

We negate,

Resolved: The United States federal government should prioritize reducing the federal debt over promoting economic growth.

Our sole contention is booms and busts.

In every capitalist economy, there are long periods of economic expansion in the private sector, followed by regular downturns to cool the economy. This cycle of booms and busts is referred to as the business cycle. And according to Hood '14 of JP Morgan Asset Management, due to more sophisticated monetary policy and a shift away from manufacturing towards the service sector, the business cycle in America has lengthened dramatically in recent years. The average cycle since 1982 is 86 months long, up from an average of 49 months between 1938-1982. This reflects a stabilization of America's economy that ensures longer periods of prosperity and shorter periods of recession.

However, reducing the federal debt will cut this redefinition of the American economy short, injecting volatility and increasing the propensity for recession in three ways.

First, by cutting automatic stabilizers.

Perry '14 of Tufts University writes that in order to reduce the federal debt, policymakers would need to put **automatic** stabilizers, or social spending that immediately kicks in to reduce the severity of a recession, on the chopping block. Wray '10 of the Levy Institute continues, that even completely eliminating welfare payments, Medicaid, Medicare, military spending, Social Security Payments, and a host of other programs would still leave the budget deficit at \$400 billion. Critically, Hood '14 of JP Morgan Asset Management continues that because of rising government spending on counter-cyclical policies, the business cycle has lengthened dramatically because federal spending takes a much more stable path than private expenditures. Overall, McKay '12 of Boston University writes that cutting automatic stabilizers by 0.6% of the GDP would increase economic volatility by 7%.

Second, by creating private borrowing spikes.

In order to reduce the debt, the government would need to take in more tax revenue than the amount of money it spends and puts back into the economy, effectively running a budget surplus. Unfortunately, Wray '10 of the Levy Economics Institute writes that when the government runs budget surpluses, it constrains the total amount of money available to the private sector, **forcing** the private sector to borrow more money to maintain the same activities as before. For example, Wray continues that after Clinton ran a budget surplus in 1998, household borrowing increased by 30% of GDP the decade after.

Unfortunately, Vague '16 of the University of Pennsylvania outlines that sudden spikes in private debt often create credit bubbles as people borrow too much, increasing susceptibility to even slight economic shocks and growing the chances of a recession. Moreover, Eli Gulker '17 of American Institute of

Economic Research continues that private debt also makes recessions harder to recover from, as households and corporations face high loan repayments alongside plummeting incomes.

Third, by prompting a safe assets conundrum.

Buchanan '12 of George Washington University explicates that paying down the debt would destabilize financial markets because it would reduce the supply of Treasuries, forcing investors to rely on riskier forms of investment. Indeed, Krishnamurthy '13 of Northwestern University writes that large supplies of Treasuries crowd out private financial debt because higher yields make it less profitable to invest in riskier, illiquid bonds. Thus, he quantifies that a \$1 **decrease** in the supply of Treasuries increases the amount of risky short-term private debt by 50 cents.

As a result, Acharya '18 of the Federal Reserve Bank of New York impacts that reductions in government debt result in the formation of risky economic bubbles, as investors speculate on overvalued debt. He continues that when these bubbles eventually burst, it plunges the country into deep recessions. Moreover, Acharya continues that larger supplies of safe assets from higher levels of government debt actually help the country ride out a recession because these treasuries serve as a foundation for our economy, limiting how far we can fall.

Because of these three reasons, Wray '10 of the Levy Economics Institute warrants that every time in our country's history we've reduced the national debt, it was immediately followed by a scathing economic depression. And due to the interconnectedness of our global economic system, every recession leaves millions devastated. For example, the World Bank '10 quantifies that the 2008 crisis plunged 64 million people into extreme poverty within the first two years of the depression.

Thus, we negate.

Hood, Michael. "Tracking the Business Cycle." JP Morgan Asset Management. 2014.

https://am.jpmorgan.com/blobcontent/1410637849352/83456/MI_Tracking_the_business_cycle_r7.pdf//RJ

The U.S. economy shows an unmistakable tendency toward longer business cycles over time, as well as briefer (though not necessarily less severe) recessions. Indeed, **the most recent three expansions** (excluding the unfinished current cycle) **all stand among the five longest since 1854**, joined by the 1960s cycle and the boom fueled by public spending during World War II. **Between 1854 and 1938, the economy spent 55% of the time** (measured in months) **in expansions, and these episodes lasted 26 months on average. Those figures rose to 82% and 49 months, respectively, in the 1938–1982 period and have climbed further to 91% and 86 months since then. This final time span became known as the “Great Moderation” before the global financial crisis struck. Although the subsequent downturn proved particularly intense, many aspects of the previous low-volatility environment have since reasserted themselves. What accounts for the lengthening** of U.S. business cycles? No consensus exists on the causes, but at least four factors very likely have played a role: • **Monetary policy formation has become significantly more sophisticated in the past several decades** (especially compared, obviously, with the 1800s, before the Federal Reserve existed) **and likely has served to dampen the economy’s cyclical fluctuations.** Heightened prudential regulation of the financial sector likely has allied with purer interest-rate and money-supply management to produce this effect. • **Manufacturing (where inventory cycles drive large swings in activity) and agriculture (subject to weather-related gyrations) have declined in importance relative to the less volatile services sector.** • **The federal government has grown larger, and its spending typically follows a more stable path than private-sector expenditure, in part because of explicit countercyclical efforts (such as unemployment insurance and food stamps) that cushion downturns and fade during booms.**

