Understanding the Federal Budget [1]

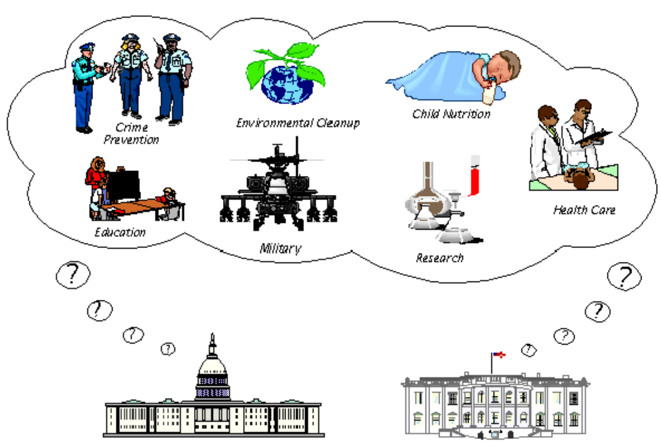
"For in the end, a budget is more than simply numbers on a page. It is a measure of how well we are living up to our obligations to ourselves and one another."
--From *Remarks by the President on the Fiscal Year 2010 Budget*,
President Barack Obama, February 26, 2009

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 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 large a deficit the government needs to run in order to stimulate our distressed economy. In this overview, we will discuss these decisions in some detail--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* (http://www.gpoaccess.gov/usbudget/fy01/pdf/guide.pdf and http://www.gpoaccess.gov/usbudget/fy02/pdf/guide.pdf). Note that most numbers and dates have been adapted to reflect the 2010 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 2011 budget document embodies the President's budget proposal to Congress for fiscal year 2011, which begins on October 1, 2010. 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 the FY (fiscal year) 2010, the federal government had forecasted that it would receive $2.3 trillion in tax revenues.

Revenues come from these sources:

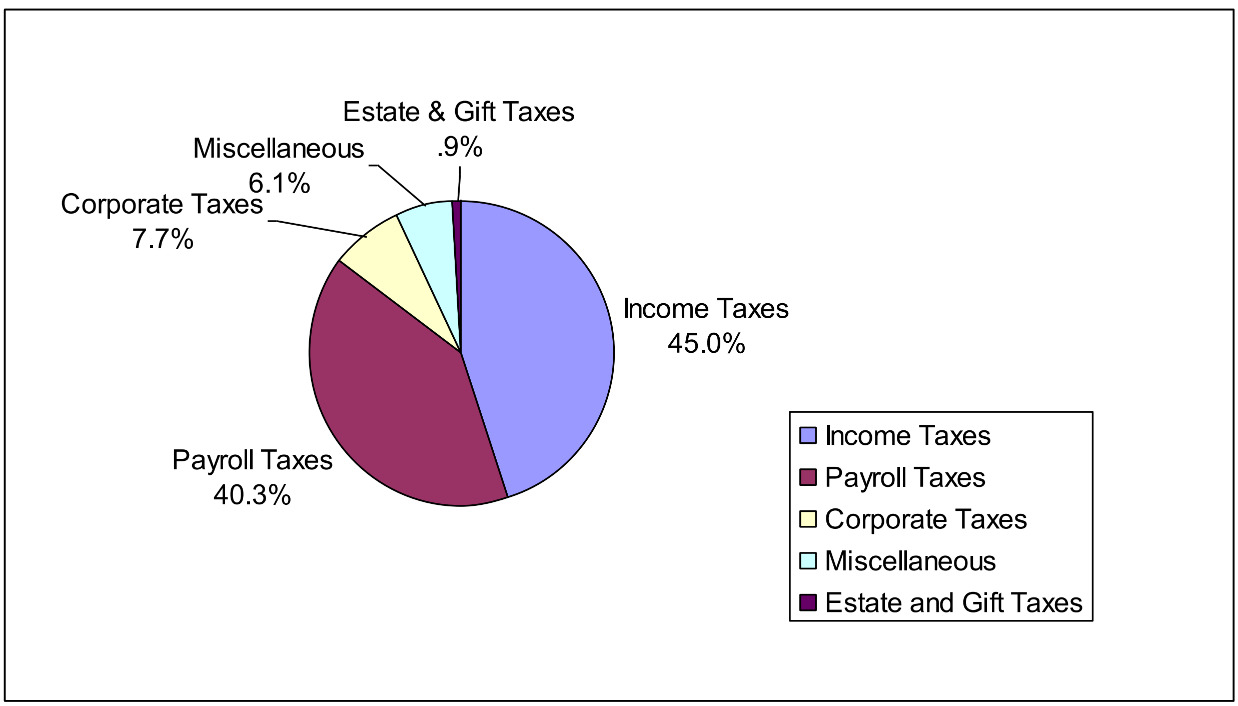
Table 1. FY 2010 Estimated Federal Taxes

