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HOW SHOULD POLICYMAKERS TREAT THE BUDGET FOR NON-DEFENSE “DISCRETIONARY” PROGRAMS?

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As Congress prepares a budget resolution that will (among other things) set funding limits for discretionary programs for fiscal year 2008, it is appropriate to examine funding trends for these programs in the context of the nation’s overall budgetary situation. Discretionary programs include defense and homeland security spending, international affairs programs, and domestic programs other than entitlements.

There is no doubt that what the Administration terms “security spending” (i.e. defense, international, and homeland security spending) has risen substantially. Some contend that funding for domestic discretionary programs outside homeland security also has grown explosively since 2001 and has been a significant factor in the re-emergence of large budget deficits. Analysis of the data shows, however, that after rising at the start of the decade, funding for domestic discretionary programs has been reduced in recent years — and is now only slightly above, or actually below, the 2001 levels, depending on which budget measure is used.

Both as a share the economy and as a share of the budget, funding for domestic discretionary programs has declined since 2001. CBO data also show that domestic discretionary programs have played only a marginal role in the return of deficits. Furthermore, virtually all long-term budget projections show that domestic discretionary programs are expected to have no role in the fiscal deterioration projected in coming decades.

In short, domestic discretionary programs are not the cause of the nation’s fiscal problems. It also should be recognized that some non-defense discretionary programs will require additional resources in coming years if the nation is to improve the productivity of the workforce and maintain international competitiveness, to confront a variety of global challenges like the global HIV/AIDS crisis and global warming, and to address poverty and rising inequality in the United States.

Expenditures for Domestic Discretionary Programs Have Declined Significantly Since 1980

Expenditures for domestic discretionary programs have declined from 4.7 percent of the Gross Domestic Product in 1980 to 3.5 percent in 2006. (Economists and budget analysts typically examine changes in spending and revenues over time by measuring them as a share of the economy, which reflects the share of the nation’s resources that are used for a particular purpose.) Under the

Congressional Budget Office baseline, which assumes that these programs will grow at the rate of inflation over the next decade, they will continue declining, to 2.6 percent of GDP by 2017.

Similarly, domestic discretionary programs constituted 22 percent of the federal budget in 1980 but have shrunk to 17 percent of the budget today. Under the latest CBO projections, they will continue shrinking, to about 14 percent of the budget by 2017.¹

Funding For Domestic Discretionary Programs Has Declined for Three Consecutive Years in Real Terms

In 2001, when policymakers believed we would be running large budget surpluses for the indefinite future, Congress significantly increased domestic appropriations for fiscal year 2002 to respond to perceived needs in education, biomedical research, and other areas. Largely due to the enactment of the President’s tax cuts, a deteriorating economy, and costs related to the September 11 terrorist attacks, the budget slid back into deficit starting in 2002.

In the ensuing two years, funding for domestic discretionary programs outside homeland security grew slightly in inflation-adjusted terms (and fell slightly as a share of the economy).² But after that, growth stopped and then reversed. In 2005 and 2006, funding for domestic discretionary programs outside homeland security failed to keep pace with inflation, falling a combined \$13 billion in 2008 dollars. In 2007, domestic discretionary funding saw another, smaller reduction in real terms, of \$300 million.³

As a result, most of the growth in domestic discretionary programs that occurred earlier in the decade has been cancelled out. Total funding for domestic discretionary programs outside homeland security is only 7 percent greater in fiscal year 2007 than in fiscal year 2001, after adjusting for inflation. And in real per capita terms — that is after adjusting for *both* inflation and population growth, a measure that many analysts believe is superior — the increase over this period

TABLE 1			
Total Funding Changes in Domestic Discretionary Programs 2001-2007			
	Domestic Programs	Security Programs	Total Discretionary
In real per capita terms	+ 1.1%	+ 22.7%	+ 12.0%
As a share of GDP	- 0.3%	+ 0.4%	+ 0.1%

Source: CBPP calculations based on CBO, OMB, BLS, and Census Bureau data. Funding totals for security programs do not include funding for operations in Iraq and Afghanistan. If funding for those operations is included (and the operations are assumed to be funded at the President's proposed level for 2007), then the cumulative growth in security programs from 2001 to 2007 exceeds 60 percent in real per capita terms.

