

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



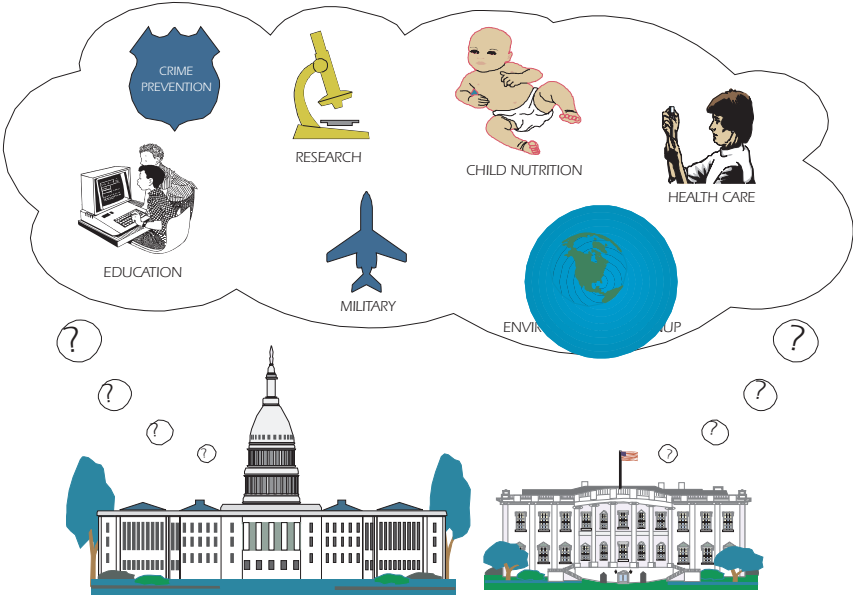
SOURCES: CASH AND CREDIT

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 goal—goals for national defense, foreign affairs, social insurance for the elderly, health insurance for the elderly and poor, law enforcement, education, transportation, science and technology, and others.

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

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

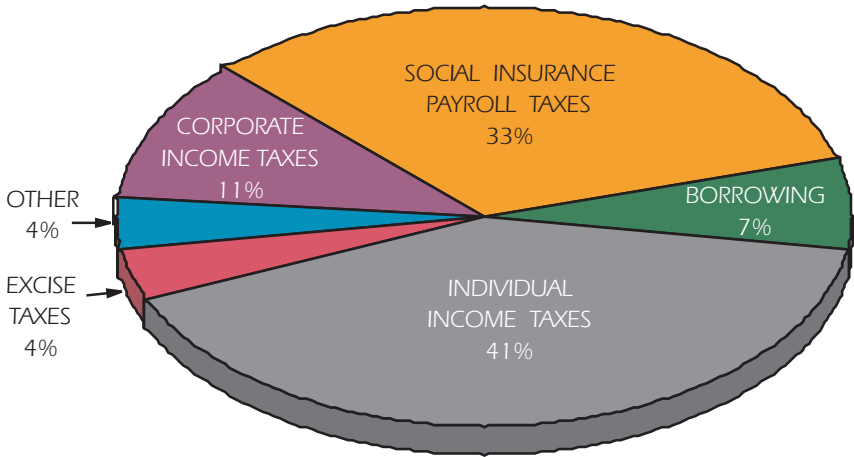
Chart 2-2. National Budgeting



SOURCES: TAXES AND BORROWING

Revenues

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



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

Revenues come from these sources:

- Individual income taxes will raise an estimated \$691 billion in 1998, equal to about eight percent of GDP—roughly about the same percent as in each of the last 40 years.
- Social insurance payroll taxes—the fastest growing category of Federal revenues—include Social Security taxes, Medicare taxes, unemployment insurance taxes, and Federal employee retirement payments. This category has grown from two percent of GDP in 1955 to nearly seven percent in 1998.
- Corporate income taxes, which will raise an estimated \$190 billion in 1998, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to 2.3 percent today.

Table 2-1. Revenues By Source—Summary

(In billions of dollars)

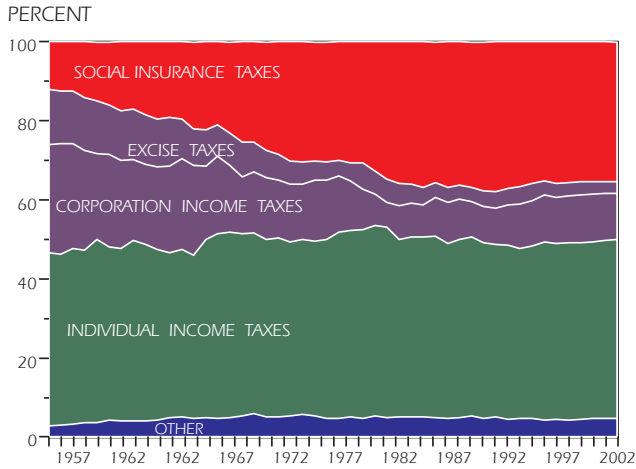
Source	1996 Actual	Estimate					
		1997	1998	1999	2000	2001	2002
Individual income taxes . . .	656	673	691	722	756	795	840
Corporate income taxes . . .	172	176	190	200	212	221	228
Payroll taxes	509	536	558	585	614	642	673
Excise taxes	54	57	61	64	65	66	67
Estate and gift taxes	17	18	19	20	21	23	25
Customs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

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

Numbers may not add to the totals due to rounding.

