Eco 10350 Principles of Macro

Lecture 13

Deficits and Debt

- As usual in economics, distinguish stock and flow
- Deficit is amount that spending exceeds revenue in a particular year (the flow) financed by borrowing
- Debt is amount that was borrowed in many past years (the stock, of past deficits)
- Governments have huge deficits generally for wars and bad economic times
- Also choices by politicians
- In US, Social Security will get more expensive in future decades (more than payroll taxes) and healthcare funding too
- recent analysis
  - https://www.brookings.edu/research/fiscal-therapy-12-framing-facts-and-what-they-mean/
  - https://www.foreignaffairs.com/articles/2019-01-27/whos-afraid-budget-deficits/

Counter-Cyclical Fiscal Policy

- Usually government spending rises in recession
  - Some of this is "automatic stabilizers" eg unemployment insurance
  - Some is discretionary
- Usually tax revenue falls in recession (less income so less income tax)
- Deficits usually rise in recession
- Expansionary Fiscal Policy increases AD so as G rises and T falls in recession, this helps stabilize
- Can calculate what would the deficit have been, if the economy were at full employment
- Automatic is useful since Congress is slow

Balanced Budget

- Can a government run a deficit forever?
- Yes, easy
- If deficit is smaller than growth rate of economy
- Then debt is a stable or falling fraction of GDP
- Is there some level of debt that's too high? No good evidence

Government Deficits, Investment, Trade Balance

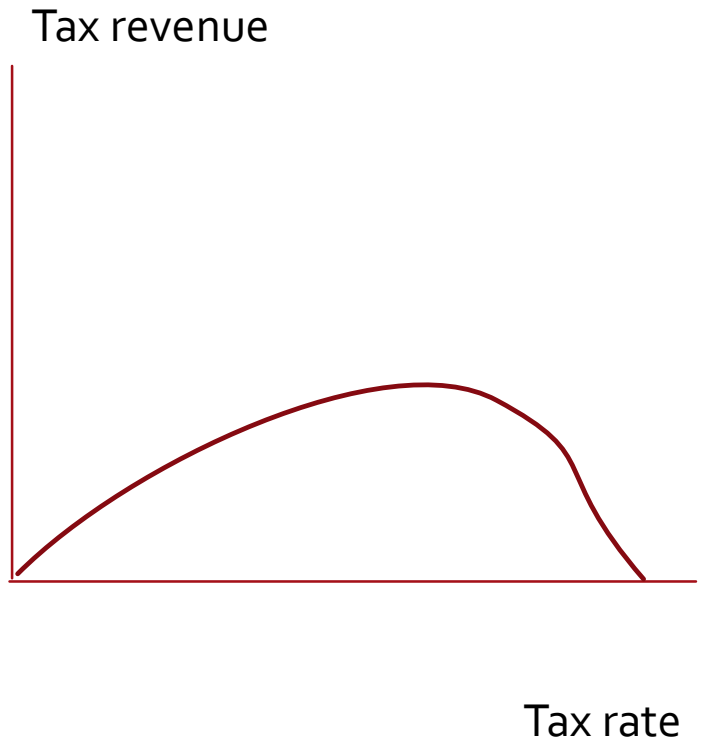
- Recall that Investment = Private Savings + Public Savings + Foreign Savings (=Trade Deficit)
- Foreign savings must equal the trade deficit – foreigners send the US physical goods in return for pieces of paper
- $I = S + (T - G) + (M - X)$
- Private domestic savings, S, therefore must satisfy equation $S + (M - X) = I + (G - T)$
- Bigger budget deficit means either less investment, more savings, or worse trade deficit
- US often has "Twin Deficits" – both government deficit and trade deficit
- This often happens via changes in exchange rates
- Odd for a government to claim to want a lower trade deficit while also increasing budget deficit

Crowding Out

- As budget deficits rise, government must sell more bonds to finance
- Often to sell more bonds, price of bonds falls = interest rates rise
- As rates on government bonds rise, this raises the opportunity cost for firms
- They have to compete with government to get savings
- Higher rates on government bonds means fewer private investment projects – crowding out
- Obviously depends on monetary policy – can keep interest rates lower by printing more money (might be inflationary)
- Public sector makes investments in physical capital (roads), human capital (education), knowledge capital (tech, R&D)

