

# **Permanent Income, Tax Smoothing and Forecasts of Government Expenditure in the United States: 1929-1994**

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The permanent income and tax smoothing hypotheses are shown to imply that changes in government expenditure are Granger-caused by a variable composed of the fiscal deficit, private savings and the marginal tax rate. In this composite variable, the role of the fiscal deficit is to signal declines in future government expenditure, for given levels of the tax base. Similarly, private saving and the marginal tax rate interact to signal declines in the future tax base, for given levels of government expenditure. This composite variable should be at least as good a predictor of changes in government expenditure as any other forecast based on publicly available information. This implication of the permanent income and tax smoothing hypotheses is found to be evident in annual data for the period 1929-1994 in the United States.

**Key words:** Permanent income, tax smoothing, forecasting government expenditure, restricted VAR  
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