¹ Because data on homeland security expenditures are not available before 1995, the domestic discretionary figures in this paragraph and the preceding paragraph include spending for homeland security programs (except for those located in the national defense and international affairs budget functions). If it were possible to remove such spending, the decline since 1980 would be even greater.

² In this paragraph and thereafter in this analysis, budget figures for domestic discretionary programs cover programs outside homeland security, which is treated as part of the “security” category.

³ These funding totals do not include emergency funding provided for hurricane relief. The totals reflect a variety of adjustments to remove distortions resulting from timing shifts and other anomalies. For details on those adjustments, see the appendix to Richard Kogan, “The Omnibus Appropriations Act: Are Appropriations for Domestic Programs Exploding?” Center on Budget and Policy Priorities, revised February 1, 2004, <http://www.cbpp.org/12-16-03bud.htm>. (Expenditure totals, in contrast, do not require such adjustments.)

is just 1.1 percent (see Table 1). As a share of the economy, funding for domestic discretionary programs outside homeland security actually has fallen, from 3.4 percent of GDP in 2001 to 3.1 percent of GDP in 2007, and the level for 2007 appears to be the lowest level in at least half a century.

Funding for security programs (i.e., defense, international, and homeland security) has followed a very different path. Between 2001 and 2007, these programs grew — even without counting the funding for the wars in Iraq and Afghanistan — nearly *20 times* as rapidly as domestic discretionary programs in real per capita terms, averaging 3.5 percent annual growth compared to 0.2 percent annual growth for domestic discretionary programs outside homeland security. Were the funding for Iraq and Afghanistan included, the increase in security would be substantially greater.

Thus, while funding for discretionary programs as a whole — including security-related programs — has grown as a share of GDP since 2001, all of this growth has occurred in the security area.

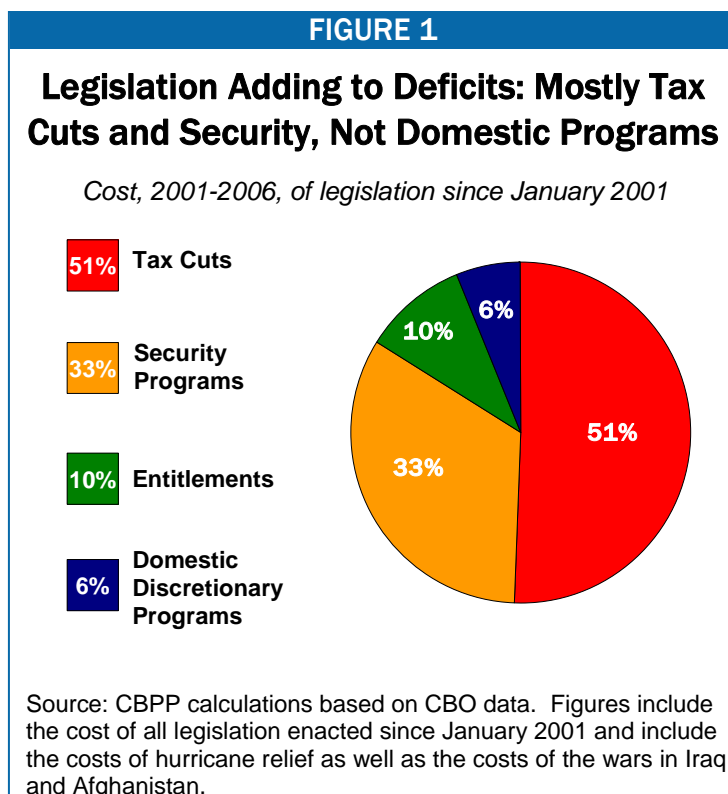
Domestic Discretionary Programs Are Not Drivers of Current or Projected Deficits

Given that funding for domestic discretionary programs has risen little or declined, depending on the measure used, it is not surprising that these programs have had little to do with the re-emergence of deficits in this decade.

