Understanding the Federal Budget [1]

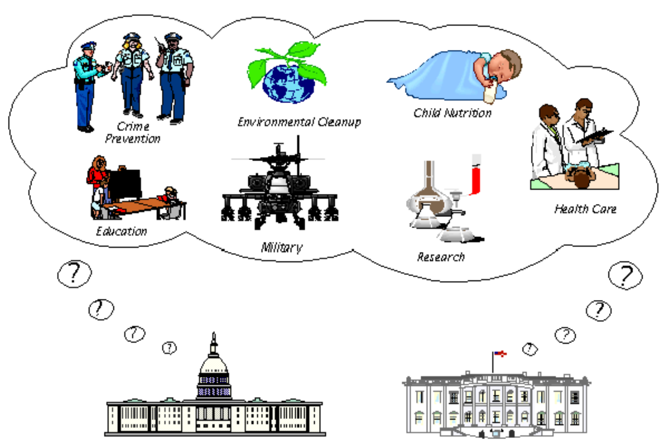
"For in the end, a budget is more than simply numbers on a page. It is a measure of how well we are living up to our obligations to ourselves and one another."

--From *Remarks by the President on the Fiscal Year 2010 Budget*,
President Barack Obama, February 26, 2009

1. Introduction

One of the most important documents produced each year by the President and Congress is the federal budget. Through a lengthy process, government leaders determine how much money they expect the government to receive during each of the next several years, where it will come from, and how much to spend to reach their goals in areas such as national defense, foreign affairs, social insurance for the elderly, health insurance for the elderly and poor, law enforcement, education, transportation, science and technology.

You will be participating in a simulation in which you will be making decisions similar to those made every year by the government to determine next year's federal discretionary budget.
The President and Congress decide how much spending they will finance through taxes, and debate how to use the budget to help the economy grow or to redistribute income. More recently, they have been debating how long we can sustain large budget deficits that many government leaders feel have been necessary to stimulate our distressed economy. In this overview, we will discuss some of these decisions--that is, how the government raises revenues and where it spends money.



Sources: Taxes and Borrowing

[1] Adapted from the Office of Management and Budget online publications, *A Citizen's Guide to the Federal Budget, FY 2001*and *FY 2002*. Note that most numbers and dates have been adapted to reflect the 2014 fiscal year.

2. What *Is* the Budget?

The federal budget is:

- a plan for how the government spends taxpayers' money.

  What activities are funded? How much should we 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 (taxes applied to various products, including alcohol, tobacco, transportation fuels and telephone services), and social insurance payroll taxes?

- a plan for government borrowing or the repayment of borrowed funds.

  If revenues are greater than spending, the government runs a surplus. If expenses are greater than revenues (as is currently the case), the government runs a deficit.

- 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 poorly, people are earning less and unemployment is high. In this atmosphere, revenues decrease and the deficit grows.

- an historical record.

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

The 2015 budget document embodies the President's budget proposal to Congress for fiscal year 2015, which begins on October 1, 2014. It reflects the President's priorities and proposes his initiative to meet our national and international needs.

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. State and local governments are independent of the federal government, and they have their own sources of revenue (taxes and borrowing).

Where the Money Comes From

The money that the federal government uses to pay its bills--its revenues or receipts--comes mostly from taxes. For FY (fiscal year) 2014, the federal government forecasted that it would receive $3 trillion in revenues.

Revenues come from these sources:

