

# 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—money it owes to American and foreign investors.*

- something that affects the Nation's economy.

*Some types of spending on things like education and support for science and technology are done in the hope they will 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.

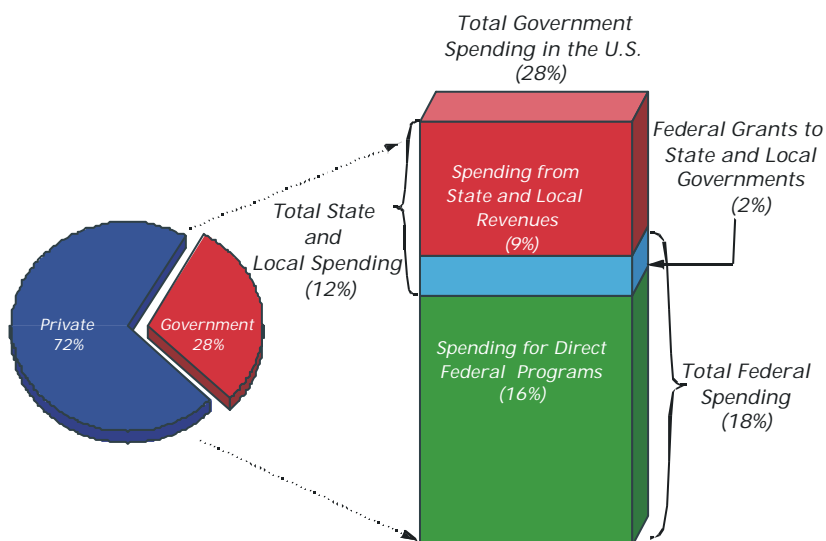
*When the economy is doing well, people earn more and unemployment is low. In this atmosphere, revenues increase and the surplus grows.*

- a historical record.

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

The 2002 Budget is a document that embodies the President's budget proposal to Congress for fiscal 2002, the *fiscal year* that begins on October 1, 2001. It reflects the President's priorities and proposes that the entire Social Security surplus be saved and set aside for Social Security and debt

**Chart 1-1. Government Spending as a Share of GDP, 2000**



***Total Government spending accounts for less than one-third of the national economy. Federal spending is about two-thirds of this amount, or about 18 percent of GDP.***

reduction. The President's budget also moderates the recent extremely rapid growth in discretionary spending, while funding national priorities and providing tax relief.

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 18 percent of the Gross Domestic Product (or GDP, which measures the size of the economy) in 2000, State and local government spending was about another nine percent (see Chart 1-1).

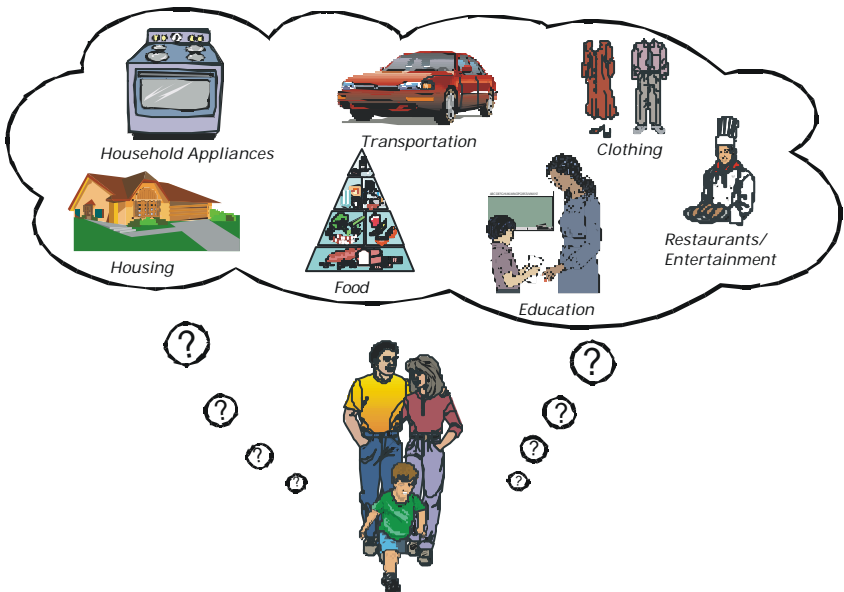
State and local governments are independent of the Federal Government, and they have their own sources of revenue (taxes and borrowing). But the Federal Government supplements State and local revenues by making grants to them. Of the \$1,152 billion that State and local governments spent in 2000, \$242 billion came from Federal grants.

## 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**



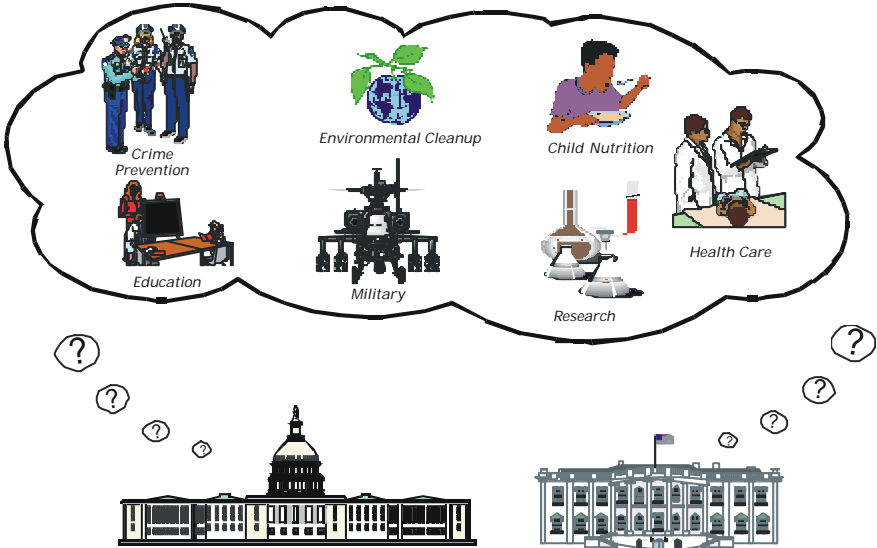
Sources: *Cash and Credit*

On the other hand, if they find themselves with more income than needed to meet their usual needs, they might use some of the extra money to improve their situation in critical areas, such as buying better health insurance, and to pay off the debts they built up in earlier years.

