CHAPTER OVERVIEW

INTRODUCTION

The central political issue for many years has been how to pay for policies that most people support. A **budget** is a policy document allocating burdens (taxes) and benefits (expenditures). Over the past 30 years, the national government has run up large annual budget deficits. A budget **deficit** occurs when expenditures exceed revenues in a fiscal year.

The president and Congress have been caught in a *budgetary squeeze*: Americans want them to balance the budget, maintain or increase the level of government spending on most policies, and still keep taxes low. Thus, two questions become central to public policy: Who bears the burdens of paying for government? Who receives the benefits?

THE GOVERNMENT'S SOURCES OF REVENUE

Probably no government policy affects as many Americans as tax policy. In addition to raising revenues to finance its services, the government can use taxes to make citizens' incomes more or less equal, to encourage or discourage growth in the economy, and to promote specific interests.

This section looks at the substance of the budget to see how the American government raises money and where that money is spent. The three major sources of federal revenues are the *personal* and *corporate income tax, social insurance taxes,* and *borrowing.* In 1913, the **Sixteenth Amendment** was added to the Constitution, explicitly permitting Congress to levy an income tax. Although corporate taxes once yielded more revenues than individual income taxes, today corporate taxes yield only about 13 cents of every federal revenue dollar, compared with 48 cents coming from individual income taxes.

Today the **federal debt**—all of the money borrowed over the years and still outstanding—exceeds ***$11 trillion.*** Nine percent of all federal expenditures goes to paying *just the interest* on this debt. When the federal government wants to borrow money, the Treasury Department sells bonds, guaranteeing to pay interest to the bondholder. Citizens, corporations, mutual funds, and other financial institutions purchase the bonds. Many economists and policymakers are concerned about the "crowding out" effect the national debt is having on available investment capital. Some have called for a *balanced budget amendment.*

Tax expenditures represent *the difference between what the government actually collects in taxes and what it would have collected without special exemptions.* Tax expenditures are essentially monies that government could collect but does not because they are *exempted* from taxation.

Early in his administration, President Reagan proposed a massive tax-cut bill, which was passed by Congress in July 1981. Families with high incomes received significant income tax reductions with the 1981 bill, but those at the lower end of the income ladder did not notice much change in their tax burden because social insurance and excise taxes (which fall disproportionately on the poor) *rose* during the same period. Many blamed the massive deficits of the 1980s and 1990s at least partially on the *1981 tax cuts*, as government continued to spend more but reduced its revenues.

The *Tax Reform Act of 1986* was one of the most sweeping alterations in federal tax policy in history. It eliminated or reduced the value of many tax deductions, removed several million low-income individuals from the tax rolls, and greatly reduced the number of tax brackets.

In 1993, President Clinton proposed, and Congress approved, a plan to raise the income tax rate for families in the highest income bracket. Spending cuts were also enacted. By the end of the Clinton administration, the yearly deficit had been reversed into surpluses. This helped make cutting taxes once again a popular rallying cry for some politicians, including George W. Bush. In 2001, Congress enacted a tax cut that gradually lowered tax rates over the next ten years. When deficits immediately reappeared, critics charged that the president was fiscally irresponsible.

FEDERAL EXPENDITURES

Among the most important changes of the twentieth century is *the rise of large governments*. American governments—national, state, and local—spend an amount equal to one-third of the Gross Domestic Product (GDP). Expenditures of the national government alone equal over 20 percent of the GDP. Nevertheless, the United States actually has one of the *smallest* public sectors among Western nations relative to the size of the Gross Domestic Product (GDP).

Two conditions associated with government growth in America are the *rise of the national security state* and the *rise of the social service state.* After World War II, the **"cold war"** with the Soviet Union resulted in a permanent military establishment and expensive military technology. President Eisenhower coined the phrase **military-industrial complex** to characterize the close relationship between the military hierarchy and the defense industry that supplies its hardware needs. The Pentagon wants weapons systems and arms makers want contracts, so they tend to be mutually *supportive*. In the 1990s, *defense expenditures decreased* in response to the lessening of tensions in Europe. The budget of the Department of Defense now constitutes only about one-sixth of all federal expenditures.

