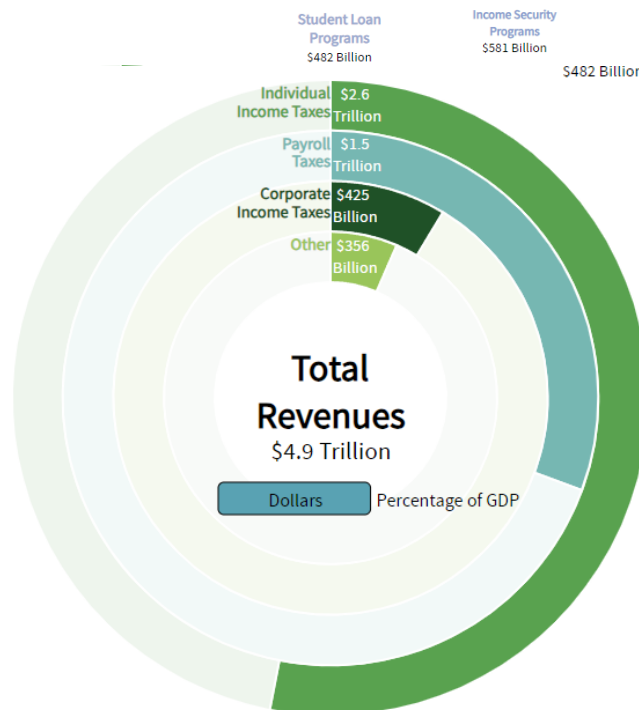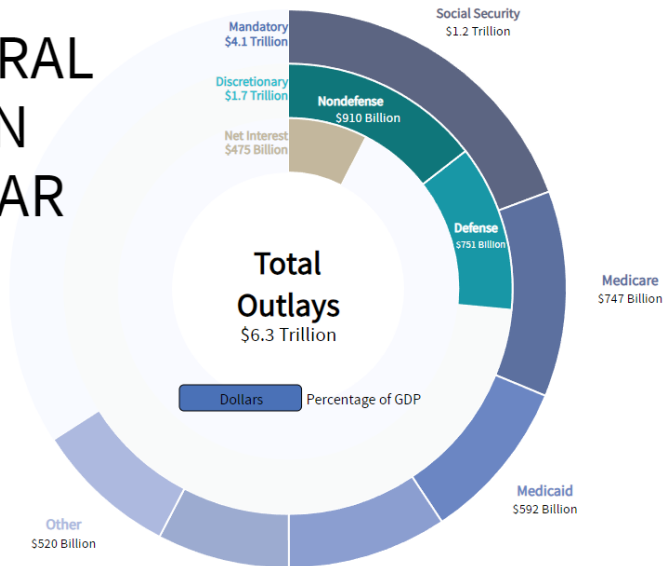David Youngberg
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TOPIC 14: THE GOVERNMENT BUDGET II

I. Outlays (spending)
   a. There are two major types of government spending: mandatory and discretionary.
   b. Mandatory is spending the government has to spend due to statutory criteria and do not have set limits. These are called entitlements—government benefits with guaranteed access assuming you meet the criteria.
      i. Social Security, Medicare, welfare, food stamps are all examples of entitlements.
   c. Discretionary spending is the spending the government decides on with explicit numbers attached. When Congress decides on a budget, this is what they're deciding on. It includes defense and nondefense spending and there are roughly equal shares of each.
      i. Nondefense spending includes funding for NASA, the National Institutes of Health, veterans' health care, transportation, etc.
   d. Both mandatory and discretionary spending include *transfers*—money the government spends on others but doesn't get anything in return. Medicare, farm subsidies, unemployment insurance are all transfers. Buying fighter jet, building a road, and doing medical research at NIH are not transfers.
II. Of debt and deficits
   a. The government spends more than it takes in from taxes. This is called a deficit (when spending for a year exceed revenue for a year).
III. The government borrows money to make up the difference (these are government bonds) and this borrowed money makes up the total debt. How much the government owes in total.
IV. On balance
   a. Here's the information for 2022, [from the Congressional Budget Office](.).

