the government should take on more debt is the focus of the remainder of the lesson.

Balancing the Budget in the Short Term

Distribute **Resource 3**, Balancing the Budget in the Short Term. Tell students they will be analyzing a cartoon and reading examples of deficit spending descriptions and of purposeful deficit spending.



See Resource 3 online

Using the same approach they used for the "Budget Crunch" cartoon (i.e., beginning with familiar points of reference), ask students to look at the cartoon, "Debt and Unemployment." Propose to students that "debt" represents long-term economic problems and "unemployment" represents short-term economic problems. Students should then develop their own interpretation of what the cartoon says about the trade-off between long- and short-term economic problems. Take the students beyond the information explicitly included in the cartoon, and lead a discussion in which they share their views on what the cartoon means, the trade-off it points to (paying down the debt at the cost of increasing unemployment), and their own initial thoughts on that trade-off.

[Student observations may include that, in the cartoon, the debt appears to be a larger problem than unemployment. However, by representing the debt as a (presumably gluttonous) pig, the cartoonist could be suggesting that politicians call a great deal of attention to the debt, a long-term problem, at the expense of concern about short-term fluctuations in the economy that lead to problems like unemployment. Student opinions will likely vary as to whether they agree with this interpretation and/or with the cartoonist's point of view.]

Students should then read the description of fiscal stimulus, which offers a very brief overview of one of the basic ideas of John Maynard Keynes; namely, that in times of short-term recession in which the economy is operating below its long-term equilibrium level of employment, the government can stimulate the economy by increasing spending and lowering taxes, even though that inevitably increases deficits and debt. This is known as *deficit spending* or *fiscal stimulus*, and stands in contrast to policies aimed at reining in debt, or *fiscal austerity*. Students should discuss with a partner how this relates to the message of the cartoon, and if their perspective on the cartoon has changed. Answer any questions students have on the basics of Keynesian theory to ensure they understand the concept and mechanics of it before moving on.

Students should then read through the "Perspectives on Short-Term Stimulus and Borrowing," first independently and then comparing notes with a partner or group to challenge and question one another. Circulate among the groups of students and probe their observations and inferences based on these perspectives. Prompt them with further questioning to engage them in looking at multiple points of view on the subject of balancing the budget versus borrowing money in the short term: What information can they gather from these excerpts? What types of evidence do the excerpts use? What is the source of this information, and do the students find the source credible? What additional information would be necessary to put this information in context and draw conclusions about the costs and benefits of balancing the budget versus borrowing money in the short term? Lead a class discussion on the findings, pushing students to dig deeper into the evidence.

For homework, students should look for examples of fiscal stimulus (and its opposite, fiscal austerity), as well as evidence and opinions on the effects of each policy, by going to the blog at teachufr.org or by looking in the newspaper. (If students have Internet access, the blog is well suited to this assignment because it is based on current economic events. A search for the terms "stimulus" or "austerity" will yield news articles on these topics.)

DAY 2 of 2

Begin with a review of the costs and benefits of balancing the budget in the short term, using the examples students found for homework as a starting point. Inform students that, although economists and policymakers disagree about the relative merits of balancing the budget compared to fiscal stimulus in the short term, the debate changes somewhat regarding long-term budget shortfalls (deficits). ("Long term" is defined by more than years. Because the economy takes time to adjust to new conditions, and some things are more flexible than others [like the price of candy—*flexible*—versus salaries, or the number of factories in a country—*not so flexible*], economists specify that a defining measure of long term be the period of time over which *all* prices have had time to adjust to changing conditions, and over which new capital goods, such as factories, can be built.) Policymakers give importance to the distinction between long- and short-term budget shortfalls because deficit spending and debt that is justified in the short term to address a recession may have different consequences, some good and some bad, over the long term. For example, some types of debt represent an investment in long-term economic growth and therefore "pay for themselves." Debt accrued to build a mass transit system might be an example of this. On the other hand, in the long run, very large debt can be unsustainable and weigh down the economy. Distinguishing between the short term and the long term, and between debt that weighs down the economy by increasing interest rates and discouraging private investment and debt that funds public investments that help the economy grow, is the challenge of the second day of this lesson.

Distribute the political cartoon in **Resource 4**, Balancing the Budget in the Long Term. Beginning with an analysis of the cartoon, students should use Resource 4 to understand the various points of view presented on the costs and benefits of balancing the budget and incurring debt in the long term.