Supply Side Economics

- Is not economics, just politics
- Laffer Curve
- No empirical evidence to support
- Experiments have been tried but failed (eg Kansas just a few years ago)
- Takes a basic statement that is true in limited cases (sometimes taxes could be too high) and over-generalizes



MMT – Modern Monetary Theory

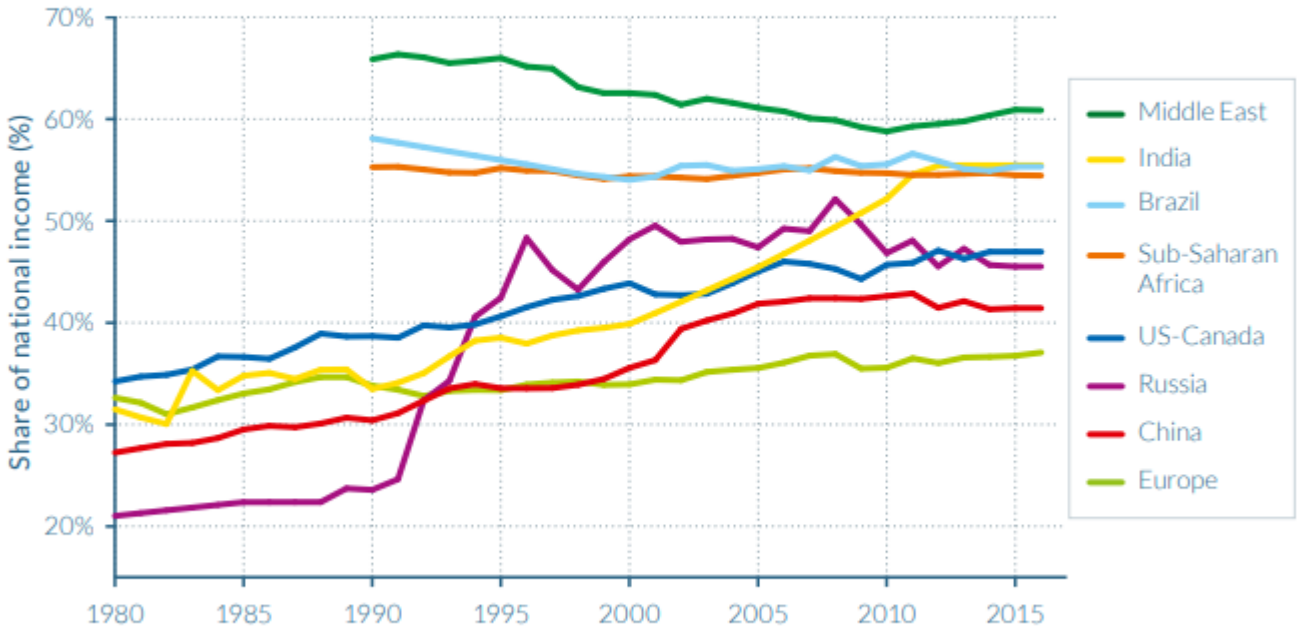
- Is not economics, just politics
- Core idea is that deficits don't matter, central bank can print money to cover costs
- If inflation looms then government should reduce spending or raise taxes
- Standard economic theory makes that point for times when economy is at zero interest rate boundary
- When rate are above zero, empirical evidence does not support MMT
- Takes a basic statement that is true in limited cases (sometimes deficits don't matter) and over-generalizes

Inequality

- Rising over most of globe
  - whether look at top 10% or top 1% or top 0.1% or 0.01%
- Careful to distinguish income from wealth (although both are unequal) – again stock vs flow
- In US, this dovetails with inequality between race/ethnicity groups

Figure E2b

Top 10% income shares across the world, 1980–2016: Is world inequality moving towards the high-inequality frontier?



