A CITIZEN'S GUIDE TO THE FEDERAL BUDGET

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 1998

Table of Contents

A Note to the Reader

Next year, your Federal Government will spend nearly *$1.7 trillion*.

Needless to say, that's a lot of money. And the Government spends it on lots of things—on programs as large and popular as Social Security, and on activities as small and unknown as repairs to the National Zoo. Together, these programs are what make up the Federal budget.

How much do you know about the budget? If your answer is "not much," you're not alone. In fact, hardly anybody knows everything that's in the thousands of pages, and several books, that make up the budget each year.

But we know you care a lot about how the Government spends your money. That's why we created *A Citizen's Guide to the Federal Budget* two years ago, and why we have published this third edition. With it, we hope to make the budget more accessible and understandable.

The *Guide* is designed to give you a walking tour of the budget. In these pages, we will outline for you how the Government raises revenues and spends money, how the President and Congress enact the budget, why the budget deficit and Federal debt are problems, and what the President hopes to accomplish with his 1998 budget.

After you read these pages, we hope that you will think the tour was worth your time. And we hope you will give us your suggestions about how we can make the *Guide* more useful to you in the future.

1. What Is the Budget?

The Federal budget is:

- a plan for how the Government spends your money.

  What activities are funded? How much does it spend for defense, national parks, the FBI, Medicare, issuing passports, and meat and fish inspection?

- a plan for how the Government pays for its activities.

  How much revenue does it raise through different kinds of taxes—income taxes, excise taxes, and social insurance payroll taxes?

- a plan for Government borrowing.

  If spending is greater than revenues, the Government runs a deficit. To finance deficits, the Government has to borrow money. Government borrowing adds to the national debt.

- something that affects the Nation's economy.

  Some types of spending—such as improvements in education and support for science and technology—increase productivity and raise incomes in the future.

  Taxes, on the other hand, reduce incomes, leaving people with less money to spend.

- something that is affected by the Nation's economy.

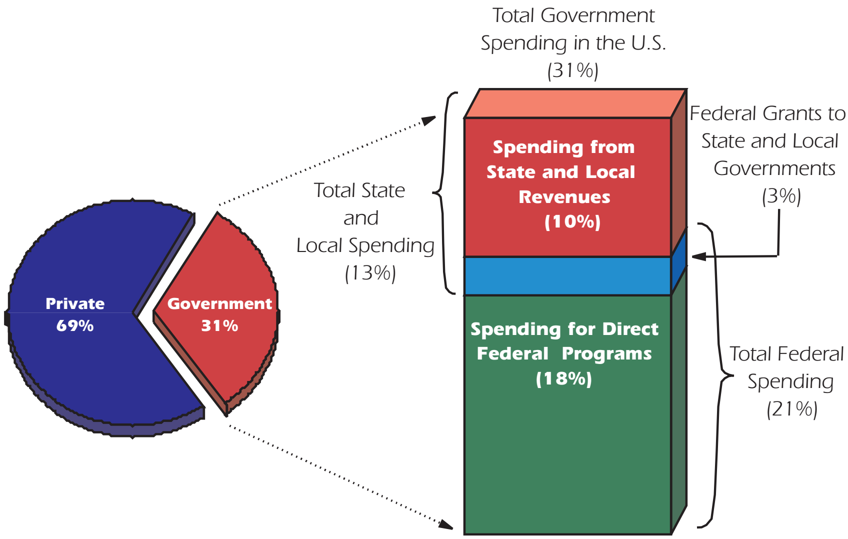
  When the economy is doing well, people are earning more and unemployment is low. In this atmosphere, revenues increase and the deficit shrinks.

- an historical record.

  The budget reports on how the Government has spent money in the past, and how that spending was financed.

The 1998 budget is a document that embodies the President's budget proposal to Congress for fiscal 1998, the *fiscal* year that begins on October 1, 1997. It reflects the President's priorities and his plan to balance the budget by 2002.

Chart 1–1. Government Spending as a Share of GDP, 1996



Note: Numbers do not add due to rounding.

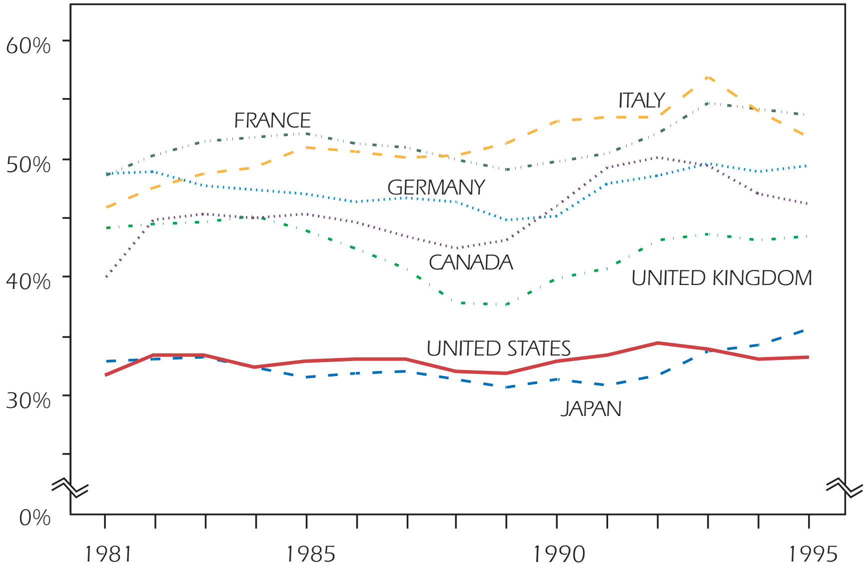
Total Government spending accounts for about one-third of the national economy. Federal spending is about two-thirds of this amount, or 21 percent of GDP.

The Federal budget, of course, is not the only budget that affects the economy or the American people. The budgets of State and local governments have an impact as well. While the Federal Government spends about 21 percent of the Gross Domestic Product (or GDP, which measures the size of the economy), State and local governments spend about another 10 percent (see Chart 1–1).

State and local governments are independent of the Federal Government, and they have their own sources of revenue (taxes and borrowing). But the Federal Government supplements State and local revenues by making grants to them. Of the $939 billion that State and local governments spent in 1996, $211 billion came from Federal grants.

As shown in Chart 1–2, compared to six other industrialized nations, the United States allocates the smallest share of its GDP to government (Federal, State, and local combined).

Chart 1–2. Total Government Outlays as a Percent of GDP



Source: OECD, calendar year data.

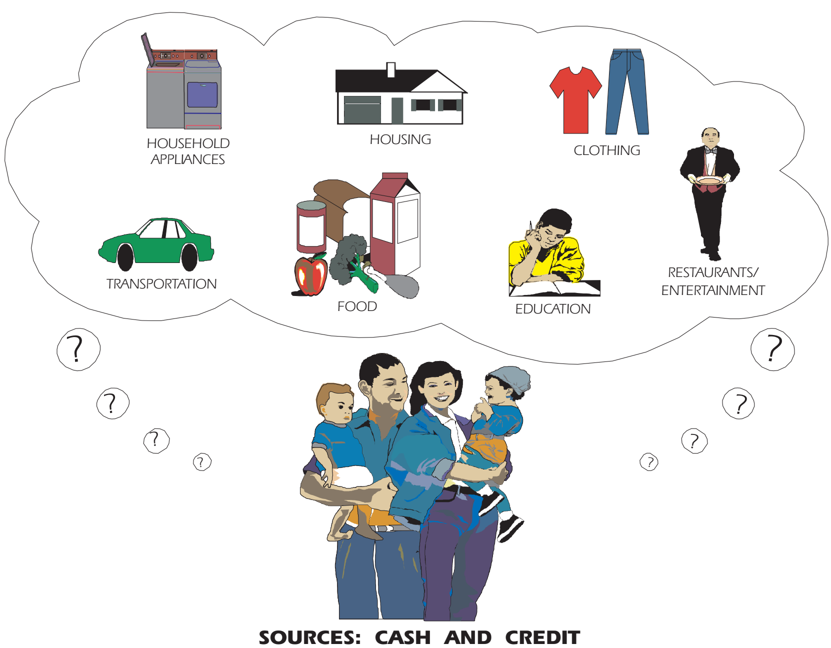
The United States allocates a smaller portion of its GDP to government than any other nation shown.

