

■ In 2008, about three-fifths of federal expenditures went to three areas: defense and security, Social Security, and the major health insurance programs (Medicare, Medicaid, and the Children's Health Insurance Program).

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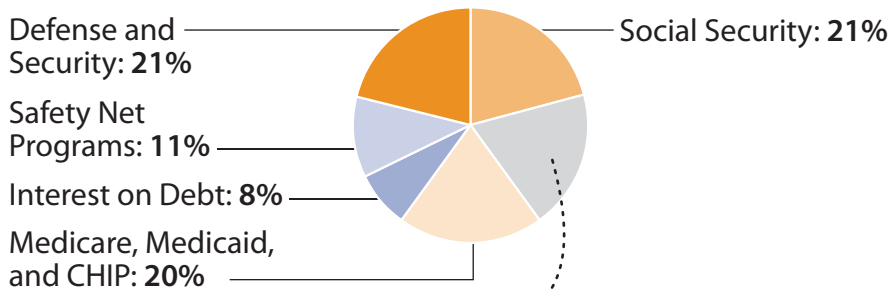
The federal government collects taxes in order to finance various public services. As policymakers weigh key decisions about revenues and expenditures, it is instructive to examine the recent usage of federal tax dollars.

In fiscal year 2008, the federal government spent \$3 trillion, amounting to 21 percent of the nation's Gross Domestic Product (GDP). While 2008 expenditures — as a share of GDP — slightly exceeded those of recent years, they roughly equaled the average for the last three decades. Of that \$3 trillion, more than \$2.5 trillion was financed by federal tax revenues. The remaining \$459 billion was financed by borrowing; this deficit will ultimately be paid for by future taxpayers. (See box on page 3 for the recession's impact on the budget.)

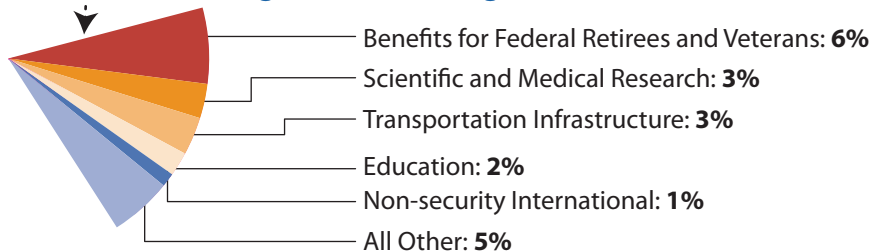
As shown in the graph below, three major areas of spending each made up about one-fifth of the budget:

- **Defense and security:** In 2008, some 21 percent of the budget, or \$625 billion, went to pay for defense and security-related international activities. The bulk of the spending in this category reflects the underlying costs of the Department of Defense and other security-related activities. The total also includes the cost of supporting operations in Iraq and Afghanistan, for which Congress appropriated approximately \$188 billion in 2008 (note that this amount represents funding, not actual spending).
- **Social Security:** Another 21 percent of the budget, or \$617 billion, went to Social Security, which provided retirement benefits averaging \$1,041 per month to 35 million retired workers (and their eligible dependents) in September 2008. Social Security also provided survivors' benefits to 6.4 million surviving children and spouses of deceased workers and disability benefits to 9.1 million disabled workers and their eligible dependents in September 2008.
- **Medicare, Medicaid, and CHIP:** Three health insurance programs — Medicare, Medicaid, and the Children's Health Insurance Program (CHIP) — together accounted for 20 percent of the budget in 2008, or \$599 billion. Nearly two-thirds of this amount, or \$391 billion, went to Medicare, which provides health coverage to around 45 million people who are over the age of 65 or have disabilities. The remainder of this category funds Medicaid and CHIP, which in a typical month in 2008 provided health care or long-term care to about 55 million low-income children, parents, elderly people, and people with disabilities. Both Medicaid and CHIP require matching payments from the states.

Most of Budget Goes Toward Defense, Social Security, and Major Health Programs



Program Areas in the Remaining Fifth of the Budget



Source: Congressional Budget Office, 2008.

Note: Percentages may not total 100 due to rounding.

Two other categories each accounted for about one-tenth of federal spending:

- **Safety net programs:** About 11 percent of the federal budget in 2008, or \$313 billion, supported programs that provide aid (other than health insurance or Social Security benefits) to individuals and families facing hardship.

