

U.S. Government Fiscal Policy

Spending, Taxing, Deficits and the Debt

**I'm thinking that if I stand
in front of the White
House long enough,
President Obama will ask
me to be on the Council of
Economic Advisors.**



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Questions about Fiscal Policy

- **What economic role is served by government?**
 - are appropriate services being provided?
 - are taxes fair and reasonable?
 - what impact does this have upon the economy?
- **How do government budgets work?**
 - spending, taxes, deficits, funding
- **How are deficits financed?**
 - connection between deficits and public debt

Primary government functions

- **Traditional**
 - National defense
 - Education (mostly S&L)
 - Infrastructure (roads, waterways, etc.)
 - Postal service
- **Modern (since WW2)**
 - Retirement
 - Health
 - Welfare (mostly S&L)

Policy Actors

- **Fiscal policy**
 - concerns itself with the **spending** and **taxing** practices of the U.S. Government
- **The policy body**
 - two houses of **Congress**, **President**, and Congressional Budget Office (**CBO**) and Office of Management and Budget (**OMB**)
- **Policy agencies**
 - U.S. Treasury and agencies of the U.S. Government (such as Social Security Agency)

Lecture Objectives

- ✓ Review categories of spending and taxing
- ✓ Define deficits and surpluses
- ✓ Define connection between deficit and debt
- ✓ Show how the debt is financed
- ✓ Discuss entitlements and long-term commitments
- ✓ Discuss the special problem of Social Security and Medicare

Definitions

- **Outlays**
 - Monetary disbursements of the U.S. Government.
- **Revenues**
 - Net receipts of the U.S. Government from parties outside of government, typically from taxes.
- **Deficit/Surplus**
 - The total of all outlays minus revenues. When negative, the difference is the deficit, when positive, a surplus.
- **U.S. Public Debt**
 - The total sum of all outstanding U.S. Treasury securities. Net debt refers to the amount in public hands (some debt is held internally by agencies)

Useful facts about the federal budget

- Each fiscal year starts on October 1. FY 2009 started on Oct. 1, 2008.
- Budgetary timetable
 - Early February President submits his budget: advisory
 - April 15: Congress submits their version of budget
 - June 30: Deadline for passage of 13 appropriations bills (never met)
- Federal debt ceiling, established in 1941, has been raised 60 times!!

Outlays, Revenues and Deficit

Major outlay categories by function

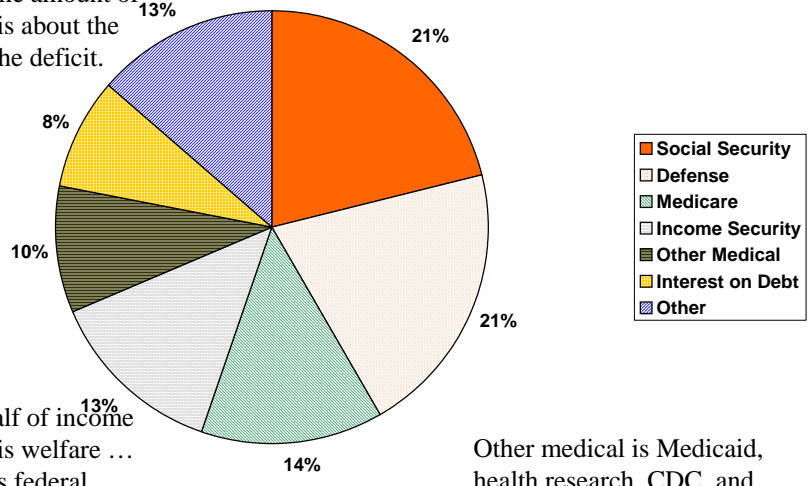
	1998	2005	2006	2007	2008	2008%
Social Security	379.2	523.3	548.6	568.2	615.3	21.0
Defense	269.5	495.3	521.8	552.6	607.3	20.7
Medicare	192.8	298.5	329.9	375.4	396.3	13.5
Income Security	237.7	345.8	352.5	366.0	388.4	13.3
Other Medical	131.4	250.6	252.8	266.4	284.5	9.7
Interest on Debt	241.1	184.0	226.6	237.1	243.9	8.3
Other	200.9	374.7	423.2	318.1	395.5	13.5
TOTAL OUTLAYS	1,652.6	2,472.2	2,655.4	2,730.2	2,931.2	100.0
less REVENUES	1,721.8	2,153.9	2,407.3	2,568.2	2,521.2	86.0
equals SURPLUS/DEFICIT	69.2	318.3	248.1	162.0	410.0	14.0

