United States General Accounting Office

GAO

Staff Study

November 1996

FEDERAL FISCAL TRENDS

Fiscal Years 1971-1995

GAO/AIMD-97-3

Preface

While federal budgeting is an inherently forward-looking activity, current debates can be informed by analysis of historical trends. In recent years, GAO has addressed a variety of cross-cutting patterns and trends regarding many aspects of federal budget structures, processes, and reporting mechanisms.[1] In this study, we focus on the fiscal components of the budget—revenue and outlay trends, and the underlying factors contributing to those trends.

This study is based on data derived primarily from the Historical Tables, Fiscal Year 1997, published by the Office of Management and Budget (OMB) as part of the President's fiscal year 1997 budget submission.[2] To facilitate understanding, trend data are presented in graphic formats accompanied by brief narrative descriptions. The trend analyses presented in this study cover fiscal years 1971 through 1995, unless otherwise noted. Trend data are presented in the following formats.

- In constant dollars, using 1995 as the base year: This statistic describes in absolute terms the magnitude of change over a period of time, exclusive of the effects of inflation.
- As a percent of gross domestic product (GDP): GDP is the value of all final goods and services produced within the borders of a nation in a given period of time. Expressing fiscal year data as a percent of fiscal year GDP provides a meaningful context for assessing trends. In effect, this ratio recognizes that a nation's economy is a principal driver of its public sector revenues and outlays. Thus, a change over time in the ratio of revenues (or outlays) as a percent of GDP provides greater insight for interpreting trends than changes in absolute levels alone.
- As a share of totals: This statistic is useful for describing relative shifts by component, for example, shares of total outlays by type of spending.

Appendix I provides additional details on our scope and methodology.

[1]Examples include previous and ongoing work regarding capital, investment, and performance budgeting; the budgetary treatment of credit and insurance programs; budget process reforms, such as balanced and biennial budget requirements; and the budget account structure and the linkages between budgeting and accounting. These products, and other work relating to structural or trend matters, are listed in the "Related GAO Products" section of this study.

[2]This study reflects current concepts and treatments applicable to federal budget presentations, as discussed in OMB's Budget Systems and Concepts, Fiscal Year 1997. The Federal Accounting Standards Advisory Board has recently developed accounting standards which address how many of the issues discussed in this study are treated and presented in financial statements. Starting with fiscal year 1996, all departments and agencies covered by the Chief Financial Officers Act will be required to obtain annual audits of their financial statements, which will include coverage of budgetary information.

Overview of Trends

The federal government's spending and tax policies constitute its fiscal policy. When outlays exceed revenues, deficits occur. In the 200 years since 1795, deficits have been a common feature of federal fiscal policy, occurring in 100 of these 200 fiscal years. As shown in figure 1, prior to World War II, deficits occurred primarily in times of war or economic downturn and generally were followed by periods of surplus. In fact, between 1795 and 1945, annual surpluses were the dominant result of federal fiscal policy, occurring in 92 of the 150 fiscal years. However in the last 50 years, the federal government has run a surplus only eight times and not at all since 1969.

Figure 1: Federal Surpluses and Deficits, Fiscal Years 1795-1995

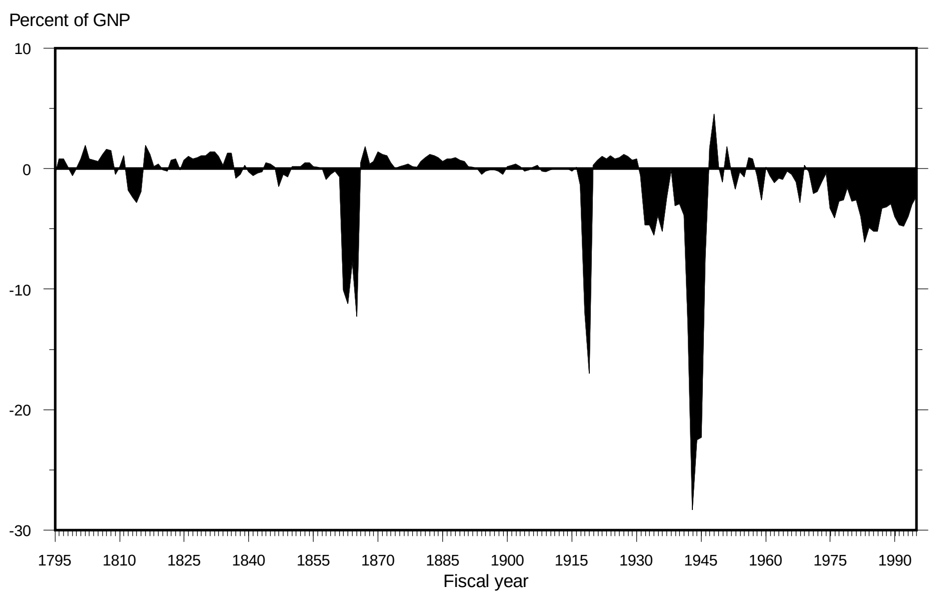


Figure 1 also indicates that deficit reduction efforts in the 1990s—notably the Budget Enforcement Act of 1990 as revised and extended by the Omnibus Budget Reconciliation Act of 1993—appear to be achieving intended results. Deficits have declined every year since 1992, and in fiscal year 1995, the deficit as a percent of GDP reached the lowest level since 1979.[3] Despite these recent gains, the Congressional Budget Office (CBO) projects that, unless further action is taken, the deficit will rise gradually

[3] Although detailed data are not yet available, the Department of the Treasury reported on October 28, 1996, that the fiscal year 1996 deficit was $107 billion, as a percent of GDP the lowest level since 1974.

beginning in 1997. CBO's and GAO's long-term models suggest that the deficit will increase more rapidly when the baby boom generation begins to retire around 2010. Thus, additional measures to reduce the deficit will be needed just to sustain recent progress.[4] These discussions and related topics are briefly summarized in chapter 1.

Underlying this modern pattern of deficits are significant changes affecting both revenues and outlays. Principal revenue trends discussed in chapter 2 include the following.

- Although federal revenues have more than doubled in constant dollars over the last 25 years, they have maintained a generally consistent share of GDP during this period.
- Significant changes have occurred in the composition of federal revenues. Although all revenue sources, except excise taxes, have shown real growth over the last 25 years, only social insurance taxes have increased as a share of total revenues, and only social insurance and individual income tax receipts have grown faster than overall economic growth. (See figures 2.2 and 2.3.)
- Tax expenditures—provisions of the tax code addressing a variety of economic and social policies but which constitute revenue forgone for the federal government—increased significantly in constant dollars and as a share of revenues until the 1986 Tax Reform Act, but since 1989 have resumed their upward climb—constituting 32 percent of revenues in 1994. (See figure 2.4.)
- Collections which arise from business-type transactions with the public, rather than through the government's exercise of its sovereign tax powers, and which offset or reduce outlays for a variety of federal activities, have doubled in constant dollars since 1971. In terms of total government collections, these receipts have generally been the third largest revenue source during this period and, since 1981, have annually exceeded the combined shares of corporate and excise taxes as a percent of total federal revenues. (See figure 2.5.)

The major outlay trends discussed in chapter 3 include the following.

- As with revenues, the trend in total outlays depends on the measure. In constant dollars, outlays have shown a consistent growth pattern over this

[4]The Deficit and the Economy: An Update of Long-Term Simulations (GAO/AIMD/OCE-95-119, April 26, 1995). This study updated Budget Policy: Prompt Action Necessary to Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992). See also chapter 4 of The Economic and Budget Outlook: Fiscal Years 1997-2006, Congressional Budget Office (May 1996). See also Federal Debt: Answers to Frequently Asked Questions (GAO/AIMD-97-12, November 27, 1996).

period, doubling from over $740 billion to over $1.5 trillion. However, as a percent of GDP, outlays grew between 1971 and 1983 but have gradually fallen thereafter, with 1995 outlays (21.7 percent of GDP) the lowest since 1979. (See figure 3.1b and table 3.1.)

- Outlay patterns have changed significantly during this period. A few large entitlement programs—Social Security, Medicare and Medicaid—and interest payments have accounted for over three-quarters of the total outlay growth since 1971. Overall, spending for entitlement and other mandatory programs arising outside of the annual appropriations process grew more than four times faster in real terms than appropriated (i.e., discretionary) spending. One result of these different growth rates has been a shift in the composition of federal outlays from about 35 percent mandatory in 1971 to about 50 percent mandatory in 1995. (See figures 3.2 and 3.3.)
- Within discretionary spending, defense and domestic outlay patterns have varied during this period, showing both periods of growth and decline. Overall, discretionary spending has declined as a percent of GDP, with most of the recent decline associated with defense spending. (See figure 3.4.)
- During the last 25 years, changes in outlay patterns have also documented shifts in the mission priorities of the federal government. For example, as a share of total spending, only outlays for human services and interest payments grew during this period; outlays for defense, economic affairs, natural resources, and central government operations all declined as shares of overall spending. Also, outlay patterns disclose a change in federal government activity from principally providing goods or services (directly or via contract) to principally providing payments to individuals. (See figures 3.5 through 3.8.)

Lastly, federal fiscal trends can be compared to the fiscal patterns of other governments. For example, federal domestic spending increased sharply in the early 1970s compared to state and local government spending and has generally maintained that gap throughout this trend period. (See figure 4.1.) Total United States government spending also can be compared to other industrialized nations; this analysis indicates that, although overall levels differ, the United States has generally allotted a smaller share of its GDP to government activities than most other governments. (See figures 4.2 through 4.4.)

Copies of this study are being provided to GAO staff members and to others upon request. If there are any questions, I can be reached at (202) 512-9573. Major contributors to this staff study were Michael J. Curro and John W. Mingus, Jr.

Paul L. Posner
Director, Budget Issues

Contents

Abbreviations

CBO	Congressional Budget Office
GAO	General Accounting Office
GDP	gross domestic product
GNP	gross national product
JCT	Joint Committee on Taxation
OECD	Organization for Economic Cooperation and Development
OMB	Office of Management and Budget

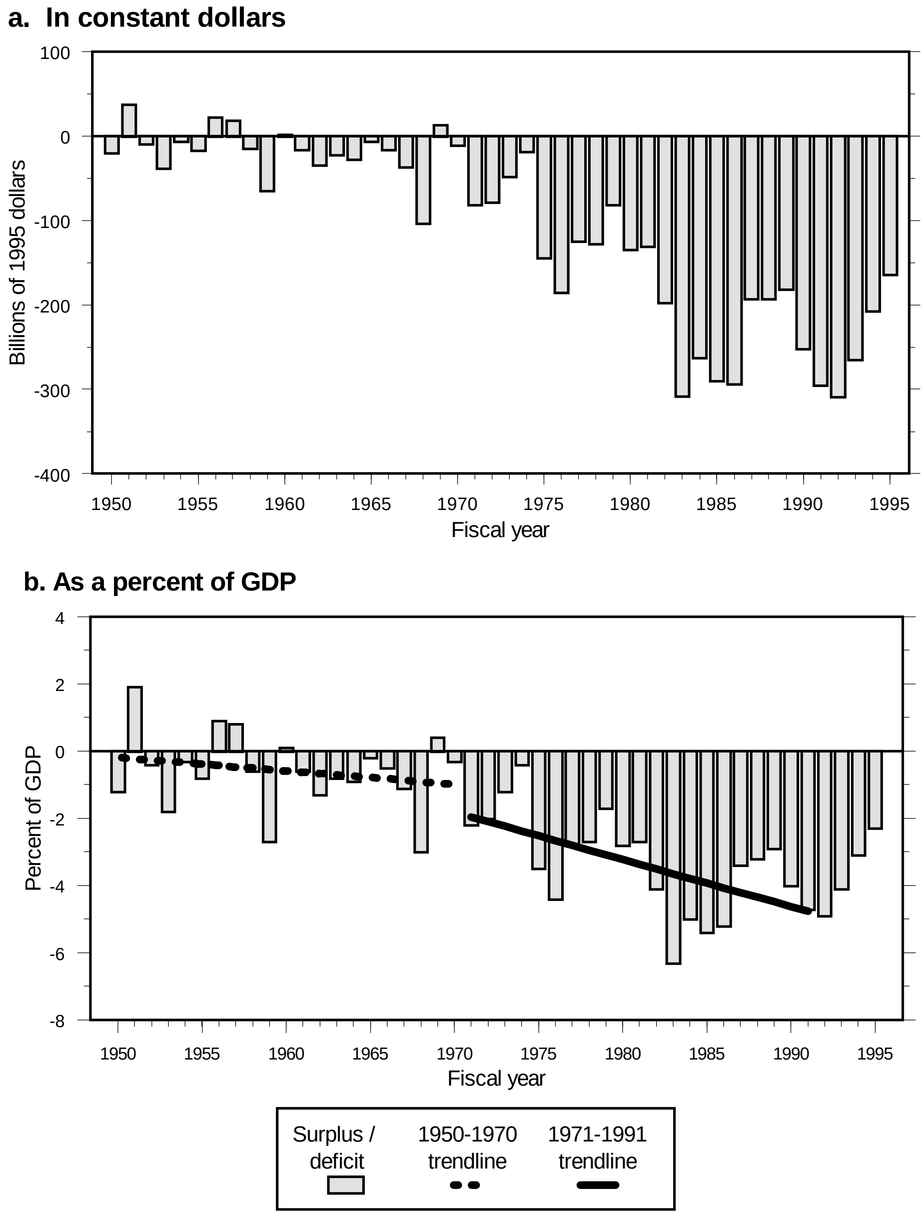
Federal Deficits: Patterns and Implications

As indicated by figures 1.1a and 1.1b, the occurrence of deficits has become a stubborn and persistent feature of federal fiscal policy although the size of deficits in constant dollars and their relationship to overall U.S. economic performance measured as a percent of GDP have varied widely during the post-World War II period. Figure 1.1b also indicates a conspicuous shift that has occurred during this period. Deficits as a percent of GDP intensified during the period 1971-1991 compared to the earlier period 1950-1970. Figure 1.1b illustrates this point; trend lines were fitted to each data series and the sharply steeper trend line for 1971-1991 indicates a worsening of federal deficits relative to national economic output. This period since 1971, and associated underlying factors, will be the focus for the more detailed examination of revenue and outlay trends in subsequent chapters of this report.

Figures 1.1a and 1.1b also indicate that deficit reduction efforts in the 1990s—notably the Budget Enforcement Act of 1990 as revised and extended by the Omnibus Budget Reconciliation Act of 1993—appear to be achieving results. Deficits have declined every year since 1992, and in fiscal year 1995, the deficit as a percent of GDP reached the lowest level (2.3 percent) since 1979. Despite these recent gains, both GAO and the Congressional Budget Office have expressed concern over the long-term outlook.[1] In our 1995 study on the long-term economic impact of persistent deficits, we noted that continuing current fiscal policies would lead to sharply escalating deficits, rising to over 23 percent of GDP by 2025, which would prompt significant declines in investment and capital stock, rising federal interest costs and, inevitably, a declining economy. Increased spending pressures arising from an aging population, rising health care costs and growing interest on the debt will combine to create unsustainable fiscal pressures. We concluded that a fiscal policy of balance or surplus would yield a stronger economy in the long term.

