


Government Spending and Taxation

Full Length Text — Part: 6 Chapter: 1
Micro Only Text — Part: 4 Chapter: 1
Macro Only Text — Part: 5 Chapter: 1

To Accompany "Economics: Private and Public Choice 11th ed."
James Gwartney, Richard Stroup, Russell Sobel, & David Macpherson
Slides authored and animated by:
James Gwartney, David Macpherson, & Charles Skipton

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Government Expenditures

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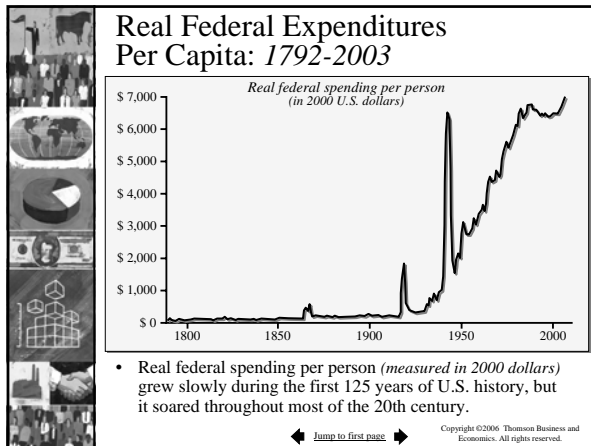


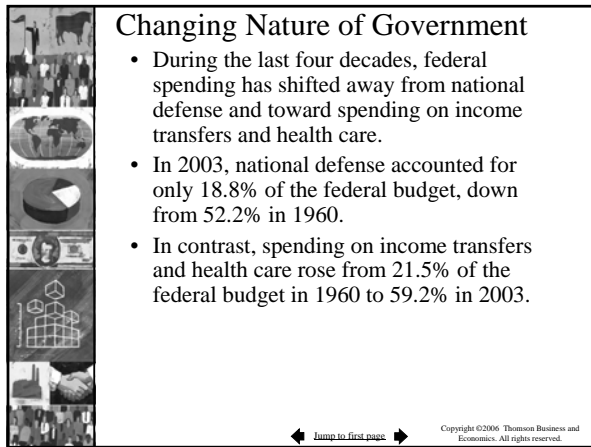
Growth of Government

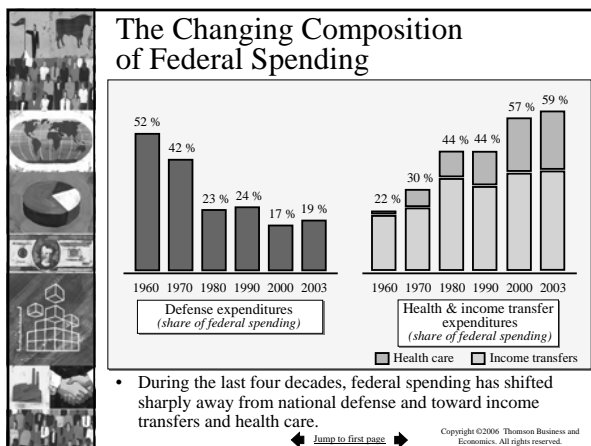
- During the first 125 years of U.S. history, federal expenditures per person were small and they grew at a relatively slow rate.
(See following slide)
- In contrast, federal spending soared throughout most of the 20th century. In 2003, real federal spending per person was roughly 60 times the level of 1916.
- During the 1990s per capita real federal spending was relatively constant. In fact, it declined slightly during the decade.
- Since 2000, per capita real federal spending has once again been increasing rapidly.


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Taxes and the Finance of Government

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Taxes and Other Revenue Sources

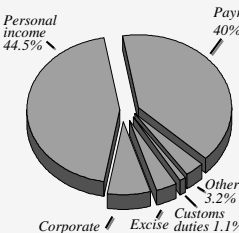
- Governments are financed by taxes, user charges, and borrowing.
 - Borrowing implies higher future taxes.
- The power to tax is a distinguishing characteristic of government.
- The major sources of federal revenue are the personal income tax (*accounts for almost 50% of federal revenue*) and the payroll tax (*accounts for about a third of the total*).
- Major revenue sources at the state and local level are sales and excise taxes, personal income taxes, user charges, and grants from the federal government.

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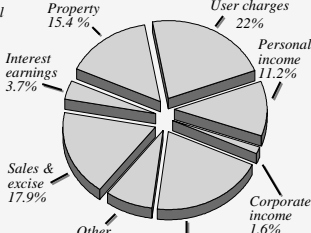
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Sources of Government Revenue



Federal government revenue
2003 -- \$ 1,782 billion




State & local government revenue
2002 -- \$ 1,808 billion

- The revenue sources of both the federal and state & local governments are displayed above.

