

# The Power of Macroeconomics

## Lecture Eight: Budget Deficits and the Public Debt



Presented By:  
Professor Peter Navarro  
University of California-Irvine

## The Purpose Of This Lesson

- Examine the economic consequences of chronic budget deficits.
- Analyze the potential dangers of an upward spiraling government debt.

## **The Budget Deficit Debate**

---

- Classical economists argue budget deficits are bad and should be avoided except in wartime.
- Keynesians believe budget deficits are a necessary byproduct of an expansionary fiscal policy during recessions.

## **Areas of Agreement**

---

- Classical and Keynesian economists agree chronic budget deficits are undesirable.

### **Key Question**

How big a danger are these chronic deficits and a collateral soaring national debt?

## In This Lesson

---

- Look at the dark side of using discretionary fiscal policy.
- This dark side is the **budget deficits** and **public debt** that can occur when the government uses Keynesian fiscal policy to boost aggregate demand.

## A Fiscal Policy Refresher

---

- **Keynesian Economics:** Favors discretionary fiscal policy to fight recessions and inflation.
- **Fiscal stimulus:** Increased government spending or tax cuts to fight recession and unemployment.
- **Fiscal restraint:** Reduced spending or increased taxes to fight inflation.



## The Deficit Financing Problem

- Fiscal stimulus typically involves **deficit spending** and can therefore lead to budget imbalances.
- **Why?** Because the government must **borrow** funds to pay for spending that exceeds tax revenues.

## The Budget Deficit Defined

$$\text{Budget Deficit} = \text{Government Spending} - \text{Tax Revenues}$$

- **Budget surplus:** Occurs when all taxes and other revenues exceed government expenditures for the year.
- **Balanced budget:** Revenues and expenditures are equal.

## The National or Public Debt Defined

- **Bonds:** The government sells them to finance a budget deficit.
- **National Debt:** The total dollar value of the bonds owned by the public.
- **Debt Calculated:** The accumulated budget deficits minus the accumulated surpluses.
- **Who holds It?** Banks, households, and businesses AND foreigners.

## The Punchline

### Key Point

Whatever the merits of Keynesian economics, it has produced few budget surpluses since the 1930s; and this has been especially true since the 1970s.