The **Social Security Act** (passed in 1935) was originally intended to provide a minimal level of sustenance to older Americans. In the mid-1960s, America's social services network greatly expanded by adding to the Social Security system and creating many new programs designed to aid the poor and the elderly. In 1965, Medicare, which provides both hospital and physician coverage to the elderly, was added to the system. Today, about 45 million Americans receive payments from the Social Security system. Social

Security is not the only social policy of the federal government that is costly. The rise of the social service state has contributed to America's growing budget in health, education, job training, and scores of other areas.

The picture of the federal budget is one of constant, slow growth. Expenditures mandated by an existing law or obligation (such as Social Security) are particularly likely to follow a pattern of **incrementalism,** which means that the best predictor of this year's budget is *last year's budget plus a little bit more*—that is, an increment. More and more of federal spending has become "uncontrollable." An **uncontrollable expenditure** is one that is *mandated* under current law or by a previous obligation. About *two-thirds of the federal budget is uncontrollable*—based on expenditures that are determined not by how much Congress appropriates to an agency but by *how many eligible beneficiaries* there are for a particular program. Many expenditures are uncontrollable because Congress has in effect obligated itself to pay *X* level of benefits to *Y* number of recipients. Such policies are called **entitlements.**

THE BUDGETARY PROCESS

Public budgets are the supreme example of Harold Lasswell's definition of politics as "who gets what, when, and how." Budget battles are fought over contending interests, ideologies, programs, and agencies.

The distribution of the government's budget is the outcome of a very complex budgetary process involving thousands of policy choices and prompting a great deal of politics. Every political actor has a stake in the budget. The main actors in the budgetary process include interest groups, agencies, the Office of Management and Budget, congressional tax committees and budget committees, congressional subject-matter committees and appropriations committees, the General Accounting Office, and, of course, the president.

According to the Constitution, *all federal appropriations must be authorized by Congress*—a control sometimes called the **"power of the purse."** Two key players in this process are the **House Ways and Means Committee** and the **Senate Finance Committee**. In 1921, Congress passed the *Budget and Accounting Act*, requiring presidents to propose an executive budget to Congress and creating the *Bureau of the Budget* to help them. In the 1970s, President Nixon reorganized the Bureau of the Budget and renamed it the **Office of Management and Budget (OMB).** The OMB now supervises preparation of the federal budget and advises the president on budgetary matters.

The **Congressional Budget and Impoundment Act of 1974** was designed to reform the congressional budgetary process. The act established *a fixed budget calendar* in which a timetable mandated by law was set for each step in the budgetary process. The **Congressional Budget Office (CBO)** advises Congress on the probable consequences of its budget decisions, forecasts revenues, and is a counterweight to the president's OMB. In April of each year, both houses of Congress are expected to agree upon a **budget resolution** which binds Congress to a total expenditure level that should form the bottom line of all federal spending for all programs.

The congressional budget resolution often requests that certain changes be made in law, primarily to achieve savings incorporated into the spending totals and thus meet the budget resolution. First is budget **reconciliation,** a process by which program authorizations are revised to achieve required savings; it frequently also includes tax or other revenue adjustments. The second way that laws are changed to meet the budget resolution (or to create or change programs for other reasons) involves more narrowly drawn legislation. An **authorization bill** is an act of Congress that establishes a discretionary government program or an entitlement, or that continues or changes such programs. An additional measure, termed an **appropriations bill,** must be passed to fund programs established by authorization bills.

