

# The State and Money

Analysis of how the U.S Federal Government spends its Money

Who is John Galt?  
November 15, 2008  
ECO 4504

*It would scarcely be an exaggeration to say that the greatest danger to liberty today comes from the men who are most needed and most powerful in modern government, namely, the efficient expert administrators exclusively concerned with what they regards as the public good.*  
-F.A Hayek

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## **Introduction**

Tax policy and government expenditure in the United States of America is always a hot topic in the realm of politics and it is a subject where economists have a lot of weight. From Keynes advocacy of government programs to increase consumption and spending to Milton Friedman and Friedrich Hayek's advocacy for limited government and less government intervention in the free-market.

In this paper I aim to study the federal budget, government expenditure, the national debt, and how it relates to politicians in office. The political parties in the United States have debated and still do about how the federal budget should be spent and what priorities the government has. The democrats are often perceived as wanting to increase spending on social program and wealth redistribution. Republicans are seen as more "fiscally responsible" and giving tax cuts that benefit mostly the rich. Some of these perceived notions do not seem to correspond with the data from the Federal Budget from 1960 onward.

Later in the paper I will discuss what I personally would recommend for the government in regards of the federal budget, legislation, and expenditure. The main arguments that I will try to make will justify what the government should and should not do and how it relates to individual liberty, the economy, and society as a whole.

## **A brief history of the United States 1960-Present**

To fully understand how taxes and spending have occurred in the United States, it is important to first discuss the historical events that occurred during the time that is being studied and to see how the data corresponds. The two party system of Democrats

and Republicans has dominated the United States political landscape since the civil war. Both parties have different goals of what the government should and should not do and even on the topics and subjects where they agree that the government should act, they differ on how to implement policies and how the government should accomplish its goals.

The parties themselves do not always have consistent policies and ideology. It is not just that simple to label one president as republican or democrat and know what goals and policies they wanted to implement. The parties; however, have been consistent on many issues over time and they do function as a way to consolidate power among like minded individuals and politicians. The two parties have so dominated American politics that no other party has won the presidency since Millard Fillmore (1850-1853) from the Whig Party and that was before the American Civil War!

One of the most interesting aspects about the two party system is that there have been large shifts of population from one party to another with entire geographic areas shifting from one party to another as well. The clearest example of this is when the “old south” shifted from the Democratic Party to become the base of the Republican Party around 1980 and the election of Ronald Reagan.

In 1960 Eisenhower was serving his last year in office, race was still a huge in American politics and the cold war was in full swing. The cold war dominates foreign policy until the demise of the Soviet Union and the United States would get into many conflicts from south-east Asia to the Middle-East.

In 1961 John F. Kennedy would come into power and the democrats had majorities in both chambers of Congress. JFK had significant foreign policy obstacles

with the Bay of Pigs debacle, the Cuban missile crisis, and the beginning of the Vietnam War. These events as well as his unfortunate assassination would overshadow the “New Frontier” which was the name of Kennedy’s plan for domestic and social programs. Most of his programs would not be implemented before his assassination but would be adapted and adopted later by his successor Lyndon B. Johnson.

Johnson would later institute many of Kennedy’s social program and many of his own with his idea for a “Great Society.”<sup>1</sup> These programs too would be overshadowed by foreign policy when the conflict in Vietnam escalated into a full blown war. Johnson would help start Medicare and Medicaid during his Presidency as well as bring about the War on Poverty. Johnson also signed many important pieces of legislation regarding civil rights. Johnson would not seek re-election in 1968 and Richard Nixon succeeded him in 1969.

Congress would continue to be dominated by the Democrat party and not until Ronald Reagan would the Republicans gain one chamber in Congress. Nixon negotiated a peace in Vietnam and effectively ended the war. He also followed a policy of détente with the Soviet Union and improved relations with China significantly. Nixon would get the United States off the gold standard and set price controls in attempts to control inflation<sup>2</sup> despite the fact that he was not an advocate of government intervention in the economy. Nixon would have his legacy completely tarnished with the Watergate Scandal and resigned to avoid the embarrassment of being the first U.S President to be impeached and taken out of office.

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<sup>1</sup> <http://www.lbjlib.utexas.edu/johnson/archives.hom/speeches.hom/640522.asp>

<sup>2</sup> [http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/ess\\_nixongold.html](http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/ess_nixongold.html)

Gerald Ford would succeed Nixon and become President in 1974. His attempts at reducing inflation included a program called “Whip Inflation Now” or WIN for short, which tried to get the public to help with curbing inflation. The program even encouraged citizens to wear pins that had WIN on it. Needless to say, inflation did not go down much during Gerald Ford’s tenure as President of the United States. Ford would win the Republican nomination against Ronald Reagan but lose to Jimmy Carter in the general election. Gerald Ford would be the only President to never win a presidential election for either the presidency or vice-presidency.

Jimmy Carter became President in 1977 and his Presidency would be remembered for having stagflation, where double digit inflation and high unemployment helped to make it last only one term. Along with the economic downturn, the Iranian hostage crisis and another oil crisis did not help the situation. This would spell disaster for his presidency and Ronald Reagan would be elected in a landslide when Jimmy Carter ran for re-election.

