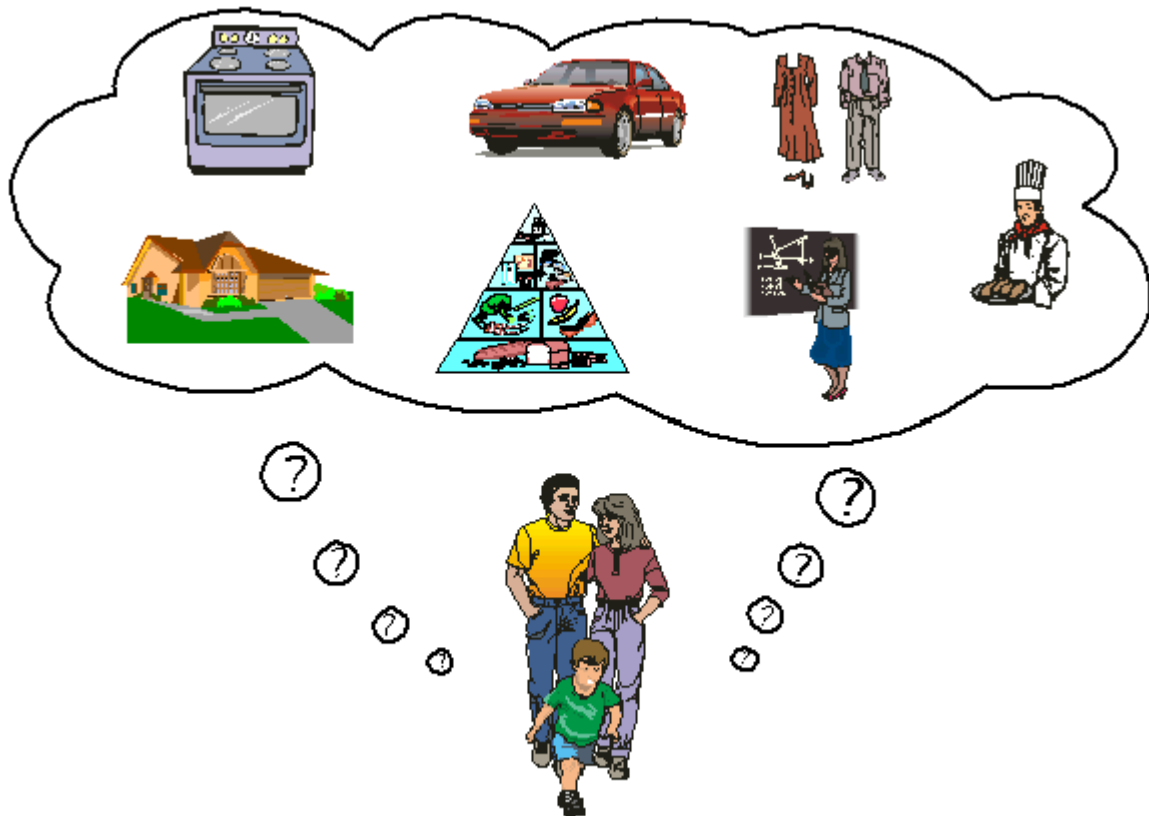


## 2. Where the Money Comes From -- and Where it Goes

In a typical American household, a father and mother might sit around the kitchen table to review the family budget. They might discuss how much they expect to earn each year, how much they can spend on food, shelter, clothing, transportation, and perhaps a vacation, and how much they might be able to save for their future needs.

If they do not have enough money to make ends meet, they might discuss how they can spend less, such as by cutting back on restaurants, movies, or other entertainment. They also might consider whether to try to earn more by working more hours or taking another job. If they expect their shortfall to be temporary, they might try to borrow.

