Comments on

# Robust Fiscal Stabilization

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# Major Results

**Empirical Results**

- Policy makers responded in a stabilizing way to deficits and the output gap during 1984-2003 (but not really to debt)
- No response to any of those items in 2004-2024 ("wait and see")

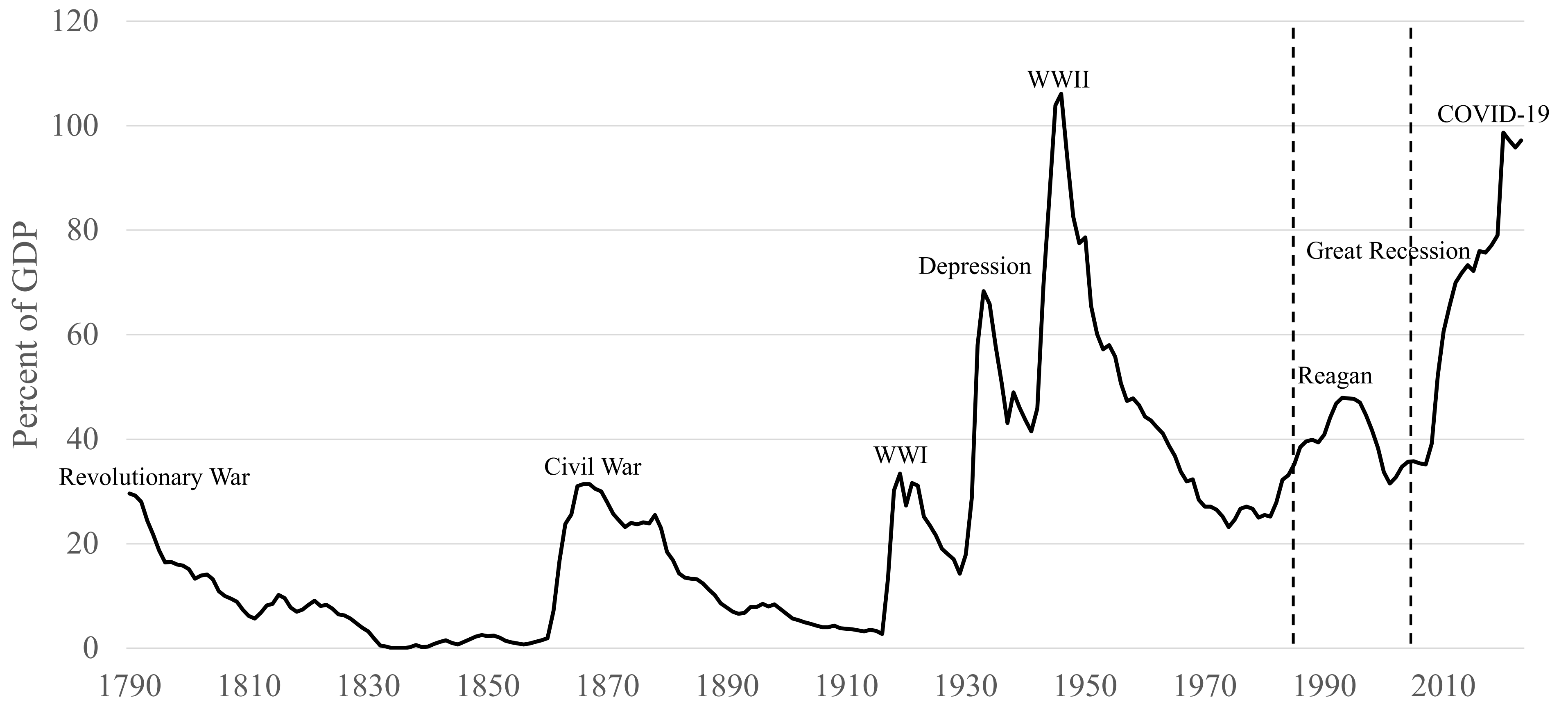
**Simulation Results**

- Standard projection: D/Y = ~ 160% in 30 years, ~ 250% in 55 years.
- Add shocks to deficits and interest rate: D/Y = ~ 250% in 45 years
- Add fiscal feedback: D/Y would be more modest and manageable.

