The fiscal policy of the U.S. government is a topic that is often discussed among individuals. Topics such as the annual federal budget deficit or annual federal budget surplus, and the national debt are topics that draw a lot of attention from the news media. What is a budget deficit? What is a budget surplus? What is the national debt? Taxes and government spending are two other topics that individuals often discuss and are addressed regularly by the news media. What is all this fiscal policy stuff?

Well the modern fiscal policy of the federal government actually has its roots in a book published by John Maynard Keynes, “The General Theory of Employment, Interest, and Money,” in 1936. Keynes was a British economist who believed that capitalist economic systems could get stuck in a depression like the one the U.S., and much of the world was experiencing during the 1930’s. Keynes advocated that governments should use their powers to tax and spend to assist the economy out of a depression, and to moderate the ups and downs of business cycles. Many have referred to the spending by government during a recession or a depression as “priming the pump” of the economy.

What is a recession? A recession is a downturn in economic activity, broadly defined as at least two consecutive quarters of decline in a nation's gross domestic product (GDP). A depression is a severe downturn in the economy that is marked by falling prices, reduced purchasing power, and high unemployment. During the Great Depression of the 1930’s, unemployment reached nearly 25 percent.
FISCAL POLICY OVERVIEW

Fiscal Policy:

Deliberate use of taxes, transfer payments, and government payments for G & S to affect the level of production (GDP), income, prices & employment in the economy.

(AKA: Government tax & Spend policy)

Fiscal policy is the deliberate use of taxes, transfer payments, and government payments for goods and services to influence the level of production (gross domestic product), income, prices and employment in the economy. Fiscal policy is often referred to as government tax and spend policy. Remember that the GDP is the $ value of all goods and services produced within the boundaries of the U.S., and is used to measure economic growth.

How high should taxes be? How much should government spend? What should government spend our tax dollars on? Are middle class taxpayers taxed too much, or too little? Should the wealthy be taxed more, or less? These questions are discussed regularly, and I’m probably not going to provide you with any easy answers either. We are going to take a look at the Federal Budget and explore where tax dollars are being spent. I am going to give you the opportunity to try and balance the budget. I hear folks all the time saying they ought to do this or they ought to do that, as if balancing the budget is a simple task. We will see.
We are going to take a look at the federal budget for fiscal year 2005. To put things in perspective, I have also provided the nominal GDP for 2005, at almost $12.5 trillion. Nominal simply means that this GDP figure is not adjusted for inflation, that the GDP is given in current dollars (2005 dollars). I hope you notice the magnitude of government spending relative to the GDP. The government is a rather large player in the economy.

In 2005, federal government spending totaled a little over $2.47 trillion. Federal government revenues totaled over $2.15 trillion. Of course, most of the federal revenues came from the collection of taxes. Notice the government spent more money than it brought in, resulting in an annual federal deficit of $318.3 billion. In 1999, the government had an annual federal surplus of $125.6 billion. Where did the government get that $318.3 billion that it did not have in revenues? Well, the government does what most folks do when they are a little short, they borrow the money. They borrow money by auctioning U.S Treasury Securities in the form of treasury bonds, notes and bills at a discount from face value. A Treasury bill is a certificate representing a short-term loan to the federal government that matures in three, six or 12 months. A Treasury note matures in two to 10 years. A Treasury bond matures in more than 10 years. A 12 month Treasury bill may have a face value of $10,000, but is auctioned to the highest bidder at discount. For example, the winning bid may be $9,500. The bidder pays $9,500 for the security, and at the end of 12 months the government pays the holder of the bill $10,000. The $500 difference is the interest paid to the purchaser.
You can see that the federal government has been running annual deficits for many years. Until 1998 when the government ran a $69.3 billion budget surplus, the last time the federal government ran a surplus was in 1969 ($3.2 billion), and before that in 1960 ($0.3 billion). Above you will notice that the annual deficit grew from 1990 to 1992. We had a recession during this time period. The economy did remarkably well with low unemployment, real GDP growth averaging about 4.8% since the end of 1995, and little inflation. That ended when the 2001 recession came along from March 2001 to November 2001. The shift from budget deficits to budget surpluses from 1998 to 2001 was due more to the increased tax revenues from a strong economy than government spending cuts. Some analysts at that time proposed that we would “grow” out of our national debt, others at that time cautioned that those budget surpluses may only be a temporary reprieve due to demographic circumstances. Baby boomers were in their prime earning years then, but TODAY the first baby boomers are retiring. Lower tax revenues? Increased spending on medicare, medicaid, and social security? Which analysts were correct?

In 1997, medical spending in the U.S. hit $1.032 trillion, that is a little over 1,000 billion dollars. In 2003, medical spending in the U.S. hit $1.7 trillion. In 2006, medical spending in the U.S. was $2.6 trillion.

A government report recently estimated that spending on health care in the United States could double by 2017, reaching $4.3 trillion and accounting for 19.5 percent of the nation's gross domestic product. The report was published in the Feb. 26, 2008 online edition of *Health Affairs*. 
A National Debt Clock

May be found on the WWW at the following URL:
http://www.brillig.com/debt_clock/

Or at the U.S. Treasury Public Debt site:
http://www.treasurydirect.gov/govt/govt.htm

You can click on the links in the slide above to visit a National Debt Clock. Note that you will be leaving this web site and visiting another. Use the <BACK> button to return to this site once you have explored. You may need to enter the URL for the class site again if you explore very much.

The Outstanding Public Debt as of 13 May 2008 at 04:52:00 PM GMT is:
$9,371,277,984,857.84

Since $9.37 trillion is a number that is hard to comprehend, we can calculate the per capita national debt by dividing the population of the U.S. into the national debt figure. This provides an estimate of: $30,828.40 per person using the estimated population of the United States to be 303,982,005.