2. Where the Money Comes From—and Where it Goes

In a typical American household, a father and mother might sit around the kitchen table to review the family budget. They might discuss how much they expect to earn each year, how much they can spend on food, shelter, clothing, transportation, and perhaps a vacation, and how much they might be able to save for their future needs.

If they do not have enough money to make ends meet, they might discuss how they can spend less, such as by cutting back on restaurants, movies, or other entertainment. They also might consider whether to try to earn more by working more hours or taking another job. If they expect their shortfall to be temporary, they might try to borrow.

Chart 2–1. Family Budgeting

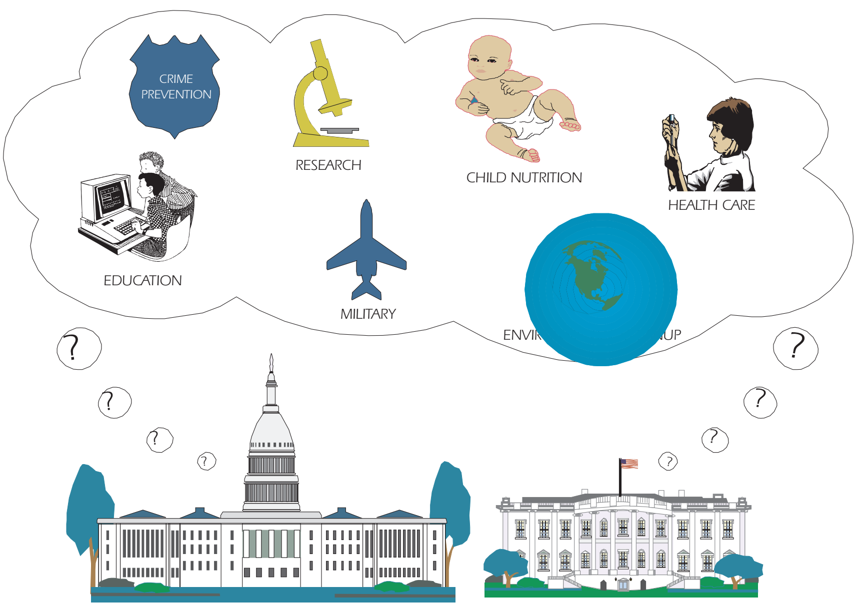


Generally speaking, the Federal Government plans its budget much like families do. The President and Congress determine how much money they expect the Government to receive in each of the next several years, where it will come from, and how much to spend to reach their goal—goals for national defense, foreign affairs, social insurance for the elderly, health insurance for the elderly and poor, law enforcement, education, transportation, science and technology, and others.

They decide how much spending they will finance through taxes and how much through borrowing. They debate how to use the budget to help the economy grow, or to redistribute income. And, especially lately, they debate how to reduce spending in order to eliminate the deficit and balance the budget.

In this chapter, we will discuss these decisions in some detail—that is, how the Government raises revenues and where it spends money.

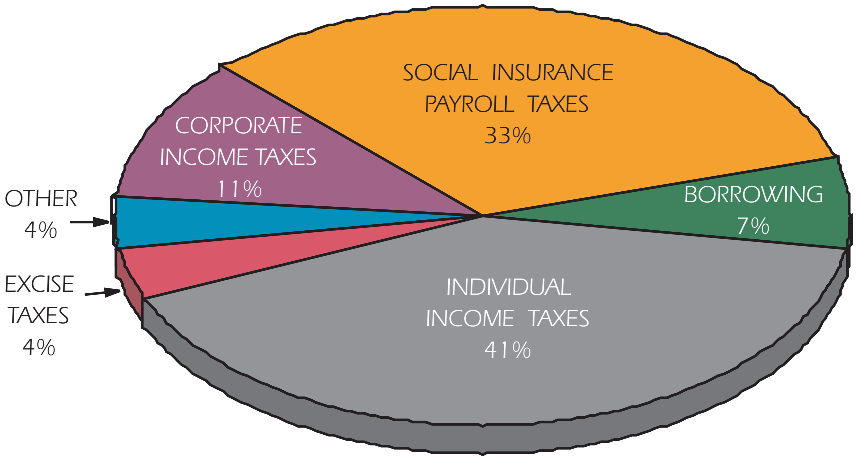
Chart 2–2. National Budgeting



SOURCES: TAXES AND BORROWING

Revenues

Chart 2–3. The Federal Government Dollar— Where It Comes From



The money that the Federal Government uses to pay its bills—its revenues—comes mostly from taxes. In recent years, revenues have been lower than spending, and the Government has borrowed to finance the difference between revenues and spending—that is, the deficit.

Revenues come from these sources:

- Individual income taxes will raise an estimated $691 billion in 1998, equal to about eight percent of GDP—roughly about the same percent as in each of the last 40 years.

- Social insurance payroll taxes—the fastest growing category of Federal revenues—include Social Security taxes, Medicare taxes, unemployment insurance taxes, and Federal employee retirement payments. This category has grown from two percent of GDP in 1955 to nearly seven percent in 1998.

- Corporate income taxes, which will raise an estimated $190 billion in 1998, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to 2.3 percent today.

Table 2–1. Revenues By Source—Summary

(In billions of dollars)

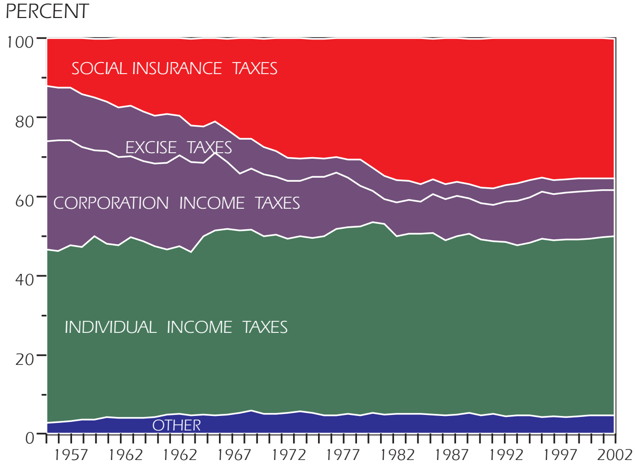
Source	1996 Actual	Estimate					
		1997	1998	1999	2000	2001	2002
Individual income taxes	656	673	691	722	756	795	840
Corporate income taxes	172	176	190	200	212	221	228
Payroll taxes	509	536	558	585	614	642	673
Excise taxes	54	57	61	64	65	66	67
Estate and gift taxes	17	18	19	20	21	23	25
Customs duties	19	17	18	18	20	21	22
Miscellaneous receipts	26	29	30	34	39	41	42
Total receipts	**1,453**	**1,505**	**1,567**	**1,643**	**1,727**	**1,808**	**1,897**

Notes: The revenues listed in this table do not include revenues from the Government's business-like activities—i.e., the sale of electricity and fees to national parks. The Government counts these revenues on the spending side of the budget, deducting them from other spending to calculate its outlays for the year.

Numbers may not add to the totals due to rounding.

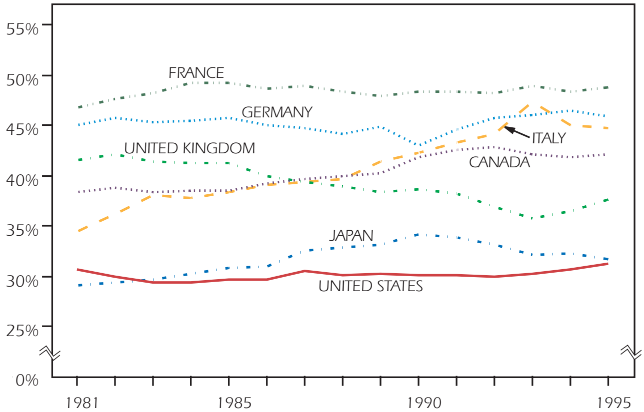
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways, airports and airways, and the cleanup of hazardous substances-and deposits others in the general fund.
- The Government also collects miscellaneous revenues—e.g., customs duties, Federal Reserve earnings, fines, penalties, and forfeitures.

