PROMOTING A RISING STANDARD OF LIVING FOR ALL AMERICANS

The Administration's central economic objective is to improve living standards for the greatest possible number of American families. Since 1993, the President has laid a firm foundation—with a series of budget, trade, education, and other policies that have helped generate the remarkable economic recovery of the last two years. With his new Middle Class Bill of Rights and this budget, the President is building upon that foundation to raise take-home pay for Americans today and help them acquire skills and more financial security tomorrow.

Two years ago, ballooning Federal budget deficits were the greatest barrier to rising standards of living. The Government soaked up so much private saving that interest rates soared and businesses could not afford investments to make our economy more productive, and our workers more prosperous. With a balanced package of spending cuts and revenue increases, the President's program brought the deficit down steeply—from $290 billion in 1992 to a projected $193 billion in 1995—marking three straight years of deficit reduction for the first time since Harry Truman was President. Through the Vice President's National Performance Review and subsequent legislation, Federal employment has fallen by nearly 100,000 and soon will drop to its lowest level since John Kennedy was President.

On the tax side, the President and Congress increased the earned income tax credit, which cut income taxes for 40 million Americans in 15 million working families. The tax cuts provided relief where it was needed most and, by augmenting low wages, fulfilled the President's pledge to "make work pay." The President also made 90 percent of America's small businesses eligible for tax relief.

Deficit reduction and spending restraint brought interest rates down. Lower interest rates and targeted tax relief jump-started what had been a weak recovery from the 1990 recession. Since this Administration took office in January of 1993, the economy has produced a whopping 5.6 million new jobs, compared to 2.4 million in the prior four years. Yet, inflation remains at the slowest pace in decades.

Rapid job growth and low inflation are prerequisites for rising living standards, widely shared. But, alone, they are not enough.

While freezing total discretionary spending for three budget years, the President shifted billions of dollars to investments in human and physical capital that will help raise productivity and, with it, living standards down the road. He focused on better educating the young, making college more affordable for millions of students, improving workers' skills, and reforming the welfare system to reduce dependency and increase opportunity. He worked with Congress to create the Goals 2000 program, which rewards local schools that set and pursue their own educational milestones, and a direct student loan program, which cut the cost of Federal support for higher education. At the same time, he focused on investments in science and technology and in physical capital.

The economy has improved far more than even the most optimistic forecasters predicted two years ago, and the deficit is much lower than anticipated. And yet, not everyone has joined in the economic recovery. Millions of Americans continue to work harder and harder, only to see their real incomes stagnate or even decline and their jobs remain uncertain. The problems are particularly acute among those with little education or few skills. With this budget, the President builds upon his economic plan with the Middle Class Bill of Rights—both short- and long-term policies to raise the living standards of those hard-working, middle-income Americans. His goal is straightforward: Having created millions of new jobs, he now wants to create jobs that are better and more secure.

The President's Middle Class Bill of Rights has the following four elements:

- For tax relief, the President proposes a middle-income tax cut—a tax credit for families with children under age 13—that will help Americans with the day-to-day costs of raising families.
- To increase the Nation's savings and the financial self-reliance and retirement reserves of American workers, the President proposes expanded eligibility for Individual Retirement Accounts (IRAs). With this provision, most American families will have a tax incentive to make their own investments in their futures. And to help with the major challenges of buying a first home, paying for catastrophic health costs, withstanding the financial pressure of job loss, and financing education (to increase our skills for the competitive economy of tomorrow), the President would create opportunities for penalty-free withdrawals from IRAs.
- To nourish the skills workers need in tomorrow's economy, the President proposes a tax deduction for the costs of post-secondary education. This gives average American families a tax cut if they invest in their children's—or their own—education and skills.
- To equip today's workers, and tomorrow's, with the education and job skills they need to compete effectively in the global economy, the President proposes a G.I. Bill for America's Workers that empowers individuals by awarding them skill grants and provides greater flexibility for State and local governments.

At the same time, the President proposes to build upon his successes in opening foreign markets, to generate more of the high-paying jobs associated with rising U.S. trade. He will negotiate to expand membership in the North American Free Trade Agreement, implement the recent General Agreement on Tariffs and Trade, and seek other bilateral and multi-lateral opportunities to open new markets. He also will restructure U.S. trade promotion programs to target assistance to exporters.

In short, this budget builds on a base of deficit reduction and economic strength by continuing to pursue sound fiscal policies and investments to bolster and further spread our improved living standards. It will make an enviable economic record even better.

1. Sharing the Benefits of Economic Growth

1996

1. SHARING THE BENEFITS OF ECONOMIC GROWTH

A MIDDLE-CLASS TAX CUT

The Problem of Lagging Incomes

On the domestic front, the President's highest priority is to spread the benefits of our economic growth to average Americans whose incomes have remained stagnant or even declined.

The roots of the problems of working Americans date back over 20 years. Rapid technological advances have put a premium on education and job skills. Generally speaking, those with high education and sophisticated skills have benefited in the last two decades; their standards of living have risen. Those without the requisite education and skills, however, have had to work longer hours or more than one job just to maintain their living standards. Even that wasn't enough for the many whose living standards declined.

In recent decades, the middle class has not fully shared in the benefits of a growing economy. From 1980–93, real incomes of the middle one-fifth of households rose by only 0.6 percent, an average of under $200 each (Table 1–1). Incomes of the top fifth, however, grew by 20.8 percent, or about $17,000 each. Even more striking, incomes of the top five percent grew by over 33 percent, or over $41,200.

As a result, the share of total household income enjoyed by the middle class fell. The share going to the middle three-fifths of households fell from 51.8 percent in 1980 to 48.2 percent in 1993. The share of income enjoyed by the top fifth rose from 44.1 percent to 48.2 percent. Thus, by 1993, the top fifth of households was receiving the same share of income as the middle three-fifths.

Moreover, the top five percent enjoyed most of the growth in income of the top one-fifth; its income share rose from 16.6 percent of all household income in 1980 to 20 percent in 1993. Meanwhile, the share of income of the lowest fifth fell from 4.2 percent to 3.6 percent.

Millions of working American families clearly have lagged behind the pace of growing economic prosperity—even in the last two years, when growth in the overall economy has been especially brisk. The President's program is designed to help lift the incomes of the broad middle class of American workers.

A First Step: The 1993 Tax Cut

Two years ago, the President and Congress took a major first step to raise the limited income growth and reduce the tax burdens of lower-middle-income American workers: They made the *earned income tax credit*

Table 1–1. AVERAGE HOUSEHOLD INCOME, BY QUINTILE

(Incomes in constant 1993 dollars)

	Quintile					Top 5 Percent
	Lowest	Second	Third	Fourth	Highest	
1993	7,411	18,647	31,260	48,572	98,589	163,228
1980	7,567	18,834	31,079	45,787	81,638	121,998
Absolute Growth, 1980–93	–156	–187	181	2,785	16,951	41,230
Percent growth 1980–93	–2.1	–1.0	0.6	6.1	20.8	33.8

Source: Bureau of the Census

(EITC) more generous and extended it to more people. Their action greatly reduced the tax burden on these people and, by lifting working families with children above the poverty line, fulfilled the President's commitment to make work pay.

The EITC, which dates back to 1975, was originally designed to offset the burden of the Social Security payroll tax for low-wage workers with children, and to supplement wages as a way to encourage work. Congress extended it for two years in 1976, and increased it while making it permanent two years later. Since then, Congress has periodically increased and refined it. In 1993, the President and Congress chose to make the EITC available for the first time to poor workers *without* children. Today, the EITC is "refundable"—that is, individuals who owe no income taxes still may be eligible for a Federal refund. Consequently, the EITC helps to raise average incomes of working families with incomes in the bottom fifth of Americans.

In 1996, when the recent changes become fully effective, low-income families with two or more children will receive a 40-percent wage subsidy on earnings up to $8,900. That is, each $100 of earnings will entitle workers to a $40 EITC. The maximum credit will be $3,560 for workers who earn between $8,900 and $11,620. The credit is phased out for workers earning between $11,620 and $28,520.

In 1993, the imperative of reducing the deficit precluded the President and Congress from extending middle-income tax relief to more Americans. Now, with the deficit expected to fall again in 1995, the President can continue the tax relief he began in 1993 while maintaining his commitment to fiscal discipline: Under the President's program, every dollar of tax cuts is offset by spending cuts described, in detail, later in this budget.

The President's New Proposal

The President targets his new tax cut squarely at the middle class. More than 60 percent of the benefits will go to families with incomes below $75,000; 87 percent will go to families with incomes below $100,000.[1] (See Table 1–2.)

The President's tax cut has three main elements aimed at strengthening families, promoting education, and encouraging saving:

$500 non-refundable credit for each dependent child under the age of 13: This credit will be fully available to taxpayers with adjusted gross income (AGI) of less than $60,000, then phased out for incomes from $60,000 to $75,000. To insure that the tax cut does not increase the deficit, the credit is phased in only as fast as spending can be cut. That is, the credit will be $300 for 1996, 1997, and 1998, and $500 for 1999 and beyond.

This credit will provide substantial tax relief. For example, a two-parent, two-child family with $50,000 of wage and salary income (in 1995 dollars) and $7,500 of itemized deductions will enjoy a 21 percent cut in taxes—from $4,875 to $3,875—once the credit is fully in place. For hard-pressed working families, this tax saving could serve as a mortgage payment or as a reserve against a significant medical bill or other important expenses.

Deduction for up to $10,000 in post-secondary education and training expenses: This benefit will be available for tuition and fees (for the taxpayer, spouse, or dependents) for any college, university, or vocational program eligible for Federal assistance. Also, taxpayers will be able to take the deduction "above the line"; it will reduce their AGI and not be limited to taxpayers who itemize deductions.

The maximum allowable deduction will be phased in. It will start at $5,000 in 1996 and rise to $10,000 in 1999 and beyond. Taxpayers with AGI (before the deduction) below $100,000 will be eligible for the full deduction; it will be phased out for taxpayers with AGI between $100,000 and $120,000.

[1] By comparison, the Republican "Contract with America" proposals would give 49.9 percent of their benefits to families with incomes over $100,000, and 28.3 percent to those with incomes over $200,000 (the 2.2 percent of families with the highest incomes). Families with incomes under $75,000 would get only 35.3 percent of the benefits. Thus, the small group of families that enjoyed the biggest income gains in recent years would get the biggest tax cuts, while the vast bulk of middle-income families that experienced only modest gains would get a smaller share.

Table 1–2. PERCENTAGE DISTRIBUTION OF THE PRESIDENT'S MIDDLE-CLASS TAX CUT PROPOSAL

(1994 income levels)

Family Economic Income Class [1] (In thousands of dollars)	Number of Families in FEI Income Class (millions)	President's Middle-Class Tax Cut (percent)
0–10	14.9	0.1
10–20	18.4	1.1
20–30	16.0	4.3
30–50	22.4	23.3
50–75	17.4	32.5
75–100	9.9	25.6
100–200	8.8	12.4
200 & over	2.4	0.6
Total [2]	110.7	100.0

Source: Department of Treasury, Office of Tax Analysis, January 9, 1995.
[1] Family Economic Income (FEI) is a comprehensive income concept that is broader than adjusted gross income.
[2] Families with negative incomes are included in the total line but are not shown separately.

(For taxpayers filing as single or head-of-household, it will be phased out over the AGI range of $70,000 to $90,000.) When fully implemented, this deduction could provide tax savings of $1,500 to $2,800 for middle-income families.

Because college costs hit in large lump sums, even upper-middle-income families find them hard to swallow. The prospect of such expenses and a burden of debt upon graduation can deter some families—especially those of lower income—from making this key investment. This deduction will strengthen the economic incentive for doing so, thus promoting long-term increases in productivity and economic growth as well as broadening economic opportunity.

It also will help level the playing field between investments for physical capital and those for human capital. Investments for physical capital, such as plant and equipment, are eligible for deductions for depreciation. Individuals' investments in skills and training, however, generally are not eligible for such deductions.

Greatly expanded Individual Retirement Account (IRA) options: Today, couples with AGI of up to $40,000 can make fully deductible contributions of up to $2,000 to IRAs. The President would double the income limit to $80,000 (phased out at $100,000) for families, and raise it to $50,000 (phased out at $70,000) for individuals.

The President's proposal would extend fully deductible IRAs to the vast majority of taxpayers. Moreover, it would index these income limits, as well as the $2,000 maximum contribution, for inflation; eligibility and income limits would increase over time. In addition, taxpayers eligible for deductible IRAs could select a new "Special IRA," which provides its tax benefits at the time of withdrawal, not contribution. Rather than receive a tax deduction for contributions, individuals could elect to pay no taxes on the money they withdraw from IRAs after at least five years. Finally, individuals with AGI below the eligibility levels could convert an existing IRA to a Special IRA.

Individuals also could withdraw funds early from an IRA without paying the 10-percent penalty—if they use the money for:

- Post-secondary education;
- Purchase of a first home;
- Unemployment spells of 12 weeks or more;

- Care of an incapacitated elderly parent or grandparent; or
- Medical expenses in excess of 7.5 percent of AGI.

From the IRA expansion, too, the tax cut could prove substantial. Taxes for middle-income families could fall $600 to $1,120 if both spouses work and contribute the maximum $4,000 to their IRAs.

Expanded IRAs will promote savings, helping families and the economy as a whole: They will encourage middle-income families to save, enhancing their long-term economic independence; and they will increase the availability of capital to U.S. business, expanding investment and speeding the growth of productivity and incomes.

Currently, the U.S. personal savings rate is low in historic terms and by international comparison, handicapping investment and economic growth. The expanded IRAs will send a signal to Americans that saving is important. The availability of these new opportunities will encourage private financial institutions to spread the word.

SECURING HIGHER INCOMES

> *Education... has a bigger impact on earnings and job security than ever before... Every American needs the skills necessary to prosper in the new economy... So let's invest the fruits of today's recovery into tomorrow's opportunity.*
>
> President Clinton
> Address to the Nation
> December 15, 1994

The President's G.I. Bill for America's Workers, the fourth element of his Middle Class Bill of Rights, will ensure that all Americans—including those who don't benefit from the tax cuts—have the opportunity to get the skills they need. This initiative not only complements other parts of the Middle Class Bill of Rights but also builds on the Administration's success, working with the last Congress, in improving the education system from preschool through college, thus helping to insure that the next generation will enter the workforce better prepared than previous ones. By focusing on adults as well as youth, this education and training initiative would make lifelong learning opportunities for all Americans a reality.

The Lifelong Learning Agenda

The comprehensive set of initiatives for lifelong learning began with successful, bipartisan legislation of the last two years to increase educational opportunity and quality for young people and make college more affordable:

- Head Start Act;
- Goals 2000: Educate America Act;
- School-to-Work Opportunities Act;
- Improving America's Schools Act; and
- Student Loan Reform Act.