[1]See GAO/AIMD/OCE-95-119, April 26, 1995; and GAO/OCG-92-2, June 5, 1992. See also chapter 4 of The Economic and Budget Outlook: Fiscal Years 1997-2006, Congressional Budget Office (May 1996).

Figure 1.1: Federal Surpluses and Deficits, Fiscal Years 1950-1995



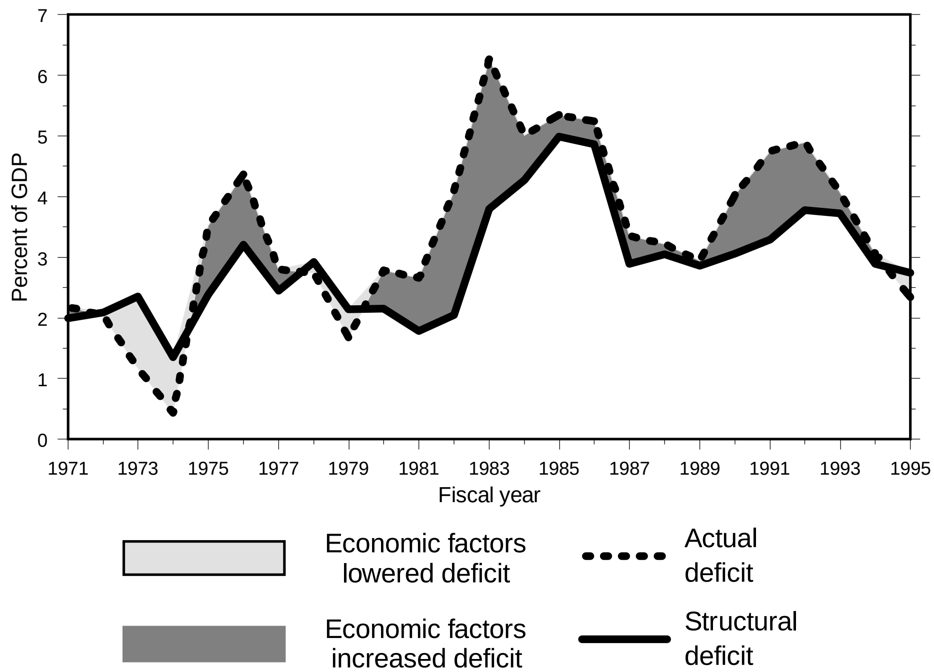
The Structural and Cyclical Components of the Deficit

Not all of the growth in the deficit has been due to the tax and spending policies of the government. The deficit is also responsive to changing economic conditions; for example, a stagnant economy can depress wages and profits, with a corresponding effect on tax revenues, or can lead to higher levels of unemployment, resulting in greater outlays. That part of the deficit resulting from economic conditions is referred to as the cyclical deficit; that part due to the effects of fiscal (i.e., tax and spending) policy, and other noncyclical factors such as demographics, is referred to as the structural deficit.

Figure 1.2 shows the combined cyclical and structural deficits since 1971. The heavy line represents the structural deficit as a percent of GDP. The darkly shaded area in this figure indicates that portion of the total federal deficit resulting from cyclical factors; in effect, it shows the contribution of economic conditions to the annual deficit, shown by the heavy dotted line. Since 1981, although the federal deficit predominantly resulted from structural factors, economic conditions typically worsened the situation. Of course, the opposite effect is also possible, and the lightly shaded areas (1972-74, 1978-79, and 1995) indicate a lowering of the reported deficit due to economic factors.[2]

[2]In figure 1.2, the area under the heavy line is analogous to the "standardized-employment deficit," a measure used by the Congressional Budget Office (CBO) to remove the effects of the business cycle from the total deficit. CBO uses this measure to estimate whether fiscal policy is stimulative (rising relative to potential GDP) or restrictive (falling relative to potential GDP). For a full discussion of this measure, see The Economic and Budget Outlook: Fiscal Years 1997 - 2006, Congressional Budget Office, May 1996.

Figure 1.2: Structural and Cyclical Components of the Deficit



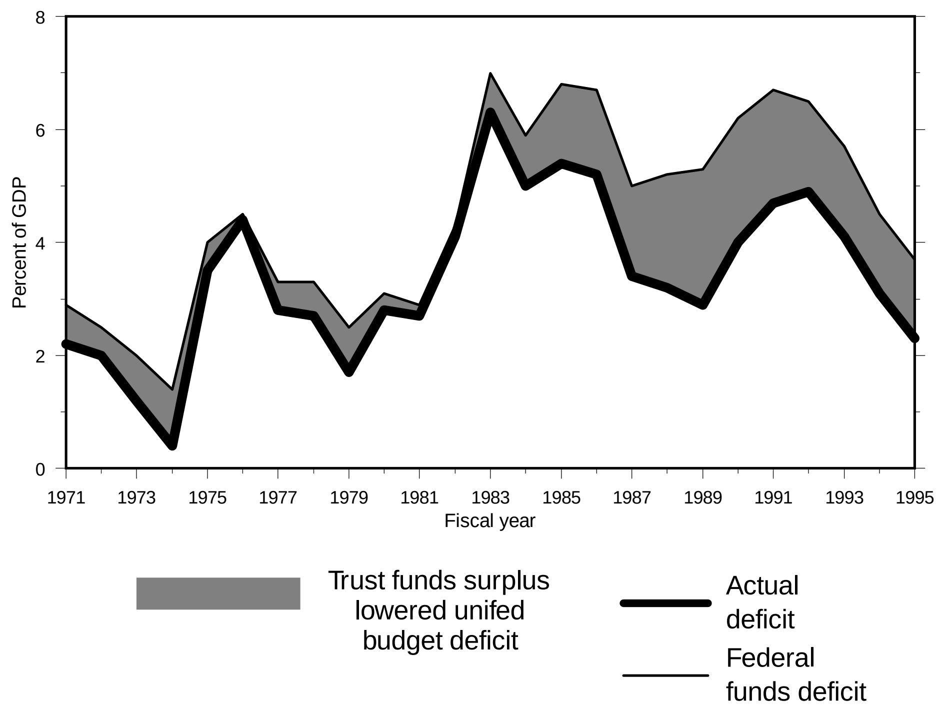
The Federal and Trust Fund Components of the Deficit

The federal budget consists of two major groups of funds: federal funds and trust funds. The latter is composed of revenues dedicated or earmarked for specific activities designated by law, including, for example, payroll taxes dedicated to the Social Security Trust Funds or gasoline excise taxes dedicated to the Highway Trust Fund. The federal funds group is financed by nondedicated revenues, such as the income tax or general Treasury borrowing and is used to carry out the general operations of the government.

Since 1969, the government's fiscal policy has been presented in terms of the "unified budget," which combines the revenues and outlays of federal and trust funds to achieve a comprehensive statement of governmental transactions with the public.[3] Figure 1.3 shows trends for the federal and trust fund components within the unified budget. The federal funds deficit, as a percent of GDP, is indicated by the line at the top of the figure; the heavy line represents the unified (or actual) budget deficit. The darkly shaded area indicates the trust fund surplus, which in the context of the unified budget presentation offsets a portion of the federal funds deficit. The trust fund surpluses of recent years are a result of policy changes intentionally designed to build large reserves, principally in retirement programs such as Social Security and federal employee pension plans.

[3]The unified budget typically measures governmental transactions with the public in its sovereign capacity, netting all business-type and interfund collections. In this study, interfund transactions are included to properly allocate the cost of federal activities to the fund group giving rise to the cost. For further discussion of business-type collections, see chapter 2.

Figure 1.3: Federal Fund and Trust Fund Components of the Deficit

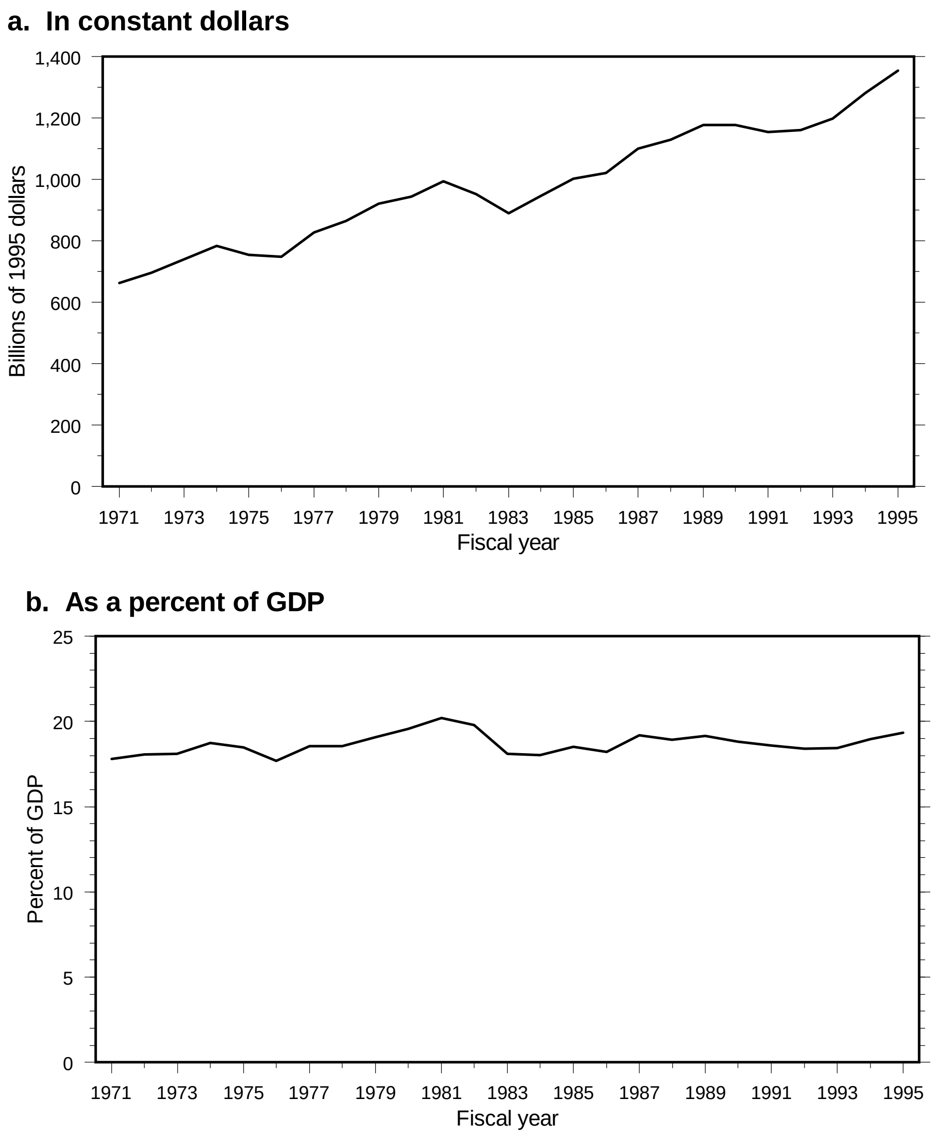


Federal Revenues: Fiscal Years 1971-1995

Federal revenues have more than doubled in constant dollars over the last 25 years, but have risen only slightly as a share of GDP. Revenue flows to the federal government are sensitive to economic conditions. As shown in figure 2.1a, federal revenue trends have experienced overall growth during this period, with downturns associated with a declining economy, as in 1975-76, 1981-82 and 1991-92. The fall-off in revenues after 1981 was also associated with the Economic Recovery Tax Act, which, among other policy changes discussed below, enacted broad rate decreases affecting corporate and individual income taxes.

Figure 2.1b depicts federal revenues as a percent of GDP, adding perspective on the size of federal revenues relative to the performance of the U.S. economy. Using this measure, revenues have risen slightly throughout this period from 17.8 to 19.3 percent of GDP. (See also table 2.1.) The increase indicated between 1976 and 1981 reflects the influence of high inflation rates, which, before the indexing of tax rates, moved taxpayers into higher income tax brackets.

Figure 2.1: Federal Revenue Trends



The Composition of Federal Revenues

The relatively modest growth of revenues as a percent of GDP masks major shifts in composition. Revenues are commonly disaggregated into five sources: individual income tax receipts, corporate income tax receipts, social insurance tax receipts, excise tax receipts, and all other sources, such as custom duties, estate and gift taxes, and miscellaneous receipts. As indicated in figures 2.2a and 2.2b and table 2.1, although all sources except excise taxes have shown real growth during the last 25 years, only individual income taxes and social insurance taxes have increased as a percent of GDP. Social insurance taxes have shown the greatest real average annual growth and account for nearly half of the observed growth in revenues during this period; in fact, the growth of social insurance tax receipts has been so significant that all other revenue sources have declined as a share of total revenue.

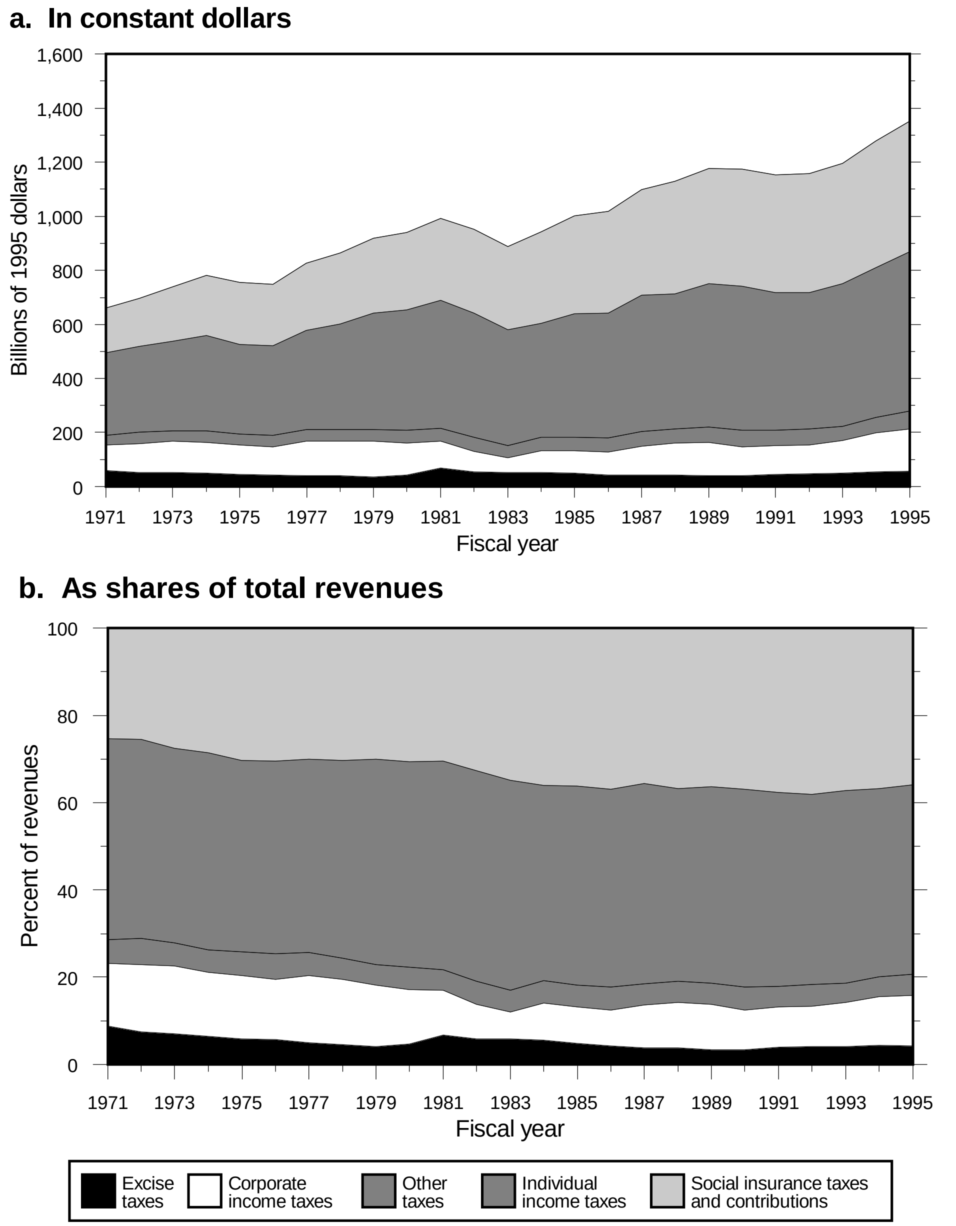
The decline in corporate tax receipts as a percent of GDP in part reflects the contraction of corporate profits as a share of national income. Several other factors have been advanced as explanations for this drop in the corporate tax base, including rising interest rates and, more recently, increasing debt-to-equity ratios which reduced corporate profits. Rate reductions and increased business investment tax preferences enacted in 1981 also contributed to the relative decline in revenue from the corporate profit tax, although corporate taxes were increased in 1986.[1]