Ronald Reagan who is probably the most admired conservative today by many who would consider themselves “fiscal” conservatives is remembered for supply side economics, lower tax rates, and less domestic government spending. Despite some of these measures, he continued to run a deficit because of high defense spending. However, the economy did well under Ronald Reagan’s presidency and interest rates, unemployment, and inflation all went down. The beginning of the end was in sight for the Soviet Union and Reagan who was very anti-communist and a big supporter of free markets was seen as a victor who helped bring it about. Ronald Reagan’s success and

high popularity paved the way for his vice-president George H.W. Bush to come into office.

The republicans gained so much popularity after the Carter administration that the Senate was controlled for the first by Republicans since 1955. This republican majority in the Senate would be short lived with the revelation of the Iran-Contra affair.

Bush Sr. would see the fruits of Reagan's presidency with the fall of the Soviet Union and the reunification of Germany. Bush Sr. would later invade Iraq to help defend the nation of Kuwait and enjoyed high approval ratings. His re-election campaign loss was seen as a result of a recession and his broken promise to not raise taxes. He lost in a three way election consisting of the billionaire Ross Perot and democrat Bill Clinton.

Bill Clinton would lead the United States into relative economic prosperity with low inflation, low unemployment, and especially low oil prices. Bill Clinton would only have a Democratic Congress during his first two years and did not get to implement the healthcare reforms that he wanted. Bill Clinton would be the first president to have a budget surplus since President Eisenhower. Although, some might give credit for the balanced budget to the Republican Congress or the fact that one party was not in charge of the legislative and executive branch of the U.S government.

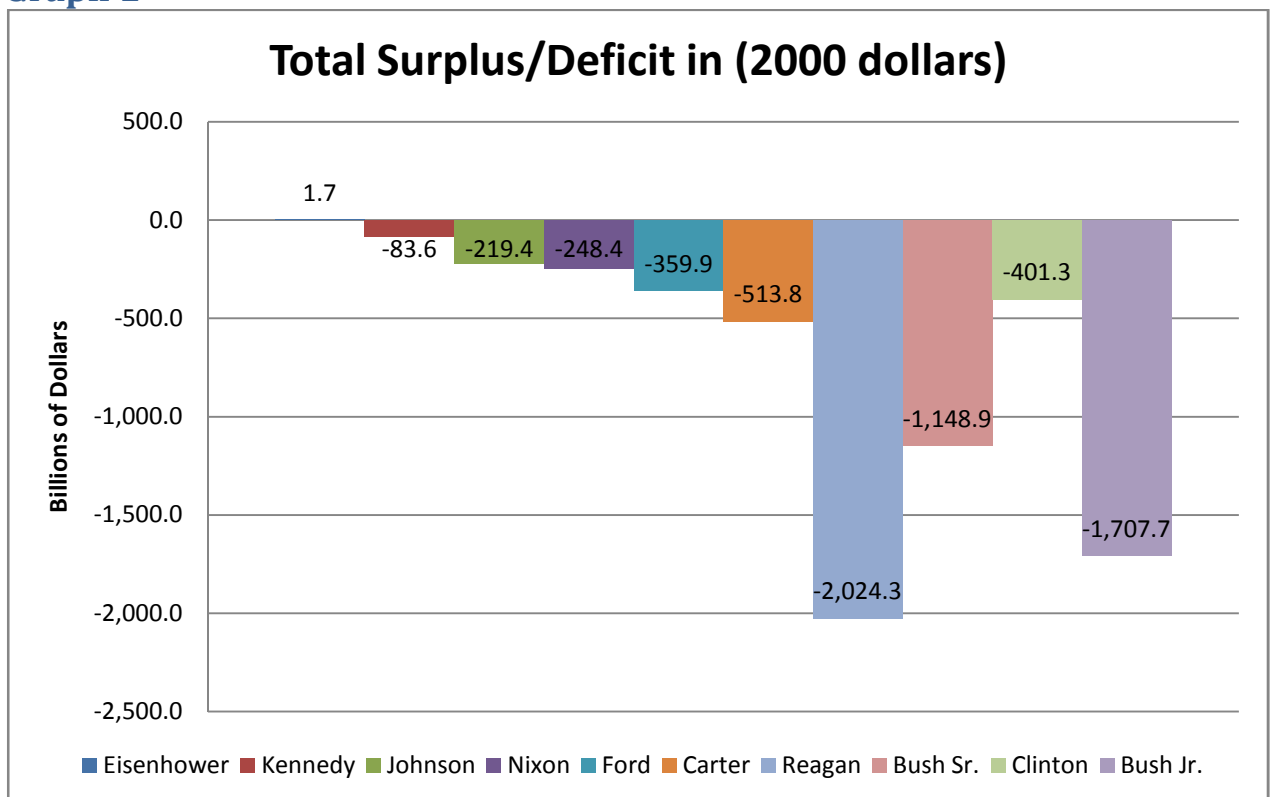
Bill Clinton's 2<sup>nd</sup> term would be dominated by the Monica Lewinsky and the ensuing impeachment. He is the 2<sup>nd</sup> President in the history of the U.S to have been impeached. With the economy slowing down (thanks in part to the dot com bubble burst) at the end of his term, Vice-President Al Gore would lose to George W. Bush in one of the closest elections in history.