Chart 2–4. Composition of Revenues



Between 1960 and 1996, payroll taxes have increased substantially as a percent of GDP, and corporate income taxes have declined, but individual income taxes have remained roughly constant.

Chart 2–5. Revenues as a Percent of GDP—Comparison With Other Countries



Source: OEDC, calendar year data.

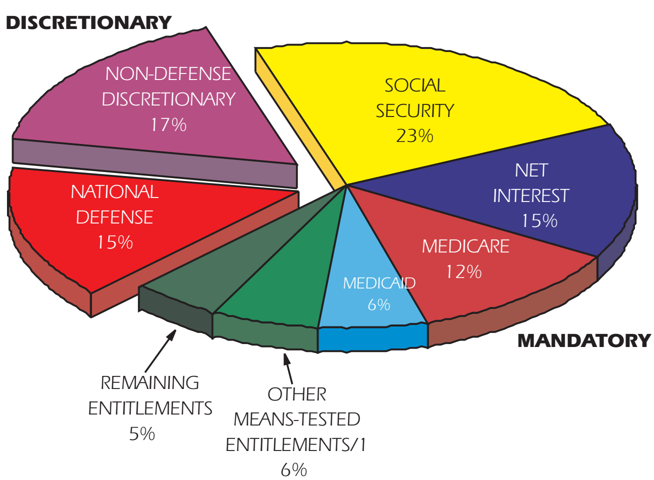
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries listed above.

Spending

As we have said, the Federal Government will spend nearly $1.7 trillion [1] in 1998, which we divided into eight large categories as shown in Chart 2–6.

- The largest Federal program is Social Security, which provides monthly benefits to more than 43 million retired and disabled workers, their dependents, and survivors. It accounts for 23 percent of all Federal spending.
- Medicare, which provides health care coverage for over 33 million elderly Americans and people with disabilities, consists of Part A (hospital insurance) and Part B (insurance for physician costs and other services). Since its birth in 1965, Medicare has accounted for an ever-growing share of spending. In 1998, it will comprise 12 percent.

Chart 2–6. The Federal Government Dollar— Where It Goes



Note: Numbers do not add due to rounding.

[1] Means-tested entitlements are those for which eligibility is based on income. The Medicaid program is also a means-tested entitlement.

---

[1] In calculating Federal spending, the Government deducts collections (revenues) generated by the Government's business-like activities, such as fees to national parks. These collections will total an estimated $209 billion in 1998. Without them, spending would total an estimated $1.9 trillion in 1998, not $1.7 trillion.

- Medicaid provides health care services to over 38 million Americans, including the poor, people with disabilities, and senior citizens in nursing homes. Unlike Medicare, the Federal Government shares the costs of Medicaid with the States, paying between 50 and 83 percent of the total (depending on each State's requirements). Federal and State costs are growing rapidly. Medicaid accounts for six percent of the Federal budget.
- Other means-tested entitlements provide benefits to people and families with incomes below certain minimum levels that vary from program to program. The major means-tested entitlements are Food Stamps and food aid to Puerto Rico, Supplemental Security Income, Child Nutrition, the Earned Income Tax Credit, and veterans' pensions. This category will account for an estimated six percent of the budget in 1998.
- The remaining entitlements, which mainly consist of Federal retirement and insurance programs and payments to farmers, comprise five percent of the budget.
- National defense discretionary spending will total an estimated $260 billion in 1998, comprising 15 percent of the budget and 3.2 percent of GDP.
- Non-defense discretionary spending—a wide array of programs that include education, training, science, technology, housing, transportation, and foreign aid—has shrunk as a share of the budget from 23 percent in 1966 to an estimated 17 percent in 1998.
- Interest payments, primarily the result of previous budget deficits, averaged seven percent of Federal spending in the 1960s and 1970s. But, due to the large budget deficits that began in the 1980s, that share quickly doubled to 15 percent, where it stands today.

Table 2–2. Spending Summary

(Outlays, in billions of dollars)

Category	1996 Actual	Estimate 1997	1998	1999	2000	2001	2002
Discretionary:							
National defense	266	268	260	262	268	269	274
International	18	20	19	20	19	19	19
Domestic	250	263	268	276	277	274	274
Subtotal, discretionary	534	550	547	558	564	561	567
Mandatory:							
Programmatic:							
Social security	347	364	381	399	418	438	460
Medicare	171	192	204	217	227	243	261
Medicaid	92	99	106	112	118	125	133
Means-tested entitlements (except Medicaid)	95	104	107	112	117	115	122
Other	117	122	147	156	169	167	166
Subtotal, programmatic	822	880	946	995	1,048	1,089	1,142
Undistributed offsetting receipts	–38	–46	–56	–44	–46	–50	–68
Subtotal, mandatory	785	834	890	951	1,002	1,038	1,074
Net interest	241	247	250	252	248	245	239
Subtotal, mandatory and net interest	1,026	1,081	1,140	1,203	1,251	1,283	1,313
Total	**1,560**	**1,631**	**1,687**	**1,761**	**1,814**	**1,844**	**1,880**

Note: Numbers may not add to the totals due to rounding.

Table 2–3. Spending by Function

(Outlays in billions of dollars)

Function	1996 Actual	Estimate 1997	1998	1999	2000	2001	2002
National defense:							
Department of Defense-Military	253	254	247	249	255	256	261
Other	13	13	12	12	12	12	12
Total National defense	266	267	259	261	267	268	273
International affairs	13	15	15	16	15	15	15
General science, space, and technology	17	17	16	16	16	16	16
Energy	3	2	2	1	2	2	–*
Natural resources and environment	22	23	22	23	23	23	23
Agriculture	9	10	12	12	11	10	10
Commerce and housing credit	–11	–9	3	6	13	7	8
Transportation	40	39	39	39	39	39	39
Community and regional development	11	13	11	11	10	8	8
Education, training, employment, and social service	52	51	56	62	63	64	63
Health	119	128	138	145	152	160	165
Medicare	174	194	207	220	229	246	263
Income security	226	239	247	256	266	269	280
Social Security	350	368	384	402	421	441	463
Veterans benefits and services	37	40	41	42	44	41	43
Administration of justice	18	21	24	26	26	26	26
General government	12	13	13	13	14	13	13
Net interest	241	247	250	252	248	245	239
Undistributed offsetting receipts	–38	–46	–56	–44	–46	–50	–68
Total	**1,560**	**1,631**	**1,687**	**1,761**	**1,814**	**1,844**	**1,880**

* $500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.
Numbers may not add to the totals due to rounding.

Table 2-4. Spending by Agency

(Outlays, in billions of dollars)

Agency	1996 Actual	Estimate					
		1997	1998	1999	2000	2001	2002
Legislative Branch	2	3	3	3	3	3	3
The Judiciary	3	4	4	4	4	4	4
Executive Office of the President	*	*	*	*	*	*	*
Funds Appropriated to the President	10	10	10	10	11	11	11
Agriculture	54	57	59	58	60	60	62
Commerce	4	4	4	5	6	4	4
Defense-Military	253	254	247	249	255	256	261
Defense-Civil	33	34	35	36	37	38	39
Education	30	28	32	36	37	37	36
Energy	16	15	15	15	15	14	12
Health and Human Services	320	351	376	397	414	439	462
Housing and Urban Development	26	30	32	33	32	30	30
Interior	7	7	7	7	7	7	7
Justice	12	15	17	19	19	19	18
Labor	32	33	36	38	39	40	40
State	5	5	6	6	5	6	6
Transportation	39	38	38	39	38	38	38
Treasury	365	381	390	398	400	402	403
Veterans Affairs	37	40	41	42	44	41	43
Environmental Protection Agency	6	6	7	7	7	7	7
General Services Administration	1	1	1	*	*	*	*
National Aeronautics and Space Administration	14	14	14	13	13	13	13
Office of Personnel Management	43	45	47	49	51	53	56
Small Business Administration	1	*	*	*	*	1	1
Social Security Administration	375	396	413	432	454	471	496
Other Independent Agencies	9	10	20	23	26	24	25
Undistributed Offsetting Receipts	–135	–151	–166	–157	–165	–174	–197
Total	**1,560**	**1,631**	**1,687**	**1,761**	**1,814**	**1,844**	**1,880**

* $500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.
Numbers may not add to the totals due to rounding.