Table 2.1: Share and Growth Rates, by Revenue Source, Fiscal Years 1971-1995

	Percent of GDP		Share of total revenues (percent)		Share of observed growth: 1971-1995 (percent)	Average annual real growth: 1971-1995 (percent)
Federal revenue source	**1971**	**1995**	**1971**	**1995**		
Individual income tax receipts	8.2	8.4	46.1	43.6	41.1	2.79
Corporate income tax receipts	2.5	2.2	14.3	11.6	9.0	2.13
Social insurance tax receipts	4.5	6.9	25.3	35.7	45.7	4.53
Excise tax receipts	1.6	0.8	8.9	4.2	–0.2	–0.09
Other receipts	1.0	0.9	5.4	4.9	4.3	2.56
Total revenues	**17.8**	**19.3**	**100**	**100**	**100**	**3.03**

[1]See C. Eugene Steuerle, The Tax Decade: How Taxes Came To Dominate the Public Agenda (Washington, D.C.: The Urban Institute Press 1992); James M. Poterba, "Why Didn't the Tax Reform Act of 1986 Raise Corporate Taxes?," National Bureau of Economic Research, Inc., Working Paper No. 3940, December 1991; and The Shortfall in Corporate Tax Receipts Since the Tax Reform Act of 1986, Congressional Budget Office (May 1992).

Figure 2.2: Federal Revenues by Source

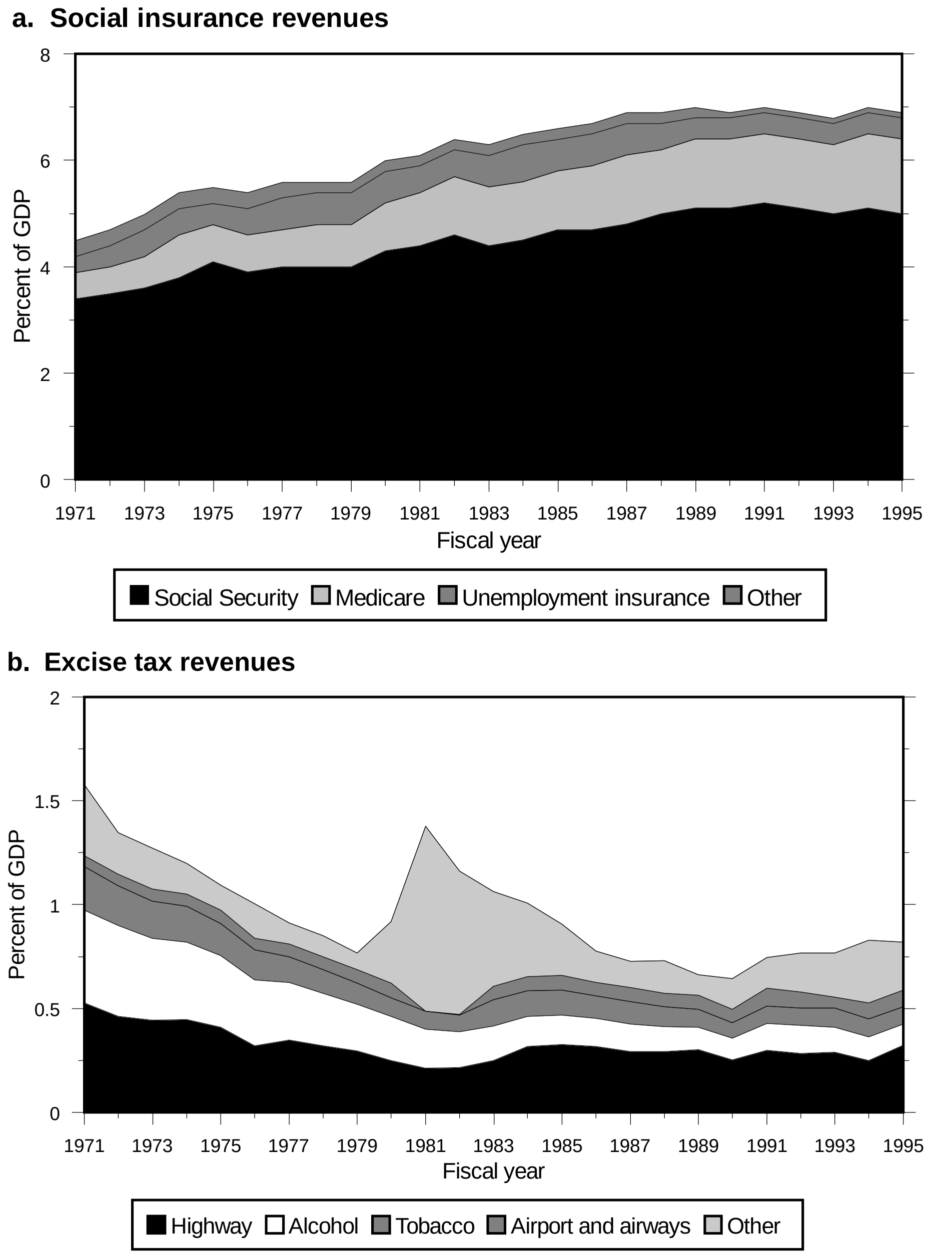


As previously noted, social insurance tax receipts grew faster than any other revenue source since 1971—both in constant dollars from $167 billion to $484 billion, and from 4.5 percent to 6.9 percent of GDP (see figure 2.3a)—principally due to increasing payroll tax rates for Social Security and Medicare.[2] Social Security remains the largest component of social insurance tax receipts, but Medicare is the fastest growing, increasing since its inception in 1965 to almost 20 percent of social insurance tax receipts.

Excise tax receipts have remained rather stable in constant dollars—$57 billion in 1995 compared to $59 billion in 1971—but have declined significantly since 1971 as a percent of GDP. (See figure 2.3b and table 2.1, above.) Excise taxes tend to be set at a fixed dollar amount—not tied to the changing price of taxed products—which accounts for some of the reported decline. Also, as shown in figure 2.3b, "other excise taxes" have experienced substantial volatility during this period. Many of these taxes, which are individually small but in the aggregate represent a major share of the total for this source, were created during this period. A few of these taxes were also eliminated during this period. For example, the large spike in 1981 was principally due to the "windfall profits" tax imposed on domestic oil producers to capture some of the profits arising from decontrol of domestic crude oil prices and price increases by other oil producing nations. This excise tax generated substantial revenue in the early 1980s, but declined sharply as oil prices dropped; ultimately, it was repealed in 1988.

[2]Payroll taxes are for the Hospital Insurance (HI) component of Medicare. Medicare Part B premiums are included in offsetting receipts.

Figure 2.3: Composition of Social Insurance and Excise Taxes



Tax Expenditures

The federal tax code has long been used as a tool for accomplishing objectives in addition to raising revenue. "Tax expenditures" refer to tax code provisions which, through deductions, exclusions, credits, or preferences, seek to encourage certain types of economic activity or provide relief to certain groups of taxpayers. In essence, tax expenditures, while pursuing these objectives, reduce tax liabilities and constitute revenue forgone for the federal government. The size of the revenue loss depends on (1) the nature of the deduction or preference, for example some eliminate whole components of the tax base, and (2) the applicable tax rate, generally the higher the rate, the greater the value of the preference and the greater the revenue loss to the government. Among the largest tax expenditures are the net exclusion from income of pension contributions and earnings, the exclusion of employer contributions for health insurance premiums and medical care, and the deductibility of state and local taxes and of mortgage interest for owner-occupied housing.

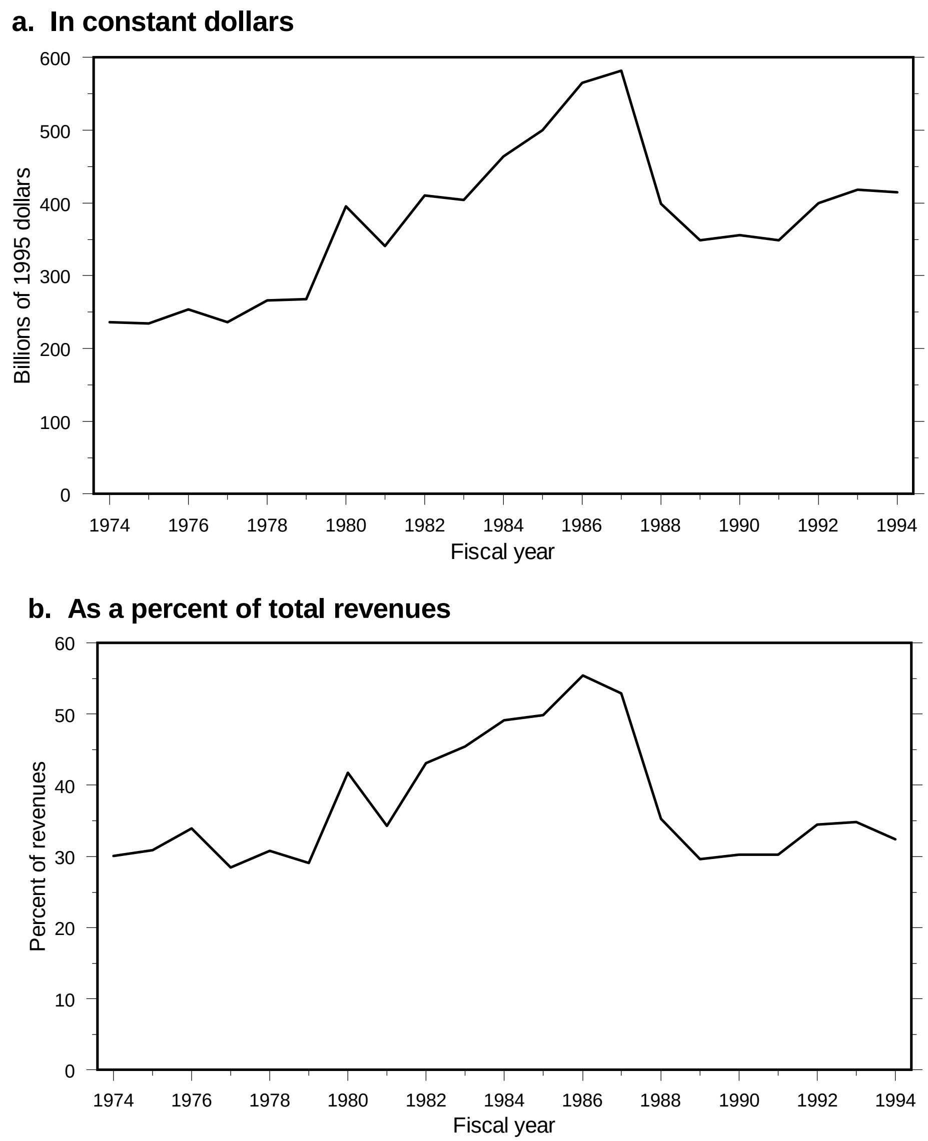
Although the Congressional Budget Act of 1974 requires OMB to list tax expenditures in each annual budget, it does not specify the provisions of tax law, and thus deciding whether tax provisions are preferential exceptions is a matter of judgment. Both the Congress' Joint Committee on Taxation (JCT) and the Department of the Treasury's Office of Tax Analysis annually compile a list of tax expenditures and estimate the revenue loss from each.[3] However, the estimated forgone revenue from a particular tax expenditure does not necessarily equal revenues that could be gained if the special tax provision was repealed. Tax expenditures are frequently interdependent, so that a change in one might have a countervailing effect on another. These interaction effects also mean that the sum of the revenue losses from individual expenditures does not equal the total revenue forgone from all tax expenditures. Also, tax expenditures can provide incentives for specific economic behavior; if repealed, the behavior may be modified but not necessarily eliminated, with corresponding effects on anticipated receipts.

Nevertheless, many observers agree that aggregating estimated revenue loss from tax expenditures can suggest an order of magnitude of revenues forgone in a given year. Figures 2.4a and 2.4b summarize JCT's estimates and indicate that although revenue forgone through tax expenditures has increased significantly in constant dollars it represents about the same percentage of total revenues in 1994 as in 1974. The sharp increase

[3]A discussion of the methodological challenges presented by tax expenditures is in chapter 5 of the Analytical Perspectives to the Budget of the United States Government, Fiscal Year 1997. For a discussion of the growth of and alternatives to tax expenditures, see Tax Policy: Tax Expenditures Deserve More Scrutiny (GAO/GGD/AIMD-94-122, June 3, 1994).

between 1979 and 1987 was reversed by the Tax Reform Act of 1986, which lowered rates and scaled back many tax expenditures. Recent growth in tax expenditures is principally due to demographic and economic factors, and changes in taxpayer behavior.