Through these laws, the Administration and Congress are making pre-school more effective, helping States set challenging standards for our schools, helping schools incorporate those standards into system-wide elementary and secondary education improvements, enabling high school students to more successfully move from school to work and further education, and making college loans more affordable. These laws help States and localities raise the achievement and skill levels of all students and workers in order to build a sounder economy, and strong democracy, in the future.

The final component of this agenda is the President's new skills initiative. Working with States, communities, and the private sector, it will produce a thorough restructuring of the wide array of Federal education and training programs, make job search assistance more effective, and put more dollars directly in the hands of workers and job seekers who need and want new skills.

For the major components of the Lifelong Learning Agenda, the budget proposes $27.7 billion, an increase of $2.5 billion over the 1995 level—and an increase of $5.2 billion, or 23 percent, over 1993. (See Table 1–3.)

What We Have Achieved

In the U.S., education is mainly a State, local, and private sector responsibility. The

Table 1–3. THE BUDGET INCREASES INVESTMENT IN MAJOR PROGRAMS FOR LIFELONG LEARNING BY $2.5 BILLION OVER 1995, AN INCREASE OF $5.2 BILLION, OR 23 PERCENT OVER THE 1993 LEVEL

(Budget authority, in millions of dollars)

	1993 Actual	1995 Estimate [1]	1996 Proposed	Change: 1995 to 1996	Change: 1993 to 1996
Head Start	2,776	3,535	3,935	+400	+1,159
Goals 2000	.....	403	750	+347	+750
Education for the Disadvantaged (Title I)	6,686	7,233	7,441	+208	+755
Professional Development (Title II)	.....	320	735	+415	+735
Charter Schools	.....	6	20	+14	+20
Education Technology (ED and DOL)	.....	40	98	+58	+98
Safe and Drug-Free Schools [2]	582	482	500	+18	–82
School-to-Work (ED and DOL) [included in G.I. Bill for America's Workers entry]					
G.I. Bill for America's Workers	12,426	13,186	14,202	+1,016	+1,776
Total BA, lifelong learning	**22,470**	**25,205**	**27,681**	**+2,476**	**+5,211**
Loans for education and training (in millions of dollars)	17,873	25,757	28,356	+2,599	+10,483

[1] Includes proposed supplementals and rescissions.
[2] Reflects Congress' cut below the appropriation request in 1995.

Federal Government provides less than 10 percent of total public funds spent for these purposes. This tradition of local responsibility and control precludes the possibility of top-down reform. If schools are to improve, States, local school districts, and individual schools—together with parents—must take the lead and play active roles. Quality, equity, and access to education are, however, critical national concerns. Acting as a partner with States, local communities, and the private sector, the Federal Government invests its resources in three primary areas:

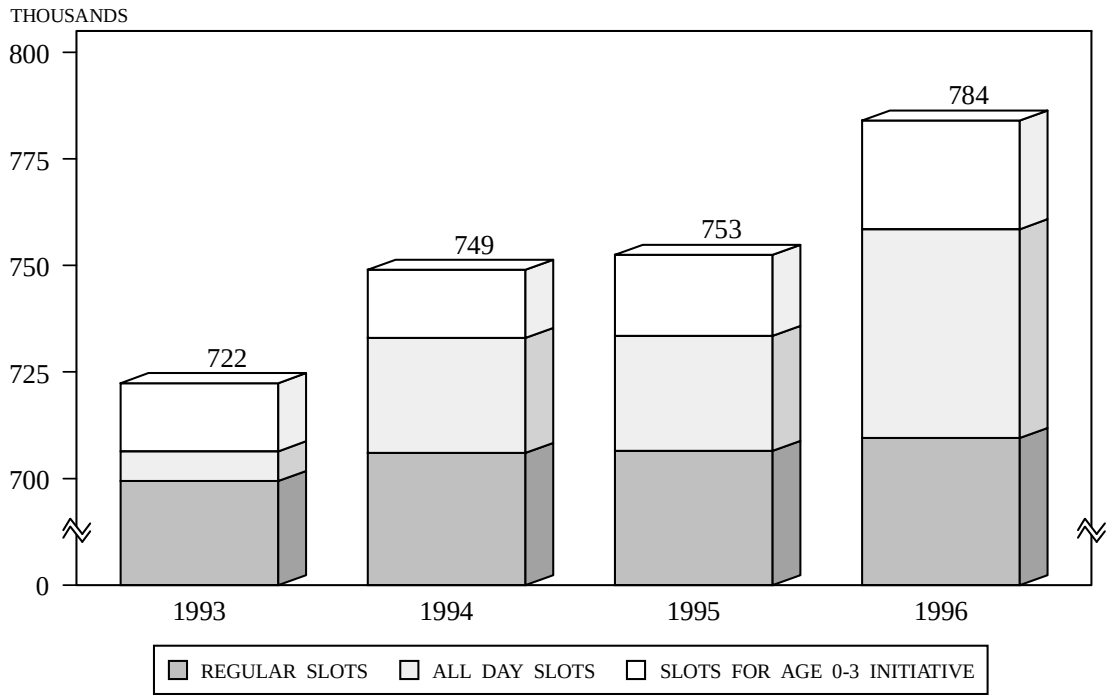
- To stimulate reform (e.g., Goals 2000 and School-to-Work);
- To supplement State and local resources for particular, high-priority purposes (e.g., educating the disadvantaged and making schools safer and more drug-free); and
- To make postsecondary education more affordable (e.g., Pell grants, student loans, and the new tax benefits for training).

Head Start—Reforming the Preschool System: Head Start provides comprehensive services, such as education, health care, and nutritious meals, for disadvantaged three-to-five-year-old children and their families. The new infant and toddler initiative that the President and Congress enacted in 1994 as part of the Head Start Act, allocates about four percent of 1996 Head Start funds to reach children under age three and their families.

Evaluations of Head Start children have found short-term gains in IQ scores, better reading and math skills, better emotional adjustment, and improved health. Former Head Start children are likelier to be promoted to the next grade and less likely to be assigned to special education classes. To assure that all Head Start programs consistently deliver the high-quality services needed to produce such results, the Administration and Congress enacted major quality improvements to Head Start in the 1994 reauthorization.

The 1994 Act supports investments to attract and retain workers at Head Start centers, thereby increasing the stability of the program environment and improving the quality of instruction. These investments enable Head Start centers to improve teacher-

Chart 1-1. 32 THOUSAND NEW HEAD START OPPORTUNITIES FOR CHILDREN IN 1996



Note: Slots for the age 0-3 initiative in 1993 and 1994 show participation in the Comprehensive Child Development Projects (CCDP) and Head Start Parent Child Centers (PCC).

child ratios, hire education and health specialists, upgrade facilities, and make other changes that local managers deem appropriate to raise the quality of their programs. By May 1995, the Department of Health and Human Services will develop performance measures for evaluating the quality of local programs. The Department is working to ensure accountability and will take prompt action against poorly performing grantees, including termination if necessary.

Having begun the process of improving Head Start's quality, the Administration will focus as well in 1996 on increasing the number of children who benefit from the program. The budget would create 31,500 new opportunities for children, including the provision of full-year, full-day slots, part-time slots, and slots for the new infant and toddler initiative. (See Chart 1–1.) All told, the budget provides for 784,000 slots in 1996, for which it proposes $3.935 billion for Head Start, an increase of $400 million, or 11 percent, over the 1995 level.

Goals 2000: Educate America Act: The 1994 enactment of Goals 2000 marked a new era in education reform, one that engages all schools and students. Goals 2000 codifies the National Education Goals, gives States new reform resources, and sets the expectation that all children will achieve the high standards that States develop. It helps States support local districts and schools in their efforts to align curriculum, instruction, and professional development with challenging new standards. And it helps States make schools more accountable to parents, students and the public.

Goals 2000 draws on research and international comparisons that show that all students can reach far higher academic standards than we have asked of them. It incorporates a strategy far different from prior Federal reform endeavors; it addresses a national

problem with a national, not a Federal, strategy. Rather than impose a top-down approach filled with mandates, it focuses on fostering bottom-up, local reform guided by challenging State standards. The goal: To create a long-term, productive partnership among local schools, school districts, States, and the Federal Government to bring all students to higher levels of achievement.

Goals 2000 calls for maximum State flexibility, as reflected in the Education Department's implementation strategy. It imposes no additional constraints and offers States new waiver flexibility through which to bring almost all Federal elementary and secondary education programs into their reform efforts. Each State is tailoring its reform approach to its needs. For example, some States may begin with improved teacher training, others with curriculum redesign, and still others with enhanced parent involvement.

Under Goals 2000, the Federal Government will work with States to carefully evaluate reform. It will help the States learn from each other while it conducts national level research and collects information that States need to support their efforts. Over time, the Federal Government will work with States to create performance indicators for systemic reform, which might include:

- The pace by which States establish objective, high-quality academic content and performance standards, and align professional development and assessment with them;
- The change in the percentage of students who meet or exceed reading and math proficiency levels, as measured by the National Assessment of Educational Progress; and
- The performance of students in high-poverty schools, compared to those in other schools.

The budget proposes $750 million for Goals 2000, an increase of $347 million, or 86 percent, over 1995.

Improving America's Schools Act (reauthorization of the Elementary and Secondary Education Act of 1965): Title I provides funds to raise the educational achievement of children in low-income areas. In 1994, the President proposed and Congress adopted changes to focus Title I resources better on areas with the largest concentrations of low-income children; set the same high standards for those children as for others; and hold schools accountable for making progress toward achieving those standards. States now have much more flexibility to use funds as they deem necessary to achieve better educational results for children. The budget includes $7.441 billion for Title I, an increase of $208 million, or three percent, over the 1995 level.

The new Title II Professional Development program provides funds to States and educational institutions to support the intensive, high-quality training of teachers and administrators. The program will enable educators to achieve higher levels of professional excellence and help students achieve the new academic standards and learn in accordance with new State curriculum designs. The budget includes $735 million for Professional Development, an increase of $415 million, or 130 percent, over 1995.

Of the other elements in the new Act, three are especially significant:

- **Charter Schools**—Funds for States and school districts to support the development of new types of public schools that enhance parental choice and operate substantially free of Federal, State, and local regulations that may impede better student achievement. The budget includes $20 million for Charter schools, an increase of $14 million over 1995's first year funding.
- **Technology for Education**—Activities (including a "Technology Learning Challenge") to create a partnership among States, schools, and the private sector to raise education and training achievement by innovatively using technology. The budget proposes $83 million for the Education Department and $15 million for the Labor Department; the $98 million total represents an increase of $58 million, or 145 percent, over 1995's first year funding.
- **Safe and Drug-free Schools and Communities**—The restructuring of programs

of drug abuse prevention and school violence reduction, giving States and schools more flexibility to use funding to meet their needs. The budget proposes $500 million for these activities, an increase of $18 million over 1995.

School-to-Work Opportunities Act: School-to-Work supports State, local, and private efforts to build an education and training system that helps all youth get the knowledge and skills to move smoothly from school to career-oriented work or to more education or training. States and localities tailor their activities to local needs, such as by developing new curricula that integrate academic and occupational learning; linking high school and one or two years of postsecondary technical education; using mentors to help young people learn the requirements of the workplace; and providing "skill certificates" that employers can trust in choosing a qualified young person.

For example:

- Boston builds on a youth apprenticeship model, integrating paid work experience with new curriculum; and
- Oregon's South Coast Region uses the skill certificate approach, focusing on careers in health care, finance, tourism, manufacturing, shipping, forest products, and commercial fishing.

Recognizing the link between schools and the labor market, the Labor and Education Departments administer School-to-Work jointly through a single office that works with States, localities, and the private sector. The budget proposes $400 million for School-to-Work, an increase of $150 million, or 60 percent, over 1995. (For more discussion, see "Helping Youth," below.)

Reforms of the Student Loan System: The guaranteed loan program structure that evolved over the past 30 years was very costly, hard to administer, and subject to abuse. In response, the President proposed the Student Loan Reform Act, which Congress enacted in 1993.

The Act launched the Federal Direct Student Loan Program to replace the guaranteed lending program, which works through 7,500 lenders and 46 State and non-profit intermediaries ("guaranty agencies"). The new program finances loans efficiently by sending them directly to students and schools through simple electronic transfers. It greatly simplifies borrowing for students, parents, and schools. And for the first time, it gives borrowers substantial repayment flexibility, particularly through the "pay-as-you-can" option—borrowers only repay each year what their income permits. Under this option, nobody needs to fear that borrowing for school might lead to loan defaults or that loan burdens might be too great. The Act extends the Pay-as-you-can option to all borrowers under the old program through "consolidation loans." The Act will save an estimated $6.8 billion from 1995–2000.

Direct lending began successfully in 1994, with 226,000 new loans. To maximize the benefits of direct lending for students, families and schools, and to further lower taxpayer costs, the Administration is proposing to speed up Direct Loan implementation so that all new loans are direct loans by July 1, 1997, saving an additional $5.2 billion from 1996–2000. (See Chart 1–2.)

THE AGENDA AHEAD

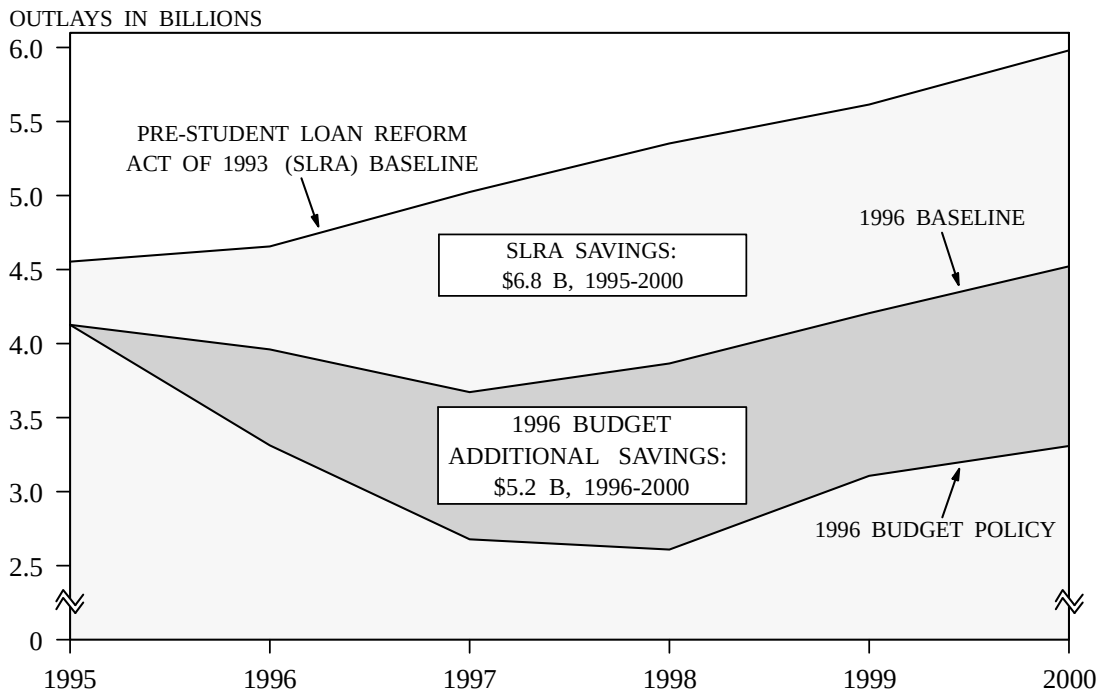
During its first two years, the Administration focused on improving education from pre-school through college. These investments are critical to the Nation's future. But we also must provide better opportunities for those adults who are already in the workforce and whose education may prove insufficient to meet the challenges of today's economy, or whose skills may prove equally insufficient to move them into new or better jobs.

