Chapter 14

The Federal Budget

Does the federal government budget and spend your tax dollars wisely?

14.1 Introduction

On January 24, 2012, the House chamber filled with representatives, senators, Supreme Court justices, cabinet heads, military leaders, and invited guests. They had gathered for the president's annual message to Congress known as the State of the Union address. The name comes from the Constitution, which says the president "shall from time to time give to the Congress Information of the State of the Union, and recommend to their Consideration such Measures as he shall judge necessary and expedient."

Just after 9:00 P.M., the Sergeant at Arms of the House called out, "Mister Speaker, the President of the United States." Barack Obama slowly made his way to the podium amid handshakes and applause. Once there, he was formally introduced to the assembled leaders and the nation by Speaker John Boehner.

In his address, Obama discussed the achievements of the U.S. military before launching into the major topic of the night: the American economy. He recalled that the Great Recession in 2008 "plunged our economy into a crisis that put millions out of work, saddled us with more debt, and left innocent hardworking Americans holding the bag." Since then, Obama said that the economy has made great strides:

President Barack Obama delivering his State of the Union address in 2012

Speaking of Politics

balanced budget
A spending plan in which the revenues coming into an organization equal its expenditures.

budget surplus
The amount by which an organization's revenues exceed its expenditures.

federal deficit
The amount by which the national government's annual expenditures exceed its revenues. To make up the difference, the government must borrow money.

national debt
The amount of money a country owes to lenders. The national debt is the total of all yearly deficits funded by borrowing plus the interest owed on those loans.

progressive tax
Any tax in which the burden falls more heavily on the rich than the poor. State and federal income taxes are both progressive taxes.

regressive tax
Any tax in which the burden falls more heavily on the poor than the rich, at least as a percentage of their incomes. Sales tax is one regressive tax.

entitlement
Benefits that must be provided to all eligible people who seek them. The most important entitlements for most Americans are Social Security, Medicare, and Medicaid payments.

earmarks
Specific spending proposals that members of Congress attach to legislation, usually to benefit their home districts or states. Most lawmakers view earmarks as a way to "bring home the bacon."

As the cartoon suggests, presidents often use the State of the Union address to introduce proposals designed to appeal to voters, especially in election years. It remains up to Congress to decide which, if any, of these initiatives will be funded.

Jeff Parker/www.caglecartoons.com

The state of our Union is getting stronger. And we've come too far to turn back now. As long as I'm President, I will work with anyone in this chamber to build on this momentum. . . . No, we will not go back to an economy weakened by outsourcing, bad debt, and phony financial profits. Tonight, I want to speak about how we move forward . . .

Obama went on to outline an ambitious agenda that included increasing manufacturing in the United States, building skills for American workers, reforming education and immigration policy, cutting taxes for small businesses and the middle class, removing tax cuts for the wealthy, developing clean energy, and improving infrastructure. These plans were part of Obama's vision to balance the budget and reduce the federal deficit. He continued,

When it comes to the deficit, we've already agreed to more than $2 trillion in cuts and savings. But we need to do more, and that means making choices.

The following month, on February 13, Obama presented the choices he made to reduce the deficit in the federal budget he submitted to Congress. Submitting a budget for the federal government to Congress is one of the president's most important responsibilities each year. This chapter explores how the process of creating that budget works, both before and after the president delivers the annual State of the Union address.

14.2 Who Controls the Budget Process?

"The president proposes, Congress disposes." This is how an old Washington saying sums up the process of creating a federal budget. As is true of the legislative process, however, the reality is far more complex. During some periods of our history, Congress dominated budget making. At other times, the president was clearly in charge. Today control is shared as the two branches work together to shape a budget that reflects their priorities.

Congressional Control of Federal Spending: 1789–1921

The federal budget is an estimate of the money the government will take in and spend on programs over the next **fiscal year**. A fiscal year is the period of time an organization uses for its budgeting, record keeping, and financial reporting. The U.S. government's fiscal year begins October 1 and ends September 30.

The Constitution talks about levying taxes and spending money, but it does not mention budgets. At the time the Constitution was written, the idea of trying to estimate revenues and expenditures a year in advance was new. In general, governments simply collected taxes and then spent money as needed. In times of crisis or a shortfall in income, taxes were raised to bring in extra money.

For more than a century, Congress dominated this simple method of raising and spending money.

As the Constitution requires, all proposals for the spending of federal funds originated in the House of Representatives. These requests were then combined into a single spending bill. Once the House approved the spending bill, it went to the Senate for approval. The president's role in this process was limited to signing the spending bill into law or vetoing it.

This system worked fairly well during the 1800s. Usually revenues and expenditures came out about even, creating a **balanced budget**. During some years, the country even had a small **budget surplus,** with extra funds left over. The only time the country experienced a **federal deficit**, or a shortfall of revenue, was during wartime.

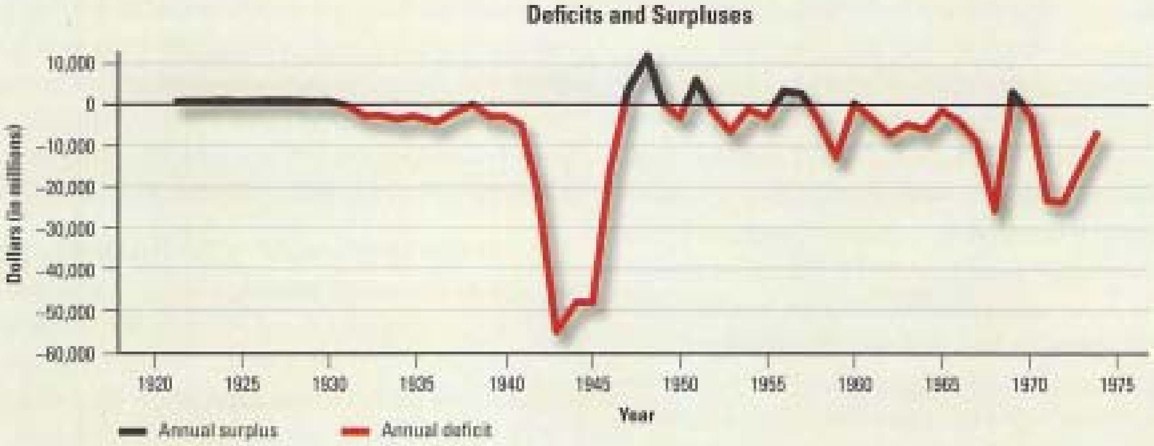
In times of war, the government raised taxes and borrowed money to fund the military campaign. The money borrowed created a **national debt**. When the war ended, Congress worked to retire, or pay off, the national debt as quickly as possible.