▶ What does the cartoon suggest about the connection between debt and growth?

[Interpreting the cartoon requires some inference. It suggests that the spending and borrowing of Big Government has created a cloud of excessive debt that shadows the nation's future prospects for long-term growth.]

See Resource 4 online

Distribute the three brief readings, Perspectives 1–3, also in Resource 4. Ask students to analyze the three points of view on balancing the budget in the long term that they represent. Students should identify the position each writer takes and the evidence the writer uses to support that position. Students should decide whether they find that evidence credible, what additional questions they would ask, and what further information they would seek to further confirm or disconfirm the validity of each author's conclusions.

After students have examined these documents, lead a class discussion on what the collection suggests about the long-term costs and benefits of balancing the budget versus incurring debt. The following questions are suggested to prompt students on key points from the documents:

- The authors agree that under some circumstances debt in the long term may be good. What are those circumstances?

  [Although they differ on the extent to which they support or are alarmed by debt in the long term, all three authors agree debt that promotes economic growth through investment can be good for the economy.]

- What are some of the concerns raised about long-term debt?

  [Some of the authors raise concerns that it is difficult to tell in advance what types of investments will help the economy grow as opposed to those that will prove wasteful. Further, too much debt can "crowd out" private investment, lead to higher interest rates, and inhibit economic growth, although the direction of causation is unclear and the evidence supporting this assertion is controversial.]

- What evidence do the authors cite to support their claims? Is this evidence credible?

  [The authors cite studies of the experience other countries have had with public debt and economic growth.]

- What additional questions do you have or information and evidence would you seek to more fully evaluate these positions?

  [Student responses may vary, but they may wish to know more about these studies, including whether the countries are representative, whether other economic factors might explain the results, or whether the causation implied by the authors is correct; for example, countries with less growth may need to incur more debt. In this case, debt would be correlated with weak growth, but would not be the cause of it. In fact, the reverse might be true.]

Establishing Criteria for Evaluating Budget Proposals

Using this information, as well as their own values and priorities, students will envision themselves as economic experts who write editorials and appear on television news broadcasts offering commentary and analysis on the news of the day. They will need to use a consistent set of economic criteria in order to judge the adequacy of a budget proposal. The proposal might be based on balancing the budget, or it might build in deficit spending that will stimulate the economy. Students should use the concepts learned in this lesson and the graphic organizer in **Resource 5** to decide on the criteria they will use for evaluating the proposal. The organizer models this process using the criterion "debt is at a sustainable level." This sample entry can be distributed to students or retained as a teacher resource. Within each criterion, students will create a set of questions. The answers to these questions will tell them whether the proposed budget meets their criteria for a good budget. Of course, they will also have to decide on the kind of evidence they consider solid.

To help students get started, give them two examples of the types of proposals they would be considering with their criteria, one short-term and one long-term. Remind them that they do not need to actually evaluate these proposals at this point; instead, the aim is to give them a tool they can use to evaluate ***any*** budget proposal as they become voters and engaged citizens.

Short-term example: Raising concerns about stagnant wages and potential weakness in the global economy due to declining energy prices, a group of representatives in Congress has proposed a stimulus package to increase wages and stave off unemployment and a potential recession. The package would consist of $100 billion in increased assistance to needy families; $100 billion in subsidies for job retraining for those who have been out of work and looking for a job for more than 6 months; $100 billion to help state and local governments hire more police officers, firefighters, and teachers; and $100 billion for major transportation and other public works projects. The proposal calls for these programs to be paid for with additional borrowing, rather than tax increases, because lawmakers fear that raising taxes will harm economic recovery.

Long-term example: Deeply concerned with the effects of excessive public debt on interest rates and private investment, and with the long-term fiscal stability and sustainability of the U.S. government, the president unveils a proposal to automatically trigger aggressive debt reduction whenever the economy is doing well. He defines “doing well” as any time unemployment dips below 6% for 6 straight months. At that point, tax revenues will increase by $500 billion a year by closing loopholes and raising rates. In addition, substantial cuts to discretionary programs and reductions in benefits for mandated programs will result in a $500 billion cut in yearly spending. The increased tax revenues and reduced spending on mandated programs will produce immediate surpluses that can be used to start paying down the debt.

CLOSURE

Have students compare the criteria, questions, and evidence they developed. For homework, have them write an essay on the essential dilemma of this lesson: When, if ever, should the nation prioritize balancing the federal budget?

