



Deficits & Debts: Crash Course Economics #9

Crash Course: Economics

<https://youtube.com/watch?v=3sUCSGVYzI0>

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=====INTRODUCTION=====

Adrienne: Hi, I'm Adrienne Hill.

Jacob: And I'm Jacob Clifford, and welcome to Crash Course Economics.

Adrienne: What's wrong with you?

Jacob: Today we're talking about deficits and debt.

[cue introduction]

=====DEFINITIONS=====

Jacob: You've probably heard a lot about the national debt, is it and where does it come from and is it a problem, and most importantly, should you even care?

Jacob: First off, deficit and debt are not the same thing. A budget deficit is when the government spends more than it brings in tax revenue in a given year. Then it has to borrow money to cover that year's shortfall. The debt is an accumulation of budget deficits.

Jacob: For example, let's start a country called, I don't know, Cliffordonia. It's a pretty cool name. In its first year, the Cliffordonian government brings in \$400 of tax revenue, and it spends \$500, because starting a new country is kinda expensive. So in that year, the deficit is \$100. Then, in the next year it brings in \$600 of tax revenue, but it spends \$800. That year's deficit is \$200. To calculate Cliffordonia's debt, add up all those yearly deficits. At the end of the second year, it has a debt of \$300 -- \$100 from the first year, and \$200 from the second year.

Jacob: Things are looking pretty tough for Cliffordonia. Not only is the nation in debt, it also has an average tax revenue of only \$500 a year. It's going to be difficult getting the space program off the ground at that rate.

=====REAL WORLD EXAMPLES=====

Adrienne: Let's leave the plight of Cliffordonia behind for a moment and talk about the real world. Specifically, let's talk about the United States, since it has the largest debt -- hooray, America #1!

Adrienne: So how big is the debt right now? \$18,236,176,274,963 -- no, wait, \$18,236,176,188 -- it's hard to keep up with, but it's a little over 18 trillion dollars.

Adrienne: So the number sounds really, really high. I have a hard enough time wrapping my head around millions and billions, not to mention trillions. The debt seems especially high when you look at the trend over time. First we need to adjust that trend for inflation because dollars today are not the same as dollars in the past. Remember, we try to keep it real around here. Second, we really should be looking at debt as a percent of GDP. Why? Well suppose I owe \$200 bucks, and a 6 year old owes \$100. Which of us will have a harder time paying it off? Well, probably the 6 year old, because even though my actual debt number is larger, I have a job. I have two jobs. What's your allowance, you unemployed 6 year old?

Adrienne: In the same way, our GDP grows every year, due to population growth and productivity increases. And our ability to sustain our debt grows along with our income. So here is the US federal government debt as a percent of GDP. As you can see, it's risen over the past several years, so, is that a bad thing?

Jacob: Well, there's a couple ways to look at it. First, compare the US to other developed nations. The US has a higher debt-to-GDP than other countries, but several other countries have a much higher ratio. Some of these are in crisis, like Greece and Italy, but there are also countries that are stable, like Japan and France, that have much higher levels of debt than the US. Second, most economists aren't concerned about the borrowing the US has done already, because they're too worried about the borrowing they're gonna do. A lot of politicians and pundits have freaked out about this, while economists are focused on this.

Adrienne: Alright. What we need to figure out is what's driving those huge deficits in coming decades. Deficits are the difference between federal spending and revenue. So let's look at those as a percent of GDP. The problem isn't a drop off in tax revenue. What economists are worried about is spending. So let's look at where the government actually spends its money. Conservatives might complain 'it's obvious, handouts!'. Liberals will say 'it's obvious, defense!'. Well, they're both wrong.

Adrienne: So who's the biggest recipient of federal dollars? Grandma and Grandpa. The government spends about a quarter of the budget on Social Security, and another quarter on healthcare programs. A lot of that goes to retired people on Medicare. They deserve it! They worked hard. And those are the programs that are expected to grow as Baby Boomers retire and live longer. Defense and other discretionary programs are actually projected to shrink slightly as a percent of GDP. We'll be making another video on these specific topics later, because we love making videos, but one thing is for sure: US policy makers will be forced to make some hard decisions about these future unfunded liabilities.

=====THOUGHT BUBBLE=====

Jacob: So the answer is obviously to just keep borrowing more and more money, right? Well, not necessarily. Let's go to the thought bubble. First, to borrow, you need lenders -- people who have decided to save money and loan it out, rather than spend it on something else. But there's a finite amount of money savers can lend, and most of that savings is borrowed by the private sector, which is consumers that take out car loans, and businesses that pay for things like factories and computers. Now, when the government runs a budget deficit, it borrows from that same pool of savings. If the government continues to borrow, many economists worry that there'll be fewer loans available for businesses, and that it'll hurt the long run growth of the economy.

Jacob: The second worry is the Greece scenario. A country's debt could grow so large that savers, individuals, and businesses in other continents might fear they'll never get paid back. They could stop lending money entirely, or they can lend at higher interest rates. Higher interest rates would make it harder to pay back the loan, which could likely lead to more debt, and eventually the government would simply be unable to pay its bills. That's called 'default', and it's basically terrible for everyone -- the investors who loaned the government money lose billions, and the government loses all credibility, and it causes a massive recession. That's what happened to Greece a few years ago, what happened to Argentina in 2001, Russia in 1998, and many other countries throughout history.

=====AMERICAN DEBT=====

Adrienne: Thanks, thought bubble. Fortunately, the US has something called 'the debt ceiling', which is a cap on how much



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debt the US Treasury can issue. The US will never ever ever be able to borrow more than the ceiling, so debt can never get out of control! Hmmm, no. Remember the debt comes from repeated deficits. Deficits come from spending higher than revenues. The debt ceiling does nothing to cut spending or raise revenue. It just gets politicians into a big fight every few months. Basically, trying to cut the debt without raising revenue or cutting spending is like trying to lose weight by buying smaller clothes instead of with diet or exercise. It doesn't work.

Adrienne: But there is good news for the US. First, both American and foreign lenders charge the US government extremely low interest on its loans. That tells us they're confident in the government's ability to pay them back, and the low interest rates actually make it easier for the government to pay. Second, there are signs that the growth and healthcare costs could actually be slow. Now, it's too early to tell if this is true, but if it is, the long-run budget picture will be much better than what we've shown. In fact, the projections for long run deficits and debt have already been revised downward. Go us!

Adrienne: So is all this debt going to destroy the American way of life? Like most things in economics, and in Crash Course, the answer is complicated, and it depends a lot on what you're looking at, as well as your political point of view. Looking at debt from the past or even the present is a good way to have political arguments, but it may not be a great way to think about the future. Right now healthcare spending is driving the debt higher, but if a massive pandemic kills off half the world, or there's a zombie apocalypse, after an initial spike, those healthcare costs are gonna fall. And frankly, in that case, the national debt and deficit spending will be the least of our worries. On that cheery note, we've gotta stop. Thanks for watching; see ya next time.

=====ENDING=====

Adrienne: Thanks for watching Crash Course economics. It was made with the help of all these nice people who do not have a deficit of talent. If you'd like to help keep CrashCourse free for everyone forever, please consider going over to Patreon. It's a voluntary subscription platform that allows you to pay whatever you want monthly to help Crash Course exist. Thanks for watching, and don't forget to be irrationally exuberant.