Source	Amount (Billions)	Percentage
Individual Income Taxes	1,051	45.0%
Payroll Taxes (Social Security, Medicare, Unemployment insurance, and other retirement)	940	40.3%
Corporate Taxes	179	7.7%
Miscellaneous*	143	6.1%
Estate and Gift Taxes	20	.9%
Total Collected	2,333	100%

From: http://www.whitehouse.gov/omb/budget/fy2010/assets/summary.pdf, Table S-4

* 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 2010 Estimated Federal Taxes



Spending

To better understand federal spending, let's look briefly at the FY 2010 federal budget in which the government projected it would spend approximately $3.6 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. (See page 7.)

- The largest federal mandatory spending program is Social Security, which provides monthly benefits to over 45 million retired and disabled workers, their dependents, and survivors. The government projected it will spend approximately $696 billion on this program, which they calculated would account for approximately 20% of all federal spending.

- Medicare provides health care coverage for over 40 million elderly Americans and people with disabilities. The government projected it will spend $452 billion on this program, approximately 13% 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. These programs account for $290 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 $604 billion, approximately 17% of all federal spending.

- Discretionary defense spending for FY 2010 was budgeted at approximately $707 billion, comprising approximately 20% 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 19% of the budget.

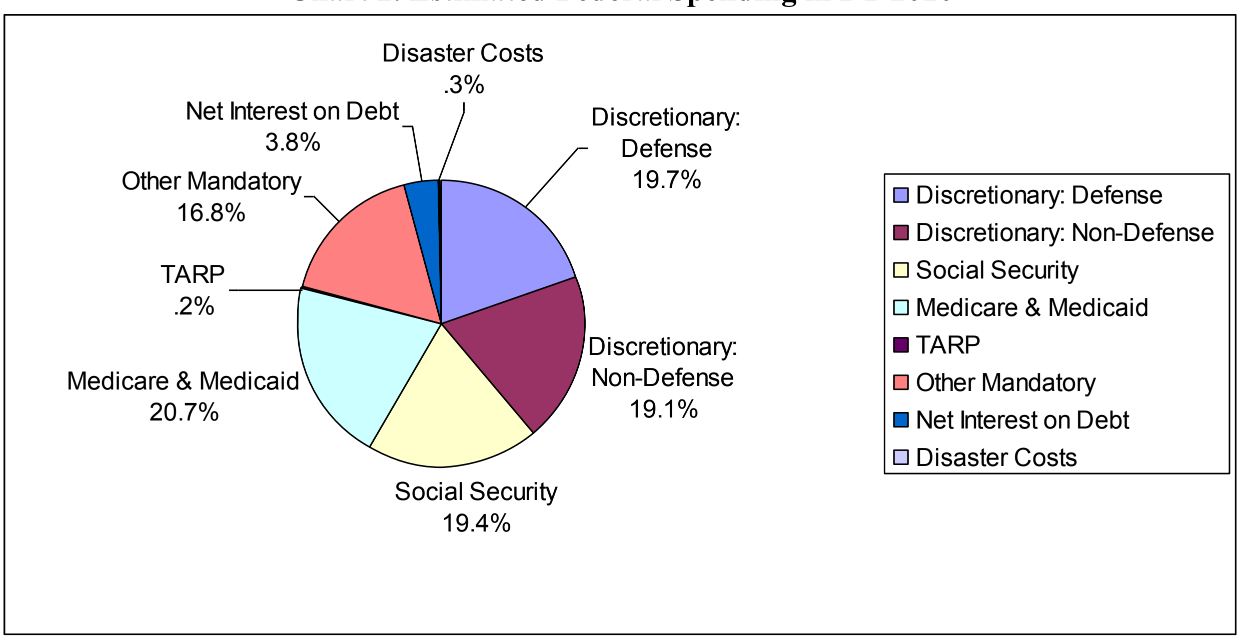
- Interest payments are payments made to pay back the interest on the federal debt. This accounts for $136 billion or approximately 4% of the federal budget. As the government increases the size of its debt, the amount of interest that must be paid increases.

