A CITIZEN'S GUIDE TO THE FEDERAL BUDGET

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 1997

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A Note to the Reader

Next year, your Federal Government will spend over *$1.6 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* last year, and why we have published this second 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 1997 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?

What is "the Federal budget"? It 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.

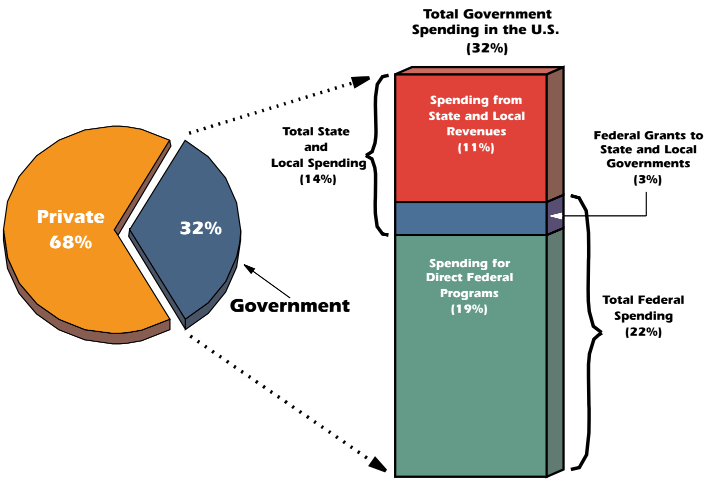
  When the economy is doing well, people are earning more and unemployment is low. In this atmosphere, revenues increase and the deficit shrinks.

- an historical record.

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

The 1997 budget is a document that embodies the President's budget proposal to Congress for fiscal 1997, the *fiscal* year that begins on October 1, 1996. 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, 1995



Note: Numbers do not add due to rounding.

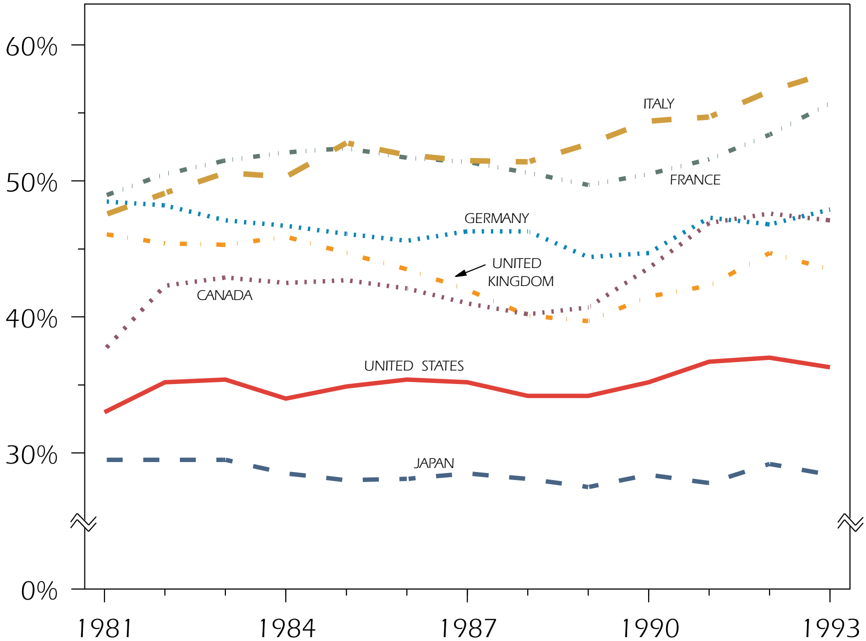
Total Government spending accounts for about one-third of the national economy. Federal spending is about two-thirds of this amount, or 22 percent of GDP.

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 22 percent of the Gross Domestic Product (or GDP, which measures the size of the economy), State and local governments spend about another 11 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 $961 billion that State and local governments spent in 1995, $213 billion came from Federal grants.

Compared to six other industrialized nations, the United States allocates the smallest share of its GDP to government (Federal, State, and local combined), except for Japan (see Chart 1–2).

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



Source: OECD, calendar year data.