Figure 2.4: Estimated Revenue Forgone From Tax Expenditures



Revenues From Offsetting Collections

An important source of revenue for many federal activities is offsetting collections from the public. These collections differ from the governmental receipts previously discussed in this chapter in that they do not arise from the exercise of sovereign powers but rather involve receipts from the public arising from business-type activities or the payment of certain regulatory or other fees. They are referred to as offsetting collections because they are treated as offsets to outlays and are not included in revenue totals. In effect, this treatment reduces the reported cost of certain governmental activities, causing total federal transactions to be understated, but produces budgetary receipt and outlay totals which reflect net governmental, rather than market-based, activities.[4]

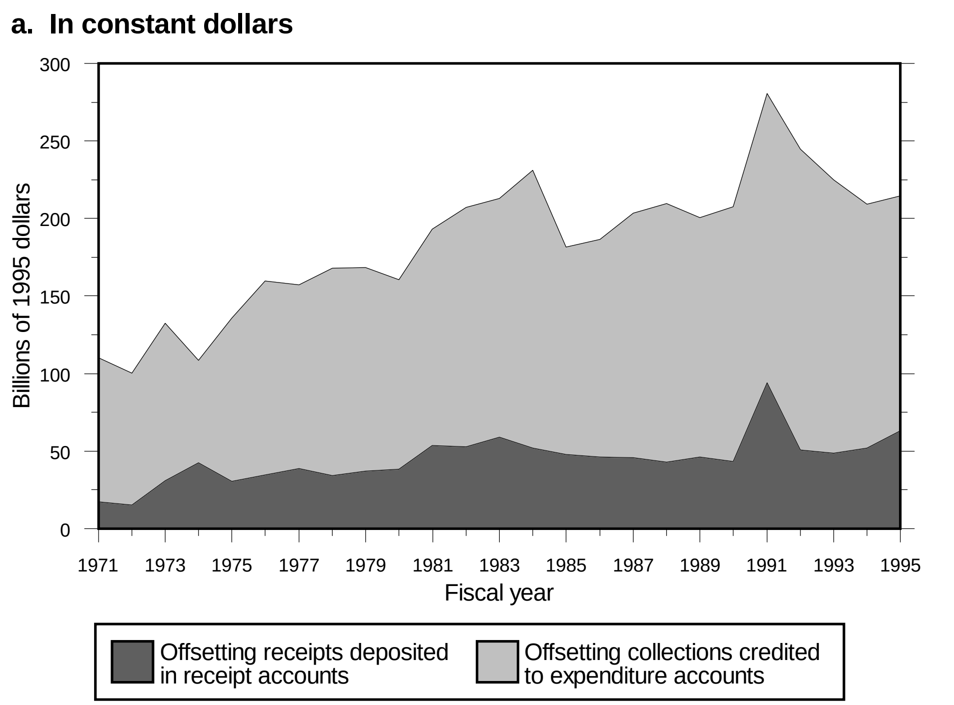
Some offsetting collections, notably a wide variety of revolving funds, are credited to and offset outlays from specific expenditure accounts; these collections are generally available for obligation with no further congressional action. The remainder are referred to as "offsetting receipts," and include collections for regulatory and nonregulatory services, the sale of property and products, or rents and royalties. Offsetting receipts are not credited to expenditure accounts, but rather to general, special, or trust fund receipt accounts, and are not available for obligation without subsequent appropriation, although a significant portion has been permanently appropriated. Offsetting receipts are generally recorded as reductions against agency (rather than specific expenditure account) outlays, or as undistributed offsets to total governmental outlays.

In constant dollars, total collections from the public—offsetting receipts and collections from the public—have about doubled since 1971 (see figure 2.5); since 1981, they have exceeded the combined shares of corporate and excise taxes as a percent of total revenues. Figure 2.5 shows the volatility of these transactions. Recent fluctuations in collections from the public are largely due to deposit insurance receipts. The large increase in 1990-1991 in offsetting receipts is largely the result of allied contributions for Operation Desert Storm collected in the Department of Defense's Defense Cooperation account. Postal Service and farm credit program collections have consistently been the largest sources of offsetting collections credited to expenditure accounts. Medicare premiums and other health insurance charges—which collectively have

[4]Some argue that this treatment can distort budget decisions, as activities funded through offsetting collections grow without apparent increases in net outlays. See, for example, John F. Cogan and Timothy J. Muris, "Changes in Discretionary Domestic Spending During the Reagan Years," The Budget Puzzle: Understanding Federal Spending, Stanford University Press, Stanford, California, 1994.

quadrupled in the last decade—and Foreign Military Sales proceeds are the largest sources of offsetting receipts.

Figure 2.5: Composition of Offsetting Collections From the Public



Federal Outlays: Fiscal Years 1971-1995

Outlays are a measure of what is more commonly called spending.[1] As with revenues, total outlays have shown a consistent growth pattern over this period, doubling from over $740 billion to over $1.5 trillion, in constant dollars (see figure 3.1a), with an average real growth rate of 3 percent. (See table 3.1.) For the most part, total outlays were less sensitive to economic conditions than revenues. Most of the growth experienced over this period resulted from structural policy decisions—the enactment, expansion, and growth of a wide variety of spending programs.

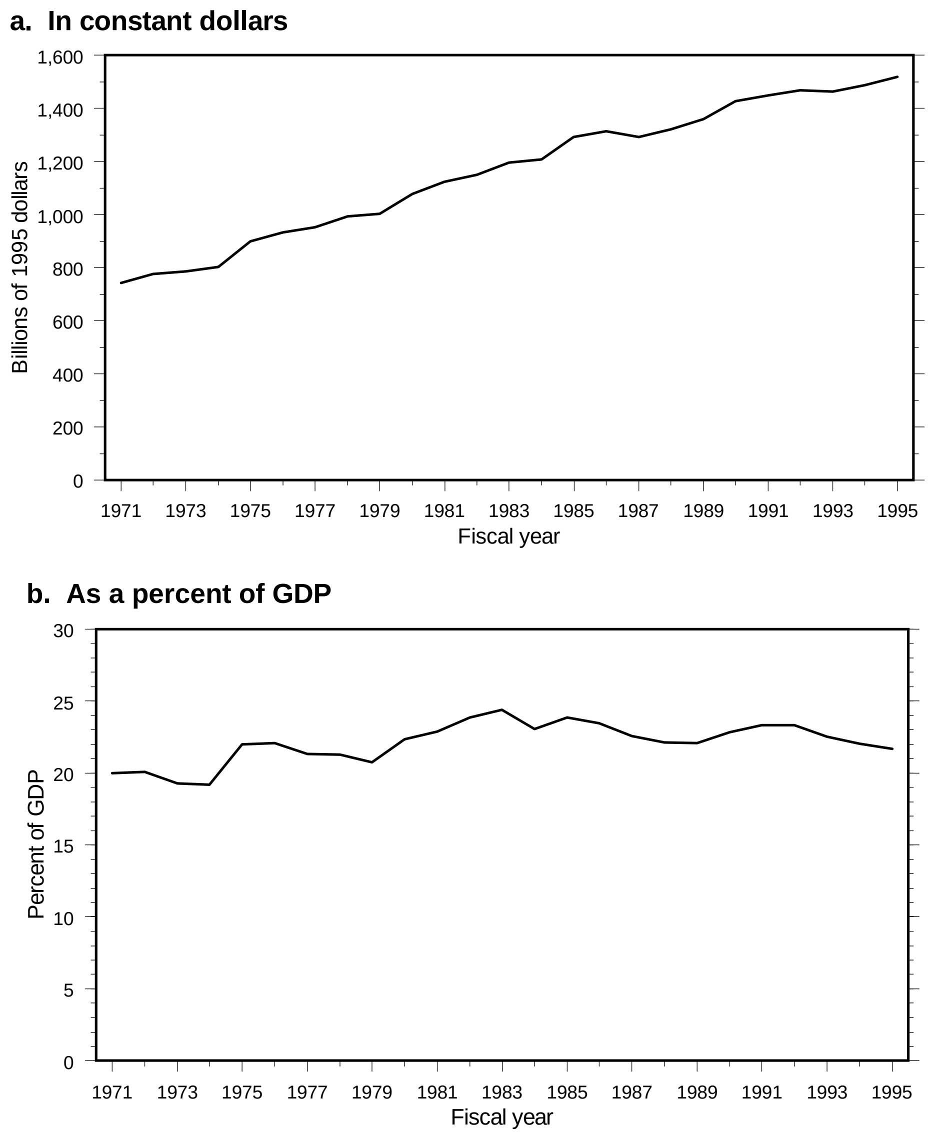
However, when measured as a percent of GDP to control for growth associated with normal expansion of the nation's economy, outlay growth is less dramatic and more sporadic. (See figure 3.1b and table 3.1.) For example, from a 1971 level of about 20 percent of GDP, outlays peaked as a percent of GDP in 1983 (24.4 percent) and have gradually fallen thereafter. The 1995 level, 21.7 percent, is the lowest since 1979.

Table 3.1: Share and Growth Rates, by Outlay Category, Fiscal Years 1971-1995

	Percent of GDP		Share of total outlays (percent)		Share of observed growth: 1971-1995	Average annual real growth: 1971-1995
Outlay category	**1971**	**1995**	**1971**	**1995**	**(percent)**	**(percent)**
Mandatory outlays	6.9	10.6	34.7	48.8	62.3	4.5
Social Security	3.3	4.8	16.7	21.9	27.0	4.2
Medicare	0.6	2.2	2.9	10.3	17.4	8.5
Medicaid	0.3	1.3	1.6	5.9	9.9	8.7
Other	2.7	2.3	13.5	10.7	8.0	2.0
Discretionary outlays	11.7	7.8	58.3	35.9	14.5	1.0
Defense	7.5	3.9	37.6	18.0	–0.8	–0.1
International	0.4	0.3	1.8	1.3	0.9	1.7
Domestic	3.8	3.6	18.9	16.6	14.4	2.5
Interest outlays	1.4	3.3	7.0	15.3	23.2	6.4
Total Outlays	**20.0**	**21.7**	**100.0**	**100.0**	**100.0**	**3.0**

[1]In a given fiscal year, outlays can result from obligations incurred in a prior year or in the current year. Thus, outlays reported for a specific fiscal year can flow from available balances of unexpended prior year budgetary resources or from budgetary resources provided in the year the money is spent.

Figure 3.1: Federal Outlay Trends



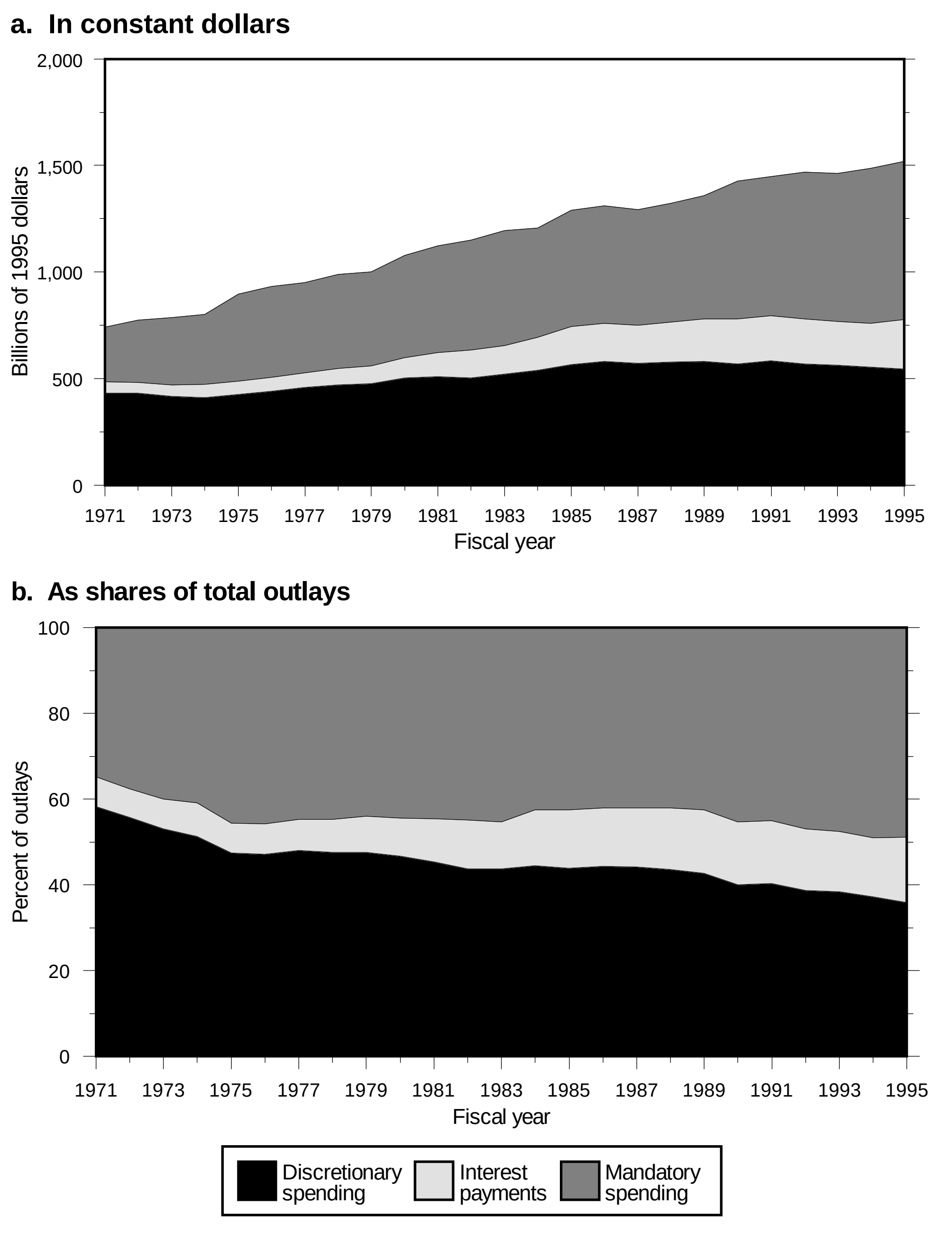
The Mandatory and Discretionary Components of Spending

The Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993, which revised and extended the 1990 act, sought to control federal spending by establishing different control mechanisms for two types of outlays: mandatory and discretionary spending. In general, the former is defined as spending for entitlement programs, such as food stamps, Medicare, or veterans' pensions; these outlays are not controlled through the appropriations process but rather by authorizing laws which define eligibility or set benefit or payment rules. Discretionary spending is that which arises from appropriations laws.

Extending the mandatory and discretionary categories created in 1990 over the entire period of this analysis reveals a significant shift. While mandatory spending nearly tripled between 1971 and 1995 in constant dollars, discretionary outlays grew by only about 25 percent. (See figure 3.2a.) This disparate growth pattern is shown in figure 3.2b. Excluding interest costs, which have quadrupled in constant dollars and doubled as a share of outlays during this period, mandatory spending has increased as a share of total outlays from 35 percent to almost 50 percent, while the discretionary outlay share has declined significantly. (See table 3.1, above.) Phrased differently, spending for entitlement and other mandatory programs—arising outside of the annual appropriations process—grew four times faster in real terms than appropriated (i.e., discretionary) spending. In effect, spending arising outside of the annual appropriations process has become the principal driver of federal outlays.[2]

[2]A recent GAO report described the implication of this trend for fiscal year 1995. Using gross budgetary resources as the universe, we noted that over 70 percent of total resources available in fiscal year 1995 did not require congressional approval in that year. (Budget Account Structure: A Descriptive Overview (GAO/AIMD-95-179, Sept. 18, 1995).

