Osher Marin Jewish Community Center

The Federal Budget

January 30, 2020

Jon Haveman, Ph.D.
National Economic Education Delegation

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National Economic Education Delegation

- **Vision**
  - One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.
- **Mission**
  - NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States.
- **NEED Presentations**
  - Are **nonpartisan** and intended to reflect the consensus of the economics profession.

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What Does the U.S. Gov't Budget Look Like?

2019 Budget Summary

Revenue	Billions		Expenditures	Billions
Income Taxes	$1,718		Mandatory	$2,735
Payroll Taxes	$1,243		Discretionary	$1,336
Corporate Taxes	$230		Interest	$376
Other	$271			
Total	$3,462		Total	$4,447

Budget Deficit: $984 Billion

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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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Outline

- Government Spending
- Government Revenues
- Government Debt

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U.S. Government Spending

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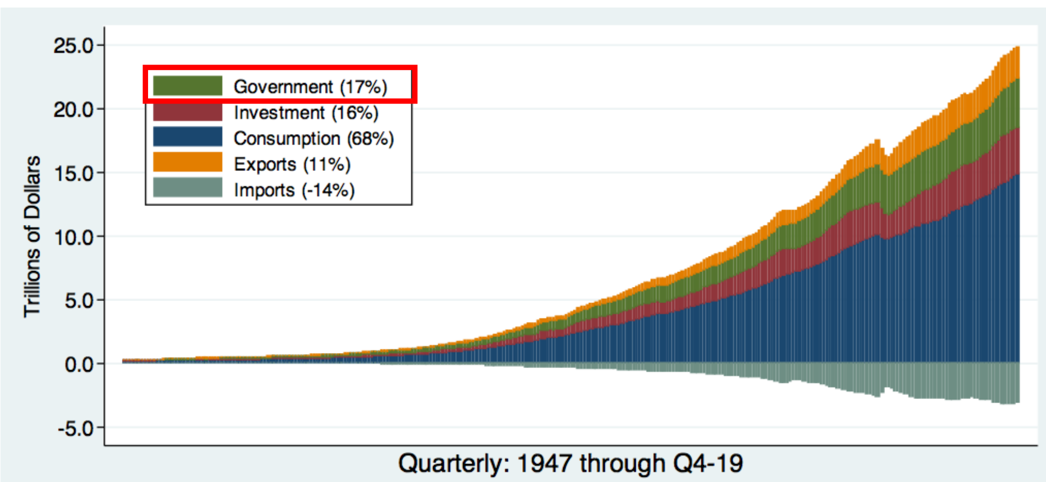
Government Spending and the US Economy



Source: U.S. Bureau of Economic Analysis
Produced by: National Economic Education Delegation (www.NEEDelegation.org)

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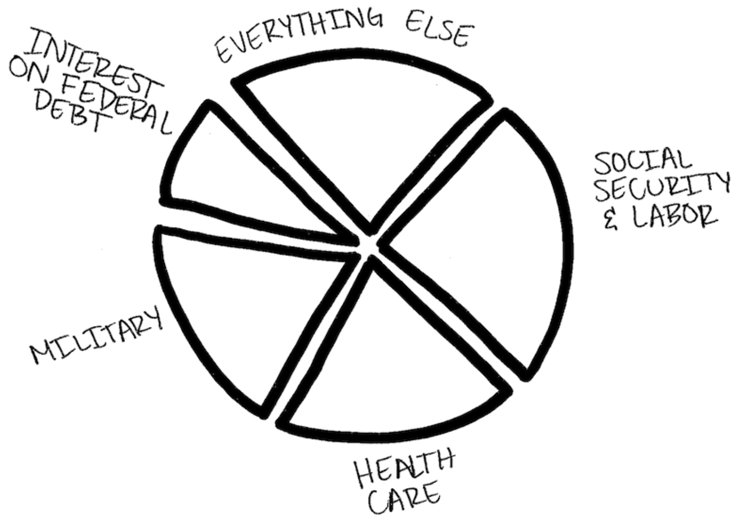
Where Does the Money Go?



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Source: https://www.nationalpriorities.org/budget-basics/federal-budget-101/

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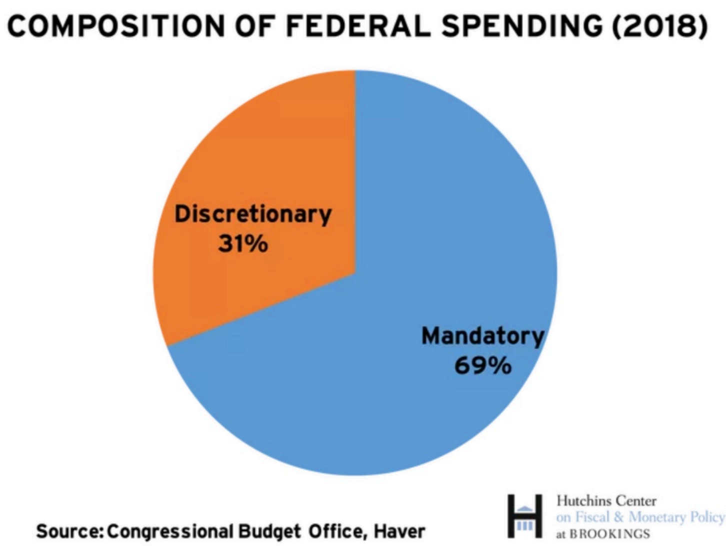
Two Important Categories



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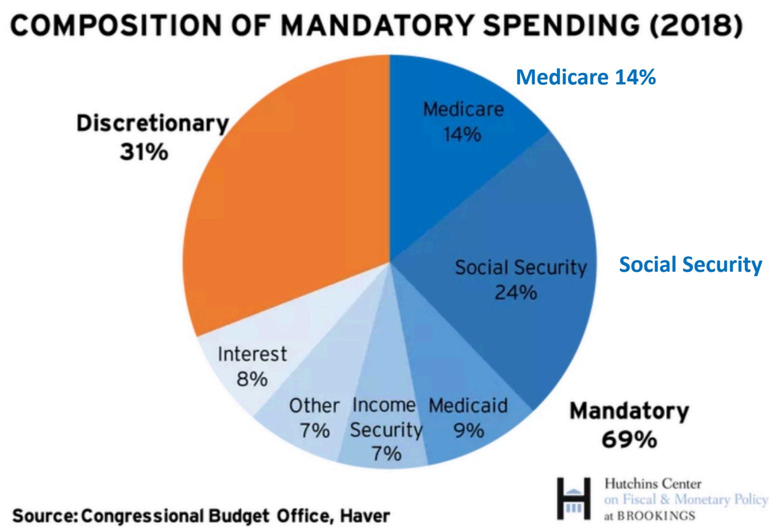
What is Mandatory Spending?



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Mandatory Spending: Social Security (24%)

- **Retirement**
  - Covers 96% of US workers.
  - Retirement age is increasing from 65-67.
- **Survivors**
  - A worker's spouse and dependents may be eligible for survivors' benefits if the worker dies.
- **Disability**
  - A medical condition expected to last at least one year or to be fatal.

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Where Do Social Security Funds Come From?

- **Payroll taxes**
  - Tax rates:
    - Employee: 6.2%
    - Employer: 6.2%
    - Self Employed: 12.4%
  - Cap in 2019: $132,900
- **Taxes on OASDI benefits**
  - Not all benefits are taxed.
- **Interest earnings**

Key Question: Who pays?

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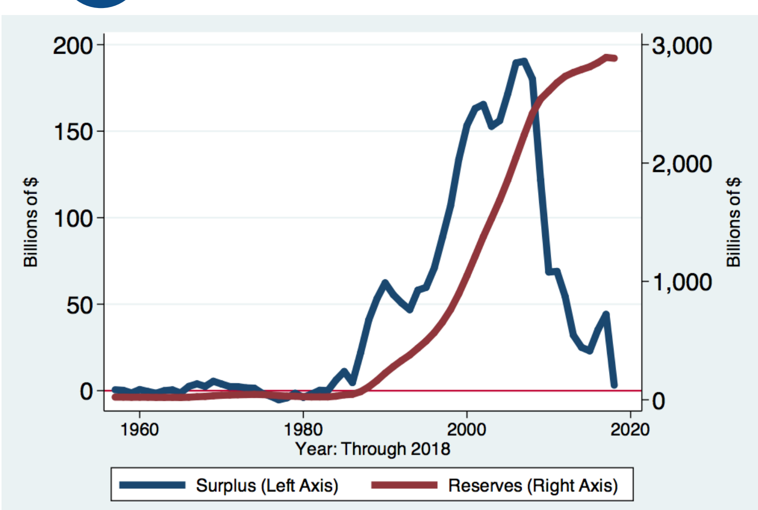
Social Security Trust Fund



- **Spending in 2018**
  - OASI: $854 billion
  - DI: $147 billion
- **Income in 2018**
  - OASI: $831
  - DI: $172
- **Surplus in 2018**
  - OASI: $-22
  - DI: $25
- **Total Surplus: $3 Billion**

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Source: https://www.ssa.gov/OACT/TRSUM/index.html

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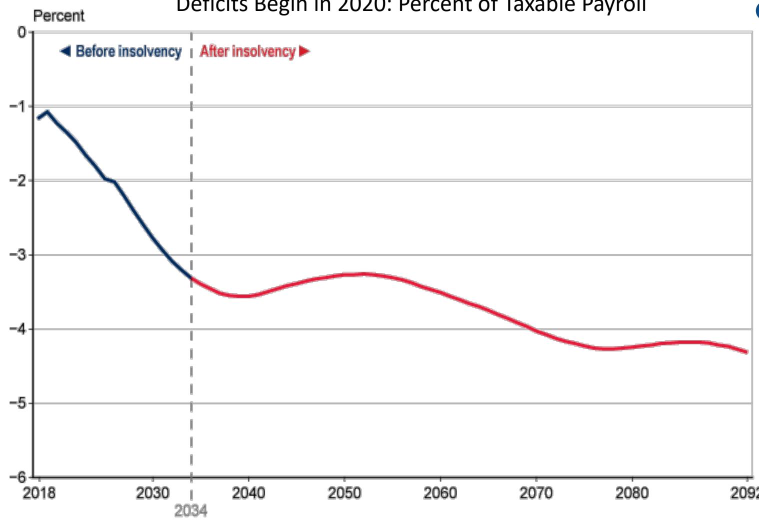
In 2018: Deficits As Far As the Eye Can See

- **Trust Fund Solvency**
  - Annual deficits after 2019
  - Fund insolvent after 2036

Deficits Begin in 2020: Percent of Taxable Payroll



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SOURCE: 2019 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table IV.B1

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Options for Eliminating the Soc Sec Deficits

Problem is 1-1.5% of GDP

- **Raise the retirement age**
- **Increase the tax rate**
  - 4 percentage pt increase raises 0.6% of GDP.
- **Raise the amount of income subject to tax**
  - Tax all wages raises 1.1% of GDP.
- **Reduce benefits**

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Mandatory Spending: Medicare (14%)

- **Part A: Hospital Insurance**
- **Part B: Physician, outpatient, home health, and other services.**
- **Part D: Subsidized access to pharmaceuticals.**

- **Part C: Medicare Advantage Plans – offered by private companies approved by Medicare.**
  - Medicare Advantage Plans may offer extra coverage, such as vision, hearing, dental, and/or health and wellness programs.