“On” and “Off” Budget

From time to time, you may hear about programs that are “off-budget,” meaning that the Government categorizes them separately from other programs.

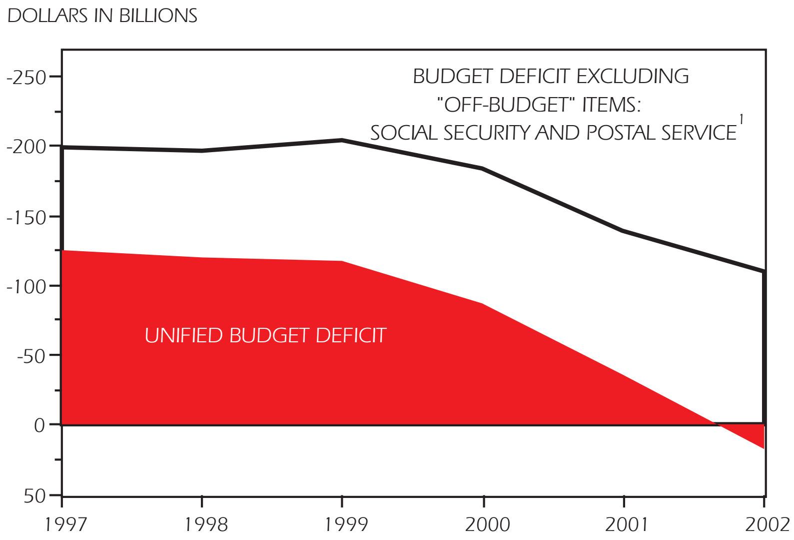
Specifically, the law requires that the spending and revenues of two Federal programs, Social Security and the Postal Service, be excluded from the budget totals-that is, categorized as “off-budget.” Therefore, the budget displays “on-budget,” “off-budget,” and “unified budget” totals to satisfy this legal requirement.

The unified budget is the most useful display of the Government’s finances; it is vital in calculating how much the Government has to borrow.

The “off-budget” category is designed to give special status to certain programs. Over the years, the Government has placed numerous programs “off-budget,” then returned them to the unified budget. But the mere listing of programs as “off-budget” does not, by itself, protect them from the budget process—e.g., Administration and congressional review, possible cuts, and hiring and procurement rules.

Chart 2–7 illustrates the relationship between on- and off-budget items, and the unified budget.

Chart 2–7. On- and Off-Budget Deficit Projections



1 By law, the Social Security trust funds and the Postal Service are “off-budget.”

3. How Does the Government Create a Budget?

The President and Congress both play major roles in developing the Federal budget.

The President's Budget

The law requires that, by the first Monday in February, the President submit to Congress his proposed Federal budget for the next *fiscal* year, which begins October 1.

The White House's Office of Management and Budget (OMB) prepares the budget proposal, after receiving direction from the President and consulting with his senior advisors and officials from Cabinet departments and other agencies.

The President's budget—which typically includes a main book and several accompanying books [1]—covers thousands of pages and provides reams of details.

The Budget Process

Through the budget process, the President and Congress decide how much to spend and tax in any one fiscal year. More specifically, they decide how much to spend on each activity, ensure that the Government spends no more and spends it only for that activity, and report on that spending at the end of each budget cycle.

The President's budget is *his* plan for the next year. But it's just a proposal. After receiving it, Congress has its own budget process to follow. Only after the Congress passes, and the President signs, the required spending bills has the Government created its actual budget.

---

[1] They are the main budget book, entitled, *Budget of the United States Government: Fiscal Year 1998,* as well as *Analytical Perspectives, Appendix, Historical Tables,* and *A Citizen's Guide to the Federal Budget,* which you are now reading.

For fiscal 1998—that is, October 1, 1997 to September 30, 1998—the major steps in the budget process are outlined in Chart 3–1.

Chart 3-1.Major Steps in the Budget Process

Formulation of the President's budget for fiscal 1998.	Executive Branch agencies develop requests for funds and submit them to the Office of Management and Budget. The President reviews the requests and makes the fiscal decisions on what goes in his budget.	February–December 1996
Budget preparation and transmittal.	The budget documents are prepared and transmitted to the Congress.	December 1996–February 1997
Congressional action on the budget.	The Congress reviews the President's proposed budget, develops its own budget, and approves spending and revenue bills.	March–September 1997
The fiscal year begins.		October 1, 1997
Agency program managers execute the budget provided in law.		October 1, 1997–September 30, 1998
Data on actual spending and receipts for the completed fiscal year become available.		October–November 1998

Action in Congress

Congress first must pass a "budget resolution"—a framework within which the Members will make their decisions about spending and taxes. It includes targets for total spending, total revenues, and the deficit, and allocations within the spending target for the two types of spending—-discretionary and *mandatory*—explained below:

- *Discretionary spending,* which accounts for 32 percent of all Federal spending, is what the President and Congress must decide to spend for the next year through the 13 annual appropriations bills. It includes money for such activities as the FBI and the Coast Guard, for housing and education, for space exploration and highway construction, and for defense and foreign aid.
- Mandatory spending, which accounts for 68 percent of all spending, is authorized by permanent laws, not by the 13 annual appropriations bills. It includes entitlements—such as Social Security, Medicare, veterans' benefits, and Food Stamps-through which individuals receive benefits

because they are eligible based on their age, income, or other criteria. It also includes interest on the national debt, which the Government pays to individuals and institutions that hold Treasury bonds and other Government securities. The President and Congress can change the law in order to change the spending on entitlements and other mandatory programs—but they don't have to.

Think of it this way: For discretionary programs, Congress and the President *must* act each year to provide spending authority. For mandatory programs, they *may* act in order to change the spending that current laws require.

Currently, the law imposes a limit, or "cap," through 1998 on total annual discretionary spending. Within the cap, however, the President and Congress can, and often do, change the spending levels from year to year for the thousands of individual Federal spending programs.

In addition, the law requires that legislation that would raise mandatory spending or lower revenues—compared to existing law-be offset by spending cuts or revenue increases. This requirement, called "pay-as-you-go," is designed to prevent new legislation from increasing the deficit.

Once Congress passes the budget resolution, it turns its attention to passing the 13 annual appropriations bills and, if it chooses, "authorizing" bills to change the laws governing mandatory spending and revenues.

Congress begins by examining the President's budget in detail. Scores of committees and subcommittees hold hearings on proposals under their jurisdiction. The House and Senate Armed Services Authorizing Committees, and the Defense and Military Construction Subcommittees of the Appropriations Committees, for instance, hold hearings on the President's defense plan. If the President's budget proposed changes in taxes, the House Ways and Means and the Senate Finance Committees would hold hearings. The Budget Director, Cabinet officers, and other Administration officials work with Congress as it accepts some of the President's proposals, rejects others, and changes still others. Congressional rules require that these committees and subcommittees take actions that reflect the budget resolution.

If you read through the President's budget, the budget resolution, or the appropriations or authorizing bills that Congress drafts, you will notice that the Government measures spending in two ways—"budget authority" and "outlays":

Budget authority (or BA) is what the law authorizes the Federal Government to spend for certain programs, projects, or activities. What the Government actually spends in a particular year, however, is an *outlay*. To see the difference, consider what happens when the Government decides to build a space exploration system.

The President and Congress may agree to spend $1 billion for the space system. Congress appropriates $1 billion in BA. But the system may take 10 years to build. Thus, the Government may spend $100 million in outlays in the first year to begin construction and the remaining $900 million over the next nine years as construction continues.

Monitoring the Budget

Once the President and Congress approve spending, the Government monitors the budget through:

- agency program managers and budget officials, including the Inspectors General, or IGs, who report only to the agency head;
- OMB;
- congressional committees; and
- the General Accounting Office, an auditing arm of Congress.

This oversight is designed to:

- ensure that agencies comply with legal limits on spending, and that they use budget authority only for the purposes intended;
- see that programs are operating consistently with legal requirements and existing policy; and, finally,
- ensure that programs are well managed and achieving the intended results.

The Government has paid more attention to good management of late, through the work of Vice President Gore's National Performance Review and implementation of the 1993 Government Performance and Results Act. This law is designed to improve Government programs by using better measurements of their results in order to evaluate their effectiveness.

