



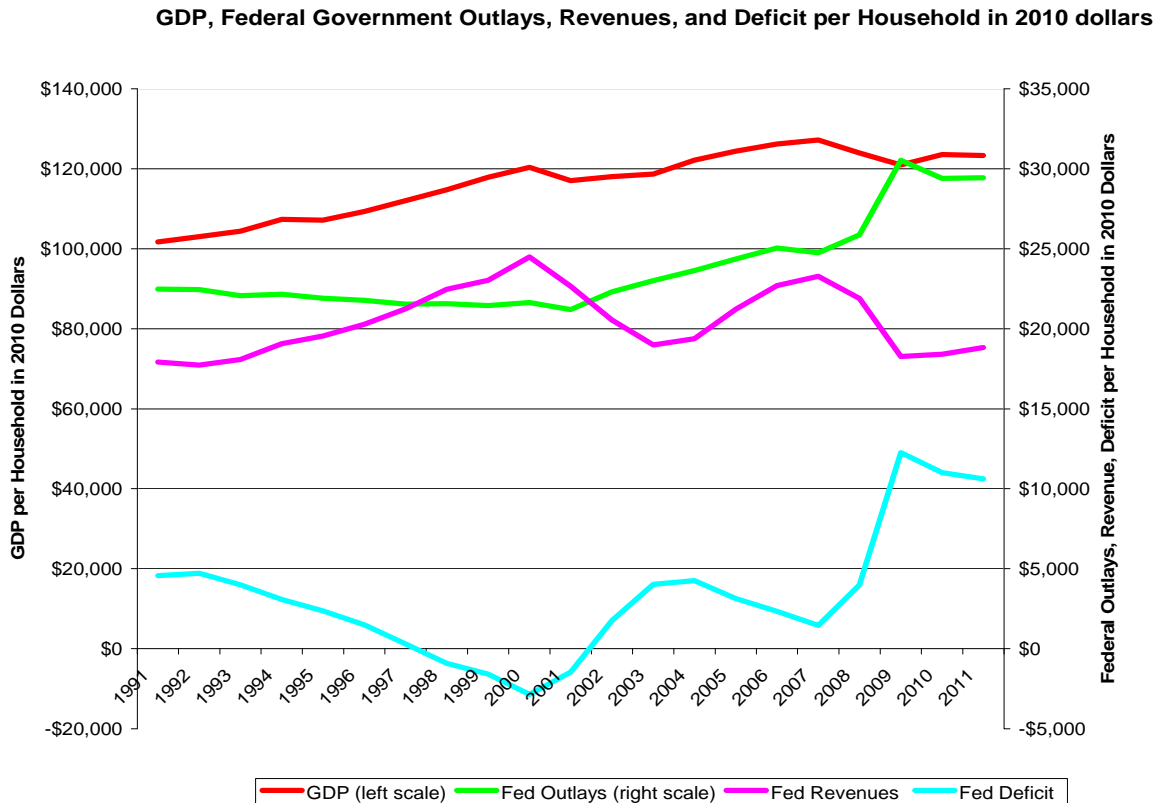
One Family's Perspective on the U.S. Federal Budget: 2012 Perspective

When people set out to discuss the federal budget, they often get glassy-eyed after the first few \$100 billion. We have all seen graphic examples of the sums involved, such as the stacks of dollar bills rising to the moon and beyond. Designed to help us understand the magnitude of federal finance, these "visual aids" are often as overwhelming as the raw numbers and don't really help at all.

In 1988 I wrote an essay that attempted to make the U.S. federal budget easier to understand by breaking the numbers down on a per household basis. That worked out pretty well, so I updated the numbers in 1992, 2002, 2006, and 2010. Given the attention federal spending is currently receiving in the press and popular discourse, it's probably time to visit the topic again. To eliminate the effects of inflation from the discussion, I have converted all the nominal dollar amounts to 2010 equivalent dollars in the following figures.

Let's start with the big picture and work our way smaller. Figure 1 shows U.S. Gross Domestic Product (GDP), along with Federal Government Outlays, Revenues, and Deficit (or surplus) on a per household basis:

Figure 1





Looking at per household GDP (red line) you can see a pretty steady movement higher, interrupted by significant drops during the 2001 and 2007 recessions. After the 2001 recession, it took until about 2004 for us to reach the prior high. We haven't yet regained the 2007 level: in 2007, GDP per capita (in 2010 dollars) was \$127,219; in 2011, it was \$123,335. In nominal terms, we have surpassed the old highs: GDP per household in 2007 was \$120,920; in 2011, it was \$127,180. Adjusting for inflation, however, reveals a different picture.