2009 fiscal year began October 1, 2008. Budget deficit for first 6 months was **\$954.1 billion**.

Source: Budget of the United States Government, FY 2009, Historical Tables, Table 3.1.

Federal Outlays (2008) (\$2,931.2 billion)

Note: The amount of "other" is about the size of the deficit.



About half of income security is welfare ... the rest is federal retirement and unemployment.

Other medical is Medicaid, health research, CDC, and VA.

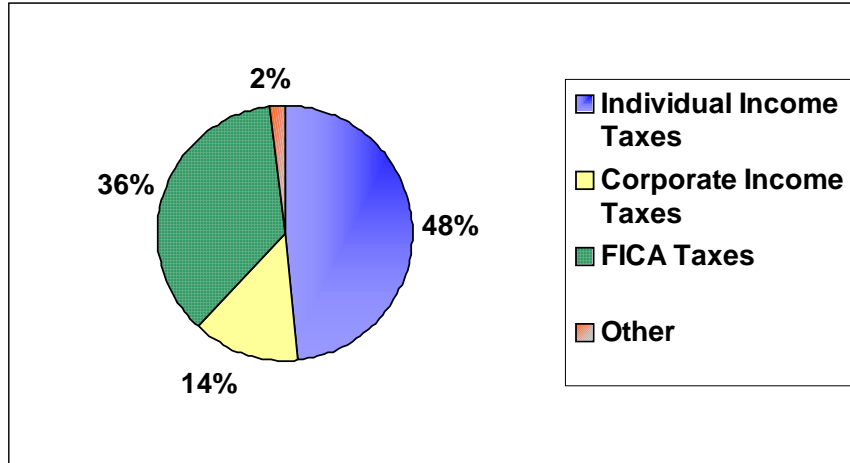
Unified Budget of the United States Government Net Outlays by Function, \$ Billions, Select Years

Red Ink table 4.2

Outlays by Function	Number	1990	1995	2000	2008	% Out 90	% Out 08	%Grth 90
Social Security	650	248.6	335.8	409.4	615.3	19.8%	21.0%	147.5%
National defense	050	299.3	272.1	294.5	607.3	23.9%	20.7%	102.9%
Medicare	570	98.1	159.9	197.1	396.3	7.8%	13.5%	304.0%
Income Security	600	147.0	220.4	253.6	388.4	11.7%	13.3%	164.2%
Health	550	57.7	115.4	154.5	284.5	4.6%	9.7%	393.1%
Net Interest	900	184.2	232.2	222.9	243.9	14.7%	8.3%	32.4%
Educ, trmg, employment	500	38.8	54.3	53.8	93.4	3.1%	3.2%	140.7%
Transportation	400	29.5	39.4	46.9	80.3	2.4%	2.7%	172.1%
Veterans benefits	700	29.1	37.9	47.0	86.6	2.3%	3.0%	197.7%
Justice	750	10.0	16.2	28.5	46.2	0.8%	1.6%	362.0%
Natural resources envirnmt	300	17.1	22.1	25.0	35.5	1.4%	1.2%	107.9%
Comm and regn dvlpmt	450	8.5	10.6	10.6	27.6	0.7%	0.9%	224.7%
International affairs	150	13.8	16.4	17.2	34.8	1.1%	1.2%	152.4%
Gen science, space, techn	250	14.4	16.7	18.6	27.6	1.1%	0.9%	91.9%
Agriculture	350	12.0	9.8	36.5	21.0	1.0%	0.7%	74.7%
General government	800	10.7	13.8	13.0	19.8	0.9%	0.7%	85.1%
Housing credit	370	67.1	-14.4	3.2	7.4	5.4%	0.3%	-89.0%
Energy	270	3.3	4.9	-0.7	3.0	0.3%	0.1%	-8.9%
Undistributed offsetting receipts	950	-36.6	-44.5	-42.6	-87.7	-2.9%	-3.0%	139.7%
Total Outlays		1,252.7	1,519.1	1,789.1	2,931.2			
Total Revenues		1,031.3	1,355.2	2,025.2	2,521.2			
Budget Deficit		221.4	203.2	236.1	410.0			