FURTHER ENGAGEMENT

This lesson can be extended into an in-class or independent research study of the European sovereign debt crisis of 2009–2012, in which students analyze the causes of the crisis, the relative merits of different proposed responses, the advantages and disadvantages of stimulus versus austerity policies in the short term, and the growth prospects of European countries as they relate to their respective levels of public debt.

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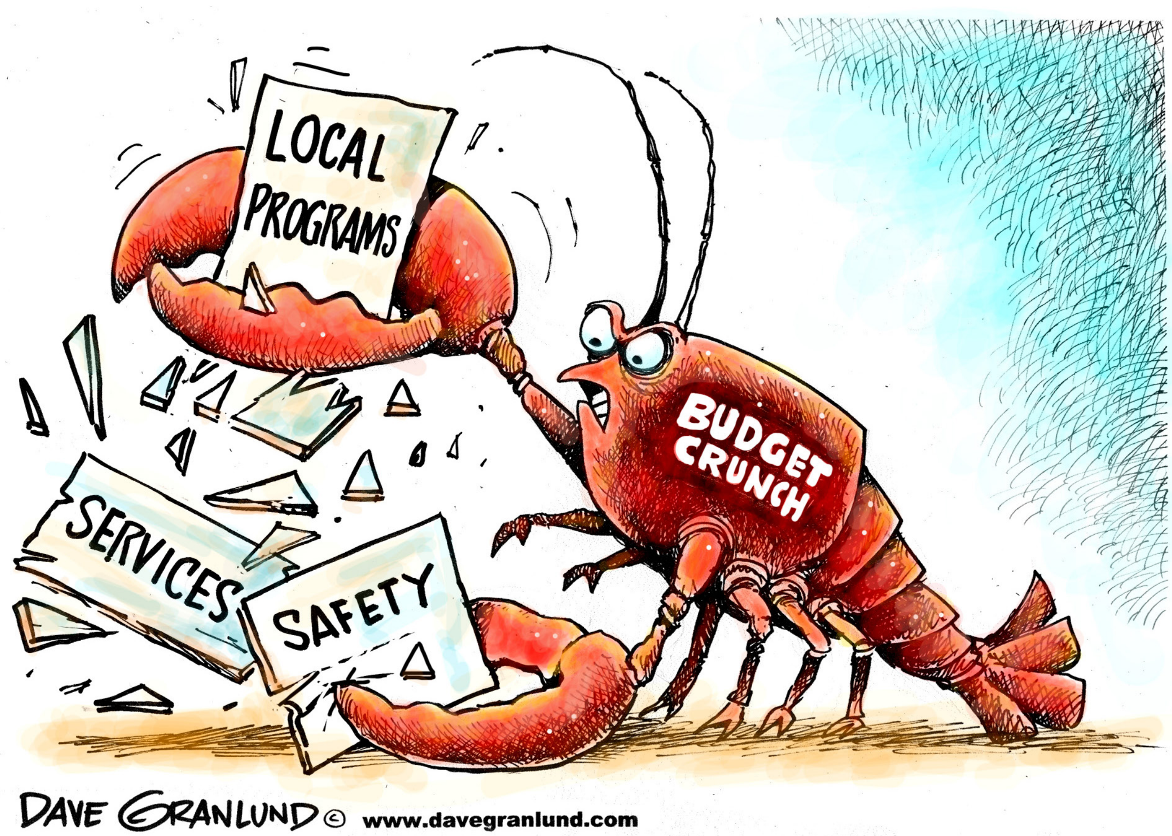
U.S. Department of Treasury, Bureau of the Fiscal Service. (2016, March). Treasury bulletin: Ownership of federal securities, Table OFS-2. Retrieved from https://www.fiscal.treasury.gov/fsreports/rpt/treasBulletin/current.htm

U.S. Government Accountability Office. (2015). Financial audit: Bureau of the Fiscal Service's fiscal years 2015 and 2014 schedules of federal debt. Figure 4, p. 20. Retrieved from http://www.gao.gov/assets/680/673641.pdf

Varvel, G. (2010, April 20). Big government. Creators Syndicate. Retrieved from http://www.gocomics.com/garyvarvel/2010/04/20/ $

Resource 1

Cartoon: "Budget Crunch"



by Dave Granlund, politicalcartoons.com

Resource 2 (1 of 3)

Background on the Debt

Each year that the federal government spends more money than it receives in revenue, it runs a deficit. It must borrow money to cover that deficit by issuing bonds. The borrowed money accumulated over time is known as the debt, although the debt takes on several forms, depending on the source of the borrowed funds.