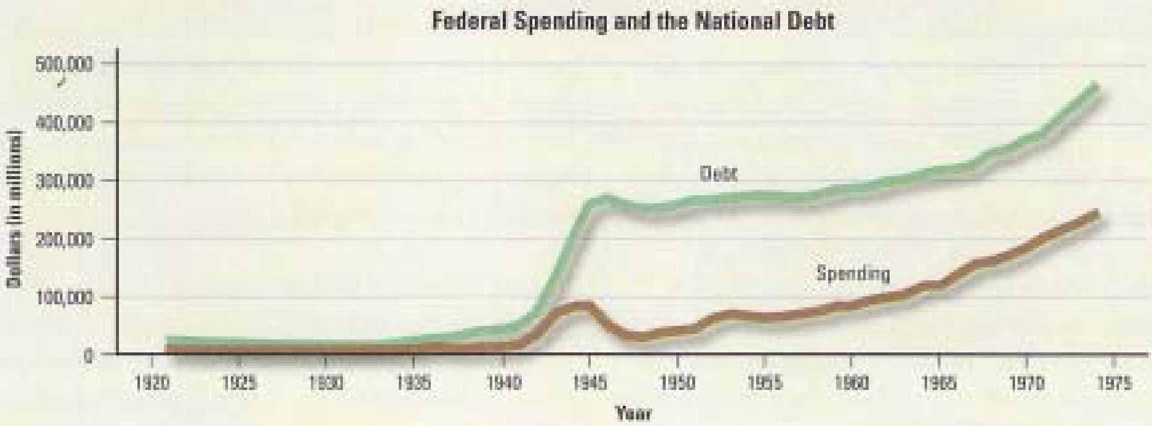
Presidential Dominance of Budget Making: 1921–1974

The rapid growth of government spending during World War I overwhelmed Congress's old way

Federal Budgets, Spending, and Borrowing, 1921–1974

In 1921, Congress gave the president the job of preparing an annual budget for the national government. In doing so, it hoped to get federal spending under better control. As the graphs show, however, presidential dominance of the budget process has led to deficit spending most years and a growing national debt.





Source: Budget of the U.S. Government FY2008, Historical Tables.

of appropriating funds. By the end of 1919, federal expenditures were more than 26 times what they had been just five years earlier. Moreover, the national debt had soared to a record $26 billion.

Faced with a huge war debt and with what looked to many like runaway spending, Congress enacted the Budget and Accounting Act of 1921. This act set up the Bureau of the Budget in the executive branch to oversee a new budget-making process. The bureau was renamed the Office of Management and Budget in 1970. The act also set up the General Accounting Office to improve congressional oversight of federal spending.

Under this new budget process, the president was required to submit a proposed budget to Congress each year. The intent of this requirement was to give Congress better information with which to make spending decisions. The effect, however, was to concentrate budget power in the executive branch.

Beginning with Franklin Roosevelt, presidents used their new budget power to promote their own policy agendas. They decided which agencies and programs should be funded and which should not. Congress could override those decisions, but generally it went along with the president's budget.

By 1970, however, it was clear that the budget process put in place in 1921 had not led to a new era of balanced budgets. Year after year, presidents sent budgets to Congress that included costly new programs that lawmakers wanted to support. But few in either branch wanted to raise taxes to fund those new projects. The result was year after year of **deficit spending**—or spending financed by borrowing rather than by tax revenues. As the deficits piled up, the national debt began to rise to levels that alarmed many national leaders.

Nixon and Congress Clash

Concern over the budget process mounted during Richard Nixon's presidency. Already facing disapproval over the Watergate scandal, Nixon enraged many legislators by using the president's power of **impoundment** to nullify congressional spending decisions. Impoundment involves the refusal of a chief executive to spend funds that have been appropriated by the legislature.

Impoundment was not new. Presidents before Nixon had used this power to make small spending cuts in programs that they viewed as unwise or unnecessary. Members of Congress might grumble when their favorite projects were canceled, but they did not rebel against the occasional decision to impound federal funds.

"Don't put up any resistance! Just keep in step."

This cartoon captures the concern that was felt by many Americans in the early 1970s that Richard Nixon was abusing his presidential powers.

President Nixon, however, used his power to impound funds on a scale never seen before. In an effort to reduce deficit spending, he refused to spend billions of dollars already appropriated by Congress. He also used impoundment to "defund" programs he did not approve of. When asked by reporters about his use of this power, Nixon declared,

> *The constitutional right for the President of the United States to impound funds . . . is absolutely clear . . . I will not spend money if the Congress overspends, and I will not be for programs that will raise the taxes and put a bigger burden on the already overburdened American taxpayer.*
>
> —Richard Nixon, Jan. 31, 1973