In some ways, 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. Unlike the Government though, a family can't just decide to take money from its neighbors when it wants to spend more than it takes in.

Also, unlike a family, the Government must keep in mind that it gets its revenue from you, the taxpayer. When the Federal budget is in surplus, the Government debates not only how much of the surplus to invest in new

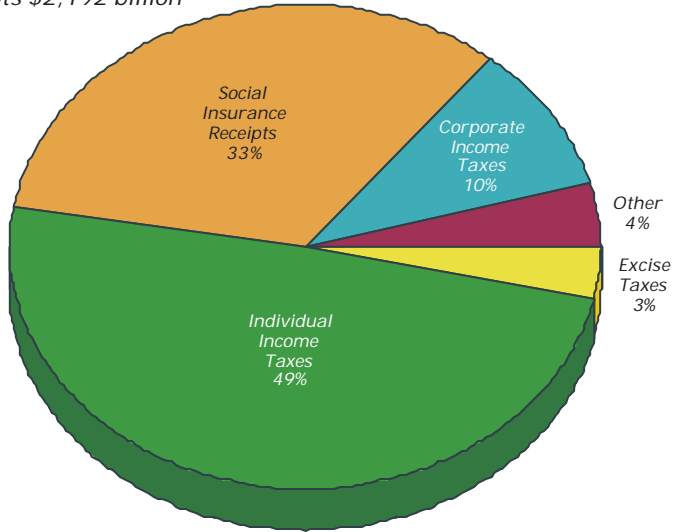
**Chart 2-2. National Budgeting**



Sources: Taxes and Borrowing

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

Receipts \$2,192 billion



***Over 90 percent of revenues come from three major categories of taxes: individual and corporate income taxes and payroll-type taxes.***

spending, or to pay down past debt, but also how much to return to the taxpayers in the form of tax relief. The Government also debates how its spending and revenue decisions will help the economy grow.

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

## Revenues

The money that the Federal Government uses to pay its bills—its revenues or receipts—comes mostly from taxes. In the past three 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.

**Table 2-1. Revenues By Source—Summary**

(In billions of dollars)

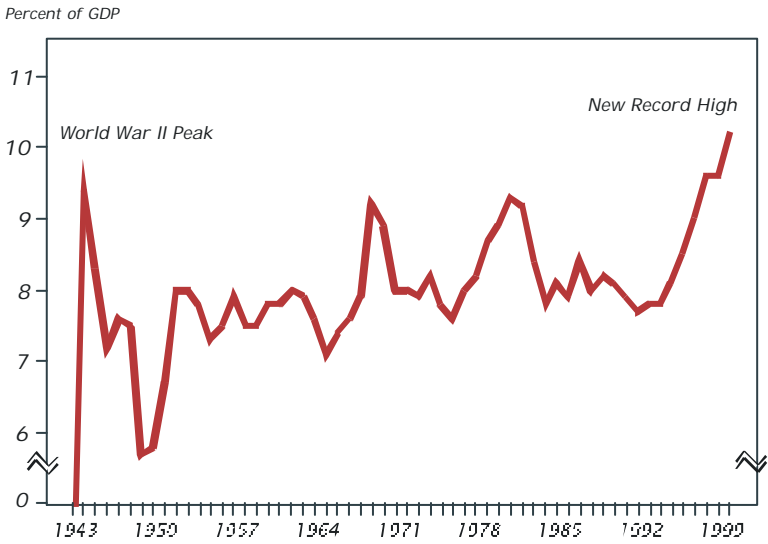
Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Individual income taxes . . . . .	1,004	1,073	1,079	1,092	1,118	1,157	1,197
Corporate income taxes . . . . .	207	213	219	227	235	244	252
Payroll taxes . . . . .	653	690	726	766	806	856	896
Excise taxes . . . . .	69	71	74	76	78	81	82
Estate and gift taxes . . . . .	29	31	29	27	28	25	22
Customs duties . . . . .	20	21	23	24	25	26	28
Miscellaneous revenues . . . . .	43	38	43	45	48	49	51
<b>Total revenues . . . . .</b>	<b>2,025</b>	<b>2,137</b>	<b>2,192</b>	<b>2,258</b>	<b>2,339</b>	<b>2,438</b>	<b>2,529</b>

Note: 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.

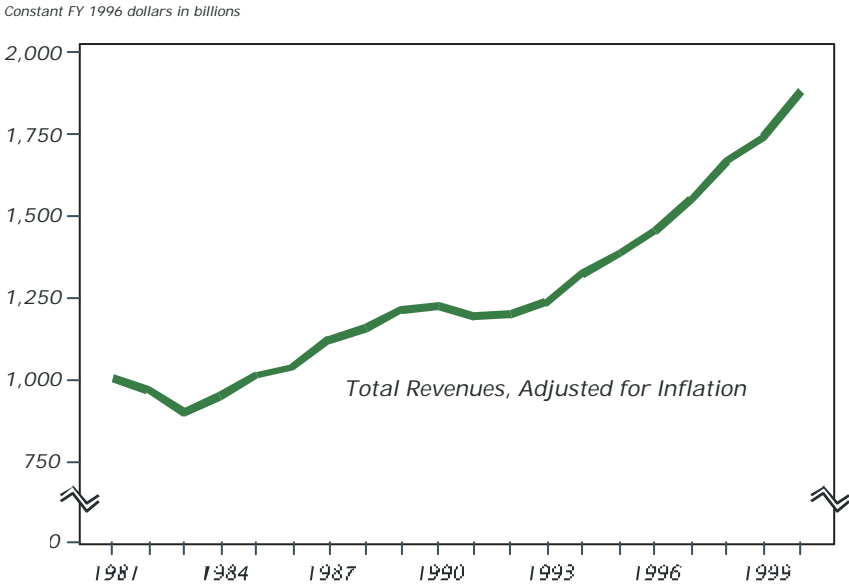
Revenues come from these sources:

- Individual income taxes will raise an estimated \$1,079 billion in 2002, equal to about 9.9 percent of GDP, after reaching an all-time high in 2001. Total taxes, as a percent of GDP, also reached a peace-time high in 2001.
- Corporate income taxes, which will raise an estimated \$219 billion, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to an estimated two percent in 2002.
- 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 6.7 percent in 2002.
- 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 deposits others in the general fund.
- The Government also collects estate and gift taxes, customs duties, and miscellaneous revenues—for example, Federal Reserve earnings, fines, penalties, and forfeitures.

