

Measuring Leviathan: How Big is the Federal Government?

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What is the size of government?

- Government affects the economy in various ways
 1. The mix of goods and services the economy produces
 2. Who pays for government (taxpayers vs. users)
 3. How private goods for private consumption are funded (transfers and subsidies vs. user payments)
 4. Who manages production (agencies, contractors, firms)
- We consider how to measure government size via its fiscal activities (taxes and spending)
- Regulation & monetary policy are beyond our scope

Examples

- The U.S. military
 - Reallocation of output from civilian to military use (#1)
 - Taxpayers fund the services (#2)
 - Production managed by government employees (career military), but equipment procured from private firms (#4)
- Social Security retirement benefits
 - Very little direct reallocation (#1)
 - Benefits funded by taxes on workers (#3)
 - SSA employees manage program, with some help from contractors (#4)

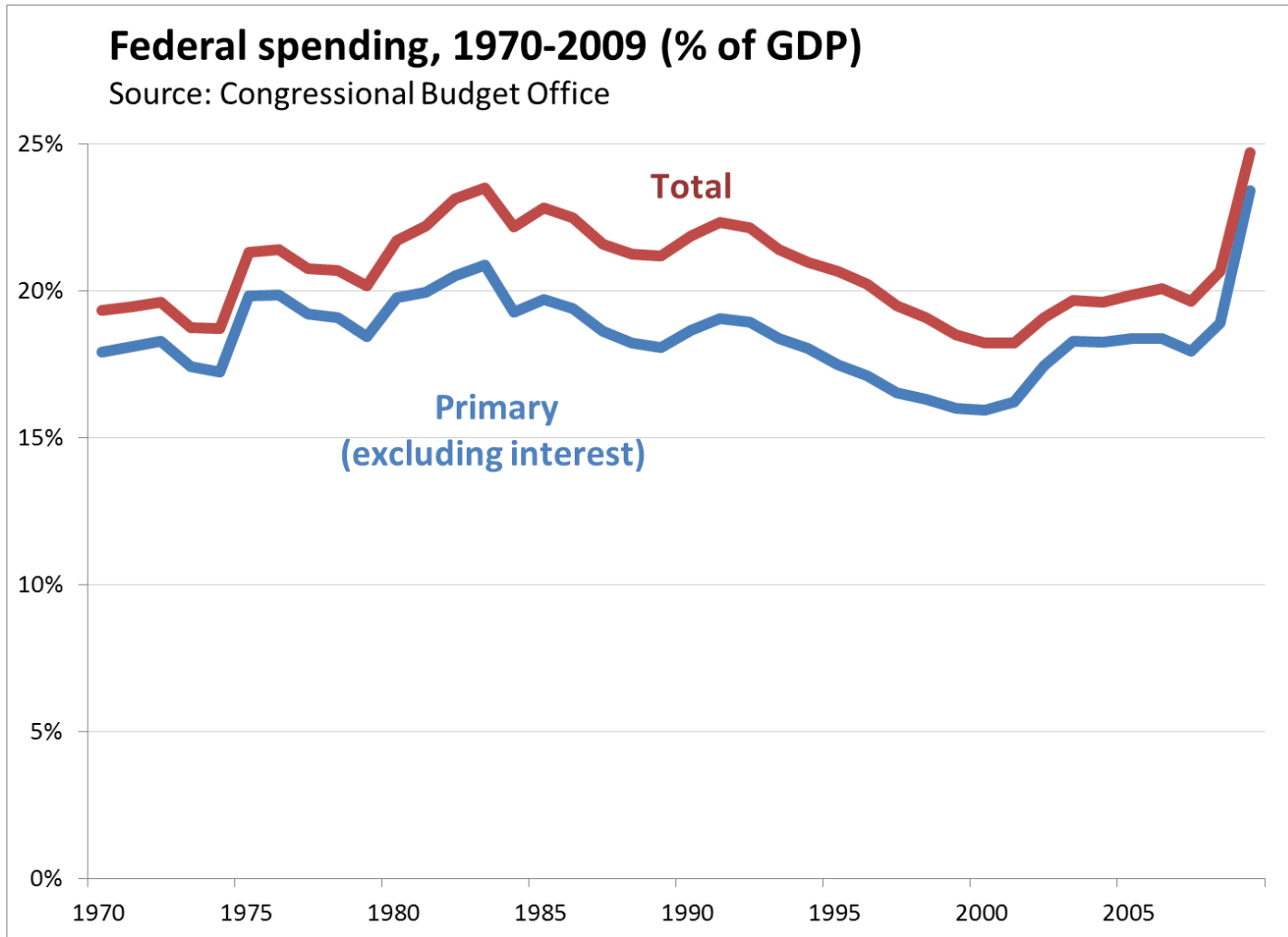
Budgetary treatment of categories

- Resource allocation
 - Direct outlays scored as spending
 - Tax expenditures and regulations not scored as spending
- Financing of government outlays
 - If funded by user fees, only the subsidy counted as spending; sometimes hard to tell a user fee from a tax
- Financing of private consumption
 - Gross transfer payments counted as spending
 - Taxes on transfer payments do not reduce spending
- Management of production
 - Does not affect whether or not counted as spending