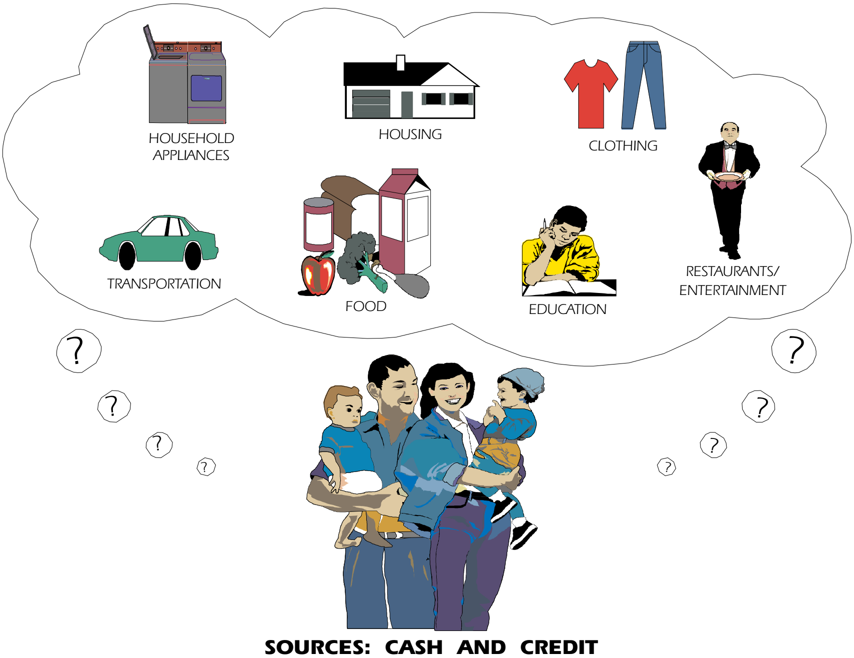
The United States allocates a smaller portion of its GDP to government than any other nation shown, except Japan.

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

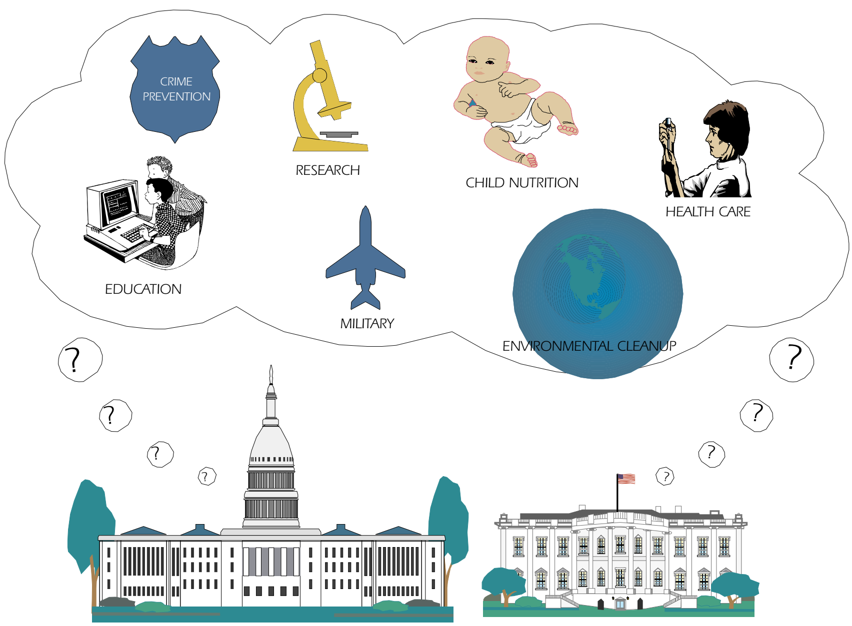


Generally speaking, the Federal Government plans its budget much like families do. The President and Congress determine how much money they expect the Government to receive in each of the next several years, where it will come from, and how much to spend to reach their goals—goals for national defense,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

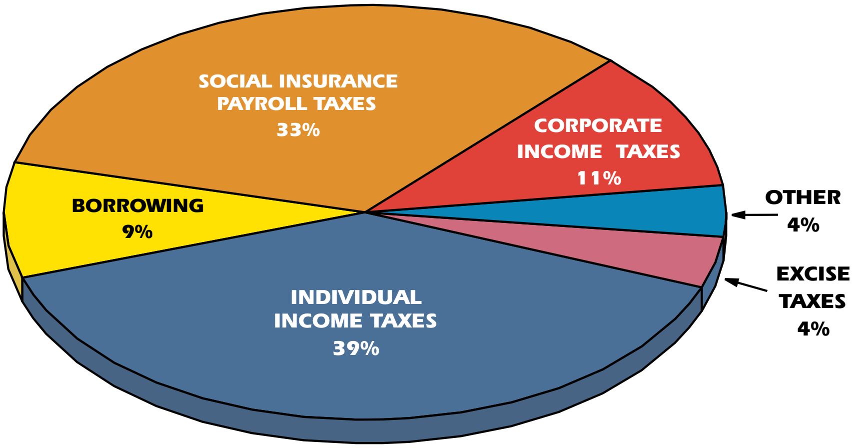
Chart 2–2. National Budgeting



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 $645 billion in 1997, equal to about 8 percent of GDP—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 seven percent in 1997.

- Corporate income taxes, which will raise an estimated $185 billion in 1997, have shrunk steadily as a percent of GDP, from 4.6 percent in 1955 to 2.2 percent today.