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Taxes and the Cost of Government

- A dollar of taxation costs the economy more than a dollar because:
 - It is costly to administer, enforce, and comply with tax legislation.
 - Taxes distort incentives and eliminate productive exchanges (*and cause people to undertake some counterproductive activities*).
 - Economists refer to this as the “dead weight loss” of taxation.


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How Has the Structure of the Personal Income Tax Changed?

- The share of the income tax paid by high-income taxpayers has risen during the past 40 years – especially since 1980. (*This is demonstrated graphically on the next slide.*)
- Why has the share paid by those with high-incomes risen?
 - The decline in marginal tax rates have created greater “incentive effects” for high-income tax payers to earn taxable income.
 - The standard deduction and personal exemption have increased substantially over the past two decades.

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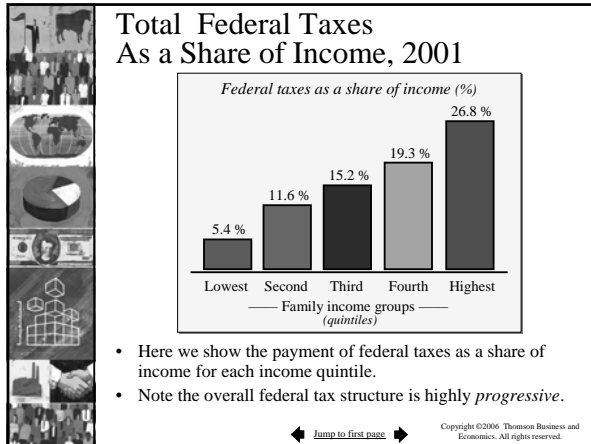


Share of Federal Income Taxes Paid By Various Income Groups

Income group	Share of total federal personal income tax paid			
	1963	1980	1990	2002
Top 1%	18.3 %	19.1 %	25.1 %	33.7 %
Top 5%	35.6 %	36.8 %	43.6 %	53.8 %
Top 10%	47.0 %	49.3 %	55.4 %	65.7 %
Top 25%	68.8 %	73.0 %	77.0 %	83.9 %
Top 50%	89.6 %	93.0 %	94.2 %	96.5 %
Bottom 50%	10.4 %	7.1 %	5.8 %	3.5 %

- Upper-income Americans pay the bulk of the federal income tax and the share they pay has risen during the last 4 decades.

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Does the Growth of Income Benefit the Federal Government?

- Federal personal income tax brackets are indexed for inflation, but no adjustments are made for increases in real income.
- Under the current progressive tax structure, the growth of real income will increase federal revenues as a share of total income if no offsetting action is taken.

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Size of Government: U.S. versus Other Countries


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Size of Government: *U.S. Versus Other Countries*

- The size of government in the U.S. is smaller than that of Japan and the major Western European countries, but larger than for a number of high-growth Asian economies. (See the following slide.)

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Size of Government: *An International Comparison*

Government expenditures as a share of GDP, 2003

Sweden	58.2 %
Denmark	56.1 %
France	54.5 %
Belgium	51.4 %
Austria	51.2 %
Germany	48.9 %
Netherlands	48.9 %
Italy	48.9 %
Norway	48.4 %
Portugal	47.9 %
Greece	47.2 %
United Kingdom	42.6 %
Canada	40.1 %
Spain	39.5 %
New Zealand	38.5 %
Japan	37.7 %
Australia	36.4 %
United States	35.7 %
Ireland	35.2 %
South Korea	24.3 %
Singapore	19.9 %
Hong Kong	19.2 %
Thailand	16.8 %


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Questions for Thought:

- A century ago, federal taxes and spending per person were substantially lower than today. How would the U.S. economy be affected if the federal government was, for example, one-third its current size? What programs would you favor cutting?
- Because the structure of the personal income tax is progressive, more income is taxed at higher rates as income grows. Therefore, economic growth automatically results in higher taxes. Do you think this is an attractive feature of the current tax system?


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Questions for Thought:

3. The marginal tax rates imposed on those with high incomes are now substantially lower than in 1980. Would you like to see higher tax rates imposed on high income Americans?
4. "Real federal spending per person grew slowly under the Reagan Administration during the 1980s, but it increased rapidly under the Clinton administration in the 1990s."
-- Is this statement *true*?


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Questions for Thought:

5. Are the following statements *true or false*?
 - a. During the first 125 years of U.S. history, federal expenditures per person were small and they grew at a relatively slow rate.
 - b. In 2003, real federal spending per person was about 60 times its level of 1916.

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**End
Special Topic 1**

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