George W. Bush began his presidency with a Republican Congress but lost the senate when one senator left the Republican Party. Having promised tax cuts and succeeded in getting them implemented. The economy suffered because of the terrorist attacks of 9/11 and then later because of high oil prices and the subprime mortgage crisis which is still having deep economic impact. Despite being a conservative, Bush Jr, only had a budget surplus one year and it was his first.

## Government Expenditure and how it relates to the Two Parties

Starting with President Eisenhower in his last year the Federal Budget had a surplus. He would be the last President to have until President Clinton. The following graph shows the surplus and deficits that each presidential administration.

**Graph 1**

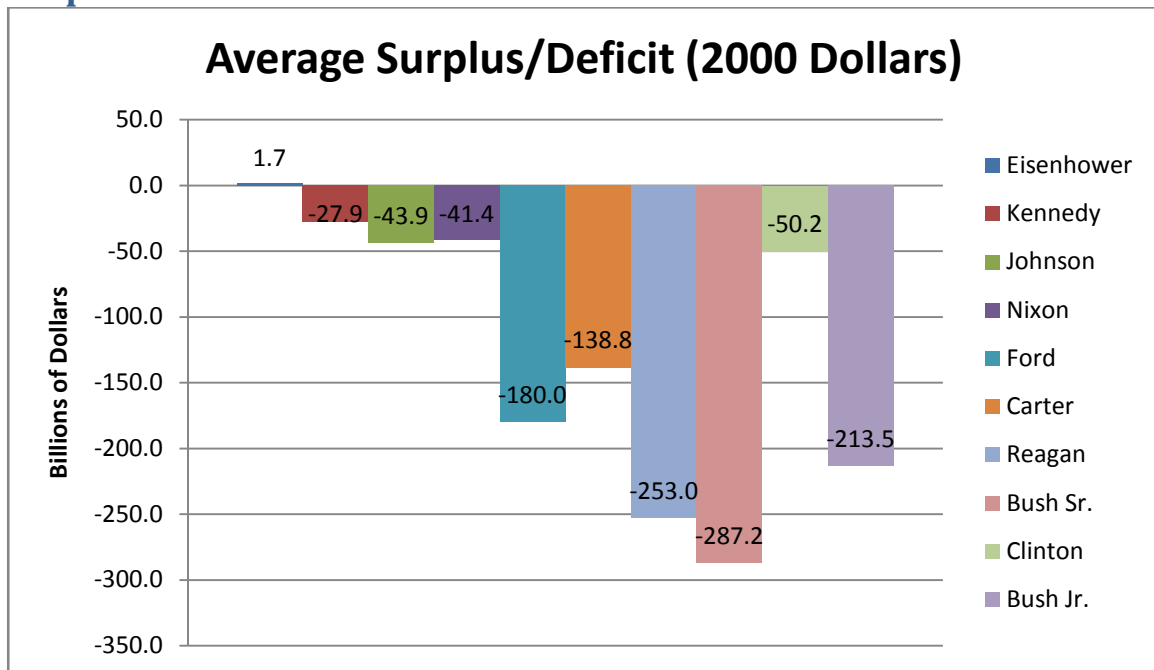




This graph gives the total amount of surplus/deficit but because some presidents serve longer than others, it can give the misimpression that some presidents ran bigger deficits on a yearly basis. This graph is important though because it shows us who has contributed most to our national debt and the impact that each president has made. Most surprising is that Ronald Reagan had the largest deficit during his administration even though he was a republican and is the model of conservatives today. Bush Jr.

The next graph gives the average surplus/deficit in (2000) dollars and gives us a better picture of how each administration managed the Federal Budget on a year to year basis. This time Bush Sr. tops the chart and his administration averaged a -287.2 billion dollar deficit for every year that he was in office. Ronald Reagan is still 2<sup>nd</sup> though in terms of average deficit per year.

