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President's Fiscal Year 1998 Budget Leaves Problems Unresolved for Next Administration

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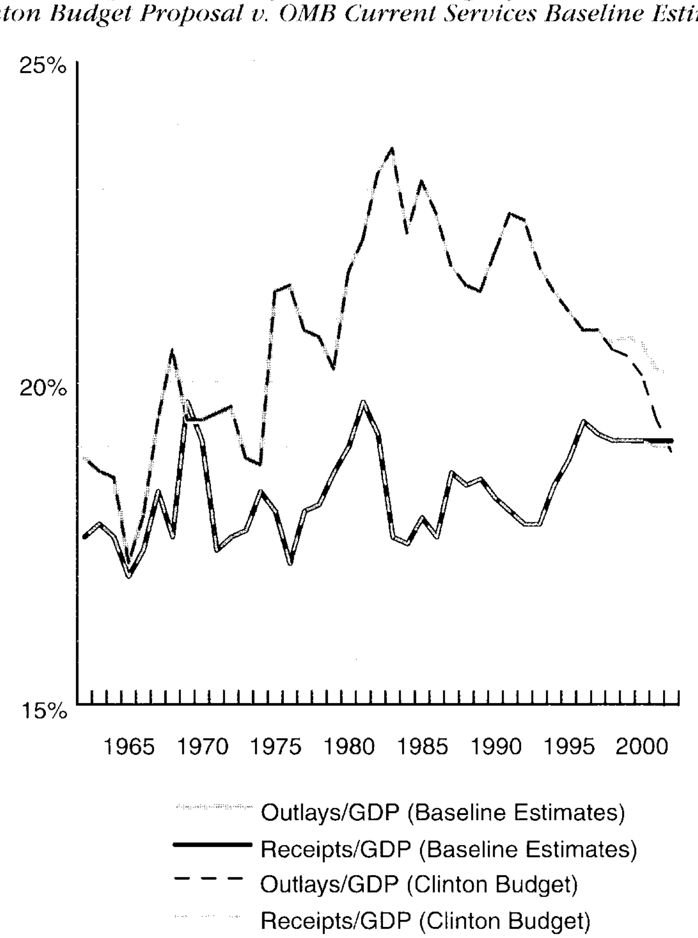
The Clinton Administration's newly proposed fiscal year 1998 budget contains a plan that it claims will reduce the deficit next fiscal year and stem the flow of red ink by FY 2002. To accomplish this objective the Administration would slow the growth of federal expenditures over the next five years, particularly those for Medicare. On the revenue side of the ledger, the Clinton plan contains a set of very modest provisions that it says will cut selected taxes by $98.4 billion over the next five years. 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 produce levels of federal receipts which are high by historical standards.

Figure 1
Federal Receipts and Outlays as a Percentage of GDP, FY 1962-2002
Clinton Budget Proposal v. OMB Current Services Baseline Estimates



Source: Tax Foundation, Office of Management and Budget.

The Clinton plan does little to address the nation's long-term fiscal maladies. Just over the five-year budget horizon the deficit will re-emerge as a major problem, driven by the rapid growth of entitlement spending. Without entitlement 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.

Figure 1 contrasts the Clinton budget proposal (symbolized by dark and light blue dashes) with what would occur if existing laws governing federal entitlement spending remained unchanged and if discretionary spending was allowed to grow with inflation (symbolized by gray and black lines). These latter figures, known as baseline estimates, are calculated by the Office of Management and Budget (OMB). The graph also shows federal outlays and receipts as a percentage of Gross Domestic Product (GDP) since 1962. Presenting federal outlays and receipts in this manner places them on a common scale and allows comparisons to be made over time. The deficit as a percentage of GDP is represented by the distance between these two lines.

Tables 1 and *3* present historical data on the budget. *Tables 2* and *4* provide data on the Clinton proposal as well as the OMB baseline estimates.

Under the Clinton plan federal outlays would be slightly lower than they would be under current law during the first three years of this period.

