A CITIZEN'S GUIDE TO THE FEDERAL BUDGET

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 1999

Table of Contents

A Note to the Reader

Next year, your Federal Government will spend over *$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* three years ago, and why we have published this fourth 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 have been problems, and what the President hopes to accomplish with his 1999 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, 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.

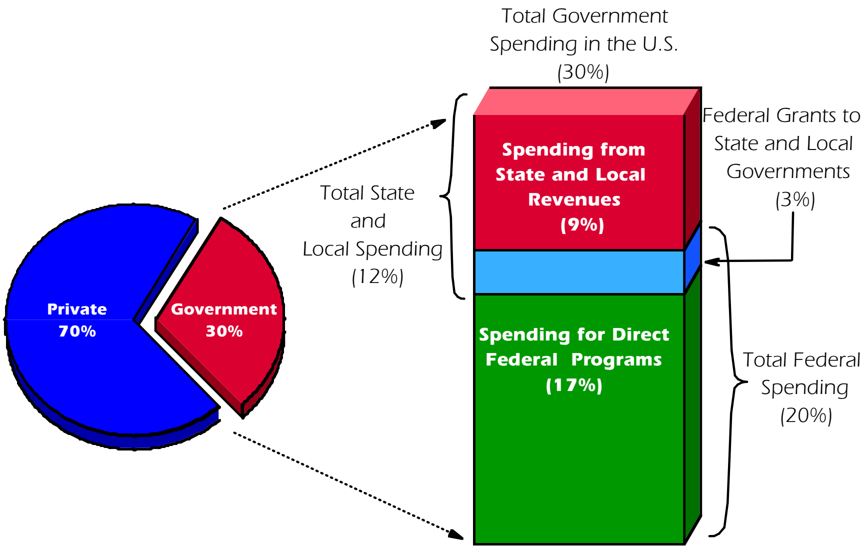
  When the economy is doing well, people are earning more and unemployment is low. In this atmosphere, revenues increase and the deficit shrinks.

- an historical record.

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

The 1999 budget is a document that embodies the President's budget proposal to Congress for fiscal 1999, the *fiscal* year that begins on October 1, 1998. It reflects the President's priorities and the first proposed balanced budget in nearly three decades.

Chart 1–1. Government Spending as a Share of GDP, 1997



Note: Numbers do not add due to rounding.

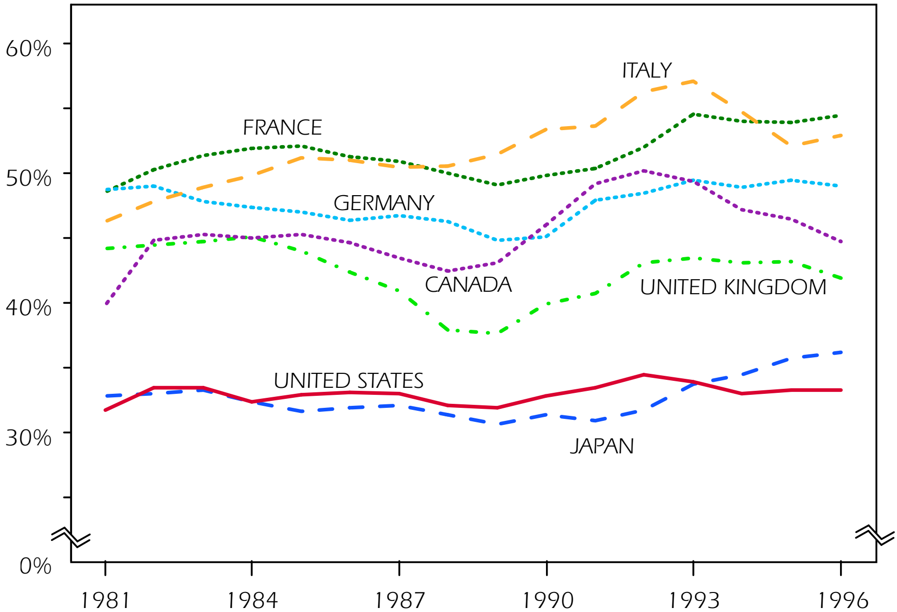
Total Government spending accounts for about one-third of the national economy. Federal spending is about two-thirds of this amount, or 20 percent of GDP.

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 Federal Government spending was about 20 percent of the Gross Domestic Product (or GDP, which measures the size of the economy) in 1997, State and local governments spending was about another nine 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 $971 billion that State and local governments spent in 1997, $221 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.