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

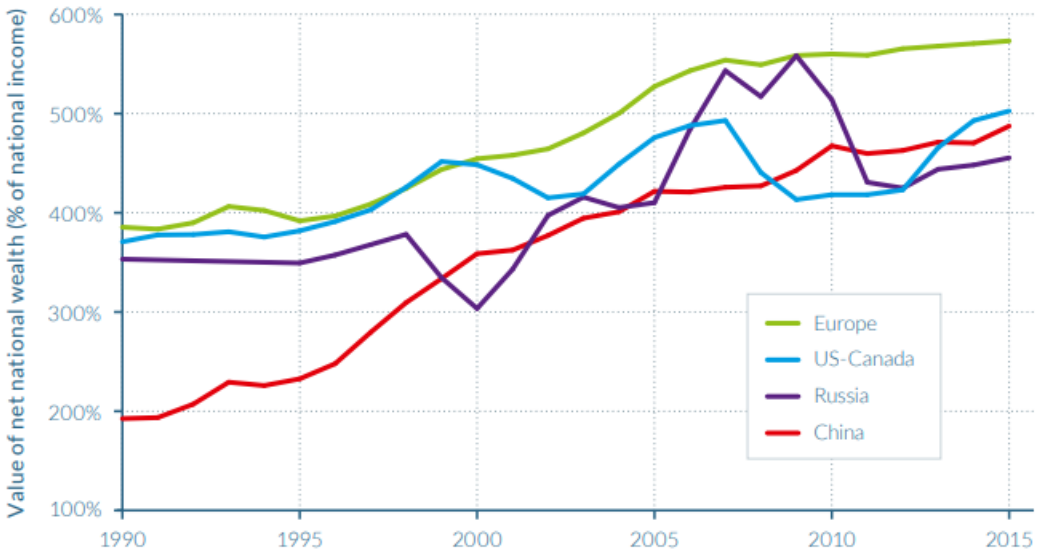
In 2016, 55% of national income was received by the Top 10% earners in India, against 31% in 1980.

most of this section follows Alvaredo, Chancel, Piketty, Saez, Zucman World Inequality Report 2018

Wealth & Income

Figure 3.1.2

Net national wealth to net national income ratio in emerging and rich countries, 1990–2015

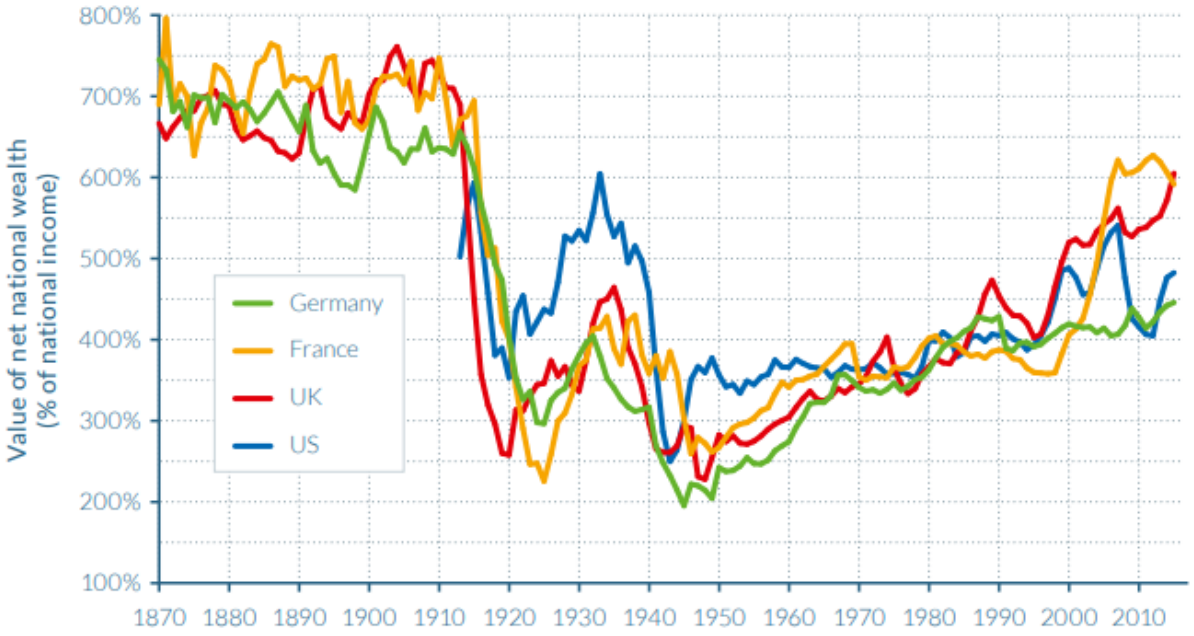


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net national wealth in China was 487% of net national income, i.e. it was worth 4.9 years of national income. Net national wealth is equal to net private wealth plus net public wealth. Net private wealth is equal to new private assets minus net private debt.

