

SPECIAL ANALYSIS B

FEDERAL TRANSACTIONS IN THE NATIONAL INCOME AND PRODUCT ACCOUNTS

The budget is designed to serve many purposes:

- It represents a proposed *allocation of resources* to serve national objectives, between the private and public sectors, and within the public sector;
- It is an *economic document* which embodies the taxing and spending policies of the Government for promoting high employment, price stability, growth of the national economy, and maintainance of the Nation's balance of payments;
- It sets forth the *President's requests to Congress* for appropriation action on existing or new programs, and changes in tax legislation;
- It is a *report to the Congress and the people* on how the Government has spent the funds entrusted to it in past years.

No single budget concept can completely satisfy all purposes. The budget is designed to provide a unified picture of the Federal Government's finances, while other series—such as the Federal sector of the national income accounts (NIA)—focus on specific areas of concern for various other purposes.

In past years, the budget document included a special analysis which concentrated on explaining the relationship among the three most widely used measures of Federal financial transactions: (1) the administrative budget, (2) consolidated cash statement (receipts from and payments to the public), and (3) the Federal sector of the national income accounts. In accordance with the recommendations of the President's Commission on Budget Concepts, neither the administrative budget nor the consolidated cash will be utilized as major measures of Federal finances. The relationship between the new budget and these two older concepts is discussed in detail in Special Analysis A.

The budget document and related Treasury reports provide detailed information on the finances of the Federal Government. The national income accounts of the United States are the most widely used measures of aggregate economic activity in the country. This analysis is designed to explain the relationships of the budget to the Federal sector of the national income accounts, and to present the budget estimates in national income terms.

This analysis is divided into three major sections: (1) the size and trends of major components in the Federal sector; (2) the relationship between the Federal sector and the budget; and (3) definitions of the major categories of the Federal sector.

TRENDS IN FEDERAL SECTOR RECEIPTS AND EXPENDITURES

Total expenditures in the Federal sector accounts budget are estimated to rise by \$13.9 billion between fiscal 1968 and 1969, receipts by \$21.4 billion. As a consequence, the Federal sector deficit will decline by \$7.5 billion, from \$10 billion in 1968 to \$2.5 billion in 1969.

Trends in Federal sector receipts.—Rising levels of economic activity expand the Nation's tax base and provide increased sources of Federal revenues. Between 1952 and 1967, Federal sector receipts more than doubled despite major decreases in tax rates and liberalization of tax provisions. Receipts in the national income accounts increased from \$65.1 billion in fiscal 1952 to \$147.6 billion in 1967. Part of this growth, however, has resulted from increases in social security tax rates and wage ceilings. Consequently, Federal receipts have kept pace with the growth in the economy.

Two major factors account for most of the changes in Federal sector receipts in 1969:

(1) *The level of economic activity.*—Personal tax and nontax receipts consist mainly of income taxes and tend to increase as personal income rises. Since income tax rates are progressive, there is a larger than proportional increase in these receipts as more people enter the higher income brackets. Corporate profits taxes, which are closely related to corporate profits, are also influenced by the level of economic activity and the profitability of business corporations. Since business taxes consist mainly of excise taxes on certain goods and services, such as tobacco, alcohol, automobiles, and telephones, they depend largely on the level of purchases of these items. Social insurance contributions expand with the growth in employment and earnings.