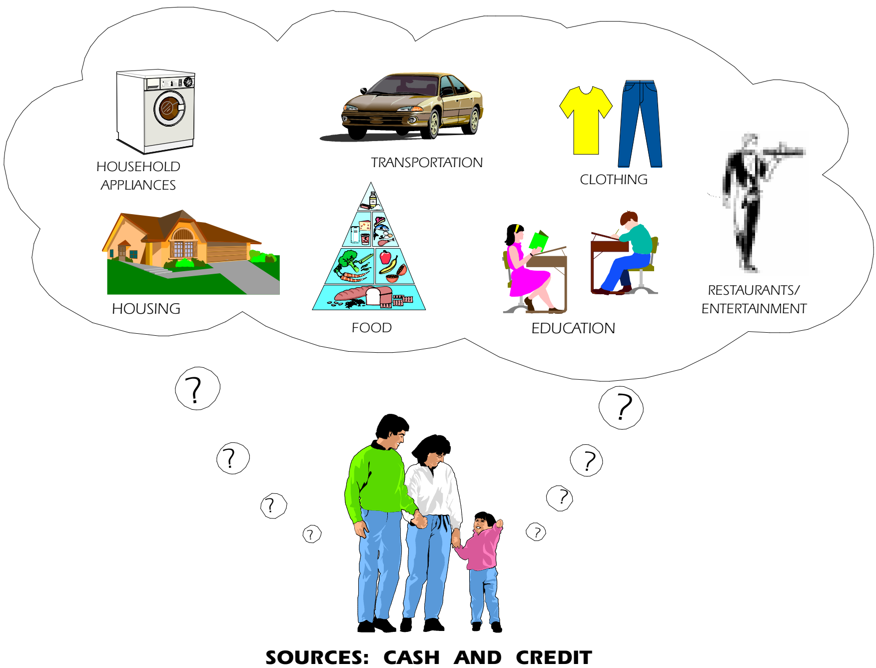
The United States allocates a smaller portion of its GDP to government than any other nation shown.

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

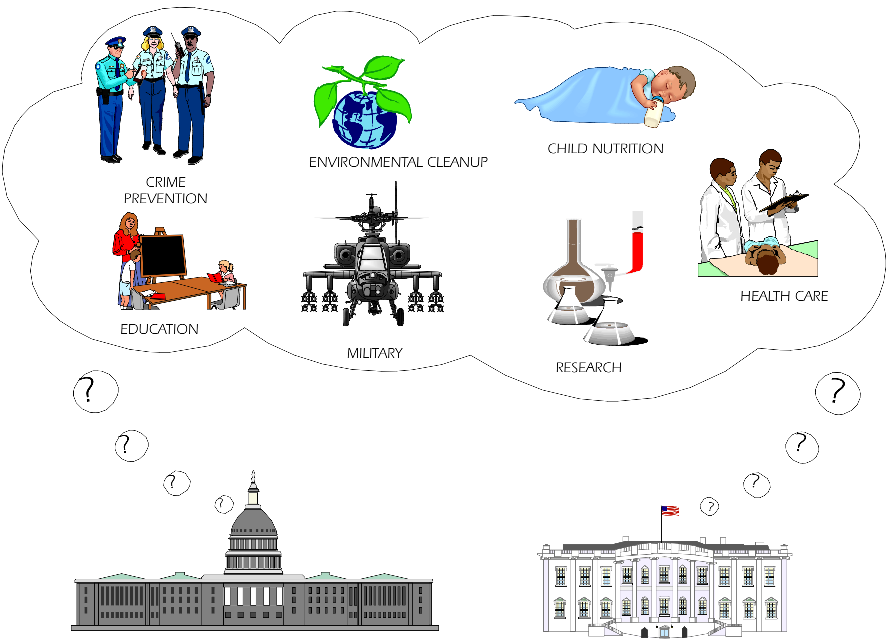


Generally speaking, the Federal Government plans its budget much like families do. The President and Congress determine how much money they expect the Government to receive in each of the next several years, where it will come from, and how much to spend to reach their goals—goals for national defense, 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.

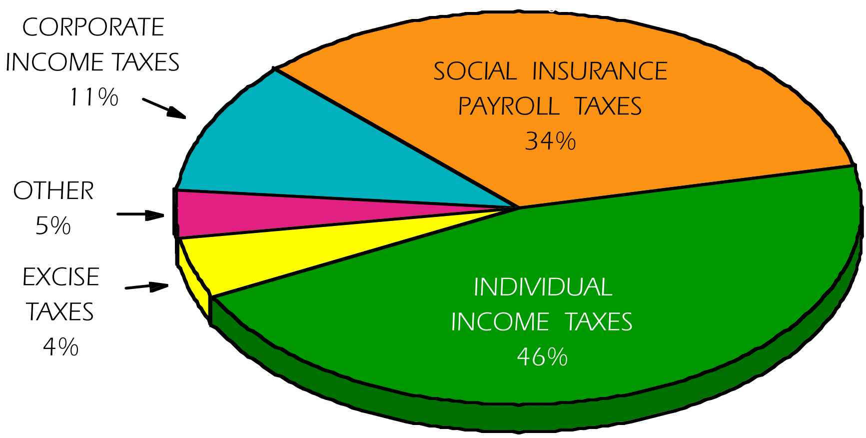
Chart 2–2. National Budgeting



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 $791 billion in 1999, equal to about nine percent of GDP—slightly higher than the average 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 1999.
- Corporate income taxes, which will raise an estimated $198 billion, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to 2.3 percent in 1999.