Figure 3.2.2

Long-run trends in the national wealth of rich countries, 1870–2015



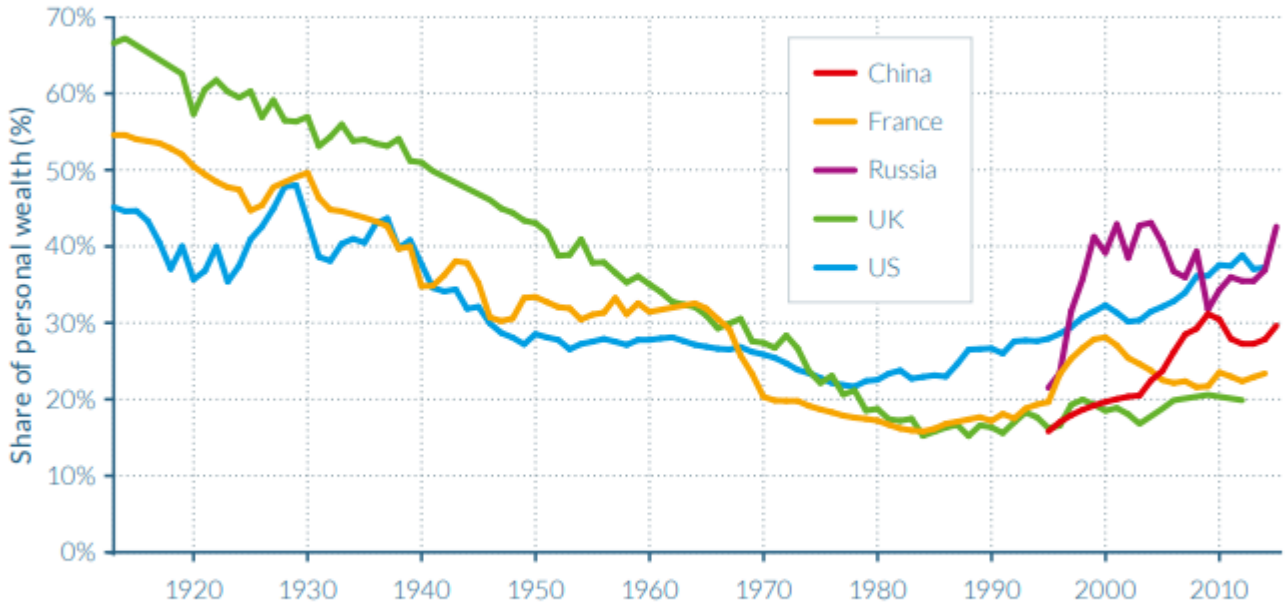
Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 1870, the value of net national wealth in Germany was 745% of net national income, i.e. it was worth 7.5 years of national income. Net national wealth is equal to net private wealth plus net public wealth.

Inequality

Figure E8

Top 1% wealth shares across the world, 1913–2015: the fall and rise of personal wealth inequality

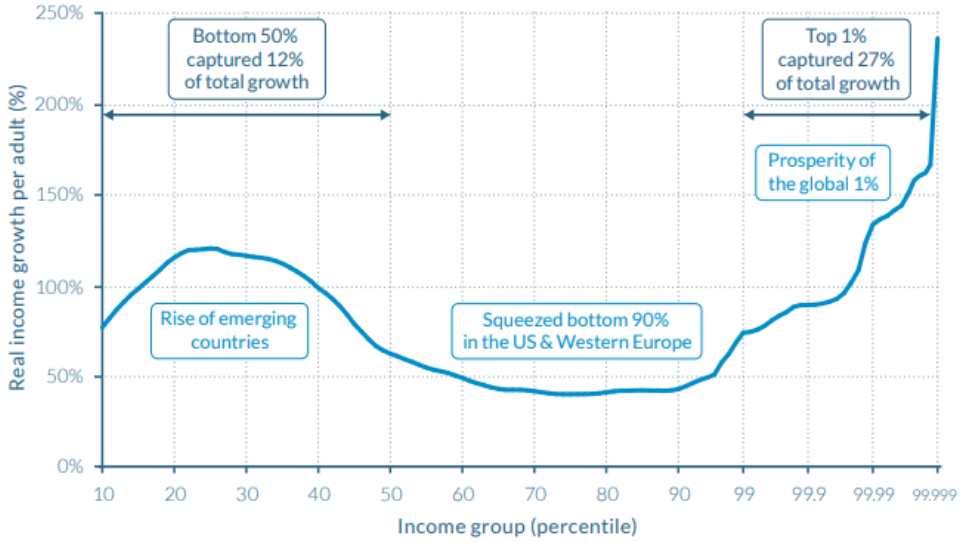


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 1% wealth share was 43% in Russia against 22% in 1995.