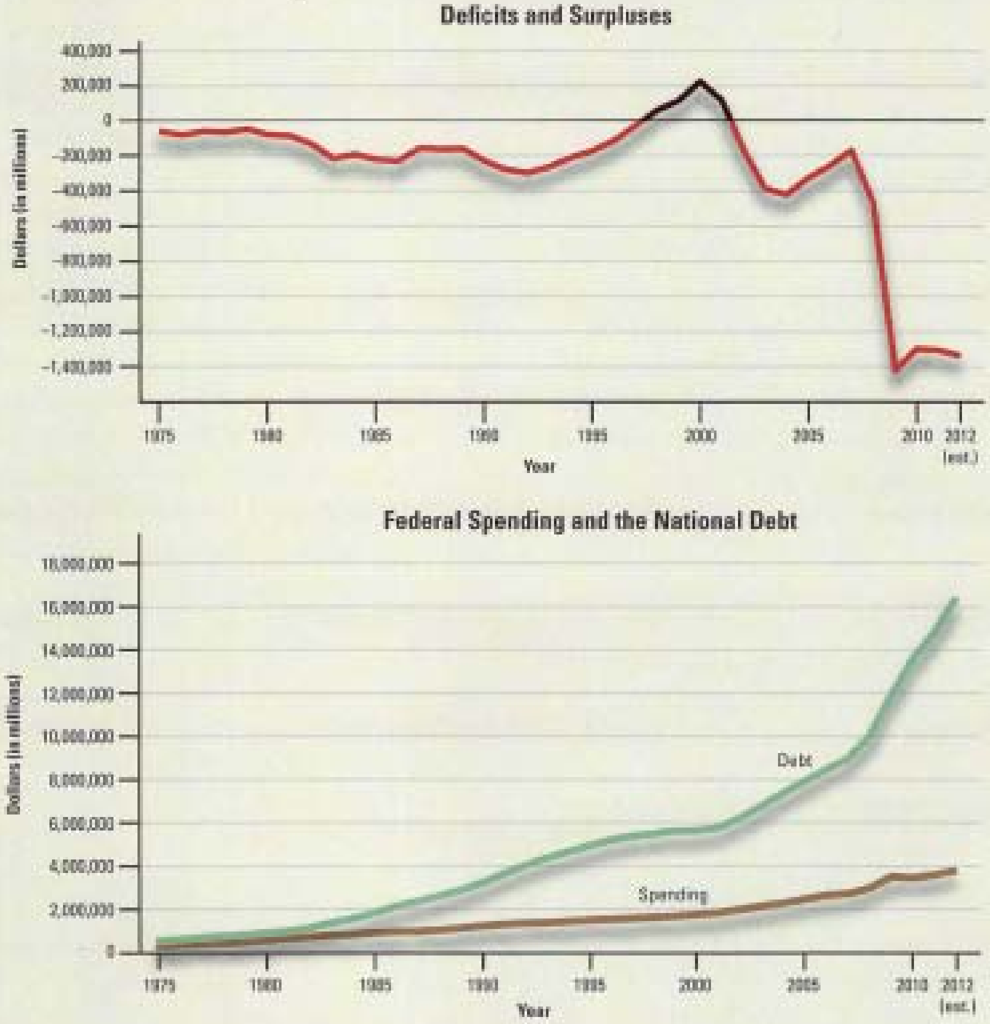
Members of Congress saw Nixon's use of impoundment as an assault on their constitutional power of the purse. In 1974, Congress responded by enacting legislation that both increased its role in shaping the federal budget and limited the president's powers of impoundment.

Shared Control of Budget Making: 1974 to the Present

The Budget and Impoundment Control Act of 1974 created the budget process that is still in use today. This process gives the legislative and executive branches shared control over budget making.

Federal Budgets, Spending, and Borrowing, 1975–2012

In 1974, Congress revised the budget process to give lawmakers more control over government spending. This change has not led to an era of balanced budgets. By 1994, the national debt was ten times the size it had been in 1974. The national debt continued to increase in the years that followed.



Source: Budget of the U.S. Government FY 2013, Historical Tables.

The main change brought about by this legislation was the creation of new budget committees in both the House and Senate. These committees are responsible for drafting Congress's own spending priorities, known as the **budget resolution**. The act also created the Congressional Budget Office to assist Congress in this process. The CBO provides nonpartisan estimates of revenue and spending. It also "scores" proposed tax and spending bills to indicate their impact on future budgets.

Many of the lawmakers who supported the new budget process laid out in the 1974 act hoped it would reduce conflict between the executive and legislative branches. In this they were disappointed. Even with responsibility more evenly shared, the budget process frequently leads to power struggles between the two branches. At the center of these struggles are deep disagreements over how revenue should be raised and how the tax dollars collected each year should be budgeted and spent.

14.3 The Federal Budget Cycle

On February 13, 2012, President Barack Obama sent a $3.8 trillion **budget proposal** for fiscal year 2013 to Capitol Hill. The nation's economy was unsteady, but Obama believed that his proposal would help balance the budget over time. "This Budget is a step in the right direction," he wrote. "And I hope it will help serve as a roadmap for how we can grow the economy, create jobs, and give Americans everywhere the security they deserve." Republicans in the House of Representatives were not so optimistic. In response to the president's budget proposal, the chair of the House Budget Committee stated that the budget "is a recipe for a debt crisis."

From the point of view of Congress, the arrival of the president's budget proposal marks the beginning of the federal **budget cycle**. From the perspective of the executive branch, however, this is the halfway point in a process that spreads over 18 months, from initial planning to the beginning of the next fiscal year.

Phase One: The Executive Branch Prepares a Budget Proposal

Constructing a federal budget is about more than just money. It reflects the broader vision of the president and Congress about the purpose and activities of the national government. "Budgets are about setting priorities," explains economist Brian Reidl. "A rational budget process should help lawmakers set priorities and separate vital needs from unaffordable luxuries."

The task of separating "vital needs" from "unaffordable luxuries" begins in the federal bureaucracy. Months before the president submits a budget to Congress, each department and agency begins work on its own budget request for the following fiscal year.

By June, these budget requests are submitted to the Office of Management and Budget for review. The main job of the OMB, an agency within the Executive Office, is to craft a budget that reflects the policy goals and political agenda of the president.