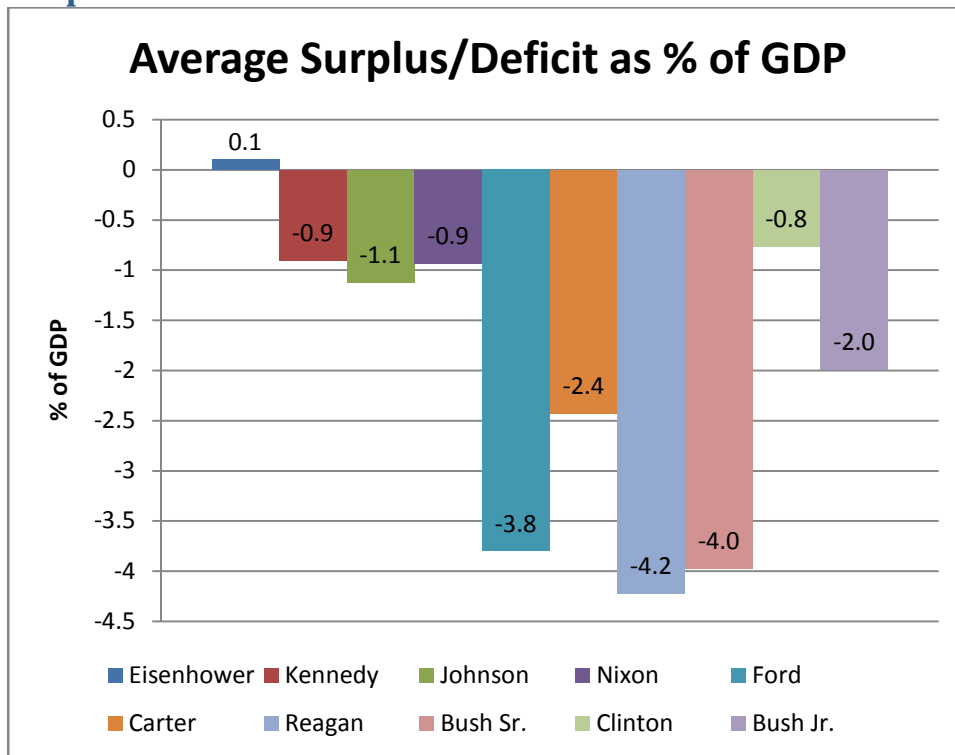
**Graph 1.1**



President Ford who had a smaller total deficit than President Carter shown in graph 1.0 has a larger deficit average per year than Carter. It is ironic that the top four in this graph are Bush Sr., Reagan, Bush Jr., and Ford. All of them Republicans! President Clinton who has the reputation of having run a surplus actually had a net deficit for his entire time in office and averaged a 50.2 billion deficit every year.

How do the deficits compare to GDP?

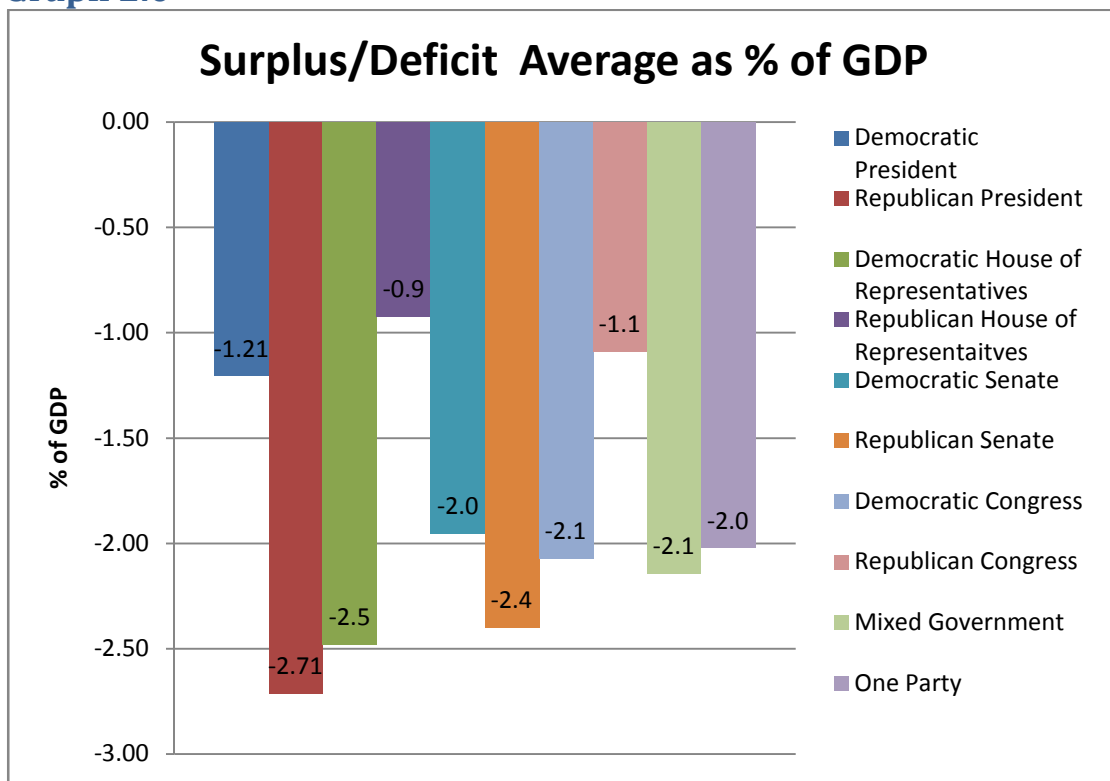
**Graph 1.3**



Once again Ronald Reagan has the largest negative impact on the budget when it is compared to GDP. There are also some other significant differences with this graph and graph 1.1. Bush Jr. who was 3<sup>rd</sup> in terms of average surplus/deficit is now 5<sup>th</sup> lowest. Both Gerald Ford and Jimmy Carter pass him up in terms of largest average deficit compared to GDP.

So are the republicans really fiscally conservative? Well definitely not in the executive branch but let's look at the U.S Congress and see if we can find data to support this notion. Below is a graph of government surplus/deficit as a percentage of GDP. We have organized the data in a way that separates the parties both in the Presidency and Congress.