Alisfair McKay. "The role of automatic stabilizers in the U.S. business cycle.." Boston University Hec.ca. 22 August 2012. Web. 24 Jan. 2018. <<http://www.hec.ca/iea/seminaires/McKayReis-AutoStab.pdf>>

Most countries have automatic rules in their tax-and-transfer systems that are partly intended to stabilize economic fluctuations. This paper measures how effective they are at lowering the volatility of U.S. economic activity. We identify seven potential stabilizers in the data and include four theoretical channels through which they may operate in a business cycle model calibrated to the U.S. data. The model is used to compare the volatility of output in the data with counterfactuals where some, or all, of the stabilizers are shut down. Our first finding is that proportional taxes, like sales, property and corporate income taxes, contribute little to stabilization. Our second finding is that a progressive personal income tax can be effective at stabilizing fluctuations but at the same time leads to significantly lower average output. Our third finding is that safety-net transfers lower the volatility of output with little cost in terms of average output, but they significantly raise the variance of aggregate consumption. **Overall, we estimate that if the automatic stabilizers were scaled back in size by 0.6% of GDP, then U.S. output would be about 7% more volatile.**

Armbruster '18 – further growth still has room to run for up to another 9 years due a variety of factors as to why it will continue growing

Armbruster, Mark. "The U.S Economy: Eight More Years of Expansion?" CFA Institute. Sept. 2018. <https://blogs.cfainstitute.org/investor/2018/09/26/the-us-economy-eight-more-years-of-expansion//RJ>

During the current recovery, however, **real GDP sits just 23% above its nadir during the Great Recession** of 2008 and 2009. What's more, the recession of the early 1990s was mild by historical standards, but the recovery was much more robust than the current one by every measure we studied. This is not usually the case. **In the past, deep recessions have generally been followed by steep recoveries. Why has this recovery**, which followed the worst recession since the Great Depression, **diverged from the historical pattern?** Some have theorized that the [housing market has not rebounded as quickly as in past recoveries](#) or that [policy uncertainty is to blame](#). Certainly, the regulatory environment shifted in the wake of the last recession. Large financial penalties were levied against those deemed to be at fault and has impacted corporations' willingness to spend and invest. But **things are turning around. During those early recovery years, policy uncertainty hit record highs. Currently, however, it is below its long-term average**, according to the baseline policy uncertainty index created by Scott R. Baker, Nick Bloom, and Steven J. Davis. This may be because of the recent regulatory rollbacks under the current administration. New residential construction has also trended up since 2011, according to US Census Bureau data. This suggests that **the present expansion**, while long in the tooth, **still has room to run**. In fact, our research indicates that **further growth at the average long-term rate for each of the indicators we studied could mean another three years of economic expansion**. This assumes only average levels of economic recovery are achieved during this business cycle. **If the US economy experiences an expansion like the more robust recovery of the 1960s, it could grow for an additional 8.8 years.** There are fundamental reasons for optimism. **Policy uncertainty is low. Monetary policy is accommodative. While short-term interest rates are rising, they are still well below the levels that create economic distortion. Longer-term fiscal policy is also stimulative. The corporate tax cuts, like low policy uncertainty, could spur further capital spending**, which could drive a virtuous circle of corporate activity that creates further economic growth. Finally, [the United States may be taking growth from other nations](#).

Wray '10 – government surpluses mean that household borrowing has to increase as the money supply shrinks dramatically

Wray, L. Randall. "Deficit Hysteria Redux? Why We Should Stop Worrying About U.S. Government Deficits." Levy Economics Institute of Bard College. 2010.

<https://www.econstor.eu/bitstream/10419/54259/1/631375910.pdf//RJ>

The most recent period of federal government surpluses was the (highly extolled) **Clinton surpluses from the first quarter of 1998 through the second quarter of 2001**. For reasons that should now be clear, **these surpluses destroyed nongovernment sector income and wealth, forcing households to borrow in order to maintain living standards. Since the United States ran current account deficits over that period, it was necessary for the (domestic) nongovernment sector to run even larger deficits to match the government's surplus**, plus the foreign sector current account deficit.⁴ **Household borrowing accelerated in the decade following the surpluses of 1998, increasing from 67 percent to 97 percent of GDP by 2007. By contrast, household debt increased from just 40 percent to 65 percent of GDP over the entire 1960–97 period**. The story wouldn't be complete without predatory lenders, who were eager to extend credit to everyone, regardless of the ability to repay; and deregulation, which freed the lenders' hands (topics beyond the scope of this brief).

