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FY 1998 Budget Leaves Problems Unresolved for Next Administration

While the Clinton Administration's proposed fiscal year 1998 budget contains a plan that it claims will eliminate the federal red ink by FY 2002, it does little to address the nation's long-term fiscal maladies. Tax Foundation Economist Patrick Fleenor's new Special Report on the budget observes that just over the five-year budget horizon, the deficit will re-emerge as a major problem, driven by the rapid growth of entitlement spending. (See *Charts 1* and *3* for a comparison of mandatory and discretionary spending.) "Without entitle-

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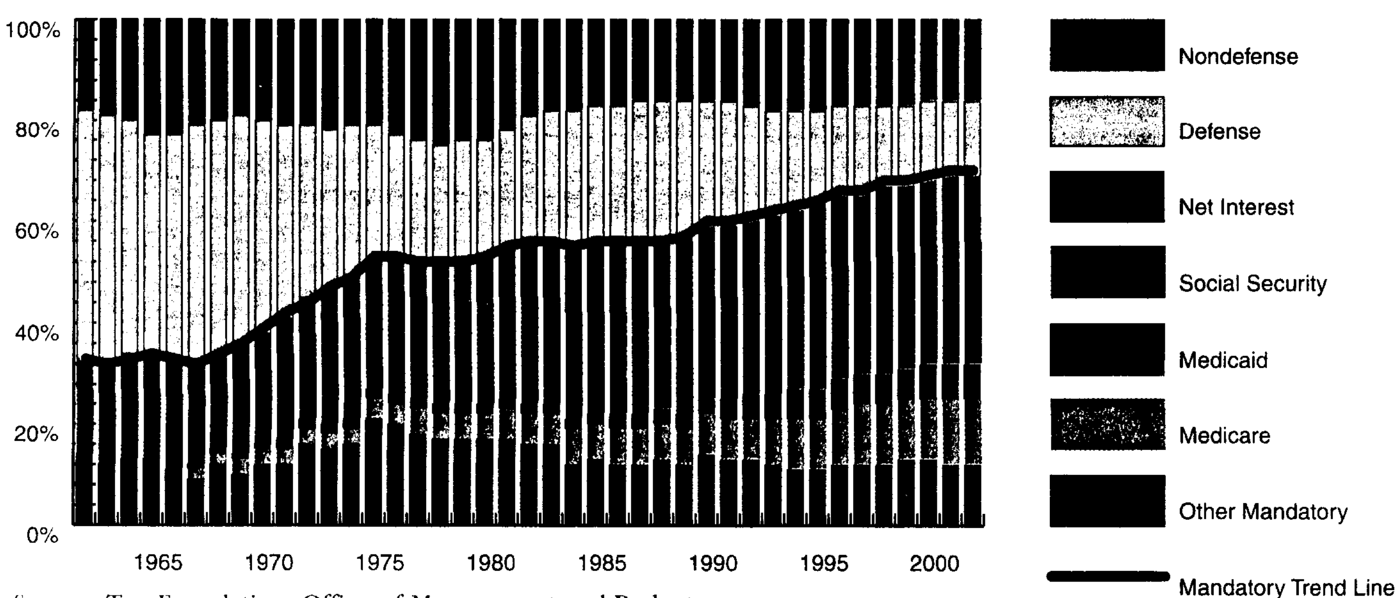
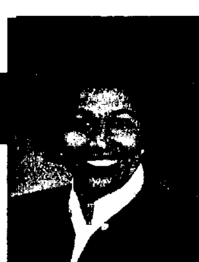
Chart 1: Types of Federal Outlays as a Percent of Total Federal Outlays. Fiscal Years 1962–2002



Source: Tax Foundation, Office of Management and Budget.



FRONT & CENTER

A Case for the Balanced Budget Amendment

Senator Carol Moseley-Braun (D-Ill.)

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FY 1998 Budget Leaves Problems Unresolved

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ment reform, the deficit will rapidly rise to levels that could threaten the economic well being of Americans during the early part of the next century."

Prior to that, however, the Office of Management and Budget projects rapidly falling deficits. To accomplish this objective the Administration would slow the growth of federal expenditures over the next five years, particularly those for Medicare. On the revenue side of the ledger, the Clinton plan contains a set of very modest tax provisions that it says will cut selected taxes by $98.4 billion over the next five years. But these losses in revenue are more than made up for by other provisions of the plan which would raise a host of other taxes and fees by $123.3 billion over that period.