**Graph 2.0**



Considering the other graphs, it should come as no surprise that the factor with the largest deficit average % of GDP was Republican President. It is so ironic that the biggest factor in the past 40 years contributing to deficits was a Republican Presidency. Not to be outdone; however, the Democrats in Congress were the 2<sup>nd</sup> largest factor. Probably the most disturbing attribute of this graph is that not one variable was positive. It did not matter what type of combination of parties we had in power, the result would always end

up being (on average) negative. It would seem that the only choice available to the voters was how big or small they wanted the deficit to become.

Another interesting detail about this graph that seems to go against conventional political wisdom is that one party controlling Congress and the White actually averaged a smaller deficit as a percentage of GDP than mixed government where at least one party had control of the White House or at least one chamber of Congress, although this is such a small difference that it is probably negligible and having either one party rule or mixed party rule of the executive and legislature did not have a significant difference. What does seem to matter though is which party was in control of the legislature and executive branches.

If I were to make an educated guess of how Barack Obama might balance the budget when looking at the above graphs, one could roughly expect somewhere between -1.51 (Democratic President) surplus/deficit average as % of GDP and -2.1 (Democratic Congress) surplus/deficit average as % of GDP. This would put him slightly above Bush Jr. in graph 1.3. This however, is a very unscientific prediction and there is nothing other than the current budget that should determine where Barack Obama might balance the budget. The difference between Clinton and Bush Sr. would attest to this fact.

## **Is the National Debt really that bad?**

These constant deficits pose the question. How bad is the National debt? Well the national debt in terms of GDP and sheer number is truly staggering. As of November 17, 2008 it is 10,618,466,094,057.06<sup>3</sup>. Represented in the graph below in terms of GDP it is worth approximately 70%. This alone however, is not such a big problem because

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<sup>3</sup> [www.treasurydirect.gov](http://www.treasurydirect.gov) <http://www.treasurydirect.gov/NP/BPDLogin?application=np>

the U.S government continues to pay the interest on the debt and it has never defaulted on a loan. However, interest payments on the debt have to be paid every year by the government and in order to pay this the U.S government has to borrow more, raise taxes or reduce spending.

Growth in the debt-to-GDP measure does not necessarily create problems in the short term, but continued growth will further reduce budgetary flexibility going forward and ultimately lead to an unsustainable fiscal path. (See fig. 15 in sec. 3 for future debt to- GDP shares under alternative fiscal policies.) Absent policy changes, the growth in spending on federal entitlements for retirees will encumber an escalating share of the government's resources. Assuming, for example, that recent tax reductions are made permanent and discretionary spending keeps pace with the economy, GAO's long-term simulations show that by 2040 federal revenues may be adequate to pay little more than interest on the federal debt.<sup>4</sup>

We also have to consider that borrowing against the future is unfair on moral grounds because it puts costs of the current government on future generations who have no ability to change this fact or vote in the present day. Also, government expenditures are included in current GDP so this artificially makes the GDP higher. Interest payments in 2008 totaled \$451,154,049,950.63<sup>5</sup> or 451 billion dollars which is larger than the deficit estimate for 2008 according to the 2009 budget.<sup>6</sup> The fact alone that the U.S government pays this much interest because of the national debt should be incentive enough to get rid

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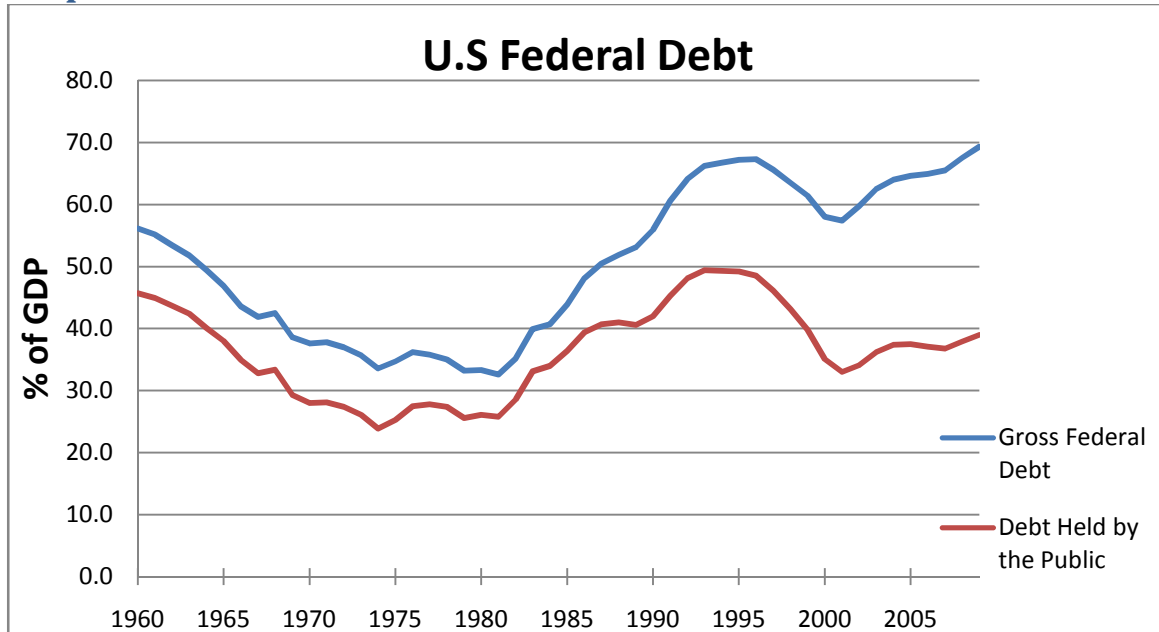
<sup>4</sup> <http://www.gao.gov/new.items/d04485sp.pdf>