Looking at the total Federal Outlays (green line), you can see they were fairly stable in the vicinity of \$23,000 per household from 1991 through 2001, and steadily increased until it stood at \$25,000 per household in 2006 where it leveled off for about two years. In 2009, Federal Outlays leaped to \$30,000 per household; that amount has come down a little bit since then, but not much.

Looking at Federal Revenues (purple line), you see them increasing a bit faster than GDP from 1991 to about 2000 and declining from 2000 to 2003, likely due to the 2001 recession. As GDP grew once again, they increased during 2003 to 2007, and then moved down again as the recession hit in 2007. I find it interesting that Federal Revenues per household were about the same in 2011 as in 1991, although GDP per household was about 20% higher in 2011 than in 1991.

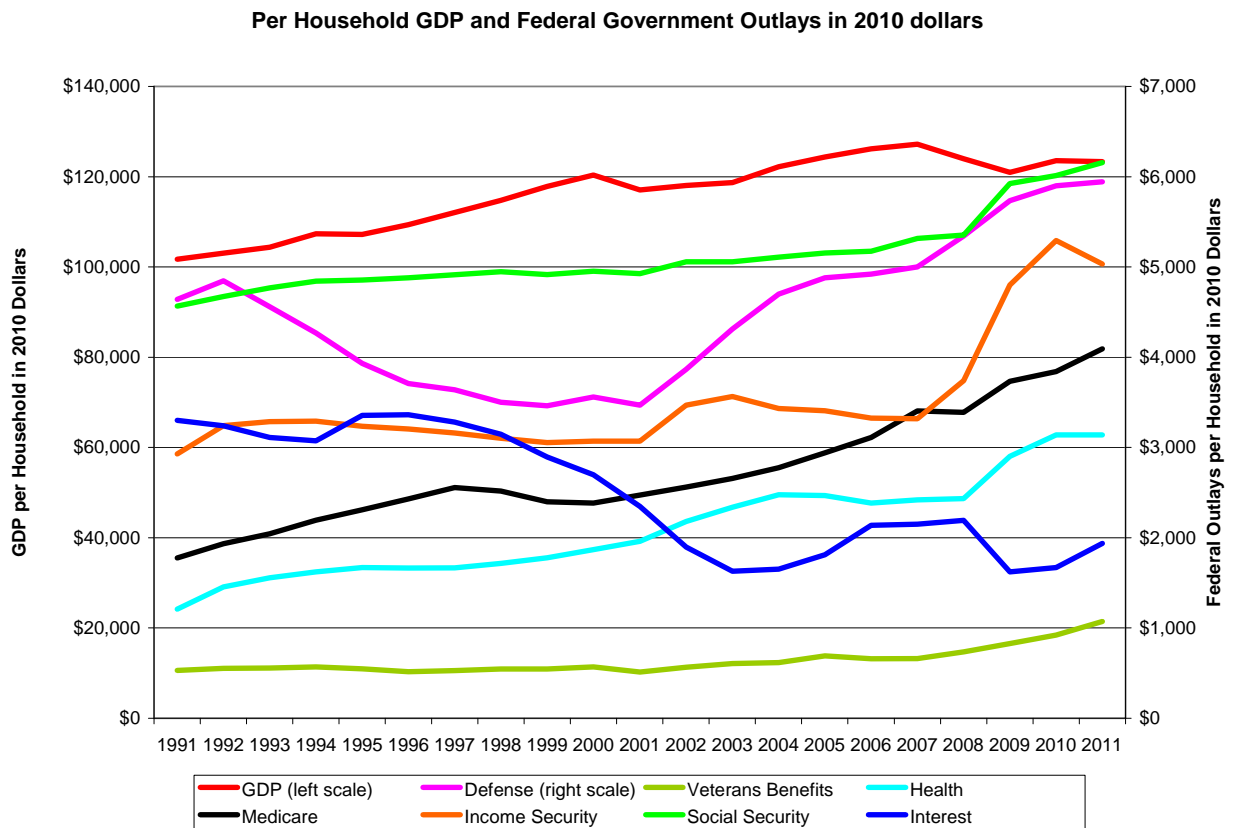
Finally, you can look at the plot of the Federal Deficit (light blue line) which steadily declined from 1991 to 2000, (actually turned into a surplus from 1997-2001), jumped in 2003 and, again, in 2009.

