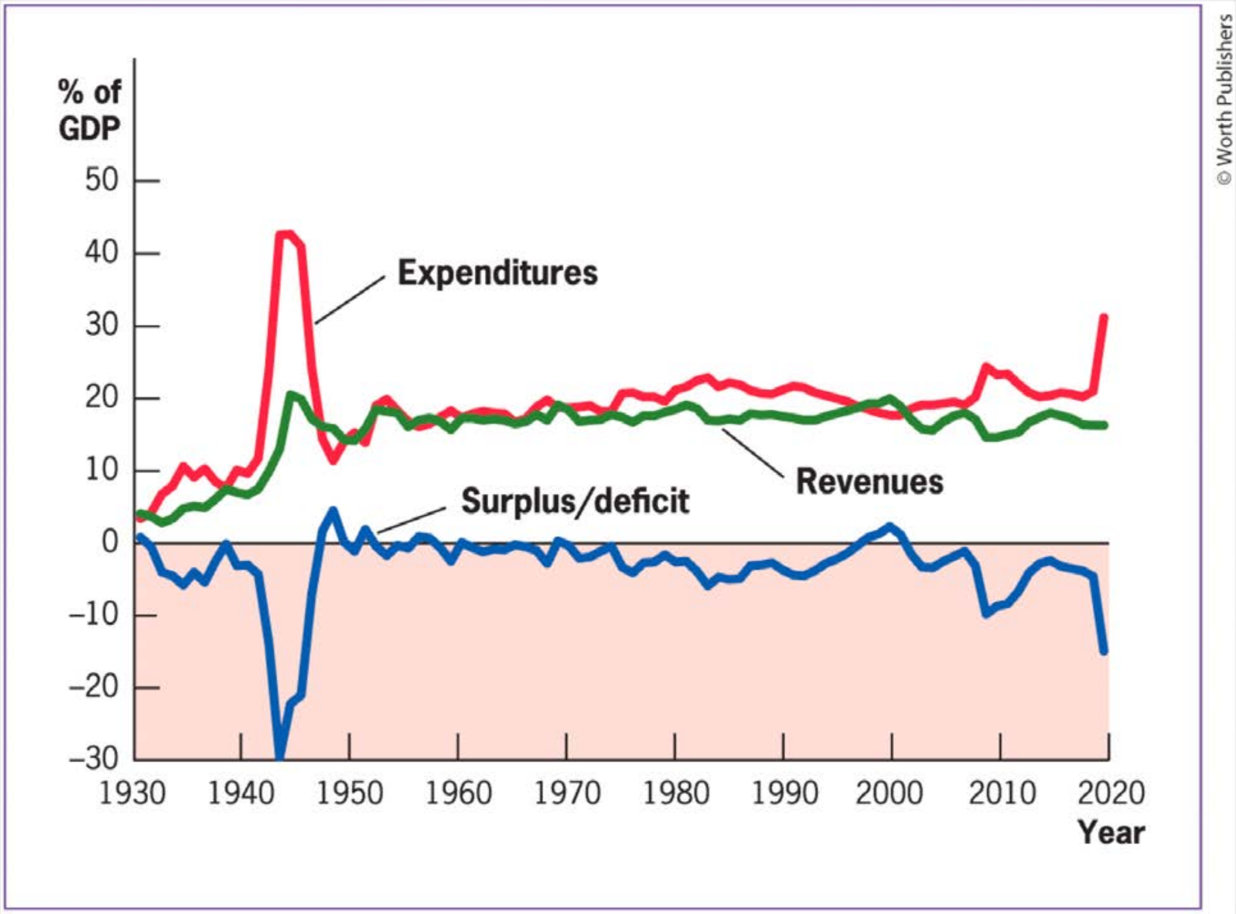

FIGURE 4-1 Federal Taxes, Spending, and the Deficit Through Time in the United States • Federal government spending rose fairly steadily from 1965 through the mid-1980s, but tax revenues did not keep pace, leading to a large deficit. This deficit was eroded and turned to a surplus in the 1990s, but by 2002, the United States was back in deficit again. This deficit grew to very large levels during the Great Recession. It then returned to levels similar to the 1980s before expanding to historic highs due to spending during the Covid-19 pandemic.

Data from: Office of Management and Budget (2021), Table 1.2.