The plan also assumes that continued economic growth will provide a steadily increasing level of federal receipts. Mr. Fleenor, however, notes that these revenue levels are high by historical standards.

In Chart 1, federal outlays are divided into two broad spending categories: discretionary and mandatory plus net interest. Levels of spending for programs funded by discretionary outlays are determined by the annual appropriations process, while spending levels for programs funded by mandatory outlays are determined by statute. Mr. Fleenor further divides these two broad categories into their major components. The thick line delineating the two types of spending in the chart illustrates how the composition of federal outlays has changed over the past three decades: Until the late 1960s, more than 70 percent of all federal spending was discretionary, controlled by the annual appropriations process, while today mandatory expenditures plus net interest constitute almost 70 percent.

Because the Clinton plan would reduce the growth of discretionary outlays proportionally more than it would mandatory and net interest outlays, the share of overall federal expenditures dedicated to mandatory spending would rise under the President's plan, from 67.6 percent in FY 1998 to 69.8 percent in FY 2002. The data in Chart 3 show that reductions in the rate of growth of Medicare outlays would account for the bulk of savings under the Clinton plan. Under the Clinton plan,

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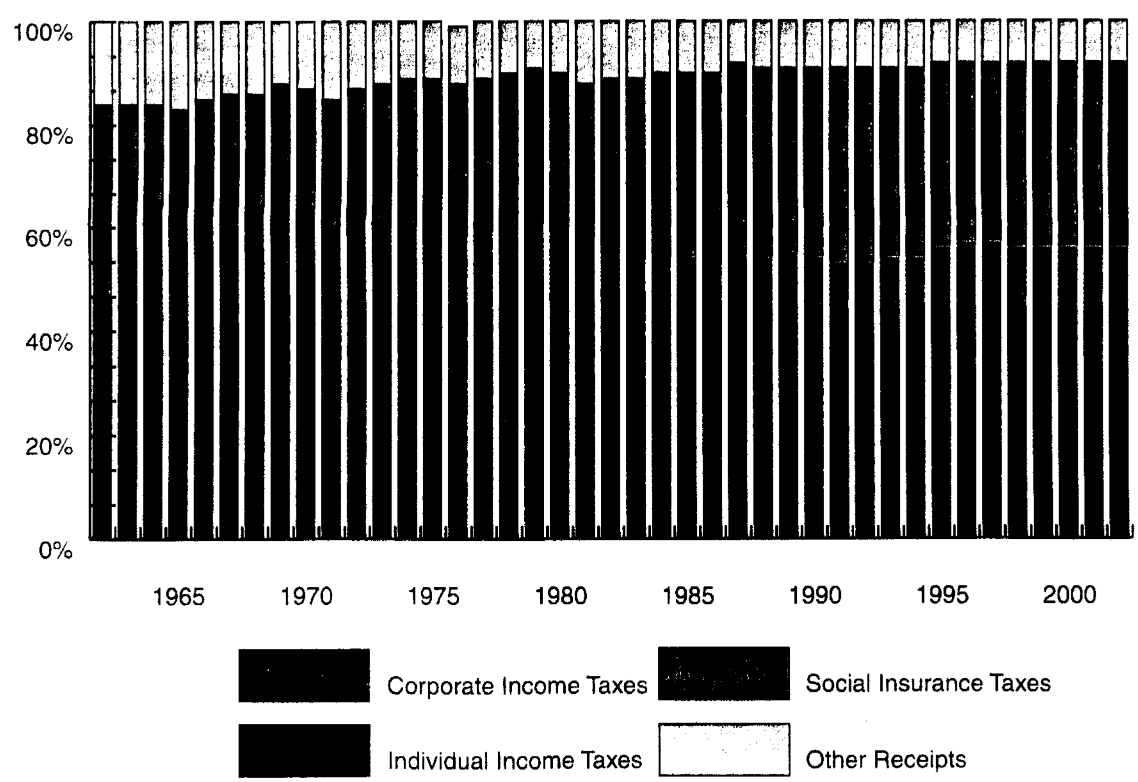
Chart 2: Total Federal Receipts by Source, Fiscal Years 1962–2002



Source: Tax Foundation, Office of Management and Budget.

President Sets Federal Budget on Cruise Control

Budget

Continued from page 2

Medicare spending would rise from $204.3 billion in FY 1998 to $260.5 billion in FY 2002, slightly less than under current law.