**Chart 2-1. Family Budgeting**



*Sources: Cash and Credit*

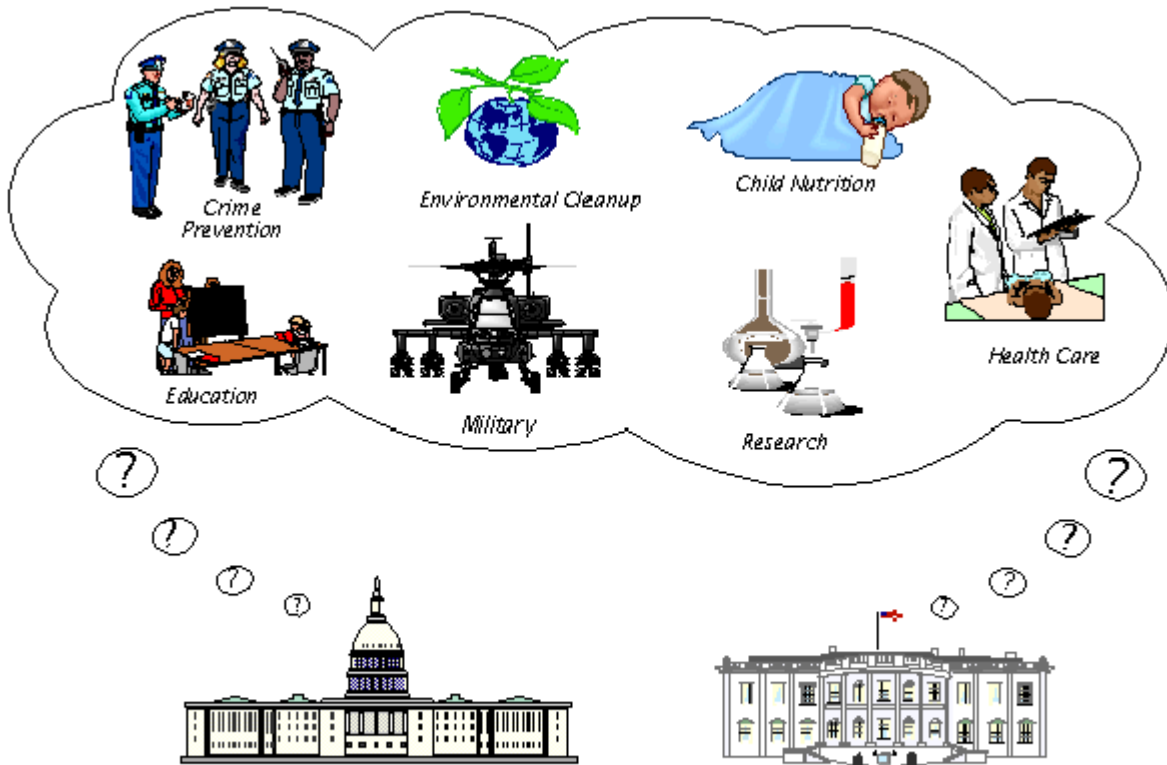
Generally speaking, the Federal Government plans its budget much like families do. The President and Congress determine how much money they expect the Government to receive in each of the next

several years, where it will come from, and how much to spend to reach their goals--goals for national defense, foreign affairs, social insurance for the elderly, health insurance for the elderly and poor, law enforcement, education, transportation, science and technology, and others.

They decide how much spending they will finance through taxes and how much through borrowing. They debate how to use the budget to help the economy grow, or to redistribute income. And, more recently, they debate how to use the budget surplus to address longer-term concerns and invest in the Nation's future.