Table 2–1. Revenues By Source—Summary

(In billions of dollars)

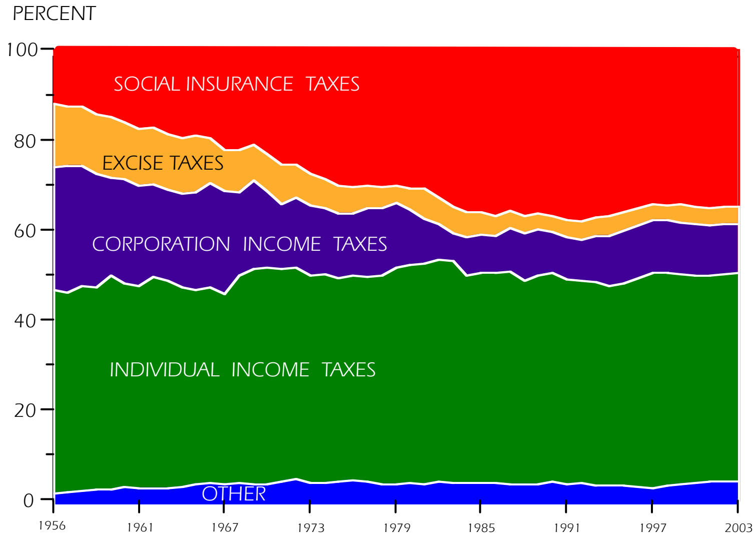
Source	1997 Actual	Estimate					
		1998	1999	2000	2001	2002	2003
Individual income taxes	737	768	791	805	833	877	916
Corporate income taxes	182	191	198	203	209	215	220
Payroll taxes	539	571	596	623	649	678	707
Excise taxes	57	56	72	70	72	74	75
Estate and gift taxes	20	20	21	22	23	24	26
Customs duties	18	18	18	20	20	22	24
Miscellaneous receipts	25	34	47	52	56	59	61
Total receipts	**1,579**	**1,658**	**1,743**	**1,794**	**1,863**	**1,949**	**2,028**

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 because of rounding.

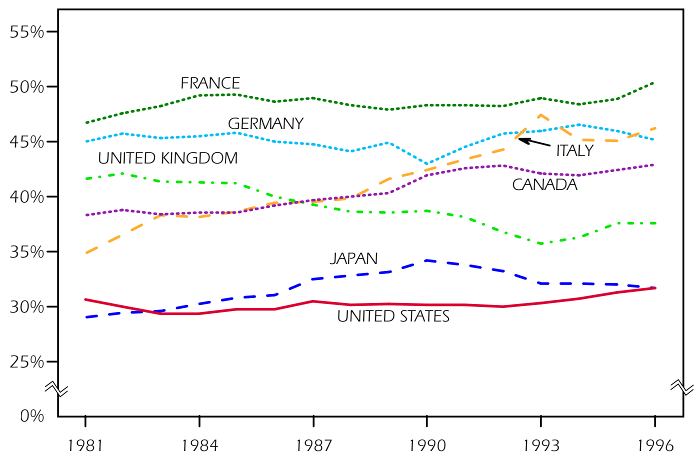
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways and airports and airways—and deposits others in the general fund.
- The Government also collects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

Chart 2–4. Composition of Revenues



Between 1960 and 1997, 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: OECD, calendar year data.

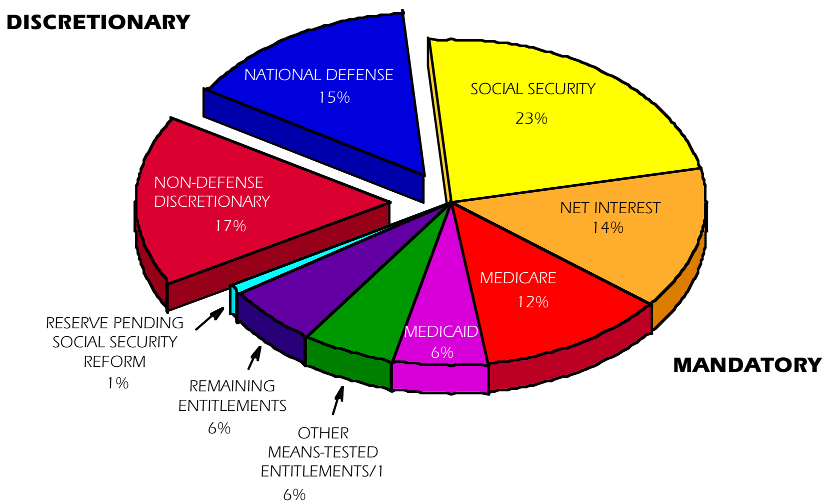
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries listed above.

Spending

As we have said, the Federal Government will spend over $1.7 trillion[1] in 1999, which we divided into eight large categories as shown in Chart 2–6.

- The largest Federal program is Social Security, which will provide monthly benefits to nearly 45 million retired and disabled workers, their dependents, and survivors. It accounts for 23 percent of all Federal spending.
- Medicare, which will provide health care coverage for over 39 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 1999 it will comprise 12 percent.

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



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

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[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 $210 billion in 1999. Without them, spending would total an estimated $1.9 trillion in 1999, not $1.7 trillion.

- Medicaid, in 1999, will provide health care services to over 35 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 1999.

- The remaining entitlements, which mainly consist of Federal retirement and insurance programs and payments to farmers, comprise six percent of the budget.

- National defense discretionary spending will total an estimated $267 billion in 1999, comprising over 15 percent of the budget and three 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 1999.

- 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. As the budget comes into balance in 1999, interest payments will drop to an estimated 14 percent.