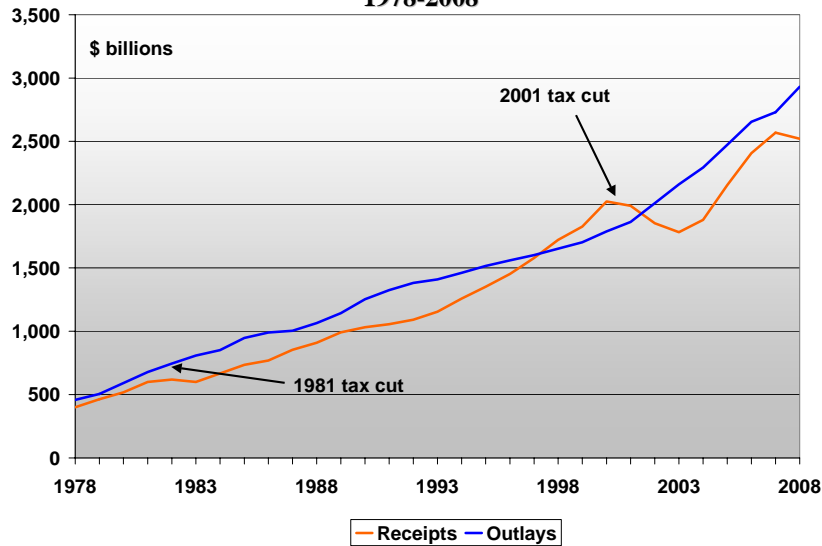
Source: Budget of the U.S. Government, FY2009, Table 3.1 Historical Tables of the U.S. Budget.

Tax Sources 2008 (\$2521.2 billion)



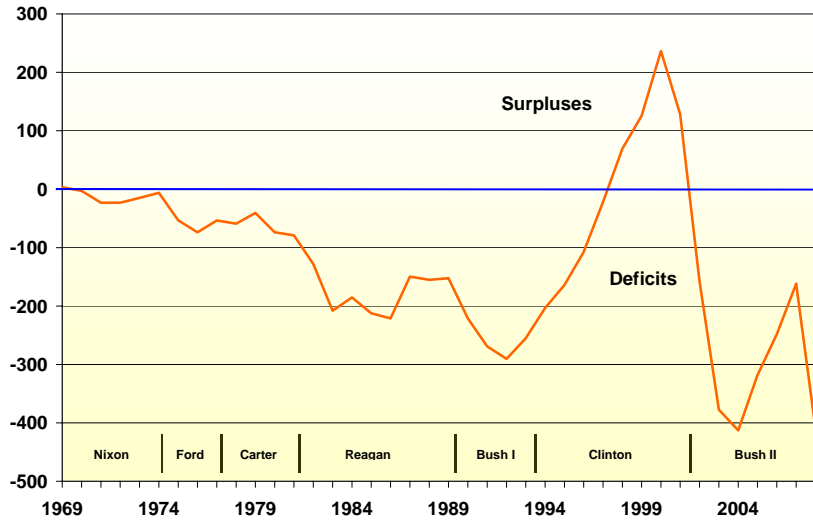
Note: All but about 15% of federal taxes are paid by individuals.