Summarizing where we stood in 2011, the Gross Domestic Product of the country was just over \$123,000 per household, while Federal Outlays were about \$29,000 per household, roughly 23% of GDP. Of the \$29,000 per household that the government spent in 2011, taxes and other revenues only covered \$18,800; the remaining \$10,200 per household was borrowed.



With that as a backdrop, let's dig a little deeper into where the federal government is spending its money. In Figure 2 we've graphed Federal Outlays by category from 1991 to 2011 on a per household basis, and adjusted them to 2010 dollars. In order to keep the plot from being too crowded, we did not include any category that was less than 3½% of Federal Outlays in 2011. (Note: Education, 2.8% of 2011 outlays, was the largest budget area that didn't make the cut.)

Figure 2

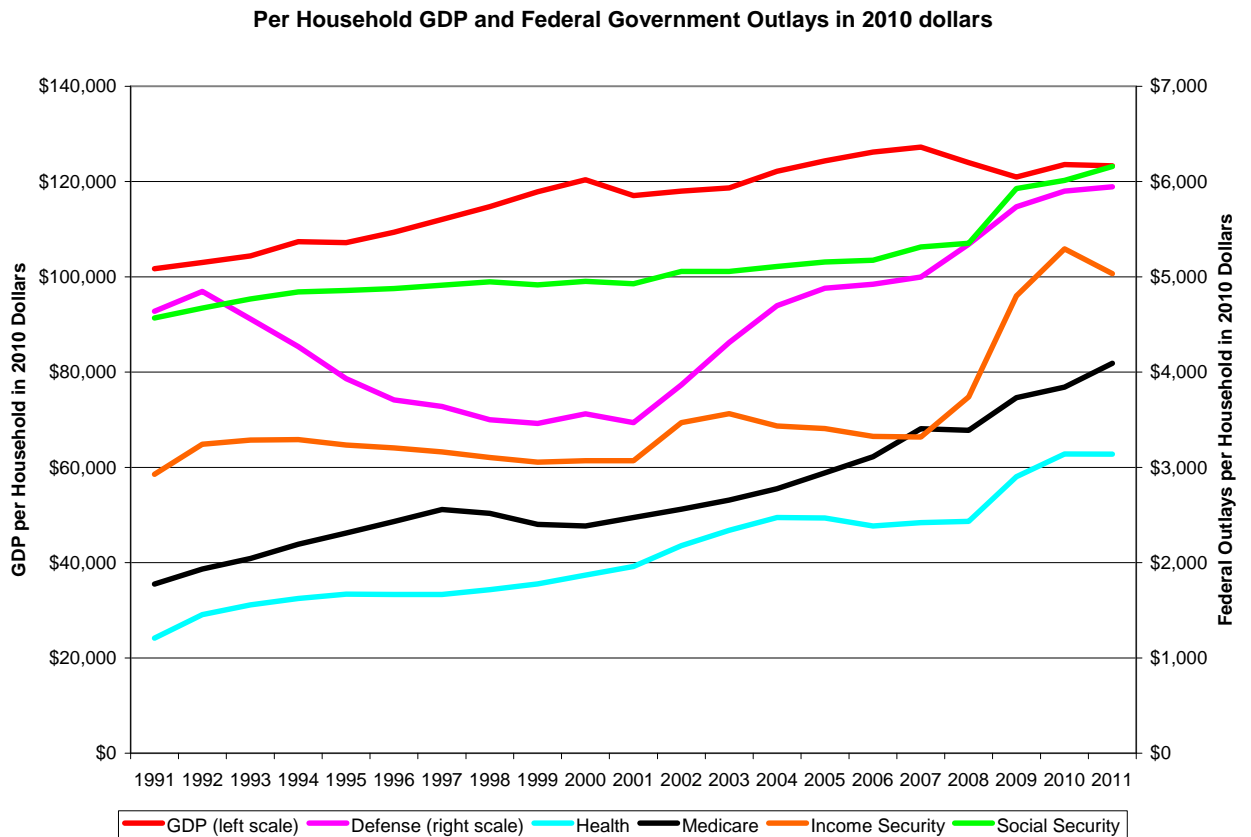




We've included per household GDP (red line) again for reference. This plot is still pretty busy, so let's talk briefly about the bottom two lines—then drop them, and see what it looks like. You'll notice that the dark blue line is the only one that has significantly declined in the last twenty years: Interest on the federal debt went from \$3,200 per household in 1991 to \$2,000 per household last year. This is mostly the result of declining interest rates. (The budget surpluses from 1997-2001 brought the debt down a bit, but not a lot.) Since 2009, interest payments have started moving up. (Interest rates have gotten as low as they can get; an increasing debt now means increasing interest payments.) The olive line is the amount we spend on Veterans Benefits: about \$1,000 per household in 2011.

