Conventional Wisdom versus The Data

Hillsdale College
February 19, 2013
Conventional Wisdom:

Government Debt Doesn’t Matter
How much money does the government owe?

- Borrowed from Social Security: $4.9 trillion
- Borrowed from people and foreign governments: $11.6 trillion
- Total debt: $16.5 trillion
How much is $16 trillion?
But wait! There's more!

Unfunded Obligations
How much money does the government owe?

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowed from Social Security</td>
<td>$4.9 trillion</td>
</tr>
<tr>
<td>Borrowed from people and foreign governments</td>
<td>$11.6 trillion</td>
</tr>
<tr>
<td><strong>Total debt</strong></td>
<td>$16.5 trillion</td>
</tr>
<tr>
<td><strong>Unfunded obligations</strong></td>
<td>$75 trillion</td>
</tr>
<tr>
<td><strong>Debt plus unfunded obligations</strong></td>
<td>$91.5 trillion</td>
</tr>
</tbody>
</table>
Dangers of so much debt

• Too easy for politicians to make much ado about nothing.

$300 million cut in Community Development Block Grants.

$300 million = 45 minutes.

= 48 hours
Dangers of so much debt

• Too easy for politicians to make much ado about nothing.

• Pressure on Federal Reserve to keep interest rates low.

+1% =
Dangers of so much debt

• Too easy for politicians to make much ado about nothing.

• Pressure on Federal Reserve to keep interest rates low.

• Quickly approaching a point of no return.
Ignore unfunded obligations.
Assume spending and revenue grow at historical average rate.
Interest on the debt remains at 2.6% indefinitely.

Interest consumes 19% of tax revenue in 2012.
Interest consumes 40% of tax revenue in 2050.

Assumes growths from 1970 to present continue
Annual tax revenue growth is 5.9%
Annual non-interest spending growth is 6.7%

Source: Bureau of Economic Analysis, US Department of the Treasury
Since 1962, interest rate on the debt has averaged 6%.

The interest rate on the debt was 5% just ten years ago.

Source: Bureau of Economic Analysis, US Department of the Treasury
Interest consumes 19% of tax revenue in 2012.

Government is bankrupt in 2046 unless it defaults on debt owed to the Social Security trust fund.

✓ Ignore unfunded obligations.
✓ Assume spending and revenue grow at historical average rate.
✓ Interest rises to 5% over ten years.

Assumes growths from 1970 to present continue
Annual tax revenue growth is 5.9%
Annual non-interest spending growth is 6.7%

Source: Bureau of Economic Analysis, US Department of the Treasury
Official Government Forecasts

Congressional Budget Office
CBO Forecasts versus Actual Federal Debt

121 forecasts since 1997
→ underestimated the future federal debt 80% of the time.

Forecasts more than 5 years into the future
→ underestimated the future debt 94% of the time.

Source: Congressional Budget Office, Budget and Economic Outlook Annual Reports, 1997 - 2012
CBO forecasts federal debt outstanding in 2023 will be $26 trillion.

Adjusting for CBO’s average historical error, 2023 federal debt will likely be $48 trillion.

Source: Congressional Budget Office, Budget and Economic Outlook Annual Reports, 1997 - 2012
Conventional Wisdom:

Raising Taxes Will Fix the Fiscal Problem
Source: Internal Revenue Service, Bureau of the Census
Source: Internal Revenue Service, Bureau of the Census
Average Effective Corporate Tax Rate

Source: Internal Revenue Service, Bureau of the Census
Average Effective Corporate Tax Rate

Source: Internal Revenue Service, Bureau of the Census
Revenue per GDP sounds dodgy.

What happens to tax revenue as tax rates change?
Source: Tax Policy Center (Urban Institute and Brookings Institute), Bureau of Economic Analysis
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Source: Tax Policy Center (Urban Institute and Brookings Institute), Bureau of Economic Analysis, Barro and Redlick (2009)
Conventional Wisdom:

Cutting Defense (etc.) Spending will Fix the Fiscal Problem
2012 Federal Budget

Source: President’s Budget for 2011, Office of Management and Budget

Eliminating all discretionary spending would still leave a $230 billion deficit.
The average price level has risen 700% since 1954.

Source: Bureau of Labor Statistics
The average price level has risen 700% since 1954.
The per-person cost of the Federal government has risen 3,000% since 1954.

Source: Bureau of Labor Statistics
The average price level has risen 700% since 1954.

The per-person cost of the Federal government has risen 3,000% since 1954.

By comparison, the cost of health care has only risen 2,000% since 1954.