The Problem with Job Placement and Job Training Programs

Today's patchwork of Federal job placement and training programs grew up over more than 60 years. Each element was designed with the best of intentions—to respond to a specific concern. In the end, however, the system does not meet the needs of today's economy or fit the President's goal of a streamlined, more effective system.

- The many programs, with their conflicting rules and administrative structures, con-

Chart 1-2. STUDENT LOAN PROGRAM COSTS WOULD BE REDUCED 12 BILLION DOLLARS OVER SIX YEARS, 1995-2000



NOTE: Pre-SLRA baseline is adjusted for interest rate, inflation and loan volume differentials, to make them comparable.

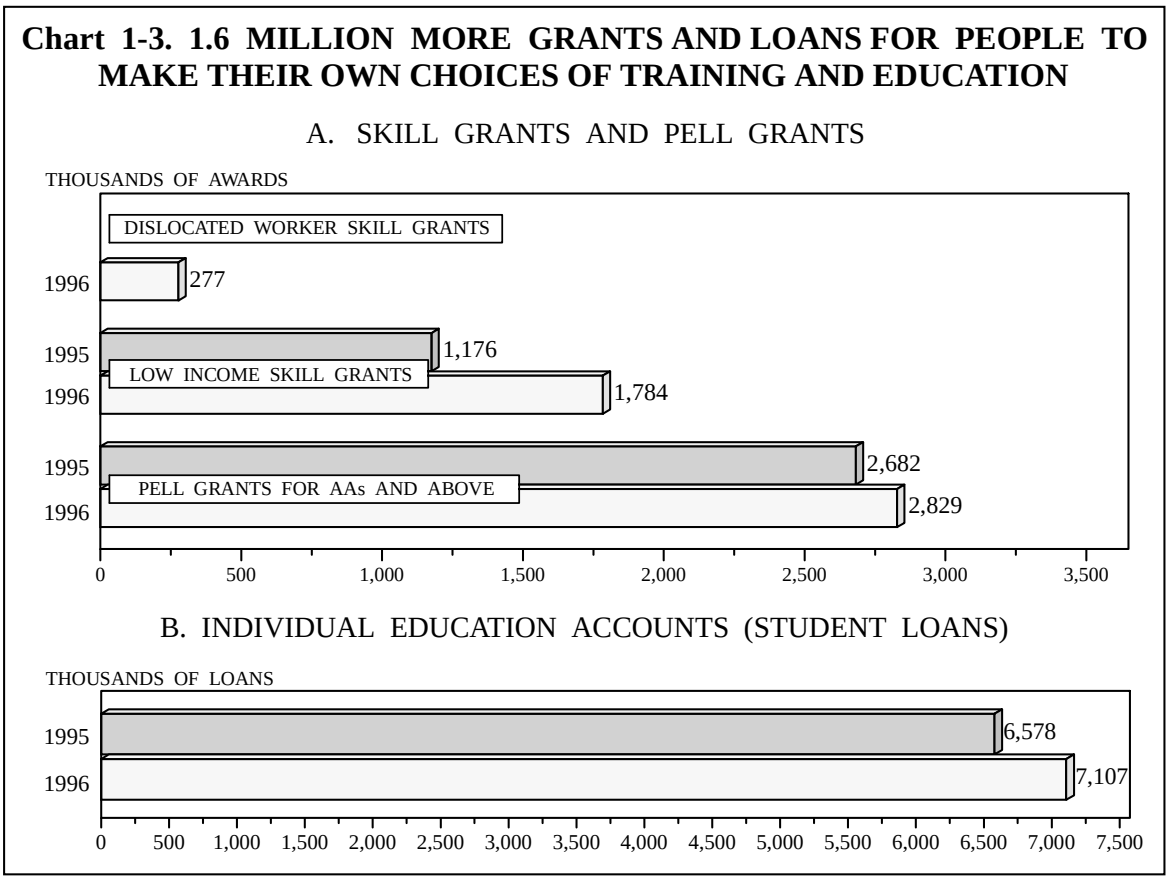
fuse the people they are intended to help, add bureaucracy at every level, and waste taxpayer money.

- Not surprisingly, States and localities complain about the problems of coping with so many different Federal rules and reporting requirements.
- In many programs, bureaucrats make choices about jobs and training for individuals, as if individuals cannot choose for themselves; nor is the private sector plugged in enough to help.
- Job seekers and those who seek skill training do not receive high-quality information and assistance. Pell grants and student loans do permit "choice"—recipients use the Federal aid at the institution they choose—but recipients cannot make informed choices because they do not get reliable information on job and career opportunities or on the quality of training providers to choose from.
- The quality of training and related services is uneven, and the programs often do not require accountability for results; institutions continue to get Federal funds regardless of performance.

The Solution: Reinventing Programs by Empowering People, States, and Local Communities

The President intends to help workers, job seekers, local governments, and the private sector meet the demands of the new economy by scrapping the confusing maze of Federal training programs. He would break down traditional hierarchies and bureaucracies, putting most resources directly into workers' hands. Funds also would go directly to States and localities, so they could design the job search and training-related systems that they determine are needed to help youth and adults to qualify for, and get, good jobs.

Chart 1-3. 1.6 MILLION MORE GRANTS AND LOANS FOR PEOPLE TO MAKE THEIR OWN CHOICES OF TRAINING AND EDUCATION



Able to acquire the skills and information they need to compete, workers will have more control over their own futures. Given the opportunity, States and communities will design the job training and related services their citizens need. The Federal Government will ensure that services continue to be provided to the disadvantaged and that the Federal funds in question produce measurable results. Thus, this initiative is based on seven key principles:

1. Empowering individuals;

2. Providing good data to guide choices;

3. Insuring accountability to consumers and taxpayers;

4. Creating leaner government;

5. Providing greater flexibility to State and local communities;

6. Making the private sector a partner; and

7. Creating effective paths from schools to work.

Of the 163 Federal job training programs that the General Accounting Office identified in January 1995, this proposal would incorporate all those that directly support general job search and job training assistance. The budget reflects the inclusion of 70 programs, representing over 60 percent of 1995 funding for the programs GAO identified. (See Table 1–4.) Of the rest, some were terminated or not funded in 1995 and the others are not appropriate for inclusion—for example, some primarily assist business development; others provide physical rehabilitation for the disabled. Thus, they do not fit the description of general job search or training.

While proposing to streamline programs, the President also seeks to increase overall funding by $1 billion, reflecting his belief that—now more than ever—education and training are the ladder into the middle-class and the best insurance that workers have against economic change.

Table 1–4. THE G.I. BILL FOR AMERICA'S WORKERS COMBINES 70 PROGRAMS INTO ONE WORKFORCE DEVELOPMENT SYSTEM, AND INCREASES FUNDING $1 BILLION OVER 1995

(Discretionary budget authority, in millions of dollars)

Sets of Categorical Programs	1995 Enacted	System Components	1996 Proposed
JTPA adult programs	997	Skill and Pell grants to individuals:	
Dislocated worker programs	1,296	Dislocated workers	582
Pell grants	6,247	Low-income persons	3,059
Employment service	912	Pell grants for AA degrees and above	4,480
State postsecondary renew program	20		
Research, evaluation and demonstrations	48	Subtotal, individual grants	8,121
One-Stop Career Centers	120		
JTPA and other youth programs	1,630	State-defined services system:	
School-to-Work (ED and DOL)	250	Adults (including One-Stop)	2,685
Vocational education programs	1,178	Adult and family literacy	490
Adult education and family literacy programs	488	Youth (including School-to-Work)	2,906
Total:		**Total:**.	
Categorical programs	**13,186**	**Better Jobs and Skills System**	**14,202**
Loans for education and training (in millions of dollars)	25,757	Loans for education and training (in millions of dollars)	28,356

The new jobs and skills initiative will allow each State to devise an integrated strategy that unifies all elements of the training and education system. The building blocks are described separately below (though the Federal Government would no longer require States to maintain separate programs).

Helping Adults: The President's proposal would create "Skill grants" for unemployed and low-income workers and job seekers. States would create systems to give individuals the information they need to make informed choices with these grants and ensure that workers are not defrauded by incompetent or unscrupulous providers. The proposal would make 1.6 million more grants and loans available in 1996 than in 1995. (See Chart 1–3.) It also would support State efforts to design new, more flexible, integrated systems that will provide information about jobs and training, counseling, placement assistance, and other services.

- Individuals would get Skill grants or Pell grants of up to $2,620 a year for training;
- The budget proposes $3.6 billion in 1996 for Skill grants for technical education and $4.5 billion for associates and bachelor's degree courses through Pell grants. The student loan programs will provide another $28 billion in loan capital to help finance training and higher education;
- Low-income persons would get Skill grants based on family income and cost of education, in the same way they do now under Pell grants; and
- Dislocated workers who need training would qualify for Skill grants without an income test. Adults who lose their jobs and need skill training to get a new one would receive income support.

The proposal would build upon progress underway through "One-Stop Career Centers" to encourage States and localities to design and implement new systems of placement and training-related services within five years.

- It would provide $2.7 billion, most of it to States to design and operate the new system; and some for Federal activities such as oversight, research, evaluation, and response to multi-State layoffs and natural disasters; and
- It would provide $490 million for adult and family literacy, which the States could use as they want for basic skills instruc-

tion, GED preparation, and English-as-a-second language training.

Helping Youth: Too many young people do not now get the necessary preparation for jobs or for more education by the time they leave high school. Many do not even finish high school, in part because they see no connection between schooling and success in the job market. As discussed above, the School-to-Work Opportunities Act launched a national reform of education and workforce preparation programs for America's youth. Now, to build on and intensify that effort, the President's proposal will help States, communities, and the private sector completely restructure the primary Federal youth training programs.

- Under the proposal, States and localities will continue to receive School-to-Work Opportunities Act funds to link school systems, postsecondary education, and the private sector. These funds phase out by 2001 as systems are implemented;
- The proposal would consolidate most funds under the Perkins Vocational Education Act into one in-school youth grant to States;
- It would consolidate most funds under the JTPA IIC (year-round youth programs), JTPA Summer Youth Jobs programs, and other youth programs into one grant to States to serve dropouts and high-risk youth; and
- It would strongly encourage States and localities to implement an integrated School-to-Work system to serve in-school and out-of-school youth. They could submit a single plan to the Education and Labor Departments to combine Perkins, JTPA, ESEA Title I, and other youth funds. The Federal Government would quickly waive upon request any remaining Federal requirements that impede success.

Maintaining and Enhancing the Private Sector Role: The private sector has an immediate, direct stake in the quality of job training and related systems. It is establishing skill standards that can serve as the basis for holding training providers accountable for results. Under the President's proposal:

- Business and labor will be key partners in designing adult and youth programs and in providing essential data on jobs and skill demands; and
- Government will recognize and give awards to firms that have enjoyed the most success in upgrading the skills of their workforce. The most competitive and productive firms are improving such skills by way of formal training, on-the-job training, and investments in mid-career education, and by empowering workers to take greater responsibility on the job.

Improving the Pell Grant Program: The Pell grant program provides need-based grants to 4 million low- and middle-income undergraduates for vocational training and associates and bachelors degree programs. About half the recipients come from families with under $10,000 in income, and over 90 percent come from families with under $30,000 in income. Awards range from a minimum of $400 up to a maximum limited by annual appropriations.

Studies show that Pell grants help raise the participation rates of low-income students in post-secondary programs. As such, they are another important ladder into the middle class. Currently, about one-third of Pell funds are used for non-degree programs and are not integrated with other Federal and State training activity. Individuals who use these funds get little information about career options or the quality of vocational schools.

In the new skills initiative, Pell grant funds for vocational training would become "Skill grants" (as described above). Recipients would benefit from information about jobs and careers before enrolling in training and would learn the quality of training at each school.

For 1996, the budget would raise the maximum Pell grant to its highest level ever at $2,620, the same as the new Skill grants—a $280, or 12-percent increase, over the 1995 level.

More Accountability at all Levels

The President proposes to make the new education and training system meet the test that businesses face every day: it must deliver

value to its customers or risk losing resources. The system will reflect the principles of performance-based management at all levels.

- Individuals will have the resources to buy training, and the detailed reports on the quality and track records of eligible education and training institutions to let them make sound choices. Ineffective institutions will not survive.
- Individuals will be able to use their Federal dollars only at institutions with good track records, in terms of their students' achievement against recognized skill standards and their success in the job market.
- State-designed job search, job information, and training-related services will have to provide data to the public and to the Federal Government on how effectively they are using resources.
- Training providers will have to meet minimum quality standards in order to receive Federal funds.
- Training providers will have to produce customer-friendly "Report Cards," spelling out how well they perform on such factors as job placement of hard-to-employ persons as well as others, and the earnings of graduates in relation to program costs.
- The Labor and Education Departments will assess the system's overall performance at the national level and make its performance the basis for future budget proposals.

WELFARE REFORM

Under true reform, the welfare system would support the President's goal of ensuring that everyone, including welfare recipients, receive the training they need to go to work. It would provide temporary help for Americans who have fallen on hard times, while giving them the tools to return to the economic mainstream.

By that standard, the current system is badly flawed. The vast majority of Americans seem to agree, according to public opinion polls:

- 75 percent believe that welfare is rife with fraud and waste and does little to help poor people;
- 85 percent believe that it should be transformed into a program that creates jobs for the low-income; and
- 89 percent support a two-year welfare limit, after which able-bodied recipients should get a job or do community service.

Today's system does too little to prevent the conditions that lead to welfare dependency, such as teen pregnancy and poor education. It also provides a series of roadblocks for those who want to get off welfare. It does not give many the training they need to be self-sufficient or help them find jobs. Nor does it force most fathers to take responsibility for their families. Low-income parents who want to work often cannot get day care or health care for their children, or find a job with wages high enough to move their families out of poverty.

