

Example 2.1

Changes in the U.S. Government: Expenditures and Revenues

The following table offers an overview of changes in government expenditures and revenues in the United States during the 41-year period from 1964 to 2005. Four years of data are displayed: fiscal years 2005, 1992, 1980, and 1964.¹ For these years, Part A of the table shows the size of the federal, state, and local governments relative to GDP, both in terms of total expenditures and government purchases of goods and services. Part B shows the composition of the more important categories of expenditures for the federal, state, and local governments. The data for the federal government include a breakdown of the transfer payments to individuals into three categories:

- Social Security pensions and disability payments and Medicare
- Medicaid
- All other transfer payments.

Part C shows the composition of the various sources of revenues for the federal, state and local governments, with a separate breakdown of tax revenues by the major taxes used at each level of government.

[Continued overleaf]

¹ The years were chosen as follows. 2005 is a good recent benchmark year because the Great Recession of 2007 has temporarily skewed the trend in the data with unusually large decreases in tax revenues, increases in federal expenditures to spur the economy, and decreases in state and local expenditures as they were forced to lay off employees to reduce their deficits; 1992 is the first year that state and local data are available on the Census Bureau's website; 1980 is twenty-five years before 2005; and 1964 was the last year before the passage of Medicare and Medicaid, which had the largest effect on government expenditures of any government program at any level of government over the past 40 years.

Table E2.1: Changes Over Time In U.S. Government Expenditures and Revenues

A: Relative Size of the Government Sector

Total Expenditures ² (% of GDP)	Fiscal Year			
	2005	1992	1980	1964
Federal	16.7	19.3	18.3	16.9
State	7.2	6.6	5.3	3.7
Local	9.4	9.1	8.4	6.6
Total	33.3	35.0	32.0	27.2

Government Purchases (% of GDP)	Fiscal Year			
	2005	1992	1980	1964
Federal	5.3	6.3	7.4	11.2
State	4.3	4.6	4.1	3.0
Local	9.0	8.7	6.6	5.8
Total	18.6	19.6	18.1	20.0

[Turn over]

² The total expenditures are net of grants-in-aid to other governments, to avoid double counting of expenditures. The total expenditures for the state and local governments are their direct general expenditures.

B. Composition of Expenditures

Federal (% of total expenditures)	Fiscal Year			
	2005	1992	1980	1964
National defense	20	22	23	46
Non-defense government purchases	6	7	11	14
Payments to individuals (including grants-in-aid) ³	60	53	47	27
Other grants-in-aid	6	5	10	6
Interest Payments	7	14	9	7

Federal Addendum: Payments to Individuals (% of total expenditures)		Fiscal Year			
		2005	1992	1980	1964
Social Security	Pensions and Disability Payments	21	21	20	14
	Medicare	14	9	6	0
Medicaid		7	5	2	0
Other ³		18	18	19	14

State (% of total expenditures)		Fiscal Year			
		2005	1992	1980	1964
Grants-in-aid		32	33	37	35
Direct General Expenditures		68	67	63	65
(% of direct general expenditures)	Public Welfare	36	31	23	20
	Education	22	21	25	24
	Health and Hospitals	9	10	11	10
	Highways	9	10	14	32
	Other	24	28	27	14

³ The grants-in-aid under payments to individuals are primarily for Medicaid, TANF, and some other public assistance programs, all of which are administered by the state governments (and the local governments in some states). Other payments are cash and in-kind public assistance to the needy, unemployment insurance, various kinds of assistance to veterans, and medical services not provided under Medicare and Medicaid.

Local (% of direct general expenditures)	Fiscal Year			
	2005	1992	1980	1964
Education	44	43	44	49
Police and Fire Protection	8	8	15	8
Health and Hospitals	8	8	7	6
Highways	4	5	6	9
Housing and Community Development	3	3	3	3
Public Welfare	4	5	6	2
Other	29	28	19	23

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C. Composition of Revenues

Federal (% of total revenues)	Fiscal Year			
	2005	1992	1980	1964
Personal Income Tax	43	44	47	43
Social Security Contributions (Payroll tax)	37	38	31	20
Corporation Income Tax	13	9	12	21
Other Taxes and Charges	7	9	10	16

State (% of total revenues)	Fiscal Year				
	2005	1992	1980	1964	
Grants-in-aid	32	28	28	25	
Direct User Charges and Miscellaneous Revenues	18	18	14	11	
Taxes	51	54	58	64	
(% of total taxes)	General Sales and Excise Taxes	48	50	50	58
	Personal Income Tax	34	32	27	14
	Other Taxes and Charges	18	18	23	18

Local (% of total revenues)	Fiscal Year				
	2005	1992	1980	1964	
Grants-in-aid	39	38	44	31	
Direct User Charges and Miscellaneous Revenues	22	22	19	15	
Taxes	39	40	37	54	
(% of total taxes)	Property Tax	72	76	76	76
	Other Taxes and Charges	28	24	24	24

(See end of Example for Sources)

The different parts of the table reveal the following trends in government expenditures and revenues over the past forty years.

