A CITIZEN'S GUIDE TO THE FEDERAL BUDGET

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 2001

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A Note to the Reader

Next year, your Federal Government will spend over $1.8 *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* five years ago, and why we have published this sixth 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, how we have been able to move from deficit to surplus, and what the President hopes to accomplish with his 2001 budget.

After you read these pages, we hope that you will think the tour was worth your time.

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 or repayment of borrowing.

  If revenues are greater than spending, the Government runs a surplus. When there is a surplus, the Government can reduce 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.

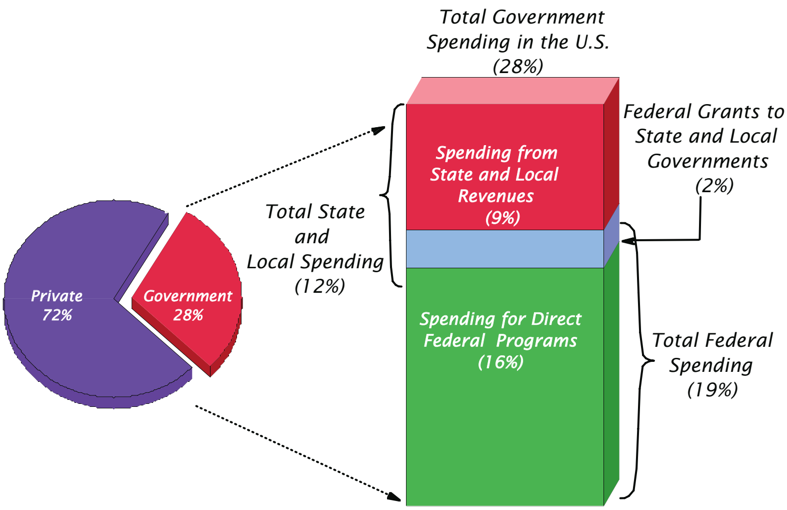
  When the economy is doing well, people are earning more and unemployment is low. In this atmosphere, revenues increase and the deficit shrinks.

- an historical record.

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

The 2001 Budget is a document that embodies the President's budget proposal to Congress for fiscal 2001, the *fiscal year* that begins on October 1, 2000. It reflects the President's priorities and proposes that Social Security be protected and solvency of the trust funds extended. With enactment of these reforms, as well as strengthening of Medicare, additional resources

Chart 1–1. Government Spending as a Share of GDP, 1999



Note: Numbers do not add due to rounding.

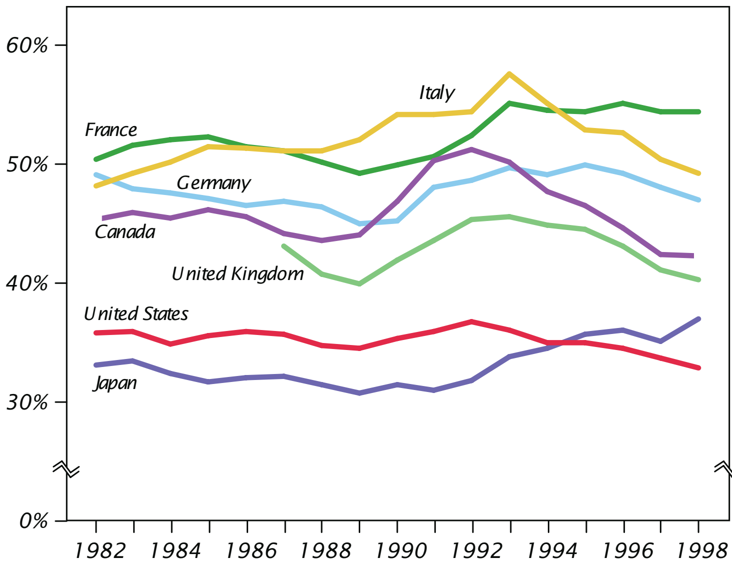
Total Government spending accounts for less than one-third of the national economy. Federal spending is about two-thirds of this amount, or about 19 percent of GDP.

would be made available for national needs, including health care initiatives and a tax cut.

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 a little less than 19 percent of the Gross Domestic Product (or GDP, which measures the size of the economy) in 1999, 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 $1,072 billion that State and local governments spent in 1999, $220 billion came from Federal grants.

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 spending than any other nation shown.

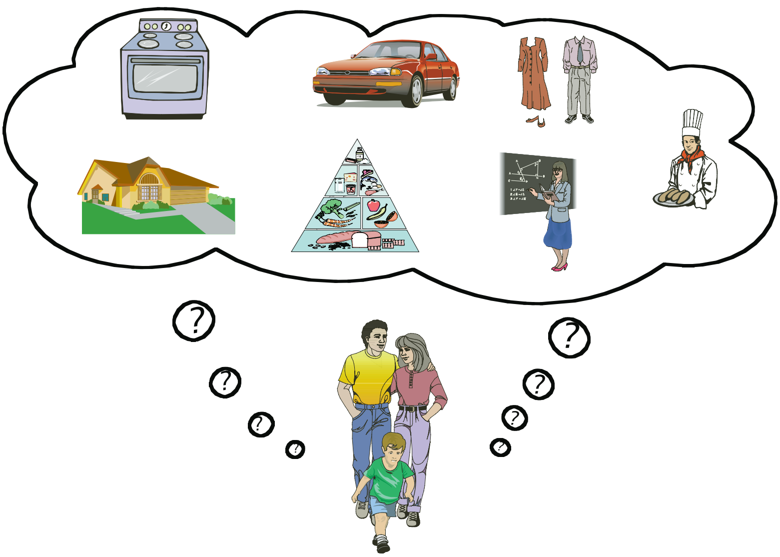
As shown in Chart 1–2, compared to six other industrialized nations, the United States allocates the smallest share of its GDP to government spending (Federal, State, and local combined).