# The Unasked Questions

- **What *is* going to happen?**
- Why did policy makers change their behavior?
- Will they revert?

- Side note / Reality check:
  - Deficit-driven feedback (consistent with long-term stabilization) would require adjustments of $4.2T (1.2% of GDP) over the next decade
  - Debt-driven feedback would require adjustments of $1.75 trillion (0.5% of GDP)


Debt/GDP
Percent of GDP
0
20
40
60
80
100
120
1790
1810
1830
1850
1870
1890
1910
1930
1950
1970
1990
2010
Revolutionary War
Civil War
WWI
Depression
WWII
Reagan
Great Recession
COVID-19

# What Reduced the Debt/GDP Ratio?

- After WWII
  - $r < g$
  - Balanced primary budgets, on average
  - Large, extended reduction in defense spending / GDP
- In the 1990s
  - Reductions in primary budget deficit (small relative to current primary deficits)
  - Strong economy / stock market

# Model

- Straightforward extension of standard budget projections.
- Add shocks to deficit (asymmetric) and to interest rates
  - Implies that non-stochastic budget projections (e.g., CBO), on average, are biased toward “better” outcomes – toward less debt.
- Add fiscal feedback rules
  - Makes r-g less important (because policy can respond to it)

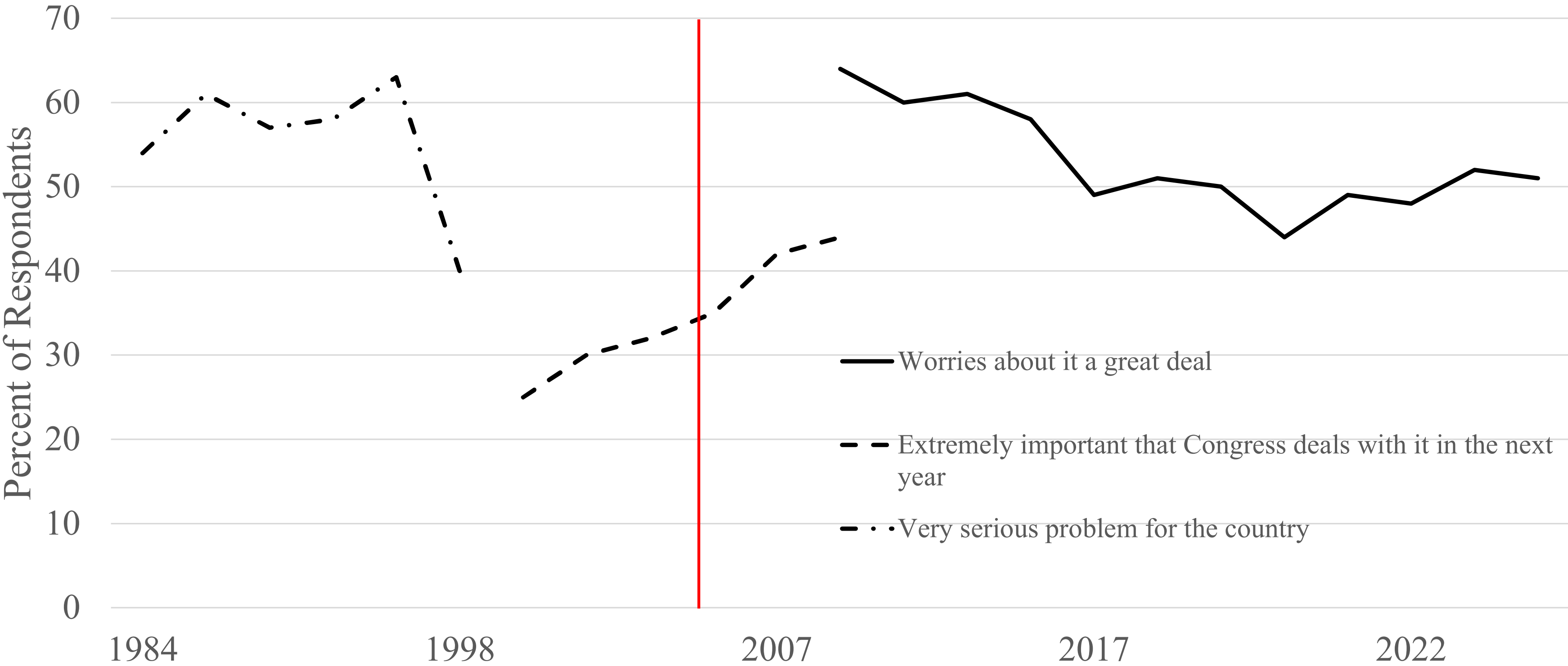
# Why did policymaker behavior change?