Vague '16 – short bursts of runaway growth in private debt leads to a crisis because lending results in overcapacity based on bad loans

Vague, Richard. "The Private Debt Crisis." Democracy Journal. Fall 2016.

<https://democracyjournal.org/magazine/42/the-private-debt-crisis//RJ>

As mentioned, **short bursts of runaway growth in private debt have often led to crisis**—the United States in 2008 and Japan in 1991 to name just two. **That is because so much lending occurs that it results in overcapacity: Far too much of something is built or produced**—housing and office buildings are two examples—**and too many bad loans are made**. In fact, **so many bad loans are made that they approach or exceed the amount of bank capital in the system**. **So, inevitably, the economies of these countries need to slow to a crawl to allow demand to catch up to this overcapacity, and the banks need to be propped up or rescued because of the extraordinary amount of bad debt.**

Vague, Richard. “Why Large Rapid Build Ups of Private Debt Cause Financial Crises.” University of Pennsylvania. 2014. <http://privatedebtproject.org/view-articles.php?Richard-Vague-on-Why-Large-Rapid-Build-Ups-of-Private-Debt-Cause-Financial-Crises.-8//RJ>

Private debt growth is integral to GDP growth. But **very rapid growth in private debt often leads to calamity because it is evidence that lenders have lent too much and those loans are leading to the construction or production of too much of something**, such as housing. I consider this the “excess credit point.” Our view is that roughly 18 percent growth in private debt to GDP growth over five years serves as the benchmark for when lending is excessive. This is especially true when that level of growth persists for several years and is coupled with 150 percent or more in absolute private debt to GDP. It signals that **debt has fueled an increase in the supply of that something** (e.g., housing) **at a rate faster than sustainable demand**. That something can vary from crisis to crisis. In the lead-up to the 2008 crisis, it was largely houses, but in other crises, it has been everything from stocks to skyscrapers.

Gulker '17 – high levels of private debt result in economic shocks that can cause economic crises

Gulker, Max. “Private Debt: How Much is Too Much?” American Institute for Economic Research. Apr. 2017. <https://www.aier.org/research/private-debt-how-much-too-much//RJ>

Private debt can lead to or exacerbate economic crises. It can do so **by leaving households and businesses more exposed and vulnerable to economic shocks, as in the case of excessive mortgage debt when home prices began to fall in the 2008 crisis. It can also trigger crises, if lender concerns cause them to stop rolling over debt, leading to liquidity and ultimately solvency problems for households and businesses**. Private debt can also slow the economy even in times of overall growth. As [Vague notes](#), “Money that would otherwise be spent on things such as business investment, cars, homes, and vacations is increasingly diverted to making payments on the growing debt—especially among middle- and lower-income groups that compose most of our population and whose spending is necessary to drive economic growth. Debt, once accumulated, constrains demand.”

Zandi '15 – Economic policies are absolutely the priority post-recession; laundry list of stats from the 2008 recession

Zandi, Mark. “The Financial Crisis: Lessons for the Next One.” Center on Budget and Policy Priorities. Oct. 2015. https://www.cbpp.org/sites/default/files/atoms/files/10-15-15pf.pdf?fbclid=IwAR3NUrtGYPAsx_fHtKFeOq61fli229QN-Dt174Zz_CYu8iJaODSbvolUMX4 //RJ

The massive and multifaceted policy responses to the financial crisis and Great Recession — ranging from traditional fiscal stimulus to tools that policymakers invented on the fly — **dramatically reduced the severity and length of the meltdown that began in 2008**; its effects on jobs, unemployment, and budget deficits; and its lasting impact on today’s economy. **Without the policy responses of late 2008 and early 2009**, we estimate that: **The peak-to-trough decline in real gross domestic product** (GDP), which was barely over 4%, **would have been close to a stunning 14%**; **The economy would have contracted for more than three years, more than twice as long as it did**; **More than 17 million**

jobs would have been lost, about twice the actual number. · **Unemployment would have peaked at just under 16%, rather than the actual 10%**; · The budget deficit would have grown to more than 20 percent of GDP, about double its actual peak of 10 percent, topping off at \$2.8 trillion in fiscal 2011. · **Today's economy might be far weaker than it is – with real GDP in the second quarter of 2015 about \$800 billion lower than its actual level, 3.6 million fewer jobs, and unemployment at a still-dizzying 7.6%**. We estimate that, **due to the fiscal and financial responses of policymakers** (the latter of which includes the Federal Reserve), **real GDP was 16.3% higher in 2011 than it would have been**. Unemployment was almost seven percentage points lower that year than it would have been, with about 10 million more jobs.