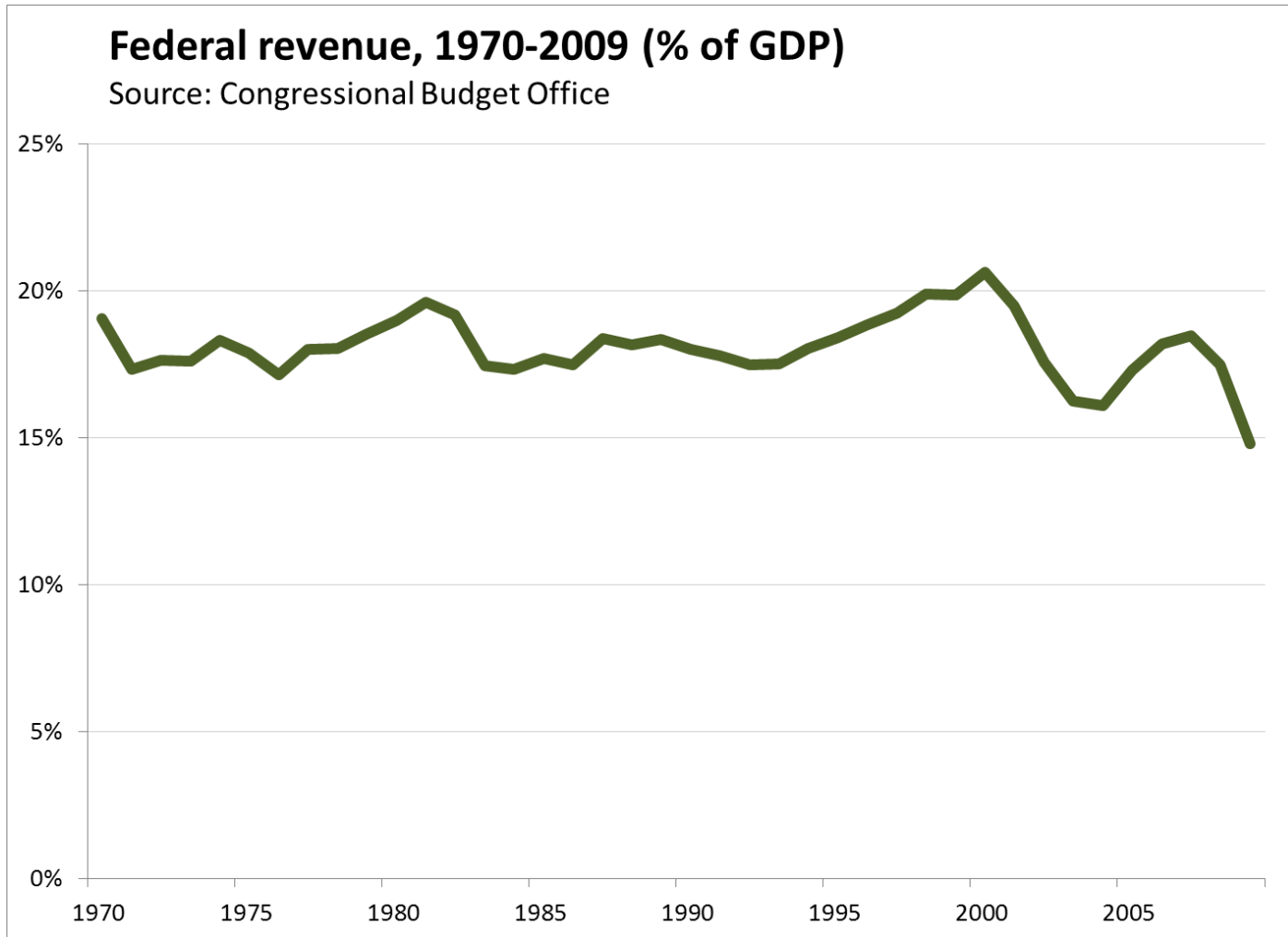
Standard budget measures

- Budget figures – outlays and revenues – are the most common measure of the size of government
- Based on 1967 budget concepts
- Based on cash accounting (with few exceptions)
 - Accrual accounting differs; beyond today's scope
 - Example: accrual cost of federal employee and veterans benefits in 2010 was about \$500 billion higher than their cash cost