Now a lot of people get upset about this figure, but let’s take a look at the magnitude of the private debt in 2007 (latest figures available):

Households: $ 13.8254 trillion
Business: $ 10.0750 trillion
Total: $23.9004 trillion

The private sector does not have a balanced budget either! Until we learn to get our “debt in order”, how do we expect those we elect to get the government “debt in order”? Just a thought.

Above you see a graph illustrating the rate of growth the national debt has experienced in recent time.

Q: What is the difference between the Debt and the Deficit?\(^1\)

A: The National Debt is the total amount of money owed by the government; the federal budget deficit is the yearly amount by which spending exceeds revenue. Add up all the deficits (and those few budget surpluses we've had) for the past 200+ years and you'll get the current National Debt.

\(^1\)This question and answer is from Ed Hall’s national debt clock web site at http://www.brillig.com/debt_clock/faq.html
Federal spending in 2005 represented over one-fifth of gross domestic product.
The chart above illustrates federal government spending as a percent of gross domestic product over time. Since 1991, the government spending as a percent of GDP had been decreasing until 2000. During the early 1980’s, spending as a percent of GDP increased to 23.5% of GDP as military spending under the Reagan Administration increased to win the Cold War with the former Soviet Union. Spending as a percent of GDP then decreased from 1985 until the fall of the Berlin Wall in November, 1989 marking the end of the Cold War.

Spending as a percent of GDP then increased from 1990 to 1992 in response to the first Persian Gulf War and a mild recession in 1990-91. Then spending as a percent of GDP decreased from 1991 to 2000, the great economic expansion of the U.S. economy. Then, the world changed on September 11, 2001 and government spending as a percent of GDP began to increase in response to the 2001 recession, as well as wars in Afghanistan and Iraq that are still ongoing.
What is Government Spending?

- Direct govt. purchases
  - some farm commodity programs,
  - defense spending
  - automobiles and trucks
  - office furniture and supplies
  - etc.

Government spending consists of direct government purchases of everything from hammers, cars, trucks, corn, cheese, and computers to services provided by the private sector.
Government spending also includes what are known as transfer payments to individuals such as unemployment compensation benefits, welfare and food stamp programs, social security, medicare, and medicaid benefits, and farm price support programs. Under old Farm Bills, many farmers qualified for “deficiency payments” if the market price of the commodities they sold were below a government mandated “target price”. These programs are now being phased out under the new Farm Bill. During the phase out period, many crop producers are receiving Farm Program Transition Payments to allow them to adjust to a more market-oriented agricultural production system.
Many individuals claim that if we cut out all this welfare, the federal budget could be balanced. Just what is welfare anyway? Well, welfare is basically a transfer payment to individuals or families from one or more different government programs. Temporary Assistance for Needy Families (which used to be called Aid to Families with Dependent Children) is probably one of the largest and most often considered “the” welfare program. Others include the Women, Infant and Children’s Program (WIC), Medicaid, Food Stamps, Supplemental Security Income (SSI), and Housing Assistance. The Supplemental Security Income program is basically targeted to citizens receiving Social Security that is at a level deemed to be “too low”. SSI supplements these individual’s Social Security checks. Some of your grandparents may be receiving SSI.

Most of the welfare programs are targeted to assist children similar to a child support payment from the government. Some parents choose to use this “child support payment” to benefit their children, while others will siphon some of this money to augment their lifestyle choices. On August 22, 1996, “The Personal Responsibility and Work Opportunity Reconciliation Act of 1996” became law. This Act revised the nation’s welfare program. Basically, Federal and State governments overhauled many of these “welfare” programs by limiting the time period that an individual or family may collect funds, and promoting the development of marketable skills through training and education. For more information see: http://www.acf.hhs.gov/opa/fact_sheets/tanf_factsheet.html
Rather than modifying welfare programs and providing for some sort of transition from those programs to a life independent from government support, we could just cut the programs out? Would we save a pile of money? What may happen to the crime rate in this country? What would happen to the budgets of law enforcement agencies to deal with this crime? Would we have to build and staff new prisons to deal with the potential increase in crime? Are we right back where we started? I have seen estimates that it costs the state of North Carolina government between $20,000 to $32,000 per year to house inmates in the prison system.

Source: [http://www.doc.state.nc.us/dop/cost/](http://www.doc.state.nc.us/dop/cost/)

Would enhancing the education and training of individuals on welfare provide them with skills that would be marketable so that they could become independent of social assistance? Easier said than done, and not an inexpensive proposition either.

I am sure that each of you never missed a class, completed every assignment your teachers provided, studied an average of four to six hours a day, and strove to get all you could from your high school education. I know none of you ever goofed off, and that you took your education seriously. You gave it 110% effort all the time. Well, there are folks out there that are not like you. Some folks do not adequately recognize the long run benefits of an education for one reason or another.
Direct benefit payments to individuals represent approximately 60.3 percent of the total federal budget outlays. Most of the tax dollars we pay are redistributed to other individuals in the form of a government check. So $.603 of every dollar we pay in taxes is put back into the economy in the pocket of someone else, or back into many of our pockets. Yes, back into our pockets either directly or indirectly. Don’t get yourselves in an uproar yet. Give me a little time to illustrate. Please remember, I do not wish to pay any more taxes than I have to either. I do not remember ever sending the state or federal government any voluntary donations.
Let’s take a look at two of the big drains on the budget. Social Security and Medicare benefits. These two programs totaled $857.2 billion in 2005, representing approximately 57.5% of all entitlement programs and about 35% of the total federal budget. The future demands on these two programs are obvious due to the increasing number of retirees in this country. Don’t forget the baby boomers that are quickly approaching their “golden years”. How many of you want to cut your grandparent’s social security benefits and increase the premiums they must pay for medicare? On top of that, the elderly population in this country is a formidable political force that is growing as I type. The population has a record of high voting participation to accompany their growing numbers. Click on the “voting data” link in the slide above and take a look. How many of you seriously participate in the electoral process? How many of you seriously keep up with what is going on in the political arenas that will have an impact on your futures, and pocket books?