THE FEDERAL
BUDGET IN
FISCAL YEAR
2022

Total Outlays
$6.3 Trillion

Mandatory $4.1 Trillion
Discretionary $1.7 Trillion
Net Interest $475 Billion
Nondefense $910 Billion
Defense $751 Billion
Social Security $1.2 Trillion
Medicare $747 Billion
Medicaid $592 Billion
Income Security Programs $581 Billion
$482 Billion
Student Loan Programs $482 Billion
Other $520 Billion

Dollars | Percentage of GDP

Total Revenues
$4.9 Trillion

Individual Income Taxes $2.6 Trillion
Payroll Taxes $1.5 Trillion
Corporate Income Taxes $425 Billion
Other $356 Billion

Dollars | Percentage of GDP

i. In 2022, mandatory spending was about 65 percent of the budget and the U.S. federal budget deficit was about $1.4 trillion.

ii. *However,* 2022 spending included the Biden's administration to cancel a large chunk of student loan debt (using a present value of $379 billion). The attempt that was ruled unconstitutional by the Supreme Court in 2023 so the actual Student Loan Program section should read about $103 billion.

1. With this adjustment in mind, mandatory spending becomes about 63 percent of the budget and the deficit drops to just over $1 trillion.
   b. [Here's a chart](#) showing the federal deficit as a percent of GDP (thus avoiding inflation issues). By that measure, the likes of the 2020 deficit hasn't been seen since World War 2.
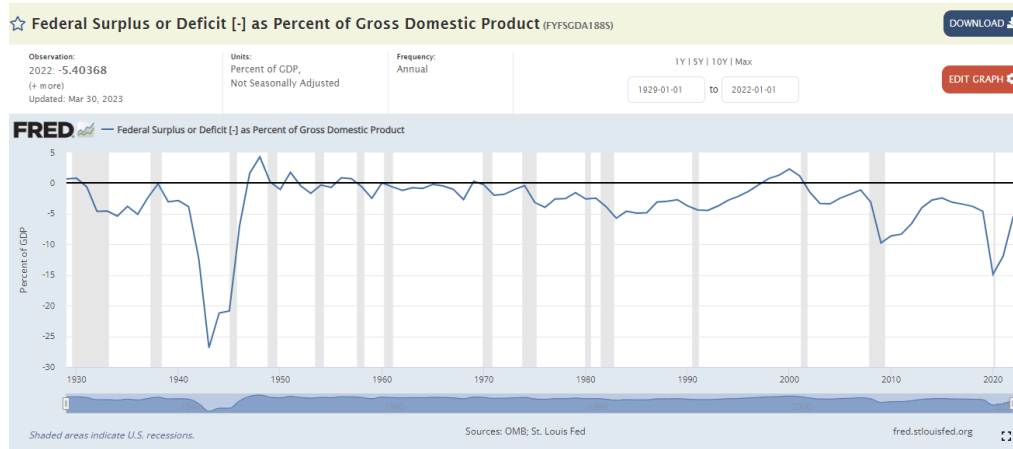

   c. Note how often the government runs a deficit. The government hasn't run a surplus since the late 1990s. Why is that?
      i. This is an application of our public choice section. The reality is that people who benefit from this spending vote and the future generations who have to pay the costs are too young to vote or aren't even born yet. [And the clock is ticking.](#)
   d. None of this, by the way, includes unfunded liabilities: especially future Social Security and Medicare payments (but also pensions and debt). Remember, these are entitlements and, by law, the government must pay them, even if it has to borrow yet more money.
   e. One final note to leave on: [total debt as a percent of GDP](#). Note that when the number's falling, it's largely due to GDP increasing, [not the debt being paid off](#). Also, this data only goes back to 1966.
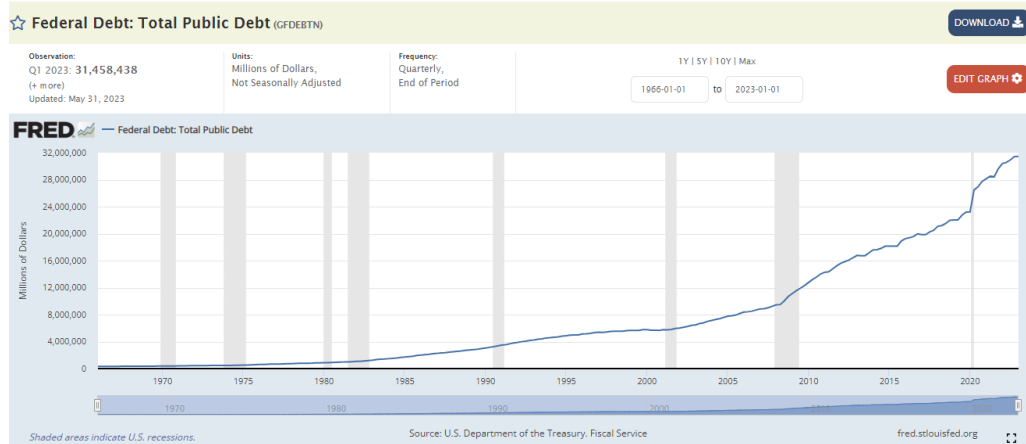
V. The Laffer Curve
   a. Isn't paying off the debt just a matter of higher income taxes?
   b. It's not so simple because the higher the income tax rate, the larger the incentive to avoid paying those taxes in the form of deductions, exemptions, and simply not working. This is especially true of very high earners who have the savings available to not work.
      i. For example, when the top tax rate was 90 percent (in the 1950s and 60s) and 70 percent (in the 1960s and 70s), no one actually paid those tax rates.
   c. The Laffer Curve illustrates this trade-off.
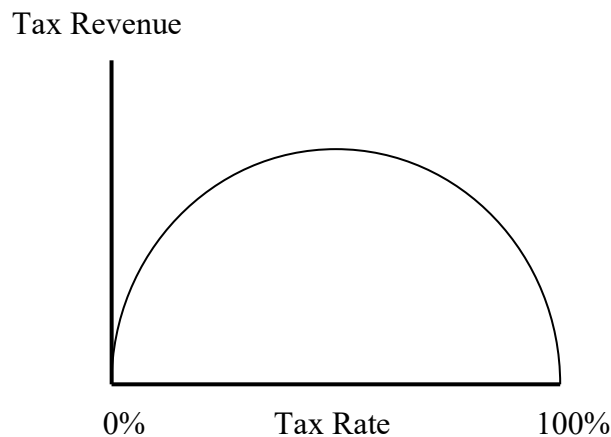
      i. If the income tax rate is 0 percent, then the government obviously collects no revenue. If the income tax rate is 100