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

**Chart 2-2. National Budgeting**

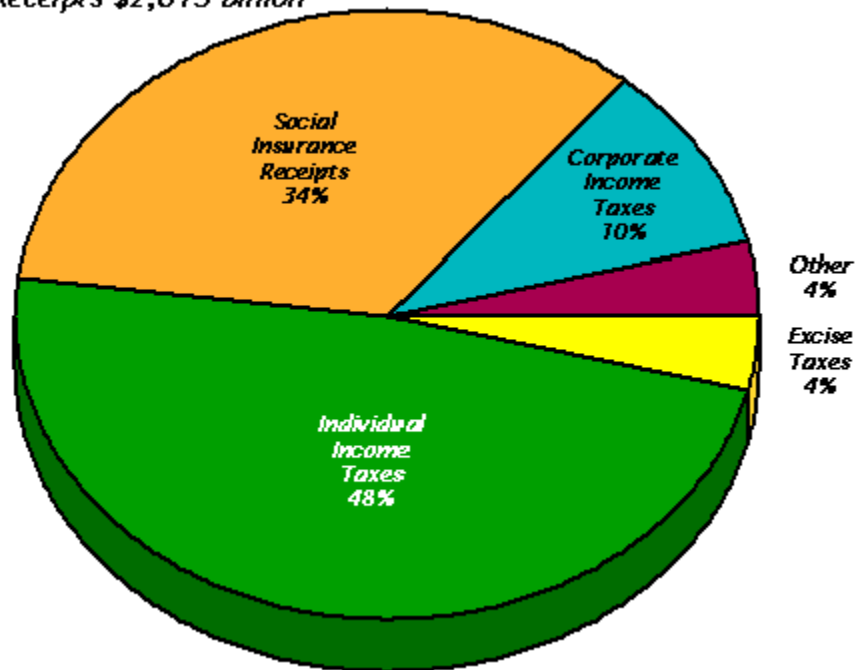


*Sources: Taxes and Borrowing*

**Revenues**

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

Receipts \$2,019 billion



The money that the Federal Government uses to pay its bills--its revenues or receipts--comes mostly from taxes. In the past two years, revenues were greater than spending, and the Government was able to reduce the national debt with the difference between revenues and spending--that is, the surplus.

Revenues come from these sources:

- Individual income taxes will raise an estimated \$972 billion in 2001, equal to about 9.7 percent of GDP.
- Social insurance payroll taxes include Social Security taxes, Medicare taxes, unemployment insurance taxes, and Federal employee retirement payments. This category has grown from two percent of GDP in 1955 to an estimated 6.8 percent in 2001.
- Corporate income taxes, which will raise an estimated \$195 billion, have shrunk steadily as a percent of GDP, from 4.5 percent in 1955 to an estimated 1.9 percent in 2001.
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities--including highways and airports and airways--and deposits others in the general fund.

- The Government also collects estate and gift taxes, customs duties, and miscellaneous revenues--e.g., Federal Reserve earnings, fines, penalties, and forfeitures.

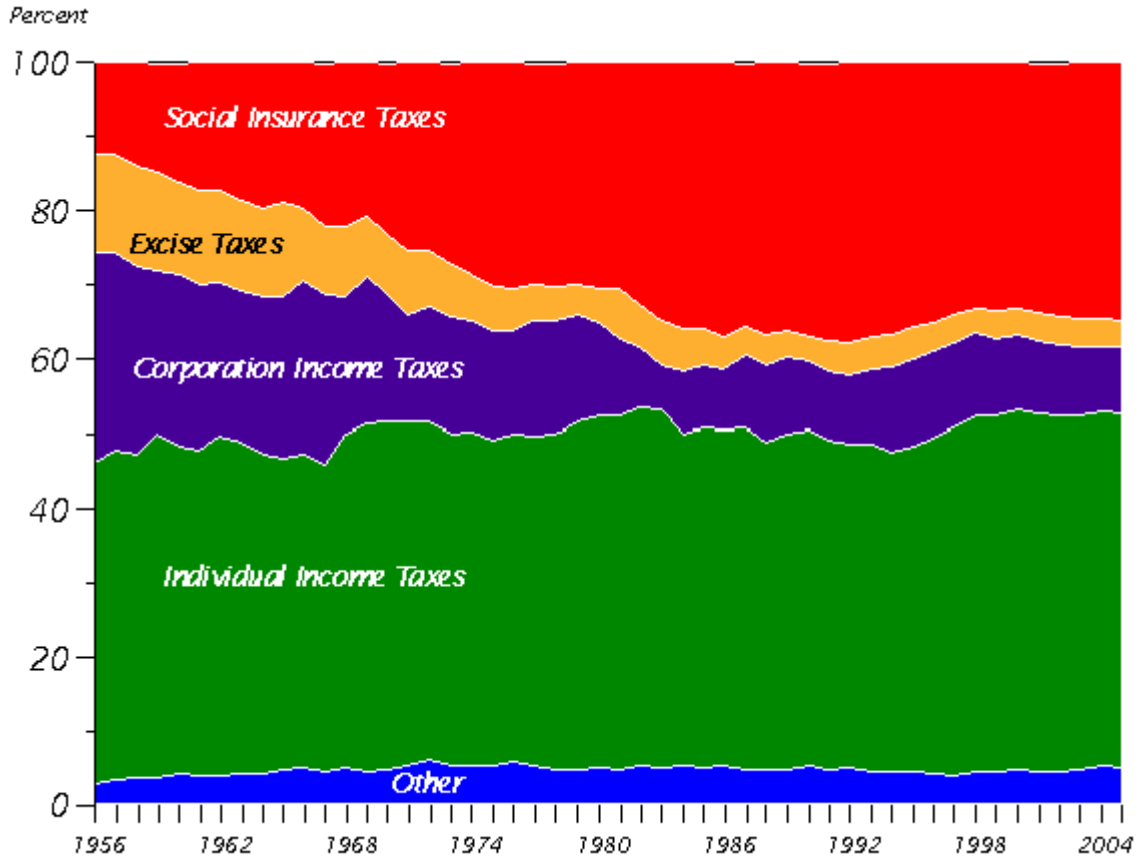
**Table 2-1. Revenues By Source--Summary**