<sup>5</sup> [http://www.treasurydirect.gov/govt/reports/ir/ir\\_expense.htm](http://www.treasurydirect.gov/govt/reports/ir/ir_expense.htm)

<sup>6</sup> <http://www.whitehouse.gov/omb/budget/fy2009/pdf/hist.pdf>

of it. Without the debt the United States would be able to tax its citizens less and still run a surplus.

**Graph 3.0**



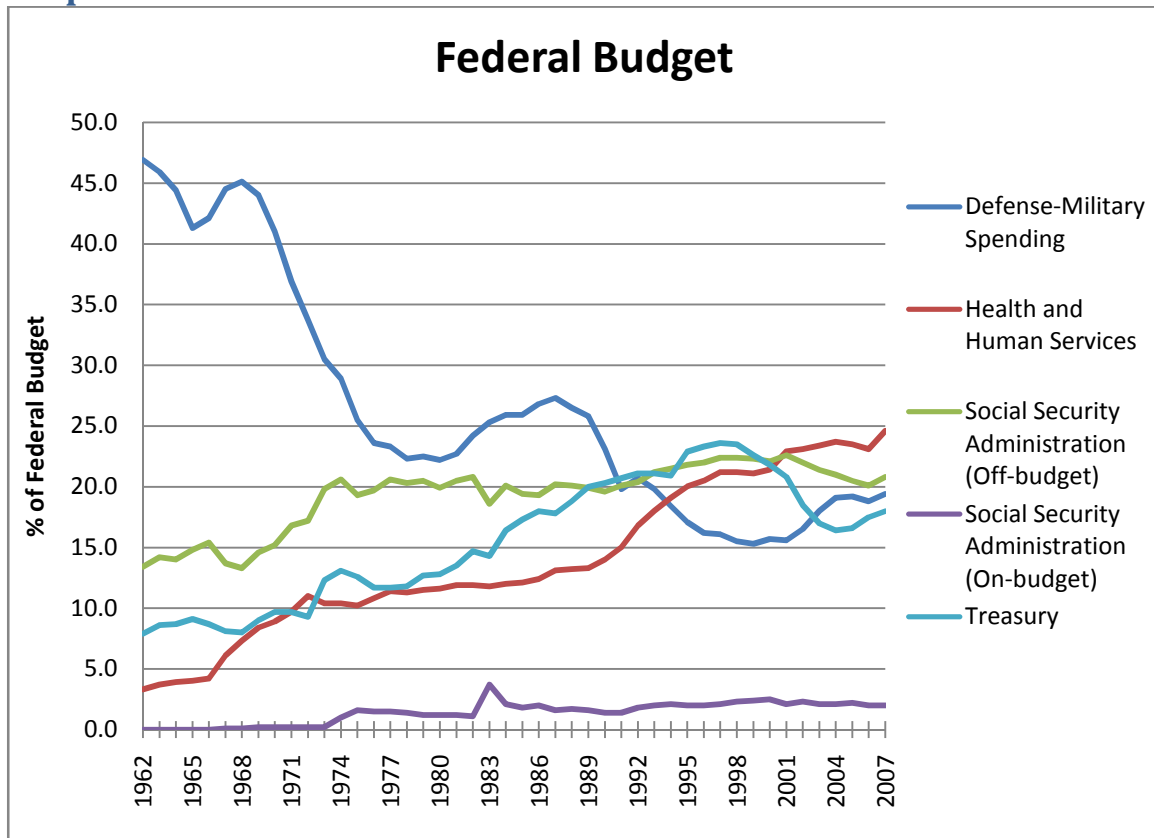
### How the Federal budget has Evolved

In 1962, there were only two agencies that exceeded 10% of the federal budget and they were military and defense spending and social security. At the time military spending was at around 46% of the federal budget and social security comprised 13.4%. Today four government agencies exceed 10% and they are social security, welfare, the treasury, and military and defense spending.

Three of the four have been on a steady increase in terms of percentage of the federal budget as illustrated below in graph 4.0 with military spending being the only one that has decreased. Considering that the United States still spends 48% of total military

spending in the world<sup>7</sup> and still manages to steadily decrease military spending in terms of percentage of the federal budget should speak volumes of how big and the federal government of the United States is.