• During FY 1998 the federal government would spend $1,687.5 billion, or 20.7 percent of GDP, under the Clinton plan. This compares to $1,693.4 billion under current law, a difference of $5.8 billion.

• During FY 1999 the federal government would spend $1,760.7 billion, or 20.2 percent of GDP, under the Clinton plan. Under current law federal spending would total $1,784.8 billion, or 21.1 percent of GDP, during this year.

• The federal government would spend $1,814.4 billion, or 19.7 percent of GDP, in FY 2000 under the Clinton plan. Under current law this figure would be $1,858.6 billion, or 21.0 percent of GDP.

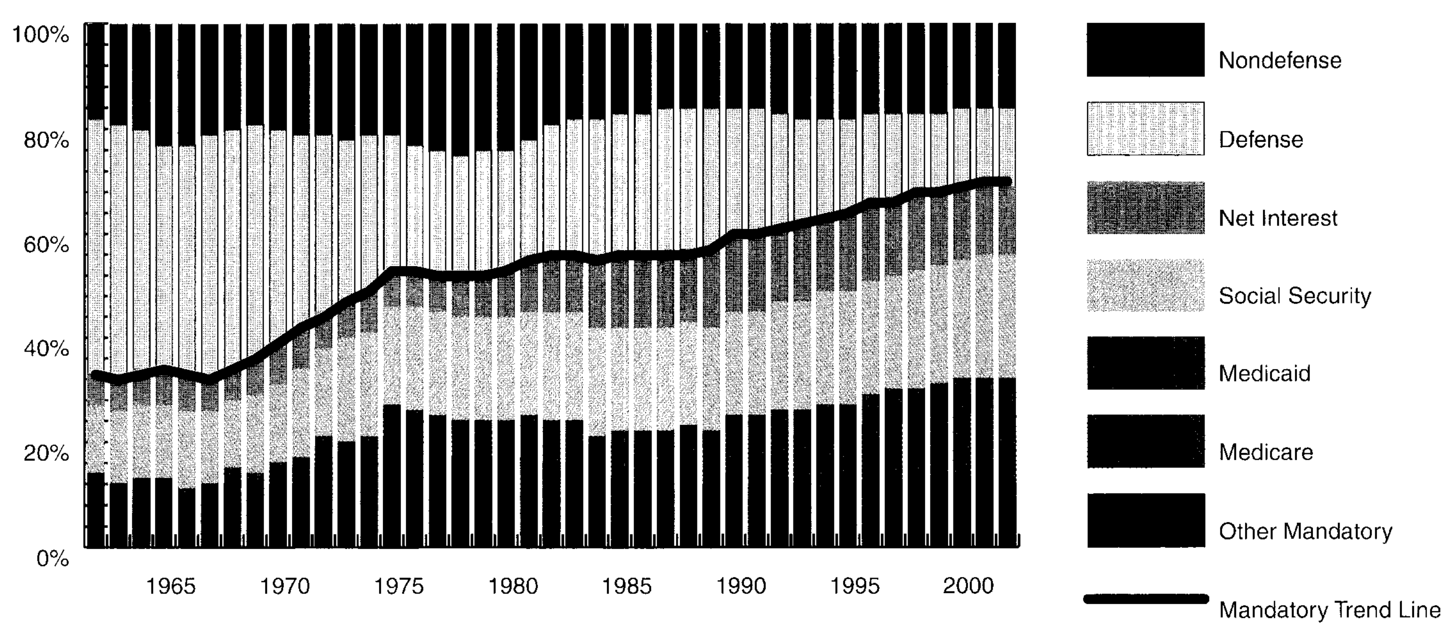
During the final two years (the out years) of the five-year budget plan, the difference between federal outlays under the Clinton plan and those under current law would be considerable. Under the Clinton plan federal outlays would total $1,844.5 billion, or 19.3 percent of GDP, in FY 2001. Under current law outlays would total $1,922.3 billion, or 20.8 percent of GDP, during this fiscal year. In FY 2002 the federal government would spend $1,879.7 billion, or 18.9 percent of GDP, under the Clinton plan. This compares to $2,002.3 billion, or 20.7 percent of GDP, under current law.