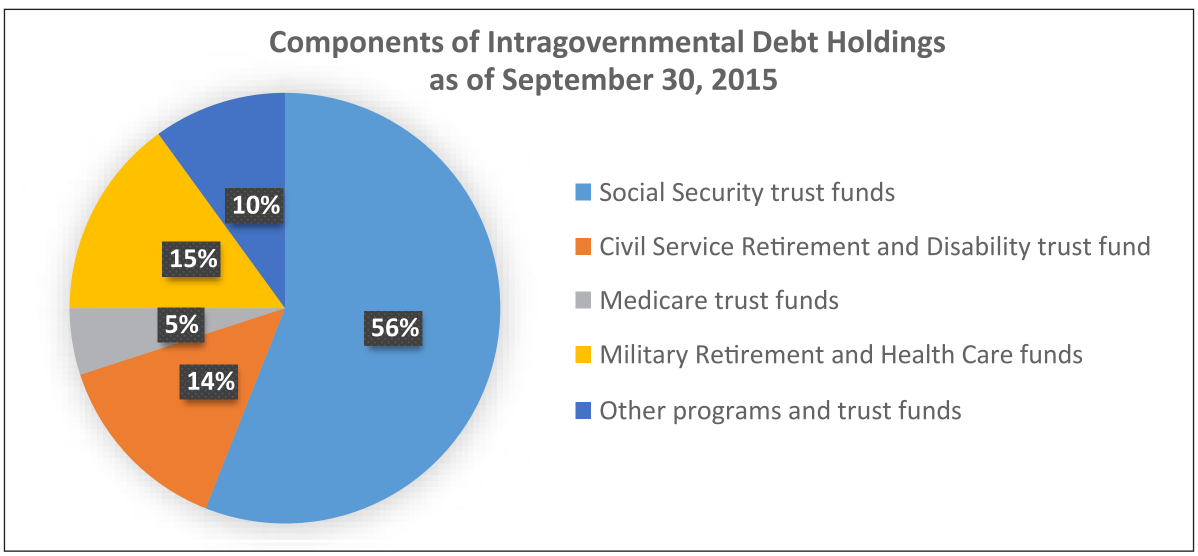
As of March 2016, the total outstanding debt was about $19.3 trillion ($19,264,938,619,643.07, to be precise).

- $13.9 trillion, or about three-quarters, is classified as “debt held by the public,” or debt held by individuals, corporations, and other governments (such as state and local governments or foreign governments), both inside and outside the United States.
- $5.3 trillion, or about one-quarter, is classified as “intragovernmental holdings,” or debt that one part of the U.S. government owes to another (such as the Social Security Trust Fund). This type of debt occurs when the main federal budget has a deficit, but trust funds to pay for future benefits have a surplus, so the former borrows from the latter.

(Note: For the most recent tally of the outstanding debt, you can go to the TreasuryDirect site listed below.)

Examine the following graphs to learn more about who holds these different types of debt and how the debt has changed over time as a share of the economy’s annual total production (measured by gross domestic product, or GDP).