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



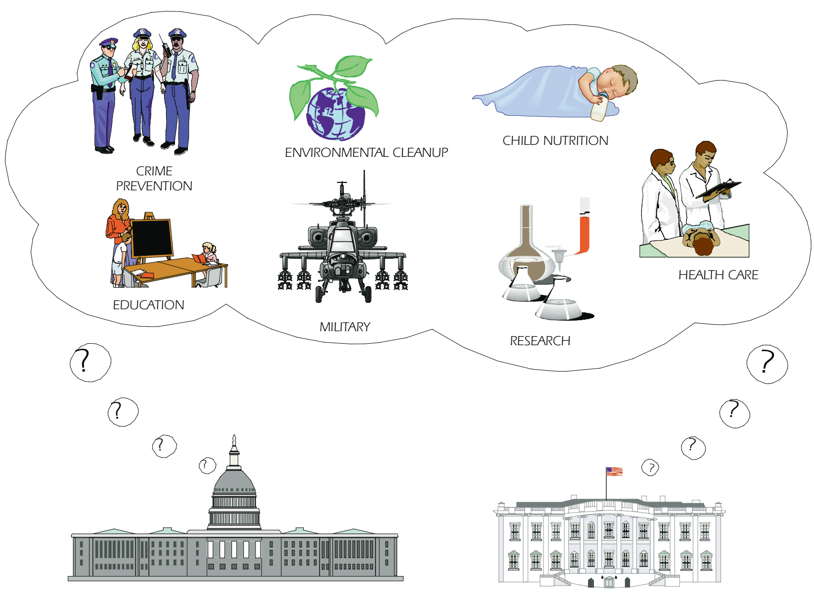
Sources: Cash and Credit

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, more recently, they debate how to use the budget surplus to address longer-term concerns and invest in the Nation's future.

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

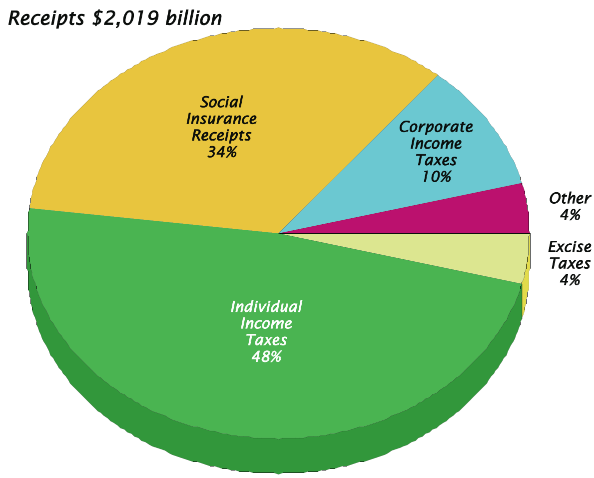
Chart 2–2. National Budgeting



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 or receipts—comes mostly from taxes. In the past two years, revenues were greater than spending, and the Government was able to reduce the national debt with the difference between revenues and spending—that is, the surplus.

Revenues come from these sources:

- Individual income taxes will raise an estimated $972 billion in 2001, equal to about 9.7 percent of GDP.
- Social insurance payroll taxes 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 an estimated 6.8 percent in 2001.
- Corporate income taxes, which will raise an estimated $195 billion, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to an estimated 1.9 percent in 2001.

Table 2–1. Revenues By Source—Summary

(In billions of dollars)

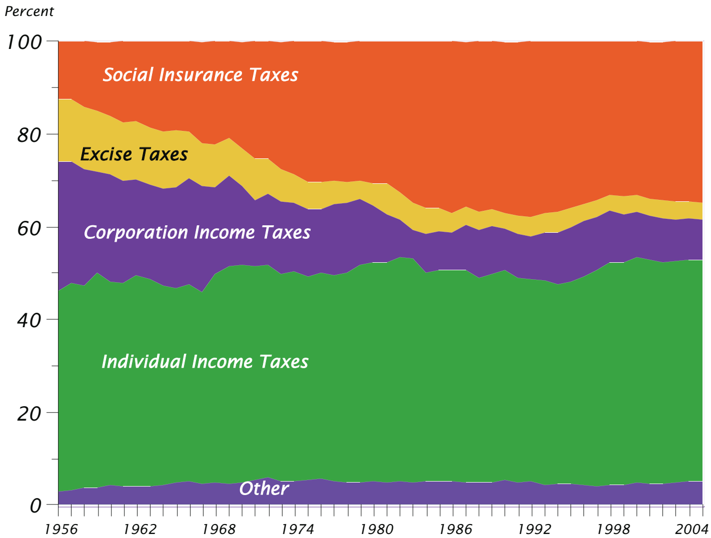
Source	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Individual income taxes	879	952	972	995	1,026	1,066	1,117
Corporate income taxes	185	192	195	195	196	200	206
Payroll taxes	612	650	682	712	742	771	815
Excise taxes	70	68	77	80	81	82	83
Estate and gift taxes	28	30	32	35	36	39	37
Customs duties	18	21	21	23	24	26	28
Miscellaneous revenues	35	43	40	41	43	53	55
Total revenues	**1,827**	**1,956**	**2,019**	**2,081**	**2,147**	**2,236**	**2,341**

Notes: The revenues listed in this table do not include revenues from the Government's business-like activities—such as entrance fees at national parks. Instead of counting these collections as revenues, the Government subtracts them from spending. This produces totals for revenues and spending that show the level of Government activity without the business-like activity.