- Changing public opinion about deficits?

- Changing financial market reaction to deficits?
  - Real interest rates
  - Net interest/GDP
  - Fiscal space

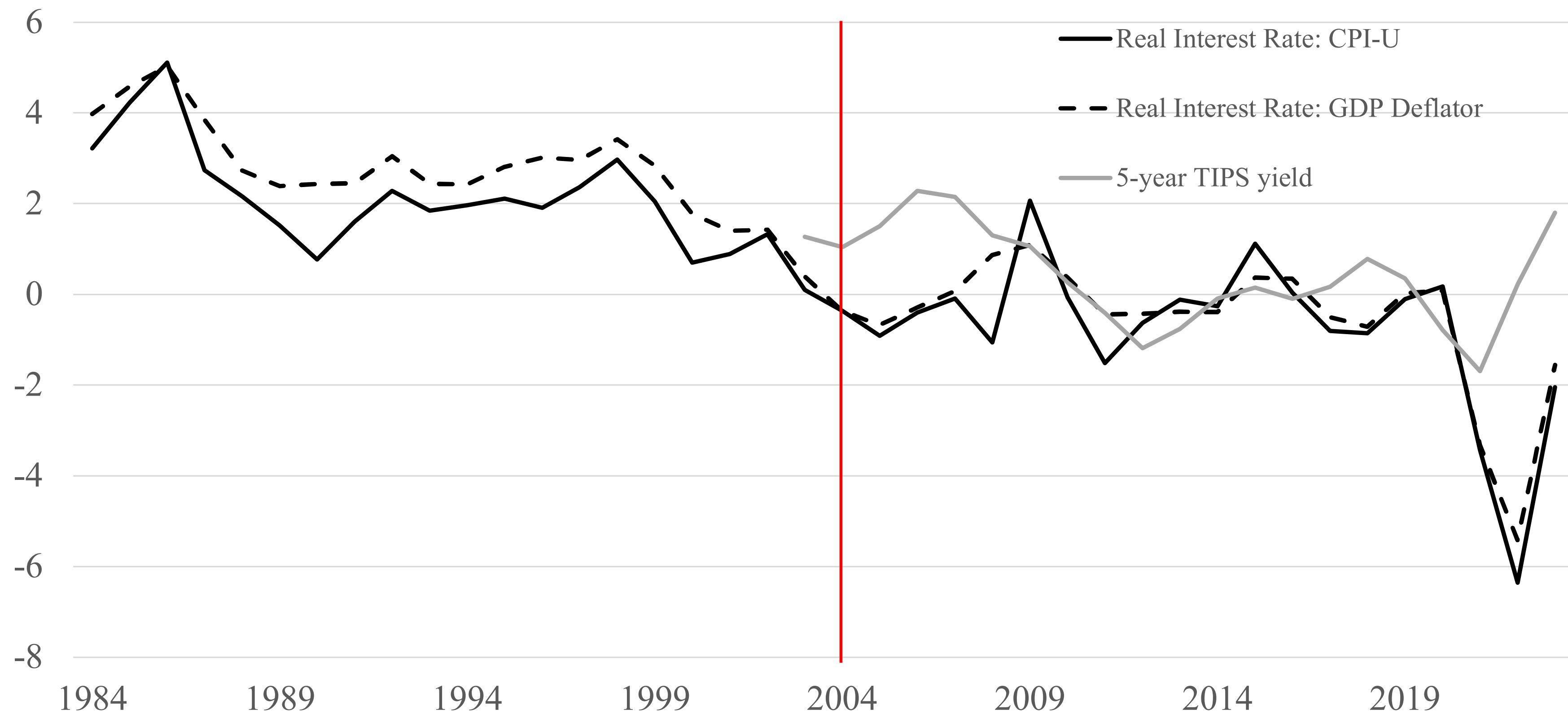
- Things were easier back then?
  - No Great Recession or pandemic
  - Peace dividend
  - Entitlement programs were a smaller share of the budget