The Clinton plan, however, would not alter any of the laws governing Social Security. Outlays for Social Security are expected to increase from $380.9 billion in FY 1998 to $459.7 billion in FY 2002.

On the revenue side, the Clinton budget contains a mix of modest, "targeted" tax relief measures that it claims would reduce Americans' tax burden by $98.4 billion over the next five years. The highlights of this package include a $500 per child tax credit, tax measures to assist individuals with post-secondary education expenses, a broadening of the eligibility of tax-deductible individual retirement accounts, an elimination of the capital gains tax on the proceeds of home sales up to $500,000, and some estate tax relief for family-owned small businesses and farms. The Clinton plan would more than make up for these losses in revenue by increasing a host of other taxes and fees by $123.3 billion over the next five years.

The modest nature of the Clinton revenue proposals, however, means that their net effects will have a negligible impact on both the composition and level of federal receipts over the next five years. (See Charts 2 and 4.) Because most of the Clinton proposal's tax relief measures would affect individual income taxes, revenue from this type of tax would be slightly lower under its plan than under current law.

In FY 1997 the corporate income tax is estimated to raise $185.0 billion, or 12.4 percent of federal revenue. As

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Chart 3: Federal Outlays by Type, Fiscal Years 1962 - 1997 ($Billions)

		Discretionary			Mandatory						
	Total Outlays	Outlays	Defense	Non-Defense	Outlays	Social Security	Medicare	Medicaid	Other	Net Interest	Memo: GDP
1962	$106.8	$72.1	$52.6	$19.5	$27.9	$14.0	$-	$0.1	$13.8	$6.9	$567.3
1963	111.3	75.3	53.7	21.5	28.3	15.5	-	0.2	12.6	7.7	599.0
1964	118.5	79.1	55.0	24.1	31.2	16.2	-	0.2	14.8	8.2	639.8
1965	118.2	77.8	51.0	26.8	31.8	17.1	-	0.3	14.4	8.6	686.8
1966	134.5	90.1	59.0	31.2	35.0	20.3	-	0.8	13.9	9.4	752.7
1967	157.5	106.4	72.0	34.4	40.7	21.3	2.5	1.2	15.7	10.3	811.9
1968	178.1	117.9	82.2	35.8	49.1	23.3	4.4	1.8	19.6	11.1	868.0
1969	183.6	117.3	82.7	34.6	53.7	26.7	5.4	2.3	19.3	12.7	948.1
1970	195.6	120.2	81.9	38.3	61.1	29.6	5.8	2.7	23.0	14.4	1,009.4
1971	210.2	122.5	79.0	43.5	72.9	35.1	6.2	3.4	28.2	14.8	1,077.4
1972	230.7	128.4	79.3	49.1	86.8	39.4	7.0	4.6	35.8	15.5	1,177.0
1973	245.7	130.2	77.1	53.1	98.1	48.2	7.6	4.6	37.7	17.3	1,306.8
1974	269.4	138.1	80.7	57.3	109.8	55.0	9.0	5.8	40.0	21.4	1,438.1
1975	332.3	157.8	87.6	70.2	151.3	63.6	12.2	6.8	68.7	23.2	1,554.5
1976	371.8	175.3	89.9	85.4	169.8	72.7	15.0	8.6	73.5	26.7	1,730.4
1977	409.2	196.8	97.5	99.3	182.5	83.7	18.6	9.9	70.3	29.9	1,971.4
1978	458.7	218.5	104.6	113.8	204.8	92.4	21.8	10.7	79.9	35.5	2,212.6
1979	504.0	239.7	116.8	122.9	221.7	102.6	25.5	12.4	81.2	42.6	2,495.9
1980	590.9	276.1	134.6	141.5	262.3	117.1	31.0	14.0	100.2	52.5	2,718.9
1981	678.2	307.8	158.0	149.7	301.7	137.9	37.9	16.8	109.1	68.8	3,049.1
1982	745.8	325.8	185.9	139.9	334.9	153.9	45.3	17.4	118.3	85.0	3,211.3
1983	808.4	353.1	209.9	143.3	365.4	168.5	51.2	19.0	126.7	89.8	3,421.9
1984	851.9	379.2	228.0	151.2	361.5	176.1	56.0	20.1	109.3	111.1	3,812.0
1985	946.5	415.7	253.1	162.6	401.3	186.4	64.1	22.7	128.1	129.5	4,102.1
1986	990.5	438.4	273.8	164.5	416.1	196.5	68.4	25.0	126.2	136.0	4,374.3
1987	1,004.2	444.0	282.5	161.5	421.5	205.1	73.4	27.4	115.6	138.7	4,605.1
1988	1,064.5	464.3	290.9	173.4	448.3	216.8	76.9	30.5	124.1	151.8	4,953.5
1989	1,143.7	488.7	304.0	184.7	485.7	230.4	82.7	34.6	138.0	169.3	5,351.8
1990	1,253.2	500.4	300.1	200.3	568.5	246.5	95.8	41.1	185.1	184.2	5,684.5
1991	1,324.4	533.3	319.7	213.6	596.6	266.8	102.0	52.5	175.3	194.5	5,858.8
1992	1,381.7	534.5	302.6	231.9	647.8	285.2	116.2	67.8	178.6	199.4	6,143.2
1993	1,409.4	541.0	292.4	248.5	669.7	302.0	127.9	75.8	164.0	198.8	6,470.8
1994	1,461.7	543.9	282.3	261.6	714.9	316.9	141.8	82.0	174.2	203.0	6,830.4
1995	1,515.7	545.6	273.6	272.1	737.9	333.3	156.9	89.1	158.6	232.2	7,186.9
1996	1,560.3	534.4	266.0	268.4	784.9	347.1	171.3	92.0	174.5	241.1	7,484.7
1997	1,631.0	550.0	268.0	282.1	833.6	364.2	191.6	98.5	179.3	247.4	7,853.8