**Breakdown of Federal Expenditures:**

<table>
<thead>
<tr>
<th>Program</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Security</td>
<td>$523.4B</td>
</tr>
<tr>
<td>Medicare Benefits</td>
<td>$333.8B</td>
</tr>
<tr>
<td></td>
<td>$857.2B</td>
</tr>
</tbody>
</table>

are ~57.5% of Entitlement Programs

~35% of total budget
The remainder of the direct benefit payments to individuals represent about 42.5% of all entitlements or about 25.6% of the total federal budget. Yes, welfare is in here, but so are some other programs that many of you benefit from. Educational grants to name one. Subsidized student loans to name another. On August 5, 1997 a tax bill was signed by former President Clinton that includes tax credits for college tuition. So, we could start cutting the budget by reducing financial assistance to college students.
Let’s take a look at some of the “welfare” programs, namely Food and Nutrition Assistance. The Food Stamp program in 2005 required $32.6 billion and totaled 1.32% of the federal budget. The Child Nutrition and Milk Program (school breakfasts and lunches) ran $11.9 billion and represent .48% of the federal budget. The Supplemental Feeding Program (WIC) which targets only families with infants and children cost $4.9 billion and represents .20% of the total budget. These three programs together cost $49.4 billion and represented 2.00% of the budget.

Cut them? You tell me what you want to do. I want you to start cutting the budget. I want you to play the role of an elected representative with an objective to “streamline government spending.” Also, remember that you wish to remain in office another term as well. Therefore, you will have to be aware of how your constituents will be affected by your decisions. I would like you to e-mail me with your recommendations on cuts, and I will try to assume a roll as an objective consultant in terms of the potential costs and benefits of your recommendations.
Here we see a breakdown of the public assistance and related programs. Supplemental Security Income (SSI) represents $35.3 billion or 1.43% of the total budget. Cut it? Some of it?

Temporary Assistance for Needy Families (TANF) cost $21.3 billion in 2005 representing .86% of the total budget. The majority of these funds are received by single parent females with children. Cut it? Cut some of it? What?

Low Income Home Energy Assistance runs $2.1 billion or .085% of the federal budget. These funds are granted to means tested low income individuals (mainly the elderly), or families to assist primarily with home heating. Cut it? Cut some? Modify it? Let me know?

## Breakdown of Federal Expenditures: Public Assistance and Related Programs

<table>
<thead>
<tr>
<th>Program</th>
<th>Amount</th>
<th>% of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supp. Sec. Inc.</td>
<td>$35.3B</td>
<td>1.43%</td>
</tr>
<tr>
<td>Family Support</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asst. (TANF)</td>
<td>21.3B</td>
<td>.86%</td>
</tr>
<tr>
<td>Low Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home Energy Asst.</td>
<td>2.1B</td>
<td>.085%</td>
</tr>
</tbody>
</table>
Here are some more public assistance and related programs. The Earned Income Tax Credit is a program designed to encourage people with low incomes to work rather than be totally dependent upon public assistance. This incentive is created by decreasing their federal income tax liability. If an individual or family makes below a certain income, their federal income tax liability is reduced by a tax credit. The lower their income, the higher the tax credit. The higher their income, the lower the credit to a point that the credit reaches zero. This program required $34.6 billion from the federal budget in 2005 representing 1.40% of the total budget. Cut it?

Legal services provided to low income individuals and daycare assistance provided to working, low income families totals .627 billion. Cut it?

Veterans assistance was $3.1 billion in 1999. Cut it?

Housing assistance to low income families was $22.7 billion. Cut it?

The programs listed here total $52.03 billion representing a little more than 3% of the total federal budget.
Let’s take a look at some health care expenditures (Medicare excluded). Medicaid, which is the federal health program for low income individuals and families, cost $181.7 billion in 2005 and represented 7.35% of the budget. Cut it? Will it cost you anything in the long run if this program is cut?

Hospital and medical care for veterans had a price tag of $23.1 billion or .93% of the budget. Do we owe anything to U.S. veterans? Cut it?

<table>
<thead>
<tr>
<th>Breakdown of Federal Expenditures:</th>
<th>Amount</th>
<th>% of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid</td>
<td>$181.7B</td>
<td>7.35%</td>
</tr>
<tr>
<td>Hospital &amp; Med. Care for Veterans</td>
<td>$23.1B</td>
<td>.93%</td>
</tr>
</tbody>
</table>
Unemployment assistance accounts for $33.1 billion dollars of which about 90% is put into the unemployment trust fund. The other 10% is used for administering the program under the Unemployment Insurance Service to pay for staff services at state unemployment offices, and to pay some benefits. What do you want to do? Do we want this program? Yes, your future employer may be required to pay into this program, but your future employer looks at that payment as a part of his/her cost of hiring you. Should we be saving ourselves for that “rainy day” rather than government taking care of us?

<table>
<thead>
<tr>
<th>Amount</th>
<th>% of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>$33.1B</td>
<td>1.34%</td>
</tr>
</tbody>
</table>
Ah, now we can get the knife out and do a little carving can’t we. The Direct Student Assistance to College Students program had a cost in 2005 of $28.9 billion or 1.17% of the total budget. Down from 1999’a budget allocation of $10.5B and .62% of the total budget. What do we need this program for? Cut it? College students should have to pay their own way, all the way, don’t you think? (What type of statement did I just make?) College students and their families now have a sizeable tax credit available to help offset the cost of college tuition. I hope you all realize that I am only trying to get you to think about the difficulty of making some of these cuts. Any cuts made will affect one group of people or another with a vested interest in the continuation of a program. Each of us are more than willing to cut items from a budget as long as we perceive those cuts not to have a negative impact on us, or a significant indirect negative impact. You must remember that there are 100 senators and 435 representatives in the 110th Congress elected to represent our interests in the development and administration of the federal budget. If those individuals do not do as the majority of us would like them to do, they lose their job. If our class had $5,000 to spend, I dare say that we would probably have a time trying to agree on what to spend that money on, and how much money to spend on each item that we may have agreed upon. I am sure you all have heard of husbands and wives fussing over where the family money is being spent, and how much; and that is just two people. I have mentioned cost/benefit analysis in making decisions but we need to remember that the benefit of spending tax money on a particular program to me, may not be the same to you. The same logic applies to cost.