4. Deficits and the Debt

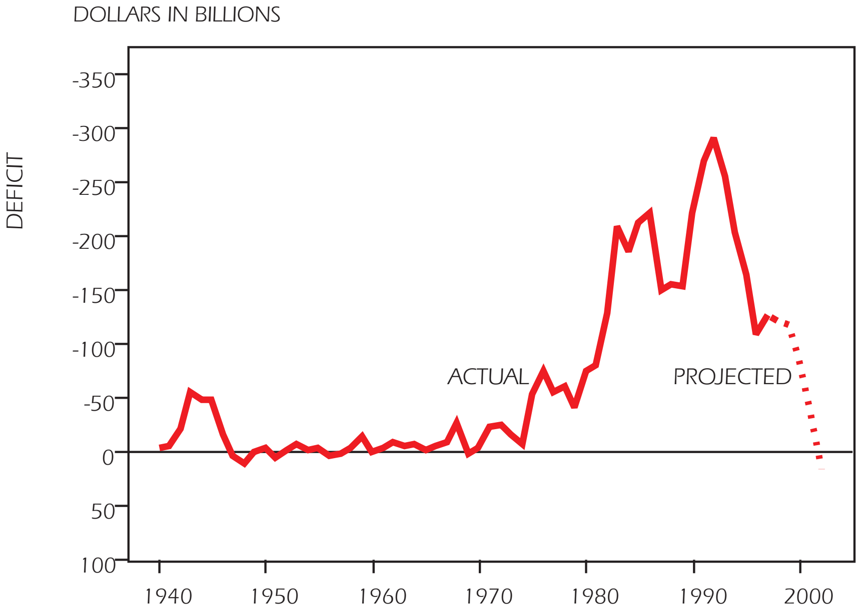
You've probably heard a lot about the Federal budget deficit and debt in recent years, primarily because both exploded in size in the 1980s.

Put simply, a *deficit* occurs when spending exceeds revenues in any year—just as a surplus occurs when revenues exceed spending. Generally, to finance our deficits, the Treasury borrows money. The *debt* is the sum total of our deficits, minus our surpluses, over the years.

The deficit is not a new phenomenon; the Government incurred its first in 1792, and it generated 69 annual deficits between 1900 and 1996.

Chart 4–1 provides the history of budget surpluses and deficits since 1940.

Chart 4–1. Past and Future Budget Deficits or Surpluses



Deficits began increasing dramatically in the 1980s, but have begun to decline. The President's budget is designed to bring the budget into balance over the next five years.

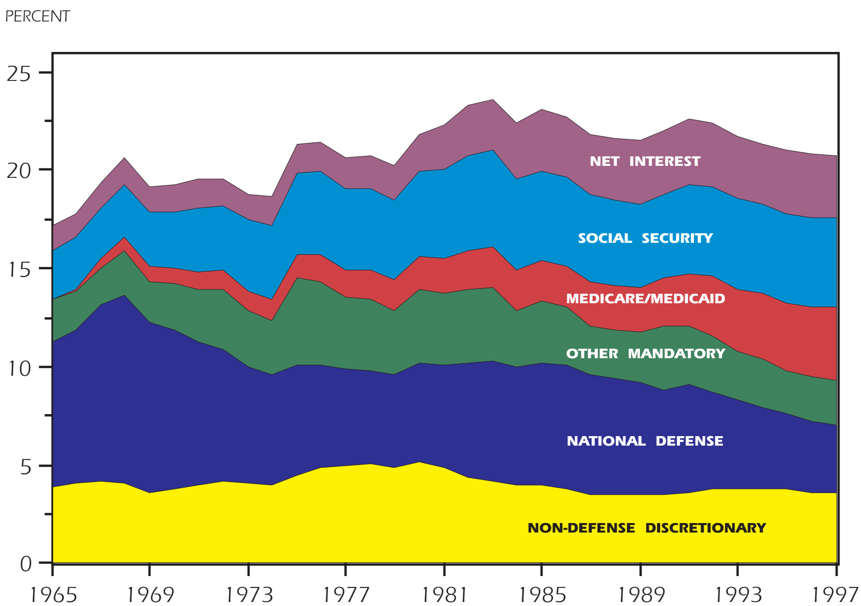
For most of the Nation's history, deficits were the result of either wars or recessions. Wars necessitated major increases in military spending, while recessions reduced Federal tax revenues from businesses and individuals.

The Government generated deficits during the War of 1812, the recession of 1837, the Civil War, the depression of the 1890s, and World War I. Once the war ended or the economy began to grow, the Government followed its deficits with budget surpluses, with which it paid down the debt.

Deficits returned in 1931 and remained for the rest of the decade—due to the Great Depression and the spending associated with President Roosevelt's New Deal. Then, World War II forced the Nation to spend unprecedented amounts on defense and to incur unprecedented deficits. Since then—with Democratic and Republican Presidents, Democratic and Republican Congresses—the Government has balanced its books only eight times, most recently in 1969.

Why have deficits become such a perennial problem for budget decisionmakers? Because spending has been growing faster than revenues.

Chart 4–2. Outlays as a Percent of GDP



Between 1965 and 1996, spending on Social Security, Medicare and Medicaid, and interest as a percentage of GDP grew, while spending on defense fell.

Revenues have stayed relatively constant, at around 17 to 19 percent of GDP, since the 1960s. In that time, however, outlays have grown from about 17 percent of GDP in 1965 to up to nearly 24 percent in 1983 before falling to 21 percent today. Much of the spending growth has come in Social Security, Medicare, Medicaid, and interest payments (see Chart 4–2).

Nevertheless, the deficits before 1981 paled in comparison to what followed. That year, the Government cut income tax rates and greatly increased defense spending, but it did not cut non-defense programs enough to make up the difference. Also, the recession of the early 1980s reduced Federal revenues, increased Federal outlays for unemployment insurance and similar programs that are closely tied to economic conditions, and forced the Government to pay interest on more national debt at a time when interest rates were high. As a result, the deficit soared.

Why the Deficit is a Problem

The United States is not alone in struggling with budget deficits. As Chart 4–3 illustrates, this Nation has a good record when compared to the recent history of six other major developed economies. (To make accurate comparisons with the governments of other nations, the U.S. data include the activities of State and local governments).

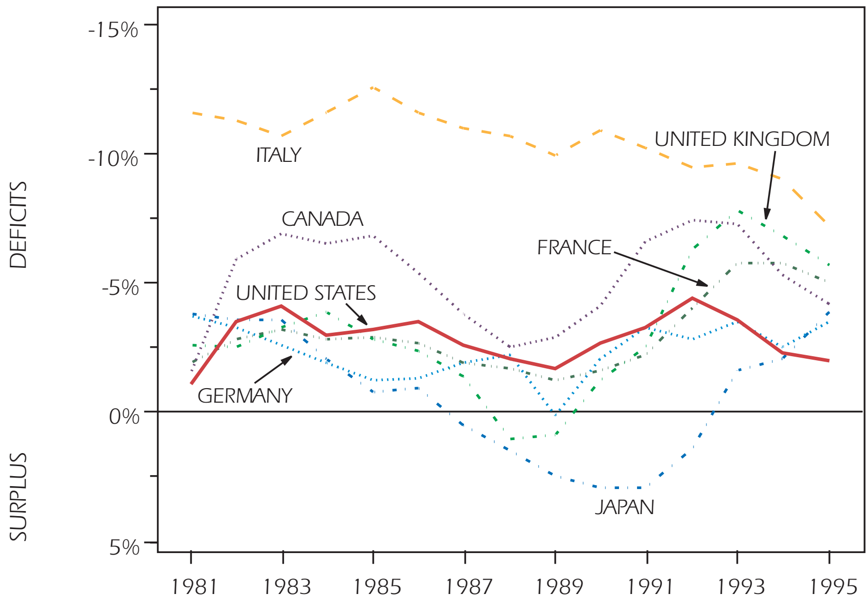
If budget deficits occur so frequently, here and abroad, should we worry about them?

The short answer is, yes. The deficit forces the Government to borrow money in the private capital markets. That borrowing competes with (1) borrowing by businesses that want to build factories and machines that make workers more productive and raise incomes, and (2) borrowing by families who hope to buy new homes, cars, and other goods. The competition for funds tends to produce higher interest rates.