Numbers may not add to the totals because of rounding.

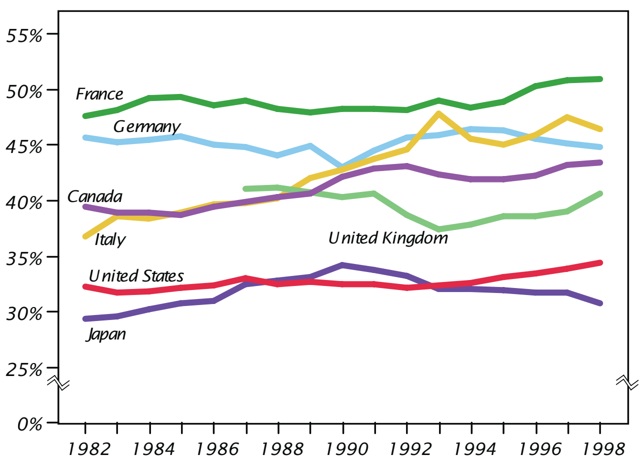
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways and airports and airways—and deposits others in the general fund.
- The Government also collects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

Chart 2–4. Composition of Revenues



Between 1956 and 1999, payroll taxes have increased substantially as a percent of total revenues, 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.

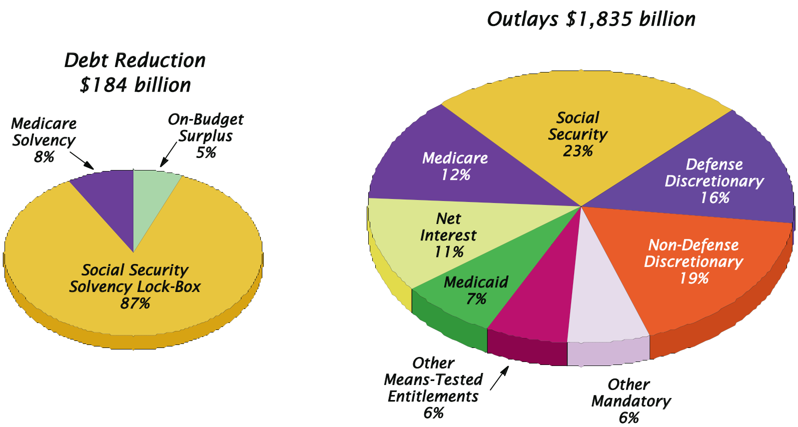
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries shown above.

Spending

As we have said, the Federal Government will spend over $1.8 trillion[1] and have a surplus of $184 billion in 2001, which we divided into nine large categories as shown in Chart 2–6.

- The largest Federal program is Social Security, which will provide monthly benefits to over 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 40 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. Medicare growth slowed down in 1998 and 1999, but is

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



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

[1] This amount does not include all of the Government's spending. As explained under "Revenues," the Government subtracts collections from its business-like activities, such as entrance fees at national parks, from spending instead of adding them to revenues. These collections are estimated to be almost $215 billion in 2001. If they were not subtracted from spending, spending would total an estimated $2.0 trillion in 2001, not $1.8 trillion.

expected to accelerate in 2000 and beyond. In 2001 it will comprise 12 percent of all Federal spending.

- Medicaid, in 2001, will provide health care services to almost 34 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, although the rate of growth has fallen from the double-digit pace of the late 1980s and early 1990s. Medicaid accounts for seven percent of the 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.

- The remaining mandatory spending, which mainly consists of Federal retirement and insurance programs, unemployment insurance, and payments to farmers, comprises six percent of the budget.

- National defense discretionary spending will total an estimated $292 billion in 2001, comprising 16 percent of the budget.

- 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 less than 19 percent in 2001.

- 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 in 1989. Since the budget is now in surplus, interest payments are estimated to drop to 11 percent of the budget in 2001.

- Nine percent of your Federal dollar (the budget surplus) will not be spent. The President has proposed that the surplus be used to reduce the Federal debt to assure the continued solvency of Social Security and Medicare.