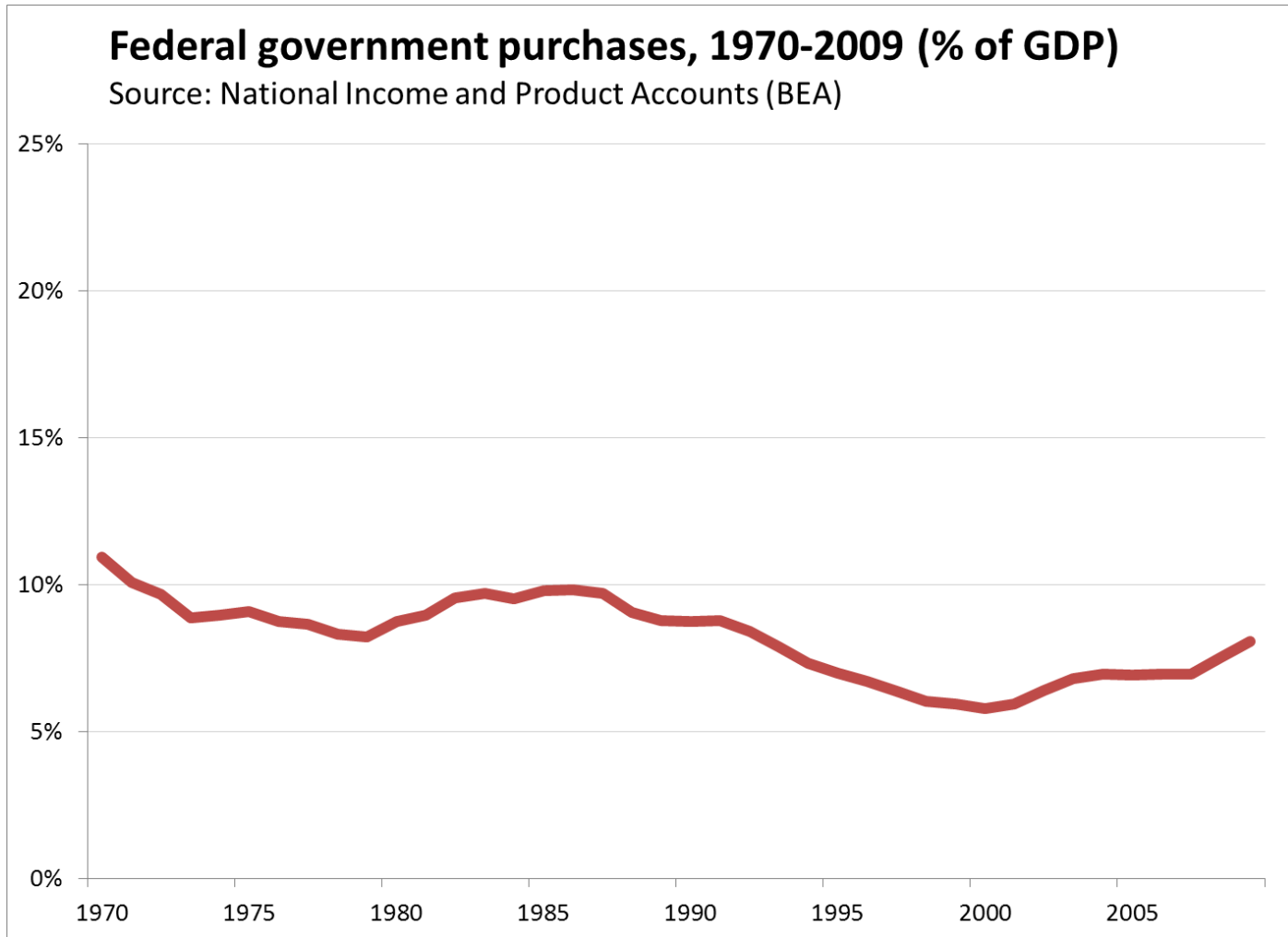
Standard budget measures: outlays



Standard budget measures: revenue



Spending on public goods



Paying for public goods



Tax expenditures

- Many tax provisions favor specific activities, types of income, or types of taxpayer. Amounts in 2007:

	\$ billions	share
Exemptions and exclusions	315	34%
Deductions	224	24%
Deferrals	177	19%
Credits	126	14%
Preferential Rates	83	9%
Total	925	100%

- How do these affect the size of government?

Are tax expenditures “spending”?

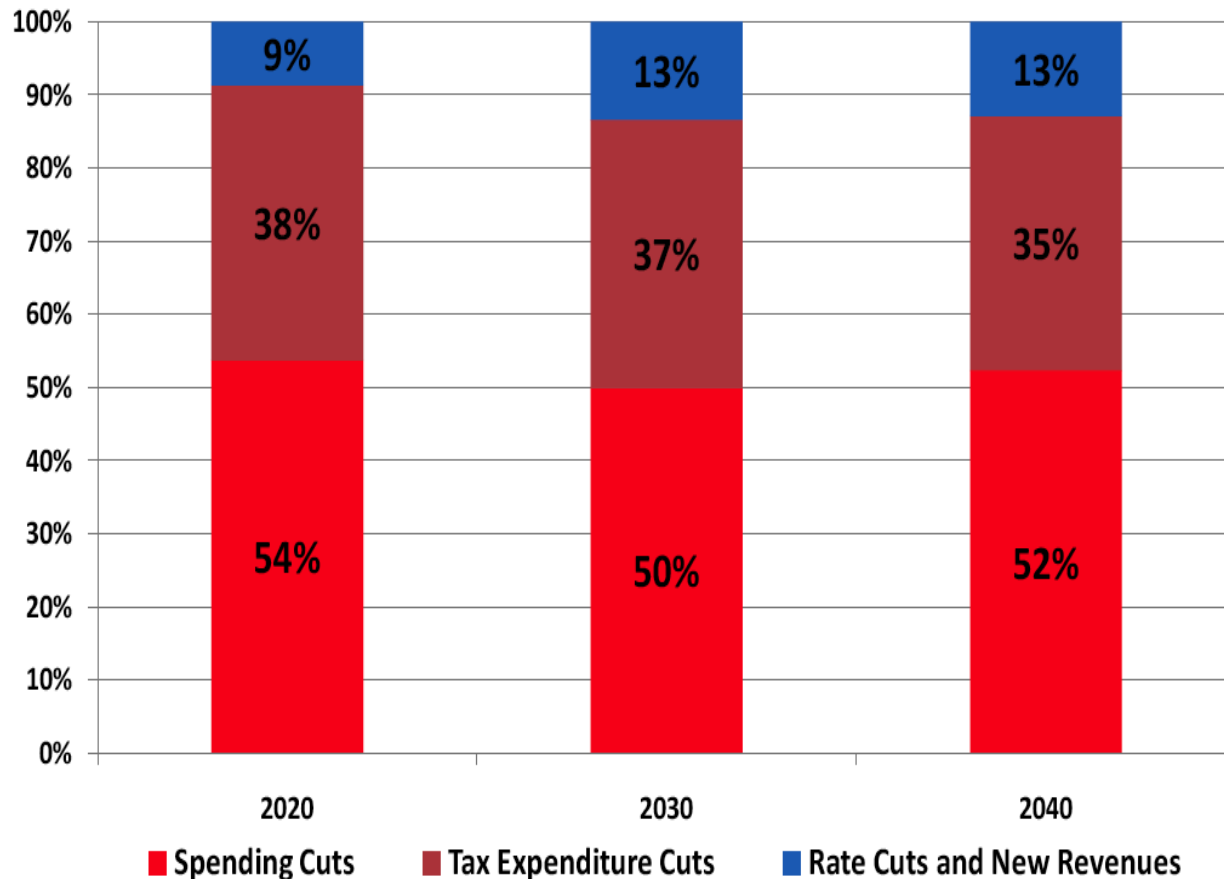
- Measured as departures from an “idealized” baseline
 - Baseline resembles a comprehensive income tax, but with adjustments for administrative convenience
 - Baseline depends on several assumptions about design
- The list mixes two types of provisions
 - Choices of tax system design that differ from a particular normative base (e.g., preferential rates on capital gains, deferral of foreign-source income of multinationals)
 - Substitutes for spending programs (e.g., energy tax credits, exclusion of employer-sponsored health insurance)

