The Debt

Source: Congressional Budget Office.

Notes: Spending in this figure excludes interest payments on the debt; hence, the gap between federal revenues and noninterest spending shown here does not equal the projected surplus or deficit.

The extended-baseline scenario adheres closely to current law, following CBO’s 10-year baseline budget projections from 2009 to 2019 and then extending the baseline concept for the rest of the projection period.
The Long-Run Fiscal Gap (Current-Law Baseline)

- 0.80%: funding Bush tax cuts and Medicare D
- 2.80%: funding of Medicare D
- 3.60%: baseline
The Long-Run Fiscal Gap II

3.60%: baseline
3.63%: with ARRA stimulus
3.23%: with ARRA and PPACA health
The Current Depression: A Fall-Off in Spending
The “Austrian” Theory: We Built too Many Houses, and Now We Must Suffer
But We Have Worked Off Our Overhang of Excess Residential Construction—Yet the Depression Continues
Jean-Baptiste Say is correct

Excess supply must be balanced by excess demand

But a “general glut” of currently-produced goods and services and of labor is possible

If there is excess demand in financial markets...
Where Is the Excess Financial Demand that Causes the Depression?

Three types of excess demand in finance can produce a “general glut”—excess supply of goods, services, and labor:

- Money
- Bonds
- Safety
We Had All Three Kinds...

- Excess demand for money (Milton Friedman, high cost of getting cash even with good collateral, solve by having Federal Reserve expand the money stock)
- Excess demand for bonds (Knut Wicksell, high value of bonds, solve by soaking up private savings)
- Excess demand for safety (Hyman Minsky, enormous risk spreads, solve by increasing supply of safe and increasing demand for risky assets)
Arguments of the Pain Caucus I

- Austerity now is necessary to deal with our long-run deficit problem
- To the contrary, austerity now has only a third-digit influence on our long-run deficit problem
Arguments of the Pain Caucus II

- Austerity is necessary because continued deficit spending would lead to record interest rates that crowd-out investment and slow growth.

- To the contrary, while interest rates are record lows, they are at record lows.
Austerity is necessary because financial markets might panic in the future over the effect of anti-recession deficit spending on our long-run deficit problem—even though anti-recession deficit spending is not worsening our long-run deficit problem and even though there are no signs of panic outside the gold market.

This has a “who are you going to believe: me or your lying eyes” character.

The stockmarket seems really unhappy with the victory of the Pain Caucus.

The bond market seems really unconcerned with the U.S. deficit.

Only the goldbugs are frightened.
Are the Arguments of the Pain Caucus Worth Heeding?

- If you think 9.7% unemployment isn’t a big problem, OK
- If you are a goldbug, OK
- Otherwise... 9.7% cyclical unemployment that every day is turning into permanent, structural unemployment is a really big problem
- We should be dealing with it
The Bond Market

10-Year Treasury Constant Maturity Rate (DGS10)
Source: Board of Governors of the Federal Reserve System

Shaded areas indicate US recessions.
2010 research.stlouisfed.org
The Stock Market

S&P 500 Index (SP500)
Source: Standard and Poor's

Shaded areas indicate US recessions.
2010 research.stlouisfed.org