Deficits increase the Federal debt and, with it, the Government's obligation to pay interest. The more it must pay in interest, the less it has available to spend on education, law enforcement, and other important services, or the more it must collect in taxes—forever after. Today, the Government spends 15 percent of its budget to pay interest.

The Federal interest burden grew substantially in the 1980s, both in actual dollars and as a percentage of Federal income tax revenues (see Chart 4–4). By 1998, net interest spending will be nearly as much as the Government will spend on national defense.

Chart 4–3. Total Government Surplus or Deficit as a Percent of GDP



Source: OECD, calendar year data.

Relative to the above economies, the total Government budget deficit in the United States is low.

In the end, the deficit is a decision about our future. We can provide a solid foundation for future generations, just as parents try to do within a family by limiting the amount of debt that they pass on; or we can generate large deficits and debt for those who come after us.

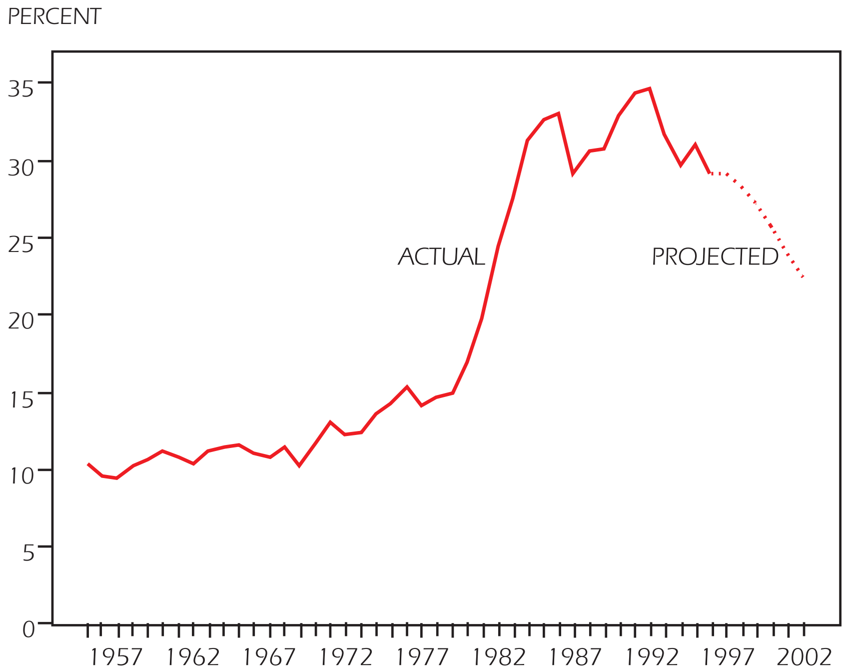
Deficits and Debt

If the Government incurs a deficit, it must borrow from the public.

Table 4–1 summarizes the relationship between the budget deficit and Federal borrowing.

Federal borrowing involves the sale, to the public, of notes and bonds of varying sizes and time periods. The cumulative amount of borrowing from the public—i.e., the debt held by the public—is the most important measure of Federal debt because it is what the Government has borrowed in the

Chart 4–4. Interest Costs as a Percent of Income Tax Revenues



private markets over the years, and it determines how much the Government pays in interest to the public.

Table 4–1. Federal Government Financing and Debt

(In billions of dollars)

	1996 Actual	Estimate					
		1997	1998	1999	2000	2001	2002
Federal Government financing:							
Budget deficit (–) or surplus	–107	–126	–121	–117	–87	–36	17
Other means of financing	–22	–17	–25	–21	–22	–23	–22
Borrowing from the public	130	143	146	138	110	59	5
Federal Government debt:							
Debt held by the public	3,733	3,876	4,021	4,159	4,269	4,328	4,333
Debt held by government accounts	1,449	1,578	1,715	1,853	2,003	2,157	2,319
Gross Federal debt	5,182	5,454	5,736	6,013	6,272	6,485	6,653
Debt subject to legal limit	5,137	5,411	5,697	5,973	6,233	6,447	6,615

Note: Numbers may not add to the totals due to rounding.

Debt held by the public was $3.7 trillion at the end of 1996—roughly the net effect of deficits and surpluses over the last 200 years. Debt held by the public does not include debt the Government owes itself—the total of all trust fund surpluses and deficits over the years, like the Social Security surpluses, that the law says must be invested in Federal securities.

The sum of debt held by the public and debt the Government owes itself is called Gross Federal Debt. At the end of 1996, it totaled $5.2 trillion.

Another measure of Federal debt is debt subject to legal limit, which is similar to Gross Federal Debt. When the Government reaches the limit, it loses its authority to borrow more to finance its spending; then, the President and Congress must enact a law to increase the limit.

The Government's ability to finance its debt is tied to the size and strength of the economy, or GDP. Debt held by the public was 50 percent of GDP at the end of 1996. As a percentage of GDP, debt held by the public was highest at the end of World War II, at 111 percent, then fell to 24 percent in 1974 before gradually rising to current levels.

That decline, from 111 to 24 percent, occurred because the economy grew faster than the debt accumulated; debt held by the public rose by amounts ranging from $242 billion to $344 billion in those years, but the economy grew faster.

Individuals and institutions in the United States hold over 70 percent of debt held by the public. The rest is held in foreign countries.

Deficit Reduction Efforts

Ever since the deficit soared in the early 1980s, successive Presidents and Congresses have tried to cut it. Until recently, they met with only limited success.

In the early 1980s, President Reagan and Congress agreed on a large tax cut, but could not agree about cutting spending; the President wanted to cut domestic spending more than Congress, while Congress sought fewer defense funds than the President wanted. They wound up spending more on domestic programs than the President wanted, and more on defense than Congress wanted. At the same time, a recession led to more spending to aid those affected by the recession, and reductions in tax revenues due to lower incomes and corporate profits.

By 1985, both sides were ready for drastic measures. That year, they enacted the Balanced Budget and Emergency Deficit Control Act, better known as Gramm-Rudman-Hollings (GRH). It set annual deficit targets for five years, declining to a balanced budget in 1991. If necessary, GRH required across-the-board cuts in programs to comply with the deficit targets.

Faced with the prospect of huge spending cuts in 1987, however, the President and Congress amended the law, postponing a balanced budget until 1993. The President and Congress never achieved those revised targets, in part because of the extraordinary costs of returning the Nation's savings and loan industry to a sound financial footing.

By 1990, President Bush and Congress enacted spending cuts and tax increases that were designed to cut the accumulated deficits by about $500 billion over five years. They also enacted the Budget Enforcement Act (BEA)—rather than set annual deficit targets, the BEA was designed to limit discretionary spending while ensuring that any new entitlement programs or tax cuts did not make the deficit worse.

First, the BEA set annual limits on total discretionary spending for defense, international affairs, and domestic programs. Second, it created "pay-as-you-go" rules for entitlements and taxes: those who proposed new spending on entitlements or lower taxes were forced to offset the costs by cutting other entitlements or raising other taxes.

For what it was designed to do, the law worked. It did, in fact, limit discretionary spending and force proponents of new entitlements and tax cuts to find ways to finance them. But the deficit, which Government and private experts said would fall, actually rose.

Why? Because the recession of the early 1990s reduced individual and corporate tax revenues and increased spending that is tied to economic fluctuations. Federal health care spending also continued to grow rapidly.

In 1993, President Clinton and the Congress made another effort to cut the deficit. They enacted a five-year deficit reduction package of spending cuts and higher revenues. The law was designed to cut the accumulated deficits from 1994 to 1998 by about $500 billion. The new law extended the limits on discretionary spending and the "pay-as-you-go" rules.

Clearly, the President's deficit reduction efforts have paid off. The deficit fell from $290 billion in 1992 to $107 billion in 1996, and by two-thirds as a share of GDP, to 1.4 percent. Now, as you will see in the next chapter, the President wants to finish the job by balancing the budget over the next five years.

5. THE PRESIDENT'S 1998 BUDGET

This budget fulfills the President's firm commitment to reach balance in 2002, building on the balanced-budget proposals that he outlined in his negotiations last year with the bipartisan leaders of Congress. Having cut the deficit by over 60 percent in his first term, the President is determined to finish the job.