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Individual income taxes . . . . .	879	952	972	995	1,026	1,066	1,117
Corporate income taxes . . . . .	185	192	195	195	196	200	206
Payroll taxes . . . . .	612	650	682	712	742	771	815
Excise taxes . . . . .	70	68	77	80	81	82	83
Estate and gift taxes . . . . .	28	30	32	35	36	39	37
Customs duties . . . . .	18	21	21	23	24	26	28
Miscellaneous revenues . . . . .	35	43	40	41	43	53	55
<b>Total revenues . . . . .</b>	<b>1,827</b>	<b>1,956</b>	<b>2,019</b>	<b>2,081</b>	<b>2,147</b>	<b>2,236</b>	<b>2,341</b>

Notes: The revenues listed in this table do not include revenues from the Government's business-like activities-- such as entrance fees at national parks. Instead of counting these collections as revenues, the Government subtracts them from spending. This produces totals for revenues and spending that show the level of Government activity without the business-like activity.

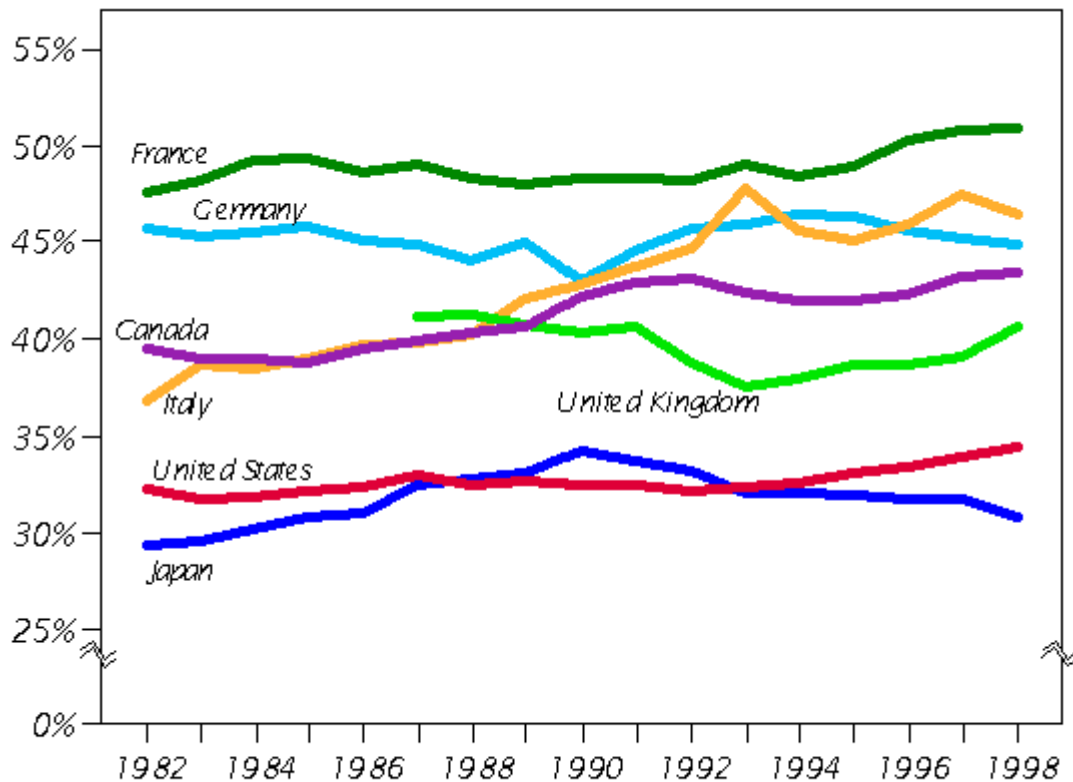
Numbers may not add to the totals because of rounding.