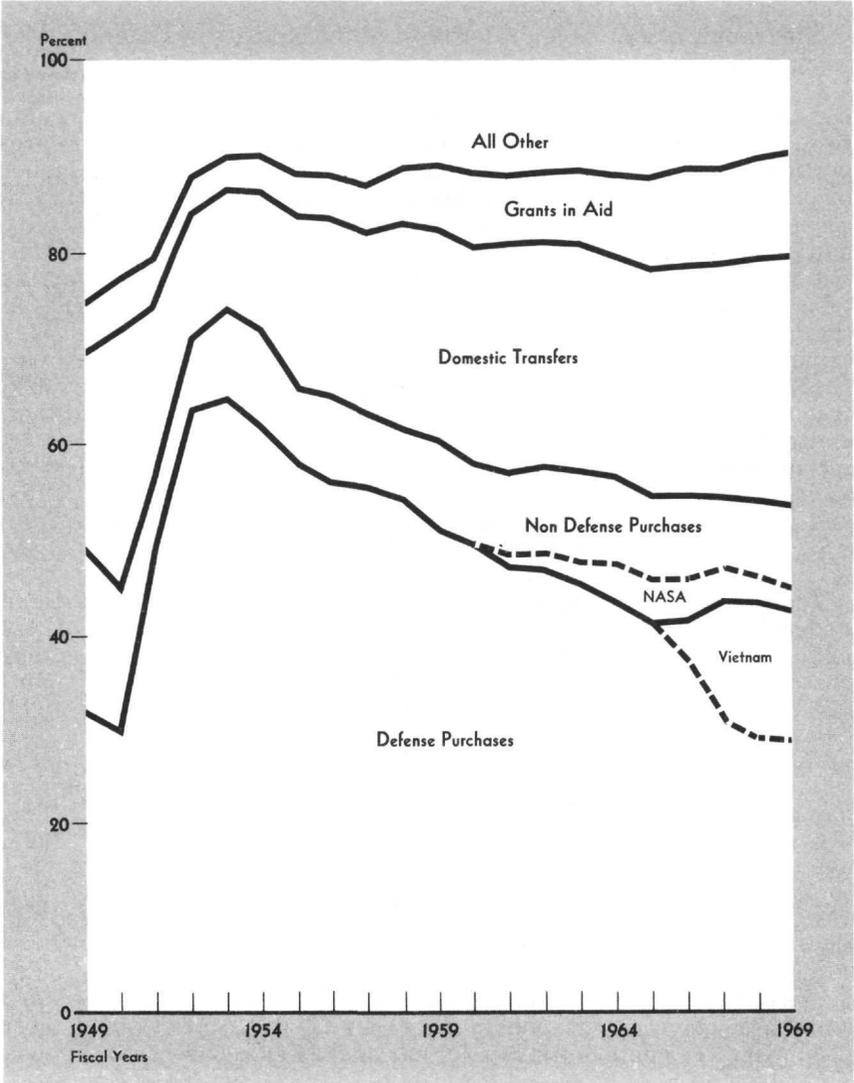
(2) *Changes in tax rates.*—The 1969 budget recommends a 10% income tax surcharge on individuals and corporations. In addition, contributions for social insurance in fiscal 1969 will be affected by recent legislation which increased the ceiling on wages subject to social security taxes from \$6,600 to \$7,800 beginning January 1, 1968, and which raised the combined employer and employee tax rate from 8.8% to 9.6% effective January 1, 1969.

Trends in Federal sector expenditures.—The \$13.9 billion rise in Federal sector expenditures in 1969 compares with increases of \$16 billion in 1968 and \$23.2 billion in 1967. The upsurge in defense purchases, starting with the large-scale commitments of American troops in Vietnam, is expected to continue in the year ahead, but at a much reduced rate. Federal sector expenditures, like receipts, have grown significantly over the past 15 years. The demands of a growing population, an expanding economy, and an unsettled world have resulted in new and expanded Federal programs to meet these needs. Nevertheless, despite a doubling of Federal sector expenditures from 1952 to 1967, about the same proportion of the gross national product was devoted to Federal programs in 1967 as prevailed 15 years previously. This year, Federal sector expenditures will account for 20.9% of the GNP, slightly lower than the 21.1% accounted for 15 years ago.