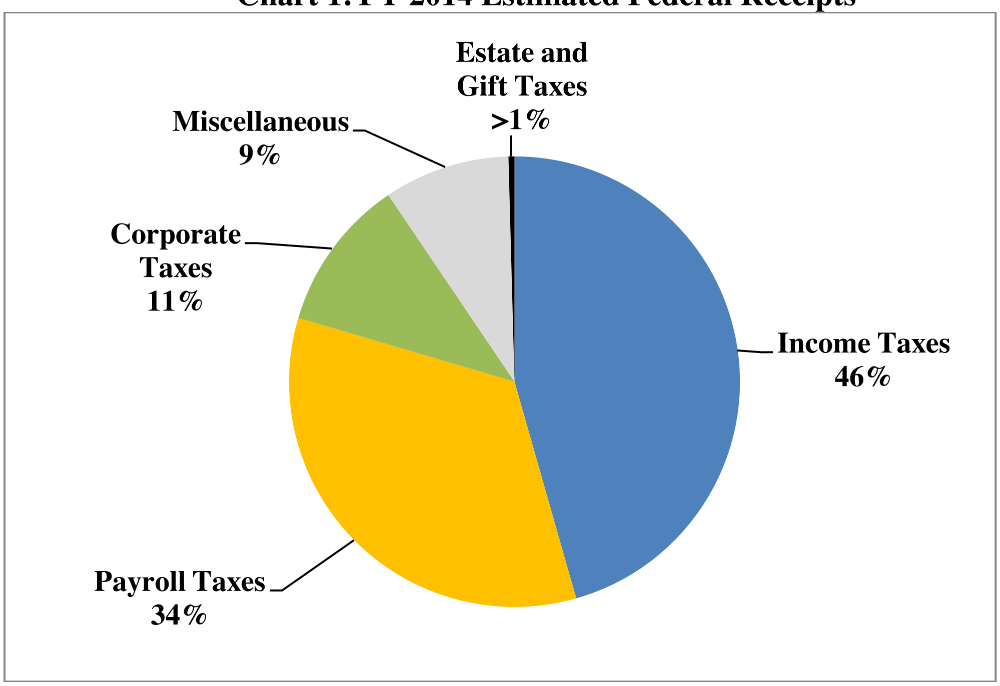
Table 1. FY 2014 Estimated Federal Receipts

Source	Amount (Billions)	Percentage
Individual Income Taxes	1,383	46%
Payroll Taxes (Social Security, Medicare, Unemployment insurance, and other retirement)	1,031	34%
Corporate Taxes	333	11%
Miscellaneous*	274	9%
Estate and Gift Taxes	13	>1%
Total Collected	3,034	100%

http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/tables.pdf
Table S-5. Proposed Budget by Category

* The government collects customs duties, excise taxes (taxes applied to various products, including alcohol, tobacco, transportation fuels and telephone services), and other miscellaneous revenues--e.g., Federal Reserve earnings, fines, penalties, and forfeitures.

Chart 1. FY 2014 Estimated Federal Receipts



Spending

To better understand federal spending, let's look briefly at President Obama's proposed FY 2014 federal budget in which the government projected it would spend approximately $3.8 trillion. Federal spending is divided into ***mandatory spending*** which is required by law, and ***discretionary spending*** which is decided upon yearly by the President and Congress.

Discretionary spending is what the President and Congress must decide to spend for the next year through annual appropriations bills. It includes money for such activities as the FBI, housing, education, space exploration, highway construction, defense, and foreign aid. Discretionary spending for FY 2014 was estimated to account for 33% of all federal spending. Mandatory spending, which accounts for approximately 67% of all FY 2014 spending, is authorized by permanent laws, not by the annual appropriations bills. It includes entitlements--such as Social Security, Medicare, Medicaid, and Food Stamps--through which individuals receive benefits because of their age, income, or other criteria. It also includes interest on the national debt. The only way the President and Congress can change how much is spent in these accounts is to change the laws which dictate the amount of spending on these mandatory programs.

- The largest federal mandatory spending program is Social Security, which provides monthly benefits to approximately 55 million retired and disabled workers, their dependents, and survivors. The government projected it will spend approximately $860 billion on this program, which they calculated would account for approximately 23% of all federal spending.

- Medicare provides health care coverage for over 45 million elderly Americans and people with disabilities. The government projected it will spend $524 billion on this program, approximately 14% of all federal spending.

- Medicaid provides health care services to millions of Americans, including the poor, people with disabilities, and senior citizens in nursing homes. This program accounts for $304 billion of the budget, approximately 8% of all federal spending.

- Other entitlements provide benefits to people and families with low incomes such as Food Stamps and veterans' pensions. The remaining mandatory spending mainly consists of federal retirement and insurance programs, unemployment insurance, and payments to farmers. All these remaining mandatory spending items account for $621 billion, approximately 16% of all federal spending.

- Discretionary security spending for FY 2014 (funding for the Pentagon, homeland and border security, etc.) was budgeted at approximately $618 billion, comprising approximately 16% of all spending.

- Discretionary spending on programs not related to defense includes a wide array of initiatives such as education, training, science, technology, housing, transportation, and foreign aid, and represents approximately 17% of the budget.