Let's drop those two categories and look at the top five Federal Outlays; refer to Figure 3. Once again, we've included per household GDP (red line) for reference:

Figure 3





In 1991, Defense (violet line) was the largest single Federal Outlay at about \$4,700 per household in 2010 dollars. This amount declined to about \$3,600 per household during the drawdown after the Gulf War and rapidly increased after September 11, 2001. (Remember the decline in Federal Outlays from 1991 to 2001 we discussed earlier? It looks like a decline in Defense spending was a big piece of that.)

Social Security (light green line) has moved from the number two position to number one, now accounting for over \$6,000 per household in federal spending. It was increasing at about the rate of GDP until 2008, and has increased rapidly in the last two years.

Income Security (orange line)—general retirement and disability insurance, unemployment compensation, housing assistance, food and nutrition assistance, and federal employee retirement and disability—has gone from about \$3,000 per household from 1991 through 2001 to \$5,000 per household in 2011. You would expect a piece of this to be sensitive to economic cycles (e.g. unemployment and food stamps); look at the increase during the 2001 recession. The jump from 2007 to 2010 is huge, reflecting the extension of unemployment benefits, some of the homeowner's assistance programs, and food stamps. This category is starting to come down a bit as employment improves.

Medicare (black line) has been on a pretty steady march upwards, doubling from just under \$2,000 per household in 1991 to just over \$4,000 per household in 2011.

Health (light blue line), which includes health care services, health research and training, and consumer and occupational health, has more than doubled from 1991 to 2011, costing each household about \$3,100 in 2011. (Note: Medicaid outlays in 2011 were 89% of the Health category, so "Health" is mostly Medicaid).

Overall, this plot highlights that of the top five spending categories two, Defense and Income Security, are at cyclical highs. We can expect them to come down if employment increases and the wars end. The remaining three, Health (Medicaid), Medicare, and Social Security, have steadily increased over the last twenty years. If they continue to increase at the same rate, they will dominate Federal Outlays.

I find this approach to the Federal Budget makes the numbers real to me. In 2011, the federal government spent \$29,000 on behalf of my family—\$13,000 (45%) of which was



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spent on Social Security, Medicare, and Health. The federal government collected \$18,800 in revenues and borrowed the remaining \$10,200. There have been times in my life where I borrowed 35% of what I spent, like the government is doing now, but I couldn't do that forever. So I found ways to earn more and spend less and get my budget into better shape.

Figures 2 and 3 show me the big expenses that dictate where we have to go looking for big savings, explaining why every politician who is serious about reducing the deficit talks about Social Security, Medicare, and Medicaid. Those two figures also show me which parts of current Federal Outlays are cyclical and will come down—unless we fail to reduce unemployment or remain in a permanent state of war.

The Appendix contains the raw data used in creating these figures, so you can look at the data yourself. Sources are also listed, so you can double check the data or dive deeper. Historical data from the 2012 Federal Budget contains a wealth of information about where we have spent our federal dollars in the past, where we are spending them today, and projections for the next few years.

The comments made by Ron Muhlenkamp are opinions and are not intended to be investment advice or a forecast of future events.