**Graph 4.0**



There are three distinct periods where military spending seem to trend upward in this graph and they were the Vietnam War, Reagan administration, the Persian Gulf War and recently with the War on Terror and Iraq. Social security for the most part has been steady with only one big jump around the early 70's and then a moderate increase during the Clinton administration which was reversed by the Bush Jr, administration. Welfare (health and human services) has steadily been on the increase regardless of who was in

<sup>7</sup> [http://www.armscontrolcenter.org/policy/securityspending/articles/fy09\\_dod\\_request\\_global/](http://www.armscontrolcenter.org/policy/securityspending/articles/fy09_dod_request_global/)

office and seems to only change the amount that it increases. The Johnson and Clinton administrations seem to be where it increased the most. The one government agency that surprised me in terms of the budget was the Treasury. This seems to be mostly due to the national debt and the payments that the government has to make regarding interest. Note the dip in the percentage for the treasury around the 2<sup>nd</sup> term of the Clinton administration corresponding with graphs 3.0 lines where there is a similar dip in both of the federal deficit lines.

This graph seems to correlate quite well with the priorities of the current President but it shows that change can not be that drastic and that the budget a President will have during his administration depends heavily on how the past presidents have affected the budget. This is probably a very good thing because it shows that any one president can not implement very drastic change with regards to the federal budget.

## **My Ideal Government**

First and foremost, I do not think it is ever appropriate for one man to decide how best to design a government. Having said that I would like to see some drastic changes in the way the United States government operates in terms of both taxation and general operation. However, the United States is one of the freest countries in the world and for the most part I would keep the U.S Constitution which has restricted and balanced the amount of power in the federal government.

The State, in this case, the United States government is a coercive force and body that enforces its law on all citizens and restricts much of their freedom and forces them to fund its operation through involuntary taxes. This is not to say that the alternative of no



government would be any better, but that there is much the United States does to enhance liberty and freedom and much to restrict it and constrain it. For the most part I would keep the U.S Constitution which has restricted and balanced the amount of power in the federal government.

The United States has many institutions that enhance liberty and freedom and these are the rule of law, representative-democracy, and the right to vote. Actions that the government does to restrict freedom are taxation, redistribution of wealth, and any laws that restrict a citizen from doing what he wants that will not harm another human being or citizen.

The rule of law is probably the most important aspect of liberty and freedom in the United States and other countries around the world.

For in all the states of created beings, capable of laws, where there is no law there is no freedom. For liberty is to be free from restraint and violence from others, which cannot be where there is no law; and is not, as we are told, "a liberty for every man to do what he lists." For who could be free, when every other man's humour might domineer over him? But a liberty to dispose and order freely as he lists his person, actions, possessions, and his whole property within the allowance of those laws under which he is, and therein not to be subject to the arbitrary will of another, but freely follow his own.<sup>8</sup>

The rule of law in the United States allows the individual to be free to a very large extent and I would continue this tradition by eliminating most laws that do not allow the individual to do what he wished without harming another human being. The War on

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<sup>8</sup> John Locke – Second Treatise on Civil Government

Drugs is a primary example of the type of laws that I would repeal. Not only is the War on Drugs a wasteful government program especially with regards to marijuana, but it also threatens through the use of force and coercion to restrict human beings to not be able to enjoy pleasures that the individual want to act upon.

I would encourage government to enact laws that enhance property rights and the necessary ingredients for markets to work at their most efficient point. This would mean that laws would be necessary to internalize externalities. Make regulations on the market place regulations which enforce trust and transparency. This will increase the amount of information that consumers have and the more information that consumers have when buying a product, the better economic decisions they will make. The government should merely reflect the demand of information with regulation and laws.

The only social or redistributive programs that I think are necessary are those which prevent the absolute ruin of a citizen both from his own actions and that of others, and those that are so obviously beneficial to society that the government should subsidize it as to reach the socially efficient point. Education for example benefits society as a whole because the resulting outcome which most likely would not have happened under a completely free market benefits the entire society. Information is easily transferred because almost every person can read, write, do basic math. Social programs can increase trust in a citizen in both the citizens around him and that of the State, which exists for the sole purpose of serving its citizens.

Social programs; however, would be heavily restricted because they can easily lead down the road to controlled and planned economies which exposes the citizen to even more coercion and restrictions on his freedom and liberty.

The government and the social programs that it would conduct would be heavily restricted by the condition that the government only spend what it collects in revenue from taxation; except in times of a just war or national emergency, with the taxation voted upon by the people in open and free elections which would require a 60% majority. Regarding taxation, the situation is quite complicated and I do not have a one size fits all answer. I would leave it up to the legislature and the people and any increase in taxes would require a 60% majority. This would make it much harder to raise taxes and the State would then be forced to spend its funds more efficiently and designate the use of its money to the most efficient social programs.

With regards to the national debt, it is not fair that we put the burden of our current government on the shoulders of future generations and the wasteful spending on the interest because of the irresponsibility of our past generations must end. It should not be allowed to continue and there should be a law or amendment to the U.S Constitution that would check the power of the government to run deficits.

I would also like to see a return of power to the state and local governments of services that are not designated to the federal government by the U.S Constitution. This would include issues like education, housing, and urban development, abortion, most social programs, and regulations on recreational drugs. The state and local governments are more likely to be more efficient in the raising of revenue and allocation of these resources in the federal government which has to make laws and regulations completely uniform across the country.