Table 2–2. Spending Summary

(In billions of dollars)

	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Outlays:							
Discretionary:							
Department of Defense	262	278	279	285	294	303	317
Non-DoD discretionary	313	339	355	366	371	378	384
Subtotal, discretionary	575	618	634	651	665	681	701
Mandatory:							
Social Security	387	403	422	443	465	490	516
Medicare and Medicaid	296	316	342	362	389	426	462
Means-tested entitlements (except Medicaid)	104	110	111	119	126	131	139
Other	112	123	117	121	128	136	144
Subtotal, mandatory	898	952	993	1,046	1,108	1,183	1,260
Net interest	230	220	208	199	189	178	164
Total, outlays	**1,703**	**1,790**	**1,835**	**1,895**	**1,963**	**2,041**	**2,125**
Receipts	**1,827**	**1,956**	**2,019**	**2,081**	**2,147**	**2,236**	**2,341**
Unified Budget Surplus	**124**	**167**	**184**	**186**	**185**	**195**	**215**
Surplus Allocated for Debt Reduction:							
Social Security solvency lock-box	124	148	160	172	184	195	214
Medicare solvency	......	......	15	13	......	......	......
On-budget surplus	1	19	9	1	*	*	2
Total Debt Reduction	124	167	184	186	185	195	215

* $500 million or less.

Table 2–3. Total Spending by Function

(Outlays, in billions of dollars)

Function	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
National defense:							
Department of Defense-Military	261	277	277	284	293	302	316
Other	13	13	14	14	14	15	15
Total, national defense	275	291	291	298	307	317	331
International affairs	15	17	20	19	19	19	20
General science, space, and technology	18	19	20	21	21	21	22
Energy	1	–2	–1	–1	–*	–1	–1
Natural resources and environment	24	24	25	26	25	26	26
Agriculture	23	32	22	18	14	12	11
Commerce and housing credit	3	6	3	2	2	2	2
Transportation	43	47	50	51	52	54	55
Community and regional development	12	11	10	10	10	10	9
Education, training, employment, and social services	56	63	68	74	77	79	81
Health	141	154	167	181	195	211	227
Medicare	190	203	221	229	242	265	287
Income security	238	251	260	276	288	301	314
Social security	390	407	426	447	469	493	520
Veterans benefits and services	43	47	46	49	51	53	56
Administration of justice	26	27	31	31	31	31	32
General government	16	15	15	16	16	17	17
Net interest	230	220	208	199	189	178	164
Allowances		1	–1	–*	–*	–*	–*
Undistributed offsetting receipts	–40	–43	–46	–49	–47	–47	–48
Total	**1,703**	**1,790**	**1,835**	**1,895**	**1,963**	**2,041**	**2,125**

* $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. Discretionary Spending by Agency

(Outlays, in billions of dollars)

Agency	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Legislative Branch	2	3	3	3	3	3	3
Judicial Branch	3	4	4	4	4	4	5
Agriculture	16	17	17	17	17	17	17
Commerce	5	8	5	5	5	5	5
Defense-Military	262	278	279	285	294	303	317
Education	29	34	35	39	40	41	41
Energy	18	17	18	19	19	20	20
Health and Human Services	38	43	46	50	50	51	52
Housing and Urban Development	32	34	35	36	37	38	38
Interior	8	8	9	9	9	9	10
Justice	17	17	21	21	21	21	21
Labor	10	11	12	12	12	13	13
State	6	8	8	8	8	8	8
Transportation	40	44	47	49	50	51	53
Treasury	12	13	14	14	14	15	15
Veterans Affairs	19	20	22	22	22	23	23
Corps of Engineers	4	4	4	4	4	4	4
Other Defense Civil Programs	*	*	*	*	*	*	*
Environmental Protection Agency	7	7	8	8	8	8	8
Executive Office of the President	*	*	*	*	*	*	*
Federal Emergency Management Agency	4	3	3	2	2	2	1
General Services Administration	*	1	1	*	1	1	*
International Assistance Programs	11	12	13	13	13	13	13
National Aeronautics and Space Administration	14	13	14	14	15	15	15
National Science Foundation	3	3	4	4	5	5	5
Office of Personnel Management	*	*	*	*	*	*	*
Small Business Administration	1	1	1	1	1	1	1
Social Security Administration	6	6	6	6	6	6	6
Other Independent Agencies	6	6	6	7	7	7	7
Allowances	......	1	–1	–*	–*	–*	–*
Undistributed offsetting receipts	......	......	–*	–*	–*	–*	–*
Total	**575**	**618**	**634**	**651**	**665**	**681**	**701**

* $500 million or less.

Note: Discretionary spending is appropriated by the Congress each year, in contrast with mandatory spending, which is automatic under permanent law. For a more complete discussion of discretionary spending, see "Action in Congress" in Chapter 3.

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 the "on-budget" which is the budget excluding certain programs that are legally designated as "off-budget."

Traditionally, the President's budget has focused on the totals for the unified budget. The unified budget encompasses all of the budgetary activities of the Government, and the unified budget surplus or deficit is the measure that best determines how much the Government has to borrow from the public (in the case of a deficit), or how much past borrowing can be repaid (in the case of a surplus).