Source: Tax Foundation; Office of Management and Budget.

A Case for the Balance Budget Amendment

By Senator Carol Moseley-Braun

I am a liberal, and I support a Balanced Budget Amendment to the United States Constitution. To some, this statement might appear a contradiction in terms. To others, including my predecessor in office, Senator Paul Simon, the statement is as logically consistent as the classical definition of liberalism.

Webster's New World Dictionary defines liberalism as:

> ...belonging to the people; giving freely, generous; tolerant of views differing from one's own; broad minded; favoring reform or progress...as in education; favoring political reforms tending toward democracy and personal freedom for the individual; progressive.

It is precisely because I care about maintaining the appropriate balance of governmental activism and private

> ***Chronic budget deficits and the cumulative national debt threaten to crowd out priorities which serve the public interest. Every day, $684 million of our national resources go to pay interest on that debt. We now devote 15¢ on every tax dollar to debt service; it was 1.6¢ per dollar 40 years ago.***

initiative that I believe the Balanced Budget Amendment is necessary. Chronic budget deficits and the cumulative national debt threaten to crowd out priorities which serve the public interest. Every day, $684 million of our national resources go to pay interest on that debt. We now devote 15¢ on every tax dollar to debt service; it was 1.6¢ per dollar 40 years ago.

This debt did not emerge out of a national emergency, nor from some massive federal initiative to build roads or educate children. It came in peace time, and largely while no one noticed. When a national consensus against chronic deficits did emerge, it came after the debt had reached historic proportions.

We should have known better. George Washington, in his farewell address, warned the nation:

> As a very important source of strength and security, cherish public credit. One method of preserving it is to use it as sparingly as possible, avoiding occasions of expense by cultivating peace, but remembering also that timely disbursements, to prepare for danger, frequently prevent much greater disbursements to repel it; avoiding likewise the accumulation of debt, not only by shunning occasion of expense, but by exertions in times of peace to discharge the debts which unavoidable wars may have occasioned, not ungenerously throwing upon posterity the burdens which we ourselves ought to bear.

Sage advice from the founding fathers did not nor could not overcome the ineluctable pressures of the political and demographic realities of our times. In the just instance, the legislative process rewards the appropriations experts. Legislators are often judged by constituents on their ability to "bring home the bacon," whether in terms of actual "pork barrel" projects or in terms of across-the-board program funding. From automatic cost-of-living adjustments for entitlements to massive military spending, each and every constituency wants its share of the collective fund. Each has legitimate rationale for its demands, whether protecting seniors from the ravages of inflation, or creating jobs for the technocrats, technicians, scientists, and washers whose employment depends on military purchases.

However, these constituency demands must be seen in the long term and overarching context of our responsibility to the public interest. The demographic bubble will mean more demand, not less, for health care and retirement security, at precisely the time that changes in technology and the global economy require more, not less, investment in education, transportation, and infrastructure. The

confluence of these trends, which government cannot control, makes it more important than ever that we make decisions about those things we do control.