The President has pledged to "end welfare as we know it." Last year he submitted legislation, the Work and Responsibility Act, to accomplish that goal. This year, he will work with Congress to enact comprehensive welfare reform that embodies the principles of work and responsibility for able-bodied welfare recipients and protects their children.

A Brief History of Our Welfare System

At the turn of the century, our welfare system still reflected the English poor laws. Assistance went to the poor, but often only to those willing to live in poorhouses or to place their children in institutions or with other families as apprentices or indentured servants. Responding to public concerns about the living conditions of large numbers of children, President Theodore Roosevelt convened the first White House Conference on Children in 1909. Conferees agreed that, where possible, children should remain with their families. As a result, many States enacted mothers' pension laws to keep families intact.

The Great Depression spurred further changes to America's decentralized, loose-knit social welfare system. Private and public agencies could not handle the massive needs

of so many destitute families. In August 1935, President Franklin Roosevelt signed the Social Security Act, establishing several assistance programs with shared Federal-State responsibility, including Aid to Dependent Children (now Aid to Families with Dependent Children, or AFDC), which is considered the Government's main welfare program.

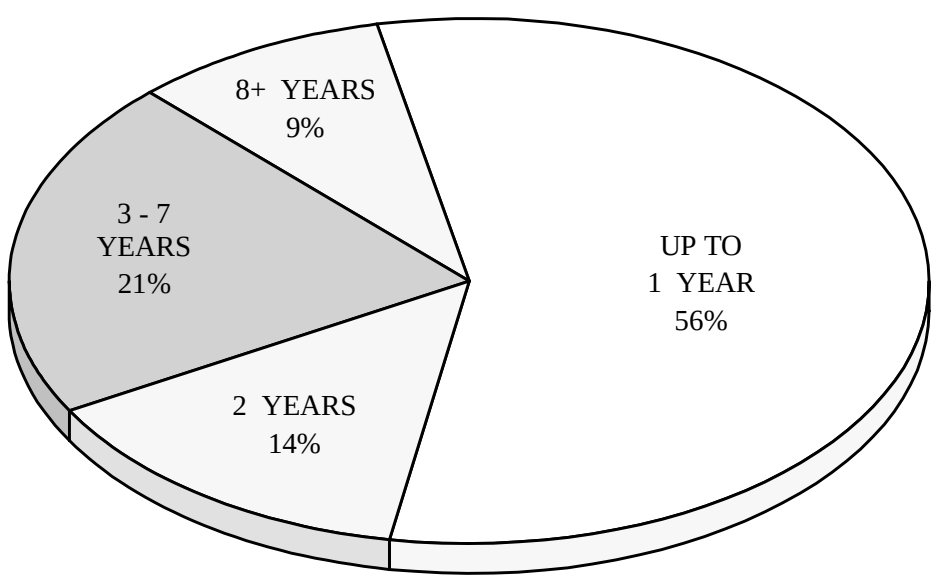
Welfare Today

First designed primarily to aid widows with young children, AFDC has expanded over the years to serve children whose father or mother is absent, disabled, or unemployed. Rising rates of divorce and out-of-wedlock childbearing, along with an expansion of eligibility and higher participation rates among the eligible, swelled the population of AFDC recipients. In 1936, a half-million individuals received AFDC assistance. Today, 14 million individuals (two-thirds of them children) get such help each year, and the Federal and State governments spend nearly $23 billion a year. (Despite perceptions to the contrary, however, Federal spending on AFDC amounts to less than one percent of the Federal budget.)

Length of Time on AFDC: Today, many believe AFDC fosters long-term dependency. Once a family begins to receive welfare, critics contend, parents may begin to rely on monthly cash payments instead of seeking work. While the charge is true of a small core of people that tend to stay on the rolls for a long time—about 9 percent stay continuously for at least eight years—most AFDC recipients receive assistance only temporarily, as Chart 1–4 shows.

Large numbers of recipients find jobs, and others marry and leave welfare. About 70 percent leave AFDC within two years, according to a recent study. But while they may want to remain independent, many families return to welfare. Some have trouble combin-

Chart 1-4. HOW LONG DOES THE AVERAGE AFDC RECIPIENT STAY CONTINUOUSLY ON WELFARE ?



SOURCE: 1994 Greenbook, p. 442.

ing work and family responsibilities; others lack the social and work-related skills to keep a steady job.

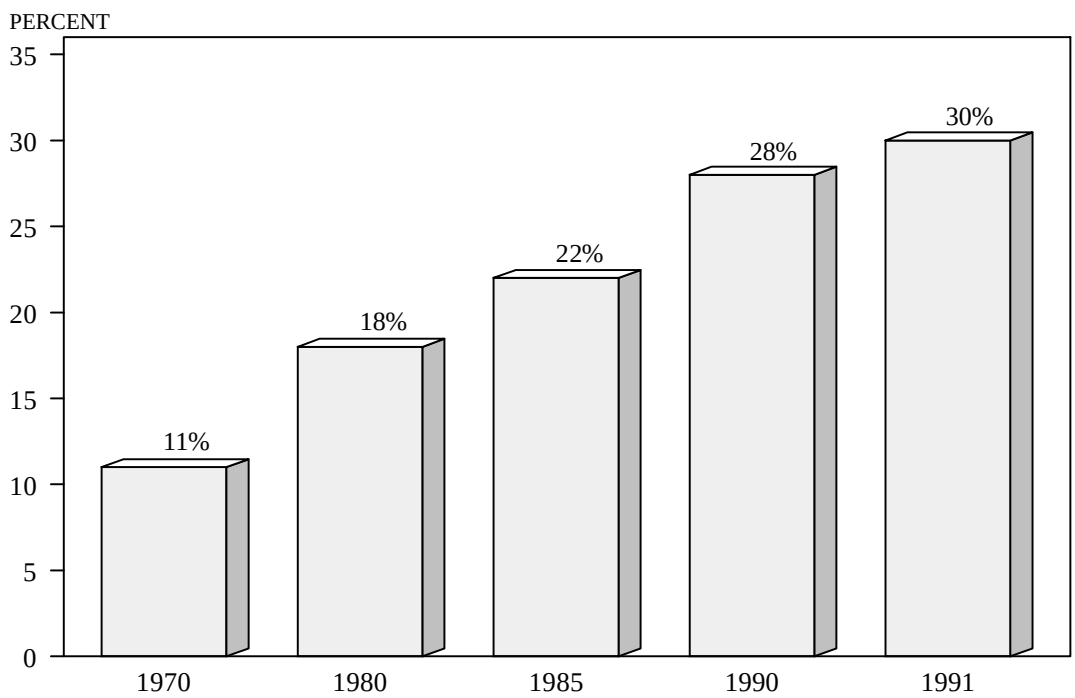
Changes in the Family: Critics also contend that the welfare system promotes out-of-wedlock childbearing. To be sure, the percentage of such births nearly tripled between 1970 and 1991; by 1991, 30 percent of all births were by unmarried women. (See Chart 1–5.) But numerous studies have found little or no relationship between these trends and the level of welfare benefits. Instead, out-of-wedlock childbearing seems rooted in broader economic and cultural changes that have affected all segments of society.

Non-Payment of Child Support: Due to changes in the family, by 1992 nearly one of every four children under age 18 in the U.S. lived in a family where the mother had never married or the father was absent because of divorce, separation, or death. A serious related problem is that large numbers of absent parents never assume responsibility for paying child support. In 1989, only 43 percent of low-income women were awarded child support through the court system. (See Chart 1–6).

Nor does a court award always translate into child support itself. Only about half of low-income women who receive a legal order mandating support receive any money. The result is that three-quarters of these families are getting no help from the child's father (57 percent with no award, and 18 percent with no payment, as Chart 1–6 shows).

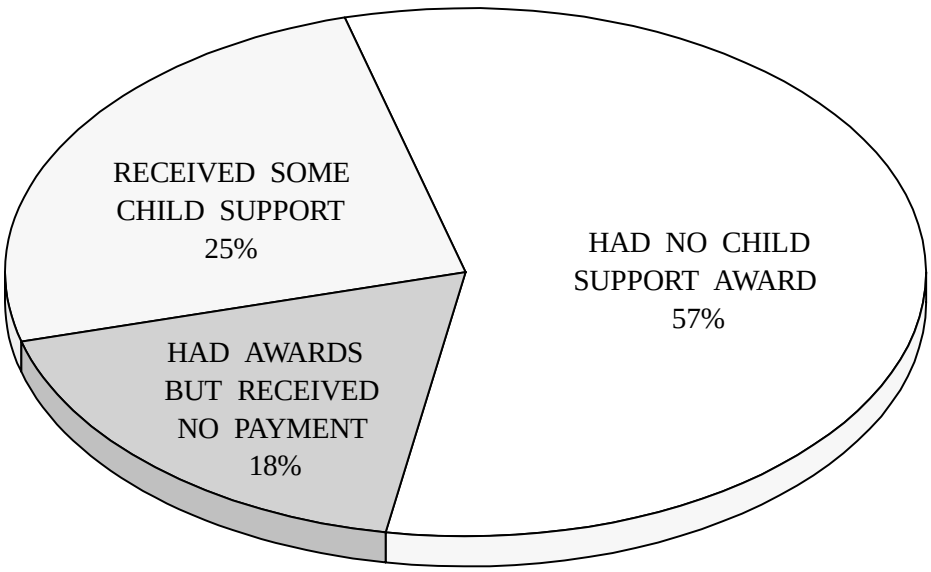
While the federally-sponsored, State-run child support system has made great strides, collecting about 14 percent more child support in 1992 than 1991 for AFDC-supported families, the system still needs vast improvement. In 1992, only about 12 percent of parents that were absent from AFDC families and being pursued by State agencies actually

Chart 1-5. OUT-OF-WEDLOCK BIRTH RATES IN THE U.S. NEARLY TRIPLED BETWEEN 1970 AND 1991



SOURCE: 1994 Statistical Abstract of the U.S., p. 80.

Chart 1-6. MOST POOR WOMEN RECEIVE NO CHILD SUPPORT



SOURCE: 1994 Greenbook, p. 463.

paid up. The Urban Institute estimates that another $34 billion in outstanding child support potentially could be collected each year, for AFDC and non-AFDC families combined.

The 1988 Family Support Act and Innovative State Programs

In 1988, Congress enacted the Family Support Act to tackle some barriers that low-income families face as they struggle to leave welfare. The law called for the creation of Job Opportunities and Basic Skills (JOBS) programs in every State, to assure that welfare recipients get the education, training, and placement assistance needed to avoid long-term welfare dependence.

JOBS programs have made progress in serving those at risk of long welfare stays. Careful research shows that a range of these programs—those that emphasize immediate job placement as well as those that provide more intensive services—have produced sustained increases in employment and earnings for those on welfare. California's training program has proved successful in moving people from welfare to work. It raised single parents' earnings over three years by 22 percent and cut welfare payments by 6 percent, starting from when enrollees began attending training classes. One particularly successful county, Riverside, returned taxpayers about $3 for each $1 invested in the program over five years.

Since enactment of the Family Support Act, many States have applied for waivers from Federal statutes to test innovative ideas to further improve the welfare system. The approved, State-inspired changes include:

- Setting time limits on cash assistance to able-bodied adults, when employment is available;
- Capping benefits for those who have additional children while on welfare; and

- Requiring children who receive AFDC to attend class regularly.

Because the Administration strongly favors State flexibility, it has approved over 20 waiver proposals—provided they maintain an adequate safety net for children, have a good research design, and do not increase Federal spending.

Work and Responsibility—the Tenets of Comprehensive Reform

The Administration supports the goal of the Family Support Act—to impart self-sufficiency to families—and believes firmly in more State experimentation. It also has proposed certain reforms that lay the foundation for welfare reform. By pushing successfully to expand the Earned Income Tax Credit, the President already has helped to boost the earning power of 15 million low-income families and ensured that many workers will be able to lift their families out of poverty, even in low-wage jobs. With a more robust economy and the skills initiative described above, many more families should be able to escape dependence on welfare. The Administration also remains committed to reform that will guarantee health insurance coverage to every American and contain health care costs for families, businesses and Federal, State, and local governments. This will allow people to retain health coverage as they move from welfare to work.

To build on these proposals and bring about the more fundamental changes needed in welfare, the welfare reform bill that the President submitted last year contained certain key principles:

Impose time limits on AFDC for parents who can work: We should make AFDC a temporary safety net for families in tough circumstances, not a long-term program that fosters dependency. Within two years, most recipients can find jobs in the private sector. Those who have tried and failed, because no jobs are available, still will have to work, in the public sector if necessary. Parents who refuse to participate will receive tough sanctions.

Provide job placement assistance and training: We should convert welfare offices from places that merely write checks to places that move people to work and independence. From the very first day, the new system will focus on helping welfare recipients to find jobs. It will orient job-ready participants to the workplace immediately. And it will refer those who need education, training, or other services to get a job.

Require parental responsibility: We should hold non-custodial parents accountable for maintaining the families they create. Measures such as stiffer penalties for not paying child support, requirements that mothers cooperate more closely with authorities in establishing paternity, and a universal process to establish paternity at birth will help improve the system. Better child support enforcement should deter parents from having children they cannot support, and boost the incomes of single-parent families.

Prevent teen pregnancy: Welfare reform will send a clear message to adolescents: you should not become a parent until you can provide for and nurture your child. Teens must understand that staying in school, postponing pregnancy, and preparing to work are the right things to do. A national campaign will bring together schools, communities, and families to emphasize the importance of delayed sexual activity and responsible parenting. Welfare reform also will change the incentives for teenagers who become parents, by requiring that they live at home or with a responsible adult and attend school.

Ensure that welfare reform does not increase the Federal deficit: A realistic plan to help adult AFDC recipients become independent requires an up-front investment. Although we may reap long-term savings, it costs money initially to give more adults the training and education they need to hold steady jobs, and to pay for child care and other services for those who work. The Administration is committed to covering these costs by cutting spending on other programs.

Ensure States the continued flexibility to experiment with innovative programs that aim to increase self-sufficiency: The cir-

cumstances facing low-income families may differ greatly across States, each of which offer varied services to help the needy. Since States best understand the unique problems that their welfare beneficiaries face, we should continue to encourage them to develop programs to best address local conditions. We will continue to grant waivers to support State innovation. And we will consult with State and local officials on the best way to insure a successful reform effort at the national level.

The Administration will work with the new Congress to enact fundamental welfare reform, the kind that embodies the principles listed above.

Real reform should mean greater independence, control, and security for all families. It should mean that government helps low-income families to help themselves while protecting their children. It should focus on work and responsibility. And one should not undertake real reform without a full appreciation for the complexities of the issue and the lives of the next generation.