At the start of the decade, CBO forecast sizeable surpluses for each of the next five fiscal years (fiscal years 2002-2006). Instead, the government ended up running substantial deficits in all of those years.

CBO data indicate that poorer-than-expected economic performance (including the effects of the 2001 recession) and technical estimating errors accounted for about 38 percent of the budgetary deterioration that occurred in the 2001-2006 period (i.e., 38 percent of the difference between the surpluses forecast for those years at the start of 2001 and the deficits that actually resulted). The other 62 percent of the deterioration, however, was the consequence of spending increases and tax cuts that Congress passed and the President signed. The CBO data also allow us to determine the types of legislation that were responsible for the large portion of the deterioration caused by legislative action.

As Figure 1, based on CBO data, indicates, increases in domestic



discretionary programs outside homeland security account for just 6 percent of the total cost of legislation that Congress has enacted since the start of 2001.⁴ Furthermore, the domestic discretionary expenditure level for 2006 includes a substantial amount of temporary costs related to Hurricane Katrina; as a result, the share of the nation's fiscal deterioration that is attributable to domestic discretionary programs will shrink below 6 percent in the years ahead. Domestic discretionary programs have thus been a bit player at most in the budgetary deterioration of this decade.

The more important budgetary questions relate to the difficult decades that lie ahead. Deficits and debt, as a share of the economy, are projected to grow to levels that are unprecedented in the nation's history and would have large negative effects on the U.S. economy. However, discretionary programs — both domestic and security programs — are not expected to play a significant role in the nation's long-term fiscal problems, for the basic reason that the costs of discretionary programs has been shrinking as a share of the economy for more than 30 years and is expected to continue to do so in the years ahead, even if we make modest investments in these programs.⁵ (The CBO baseline shows discretionary program costs continuing to decline as a share of the economy.) If discretionary expenditures *fall* as a share of GDP, they cannot be a factor contributing to the anticipated *rise* in overall federal expenditures, deficits, and debt as a share of GDP.

In terms of addressing the nation's serious long-term fiscal problems, domestic discretionary programs are essentially a sideshow. Major progress in addressing the grim long-term budget outlook will not be made until policymakers address three factors: increases in health care costs throughout the U.S. health care system, which will drive up Medicare and Medicaid costs (as well as private-sector health care costs); the aging of the population, which will raise the costs of Social Security, Medicare, and Medicaid; and the costs of the 2001 and 2003 tax cuts if they are permanently extended but not paid for. These three factors account for all of the nation's projected long-term fiscal deterioration. (Like discretionary spending, overall expenditures for entitlement programs other than Social Security, Medicare, and Medicaid are expected to grow more slowly than the economy in coming decades.)

The 2008 Budget

The President's budget for fiscal year 2008 would reduce funding for domestic discretionary programs by about 3 percent below the 2007 funding level adjusted for inflation. The proposed cuts in domestic discretionary programs would grow deeper and broader in the four succeeding years, 2009-2012.

In some areas, the proposed cuts would come on top of substantial cuts already made in these programs over the past several years. For example, EPA clean-water funding has already been cut significantly, and the President's proposed funding level for 2008 is 40 percent below the 2001 level, adjusted for inflation. Similarly, funding to repair and maintain public housing units has already

⁴ The spending increases and tax cuts shown in Figure 1 are relative to the January 2001 CBO baseline. The increases reflected in Figure 1 in domestic discretionary spending thus are increases above the funding levels for fiscal year 2001 as they stood in January 2001, adjusted for inflation.

⁵ See Richard Kogan, Matt Fiedler, Aviva Aron-Dine, and James Horney, "The Long-Term Fiscal Outlook is Bleak," Center on Budget and Policy Priorities, January 29, 2007.

sustained large reductions and would be cut further under the President's budget, falling 43 percent below the 2001 level.