Specifically, the President continues to seek cuts in unnecessary and lower-priority spending in both discretionary and mandatory programs, and to eliminate unwarranted tax and other preferences for corporations and others. The cuts would generate enough savings to provide tax relief to help middle-income Americans raise their children, send them to college, and save for the future; and to restore some harsh cuts in anti-poverty programs that Congress attached to last year's welfare reform bill.

Reaching Balance

Among its major elements, the budget:

- saves $137 billion in discretionary spending, cutting unnecessary and lower-priority programs while investing in education and training, the environment, science and technology, law enforcement, and other priorities that would raise living standards and the quality of life for average Americans;
- saves $100 billion in Medicare, ensuring the solvency of the Part A trust fund until 2007 while maintaining the essential quality of Medicare services for the elderly and people with disabilities;
- saves $22 billion in Medicaid, building upon the substantial savings that Federal and State experimentation in this jointly-run program is already generating, and continuing the guarantee of essential health and long-term care coverage for the most vulnerable Americans;
- saves $76 billion by ending corporate subsidies and other tax loopholes, extending expired tax provisions, and improving tax compliance;
- saves $36 billion by continuing the Administration's successful policy of auctioning segments of the broadcast spectrum;

- provides $18 billion to correct the harsh provisions that Congress attached to last year's welfare reform law; and
- cuts taxes by $98 billion, providing tax relief to tens of millions of middle-income Americans and small businesses.

Investing in the Future

Balancing the budget is not an end in itself. Rather, it helps fulfill the President's main economic goal—to raise the standard of living for average Americans, both now and in the future. So do his spending priorities.

The budget continues the President's policy of shifting Federal resources to education and training, science and technology, and other investments to enable Americans to get the skills to acquire good jobs, and to give businesses the tools to become more competitive, in the new economy. It also continues to shift resources to the environment and law enforcement, raising the quality of life for average Americans.

For education and training, the budget proposes to fulfill the President's commitment to put one million disadvantaged children in the Head Start program by 2002; to create safe learning environments for more children; to help more school systems extend high academic standards, better teaching, and better learning to all students; to enable more Americans to serve their communities and earn money for college; to bring technology into more classrooms; to create a $1,000 merit scholarship for the top five percent of graduates in every high school; to let more parents, teachers, and communities create public schools to meet their own children's needs; to make it easier for parents and students to borrow and repay college loans; to create the largest increase in Pell Grant scholarships in history in 20 years; and, finally, to provide Skill Grants to adults for job training.

The budget proposes to maintain environmental enforcement; protect national parks and other sensitive resources; and provide tax incentives to encourage companies to clean up "brownfields"—abandoned, contaminated industrial properties in distressed areas. It would put 17,000 more police on the street, bringing the total to 81,000 and moving closer to the President's goal of 100,000 by the year 2000; and it would provide more funds to combat juvenile crime and step up the fight against drugs, largely by focusing on treatment and prevention aimed at young Americans. It would increase the number of Border Patrol agents and workplace investigations to prevent illegal immigration and deter the hiring of illegal immigrants.

The budget invests in research, including biomedical research at the National Institutes of Health, in programs to combat infectious diseases at the Centers for Disease Control, in the Ryan White AIDS program that provides potentially life-extending drug therapies to many people with AIDS, and in community health centers and Indian Health Service facilities. The budget funds full participation in the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), which would serve 7.5 million people by the end of 1998.

Over the last year, the President also has proposed a series of initiatives to more quickly, and more effectively, meet his goal of higher living standards and a better quality of life for all Americans.

- Along with his earlier call for a tax deduction of up to $10,000 for college tuition and job training, the President proposes a new $1,500-a-year HOPE scholarship tax credit to make two years of college universal. The budget also proposes to increase Pell Grants for lower-income families who lack the tax liability to benefit from the tax cuts.
- The President proposes America Reads to help ensure that all children can read by the third grade, and a five-year, $5 billion school construction fund to help States and communities address the serious problem of dilapidated school buildings.
- Building on his earlier proposal to help the unemployed keep their health care for six months, the President now proposes to help expand health care coverage to uninsured children.
- Having taken the first step to reform welfare, the President now proposes to enhance the Work Opportunity Tax Credit to encourage employers to hire long-term welfare recipients.

Improving Performance in a Balanced Budget World

"We still have work to do," the President declared in late 1996, "for while the era of big Government is over, the era of big challenges is not."

Over the last four years, the President has used Federal resources and the power of his office to begin achieving educational excellence, expanding opportunity, cleaning up the environment, investing in promising research, ending welfare as we know it, protecting health care and pensions, making the tax system fairer, and keeping America strong. Americans want more progress on these and other issues and, with limited funds, the Federal Government must be able to respond effectively.

Led by Vice President Gore's National Performance Review, the Administration promised to create a Government that "works better and costs less." It is saving money, cutting the workforce, eliminating needless regulations and improving the necessary ones, streamlining bureaucracies, cutting red tape, and finding ways to better serve Government's "customers"—the American people.

In 1993, President Clinton pledged to cut the Federal workforce by 252,000 full-time equivalent (FTE) positions. A year later, the President and Congress enacted the Federal Workforce Restructuring Act, requiring cuts of 272,900 FTEs by the end of this decade. (An FTE is not necessarily synonymous with an employee. One full-time employee counts as one FTE, and two half-time employees also count as one FTE.)

To date, the Administration has cut the work force by over 250,000 employees out of 2.2 million in January 1993, creating the smallest Federal workforce in 30 years and, as a percentage of all civilian workers, the smallest since 1931. The cuts correspond to a reduction of over 250,000 FTEs (see Chart 5–1).

But, while Americans want a smaller Government, they also deserve one that works better—that treats them as valued customers at Social Security, veterans', and other offices; that uses their tax dollars wisely; and that makes a real impact on their lives when it addresses the problems of crime and poverty and the challenges of work and education.

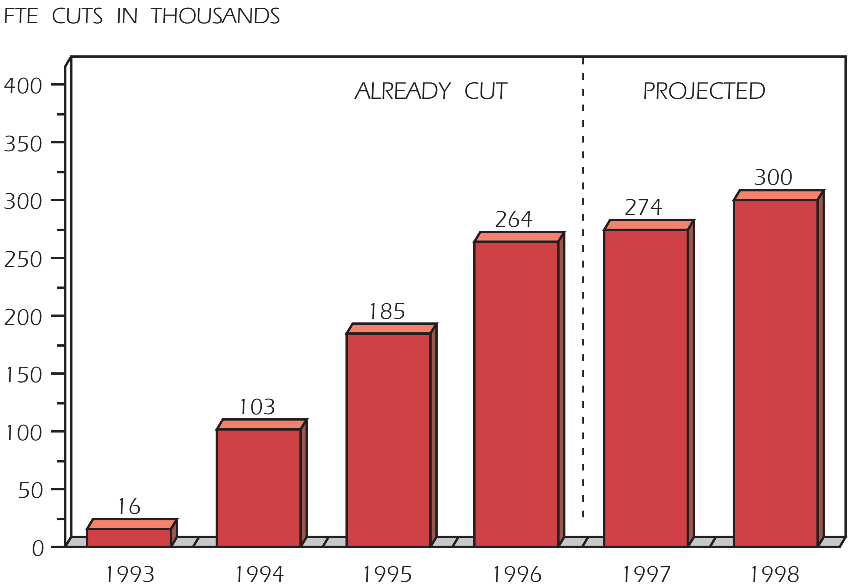
The Administration has found many ways for agencies to improve their performance and cut costs. Some of them focus on eliminating obsolete processes, others on improving the ones they have. Because agencies and programs are so different from one another, not every tool, technique, or strategy applies to each agency and department. But every agency and program can benefit from a number of them.

Based on lessons learned over the past four years, the Administration plans to use the following seven tools.

Restructure Agencies: Agencies are streamlining their workforces; eliminating redundant layers of bureaucracy; closing small, inefficient field offices; and creating partnerships with State and local governments and the private sector to focus on joint goals and the progress toward meeting them.

Improve Effectiveness of the Federal Workplace: Federal workers are working harder and smarter each and every day, but the Government must continue to downsize the workforce to live within the means of a

Chart 5–1. Cuts in Civilian Employment



Note: In 1993, the President pledged to cut the Federal work force by 252,000 full-time equivalent (FTE) positions. Simply put, one full-time employee counts as one FTE, and two employees who work half-time also count as one FTE.

balanced budget. The Administration will continue to closely manage and target its downsizing, while agencies work to avoid employee disputes and resolve them quickly when they occur.