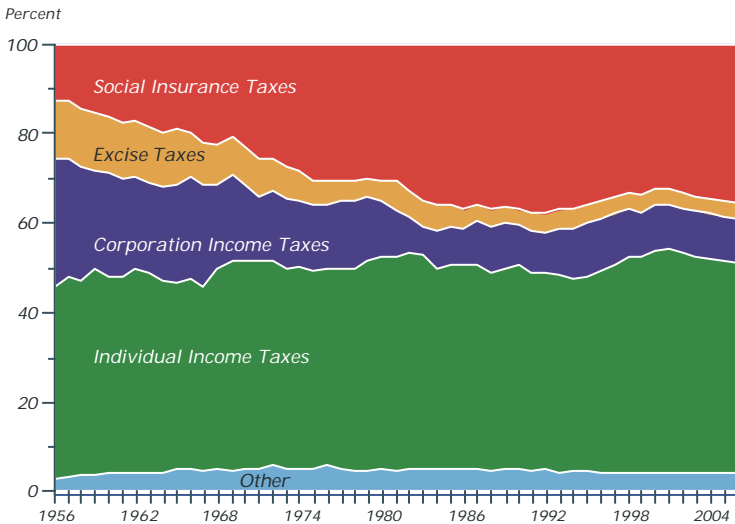
**Chart 2-4. Individual Income Taxes as a Share of GDP at Record High**



**Chart 2-5. Constant Dollar Revenue Growth**



**Chart 2-6. Composition of Revenues**



***Between 1956 and 2000, payroll taxes increased substantially as a percent of total revenues, and corporate income taxes declined, but the individual income tax share remained roughly constant.***

## Spending

As noted, the Federal Government will collect around \$2.2 trillion and spend nearly \$2.0 trillion,<sup>1</sup> which is divided into several categories as shown in Chart 2-7, leaving a surplus of \$231 billion in 2002.

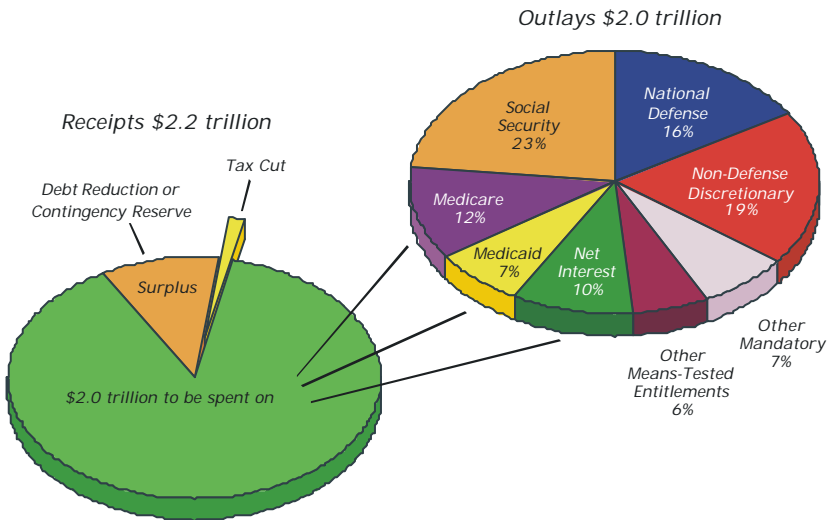
- The largest Federal program is Social Security, which will provide monthly benefits to more than 46 million retired and disabled workers, their dependents, and survivors. It accounts for 23 percent of all Federal spending.

<sup>1</sup> 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 \$0.2 trillion in 2002. If they were not subtracted from spending, spending would total an estimated \$2.2 trillion in 2002, not \$2.0 trillion.



- Medicare will provide health care coverage for more than 40 million elderly Americans and people with disabilities. Since its creation in 1965, Medicare has accounted for an ever-growing share of spending. In 2002, it will comprise 12 percent of all Federal spending.
- Medicaid will provide health care services to a little more than 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. In 2002, Medicaid will account 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, 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.

**Chart 2-7. How Your Tax Dollar Is Used**



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

- The remaining mandatory spending, which mainly consists of Federal retirement and insurance programs, unemployment insurance, and payments to farmers, makes up seven percent of the budget.
- National defense discretionary spending will total an estimated \$319 billion in 2002, 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—will total an estimated \$373 billion in 2002, or 19 percent of the budget.
- Interest payments, primarily the result of previous budget deficits, averaged seven percent of Federal spending in the 1960s and 1970s and rose to a high of 15 percent in 1996. Since 1998, the budget has been in surplus. As a result, interest payments are estimated to drop to less than 10 percent of the budget in 2002.
- Slightly less than 11 percent of your Federal dollar (the budget surplus) will be reserved for contingencies or used to reduce the Federal debt to ensure the continued solvency of Social Security.

## **“On” and “Off” Budget**

From time to time, you may hear the term “on-budget,” which refers to 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 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).