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Where Do Funds Come From?

- **Payroll taxes**
  - Tax rates:
    - Employee: 1.45%
    - Employer: 1.45%
    - Self Employed: 2.9%
  - No Cap
- **Interest earnings**
- **General revenues**
- **Beneficiary premiums**

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Medicare Finances in 2018

- **Part A:**
  - Income in 2018: $299 billion
  - Expenses in 2018: $297 billion
  - Surplus: $2.8 billion
- **Part B and Part D:**
  - Income in 2018: $406 billion
  - Expenses in 2018: $414 billion
  - Surplus: **$-7.9 billion**
- **Long term sustainability:**
  - Deficits began in 2016
  - For as far as the eye can see

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Mandatory Spending: Medicaid (9%)

- **Medicaid provides medical insurance for those whose income and resources are insufficient to pay for health care.**
- **It is a program with costs shared with the states.**
- **Amount spent in 2017: $576.6 Billion**
  - Federal: 61.5% or $354.6 Billion
  - States: 38.5% $222.0 Billion
- **People served in 2017: 72 million (22% of Americans)**

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Mandatory Spending: Income Security (7%)

- EITC
- SNAP
- SSI
- TANF
- Housing
- WIC
- School Lunches
- Head Start

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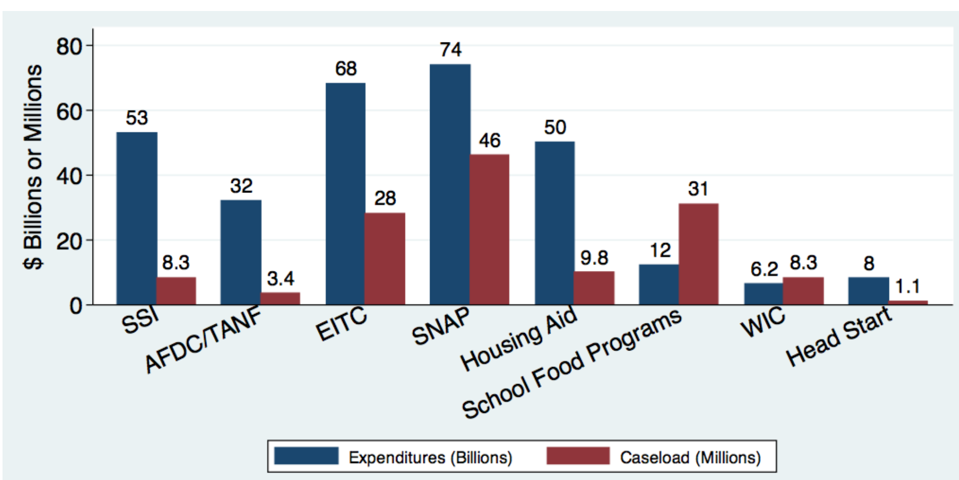
U.S. Safety Net Expenditures ($ Billions) and Caseload (Millions) – No Medicaid, 2014 or 2015



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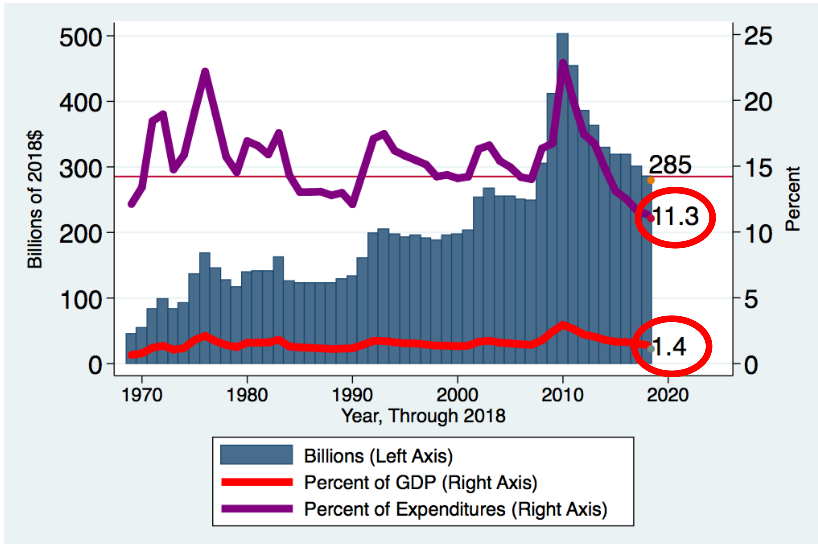
Income Security Spending Over Time



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Mandatory Spending: Interest (8%)

- **Interest costs in 2019: $376 Billion**
  - 1.6% of GDP, or 8% of the Federal Budget
- **Forecast to increase to $1,323 Billion in 2050**
  - 6% of GDP, or 21% of the Federal budget

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Source: CBO, January 2019 Budget Projections

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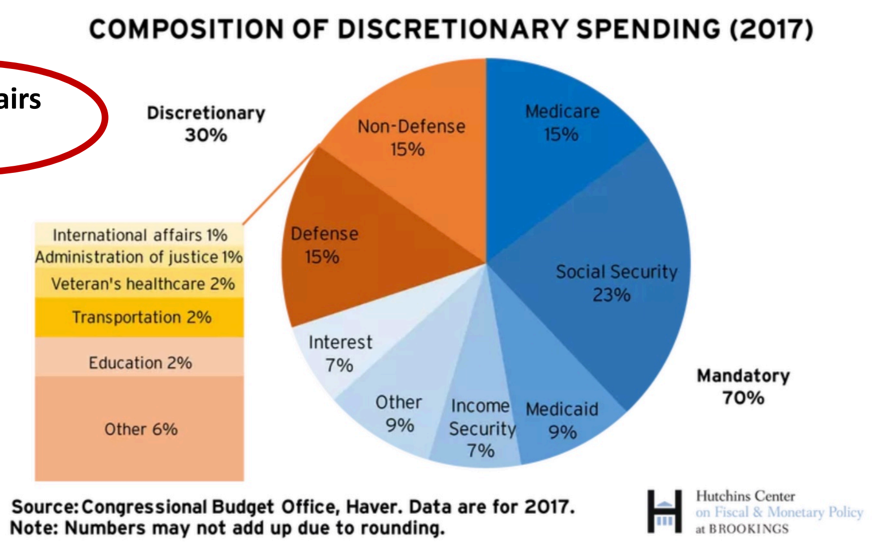
Mandatory Spending: Other (7%)

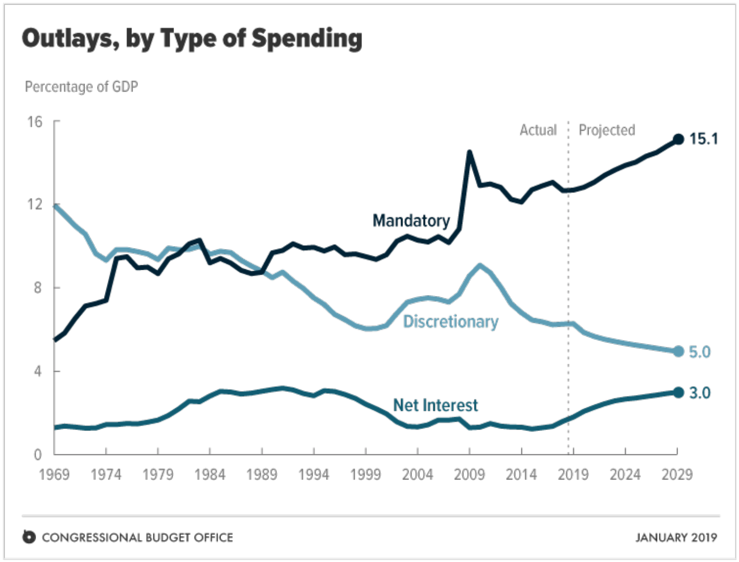
- Food and agriculture
- Veterans' Benefits
- Transportation
- Other

What is Discretionary Spending?

Int'l Affairs 1%



Mandatory Spending Dominates Forecasts



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Source: Congressional Budget Office, The Budget and Economic Outlook: 2019 to 2029

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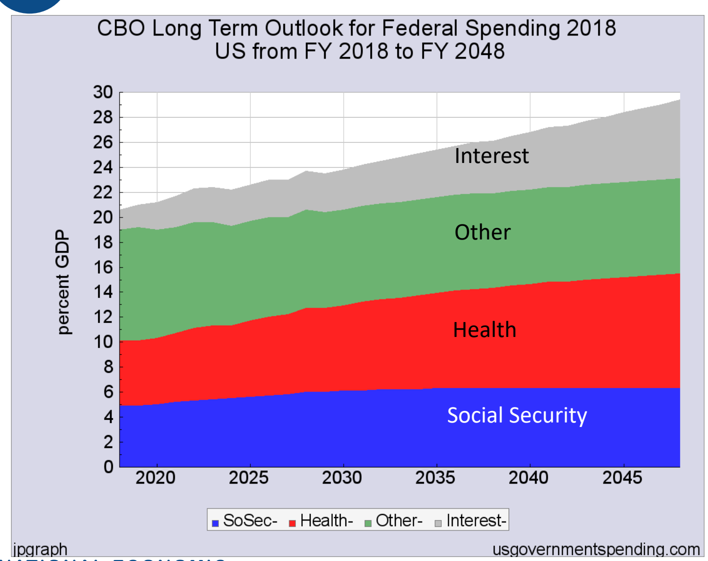
Forecast Spending



What trends do you see?