Buchanan '12 – paying down the debt would eliminate Treasury bonds which carry zero risk of default; if government bonds disappear entirely, financial markets will be harmed

Buchanan, Neil. “Why We Should Never Pay Down the National Debt.” George Washington University Law School. 2012.

https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1025&context=faculty_publications//RJ

In this article, I will describe the accounting concepts underlying federal budget deficits and the national debt, as a prelude to explaining the possible costs and benefits of increasing the national debt. I will then argue that, **rather than agreeing to decrease the**

national debt, we should instead commit to a long-term plan to allow the federal debt to rise in a

controlled fashion, using the borrowed funds to truly protect the interests of future generations. I will

argue further that **paying down the national debt would destabilize financial markets, by removing an**

essential source of risk-free financing that is used in nearly all major private-sector financial transactions, and that is the basis of sound financial planning for households and businesses alike.

Although it is understandable that people are confused by a subject as technical and complicated as federal budgeting, it is disturbing that this confusion is being reflected—and even amplified—in the national political debate. Fiscal responsibility is not a simple matter of refusing to borrow money. For families, businesses, and especially governments, borrowing money is often the most responsible path to future prosperity.

Buchanan, Neil. “Why We Should Never Pay Down the National Debt.” George Washington University Law School. 2012.

https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1025&context=faculty_publications//RJ

The desire to pay down the debt is, in part, based on the common intuition that being in debt is undesirable. If it is bad for a family to be in debt, the thinking goes,

then it must also be bad for a government to be in debt.⁶¹ This intuition, however, **ignores that those who lend money quite properly view**

the bonds that they hold as important assets. No one is forced to lend money to the federal

government, but lenders are currently willing to be paid historically low interest rates to do so.⁶² **The**

federal government's bonds are a safe haven for investors.⁶³ Because of the broad appeal of holding government bonds—based on those

bonds being backed by the government's full faith and credit⁶⁴— Treasury bonds are also easy to trade on secondary markets.⁶⁵ A lender need not wait until the bonds in her possession mature, because she can sell her bonds on large and transparent markets to others who are willing to hold the bonds as assets. These secondary markets are so large and well-regulated, in fact, that government bonds are used as the equivalent of cash in many large financial transactions. Anyone who wishes to turn a Treasury bond into cash can do so quite readily, making such

bonds an important element of the financial system. **During the late 1990's, when large projected annual budget surpluses**

implied that the national debt would be paid down to zero in less than a decade, there was serious

concern about the disappearance of Treasury bonds from the financial system.⁶⁶ **There are no**

acceptable substitutes, because only Treasury bonds carry zero risk of default.⁶⁷ **An internal**

government study documented the importance of having a large, deep, and growing pool of federal

bonds to lubricate the financial system.⁶⁸ Admittedly, there is little theoretical guidance to indicate whether the financial system could survive with only \$8

trillion or \$9 trillion in Treasury bonds, rather than the current \$10 trillion—or, for that matter, whether it would be better still to have \$12 trillion or \$15 trillion worth of cash-equivalent

government bonds in circulation. Even so, **it is abundantly clear that the financial system has found important uses for all**

of the government's bonds in circulation today. Pension funds invest in Treasury bonds to eliminate the risk of losses, while guaranteeing small (but

predictable) returns on investment, in support of a conservative investment strategy appropriate to their older clients.⁶⁹ **Corporations hold Treasury bonds to use as cash in business transactions and to diversify their portfolios.**⁷⁰ Families and individuals are also well-advised to include Treasuries as an essential part of a balanced portfolio. And because the Social Security system is able to put its surplus funds into Treasury bonds,⁷¹ it does not need to invest those funds in private companies—eliminating the unappealing idea of having the federal government own, or be a creditor to, private corporations. As the economy grows over time, the demand for such securities will grow apace. If government bonds disappear entirely, or **if their number becomes inadequate to support a deep and wide secondary market,** then surely financial markets will be forced to find ways to adapt. **Any such alternative, however, will be inferior to the real thing. Eliminating Treasury bonds for the sake of eliminating them would thus impose needless burdens on the financial markets.**

Krishnamurthy '13 – reductions in supply of Treasury bonds lower yield on Treasury bonds relative to corporate securities that are less liquid and more risky than Treasury bonds; decreases in treasury supply increase the shift to risky/illiquid investments

Krishnamurthy, Arvind. “Short-term Debt and Financial Crises: What We Can Learn from U.S. Treasury Supply.” Northwestern University. Mar. 2013.

<https://pdfs.semanticscholar.org/b5ed/7f384a3ee2205dc5fce2fc7fb028b0ad4823.pdf//RJ>