Does it matter if we call it spending?

- Not for measuring deficits
- Yes for measuring the size of government using either spending or revenues
 - Farm subsidies are “spending”, but residential energy credits are “tax cuts”
 - Bradford: funding defense procurement with “weapons supply tax credit”
- Tax expenditures can make government appear smaller than it really is

Example: BPC budget proposal

- The Bipartisan Policy Center used three categories:



Classifying tax expenditures

- Not all tax expenditures are effectively “spending”
- Options for identifying those that are “spending”
 1. Clear spending substitutes
 2. Targeted incentives to reallocate resources
 3. Substitutes for transfer programs
 4. Departures from both consumption and income base
- Other tax expenditures are just tax policy choices.

Tax expenditures by type, 2007

	\$ billions	share
Replaceable by a spending program	600	65%
Directly affects resource allocation	466	50%
Substitutes for a transfer program	133	14%
-- excluding taxes on transfers	107	12%
Also a T.E. with a consumption base	654	71%

Offsetting collections and receipts

- Some cash inflows subtract from measured budget spending rather than add to revenues
- Receipts from “business-like” transactions that do not reflect exercise of sovereign power
 - Postal Service stamps and fees
 - Medicare premiums
 - Proceeds from asset sales (timber, oil, minerals, spectrum)
- Some activities that involve sovereign power
 - Fees for regulatory services and licenses