Table 2–1. Revenues By Source—Summary

(In billions of dollars)

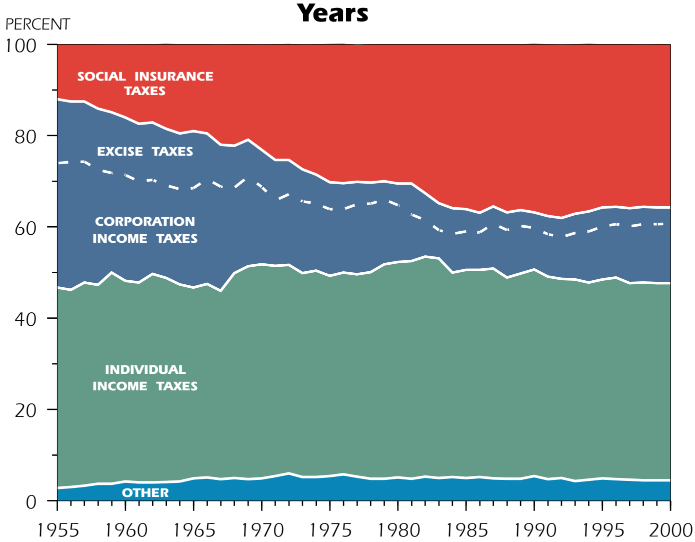
Source	1995 Actual	Estimate 1996	1997	1998	1999	2000	2001	2002
Individual income taxes	590	631	645	683	714	749	790	835
Corporate income taxes	157	167	185	202	213	225	237	246
Payroll taxes	484	508	536	561	589	619	647	679
Excise taxes	57	54	60	60	62	63	64	66
Estate and gift taxes	15	16	17	18	19	21	22	24
Customs duties	19	19	20	21	21	22	22	24
Miscellaneous receipts	32	32	32	33	34	35	37	38
Total revenues	**1,355**	**1,427**	**1,495**	**1,578**	**1,653**	**1,734**	**1,820**	**1,912**

Notes: The revenues listed in this table do not include revenues from the Government's business-like activities—e.g., 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.

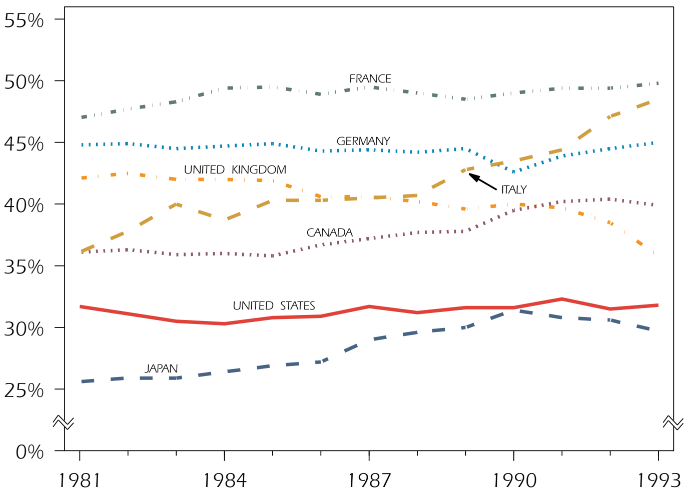
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways, airports and airways, and the cleanup of hazardous substances—and deposits others in the general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

Chart 2–4. Composition of Revenues Over the Last 40 Years



Between 1960 and 1995, payroll taxes have increased substantially as a percent of GDP, and corporate income taxes have declined, but individual income taxes have remained roughly constant. These trends are not expected to change over the next five years.

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



Source: OECD, calendar year data.

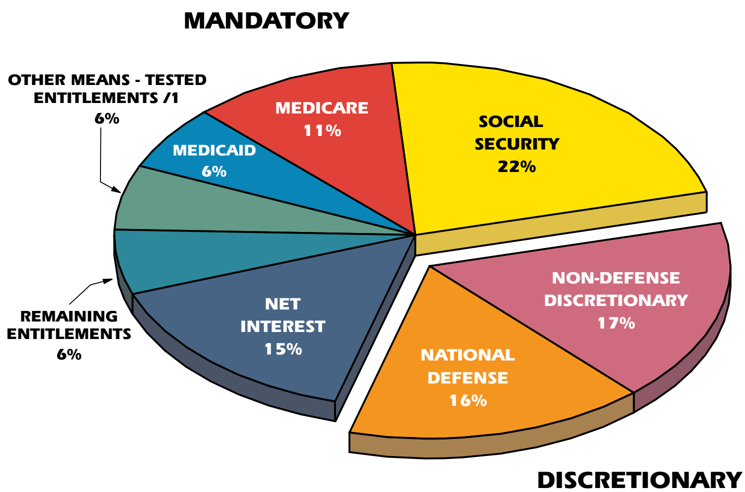
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries listed above.

Spending

As we have said, the Federal Government will spend over $1.6 trillion[1] in 1997, 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 22 percent of all Federal spending.
- Medicare, which provides health care coverage for over 37 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 1997, it will comprise 11 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 abased on income. The Medicaid program is also a means-tested entitlement

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[1] In calculating Federal spending, the Government deducts collections (or revenues) generated by the Government's business-like activities, such as fees to national parks. These collections will total an estimated $190 billion in 1997. Without them, spending would total an estimated $1.8 trillion in 1997, not $1.6 trillion.

