The Budget: The Politics of Taxing and Spending
American Economy

• Based on the principles of capitalism & laissez-faire

• Reality - mixed economy
  – government plays a regulatory role.
Federal Revenue and Borrowing

Sources of Federal Tax Revenue, 2014

- Corporate Income Tax: 11%
- Payroll Tax: 34%
- Income Tax: 46%
- Excise, Estate, and Other Taxes: 9%

Note: “Other Taxes” category includes profits on assets held by the federal reserve.
Source: Office of Management and Budget

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG
FIGURE 13.1 The federal budget: An overview

$3.337 trillion

$3.901 trillion

Expenditures minus revenues

$564 billion

Deficit

Added to national debt

National debt $18.713 trillion
Personal and Corporate Income Tax

- Sixteenth Amendment (1913)
  - IRS
  - 140 million individual income tax returns
  - Income tax is progressive
  - 10-39.6% current tax rates
Who pays taxes?
- 42% paid no taxes
- 1% paid 37%
- 10% paid 70%
- Bottom 50% paid 2%

The flat tax
• Graduated income tax
  – Used to redistribute wealth
    • Wealthiest pay more in taxes
• **Progressive taxation** - taxation that hits upper income brackets more heavily.
  • Graduated income tax
• **Regressive taxation** - taxation that hits lower income brackets more heavily.
  • Sales tax
Monetary Policies

• Regulate economy through manipulation of supply of money and credit.

• Federal Reserve System
  – 12 Federal Reserve Banks
    • Regulates member banks
    • Affect supply of money and credit
    • Fight inflation & deflation in economy.
Fiscal Policies

• Government’s use of taxation and spending to affect the economy.
  – regulating expenditures through the federal budget
  – determined by Congress and President

• Two Theories
  – Keynesian economic theory
  – Supply- side economics
Keynesian Economic Theory (Liberal)

- Encourages governments active participation in economy
- Expansionary Fiscal Policy
  - Government spending stimulates economy by creating demand
  - Cutting taxes is another way the government can create demand
- Contractionary Fiscal Policy
  - Government can decrease demand by cutting spending and increasing taxes
Supply- Side Economics (Conservative)

- Decreasing government involvement economy
  - People will be forced to work and save more
- Cutting taxes increases the money supply
FIGURE 13.2  Federal revenues

- Individual income taxes
- Corporation income taxes
- Excise taxes and other receipts
- Social insurance taxes and contributions
- ESTIMATES for 2014–2015

YEAR
1970  '72  '74  '76  '78  '80  '82  '84  '86  '88  '90  '92  '94  '96  '98  '00  '02  '04  '06  '08  '10  '12  '14

BILLIONS OF DOLLARS
0  200  400  600  800  1,000  1,200  1,400  1,600  1,800  2,000  2,200  2,400  2,600  2,800  3,000  3,200  3,400
U.S. Budget

• Government spending and budgeting decisions
  – Large impact on economy.
• Government directs resources toward certain sectors or problems
• Government’s budget deficit
  – Affects long-term growth & interest rates
Uncontrollables

• Budgetary items that are beyond the control of budgetary committees

• Controlled only by substantive legislative action in Congress

• Some uncontrollables beyond power of Congress
  – Interest on debt
    • terms of payments are set in contracts.
ANALYZING THE EVIDENCE

Mandatory (or “uncontrollable”) spending has been growing for nearly half a century, both in actual dollars and as a percentage of the total budget. Are “uncontrollable” expenditures really uncontrollable?


*Data for 2007 and 2008 are estimates.

FIGURE 14.2 Uncontrollables as a Percentage of the Total Federal Budget
Social Insurance Taxes

- Social Security
- Medicare
  - Both matched by employers
- Provide 1/3 of federal revenue
Borrowing

- Tax revenue does not cover expenditures
- Bonds
  - Sold by Treasury Department
- Borrowing from itself
  - Intra governmental debt
Borrowing

- National debt is about $18.2 trillion
  - 6% of federal spending are interest payments
  - Debt ceiling
  - Spending increases when revenue declines
FIGURE 13.3  Total national debt

- Financial crisis
- Bush tax cuts
- Reagan tax cut and defense increase are implemented

BILLIONS OF DOLLARS

YEAR

1970  '72  '74  '76  '78  '80  '82  '84  '86  '88  '90  '92  '94  '96  '98  '00  '02  '04  '06  '08  '10  '12  '14

ESTIMATE for 2014–2015
Taxes and Public Policy

- Tax expenditures
  - Charitable contributions
  - Mortgage interest
  - Business equipment
  - Benefit the wealthy and businesses

- Tax reduction
  - Popular with voters
  - Benefits the wealthy
TABLE 13.1  Tax expenditures: The money government does not collect