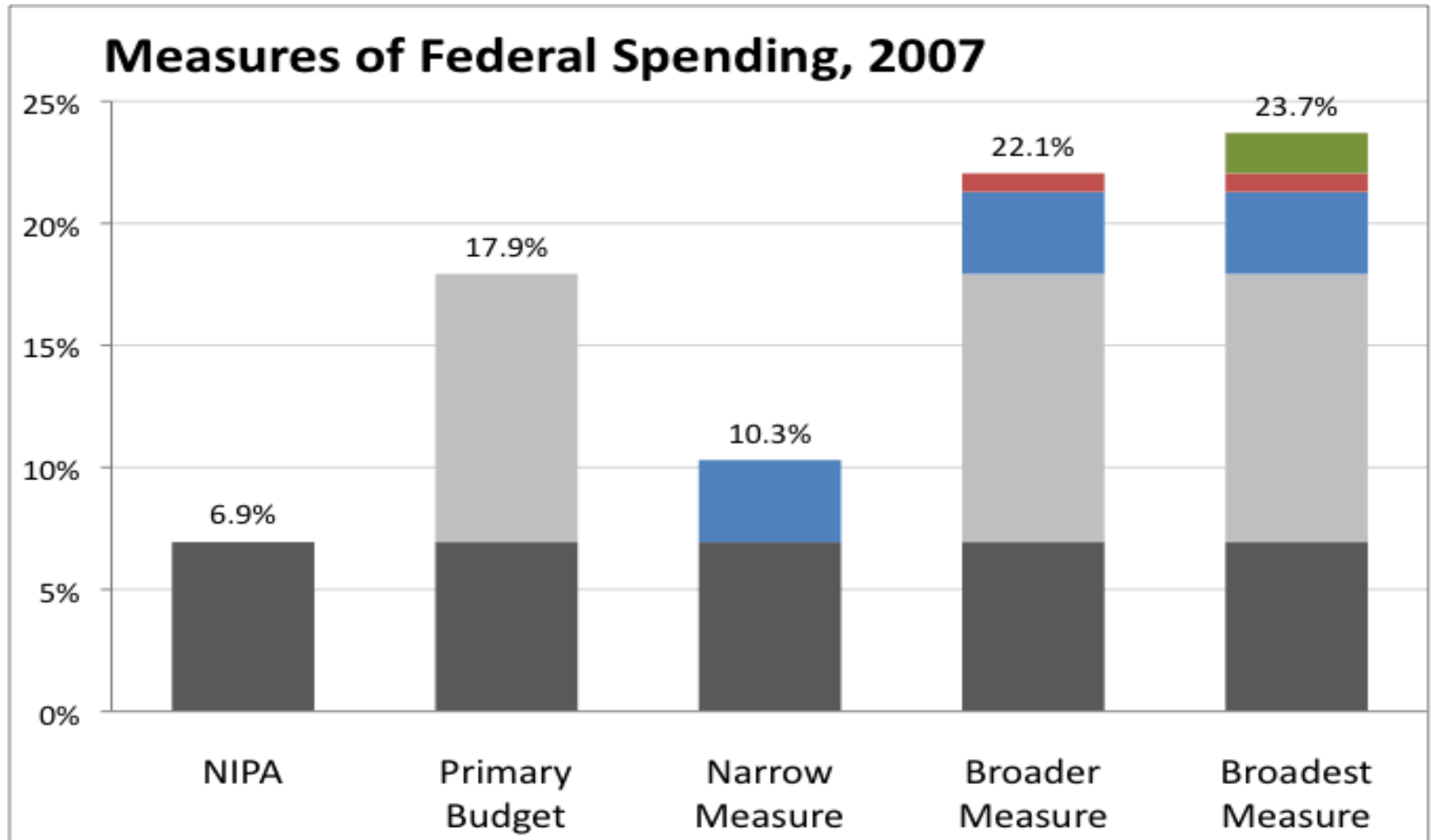
Offsetting collections and receipts, II

- Does this accounting understate government size?
- Would government be smaller if these activities were privatized?
- Asset sales do reduce government size, so budget accounting seems appropriate (\$91 billion in 2007)
- User fees create a wedge between the gross and net size of government activities. A broad measure would add them to spending (\$230 billion in 2007)