These programs include: the refundable portion of the earned-income and child tax credits, which assist low- and moderate-income working families through the tax code; programs that provide cash payments to eligible individuals or households, including Supplemental Security Income for the elderly or disabled poor and unemployment insurance; various forms of in-kind assistance for low-income families and individuals, including food stamps, school meals, low-income housing assistance, child-care assistance, assistance in meeting home energy bills; and various other programs such as those that aid abused and neglected children.

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2009 Budget Outcomes Were Highly Unusual

Due to one of the worst economic downturns since the Great Depression – and the policies enacted to combat it – 2009 tax and spending levels diverged sharply from recent patterns. Preliminary data show that federal revenues plunged to less than 15 percent of GDP in 2009, the lowest level in decades. The efforts to prevent collapse of the financial system and to deal with the failure of Fannie Mae and Freddie Mac, the automatic expansion of programs like unemployment insurance and food stamps (which always grow during economic downturns to meet rising need), and spending from the February 2009 stimulus package together pushed federal outlays to almost 25 percent of GDP. The deficit reached record levels.

Under current policies, federal spending and revenues will gradually return to more normal levels that resemble fiscal year 2008. It will take the economy several years to fully recover, and during that time federal revenues and expenditures will continue to differ from historical experience.

- **Interest on the national debt:** The federal government must make regular interest payments on the money it has borrowed to finance past deficits — that is, on the national debt, which reached \$5.8 trillion by the end of fiscal 2008. In 2008, these interest payments (net of some interest income) claimed \$253 billion, or a little more than 8 percent of the budget.

As the graph shows, the remaining 19 percent of federal spending goes to support a wide variety of other public services. These include providing health care and other benefits to veterans and retirement benefits to retired federal employees, assuring safe food and drugs, protecting the environment, and investing in education, scientific and medical research, and basic infrastructure such as roads, bridges, and airports. A very small slice of this remaining 19 percent — about 1 percent of the total budget — goes for non-security programs that operate internationally, including programs that provide humanitarian aid.

While critics often decry “government spending,” it is important to look behind the rhetoric and determine whether the actual public services that government provides are valuable. To the extent that such services are worth paying for, the only way to do so is ultimately with tax revenue. Consequently, when thinking about the costs that taxes impose, it is essential to balance those costs against the benefits the nation receives from public services.

The broad expenditure categories presented in this paper were constructed on the basis of classifications commonly used by budget agencies. The categories are constructed by grouping related programs and activities into broad functions, which are further broken down into subfunctions. The details of how the categories used in this paper were constructed from those functions and subfunctions are described below.

Defense and security: The largest component of the “defense and security” category is the national defense function (050). In addition, this category includes the international security assistance subfunction (152) of the international affairs function.

Social Security: This category consists of all expenditures in the Social Security function (650), including benefits and administrative costs.

Medicare, Medicaid, and CHIP: This category consists of the Medicare function (570), including benefits, administrative costs, and premiums, as well as the “Grants to States for Medicaid” account and the “children’s health insurance fund” account (both in 550).

Safety net programs: This category of programs includes all programs in the income security function (600) except those that fall in the following two subfunctions: federal employees’ retirement and disability (602) and general retirement and disability insurance (601). The latter contains the Pension Benefit Guarantee Corporation and also covers programs that provide pension and disability benefits to certain small groups of private sector workers.

Interest on the national debt: This category contains the net interest function (900).

Everything else: This category includes all federal expenditures not included in one of the five categories defined above. The subcomponents of this category that are displayed in the graph are defined as follows:

- *Benefits for civilian retirees and veterans:* This subcategory combines the veterans benefits and services function (700) and the federal employee retirement and disability subfunction (602, which is part of the income security function).

- *Education:* The education subcategory combines three subfunctions of the education, training, employment, and social services function: elementary, secondary, and vocational education; higher education; and research and general educational aids (subfunctions 501, 502, and 503 respectively).
- *Scientific and medical research:* This subcategory consists of the general science, space, and technology function (250), the energy function (270), and two subfunctions in the health area: health research and training (subfunction 552) and health care services (subfunction 551), excluding Medicaid and CHIP.
- *Transportation:* This subcategory consists of the entire transportation function (400).
- *Non-security international:* This subcategory consists of the international affairs function (150) except for international security assistance, which is included with defense, above.
- *All other:* This subcategory consists of all other federal expenditures.