Significant shifts, however, have occurred among the several categories of expenditures, reflecting world conditions, domestic problems, and basic Government policy. As chart B-1 indicates, the largest proportion of Federal outlays is for national defense purchases of goods

and services, which increased rapidly early in the 1950's due primarily to the requirements of the Korean war. Since that time defense spending as a percent of the total declined to a low point of 7.5% in 1965, and has risen somewhat since as a result of the conflict in Vietnam; they are expected to reach 9.1% of GNP this year, compared with 13.6% in 1953.

Federal Sector Expenditures *Major Categories as a Percent of Total*



Aside from space, nondefense spending for goods and services has been a very stable proportion of total expenditures. Nondefense purchases have been subject to especially heavy economy efforts recently in order to mitigate inflationary pressures. Expenditures for space exploration have grown rapidly in recent years, rising from \$401 million in 1960 to a high of \$5.9 billion in 1966; they have declined somewhat since then, and are expected to total \$4.6 billion in 1969.

Grants-in-aid reflect Federal efforts to assist State and local governments in meeting pressing domestic needs. Most of the items included in the grants-in-aid category in the Federal sector accounts are also included in the discussion of Federal aids in Special Analysis K of this budget. Table B-1 shows both grants and domestic transfer payments—broken into several major groupings—for the past 10 years.

Table B-1. GRANTS-IN-AID AND DOMESTIC TRANSFER PAYMENTS
(In billions of dollars)

Fiscal year	Grants-in-aid			Domestic transfer payments			
	Public assistance	Highways	All other	Retirement and disability	Unemployment insurance	Hospital and supplemental medical insurance	All other
1960.....	2.1	2.9	1.9	16.5	2.6	-----	1.5
1961.....	2.2	2.6	2.1	18.1	4.0	-----	1.5
1962.....	2.4	2.8	2.4	20.1	3.5	-----	1.5
1963.....	2.7	3.0	2.6	21.9	2.9	-----	1.6
1964.....	2.9	3.6	3.3	23.1	2.8	-----	1.4
1965.....	3.3	4.0	3.6	24.3	2.4	-----	1.6
1966.....	3.5	3.9	5.3	28.1	2.0	-----	1.7
1967.....	4.2	4.0	7.2	29.7	2.0	3.2	2.8
1968.....	5.2	4.3	8.5	32.5	2.4	4.8	3.3
1969.....	5.8	4.3	9.9	36.4	2.4	5.5	3.6

Domestic transfer payments (which are mainly pensions, unemployment benefits, and veterans benefits) account for the second largest share of total Federal expenditures—an estimated 25.9% in 1969. During the late 1950's there was a rapid decline in expenditures for the GI bill but recent legislation is providing benefits for veterans who were ineligible under the earlier programs, while social security benefits under both retirement and health programs have expanded rapidly in recent years. A significant part of the war on poverty is in the form of transfer payments. In general, the growth of these programs has been the result of efforts to meet the needs of the poor, sick, and elderly—an obligation that our Nation cannot afford to shirk.

Table B-2 shows Federal expenditures as a percent of total GNP, for alternate years, since 1952. These expenditures have been remarkably stable as a portion of our Nation's economy.

Table B-2. FEDERAL SECTOR NIA EXPENDITURES AS A PERCENT OF GNP

Fiscal year	Total expenditures	Purchases			Domestic transfer payments	Grants-in-aid	All other
		Defense	Nondefense				
			NASA	Other			
1952.....	19.6	12.4	(1)	1.4	2.5	0.7	2.5
1954.....	20.5	12.6	(1)	2.1	2.9	.8	2.1
1956.....	17.0	9.6	(1)	1.5	3.1	.8	2.1
1958.....	18.9	10.2	(1)	1.3	4.0	1.1	2.2
1960.....	18.4	9.1	0.1	1.5	4.2	1.4	2.2
1962.....	19.6	9.3	.2	1.7	4.6	1.4	2.4
1964.....	19.1	8.3	.7	1.7	4.5	1.6	2.3
1966.....	18.4	7.6	.8	1.6	4.4	1.8	2.2
1968.....	20.9	9.1	.6	1.7	5.3	2.2	2.1
Excluding Vietnam:							
1966.....	17.5	6.8	.8	1.6	4.4	1.8	2.2
1968.....	17.9	6.4	.6	1.7	5.3	2.2	2.1

¹ Less than 0.05%.