Figure 3.2: Outlay Trends by Spending Category

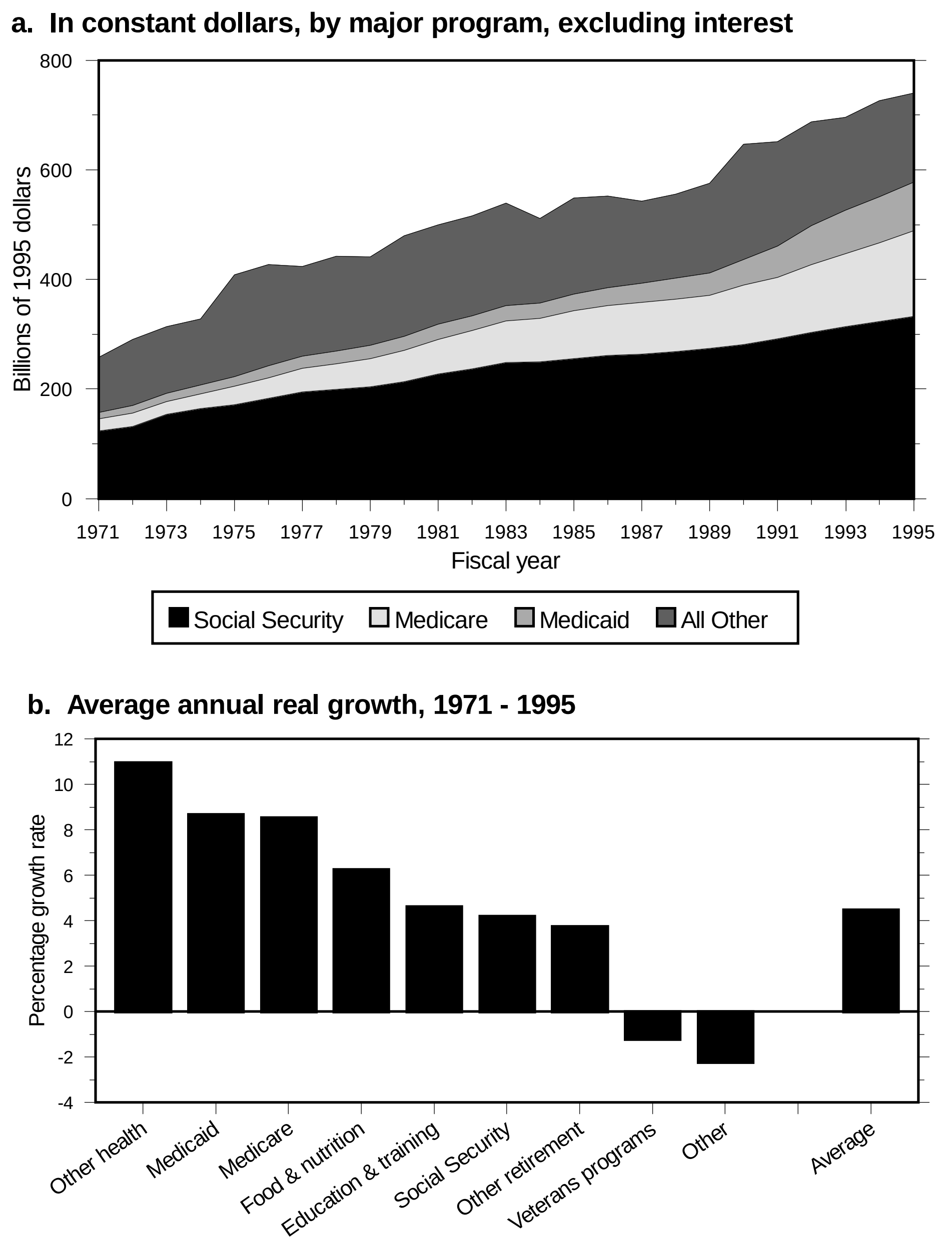


Social Security has been consistently the largest program within the mandatory spending category. (See figure 3.3a.) However two health programs begun in the mid-1960s, Medicare and Medicaid, are among the fastest growing components. Collectively, these three programs account for more than half of the total observed outlay growth during the last 25 years.

As shown in figure 3.3b, there is wide variation in the average annual growth rates in mandatory programs. The principal factors that contribute to the growth rates of mandatory programs include changes in the numbers of beneficiaries and inflation.[3] Although average annual growth rates provide an indication of the rate of change of a program, they do not necessarily capture large constant dollar changes. For example, the 11 percent average annual real growth in other health programs represents a constant dollar increase from $0.4 billion in 1971 to $4.3 billion in 1995. On the other hand, the smaller 4.2 percent growth in social security represents an increase from $124.2 billion to $333.3 billion, in constant dollars.

[3]For larger discussion of mandatory programs, see Budget Policy: Issues in Capping Mandatory Spending (GAO/AIMD-94-155, July 18, 1994).

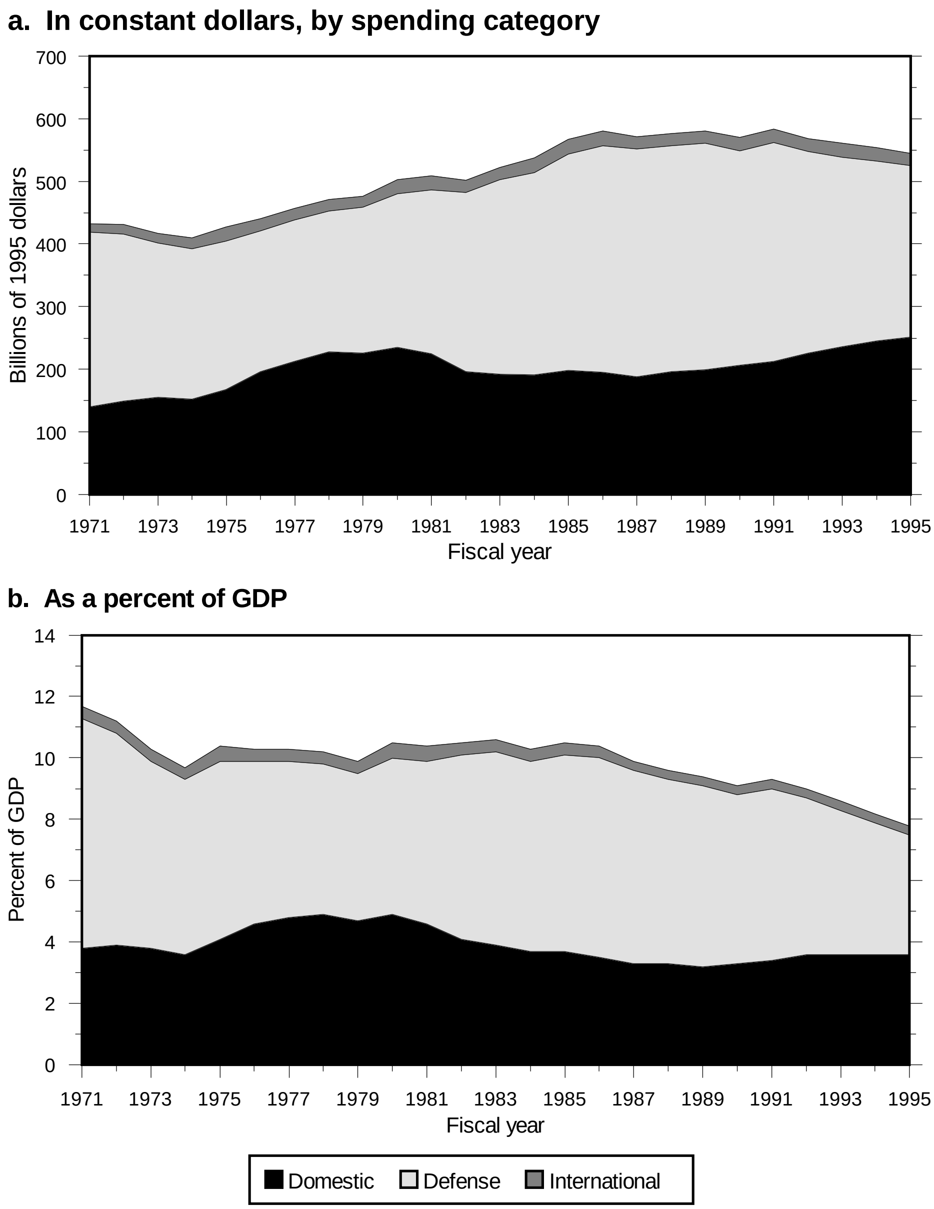
Figure 3.3: Mandatory Spending



Overall, discretionary spending declined relative to total spending and GDP but did experience very modest average annual real growth (1.0 percent) since 1971. (See figure 3.4 and table 3.1, above.) Defense discretionary outlays declined slightly in real terms (–0.1 percent) during this period, but fell sharply as a percent of GDP and declined from two-thirds to one-half of total discretionary spending. This overall trend is somewhat misleading, masking three distinct periods in defense spending: decreases between 1971 and 1980, and increases between 1980 and 1987 followed by declines thereafter (except for the increase in 1991 due to Operation Desert Storm).

Although domestic discretionary spending as a percent of GDP was generally stable throughout this period, in real terms it increased by 80 percent ($140 billion to $252 billion) between 1971 and 1995. As a share of total outlays, domestic discretionary spending decreased from 18.9 to 16.6 percent between 1971 and 1995, but as a share of total discretionary outlays grew from 32.4 to 46.2 percent. As with defense discretionary spending, three distinct spending trends can be discerned. Specifically, domestic discretionary outlays grew by 67 percent, in real terms, between 1971 and 1980, declined in the early 1980s, and then have grown fairly steadily thereafter.

Figure 3.4: Discretionary Spending



Outlay Trends by Federal Mission Area

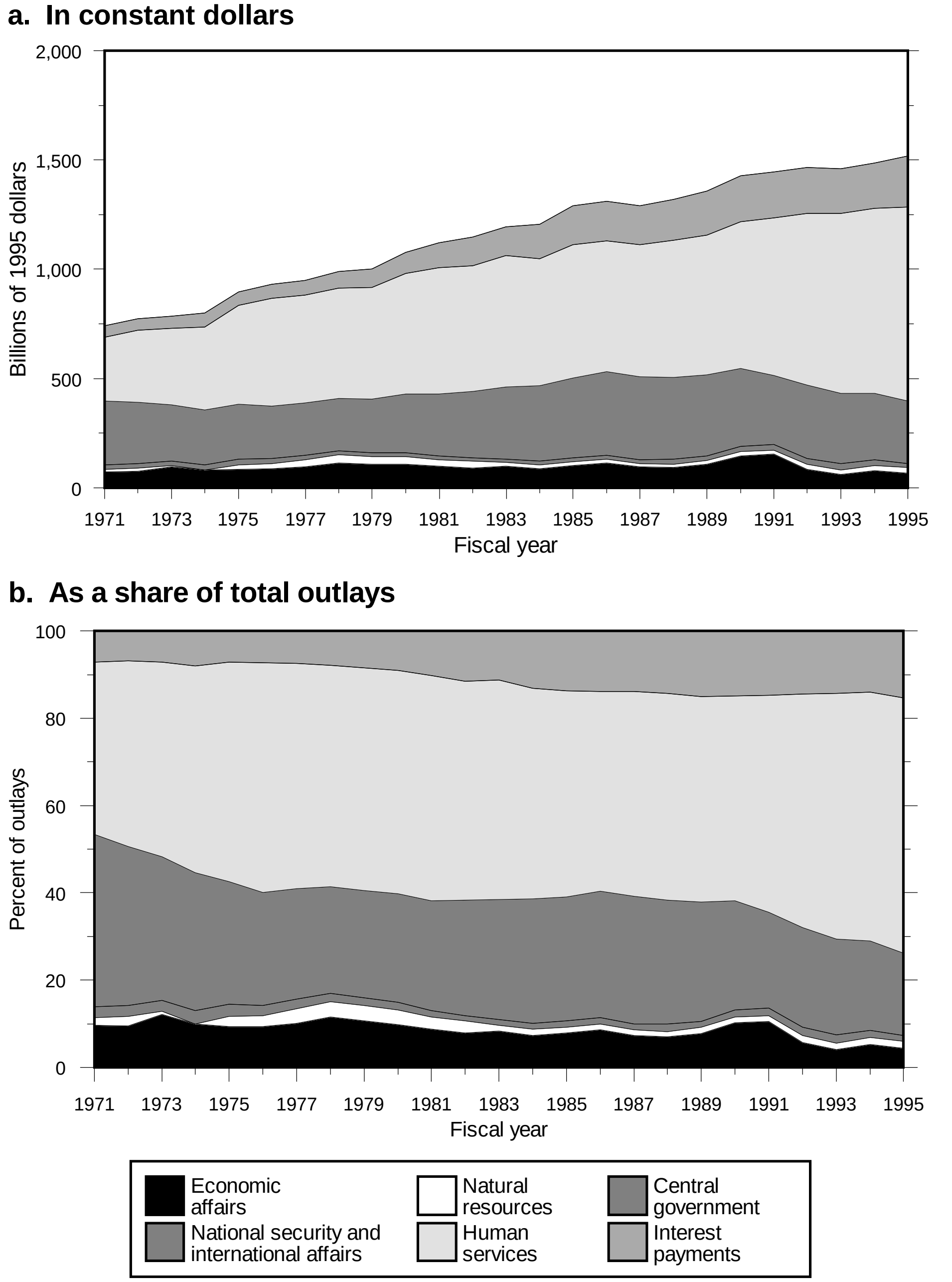
Within overall outlay trends, there has also been substantial variation in spending by federal mission or priority. One way to observe this variation is to array outlays by budget function. Budget function presentations have existed for over 70 years. The current classification system can be traced to the Budget of the U.S. Government for Fiscal Year 1948, which revised earlier classifications to provide a cross-cutting presentation of outlays according to "the ultimate purpose which the . . . programs are designed to serve." Since then, budget functions have been revised several times to reflect changing federal priorities but still provide the most complete perspective on federal missions.[4] These budget functions are also the categories used by the Congress in the concurrent resolutions on the budget, pursuant to the Congressional Budget and Impoundment Control Act.

For this report, we have grouped the 18 budget functions and over 70 subfunctions into 6 broad mission areas: central government operations, economic affairs, human services, natural resources, national security and international affairs, and interest payments.[5] As shown in figures 3.5a and 3.5b, there have been significant shifts in federal spending by mission since 1971. Outlays for human services—principally Social Security and health-related spending—and for interest payments grew as a share of the total, while outlays for all other mission areas, some of which are discussed next, declined in constant dollars and/or as shares of the total.

[4]While this classification system provides complete coverage of the federal budget, with generally exclusive categories, there are limitations arising from data reporting procedures. For a discussion on this point, see Budget Function Classification: Agency Spending and Personnel Levels for Fiscal Years 1994 and 1995 (GAO/AIMD-95-115FS, April 11, 1995).

[5]For a description of the crosswalk between functions/subfunctions and the macrofunctions used in this report, see appendix I, Scope and Methodology.