To arrive at these results, we exploit variation in the supply of government securities. In Krishnamurthy and Vissing-Jorgensen (2012) we showed that Treasury bonds are “money-like” in many respects. We established this by showing that **reductions in the supply of Treasury bonds lower the yield on Treasury bonds relative to corporate securities that are less liquid and more risky than Treasury bonds,** controlling for the default component of the corporate securities. Section 2 below reviews this evidence and extends it to show that results are similar if Treasury yields are replaced with the interest rate on bank accounts (time and savings deposits), suggesting that bank accounts (a large fraction of the financial sector’s short-term debt) share the safety/liquidity features of Treasuries. Given that, section 3 offers a theoretical equilibrium model to explain how changes in Treasury supply can be expected to affect financial sector short-term debt quantities if both satisfy the safety/liquidity demand of the non-financial sector. The main implication is that **Treasury supply should crowd out financial sector short-term debt because the reduction in the yield spreads between risky/illiquid asset and safe/liquid asset brought about by an increase in Treasury supply makes it less profitable for banks to take in deposits in order to invest in riskier, less liquid assets.** To test this main prediction, we construct the supply of government securities, defined as the net supply of Treasuries, reserves and currency by the U.S. Treasury and Federal Reserve (i.e. we subtract out the Federal Reserve’s Treasury holdings from total supply of Treasuries) and study the relation between this government net supply variable and the net private supply of short-term debt. The latter variable is the total of all short-term debt issued by the financial sector net of the financial sector’s holdings of Treasuries, reserves, and currency (and net of any short-term assets but these are tiny in practice). We show that the private net supply variable is strongly negatively correlated with the government net supply. This result, together with the result on the impact of Treasury supply on yield spreads between bank accounts relative to corporate securities, suggests that financial sector short-term debt is special and that the financial sector issues such debt in large part to satisfy the special demand for safe/liquid debt. Moreover, we show that **reductions in government supply are correlated with increases in financial sector risky/illiquid loans.** The picture that emerges from the data is that of a financial sector that is active in transforming risky/illiquid loans into liquid/low-risk liabilities.

Krishnamurthy '13 - \$1 increase in Treasury supply reduces short-term debt by 50 cents

Krishnamurthy, Arvind. “Short-term Debt and Financial Crises: What We Can Learn from U.S. Treasury Supply.” Northwestern University. Mar. 2013.

<https://pdfs.semanticscholar.org/b5ed/7f384a3ee2205dc5fce2fc7fb028b0ad4823.pdf//RJ>

Table 4 Panel A and Figure 3 Panel A provide strong evidence in favor of prediction 1 and 2. In Table 4 we estimate regressions of various dependent variables (all scaled by GDP) on government supply/GDP and a trend. Regressions are estimated by OLS but with standard errors adjusted up to account for large positive autocorrelation in the error terms. Based on a standard Box-Jenkins analysis of the error term autocorrelation structure we model the error term as an AR(1) process. One could consider using a GLS estimator (which in many of the regressions would approximately amount to running the regressions in first differences), but as argued by Cochrane (2012) this removes a lot of the most interesting variation in the data. The regression estimates in Table 4 Panel A show that **increases in government supply lead to dramatic reductions in the financial sector’s net short-term debt and its net long-term investments,** with regression coefficients in both cases around -0.5 and significant at the 1 percent level. The negative relations are

apparent in Figure 3 Panel A and seem consistently present over the 98 year period. These results suggest that **a one-dollar increase in Treasury supply reduce the net short-term debt issued by the financial sector by 50 cents**, and reduce long-term lending of the financial sector by 50 cents.

Acharya '18 – government debt is key to increase the supply of safe assets; failure to do so creates risky bubbles that pop and create a deep recession

Acharya, Sushant. "The Side Effects of Safe Asset Creation." Federal Reserve Bank of New York. 2018.
https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr842.pdf//RJ

An increase in government debt satiates the demand for safe assets without requiring negative interest rates, allowing conventional monetary policy to restore full employment. This short-circuits the adverse feedback loop between unemployment and low investment, resulting in higher steady state capital than would occur without an increase in the supply of safe assets. But this level of capital is lower than the optimal natural allocation, which featured no safe asset creation and negative real rates. In this sense, the costs of a risk-induced recession may persist even after the economy has returned to full employment, manifesting as sluggish investment and low labor productivity. The fundamental problem is that the optimal natural allocation in a risky economy requires negative real rates to sustain high investment. When the ZLB binds, monetary policy cannot replicate this allocation. Safe asset creation shifts the goalposts, presenting monetary policy with the easier task of implementing a different, suboptimal natural allocation with positive real rates. Policies such as higher target inflation which permit negative real rates would instead implement the optimal natural allocation with high investment and full employment. While these policies have their own trade-offs,⁶ they are worth considering, since safe asset creation is no panacea. In this regard, our analysis forces us to reassess the question of whether low safe rates indicate a shortage of safe assets, as is sometimes argued.⁷ We formalize the notion of a safe asset shortage as a situation in which issuing more safe assets increases welfare. Whether low rates indicate a shortage in this sense depends critically on whether negative real rates are implementable. **Besides pushing an economy to the ZLB, an increase in risk can also generate bubbles- assets with no intrinsic value which trade at a positive price.** As in Samuelson (1958), in an environment with nonpositive real interest rates, such assets can be held in equilibrium even when they have a stable price and pay no dividend. At zero interest rates, pseudo-safe bubbles with a zero probability of bursting may emerge in equilibrium. **Pseudo-safe bubbles are a perfect substitute for government debt, and crowd out capital- which reduces welfare since our economy is dynamically efficient.** This contrasts with classic models of rational bubbles (Tirole, 1985), in which bubbles can arise only in dynamically inefficient economies, and thus raise welfare if they emerge.⁸ **Worse still, risky bubbles which burst with some probability may arise. Risky bubbles reduce welfare both because they crowd out capital, and when they burst.** It is often suggested that monetary policy should lean against the wind to prevent bubbles; our model suggests that **fiscal policy should do so, by committing to aggressively increase the public supply of safe assets to crowd out privately provided safe-ish assets.** This resonates with the argument of Greenwood et al. (2016) that **public creation of safe assets should crowd out inefficient private creation of money-like assets. The adverse consequences of bubbles are even worse when monetary policy faces constraints, since the bursting of a bubble pushes the natural rate of interest below zero, potentially constraining monetary policy at the ZLB and increasing unemployment.** Some commentators have argued that, prior to 2008, advanced economies 'needed' bubbles to maintain full employment; our model clarifies the sense in which this is true. When risk is sufficiently high, full employment requires one of three things: negative real interest rates, public safe assets, or private pseudo-safe assets. **A bubble can sustain full employment with positive interest rates even when public debt is insufficient to meet safe asset demand - for a while. When the bubble bursts, however, it can cause a deep recession. Substituting public safe assets for private pseudo-safe bubbles maintains full employment, but fails to raise investment below the inefficiently low levels prevailing even before the recession.**