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Aging and Health Care Costs

Percentage of GDP

	Outlays 2020	Outlays 2030	Change (Percentage points)	Major Reasons for Change
Social Security	4.9	6.0	1.1	Aging of the population
Major Health Care Programs[a]	5.4	7.0	1.6	Aging of the population; rising costs of health care
Other Mandatory Spending	2.6	2.2	−0.4	Inflation rate is less than nominal GDP growth
Discretionary Spending	6.4	5.6	−0.8	Caps on funding; inflation rate is less than nominal GDP growth
Net Interest	1.7	2.6	0.8	Accumulating debt; rising interest rates

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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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Another Category of Spending: Tax Expenditures

- **Description**
  - Social policies that are implemented and paid for through the tax code.
- **List of the largest tax breaks:**
  - Mortgage interest deduction
  - Retirement contributions
  - State and local taxes
  - Health insurance
  - Low tax rates for Capital Gains
  - Child related tax credits
  - Charitable gifts
  - Lifetime Learning
- **Evidence of who they benefit**
  - Regressive

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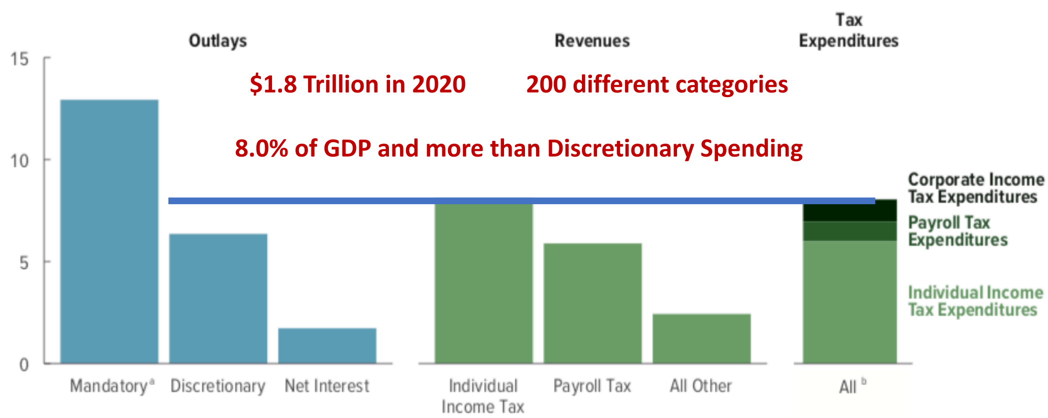
Tax Expenditures are Significant, 2020

Percentage of GDP



Source: Congressional Budget Office, using estimates by the staff of the Joint Committee on Taxation.

GDP = gross domestic product.

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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

Tax Expenditures Tend to be Regressive

Percent Change in After-Tax Income due to Tax Expenditures, 2007 (with no AMT)*

	Tax Exclusions	Lower capital gains and dividends rates	Itemized deductions	Above-the-line deductions	Non-refundable credits	Refundable credits	All provisions
Bottom 20 percent	0.54%	0.00%	0.02%	0.01%	0.05%	5.81%	6.97%
Second 20 percent						5.26%	8.89%
Middle 20 percent						2.25%	7.25%
Fourth 20 percent						1.00%	7.28%
Top 20 percent						0.25%	12.82%
Total Cost (no AMT)	$326 billion	$99 billion	$153 billion	$6.6 billion	$11.3 billion	$89 billion	$746.7 billion
Total Cost (with AMT)	$344 billion	$96 billion	$154 billion	$6.4 billion	$8.2 billion	$89 billion	$760.5 billion

Income Group	Benefits
Bottom 20%	7.0%
Top 20%	12.8%

Source: Center on Budget and Policy Priorities calculations based on TPC calculations of effect of eliminating tax expenditures.
*Note: These figures take into account the interaction among individual tax expenditure provisions.

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Important things that people get from gov't

- Roads and highways
- Public education
- Defense
- Research and development
- Space exploration
- Income Security
- Improved public health
  - Sanitation
- Investments in communications
- Energy
- Many, many, inventions
  - Microchips
  - GPS
  - Wind turbines
  - Tang
  - Touch screens
  - Internet
  - Bar Codes
  - Wii

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US Government Revenues

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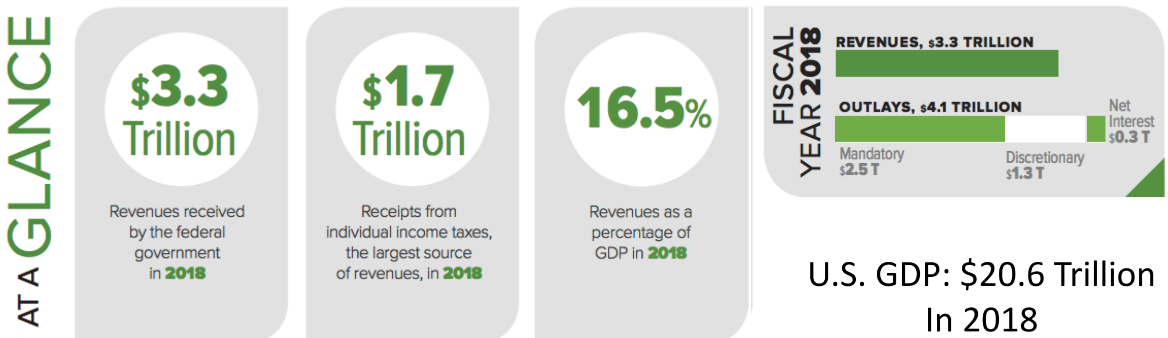
Federal Government Revenues in 2018

Funds collected from the public that arise from the government's exercise of its sovereign powers



U.S. GDP: $20.6 Trillion
In 2018

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Source: CBO – Revenues in 2018: An Infographic

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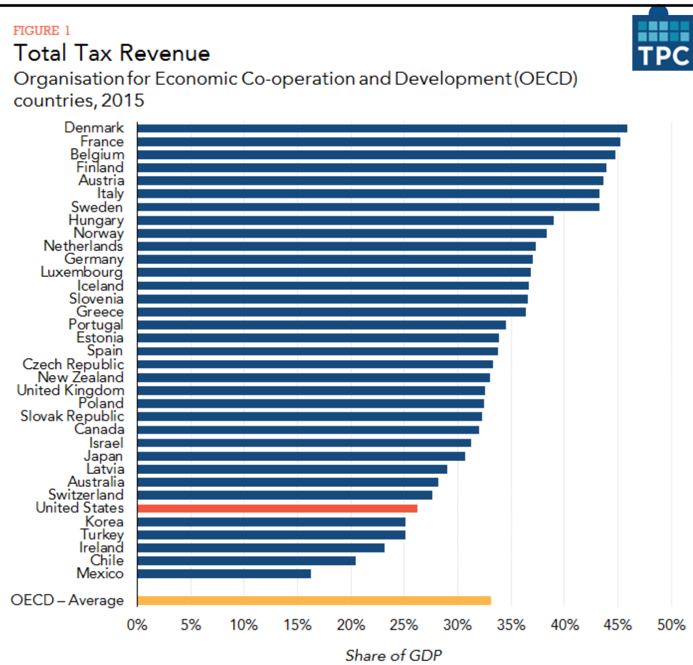
International Comparison

FIGURE 1

Total Tax Revenue

Organisation for Economic Co-operation and Development (OECD) countries, 2015



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Source: Organisation for Economic Co-operation and Development. 2015. OECD Tax Statistics. "Revenue Statistics: OECD Countries—Comparative Tables."

Note: The "OECD – Average" is a weighted average by GDP for all countries excluding the United States.

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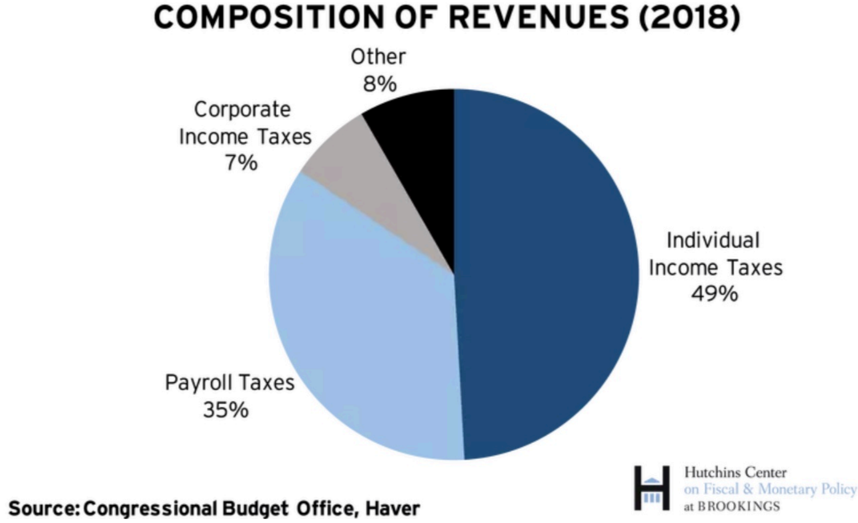
Where Do Government Revenues Come From?



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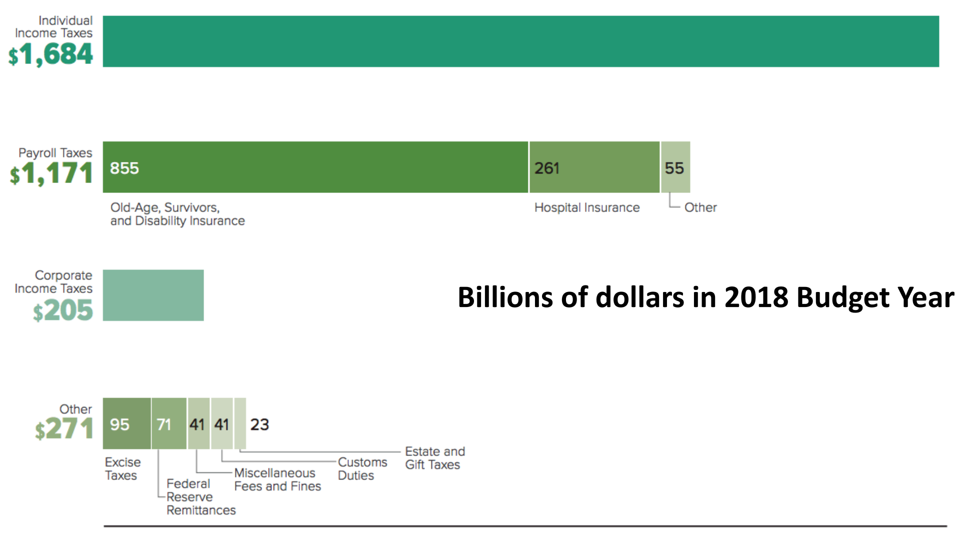
Where Do Government Revenues Come From?