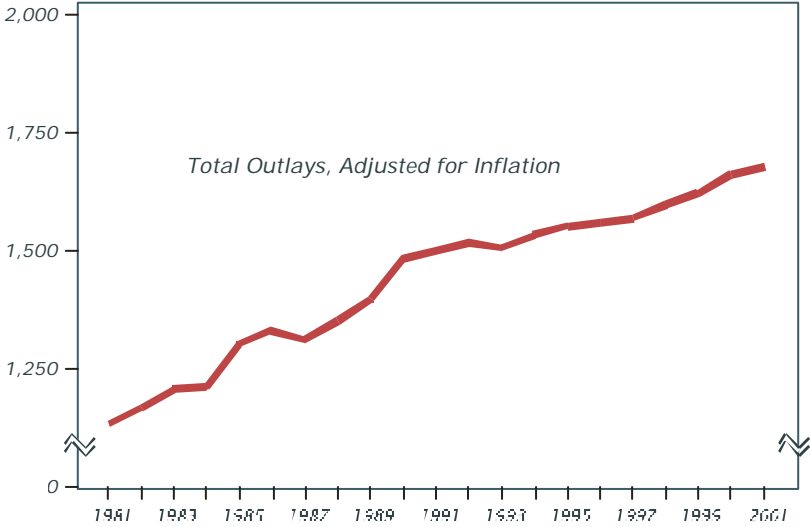
More recently, the on-budget surplus has received increasing attention. For all practical purposes, the off-budget surplus is the surplus in the Social Security program. This means that the on-budget surplus is the budget surplus excluding the Social Security surplus.<sup>2</sup>

---

<sup>2</sup> 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 2-8. Constant Dollar Spending Growth

Constant FY 1996 dollars in billions



**Table 2-2. Spending Summary**  
(In billions of dollars)

	Estimate					
	2001	2002	2003	2004	2005	2006
<b>Outlays:</b>						
Discretionary . . . . .	649	692	712	731	754	770
<b>Mandatory:</b>						
Social Security . . . . .	430	452	474	498	524	553
Medicare . . . . .	216	226	239	252	279	292
Medicaid . . . . .	129	142	153	166	181	196
Other mandatory . . . . .	226	260	264	268	286	285
Subtotal, mandatory . . . . .	1,001	1,081	1,129	1,184	1,270	1,326
Net interest . . . . .	206	188	175	161	145	127
<b>Total, outlays . . . . .</b>	<b>1,856</b>	<b>1,961</b>	<b>2,016</b>	<b>2,077</b>	<b>2,169</b>	<b>2,224</b>
<b>Receipts . . . . .</b>	<b>2,137</b>	<b>2,192</b>	<b>2,258</b>	<b>2,339</b>	<b>2,438</b>	<b>2,529</b>
Unified surplus . . . . .	281	231	242	262	269	305
On-budget surplus/contingency . . . . .	125	59	49	52	32	52
Off-budget surplus . . . . .	156	172	193	211	237	252

**Table 2-3. Total Spending by Function**  
(Outlays, in billions of dollars)

Function	Actual			Estimate					
	1998	1999	2000	2001	2002	2003	2004	2005	2006
National defense . . . . .	268	274	294	299	319	322	333	347	354
International affairs . . . . .	13	15	17	17	21	21	21	22	22
General science, space, and technology . . . . .	18	18	19	20	21	21	22	23	23
Energy . . . . .	1	1	-1	-1	-*	-*	-1	-*	-*
Natural resources and environment . . . . .	22	24	25	27	27	28	28	28	29
Agriculture . . . . .	12	23	37	26	19	15	14	14	14
Commerce and housing credit . . . . .	1	3	3	-1	7	5	4	4	2
Transportation . . . . .	40	43	47	51	55	57	60	62	64
Community and regional development . . . . .	10	12	11	11	12	11	11	10	10
Education, training, employment, and social services . . . . .	55	56	59	65	77	81	83	85	87
Health . . . . .	131	141	155	175	202	224	243	251	265
Medicare . . . . .	193	190	197	219	230	242	256	283	296
Income security . . . . .	233	238	248	263	276	286	296	309	317
Social security . . . . .	379	390	409	434	455	477	502	528	557
Veterans benefits and services . . . . .	42	43	47	45	52	54	56	60	60
Administration of justice . . . . .	23	26	28	29	32	35	35	35	36
General government . . . . .	16	16	13	17	16	17	18	17	18
Net interest . . . . .	241	230	223	206	188	175	161	145	127
Allowances . . . . .	...	...	...	...	2	4	5	5	6
Undistributed offsetting receipts . . . . .	-47	-40	-43	-48	-49	-60	-71	-59	-62
<b>Total . . . . .</b>	<b>1,653</b>	<b>1,703</b>	<b>1,789</b>	<b>1,856</b>	<b>1,961</b>	<b>2,016</b>	<b>2,077</b>	<b>2,169</b>	<b>2,224</b>

\* \$500 million or less.

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

**Table 2-4. Discretionary Budget Authority by Agency**  
(In billions of dollars)

Agency	Actual			Estimate					
	1998	1999	2000	2001	2002	2003	2004	2005	2006
Legislative Branch . . . . .	2	3	3	3	3	3	3	3	3
Judicial Branch . . . . .	3	3	4	4	5	5	5	5	5
Agriculture . . . . .	16	16	17	19	18	19	19	19	20
Commerce . . . . .	4	5	9	5	5	5	5	5	6
Defense-Military . . . . .	260	275	287	296	310	319	328	337	347
Education . . . . .	30	29	29	40	45	46	47	48	49
Energy . . . . .	17	18	18	20	19	20	20	21	21
Health and Human Services . . . . .	37	42	45	54	57	62	63	65	67
Housing and Urban Development . . . . .	20	22	21	28	30	32	33	35	36
Interior . . . . .	8	8	8	10	10	10	10	10	11
Justice . . . . .	18	18	19	21	20	22	22	22	23
Labor . . . . .	11	11	9	12	11	12	12	12	13
State . . . . .	6	8	8	8	9	9	9	10	10
Transportation . . . . .	13	14	14	18	16	17	18	18	18
Treasury . . . . .	11	13	13	14	15	15	15	16	16
Veterans Affairs . . . . .	19	19	21	22	23	24	24	25	26
Corps of Engineers . . . . .	4	4	4	5	4	4	4	4	4
Other Defense Civil Programs . . . . .	*	*	*	*	*	*	*	*	*
Environmental Protection Agency . . . . .	7	8	8	8	7	7	8	7	7
Executive Office of the President . . . . .	*	*	*	*	*	*	*	*	*
Federal Emergency Management Agency . . . . .	3	3	4	2	2	2	2	2	2
General Services Administration . . . . .	*	1	—*	*	1	1	1	1	1
International Assistance Programs . . . . .	11	31	14	13	13	13	13	14	14
National Aeronautics and Space Administration . . . . .	14	14	14	14	15	15	15	16	16
National Science Foundation . . . . .	3	4	4	4	4	5	5	5	5
Office of Personnel Management . . . . .	*	*	*	*	*	*	*	*	*
Small Business Administration . . . . .	1	1	1	*	1	1	1	1	1
Social Security Administration . . . . .	5	5	6	6	6	7	7	7	7
Other Independent Agencies . . . . .	6	6	6	6	6	6	6	6	6
Allowances . . . . .					5	5	6	6	6
<b>Total . . . . .</b>	<b>530</b>	<b>582</b>	<b>584</b>	<b>635</b>	<b>661</b>	<b>685</b>	<b>703</b>	<b>720</b>	<b>738</b>

\* \$500 million or less.