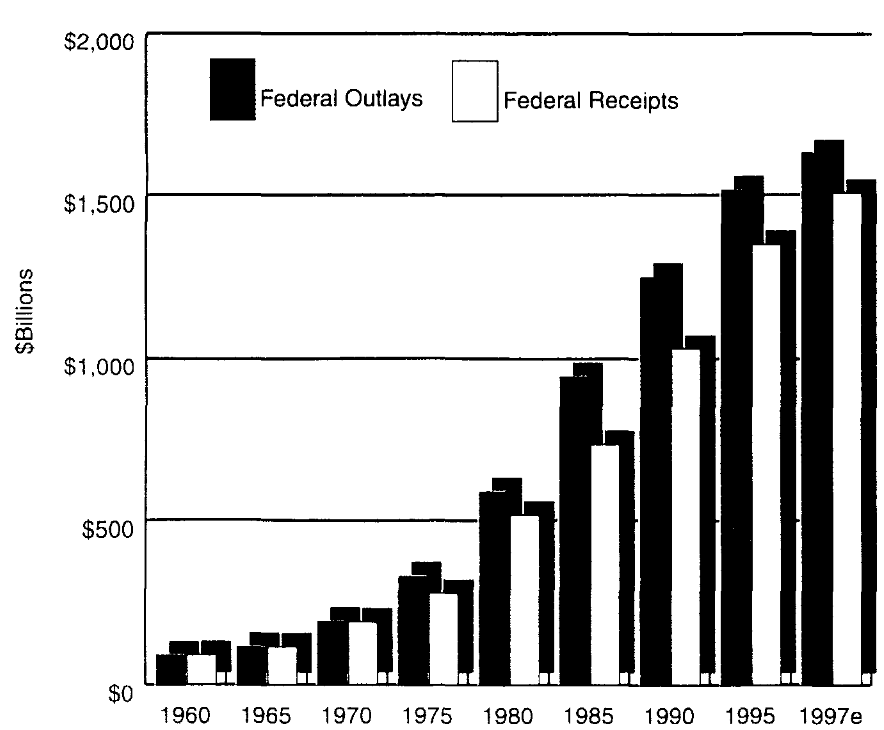
I am not keen about tinkering with the Constitution. Happily, the founding fathers envisaged the periodic popularity of constitutional amendments, and required absolute consensus in the process. Right now, there are 53 pending constitutional amendments; 773 have been introduced since 1990, more than all the amendments proposed since the founding of the republic. I hope the Balance Budget Amendment is one of the few to make it through the Congress and ratification by the states.

An economist friend argues that we should not be concerned about the debt because it is money we owe ourselves. After all, the interest is paid on Treasury bonds, so reduced to its essentials, it is money recirculated in other ways. I would argue that if that is so, then the recirculation is precisely the problem, putting "off the books" and out of Congress's control scarce resources which are then no longer available for our national priorities. He argues further that the Balanced Budget Amendment does not allow for capital investment in preparation for national emergency. While most states which have a balanced budget requirement do provide for a separate capital budget, this limitation, as with national emergencies, can yet be overcome under the same vote required to waive the Balanced Budget Act.

I come from a working class family. Availability of public education made it possible for me to get advanced degrees. I have no doubt that, without the commitment my parents' generation made to create a national community which nurtured my talents, I would not be here today speaking to you as a United States Senator. It saddens me that it is harder for a child to get a quality education, or for a teenager to pay for college, or for a young couple to have a single-wage earner outside the home today than it was a generation ago. The recent dismantling of the national commitment to support poor children is just the beginning of the chilling effect that chronic budget deficits will have. We are faced with making the hard choices by which this generation will define our national community.

I have no doubt that this generation of Americans is as compassionate, creative, and patriotic as previous generations were. We will be forced to make artificially draconian choices if we continued to spend what we don't have, and delude ourselves that debt passed on to future generations isn't debt. The Balanced Budget Amendment will force a fiscal discipline which must be the first step toward ensuring that our generation will honestly address its needs so that future generations will have at least the same opportunity. •

Federal Outlays v. Federal Receipts, 1960–1997e



Source: Office of Management and Budget.

The Tax Foundation invites a national leader to provide a "Front and Center" column each month in Tax Features. *The views expressed in these columns are not necessarily those of the Tax Foundation.*

Budget Deficits Start Downslide—Or Do They?