During the summer and fall, OMB staffers review the various budget requests. They consider what is vital and affordable based on projected revenue. They also work with the president and his advisers to see how well the various requests reflect the president's priorities. Based on all of this information, the OMB prepares a budget proposal for the president to review and revise. By law, the president must submit this proposal to Congress by the first Monday in February.

Phase Two: Congress Crafts a Budget Resolution

Once the president's budget proposal reaches Congress, the House and Senate budget committees take

The Budget Calendar

The four phases of the budget process often overlap. During the spring and summer, federal agencies have to juggle three different budgets. They operate under their budgets for the current fiscal year. They lobby Congress for funds in next fiscal year's budget. And they work with the Office of Management and Budget to plan for the budget after that.

Sources: Library of Congress Congressional Research Service; House of Representatives Committee on Rules; Ethel Wood and Steven C. Sansone, *American Government: A Complete Coursebook*, Wilmington, MA: Great Source Education Group, 2000.

over. Their job is to analyze the proposed budget and to recommend changes that reflect Congress's spending priorities.

The two budget committees are assisted by the Congressional Budget Office. The CBO's main job is to compare how well the president's budget matches its own estimates of future revenues and expenses. As a nonpartisan agency, the CBO does not make policy recommendations to Congress.

During March and April, House and Senate budget committees hold hearings on the president's proposed budget. They hear testimony from OMB staffers about their analysis. They quiz agency officials about funding needs. They consult with other committees to hear their views and estimates about next year's budget.

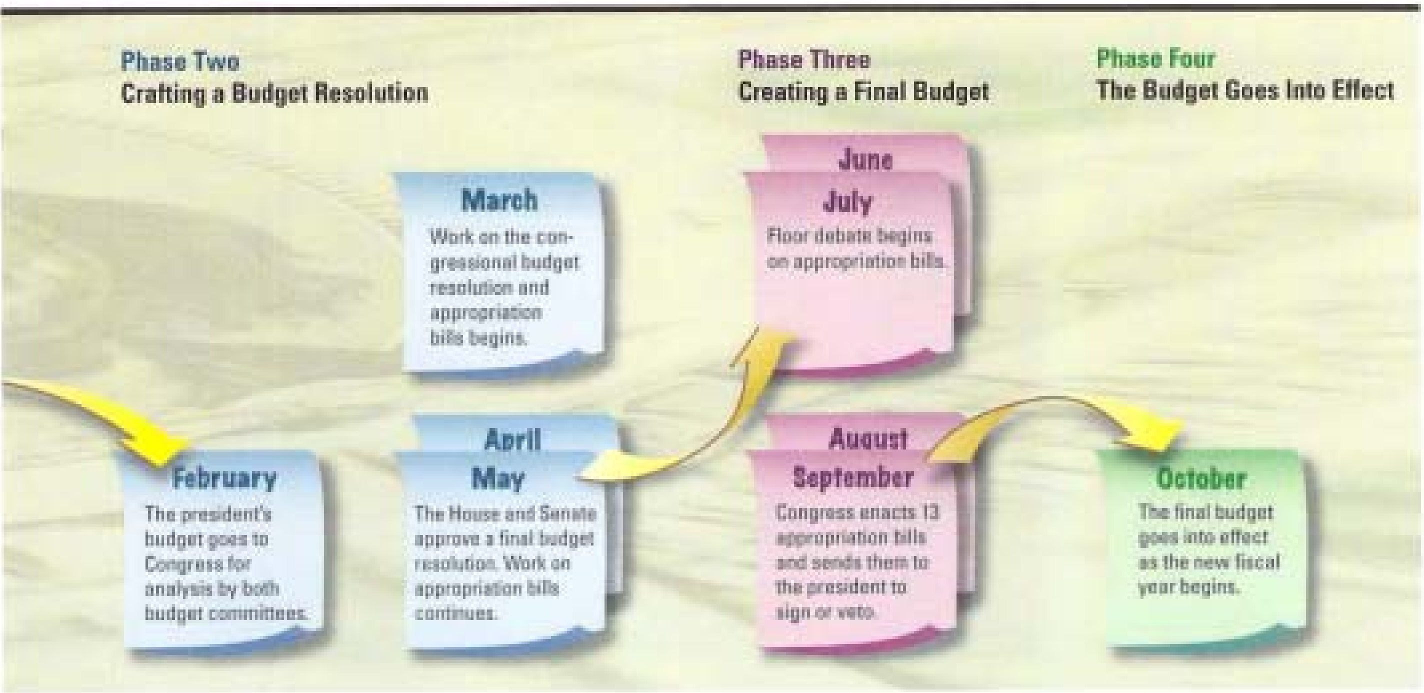
Based on this information, each budget committee prepares its own budget resolution. A budget resolution sets guidelines for how much money Congress should spend in 20 broad categories. These categories include national defense, agriculture, and health. A budget resolution is not a detailed spending plan like the president's budget proposal. Nor does it have the force of law. But it does guide Congress over the next few months.

After each chamber passes its own budget resolution, the two versions go to a conference committee to be reconciled. The final version is supposed to be approved by the full House and Senate by April 15. That deadline is not always met, however, and some years no budget resolution has been approved.

Phase Three: Congress Enacts Appropriation Bills Beginning as early as March, the Senate and the House Appropriations Committees start work on Congress's 13 appropriation bills. Each bill deals with one of the spending categories laid out in the budget resolution. These bills, taken together, make up the government's final budget.

Work on appropriation bills continues through the spring and summer. During this time, the president pays close attention to the budget process. If all goes well, most of the work on the 13 bills will be completed before Congress goes on vacation in August.

When Congress returns in September, it works out any differences between the appropriation bills passed by the House and Senate. The bills then go to the president for approval. The president may sign or veto some or all of the bills. In the latter case, Congress can either seek to override the veto or revise the bill to gain the president's approval. Ideally, all 13 appropriation bills are law and the budget is in place before the new fiscal year begins on October 1.



Phase Four: The New Fiscal Year Begins . . . Or Does It?