Billions of dollars in 2018 Budget Year

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Source: CBO – Revenues in 2018: An Infographic

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Individual Income Taxes

- **Marginal tax rates**
- **Not all income is subject to the same tax rates**
  - capital gains
- **Deductions**
  - Talked about as Tax Expenditures

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Marginal Tax Rates: Married Filing Jointly

- **Income is taxed differently at different levels.**
- **Individuals are taxed the same way, regardless of overall income:**
  - First dollar is taxed at 10%
  - 19,401st dollar is taxed at 12%
  - Millionth dollar is taxed at 37%

Income Above	Tax Rate
0	10%
19,400	12%
78,590	22%
168,400	24%
321,450	32%
408,200	35%
612,350	37%

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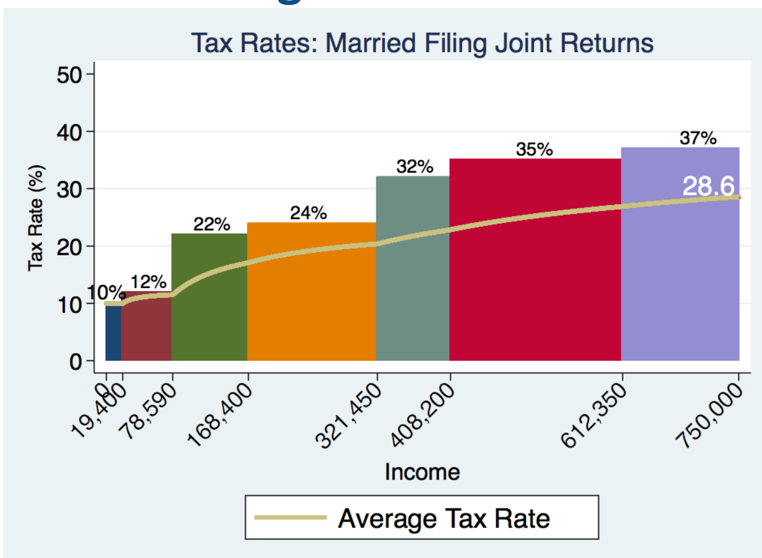
Marginal and Average Tax Rates: 2019



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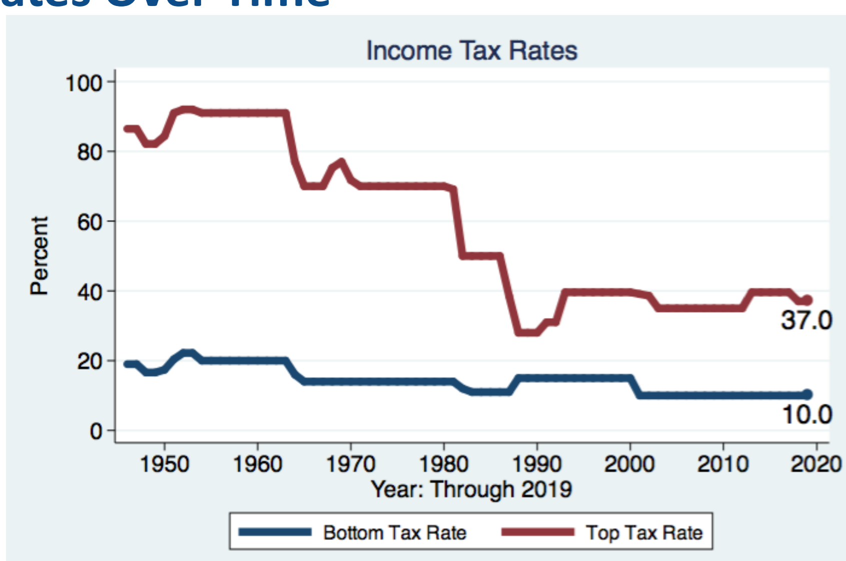
Source: IRS and Calculations by NEED

Tax Rates Over Time



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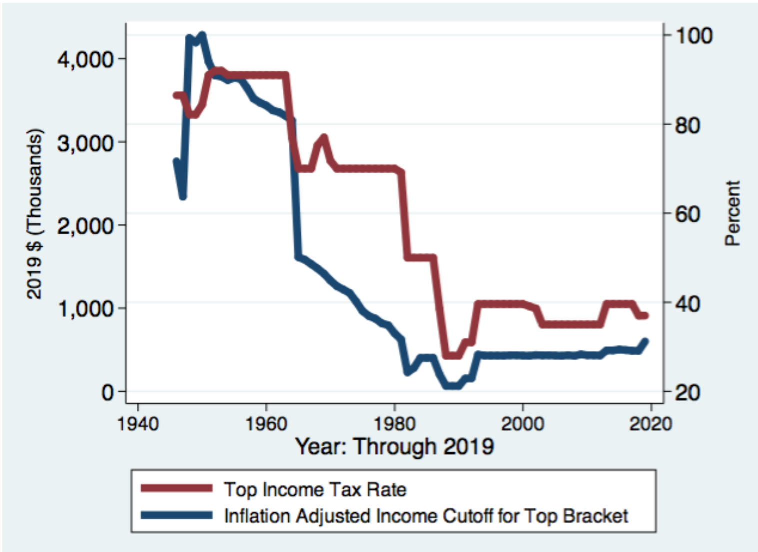
Income at Which Top Rate Kicks In



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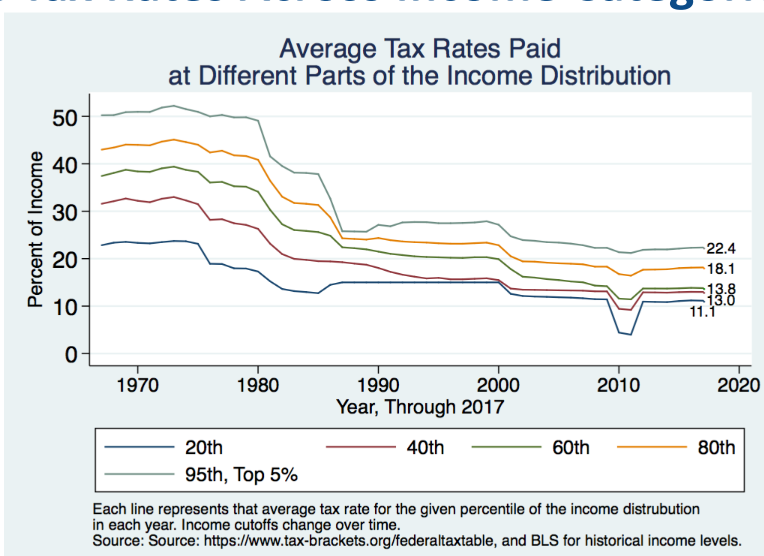
Average Tax Rates Across Income Categories



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We have a Progressive Tax System

- **Our options are:**
  - Progressive: increasing average tax with income
  - Neutral or flat: same share of income at all income levels
  - Regressive: decreasing average tax of income
- **Additional income is of greater consequence to those with lower incomes.**
- **Other parts of the tax system are regressive.**

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Capital Gains Taxes (2020)

- **Capital gains taxes can apply on investments, such as stocks or bonds, real estate (though usually not your home), cars, boats and other tangible items.**
- **Short term**
  - Held for more or less than a year – taxed as regular income.
- **Graduated rate – for long term capital gains**
  - 0% < $38,600
  - 15% $38,601 - $425,800
  - 20% $425,801+

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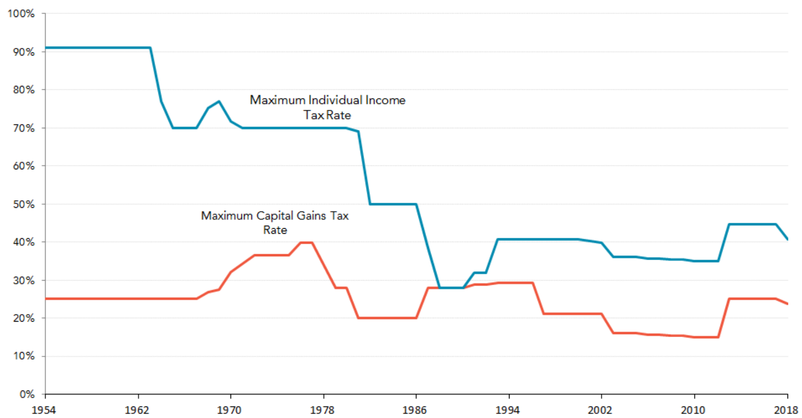
Capital Gains vs Income Taxes: Maximum Rates

FIGURE 1

Maximum Capital Gains and Individual Income Tax Rate

Tax years 1954–2018

TPC



Sources: US Department of the Treasury, Office of Tax Analysis (2016); Urban-Brookings Tax Policy Center calculations.
Note: The maximum rates include the 3.8 percent tax on net investment income (2013-) and adjusts for the phaseout of itemized deductions (1991–2009, 2013–2017).

Revenues: Other (8%)

- **Federal Reserve Remittances**
- **Miscellaneous Fees and Fines**
- **Customs Duties**
- **Estate and Gift Taxes**

- **Excise Taxes**
  - Motor fuel
  - Airline tickets
  - Tobacco
  - Alcohol
  - Health-related goods

Estate Taxes

- $23B in revenues in 2018
- Exemption: $11.4 million for singles $22.8 million for couples
- Tax rate: 40%
- Top 10% pay more than 90%, Top 1% pays nearly 40%
- 1,900 estates (0.1% of all estates)
- Businesses and farms: 140 subject to tax
  - **No** Small businesses or farms because of the $11.2 million exemption

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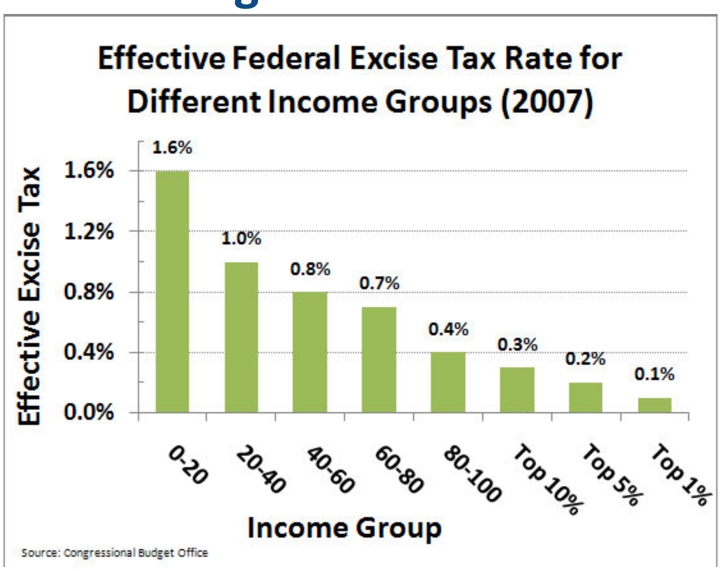
Excise Taxes are Regressive



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Revenue Sources: Share of GDP over Time

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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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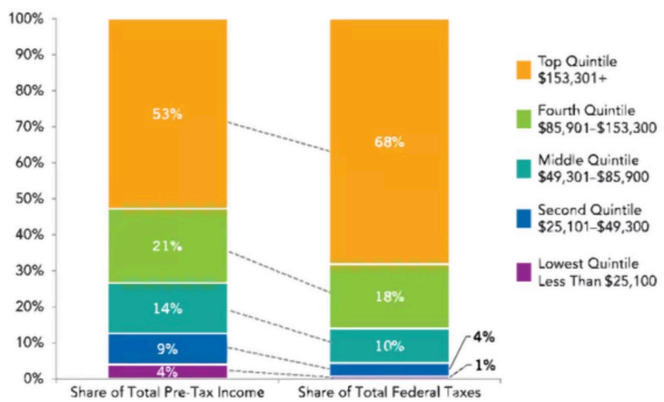
Who Pays?