- Medicaid provides health care services to over 36 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, Aid to Families with Dependent Children, 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 1997.
- 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 $259 billion in 1997, comprising 16 percent of the budget and 3.3 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 1997.
- 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	1995 Actual	Estimate 1996	1997	1998	1999	2000	2001	2002
Discretionary:								
National Defense	274	266	259	256	257	264	267	276
International	20	20	20	19	19	18	18	19
Domestic	252	255	263	264	260	255	264	278
Subtotal, discretionary	546	541	542	539	536	537	548	573
Mandatory:								
Programmatic:								
Social Security	333	348	365	383	402	421	442	464
Medicare	157	175	187	202	216	228	246	264
Medicaid	89	95	106	111	117	122	129	133
Means-tested entitlements (except Medicaid)	92	97	104	109	114	121	121	129
Other	114	118	134	138	142	147	147	151
Subtotal, programmatic	786	832	896	943	990	1,040	1,084	1,141
Undistributed offsetting receipts	–44	–42	–41	–42	–43	–46	–48	–69
Subtotal, mandatory	741	790	855	901	947	955	1,036	1,072
Net interest	232	241	238	236	235	230	227	223
Subtotal, mandatory and net interest	973	1,031	1,093	1,137	1,181	1,225	1,263	1,295
Total	**1,519**	**1,572**	**1,635**	**1,676**	**1,717**	**1,761**	**1,812**	**1,868**

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

Table 2–3. Spending by Function

(Outlays, in billions of dollars)

Function	1995 Actual	Estimate 1996	1997	1998	1999	2000	2001	2002
National defense:								
Department of Defense-Military	259	254	247	244	246	254	257	265
Other	13	11	11	11	10	9	9	11
Total, National defense	272	266	259	255	256	263	266	275
International affairs	16	15	15	14	14	13	14	15
General science, space, and technology	17	17	17	17	16	15	15	17
Energy	5	3	2	2	2	1	2	*
Natural resources and environment	22	22	22	21	21	20	21	22
Agriculture	10	8	8	9	9	8	7	7
Commerce and housing credit	–14	–11	6	6	7	7	5	5
Transportation	39	40	39	39	37	35	34	35
Community and regional development	11	13	12	10	9	8	8	8
Education, training, employment, and social services	54	54	54	54	56	57	59	62
Health	115	121	135	141	147	152	156	162
Medicare	160	178	190	205	218	231	248	267
Income security	220	228	237	245	253	264	269	282
Social Security	336	351	368	386	405	424	445	467
Veterans benefits and services	38	38	40	39	37	37	36	40
Administration of justice	16	19	22	24	25	26	26	25
General government	14	14	15	14	14	14	15	15
Net interest	232	241	238	236	235	230	227	223
Allowances	.....	–*	–*	–*	–*	–*	5	9
Undistributed offsetting receipts	–44	–42	–41	–42	–43	–46	–48	–69
Total	**1,519**	**1,572**	**1,635**	**1,676**	**1,717**	**1,761**	**1,812**	**1,868**

* $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)

Function	1995 Actual	Estimate 1996	1997	1998	1999	2000	2001	2002
Legislative Branch	3	3	3	3	3	3	3	3
The Judiciary	3	3	4	4	4	4	4	4
Executive Office of the President	*	*	*	*	*	*	*	*
Funds Appropriated to the President	11	10	10	10	10	10	9	10
Agriculture	57	55	56	58	59	59	61	63
Commerce	3	4	4	4	5	6	4	4
Defense—Military	260	254	247	244	246	254	257	265
Defense—Civil	32	32	33	34	35	36	37	38
Education	31	30	30	29	30	31	32	33
Energy	18	15	15	14	13	12	12	12
Health and Human Services	303	327	354	378	397	416	439	465
Housing and Urban Development	29	26	32	33	33	31	30	30
Interior	7	7	7	7	7	7	7	7
Justice	11	13	16	18	19	20	20	19
Labor	32	34	35	36	37	38	40	41
State	5	6	6	5	5	5	5	5
Transportation	39	39	38	38	36	34	33	35
Treasury	349	365	369	370	374	376	377	381
Veterans Affairs	38	38	40	39	37	37	36	40
Environmental Protection Agency	6	6	6	7	7	7	7	7
General Services Administration	1	*	1	1	*	*	*	*
National Aeronautics and Space Administration	13	14	14	14	13	12	12	13
Office of Personnel Management	41	42	45	47	49	51	54	57
Small Business Administration	1	1	*	*	*	*	*	1
Social Security Administration	362	377	398	418	438	462	480	506
Other Independent Agencies	2	9	21	20	20	19	19	20
Allowances	.....	–1	–5	–7	–6	–7	–2	*
Undistributed offsetting receipts	–138	–140	–143	–148	–153	–161	-166	-192
Total	**1,519**	**1,572**	**1,635**	**1,676**	**1,717**	**1,761**	**1,812**	**1,868**

* $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.