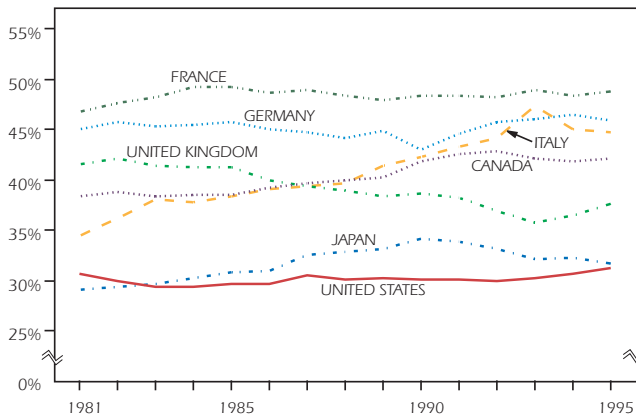
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways, airports and airways, and the cleanup of hazardous substances—and deposits others in the general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

Chart 2-4. Composition of Revenues



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

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



Source: OEDC, calendar year data.

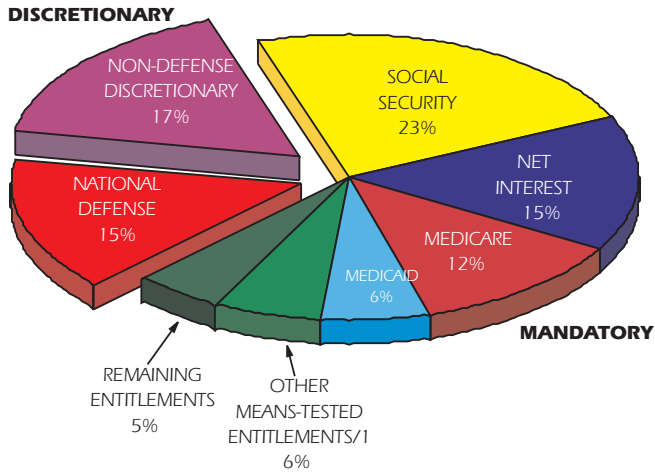
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries listed above.

Spending

As we have said, the Federal Government will spend nearly \$1.7 trillion¹ in 1998, which we divided into eight large categories as shown in Chart 2-6.

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

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



Note: Numbers do not add due to rounding.

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

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

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

Table 2-2. Spending Summary

(Outlays, in billions of dollars)

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

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

Table 2-3. Spending by Function

(Outlays in billions of dollars)

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

* \$500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.

Numbers may not add to the totals due to rounding.

Table 2-4. Spending by Agency

(Outlays, in billions of dollars)

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

* \$500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.

Numbers may not add to the totals due to rounding.

“On” and “Off” Budget

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

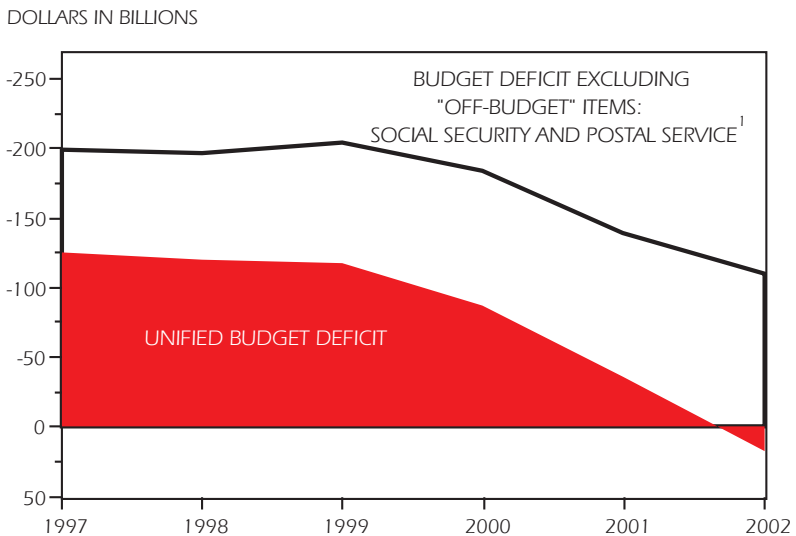
Specifically, the law requires that the spending and revenues of two Federal programs, Social Security and the Postal Service, be excluded from the budget totals—that is, categorized as “off-budget.” Therefore, the budget displays “on-budget,” “off-budget,” and “unified budget” totals to satisfy this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

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

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

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

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



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