Appendix: U.S. GDP, U.S. Federal Spending raw data, in millions of dollars

	CPI	# of Households	Nominal GDP	Nominal Total Federal Outlays	Nominal Total Federal Revenues	Nominal Federal Deficit	Gross Nominal Expenditures						
							Defense	Education	Health	Medicare	Income Security	Social Security	Interest
1991	136.2	94,312,000	\$5,992,000	\$1,324,226	\$1,054,988	\$269,238	\$273,285	\$31,275	\$71,168	\$104,489	\$172,462	\$269,015	\$194,448
1992	140.3	95,669,000	\$6,342,000	\$1,381,529	\$1,091,208	\$290,321	\$298,346	\$34,037	\$89,486	\$119,024	\$199,562	\$287,584	\$199,344
1993	144.5	96,391,000	\$6,667,000	\$1,409,386	\$1,154,335	\$255,051	\$291,084	\$35,642	\$99,401	\$130,552	\$209,969	\$304,585	\$198,713
1994	148.2	97,107,000	\$7,085,000	\$1,461,753	\$1,258,566	\$203,186	\$281,640	\$37,559	\$107,107	\$144,747	\$217,166	\$319,565	\$202,932
1995	152.4	98,990,000	\$7,414,000	\$1,515,742	\$1,351,790	\$163,952	\$272,063	\$37,862	\$115,399	\$159,855	\$223,799	\$335,846	\$232,134
1996	156.9	99,627,000	\$7,838,000	\$1,560,484	\$1,453,053	\$107,431	\$265,748	\$36,956	\$119,365	\$174,225	\$229,736	\$349,671	\$241,053
1997	160.5	101,018,000	\$8,332,000	\$1,601,116	\$1,579,232	\$21,884	\$270,502	\$39,283	\$123,832	\$190,016	\$235,032	\$365,251	\$243,984
1998	163	102,528,000	\$8,793,000	\$1,652,458	\$1,721,728	-\$69,270	\$268,194	\$41,741	\$131,425	\$192,822	\$237,750	\$379,215	\$241,118
1999	166.6	103,874,000	\$9,353,000	\$1,701,842	\$1,827,452	-\$125,610	\$274,769	\$43,155	\$141,048	\$190,447	\$242,478	\$390,037	\$229,755
2000	172.2	104,705,000	\$9,951,000	\$1,788,950	\$2,025,191	-\$236,241	\$294,363	\$46,989	\$154,504	\$197,113	\$253,724	\$409,423	\$222,949
2001	177.1	108,209,000	\$10,286,000	\$1,862,846	\$1,991,082	-\$128,236	\$304,732	\$44,974	\$172,233	\$217,384	\$269,774	\$432,958	\$206,167
2002	179.9	109,297,000	\$10,642,000	\$2,010,894	\$1,853,136	\$157,758	\$348,456	\$50,929	\$196,497	\$230,855	\$312,720	\$455,980	\$170,949
2003	184	111,278,000	\$11,142,000	\$2,159,899	\$1,782,314	\$377,585	\$404,744	\$56,984	\$219,541	\$249,433	\$334,632	\$474,680	\$153,073
2004	188.9	112,000,000	\$11,853,000	\$2,292,841	\$1,880,114	\$412,727	\$455,833	\$59,746	\$240,122	\$269,360	\$333,059	\$495,548	\$160,245
2005	195.3	113,343,000	\$12,623,000	\$2,471,957	\$2,153,661	\$318,346	\$495,308	\$70,120	\$250,548	\$298,638	\$345,847	\$523,305	\$183,986
2006	201.6	114,684,000	\$13,377,000	\$2,655,050	\$2,406,869	\$248,181	\$521,827	\$698,111	\$252,739	\$329,868	\$352,477	\$548,549	\$226,603
2007	207.3	116,011,000	\$14,028,000	\$2,728,686	\$2,567,985	\$160,701	\$551,271	\$72,818	\$266,832	\$375,407	\$365,975	\$586,153	\$237,109
2008	215.3	116,783,000	\$14,291,000	\$2,982,544	\$2,523,991	\$458,553	\$616,073	\$84,653	\$280,599	\$390,758	\$431,313	\$617,027	\$252,757
2009	214.5	117,181,000	\$13,939,000	\$3,517,677	\$2,104,989	\$1,412,688	\$661,049	\$95,429	\$334,335	\$430,093	\$553,224	\$682,963	\$186,902
2010	218.1	117,538,000	\$14,526,000	\$3,456,213	\$2,162,724	\$1,293,489	\$693,586	\$108,384	\$369,054	\$451,636	\$622,210	\$706,737	\$196,194
2011	224.9	118,682,000	\$15,094,000	\$3,603,061	\$2,303,466	\$1,299,995	\$705,625	\$127,189	\$372,500	\$485,653	\$597,352	\$730,811	\$229,968

CPI data from Bureau of labor statistics <ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>

Household numbers from US Census Bureau Historical Time Series table HH-1

Source of Budget data: U.S. 2012 Budget Historical Tables, Tables 1.1 and 3.1, U.S. Office of Management and Budget