Acharya '18 – policymakers can issue more debt to crowd out bubbles by raising the natural rate of interest

Acharya, Sushant. "The Side Effects of Safe Asset Creation." Federal Reserve Bank of New York. 2018.

https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr842.pdf//RJ

Gali (2014) argued that monetary policy should not necessarily 'lean against the wind', since in equilibrium, a systematic response of interest rates to the size of a bubble may increase bubble growth. Allen et al. (2017) argued that, on the contrary, **policymakers may be able to raise interest rates and crowd out bubbles, for example by issuing more government debt**. Our results are consistent with both authors: **government debt policy can crowd out bubbles by raising the natural rate of interest, and this may be more effective than a monetary policy rule which adjusts the policy rate in response to bubbles**. This prescription relates to a emerging literature which focuses on the financial stability consequences of low real interest rates, and the role of public debt management in regulating these. For example, Greenwood et al. (2016) and Woodford (2016) study whether a central bank should increase its supply of short term claims to promote financial stability. Whereas these papers interpret financial instability as socially excessive private sector maturity transformation, we interpret this as the risk of bubbles bursting.

Acharya '18 – government should supply short-term safe assets to crowd out bubbles that pop

Acharya, Sushant. "The Side Effects of Safe Asset Creation." Federal Reserve Bank of New York. 2018.

https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr842.pdf//RJ

Consider instead risky bubbles which have a constant positive probability $1 - p$ of bursting each period.⁵⁵ In this case, risky bubbles are no longer a perfect substitute for safe government debt, so we must have $R_t < q_{t+1}/q_t$ (assuming the bubble does not burst at date $t + 1$).

Bubbles still crowd out capital, but now introduce another risk: they can burst, leading to consumption losses for old households whose wealth vanishes. In principle this can be prevented via commitment to a fiscal rule as described above. However, if such commitments are not credible, **a government wishing to eliminate bubbles must increase the supply of public safe assets on-equilibrium**. This resonates with the argument of Greenwood et al. (2016) that **the government should supply short-term safe assets to crowd out socially excessive private safe asset creation**. While our model abstracts from the externalities associated with private transformation which are the focus of Greenwood et al. (2016), **risky bubbles can be thought of as an example of excessive private safe asset creation - which public safe asset creation can prevent**.

Acharya '18 – increase in supply of public safe assets counteracts when bubbles pop and mitigate the fall in output

Acharya, Sushant. "The Side Effects of Safe Asset Creation." Federal Reserve Bank of New York. 2018.

https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr842.pdf//RJ

As depicted in Figure 11, the dynamics of such an economy are broadly similar to those described in section 4, where we instead subjected the economy to an increase in risk starting from a bubble-free steady state. **The bursting of the bubble reduces the available supply of pseudo-safe assets in the economy. This contraction in supply puts upward pressure on the price of safe assets**, i.e. reduces the natural rate of interest. Since this economy features zero real interest rate even with the bubble, full employment requires negative real rates absent the bubble. The ZLB prevents this. **Finding no bubbles to invest in, households attempt to re-balance their portfolios towards safe government debt, slashing spending on investment, resulting in a permanent decline in investment and economic activity**. In this sense a bubble can mask risk-induced stagnation, and the bursting of such a bubble can reveal the rot within the economy. **An increase in the supply**

of publicly provided safe assets can counteract the reduced supply of privately produced pseudo-safe bubbles, mitigating the fall in output.⁵⁸ Bear in mind, though, that the bubble, before it burst, was already crowding out capital investment relative to the optimal natural allocation. Replacing a private bubble with safe public debt, at best, only replicates this subpar outcome. As discussed above, the cure the economy needs is negative real interest rates and not more safe assets.