More recently, the on-budget surplus has received increasing attention. For all practical purposes, the off-budget surplus is the surplus in the Social Security program. This means that the on-budget surplus is the budget surplus excluding the Social Security surplus.[2]

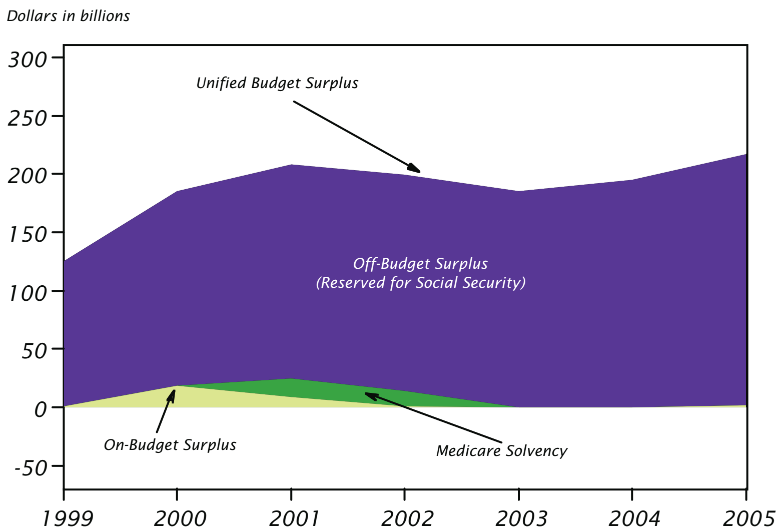
Social Security is running large surpluses right now, because the payroll taxes of the relatively large "baby-boom" generation exceed the Social Security benefits paid to the relatively small generation of current retirees. These surpluses have held down the unified deficit, by offsetting part of the deficit in the on-budget accounts. When the unified budget first booked a surplus of $69 billion in 1998, the on-budget accounts were still in deficit by $30 billion. In 1999, the unified budget ran a $124 billion surplus, nearly all of which was the result of the Social Security surplus. The on-budget accounts were almost exactly in balance.

Under the President's proposals, the off-budget surplus would be reserved for debt reduction to enhance Social Security solvency. The President's budget also proposes that part of the on-budget surplus be reserved for Medicare solvency and for catastrophic prescription drug coverage. The President's overall budgetary framework is discussed in Chapter 5.

[2] The Postal Service is also designated as off-budget, which is why the off-budget surplus and the Social Security surplus are not exactly the same.

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



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 an abundance 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 2001,* as well as *Analytical Perspectives, Appendix, Historical Tables,* and *A Citizen's Guide to the Federal Budget,* which you are now reading.

For fiscal 2001—that is, October 1, 2000 to September 30, 2001—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 2001.	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 1999
Budget preparation and transmittal.	The budget documents are prepared and transmitted to Congress.	December 1999–February 2000
Congressional action on the budget.	Congress reviews the President's budget, develops its own budget, and approves spending and revenue bills.	March–September 2000
The fiscal year begins.		October 1, 2000
Agency program managers execute the budget provided in law.		October 1, 2000–September 30, 2001
Data on actual spending and receipts for the completed fiscal year become available.		October–November 2001

Action in Congress

Congress first passes 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 surplus or deficit, and allocations within the spending target for the two types of spending—*discretionary* and *mandatory*—explained below.

- *Discretionary spending,* which accounts for one-third 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 two-thirds 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. The budget proposes to revise these caps beginning in 2001 to recognize changing fiscal conditions, and extend the caps to 2010. 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," or PAYGO, is designed to prevent new legislation from reducing the surplus or increasing the deficit. The budget also proposes extending the PAYGO system to 2010.

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;
- 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.

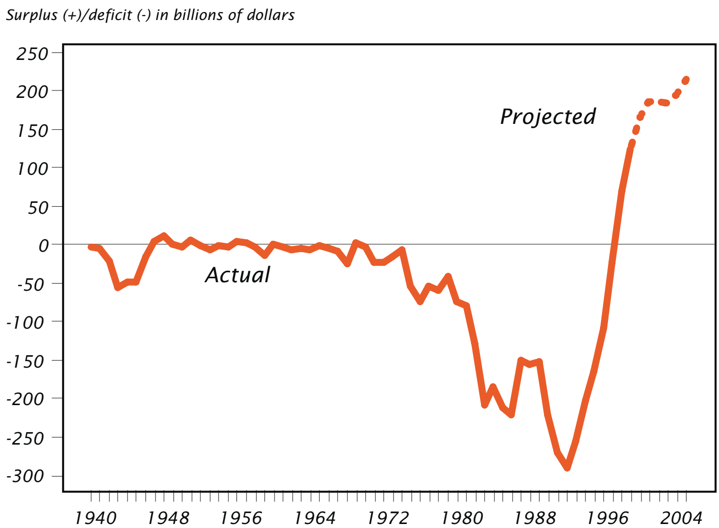
The Government has paid more attention to good management of late, through the work of Vice President Gore’s National Partnership for Reinventing Government and implementation of the 1993 Government Performance and Results Act. This law is designed to improve Government programs by using better measurements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

4. The Budget Surplus and Fiscal Discipline

In 1998, the Federal budget reported its first surplus ($69 billion) since 1969. In 1999, the surplus nearly doubled to $124 billion. As a result of these surpluses, Federal debt held by the public has been reduced from $3.8 trillion at the end of 1997 to $3.6 trillion at the end of 1999. With continued prudent fiscal policies, the budget can remain in surplus for many years. Under the President's budget proposals, the Federal debt held by the public would be fully paid back by 2013.

Put simply, a surplus occurs when revenues exceed spending in any year—just as a deficit occurs when spending exceeds revenues. Generally, to finance

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



Deficits began increasing dramatically in the 1980s, but have now been reversed.

past deficits, the Treasury has borrowed money. With certain exceptions, the *debt* is the sum total of our deficits, minus our surpluses, over the years.