On the revenue side of the federal balance sheet, there is very little difference between what the plan proposes and what OMB projects would occur under current law. The Clinton budget projects that federal revenues will average 19.39 percent of GDP during fiscal years 1998 - 2002 under its plan. This is slightly less than the 19.43 percent projected to be collected under current law. The Clinton plan counts $47.3 billion of tax and fee increases as offsets to outlays rather than as revenues. If these funds were treated as revenues, federal revenue as a percent of GDP would be slightly higher under the Clinton plan. These minor differences reflect the very modest nature of the Clinton plan's revenue provisions. Federal receipts would, however, be high by historical standards under the plan. From 1962 to 1997 federal revenues averaged 18.7 percent of GDP.

Federal Expenditures Under the Clinton Budget

The budget shares of the major categories of federal spending under the Clinton plan are illustrated in *Figure 2* by the stacked bar graphs for fiscal years 1998 - 2002. The graph

Figure 2
Types of Federal Outlays as a Percentage of Total Federal Outlays. Fiscal Years 1962-2002



Source: Tax Foundation, Office of Management and Budget.

Table 1
Federal Outlays by Type, Fiscal Years 1962 - 1997
(Billions)

	Total Outlays	Discretionary			Mandatory					Net Interest	Memo: GDP
		Outlays	Defense	Non-Defense	Outlays	Social Security	Medicare	Medicaid	Other		
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.

also contains historical data for fiscal years 1962 - 1997.

In the graph, federal outlays are divided into two broad categories: discretionary and mandatory plus net interest. Levels of spending for programs funded by discretionary outlays are determined by the annual appropriations process. Spending levels for programs funded by so-called mandatory outlays are determined by statutes other than appropriations acts. To alter levels of funding for these types of outlays, a program's authorizing legislation must be amended. The federal government incurs a legal obligation to make interest payments when it issues debt. Because Congress and the President cannot regulate such expenditures through the annual appropriations process, such expenditures are combined with mandatory outlays in the *Figure 2*.

These two broad categories of federal spending are then subdivided into their major components. Discretionary spending is divided into defense and non-defense outlays. Mandatory and net interest outlays are divided into outlays for Social Security, Medicare, Medicaid, other mandatory programs, plus net interest. The budget shares of each of these subcategories are illustrated in the graph.

The thick line delineating the two types of spending in *Figure 2* 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

Table 2
Federal Outlays by Type, President's Proposal and OMB Current Services Baseline, Fiscal Years 1998-2002 ($Billions)

		Discretionary			Mandatory						
	Total Outlays	Total	Defense	Non-Defense	Total	Social Security	Medicare	Medicaid	Other	Net Interest	Memo: GDP
President's Proposal											
1998	$1,687.5	$547.5	$260.1	$287.3	$890.2	$380.9	$204.3	$105.9	$199.1	$249.9	$8,101.4
1999	1,760.7	557.5	262.1	295.4	951.3	398.6	216.8	111.6	224.3	251.8	8,516.8
2000	1,814.4	563.9	267.7	296.2	1,002.3	417.7	226.6	118.2	239.8	248.2	8,945.8
2001	1,844.5	561.0	268.6	292.4	1,038.5	438.0	243.3	125.2	232.0	245.0	9,405.0
2002	1,879.7	567.2	273.9	293.3	1,073.8	459.7	260.5	133.4	220.2	238.8	9,880.6
OMB Current Services Baseline											
1998	1,693.4	553.4	265.4	288.0	890.0	380.9	208.6	104.5	196.0	249.9	8,218.6
1999	1,784.8	575.4	276.7	298.7	957.0	398.6	228.2	111.2	218.9	252.4	8,611.8
2000	1,858.6	586.6	282.2	304.4	1,021.8	417.7	248.8	119.6	235.7	250.2	9,042.9
2001	1,922.3	601.8	290.5	311.3	1,071.2	438.0	271.1	129.1	233.0	249.4	9,493.5
2002	2,002.3	617.4	297.1	320.3	1,137.7	459.7	295.1	139.2	243.8	247.2	9,965.4