Table 2. Estimated Federal Spending in FY 2010

Budget Item	**Amount (Billions)**	**Percentage**
Discretionary:		
Defense	707	19.7%
Other Discretionary	687	19.1%
Mandatory:		
Social Security	696	19.4%
Medicare & Medicaid	742	20.7%
TARP	8	.2%
Other Mandatory	604	16.8%
Net Interest on Debt	136	3.8%
Disaster Costs*	11	.3%
Total	3,591	100 %

*These costs represent the statistical probability of a major disaster requiring federal assistance for relief and construction. Such assistance might be provided in the form of discretionary or mandatory spending or tax relief. These amounts are included as spending for convenience.
http://www.whitehouse.gov/omb/budget/fy2010/assets/summary.pdf, Table S-4

Chart 2. Estimated Federal Spending in FY 2010



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 2011 budget, President Obama submitted his budget to Congress on February 1, 2010. Occasionally, however, Presidents have sent it later for various reasons. For example, in a year with a transition between outgoing and incoming Administrations, the timing may change. In late February 2009, President Obama provided a broad outline of his budget request for FY 2010 to Congress. A more detailed budget was submitted in May 2009.

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 2011--that is, October 1, 2010 to September 30, 2011--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 2011	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 2009 – January 2010
State of the Union Address	The President speaks to the country about his priorities for the year ahead.	Late January/Early February 2010

Budget preparation and submission	The budget documents are completed by the OMB and sent to Congress.	January 2010 – February 2010
Congressional action	Congress reviews the President's budget, develops its own, and eventually approves spending and revenue bills.	March 2010– September 2010
President's final approval	President signs spending and revenue bills to make them law.[2]	Late September 2010
Fiscal year begins		October 1, 2010
Budget implemented	Agency program managers begin to spend (and raise) the money approved by the Congress and the President.	October 1, 2010 through September 30, 2011

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--explained below.

- 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, the Coast Guard, housing, education, space exploration, highway construction, defense, and foreign aid. Discretionary spending for FY 2010 was estimated to account for 39% of all federal spending.

- Mandatory spending, which accounts for approximately 61% of all spending in FY 2010, is authorized by permanent laws, not by the annual appropriations bills. It includes entitlements--such as Social Security, Medicare, 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.

[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 these budget bills.

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.

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 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 and achieving the intended results and are operating consistently within legal requirements.

4. Supplemental Spending

Sometimes the President requests that Congress go outside the regular appropriations process to provide "emergency" funding for particular situations. From 1975-2002, supplemental spending averaged $14 billion a year. In the past seven years, however, supplemental spending has skyrocketed, first through military spending for military operations in Iraq and Afghanistan, and more recently, in financial rescue programs.

Supplemental Spending for Military Operations
Under President Bush, military operations in Iraq and Afghanistan were mostly funded by supplemental spending that was not included in his proposed budgets. President Obama promised to end this practice, so for FY 2010 the $130 billion he requested in supplemental spending to pay for war costs was included in his proposed budget.