Table 2–2. Spending Summary

(Outlays, in billions of dollars)

Source	1997 Actual	Estimate 1998	1999	2000	2001	2002	2003
Discretionary:							
National defense	272	265	267	270	271	273	289
International	19	19	19	19	19	19	19
Domestic	258	269	281	285	285	285	287
Subtotal, discretionary	548	553	566	574	575	577	595
Mandatory:							
Programmatic:							
Social security	362	378	393	409	427	447	468
Medicare	187	195	205	214	230	232	253
Medicaid	96	101	108	115	123	133	143
Means-tested entitlements (except Medicaid)	98	104	112	117	121	124	129
Other	115	141	151	165	172	175	185
Subtotal, programmatic	859	919	968	1,021	1,073	1,111	1,178
Undistributed offsetting receipts	–50	–46	–42	–46	–47	–56	–48
Subtotal, mandatory	809	872	925	975	1,026	1,056	1,129
Net interest	244	243	242	236	234	227	221
Subtotal, mandatory and net interest	1,053	1,115	1,167	1,211	1,259	1,283	1,350
Total	**1,601**	**1,668**	**1,733**	**1,785**	**1,834**	**1,860**	**1,945**

Note: Numbers may not add to the totals because of rounding.

Table 2–3. Spending by Function

(Outlays, in billions of dollars)

Source	1997 Actual	Estimate 1998	1999	2000	2001	2002	2003
National defense:							
Department of Defense-Military	258	251	253	256	257	260	276
Other	12	13	13	13	13	12	13
Total, national defense	270	264	265	269	270	272	289
International affairs	15	14	14	15	15	16	16
General science, space, and technology	17	17	18	18	18	19	19
Energy	1	*	−1	*	−*	−*	−*
Natural resources and environment	21	24	23	24	24	23	24
Agriculture	9	11	11	11	9	9	9
Commerce and housing credit	−15	4	4	12	11	11	10
Transportation	41	42	42	43	43	44	45
Community and regional development	11	12	11	10	10	9	8
Education, training, employment, and social services	53	55	59	63	63	63	66
Health	124	132	141	150	160	171	183
Medicare	190	198	207	217	233	235	256
Income security	231	239	253	263	272	278	287
Social security	365	381	396	413	430	450	471
Veterans benefits and services	39	43	43	44	45	45	47
Administration of justice	20	22	26	26	27	26	26
General government	13	13	17	17	18	18	19
Net interest	244	243	242	236	234	227	221
Allowances	......	......	3	......	......	......	......
Undistributed offsetting receipts	−50	−46	−42	−46	−47	−56	−48
Total	**1,601**	**1,668**	**1,733**	**1,785**	**1,834**	**1,860**	**1,945**

* $500 million or less.

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

Table 2–4. Spending by Agency

(Outlays, in billions of dollars)

Source	1997 Actual	Estimate 1998	1999	2000	2001	2002	2003
Legislative Branch	2	3	3	3	3	3	3
Judicial Branch	3	4	4	4	4	4	4
Agriculture	53	55	54	56	57	58	60
Commerce	4	4	5	6	4	4	4
Defense-Military	258	251	253	256	257	260	276
Education	30	31	34	36	37	37	38
Energy	14	14	15	15	15	14	15
Health and Human Services	340	359	381	401	428	441	476
Housing and Urban Development	28	31	32	32	31	31	29
Interior	7	8	8	8	8	8	8
Justice	14	15	18	19	19	18	18
Labor	30	32	36	38	39	40	42
State	5	5	5	5	5	6	6
Transportation	40	40	41	42	43	43	44
Treasury	379	387	399	402	408	411	414
Veterans Affairs	39	43	43	44	45	45	47
Corps of Engineers	4	4	3	3	3	3	3
Other Defense Civil Programs	30	31	32	33	34	35	36
Environmental Protection Agency	6	6	7	7	7	7	7
Executive Office of the President	*	*	*	*	*	*	*
Federal Emergency Management Agency	3	4	3	2	1	1	1
General Services Administration	1	1	*	*	*	–1	*
International Assistance Programs	10	10	9	10	10	10	10
National Aeronautics and Space Administration	14	14	14	13	13	13	13
National Science Foundation	3	3	3	4	4	4	4
Office of Personnel Management	45	46	49	51	53	55	58
Small Business Administration	*	–*	–*	–*	1	1	1
Social Security Administration	393	410	426	443	462	482	504
Other Independent Agencies	–2	14	14	22	22	22	22
Allowances	......	......	3	......	......	......	......
Undistributed offsetting receipts	–155	–160	–162	–172	–181	–197	–199
Total	**1,601**	**1,668**	**1,733**	**1,785**	**1,834**	**1,860**	**1,945**

* $500 million or less.

Note: Spending that is shown as a minus means that receipts exceed outlays.
Numbers may not add to the totals because of 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.

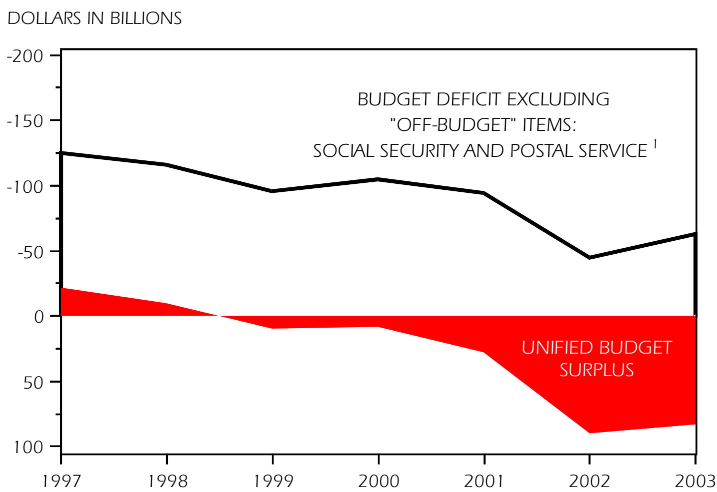
Specifically, the law requires that the spending and revenues of two Federal programs, Social Security and the Postal Service, be excluded from the budget totals—that is, categorized as “off-budget.” Therefore, the budget displays “on-budget,” “off-budget,” and “unified budget” totals to satisfy this 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 1999,* as well as *Analytical Perspectives, Appendix, Historical Tables,* and A *Citizen's Guide to the Federal Budget,* which you are now reading.