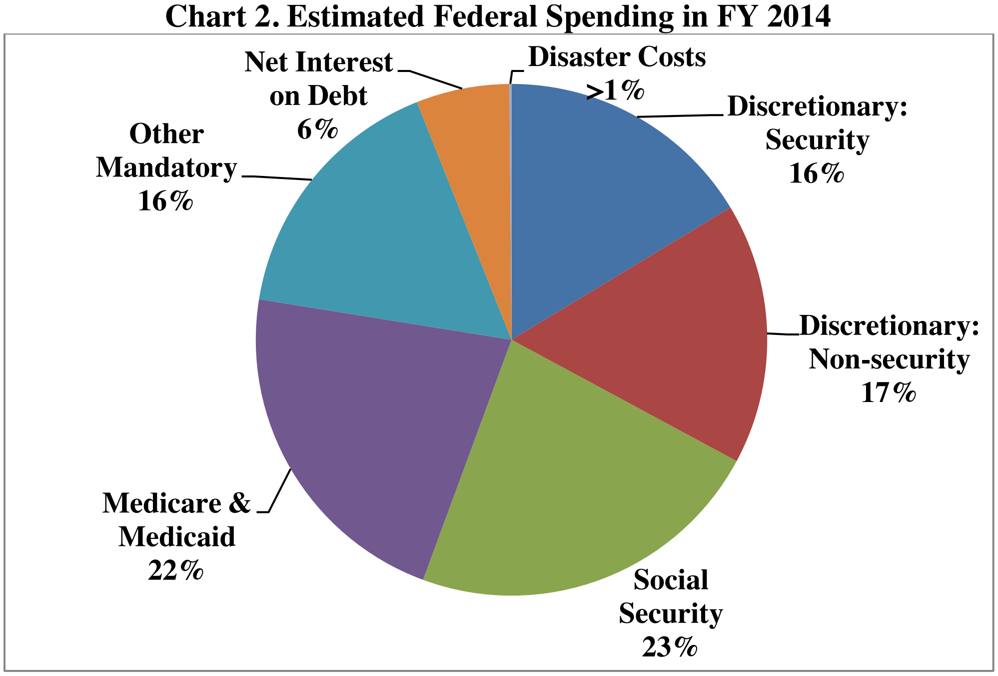
- Interest payments are payments made to pay back the interest on the federal debt. This accounts for $223 billion or approximately 6% of the federal budget. As the government increases the size of its debt, the amount of interest that must be paid increases.

Table 2. Estimated Federal Spending in FY 2014

Budget Item	Amount (Billions)	Percentage
Discretionary:		
Security	618	16%
Non-security	624	17%
Mandatory:		
Social Security	860	23%
Medicare & Medicaid	828	22%
Other Mandatory	621	16%
Net Interest on Debt	223	6%
Disaster Costs*	5	>1%
Total	3,778	100%

http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/tables.pdf
Table S-5. Proposed Budget by Category
*These amounts represent a placeholder for major disasters requiring Federal assistance for relief and reconstruction. Such assistance might be provided in the form of discretionary or mandatory outlays or tax relief.

Chart 2. Estimated Federal Spending in FY 2014



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. For the fiscal year 2014 budget, President Obama is supposed to submit his budget to Congress on February 3, 2014, however, there have been several instances over the years in which the budget proposal has been delayed.

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 is thousands of pages long 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. 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 spending bills has the Government created its actual budget*.
For fiscal year 2015--that is, October 1, 2014 to September 30, 2015--the major steps in the budget process are outlined in Table 3 below.

Table 3. Major Steps in the Budget Process

Formulation of the President's budget for 2015	Executive Branch agencies develop requests for funds and submit them to the Office of Management and Budget. The President reviews the requests and decides what to include in his budget.	February 2013 – January 2014
State of the Union Address	The President speaks to the country about his priorities for the year ahead.	Late January/Early February 2014
Budget preparation and submission	The budget documents are completed by the OMB and sent to Congress.	January 2014 – February 2014

Congressional action	Congress reviews the President's budget, develops its own, and eventually approves spending and revenue bills.	March 2014– September 2014
President's final approval	President signs spending and revenue bills to make them law.[2]	Late September 2014
Fiscal year begins		October 1, 2014
Budget implemented	Agency program managers begin to spend (and raise) the money approved by the Congress and the President.	October 1, 2014 through September 30, 2015

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, the surplus or deficit, and allocations within the spending target for the two types of spending--discretionary and mandatory.