2. Building on Our Economic Record

1996

2. BUILDING ON OUR ECONOMIC RECORD

THE FISCAL RECORD

Although the Federal Government has generated budget deficits for most years since World War II, deficits reached unprecedented peacetime levels in the 1980s. Recent efforts to reduce the deficit—including the 1985 Gramm-Rudman-Hollings law that was supposed to balance the budget—failed, because they evaded the tough choices of which programs to cut and which revenues to raise. When this Administration took office, the deficit had ballooned to nearly $300 billion and was expected to continue rising.

Those ballooning deficits were taking a dear toll on our Nation's economy. They drained the savings of the private sector, raising interest rates above what they otherwise would be. Those higher interest rates deterred business investment in productivity-increasing equipment and factories, and consumer investment in homes and durable goods. Rising budget deficits also inhibited the Federal Government from investing in the skills, knowledge, and infrastructure needed to ensure economic growth, and threatened future generations with a mounting burden of debt. Thus, the deficit legacy of the 1980s imperiled the very foundations of our prosperity.

Through its leadership, this Administration reversed the path of fiscal irresponsibility that had plagued the Federal Government for more than a decade and brought the deficit under control. Its effort paid off. With his economic plan, which Congress enacted in 1993, the President reduced the deficit from $290 billion in 1992 to $203 billion in 1994; we project that it will fall again, to $193 billion, in 1995. For this and other reasons, the economy is well positioned for long-term growth and prosperity.

Moreover, we expect the deficit to remain under control in dollar terms and to fall gradually relative to the size of the economy (measured by Gross Domestic Product, or GDP). We expect our proposals to bring the deficit-to-GDP ratio by 1998 to its lowest level since 1979.

Real deficit reduction is not easy. It forces elected officials to identify specific programs to cut and specific revenues to raise. Every program benefits a constituency which, in turn, voices its unhappiness if its program is slated for cuts. It was only because the President and Congress displayed unusual political courage that they accomplished so much.

How did they do it?

OBRA 1993

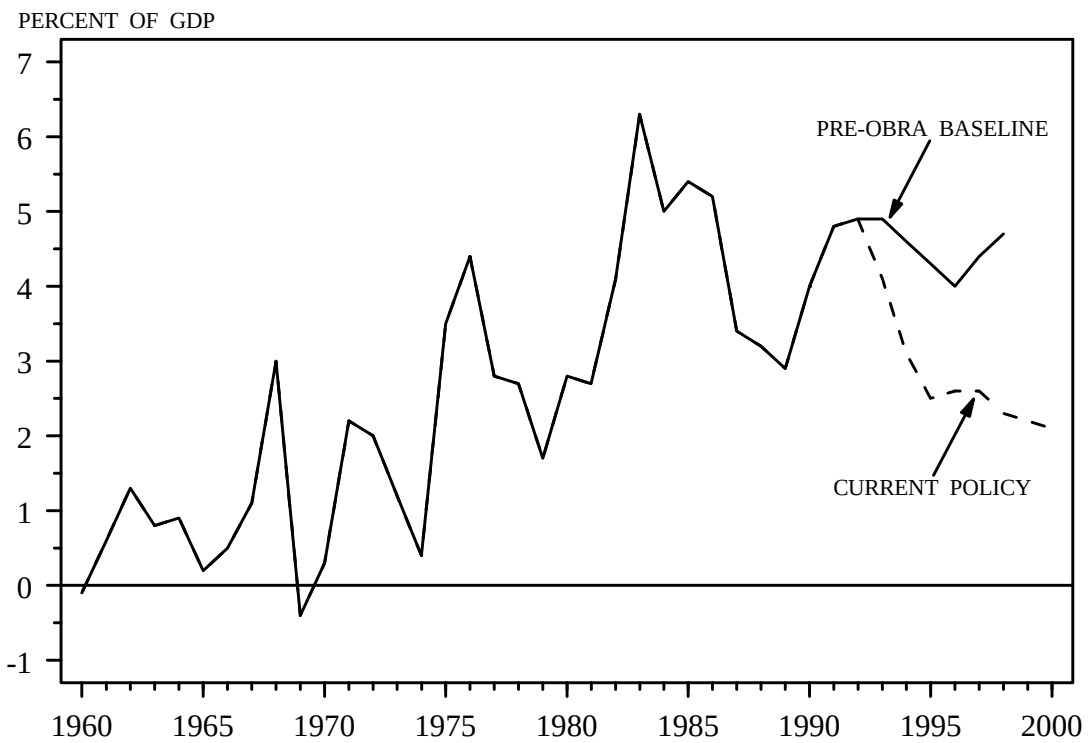
The Omnibus Budget Reconciliation Act of 1993 (OBRA) was a $505 billion package of spending cuts and revenue increases—$255 billion of spending cuts and $250 billion of revenues—for the years 1994–98. Spending reductions came from both entitlements and discretionary programs. The revenue increases were targeted almost exclusively at wealthy Americans.

Entitlements: OBRA cut projected spending on entitlements by $71.3 billion over five years, mostly in the fast-growing Medicare program. Savings also came from Medicaid, Federal retirement, farm subsidies, veterans' programs, and the student loan program. In some cases, such as student loans, the plan garnered savings through efficiencies, rather than by requiring cuts in benefits.

Discretionary Spending: OBRA also cut discretionary spending relative to projections. OBRA extended the existing "caps" on discretionary spending, which dated from 1990, through 1998. (This budget proposes to extend them further, through the year 2000.) By not allowing programs to grow with inflation, OBRA's caps reduced projected spending by $108 billion. Through the appropriations process, the President and Congress later agreed on the specific program cuts needed to meet the caps.

Fairer Taxes: OBRA raised revenues from those who were most able to bear that

Chart 2-1. FEDERAL BUDGET DEFICIT



burden. Most taxpayers experienced no increase in their income taxes. To raise $70 billion by 1998, the law created a new marginal tax bracket for families with taxable incomes over $140,000.

OBRA's only broad-based tax increase, raising $24 billion over five years, was a 4.3 cents-per-gallon increase in the Federal gasoline tax. Even with that higher tax, the overall price of gasoline (including the tax) is about the same today as in the early 1980s. In real terms—that is, after adjusting for overall inflation—the total cost of gasoline has fallen significantly.

OBRA also included tax incentives to make the tax system fairer. It expanded the EITC—which, as discussed in Chapter 1, guarantees that any family with children and at least one parent who works full time eventually will rise above the poverty line. Today, the tax system is more progressive than at any time in 18 years.

The Economic Dividend: As we have noted above, OBRA included $505 billion in savings over five years from changes in actual revenue and spending policies. But because the economy responded so well to the plan (as the next section explains), OBRA actually has generated even more savings, bringing the deficit down further (Chart 2–1).

With higher economic growth than expected, the Government received more in business and personal tax payments, boosting Federal revenues. With interest rates lower, the Government has paid out less in interest costs associated with financing the national debt. And with unemployment lower, the Government has spent less on unemployment compensation and other social programs.

All told, the policy changes and the healthier economy have generated not just the $505 billion in savings that was once expected. Instead, the Administration now estimates

that OBRA will reduce the accumulated deficits of 1994–98 by some $616 billion.

What Lower Deficits Mean for the Economy

When the President took office, the deficit was rising unsustainably, draining much of the Nation's savings to finance Government activities, keeping interest rates high and imposing a rising burden of debt service on taxpayers—present and future. Before it could move to other problems, the Administration first had to establish a firm plan to bring the deficit under control.

Since OBRA's enactment in the summer of 1993, the economy has performed extremely well. In the year that followed, economic growth averaged 4.4 percent—the best performance in over six years.

Surging Job Creation: Job creation accelerated. Since August 1993, the economy has created over four million payroll jobs—an average of 266,000 jobs a month—bringing the total to 5.6 million since the President took office (Chart 2–2). Over 90 percent have been in the private sector, and 39 percent are classified as either managerial or professional. In short, the economy has generated jobs at a vigorous pace, with a large portion in the highest-paying occupations.

Falling Unemployment: Unemployment, which was over seven percent when the President arrived, keeps falling (Chart 2–3). The unemployment rate fell to 5.4 percent in December, nearing its low point from the end of the last business cycle. (The survey on which the rate is based was redesigned in January 1994, making exact comparisons with prior years difficult).

Confident Consumers: The improving job market has buoyed consumer confidence. After rising by 22 percent in the four months after OBRA was enacted, the Index of Consumer Sentiment fluctuated for most of 1994. Nevertheless, it recently reached a new peak (Chart 2–4).

Consumers have acted on their confidence. Demand for automobiles and other consumer durables has remained strong, and housing starts have climbed to a high level. In the four quarters following OBRA's enactment, real consumer spending rose by 3¼ percent.

Healthy consumer spending is a prerequisite to prolonged economic expansion, and the burst of consumer spending in late 1993 helped accelerate growth and job creation. The rapid rise in consumption, however, has precluded any big increase in personal saving. The personal saving rate has stayed near four percent, similar to the late 1980s.

The Investment Boom: A strong rise in business fixed investment has led the recovery (Chart 2–5). In the last two years, real investment in equipment—led by the new generation of personal computers and related productivity-enhancing devices—jumped by over 18 percent.

Productivity: The key to greater prosperity is greater productivity, and productivity has been rising rapidly. Over the last year, output per hour in the nonfarm business sector is up by over two percent—a rate not seen on a sustained basis in over 20 years.

The recent news is very encouraging, but one cannot yet conclude that higher productivity growth will continue. Productivity rebounded strongly after recessions in the mid-1970s and early 1980s. The real test will be whether the growth rate since 1990 will continue as the business expansion matures. The next few quarters could tell the tale, as the surge in demand abates and the economy approaches its long-run, steady path.

Inflation: While the economy surged, inflation remained subdued. The core rate of inflation, excluding volatile food and energy prices, actually fell in 1994 (Chart 2–6). Low inflation has helped foster consumer and business confidence; previously, high and variable inflation rates made planning difficult. Today's inflation rate, and the promise that inflation will remain under control, help to sustain the current expansion and prolong the boom in investment spending.

Chart 2-2. CHANGES IN PAYROLL EMPLOYMENT

(jobs created December to December)

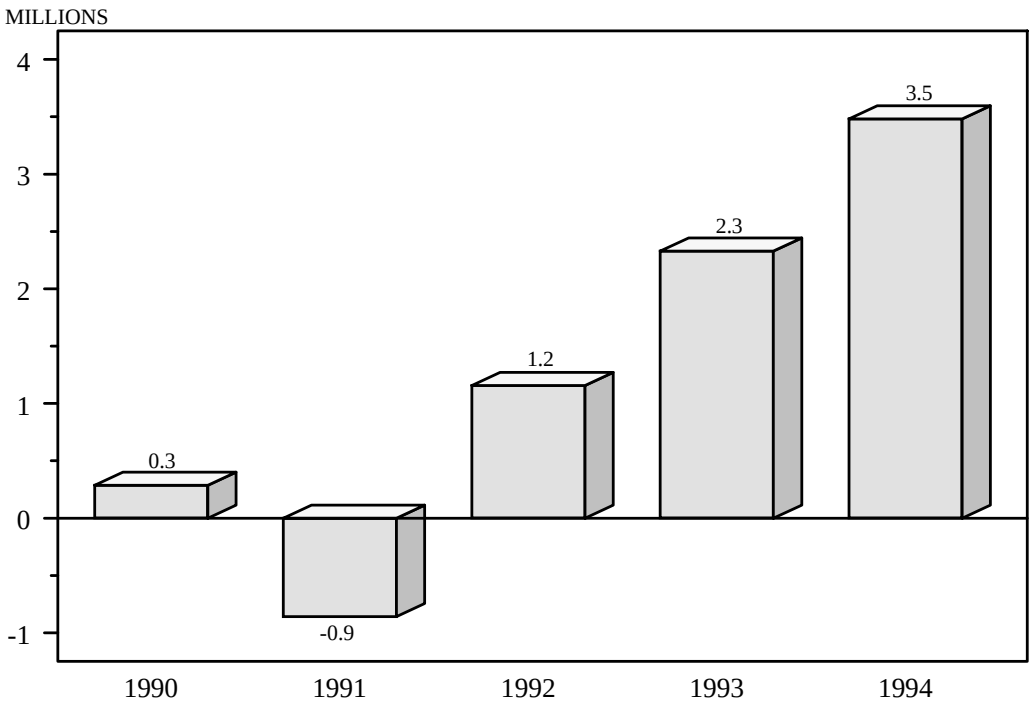
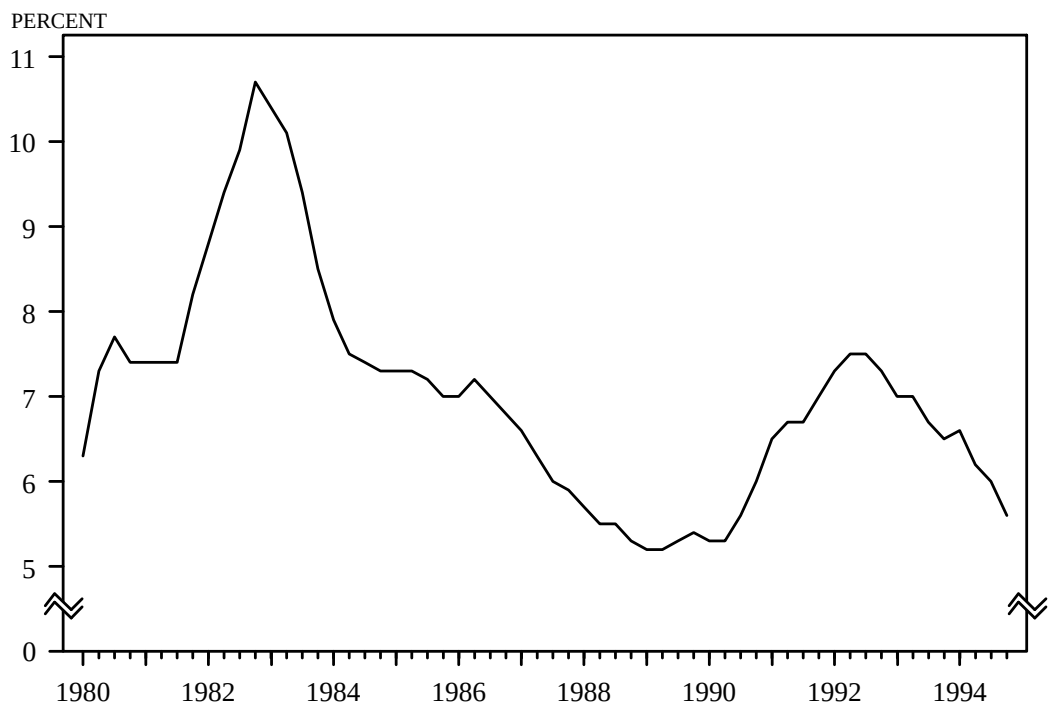


Chart 2-3. CIVILIAN UNEMPLOYMENT RATE



Interest Rates: Interest rates fell sharply in recognition of our serious commitment to deficit reduction. In the past year, interest rates have risen. The Federal Reserve has tightened monetary policy steadily since last winter; the unexpected strength of the expansion increased the demand for credit, and thus its price; and the financial markets reflected fears that the economy could face higher inflation if growth continued unabated. Rapid growth has brought the economy closer to the limits of productive capacity than expected a year ago; but signs of inflation did not emerge. If, as we now expect, the economy attains a steady, sustainable rate of growth in the next year and inflation remains low, the upward pressure on interest rates should ease.