Figure E4

The elephant curve of global inequality and growth, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for more details.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 74% between 1980 and 2016. The Top 1% captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

Inequality in US

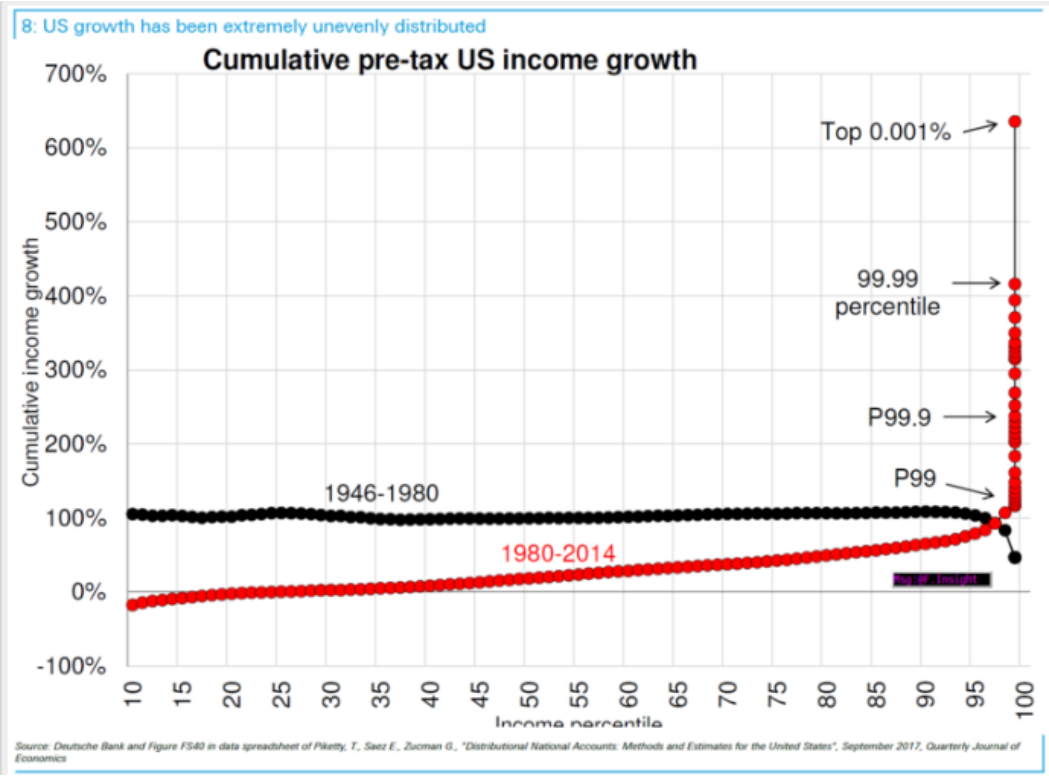


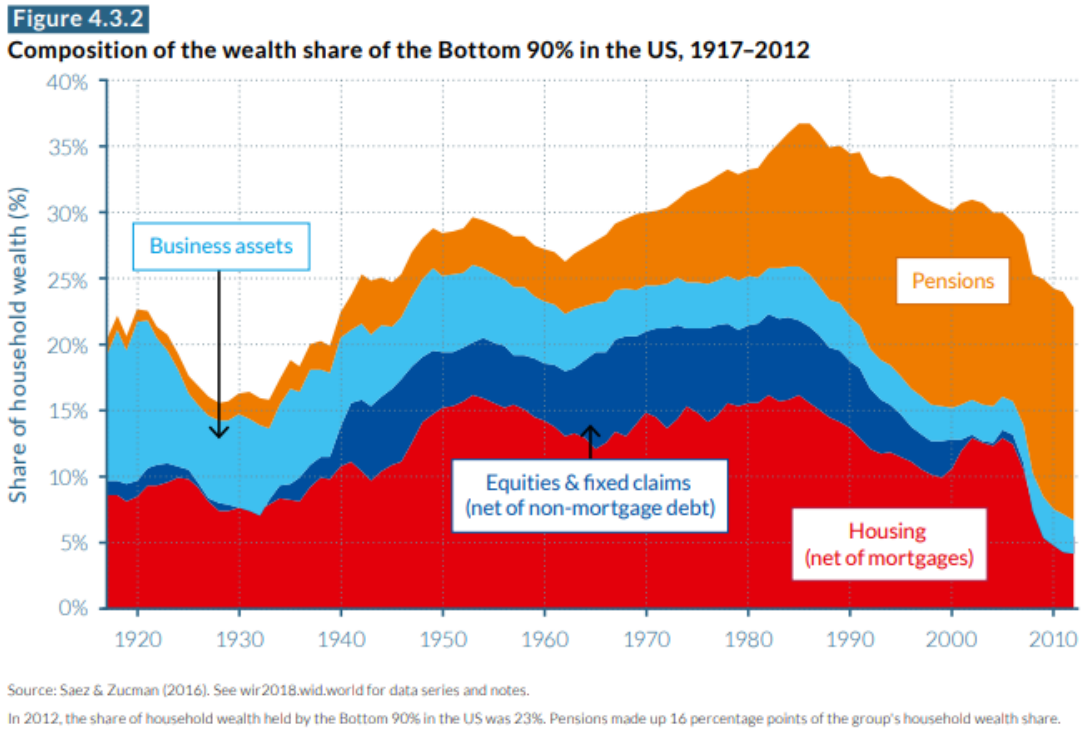
Table 4.3.1

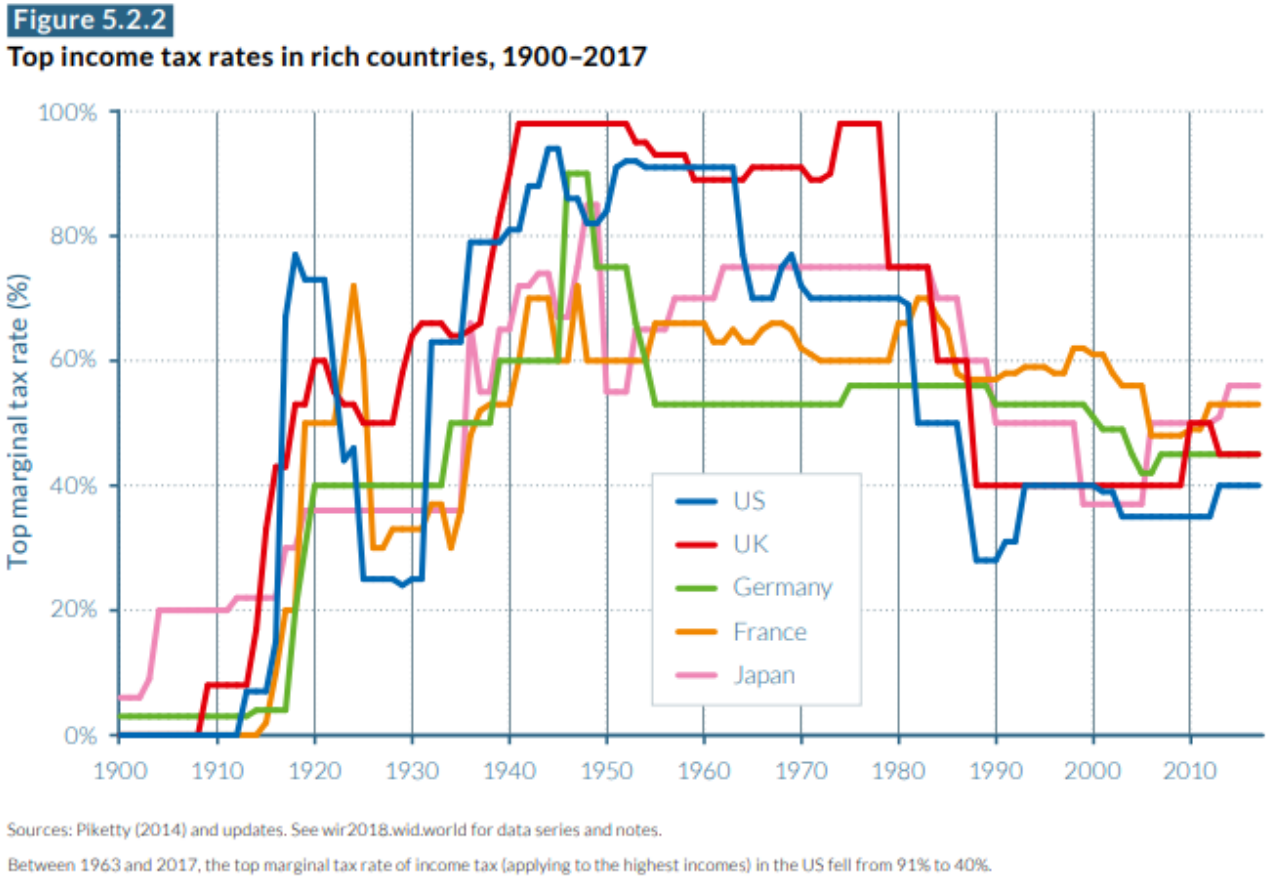
The distribution of household wealth in the US, 2012