**Breakdown of Federal Expenditures:**

**Assistance to Students**

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>% of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Student</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asst. to College</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Students</td>
<td>$28.9B</td>
<td>1.17%</td>
</tr>
<tr>
<td>Veterans Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td>3.2B</td>
<td>.129%</td>
</tr>
</tbody>
</table>

Ah, now we can get the knife out and do a little carving can’t we. The Direct Student Assistance to College Students program had a cost in 2005 of $28.9 billion or 1.17% of the total budget. Down from 1999’a budget allocation of $10.5B and .62% of the total budget. What do we need this program for? Cut it? College students should have to pay their own way, all the way, don’t you think? (What type of statement did I just make?) College students and their families now have a sizeable tax credit available to help offset the cost of college tuition. I hope you all realize that I am only trying to get you to think about the difficulty of making some of these cuts. Any cuts made will affect one group of people or another with a vested interest in the continuation of a program. Each of us are more than willing to cut items from a budget as long as we perceive those cuts not to have a negative impact on us, or a significant indirect negative impact. You must remember that there are 100 senators and 435 representatives in the 110th Congress elected to represent our interests in the development and administration of the federal budget. If those individuals do not do as the majority of us would like them to do, they lose their job. If our class had $5,000 to spend, I dare say that we would probably have a time trying to agree on what to spend that money on, and how much money to spend on each item that we may have agreed upon. I am sure you all have heard of husbands and wives fussing over where the family money is being spent, and how much; and that is just two people. I have mentioned cost/benefit analysis in making decisions but we need to remember that the benefit of spending tax money on a particular program to me, may not be the same to you. The same logic applies to cost.
Breakdown of Federal Expenditures:

$314.6 B or 12.7% of total budget:

Medicaid, Food Stamps, TANF,
Supplemental Security Income, WIC,
Assisted Housing, Home Energy Asst.,
Day Care Asst.

If we cut out Medicaid, Food Stamps, TANF, SSI, WIC, Assisted Housing, Home Energy Assistance and Day Care Assistance; we can save $314.6 billion or 12.7% of the total budget. Now that will give us a little more spare change to put toward the National Debt. But I doubt we cut all those programs in our discussion. If this class is anything like other classes I have had, we have probably not made much headway at all towards cutting the federal budget. We have probably spent a great deal of time debating amongst ourselves with me egging you on. Sounds a lot like what goes on downtown in Raleigh and Washington D.C. to me.

This exercise is a lot of fun in the classroom, I don’t know how it will work out on line. Post some comments on the listserv and let’s get a sensible and mature discussion going or something.

You may be realizing that this is a difficult process because of the complexity of the issues and the costs and benefits associated with different groups of individuals. Remember, congressional representatives and senators are to look out for the interests of their constituents. What is in the best interest of North Carolina may not be in the best interest of another state or states.
Several years or so ago, ABC’s 20/20 news magazine broadcast did a story on the Social Security program and calculated that people retiring back then would receive all the money they had ever put into Social Security, plus the interest earned, in just three years. That is 36 Social Security checks.

I decided to gather the data and check this claim out. I do not know the assumptions that were made by ABC’s 20/20 staff, but I will provide you with assumptions I used. An employee retiring at age 65 on January 1, 2000, started working when they were 16 years old (Jan. 1, 1951), and paid the maximum amount to the social security retirement trust fund (OASI), and therefore receives the maximum benefit, will receive all the money they ever put into Social Security + interest in 3.78 years (46 checks)!

Will Social Security Be There For You?

Spreadsheet Used to Compute

As of December 31, 1999, the value of this employee’s trust fund (using the effective annual interest rates for the OASI trust fund, compounded annually, and as published in Actuarial Note, Number 138, October 1997, by the Social Security Administration’s Office of the Chief Actuary) is $64,998.21. The maximum social security benefit for a worker retiring at age 65 in January of 2000 is $1,433 per month (Social Security Administration Fact Sheet, revised April 26, 2000). $64,998.21 / $1,433 = 45.36 months. Will social security be there for you? Click on the links in the slide above and draw your own conclusion.
Yes, this can be hard to believe, so let us do a little figuring. Nothing fancy, just a little common sense figuring. First, you all do understand that the social security tax, or OASDI tax as it is currently known, is a payroll tax that you pay as a percentage of your gross wages. Your employer must match the same amount to the system that you pay. If you are self-employed, you pay twice as much as a person employed by a business or individual. Self-employed individuals do get a little break on their income taxes which lowers the net cost of their “contribution.” Oh, OASDI stands for Old-Age, Survivors, and Disability Insurance fund. The true retirement part of social security is the Old-Age and Survivors Insurance fund, or OASI. We are going to focus only on OASI, the retirement portion of social security.

Between 1937 and 1949, only the first $3,000 of gross income earned was taxed, known as the “maximum earnings taxed.” The social security tax rate back then was 1%. So the maximum tax any employee paid for that year was $30.00. Of course the employer contributed $30.00 as well for a total of $60.00 credited to the account. Also note, that this 1% tax covered only retirement benefits at this time. There was not a disability insurance fund (started in 1957) or a medicare program (started July 1, 1966) in existence at this time either.
In 1950, the tax rate increased to 1.5% of the first $3,000 earned. The maximum tax paid by employees was $45.00 for the year matched by a $45.00 contribution from the employer.