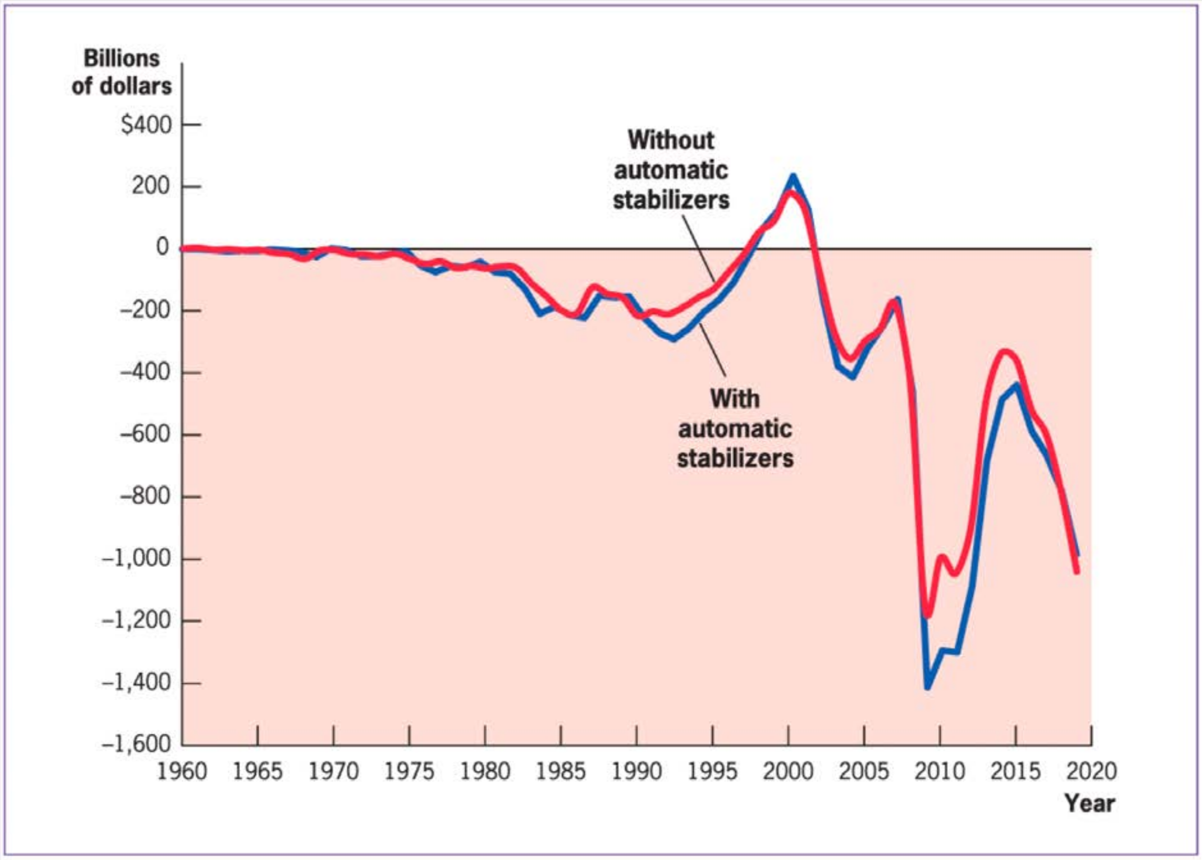

FIGURE 4-2 Economic Adjustment to Measuring the Budget Deficit • The cyclically adjusted budget deficit controls for the impacts of economic activity on the budget. In periods of economic expansion (e.g., the late 1990s), the cyclically adjusted deficit is actually higher than the reported deficit. On the other hand, when the economy is underperforming—such as in the early 1990s, the early 2000s, and the early to mid-2010s—the cyclically adjusted deficit is significantly lower than the reported deficit.

Data from: Congressional Budget Office (2021a).