For fiscal 1999—that is, October 1, 1998 to September 30, 1999—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 1999.	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 final decisions on what goes in his budget.	February–December 1997
Budget preparation and transmittal.	The budget documents are prepared and transmitted to Congress.	December 1997–February 1998
Congressional action on the budget.	Congress reviews the President's budget, develops its own budget, and approves spending and revenue bills.	March–September 1998
The fiscal year begins.		October 1, 1998
Agency program managers execute the budget provided in law.		October 1, 1998–September 30, 1999
Data on actual spending and receipts for the completed fiscal year become available.		October–November 1999

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 33 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 67 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 2002 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

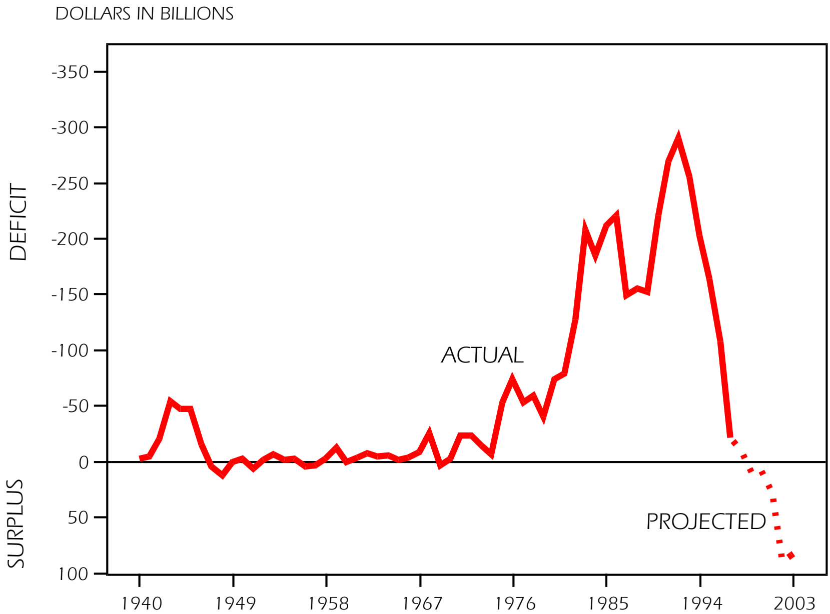
You've probably heard a lot about the Federal budget deficit and debt in recent years, primarily because both exploded in size in the 1980s.

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 70 annual deficits between 1900 and 1997.

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 declined. The President's budget proposes to reach balance in 1999.

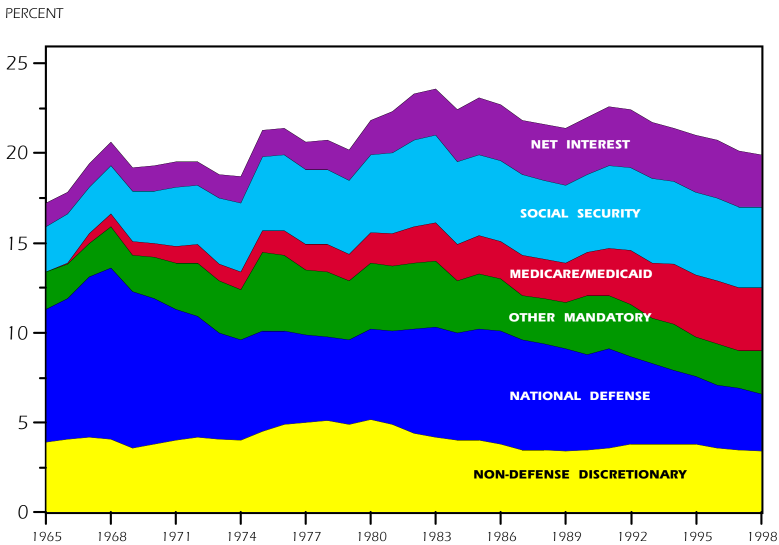
For most of the Nation's history, deficits were the result of either wars or recessions. Wars necessitated major increases in military spending, while recessions reduced Federal tax revenues from businesses and individuals.

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 1997, 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 20 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 20 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.)