<table>
<thead>
<tr>
<th>Tax Expenditure</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exclusion of employer contributions to health care and insurance</td>
<td>$207 billion</td>
</tr>
<tr>
<td>Exclusion of net imputed rental income</td>
<td>$80 billion</td>
</tr>
<tr>
<td>Deduction of mortgage interest on owner-occupied houses</td>
<td>$74 billion</td>
</tr>
<tr>
<td>Deductions for state and local taxes</td>
<td>$67 billion</td>
</tr>
<tr>
<td>Capital gains (nonhome, agriculture, or mining)</td>
<td>$69 billion</td>
</tr>
<tr>
<td>Deferral of income from controlled foreign corporations</td>
<td>$76 billion</td>
</tr>
<tr>
<td>Deductions for charitable contributions</td>
<td>$58 billion</td>
</tr>
<tr>
<td>Exclusion of capital gains on home sales</td>
<td>$57 billion</td>
</tr>
<tr>
<td>Exclusion of Social Security and disability benefits</td>
<td>$39 billion</td>
</tr>
<tr>
<td>Exclusion for interest earned on state and local government bonds</td>
<td>$35 billion</td>
</tr>
<tr>
<td>Exclusion of capital gains on home sales</td>
<td>$57 billion</td>
</tr>
<tr>
<td>Capital gains at death</td>
<td>$32 billion</td>
</tr>
<tr>
<td>Treatment of qualified dividends</td>
<td>$27 billion</td>
</tr>
<tr>
<td>Child credit</td>
<td>$24 billion</td>
</tr>
<tr>
<td>Exclusion of interest on life insurance savings</td>
<td>$23 billion</td>
</tr>
</tbody>
</table>
13.1 What percentage of federal spending is simply interest payments on the national debt?

a. 6%

b. 3%

c. 11%

d. None
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Federal Expenditures

Total Federal Spending 2015: $3.9 trillion

- Military: $648 billion (16.3%)
- Medicare & Health: $1.05 trillion (26.6%)
- Social Security, Unemployment & Labor: $1.33 trillion (33.6%)
- Interest on Debt: $251 billion (6.3%)
- Veterans Benefits: $161 billion (4.1%)
- Food & Agriculture: $130 billion (3.3%)
- Transportation: $103 billion (2.6%)
- Housing & Community: $102 billion (2.6%)
- Education: $80.9 billion (2.0%)
- Energy & Environment: $44.5 billion (1.1%)
- Science: $29.3 billion (0.7%)
- International Affairs: $27.2 billion (0.7%)
- Government: $2.7 billion (0.1%)

Data source: OMB, National Priorities Project
FIGURE 13.4 Federal expenditures

ESTIMATES for 2014–2015

Billions of dollars

Year

1967 '70 '75 '80 '85 '90 '95 '00 '05 '10 '15

National defense

Payments for individuals

Other nondefense

Net interest
Big Governments, Big Budgets

- Big government needs big money
  - 1/3 of GDP is govt. spending

- Why has government grown?
  - Public demand
  - Changes in economy
  - Changes in social conditions
  - Economic downturns
  - Urbanization
  - Pollution
The Rise of the National Security State

- Permanent military establishment
  - Cold War
  - Military-industrial complex

- DoD spending half of federal budget during Cold War
  - Decreased until 9/11
  - 1/5 of federal budget today

- Military expenses
  - 7 million pensions
  - Procurement
  - Cost overruns
FIGURE 13.5  Trends in national defense spending

- **Reagan defense buildup begins**
- **Vietnam War buildup begins**
- **End of the Cold War**
- **War on terrorism begins**

**Current dollars**

**Constant dollars (2005)**
The Rise of the Social Service State

- Income security expenditures
  - Social Security
  - Medicare
  - Intergenerational contract
  - More beneficiaries than workers
FIGURE 13.6 Trends in social service spending
Incrementalism

- Best predictor of this year's budget is last year's
  - Incremental increase for each agency
- Exceptions
"Uncontrollable" Expenditures

- Why is the budget uncontrollable?
- 2/3 of budget automatic
  - Interest
"Uncontrollable" Expenditures

- 2/3 of budget automatic
  - Interest
  - Entitlements
13.2 Why does the federal government have so little discretion over its own budget?

a. Federal law forbids Congress from tampering with president's budget

b. The president is obliged by the Constitution to sign whatever budget bill Congress sends him

c. Entitlements create uncontrollable obligations

d. All of the above
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The Budgetary Process

President's Proposed $4.1 Trillion Total Spending Budget (FY 2016)

