DEPARTMENT OF POLITICAL SCIENCE
AND
INTERNATIONAL RELATIONS

POSC 105
THE FEDERAL BUDGET

I. THIS MORNING:
   A. The federal budget:
      1. The composition of the budget.
      2. How it differs from household and business budgets.
      3. An assessment of government debt and deficits

II. COMPOSITION:
   A. Looking at the usual spending categories such as national defense, education, and so forth looking can be misleading.
      1. Spending by function and agency does not reveal the total picture.
   B. **Discretionary** programs
      1. First Congress authorizes a program then it
      2. **appropriates** money for it.
      3. Hence Congress can control spending directly.
   C. **Entitlements**: entitlements are characterized by:
      1. Recipients or beneficiaries are entitled to benefits
         a. Examples: social security, medicare
      2. Congress does not annually appropriate money for them in the usual fashion.
      3. Costs go up with inflation, changes in demographics, state of the economy, etc.
      4. Hence, spending on entitlements is called relatively **mandatory** or **uncontrollable**.
   D. **Interest payments**: a large chunk of money goes to paying interest charges on the debt.
   E. Major point: since the early 1970s spending on entitlements has increased by leaps and bounds.
      1. Contrary to popular belief, spending on **discretionary** programs has remained more or less steady; in fact, for many categories it has decreased.
      2. Greatest growth has been in entitlement spending
      3. Furthermore, many entitlement programs are very popular with the public and/or very powerful groups such as seniors and farmers.

III. DIFFERENCES BETWEEN FEDERAL AND HOUSEHOLD OR BUSINESS BUDGETS:
   A. Politicians, editors--nearly everyone in fact--insists on comparing the federal budget with business or household budgets.

1. I called this an aspect of Calvinist political economy

B. How the budget differs from "ordinary" budgets

1. What is recorded in federal budget documents are expenditures for all activities and purposes.
   a. They are not broken down into funds for **consumption** and for **assets**.

C. Moreover, spending is not considered investment.

1. In a household borrowing for a college education or a new addition is considered an investment that retains value far beyond the period of the loan.
2. Spending versus investment
   a. Should investment be thought of the same way as spending for consumption?
   b. Investment in human and physical capital leads to future productivity
      * Human capital: education, training, health, psychological and social well-being sufficient to make the labor productive.
      * Physical capital such as communications, highways, research laboratories.
        - Example: Interstate highway system.
3. Question: if the next generation is in jeopardy as many politicians claim, shouldn't the country invest more to increase future productivity?

D. Democrats tend to make this distinction but seldom explicitly articulate it because they are intimidated by current hostility to government spending.

IV. HOW BAD ARE DEFICITS AND DEBTS?:

A. The debt in perspective:

1. One person's debt is another's assets
2. Net debt = gross debt minus government assets
3. Who owns the nation's debt?
   a. Look at the table in Bernstein and Heilbroner, ***The Debt and Deficits***.
4. Debt discounted for inflation.

B. The case for deficit spending:

1. Deficit spending can be useful to deal with economic hard times.
2. The economy in balance: relatively low unemployment and stable (gradual) price increases
   a. "Full" employment and no inflation.
3. Twin problems: maintaining demand and controlling prices
   a. Aggregate demand
   b. Inflation: rapid rise in prices and interest rates
      * Interest rates = the cost of money

C. Macroeconomic policy:
   1. Fiscal policy: using taxes and public spending to keep aggregate demand steady and growing evenly.
      a. "Pump priming"
      b. See Bernstein and Heilbroner for an explanation of the benefits of “deficit” spending in a recession.
   2. Conversely, to fight inflation government attempts to reduce aggregate demand by “taking” money out of the economy: it reduces spending and/or increases taxes.
      a. The net result is reduction in income that leads to lower aggregate demand.
      b. Price increases slow down or level off but unemployment may rise.
   3. Monetary policy
      a. FED attempts to control the money supply by adjusting interest rates.

D. Economists debate the efficacy of fiscal and monetary policy.

V. NEXT TIME:
   A. Second test

Go to Notes page

Go to American Political System page