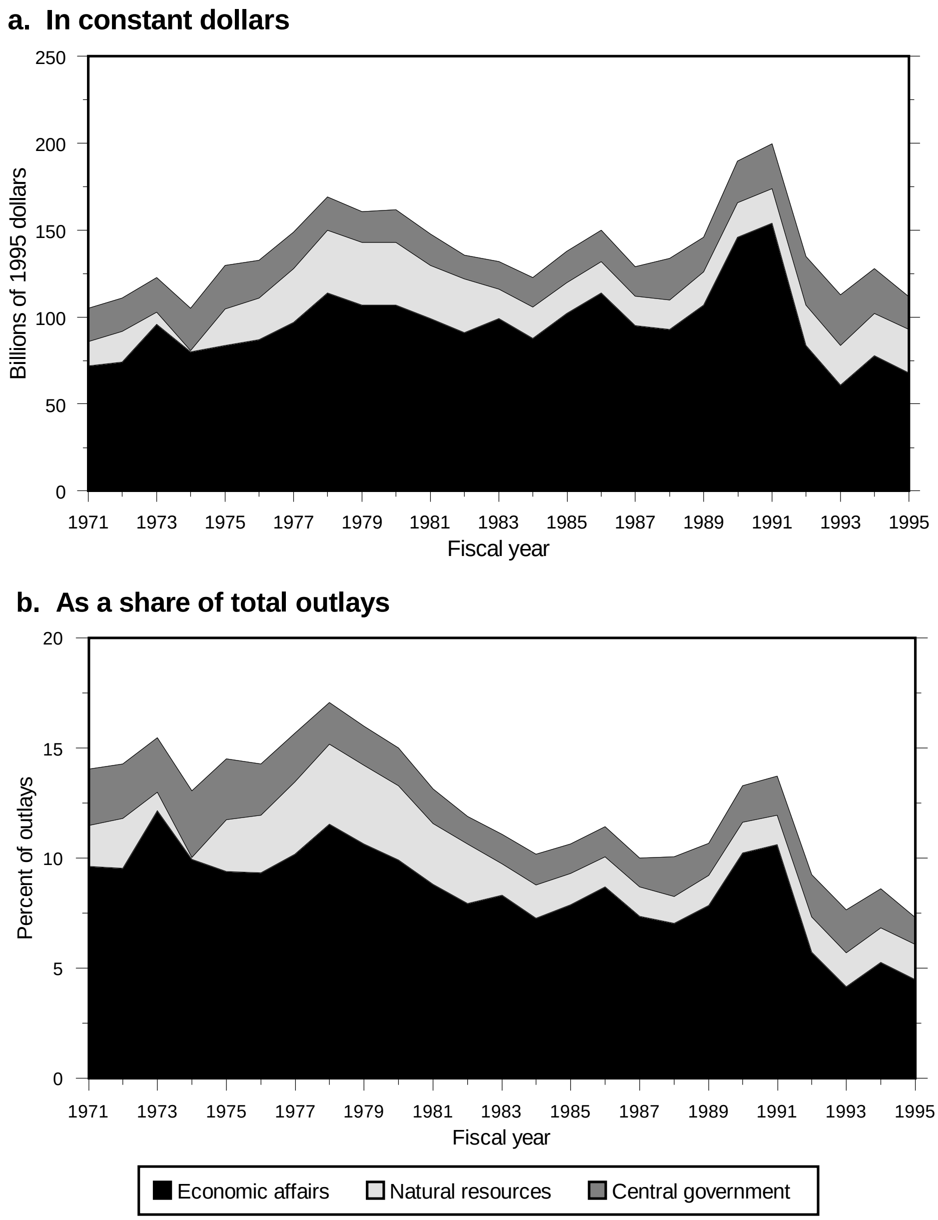
Figure 3.5: Outlay Trends by Mission Area



Overall spending in the areas of economic affairs, natural resources, and central government operations constitutes a very visible but small and declining share of total spending. Spending in these areas has declined to 7.3 percent of total outlays from a 1971 level of 14.1 percent. (See figures 3.6a and 3.6b.) Not surprisingly, these overall trends conceal substantial variation within the separate mission areas.

- Economic affairs spending, for such activities as economic stabilization and development, nondefense research and development, and disaster relief, displayed the greatest variability over the trend period, ranging from 4 to 12 percent of total outlays. The spikes seen in the spending patterns were largely due to agricultural income support and area and regional development programs in 1977-1979 and increased deposit insurance outlays in 1990-1991.
- Natural resources spending fell off sharply in 1973 and 1974 largely due to an increase in oil and gas royalties on the outer continental shelf, which as offsetting receipts reduced the apparent spending in this area. Spending in this area rebounded in the late 1970s due to the effects of the energy crisis and changing environmental policies, notably grants associated with wastewater treatment. Throughout the period, natural resources missions drove a small share (0.1 to 4 percent) of total spending.
- Central government operations, covering such diverse areas as legislative operations, central support services for financial and property management, and all justice and law enforcement activities, represents a consistently small (less than 3 percent) and generally declining share of federal outlays. Recent increases were generally associated with spending on law enforcement activities.

Figure 3.6: Outlay Trends for Selected Federal Missions

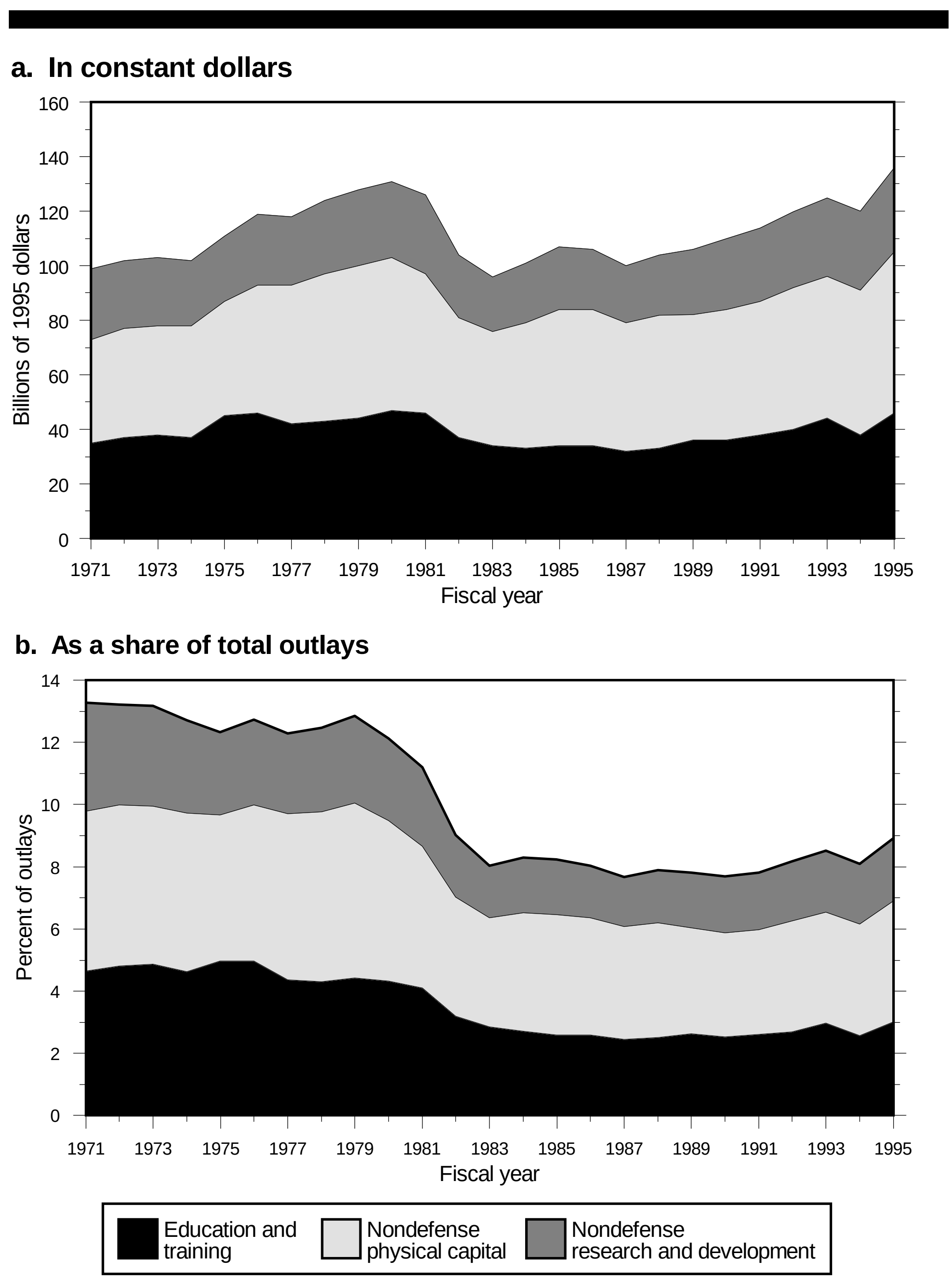


Federal Investment Outlays

The shift in spending among federal missions has directly affected federal investment outlays—spending intended to foster long-term economic growth.[6] Included in this category of spending are nondefense outlays for physical capital, such as highways and airports; research and development; and education and training. Although in recent years investment spending has increased in real terms, investment spending as a percent of GDP has remained essentially constant since 1983. (See figure 3.7a.) Overall, investment-related outlays were a generally consistent share (about 13 percent) of total spending during the 1970s, then fell to and maintained a lower share (about 8 percent) until recent upturns. (See figure 3.7b.) Research and development outlays declined from 1971 through 1987 and increased slightly thereafter. Outlays for physical capital and for education and training increased during the 1970s but declined thereafter.

[6]For this analysis, we have used OMB definitions regarding investment outlays. For a discussion of GAO views on this subject, see Budget Structure: Providing an Investment Focus in the Federal Budget (GAO/T-AIMD-95-178, June 29, 1995).

Figure 3.7: Outlay Trends by Investment Category



Outlay Trends Disclose Change in Governmental Activities

As federal missions and priorities have changed, so has the approach or method of governmental activities. Two different trend series help to disclose how the federal government's activities have shifted over the last 25 years—from a "do-er" or direct service provider to a distributer of cash benefits and vouchers for other benefits to individuals.[7]

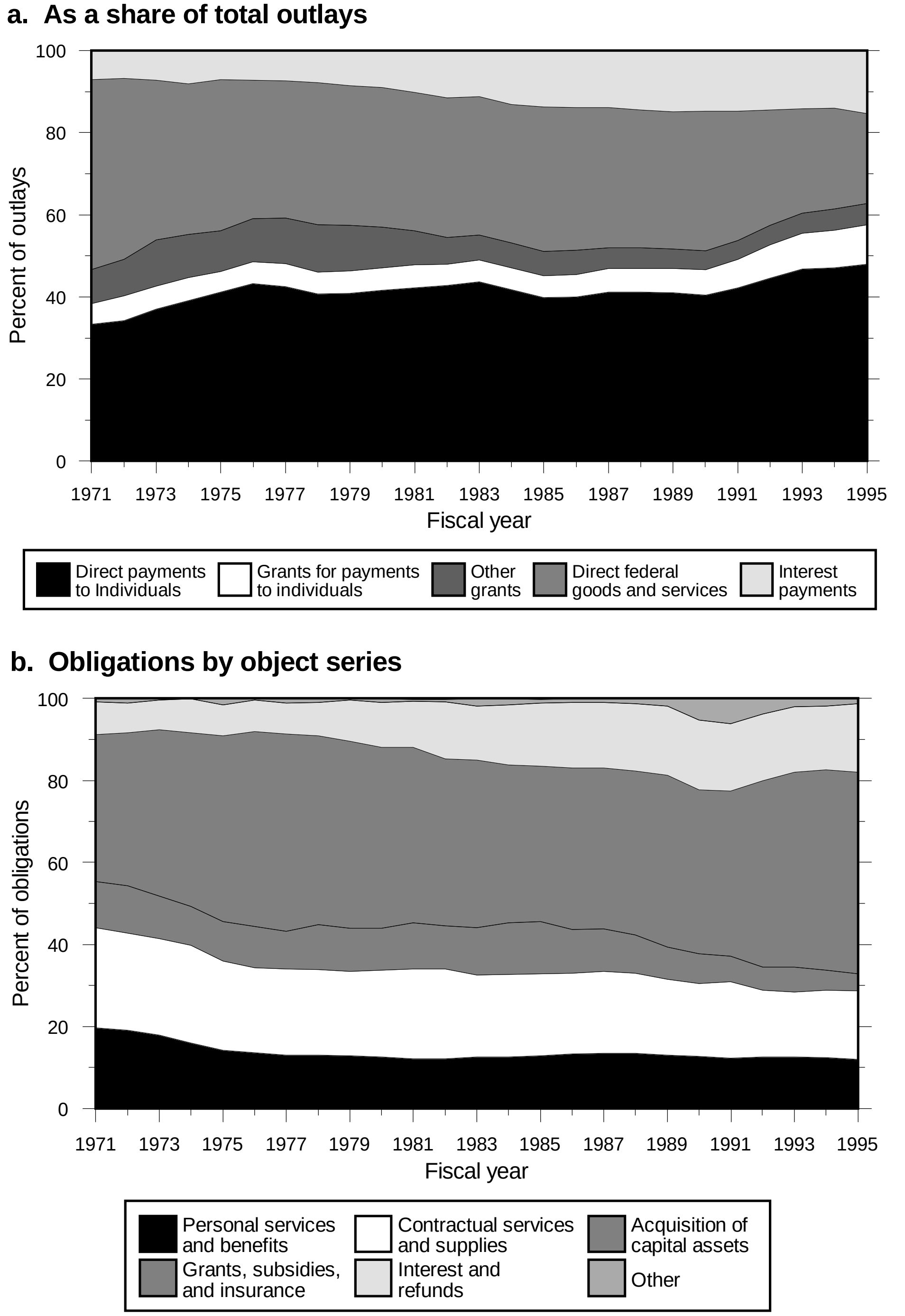
Figure 3.8a depicts shares of total outlays for payments to individuals—either as cash payments (e.g., Social Security) or entitlements to other benefits (i.e., medical care or housing assistance)—apart from outlays for all other federal programs. In effect, this figure portrays the shift in governmental activity toward principally dispensing cash or vouchers for in-kind benefits to individuals, and away from providing other goods or services directly or through contracts or grants.

The shift in how the federal government conducts its activities can also be seen by classifying spending according to the items of expense—that is, the articles or objects procured, rather than the service or result achieved.[8] As figure 3.8b shows, a clear shift in federal spending has occurred, toward "transfer payments" (i.e., grants, subsidies, and insurance) and interest costs, and away from what could be called the "operating expenses" of government. In this analysis, "operating expenses" are the direct costs of government associated with personal services and benefits (i.e., federal employee compensation and benefits), contractual services and supplies, and capital asset acquisition (i.e., the three segments on the bottom of figure 3.8b). Collectively, spending for these "operating expenses" of the federal government has declined as a share of total spending over the last 25 years, while spending for "transfer payments" and interest costs have steadily increased.

[7]As discussed in chapter 2, governmental collections arising from business-type transactions, which often involve direct services to the public, are offset from federal outlays and are thus excluded from this discussion.

[8]This classification of federal spending uses gross obligations rather than outlays and is sometimes referred to as an object class analysis. For a full discussion of this budget presentation approach, see Budget Trends: Obligations by Item of Expense, Fiscal Years 1971 - 1994 (GAO/AIMD-95-227, Sept. 12, 1995).