The new system was supposed to force Congress to consider the budget (both projected expenditures and projected revenues) as a whole. However, Congress has often failed to meet its own budgetary timetable, and presidents have made matters worse by submitting budget proposals containing large deficits. Moreover, in many instances Congress has not been able to reach agreement and pass appropriations bills at all and has instead resorted to **continuing resolutions**—laws that allow agencies to spend at the previous year's level.

In response to growing frustration at its inability to substantially reduce annual budget deficits, Congress enacted the Balanced Budget and Emergency Deficit Control Act (1985), better known as the *Gramm-Rudman-Hollings Act.* As amended in 1987, the act mandated maximum allowable deficit levels for each year until 1993—at which point the budget was supposed to be in balance. If Congress failed to meet the deficit goals, automatic across-the-board spending cuts (called *sequestrations*) were to be ordered by the president, although a number of programs were exempt from the process.

In 1990, Congress decided to shift the focus from controlling the size of the deficit (which was the trigger for sequestration) to controlling increases in spending (under which the sheer size of the deficit would not matter). While Congress shifted to keeping a lid on expenditures, it allowed events beyond its control—such as war or a recession—to increase the size of the deficit without penalty. The bottom line was a bigger deficit; yearly deficits continued to climb until the Clinton administration.

The results of the 1994 congressional elections once again altered the budgetary game. In 1995, the new Republican majorities in each house, determined to balance the budget within seven years, argued for substantial cuts in the rate of growth of popular entitlement programs. The president agreed with the goal of balancing the budget but on his terms and took his case to the voters in 1996. The outcome, as we have seen, was divided government. In 1997, the president and Congress agreed to a budget that was to be in balance by 2002. However, decreased tax revenues resulting from the economic downturn in 2000–2001 and the income tax cut of 2001 sent the budget into deficit again.

UNDERSTANDING BUDGETING

Almost all democracies have seen a substantial growth in government in the twentieth century. Economists Allen Meltzer and Scott Richard argue that *government grows in a democracy* because of the *equality of suffrage*. Poorer voters will always use their votes to support public policies that redistribute benefits from the rich to the poor. Indeed, the most rapidly growing expenditures are items like Social Security, Medicaid, Medicare, and social welfare programs (all of which benefit the poor more than the rich).

One often thinks of elites—particularly corporate elites—as being opposed to big government. However, Lockheed and Chrysler corporations have appealed to the government for large bailouts when times got rough. Corporations support a big government that offers them contracts, subsidies, and other benefits. Poor and rich voters alike have voted for parties and politicians who promised them benefits. Government often grows by responding to groups and their demands.

Conversely, some politicians compete for votes by promising *not* to spend money (such as Ronald Reagan). In contrast with other nations, Americans have chosen to tax less and spend less on public services than almost all other democracies with developed economies. Paradoxically, Americans want to spend but they do not want to pay taxes. Being a democracy, that is exactly what the government does—and the inevitable result is red ink. America's large budget deficits have been as much a constraint on government as they have been evidence of a burgeoning public sector.

CHAPTER OUTLINE

I. INTRODUCTION

A. The president and Congress have been caught in a *budgetary squeeze*: Americans want them to balance the budget, maintain or increase the level of government spending on most policies, and still keep taxes low.
   1. Because budgets are so important to almost all other policies, *the budgetary process is the center of political battles* in Washington and involves nearly everyone in government.
   2. The central political issue for many years has been how to *pay* for policies that most people support.
      a. Resources have been scarce because the national government has run up large annual budget deficits over the past 30 years. A budget **deficit** occurs when **expenditures** exceed **revenues.**
      b. The total national **debt** rose sharply during the 1980s, increasing from less than one trillion dollars to $11 trillion dollars by 2010.

II. THE GOVERNMENT'S SOURCES OF REVENUE

A. Where it comes from.
   1. The three major sources of federal revenues are the *personal* and *corporate income tax, social insurance taxes,* and *borrowing.* Only a small portion comes from *excise taxes* (such as tax on gasoline) and other sources.