Notes:

Discretionary budget authority is appropriated by Congress each year, in contrast to mandatory authority, which is automatic under permanent law.

For a more complete discussion of discretionary appropriations, see "Action in Congress" in Chapter 3.

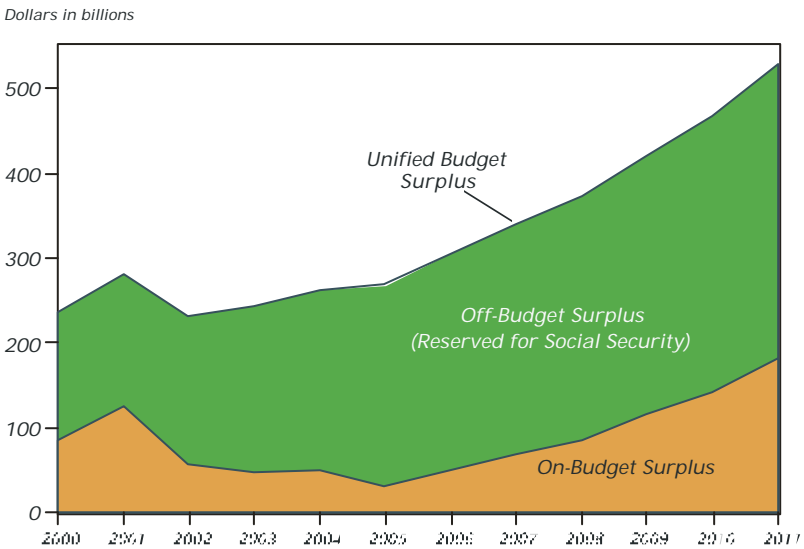
Budget authority that is shown as a minus means that receipts exceed budget authority.

Social Security is running large surpluses right now, because payroll taxes were raised dramatically in the early 1980s and because the relatively large “baby-boom” generation is big enough to provide the Social Security benefits provided 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 \$125 billion surplus, nearly all of which was the result of the Social Security surplus. The on-budget accounts were almost exactly in balance. For 2002, \$59 billion of the estimated \$231 billion surplus comes from the on-budget accounts.

Under the President’s proposals, the entire Social Security surplus would be saved and set aside for Social Security and debt reduction. The President’s overall budgetary framework is discussed in Chapter 5.

Chart 2–9 illustrates the relationship between on- and off-budget items, and the unified budget.

**Chart 2–9. On- and Off-Budget Surplus 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 specifies 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.

In some years, it is not possible for the President to adhere to the normal schedule. The law does not require an outgoing President to transmit a budget, and it is impractical for an incoming President to complete a budget within a few days of taking office. President George W. Bush submitted a summary budget plan, *A Blueprint for New Beginnings—A Responsible Budget for America's Priorities*, to Congress on February 28, 2001.

President Bush's detailed budget—which includes a main book and several accompanying books<sup>1</sup>—covers thousands of pages and provides an abundance of information. These books, which were submitted in April 2001, allow people from all walks of life to examine the budget from many different perspectives.

## 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

---

<sup>1</sup> They are the main budget book, entitled *Budget of the United States Government: Fiscal Year 2002*, as well as *Analytical Perspectives, Appendix, Historical Tables*, and *A Citizen's Guide to the Federal Budget*, which you are now reading.

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 to change the spending that current laws require.

Currently, the law imposes limits, or “caps,” through 2002 on annual discretionary spending. The budget proposes to revise these caps beginning in 2001 to recognize changing fiscal conditions, and extend the caps at appropriate levels through 2006. 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.

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. To consider the budget’s proposed changes in taxes, the House Ways and Means and the Senate Finance Committees will 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 are consistent with 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;
- the Office of Management and Budget;
- 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
- ensure that programs are well managed and achieving the intended results.

Prodded by Congress, the Executive Branch has begun to pay more attention to good management of late, starting with 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 \$125 billion, and then again in 2000 to \$236 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 \$3.4 trillion at the end of 2000 and to an estimated \$3.2 trillion in 2001. With continued prudent fiscal policies, the budget can remain in surplus for many years. Under the President's budget proposals, \$2.0 trillion in Federal debt held by the public will be retired over the next 10 years—all of the debt that can responsibly be retired.

Put simply, a surplus occurs when receipts exceed spending in any year—just as a deficit occurs when spending exceeds receipts. Generally, to finance 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 surpluses and deficits since 1940.

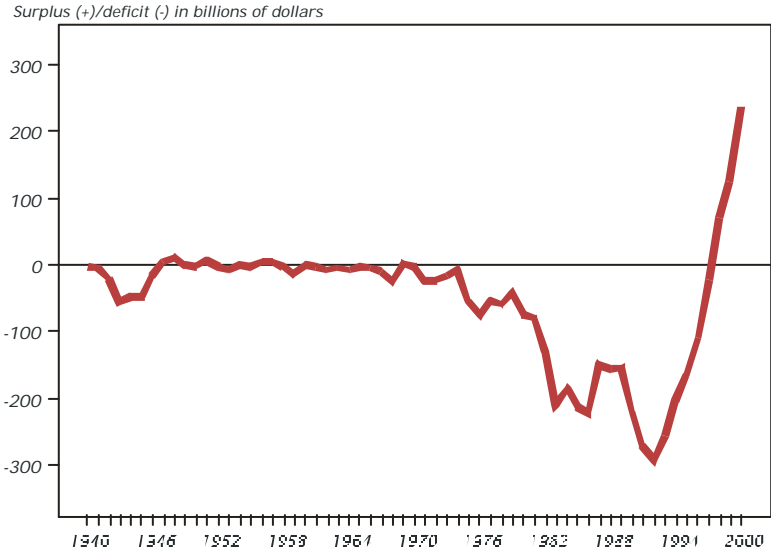
For most of the Nation's history, deficits were the result of either wars or recessions. Wars necessitated major increases in military spending, while recessions reduced Federal tax receipts from businesses and individuals.