Rapid growth, strong job creation, and low inflation made 1993 and 1994 one of the most successful and prosperous periods on record. Seldom has the U.S. enjoyed such an array of good economic news. Of course, not *all* of the news was good. Family income growth remained slow for the middle class, and the rise in income inequality showed no signs of ending. Even so, many of the nagging problems that had bedeviled the U.S. economy in the previous four years or more faded.

Jobs were plentiful, business was strong, productivity growth was robust, and inflation remained modest. We must maintain these conditions, which are necessary for middle-class prosperity and economic security. Our economic policies proved themselves by reversing the deficit surge and slow productivity growth of the 1980s. We must not return to the failed policies of the past.

What Lower Deficits Mean for You

While benefiting the economy as a whole, the President's deficit reduction plan also has helped average Americans.

Debt held by the public now totals $3-and-a-half trillion—an average of about $50,000 per family. Think of this debt as a $50,000 mortgage, on which the family must pay interest in the form of taxes—forever. Without the President's program, that national mortgage would have grown another $616 billion by 1998—or about $9,000 per American family. Thus, the Administration's efforts have reduced the size of the mortgage that each family owes. A $616 billion reduction in the debt will mean savings in Federal interest costs alone of $42 billion a year (by the year 2000)—or more than $600 per family.

Higher national saving is the ultimate benefit of lower deficits. Greater savings provide capital for investment and boost productivity. While the investment and productivity gains may be small in the short term, they compound and grow over time.

Deficit reduction may bring important intangible benefits that foster a better business climate. The longstanding failure to deal seriously with the deficit encouraged public cynicism about Government and damaged confidence in the economy's future. A budget that seemed out of control suggested that, as a people, we could not govern ourselves. Our renewed willingness to save for the future may, over time, considerably augment the economic benefits of lower deficits.

Finally, deficit reduction is essential to U.S. global leadership, in economic and political terms. A nation cannot provide moral direction and set standards of conduct for its creditors. Trading partners can easily dismiss the concerns of a nation whose trade imbalance is tied to its undisciplined need to borrow money. By contrast, U.S. officials in the last two years have attended international economic forums from a renewed position of strength.

Sustaining Our Commitment to Fiscal Discipline

We must maintain the commitment to fiscal discipline reflected in the President's plan and last year's budget. As a result, this budget directs resources to our Nation's major economic challenges—principally, the short- and long-term measures for the middle class—while providing still further deficit reduction.

Chart 2-4. CONSUMER SENTIMENT

(University of Michigan Index, 1966 = 100)

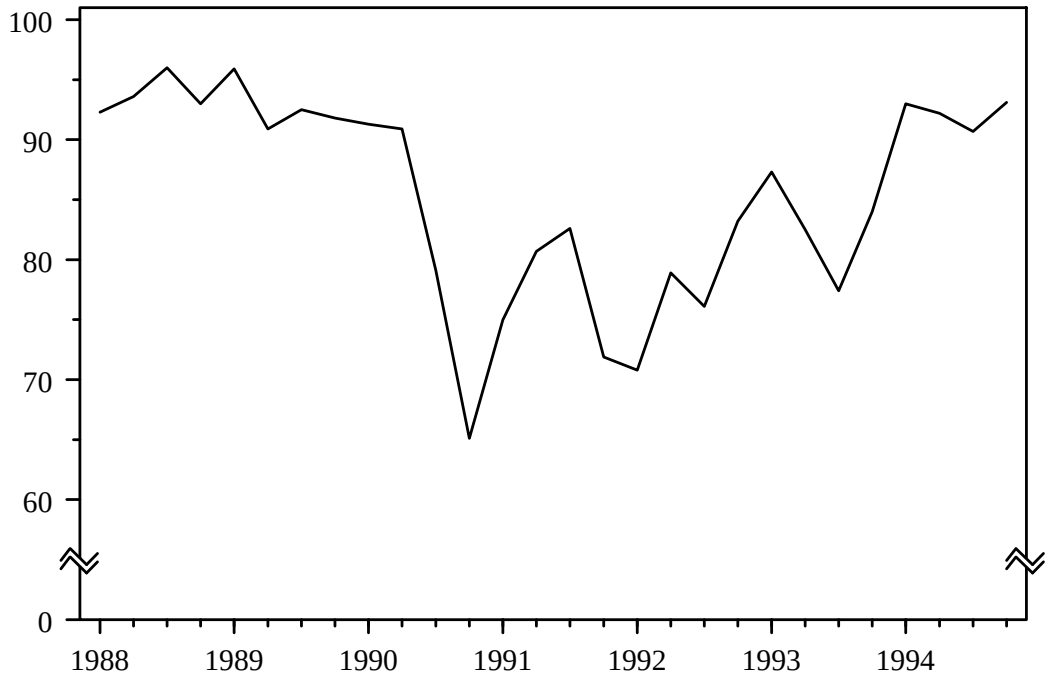
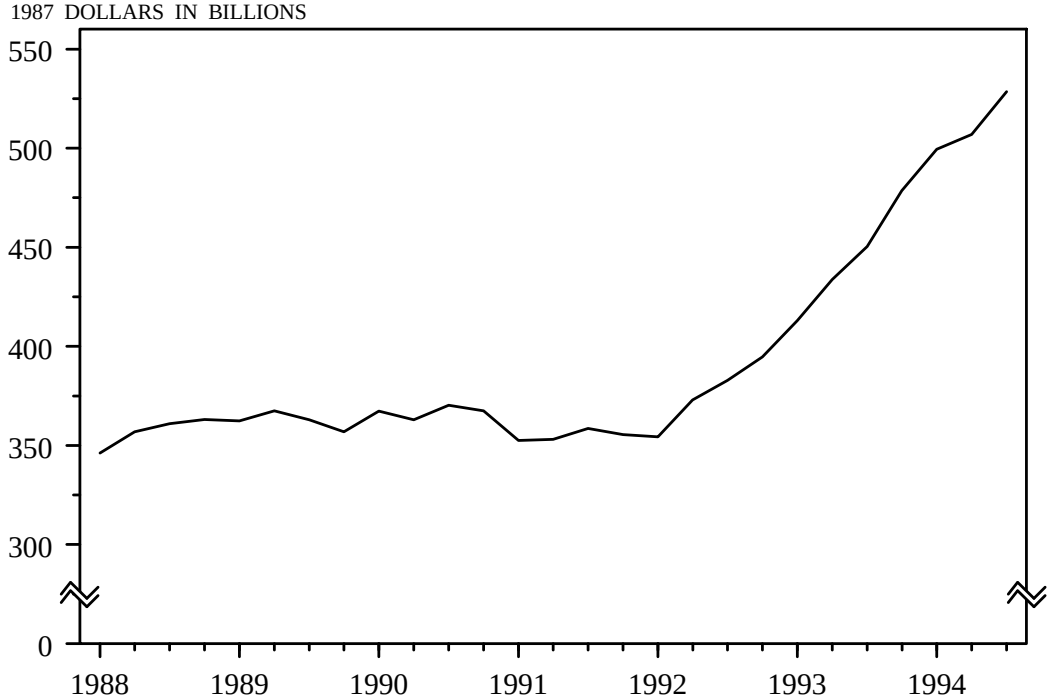


Chart 2-5. REAL BUSINESS FIXED INVESTMENT

1987 DOLLARS IN BILLIONS



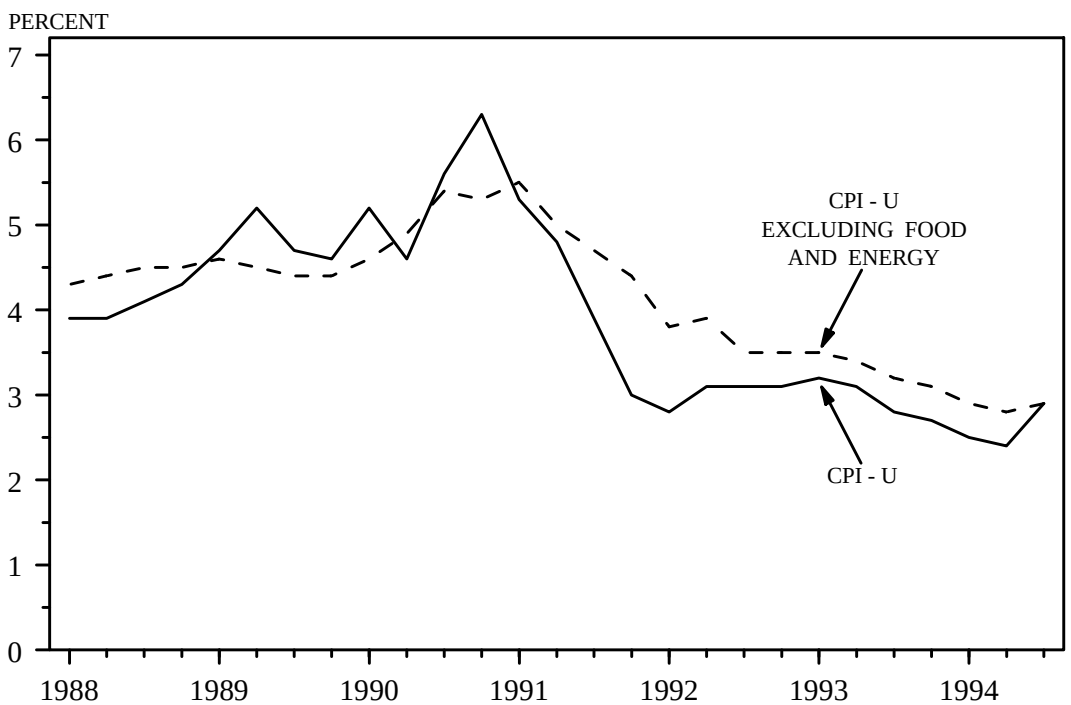
Financing the Tax Cut: The President's middle-class tax cut will reduce Federal receipts by $63.3 billion from 1996 to the year 2000. This budget more than offsets that revenue loss with savings of $26.2 billion from the second phase of reinventing Government, $80.5 billion from other discretionary programs, and $37.4 billion from mandatory programs, other initiatives, and debt service. All told, the budget proposes another $80.6 billion in deficit savings over the next five years (See Table 2–1.)

Savings from Government Restructuring: As outlined in "Making Government Work," this budget envisions savings of $22.8 billion over five years through restructuring five agencies—the Departments of Transportation (DOT), Energy (DOE), and Housing and Urban Development (HUD), the General Services Administration (GSA), and the Office of Personnel Management (OPM). We also expect another $3.4 billion of savings from eliminating some small agencies, streamlining others, and achieving other efficiencies.

From DOE, the budget proposes to save $14.1 billion by realigning programs and resources while privatizing or selling functions. From DOT, it proposes to save $6.4 billion by consolidating programs and transferring air traffic control services to a Government corporation. From HUD, it proposes to save $0.8 billion by consolidating programs and revamping public housing and the Federal Housing Administration. From GSA, it proposes to save $1.4 billion by focusing its mission and transferring some functions to other agencies.

The budget proposes to extend the current caps on discretionary spending for two years beyond their scheduled expiration in 1998, thus cutting this budget category in real—inflation-adjusted—terms. However, we also propose additional savings below the "freeze" level in 1996–2000. We will achieve many

Chart 2-6. INFLATION TRENDS



NOTE: CPI - U is the Consumer Price Index for All Urban Consumers. The inflation rate is measured as the change over four quarters.

Table 2–1. FUNDING THE MIDDLE-CLASS TAX CUT AND DEFICIT REDUCTION

(In billions of dollars)

	Estimate						Total 1995–2000
	1995	1996	1997	1998	1999	2000	
Baseline deficits	192.8	201.1	217.7	209.2	221.3	229.0	
Proposals:							
Middle-class tax cut and additional empowerment zones	0.1	3.9	11.9	12.5	15.2	19.8	63.3
Offsets:							
Reinventing Government, Phase II	0.0	–1.4	–7.3	–8.1	–4.7	–4.8	–26.2
Additional discretionary cap reductions	0.0	–5.1	–4.4	–11.8	–24.1	–35.0	–80.5
Other PAYGO savings	–0.1	–1.6	–4.7	–5.0	–8.9	–11.7	–32.1
Total, offsets	–0.1	–8.1	–16.4	–24.9	–37.8	–51.4	–138.7
Debt service and other non-PAYGO	–0.3	–0.3	–0.1	–0.4	–1.3	–2.9	–5.3
Total, change to baseline deficits	–0.3	–4.5	–4.6	–12.8	–23.9	–34.5	–80.6
Deficits after proposals	192.5	196.7	213.1	196.4	197.4	194.4	
Memorandum:							
Deficit after proposals as a percent of GDP	2.7	2.7	2.7	2.4	2.3	2.1	

of those savings by proposing, as part of Phase II of reinventing Government, to terminate and restructure agencies and programs, and to shift functions to the States, localities, and the private sector.

Other Savings: The budget also proposes savings from mandatory programs and other initiatives. It raises about $10 billion from 1996–2000 by extending some of OBRA's expiring provisions that affect the Medicare program. It also imposes fees or other charges on users of the increasingly lucrative electromagnetic spectrum. The budget accelerates the successful direct student loan program. And it achieves new savings in agriculture programs.

The Problem of Rising Deficits

This budget preserves the deficit reductions that OBRA accomplished. As reported above, we expect the deficit to drop again in 1995, this time to $193 billion. After that, it will fluctuate in a narrow range—rising to $197 billion in 1996 and to $213 billion in 1997, then falling to $194 billion in 2000.

Relative to GDP, the deficit continues to decline. It drops from 2.7 percent of GDP in 1996 to 2.1 percent in 2000. By this measure, the budget returns the deficit to its lowest level since 1979.

Current law requires that the President submit budget estimates through 2000. By enacting the policy proposals in this budget, however, we can preserve the improvement in the deficit for at least the next 10 years. Looking beyond the year 2000, we anticipate rough stability in the dollar amount of the deficit through 2005. As a share of GDP, however, the deficit likely will continue its gradual decline, falling below two percent early in the next century.