Reform Federal Purchasing Practices: Before President Clinton took office, efforts to make Government work better and cost less were often hindered by the Government's unique acquisition system. But now, with strong bipartisan support from Congress, the Administration is transforming the system into one that operates much more like those of our most successful companies.

Expand Competition to Improve Services and Reduce Costs: Competition spurs efficiency. The Administration is encouraging agencies to compete with one another, and with the private sector, to provide common administrative support services. More competition will bring new technologies, capital, management techniques, and opportunity to Federal employees and their customers.

Follow the Best Private Sector Practices in Using Information Technology: Well-managed information technology should improve Government's productivity while cutting costs. Agencies are copying the successful practices of private firms to ensure that the technology provides workable solutions to real problems at a reasonable cost.

Improve Credit Program Performance: The Government must manage its cash and loan assets as wisely as possible. It must design and administer its loan programs prudently, and provide incentives to ensure that it can collect its "receivables" (the amounts owed) in a timely fashion.

Improve Business Management Practices: An efficient, effective Government needs sound financial management, reliable information, and, where appropriate, fees from those who benefit from Government's business-like activities.

These tools are designed to do more than let agencies function better for their own sake. Ultimately, they are designed to help agencies provide better, more effective services to the American people.

Already, agencies are assessing what their programs actually accomplish and what they must do to improve their performance. The Government Performance and Results Act (GPRA)—the landmark legislation that enjoyed broad bipartisan support in Congress before the President signed it in 1993—makes agencies more accountable for, and focused on, what their programs achieve.

Agencies now have many of the tools they need. Others will require legislation. The President wants to work with Congress to help agencies improve their performance in a balanced budget world.

Glossary

Appropriation

An appropriation is an act of Congress that enables Federal agencies to spend money for specific purposes.

Authorization

An authorization is an act of Congress that establishes or continues a Federal program or agency, and sets forth the guidelines to which it must adhere.

Balanced Budget

A balanced budget occurs when total revenues equal total outlays for a fiscal year.

Budget Authority (BA)

Budget authority is what the law authorizes, or allows, the Federal Government to spend for programs, projects, or activities.

Budget Enforcement Act (BEA) of 1990

The BEA is the law that was designed to limit discretionary spending while ensuring that any new entitlement program or tax cuts did not make the deficit worse. It set annual limits on total discretionary spending and created "pay-as-you-go" rules for any changes in entitlements and taxes. (See "pay-as-you-go.")

Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings, or GRH)

The Balanced Budget and Emergency Deficit Control Act of 1985 was designed to end deficit spending. It set annual deficit targets for five years, declining to a balanced budget in 1991. If necessary, it required across-the-board cuts in programs to comply with the deficit targets. It was never fully implemented.

Budget Resolution

The budget resolution is the annual framework within which Congress makes its decisions about spending and taxes. This framework includes targets for total spending, total revenues, and the deficit, as well as allocations, within the spending target, for discretionary and mandatory spending.

“Cap”

A “cap” is a legal limit on total annual discretionary spending.

Deficit

The deficit is the difference produced when spending exceeds revenues in a fiscal year.

Discretionary Spending

Discretionary spending is what the President and Congress must decide to spend for the next fiscal year through 13 annual appropriations bills. Examples include money for such activities as the FBI and the Coast Guard, housing and education, space exploration and highway construction, and defense and foreign aid.

Entitlement

An entitlement is a program that legally obligates the Federal Government to make payments to any person who meets the legal criteria for eligibility. Examples include Social Security, Medicare, and Medicaid.

Excise Taxes

Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone service.

Federal Debt

The gross Federal debt is divided into two categories: debt held by the public, and debt the Government owes itself. Another category is debt subject to legal limit.

Debt Held by the Public

Debt held by the public is the total of all Federal deficits, minus surpluses, over the years. This is the cumulative amount of money the Federal Government has borrowed from the public, through the sale of notes and bonds of varying sizes and time periods.

Debt the Government Owes Itself

Debt the Government owes itself is the total of all trust fund surpluses over the years, like the Social Security surpluses, that the law says must be invested in Federal securities.

Debt Subject to Legal Limit

Debt subject to legal limit, which is roughly the same as gross Federal debt, is the maximum amount of Federal securities that may be legally outstanding at any time. When the limit is reached, the President and Congress must enact a law to increase it.

Fiscal Year

The fiscal year is the Government's accounting period. It begins October 1 and ends on September 30. For example, fiscal 1998 ends September 30, 1998.

Gramm-Rudman-Hollings

See Balanced Budget and Emergency Deficit Control Act of 1985.

Gross Domestic Product (GDP)

GDP is the standard measurement of the size of the economy. It is the total production of goods and services within the United States.

Mandatory Spending

Mandatory spending is authorized by permanent law. An example is Social Security. The President and Congress can change the law to change the level of spending on mandatory programs—but they don't have to.

"Off-Budget"

By law, the Government must distinguish "off-budget" programs separate from the budget totals. Social Security and the Postal Service are "off-budget."

Outlays

Outlays are the amount of money the Government actually spends in a given fiscal year.

"Pay-As-You-Go"

Set forth by the BEA, "pay-as-you-go" refers to requirements that new spending proposals on entitlements or tax cuts must be offset by cuts in other entitlements or by other tax increases, to ensure that the deficit does not rise. (See BEA.)

Revenue

Revenue is money collected by the Government.

Social Insurance Payroll Taxes

This tax category includes Social Security taxes, Medicare taxes, unemployment insurance taxes, and Federal employee retirement payments.

Surplus

A surplus is the amount by which revenues exceed outlays.

Trust Funds

Trust funds are Government accounts, set forth by law as trust funds, for revenues and spending designated for specific purposes.

Unified Federal Budget

The unified budget, the most useful display of the Government's finances, is the presentation of the Federal budget in which revenues from all sources and outlays to all activities are consolidated.

List of Charts and Tables

List of Charts

Page

What Is the Budget?

Where the Money Comes From—and Where It Goes

How Does the Government Create a Budget?

Deficits and the Debt

The President's 1998 Budget

List of Tables

Page

ORDER FORM

MAIL ORDER FORM To:

Superintendent of Documents
U.S. Government Printing Office
Washington, DC 20402

Enclosed find $..........................
(Check or money order payable to the Superintendent of Documents)
(Please do not send cash or stamps.)
Please send me the publications I have indicated.

FOR OFFICE USE ONLY	
Quantity	Charges
........Publications	....
........Subscriptions	....
Special Shipping Charges	....
International Handling	....
Special Charges	....
OPNR	....
.........................UPNS	
.........................Balance Due	
.........................Discount	
.........................Refund	

Please charge this order to my Deposit Account

Deposit Account Number

☐☐☐☐☐☐ — ☐

Name ....

Street address ....

City and State .... ZIP Code ....

Credit Card Orders Only

Total charges $________________ Fill in the boxes below.

Credit Card No. ☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐

VISA MasterCard

Expiration Date Month/Year ☐☐☐☐

There is a 25% discount on all orders for 100 or more copies of a single title mailed to a single address. No discount is allowed if such orders are mailed to multiple addresses.

No. of copies	PUBLICATIONS	Price per copy	Total cost
....	The Budget of the United States Government, FY 1998, S/N 041–001–00478–5	$21.00	....
....	The Budget of the United States Government, FY 1998—Appendix, S/N 041–001–00479–3	61.00	....
....	Analytical Perspectives, FY 1998, S/N 041–001–00480–7	40.00	....
....	Historical Tables, FY 1998, S/N 041–001–00481–5	22.00	....
....	A Citizen's Guide to the Federal Budget, FY 1998, S/N 041–001–00482–3	3.75	....
....	The Budget System and Concepts, FY 1998, S/N 041–001–00483–1	3.50	....
....	The Budget on CD-ROM, FY 1998, S/N 041–001–00484–0	16.00	....
	Total	....	....

CHECK HERE IF YOU WISH TO RECEIVE PRIORITY ANNOUNCEMENTS OF FUTURE BUDGET PUBLICATIONS.

☐