Some Additional Investments Needed

Various developments in the nation — and the world — are creating an imperative for increased resources for certain non-defense discretionary areas in the years ahead. These factors can be grouped into four broad categories: 1) meeting critical global challenges; 2) making American workers and businesses more competitive, and doing so in a way that helps to prevent income inequality from becoming still more severe; 3) addressing the challenges of poverty and demography; and 4) enabling government to perform its basic functions adequately.

- **Meeting global challenges.** President Bush has spoken of the need for increased funding to fight diseases such as HIV/AIDS and malaria around the world, especially in very poor countries, and to help combat severe poverty and underdevelopment abroad through the Millennium Challenge Account. From both a security and a humanitarian standpoint, these measures are important. Primarily because of overly tight levels placed on the appropriations committees, however, Congress has yet to fully fund the President's request in this area. (In 2007, the HIV/AIDS request is fully funded, but the Millennium Challenge Account is well below the President's request.)

The United States continues to rank near the bottom in the western world in terms of the share of its budget and its economy that it devotes to these matters. Increased resources are needed here and will continue to be needed for a considerable period of time.

The President and others also have spoken of the need for increased investment in alternative energy research. Climate change may be the single greatest danger facing the planet. Action to deal with it is needed on a number of fronts, one of which is energy research. This, too, will require more resources.

- **Improving U.S. competitiveness and addressing growing income inequality.** In an increasingly global economy, there is growing concern about jobs and economic activity shifting from the United States to other countries. There also is mounting concern over the rise in income inequality in the United States, including concern about how that trend could generate pressure to pursue policies that would make it harder to improve U.S. competitiveness in the global economy.

Among those who have recently voiced strong concern about growing inequality are President Bush, former Federal Reserve chair Alan Greenspan, and current Fed chair Ben Bernanke. Bernanke recently called for “policies that boost our national investment in education and training,” noting that “A substantial body of research demonstrates that investments in education and training pay high rates of return both to individuals and to the society at large,” as do early childhood programs.⁶

⁶ Chairman Ben S. Bernanke, “The Level and Distribution of Economic Well-Being,” Remarks before the Greater Omaha Chamber of Commerce, February 6, 2007. See also Julia B. Isaacs, “Cost-Effective Investments in Children,” The Brookings Institution, January 2007.

Similarly, in recent testimony before the Joint Economic Committee, former Treasury Secretary Larry Summers called for boosting productivity by increasing investment in education, infrastructure, and research and development. He expressed concern at the “remarkable” decline in federal support for basic research and pointed to “key areas such as transportation and other infrastructure facilities where investment has been grossly inadequate.” He also noted that “A growing body of evidence suggests that pre-school education has an enormous rate of return, particularly for children from a disadvantaged background and funding for these kinds of programs should be a priority.”⁷

- **Addressing challenges related to poverty and demography.** The United States tolerates a level of child poverty well above that of nearly all other western industrialized nations. For hard-headed economic reasons, as well as for humanitarian reasons and the good of the society at large, this matter ought to be addressed. (The United Kingdom has set a goal of cutting child poverty in half by 2010, and ultimately eliminating it, and has made impressive initial progress toward this goal.)

After years of experience with various programs, certain programs and types of interventions have been found to deliver results. Yet we underfund them. While a good part of the federal policy reforms needed to address poverty lie outside the discretionary part of the budget, some discretionary areas will need more funding if we are serious about making significant progress. They include Head Start, child care and early education initiatives, and housing vouchers, among others.

For example, millions of low-income working families that need help paying for child care do not get it because of insufficient funding. Some of these families resort to inappropriate, unstable, or unsafe child care arrangements; others have to forgo employment. Similarly, although studies have shown that families — and especially children — benefit when they use federal housing vouchers to relocate to lower-poverty areas with more jobs and better schools, only about one-quarter of the families eligible for vouchers receive any housing assistance due to funding limitations. Nearly 3 million low-income families with children now pay more than half of their income for housing.