Source: Tax Foundation, Office of Management and Budget.

was discretionary, controlled by the annual appropriations process. Following the implementation of several new entitlement programs in the late 1960s, the composition of federal outlays changed dramatically. Increasingly, federal spending was comprised of mandatory and net interest outlays. For a time it was possible to finance some of the rapid growth of these types of expenditures by making offsetting reductions in defense spending. By the mid-1970s, cuts in defense spending were no longer feasible. *Figure 1* shows that the budget deficit began to grow rapidly as federal outlays quickly increased as a percent of GDP. The deficit problem was exacerbated by the perceived need to increase defense expenditures during the 1980s. Since 1989, however, cuts in defense spending have once again cushioned the impact of the rapid growth of mandatory and net interest outlays and allowed the deficit to shrink relative to GDP.

Under current law the share of the budget dedicated to mandatory and net interest outlays would grow from 67.3 percent in FY 1998 to 69.2 percent in FY 2002. 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 these types of outlays would rise from 67.6 percent in FY 1998 to 69.8 percent in FY 2002 under the Administration's proposal.

The data in *Table 2* show that reductions in the rate of growth of Medicare outlays would account for the bulk of savings under the Clinton plan. Under current law, Medicare spending will grow from $208.6 billion in FY 1998 to $295.1 billion in FY 2002. Under the Clinton plan, Medicare spending would rise from $204.3 billion in FY 1998 to $260.5 billion in FY 2002.

The Clinton plan would not alter any of the laws governing Social Security. As a result, outlays for Social Security under its plan would be identical to those under current law. These outlays are expected to increase from $380.9 billion in FY 1998 to $459.7 billion in FY 2002.

Medicaid expenditures under the Clinton plan would vary only slightly from those under current law. During the initial two years, Medicaid expenditures would be slightly higher under the Clinton proposal than under current law. This situation would reverse itself during the later three years of this period. During this time Medicaid expenditures under the Clinton plan would fall slightly below those projected under current law.

During the first three years of the Clinton plan, funding for other mandatory programs would be slightly higher under the President's proposal than under current law. During the last two years, however, such outlays under the Clinton plan would dip below levels proscribed by current law.

The shrinking deficit projected by the Clinton Administration would mean that federal outlays for net interest payments would grow more slowly under the Clinton plan than under current law. Under current law interest payments are projected to increase from $249.9 billion in FY 1998 to $247.2 billion in FY 2002, while under the Clinton plan they are

Table 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

expected to increase from $249.9 billion to $238.8.

On the discretionary side of the budget, defense expenditures would grow much more slowly under the Clinton budget proposal than if such outlays were capped in real terms at levels equal to enacted FY 1997 appropriations. In the latter case, discretionary defense expenditures would grow from $265.4 billion in FY 1998 to $297.1 billion in FY 2002. Under the Clinton plan such expenditures would grow from $260.1 billion in FY 1998 to $273.9 billion in FY 2002.

Nondefense expenditures would also grow much more slowly under the Clinton proposal than if such expenditures were capped in real terms at FY 1997 appropriated levels. In the baseline case, nondiscretionary outlays would grow from $288.0 billion in FY 1998 to $320.3 billion in FY 2002. Under the Clinton plan nondefense discretionary expenditures would grow from $287.3 billion in FY 1998 to $293.3 billion in FY 2002.