Federal Receipts and Outlays 1978-2008



Source: Budget of the United States Government, Fiscal Year 2009, Historical Tables, Table 1.1

U.S. Government Budget Surpluses and Deficits 1969 - 2008



Source: Budget of the United States Government, Fiscal Year 2009, Historical Tables, Table 1.1

Primary features of Bush 2001 Tax Cuts

1. Reduced current tax rates of 15, 28, 31, 36, and 39.6 % with 10, 15, 25, and 33 %
2. Doubled child tax credit to \$1,000 per child
3. Eliminated estate taxes (sunset)
 - There are no federal inheritance taxes, only a tax based upon the size of the estate. Current cut-off is a little less than \$1 million.

The 2001 Bush Tax Rates

For Married Filing Jointly					
Old Code			Bush Plan		
\$0	\$45,200	15%	\$0	\$12,000	10%
\$45,200	\$109,250	28%	\$12,000	\$45,200	15%
\$109,250	\$166,500	31%	\$45,200	\$166,500	25%
\$166,500	\$297,350	36%	\$166,500	--	33%
\$297,350	--	39.60%			

Note: Studies seem to show that this will benefit high income earners more than it will low income earners. (See handout).

Our primary concern is what impact it would have upon the deficit.

<http://www.whitehouse.gov/news/reports/taxplan.html>

Deficit financed by U.S. Treasury Securities

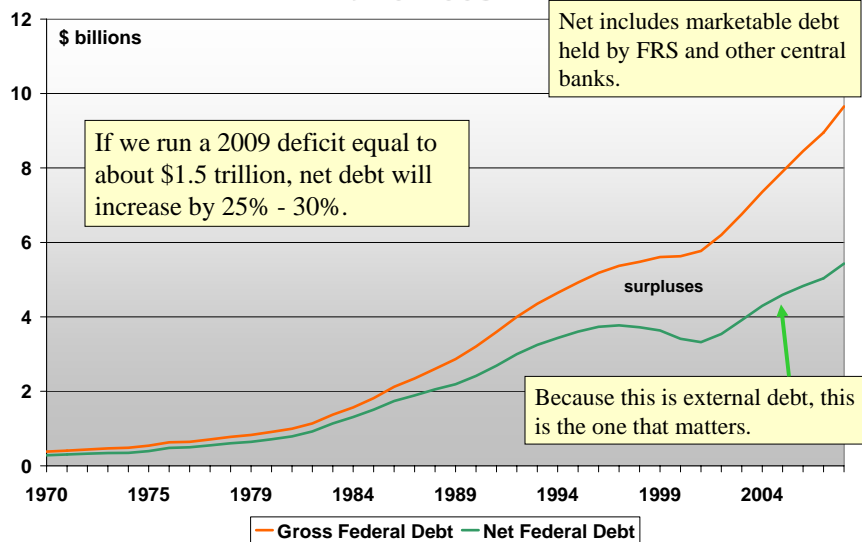
U.S Treasury Securities Offered to the Public			Minimum Purchase
Security	Maturity	Now Offered	
Bills:	Less than one year	4, 13 26 and 52 weeks	\$100
Notes:	More than one to ten years	2,3,5,7 and 10	\$100
Bonds:	20 to 30 years	30 years	\$100
Inflation Indexed:	5, 10, and 20 years	All	\$100

The budget deficit is financed by the sale of interest-bearing U.S. Treasury securities to the public, including corporations, financial institutions, and foreign investors. The securities differ largely by the maturities. After a 5-year hiatus, the Treasury began selling 30 year bonds in February 2006. The Treasury in recent years has sold 20 year bonds also, but is not currently selling them. Inflation-indexed securities are called TIPS, and are described in the reading material for this section.