With regards to central banking and the money supply, I would put in place a law or regulation that enforces that the Federal Reserve may not make any more currency or

cash then it replaces in circulation. The amount of cash and money created by the Federal Reserve should always be the same as to prevent unnecessary inflation which decreases the purchasing power of Americans compared to the rest of the world. I would slowly set a 50% fractional reserve requirement for all banks which I think would almost completely eliminate the possibility of bank runs compared with the 10% amount today.<sup>9</sup> Americans should never ever have to worry about their money in a banking institution with regards to on demand accounts. The United States government should also not have to bail out banking institutions because they can not pay out their own customers. I would keep the FDIC and increase the amount they insure also. I do not think that with a 50% reserve the need for insurance would ever come up, but if need be Americans should be able to get their money back. Americans should be able to fully trust that another great depression can not occur.

Overall, the way the United States government is run is quite good and I would hesitate to change any of it because it has evolved with the consent of the people that it governs and has shown itself to be the most powerful country in the world economically<sup>10</sup>, politically<sup>12</sup>, and militarily<sup>13</sup>. The changes I have outlined are a simple and short way that I think the U.S government can improve both economically and morally with regard to freedom and Liberty.

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<sup>9</sup> <http://www.federalreserve.gov/monetarypolicy/reservereq.htm>

<sup>10</sup> <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html>

<sup>11</sup> <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>

<sup>12</sup> <http://post.queensu.ca/~nossalk/papers/hyperpower.htm>

<sup>13</sup> [http://www.armscontrolcenter.org/policy/securityspending/articles/fy09\\_dod\\_request\\_global/](http://www.armscontrolcenter.org/policy/securityspending/articles/fy09_dod_request_global/)

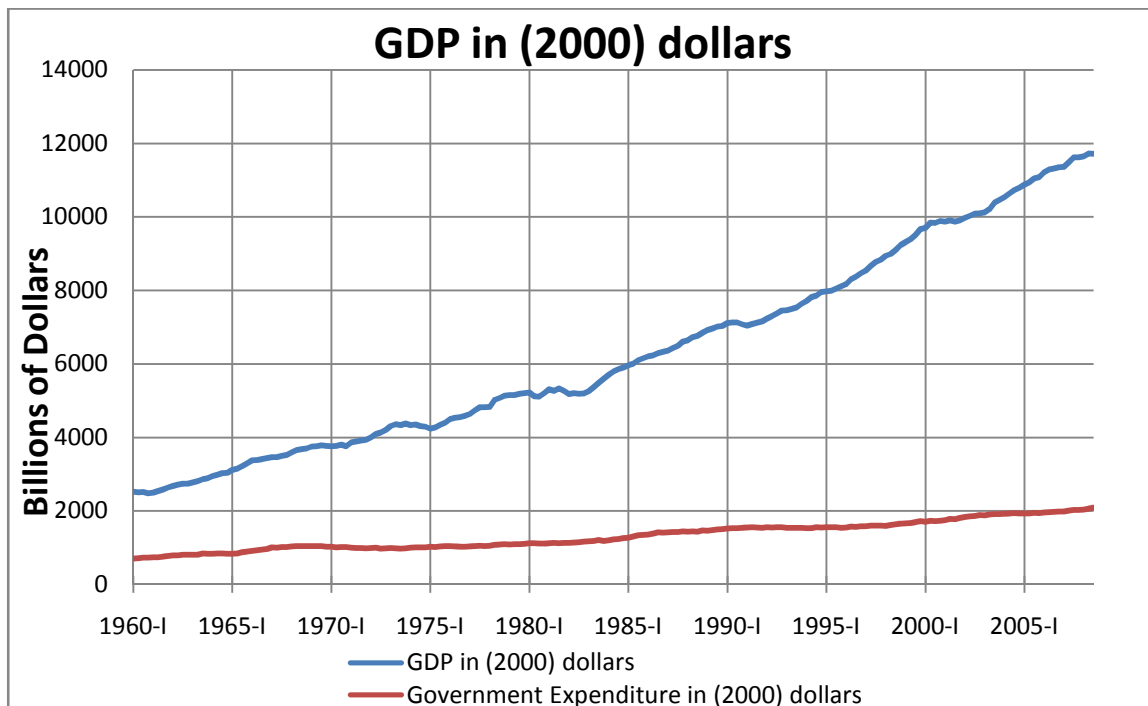
## Conclusion

The federal budget of the United States has changed over time with the parties and leaders in charge. They have changed it mildly over time and have to adapt and balance their preferences for government expenditure and policy with the budget they inherit from past leaders and current events.

With regards to the national debt and deficits, both political parties do not seem to be doing any significant change and continue to run the government by spending more than it collects in revenue. This will have significant impacts on our future as we will have significant challenges with regards for funding social programs.

Hopefully the new president will deliver on his promises of change and run a government surplus that will help pay off the national debt and reform social programs so that they can be sustainable in the future.

Economically, the United States continues to grow despite increased total government expenditure.



Hopefully, GDP continues to grow and the United States gets over the subprime mortgage credit crisis it is currently in and continues to have the freedom and liberty that it currently enjoys.

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