It sometimes happens that the president and Congress are not able to reach agreement on the budget by October 1. Usually in this situation, Congress enacts and the president signs a **continuing resolution** to keep the government working. A continuing resolution allows government programs to operate at current funding levels for a fixed period. During this time, both sides try to work out their differences on the budget.

If Congress and the president cannot reach an agreement by the time the continuing resolution ends and another one is not enacted, the result is a **budget crisis**. In extreme cases, a budget crisis can lead to a shutdown of "nonessential" government activities. Such shutdowns have occurred many times over the years, sometimes for a few hours, sometimes for several days.

One of the most serious budget crises began in 1995, when budget negotiations between President Bill Clinton and Congress broke down. A continuing resolution was passed to keep the government going for a few weeks. When that time ran out, Congress and the president could not agree on another resolution, much less a final budget. As a result, the many agencies of the federal government were shut down for weeks.

The crisis ended the following January, when the president and Congress agreed to another continuing resolution. As he signed the resolution, Clinton expressed his hope that "no Congress will ever again shut the federal government down in this way."

14.4 Where the Money Comes from and Where It Goes

In 1948, Florida businessman Dallas Hostetler sat down and calculated how many days he had to work each year to pay his tax bills. According to his estimate, every penny he earned from January through March went to pay taxes. Hostetler called the first day that he began earning money that he could keep for himself **Tax Freedom Day**. Over time, Tax Freedom Day has been pushed back on the calendar. Experts estimate that the average American today works four full months to fund government at the national, state, and local levels.

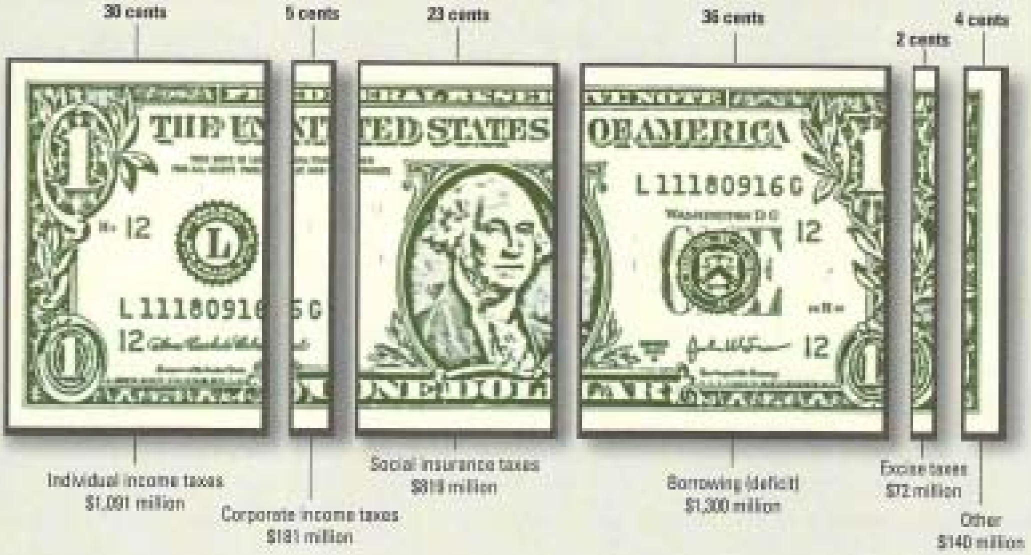
The Federal Government's Revenue Sources

The most important revenue source for the federal government is the **individual income tax**. This is a tax levied on an individual's or a married couple's annual income. Individual income is taxed whether it comes from wages or from earnings on investments. **Social insurance taxes** are a second major source of federal funding. You may have seen these taxes in the form of Social Security and Medicare deductions from a paycheck. These payroll taxes are used to

Most of the federal government's tax revenue comes from individual income taxes. Each year, an individual or a married couple who earns income is required to submit their taxes by mid-April. Taxes help fund the U.S. military, interest on national debt, federal agencies, and other programs.

Sources of Federal Revenue, Fiscal Year 2011

The government's greatest source of tax revenue comes from individual income taxes, followed by social insurance taxes, which fund Social Security and Medicare benefits. In 2011, however, borrowing funded much of the government's expenditures. The government borrows money when tax revenues do not cover federal spending.



Source: Budget of the U.S. Government FY 2013, Historical Tables.

fund pensions and health insurance for the elderly. They also fund unemployment insurance and disability insurance for workers who are laid off or injured on the job.

The third-largest source of federal revenue is the **corporate income tax.** This is a tax paid by businesses on their profits each year. For this reason, it is sometimes called a profit tax.

The government also raises money with **excise taxes.** These are taxes levied on the sale of goods, like alcohol, and services. Your family probably pays federal excise tax on its local telephone service.

Federal taxes differ in both what they tax and whether they are progressive or regressive. A **progressive tax** is one in which the tax burden falls more heavily on wealthy than poor taxpayers. The term *progressive* refers to the way tax rates progress from low to high as one's income rises. Individual and corporate income taxes are progressive taxes.

In contrast, a **regressive tax** is one in which the tax burden, as a percentage of income, falls more heavily on poor taxpayers than on wealthy ones. Excise taxes are an example of a regressive tax. A person earning $20,000 a year pays the same excise tax on local phone service as someone earning $2 million a year. But that tax, measured as a percentage of income, is much higher for the low-income person.

Another way for the government to fund expenditures is borrowing. When federal spending exceeds tax revenue, the government borrows from private sources and foreign countries. In 2011, the government borrowed about $1.3 trillion to fund the deficit.

Mandatory Spending: Entitlements and Interest

Only about one-third of government spending is covered by the budget hashed out each year by Congress and the president. That is because most government revenue today is already committed by law to be spent in specified ways. This **mandatory spending** can be altered only by special legislation that changes the amount to be spent.