From 1951 to 1953 the maximum amount of taxable earnings was increased to $3,600 per year and the OASI tax rate was 1.5% for a maximum tax paid by the employee of $54 per year. In 1954, the tax rate was increased to 2.0% increasing the maximum tax paid by the employee to $72 per year. From 1955 through 1958 the maximum amount of taxable earnings was increased to $4,200 per year with an OASI tax rate of 2.0%. The maximum tax paid by the employee from 1955 to 1958 was $84 per year. In 1959, the OASI tax rate was increased to 2.25% with a maximum amount of taxable earnings of $4,800 for a maximum tax paid by the employee of $108 per year.
The maximum earnings taxed in 1961 was $4,800, and the tax rate was 2.75%. Maximum tax paid and employer contribution made was $264.00 that year. In 1962 the tax rate was increased to 2.875%, but the maximum earnings taxed remained at $4,800. In 1962 the maximum tax paid and employer contribution totaled $276.00.

From 1963 to 1965, the tax rate was 3.375% and the maximum earnings taxed remained $4,800. This provided a total of $324.00 credited to an employee’s account. In 1966 the tax rate was increased to 3.50% with a maximum earnings taxed remaining at $6,600 for a total of 462.00 credited that year. In 1967, the tax rate was increased to 3.55% and the maximum earnings taxed remained at $6,600 for a total of $468.60 contributed.

The tax rate was lowered in 1968 to 3.325% but the maximum earnings taxed was increased to $7,800 for a total of $518.70 contributed. In 1969 the tax rate increased to 3.725% while maximum earnings taxed remained the same as 1968, $7,800. Maximum contribution was $581.10 in 1969.
Hard To Believe

For the Year 1970:

Maximum Earnings Taxed = $7,800
OASI tax rate = 3.65%
Max. Tax Paid = $284.70 per employee
Employer’s Share = $284.70 per employee
Total Tax Paid = $569.40 per employee

From: Social Security Tax Rate Table

The maximum earnings taxed in 1971 was $7,800, and the tax rate was 4.05%. Maximum tax paid and employer contribution made was $631.80 that year. In 1972 the tax rate remained the same at 4.05%, but the maximum earnings taxed remained increased to $9,000. In 1972 the maximum employee tax paid and employer contribution totaled $729.00.

In 1973, the tax rate was 4.3% and the maximum earnings taxed remained $10,800. This provided a total of $928.80 credited to an employee’s account. From 1974 to 1977, the tax rate was held steady at 4.375% but the maximum earnings taxed increased each year. In 1974, $13,200 for a total of $1,155.00 credited the year. In 1975, $14,100 for a total $1,233.75 credited for the year. In 1976, $15,300 for a total of $1,338.75 credited for the year. In 1977, $16,500 for a total of $1,443.75 for the year.

In 1978, the OASI tax rate was lowered to 4.275% with a maximum earnings taxed of $17,700 for a total of $1,513.35 credited for the year. In 1979, the maximum earnings taxed climbed to $22,900 with an increase in the retirement tax rate to 4.33%. Employee and employer contributions totaled $1983.14.
## Hard To Believe

For the Year 1980:

Maximum Earnings Taxed = $25,900  
OASI tax rate = 4.52%  
Max. Tax Paid = $1,170.68 per employee  
Employer’s Share = $1,170.68 per employee  
Total Tax Paid = $2,341.36 per employee

From: Social Security Tax Rate Table

<table>
<thead>
<tr>
<th>Year</th>
<th>Maximum Earnings</th>
<th>OASI Tax</th>
<th>Employee Contribution</th>
<th>Total OASI Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>$29,700</td>
<td>4.700%</td>
<td>$1,395.90</td>
<td>$2,791.80</td>
</tr>
<tr>
<td>1982</td>
<td>32,400</td>
<td>4.575%</td>
<td>1,482.30</td>
<td>2,964.60</td>
</tr>
<tr>
<td>1983</td>
<td>35,700</td>
<td>4.775%</td>
<td>1,704.675</td>
<td>3,409.35</td>
</tr>
<tr>
<td>1984</td>
<td>37,800</td>
<td>5.200%</td>
<td>1,965.60</td>
<td>3,931.20</td>
</tr>
<tr>
<td>1985</td>
<td>39,600</td>
<td>5.200%</td>
<td>2,059.20</td>
<td>4,118.40</td>
</tr>
<tr>
<td>1986</td>
<td>42,000</td>
<td>5.200%</td>
<td>2,184.00</td>
<td>4,368.00</td>
</tr>
<tr>
<td>1987</td>
<td>43,800</td>
<td>5.200%</td>
<td>2,277.60</td>
<td>4,555.20</td>
</tr>
<tr>
<td>1988</td>
<td>45,000</td>
<td>5.530%</td>
<td>2,488.50</td>
<td>4977.00</td>
</tr>
<tr>
<td>1989</td>
<td>48,000</td>
<td>5.530%</td>
<td>2,654.40</td>
<td>5308.80</td>
</tr>
</tbody>
</table>
For the Year 1990:

Maximum Earnings Taxed = $51,300
OASI tax rate = 5.60%
Max. Tax Paid = $2,872.80 per employee
Employer’s Share = $2,872.80 per employee
Total Tax Paid = $5,745.60 per employee

From: Social Security Tax Rate Table

<table>
<thead>
<tr>
<th>Year</th>
<th>Maximum Earnings</th>
<th>OASI Taxed</th>
<th>OASI Rate</th>
<th>Employee Contribution</th>
<th>Total OASI Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>$53,400</td>
<td>5.600%</td>
<td>$2,990.40</td>
<td>$5,980.80</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>55,500</td>
<td>5.600%</td>
<td>3,108.00</td>
<td>6,216.00</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>57,600</td>
<td>5.600%</td>
<td>3,225.60</td>
<td>6,451.20</td>
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<tr>
<td>1994</td>
<td>60,600</td>
<td>5.260%</td>
<td>3,187.56</td>
<td>6,375.12</td>
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</tr>
<tr>
<td>1996</td>
<td>62,700</td>
<td>5.260%</td>
<td>3,298.02</td>
<td>6,596.04</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>65,400</td>
<td>5.350%</td>
<td>3,498.90</td>
<td>6,997.80</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>68,400</td>
<td>5.350%</td>
<td>3,659.40</td>
<td>7,318.80</td>
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<tr>
<td>1999</td>
<td>72,600</td>
<td>5.350%</td>
<td>3,884.10</td>
<td>7,768.20</td>
<td></td>
</tr>
</tbody>
</table>
Hard To Believe

For the Year 2000:

Maximum Earnings Taxed = $76,200
OASI tax rate = 5.30%
Max. Tax Paid = $4,038.60 per employee
Employer’s Share = $4,038.60 per employee
Total Tax Paid = $8,077.20 per employee

From: Social Security Tax Rate Table

What will happen when those baby boomers start retiring? Will there be enough funds to take care of their retirement and medical benefits? If not, where will the money come from? These are issues you will face and must deal with.