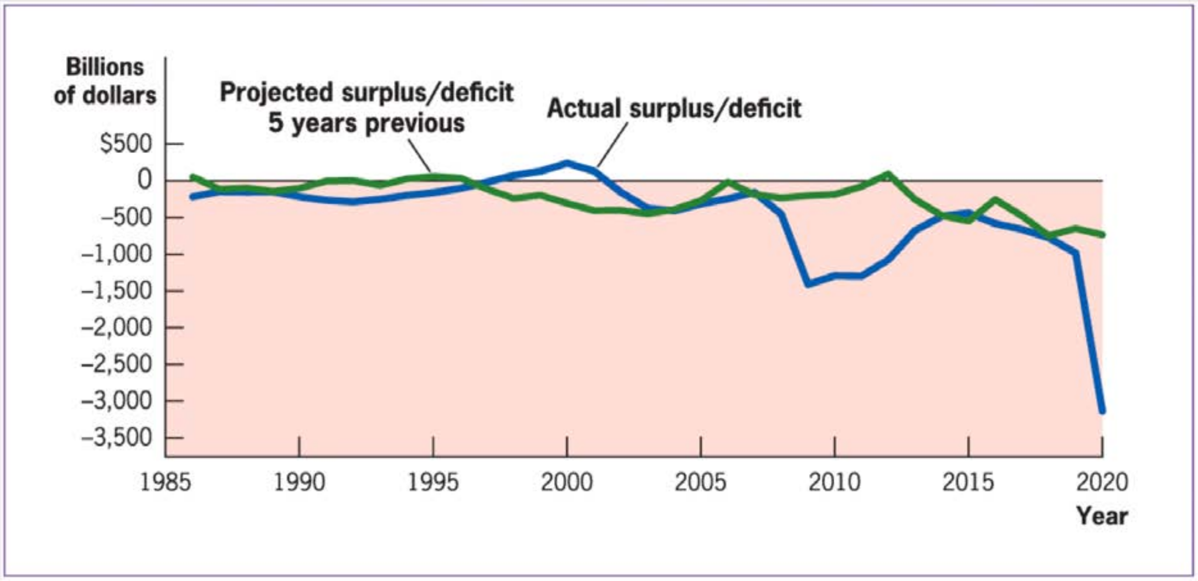

FIGURE 4-3 Projected Versus Actual Surplus/Deficit • CBO projections of the budget surplus/deficit five years ahead have deviated significantly from the actual surplus/deficit, particularly during the high-deficit years of the early 1990s and the high-surplus years of the late 1990s and early twenty-first century, with the most drastic deviation occurring in 2020 due to the unprecedented Covid-19 pandemic.

Data from: Congressional Budget Office (2015a). Projected surplus figures are taken from the CBO's Uncertainty Data (link in A1) through 2007, after which they are taken from the CBO's annual Budget and Economic Outlook (2015a). Actual figures from Office of Management and Budget (2021).