The federal government has officially run a budget deficit every year since 1969, according to records kept by the Office of Management and Budget. That means in each fiscal year for more than a quarter of a century, total federal expenditures have surpassed total federal revenues.

While this time span and the accompanying levels of deficits are unprecedented in U.S. history, the practice of running a budget deficit isn't new. There have in fact only been eight budget-surplus years over the past half century. Two occurred in the 1960s, three in the 1950s, and three in the 1940s.

Yet relying on borrowed dollars to keep the government open isn't the norm, either. Under Presidents Harding, Coolidge, and Hoover, the federal government made it through the entire decade of the 1920s in the black. The government also managed to operate from 1866 to 1893 without experiencing a single budget deficit.

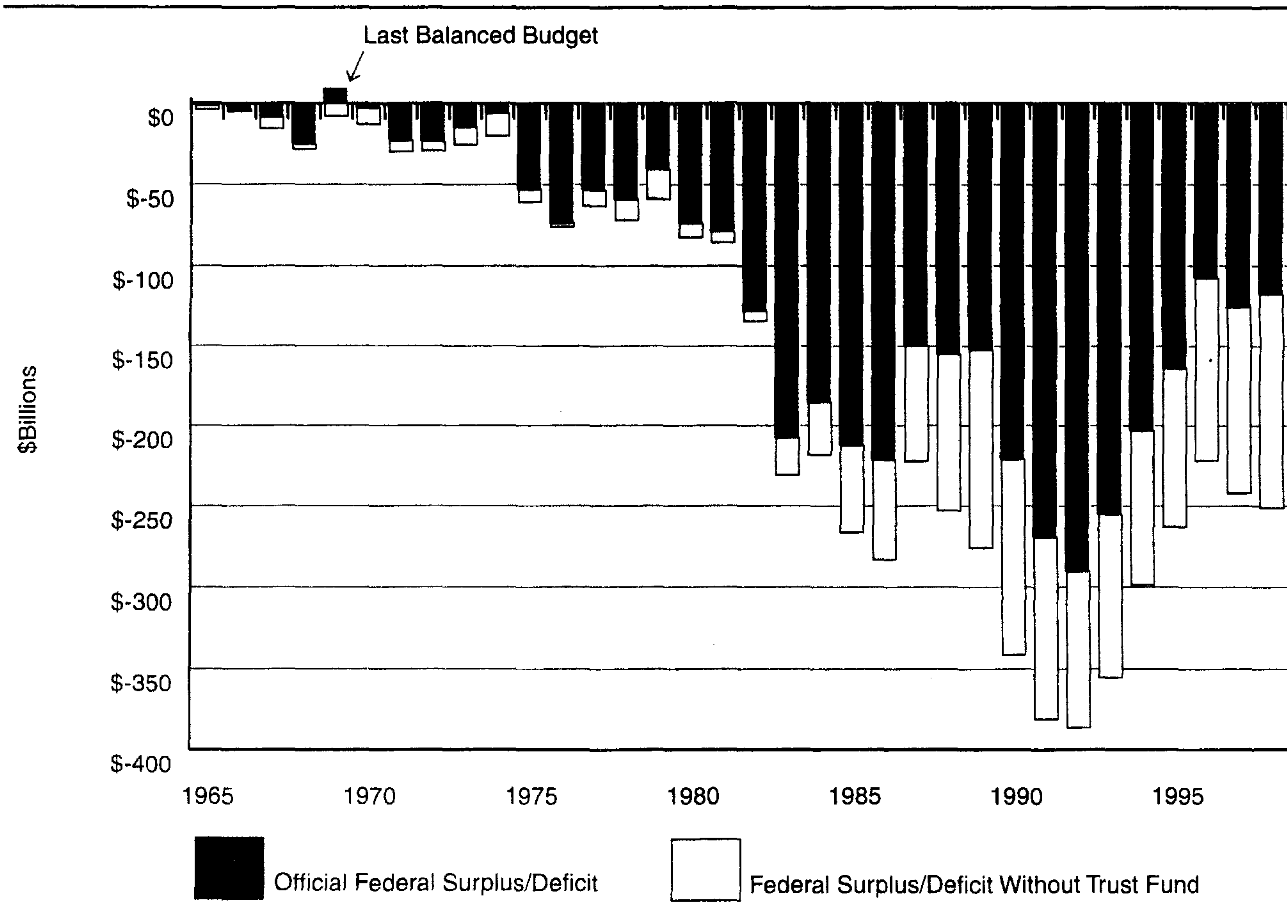
President Clinton's latest budget shows that the annual deficit fell about 170 percent between 1992 and 1996 (from $290 billion to $107 billion).

