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February 1997
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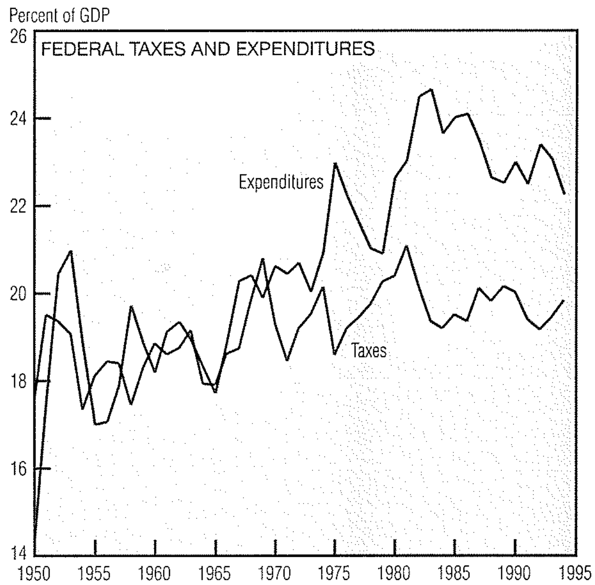
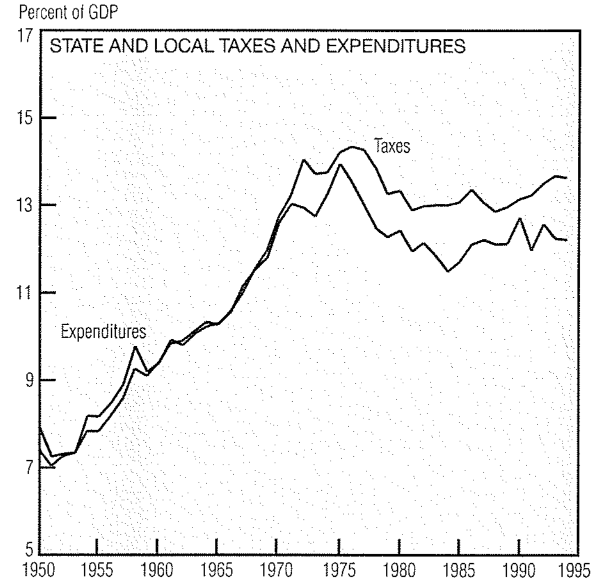
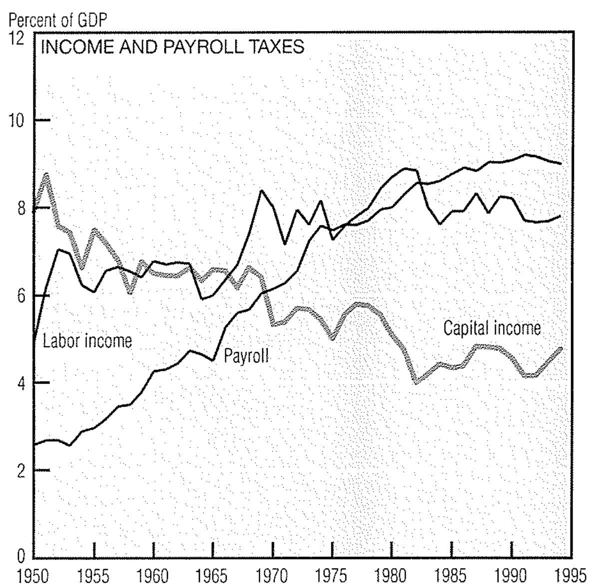
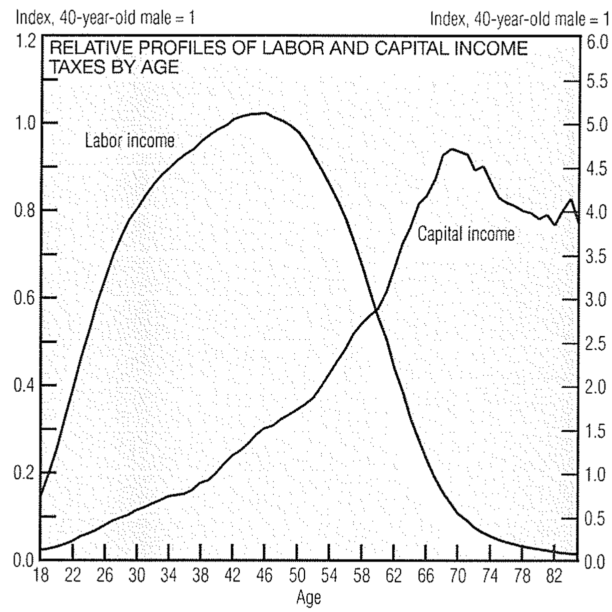
Structural Changes in U.S. Fiscal Policy









SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and University of Michigan, Survey Research Center.

Federal spending has consistently outpaced federal revenues since the 1970s. Although the opposite is true for the sum of state and local budgets, the total national debt (both nominal and inflation-adjusted) has mushroomed over the last 25 years.

Many analysts view the higher level of explicit debt as an indication of how far the burden of paying for current government spending has been shifted onto future generations. Some suggest that the level of explicit debt alone underestimates the extent of such burden-shifting, citing the government's implicit Social Security and Medicare liabilities to current generations, which future generations of workers will have to pay. However, the payment burden on future generations has increased in a third way—through structural changes in fiscal policy.

The government has many fiscal instruments at its disposal. It obtains revenue through taxes on labor and capital income, payroll taxes, and indirect (sales and excise) taxes, among others. Apart from spending to purchase goods and services for its own operation and to provide public goods like national defense, it also makes Social Security, Medicare, Medicaid, and welfare transfers.