Figure 3.8: Trends by Nature and by Item of Expense



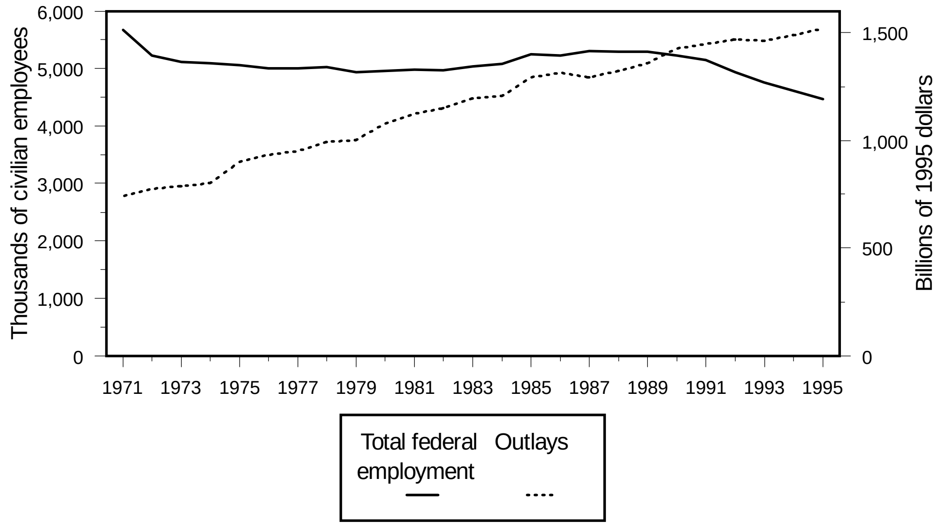
Federal Outlay and Employment Trends

Over the last 25 years, total federal employment has declined relative to federal outlays and the overall U. S. population.[9] (See figures 3.9a and 3.9b.) In recent years, the sharp decline has resulted from the downsizing of the Department of Defense, and the associated reduction in uniformed military employees, and from the Federal Workforce Restructuring Act of 1994 (Public Law 103-226), which mandated over 272,000 reductions in federal employment through fiscal year 1999.

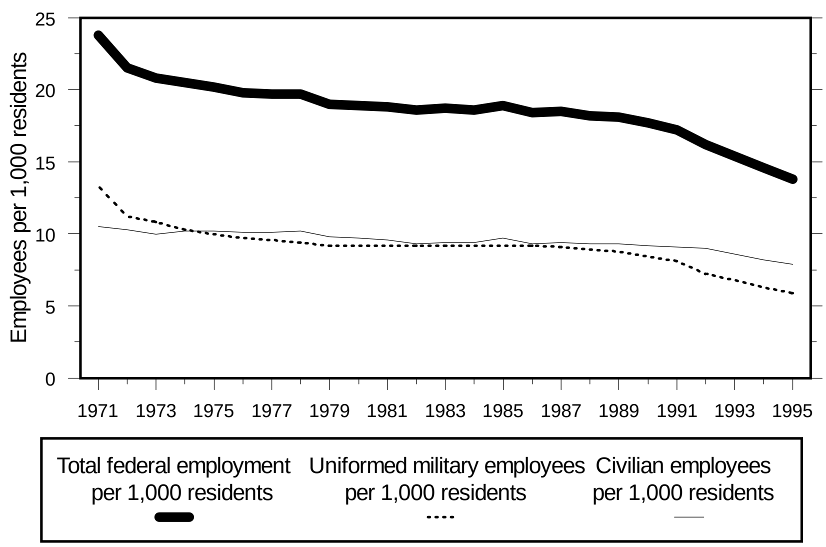
[9]This figure includes all legislative, executive (civilian and uniformed military) and judicial branch employees but excludes outlays and employees of the Postal Service.

Figure 3.9: Federal Employment Trends

a. Comparing federal employment to federal outlays



b. Ratio of Federal Employees to Population



Note: These figures exclude Postal Service employees and outlays.

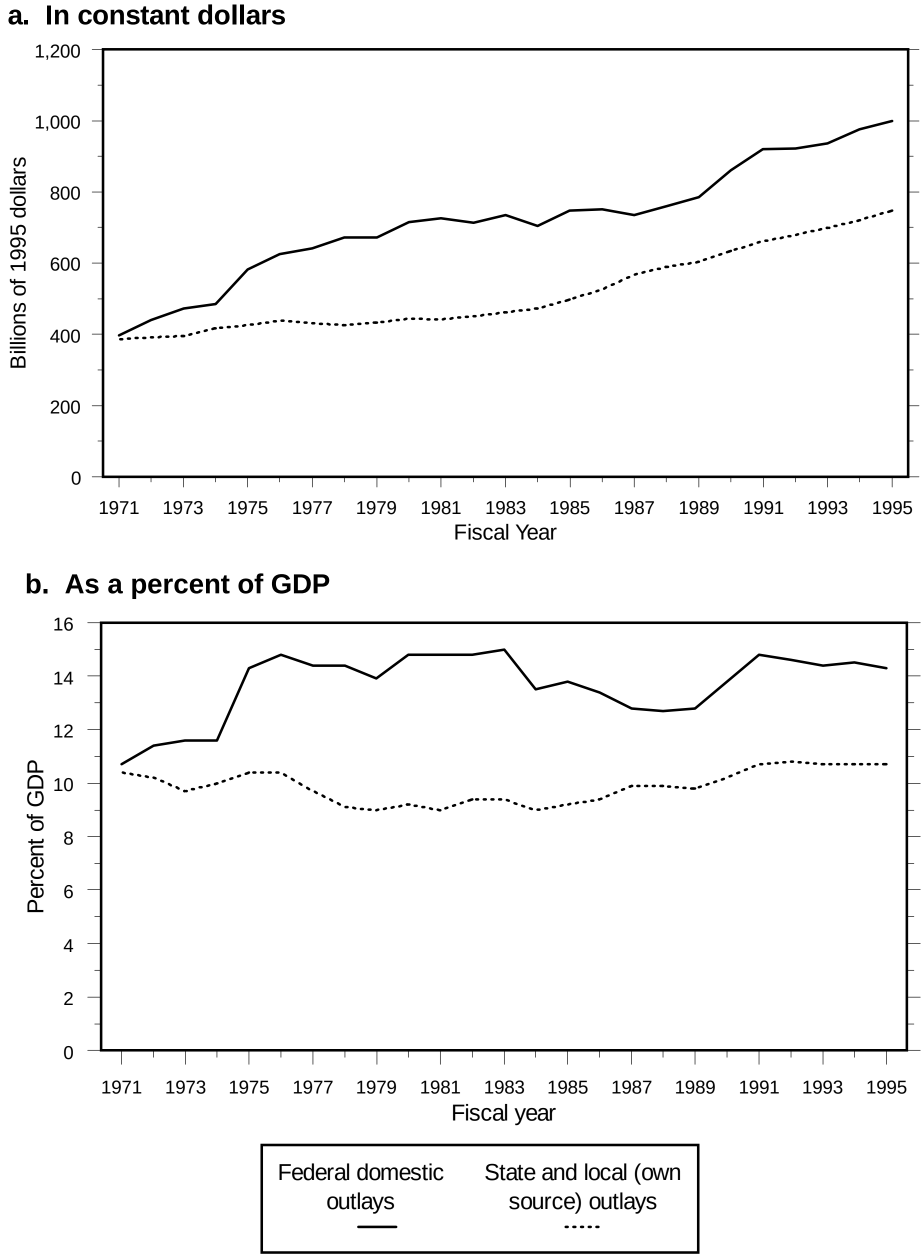
Comparison With Other Governments

Federal Outlays Compared to State and Local Government Spending

It can also be informative to compare federal government spending trends to those of other governments. For example, within the United States, federal government spending trends can be compared to the combined totals for state and local governments, the partners in our federal system.[1] As shown in figures 4.1a and 4.1b, both federal government domestic spending and state-local spending have grown in constant dollars and as a percent of GDP over the trend period, but at varying rates. The gap between federal domestic and state-local spending expanded in the early 1970s following enactment of general revenue sharing and increases in social security benefit payments. Although the gap narrowed in the late 1980s, it has remained relatively constant since 1990, with state-local spending being about 25 percent less than federal domestic spending.

[1]State and local data reflect spending from own-source revenues, exclusive of federal grants, as reported in OMB's Historical Tables. These data are collected by the Bureau of the Census and Bureau of Economic Analysis within the Department of Commerce.

Figure 4.1: Federal Domestic Outlays Compared to State and Local Outlays



Comparing United States and Foreign Government Fiscal Trends

The experience and trends of the United States can also be compared to those of other industrialized nations. Cross-country comparisons present unique measurement challenges due to differences in the form (federal versus unitary) of various nations' governments, but such comparisons can provide useful insight into a nation's fiscal condition relative to its economic output. One way to minimize these challenges and make meaningful comparisons of the size of the government relative to the economy is to examine the combined totals for all levels of government. Thus, for the United States, federal government data can be combined with that from state and local governments to determine United States government totals. Figures 4.2 and 4.3 compare United States government revenues and outlays for 1973, 1983, and 1993[2] to those of six other industrialized countries: Canada, France, Germany, Italy, Japan, and the United Kingdom. As these figures show, although overall levels as a percent of GDP in each country differ, the United States allotted a smaller share of its GDP to government activities in each of these years than all nations except Japan.

Figure 4.4 shows United States government deficits compared to total government deficits of the six other industrialized nations, as a percent of GDP in each country. Several of these countries embarked on major deficit reduction efforts during and after the 1980s; although results were mixed and some have slid back into worsening deficits during the 1990s, all face overall better situations for having taken action.[3]

[2] 1993 is the most recent year for which the data is available for all countries.

[3] For a discussion of the actions taken by these countries to reduce their deficits, see Deficit Reduction: Experiences of Other Nations (GAO/AIMD-95-30), December 13, 1994.