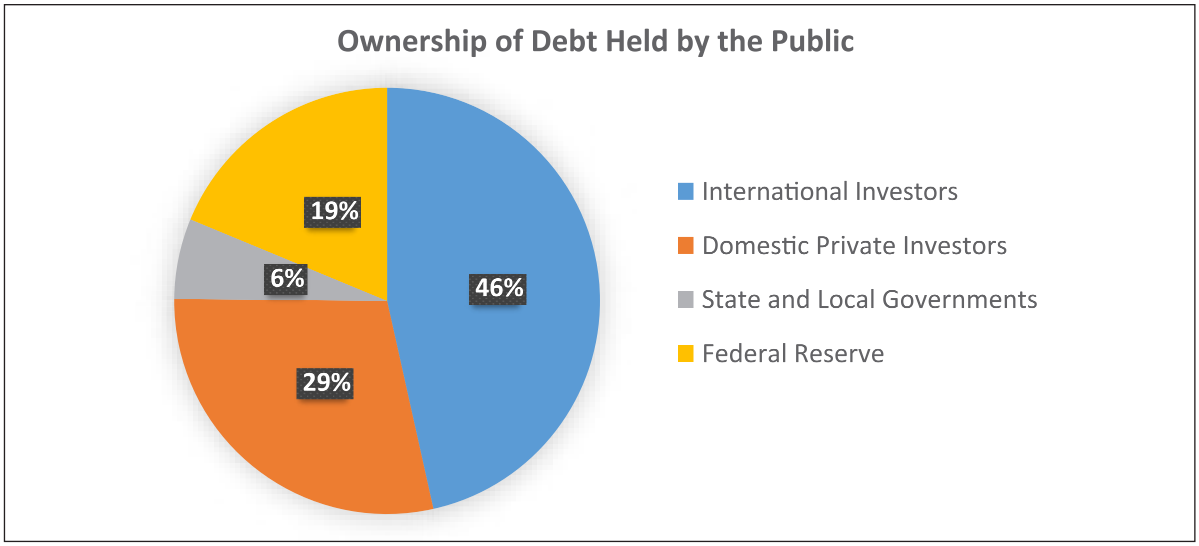
Source: TreasuryDirect. (2016). The debt to the penny and who holds it. Retrieved from http://www.treasurydirect.gov/NP/BPDLogin?application=np



Source: U.S. Government Accountability Office. (2015). Financial audit: Bureau of the Fiscal Service’s fiscal years 2015 and 2014 schedules of federal debt. Figure 4, p. 20. Retrieved from http://www.gao.gov/assets/680/673641.pdf

Resource 2 (2 of 3)

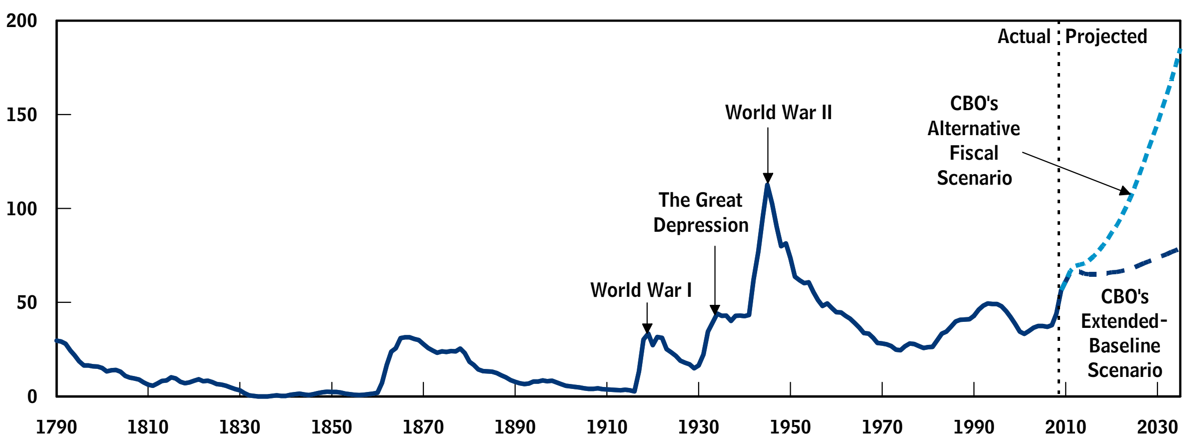
Background on the Debt



Source: Federal Reserve. (2016, March 31). Factors affecting reserve balances. Retrieved from http://www.federalreserve.gov/releases/h41/Current/; U.S. Department of Treasury, Bureau of the Fiscal Service. (2016, March). Treasury bulletin: Ownership of federal securities, Table OFS-2. Retrieved from https://www.fiscal.treasury.gov/fsreports/rpt/treasBulletin/current.htm

Federal Debt Held by the Public, 1790 to 2035

(Percentage of gross domestic product)



Source: Congressional Budget Office, *The Long-Term Budget Outlook* (June 2010); *Historical Data on Federal Debt Held by the Public* (July 2010).