In the simulation in which you will be participating, you will only be examining the discretionary programs that are part of the federal budget. It is these programs that the President and Congress must act upon each year.

Once Congress passes the budget resolution, it turns its attention to passing the annual appropriations bills – ideally by the end of September. For the past several years, the annual appropriations bills have not been passed by the beginning of the fiscal year and most government activities were funded through "continuing resolutions" which keep funding no higher than the levels of the previous fiscal year until the current budget is passed.
Congress begins by examining the President's budget in detail. Scores of committees and subcommittees hold hearings on proposals under their jurisdiction. The President's Budget Director, Cabinet officers, and other Administration officials work with Congress as it accepts

[2] In 1996, President Clinton refused to sign the bills that Congress passed and the whole government was shut down until the President and Congress could agree on the budget bills.

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.

Monitoring the Budget

Once the President and Congress approve spending, a number of government agencies oversee the budget in order to ensure that programs are well managed, are achieving the intended results and are operating consistently within legal requirements.

4. Deficits and Debt

When President Clinton was first elected in 1992, the federal budget was in a deficit. During the 1990s, as a result of a strong economy, the government brought in much higher revenues than expected and began, by the end of the decade, to run a budget surplus. In 2002, as a result of September 11, increased military spending and anti-terrorism spending, tax cuts, and the downturn in the economy, the federal budget went back into deficit.

For the past several years, the U.S. economy has been in distress. Due to the economic downturn, the government has been collecting less tax revenues and has passed bills to stimulate economic and job growth which have reduced taxes further and added to spending. Additionally, costs for entitlement programs such as Social Security, Medicare and Medicaid have risen. As a result, the non-partisan Congressional Budget has recorded many years of significant budget deficits (see *Chart 4: The Federal Deficit* on the following page).

There are different economic arguments about whether running a large deficit is a good idea or not. In the past years our increase in borrowing was widely seen as a necessary response to a very weak economy. Many economists have argued the necessity of increased government spending as an investment to help our economy grow. You might think of it as the way a family takes out a mortgage to buy a house. Most people think taking out a mortgage is a good idea and an investment in a family's future. Credit card debt, on the other hand, is something that most families try to avoid as they end up spending needlessly on the high interest on these accounts.

The Politics of Deficit/Debt Reduction

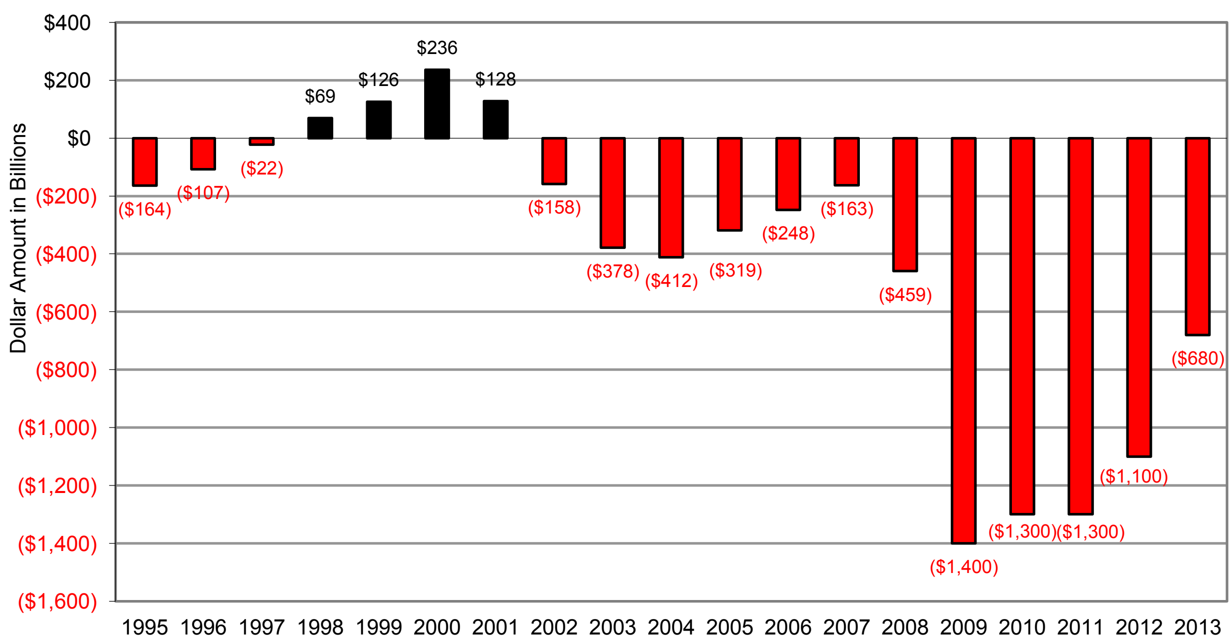
Deficits may be necessary during difficult economic times, but the concern currently confronting government leaders is how long high deficits can be sustained, and what can be done to lower them in the future. During FY 2011, members of Congress and the President were unable to agree upon solutions to the problem of our long term debt. In December 2010, a bipartisan commission (Simpson-Bowles Debt Commission) set up by President Obama to investigate this issue recommended an increase in taxes and future cuts in Social Security and Medicare benefits, among other proposals. These recommendations are politically charged, since both raising taxes and lowering benefits to these entitlement programs can be politically unpopular. The Simpson-Bowles proposal did not gain the 14 votes required to send the plan to Congress.