Yet even with this trend of shrinking deficits in recent years, the overall picture for Uncle Sam isn't so rosy. When the federal government takes an end-of-the-year accounting to determine if it will be in the red or in the black, budget officials include in their calculations any surplus monies in the federal Trust Funds. That is, although the Trust Funds — including Social Security and Medicare — are allegedly earmarked for specific spending purposes, these dollars are made available for accounting purposes.

Thus, in the current fiscal year, while the Clinton Administration is projecting a budget deficit of $125.6 billion, if the Trust Funds are not counted that deficit rises to $242.2 billion (see chart below). In fact, while the Administration projects a budget surplus of $17 billion in fiscal year 2002, if the Trust Funds are removed from the calculation, the actual balance of accounts will stand at -$145.1 billion that year.

Of course, while Trust Funds are legally off limits for general outlays, the funds in them are in fact used to enable Congress and the President to maintain spending levels without increasing the deficit. ●

Official Federal Budget Surplus/Deficit and Actual Federal Budget Surplus/Deficit, FY 1965–1998



Source: Tax Foundation, Office of Management and Budget.

FOUNDATION MESSAGE

Correct Observation, Wrong Conclusion

J.D. Foster
Executive Director
& Chief Economist

A recent *Washington Post* editorial in opposition to the Balanced Budget Amendment (BBA) underscored one of the few valid arguments actually supporting such an amendment. The *Post's* misfire should surprise no one. A curious thing about the balanced budget debate is that most of the arguments on both sides are downright ridiculous. For example, the White House recently released a letter to Senate Minority Leader Tom Daschle suggesting that a BBA could threaten Social Security checks. Another way of saying this is that a BBA could threaten federal spending. Typical of Washington, the White House adopted the Washington Monument strategy.

The real benefit of the Balanced Budget Amendment is not to get the budget balanced today or tomorrow. It is to break the habit in recent years of legislating new programs, or increases in programs, or even allowing them to grow unchecked, without paying for them.

Haven't heard of the Washington Monument strategy? It derives from earlier attempts to reduce funding at the Interior Department generally, or the National Park Service specifically. Any time either agency's funding was threatened, it'd announce the closing of the Washington Monument, along with the Grand Canyon and a few other popular national treasures.

The White House letter was part of a larger strategy — the Social Security gambit — to side-track the Amendment. The idea is to suggest that a balanced budget is fine, but only if Social Security is taken off budget, otherwise, the saying goes, the budget could be balanced on the backs of senior citizens. Assuming for a moment that most legislators are not fools, this strategy is a cynical ruse. For one thing, it is fair to ask why Social Security beneficiaries should be utterly exempt from budget pressures.

For another, there is, in fact, no more politically secure spending in the federal budget, with the possible exception of interest on the debt, than Social Security checks. The Department of Defense would probably be eliminated before those checks were threatened by a sudden and balance budget amendment-prohibited surge in the deficit. Which means the White House's warnings regarding Social Security were, to put it kindly, exaggerated.

Just to be fair, the amendment's proponents are equally as likely to make silly claims. For example, every once and a while a BBA fan will talk about how interest rates are artificially high because of the deficit and would fall dramatically if we would only balance the budget forever more. Newt Gingrich, Speaker of the House, provided a good example of such a claim when, during the Great Budget Debate of 1995-96 he predicted that if a deal wasn't struck eliminating the deficit by 2002, then you'd "see interest rates skyrocket and the stock market crash."

To be sure, some reduction in interest rates is possible, say one or two one-hundredths of a percentage point, if the budget were balanced. But to think that deficits in the ranges currently projected can dramatically affect interest rates set in worldwide capital markets is naive. Just for the record, following the budget compromise in early 1996, the budget deficits continued, interest rates fell, and the stock market rose. As *The Post* wrote of Gingrich at the time, "That's why he's an historian."

Which brings us back to *The Post's* editorial, correctly observing that, with the pending retirement of the baby boomers over the next few years, the costs of federal entitlements such as Social Security and Medicare will explode, far outstripping projected, or even feasible, revenue growth. Therefore, the federal government will need to run enormous deficits and borrow "vast amounts of money." In other words, federal spending needs to soar and a BBA definitely would inhibit this growth. To which one can only say — exactly.