Wray '10 – every single time we've reduced the national debt, there's been a depression and even every time we reduce our deficit, there's a downturn

Wray, L. Randall. "Deficit Hysteria Redux? Why We Should Stop Worrying About U.S. Government Deficits." Levy Economics Institute of Bard College. 2010.

<https://www.econstor.eu/bitstream/10419/54259/1/631375910.pdf//RJ>

Fourth, **the United States has also experienced six periods of depression that began in 1819, 1837, 1857, 1873, 1893, and 1929. Comparing these dates with the periods of budget surpluses, one finds that every significant reduction of the outstanding debt, with the exception of the Clinton surpluses, has been followed by a depression, and that every depression has been preceded by significant debt reduction. The Clinton surpluses were followed by the Bush recession that was ended by a speculative, private debt-fueled euphoria, and was followed in turn by our current economic collapse.** The jury is still out on whether we might yet suffer another

Great Depression. While we cannot rule out coincidences, **seven periods of surplus followed by six and a half depressions** (with some possibility for making it a perfect seven) **should raise eyebrows.** And, as we show below, **our less serious downturns in the postwar period have almost always been preceded by reductions of federal budget deficits.** This brings us to an obvious point: **the federal government is big, and any movement in its budget position has a big impact on the economy,** which is the subject of the next section. As we will discuss, **the government's budget plays an important balancing role in the economy—filling demand gaps that allow the nongovernment sectors to achieve the surplus that they normally desire.** For this reason, trying to operate the federal government's budget as if it were a household that normally wants to save has a disastrous impact on the economy.

World Bank '10 – recession of 2008/2009 pushed 64 million people into extreme poverty by 2010

The World Bank. "Global Economic Prospects: Crisis, Finance, and Growth." 2010.

<http://pubdocs.worldbank.org/en/308811443469733024/Global-Economic-Prospect-2010-Crisis-finance-and-growth.pdf//RJ>

The financial crisis has taken its toll on achieving the 2015 poverty Millennium Development Goal (MDG). Newly updated World Bank estimates suggest that **the crisis will leave an additional 50 million people in extreme poverty in 2009 and some 64 million by the end of 2010** relative to a no-crisis scenario.⁶ These depressing statistics notwithstanding, the relatively rapid rebound in developing countries, their future medium term prospects as described in the first part of this chapter combined with the significant progress in most regions since 1990, the poverty MDG is likely to be met at the global level.

Perry '14 – in order to perfectly balance the budget we would need to cut automatic stabilizers

Perry, Nathan. "Debt and Deficits: Economic and Political Issues." Tufts University. 2014.

http://www.ase.tufts.edu/gdae/education_materials/modules/DebtAndDeficits.pdf//RJ

Perfectly balancing the budget over the business cycle would entail cutting expenditures, including automatic stabilizers, when people rely on these programs the most. We all pay taxes for unemployment insurance and expect to receive it when we need it, and the duration of unemployment insurance is often extended during severe recessions. On the revenue side, raising taxes is also not advisable during a recession because it would hurt consumer spending power when the economy needs it most. A policy of running surpluses during good economic times and running deficits in bad economic times is called “countercyclical policy.”

Wray ’10 – automatic stabilizers make up the bulk of our deficit; even if we eliminated all programs except entitlements, shut down education, doubled corporate taxes, etc, our budget deficit will still be over \$400 billion

Wray, L. Randall. “Deficit Hysteria Redux? Why We Should Stop Worrying About U.S. Government Deficits.” Levy Economics Institute of Bard College. 2010.

<https://www.econstor.eu/bitstream/10419/54259/1/631375910.pdf/RJ>

Just as surpluses precede recessions, large (nondiscretionary) budget deficits almost always result from recessions because of automatic stabilizers. When the economy slides into recession, tax revenues fall as economic activity declines. Social transfer payments, particularly unemployment benefits, increase automatically as more people lose their jobs.

Despite all the conservative uproar against Obama’s stimulus plan, the largest portion of the deficit increase to date has come from automatic stabilizers rather than from discretionary spending. This is observable in Figure 8, which shows the growth rate of tax revenues (mostly automatic, moving with the cycle because income and payroll taxes depend on economic performance), government consumption expenditures (somewhat discretionary), and transfer payments (largely automatic) relative to that in the same quarter a year earlier. In 2005, tax revenues were growing at an accelerated rate of 15 percent per year—far above the GDP growth rate (hence, reducing nongovernment sector income) and above the government spending growth rate (5 percent). As shown in Figure 8, this fiscal tightening was followed by a downturn—which automatically slowed growth of tax revenue. While government consumption expenditures remained relatively stable during the downturn (after a short spike in 2007–08), the tax revenue growth rate dropped sharply from 5 percent to negative 10 percent within just three quarters (from the fourth quarter of 2007 to the second quarter of 2008), and to negative 15 percent by the first quarter of 2009. Transfer payments have been growing at an average quarterly rate of 10 percent (relative to the same quarter the previous year) since 2007.

