Jason Furman @jasonfurman

Jun 25, 2024 · 8 tweets · jasonfurman/status/1805620869911204119

Some say the best way to achieve fiscal sustainability is through more growth rather than raising taxes or cutting spending. And while higher growth would be welcome for this (and many other reasons), the arithmetic on it making much of a difference is very challenging.

A 🧵.

The heart of the arithmetic issue is this equation which describes the evolution of the debt. It says that debt/GDP goes up to the extent that:

(1) Interest rates exceed growth rates (with the effect larger when debt/GDP is higher)

(2) The government runs primary deficits.

$$\left(\frac{\text{Debt}}{\text{GDP}}\right)_t - \left(\frac{\text{Debt}}{\text{GDP}}\right)_{t-1} \approx (i_t - g_t)\left(\frac{\text{Debt}}{\text{GDP}}\right)_{t-1} + \left(\frac{\text{Primary Deficit}}{\text{GDP}}\right)_t$$

Most of the growth policies we have, including the ones I am wildly enthusiastic about , would raise g by a few tenths (the picture is something I use with my Ec10 class).

Policy	Change in annual growth rate (pp)
Expand immigration (CBO 2013a)	0.30
Corporate tax reform (Barro and Furman 2018)	0.20
$3 trillion reduction in primary budget deficit (CBO 2013b)	0.10
Trade agreements with Europe and Asia (World Bank 2011 and CEPR 2013)	0.08
$1 trillion of public investment (Gaspar et al 2016 and CEA 2016)	0.07
Regulatory Reductions (Holtz-Eakin 2015 and Barro 2017)	0.05
Universal childcare (PWBM 2021)	0.03

Supposed you succeeded in raising the growth rate by 0.5pp. That would be a huge difference for our long-term well being. But given a debt/GDP ratio of 100% that would be the equivalent of only 0.5% of GDP in primary deficit reduction.

(Moreover even that 0.5% of GDP in primary deficit reduction is probably an overstatement--if we got more growth it would also drive up interest rates through the Ramsey model so you might not even lower (i - g) by much if at all with growth policies.)
https://obamawhitehouse.archives.gov/sites/default/files/docs/interest_rate_report_final.pdf

So growth policies, especially accounting for interest feedback, can substitute for 0% to ~0.5% of GDP in primary deficit reduction. Think plausibly something like 0.1% or 0.2%.

In contrast, the 1990 & 1993 deficit reductions were 2.0% & 1.5% of GDP respectively.

The tax cut extension debate itself is about 1.5% of GDP in primary deficit, dwarfing any conceivable growth policy. (@BudgetHawks makes the same point a different way.)

Tax Cut Extension Would Only Pay for 1% to 14% of Itself | Committe...
2024-06-06-Several major elements of the 2017 Tax Cuts and Jobs Act (TCJA) are scheduled to expire at the end of 2025.

https://www.crfb.org/blogs/tax-cut-extension-only-pays-1-14-itself

So yes, growth is good for its own sake. Growth will also help a little with the fiscal outlook. But even large growth policies are like a relatively small tax or spending policy when it comes to their image on the trajectory of debt relative to GDP.

• • •