- **Maintaining the quality of government services.** There are several areas where increased resources will be needed for the government to do an adequate job. One is IRS enforcement. The “tax gap” — the gap between what taxpayers owe and what is actually collected — is estimated at upwards of \$300 billion a year. Expanded IRS tax enforcement is essential to reducing the tax gap; the IRS currently lacks the resources to do the job that is needed. Given the massive budget holes the nation will face in coming decades, this matter badly needs to be addressed.

There also is growing concern about the federal workforce. For years, the federal workforce has been squeezed down, even as Congress has placed more tasks on many federal agencies. A large cohort of dedicated, highly skilled individuals who joined federal service between the 1960s and the early 1980s is now approaching retirement.

⁷ Testimony of Lawrence H. Summers before the Joint Economic Committee, January 31, 2007.

Unfortunately, the workforce coming up behind these highly skilled individuals is, in many agencies, quite thin — in no small part because years of reductions in real resources for agency staffing made it difficult for many agencies to hire talented new blood in adequate numbers. There is growing risk that performance will decline significantly in the coming decade. While more is needed than simply infusions of resources, additional resources for staffing are a necessary (though not sufficient) condition to averting a marked deterioration in performance.

In certain other discretionary programs as well, multiple years of inadequate funding have had an adverse effect. One example is the national park system, which the Administration now acknowledges has suffered as a result of recent funding cuts; the Administration has proposed to boost funding for the parks in its 2008 budget, and additional increases may prove necessary. Another example is the military health care system, whose difficulties — exemplified by the problems recently uncovered at Walter Reed Medical Center — appear to reflect in part the lack of resources to handle the large number of servicemen and women returning from Iraq and Afghanistan. In cases like these, additional funds are likely to be needed to repair the damage caused by previous underinvestment. (The veterans’ medical care system, which is administered separately

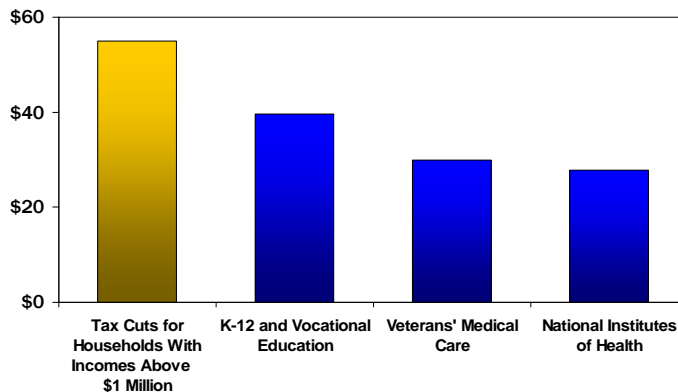
Are Resources Available to Address These Needs?

Domestic discretionary funding will continue to decline as a share of the economy in coming years — meaning that these programs will use a shrinking share of the nation’s resources — even if modest increases are made in this part of the budget. As noted in this report, the drivers of the nation’s long-term fiscal problems are rising health care costs, the aging of the population, and the 2001 and 2003 tax cuts if they are extended but not paid for. These three factors dwarf the budgetary impact of targeted investments in domestic programs.

For example, when the 2001 and 2003 tax cuts are fully in effect, their annual cost just for households with incomes of more than \$1 million (the top 0.3 percent of households) will exceed the *total* amount the federal government devotes each year to K-12 and vocational education. It will also exceed the total amount the federal government spends on veterans’ health care, or to fund the National Institutes of Health.

Cost of Tax Cuts for Highest Income Households Compared to Spending on Various Priority Programs

2006 Program Expenditures; Tax Cuts If Fully in Effect in 2006



Source: CBPP calculations based on Tax Policy Center, CBO, & Treasury Department data.

from health care provided to active military personnel, as at Walter Reed, will need growing resources as well.)

Savings can and should be found in various other discretionary programs to help pay for additional investments in the areas discussed above. The savings that can be achieved, however, are likely to fall well short of the costs of the needed investments. Addressing these issues will require an increase in overall funding for non-defense discretionary programs, which the nation should readily be able to afford if policymakers make the tough choices needed in other parts of the budget, as discussed above.