The top 20% of households get more than half of all pre-tax income and pay an even larger share of all federal taxes



SOURCE: Tax Policy Center, *Baseline Distribution of Income and Federal Taxes*, August 2018. Data are for 2018. Compiled by PGPF.
NOTE: Federal taxes include excise tax, estate tax, corporate income tax, payroll tax, and individual income tax. Quintiles are defined by households' expanded cash income in 2018. Each quintile contains one fifth of the population.

PGPF.ORG

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The Bottom 40% Don't Pay Income Taxes

- There is a common narrative that the bottom 40% don't pay income taxes.
- But they pay other taxes and they also pay state and local taxes
  - Payroll
  - State and local taxes
  - Excise taxes – see the slide 4 slides ago
- Does it matter from what source tax revenues are derived?
- Should the income tax be used to make the system progressive?

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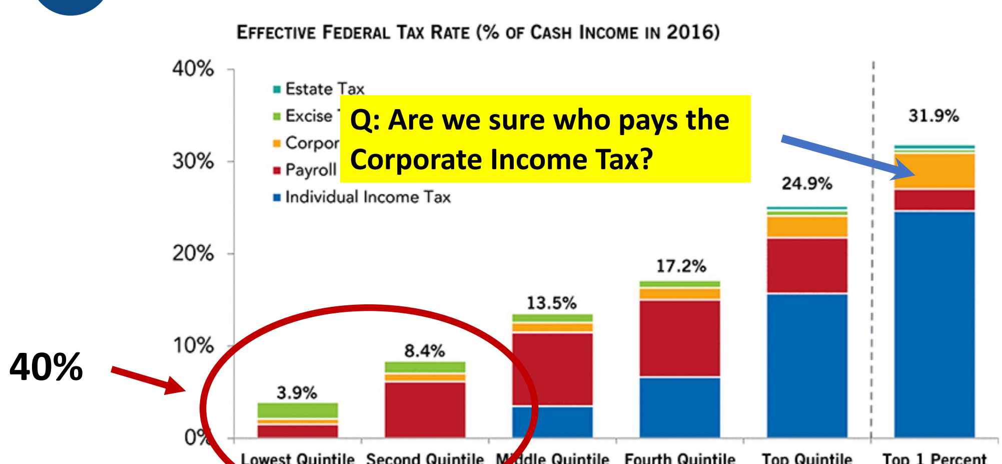
The Bottom 40% Does Pay Other Taxes



SOURCE: Tax Po[illegible] Center, *Effective Federal Tax R[illegible] By Expanded Cash Income Percentile,* March 2017. Data are for 2016. Compiled by PGPF.
NOTE: Individual income [illegible] rates for the l[illegible] and second lowest quintiles are negative and are netted against the payroll tax rate. A quintile is one fifth of the population. In 2017 dollars, the income breaks are: 20% $24,600; 40% $47,700; 60% $84,300; 80% $147,700; 99% $717,900. Includes both filing and non-filing units but excludes those that are dependents of other tax units.

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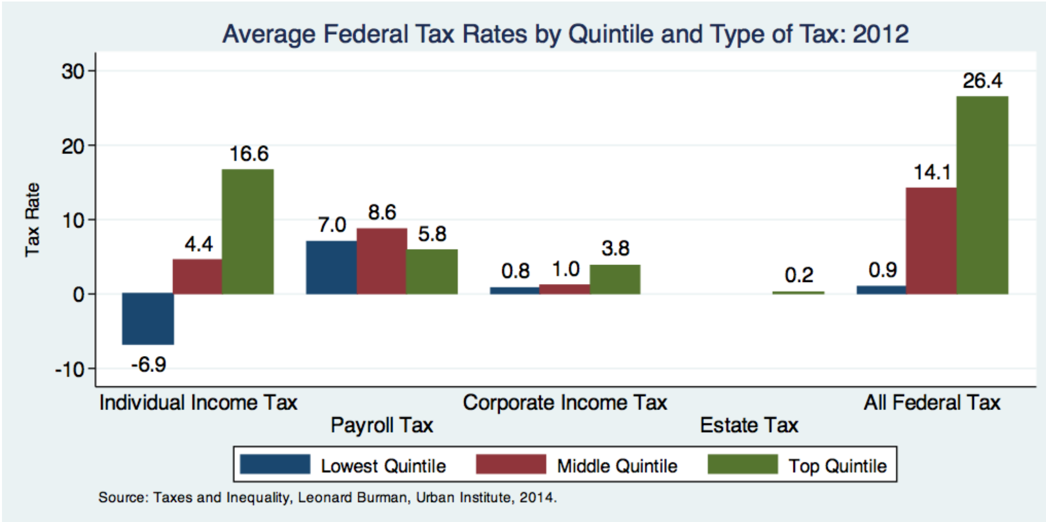
Regressivity in Federal Taxes?



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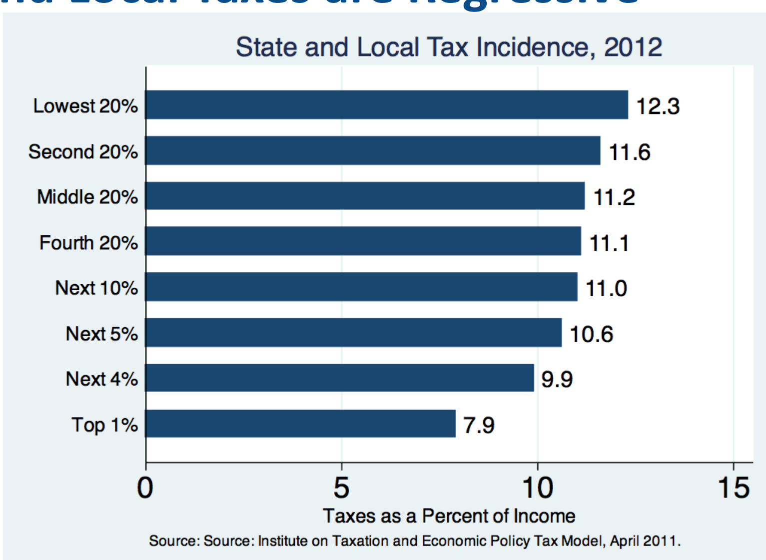
State and Local Taxes are Regressive



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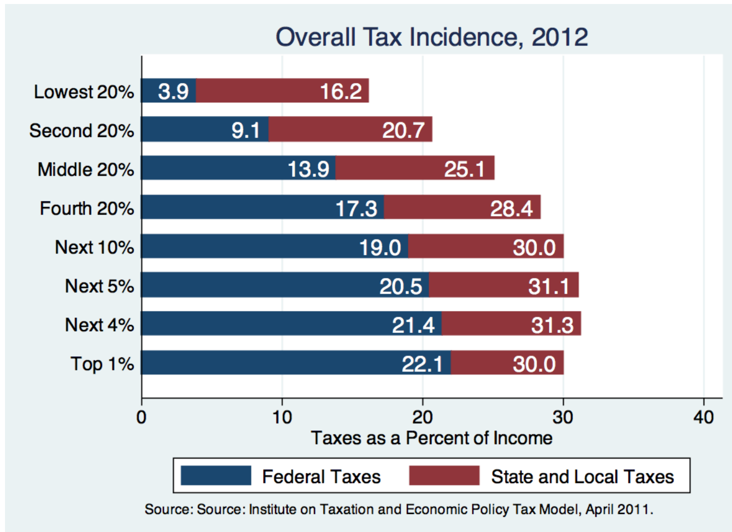
Overall, Taxes are (mostly) Progressive



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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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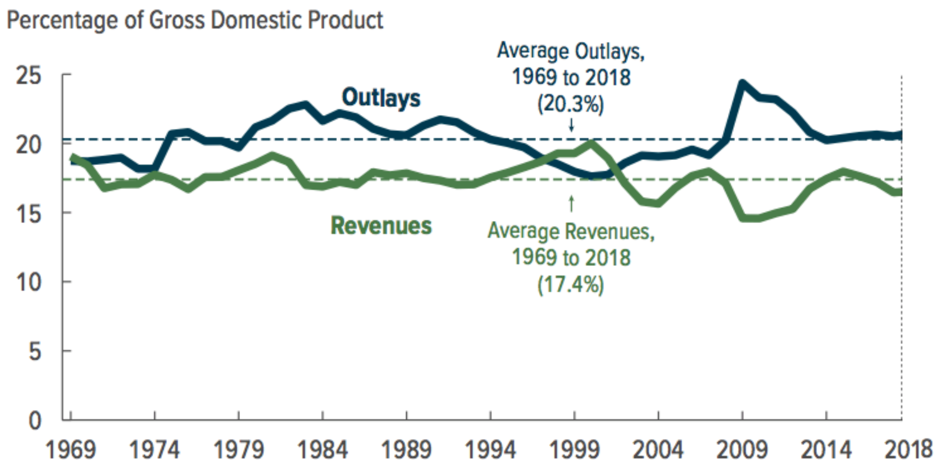
How has the Size of Government Changed?