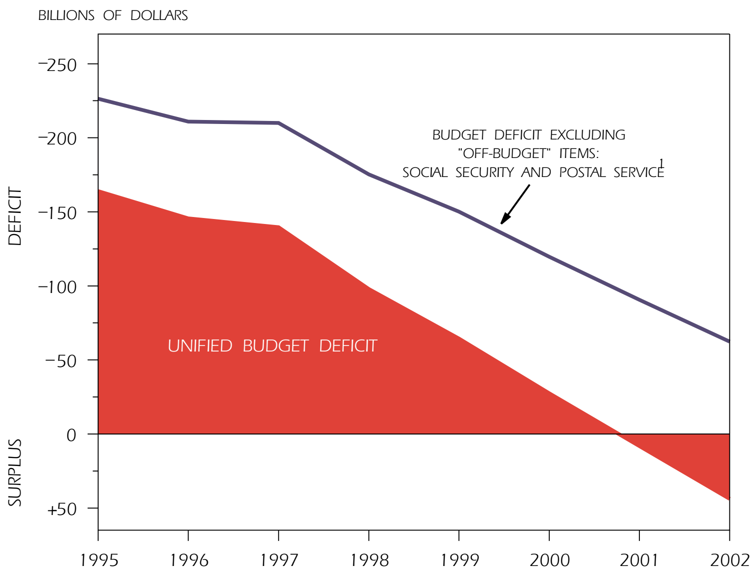
Specifically, the law requires that the spending and revenues of two Federal programs, Social Security and the Postal Service, be excluded from the budget totals—that is, categorized as “off-budget.” Therefore, the budget displays “on-budget,” “off-budget,” and “unified budget” totals to satisfy this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

This year, President Clinton faced unusual challenges in presenting his budget. At a time when OMB normally would have prepared that budget, the President and congressional leaders of both parties were negotiating a plan to balance the budget over seven years, and Congress had not finished the necessary spending bills for 1996.

As a result, the President submitted a brief budget document on February 5 to comply with the legal requirement, and the rest of the budget books,[1] with the traditional amount of back-up details, in March.

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[1] They are the main budget book, entitled, *Budget of the United States Government—Supplement: Fiscal Year 1997,* as well as *Analytical Perspectives, Appendix, Historical Tables,* and *A Citizen's Guide to the Federal Budget,* which you are now reading.

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.

For fiscal 1997—that is, October 1, 1996 to September 30, 1997—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 1997.	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 1995
Budget preparation and transmittal.	The budget documents are prepared and transmitted to the Congress.	December 1995–February/March 1996 [1]
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 1996
The fiscal year begins.		October 1, 1996
Agency program managers execute the budget provided in law.		October 1, 1996–September 30, 1997
Data on actual spending and receipts for the completed fiscal year become available.		October–November 1997

[1] Due to unusual circumstances, the President submitted the 1997 budget in two steps—one in February, the other in March.

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 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

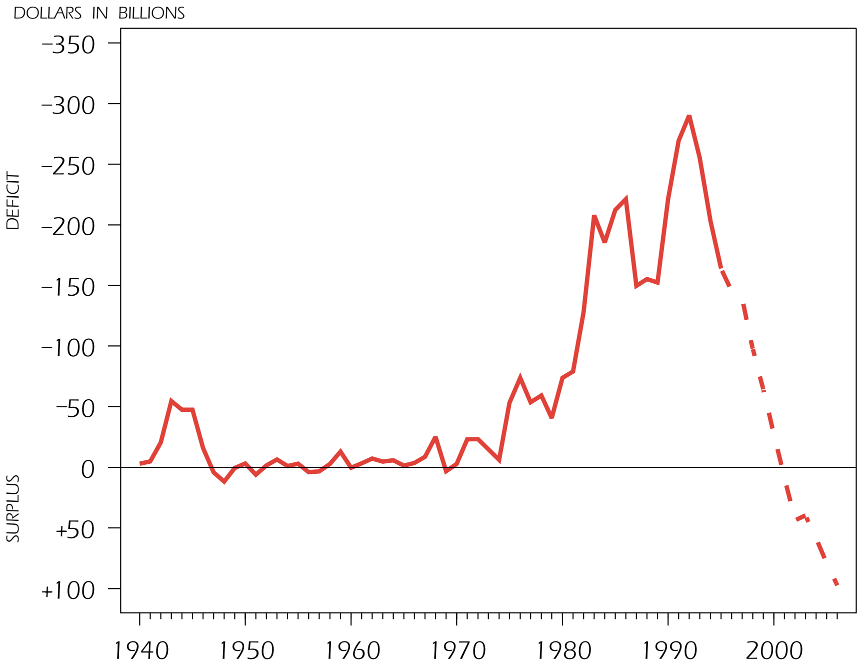
You've probably heard a lot about the Federal budget deficit and debt in recent years, primarily because both exploded in size in the 1980s.

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 68 annual deficits between 1900 and 1995.

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 seven years.