Decreasing taxes, coupled with increasing transfer payments, have automatically pushed the budget into a larger deficit, notwithstanding the flat consumption expenditures. These automatic stabilizers, not the bailouts or stimulus package, are the reason why the U.S. economy has not been in a free fall comparable to that of the Great Depression. When the economy slowed, the budget automatically went into a deficit, placing a floor under aggregate demand. And in spite of all the calls to rein in deficits, the truth is that deficits will not come down until the economy begins to recover. **Even if we eliminated welfare payments, Medicaid, Medicare, military spending, earmarks, Social Security payments, and all programs except for entitlements; and also stopped the stimulus injections, shut down the education department, and doubled corporate taxes, the New York Times estimates that the budget deficit would still be over \$400 billion.** This example further demonstrates the nondiscretionary nature of the budget deficit. And, of course, this example doesn’t consider how much more tax revenues would fall and transfer payments would rise if these cuts were actually undertaken. **With the current automatic stabilizers in place, the budget cannot be balanced, and attempts to do so will only damage the real economy as incomes and employment fall.**

Capretta 18 - The US would have to cut spending and raises taxes by 3.9% of GDP every year until 2033 in order to get debt back to the post-war era (under control)

Capretta, James. "What Would it Take to Get the US Debt Under Control November?" AEI. November 2018. <http://www.aei.org/publication/what-would-it-take-to-get-the-u-s-debt-under-control/> // RH

Over the past quarter century, analysts have begun to calculate various measures of the fiscal consolidation needed within a government's primary budget to keep debt under control. Recently, CBO issued a report providing estimates of what it would take for the U.S. government to keep federal debt below certain benchmarks in the coming years. CBO chose three separate potential levels at which policymakers might want to stabilize federal debt: 41 percent of GDP (the average level of debt over the past half century); 78 percent of GDP (the level at the end of fiscal year 2018); and 100 percent of GDP. The agency then calculated the amounts of sustained reduction in the government's primary deficit that would be necessary over varying time periods to bring federal debt within the targeted levels. The results of this analysis are revealing and sobering. For starters, it appears to be beyond the reach of political leaders to return the country to debt levels that were the norm in the post-war era. **If policymakers wanted to bring federal debt back to 41 percent of GDP** in fifteen years (by 2033), **they would need to enact policies to cut spending and raise taxes by a combined 3.9 percentage points of GDP, and those policies would need to go into effect immediately and be sustained through 2033.** In 2019, 3.9 percentage points of GDP is \$830 billion. To put that in perspective, the entire annual budget for the Medicare program will be \$776 billion next year. There is no consensus in Congress to enact deficit reduction of 1 percentage point of GDP starting next year, much less to produce 3.9 percentage points of GDP every year for fifteen years. Congress's job wouldn't get much easier with more relaxed goals. If Congress wanted to reduce debt to 41 percent of GDP by 2048 instead of 2033, the required amount of sustained deficit reduction would drop from 3.9 to 3.0 percentage points of GDP, which is the equivalent of \$630 billion in 2019. If Congress simply wanted to keep federal debt in 2048 from rising above its current level (relative to the size of the overall economy), it would need to enact deficit reduction equal to 1.9 percentage points of GDP, or \$400 billion, in 2019, and then keep that deficit reduction going for a full three decades.

Zandi '15 – Economic policies are absolutely the priority post-recession; laundry list of stats from the 2008 recession

Zandi, Mark. "The Financial Crisis: Lessons for the Next One." Center on Budget and Policy Priorities. Oct. 2015. https://www.cbpp.org/sites/default/files/atoms/files/10-15-15pf.pdf?fbclid=IwAR3NUrtGYPAsx_fHtKFeOq61fli229QN-Dt174Zz_CYu8iJaODSbvolUMX4//RJ

The massive and multifaceted policy responses to the financial crisis and Great Recession – ranging from traditional fiscal stimulus to tools that policymakers invented on the fly – **dramatically reduced the severity and length of the meltdown that began in 2008**; its effects on jobs, unemployment, and budget deficits; and its lasting impact on today's economy. **Without the policy responses of late 2008 and early 2009**, we estimate that: **The peak-to-trough decline in real gross domestic product**(GDP), which was barely over 4%, **would have been close to a stunning 14%**; **The economy would have contracted for more than three years, more than twice as long as it did**; **More than 17 million jobs would have been lost**, about twice the actual number. **Unemployment would have peaked at just under 16%, rather than the actual 10%**; **The budget deficit would have grown to more than 20 percent of GDP, about double its actual peak of 10 percent, topping off at \$2.8 trillion in fiscal 2011**. **Today's economy might be far weaker than it is – with real GDP in the second quarter of 2015 about \$800 billion lower than its actual level, 3.6 million fewer jobs, and unemployment at a still-dizzying 7.6%**. We estimate that, **due to the fiscal and financial responses of policymakers**(the latter of which includes the Federal Reserve), **real GDP was 16.3% higher in 2011 than it would have been**. Unemployment was almost seven percentage points lower that year than it would have been, with about 10 million more jobs.