Total U.S. Securities Outstanding & Gross and Net Debt; February 28, 2009

Instrument	Amount
Marketable	5,989.0
Bills	1,979.8
Notes	2,458.6
Bonds	606.7
Inflation-indexed	511.2
Non-Marketable	4,825.6
Government Account	4,298.0
U.S. Savings Bonds	194.1
TOTAL PUBLIC DEBT:	10,814.6
NET PUBLIC DEBT:	6,516.6
(Net is total less govt. account)	

Total Public Federal Debt 1970-2008



Source: Budget of the United States Government, Fiscal Year 2009, Historical Tables, Table 7.1

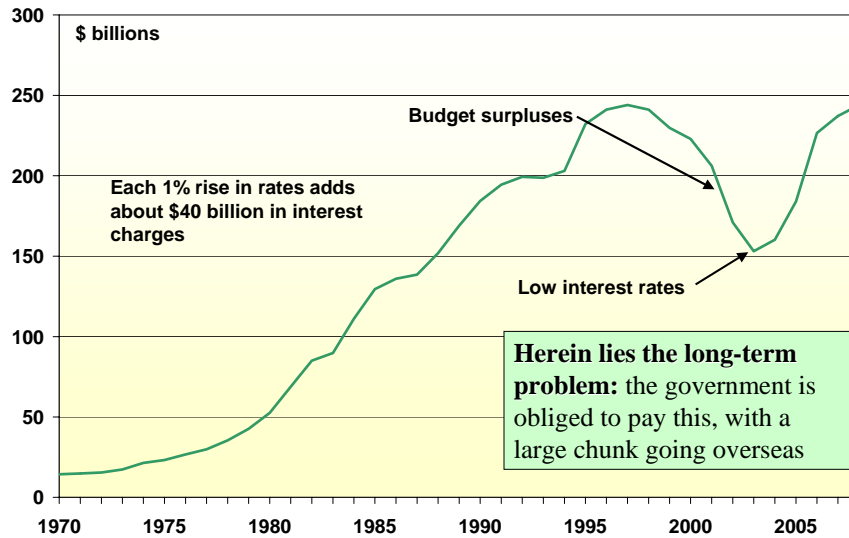
Who owns the U.S. Treasury Debt?

Ownership of Privately Held U.S. Treasury Debt

	December 1995		September 2008	
	Billions \$	% total	Billions \$	% total
Deposit institutions	315.4	9.5%	133.0	2.5%
US Savings Bonds	155.0	4.7%	194.3	3.6%
Private pension funds	142.9	4.3%	290.2	5.4%
S&L govt pension funds	208.2	6.3%	166.2	3.1%
Insurance companies	241.5	7.3%	130.0	2.4%
Mutual funds	225.1	6.8%	621.3	11.7%
State & local governments	289.8	8.8%	535.7	10.0%
Foreign holdings	835.2	25.3%	2,848.2	53.4%
Other (mostly individuals)	864.6	26.1%	413.2	7.7%
Total privately held	3,307.7	100.0%	5,332.0	100.0%

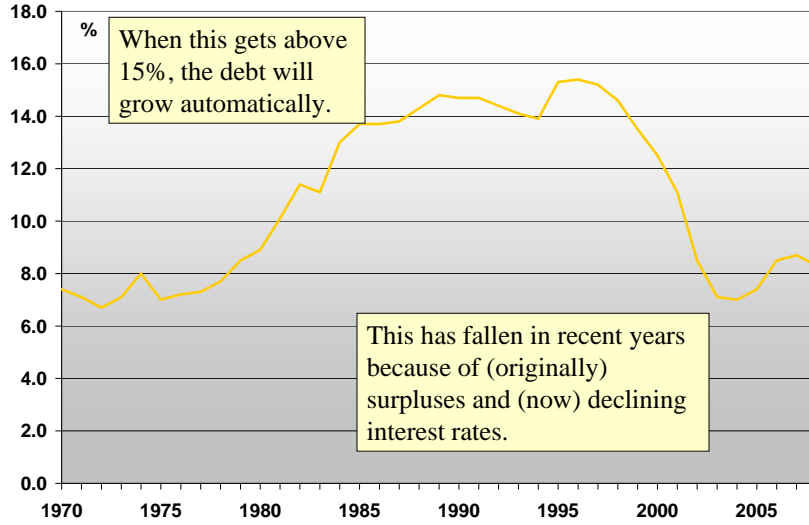
Source: Treasury Bulletin, March 2009, <http://www.fms.treas.gov/bulletin/index.html>

