



# The US Macroeconomy

Current challenges and prospects for a sustainable future

# Synopsis

- The federal government is insolvent
- Current policies cannot be sustained in the long run (intertemporal inconsistency)
- Demographic prospects are relatively favorable, if immigration is permitted
- Potential real GDP growth will slow down
- Reaganomics has run its course; a new model needs to be found
- Taxes will need to be increased—some convergence to Europe
- A tragedy—the republican party has been destroyed. The US no longer has a conservative party, only an ideological, reckless one
- Still, the future is for the US to lose

# The Federal Government is insolvent

- ▶ According to the Secretary of the Treasury, the US federal government runs a negative net worth on the balance sheet.
- ▶ Notwithstanding, the Secretary does nothing, the Congress does nothing. Who blinks first?
- ▶ The staff at Treasury, the Congressional Budget Office, the Trustees of the Social Security Funds, have been saying this for years.
- ▶ The hole is getting deeper over time.
- ▶ Population aging will accelerate it significantly as the boomers retire.
- ▶ Waiting is not an option. You can't reform when most are elderly.
- ▶ The default option—cut benefits. Let's see if this is politically possible

# Intertemporal Inconsistency

- ▶ Dynamics for the future do not make the challenge go away. The US cannot “grow” out of this problem.
- ▶ Demographics are increasing at a decreasing rate; productivity growth is increasing at a decreasing rate. Population structure (aging) proceeds to put pressure on government finances.
- ▶ Because of poverty, unequal distribution, and continuing health concerns, US politics continues to expand entitlements. Spending rises structurally.
- ▶ Favorable growth scenarios postpone the problem, they do not resolve it.
- ▶ A big “primary balance gap,” in various scenarios, with various assumptions.

# Potential real GDP growth will slow

- ▶ Real GDP = number of "workers" times productivity per "worker:"  $Q=L*(Q/L)$
- ▶ L is the supply of labor. It is determined by population growth, growth in the working-age population, participation, and structural unemployment.
- ▶ Ultimately labor is a demographic variable (with some policy influence).
- ▶ Productivity is determined by the quality or efficiency of L.
- ▶ If population growth slows down, L will slow down as well.
- ▶ Productivity is on a declining trend.
- ▶ Together, underlying potential real GDP growth will slow down as well.
- ▶ Potential growth is estimated to fall from 1.7 now to 1.2 percent a year toward 2100.

# Reaganomics has run its course

- ▶ Reaganomics was a reaction to the troubled 1960s & 1970s (demand).
- ▶ Three key elements: tax cuts, “deficits don’t matter”, deregulation (supply).
- ▶ No evidence that tax cuts accelerate growth (but there is evidence that it worsens distributional outcomes).
- ▶ “Deficits don’t matter” has led to a debt addiction. Debt addiction favors the well-off, traps monetary policy, creates zombie companies, and destabilizes the financial system (Minsky).
- ▶ Reaganomics became highly pro-cyclical.
- ▶ Deregulation has been indiscriminate (and caused financial instability under Bush Jr.).
- ▶ Growing inequality, growing recognition that some (smart) regulation is important (externalities, market failure), and worries about ever larger debt are calling the end of Reaganomics (a four decade structural force).

# Taxes will increase; “European socialism”

- ▶ The public demands certain government services, including social insurance (health, welfare, child support, pensions), infrastructure, etc.
- ▶ This places a floor under expenditure. Taxes will rise in the future.
- ▶ The US general government is about 35 percent of GDP. The EU governments run around 45 percent of GDP (and higher).
- ▶ Health care does not deliver the best outcomes in the US; but it is the most expensive in the world. Life expectancy in the US seems to be plateauing.
- ▶ Biden's early success could indicate a new era (the government can be a force for good) and would be a break with Reaganomics (government is the problem).
- ▶ Is the US moving toward a European system—social convergence?

# The Tragedy of the Republican Party

- ▶ The US needs a strong conservative party. For checks and balances.
- ▶ Demographics moves in favor of the Democrats.
- ▶ Discrimination by current republicans against demographic diversification is an untenable policy.
- ▶ Resisting modernization when the world changes is not “conservative” but causes instead rigidity and recklessness (we cannot win against Mother Nature).
- ▶ Conservatism used to denote “caution.” Now it denotes “ideology” and has a culture-war aspect. Again, this is unsustainable in view of the dynamics of nature.
- ▶ Current political imbalance and divisiveness can cause great damage (from Yankee Ingenuity to Identity Politics).

# Still, the Future is for the US to lose

- ▶ US demographics are stronger than other countries.
- ▶ US population will keep growing, if immigration is allowed. (China, Germany, Japan, South Korea, Southern and Eastern European countries, Russia, are all shrinking).
- ▶ Productivity growth is still stronger than in many countries.
- ▶ The US is still a center of innovation. It has good dynamic efficiency.
- ▶ If US politics further calcifies and becomes even more ideological and rigid, then the future may look different.
- ▶ In such case, my central potential growth scenario will prove too optimistic. A bid debt/inflation crisis may ensue. The role of the US\$ may falter. A US crisis will be a global crisis.
- ▶ Trump was extremely damaging, nativism is not the answer. (The real drama is not Trump; it is the intellectual bankruptcy of the Republican Party.) Let us hope that politics can rebalance. The US has recovered before.

[https://www.amazon.com/Macroeconomy-United-States-Government-Discussion/dp/B08HW5W8B3/ref=sr\\_1\\_1?dchild=1&keywords=bob+Traa+the+macroeconomy+of+the+united+states&qid=1620233503&sr=8-1](https://www.amazon.com/Macroeconomy-United-States-Government-Discussion/dp/B08HW5W8B3/ref=sr_1_1?dchild=1&keywords=bob+Traa+the+macroeconomy+of+the+united+states&qid=1620233503&sr=8-1)