<table>
<thead>
<tr>
<th>Year</th>
<th>Maximum Earnings Taxed</th>
<th>OASI Tax Rate</th>
<th>Max. Tax Paid</th>
<th>Employer’s Share</th>
<th>Total Tax Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>76,200</td>
<td>5.30%</td>
<td>4,038.60</td>
<td>8,077.20</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>80,400</td>
<td>5.30%</td>
<td>4,261.20</td>
<td>8,522.40</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>84,900</td>
<td>5.30%</td>
<td>4,497.70</td>
<td>8,995.40</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>87,000</td>
<td>5.30%</td>
<td>4,611.00</td>
<td>9,222.00</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>87,900</td>
<td>5.30%</td>
<td>4,658.70</td>
<td>9,317.40</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>90,000</td>
<td>5.30%</td>
<td>4,770.00</td>
<td>9,540.00</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>94,200</td>
<td>5.30%</td>
<td>4,992.60</td>
<td>9,985.20</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>97,500</td>
<td>5.30%</td>
<td>5,167.50</td>
<td>10,335.00</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>102,000</td>
<td>5.30%</td>
<td>5,406.00</td>
<td>10,812.00</td>
<td></td>
</tr>
</tbody>
</table>
I don’t mean to be depressing. I just want you to be aware of some of the issues that you will probably confront. Hopefully, you are getting prepared to confront those future issues while you are here. Think of these as challenges. No, I have not given you any answers yet. If I had all the answers, I would be a very wealthy man, and teaching an economics class for the sheer fun of it. I have some ideas, but I want you to develop your own. I want you to start thinking about your own solutions as objectively as is possible.

Back to the budget. Agriculture, $26.6 billion or 1.08% of the total budget. $22.1 billion is allocated to farm income stabilization, and $4.5 billion is earmarked for agricultural research and services. Though not included formally in the budget as an entitlement program, former farm programs paid deficiency payments to many farmers if the market price of their commodity was lower than a legislated target price. For example, if the target price was $3.00 per bushel for corn, and the average market price for corn was $2.80 per bushel; a corn producer would receive a government check for $.20 per bushel of corn produced as a deficiency payment. As I have said before, these programs are being phased out at this time. Transition payments to farmers are now being made and will last only a few years under the current law. Any way you look at it, these payments are transfer payments to individuals or corporations that had to follow certain guidelines to be entitled to them. The budget allocation for USDA was $75.5 billion in 2000 and $85.3 billion in 2005.
Breakdown of Federal Expenditures:

- Transportation programs: $67.9 B (2.75%)
  - Highways, Air, and Water

- Elementary, Secondary, and Vocational Education:
  - $38.3 B (1.55%)

How much of the above do you want to cut?
How much do you want to cut here? Eastern North Carolina benefits from federal spending in the areas of Community and Regional Development. Many folks believe the Space Program is a waste of money, cut it? Be careful though, because a great deal of technology is developed in this program with significant private sector benefits. That computer you are working with had some development background in the space program.

Breakdown of Federal Expenditures:

- **Job training, Employment and Social Services:** $24.7 B (1.00%)
- **Community and Regional Development Programs:** $26.3 B (1.06%)
- **Space, energy, and general science programs:** $23.7 B (.96%)
Here is one that gets everybody in an uproar. Foreign aid is a slice out of the foreign affairs budget. If we cut all that help we give foreign countries out, would we get close to balancing that budget?

Well defense, veterans, and foreign affairs spending account for 24.3% of the total budget. Spending for national defense alone is 20.03% ($495.3B) of the total budget, and has been increasing more recently. Veteran benefits and services account for 2.84% ($70.1B) of the budget (medical care excluded, we considered veteran medical care earlier) and really could be considered another entitlement program.

What about foreign affairs? How much spending is there?
Foreign affairs spending was .89% ($34.6B) of the total budget in 2005. This spending included military assistance to foreign countries, economic assistance to foreign countries and the maintenance of U.S. Embassies abroad.

International development and humanitarian assistance: $17.7B
International security assistance (military): $7.9B
Conduct of foreign affairs (embassies): $9.2B
Foreign information and exchange activities: $1.1 B
International financial programs: ($1.3B)

I don’t think cutting this spending is going to balance the budget. Also, you need to think about the spending we do in the Middle East where most of our oil now comes from. Instability in the Middle East probably means instability in the U.S. economy since oil is such an important economic resource to our country’s overall economic health.
Law Enforcement activities by the Justice Department and the Treasury Department, and general government allocations for Congress, the Judiciary, and the President totaled approximately $45.8 billion for 2005. This amounts to 1.85% of the total budget for these two basic government activities.

