AT A GLANCE

Economic Governance Structures in the United States

Summary of a Study

FOCUS OF THE STUDY

This study (author *Jacob Kirkegaard, Peterson Institute of International Economics*, October 2015) requested by the ECON Committee does not compare the US to the EU nor does it draw any conclusions. Rather it examines the design and operations of, and political, economic and legal interactions between the most important American economic governance institutions: The federal government, state and local governments, the central bank, and the bank deposit insurance and resolution framework.

The study covers the history and organization of the principal economic governance institutions in the United States. Particular emphasis is given to the main U.S. fiscal actors at the federal and state and local governmental level. Sources and beneficiaries of, and trends in government revenues and expenditures are analysed, and the lines of democratic oversight relations over other appointed U.S. economic governance institutions are described. Debt issuance procedures at all governmental levels are examined, including the legal circumstances of U.S. local government bankruptcies. In-depth explorations of also the U.S. central bank in the Federal Reserve System, and the U.S. bank deposit and resolution framework centered on the Federal Deposit Insurance Corporation (FDIC) are presented, and brief descriptions of other relevant U.S. financial regulatory agencies provided.

KEY FINDINGS

- **The federal government accounts for most U.S. public sector economic activity and the majority of general U.S. government debt. It also controls the top management of other US economic governance institutions.** Federal government revenues are derived predominantly from personal income taxes and earmarked employment-based social insurance contributions, while only a limited and declining revenue share origins with corporate and excise taxes. Federal government expenditures consist mostly of direct government social benefit payments made to individuals, with national defense and federal grants to state governments also sizable spending items. Federal outlays on areas such as agriculture, education, training and employment services and R&D remain very small components of the overall budget.

- **Automatic budgetary stabilizers constitute only a very small part of the total federal government budget.** The federal government's revenue base and spending patterns generate significant geographic budgetary redistribution among U.S. states. However, this fiscal redistribution is overwhelmingly structural in nature and related to the overall income levels of states, their demographic characteristics and the particular location of large federal government facilities.

  State and local government entities represent about 40 percent of general government economic activity, and are funded through property, sales and to a lesser extent personal and corporate taxes. Conditional federal government grants account for roughly a fifth of all state and local government revenues. Such grants with political obligations have proved

useful in fiscal governance in the US. State and local governments are responsible for most U.S. primary, secondary and some tertiary education, as well as have sizable outlays towards social spending, infrastructure and public safety.

- **A strict no-bailout political norm governs the fiscal relationship between the federal and state governments.** While some states do allow local government entities within their jurisdiction to enter bankruptcy under federal law, constitutional balanced budget amendments or other legislative procedures aiming at fiscal stability exist in all 50 U.S. states. However, reducing the growth of indebtedness has been the primary feature at state and local level as opposed to achieving a 'balanced budget'. Rapidly rising pension and healthcare costs for retired workers constitute a growing fiscal problem for many state and local governments.

- **The Federal Reserve System controls America's monetary policy and is responsible for a significant part of financial regulation and sector supervision of especially the largest U.S. banks.** It is tasked by law to pursue a dual mandate of maximizing employment and deliver price stability. As a result of its emergency crisis management actions during the 2008 to 2009 crisis, which included sizable purchases of federal government and federal government guaranteed debt as part of quantitative easing (QE), the Federal Reserve has since earned very large financial profits for the U.S. Treasury. In its open market operations the Fed may include any type of federal government debt, as well as state and local government debt and mortgage debt guaranteed by the federal government up to a maturity of 6 months.

- **The Federal Deposit Insurance Corporation (FDIC) is responsible for American deposit insurance and the resolution of failed – at least small and medium-sized – U.S. banks.** It is funded exclusively by fees paid by insured banks, though the FDIC does have an explicit emergency borrowing capacity with the U.S.Treasury. Through its national geographic scope and rapid takeover and resale or resolution of failed banks, the FDIC provides an important complement to the regular federal government budget's shock absorbing capabilities in assisting otherwise likely overburdened state and local governments.

The entire study is available on the homepage of the European Parliament and can be consulted by clicking here.

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