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.

Since then—with Democratic and Republican Presidents, Democratic and Republican Congresses—the Government has balanced its books only 11 times, most recently last year.

**Chart 4-1. Returning the Budget to Surplus**



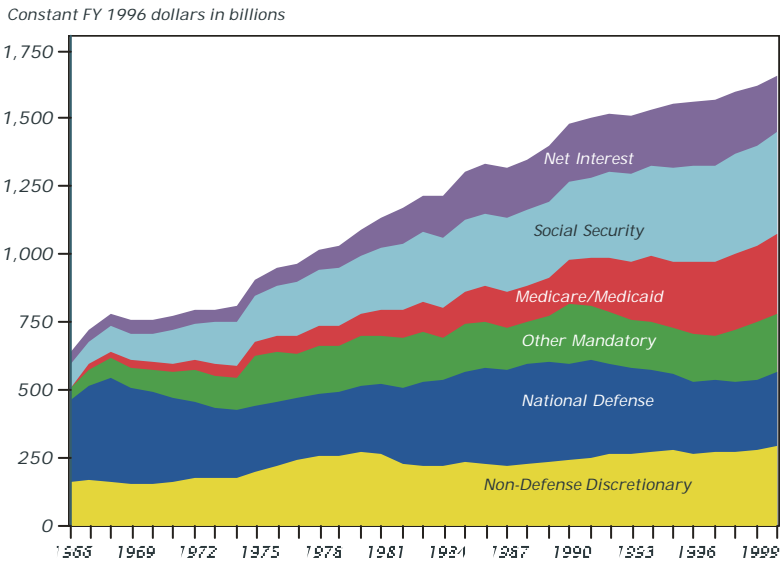
***Deficits began increasing dramatically in the late 1970s and 1980s, but have now been reversed.***

During the 1970s, large budget deficits emerged as the economy was disrupted by oil shocks and inflation. In the 1980s, this trend increased. By 1992, the deficit reached \$290 billion. Budget deficits have gradually declined since that high point, returning to balance in 1998. In 2000, the budget surplus was \$236 billion.

Why have we been able to move from deficit to balance? The main reason is because strong economic growth has increased tax receipts faster than the growth in Federal spending. Also, the end of the Cold War allowed the growth in defense spending to slow.

Until recently, receipts have stayed relatively constant, at around 17 to 20 percent of GDP, since the 1960s. However, strong economic growth since the mid-1990s has increased receipts to nearly 21 percent of GDP, the highest level since World War II. In that same time, outlays grew from about

**Chart 4-2. Constant Dollar Outlays by Category**

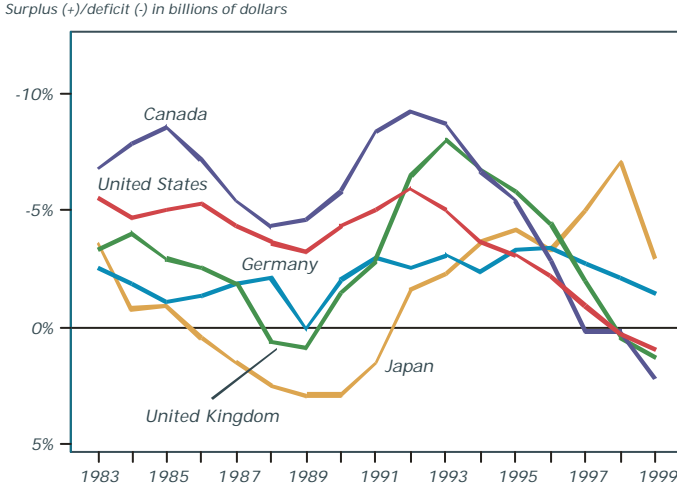


***Between 1966 and 2000, spending on Social Security, Medicare and Medicaid, and interest grew, while spending on defense fell.***

17 percent of GDP in 1965 to nearly 24 percent in 1983 before falling to 18 percent in 2000.

Nevertheless, since 1983, spending has grown dramatically across a wide variety of programs. Total spending in 2000 is 37 percent higher than in 1983 in constant dollars. Medicare and Medicaid, combined, are 175 percent higher and Social Security is 48 percent higher. Similarly, spending for net interest is 60 percent higher in 2000 than in 1983. In total, discretionary spending is six percent higher. But non-defense discretionary spending is 30 percent higher while national defense discretionary spending is 11 percent lower than in 1983. In recent years the growth in discretionary spending has accelerated, especially since 1997. Between 1997 and 2000, total discretionary spending has increased five percent, with non-defense discretionary spending increasing more than eight percent during this three-year period. (Note: all numbers adjusted for inflation). (See Chart 4-2.)

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



Source: Organization for Economic Cooperation and Development (OECD), calendar year data.

***Of the five nations shown above, only the United States, Canada, and the United Kingdom eliminated their total government budget deficits in recent years.***

## Why a Budget Surplus is Important

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

The 2002 Budget forecasts surpluses for decades to come if we maintain a policy of fiscal discipline.

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

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, defense, law enforcement, and other important services,

or the more it must collect in taxes. As recently as 1997, the Government spent more than 15 percent of its budget to pay interest, in contrast to less than 10 percent projected for 2002. The President's budget will reduce these interest payments dramatically in the next 10 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.