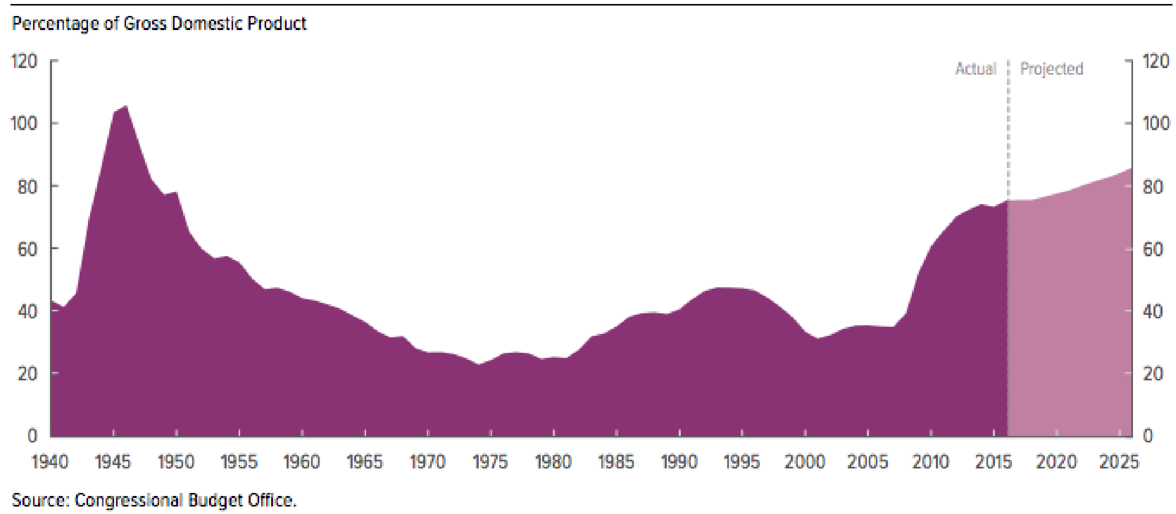
Note: The Extended-Baseline Scenario was the Congressional Budget Office's projection of future debt based on the laws as written in 2010, which would include expiration of the Bush tax cuts. The Alternative Fiscal Scenario made assumptions about changes that were likely as of 2010, such as the extension of some tax cuts that were set to expire. See the next graph in this set for updates to actual debt figures through 2016 and revised projections through 2026.

Source: Congressional Budget Office. (2010, July 27). Federal debt and the risk of a fiscal crisis. Retrieved from http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/116xx/doc11659/07-27_debt_fiscalcrisis_brief.pdf

Resource 2 (3 of 3)

Background on the Debt

Federal Debt Held by the Public



Source: Congressional Budget Office. (2016, January). The budget and economic outlook: 2016 to 2026. Retrieved from: https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51129-2016Outlook.pdf

Resource 3 (1 of 4)

Balancing the Budget in the Short Term

Cartoon: "Debt and Unemployment"

by Daryl Cagle, politicalcartoons.com

Resource 3 (2 of 4)

Balancing the Budget in the Short Term

What Is Fiscal Stimulus?

Why might a country want to *deliberately* spend more money than it receives in taxes? It may be understandable that, in any given year, the federal budget is not balanced because politicians are reluctant to address deficits by raising taxes or cutting spending, because both tend to be politically unpopular. Nonetheless, would there be any reason to take on additional debt by running a deficit on purpose? Economist John Maynard Keynes argued that, under certain economic conditions, the government should purposely spend more money than it receives (called deficit spending or fiscal stimulus) to help “jump start” the economy.

> Keynes’ idea, radical when he proposed it, was that a government could pull a country out of a deep recession by spending money—a lot of money. Congress followed Keynes’ advice. In February 2009, it passed a $787 billion stimulus bill.
>
> —David Kestenbaum (2010)

Examples of fiscal stimulus can include tax cuts to individuals, to encourage them to spend more money, or to businesses, to encourage them to produce more and hire more people. It can also include government spending on things like public works (such as the Works Progress Administration during the New Deal) to create jobs, or social services like increasing or extending unemployment benefits to stimulate aggregate demand and ease the short-term pain of an economic recession.

Source: Kestenbaum, D. (2010, August 6). Economists question Keynes-inspired stimulus. Retrieved from http://www.npr.org/templates/story/story.php?storyId=129031780

Resource 3 (3 of 4)

Balancing the Budget in the Short Term

Perspectives on Short-Term Stimulus and Borrowing

Perspective 1

Fiscal stimulus is appropriate as insurance because it is the fastest and most reliable way of encouraging short run economic growth at a time when a serious recession downturn would pressure American families, exacerbate financial strains, raise protectionist pressures and hurt the global economy.