A glance at the components of aggregate taxes and transfers is sufficient to convince anyone of the significant structural changes in postwar U.S. fiscal policy. As a share of GDP, labor income taxes and payroll taxes (which also fall on workers) have trended upward. Because younger generations work more than retirees, their taxes have increased more. On the other hand, taxes on capital income have declined over this period, reducing the taxes of older genera-

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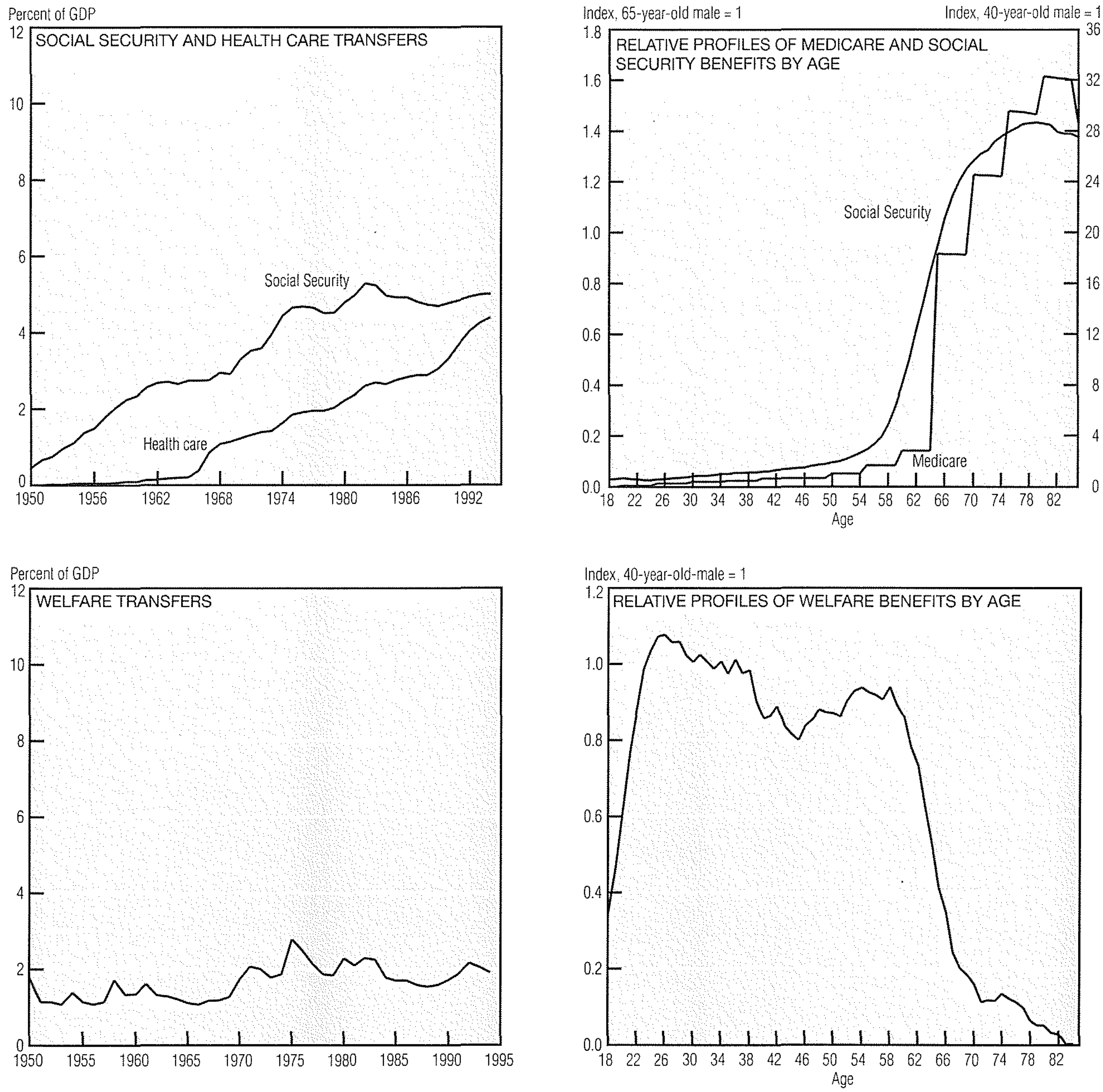
Structural Changes in U.S. Fiscal Policy (cont.)



SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; Social Security Administration; and Mark McClellan and Jonathan Skinner, "The Distribution of Medicare Benefits: A Lifetime Perspective," Stanford University, unpublished manuscript, April 1996.

tions, who own most of the economy's physical capital.

Further, Social Security and health care transfers have risen rapidly as a share of GDP, implying a decline in the net tax burdens of older generations, who make up a significant majority of recipients. However, the increase in these transfers implies a smaller decline in the net burdens of younger and unborn generations, who will receive them in the distant future, and then only after making substantial payroll contributions while working. The share of welfare transfers that accrue mainly to young, poor individuals—single mothers and the unemployed—has also increased, but at a much slower pace than Social Security and health care transfers.

The government's choice of a particular mix of taxes, spending, and transfers determines the distribution of net payment burdens (taxes net of transfer receipts) among current and future generations. A structural change in the mix of these instruments may not much affect overall revenue and spending numbers—that is, annual deficits may remain unchanged. It may nevertheless significantly alter the generational distribution of net payment burdens. Because different generations have dissimilar saving patterns and inclinations to participate in the workforce (depending on their age), changes in this distribution are likely to affect the nation's overall economic performance.