**Chart 2-4. Composition of Revenues**



*Between 1956 and 1999, payroll taxes have increased substantially as a percent of total revenues, and corporate income taxes have declined, but individual income taxes have remained roughly constant.*

**Chart 2-5. Revenues as a Percent of GDP--Comparison With Other Countries**



Source: OECD, calendar year data.

***The United States and Japan have the lowest revenues as a percent of GDP of the seven countries shown above.***

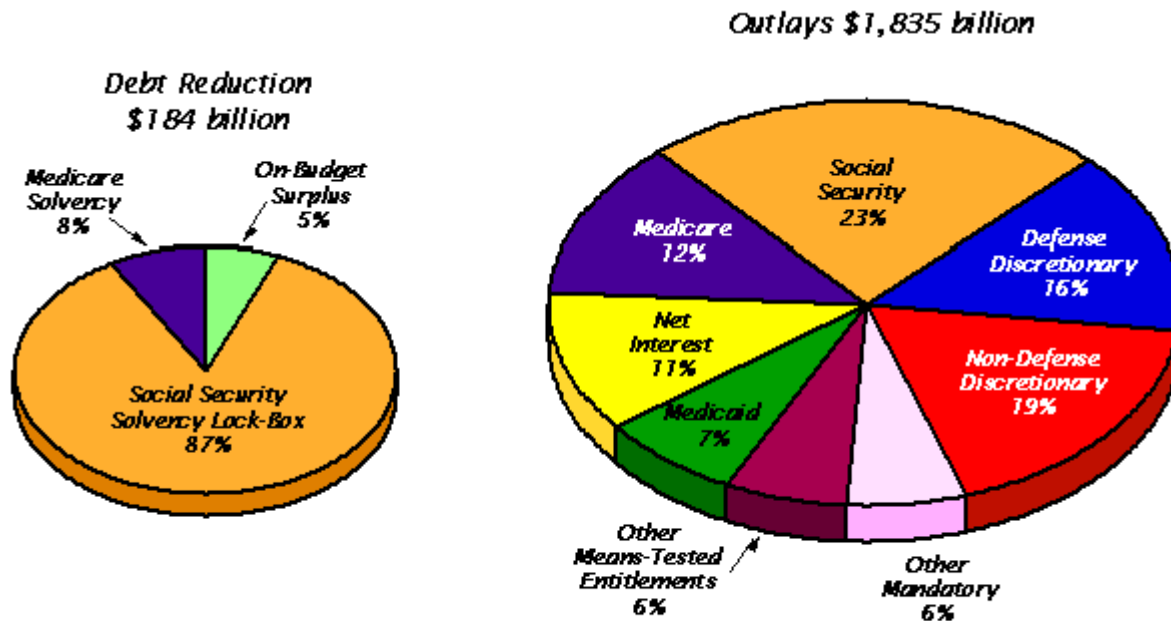
## Spending

As we have said, the Federal Government will spend over \$1.8 trillion<sup>1</sup> and have a surplus of \$184 billion in 2001, which we divided into nine large categories as shown in Chart 2-6.

- The largest Federal program is Social Security, which will provide monthly benefits to over 45 million retired and disabled workers, their dependents, and survivors. It accounts for 23 percent of all Federal spending.
- Medicare, which will provide health care coverage for over 40 million elderly Americans and people with disabilities, consists of Part A (hospital insurance) and Part B (insurance for physician costs and other services). Since its birth in 1965, Medicare has accounted for an ever-growing share of spending. Medicare growth slowed down in 1998 and 1999, but is expected to accelerate in 2000 and beyond. In 2001 it will comprise 12 percent of all Federal spending.