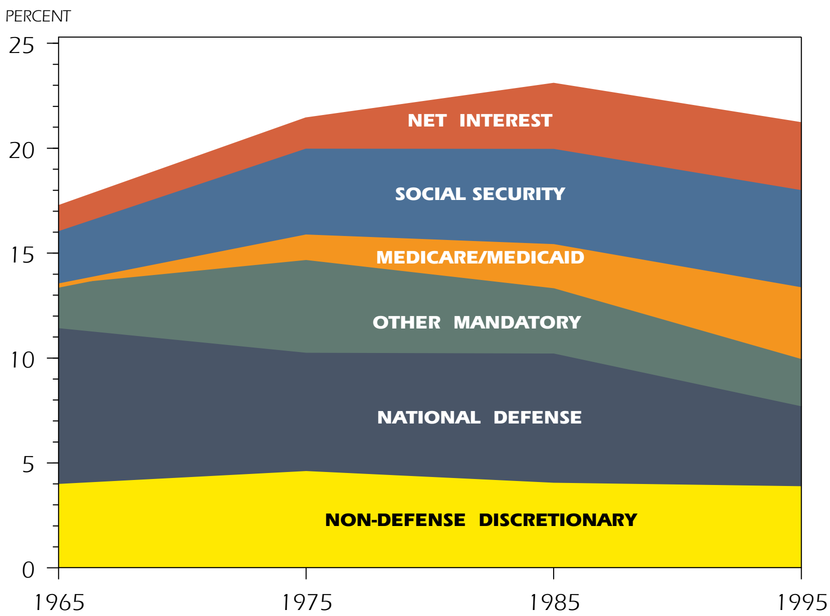
For most of the Nation's history, deficits were the result of either wars or recessions. Wars necessitated major increases in military spending, while recessions reduced Federal tax revenues from businesses and individuals.

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 1995, 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 19 percent of GDP, since the 1960s. In that time, however, outlays have grown from below 18 percent of GDP in 1965 to up to 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 an average 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?

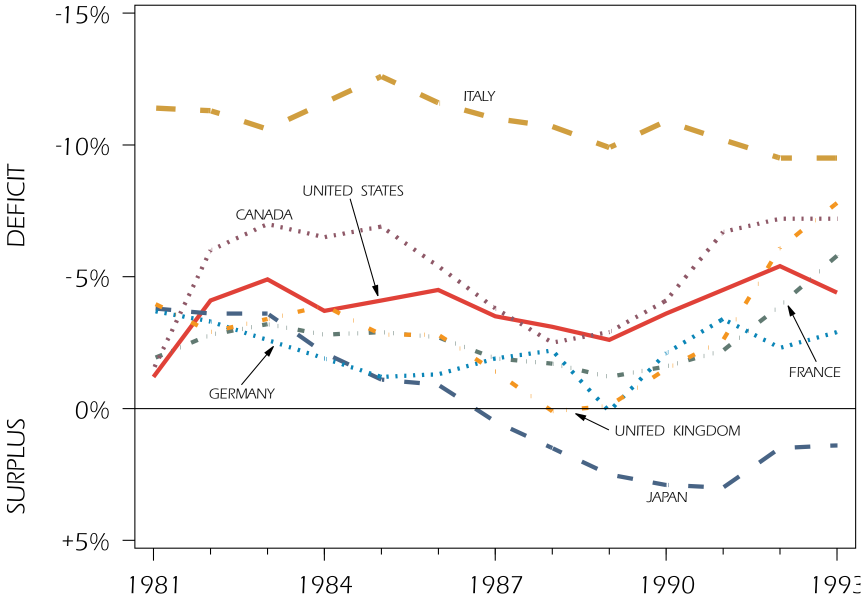
The short answer is, yes. The deficit forces the Government to borrow money in the private capital markets. That borrowing competes with (1) borrowing by businesses that want to build factories and machines that make workers more productive and raise incomes, and (2) borrowing by families who hope to 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.

As shown in Chart 4–4, the Federal interest burden grew substantially in the 1980s. By 1997, net interest spending will be nearly as much as the Government will spend on national defense.

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

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 average.

limiting the amount of debt that they pass on; or we can generate large deficits and debt for those who come after us.