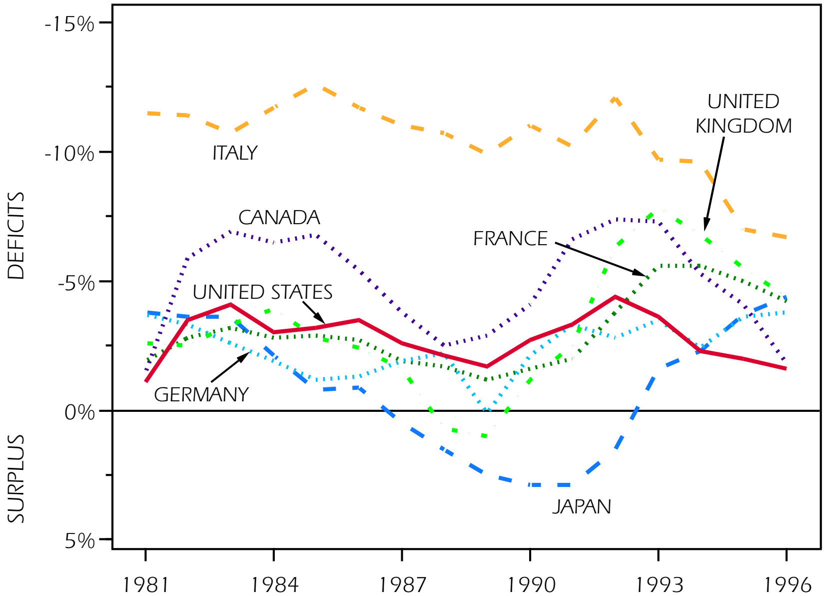
If budget deficits occur so frequently, here and abroad, should we worry about them?

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. The Government will spend 14 percent of its budget to pay interest in 1999.

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 1999, net interest spending will be nearly as much as the Government will

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.

spend on national defense, although it is declining as a percent of the budget with the President's proposal to reach balance in 1999.

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.

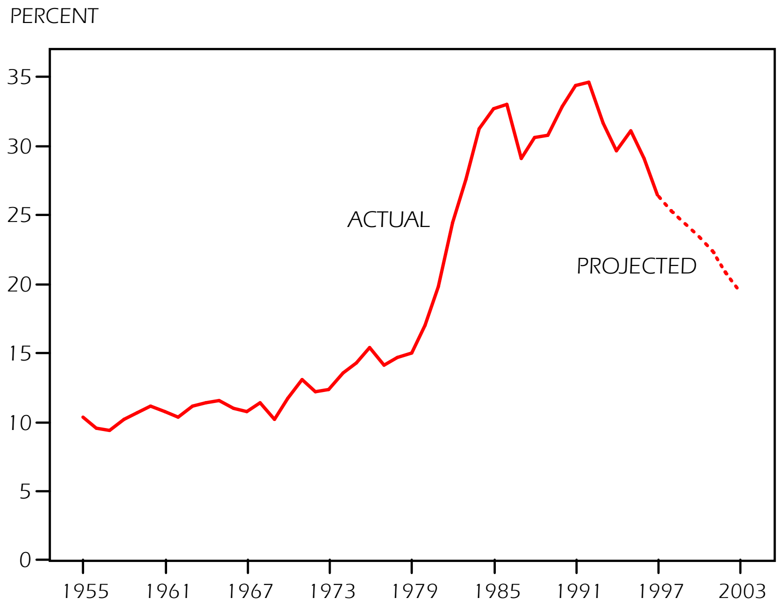
Deficits and Debt

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

Table 4–1 summarizes the relationship between the budget deficit or surplus and Federal borrowing or the repayment of debt.

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

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



Federal debt because it is what the Government has borrowed in the 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)

	1997 Actual	Estimate 1998	1999	2000	2001	2002	2003
Federal Government financing:							
Budget deficit (–) or surplus	–22	–10	10	9	28	90	83
Other means of financing	–16	–16	–20	–13	–15	–14	–13
Borrowing from the public	38	26	10	4	–13	–76	–70
Federal Government debt:							
Debt held by the public	3,771	3,797	3,807	3,812	3,798	3,722	3,652
Debt held by government accounts	1,599	1,747	1,931	2,104	2,281	2,482	2,684
Gross Federal debt	5,370	5,544	5,738	5,916	6,079	6,204	6,336
Debt subject to legal limit	5,328	5,506	5,701	5,880	6,044	6,170	6,305

Note: Numbers may not add to the totals because of rounding.

Debt held by the public was $3.8 trillion at the end of 1997—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 1997, it totaled $5.4 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 47 percent of GDP at the end of 1997. As a percentage of GDP, debt held by the public was highest at the end of World War II, at 109 percent, then fell to 24 percent in 1974 before gradually rising to a peak in the middle 1990s.

That decline, from 109 to 24 percent, occurred because the economy grew faster than the debt accumulated; debt held by the public rose from $242 billion to $344 billion in those years, but the economy grew faster.

Individuals and institutions in the United States hold two-thirds 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 $22 billion in 1997, and by nearly 95 percent as a share of GDP, to 0.3 percent.

Although the 1993 plan had exceeded all expectations in reducing the deficit, the task of reaching balance would require one final push. That would come with the historic 1997 Balanced Budget Act (BBA), on which the President and Congress agreed last summer.

Originally designed to balance the budget by 2002, the BBA provided for $247 billion in savings over five years. It also extended the solvency of Medicare's trust fund for at least 10 years while providing for the largest investment in higher education since the G.I. Bill in 1945, the largest investment in children's health care since the creation of Medicaid in 1965, and a $500-per-child tax credit for about 27 million working families.

The President is now proposing to balance the budget three years ahead of schedule, in 1999, but the challenge for both the President and Congress is the same: keeping the budget in balance while continuing to invest in the American people. The next chapter describes the President's plans for achieving that goal.

5. THE PRESIDENT'S 1999 BUDGET

The President's balanced budget builds on his efforts to invest in the skills of the American people. It continues his policy of helping working families with their basic needs—raising their children, sending them to college, and paying for health care. It also invests in education and training, the environment, science and technology, and other priorities to help raise the standard of living and quality of life of average Americans.