# Poll Results: Opinions on the Deficit

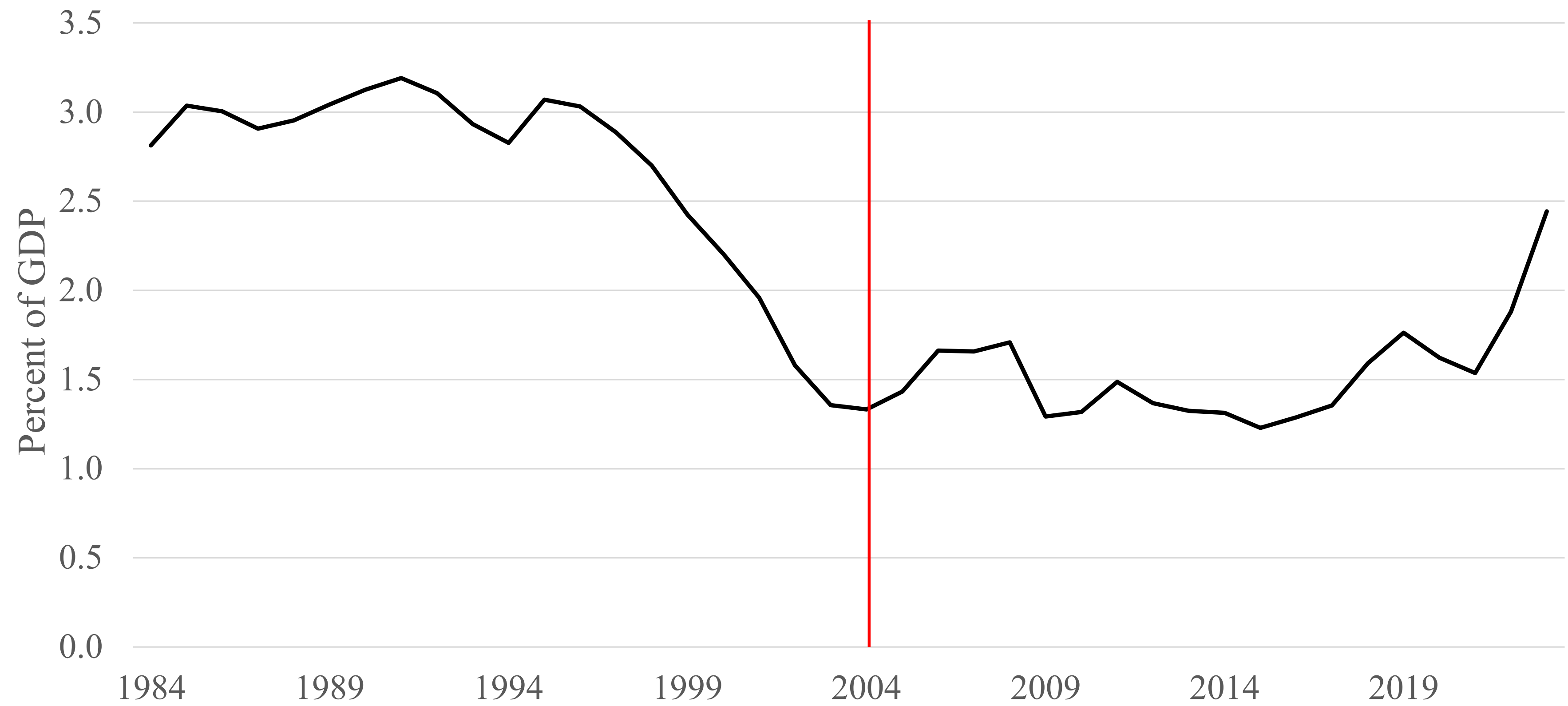


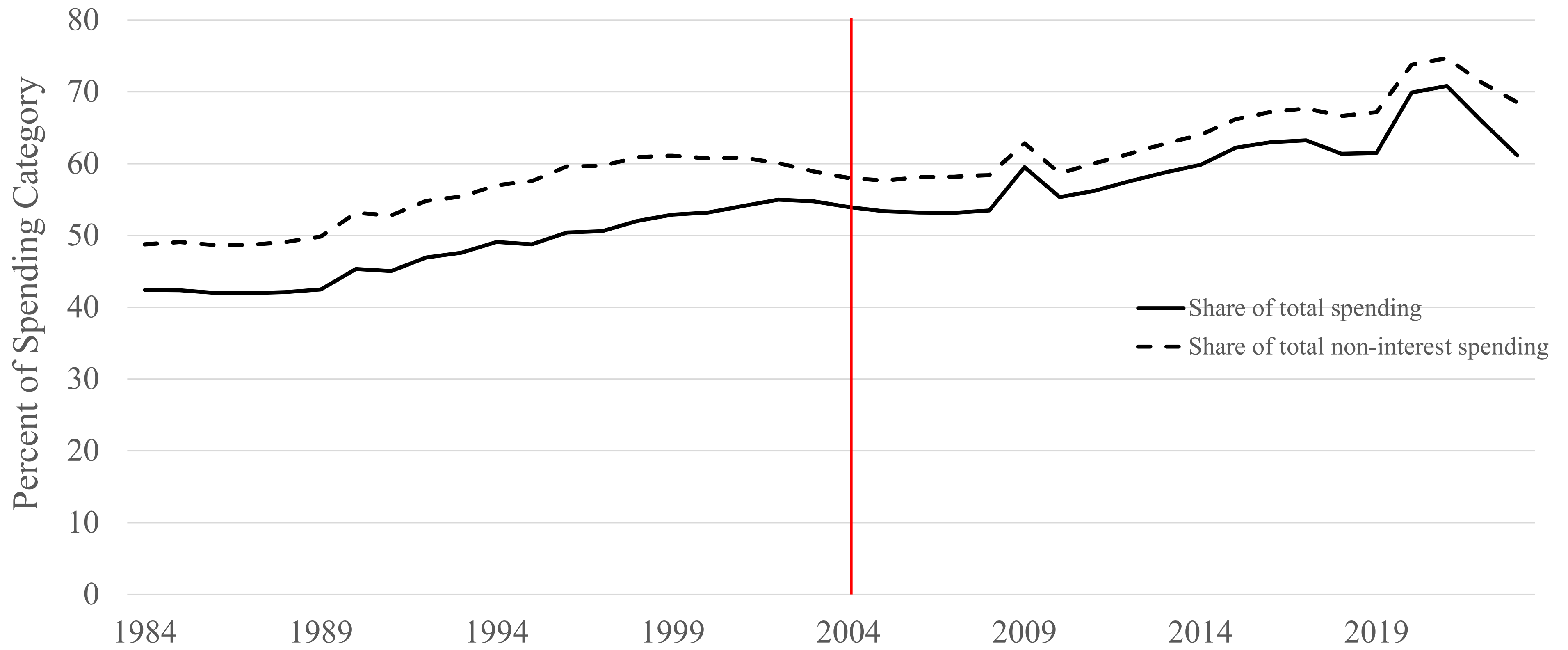

Source: Gallup

# Real Interest Rate




The nominal interest rate in year t is defined as net interest payments in year t / (the debt in year t-1 + ½ * the deficit in year t).
The real interest rate = the nominal interest rate – inflation


Net Interest/GDP
Percent of GDP
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1984
1989
1994
1999
2004
2009
2014
2019


Entitlement Spending
Percent of Spending Category
80
70
60
50
40
30
20
10
0
1984
1989
1994
1999
2004
2009
2014
2019
Share of total spending
Share of total non-interest spending