The Government incurred its first deficit in 1792, and it generated 70 annual deficits between 1900 and 1997.

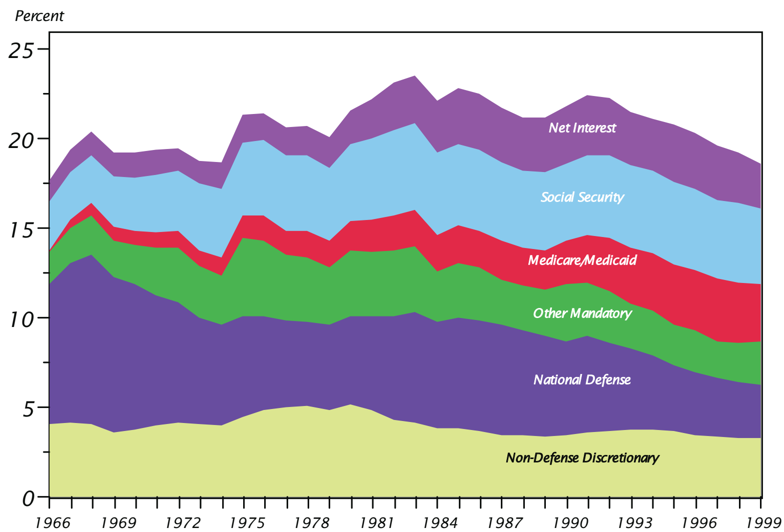
Chart 4–1 provides the history of budget surplus and deficits since 1940.

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 corresponding unprecedented deficits.

Chart 4–2. Outlays as a Percent of GDP



Between 1966 and 1999, spending on Social Security, Medicare and Medicaid, and interest as a percentage of GDP grew, while spending on defense fell.

Since then—with Democratic and Republican Presidents, Democratic and Republican Congresses—the Government has balanced its books only ten times, most recently last year.

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 have we been able to move from deficit to balance? Because spending growth has been restrained. Outlays are growing slower than revenues.

Revenues have stayed relatively constant, at around 16 to 20 percent of GDP, since the 1960s. In that time, however, outlays grew from about 17 percent of GDP in 1965 to nearly 24 percent in 1983 before falling below 19 percent today.

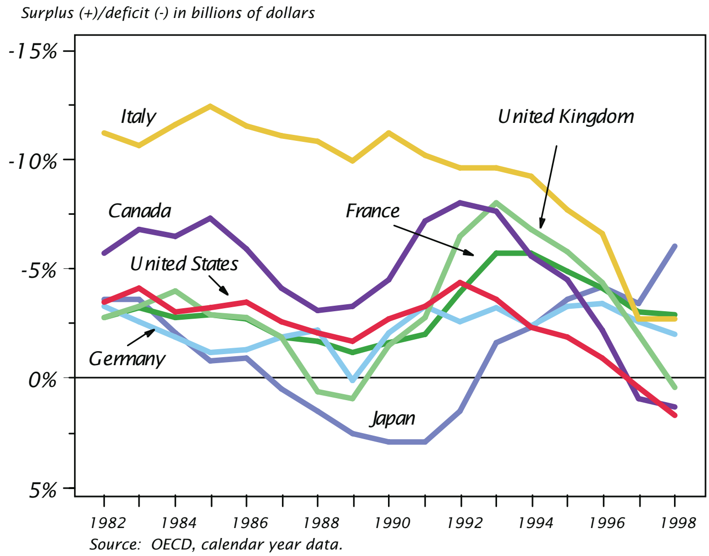
Since 1983, spending has been reduced or held constant as a percent of GDP across a wide variety of programs. The most significant reduction has occurred in discretionary spending, which has fallen from 10.3 percent to 6.3 percent in 1999. Combined spending on social security and net interest has remained roughly constant at about 7 1/2 percent of GDP from 1983 to 1997. However, the debt reduction of the last two years has brought this spending down to 6.7 percent of GDP in 1999. A similar path has been followed in the rest of mandatory spending in total, but only because the growth in Medicare and Medicaid has been offset by declines in other mandatory spending (see Chart 4–2).

Why a Budget Surplus is Important

As Chart 4–3 illustrates, this Nation has a good record when compared to the recent history of the 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.)

Should we worry about the possibility of a return to budget deficits?

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



Of the seven nations shown above, only the United States, Canada, and the United Kingdom eliminated their total government budget deficits in 1997 or 1998.

The 2001 Budget forecasts surplus for decades to come, if we maintain the policy of fiscal discipline and strategic investments in the American people.

We must do all we can to keep the days of deficits in the past. Budget deficits force 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. As recently as 1997, the Government spent over 15 percent of its budget to pay interest, in contrast to a projected 11 percent for 2001. Continuing surplus will reduce these interest payments further in future years.

In the end, the surplus is a decision about our future. We can provide a solid foundation for future generations, just as parents try to do within a family. For a Nation, this means a strong economy and low interest rates and debt. Alternatively, we can generate large deficits and debt for those who come after us.

Surplus and Debt

If the Government incurs a surplus, it generally repays debt held by the public.

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

Federal borrowing involves the sale, to the public, of notes and bonds of varying sizes and time periods until maturity. 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.