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Budget Summary: Slide 1

- **Total Spending: $4.4 Trillion in 2019**
- **There is remarkably little discretion in the budget:**
  - Mandatory: 69%
  - Discretionary 31%
- **Fastest growing parts of the budget: Health Care and Interest**
- **By 2050:**
  - Debt is forecast to grow to 180% of GDP, from 80% today
  - Interest payments are forecast to grow from 8% to 22% of budget

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Budget Summary: Slide 2

- **Categories that get a lot of attention are relatively small**
  - Foreign Aid: 1% of the budget
  - Income support/welfare: 7-12% of the budget
- **Or are not forecast to grow significantly**
  - Social security
  - Most other categories of spending

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Budget Summary Slide: Tax Expenditures

- **Are policy enacted through the tax code.**
- **Are not explicitly on the books.**
- **They add > 25% to actual government expenditures.**
- **Reduce the progressive nature of the tax code.**
- **Are larger than all of "Discretionary Spending".**

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Government Debt

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How Does the U.S. Government Borrow?

- **It issues debt**
  - Treasury marketable securities:
    - Treasury bills, notes, and bonds
    - TIPS: Treasury inflation-protected securities
- **Who buys the debt?**
  - Other federal government agencies
  - Individuals and businesses
  - State and local governments
  - People, businesses, and governments from other countries.

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Of Debt, Deficits, and Surpluses

- **FLOW**
  - ***Deficit***: The amount of debt accrued in a single year.
  - ***Surplus***: The excess of revenues over expenses in a single year.
- **STOCK**
  - ***Debt***: The accumulation of debt over time.
    - The sum of all past deficits and surpluses.

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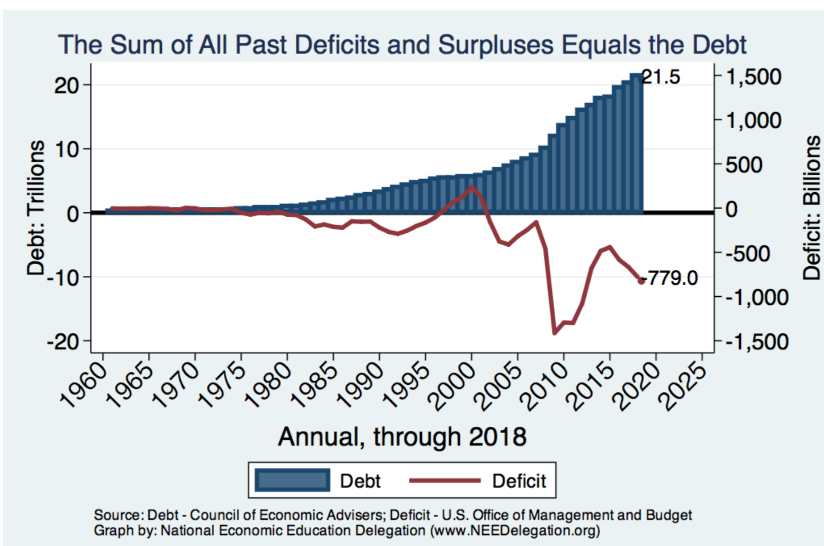
Debt vs. Deficit



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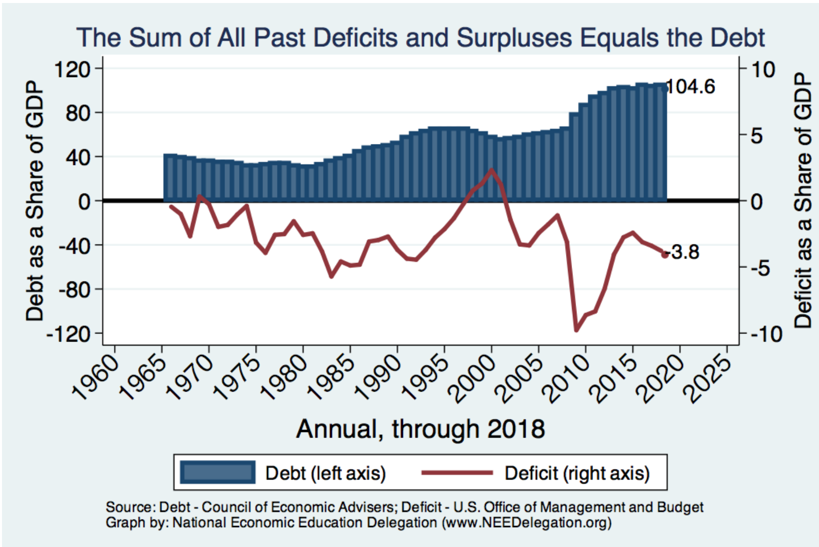
Debt vs. Deficit: Share of GDP



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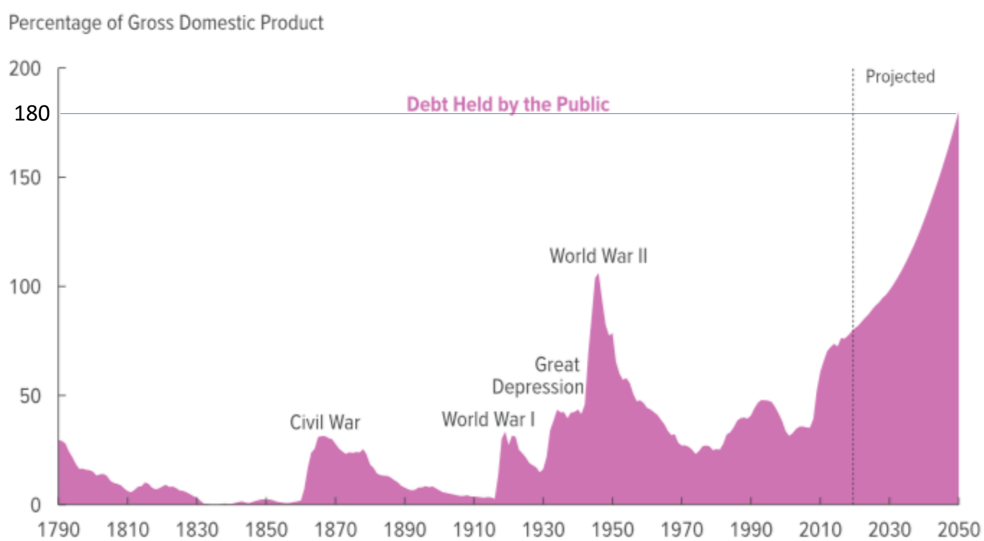
Record Levels of Debt are Forecast



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Source: Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030

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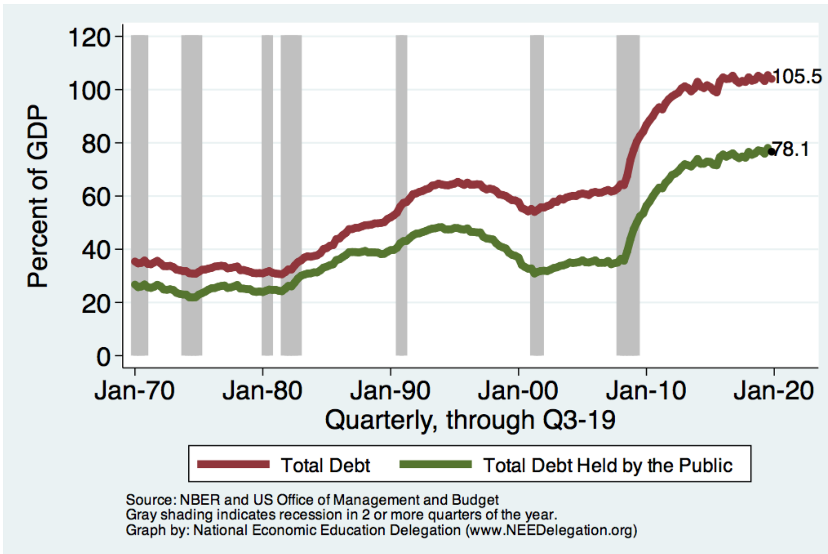
Two Measures of the Debt



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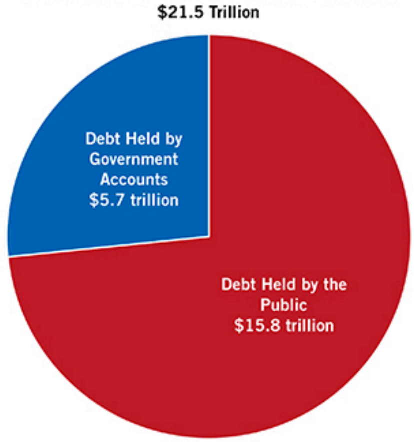
PETER G. PETERSON FOUNDATION

What makes up gross federal debt?

Gross Federal Debt at the End of Fiscal Year 2018: $21.5 Trillion



SOURCE: Department of Treasury, *Monthly Treasury Statement*, issue for September 2018. Compiled by PGPF.

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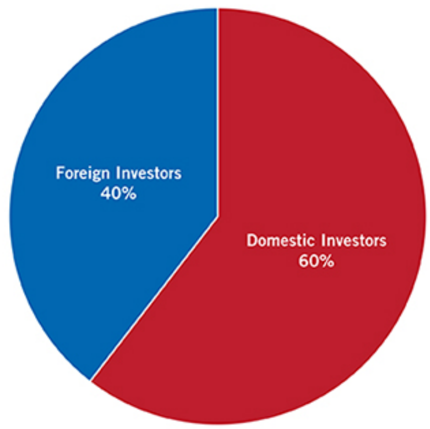
PETER G. PETERSON FOUNDATION

Foreign investors own over one-third of all U.S. public debt



SOURCE: Department of the Treasury, *Monthly Treasury Statement*, issue for September 2018; and Department of Treasury, *Treasury Bulletin*, December 2018. Compiled by PGPF.