Federal Revenues Under the Clinton Budget

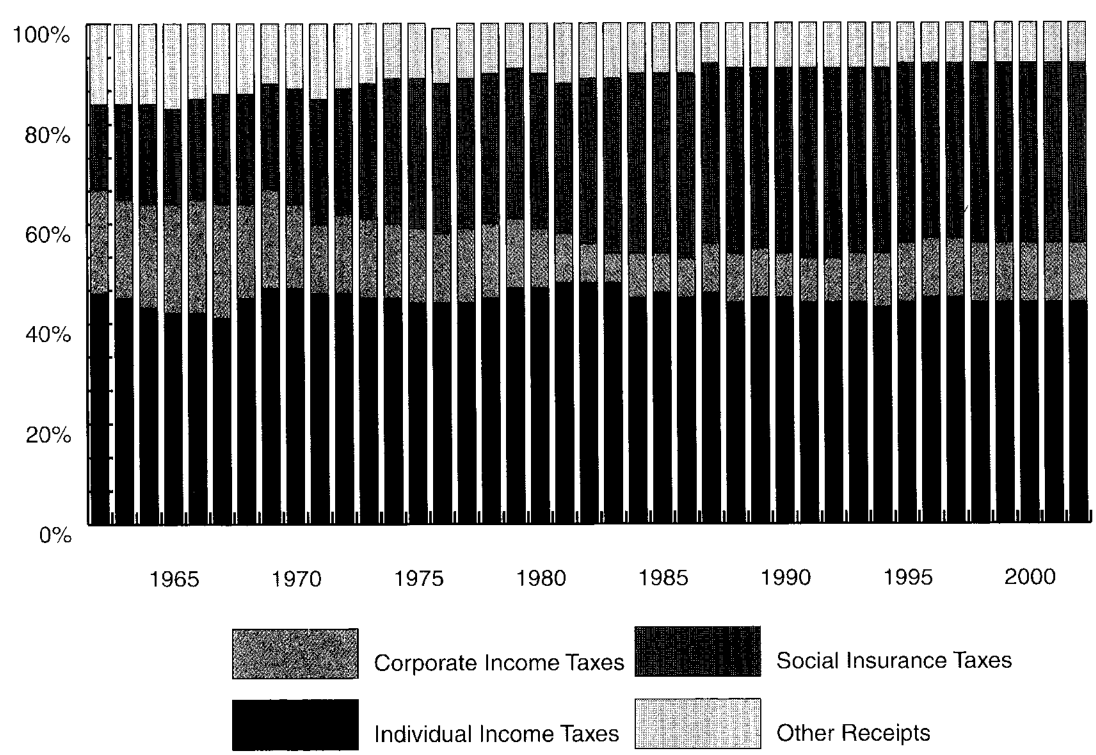
The Clinton budget contains a mix of modest, "targeted" tax relief measures that it claims would reduce Americans' tax burden by $98.4 billion over the next five years. The highlights of this package include a $500 per child tax credit, tax measures to assist individuals with post-secondary education 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. However, because the budget rules allow $47.3 billion of these funds to be treated as offsets to outlays instead of additional receipts, only $76.0 billion are counted as revenue increases by the plan. This gives the impression (reflected in *Figure 1* and *Table 4*) that federal revenues under the plan are slightly lower than those under current law, when in fact they would be slightly higher.

The modest nature of the Clinton revenue proposals, however, means that their net effect will have a negligible impact on both the composition and level of federal receipts over the next five years.

The major sources of federal revenue under the Clinton budget are listed in Table 4 and are illustrated in Figure 3 by the stacked bar graphs for fiscal years 1998 - 2002. The graph also contains historical data since 1962. It shows that individual income tax collections have been a relatively stable source of federal revenue over the past 35 years, averaging 44.9 percent of federal receipts. Under current law, federal revenue from individual income taxes is expected to rise from $708.4 billion in FY 1998 to $863.9 billion in FY 2002. 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. Under the proposal, individual income tax collections would grow from $691.2 billion in FY 1998 to $839.9 billion in FY 2002.