- Medicaid, in 2001, will provide health care services to almost 34 million Americans, including the poor, people with disabilities, and senior citizens in nursing homes. Unlike Medicare, the Federal Government shares the costs of Medicaid with the States, paying between 50 and 83 percent of the total (depending on each State's requirements). Federal and State costs are growing rapidly, although the rate of growth has fallen from the double-digit pace of the late 1980s and early 1990s. Medicaid accounts for seven percent of the budget.
- Other means-tested entitlements provide benefits to people and families with incomes below certain minimum levels that vary from program to program. The major means-tested entitlements are Food Stamps and food aid to Puerto Rico, Supplemental Security Income, Child Nutrition, the Earned Income Tax Credit, and veterans' pensions. This category will account for an estimated six percent of the budget.
- The remaining mandatory spending, which mainly consists of Federal retirement and insurance programs, unemployment insurance, and payments to farmers, comprises six percent of the budget.
- National defense discretionary spending will total an estimated \$292 billion in 2001, comprising 16 percent of the budget.
- Non-defense discretionary spending--a wide array of programs that include education, training, science, technology, housing, transportation, and foreign aid--has shrunk as a share of the budget from 23 percent in 1966 to less than 19 percent in 2001.
- Interest payments, primarily the result of previous budget deficits, averaged seven percent of Federal spending in the 1960s and 1970s. But, due to the large budget deficits that began in the 1980s that share quickly doubled to 15 percent in 1989. Since the budget is now in surplus, interest payments are estimated to drop to 11 percent of the budget in 2001.
- Nine percent of your Federal dollar (the budget surplus) will not be spent. The President has proposed that the surplus be used to reduce the Federal debt to assure the continued solvency of Social Security and Medicare.

#### **Chart 2-6. The Federal Government Dollar--Where It Goes**



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

<sup>1</sup> This amount does not include all of the Government's spending. As explained under "Revenues," the Government subtracts collections from its business-like activities, such as entrance fees at national parks, from spending instead of adding them to revenues. These collections are estimated to be almost \$215 billion in 2001. If they were not subtracted from spending, spending would total an estimated \$2.0 trillion in 2001, not \$1.8 trillion.

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



	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
<b>Outlays:</b>							
Discretionary:							
Department of Defense . . . . .	262	278	279	285	294	303	317
Non-DoD discretionary . . . . .	313	339	355	366	371	378	384
Subtotal, discretionary . . . . .	575	618	634	651	665	681	701
Mandatory:							
Social Security . . . . .	387	403	422	443	465	490	516
Medicare and Medicaid . . . . .	296	316	342	362	389	426	462
Means-tested entitlements (except Medicaid). . . . .	104	110	111	119	126	131	139
Other. . . . .	112	123	117	121	128	136	144
Subtotal, mandatory . . . . .	898	952	993	1,046	1,108	1,183	1,260
Net interest . . . . .	230	220	208	199	189	178	164
<b>Total, outlays . . . . .</b>	<b>1,703</b>	<b>1,790</b>	<b>1,835</b>	<b>1,895</b>	<b>1,963</b>	<b>2,041</b>	<b>2,125</b>
<b>Receipts . . . . .</b>	<b>1,827</b>	<b>1,956</b>	<b>2,019</b>	<b>2,081</b>	<b>2,147</b>	<b>2,236</b>	<b>2,341</b>
<b>Unified Budget Surplus . . . . .</b>	<b>124</b>	<b>167</b>	<b>184</b>	<b>186</b>	<b>185</b>	<b>195</b>	<b>215</b>
<b>Surplus Allocated for Debt Reduction:</b>							
Social Security solvency lock-box . . . . .	124	148	160	172	184	195	214
Medicare solvency . . . . .			15	13			
On-budget surplus . . . . .	1	19	9	1	*	*	2
Total Debt Reduction . . . . .	124	167	184	186	185	195	215

\* \$500 million or less.