The two main categories of mandatory spending are interest on the national debt and **entitlements.** Entitlements are programs through which individuals receive benefits based on their age, income, or some other criteria. Examples include food stamps and Social Security pensions. The amount of money spent on such programs depends on the number of people who sign up for their benefits, not on an annual appropriation. The amount of federal revenue dedicated to mandatory spending has grown significantly in recent years.

Discretionary Spending: Defense, Government Services, and Pork

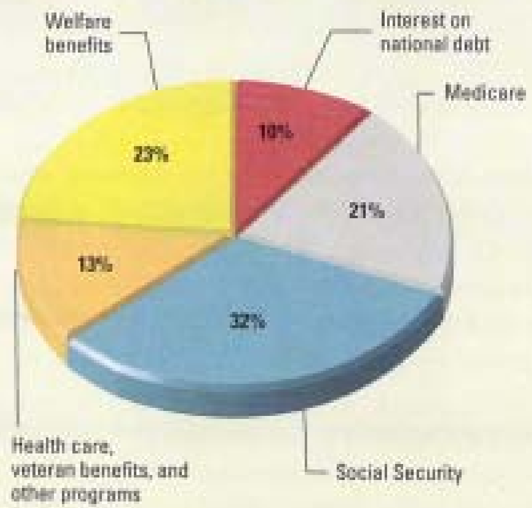
The budget debated in Congress is made up of **discretionary spending**. Funding for discretionary items can be raised or lowered as Congress sees fit. By far, the biggest chunk of discretionary spending goes to the Department of Defense to support the armed forces. The rest funds the many services provided by federal agencies.

A frequent complaint about the budget process focuses on the practice of using **earmarks** to set aside funds for specific projects. The 2005 Transportation Equity Act, for instance, included more than 6,000 earmarks for home-district projects. The most notorious

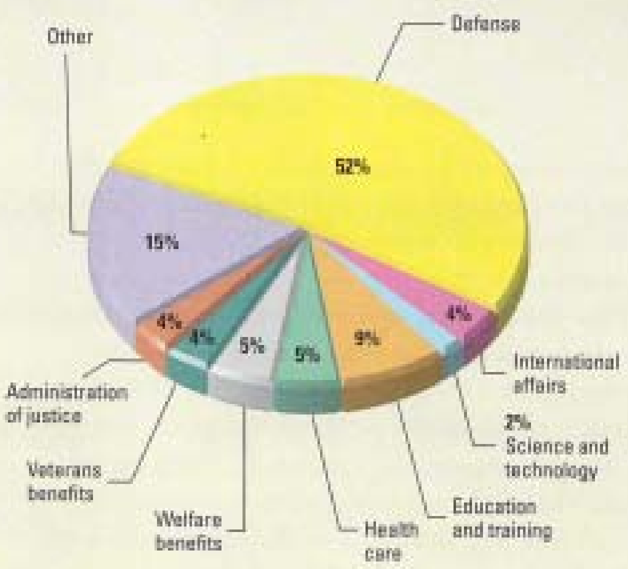
How Federal Tax Dollars Are Spent

Over the years, the amount of the federal budget dedicated to mandatory spending has grown. Today about two-thirds of federal revenue is spent on interest and entitlement benefits. The remaining third makes up the discretionary budget. By far, the largest discretionary budget item is defense spending.

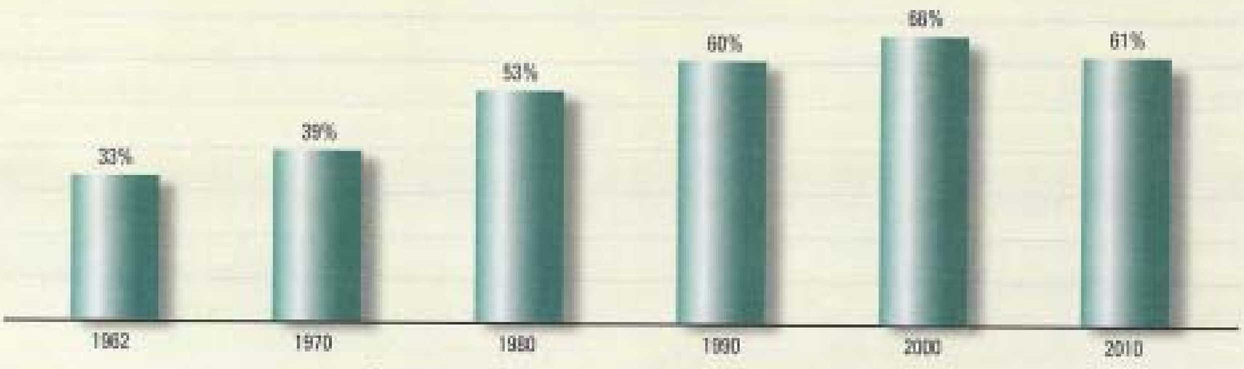
Mandatory Spending, Fiscal Year 2011



Discretionary Spending, Fiscal Year 2011



Growth of Mandatory Spending, 1962–2010



Percentage of Revenue Spent on Mandatory Expenditures

Source: Budget of the U.S. Government FY 2013, Historical Tables.

Here, California state legislators negotiate a budget to repair a growing shortfall in 2009. The state's constitution required a two-thirds vote to pass a budget, but members of Congress had difficulty agreeing on an approach on how to fix the shortfall. Eventually, the legislature approved a budget that relied on California voters to pass several propositions. When voters did not pass them, legislators returned to the capitol to negotiate a new budget.

was a $223 million set-aside to fund construction of a bridge to a sparsely populated island in Alaska. This much-criticized "bridge to nowhere" was finally removed from the bill, but not before fueling a nationwide debate over the use of earmarks to fund pork-barrel projects. In his State of the Union address in 2007, President George W. Bush called on Congress to begin earmark reform and "expose every earmark to the light of day."

