I. Introduction
   A. Interest in the national debt has waned.
   B. The key question between the traditional and Ricardian views is how fiscal policy affects consumer spending.
      1. Are consumer short sighted or forward looking and
      2. whether they face borrowing constraints?

II. The Size of the Government Debt
   A. Compare it to other countries
      1. **Table 15-1: How indebted are the world's governments?, p. 408.**
   B. Look at the historical record
      1. **Figure 15-1: The Ratio of Government Debt to GDP Since 1790, p. 409.**
   C. Case Study: The Fiscal Future, p. 410.
      1. There is cause for concern because many government programs benefit the elderly and that group is growing.
      2. **Table 15-2: The Elderly as a Percentage of the Working Age Population, p. 411.**
      3. Table 15-3: Fiscal Policy Projections, p. 411.

III. Problems in Measurement
   A. The general principle is that the government budget deficit should accurately reflect the change in the government's overall indebtedness.
   B. Measurement problem 1: Inflation.
      1. The deficit should be measured in real terms.
      2. ÄD / D= ð
      3. The deficit is over stated by ðD.
   C. Measurement problem 2: Capital assets.
      1. **Capital budgeting**: A budget procedure that accounts for assets as well as liabilities, taking into account changes in capital.
      2. Capital goods only impose a cost as they depreciate.
   D. Measurement problem 3: Uncounted liabilities.
      1. The government uses a cash basis accounting system.
      2. The unrecognized liabilities of government pensions and Social Security are substantial.
   E. Measurement problem 4: The Business Cycle
      1. This was important to Keynesians who wanted to differentiate between a deficit caused by the business cycle from that due to discretionary government action.
      2. Since discretionary fiscal policy is less of an issue this concern has been

reduced.

F. Summing Up
 1. **Case-study: Generational accounting, p. 416.**
 2. We should look at the taxes paid, and transfers received, by people over their entire lives.
 3. *This is virtually impossible to calculate.*

IV. The Traditional View of Government Debt.
 A. A reduction in national saving causes interest rates to increase crowding out investment.
 B. An open economy view recognizes that the deficit can cause an inflow of capital and an appreciation in the value of a country's currency.
  1. This reduces the impact of fiscal policy.

V. The Ricardian View of Government Debt.
 A. Consumers are forward looking.
  1. *This ties into a discussion that we will have in Chapter 16.*
 B. The basic logic of Ricardian equivalence.
  1. Government debt is equivalent to future taxes, and if consumers are sufficiently forward looking, future taxes are equivalent to current taxes.
  2. Financing the government debt is equivalent to financing it by taxes.
   a. This is called Ricardian equivalence.
  3. A debt financed tax cut leaves consumption unaffected.
  4. Changes in fiscal policy do influences consumer spending if they influence present or future government purchases.
 C. Consumers and future taxes.
  1. The essence of the Ricardian view is that when people choose their consumption, they rationally look ahead to the future taxes implied by government debt.
  2. Defenders of the traditional view of government debt believe that future taxes do not have as large an influence on current consumption as the Ricardian view assumes and they use the following arguments.
   a. Myopia.
    (1) People are short sighted.
   b. Borrowing constraints.
    (1) **Case-study: George Bush's withholding experiment, p. 421.**
     (a) The majority acted Ricardian.
   c. Future generations.
    (1) One school has people unconcerned about the welfare of the next generation, while another says that this generation will

save more to cover the liabilities of future generations.

3. **Case-study: Why do parents leave bequests?, p. 423.**
   a. Bequests can be used to control.
   b. Children are more likely to visit wealthy parents.

D. Making a choice.
   1. It is difficult to isolate the reasons for a response to tax changes.

VI. Other Perspectives on Government Debt

A. Effects on Monetary Policy
   1. *This is an important topic because a cornerstone of the attraction of the Phillips Curve was that deficits caused inflation, which in turn reduced unemployment.*
   2. Of course, it is clear that the money supply rather than deficits cause inflation.
   3. For developed countries there is no direct link between deficits and the money supply.

B. Debt and the Political Process
   1. A balanced budget requirement would force policy makers to determine the programs that are most important for a country.

C. International Dimensions
   1. There can be concerns about capital flight.
   2. Deficits may reduce a nations political clout.
      a. *This has an emotional appeal and yet is not relevant.*

D. **Case Study: The Benefits of Indexed Bonds, p. 428.**
   1. *Again, a corrective response when the issue of inflation is moot.*

VII. Conclusion.

VIII. Summary.