Poorly provided fiscal stimulus can have worse side effects than the disease that is to be cured. This suggests close attention to three issues:

First, to be effective, fiscal stimulus must be timely. To be worth undertaking, it must be legislated by the middle of the year and be based on changes in taxes and benefits that can be implemented almost immediately.

Second, fiscal stimulus only works if it is spent so it must be targeted. Targeting should favour those with low incomes and those whose incomes have recently fallen for whom spending is most urgent.

Third, fiscal stimulus, to be maximally effective, must be clearly and credibly temporary—with no significant adverse impact on the deficit for more than a year or so after implementation. Otherwise it risks being counterproductive by raising the spectre of enlarged future deficits pushing up longer-term interest rates and undermining confidence and longer-term growth prospects.

Source: Summers, L. (2008, January 6). Why America must have a fiscal stimulus. Retrieved from http://belfercenter.ksg.harvard.edu/publication/17845/why_america_must_have_a_fiscal_stimulus.htm

Perspective 2

. . . there is no successful example of Keynesian economics. It didn't work for Hoover and Roosevelt in the 1930s. It didn't work for Japan in the 1990s. It didn't work for Bush in 2001 or 2008, and it didn't work for Obama. The reason, . . . is that Keynesian economics seeks to transform saving into consumption. But a recession or depression exists when national income is falling. Shifting how some of that income is used does not solve the problem.

This is why free market policies are the best response to an economic downturn. Lower marginal tax rates. Reductions in the burden of government spending. Eliminating needless regulations and red tape. Getting rid of trade barriers. These are the policies that work when the economy is weak. But they're also desirable policies when the economy is strong. In other words, there is no magic formula for dealing with a downturn. But there are policies that improve the economy's performance, regardless of short-term economic conditions. Equally important, supporters of economic liberalization also point out that misguided government policies (especially bad

Resource 3 (4 of 4)

Balancing the Budget in the Short Term

monetary policy by the Federal Reserve) almost always are responsible for downturns. And wouldn't it be better to adopt reforms that prevent downturns rather than engage in futile stimulus schemes once downturns begin?

Source: Mitchell, D. (2010, September 13). Keynes was wrong on stimulus, but the Keynesians are wrong on just about everything. Retrieved from http://www.cato-at-liberty.org/keynes-was-wrong-on-stimulus-but-the-keynesians-are-wrong-on-just-about-everything

Perspective 3

In 1980, I had the privilege of advising Prime Minister Margaret Thatcher to ignore the demands of 360 British economists who made the outrageous claim that Britain would never (yes, never) recover from her decision to reduce government spending during a severe recession. They wanted more spending. She responded with a speech promising to stay with her tight budget. She kept a sustained focus on long-term problems. Expectations about the economy's future improved, and the recovery soon began.

That's what the U.S. needs now. Not major cuts in current spending, but a credible plan showing that authorities will not wait for a fiscal crisis but begin to act prudently and continue until deficits disappear, and the debt is below 60% of GDP. . . .

Source: Meltzer, A. (2010, June 30). Why Obamanomics has failed. *Wall Street Journal*. Retrieved from http://online.wsj.com/article/SB10001424052748704629804575325233508651458.html?mod=djemEditorialPage_h

Resource 4 (1 of 3)

Balancing the Budget in the Long Term

Cartoon: “Big Government”

by permission of Gary Varvel and Creators Syndicate, Inc.

Resource 4 (2 of 3)

Balancing the Budget in the Long Term

Perspectives on Balancing the Budget and Debt in the Long Term

Perspective 1

This perspective offers a point of view and supporting evidence related to investments. These investments are relevant to the discussion of balancing the budget and debt in the long term because they are *public* investments, and thus are funded through debt. (Note that "the president's budget" refers to proposals by President Barack Obama.)