# Why did policymaker behavior change – 2?

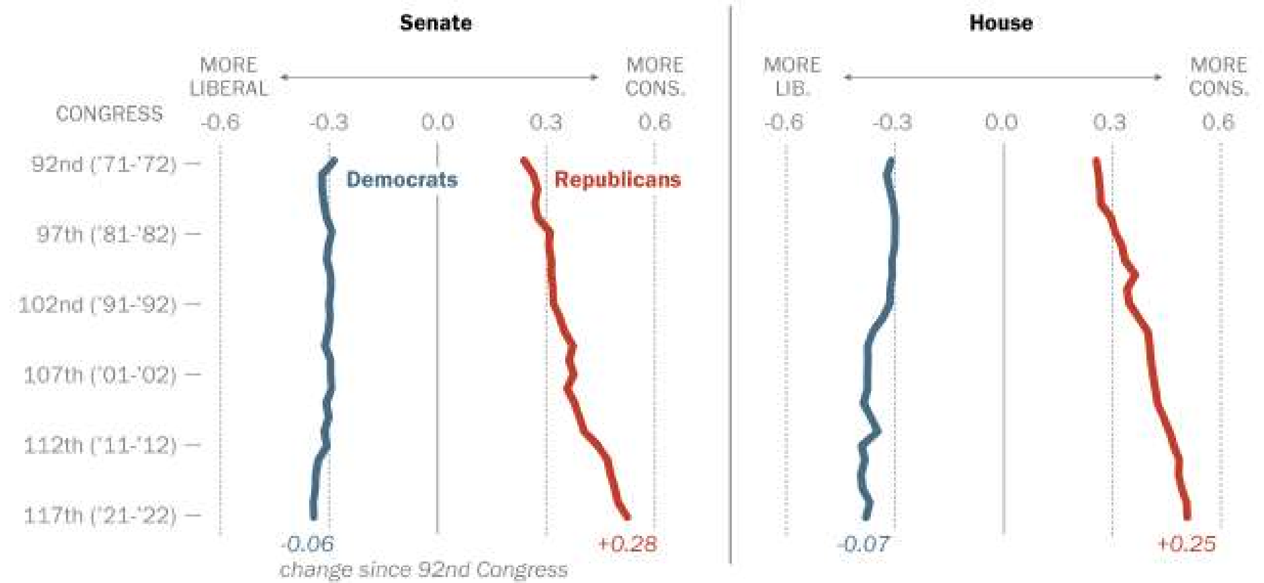
- Demise of the budget rules?
  - Expired in 2002; were partially reinstated later
  - But that may just reflect pent-up demand for looser fiscal policy

- Increasing partisanship, polarization, tribalism in Congress?
  - Republicans were willing to vote for tax increases in the 1980s but not much since (No New Taxes Pledge). Makes negotiations harder.

- Increased prevalence of unified government?
  - Raises deficits
  - Increased use of reconciliation for deficit-increasing policies (EGTRRA, JGTRRA, ACA*, TCJA, ARP, IRA etc.) rather than original purpose of deficit reduction.

# Partisanship Has Increased

- Parties growing further apart ideologically
- No longer any overlap between conservative Democrats and liberal Republicans since 2002 in the House and 2004 in the Senate
- Average House members now vote with their party on the vast majority of bills




Source: Pew Research Center

# Cheney

- The NYT reported on January 10, 2004, that Paul O'Neill had argued that what would become the 2003 tax cuts would raise the deficit too much, only to be told by Dick Cheney (in November 2002) that Reagan taught us that "deficits don't matter."

- At the very least, a notable contrast with Rubinomics in the 1990s and Ross Perot receiving 19% of the popular vote in 1992 on a largely anti-deficit platform.

# Conclusion

- The key question is whether policy makers will change their behavior.
  - Is 2004-2024 a blip or a trend?

- Some of the causes of policy makers' behavioral change seem temporary but many seem more durable.

- On net, it will be harder to reduce D/Y now than in the past
  - Holding D/Y constant or growing slowly may the best feasible outcome.