Historically, lawmakers could attach earmarks to bills without identifying themselves. In response to the growing chorus of criticism, Congress has made earmarking more transparent, or open to public scrutiny. For example, sponsors of earmarks are required to make their identity public 48 hours before floor debate begins on the bill to which they have attached spending set-asides.

President Obama also supported earmark reform and called on Congress to increase transparency by publishing earmarks on a Web site open to the public. In 2009, he also asked Congress to regulate earmarks set for private businesses. Soon after, in 2010, Congress banned earmarks to for-profit companies.

14.5 Funding State and Local Government

Like the federal government, state and local governments must make decisions each year about how to collect the revenue they need and how to spend those tax dollars. The chief executive of each state, county, or city usually prepares the annual budget. The budget is then approved by the state legislature, county board, or city council. However, unlike the federal government, state and local governments often face limitations that make the creation of budgets especially difficult.

State and Local Versus Federal Budget Making

State and local governments, like the federal government, raise most of their revenue from taxes. However, they are often more limited in their power to spend money than is the federal government.

Many state constitutions, for example, require their legislatures to approve a balanced budget each year. They are not allowed, like Congress, to borrow money to fill a gap between revenue and expenses. Instead, lawmakers must either cut programs or raise taxes when revenues fall short of proposed expenditures.

Some state constitutions prohibit state lawmakers from enacting certain types of taxes. Seven states, for instance, ban the imposition of taxes on personal income. Other constitutions limit how much certain taxes can increase from year to year. In Massachusetts, for example, taxes on property cannot rise by more than 2½ percent a year. Such restrictions can be changed only if voters approve amending the state constitution.

In addition, citizens play a much larger role in tax policy at the local and state levels than at the federal level. Many states and localities require voters to approve tax hikes through referenda. Some states, such as California, require a supermajority of two-thirds of the votes cast to approve increases in many types of taxes.

Revenue Sources for State and Local Governments

Sales Tax
A tax on the sale of goods that is paid by the customer at the time of purchase. Today, 45 states and many cities have a general sales tax.

Pro: Relatively easy to collect.

Con: Regressive tax. Affects rich and poor equally.

Property Tax
A tax levied on the value of real property, such as land, homes, and buildings. Serves as the chief source of income for local governments.

Pro: Real property cannot be easily hidden from the tax collector.

Con: The tax levied on real property may not reflect the owner's ability to pay.

Individual Income Tax
A tax on the incomes of state residents. Today, 43 states and a number of cities collect income taxes.

Pro: Progressive tax. Rates vary from less than 1 percent on lower incomes to nearly 10 percent on higher incomes.

Con: High rates may drive wealthy people to states with no or low income taxes.

Excise Tax
A tax levied on the sale of certain goods or services. Also called "sin taxes" because they are often levied on tobacco, alcohol, and gambling.

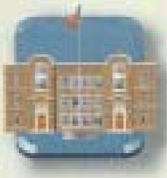
Pro: Taxing "sin" is easy for politicians.

Con: If raised too high, may encourage illegal traffic in taxed goods.

Lottery
A large-scale, legal gambling game organized to raise money for a public cause.

Pro: Provides money for public services without raising taxes.

Con: Regressive tax. Low-income people buy most lottery tickets.



Bonds
Debt issued by a government to raise funds for a specific purpose. Bonds are repaid, with interest, on fixed dates.

Pro: Help governments fund large projects, such as schools, that are too costly to pay for from current tax revenues.

Con: Debt created by bond sales may be a heavy burden on future taxpayers.

Inheritance and Estate Taxes
A tax levied on some or all of the estate (property and possessions) a person leaves behind at death. Those who inherit the estate pay the tax.

Pro: Progressive tax. The larger the estate, the more taxes paid.

Con: May discourage saving if people believe their nest egg will go to the government upon their death.

User Fees
Fees charged to use public facilities and services and for permits and licenses.

Pro: Those who want public services support them with their fees.

Con: Poor people may not be able to afford fee-based services, such as trash collection

Faced with these limitations, state and local leaders often scramble to generate needed revenue. The list above shows eight sources of revenue commonly used to raise money for state and local government services.

How State and Local Governments Spend Their Funds

At the federal level, the bulk of spending goes to entitlements for the elderly and national defense. In contrast, state and local governments devote large shares of their budgets to services that affect young people and their families in direct ways.

The most important of those services is education. By 2012, almost 50 million children were enrolled in public elementary and secondary schools across the United States. The average amount spent on each of these students exceeded $11,400 per year. More than 85 percent of that money came from state and local governments.

Law enforcement and fire protection are also responsibilities relegated mainly to local governments. The United States did not even have a national police force until the creation of the Federal Bureau of Investigation in 1909. In many communities, police protection is the second largest public expense after education.

State and local governments also fund a variety of health and welfare services, often with assistance from the federal government. Typical examples

State and Local Funding and Spending

State and local governments rely on revenue from various sources and spend their money in multiple ways. As these graphs show, revenues in 2010 came mainly from taxes and federal funding, while around half of all expenditures went to education and to health and social services.

Note: Percentages do not add to 100 due to rounding.
Source: U.S. Census Bureau

include public health clinics for low-income families, health care centers for the mentally ill, and childcare for low-income working families.

Many other services are funded at the state and local levels. For example, state and local governments spend money to build and maintain roads and bridges. They create and maintain parks and playgrounds for the public to enjoy. They fund public libraries, civic auditoriums, and museums. All of these services have been developed in response to public demand. The ever-present challenge is finding the money to pay for what the public wants.

Summary

The federal budget is an estimate of the money the government will take in and spend over a fiscal year. It is created by a long process that involves the executive and legislative branches of the government.

Control of the federal budget First Congress and then the president controlled development of the federal budget. The current budget process calls for cooperation between the executive and legislative branches.

Federal budget cycle Preparation of a federal budget is a long process that lasts almost two years. It begins with preparation of initial budget requests by federal departments and agencies and ends with a final budget approved by Congress and the president.