Financial Rescue Programs for FY 2007-2010
Due to the economic downturn, several financial rescue programs have been implemented by the federal government. These are some of the programs:

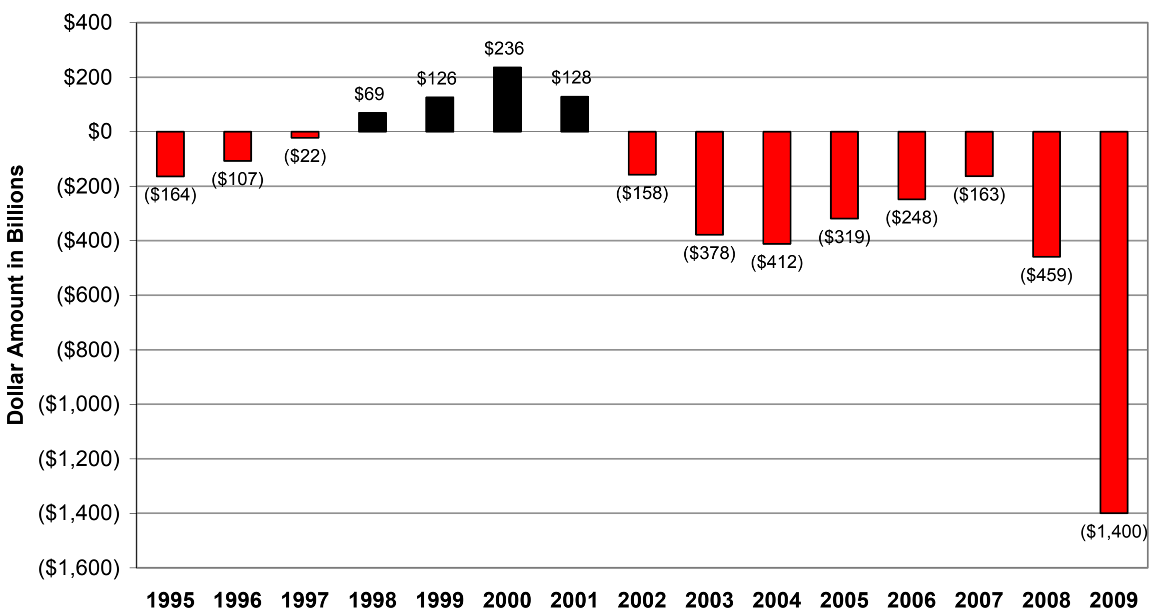
> **TARP**
> The Troubled Asset Relief Program (TARP) was signed into law October 3, 2008 in order to ease the credit crisis in our ailing economy. It provides the U.S. government with up to $700 billion to help failing financial institutions. Some of that money is already being repaid by these financial institutions.
>
> **American Recovery and Reinvestment Act**
> On February 13, 2009, Congress passed an economic stimulus package of $787 billion in new spending and tax cuts over the next several years to jump-start the economy and save jobs. The stimulus program provides aid to state governments, tax cuts for workers and

businesses, expansion of health and unemployment benefits, and significant investments in areas such as infrastructure, renewable energy, and education.

5. Surpluses and Deficits

When President Clinton was first elected in 1992, the federal budget was in a deficit. During the 1990's, as a result 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. In October 2009, the Congressional Budget Office (CBO) estimated a deficit for FY 2009 of $1.4 trillion—a figure that includes the cost of the cost of TARP and stimulus spending for the fiscal year. See Chart 4 (the dollars represent billions of dollars).

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.

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 2010 ends September 30, 2010.

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.

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.

Understanding the Federal Budget Review Questions

Please answer the following questions (use back of this page if necessary).

1. When the President and Congress begin to create a budget for the coming year, they must make some key determinations. What are the three things they must determine?

    1.

    2.

    3.

2. What is it called when the government spends more money than it brings in?

3. Where do most federal government dollars come from? (What is the federal government's primary source of funds?)

4. What program accounts for more federal spending than any other? Describe this program.

5. Explain the difference between mandatory and discretionary spending? Provide an example of each kind of spending.

6. On what day is the President's budget usually submitted to Congress for its approval?

7. What has to happen, and who has to agree, for the 2011 budget to finally become law?

8. Why has supplemental spending increased dramatically since 2002?