The improved outlook is attributable not only to our deficit-cutting efforts, but also to much lower projected spending on Medicare and Medicaid, the Federal Government's two main health programs.

The primary contribution to lower Medicare projections is slower growth in Medicare's Hospital Insurance expenditures. That, in turn, results primarily from slower forecasted hospital cost inflation and slower growth in the complexity of Medicare inpatient cases. Lower Medicaid costs, which continue a trend dating from the President's 1993 budget, are rooted in various factors—actual program experience; improved economic conditions; slower projected growth of the population that receives Supplemental Security Income benefits; slower projected provider cost inflation; and changes in law that have limited the States' use of provider taxes, donations, and disproportionate share payments that had increased the Federal contribution to States.

Though the projected Medicare and Medicaid growth rates are slower, they remain very high. We project that Medicare will grow at an average annual rate of 9.1 percent over the next five years, and that Medicaid will grow at 9.3 percent. These growth rates are nearly three times the projected general inflation rate of 3.2 percent per year (CPI-U), and will double Medicare and Medicaid spending every eight years. As a result, Medicare and Medicaid will rise from 3.4 percent of GDP in the year just ended, to a projected 4.2 percent by 2000 and 4.9 percent by 2005.

These programs' growth is among the main reasons why deficits stay as high as they do in these budget projections. The growth in all Federal health programs, of which Medicare and Medicaid are by far the largest, accounts for almost 40 percent of the total increase in Federal outlays between now and 2000, and is the single most important factor pushing up the deficit.

An increase in Medicare and Medicaid expenditures is unavoidable without universal health insurance coverage, through health reform. We expect the number of people participating in Medicare and Medicaid to increase, bringing insurance protection to some of our most vulnerable citizens. The Medicaid population will grow at a projected average annual rate of 3.8 percent between now and 2000.

But, this expansion in covered populations explains a relatively small part of the increasd Federal spending for Medicare and Medicaid—and could be accommodated without undue pressure on the deficit. More important, from a fiscal standpoint, is that Medicare and Medicaid expenditures per beneficiary keep rising faster than inflation—indeed, faster than inflation plus the general increase in real per capita GDP.

What would the deficit be if health care costs did not rise disproportionately? Chart 2–7 assumes that Medicare and Medicaid expenditures continue rising to accommodate increases in the beneficiary population, but that per capita expenditures rise with the general rate of inflation and the increase in per capita output, not at the higher current rate. Under these assumptions, the deficit would fall to zero.

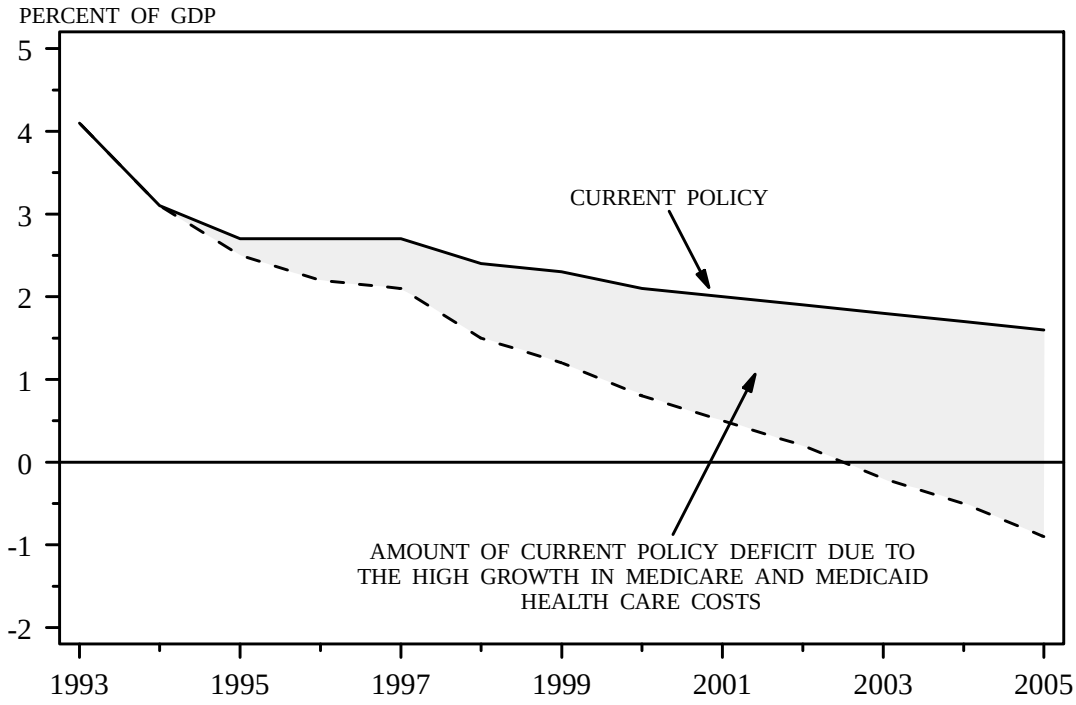
Beyond the year 2000, the challenge of fiscal discipline will only increase. The aging of the population will continue, even accelerate, as the so-called "baby boom" generation—those born in the first two decades after World War II—begins to retire. This demographic phenomenon contributes to rising expenses for Social Security and for the Federal medical programs which the elderly use heavily. Medicare is largely devoted to those over age 65, and Medicaid is increasingly a program for elderly people needing nursing home care.

PUBLIC INVESTMENT

Throughout his Administration, the President has drawn a clear distinction between the "tax and spend" policies of the past and a new policy of "invest and grow"—between yesterday's Government and that of tomorrow. True investments will translate into stronger productivity and higher living standards for years to come. This budget continues the President's program: to reduce the deficit in order to increase *private* investment, and reallocate the Government's resources to increase true *public* investment.

The Federal Government is, by far, the Nation's single largest investor (Table 2–2). In 1995, it will spend an estimated $235 billion for physical investment, such as struc-

Chart 2-7. THE IMPACT OF MEDICARE AND MEDICAID ON THE FEDERAL BUDGET DEFICIT



tures, roads, and equipment, and "intangible" investment, such as education and training and research and development (R&D)—about 10 percent of total investment in the U.S. economy.[1]

Government's role in investment is to provide the capital essential for a prosperous economy, cleaner environment, more efficient transportation network, and other worthy goals—but that the market would not provide, or not provide enough of. The private sector could not profitably run many roads and bridges needed to move traffic quickly and safely, and treatment plants needed to provide clean water. States and localities might not clean up emissions that would otherwise flow across jurisdictional boundaries. Publicly supported research yields discoveries that the private sector would not seek because financial returns are too uncertain or too far off. Public support for education and training helps people to invest more than they could on their own.

When businesses and individuals invest, they risk their own money. If the investment pays off, they enjoy a share of the benefits. When Government invests, however, taxpayers incur the costs and the benefits go to the society at large, not to the people making investment decisions. Public investments can have high payoffs but we must choose them wisely, because market forces do not automatically weed out bad choices.

Public investment comes in three major categories, all of which contribute to future productivity.

Federal Investment in Infrastructure: The budget proposes $58.8 billion for 1996 for investment in non-defense physical assets, up $8.6 billion from 1993. Grants to States

[1] For discussions of trends in Federal investment and associated capital stocks, see the *Analytical Perspectives* volume of the budget, Section 2, "Stewardship: Toward a Federal Balance Sheet" and Section 7, "Federal Investment Outlays and Capital Budgeting."

Table 2–2. MAJOR FEDERAL INVESTMENT OUTLAYS

(In billions of dollars)

	1993 Actual	1995 Estimate	1996 Proposed	Change: 1995 to 1996	Change: 1993 to 1996
National Defense [1]	116.6	98.1	91.4	–6.7	–25.2
Total Nondefense	120.1	136.6	137.8	+1.3	+17.8
Physical Investment	50.2	58.6	58.8	+0.2	+8.6
R&D	28.0	30.7	31.7	+1.0	+3.7
Education and Training	41.9	47.2	47.3	+0.1	+5.4
Total	236.7	234.7	229.3	–5.4	+7.5

[1]Including research and development and civilian education and training.

and local governments account for about two-thirds of the total.

While infrastructure spending can be among the most effective ways to boost productivity, we must choose projects carefully. That is why we propose to restructure the Transportation Department, consolidating its infrastructure activities into a single transportation block grant. Local governments will have more flexibility to direct resources to the transportation modes that best address community needs. For the same reason, the Environmental Protection Agency is consolidating 12 grants that total over $600 million, and providing greater State flexibility and simplified administrative procedures. States will direct resources to their most serious pollution problems—air, water, soil, etc.—subject to the fulfillment of national priorities as well. Our goal is more and better infrastructure, at less cost and with less red tape. (For more on these and other proposals to restructure Federal programs, see "Making Government Work.") The President in January 1993 issued Executive Order 12893—requiring increased use of economic analysis and promoting public-private partnerships—to help ensure that our infrastructure investments are as effective as possible.

Federal Investment in Human Capital: The budget proposes $47.3 billion in 1996 for investment in education and training, an increase of $5.4 billion, or 13 percent, over 1993.

Early on, the President enunciated a goal of fostering "lifelong learning" for a changing economy in which only the best-educated, best-trained workers will have the skills to compete effectively enough to boost their productivity and, in the end, their living standards. As Chart 2–8 shows, the earnings of workers with a college degree have risen compared with those with only a high school degree. Men who lack a high school degree have experienced declines in their real incomes since the late 1970s, and their female counterparts have barely had an increase.

To date, this Administration has emphasized improved education from pre-school through post-secondary levels. Working with Congress, the President has launched five major pieces of legislation: to expand and improve the Head Start program; to reward schools that set and pursue their own standards using broad waiver authority; to launch Charter Schools, Safe and Drug-free Schools, and other innovations; to meet the career-training needs of all youth with State, local, and private-sector involvement; and to cut the costs of higher-education loans for our students.

This year, the President will focus on better opportunities for those adults already in the workforce whose initial education has not provided all the skills they need to meet the challenges of today's economy. The President's proposal will consolidate and streamline a patchwork of programs that have built up over 60 years and do not meet today's needs. It will give "Skill grants"

Chart 2-8. ANNUAL AVERAGE EARNINGS OF WORKERS

NOTE: Workers 25 years and older, working year round, full time.
SOURCE: Bureau of the Census, Current Population Survey

directly to individuals, like the GI Bill; it will support new, more flexible State systems to provide information about jobs and training; it will ensure access to those who need it, particularly dislocated workers and disadvantaged youth; and it will ensure accountability, with a strong private-sector role, monitoring of results, and quality standards for training providers.

Federal Investment in Science and Technology: The budget proposes $69.4 billion in 1996 for R&D. Nondefense R&D is expected to increase $3.74 billion over 1993. Federal spending accounts for nearly 40 percent of the Nation's R&D spending. Rates of return for R&D are high in the private sector, about 30 percent, and industry R&D may have accounted for about a quarter of overall productivity growth in recent decades. The contribution of federally financed R&D is much harder to estimate, because the Government devotes much of its R&D to products and processes that are not widely bought and sold in the marketplace. Still, the return is probably substantial, through spillovers of developments to the commercial sector (such as lasers and integrated circuits) and earlier basic scientific research whose eventual profitability is hard to discern at first (contributing to advances like fiber optics and disease-resistant hybrid corn).

Commercial firms cannot reap the rewards of basic research; other firms can easily use the knowledge it generates. Thus, despite the high rates of return it produces, the private sector will always do too little basic research to meet society's needs. So, for society at large, the Federal Government plays an important role in promoting and investing in R&D. Through the President's National Science and Technology Council, the Administration seeks to achieve the best possible science on a tight budget. The science and technology program pursues advances in health, business, the environment, information technology, national security, and science itself—with effective management that emphasizes peer review, integration of civilian and

military research, cost-shared partnerships with industry, international cooperation, and reform of the payment system for federally sponsored research.

In sum, this budget provides for investment in the truest sense of the word—only in areas that the private sector could not or would not develop. The goal: to make Government an effective support for the private sector, as it creates jobs and prosperity.

EXPANDING TRADE TO CREATE BETTER JOBS

The Administration has worked hard, and with great success, to expand trade and investment, and enhance U.S. competitiveness. Since 1993, we have concluded negotiations on—and the Congress has ratified—two of the largest trade agreements ever completed. The Uruguay Round of the General Agreements on Tariffs and Trade (GATT) reduced trade barriers around the world; and the North American Free Trade Agreement (NAFTA) established a free trade area among the U.S., Mexico and Canada. On the bilateral level, we concluded a number of agreements, including several under the 1993 Framework for a New Economic Partnership with Japan.

We are aggressively examining other avenues to continue expanding opportunities for U.S. exporters. In 1993, the U.S. hosted the meeting of the Asia Pacific Economic Cooperation (APEC) forum. In 1994, APEC made an historic commitment at its Indonesian Summit to eliminate barriers to trade in goods, services, and investment by the year 2020. At the Summit of the Americas meeting last December, Latin American leaders called for a Free Trade Area of the Americas by 2005.

Through its Trade Promotion Coordinating Committee (TPCC), the Administration is working to restructure Federal trade promotion programs to help U.S. exporters take fullest advantage of expanding global markets.

The Importance of Trade

With the globalization of trade in recent decades, the prosperity of the U.S. economy increasingly depends on competing and winning in world markets. In 1993, exports accounted for 10.4 percent of final sales in our economy, compared with only 6.9 percent 20 years earlier. Over 10 million U.S. jobs in 1992 were directly tied to merchandise or service exports, while another five million provided goods or services to export firms. Moreover, export-related jobs pay, on average, 13–17 percent more than the average wages of all U.S. workers. By increasing trade, the U.S. can broaden its economic base, expand the number of high-paying jobs, and provide higher living standards for all Americans.

To expand exports, we must improve the competitiveness of U.S. producers in world markets. However, foreign trade barriers (such as export subsidies, import tariffs and quotas, and product quality standards designed to limit other nations' imports) can make even low-cost, high-quality export goods non-competitive. To give U.S. firms an equal opportunity to compete in foreign markets, the U.S. has played a leading role in negotiations around the world to reduce and eliminate trade barriers on global (GATT), regional (NAFTA), and bilateral (e.g., Japan Framework) bases.

The North American Free Trade Agreement

NAFTA, approved by Congress in late 1993, created a free trade area of over 360 million consumers and over $7 trillion annual output, linking the U.S. to our first and third largest trading partners (Canada and Mexico, respectively). Already, the agreement has stimulated growth and created job opportunities in all three countries.