- Education: $78.9 billion - 2%
- Housing & Community: $92.7 billion - 2%
- Transportation: $107.8 billion - 3%
- Food & Agriculture: $139.7 billion - 3%
- Veterans' Benefits: $165.8 billion - 4%
- Interest on Debt: $283 billion - 7%
- Military: $534.2 billion - 16%
- Medicare & Health: $1,106 billion - 27%
- International Affairs: $33.5 billion - 1%
- Science: $31.1 billion - 1%
- Social Security, Unemployment & Labor: $1,365.1 billion - 33%

Source: CBO, National Priorities Project

The Congressional Budget Process

Senate
- Bill introduced
- Committee hearing
- Floor action
- Conference committee
- Bill sent to President
- Budget resolution
- Concurrent budget resolution
- Budget resolution

House
- Bill introduced
- Full committee markup
- Floor action
- Calendar
- Budget resolution
- Concurrent budget resolution
- Budget resolution
Budgetary Politics

- **Stakes and strategies**
  - "Who gets what, when, and how"
  - Actors adopt strategies

- **Players**
  - Large cast
  - Roles carefully scripted
FIGURE 13.7  The players in the budgetary process
The President's Budget

- Presidents used to play limited role
  - Budget and Accounting Act
  - Prepares budget with help of OMB

- Budget schedule
  - Due first Monday in February
  - Process begins a year in advance
Congress and the Budget

- Power of the purse
- Budget resolution
  - Reconciliation
  - Authorization bills
  - Appropriations bills
  - Continuing resolutions
FIGURE 13.8  The budget process

**Prior Year**

**Spring**
- OMB and president discuss budgetary outlook and policies.
- OMB gives guidelines to agencies.
- Agencies submit projections of budgetary needs to OMB.
- OMB prepares recommendations for president on final policies, programs, and budget levels.
- President establishes guidelines and targets for agencies.

**Summer**
- Budget decisions conveyed to agencies:
  - OMB conveys president's guidelines and targets to agencies.
  - Agencies prepare budgets, with advice and assistance from OMB.

**Fall**
- Agencies' budgets submitted and reviewed:
  - Agencies submit formal budget estimates to OMB for coming fiscal year, with projections for future years.
  - OMB holds hearings, reviews its economic assessments, and prepares budget recommendations for president.
  - President reviews OMB's recommendations and decides on agencies' budgets and an overall budgetary policy.
  - OMB advises agencies of president's decisions.

**Winter**
- President's budget determined and submitted:
  - Agencies revise their estimates to conform with president's decisions.
  - OMB again reviews economic situation and then drafts president's budget message and prepares budget document.
  - President reviews and approves budget message and transmits budget document to Congress.

**Congressional Budget Process:**
**Targets and Timelines**

**Current Year**

- First Monday in February:
  - Congress receives president's budget.
  - Congressional Budget Office submits budget report to House and Senate Budget Committees, including analysis of president's budget.

- February 15:
  - Congressional Budget Committees report concurrent resolution on budget.
  - Setting total for budget outlays, estimate of expenditures for major budget categories, and recommended level of revenues. This resolution acts as agenda for remainder of budgetary process.

- February 25:
  - Other committees submit reports on outlays and revenues to Budget Committees in each house.
  - Congress completes action on concurrent resolution on the budget.

- April 1:
  - Budget Committees report concurrent resolution on budget.
  - Congress completes action on concurrent resolution on budget.

- April 15:
  - Congress completes action on concurrent resolution on the budget.

- May 15:
  - Annual appropriations bills may be considered in House.
  - House Appropriations Committee reports last annual appropriations bill.

- June 10:
  - House Appropriations Committee reports last annual appropriations bill.

- June 15:
  - Congress completes action on reconciliation legislation, bringing budget totals into conformity with established ceilings.

- June 20:
  - House completes action on annual appropriations bills.

- October 1:
  - New fiscal year begins.
FIGURE 13.9 Fluctuating deficits
13.3 What type of bill must follow an authorization bill?

a. Continuing resolution
b. Reconciliation bill
c. Appropriations bill
d. None of the above
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a. Continuing resolution
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Understanding Budgeting
Democracy and Budgeting

- Growth in government tied to democracy
- Do elites oppose big government?
  - Bailouts
  - Contracts and subsidies
- Interest groups want their piece, too
- Americans tax and spend less
- Americans want lower taxes but more pork
  - Deficits result
The Budget and the Scope of Government

- The budget is the scope of government
  - When country has need, government pays

- Politics of scarcity
  - Never enough funds
What feature of American government tends to promote its growth?

a. Republicanism
b. Federalism
c. Democracy
d. All of the above
13.4 What feature of American government tends to promote its growth?

a. Republicanism

b. Federalism

c. Democracy

d. All of the above