**Table 4–1. Federal Government Financing and Debt**

(In billions of dollars)

	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Federal Government financing:							
Unified budget surplus . . . . .	236	281	231	242	262	269	305
On-budget surplus/reserve							
for contingencies <sup>1</sup> . . . . .	87	125	59	49	52	32	52
Off-budget surplus . . . . .	150	156	172	193	211	237	252
Financing other than the change in debt held by the public . . . . .	–13	–45	–4	–15	–16	–15	–14
Amount available to repay debt held by the public; . . . . .	223	236	227	227	246	254	291
Federal Government debt:							
Debt subject to legal limit . . . . .	5,592	5,588	5,627	5,688	5,749	5,822	5,881
Gross Federal debt . . . . .	5,629	5,625	5,664	5,724	5,784	5,856	5,913
Debt held by Government accounts . . . . .	2,219	2,451	2,717	3,004	3,310	3,636	3,985
Debt held by the public . . . . .	3,410	3,174	2,947	2,720	2,473	2,219	1,928

<sup>1</sup> The actual amount of annual debt retirement will vary depending upon the availability of eligible redeemable debt, and the use, if any, of the contingency reserve.

Debt held by the public was \$3.4 trillion at the end of 2000—roughly the net effect of deficits and surpluses over the last 200 years. Debt held by the public does not include debt the Government owes itself—the total of all trust fund surpluses and deficits over the years, like the Social Security surplus, which the law says must be invested in Federal securities.

Because the large budget deficit has been turned into a surplus, the debt held by the public was reduced for three years in a row, for the first time since 1947–1949.

The sum of debt held by the public and debt the Government owes itself is called Gross Federal Debt. At the end of 2000, 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 either reduce the debt by raising receipts or reducing spending, or 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 2002.

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 35 percent of GDP at the end of 2000. 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 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.



## 5. THE PRESIDENT'S 2002 BUDGET

---

*A budget is much more than a collection of numbers. A budget is a reflection of a nation's priorities, needs, and promise. With this budget I am confident that we can make a great Nation even better. In the midst of this budget's heft and detail, there is a vision for a better and more prosperous America.*—President George W. Bush

President George W. Bush's 2002 Budget is shaped around a clearly defined goal—the belief that Government should be activist but limited. Government cannot create a strong economy, but it can create the conditions that permit a free citizenry to do so.

At the same time, Government must also learn from the private sector, finding ways to increase efficiency and customer satisfaction. The President's Budget moderates the rapid growth of discretionary spending that began with the arrival of budget surpluses in 1998 while funding key Federal priorities in education, health, environment, and other programs.

### **Thematic Highlights of President Bush's 2002 Budget**

- Funds the Nation's spending priorities. For example, the budget strengthens and reforms education, granting the Education Department the largest percentage spending increase of any department (11.5 percent increase in 2002).
- Moderates recent explosive growth in discretionary spending to 4.0 percent growth in 2002, an increase of \$26 billion over 2001.
- Achieves historic levels of debt reduction, retiring the maximum amount of debt possible over 10 years (\$2 trillion).
- Allocates projected \$5.6 trillion surplus over 10 years. Breakdown of surplus:
  - Saves all of Social Security surplus (\$2.6 trillion) for Social Security and commits to reforming the program.
  - Lets taxpayers keep roughly one-fourth of the surplus they produced (\$1.6 trillion over 10 years).

—Creates an unprecedented \$1.0 trillion reserve for additional needs and contingencies.

- Modernizes and reforms Medicare, and spends every penny of Medicare tax and premium collections over the next 10 years only on Medicare.
- Restores commitment to military personnel and begins transition to a 21st Century force structure.
- Champions compassionate conservatism by supporting the critical role that faith-based and community organizations play in helping people at the local level.
- Saves taxpayers billions of dollars by making reductions in one-time spending, unjustified programs, duplicative programs, and programs that have completed their mission in 2002.

## The President's Policy Priorities

The President's Budget, which is balanced for 10 consecutive years, funds America's priorities, retires an unprecedented \$2 trillion in debt, provides needed tax relief for everyone who pays income taxes, revitalizes education, reforms and modernizes Social Security and Medicare, brings defense strategy and spending in line with the challenges of the next half-century, supports faith-based and community outreach efforts, moderates Government spending growth to a reasonable four percent, and establishes a first-ever \$1 trillion contingency fund for unexpected needs.

- *The President's Budget commits to using today's surpluses to reduce the Federal Government's publicly held debt so that future generations are not shackled with the responsibility of paying for the current generation's overspending.* It commits to an unprecedented amount of debt retirement—\$2 trillion in debt over the next 10 years and reduces Federal debt as a share of the economy to the lowest level in a century.
- *The President's Budget proposes a bold and fair tax relief plan that will reduce the inequities of the current tax code and help ensure that America remains prosperous.* This tax relief plan promotes the values that make the American economy second to none—access to the middle class, family, equal opportunity, and the entrepreneurial spirit. This plan will reduce taxes for everyone who pays income taxes, and it will encourage enterprise by lowering marginal tax rates.

- *The Administration believes that every young American should have the opportunity to go to a good school and acquire the skills that will be needed to advance in today's high technology society.* Today, America's public schools serve some children well. But some schools clearly do not teach adequately, nurture consistently, or offer a fair start in life. Members of both parties and both Houses of Congress agree that Federal education dollars should be spent in ways that restore local control; encourages States to set high standards; hold schools accountable for improving student achievement, including by measuring achievement through frequent assessment; improve the quality of classroom instruction and school safety; and, where a school persistently fails, assist parents in finding better options. Some education initiatives in this budget originated on one side of the political aisle, some on the other. All stress results over promises and accountability over process. Federal spending is a small part of America's total education spending. The President's Budget declares that the Federal Government must not spend for spending's sake. This budget puts together an education program and budget that ensures that "no child is left behind."
- *The President's Budget shores up Social Security's finances so that this program can continue to provide retirement security for all future retirees.* Today, the Social Security program is in surplus. Beginning around 2016, beyond the Government's 10-year planning horizon, the program will begin to run a cash deficit. After 2038, the trust fund will be depleted and payroll taxes at that time will cover only 73 percent of promised benefits. Returns have declined to such a point that future retirees would do two or three times better if they invested their Social Security taxes in low risk securities. Unless Social Security is reformed, many young people of following generations might not get back from Social Security what they put in. Social Security could be a losing proposition for them. Reform must make Social Security a sound program for tomorrow's retirees. The cost of saving Social Security goes up with every passing year, and our ability to improve returns on total contributions goes down. With this budget, the Administration commits itself to working with both parties and Houses of Congress to fix Social Security now.
- *The President is committed to shoring up Medicare's finances as well, while providing better, more efficient coverage for our seniors.* Medicare is already spending more than it takes in. Medicare spending already exceeds taxes and premiums by \$66 billion this year. That will grow to \$216 billion (constant dollars) by 2020. The antiquated division of the program into hospital and non-hospital pieces does not encourage

efficient medical care. Medicare has not adapted to 21st Century medicine. Medicare is often slow to incorporate new technologies and methods of delivering health care. In addition, although medical care increasingly relies on pharmaceuticals, it lacks prescription drug coverage. As in virtually all fields, technological and entrepreneurial innovation are among the keys to creating more value for the dollar in health care. Reform that works for patients must make room for such innovation. Reform should expand patients' choices—not restrict them. This budget initiates the process of Medicare modernization and delivers immediate relief on prescription drugs for our neediest seniors.