Wealth group	Number of families	Wealth threshold ($)	Average wealth ($)	Wealth share
A. Top Wealth groups				
Full Population	160 700 000	–	384 000	100%
Top 10%	16 070 000	740 000	2 871 000	77.2%
Top 1%	1 607 000	4 442 000	15 526 000	41.8%
Top 0.1%	160 700	23 110 000	81 671 000	22.0%
Top 0.01%	16 070	124 525 000	416 205 000	11.2%

Rising wealth inequality since the 1980s is almost entirely due to the top 0.1%

Inequality in US





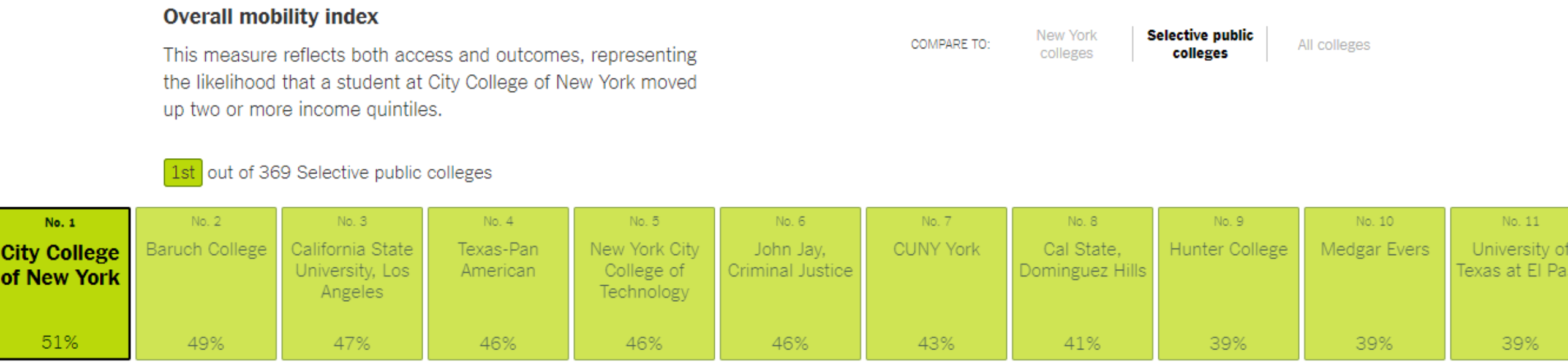
Change in wealth driven by changes in saving (due to attempts to keep off inequality of consumption?)

Policy

- Fiscal policy effectiveness depends on Marginal Propensity to Consume – do rich or poor have different MPC?
- Worry about persistence over time – high inequality/high mobility vs high inequality/low mobility
- Political power follows economic power
- Policies that promote mobility (eg public education) get less support with rising inequality
- Progressive taxation can ameliorate inequality
- Acemoglu & Robinson distinguish policies to get a larger share of fixed pie vs grow the pie