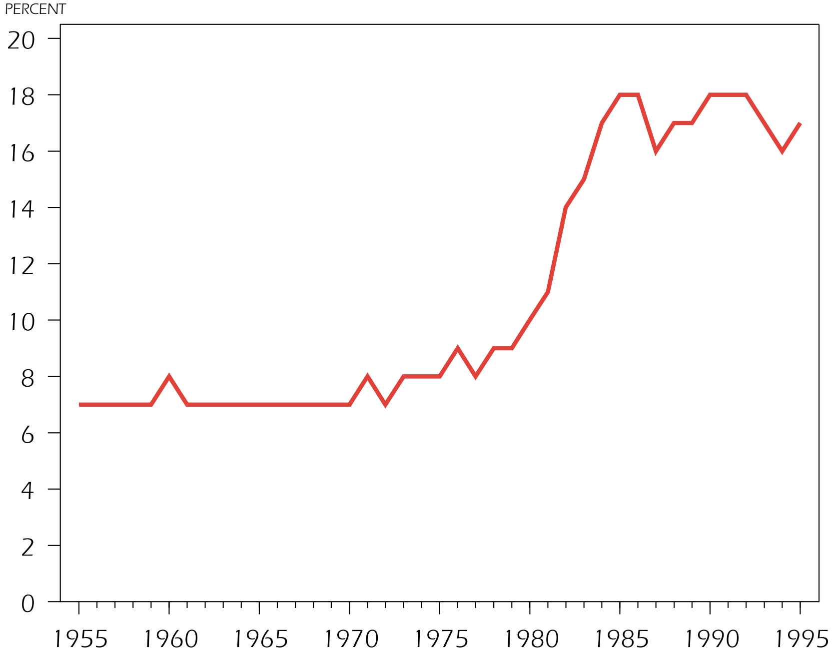
Deficits and Debt

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

Chart 4–4. Interest Costs as a Percent of Income Tax Revenues Over 40 Years



Debt held by the public was $3.6 trillion at the end of 1995—roughly the net effect of deficits and surpluses over the last 200 years. Debt held by the

Table 4–1. Federal Government Financing and Debt

(In billions of dollars)

	1995 Actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
Federal Government financing:								
Budget deficit (–) or surplus	-164	–146	–140	–98	–64	–28	8	44
Other means of financing.......	–7	–20	–24	–27	–29	–29	–28	–27
Borrowing from the public	171	165	164	124	93	57	20	–17
Federal Government debt:								
Debt held by the public	3,603	3,769	3,933	4,057	4,151	4,207	4,227	4,210
Debt held by government accounts	1,318	1,439	1,566	1,693	1,828	1,978	2,133	2,297
Gross Federal debt..............	4,921	5,207	5,499	5,750	5,979	6,185	6,360	6,506
Debt subject to legal limit	4,885	5,163	5,456	5,711	5,939	6,145	6,321	6,468

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

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 1995, it totaled $4.9 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 exceeded 50 percent of GDP at the end of 1996. As a share of GDP, debt held by the public was highest at the end of World War II, at 114 percent, then fell to 24 percent in 1974 before gradually rising to current levels.

That decline, from 114 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 over 75 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 $164 billion in 1995, and by over half as a share of GDP, to 2.3 percent. Now, as you will see in the next chapter, the President wants to finish the job by balancing the budget over the next seven years.

5. The President's 1997 Budget

As we have said, the President released his 1997 budget in two steps this year. On February 5, he released a brief document that outlined his priorities. Then in March, he released the budget books with the details that traditionally comprise the annual budget proposal.

The President's 1997 budget would reach balance over the next seven years by cutting unnecessary and lower priority spending.

The budget would strengthen Medicare and Medicaid; invest in education and training, the environment, science and technology, and other priorities; reform welfare; maintain a strong defense; and provide tax relief to help families raise their children, send them to college, and save for the future.

Like his earlier budgets, this budget contributes to two of the President's key goals—strengthening the economy and making Government work.

Reaching Balance

The President's budget saves $593 billion [1] over seven years (after subtracting the costs of his proposed tax cut). Among its major elements, the budget:

- saves $297 billion in discretionary spending, cutting unnecessary and lower priority spending but investing in education and training, the environment, science and technology, law enforcement, and other priorities that will raise living standards and improve the quality of American life;
- saves $124 billion in Medicare, strengthening and improving the program and guaranteeing the solvency of its trust fund for over a decade;
- saves $59 billion in Medicaid, reforming the program but continuing the guarantee of meaningful health and long-term care coverage for the most vulnerable Americans;

[1] Using the last available assumptions of the Congressional Budget Office.

- saves $40 billion through real welfare reform, moving recipients to work while protecting children;
- saves $49 billion by reforming a host of other mandatory programs;
- saves $62 billion by ending corporate subsidies and other tax loopholes; and
- cuts taxes by $100 billion, providing tax relief to tens of millions of middle-income Americans and to small businesses.

Maintaining Our Values

From the start, the President's economic program has emphasized one primary concern—to raise the standard of living for average Americans now and in the future. His budget policy has played a central role.

The President's budget plan of 1993, which he enacted with the last Congress, has cut the budget deficit nearly in half in three years—from $290 billion in 1992 to $164 billion in 1995. That, in turn, has cut Federal borrowing, making more funds available in the private markets so businesses can invest, grow more productive, expand, and create jobs.

Working with Congress, the President also has shifted Federal resources to education and training, science and technology, and other priorities, not only to make businesses more competitive but to give Americans the skills they need to compete in the new economy.

This budget maintains or expands his investments in these key areas.

In education and training, these investments include the Head Start program for disadvantaged children; the Safe and Drug-Free Schools and Communities program to create safe learning environments; Goals 2000, which helps States and school systems extend high academic standards, better teaching, and better learning to all students; AmeriCorps, through which 25,000 Americans this year are serving their communities and earning money for college; Pell grant scholarships for needy students; and Skill Grants (or job training vouchers) for dislocated workers and low-income adults.