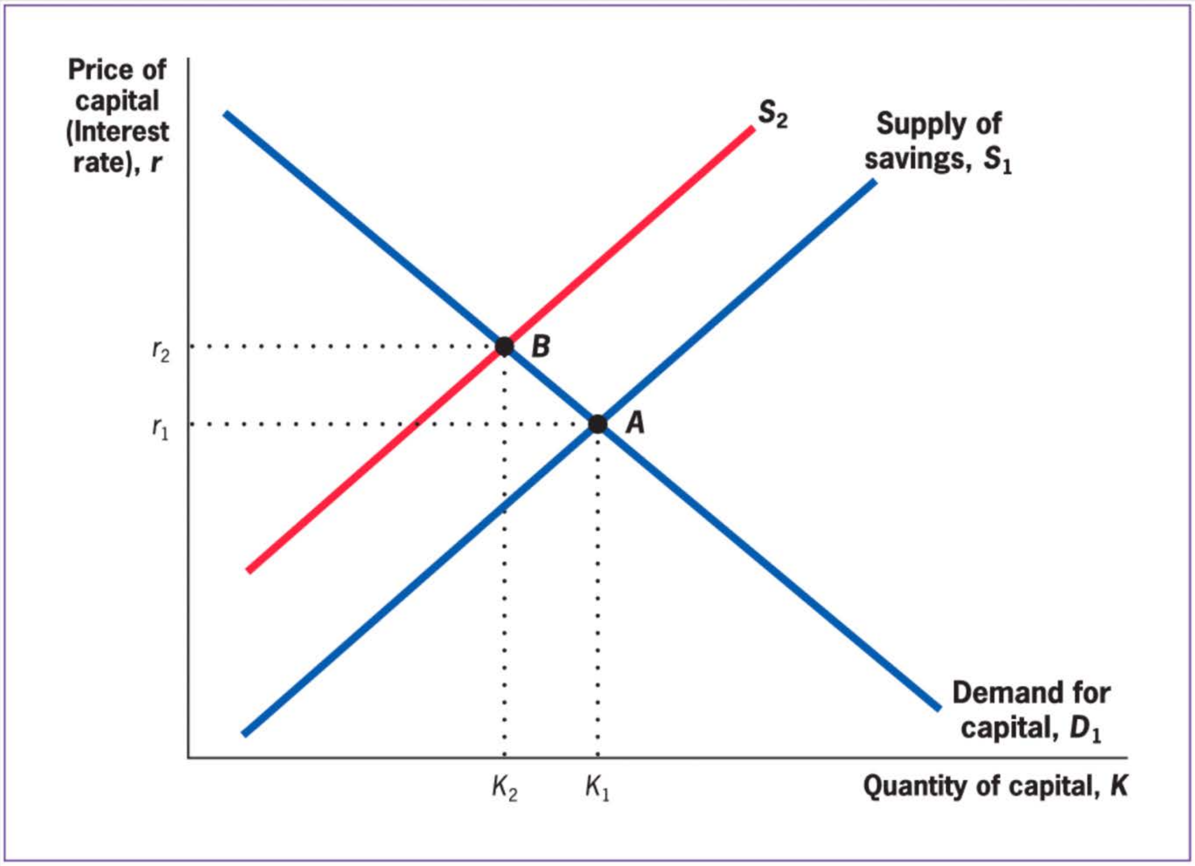

FIGURE 4-4 Capital Market Equilibrium • The equilibrium in the capital market is determined by the interaction of the demand for capital by firms (D_1) and the supply of savings by individual savers (S_1). When the government demands more savings to finance its deficits, this lowers the supply of savings available to private capital markets to S_2, raising interest rates to r_2 and reducing capital accumulation to K_2. This reduction ultimately reduces economic growth.

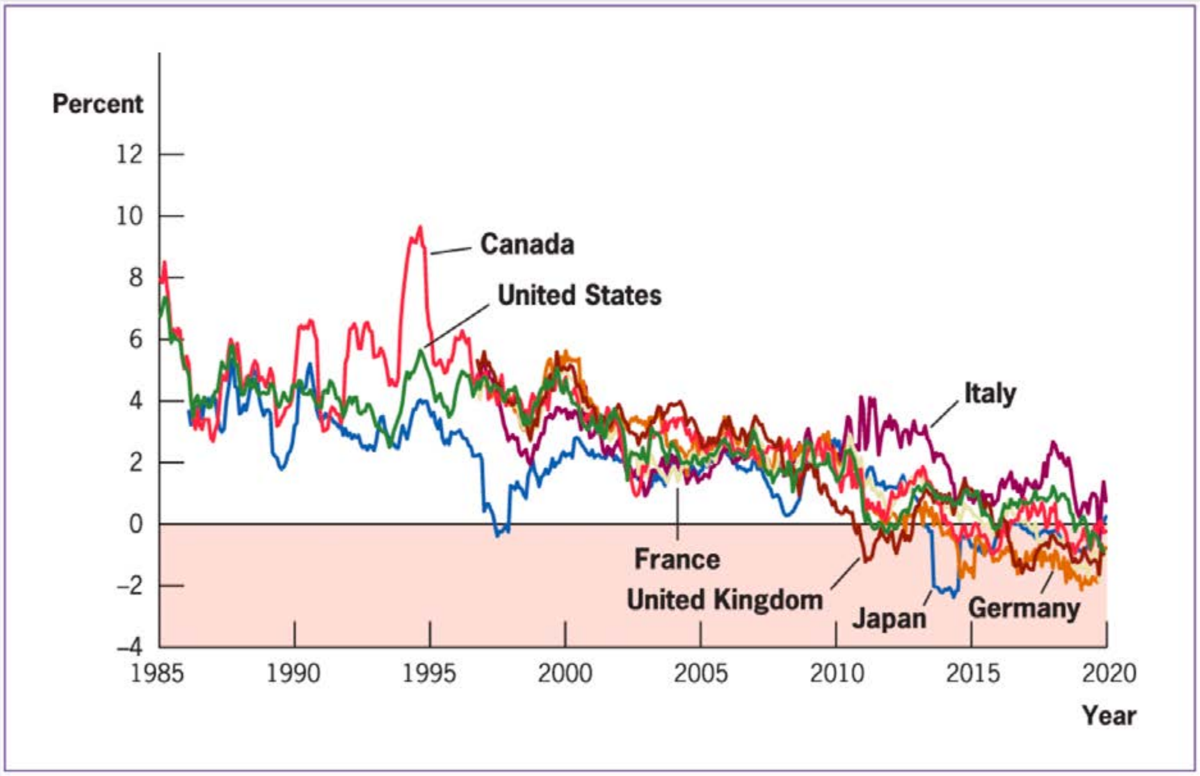

FIGURE 4-5 The Worldwide Decline in Real Interest rates • Over the past 35 years, there has been a strong and systematic decline in real interest rates around the world.

Data from: Furman and Summers (2020)