Interest on the Debt 1970-2008

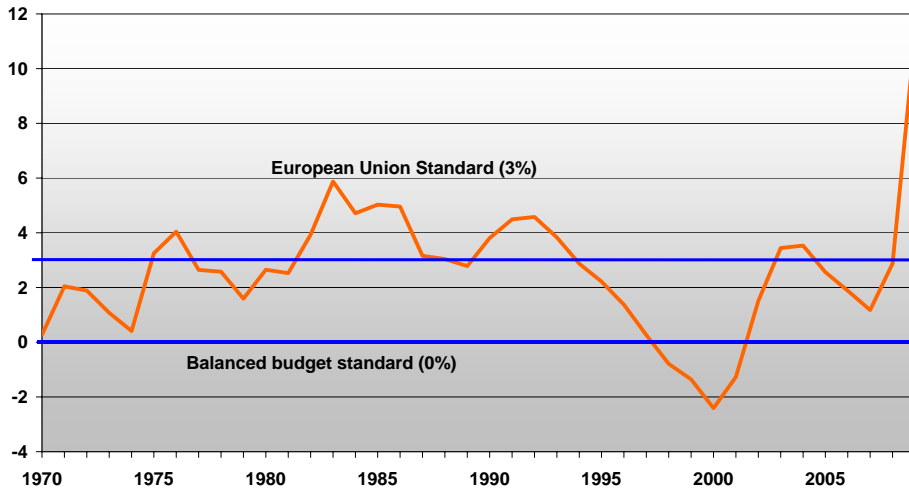


Source: Budget of the United States Government, Fiscal Year 2009, Historical Tables, Table 3.1

Net Interest as a % of Outlays 1970-2008

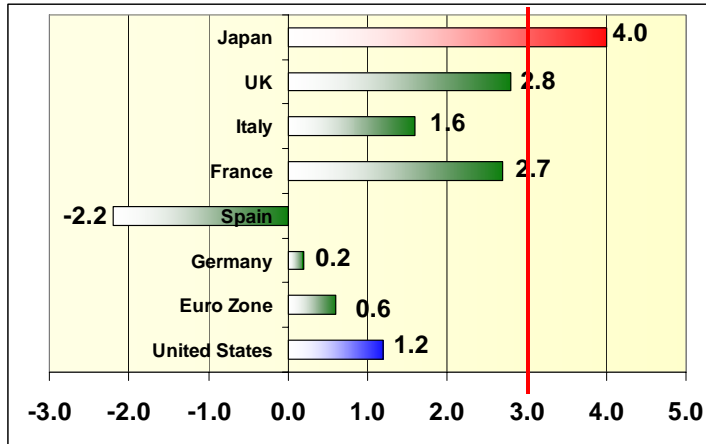


The Deficit as % of GDP 1970-2008 with 2009 estimated



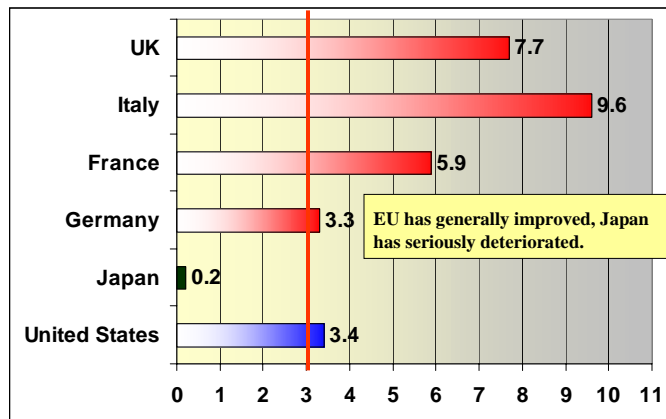
Note: The FY 2008 value was 2.87%. The value for 2009 was estimated by your teacher and assumes a deficit of \$1.6 trillions and GDP of \$14.3 trillion.