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

Function	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
National defense:							
Department of Defense-Military . . . . .	261	277	277	284	293	302	316
Other. . . . .	13	13	14	14	14	15	15
Total, national defense . . . . .	275	291	291	298	307	317	331
International affairs. . . . .	15	17	20	19	19	19	20
General science, space, and technology . . .	18	19	20	21	21	21	22
Energy . . . . .	1	-2	-1	-1	-*	-1	-1
Natural resources and environment. . . . .	24	24	25	26	25	26	26
Agriculture. . . . .	23	32	22	18	14	12	11
Commerce and housing credit . . . . .	3	6	3	2	2	2	2
Transportation . . . . .	43	47	50	51	52	54	55
Community and regional development . . . .	12	11	10	10	10	10	9
Education, training, employment, and social services . . . . .	56	63	68	74	77	79	81
Health. . . . .	141	154	167	181	195	211	227
Medicare . . . . .	190	203	221	229	242	265	287
Income security . . . . .	238	251	260	276	288	301	314
Social security . . . . .	390	407	426	447	469	493	520
Veterans benefits and services. . . . .	43	47	46	49	51	53	56
Administration of justice . . . . .	26	27	31	31	31	31	32
General government . . . . .	16	15	15	16	16	17	17
Net interest . . . . .	230	220	208	199	189	178	164
Allowances . . . . .		1	-1	-*	-*	-*	-*
Undistributed offsetting receipts . . . . .	-40	-43	-46	-49	-47	-47	-48
<b>Total. . . . .</b>	<b>1,703</b>	<b>1,790</b>	<b>1,835</b>	<b>1,895</b>	<b>1,963</b>	<b>2,041</b>	<b>2,125</b>

\* \$500 million or less.

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

Numbers may not add to the totals because of rounding.

**Table 2-4. Discretionary Spending by Agency**  
(Outlays, in billions of dollars)

Agency	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Legislative Branch . . . . .	2	3	3	3	3	3	3
Judicial Branch. . . . .	3	4	4	4	4	4	5
Agriculture. . . . .	16	17	17	17	17	17	17
Commerce. . . . .	5	8	5	5	5	5	5
Defense-Military . . . . .	262	278	279	285	294	303	317
Education . . . . .	29	34	35	39	40	41	41
Energy . . . . .	18	17	18	19	19	20	20
Health and Human Services . . . . .	38	43	46	50	50	51	52
Housing and Urban Development. . . . .	32	34	35	36	37	38	38
Interior . . . . .	8	8	9	9	9	9	10
Justice. . . . .	17	17	21	21	21	21	21
Labor . . . . .	10	11	12	12	12	13	13
State . . . . .	6	8	8	8	8	8	8
Transportation . . . . .	40	44	47	49	50	51	53
Treasury. . . . .	12	13	14	14	14	15	15
Veterans Affairs . . . . .	19	20	22	22	22	23	23
Corps of Engineers. . . . .	4	4	4	4	4	4	4
Other Defense Civil Programs . . . . .	*	*	*	*	*	*	*
Environmental Protection Agency . . . . .	7	7	8	8	8	8	8
Executive Office of the President . . . . .	*	*	*	*	*	*	*
Federal Emergency Management Agency . . . . .	4	3	3	2	2	2	1
General Services Administration. . . . .	*	1	1	*	1	1	*
International Assistance Programs . . . . .	11	12	13	13	13	13	13
National Aeronautics and Space Administration . . . . .	14	13	14	14	15	15	15
National Science Foundation . . . . .	3	3	4	4	5	5	5
Office of Personnel Management . . . . .	*	*	*	*	*	*	*
Small Business Administration . . . . .	1	1	1	1	1	1	1
Social Security Administration . . . . .	6	6	6	6	6	6	6
Other Independent Agencies . . . . .	6	6	6	7	7	7	7
Allowances . . . . .		1	-1	-*	-*	-*	-*
Undistributed offsetting receipts . . . . .			-*	-*	-*	-*	-*
<b>Total . . . . .</b>	<b>575</b>	<b>618</b>	<b>634</b>	<b>651</b>	<b>665</b>	<b>681</b>	<b>701</b>

\* \$500 million or less.

Note: Discretionary spending is appropriated by the Congress each year, in contrast with mandatory spending, which is automatic under permanent law. For a more complete discussion of discretionary spending, see "Action in Congress" in Chapter 3.

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

Numbers may not add to the totals because of rounding.

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## "On" and "Off" Budget

From time to time, you may hear about the "on-budget" which is the budget excluding certain programs that are legally designated as "off-budget."