Source: Bureau of Labor Statistics
Conventional Wisdom:

Taxing the Rich Will Fix the Fiscal Problem

Corollary:

The Rich Aren’t Paying Their Fair Share
## Distribution of Federal Taxes (all taxes combined)

<table>
<thead>
<tr>
<th></th>
<th>Average Income</th>
<th>Average Tax Rate</th>
<th>Number of Households (millions)</th>
<th>Taxes Paid (billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 1%</td>
<td>$1,873,000</td>
<td>30%</td>
<td>1.2</td>
<td>$663</td>
</tr>
<tr>
<td>Top 5% (excluding top 1%)</td>
<td>$289,038</td>
<td>25%</td>
<td>4.7</td>
<td>$343</td>
</tr>
<tr>
<td>Top 10% (excluding top 5%)</td>
<td>$181,412</td>
<td>23%</td>
<td>6.0</td>
<td>$247</td>
</tr>
<tr>
<td>Highest Quintile (excluding top 10%)</td>
<td>$133,800</td>
<td>20%</td>
<td>11.8</td>
<td>$321</td>
</tr>
<tr>
<td>Fourth Quintile</td>
<td>$94,100</td>
<td>17%</td>
<td>23.0</td>
<td>$377</td>
</tr>
<tr>
<td>Middle Quintile</td>
<td>$64,500</td>
<td>14%</td>
<td>22.9</td>
<td>$211</td>
</tr>
<tr>
<td>Second Quintile</td>
<td>$42,500</td>
<td>11%</td>
<td>22.2</td>
<td>$100</td>
</tr>
<tr>
<td>Lowest Quintile</td>
<td>$18,400</td>
<td>4%</td>
<td>24.6</td>
<td>$18</td>
</tr>
</tbody>
</table>

*Source: Congressional Budget Office*
How much government spending do people fund with their tax dollars?

<table>
<thead>
<tr>
<th>Percentage Range</th>
<th>Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 1%</td>
<td>56</td>
</tr>
<tr>
<td>2% to 5%</td>
<td>44</td>
</tr>
<tr>
<td>5% to 10%</td>
<td>31</td>
</tr>
<tr>
<td>10% to 20%</td>
<td>41</td>
</tr>
<tr>
<td>20% to 40%</td>
<td>47</td>
</tr>
<tr>
<td>40% to 60%</td>
<td>24</td>
</tr>
<tr>
<td>60% to 80%</td>
<td>10</td>
</tr>
<tr>
<td>80% to 100%</td>
<td>18</td>
</tr>
<tr>
<td>Children</td>
<td>112</td>
</tr>
</tbody>
</table>

Deficit Day
The larger economic problem involves the “not yet” rich.
Conventional Wisdom:

Stimulus Spending Will Fix the Fiscal Problem
Stimulating the economy will generate more tax revenue!

Spend more! GDP grows! 18% x = 😊
TARP = $356 b.

Stimulus = $578 b.

Federal Reserve = $1,500 b.

Financial Initiatives = $366 b.

Housing Initiatives = $130 b.

Total (net) stimulus = $3 trillion

Data Source: money.cnn.com/news/storysupplement/economy/bailouttracker/
Total (net) stimulus = $3 trillion

Unemployment Rate: 10%
Historically, how has the economy reacted to stimulus spending?
If stimulus spending worked, we should see a relationship like this.
Increased government spending does not appear to increase economic activity.

Source: Bureau of Economic Analysis
Stimulus Spending and Economic Growth (1954.1 to 2011.1)

Increased government spending does not appear to increase economic activity one year in the future.

Source: Bureau of Economic Analysis
Stimulus Spending and Economic Growth (1954.1 to 2011.1)

Increased government spending appears to have a negative cumulative effect over 4 quarters.

Source: Bureau of Economic Analysis

www.antonydavies.org
Conventional Wisdom versus The Data:

Government Debt Doesn’t Matter

Data: Debt today means inflation, higher taxes, or reduced government services tomorrow

Raising Taxes Will Fix the Problem

Data: Raising tax rates doesn’t increase tax revenue.
Conventional Wisdom versus The Data:

Cutting Specific Spending will Fix the Problem

Data: Only a radical overhaul of spending will fix the problem.

Taxing the Rich Will Fix the Problem

Data: There aren’t enough rich people to tax to fix the problem.
Conventional Wisdom versus The Data:

The Rich Aren’t Paying Their Fair Share
Data: Actually, it’s the middle class and poor who aren’t paying their fair shares.

Stimulus Spending Will Fix the Problem
Data: Spending is what caused the problem in the first place.
Conventional Wisdom versus The Data

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February 19, 2013
Conventional Wisdom:

The Poor Are Getting Poorer
Distribution of Household Incomes (2009$)

Source: Bureau of the Census
Distribution of Household Incomes (2009$)

Source: Bureau of the Census
The rich get richer and the poor get poorer.

Source: Bureau of the Census
The old get older and the young get younger.

Source: Bureau of the Census
Median Income Within Each Quintile (2006$)

Source: Pew Economic Mobility Project