General Government Budget Deficits % GDP; Some Comparisons 2007

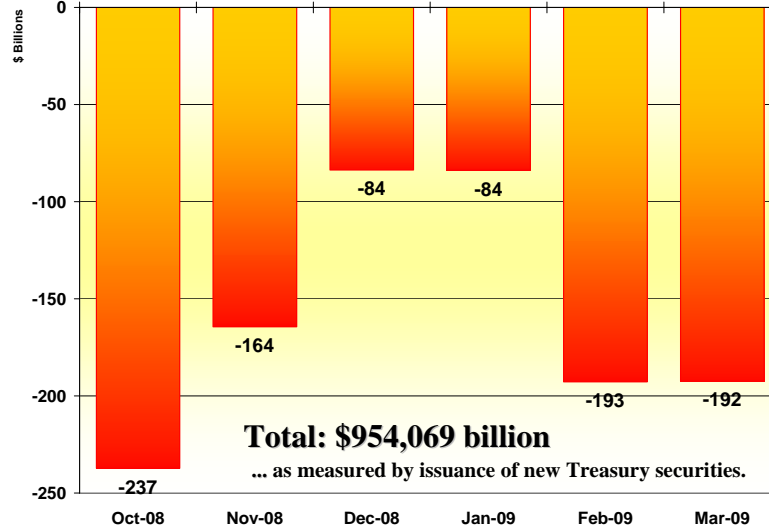


Note: Japan is 2007 rather than 2006. Euro data are from *Monthly Bulletin, Euro Area Statistics*, UK data is from *Bank of England, Government Deficit and Debt under the Maastricht Treaty*, Japan is from *OECD Economic Survey of Japan, 2008*.

... the same data for 1993



The FY2009 Monthly Budget Deficits (First 6 months: Oct 08 - Mar 09)



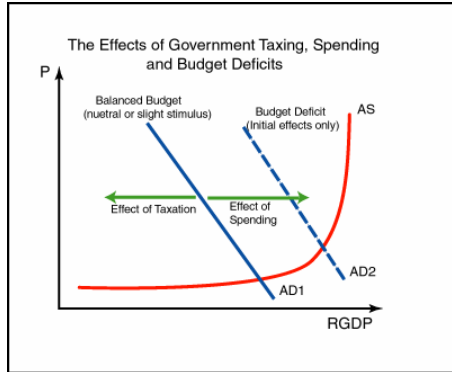
Source: U.S. Treasury *Monthly Treasury Statement*, March 2009.

Some general observations

- Short-term budget deficits can be caused by the decline in tax receipts during recessions
- Structural deficits, which are more harmful, have been caused more by tax cuts (1981-1984 and 2002-2003) than by increases in spending
- Spending has been largely independent of whatever President or political party has been in power
- Each deficit adds to the public debt, each surplus subtracts from it
- Deficits do stimulate the economy in the short run
- The primary long-run effect of deficits is through interest rates

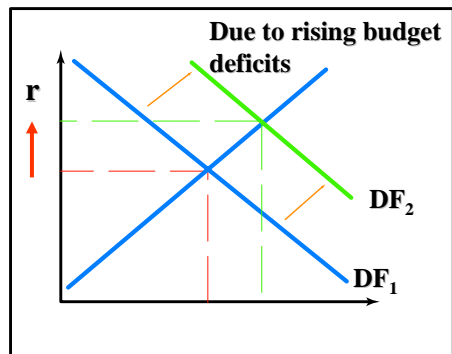
The fiscal effects of budget deficits

- Our models tell us that budget deficits should stimulate the economy in the short run
- The potential for such stimulation to be inflationary depends upon the starting point (context).
- The primary long-term effects are through the finance markets (to be shown later).



The economic effect of deficits

- Loanable Funds model tells us that deficits can crowd out private borrowing
- This can be **offset** by "easy" FRS OMO policy
- Can also be **offset** by surge in supply of funds to markets during times of crisis or from foreign investors
- Therefore, deficits can be said to have a tendency to cause interest rates to rise



FRS intervention to keep rates low ...