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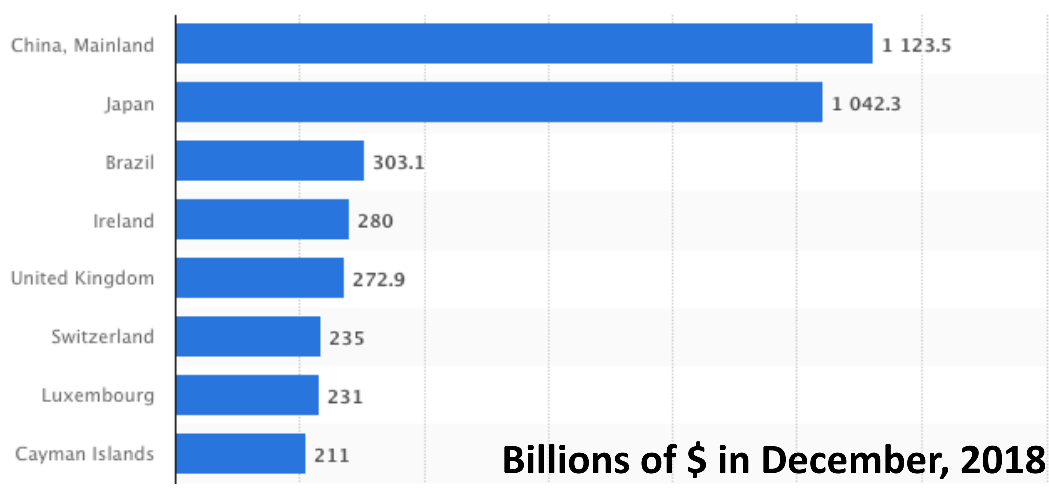
Who Holds Debt to Foreigners



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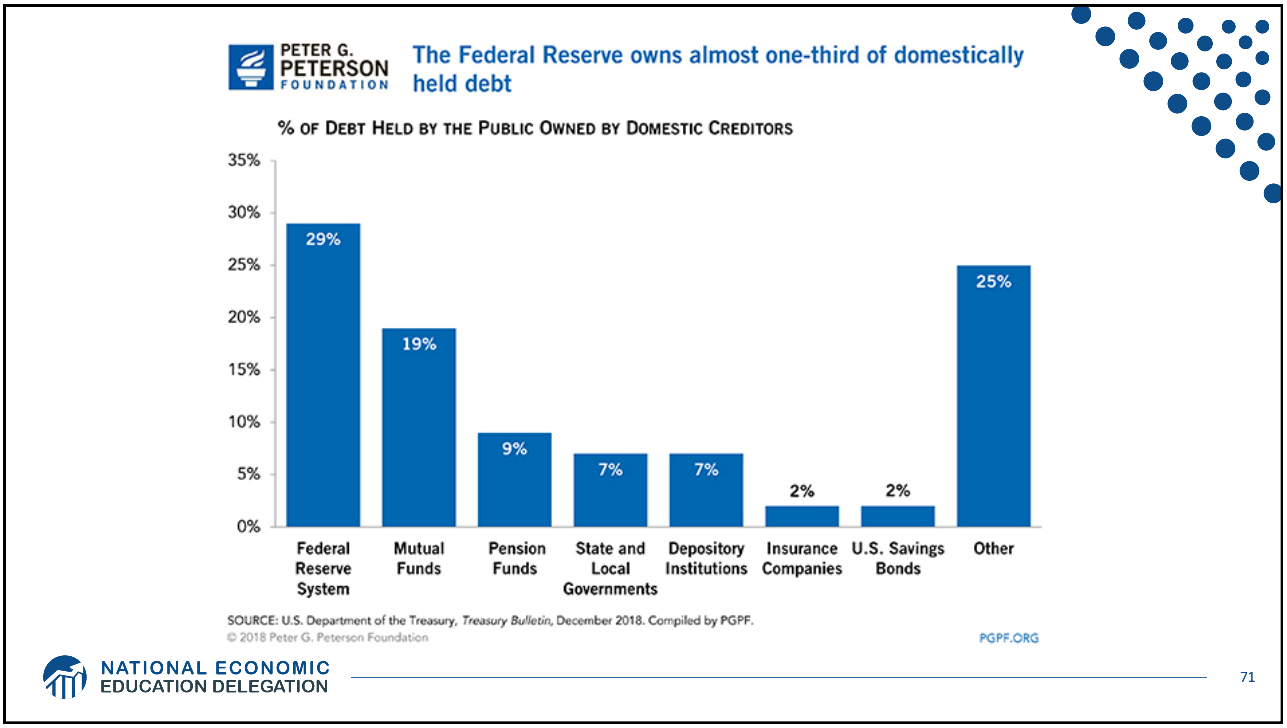
PETER G. PETERSON FOUNDATION
The Federal Reserve owns almost one-third of domestically held debt
% OF DEBT HELD BY THE PUBLIC OWNED BY DOMESTIC CREDITORS
35%
30%
25%
20%
15%
10%
5%
0%
29%
19%
9%
7%
7%
2%
2%
25%
Federal Reserve System
Mutual Funds
Pension Funds
State and Local Governments
Depository Institutions
Insurance Companies
U.S. Savings Bonds
Other
SOURCE: U.S. Department of the Treasury, Treasury Bulletin, December 2018. Compiled by PGPF.
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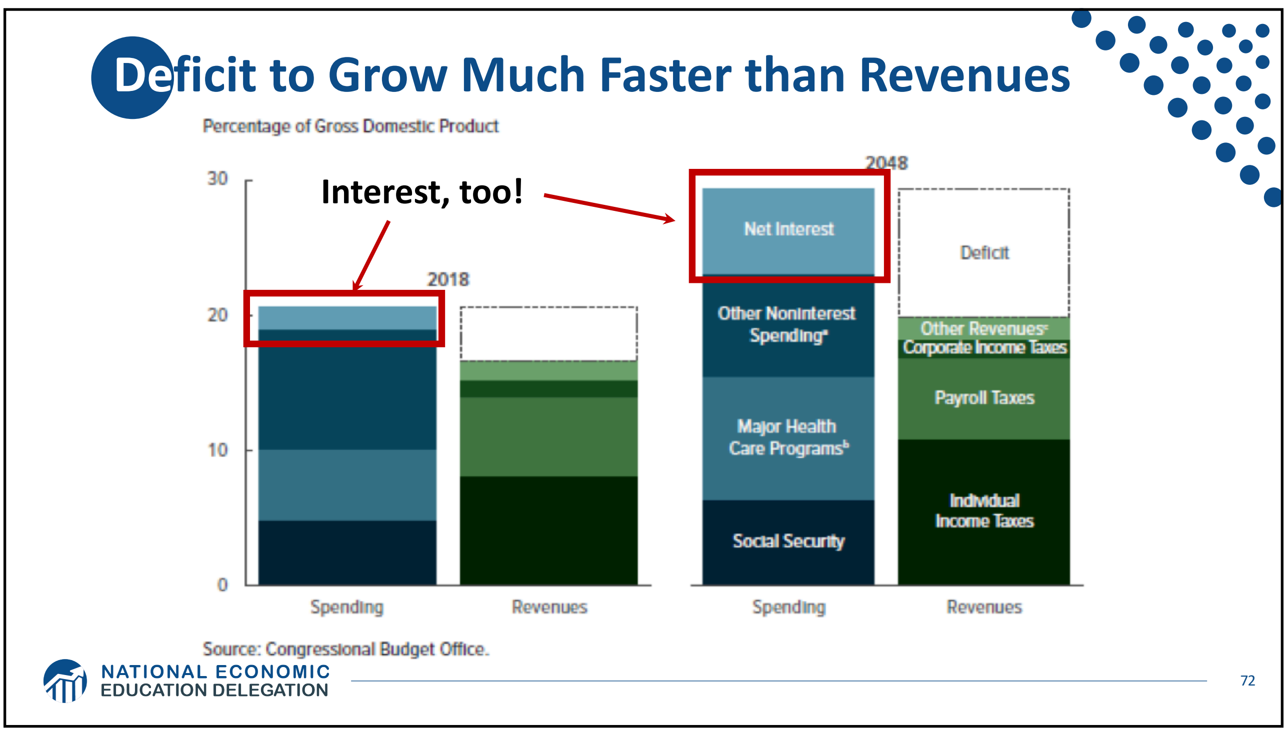
Deficit to Grow Much Faster than Revenues
Percentage of Gross Domestic Product
Interest, too!
2018
2048
30
20
10
0
Net Interest
Deficit
Other Noninterest Spending
Other Revenues
Corporate Income Taxes
Payroll Taxes
Major Health Care Programs
Individual Income Taxes
Social Security
Spending
Revenues
Spending
Revenues
Source: Congressional Budget Office.
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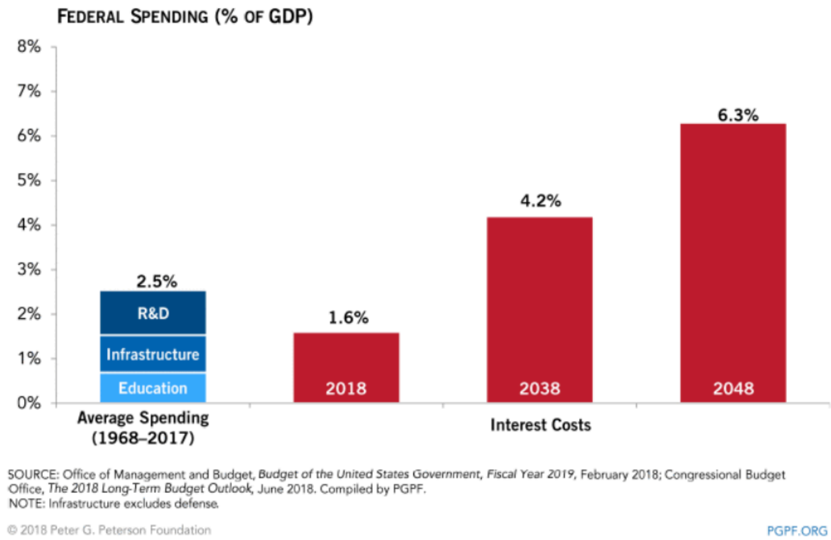
Interest Payments to Grow Significantly



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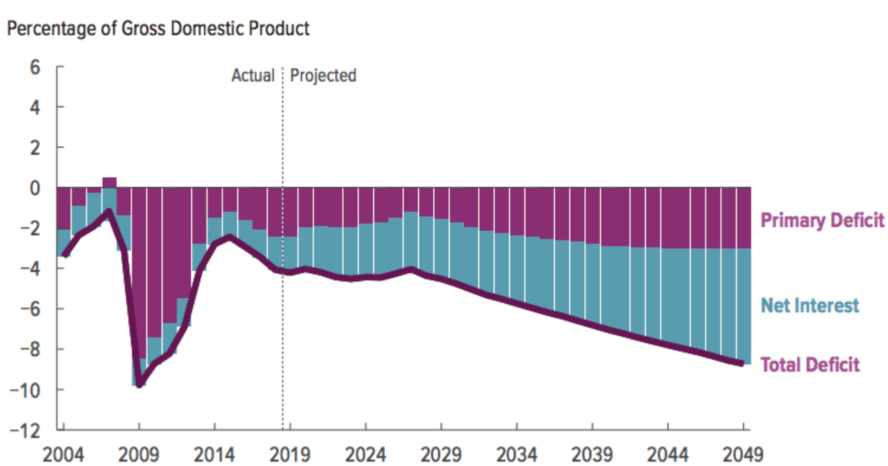
Interest Will Start to Drive Growth in Deficit



Deficits grow from 4.2 percent of GDP in 2019 to 8.7 percent in 2049, driving up debt. Net spending for interest on debt accounts for most of the growth in total deficits.