Debt held by the public was $3.6 trillion at the end of 1999—roughly the net effect of deficits and surplus 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 surplus, which the law says must be invested in Federal securities.

Table 4–1. Federal Government Financing and Debt

(In billions of dollars)

	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Federal Government financing:							
Unified budget surplus	124	167	184	186	185	195	215
Social Security solvency lock-box:							
Off-budget	124	148	160	172	184	195	214
Medicare solvency	.....	.....	15	13	.....	.....	.....
On-budget	1	19	9	1	*	*	2
Other means of financing	–36	–9	–13	–15	–14	–12	–12
Repayment of debt held by the public	89	157	171	171	170	183	203
Federal Government debt::							
Debt subject to legal limit	5,568	5,648	5,732	5,819	5,912	5,999	6,086
Gross Federal debt	5,606	5,686	5,769	5,855	5,947	6,034	6,118
Debt held by government accounts	1,973	2,210	2,464	2,721	2,984	3,253	3,541
Debt held by the public	3,633	3,476	3,305	3,134	2,963	2,781	2,578

* 500 million or less.

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

Note: The stub title for the final line in Table 4.1 has been corrected to read "Debt held by the public".

Because the large budget deficit has been turned into a surplus, the debt held by the public was reduced in the last two years for the first time since 1969.

The sum of debt held by the public and debt the Government owes itself is called Gross Federal Debt. At the end of 1999, it totaled $5.6 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. Because the budget has returned to surplus and publicly held debt is being reduced, there will be no need to increase the statutory limit in 2001.

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 less than 40 percent of GDP at the end of 1999. 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 of over 49 percent 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 about two-thirds of debt held by the public. The rest is held in foreign countries.

Returning the Budget to Surplus

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 (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.

Although the 1993 plan 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).

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.

Clearly, the President's deficit reduction efforts have paid off. The deficit fell from $290 billion in 1992 to a surplus of $124 billion in 1999.

The President is now proposing that Social Security be protected and the solvency of its trust funds be extended. With enactment of these reforms, as well as strengthening of Medicare, additional resources would be made available for national needs, including health care initiatives and a tax cut. The next chapter describes the President's plans for achieving that goal.

5. THE PRESIDENT'S 2001 BUDGET

The President's 2001 Budget promises the fourth balanced budget of this Administration. With it, the Nation's fiscal house is in order. The budget upholds fiscal discipline while investing wisely in our Nation's priorities. The policy of fiscal discipline which President Clinton pursued from the start of his term has produced a profound reversal of course, replacing the largest Federal budget deficit in history with the largest surplus in history. As a result, we have created the conditions for unprecedented prosperity, and we prepared to meet the challenges of the new century by expanding opportunity and prosperity to all reaches of the Nation.

The President is committed to saving Social Security and Medicare and ensuring the long-range health of these plans. The pending retirement of America's baby boomers will put significant pressure on these important programs. The President's efforts have led to a general acceptance of the vital importance of protecting the Social Security surplus. The next step is to extend Social Security solvency through debt reduction. The President's plan to save Social Security will protect the entire Social Security surplus, dedicating it to pay down the debt and extend the solvency of the program to mid-century. This plan will extend Medicare until 2025, modernizing it with a needed prescription drug benefit.

While respecting fiscal discipline, the budget also invests wisely in the American people, through investments that will promote economic growth, advance our quality of life, including health, safety and a clean environment, protect our national security, and otherwise provide for our Nation's needs in the future. The budget invests in education and training so Americans can make the most of this economy's opportunities. It invests in health and the environment to improve our quality of life. It invests in our security at home and abroad and strengthens law enforcement with the resources they need to safeguard our national interests.

The President's budget makes these investments while maintaining the discipline that has been the hallmark of this Administration's fiscal policy. The budget forecasts that the Government will produce a surplus again this year, and will continue to do so for decades to come. Our success in eliminating the budget deficit has brought with it unprecedented prosperity to the Nation. It is now our responsibility to maintain this fiscal discipline at a time of prosperity, to meet the challenges of the aging of America and to provide for the investments that will keep our Nation strong in the future.

Investing in Our Future

The President's budget maintains fiscal discipline while building on efforts to invest in the American people. It continues his policy of helping working families with their basic needs—raising their children, sending them to college, and expanding access to health care. It invests in education and training, the environment, science and technology, law enforcement, and other priorities to help raise the standard of living and quality of life of Americans.

In this budget, the President is proposing major initiatives that will continue his investments in high-priority areas—from expanding access to health insurance for low-income children and extending it to their hard-working parents, to helping working parents with their child care expenses; to helping States and school districts recruit and prepare thousands more teachers and build thousands more classrooms, and, to making every effort to fight gun violence.

The President has sought to support working families, to encourage responsibility and to help balance the demands of work and family. In this budget he proposes an expansion of the Earned Income Tax Credit to lift more hard-pressed working families out of poverty. He proposes making child care more affordable, accessible and safe, by expanding tax credits for middle-income families and for businesses to expand their child care resources. The budget proposes an Early Learning Fund, to promote activities to improve early childhood education and the quality of child care for those under age five.