- *The Administration is committed to enhancing our national security.* Today our Nation faces no major foreign adversary. Our military is unquestionably the strongest on earth. And yet our forces are deployed around the world maintaining peace and keeping a watchful eye on our national interests with increasing frequency. These deployments have created some stress on our military. To boost the morale of these dedicated men and women, the President's budget will, in addition to the well-deserved pay raises earned each year, include an additional \$1.4 billion to ensure better compensation for our troops. The budget also includes \$3 billion in additional funding to improve military housing and increase research and development.

Furthermore, the United States must develop a strategic vision for the 21st Century national security agenda that will inform research, development, and procurement decisions for the next generation of defense systems. This budget begins the process of force re-examination. And it commits America to developing, designing, and building a national missile defense as fast as possible.

- *The President's plan will support community and faith-based efforts to help needy Americans.* Today, Federal funds are denied to many faith-based and other community-based programs that have succeeded in helping people curb criminal behavior, conquer addiction, strengthen families, and overcome poverty.

Federal policy should become outcome-based, insisting on success and steering resources to the effective and to the inspired. Federal tax policy must spark an outpouring of private philanthropy in America, spurring billions more annually in charitable giving to neighborhood-serving groups, both sacred and secular. The Government must heed the growing consensus across America that successful Government programs can work in fruitful partnership with community-serving and faith-based

organizations, whether run by Methodists, Muslims, Mormons, or good people of no faith at all. The United States must observe the bedrock principles of pluralism, nondiscrimination, evenhandedness, and neutrality. With this budget, private and charitable groups, including religious ones, will have the fullest opportunity permitted by law to compete on a level playing field for Federal funds, so long as they achieve valid public purposes. With this budget, the Federal Government rallied and supports these armies of compassion across America.

## **Additional Budget Highlights**

- K-12 Education. Increases funding for elementary and secondary education by \$1.9 billion in 2002 over 2001 funding.
- Reading. Fully funds the President's Reading First initiative, including Early Reading First, at \$975 million in 2002, more than tripling funding for reading.
- Medicare. Sets aside \$153 billion over the next 10 years for the Immediate Helping Hand initiative and Medicare modernization.
- National Institutes of Health (NIH). Continues commitment to double NIH, by providing a \$2.8 billion increase, the largest annual funding increase in NIH's history.
- WIC. Funds the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) at 7.25 million individuals a month, maintaining current program level.
- Conservation. Provides the highest ever request for the Land and Water Conservation Fund—fully funding the program at \$900 million.
- Energy Assistance. Nearly doubles the existing Weatherization Assistance Program providing an increase of \$1.4 billion over 10 years.
- Community Health Centers. Launches a doubling of the number of people served by Community Health Centers by adding 1,200 sites.
- Provides tax relief to all Americans who pay income tax.
- Reduces the marriage penalty.
- Ends the death tax.
- Tax incentives. Provides other tax incentives for education, farmers, the disabled, health care, the environment, and charitable purposes.

- National Defense. Provides a \$14 billion increase in Department of Defense spending in 2002 to begin to arrest the decline in national security, including \$1.4 billion for military compensation to improve quality of life and reenlistment and retention of military personnel, \$2.6 billion for research and development for new technologies (including missile defense alternatives), and \$400 million to improve housing for our military members and their families.
- Veterans' Assistance: Increases funding to \$1.1 billion to fully implement legislation that will assist in the processing of veterans' disability claims.
- International Security. Improves embassy security overseas, adding \$1.2 billion.

*The time for bold action is now. We have the unprecedented opportunity to fund our national priorities, reform critical programs, pay off all of the Federal debt that makes sense to, and provide needed tax relief. I present this budget in the spirit of cooperation and with the great expectation that the will of the people and the needs of the Nation will guide our deliberations and lead us to success.—President George W. Bush*

# 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 2002 ends September 30, 2002.

### **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.

# List of Charts and Tables

---

## List of Charts

Page

### What Is the Budget?

1-1	Government Spending as a Share of GDP, 2000 . . . . .	2
-----	-------------------------------------------------------	---

### Where the Money Comes From—and Where It Goes

2-1	Family Budgeting . . . . .	3
2-2	National Budgeting. . . . .	4
2-3	The Federal Government Dollar—Where It Comes From. . . . .	5
2-4	Individual Income Taxes as a Share of GDP at Record High . . . . .	7
2-5	Constant Dollar Revenue Growth . . . . .	7
2-6	Composition of Revenues . . . . .	8
2-7	How Your Tax Dollar is Used . . . . .	9
2-8	Constant Dollar Spending Growth . . . . .	11
2-9	On- and Off-Budget Surplus Projections . . . . .	14

### The Budget Surplus and Fiscal Discipline

4-1	Returning the Budget to Surplus . . . . .	20
4-2	Constant Dollar Outlays by Category . . . . .	21
4-3	Total Government Surplus or Deficit as a Percent of GDP . . . . .	22

## List of Tables

Page

### Where the Money Comes From—and Where It Goes

2-1	Revenues by Source—Summary . . . . .	6
2-2	Spending Summary . . . . .	11
2-3	Total Spending by Function . . . . .	12
2-4	Discretionary Budget Authority by Agency. . . . .	13

### The Budget Surplus and Fiscal Discipline

4-1	Federal Government Financing and Debt. . . . .	23
-----	------------------------------------------------	----