Federal corporate income tax receipts have fluctuated somewhat over the past 35 years. In 1962 such levies accounted for 20.6 percent of federal revenue. By 1967 this figure had grown to 22.8 percent. From 1967 to 1982 the share of federal revenue comprised of corporate income tax collections gradually declined. In 1982 the $49.2 billion collected by the corporate income tax represented just 7.8 percent of federal revenue. Since FY 1982, however, the importance of the corporate income tax as a source of federal revenue has rebounded somewhat. In FY 1997 the corporate income tax is estimated to have raised

Figure 3
Total Federal Receipts by Source, Fiscal Years 1962-2002



Source: Tax Foundation, Office of Management and Budget.

Table 4
Federal Receipts by Source, President's Proposal and OMB Current Services Baseline, Fiscal Years 1998-2002
($Billions)

	Total Receipts	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Other
President's Proposal					
1998	$1,566.8	$691.2	$189.7	$557.8	$128.2
1999	1,643.3	721.6	199.6	585.2	137.0
2000	1,727.3	755.6	212.0	614.4	145.3
2001	1,808.3	795.2	220.5	642.2	155.9
2002	1,896.7	839.9	227.8	673.1	155.9
OMB Current Services Baseline					
1998	1,573.8	708.4	187.0	557.9	120.5
1999	1,644.7	737.7	195.9	584.1	127.0
2000	1,731.0	775.6	207.4	612.7	140.3
2001	1,813.8	818.0	215.3	640.2	140.3
2002	1,901.6	863.9	222.4	669.7	145.6

Source: Tax Foundation, Office of Management and Budget.

$185.0 billion, or 12.4 percent of federal revenue. Under current law, the corporate income tax is projected to raise $187.0 billion in revenue during FY 1998. By FY 2002 this figure is expected to rise to $222.4 billion. As 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. In 1962 just 17.1 percent of the federal government's revenue came from these types of taxes. By FY 1997, this figure is estimated to have grown to 35.9 percent. Under the Clinton budget proposal the federal government would collect $557.8 billion in social insurance taxes during FY 1998. This figure will climb to $673.1 billion by FY 2002. *Table 4* shows that these figures differ only slightly from what is projected to occur under current law.

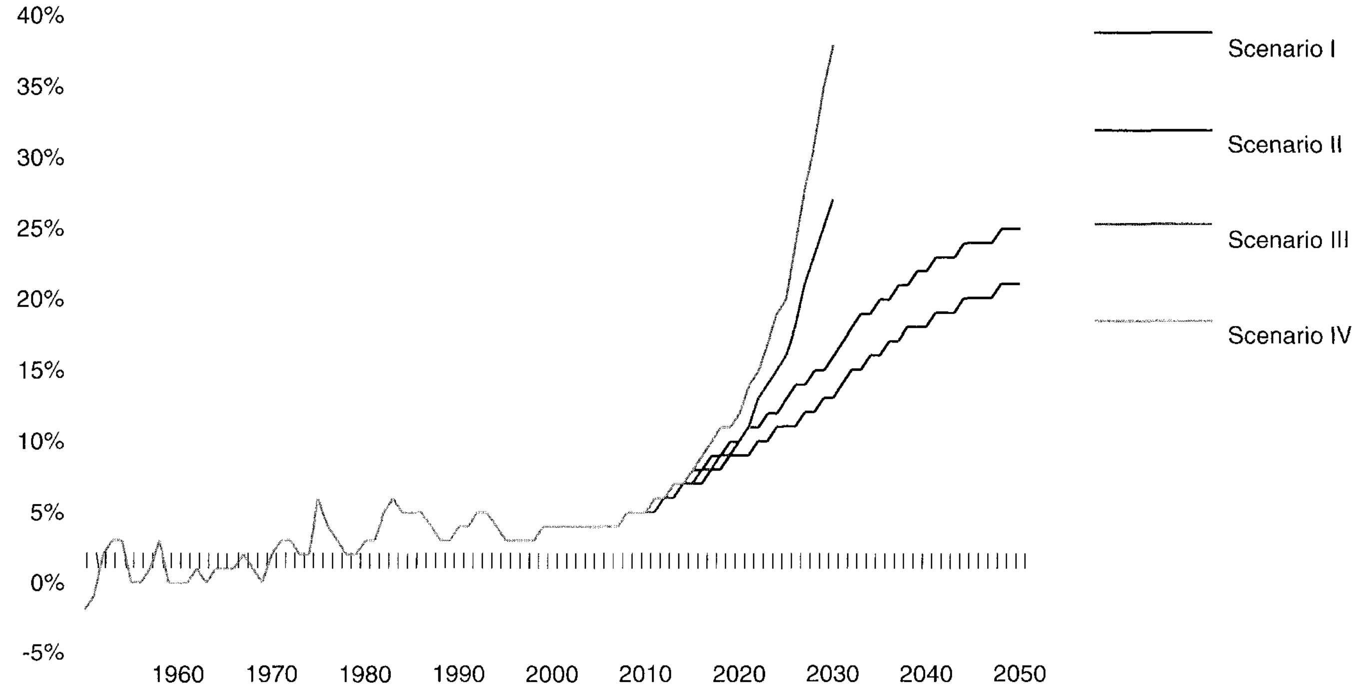
The share of total federal revenue raised from other sources has declined over the past 35 years. Such revenue includes federal excise taxes, customs duties and fees, estate and gift taxes, and other miscellaneous taxes and fees. In 1962, these types of receipts made up 16.6 percent of federal revenue. By FY 1997 this figure is estimated to have declined to 8.6 percent. The OMB predicts that under current law the federal government will collect $120.5 billion in these types of receipts during FY 1998. By FY 2002, it predicts that this figure would climb to $145.6 billion. Under the Clinton plan the federal government would collect $128.2 billion in these types of receipts during FY 1998. By FY 2002, this figure would rise to $155.9 billion under the plan.