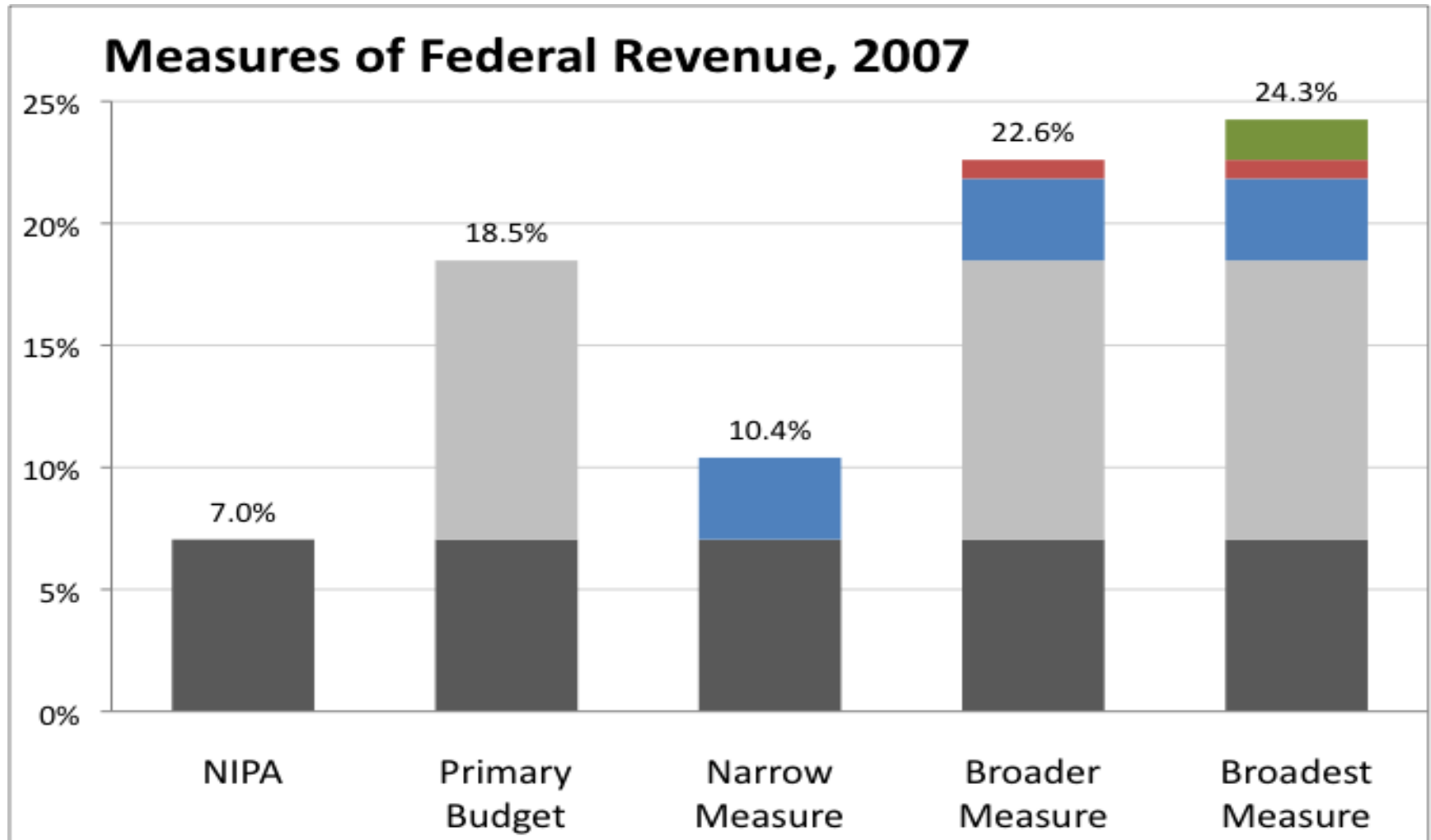
Possible measures of government

- **Narrow measure**
 - Public good outlays plus “reallocation” tax expenditures
- **Broader measure**
 - All federal spending except interest on the debt
 - All spending-substitute tax expenditures except taxation of transfers
- **Broadest measure**
 - Broader measure plus user fees

Comparing spending measures



Comparing revenue measures



Effects of policy on spending measures

	NIPA		<u>Possible Size Measures</u>		
	G	Budget	Narrow	Broader	Broadest
Reduce weapons procurement	↓	↓	↓	↓	↓
Reduce food stamps	None	↓	None	↓	↓
Reduce mortgage interest deduction	None	None	↓	↓	↓
Reduce child credit*	None	None	None	↓	↓
Increase Medicare premiums	None	↓	↓	↓	None

* Non-refundable

Effects of policy on revenue measures

	NIPA		<u>Possible Size Measures</u>		
	Net T	Budget	Narrow	Broader	Broadest
Reduce weapons procurement	None	None	None	None	None
Reduce food stamps	↑	None	↑	None	None
Reduce mortgage interest deduction	↑	↑	None	None	None
Reduce child credit*	↑	↑	↑	None	None
Increase Medicare premiums	None	None	None	None	↑

* Non-refundable

Takeaways on measuring government

- Standard budget figures are imperfect
- Constructing alternatives is challenging
 - Policies differ in degree of intervention
 - Analysts disagree about baseline
- Effect of policy depends on the measure
 - Reducing tax expenditures can increase measured revenue yet reduce size of government
 - Increasing user fees can reduce measured spending yet leave government size unchanged