RELATIONSHIP OF THE BUDGET TO THE FEDERAL SECTOR OF THE NATIONAL INCOME ACCOUNTS

The national income accounts depict the Nation's current production, income, and spending in separate major categories which are designed to aid understanding of the operations of the economy and to facilitate useful economic analysis. These accounts attempt to include all current income and production activities and do not measure transactions—such as loans—which represent an exchange of assets rather than income or production. Loan transactions have a significant economic impact, affecting both income and output, but they are best analyzed as part of monetary rather than fiscal policy. Special Analysis E (Federal credit programs) and the means of financing statement (p. 61 of the budget) are both designed to facilitate a study of the monetary policy implications of the budget.

Budget outlays are divided into two major segments—the expenditure account and the loan account. All transactions included in the loan account are excluded from the Federal sector, so this discussion will focus exclusively on how the Federal budget expenditure account relates to the Federal sector account.

Table B-3 shows the major differences between the receipt-expenditure account in the budget and the Federal sector estimates. These differences are explained in the following paragraphs.

Employee retirement.—The Civil Service and Foreign Service retirement programs are financed by employer and employee contributions. Retirement benefits under these programs are recorded as expenditures in the budget and as transfer payments in the Federal sector

Table B-3. RELATIONSHIP OF THE RECEIPT-EXPENDITURE ACCOUNT TO THE FEDERAL SECTOR NIA (in billions of dollars)

	1967 actual	1968 estimate	1969 estimate
RECEIPTS			
Total budget receipts.....	149.6	155.8	178.1
Employer share, employee retirement (grossing).....	1.7	1.9	2.0
Other netting and grossing.....	1.1	1.2	1.2
Adjustment to accruals.....	-4.8	2.2	1.1
Other.....	(¹)	(¹)	(¹)
Federal sector, NIA receipts.....	147.6	161.1	182.5
EXPENDITURES			
Total budget expenditures (excludes net lending).....	153.2	169.9	182.8
Employer share, employee retirement (grossing).....	1.7	1.9	2.0
Other netting and grossing.....	1.1	1.2	1.2
Defense timing adjustment.....	-.4	.3	.4
Lending in the expenditure account.....	-1.4	-1.7	-2.1
Dollar expenditures to finance agricultural exports.....	-.8	-.7	-.5
Other.....	1.6	.2	1.1
Federal sector, NIA expenditures.....	155.1	171.1	185.0

¹ Less than \$50 million.

accounts. The contributions of Government agencies, as employers, to these retirement trust funds are deducted from total budget expenditures since these contributions represent intragovernmental transactions. However, the NIA accounts consider Government payments for employee retirement to be part of the compensation paid to Government employees who, in turn, make their trust fund contributions. Therefore, the Federal sector accounts include the Government's contributions to employee retirement funds in both receipts and expenditures. Likewise, Federal payments on behalf of its employees to the old-age and survivors disability insurance programs are included in Federal sector receipts and expenditures. These adjustments affect total receipts and expenditures equally and thus do not alter the budget surplus or deficit.

Other netting and grossing.—The budget normally counts as receipts only income from taxation or revenues due to the exercise of governmental power to compel. Money received in the course of business type transactions, therefore, are normally shown as offsets against expenditures. For instance, receipts from two major insurance programs operated by the Veterans Administration (National Service Life Insurance and United States Government Life Insurance) are

netted against expenditures in the budget since these programs are voluntary, business-type activities. However, in the NIA the receipts are treated in the same way as receipts from compulsory Government insurance programs. This adjustment also has no impact on the budget surplus or deficit.