Revenue and expenditures Most revenue, at all levels of government, is raised through a variety of taxes. At the federal level, entitlements are the largest expenditure. At the state and local levels, education tops the expenditure list.

State and local budgets People depend on state and local governments to fund public schools, police and fire departments, roads and bridges, and health and welfare services. State and local governments pay for services through taxation, lotteries, and user fees.

What can the government do to repair the economy?

In 2008, the United States faced an economic crisis known as the Great Recession, the effects of which rolled into the next decade. When there is an economic crisis, the government can take a number of actions to improve the situation. Which action is the best to take is debatable.

Read about two different approaches that two economists argue are the best ways to deal with the U.S. economy. Which approach do you agree with?

Economists Debate Governments' Role in Repairing Economies

by Lorie Konish

Two renowned economists engaged in a fierce debate at the IMCA New York Consultants Conference on Tuesday on a question that both admitted had no concrete answer: What can the government do to repair the economy?

That question comes several years after a massive federal bailout in the U.S., and as some European nations totter on the brink of requiring rescue of their own. But the discussion titled "Keynes vs. Hayek," in honor of the famed debate between economists John Maynard Keynes and Friedrich Hayek more than 80 years ago, shows that different approaches to those problems exist just as much today.

The debate included Jared Bernstein, a senior fellow at the Center on Budget and Policy Priorities who was a member of President Barack Obama's economic team, and Russell Roberts, a professor of economics at George Mason University.

Bernstein argued on behalf of Keynes' philosophies that economies sometimes require outside intervention to run smoothly. Roberts argued for Hayek's beliefs that economies should mostly have the opportunity to correct themselves.

For Bernstein, who was a newly named member of President-elect Obama's economic team in December 2008 when the U.S. economy was losing jobs at a rate of 800,000 per month, the choice was clear to create a stimulus package, he said.

Shortly after the stimulus funds were applied in 2009, the rate of GDP contraction got smaller, Bernstein said. While the unemployment rate actually increased from 7% when the stimulus was passed to 9.5% a year later, Bernstein cautioned that it's important to think about where that rate could have been, at 10% or 11%.

Bernstein argued that the opposite of Hayek's free market theory would be central planning, which has also proven it cannot work. What is needed instead is a hybrid, Bernstein said, where large government can sometimes take a lead role when necessary.

"There are times when the economy's in a bust, when there's a recession, where you need to do more stuff that looks a bit like central planning," Bernstein said.

Roberts, the professor of economics, sought to dispel the notion that government spending directly promotes economic growth.

"The New Deal didn't end the Great Depression. It was the war time spending," Roberts said. And even that injection did not benefit the economy evenly, Roberts argued. While weapons manufacturers saw a boost, the private sector did not.

Japan, which has also weathered its own prolonged downturn, has spent trillions on paving projects. The result has been good for contractors, Roberts said, yet has not resulted in a lift for the economy. The American Recovery and Reinvestment Act may follow that same pattern.

"Did it work? The right answer is we don't know. But we don't have any evidence that it was successful," Roberts said.

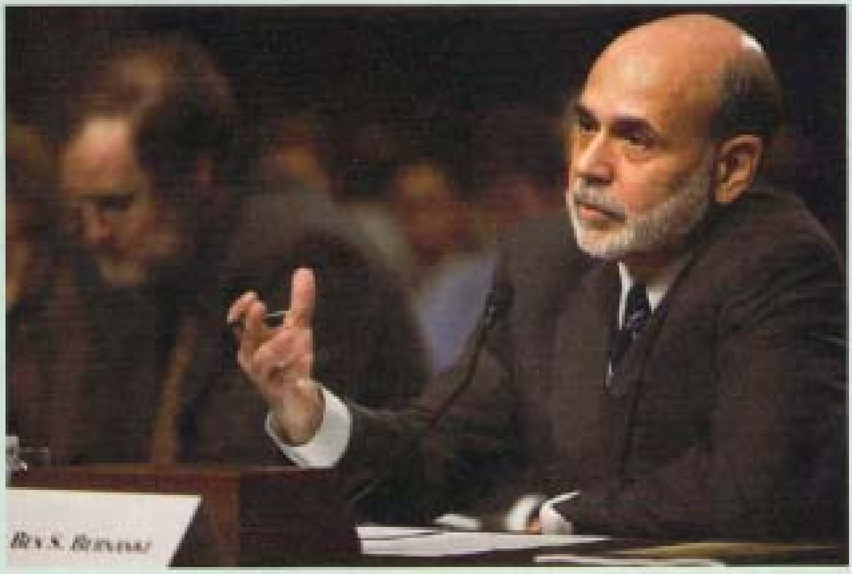
That comes as the Congressional Budget Office estimates that, as of the third quarter of 2011, 400,000 to 2.4 million new jobs were created. Having a six-fold difference between those estimates—from .4 to 2.4—makes for an "imprecise world," according to Roberts.

"We should not put our children in debt . . . in the name of jump starting the economy where there's no evidence that the jumper cables are actually connected to anything," Roberts said.

Bernstein rebutted Roberts, saying he saw stimulus funding directly help job creation while he was working with Vice President Joe Biden. In an area of Florida where the unemployment rate was 20% among construction workers, one project helped put a few hundred individuals to work.

"This is what actually happened. It's not philosophy," Bernstein said. "When the government temporarily steps in and helps to replace some of the lost demand, some of the lost jobs, its helps to make people's lives a little more comfortable while the private sector is getting its act back together."

Lorie Konish is a contributor to On Wall Street, *a Web site that reports on the financial industry.*



In 2006, President George W. Bush appointed Ben Bernanke to a 14-year term in the Board of Governors of the Federal Reserve, or the Fed, the central bank of the United States. At the same time, Bush appointed him to a four-year term as chair of the Fed. President Barack Obama reappointed Bernanke for a second term as chair in 2010. The chair of the Fed plays a major role in monetary policy in the United States by having authority over the regulation of the Federal Reserve Banks, money supply, and interest rates.