percent, there's no incentive to work and the government still collects no revenue.[1]

    ii. Crucially, we don't know the exact shape of the curve. I drew the maximizing revenue point at 50 percent tax rate mark, but maybe the maximum point is lower than that mark or higher than that mark.

    iii. We also don't know how "flat" the curve is, though it's worth noting that income tax revenue as a percent of GDP is pretty constant, suggesting that the Laffer Curve itself is pretty flat.
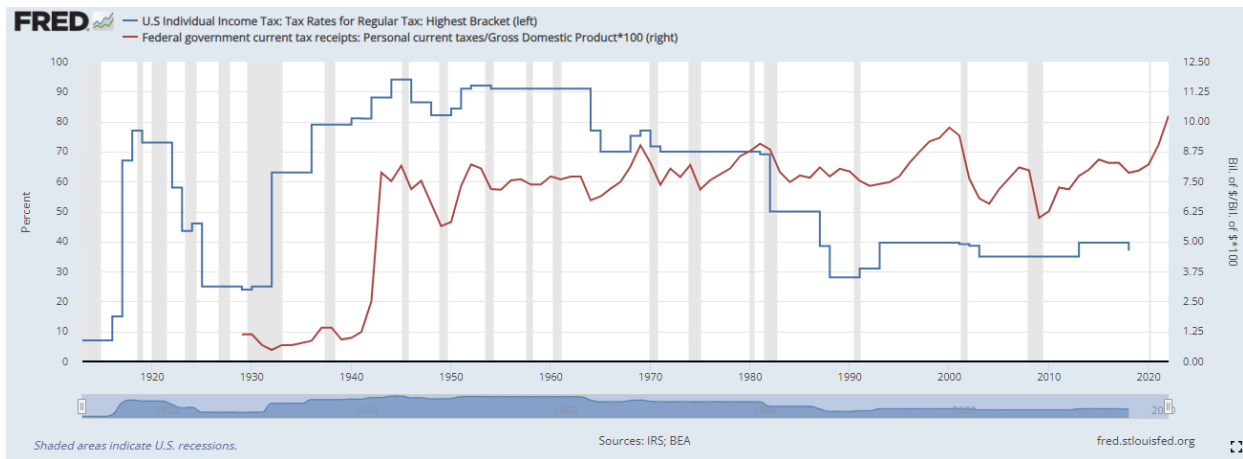
    1. The blue line is the top marginal income tax rate.
    2. The red line is the Federal tax receipts for personal current taxes divided by gross domestic product times 100.

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[1] The government would still probably collect some revenue since some people would be motivated by other reasons to do their job. But it's safe to say that, at least officially, most people would not be working.