Within tight constraints, the budget proposes major initiatives that will continue the President's investments in high-priority areas—from helping working families with their child care expenses to allowing Americans aged 55 to 65 to buy into Medicare; from helping States and school districts recruit and prepare thousands more teachers and build thousands more classrooms to addressing the world-wide problem of global warming. The budget pays for every initiative—in the President's words, "line by line, dime by dime."

Investing in the Future

For the President, balancing the budget is not an end in itself. Instead, it helps fulfill his main economic goal—to raise the standard of living for average Americans, both now and in the future. So do his investment priorities.

The budget continues the President's commitment to helping working families balance the demands of work and family with a major effort to make child care more affordable, accessible, and safe. It proposes a Child Care Initiative that would provide tax breaks to help families pay for care; tax incentives to help businesses create or expand child care facilities; direct subsidies for over two million poor or near-poor children; increased funding for before- and after-school programs; and funds to help States enforce safety and quality, to train child care staff, to promote early childhood development, and to improve the health of young children in child care. Also to help working families, the budget proposes tax incentives to encourage small businesses to create pension plans for more workers.

For health care, the budget proposes initiatives to expand health care coverage and improve the Nation's health. It would give new insurance options to hundreds of thousands of Americans aged 55 to 65 and it proposes new initiatives to ensure that as many uninsured children as possible are covered. In addition, the budget provides for unprecedented investments in biomedical research at the National Institutes of Health; advocates bipartisan national legislation that would reduce tobacco use among the young; expands access to new AIDS therapies through the Ryan White program; enables more Medicare recipients to receive promising cancer treatments by participating more easily in “clinical trials”; expands substance abuse prevention and treatment activities; and enhances food safety. It also funds full participation in the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), which will provide benefits to 7.5 million people by the end of 1999.

Continuing the President’s efforts to enhance access to, and the quality of, education and training, the budget takes the next step—helping States and school districts to reduce class size by recruiting and preparing thousands more teachers and building thousands more classrooms; and creating new Education Opportunity Zones to provide needed support for high-poverty, low-achieving urban and rural districts while holding them accountable to boost student achievement. The budget also proposes to move further toward the President’s commitment to put a million disadvantaged children in Head Start by 2002; begin field testing voluntary national tests; mobilize and train reading tutors for children; help parents, teachers, and communities create more charter schools that are free of most State regulations; integrate technology into the classroom as we connect every classroom to the Internet; enable more Americans to serve their communities and earn money for college; expand college work-study to a million students; make it easier for parents and students to borrow and repay college loans; raise the maximum Pell Grant college scholarship to its highest level ever; expand assistance to workers dislocated as a result of global trade and technological change; increase G.I. Bill educational benefits for veterans; and expand resources for veterans who lose their jobs.

For the environment, the budget builds on the President’s efforts to address climate change by proposing tax incentives and spending that will spur energy efficiency and help develop low-carbon emission energy sources. It includes incentives for buying new, highly fuel-efficient cars with technologies to reduce carbon emissions; for investing in energy-saving equipment for commercial and residential buildings; for commuting by public transit or vanpool; and for developing innovative energy generation techniques, such as biomass, wind, and photovoltaics. The budget also would restore and rehabilitate national parks, forests, and public lands and facilities; expand efforts to restore and protect the water quality of rivers and lakes; continue efforts to double the pace of Superfund clean-ups; extend the Brownfields initiative to promote local cleanup and redevelopment; better protect endangered species; continue to restore Florida's Everglades and California's Bay-Delta and protect Yellowstone National Park and California's Headwaters Forest; improve the roads through national parks; and expand the public's access to information about environmental conditions in their neighborhoods.

The budget invests heavily in basic and applied research. Along with increasing funds for biomedical research at the National Institutes of Health, the budget would promote science and engineering research at the National Science Foundation; support space-related activities that enhance our knowledge of Earth; invest in Federal-private ventures to more quickly develop cutting-edge technologies that create jobs; strengthen university-based research; invest in environmental research on safe food and clean air and water; expand support for energy efficiency and renewable energy programs; enable Americans to travel more safely, more quickly, and more efficiently; and put commercial industry's technical know-how and economies of scale to work for national defense.

Challenging times demand innovative solutions, and this budget meets the challenge by proposing three new investment funds for America—for research, the environment, and transportation—that will focus attention on these critical priorities. Together, the funds provide $75.5 billion, a $4.7 billion increase over the 1998 level for the programs they contain.

- ***The Research Fund for America,*** which includes a broad range of investments in knowledge, including programs of the National Institutes of Health, the Centers for Disease Control and Prevention, the National Science Foundation, the National Aeronautics and Space Administration, the Energy Department, the Commerce Department's National Institute of Standards and Technology, Agriculture Department research programs, the multi-agency Climate Change Technology Initiative, and other programs. The budget finances this Fund, in part, through receipts from tobacco legislation and savings in mandatory programs.

- ***The Environmental Resources Fund for America,*** which encompasses the multi-agency Clean Water Initiative; the new Land, Water, and Facility Restoration Initiative of the Interior and Agriculture Departments; the Agriculture Department's water and wastewater program for rural communities; and the Environmental Protection Agency's programs for cleaning up hazardous waste sites (within the Superfund) and upgrading clean water and safe drinking water infrastructure. The budget finances the Fund, in part, through an extension of Federal taxes that support the Superfund.