The budget also protects environmental enforcement through the Environmental Protection Agency's operating program; funds programs to protect national parks and other sensitive resources; and invests in basic and applied research and technology.

The budget funds the Community Oriented Policing Services (COPS) initiative to put 100,000 more police on the street by the year 2000; more border patrols to prevent illegal immigration and more inspections to prevent the hiring of illegal immigrants; and the Community Development Financial Institutions fund to spur growth and create jobs in communities that have been left behind.

In addition, the budget includes funds to launch the important initiatives that the President outlined in his State of the Union address:

- for education, it funds a Technology Literacy Challenge to connect every classroom to the information superhighway by the year 2000; expanded work-study to help one million students work their way through college by 2000; a $1,000 merit scholarship for the top five percent of graduates in every high school; and Charter Schools to let parents, teachers, and communities create public schools to meet their own children's needs;

- for workers, it funds initiatives to make it easier for small businesses and farmers to establish their own pension plans; to encourage these and other employees to establish flexible pension plans that workers can take with them when they change jobs; and to help workers who lose their health insurance when they lose their jobs pay for private insurance coverage for up to six months;

- for the environment, it funds tax incentives to encourage companies to clean up "brownfields"—abandoned, contaminated industrial properties in distressed areas; and

- for law enforcement, it provides funds with which the FBI and other law enforcement agencies will launch a war on juvenile crime and gangs that involve juveniles.

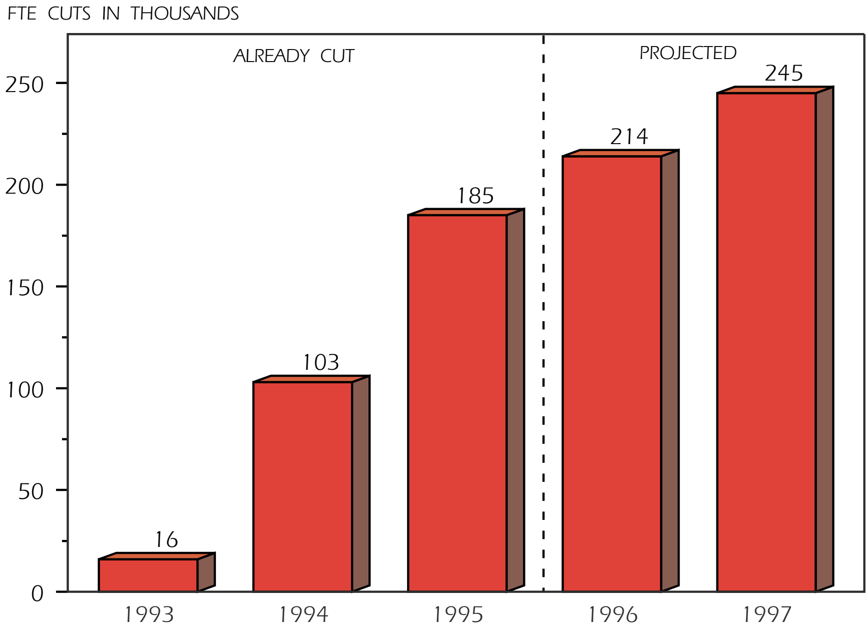
Making Government Work

"The era of big Government is over," President Clinton declared in his State of the Union address in late January 1996. "But we cannot go back to the time when our citizens were left to fend for themselves."

The President has worked hard to create a leaner, but not meaner, Federal Government, one that works hand-in-hand with States, localities, businesses, and community and civic associations to manage resources wisely while helping those Americans who cannot help themselves.

In 1993, the President 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

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.

In the future, the number of Federal workers will decline even further.

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 workforce by over 200,000 employees out of 2.2 million in January 1993, giving us the smallest Federal workforce in 30 years. This corresponds to a reduction of 185,000 FTEs (see Chart 5–1).

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.

From the start, the President has stressed the importance of providing better service to Government's customers—the tens of millions of Americans who come in contact with it. His efforts are bearing fruit:

Social Security Administration's (SSA) Customer Service Hotline: Business Week reported in mid-1995 that an independent survey of some of the Nation's best 1-800 customer services hotlines ranked SSA's hotline on top, ahead of companies like L.L. Bean, Federal Express, and Disney. SSA's reputation for solving problems quickly and courteously earned it the highest overall score.

Customs Service—Streamlining Inspections: In Miami, the airlines and Federal agencies formed partnerships to overhaul Customs procedures for international travelers, eliminating three-hour delays and missed connecting flights. Officials from the Customs Service, the Immigration and Naturalization Service, and the Agriculture Department worked with airline officials to reduce waiting times to 45 minutes, on average.

Veterans Affairs (VA) Department Responding to Customers: Responding to complaints about long waits to see benefits counselors, the VA promised veterans that it would cut waiting times to 30 minutes or less. Having met that promise, the VA has aimed higher; it now promises veterans no more than a 20-minute wait and is meeting that goal 90 percent of the time.

Americans want a Government that uses common sense when it makes decisions that affect their lives. The Administration is answering their call.

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 1997 ends September 30, 1997.

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.

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