Timing adjustments.—At the present time the budget counts receipts when the cash is collected, and most expenditures when the checks are issued to pay the bills. In the NIA receipts are counted when the income is earned or when the transaction giving rise to the receipt occurs, even though the cash may be received at a later point. Accrued expenditures record outlays when the production or work takes place rather than when the payment is made. This permits changes in receipts and expenditures to more accurately reflect the impact of the Government on the economy. Since the accrual concept is followed in the national income accounts receipts, they differ from budget receipts by the amount of estimated accruals which are not collected in the time period covered.

Defense purchases are recorded in the Federal sector at the time of delivery of goods instead of when they are paid for; work in process on fixed-price contracts is counted as change in business inventories. Both the budget and the Federal sector record public debt interest when it accrues.

Lending.—The loan account in the budget includes only those domestic credit transactions where there are definite requirements for full repayment of the loans, plus all foreign loans made on commercial terms. Those credit programs which do not meet these requirements are included in the expenditure account. The Federal sector, however, excludes not only all lending transactions included in the loan account, but also some credit programs included as expenditures in the budget—such as foreign loans in AID and tobacco and foreign loans in the Commodity Credit Corporation (CCC). Certain credit transactions in the expenditure account—like most CCC nonrecourse commodity loans—are treated as purchases of goods under the national income accounts concept.

Dollar expenditures to finance agricultural exports.—The Commodity Credit Corporation facilitates the export of agricultural products by acquiring the foreign currencies used to pay for such commodities. This expenditure of dollars is included in the budget but excluded from the Federal sector on the ground that it is an exchange of financial assets: dollars for foreign currencies. When the foreign currencies thus acquired are spent, they are then counted as Federal sector expenditures.

Other.—This category includes some of miscellaneous adjustments largely for certain specialized aspects of the national income accounts

such as purchases and sale of land, which are included in the budget but not in the national income accounts. Certain nondefense timing adjustments are included here because of the difficulty in separating them from other adjustment categories included herein. It also includes adjustments for the expenditure of foreign currency acquired as described in the paragraph above.

MAJOR CATEGORIES OF THE FEDERAL SECTOR OF THE NATIONAL INCOME ACCOUNTS

Federal sector receipts.—Federal receipts on a national income basis largely reflect the tax payments or liabilities of individuals and of corporations and other businesses arising out of incomes earned. They also include other tax and nontax receipts. These receipts are classified into the following four categories: (1) personal tax and nontax receipts, (2) corporate profits tax accruals, (3) indirect business tax and nontax accruals, and (4) receipts from contributions for social insurance.

1. *Personal tax and nontax receipts* consist mostly of individual income taxes, estate and gift taxes, fines, fees, and donations.

2. *Corporate profits tax accruals* comprise the Federal tax liability incurred and accrued on corporate earnings during the specified year or period. While the budget treats Federal Reserve payments of earnings to the Treasury as miscellaneous receipts, these are included in the corporate profit tax category in the Federal sector.

3. *Indirect business tax and nontax accruals* consist primarily of excise taxes, customs duties, and Federal receipts from rents and royalties.

4. *Contributions for social insurance* are composed chiefly of payroll taxes for retirement, disability, hospital, and unemployment insurance, plus employer and employee contributions to retirement funds of Federal Government employees and premiums for federally operated veterans and medical insurance programs.

Table B-4 shows the adjusted receipts and expenditures after reclassification into the national income accounts categories.