The Long Run Deficit Picture

While there are reasons to be optimistic about the short-run deficit forecast, the long-run outlook is potentially much more 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 that such individuals will eventually 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.

To gauge the effect of continued growth of entitlement spending on the federal budget and the economy as a whole, the Congres-

Figure 4
Federal Deficits as a Percentage of GDP Under Four CBO Scenarios, 1950-2050



Source: Tax Foundation based on projections of the Congressional Budget Office.

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sional Budget Office (CBO) developed an economic model of the budget and the economy to examine four scenarios. Each scenario assumes that federal receipts will be equal to 20 percent of GDP for the years 2007-2025. In the first two scenarios this would continue to be the case through 2050. In the latter two, federal receipts would eventually rise to 21 percent of GDP by 2030. All of the scenarios assume that budget shortfalls will be financed by the issuance of debt. In the first two scenarios the issuance of such debt is assumed to have no harmful effects on the economy. In the later two, there is assumed to be a fiscal penalty, in the form of higher interest rates, associated with the accumulation of such debt.

On the expenditure side of the budget, mandatory and net interest outlays, in both the medium (1997-2006) and long run (2007-2050), are assumed to be determined by current law. Discretionary spending under the first and third scenarios are assumed to remain constant in real terms and grow only with inflation after 2006. In the second and fourth scenarios discretionary spending is assumed to grow with the economy after 2006.

Figure 4 illustrates what the model predicts would happen to federal receipts and outlays in each of the four scenarios during the first half of the next century. In the first scenario the deficit grows from 4.0 percent of GDP in 2010 to 19.0 percent in 2050. Similarly, in the second scenario, the deficit grows from 5.0 percent of GDP in 2010 to 24.0 percent in 2050. In the two scenarios that assume there to be adverse economic affects associated with the rapidly rising federal debt, the results are even more dramatic. In the third scenario the deficit rises from 4.0 percent of GDP in 2010 to 26.0 percent in 2030. The model does not make projections after this date since the nations's debt load would soon exceed levels that could reasonably be supported by the economy. In the fourth scenario the deficit as a percent of GDP rises from 5.0 percent in 2010 to 37.0 percent in 2030.

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.