The real benefit of the BBA is not to get the budget balanced today or tomorrow. It is to break the habit in recent years of legislating new programs, or increases in programs, or even allowing them to grow unchecked as with the entitlements, without paying for them.

The upcoming surge in entitlement spending is a case in point. If policymakers decide this spending should grow as fast as projected, believing that is the will of the people, then they should be confident asking taxpayers to foot the bill, either through tax increases or reductions in other spending.

The President's 1998 budget submission also provides plenty of ammunition for BBA proponents. Following a long and hallowed tradition, the Administration budget proposes a net tax increase and still makes little progress on reducing spending until, surprise surprise, the last two years of the budget. With President Clinton working so hard to establish a legacy, no doubt Vice President Gore appreciated his boss leaving something for him to do if he gets a promotion in four years.

Budget

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a result of the corporate income tax provisions contained in the Clinton budget, federal revenue from this type of tax is projected to total $189.7 billion in FY 1998 and then rise to $227.8 billion in FY 2002.

The rapid growth in the share of federal outlays allocated to mandatory spending has been accompanied by a steady increase in the taxes collected to pay for these programs. Under the Clinton budget proposal the federal government would collect $557.8 billion in social insurance taxes during FY 1998, a figure that will climb to $673.1 billion by FY 2002.

Mr. Fleenor observes that the long-term outlook federal finances is potentially bleak. Late in the next decade the baby boom generation will begin to retire and become eligible for Social Security and Medicare. Under current law, the demands these individuals will place on the federal treasury are unsustainable. Even under the most optimistic assumptions, if the federal government attempted to meet these demands it would have to raise taxes to unprecedented levels or go deeply into debt. In either case the economy would likely falter and the economic well-being of Americans could be forever jeopardized.

The Clinton budget contains no major policy proposals for dealing with these massive fiscal problems that lie just over the five year budget horizon. If these problems are not addressed, federal red ink will soon flow at levels that make last year's deficit, which was equal to 1.6 percent of GDP, look responsible. •

Chart 3: Federal Receipts by Source, Fiscal Years 1962–1997 ($Billions)

	Total Receipts	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Other
1962	$99.7	$45.6	$20.5	$17.0	$16.5
1963	106.6	47.6	21.6	19.8	17.6
1964	112.6	48.7	23.5	22.0	18.5
1965	116.8	48.8	25.5	22.2	20.3
1966	130.8	55.4	30.1	25.5	19.8
1967	148.8	61.5	34.0	32.6	20.7
1968	153.0	68.7	28.7	33.9	21.7
1969	186.9	87.2	36.7	39.0	23.9
1970	192.8	90.4	32.8	44.4	25.2
1971	187.1	86.2	26.8	47.3	26.8
1972	207.3	94.7	32.2	52.6	27.8
1973	230.8	103.2	36.2	63.1	28.3
1974	263.2	119.0	38.6	75.1	30.6
1975	279.1	122.4	40.6	84.5	31.5
1976	298.1	131.6	41.4	90.8	34.3
1977	355.6	157.6	54.9	106.5	36.6
1978	399.6	181.0	60.0	121.0	37.7
1979	463.3	217.8	65.7	138.9	40.8
1980	517.1	244.1	64.6	157.8	50.6
1981	599.3	285.9	61.1	182.7	69.5
1982	617.8	297.7	49.2	201.5	69.3
1983	600.6	288.9	37.0	209.0	65.6
1984	666.5	298.4	56.9	239.4	71.8
1985	734.2	334.5	61.3	265.2	73.1
1986	769.3	349.0	63.1	283.9	73.3
1987	854.4	392.6	83.9	303.3	74.6
1988	909.3	401.2	94.5	334.3	79.3
1989	991.2	445.7	103.3	359.4	82.8
1990	1,032.0	466.9	93.5	380.0	91.5
1991	1,055.0	467.8	98.1	396.0	93.1
1992	1,091.3	476.0	100.3	413.7	101.4
1993	1,154.4	509.7	117.5	428.3	98.9
1994	1,258.6	543.1	140.4	461.5	113.7
1995	1,351.8	590.2	157.0	484.5	120.1
1996	1,453.1	656.4	171.8	509.4	115.4
1997	1,505.4	672.7	176.2	535.8	120.8

Source: Tax Foundation, Office of Management and Budget

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