Table B-4. FEDERAL RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS (in billions of dollars)

Description	1967 actual	1968 estimate	1969 estimate
RECEIPTS, NATIONAL INCOME BASIS			
Personal tax and nontax receipts.....	64.6	71.0	83.8
Corporate profits tax accruals.....	31.4	34.3	37.2
Indirect business tax and nontax accruals.....	15.9	17.1	18.1
Contributions for social insurance.....	35.7	38.7	43.4
Total receipts, national income basis.....	147.6	161.1	182.5
EXPENDITURES, NATIONAL INCOME BASIS			
Purchases of goods and services.....	84.5	92.8	99.4
Defense.....	(67.6)	(74.4)	(78.8)
Nondefense.....	(16.9)	(18.4)	(20.6)
Transfer payments.....	39.8	44.9	49.9
Domestic ("to persons").....	(37.7)	(43.0)	(47.9)
Foreign.....	(2.1)	(1.9)	(2.0)
Grants-in-aid to State and local governments.....	15.4	18.0	20.0
Net interest paid.....	10.1	10.7	11.2
Subsidies less current surplus of Government enterprises.....	5.3	4.6	4.5
Total expenditures, national income basis.....	155.1	171.1	185.0
Surplus (+) or deficit (-), national income basis.....	-7.5	-10.0	-2.5

Federal sector expenditures.—Federal expenditures on a national income basis represent either purchases of goods and services or outlays which directly affect current levels of income. These expenditures are classified in the following five categories: (1) purchases of goods and services, (2) transfer payments, (3) grants-in-aid to State and local governments, (4) net interest paid, and (5) subsidies less current surplus of Government enterprises. The definitions of the categories have been developed by the Department of Commerce so that they are consistent with the framework of accounts used to cover all sectors of the Nation's economic activity.

1. *Purchases of goods and services* measure the value of the Nation's output (i.e., gross national product) bought directly by the Federal Government. Thus, Federal expenditures for goods and services represent the value of output taken by the Federal Government itself.

These purchases include the pay of active military and civilian employees of the Federal Government, employer contributions for retirement, insurance, and other benefits for Federal employees; deliveries of equipment and supplies for defense and other programs; construction put in place for the Government; payments on research and development contracts with corporations and on similar agree-

ments with private nonprofit institutions; expenditures for the purchase of commodities to be donated to schools or similar institutions; and, generally, the administrative expenses of Government programs.

Federal purchases, in turn, are classified in two major subcategories—defense and nondefense. The defense category includes purchases for those activities classified under the defense function of the budget. Purchases for all other types of activities are classified as nondefense.

2. *Transfer payments* consist of expenditures by the Federal Government for which no *current* services have been rendered. Examples of transfer payments are: veterans compensation, pensions, and benefits; retired pay to Federal civilian or military personnel; unemployment benefits; old-age, survivors, disability, health, and supplemental medical insurance; and nonrepayable outlays for scholarships and fellowships.

Although transfer payments do not directly enter gross national product as a Federal Government component, they are a part of personal income and are counted as part of national output when respent by the recipients.

3. *Grants-in-aid to State and local governments*, for purposes of the national income accounts, are Federal payments (other than for interest on the public debt) to State and local governments, including State and local educational institutions. Like transfer payments and net interest paid, Federal grants-in-aid are counted in the GNP when spent by recipients—in this case, as purchases by State and local governments or as consumption expenditures of individuals receiving State or local transfer payments.

4. *Net interest paid* consists of the interest outlays to residents (including State and local governments) minus the interest received from them.

5. *Subsidies less current surplus of Government enterprises* consists of two elements which are consolidated for statistical reasons: (a) subsidy payments to resident businesses and (b) the “current surplus” or “deficit” of Government enterprises.

(a) A subsidy is a monetary grant to a private business. By definition, therefore, subsidies are made only to businesses organized for profitmaking purposes (including farms). Examples of subsidies are Government payments to farmers for land retirement, payments to air carriers, and the operating differential subsidy of the Maritime Administration.

(b) Government enterprise is the term applied to those functions of the Government (usually appearing in the budget as public enterprise revolving funds) for which operating costs are to a great extent covered by the sale of goods and services to the public, as distinguished from those being financed by tax receipts. Government enterprises conduct operations which are of a business-type nature. The difference between their sales and current operating expenses constitutes the surplus or deficit of Government enterprises. The Post Office and the Tennessee Valley Authority are two of the largest enterprises.