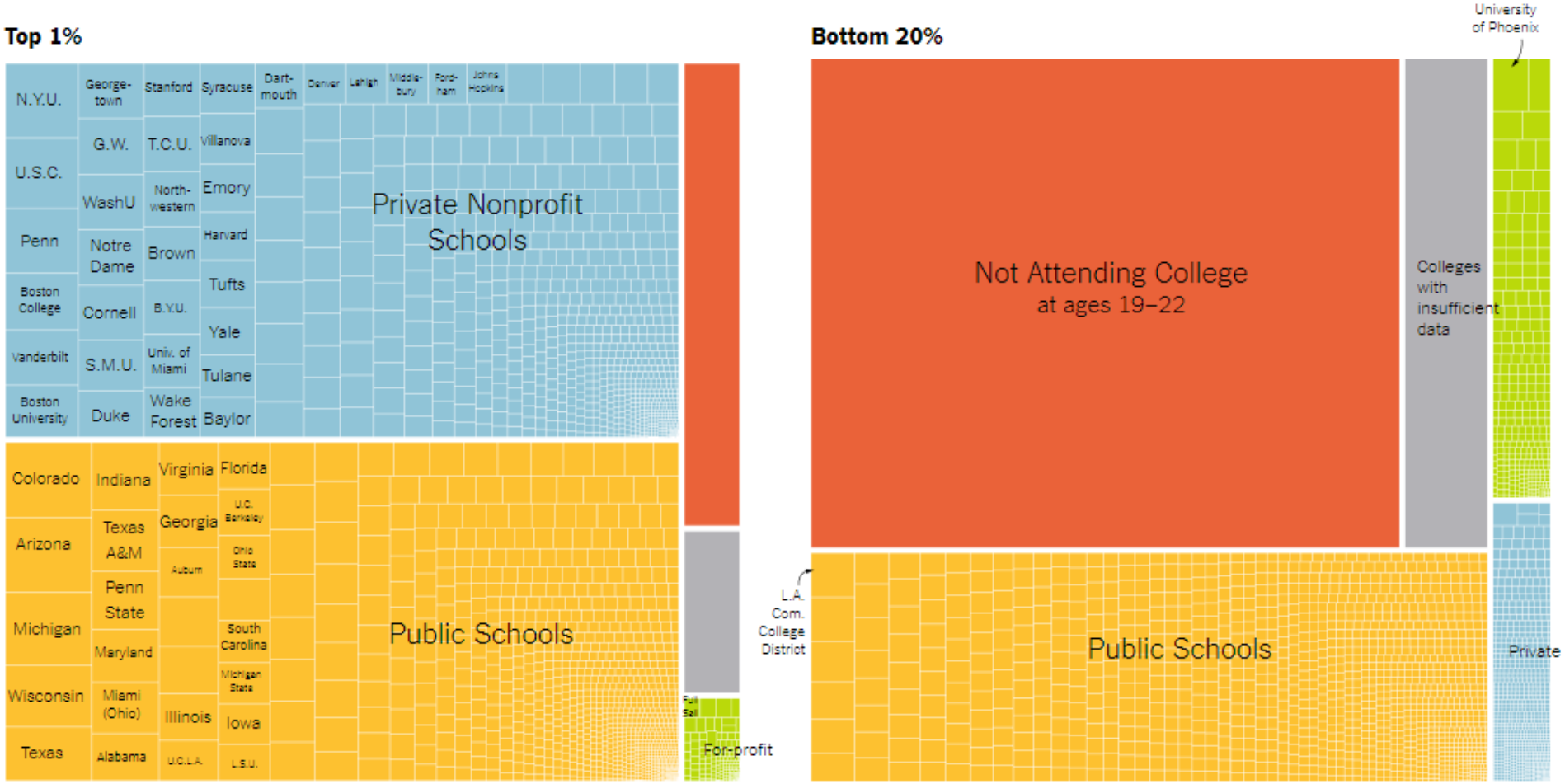
Inequality & Educational Opportunity

- In US, at Ivy League & similar, more students from top 1% of families than from bottom 50%
- CUNY & especially CCNY lead the USA in social mobility
- from *Equality of Opportunity*, by Raj Chetty, John Friedman, Emmanuel Saez, Nicholas Turner and Danny Yagan
- all the more surprising since it looks at people in the Slow Period of mobility (born around 1980) past the era of Jonas Salk, Andy Grove, Colin Powell & 10 Nobel Prize winners



Inequality & Educational Opportunity

Where the top 1% and the bottom 20% go to college



recall recent news about bribes for college admit…