Net interest paid on the National Debt totaled $183.9 billion in 2005 representing 7.44% of the federal budget. You may see a figure of $275.8 billion as the interest on public debt in some literature. The government does receive some interest payments from trust funds and other sources that offsets approximately $91.8 billion in interest on the public debt.
Federal Budget Breakdown: 2005

- Defense: 20.04 percent
- Social Security: 21.17 percent
- Medicare: 12.08 percent
- Medicaid: 7.35 percent
- Interest on National Debt: 7.44 percent
- All Other: 31.92 percent

The table above summarizes much of what we have discussed and helps put into perspective where the majority of tax dollars are being spent. Defense, Social Security, Medicare, Medicaid, and the Net Interest on the National Debt account for 71.14% of all federal government spending. All the other spending combined totals 28.86%.
This is just a pie chart illustrating the information provided in the previous slide in graphically.
The pie chart above illustrates the sources of U.S. government revenue and their relative contribution.
For More Information:

Read:

• **Budget of the United States Government:**
  
  Fiscal Year 2007

Additional Resource:

**Budget of the United States Government:**

Fiscal Year 1999

Other Budgets of the United States Government:

Fiscal Years 1996 forward

The links provided above, and in the next few slides, will give you further insight into the federal budget and the uses of tax dollars. The publication entitled *A Citizens Guide to the Federal Budget, Fiscal Year xxxx* is a political document prepared by the White House providing some good facts but a little propaganda as well.
For More Information:

Read:
• “A Citizens Guide to the Federal Budget, Various Fiscal Years”
For More Information:
Take a look at:

**Budget of the United States Government, Fiscal Year 2007, Historical Tables**

This was my primary source for the Federal Budget Presentation.

You can get right into the “nitty gritty” of the budget with this resource, and even check my figures if you wish. I primarily used the following tables:

Table 1.1
Table 1.2
Table 2.1
Table 3.2
Table 8.5
Table 8.7
Table 11.3

You can download this information to your computer if you wish. The files are spreadsheet files compatible with most spreadsheet programs.
Now that we have a little knowledge about fiscal policy, and understand the complexities of the federal spending; let us use the consumption-production model to explain a few things.

First, we need to define another term, disposable income. A person’s disposable income is their gross income minus all of their government obligations.

Think of the last paycheck you received. You opened it up and you probably saw a number that made you think something was wrong. So, you look at your pay stub that has all the details. You look at something that says “Gross Pay”, and you think, “Yea, this is what I thought I should be getting.” Then you look on down further and see all these deductions: OASDI tax, HI tax, Fed W/H, and NC W/H. Those are social security and medicare taxes, as well as, the federal and state income taxes that were withheld by your employer. These are your government obligations. Next you look at that number next to “Net Pay”, and you probably say, “Daggone!!!” Well, if taxes are the only thing “pulled” from your paycheck, then that “Daggone!!!” number is your disposable income.

When taxes are increased, your disposable income decreases
When taxes are decreased, your disposable income increases
Using our consumption-production model, and assuming the economy is currently in equilibrium; what will be the affect of lowering taxes, ceteris paribus?

As taxes (T) are lowered (illustrated by the downward arrow in the slide above), then disposable income (Id) will probably increase (illustrated by the upward arrow in the slide above). As a result of the increase in disposable income, people now have more money to spend. Americans, on average, in general, typically save around 5% of their take-home pay. So, around 95% of the increased money that Americans will have due to lower taxes will probably be consumed. This is generally true unless consumers are using this additional disposable income to reduce debt, or there is widespread job insecurity. Therefore, consumption (C) increases. As consumption becomes greater than production (Pr) in the short run, inventories (Iv) will start to fall.

Managers notice the decline in their inventories, and realize they need to make adjustments to bring the system back into equilibrium. If the economy is currently experiencing low unemployment and factories are operating near capacity, managers do not have many options in the short run. Managers will probably increase prices which may result in inflation. On the other hand, if unemployment was rather high and factories were operating at less than full capacity; then managers would probably choose to increase production by calling back laid off employees. What about the affects of this cut in taxes on the federal budget deficit or surplus?
Well, the affect on the federal deficit or surplus is pretty tricky and depends on quite a few unknowns and educated guesses. Economics is certainly not an exact science. It will depend on how much that tax cut stimulates the economy. If the tax cuts are imposed on an economy with high unemployment and under utilized production capacity, then future tax revenues may be larger. As people go back to work, spending on social programs and unemployment compensation start to decrease. People bringing home paychecks are paying taxes. Therefore, tax revenues may increase. The deficit could actually decrease, or the surplus increase.

On the other hand, if the economy is humming along fairly well with low unemployment and fully utilized capacity, a tax cut may result in lower tax revenues. If tax revenues decrease more than the decrease in social program spending, unemployment compensation and other spending due to the low unemployment rates, then the deficit could actually increase, or surplus decrease.

As of August, 1998, the government reported a budget surplus. As of September, 2000, the surplus was increasing due to significant increases in tax revenues. Unemployment is low. Some economists feel that productivity has improved much more than our current statistical measures are indicating because of computer technology. People generally feel the economy is in good shape as evidenced by the Consumer Confidence Index. People are earning money and spending it. Tax revenues are rolling in.
Let’s look at another popular suggestion, decreased government spending (G), ceteris paribus. We know the government purchases large quantities of commodities and provides income to individuals through entitlement programs. Cuts in spending will probably reduce disposable income in the short run. The California economy took some hits in the short run due to recent cuts in military spending. As government contracts were scaled back and canceled, industries that depended on military spending by the government were forced to find other customers. Think of the economic impact on Fayetteville, and Cumberland county, if Fort Bragg were to be closed down as the military downsized its operations. North Carolina’s eastern economy is influenced a great deal by government spending. Many citizens would like to see government spending curtailed, but not in their own “backyards.” This can make it very difficult to cut spending because we all have “backyards” that we expect our elected representatives to defend. As disposable income decreases, we would expect consumption to decrease as well.

As consumption becomes less than production in the short run, inventories begin to swell. Managers notice the increase in inventories, and realize they need to make adjustments to bring the system back into equilibrium. If the economy is currently experiencing low unemployment and factories are operating near capacity, managers may choose to decrease production by cutting work hours, or laying employees off. On the other hand, if unemployment was rather high and factories were operating at less than full capacity; then managers may choose to decrease prices.
What about the affects of this cut in government spending on the federal budget deficit or surplus?