The President has worked hard to expand health care coverage and improve the Nation's health. The budget seeks to expand the State Children's Health Insurance Initiative, established in 1997, to provide access to health care coverage for low-income children and to extend it to their hard-working parents. The budget gives new insurance options to hundreds of thousands of Americans aged 55 to 65. The President's budget proposes initiatives to help patients, families, and care givers cope with the burdens of long-term care. It enables more Medicare beneficiaries to receive promising cancer treatments by participating more easily in clinical trials. And, it improves the fiscal soundness of Medicare and Medicaid through new management proposals, including programs to combat waste, fraud, and abuse.

The President's efforts have also enhanced access to, and the quality of, education and training. The budget takes the next step by continuing to help States and school districts reduce class size by recruiting and preparing thousands more teachers and repairing and building thousands more classrooms. The budget proposes a peer review initiative to raise teacher standards and teacher pay, and a school accountability initiative holding States and schools accountable for results by providing resources to identify and turn around the worst-performing schools, and incentives to reward States that do the most to improve student performance and close the achievement gap. The budget also proposes further increases in the maximum Pell Grant to help low-income undergraduates complete their college education.

The budget expands the interagency Lands Legacy initiative, which preserves our national heritage by protecting the Nation's natural treasures and historic places and advancing preservation of open spaces in communities. The resources will give State and local governments the tools for orderly growth while protecting and enhancing green spaces, clean water, wildlife habitats, and outdoor recreation. The budget proposes a dedicated and protected stream of funding for Lands Legacy to continue to meet these needs in the future. It also proposes an initiative to help reduce the threat of global warming through clean energy technologies and an action plan to combat pollution in the Great Lakes.

The President has worked to bring peace to troubled parts of the world, and he has played a leadership role in Northern Ireland, Bosnia, and the Middle East. Last year, the United States stood against the vicious campaign of ethnic cleansing in Kosovo and is now helping to build stability and democracy there. We have worked to detect and counter terrorist threats and continue efforts with Russia and other former Soviet nations to halt the spread of dangerous weapons materials. The budget seeks to build on these efforts, with funding to build a more stable society in Kosovo, to further protect our men and women serving the Nation's interests through diplomacy overseas, and, in a 2000 emergency supplemental appropriations request, to provide critical assistance to the Government of Colombia in its fight against narcotics traffickers.

The Armed Forces of the United States serve as the backbone of our national security strategy. As it did successfully last year in Kosovo, the military must be in a position to protect our national security interests and guard against the major threats to U.S. security. This budget builds upon the major commitment last year to maintain military readiness, with additional resources for required training standards, maintain equipment in top condition, recruit and retain quality personnel, and procure sufficient spare parts and other equipment. This budget also provides resources to combat emerging threats, including terrorism, weapons of mass destruction and cyber crime, and to protect critical infrastructure.

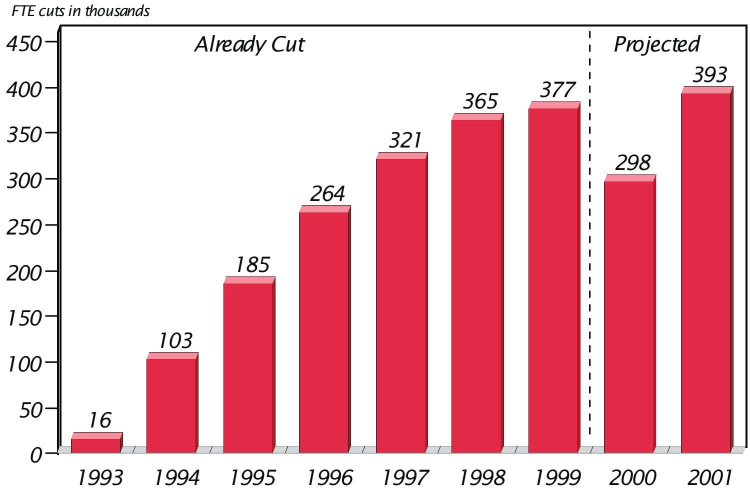
Improving Performance Through Better Management

A key element in the Administration's ability to expand strategic investments, while balancing the budget, is improving performance through better management. Improved stewardship of the Government can help it better achieve its mission and improve the quality of life for all Americans. To this end, the President and Vice President have streamlined Government, reducing its work force by 377,000, and eliminated obsolete or duplicative programs (see Chart 5–1).

The Administration is working to create not just a smaller Government—but a better one, Government that provides services and benefits to its ultimate customers, the American people. When Government works for the people—when citizens receive good basic services and have faith in the Government that provides them—their trust in Government can be restored.

Therefore, the Administration is forging ahead with new and additional efforts to improve the quality of the service that the Government offers its customers. It has identified its highest priorities—24 Priority Management Objectives (PMOs) that will receive heightened attention to ensure positive changes in the way Government works. These PMOs include modernizing student aid delivery, implementing IRS reforms, and improving the management of the Health Care Financing Administration, which oversees Medicare.

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. There will be a temporary increase in employment due to the 2000 Census.

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 surplus, 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 until maturity.

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 surplus, 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 2001 ends September 30, 2001.

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."

"On-Budget"

Those programs not legally designated as 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).

Receipt

This is another word for revenue.

Revenue

This is another word for receipt. Revenues include the collections that result from Government activity, such as taxes. They do not include collections that result from the Government's business-like activities, such as the entrance fees at national parks. Business-like collections are subtracted from total spending to calculate outlays for the year.

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 comprehensive 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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