Figure 4.2: U.S. Revenues Compared to Other Countries—1973, 1983, 1993

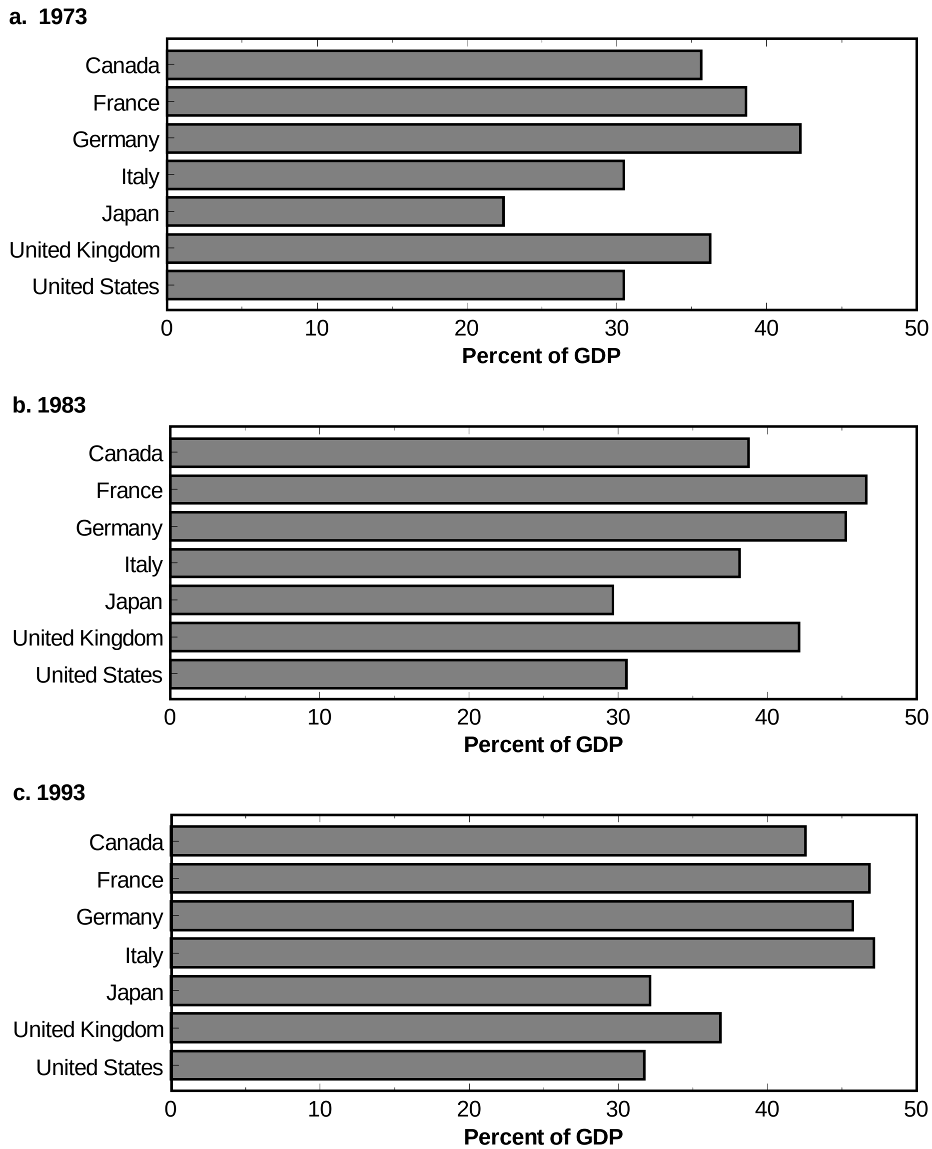


Figure 4.3: U.S. Outlays Compared to Other Countries—1973, 1983, 1993

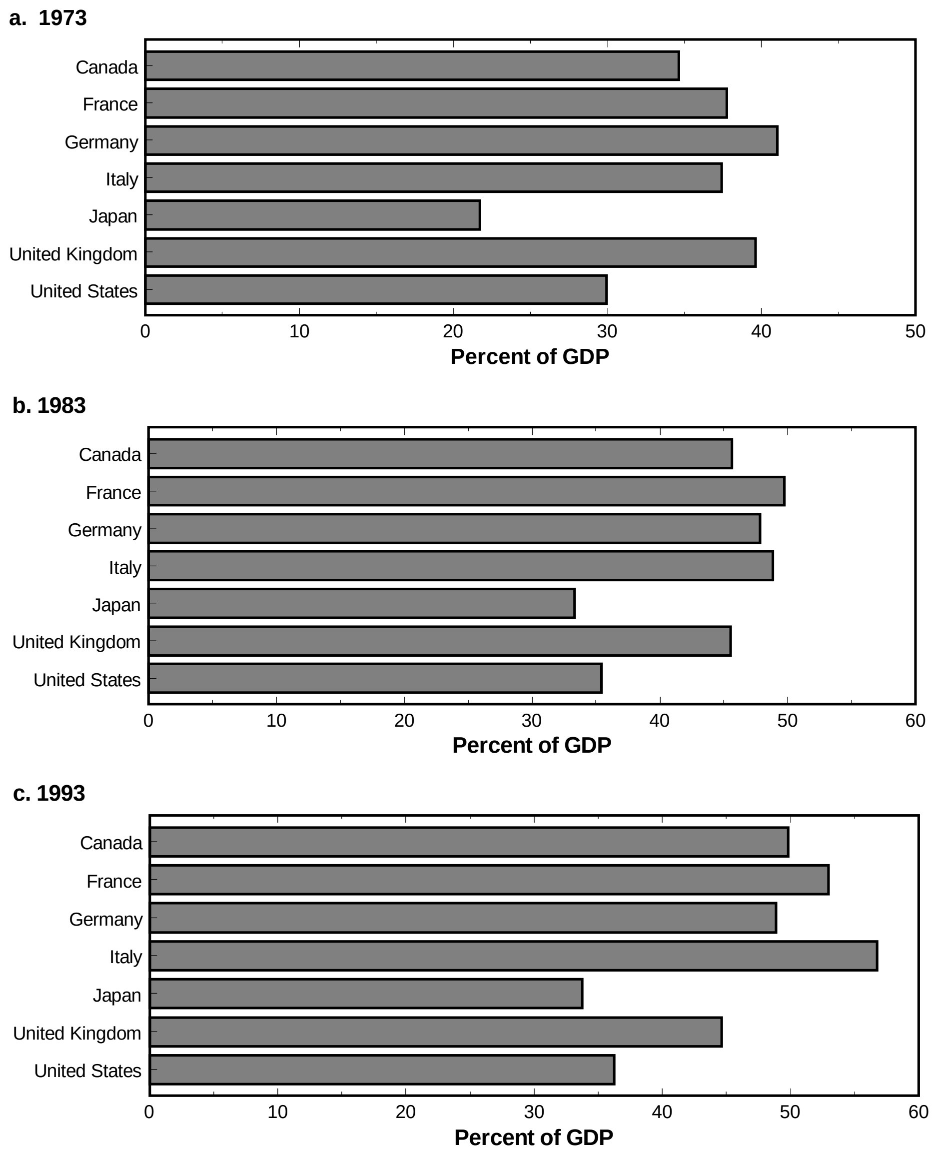
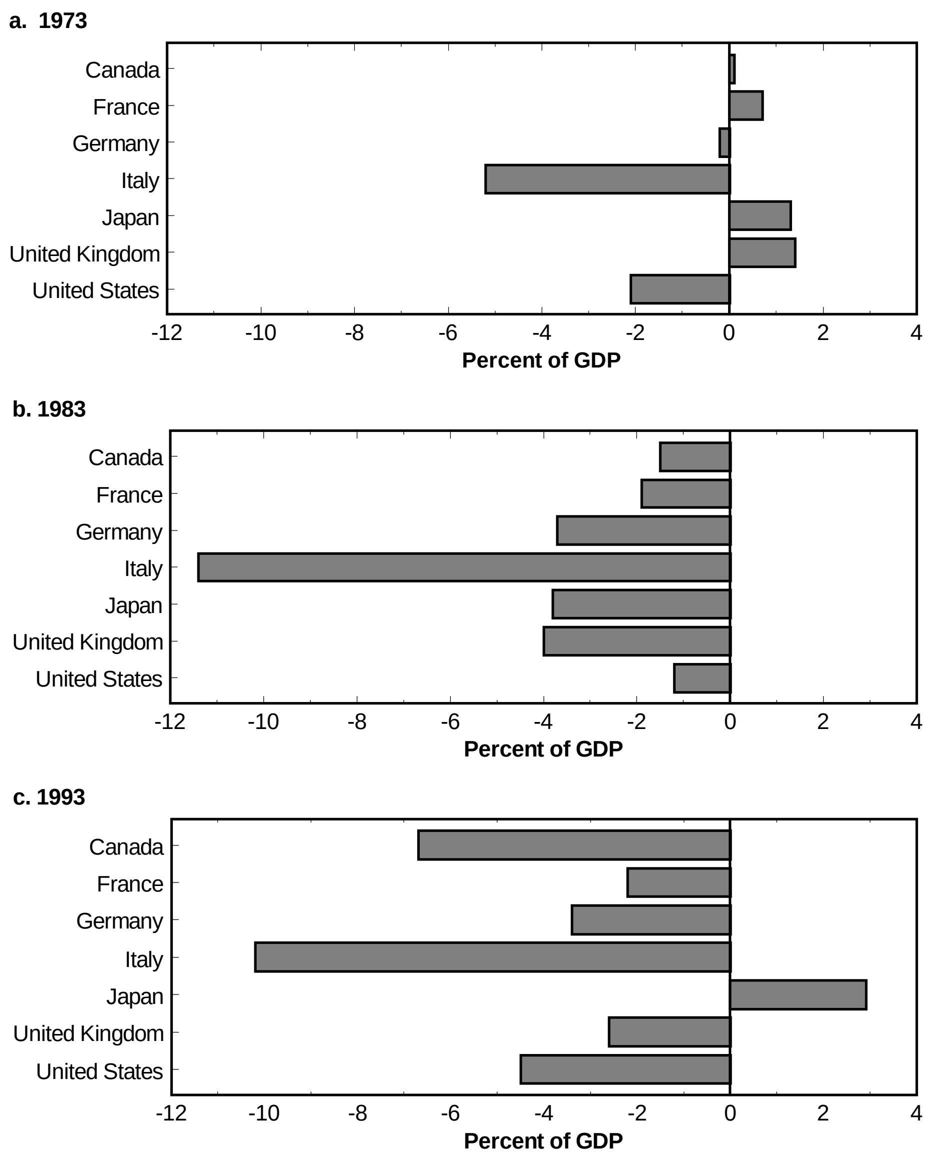


Figure 4.4: U.S. Deficits Compared to Other Countries—1973, 1983, 1993



Note: Negative numbers represent deficits and positive numbers represent surpluses.

Scope and Methodology

The primary data source for this report was Historical Tables published annually by OMB. Historical Tables presents a wide variety of information concerning federal deficits, revenues, outlays, and employment. Although much of this information is subject to verification processes and edit checks by OMB as part of the development of the President's annual budget submission, it is not audited, and we did not independently verify the data.[1] Historical Tables is annually updated and adjusted to reflect changes in budget concepts and definitions. The tabular presentations typically provide budgetary information in both nominal and constant 1987 dollars, and as a percent of GDP. For this report, we used deflator levels included in Historical Tables to convert all data to constant 1995 dollars.

In addition to Historical Tables, the following data sources were used to develop specific presentations for this report.

- Figure 1.2, which depicts the cyclical and structural components of the federal deficit, is based on data from the Congressional Budget Office's annual report, The Economic and Budget Outlook.
- Figure 2.4, regarding estimated revenue forgone due to tax expenditures, was derived from reports prepared by the Joint Committee on Taxation of the U. S. Congress.
- Figure 2.5, showing the impact of offsetting collections, was developed from information extracted from GAO's Budget Database. This automated resource compiles into trend files budget data submitted by departments and agencies to OMB and subsequently used to prepare the President's annual budget submission. This resource covers all fiscal years since 1971. The figures in this report are consistent with the presentation in chapter 26 of the fiscal year 1997 Analytical Perspectives and were developed by extracting and converting to constant 1995 dollars (1) offsetting collections from the public[2] and (2) offsetting receipts, including proprietary receipts from the public and offsetting governmental receipts.[3]

- Figures 3.5a and 3.5b, which describe federal outlays in terms of primary mission, were developed by extracting budget subfunction data from the GAO Budget Database and then reconfiguring the data into six broad

[1]Some recent GAO work has indicated significant problems in the accounting information underlying certain revenue and expenditure presentations in the budget. See, for example, Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996).

[2]For fiscal years 1971-1989, offsetting collections from the public were reported on line 14.00 of the program and financing schedules included in the President's Budget Appendix; line 88.40 for fiscal years 1990-1993; and lines 88.40 and 88.45 for fiscal years 1994-1995.

[3]Proprietary receipts are defined as line types "P" and "UP" and offsetting governmental receipts are line type "OG" in the receipts schedule.

mission areas: central government operations, economic affairs, human services, natural resources, national security and international affairs, and net interest. To develop this presentation, we examined each subfunction category and then judgmentally assigned each to the mission area most closely related. The following table summarizes these assignments.

Table I.1: Crosswalk Between GAO Mission Areas and Budget Functions/Subfunctions

GAO category	Function	Subfunction
Human services	Commerce and Housing Credit (370)	Mortgage Credit (371)
	Education, Training, Employment and Social Services (500)	Elementary, Secondary, and Vocational Education (501)
		Higher Education (502)
		Research and General Education Aids (503)
		Training and Employment (504)
		Social Services (506)
	Health (550)	Health Care Services (551)
		Health Research and Training (552)
		Consumer and Occupational Health and Safety (554)
	Medicare (570)	Medicare (571)
	Income Security (600)	General Retirement and Disability (excluding Social Security) (601)
		Federal Employee Retirement and Disability (602)
		Unemployment Compensation (603)
		Housing Assistance (604)
		Food and Nutrition Assistance (605)
		Other Income Security (609)
	Social Security (650)	Social Security (651)
	Veterans Benefits and Services (700)	Income Security for Veterans (701)
		Veterans Education, Training, and Rehabilitation (702)
		Hospital and Medical Care For Veterans (703)
		Veterans Housing (704)
		Other Veterans Benefits and Services (705)
	Undistributed Offsetting Receipts (950)	Employer Share, employee retirement— on budget (951)
		Employer Share, employee retirement— off budget (952)
Interest payments	Net Interest (900)	Interest on the Public Debt (901)
		Interest Received by On-Budget Trust Funds (902)
		Interest Received by Off-Budget Trust Funds (903)
		Other Interest (908)
National security and international affairs	National Defense (050)	Department of Defense—Military (051)

(continued)

GAO category	Function	Subfunction
		Atomic Energy Defense Activities (053)
		Defense-related Activities (054)
	International Affairs (150)	International Development and Humanitarian Assistance (151)
		International Security Assistance (152)
		Conduct of Foreign Affairs (153)
		Foreign Information and Exchange Activities (154)
		International Financial Programs (155)
Natural resources	Energy (270)	Energy Supply (271)
		Energy Conservation (272)
		Emergency Energy Preparedness (274)
		Energy Information, Policy, and Regulation (276)
	Natural Resources and Environment (300)	Water Resources (301)
		Conservation and Land Management (302)
		Recreational Resources (303)
		Pollution Control and Abatement (304)
		Other Natural Resources (306)
	Undistributed Offsetting Receipts (950)	Rents and Royalties on the Outer Continental Shelf (953)
Central government operations	Commerce and Housing Credit (370)	Postal Service (372)
	Administration of Justice (750)	Federal Law Enforcement Activities (751)
		Federal Litigative and Judicial Activities (752)
		Federal Correctional Activities (753)
		Criminal Justice Assistance (754)
	General Government (800)	Legislative Functions (801)
		Executive Direction and Management (802)
		Central Fiscal Operations (803)
		General Property and Records Management (804)
		Central Personnel Management (805)
		Other General Government (808)
		Deductions for Offsetting Receipts (809)
	Undistributed Offsetting Receipts (950)	Proceeds from Asset Sales (954)
		Other Undistributed Offsetting Receipts (959)
Economic affairs	General Science, Space and Technology (250)	General Science and Basic Research (251)
		Space Flight, Research, and Supporting Activities (252)
	Agriculture (350)	Farm Income Stabilization (351)
		Agricultural Research and Services (352)
	Commerce and Housing Credit (370)	Deposit Insurance (373)

(continued)

GAO category	Function	Subfunction
		Other Advancement Of Commerce (376)
	Transportation (400)	Ground Transportation (401)
		Air Transportation (402)
		Water Transportation (403)
		Other Transportation (407)
	Community and Regional Development (450)	Community Development (451)
		Area and Regional Development (452)
		Disaster Relief and Insurance (453)
	Education, Training, Employment, and Social Services (500)	Other Labor Services (505)
	General Government (800)	General Purpose Fiscal Assistance (806)

- Figure 3.8b, showing obligations by item of expense, was developed by extracting budget object class data from the GAO Budget Database and summarizing this data by object series. The object classification system, unique among budget presentations in that it deals with obligations rather than budget authority or outlays, summarizes spending according to the item or object procured. This data presentation is required for all expenditure accounts, except credit financing accounts. OMB prescribes definitions for and instructions on recording obligations by object series and class in Circular A-11, "Preparation and Submission of Budget Estimates."
- Figures 4.2, 4.3, and 4.4, comparing United States government revenues, outlays, and deficits to those of several foreign countries, were compiled from data published by the Organization for Economic Cooperation and Development (OECD). OECD uses a variety of techniques to standardize data across countries and is widely considered the best source for cross-country comparisons.

Related GAO Products

Federal Debt: Answers to Frequently Asked Questions (GAO/AIMD-97-12, November 27, 1996).

Budget Process: Evolution and Challenges (GAO/T-AIMD-96-129, July 11, 1996).

Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996).

Budget Issues: Inventory of Accounts With Spending Authority and Permanent Appropriations, 1996 (GAO/AIMD-96-79, May 31, 1996).

Budget Issues: Deficit Reduction and the Long Term (GAO/T-AIMD-96-66, March 13, 1996).

Deficit Reduction: Better Targeting Can Reduce Spending and Improve Programs and Services (GAO/AIMD-96-14, January 16, 1996).

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Budget Trends: Obligations by Item of Expense, Fiscal Years 1971-1994 (GAO/AIMD-95-227, September 12, 1995).

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Budget Function Classification: Agency Spending by Subfunction and Object Category, Fiscal Year 1994 (GAO/AIMD-95-116FS, May 10, 1995).

The Deficit and the Economy: An Update of Long-Term Simulations (GAO/AIMD/OCE-95-119, April 26, 1995).

Budget Function Classification: Agency Spending and Personnel Levels for Fiscal Years 1994 and 1995 (GAO/AIMD-95-115FS, April 11, 1995).

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Budget Function Classification: Relating Agency Spending and Personnel Levels to Budget Functions (GAO/AIMD/GGD-95-69FS, January 30, 1995).

Deficit Reduction: Experiences of Other Nations (GAO/AIMD-95-30, December 13, 1994).

Budget Process: Issues Concerning the 1990 Reconciliation Act (GAO/AIMD-95-3, October 7, 1994).

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Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings (GAO/T-AIMD-94-189, September 20, 1994).

Budget Object Classification: Origins and Recent Trends (GAO/AIMD-94-147, September 13, 1994).

Credit Reform: Case-by-Case Assessment Advisable in Evaluating Coverage, Compliance (GAO/AIMD-94-57, July 28, 1994).

Budget Policy: Issues in Capping Mandatory Spending (GAO/AIMD-94-155, July 18, 1994).

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Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

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Federal Budget: Choosing Public Investment Programs (GAO/AIMD-93-25, July 23, 1993).

Budget Issues: Financial Reporting to Better Support Decision-making (GAO/AFMD-93-22, June 1993).

Budget Policy: Federal Capital Budgeting (GAO/T-AFMD-93-7, May 26, 1993).

Balanced Budget Requirements: State Experiences and Implications for the Federal Government (GAO/AFMD-93-58BR, March 26, 1993).

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