> Economists agree that the key to creating good jobs and a strong economy is investments—particularly investments in infrastructure, research innovation, and worker productivity. . . .
>
> **Transportation and infrastructure**
>
> Investments in high-productivity infrastructure create lower costs for American businesses, stimulate manufacturing innovation and the jobs that go along with it, and will ease the billions of dollars in wasted time and gas due to congestion. . . .
>
> **Science, research, and technology**
>
> The president's budget invests in the science and research that will encourage the United States to develop and deploy renewable energy technologies, health and life sciences, and spawn entirely new industries and jobs that today don't even exist. It boosts funding for the National Science Foundation by 13 percent, the National Institute of Standards and Technology by 15 percent, the Department of Energy's Office of Science by 10 percent, and funding for science and technology research at the Department of Homeland Security by 18 percent. . . .
>
> **Job skills and worker productivity**
>
> Ensuring our workforce has the necessary technical skills is critical to securing middle-class jobs and promoting the competitiveness and productivity of the U.S. economy. . . .
>
> **Competitiveness and innovation**
>
> The president's budget invests in the global competitiveness of the U.S. economy by supporting agencies that promote export market growth and business development—especially for small businesses. His budget includes a 16 percent boost for the International Trade Administration, an additional 11 percent for the Economic Development Administration, and an increase of $35 million for the Small Business Administration. . . .
>
> **Education**
>
> Decades of economics research show that education investment is a leading factor in long-run economic growth. The president's budget expands investments in educating the workforce of the future by more than $800 million. . . .

Source: Hersh, A., & Ayres, S. (2011, February 25). RELEASE: Cuts vs. investments: Comparing budget plans and their impact on the U.S. economy. Retrieved from https://www.americanprogress.org/press/release/2011/02/25/15073/release-cuts-vs-investments-comparing-budget-plans-and-their-impact-on-the-u-s-economy/

Resource 4 (3 of 3)

Balancing the Budget in the Long Term

Perspective 2

In theory, debt financing of public spending could make a positive contribution to productive investment and ultimately to economic growth. Debt could also be a mechanism for accelerating the economy in times of recession (like fiscal stimulus, discussed in Day 1 of this lesson) or even long-term growth policies such as marginal tax rate reductions. On the other hand, high levels of public debt may have numerous negative impacts such as raising interest rates, crowding out private investment, and limiting the flexibility of government to respond to future economic or national security crises. Mounting public debt, particularly debt that merely boosts government consumption or transfer payments, is likely to undermine overall productivity growth and ultimately lead to economic stagnation rather than growth.

> . . .
>
> Lost in the shuffle may be the most important question of all: Will the government action being contemplated truly improve the economic situation? If it does, tax revenues are likely to recover along with gross domestic product (GDP), and debt is less likely to accumulate. On the other hand, if the government action fails to boost recovery (or even makes it worse), tax revenues will be stagnant or will fall, and debt will inevitably rise. The permanent increase in the ratio of public debt to GDP in such circumstance is *prima facie* evidence of policy failure. The high levels of public debt accrued in many countries thus reflect years of bad public financial management and the cumulative impact of poor policy choices. Such poor policy choices are highly likely to have restrained economic freedom as well.
>
> . . .
>
> One pioneering study by Carmen Reinhart and Ken Rogoff looked at 44 advanced and emerging countries with data spanning about 200 years. Reinhart and Rogoff found little relationship between overall government debt and real GDP growth for debt-to-GDP ratios below 90 percent of GDP. Above that debt level, however, they found that median growth rates fell by 1 percent and that average growth fell even more. They also looked at the impact of debt on inflation and found no apparent link between debt levels and inflation for advanced countries as a group but sharp rises in inflation for emerging markets as their debt increases.[1]
>
> **Source:** Miller, T., & Foster, J. (2012). Public debt, economic freedom, and growth. Retrieved from https://thf_media.s3.amazonaws.com/index/pdf/2012/chapter3.pdf

1. A controversy has arisen around the research supporting the claims by Professors Reinhart and Rogoff. Please see http://teachufr.org/robertshand/we-made-a-mistake/ for further information about this resource and the research supporting it.

Resource 5 (1 of 2)

Criteria, Questions, and Evidence for Evaluating Budget Proposals

Sample Response

Criterion: Debt is at a sustainable level.

Short-Term	
Questions	**Evidence**
Does any short-term borrowing involve a plan to phase out when the economy improves?	-Debt-to-GDP ratio -Content of specific proposal -Level of commitment or contractual obligation to phase out and repay debt

Long-Term	
Questions	**Evidence**
Are economic stimulus plans tied to things that could lead the economy to grow in the long term, increasing GDP and therefore reducing debt as a share of the economy?	-Debt-to-GDP ratio -Interest rates -Levels of private investment -Prior experience with long-term consequences of short-term stimulus

Resource 5 (2 of 2)

Criteria, Questions, and Evidence for Evaluating Budget Proposals

Criteria	Short-Term		Long-Term	
	Questions	Evidence	Questions	Evidence