Traditionally, the President's budget has focused on the totals for the unified budget. The unified budget encompasses all of the budgetary activities of the Government, and the unified budget surplus or deficit is the measure that best determines how much the Government has to borrow from the public (in the case of a deficit), or how much past borrowing can be repaid (in the case of a surplus). More recently, the on-budget surplus has received increasing attention. For all practical purposes, the off-budget surplus is the surplus in the Social Security program. This means that the on-budget surplus is the budget surplus excluding the Social Security surplus.<sup>2</sup>

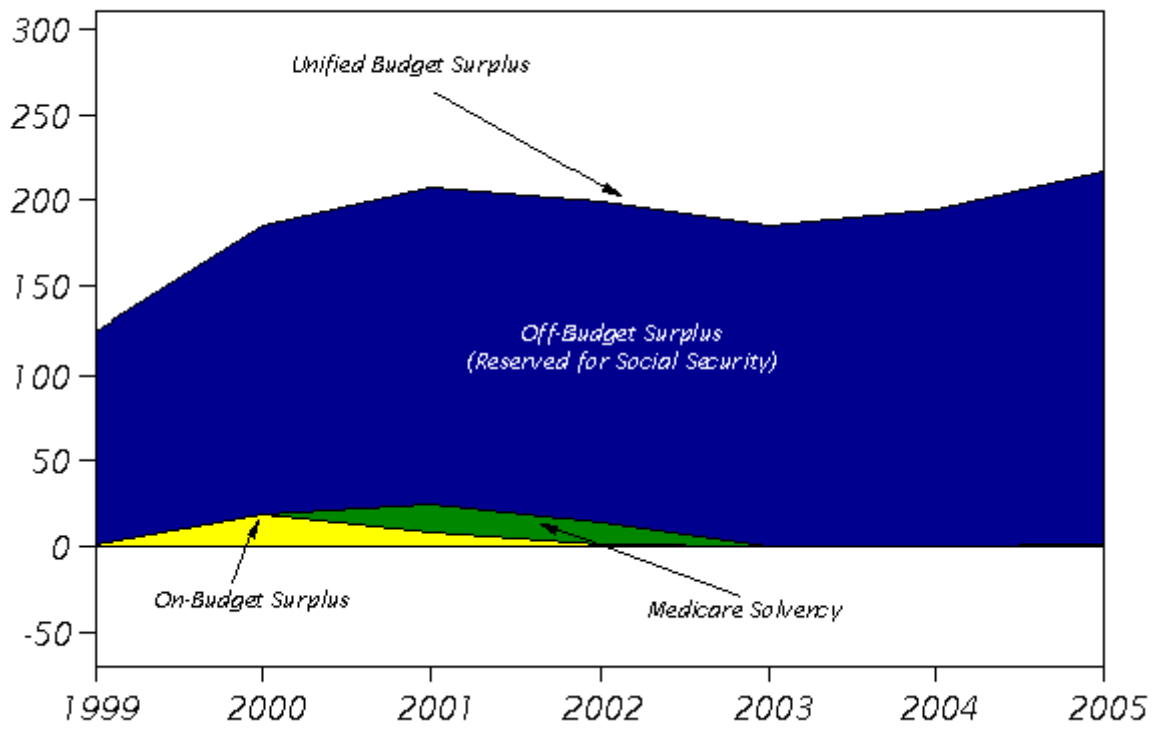
Social Security is running large surpluses right now, because the payroll taxes of the relatively large "baby-boom" generation exceed the Social Security benefits paid to the relatively small generation of current retirees. These surpluses have held down the unified deficit, by offsetting part of the deficit in the on-budget accounts. When the unified budget first booked a surplus of \$69 billion in 1998, the on-budget accounts were still in deficit by \$30 billion. In 1999, the unified budget ran a \$124 billion surplus, nearly all of which was the result of the Social Security surplus. The on-budget accounts were almost exactly in balance.

Under the President's proposals, the off-budget surplus would be reserved for debt reduction to enhance Social Security solvency. The President's budget also proposes that part of the on-budget surplus be reserved for Medicare solvency and for catastrophic prescription drug coverage. The President's overall budgetary framework is discussed in Chapter 5.

Chart 2-7 illustrates the relationship between on- and off-budget items, and the unified budget

### **Chart 2-7. On- and Off-Budget Deficit Projections**

Dollars in billions



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<sup>2</sup> The Postal Service is also designated as off-budget, which is why the off-budget surplus and the Social Security surplus are not exactly the same.

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Continue to: [3. How Does the Government Create a Budget?](#)

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