PART A: RELATIVE SIZE OF THE GOVERNMENT SECTOR

1. Total expenditures, which include transfer payments and government purchases of goods and services, increased steadily as a percentage of GDP from 1964 to 1992 and have declined somewhat since then. The decline since 1992 is due entirely to the federal government; state and local spending as a percentage of GDP increased steadily from 1964 to 2005.
2. The data on government purchases of goods and services as a percentage of GDP give a better indication of changes in the public sector–private sector mix because government purchases are the resource-using expenditures. In contrast, transfer payments return tax revenues to the private sector to be spent by their recipients as they wish. The table shows that the public–private sector mix has been roughly constant over the past 40 years, the result of decreases in federal purchases and increases in state and local purchases, especially local purchases. The increase in purchases by local governments has been one of the bigger changes in the U.S. government sector since 1964. Do not forget the state and local governments when thinking about the government sector. Demand for their services has been extremely robust over the past 40 years.

PART B: COMPOSITION OF EXPENDITURES

1. The overall message to draw from part B of the table is that all three governments continue to do what they have always done for the past forty years in terms of the kinds of public services they provide.
2. The one important exception was the 1965 reform of the Social Security Act, which established Medicare and Medicaid and dramatically increased government financing of medical care by the federal and state governments. Medicare was a new medical insurance program for the elderly operated as part of the Social Security System and financed by the payroll tax. Medicaid provided medical care for the poor. Medicaid was originally designed to consolidate the medical payments that had been offered under the existing public assistance programs, which gave cash and medical assistance to the poor who were also either aged, or blind, or disabled, or single-parent families with children. Coverage was expanded to non-poor but medically needy families with low incomes in the 1990s and Medicaid grew rapidly. It was approaching \$300 billion by FY2005, larger than all other public assistance programs combined, with the federal government paying about 60% and the states (plus local governments in some states) 40% of the total expenditures. Medicare and Medicaid were primarily responsible for the steady increase in the transfer payments to individuals from 27% of total federal expenditures in 1964 to 60% in 2005. Similarly,

Medicaid is primarily responsible for the steady increase in public welfare expenditures by state governments, from 20% of their total expenditures in 1964 to 36% in 2005.

3. Other features of note:

Federal government

- a. Federal interest payments are quite volatile. They can vary considerably over time depending on the amount of federal debt outstanding and the level of interest rates on U.S. Treasury securities, which determines the borrowing rate for the government. Interest payments rose sharply from 1980 to 1992 because of the large budget deficits during the Reagan and George H. W. Bush administrations and relatively high interest rates in 1992. Interest payments fell roughly in half from 1992 to 2005 as a percentage of total expenditures despite the renewed deficit spending of the George W. Bush administration, which had increased the debt outstanding to \$7 trillion in 2005. The decrease occurred because interest rates on Treasury securities were relatively low and also because of the dramatic rise in the importance of payments to individuals within the federal budget.
- b. The federal government has been increasing its grants-in-aid to state and local governments since 1992. They are unlikely, however, to reach their 1992 level of 10% of federal expenditures, in part because of the ever-increasing spending on transfer payments to individuals.

State and local governments

- c. There are no important expenditure trends in state and local spending other than the increase in state spending on public welfare already noted. Education as a percentage of total spending fell somewhat from 1964 to 1980, but has been steady ever since. Grants-in-aid to local governments continue to represent approximately one-third of state spending.

PART C: COMPOSITION OF REVENUES

1. The overall message is the same as for expenditures: there has been no fundamental change in the sources of revenues for the three levels of government, including their choice of taxes.
2. Some compositional changes of note:
 - a. **Federal government**

The biggest change is the increasing importance of contributions to the Social Security System through the payroll tax, brought about by the 1983 reforms which increased the payroll tax rates to create a surplus in the Social Security Trust Fund which would then be drawn down to finance the retirement pensions of the baby boom generation born between 1946 and 1964. The increasing importance of the payroll tax came at the expense of the corporation income tax and the other taxes and charges. (The increase in the corporation income tax revenues from 1992 to 2005 is somewhat of an anomaly caused by a sharp run-up in corporate earnings in the recovery from the 2001 recession.)
 - b. **State governments**

Over the past 40 years, states have been relying more on grants-in-aid from the federal government and direct user charges, and less on tax revenues, to finance

their expenditures. The states have also increased their reliance on the personal income tax relative to general sales and excise taxes.

c. **Local governments**

Over the past 25 years, local governments have been relying less on grants-in-aid from their state governments and more on direct user charges and taxes to finance their expenditures. The increased reliance on direct user charges by the state and local governments may reflect the popularity among U.S. citizens of paying for public services on the basis of the benefits received from them, if possible.

Examples are direct payments for trash collection and purchase of beach tags to finance public beaches and pools.

Sources

U.S. Census Bureau website for state and local data since 1992; pre-1992 state data provided by John Curry of the Census Bureau

Budget of the United States Government, Fiscal Year 2008, Historical Tables 2.2, 6.1, and 11.3 (Washington, D.C.: U.S. Government Printing Office, 2007)

Statistical Abstract of the United States, 1981 and 1966 (Washington, D.C.: U.S. Government Printing Office, 1981, 1966).