

Interventionism

Lesson 22:

Government

Debt

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4. Chapter: Lesson 22: Government Debt

1. Lesson 22: Government Debt Questions

4.1.1. *Explain: "The government deficit is a flow variable, while the deb...

Author: Robert Murphy

*Explain: "The government deficit is a flow variable, while the debt is a stock variable."

- It only makes sense to measure the deficit in reference to a certain duration of time. For example, we can talk about the deficit during fiscal year 2010, or during the first three months of calendar year 2009. In contrast, the debt is a measure that applies at a particular moment in time. For example, we can talk about the debt as of December 31, 2009. (To understand the flow/variable distinction, an example of water might help. If someone is using a hose to fill a backyard pool, the rate at which the water shoots out of the hose—say, 5 gallons per minute—is a flow variable. On the other hand, the depth of the water in the pool—say, 3 feet—at any given time is a stock variable.)

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4.1.2. When the government spends more than it collects in tax revenues, w...

Author: Robert Murphy

When the government spends more than it collects in tax revenues, what can we say about the budget?

- The budget is in deficit.

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4.1.3. *Is it possible for the government to sell new bonds in a given yea...

Author: Robert Murphy

*Is it possible for the government to sell new bonds in a given year, even if the budget is in surplus?

- Yes. If the government carries forward an existing debt that is larger than the surplus, then the government ends the period with a debt (though a lower one). If some of the carried debt had to be "rolled over" into new bonds, then the government would have issued new bonds to replace the maturing ones (which were not being paid off with the surplus). For example, in the student text's table, in the year 2012 the government runs a \$25 billion surplus, but also (re)issues \$75 billion worth of new bonds.

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4.1.4. Are government budget deficits directly inflationary?

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Are government budget deficits directly inflationary?

- No, because by itself a budget deficit doesn't create new money.

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4.1.5. *Does it help future generations by raising taxes now to close a bu...

Author: Robert Murphy

*Does it help future generations by raising taxes now to close a budget deficit?

- No, because the actual mechanisms through which government budget deficits impoverish future generations—lower capital formation, distortions to the future economy when taxes are raised, etc.—are applicable to present tax hikes.

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4.1.6. Could a government run a budget surplus while still having a large ...

Author: Robert Murphy

Could a government run a budget surplus while still having a large debt? Explain.

- Yes, because a budget surplus just refers to the government spending less than it collects in taxes, for a given time period (such as a year). The government could do this, while still carrying a large debt that it accumulated from years and years of past deficits.
Sample Partial Credit Answer
Yes.

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4.1.7. If the government retires some of its outstanding bonds during the ...

Author: Robert Murphy

If the government retires some of its outstanding bonds during the year, does that mean it's necessarily running a budget surplus? Explain.

- No, because in any given year, some portion of the outstanding bonds will probably mature, meaning the government will have to return the principal to those lenders. Yet the government can re-enter the bond market and borrow that same principal back again, keeping the outstanding debt at the same level (looking at just these transactions). This process can occur regardless of whether the government happens to be also running a deficit or surplus that year.
Sample Partial Credit Answer
No, it could be running a deficit and still have to pay off some of the existing bondholders.

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4.1.8. Explain the accurate sense in which government deficits today make ...

Author: Robert Murphy

Explain the accurate sense in which government deficits today make our grandchildren poorer.

- Deficits today are financed by borrowing money, which drives up interest rates and diverts savings out of the private sector. Other things equal, this reduces the amount of private sector investment, meaning that our grandchildren end up inheriting a smaller collection of machines, tools, and equipment. This reduction in capital goods makes their labor less productive and lowers their standard of living (relative to what they otherwise would have achieved).
Sample Partial Credit Answer
Government deficits reduce private investment.

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