In August 2011, a crisis in government funding almost occurred when Congress appeared ready to prevent the raising of the debt ceiling—the maximum amount of money the United States can borrow. The deal they reached at the last moment (the Budget Control Act of 2011) places annual caps on discretionary spending and created the Joint Select Committee on Deficit Reduction (the "Super Committee")--6 Senators and 6 Representatives from both parties who were given the task of finding a minimum of $1.2 trillion in spending cuts spread out over 10 years.

Since the "Super Committee" failed to come to an agreement by their November 2011 deadline, significant automatic spending cuts were triggered for FY 2013 in both national security and non-security discretionary spending—cutting $85 billion from FY 2013 the budget. These across-the board cuts (known as "sequestration") meant drastic cuts not only for the military, but for programs in areas such as medical research, clean air, and transportation.

Even with these cuts, however, the government reached another crisis over the federal budget this past fall over the FY 2014 federal budget and another raising of the debt ceiling. The government was partially shut down for the first 16 days of the fiscal year (October 1-16, 2013) and was only reopened when both parties agreed to pass a continuing resolution which gave them another three months to come up with a budget agreement. In December 2013, the government agreed to scale back some--not all--of the significant sequestration budget cuts for FY 2014 and 2015 which would have been required under the Budget Control Act of 2011.

Chart 4: The Federal Deficit



Source: Congressional Budget Office

Glossary

Appropriation

An appropriation is an act of Congress that enables federal agencies to spend money for specific purposes.

Balanced Budget

A balanced budget occurs when total revenues equal total outlays for a fiscal year.

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.

Continuing Resolution

Legislation used by Congress to fund the government if appropriations have not been signed into law by the beginning of the fiscal year.

Debt

See "National Debt."

Debt Ceiling

Enacted in 1917, this law limits the amount of money the United States can borrow.

Deficit

The deficit is the difference produced when spending exceeds revenues in a fiscal year.

Deficit Spending

Deficit spending occurs when the government's revenues do not cover the cost of all its spending and it borrows money to finance its programs, using that borrowed money to pay for items in the budget.

Discretionary Spending

Discretionary spending is what the President and Congress must decide to spend for the next fiscal year through annual appropriations bills. Examples include money for such programs as the FBI, the Coast Guard, housing, education, space exploration, highway construction, 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.

Fiscal Year

The fiscal year is the government's accounting period. It begins October 1 and ends on September 30. For example, fiscal year 2014 ends September 30, 2014.

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 (Non-discretionary Spending)

Mandatory spending (also called non-discretionary 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 do so.

National Debt

When revenues do not cover the costs of government spending, the government borrows money to finance this deficit. The total it has borrowed over the years, but not repaid, is the national debt.

OMB

Part of the Executive Office, the Office of Management and Budget assists the President in the development and implementation of the federal budget.

Revenue

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.

Sequestration

Automatic, across-the-board, spending cuts that apply to all programs and activities of government agencies.

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.