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Perspectives on Increased Debt

- **Government borrowing crowds out private capital and investments.**
  - Weakened by ability to borrow from abroad
- **It is reasonable to borrow at low interest rates for investments.**
  - For example, infrastructure
- **Debt imposes a burden on future generations.**
  - Does it inevitably have to be paid off?
- **In time, it will start to crowd out other government spending.**
  - Diminishing policy priorities in the budget.

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The Reason for Borrowing Matters

- **Two good reasons to borrow heavily:**
  - To ***support the economy*** during a recession – fiscal expansion.
  - ***Investments*** that will increase economic activity in the future.
- **Should not borrow for:**
  - Items consumed today
    - Government salaries
    - Retirement benefits
  - Tax breaks of uncertain benefit to the economy.

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Is the Debt a Problem Today?

- **Currently borrow about $100 billion each month with little difficulty.**
- **Interest rates are very low, less than 2% on 10-year notes.**
- **Very little evidence of "crowding out".**

So, Why Worry About it?

- **If debt gets too high:**
  - There is the potential for investors to start questioning the creditworthiness of the U.S. Government.
    - Problem: Nobody knows how high might be too high?
  - It becomes more difficult to borrow in times of crisis.
    - War, severe recession
    - "Fiscal space" – impossible to measure how much we have, but clear that we have less now than back in 2007.
  - Could start to crowd out investments by consumers and businesses.
    - Not currently a problem. No idea if/when it might be come one.
  - Could be inflationary.

So, Why Worry About it?

- **If debt continues to grow:**
  - Interest payments will grow with it.
    - 8% of spending in 2018.
    - 22% of spending in 2050.
    - Less room for using the budget for policy priorities.
    - 40% of payments go abroad.
  - The longer we wait to address it, the harder and more disruptive it will be to address it.
  - Interest rates may increase.

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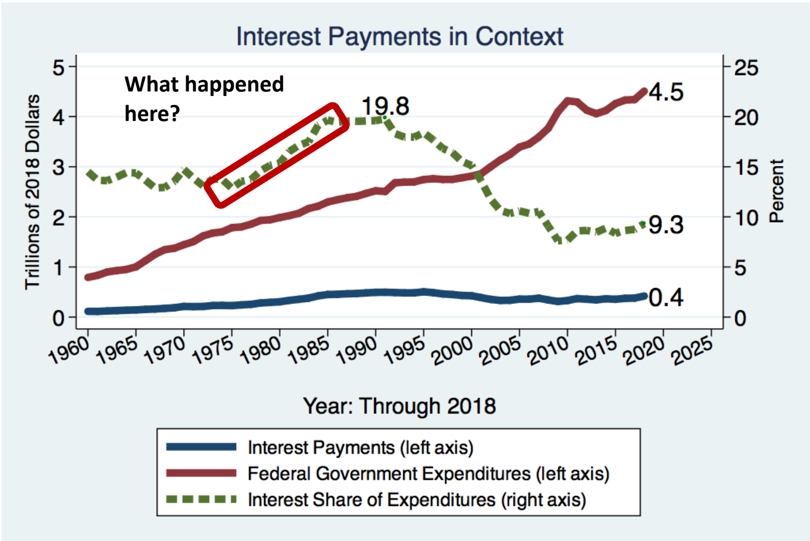
History: A Cautionary Tale?



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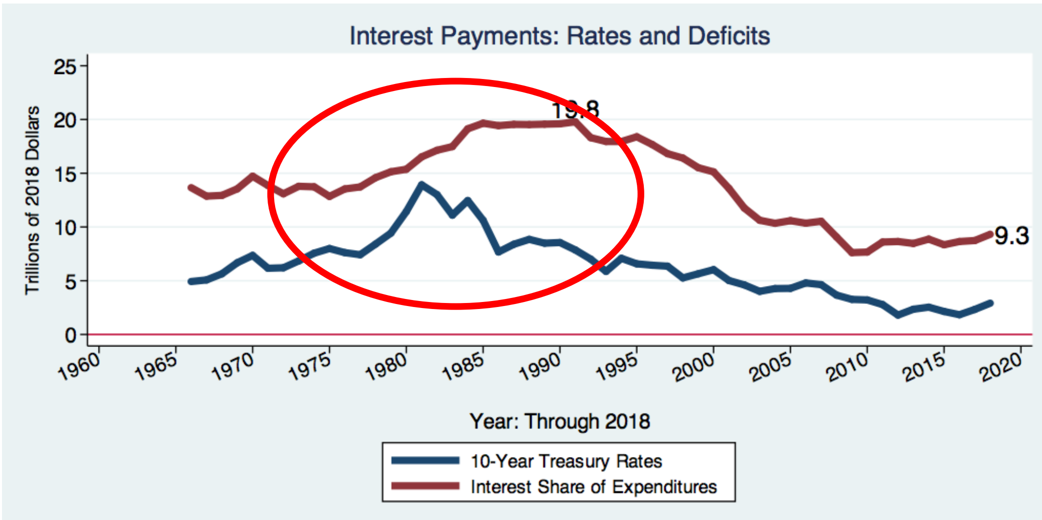
Interest Payments and Interest Rates



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Are There Reasons to Wait?

- **Very little evidence of:**
  - Crowding out
  - Inflationary impact
- **Uncertainty about the future**
  - Economic growth may render action today unnecessary.
- **There are a great many investments to be made by the gov't.**
  - Infrastructure
  - Education
  - Much, much more…

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Bottom Line

- Question is not ***WHETHER*** the U.S. will have to act…

  …but ***WHEN***.

- Some combination of the following ***WILL*** be necessary:
  - **Raising taxes**
  - **Cutting spending**
  - **Reining in health care costs**

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Proposals Do Exist

- **Simpson-Bowles**
- **Domenici-Rivlin Task Force**
- **Solutions Initiative – Peter G. Peterson Foundation**
  - American Action Forum
  - American Enterprise Institute
  - Bipartisan Policy Center
  - Center for American Progress
  - Economic Policy Institute

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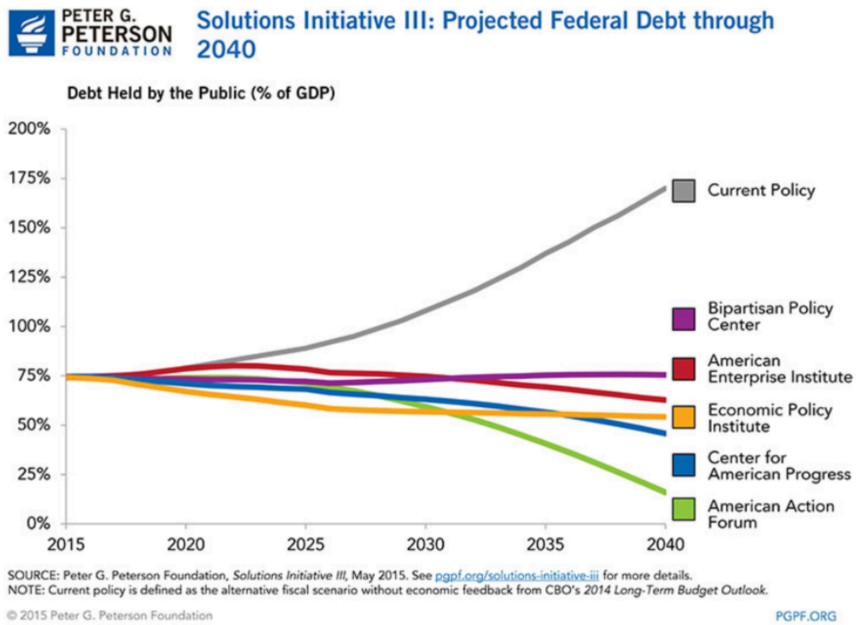

Summary: The Debt

- **The jury is (sort of) out on the debt.**
- **Conventional wisdom is being challenged:**
  - Previously: inflationary and crowd out private investment
  - New assertion: these things don't matter for a country that can borrow in its own currency.
- **Upshot?**
  - This is a policy choice.
  - The cautious approach is to rein in the debt.
  - The cautious approach may lead to slower economic growth.

Summary

- **Debt: $22.9 Trillion**
- **Deficits drive growth in the debt.**
  - Likely greater than $1 Trillion per year.
- **Publicly held debt matters most.**
  - Will grow from 81% of GDP today to 180% in 2049.
- **Multiple ways to offset this growth.**
- **Growing interest payments can be a real problem.**

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Summary: Address The Debt?

- **Risks:**
  - Inflation
  - Slower economic growth
    - Higher interest rates
    - Crowding out
  - Default

- **Reasons to wait:**
  - Interest rates are very low
  - Lots of important investments to make
  - Economic growth may take care of it

And then there is: Modern Monetary Theory

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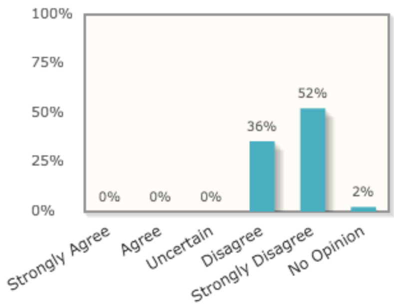
General Sense on Modern Monetary Theory

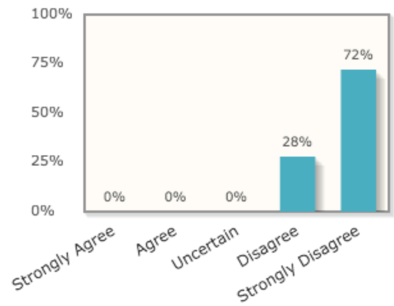
Question A: Countries that borrow in their own currency should not worry about government deficits because they can always create money to finance their debt.

Responses



Source: IGM Economic Experts Panel
www.igmchicago.org/igm-economic-experts-panel

Responses weighted by each expert's confidence



Source: IGM Economic Experts Panel
www.igmchicago.org/igm-economic-experts-panel

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Thank you!

Any Questions?

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