NAFTA eliminates tariff and most non-tariff barriers for industrial and agricultural products, liberalizes trade in services, and protects U.S. intellectual property rights. Among its highlights:

- The agreement phases out most tariffs and non-tariff barriers in industrial products over 10 years, and most of those in agricultural products over 15 years.
- Investment rules ensure consistent treatment between foreign and domestic firms, eliminate most performance requirements,

and reduce barriers to U.S. investment in certain sectors in Mexico.

- The agreement liberalizes trade in services, including financial services, land transportation, and telecommunications.
- NAFTA's innovative side agreements also require standards of enforcement of national labor and environmental laws, and provide funds for border environmental activities and community adjustment in areas adversely affected by trade liberalization.

NAFTA's effect on the U.S. economy will be positive but relatively small, because Mexico's national income is only four percent of ours, and the U.S. already had a free trade agreement with Canada. Nevertheless, the accord helped to accelerate U.S.-Mexico trade in its first year:

- U.S. exports to Mexico surged by 21.7 percent in the first three quarters of 1994, compared to the same period in 1993—more than twice the growth rate of total U.S. exports. The growth was concentrated in capital goods, automobiles, and high-technology products.
- Imports from Mexico increased by 22.8 percent during this period, particularly in capital goods and automotive parts and vehicles.

This expansion of trade depends on overall economic conditions, so trade flows will fluctuate over time. Still, the evidence so far strongly suggests NAFTA will have beneficial long-run effects for both nations.

The Uruguay Round

The successful conclusion of the seven-year negotiations over the Uruguay Round, and the bipartisan congressional approval, marked a milestone in our efforts to strengthen the economy. GATT will expand U.S. business opportunities abroad and broaden the range of goods and services available to U.S. industry and consumers. For the first time in the 48-year history of GATT, the agreements dealt extensively with reducing non-tariff barriers to trade, incorporated several new product sectors such as agriculture and services under GATT rules, and moved a long way toward establishing a single set of trade rules applicable to all countries.

Tariff Cuts: This agreement will reduce tariffs on U.S. industrial exports by an average of 33 percent overall, and 40 percent in developed countries:

- GATT eliminated tariffs completely in several sectors, including construction equipment, agricultural equipment, medical equipment, steel, pharmaceuticals, and paper products.
- It cut tariffs of major trading partners 50–100 percent for electronic items such as computer parts, semiconductors, and semiconductor manufacturing equipment, and it set tariffs in developed or major developing countries to very low uniform levels (0, 5.5, and 6.5 percent) for the chemical sector.
- It will cap 99 percent of developed country tariffs on industrial products, and 73 percent of developing country tariffs on industrial products, at agreed-upon rates—preventing future increases without compensation.
- The Uruguay Round accords also made significant progress in eliminating quantity restraints (such as quotas) on trade—in some cases replacing quotas with tariff-based equivalents.

New Sectors: By including agriculture and the General Agreement on Trade in Services, the accord greatly broadened the reach of international trade rules.

- The Uruguay Round will cut agricultural tariffs and subsidies, and thereby make it easier for highly efficient U.S. farms and processors to penetrate foreign markets. The agreements cut outlays for export subsidies by 36 percent; reduce the quantity of subsidized exports by 21 percent; convert non-tariff agriculture barriers to their tariff equivalents that will be reduced an average of 36 percent; open previously closed markets (e.g., rice imports in Japan and Korea); and reduce trade-distorting internal subsidies by 20 percent (as the U.S. has already done). Economists estimate that U.S. agricultural exports will rise by

$5 billion to $14 billion in the next five years, and $22 billion to $50 billion over 10 years.

- For the first time, the Uruguay Round extends GATT principles such as most-favored nation and national treatment to service products, where the U.S. is extremely competitive. This opens foreign markets for U.S. exporters in such areas as accounting, advertising, computer services, construction, engineering, and tourism.
- The Uruguay Round agreement clears the way for U.S. creativity and innovation by protecting the intellectual property rights of U.S. entrepreneurs against production piracy in industries such as pharmaceuticals, entertainment, and software.

Widening Participation: By including developing countries as full participants in the new world trading system, the accords ended a serious "free-rider" problem. Developing countries participated in Uruguay Round liberalizations and are now subject to almost all GATT agreements.

Foreign Investment and the Environment: The accords reduced barriers to foreign investment, such as by eliminating requirements that a minimum percentage of production must occur in an importing country—requirements that often restricted foreign operations of U.S. firms. They also broke new ground by endorsing the concept of "sustainable development," granting environmental concerns new stature in international trade and development policy.

Dispute Settlement and the World Trade Organization: The accords also replaced a slow, weak dispute settlement process with a single, effective, enforceable set of rules for prompt settlement. They also provided fairer anti-dumping rules; enhanced tools to fight unfairly subsidized foreign products; equitable guidelines on import-surge safeguards; and stronger, more comprehensive rules on product standards. A new World Trade Organization (WTO) will implement these standards. Contrary to common assertions, the WTO is a major victory for the U.S., which suffered more than any other nation under the prior system. Because WTO decisions do not automatically preempt domestic law in this Nation or any other member nations, the WTO will not compromise U.S. sovereignty.

Multilateral reductions in trade barriers have always generated large, measurable increases in domestic and world growth. The Uruguay Round will be no exception. When fully implemented, these agreements are expected to raise world trade, and generate annual increases in U.S. output of $100 billion to $200 billion. In addition, the net gain in U.S. employment—over and above normal employment growth in the economy in this period—is expected to be just under 500,000 by the tenth year of the agreement.

The Framework for a New Economic Partnership with Japan

In addition to multilateral and regional efforts to expand trade, the U.S. continues to pursue trade liberalization bilaterally. A major focus has been Japan, our second largest trading partner and the nation with which the U.S. has its largest bilateral trade imbalance. Japan has relatively low formal trade barriers outside of agriculture, but also relatively low import penetration in many sectors. For many tradable goods and services, its domestic prices are significantly higher than world market levels. These facts suggest that Japan has significant informal barriers to trade.

In July 1993, President Clinton and then-Japanese Prime Minister Miyazawa announced a Framework for a New Economic Partnership at the Economic Summit in Tokyo. It covers several "baskets" of negotiations, including government procurement, regulatory reforms and competitiveness, major sectors (notably, automobiles and auto parts), economic harmonization, and the implementation of existing agreements.

Despite complications arising from major changes in Japan's government, the U.S. recently negotiated several bilateral trade agreements under the Framework. They include agreements to improve foreign market access in financial services, insurance, flat glass, government procurement of medical technologies and telecommunications equipment, and intellectual property. Other negotia-

tions continue, including in the key areas of Japanese market deregulation and competition policy. The agreements seek to increase foreign access to Japan's markets for all countries, not just the U.S. The U.S. also is seeking progress on automobiles and automobile parts. In October 1994, we initiated a case against Japan under Section 301 of the 1974 Trade Act related to Japan's automobile parts aftermarket.

The Administration's Trade Agenda

Moving forward, the Administration will implement the recent GATT agreements, and seek multilateral agreements on trade barriers in two important sectors in which the U.S. is competitive but which the Uruguay Round negotiators did not address: the financial service and basic telecommunications industries.

Latin America: At the "Summit of the Americas" in December, the Administration launched a new initiative to create a free trade zone to encompass all of the Americas by 2005. When complete, this free trade zone would comprise over 850 million consumers with income of over $13 trillion. As a first step, the Administration will begin negotiations to admit Chile—one of South America's most stable economies—into NAFTA.

Asia: U.S. exports to Asian APEC members grew an average of about 10 percent per year in the past decade. Exports to Asia now account for 29 percent of U.S. exports, a share that's expected to grow. But the Uruguay Round did not eliminate all barriers to trade. Building on their 1993 meeting in Seattle that President Clinton hosted, APEC leaders committed this year to eliminate barriers to trade in goods, services, and investment in the region by 2020. In 1995, APEC ministers will develop a detailed plan for progressive trade liberalization. The Administration will work to see that APEC reforms stay on track. In addition, the Administration will continue to explore market-opening expansions in several key areas of the recent Framework agreements with Japan.

Implementing a "National Export Strategy"

Lower foreign barriers to trade have been a potent tool for expanding U.S. exports. The Administration, however, has taken more steps to help firms compete successfully in these expanding markets. In the 1994 Annual Report of the Trade Promotion Coordinating Committee (TPCC), the Administration established a new strategy to tailor Federal trade promotion support to the needs of exporters in each geographic and sectoral market. As a first step, the Administration is dedicating more resources to six fast-growing sectors where we expect the private demand for export assistance and opportunities for U.S. exporters to be strong.

The TPCC focuses on the 10 "big emerging markets,"[3] which are expected to account for over 40 percent of the growth in potential U.S. export markets over the next two decades. Other fast-growing sectors and markets highlighted in the TPCC annual report include the regions of Latin America and Asia; the traditional U.S. export markets of Canada, Japan, and Western Europe that represent over 50 percent of total U.S. export sales; the economies in transition (e.g., Russia); the service sector, where trade promotion support has been historically weak; and the growing area of trade finance. Through a newly developed unified trade promotion budget and the TPCC, the Administration will continue to give U.S. exporters cost-effective trade promotion support that is unavailable in the private market.

WHAT THE FEDERAL GOVERNMENT DOES

From the broad economic agenda, we now turn to the more detailed discussions of how the Administration proposes to spend the taxpayers' money and to make Government work better. Before we do, however, we should put these details in proper perspective.

As we have all learned too well, the Federal Government cannot solve all of the

[3] Mexico, Brazil, Argentina, China (including Taiwan and Hong Kong), India, Indonesia, South Korea, Poland, Turkey, and South Africa.

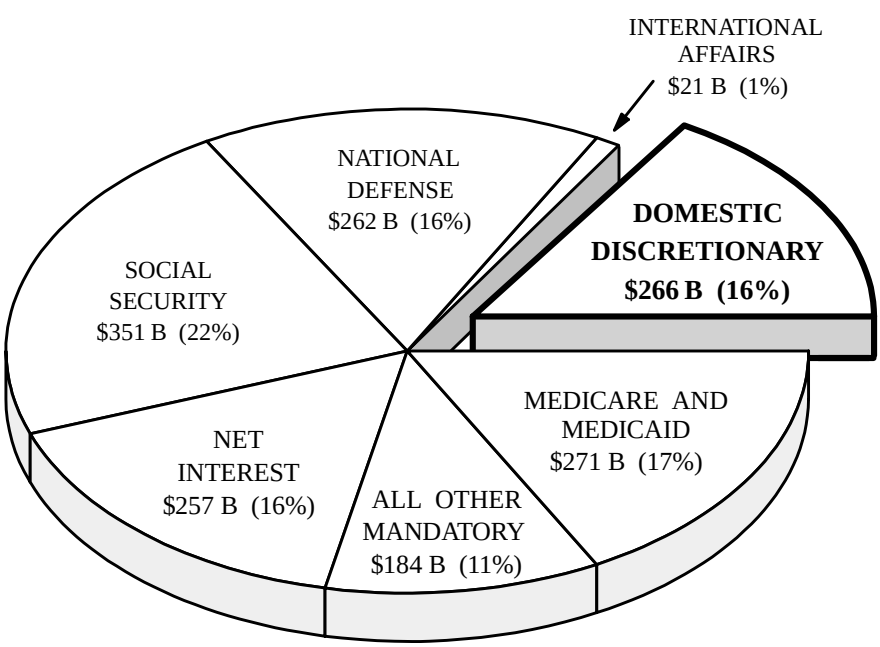
Nation's problems. Nor do we propose that it try. In many areas, solutions are more likely to emanate from States or more local units of government, such as counties, municipalities, and school districts. Some solutions, meanwhile, are better left to businesses, churches, community groups, and families.

The Federal Government has a limited, though important, role to play. Clearly, it must provide for the Nation's defense and conduct international affairs. It also must play a large leadership role on problems that cross State lines, such as environmental pollution and air traffic control. In other areas, its role is inherently more limited. It can, for instance, help set the general tone for education reform—but most spending for education comes from States and localities, and only teachers, parents, students, and concerned citizens can really improve their local schools. The Federal Government can help give communities the tools they need to fight crime, but much redevelopment must come from the ground up.

What we can do, and what we are proposing throughout this budget, is to better target Federal resources where they will do the most good, and to give State and local governments more flexibility to allocate Federal resources to address the specific problems before them. As detailed in "Making Government Work," the Administration proposes to capitalize on its earlier successes in reinventing the Federal Government, and it has begun to ask fundamental questions about which agencies and programs work well, which to restructure, and which to eliminate.

In reviewing our proposals, one should keep the whole budget in mind. The proposals discussed in these pages mostly relate to discretionary spending—the $549 billion that Congress votes on each year—which represents

Chart 2-9. 1996 PROPOSED SPENDING BY CATEGORY



34 percent of the $1.6 trillion in total Federal spending. (See Chart 2–9.)

About half of discretionary spending goes for defense and about $21 billion (or just one percent of the total budget, despite perceptions to the contrary) goes for international affairs. Chapters 9 and 10 explain how the Administration's proposals for defense and international affairs help to project American leadership across the globe.

The other half of discretionary spending includes many of the Federal agencies and programs that people think of when they hear the term "Government"—the FBI, IRS, science and space programs, highway construction, environmental protection, community development, Head Start, and national parks. In many cases, the Administration is not proposing huge sums of money to attack problems. Rather, it seeks to use the Federal Government as a catalyst for State and local decision-making, or to leverage those funds for assistance from State and local governments or the private sector.

Of much greater size, 66 percent of all spending, is mandatory spending—the money that the Federal Government spends automatically unless the President and Congress take specific action to stop it, such as by changing the laws that govern programs. This category includes entitlements—such as Social Security, Medicare and Medicaid, and Food Stamps—through which individuals receive benefits because they meet some criteria of eligibility, such as age or income. It also includes interest on the national debt, the 16 percent of Federal spending that the Government pays to individuals and institutions that buy U.S. securities.

Although the budget proposes no changes in Social Security, which alone accounts for 22 percent of all Federal spending, it does recommend changes to generate savings from several other entitlements; for instance, it proposes a royalty fee for users of the electro-magnetic spectrum. To generate further savings, it recommends extending some expiring provisions that affect Medicare. Moreover, the President continues to support a complete overhaul of the welfare system, to increase opportunity and reduce long-term dependency.

Of greater long-term consequence for the budget as a whole, however, is the President's continued commitment to comprehensive health care reform, as outlined in Chapter 8. The two main Federal health programs, Medicare and Medicaid, continue to grow much faster than the overall rate of inflation. Together, these programs account for 17 percent of Federal spending and, at current growth rates, will double in size in eight years. By helping to control health care costs, reform would slow the rate of growth in Medicare and Medicaid and, in doing so, go a long way toward solving the long-term problem of Federal budget deficits.