- ***The Transportation Fund for America,*** which includes the Transportation Department's highway, highway safety, and transit programs; the Flight 2000 free flight demonstration program; and the Federal Aviation Administration's programs, including Airport Grants. The budget finances the Fund, in part, through a new Federal aviation user fee.

Improving Performance Through Better Management

The President has challenged the Federal Government to do more with less—and with good reason.

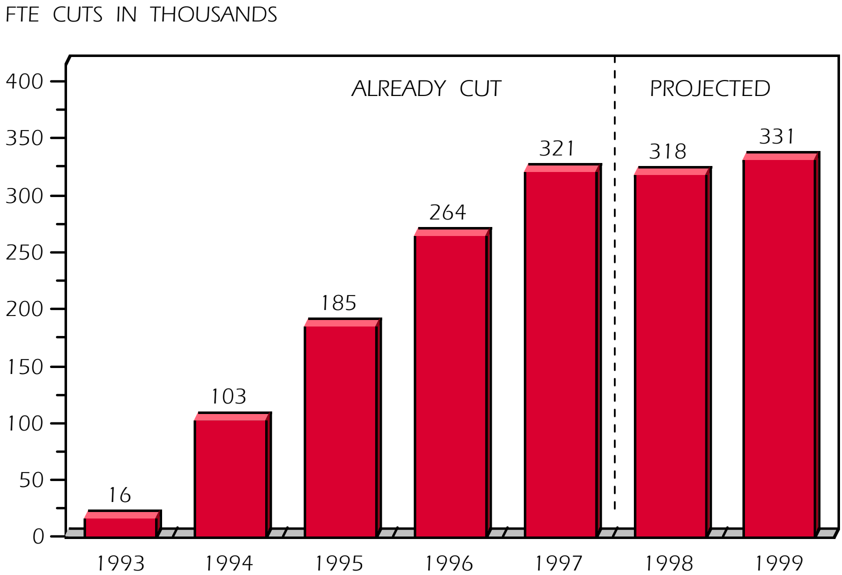
Departments and agencies, which once could count on more funds from year to year, no longer can; indeed, with the Administration committed to balancing the budget, some agencies will get less. But public demands for more and better services have not shrunk. Americans continue to want good schools, a clean environment, high-quality health care, and secure retirement benefits. Thus, the Government must satisfy these demands by managing better and improving the performance of programs.

The Administration has answered the call. Vice President Gore, working with the departments, agencies, and inter-agency working groups, and drawing on the expertise of the private sector, has led an unprecedented effort to cut the size of the Federal Government and make it more efficient and effective. Through these reinvention efforts, the Administration has saved $137 billion over the last five years.

The Administration has cut the civilian Federal work force by over 316,000 employees, creating the smallest work force in 35 years and, as a share of total civilian employment, the smallest work force since 1931 (see Chart 5–1). Almost all of the 14 Cabinet Departments have cut their work forces; only the Justice Department's work force is growing due to the Administration's expanded war on crime and drugs, while the Commerce Department's work force is growing due to the decennial census.

In addition, the Vice President has challenged the leaders of 32 agencies, with over 1.4 million full-time equivalent positions, to commit to achieving significant, concrete, measurable goals over the next three years. These "High Impact Agencies" include the Immigration and Naturalization Service, National Park Service, and Social Security Administration.

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.

Working with the National Performance Review (NPR), these agencies have developed over 200 specific, measurable commitments that they will complete by the year 2000. They involve improving services in areas that Americans care about.[1] Major performance goals include:

- ***Improving student aid delivery:*** The Education Department will determine, within four days, the eligibility of students and families who apply for student aid electronically, cutting the processing time in half.
- ***Speeding aid to disaster victims:*** Through partnerships with Federal, State, local, and voluntary agencies, the Federal Emergency Management Agency will act on all requests to meet victims' needs for water, food and shelter within 12 hours of a disaster event, with the intent to coordinate services within 72 hours of a Presidential declaration of disaster.

[1] The NPR's home page, at www.npr.gov, links to the performance commitments of each agency.

- ***Finding the right agency on the first try:*** The General Services Administration will restructure Federal listings in the blue pages of local telephone books, ensuring that Americans can find the Government service they need the first time they look.
- ***Reducing time for clearance at U.S. airports:*** Working with the Agriculture Department and the Customs Service, the Justice Department's Immigration and Naturalization Service will clear international passengers at airports in 30 minutes or less while improving enforcement and regulatory processing.
- ***Reducing injury and illnesses in the workplace:*** The Labor Department's Occupational Safety and Health Administration will cut injury and illness rates by a fifth in at least 50,000 of the most hazardous workplaces.
- ***Increasing access to Federal recreation opportunities:*** The National Park Service will create, with other Federal natural resource agencies, an integrated Nation-wide outdoor recreation information system that gives all Americans electronic access to information about recreation on Federal lands, recreation use permits, and reservations.
- ***Speeding Social Security information:*** The Social Security Administration will provide overnight electronic Social Security number verification for employers. Today, verification can take up to two weeks.

Already, agencies are assessing what their programs actually accomplish and what they must do to improve their performance.

Under the 1993 Government Performance and Results Act, Cabinet departments and agencies have prepared individual performance plans that they will send to Congress with the performance goals they plan to meet in 1999. These plans, in turn, form the basis for the first Government-wide performance plan, which the Administration is sending to Congress along with the budget.

This plan is a good first step in the area of performance measurement, and the President is committed to working with Congress to help agencies continue to 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 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 1999 ends September 30, 1999.

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

List of Tables

Page

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