

LECTURE EIGHT - PART FIVE

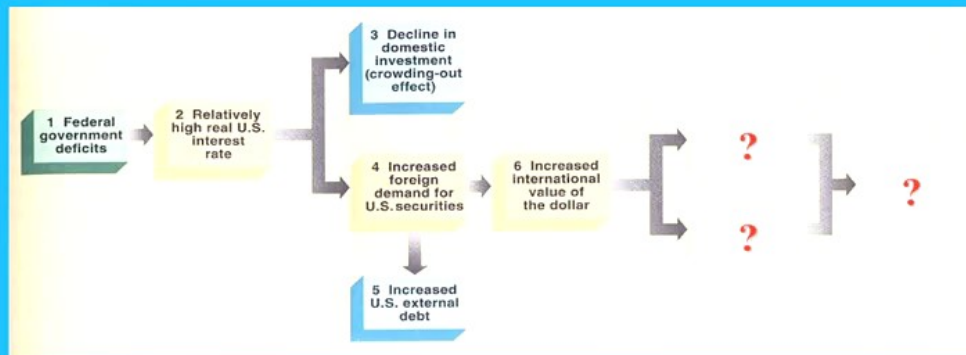
Budget Deficit Pros and Cons

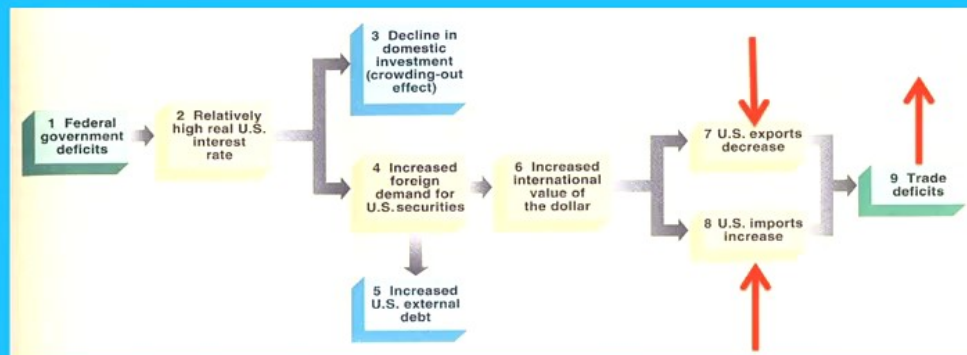
- **Deficit Hawks:** Budget deficits and a rising national debt are a serious threat.
- **Deficit Doves:** Budget deficits and public debt are relatively harmless.



The Trade Deficit Argument: Hawks

1. Chronic budget deficits have been responsible for **crowding out** private investment **AND**
2. Chronic budget deficits have also led to America's huge **trade deficits** over the last several decades.





Hence the term: “The Twin Deficits”

Other Policy Implications

- A trade deficit means a nation is not exporting enough to pay for its imports.
- The difference can be paid for either by borrowing from abroad or by selling U.S. assets.

Mortgaging America

- To finance its trade deficit, America sells off factories, shopping centers, hotels, golf courses, and farms to foreign investors.
- Over time, this “mortgaging” of America will reduce both economic growth and real income.

Government Debt, Economic Growth & Living Standards

1. Distinguish between **external** and **internal** debt.
2. Discuss the **inefficiencies** of levying taxes to pay interest on the debt.
3. Examine the impact of the debt on **productivity** & **capital accumulation**.

Deficit Doves Say “Don’t Worry!”

- **Internal** Debt: Owed by a nation to its citizens.
- **External** Debt: Owed to foreigners!

The Dove’s Main Point
Since we owe most of the debt to ourselves,
we shouldn’t worry!

Deficit Hawks Warn of Great Danger

- As far back as the 1960s, the percentage of U.S. debt held by foreigners has steadily risen.

The Hawk’s Main Point
The more U.S. debt foreigners hold, the
more foreign nations can use that debt for
political and economic leverage!

A Tax On U.S. Citizens

- Paying interest on the external debt acts like a tax on U.S. citizens by foreigners.
- This “debtor’s tax” reduces the economy’s short and long term growth rates.
- Foreign debt exposes American public policy to undue political pressures.

Other Arguments of Deficit Hawks

Key Deficit Hawk Point
A large internal debt is unacceptable
for four reasons.

#1: Internal Debt Leads to Higher Taxes

- Internal debt requires payments of interest to bondholders and that means higher taxes.
- Higher taxes distort the allocation of national resources and lead to an efficiency loss.

#2: Internal Debt Redistributes Income From Poor To Rich

- This happens because government bondholders tend to be wealthier than taxpayers.

#3: Servicing The Debt Cuts Government Services

- Interest payments could otherwise be spent on more education, health care, & other services.
- The ratio of interest payments to total tax revenues is steadily rising.
- We may eventually wind up using all available tax revenues just to service the debt.



#4: A Burden on Future Generations

- A large debt places an unreasonable burden on future generations which must pay this debt off.



The Dove's Benefits Of Debt

- Any debt incurred now as a result of public investment will provide benefits--not just a burden--to future generations.
- This leads us to our next area of debate:

What are the impacts of budget deficits and debt on investment and productivity?