Again, the affect on the deficit or surplus is pretty tricky and depends on quite a few unknowns and educated guesses. It will depend on how much the cut in government spending softens the economy. If the cuts are imposed on an economy with high unemployment and under utilized production capacity, then the government could trigger a recession with its cuts. Increased layoffs and long term unemployment may place additional demands on entitlement programs. If the new demands for government assistance are greater than the savings from previous cuts, the deficit could actually increase, or surplus decrease.

On the other hand, if the economy is humming along fairly well with low unemployment and fully utilized capacity, moderate cuts in spending may be good medicine to keep the economy from over heating. If cuts in spending are greater than any increase in social program spending and unemployment compensation that may occur due to the spending cuts, the deficit may decrease, or the surplus may increase.

As of September, 2000, the economy is humming along rather nicely. Tax revenues have increased, and spending on social programs has decreased on its own due to low unemployment rates. These two events have resulted in federal budget surpluses for 1998, 1999, and 2000. The economy could probably absorb moderate spending cuts at this time.
Let’s take a look at a rather unpopular idea among citizens, raising taxes. Look at the graphic above. Now flip back to the previous slide and look at it, then flip back to this slide. Is there much of a difference with respect to the final outcome for the economy?

Increasing taxes, ceteris paribus, will result in less disposable income and probably less consumption. Inventory levels will start to increase, and managers will be called upon to take some action to return their systems to equilibrium. If the economy had very low unemployment and production was occurring near capacity, managers may elect to slow production down by shortening the work week or possibly laying employees off. If the economy had relatively high unemployment and production was occurring at levels significantly below full capacity, raising taxes may push the economy into a recession. Managers may opt to decrease prices in response to the increase in taxes under these circumstances.

I would like you to e-mail me with a discussion on what the possible affects on the deficit or surplus may be. E-mail me at herman_sampson@ncsu.edu
What may happen if government spending is increased? Well, essentially the same economic outcome that occurs when taxes are decreased. Flip back and take a look.

If the government were to increase military spending or highway spending for example, private companies would be awarded the bids. If the economy had high unemployment and under utilized production capacity, business firms awarded new government contracts would start cranking up employment and production. People would start going back to work. In this example, government spending was used to stimulate the economy, possibly pulling the economy from a recession. If the increased government spending is less than the tax revenues generated by the economy coming out of the recession, then the deficit may decrease or the surplus may increase. If not, the deficit will increase or the surplus will decrease.

On the other hand, if government spending were increased at a time when the economy has low unemployment and is operating at or near production capacity: stimulating the economy further may result in inflation as managers opt to increase prices to stabilize inventories. Under this scenario, additional government spending will probably not be offset by increased tax revenues, and the deficit will probably increase or the surplus will decrease.
A balanced budget amendment to the U.S. Constitution would require the federal government not to run a deficit, and perhaps even a surplus. This may sound like a sound financial practice, but then again it may cause some problems. Could you imagine if all of us were forced to run balanced budgets. No credit. What do you think would happen to our economy without credit? Too much available credit is probably not very wise either. Like many things in this world, too much or too little, can create problems.

Forcing a balanced budget would mean that government would not be able to increase government spending during a recession to stabilize the economy if that additional spending would create a deficit. There would be a real possibility that the economy could slip into a depression like that of the 1930’s. If the economy began to overheat creating rampant inflation, then the government would not be able to raise taxes in an effort to cool the economy down if those additional tax revenues would create a budget surplus. The government would be left with little, if any, fiscal policy tools to use to manage the economy.

Credit can be used wisely and productively, or it can be misused. This is true at the government level, and at the individual level. I am not sure that we want to “throw the baby out with the dirty bath water.” to force fiscal restraint. That may be a very expensive mistake for all parties.
Let’s take a look at a hypothetical government employee earning $40,000 per year plus benefits (health insurance, retirement, disability, etc.). Depending on the employee’s family situation, he/she may be paying about 20 percent of their gross salary in federal and state income taxes. Assuming that our government employee would be equally productive in the private sector, could we think of the federal and state income taxes the employee pays as a “taxpayer rebate?”

The net cost to the taxpayer in this example, is $32,000 plus the value of the benefits the employee receives. Now, what does that government employee do with that $32,000 of taxpayer money? Does that employee bury it in the ground? Hide it in their mattress? Put it in a safe deposit box? Open a Swiss Bank account?
Govt. Employees: Are They Feeding at Public Trough?

- Pays property taxes, sales taxes, and excise taxes.
- Buys automobiles.
- Buys home.
- Goes to Food Lion, WalMart, Dry Cleaners, etc.!

Do taxpayers ultimately get their $32,000 /yr. back?

Well, I am a state employee, so I can speak for my own actions. I purchased a house, and the seller did not refuse my money that originated from taxpayers. I pay property taxes on that house. I have purchased a few pickup trucks in my life, and I never had a person refuse my money. Most of the time they were smiling as I paid them. I go to the grocery store, K-mart, WalMart, Sam’s Club, gas station, and the dry cleaners. As I spend my money, I have to pay sales taxes and excise taxes. My point here is that most of the taxpayer dollars I receive as a state employee become someone else’s income.

What if the State Legislature and the Governor cannot agree on a new budget, and they decide to furlough state employees (send them home without pay until the budget issue is resolved)? Well, I know what actions I would take. If I had someone that was mowing my grass, you can imagine what I would tell them when they showed up to mow. See you later, let it grow. I would probably turn the air conditioning down, or off, in my home. Sorry CP&L. Go out to eat? I don’t think so. Highly processed frozen food items at the grocery store? I don’t think so. I’ve got enough time to get the fall garden expanded and do some freezing. The freezer is half full and running, it might as well be full and running. Dry cleaning? Ah, it just smells a little, I can get another wear or two out of that sport coat. Some new clothes? I don’t think so. I think you get the idea that the only spending would be for essentials and bills incurred prior to the furlough. Would the Research Triangle economy feel any ripple affects from similar behavior of state employees?