

7. Federal Budget and Spending

FEDERAL spending has reached \$22,000 per household, in constant dollars, for the first time since World War II. “Discretionary” spending voted on each year by Congress has jumped 49 percent in just three years, and entitlement spending nears 11 percent of gross domestic product (GDP) for the first time ever. Furthermore, the upcoming retirement of the baby boomers will put an enormous strain on Social Security, Medicare, and Medicaid and sharply increase spending. It is imperative for lawmakers to get the nation’s finances in order immediately by restructuring entitlement programs and reducing federal spending. Putting off the difficult decisions until the federal budget’s condition deteriorates further will result in much harsher and more expensive policy choices.

by *Brian M. Riedl*

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Recommendations

- 1. Freeze 2007 discretionary spending and remember that the core problem is runaway federal spending, not the budget deficit or taxes that are too low.** Current budget deficits are merely a symptom of a larger problem: runaway spending. Lawmakers should prioritize economic growth and the low taxes needed to spur growth and recognize that runaway spending represents the most dangerous long-term threat to pro-growth tax relief. As long as federal spending remains low enough to maintain a prosperous, low-tax economy, the budget deficit will solve itself. A positive first step would be freezing 2007 discretionary spending at the 2006 level.
- 2. Rein in runaway entitlement spending.** The retirement of 77 million baby boomers could well push Social Security, Medicare, and Medicaid spending to unsustainable levels. The total cost of Social Security, Medicare, and Medicaid is projected to leap from today’s 8.4 percent of GDP to 18.9 percent of GDP by 2050. In the absence of reform, lawmakers face three options: (1) raise taxes every year until they are 57 percent (\$11,000 per household) higher than today; (2) eliminate every federal program except Social Security, Medicare, and Medicaid by 2045; or (3) do nothing and watch the federal debt expand so that even a minor interest rate response would induce a spiral of rising debt and interest

rates, threatening the entire economy. Clearly, reforming these programs is the only real option.

3. Reform the budget process. The current budget process encourages runaway federal spending because of its incentives and rules. Budget resolutions are rarely enforced, meaningful spending caps are absent, and lawmakers can create major new entitlements without proposing any plan to pay for them. Senators and Representatives who generally support spending restraint should not also seek earmarked pork-barrel spending or special programs. Budget process reform should be based on four principles: (1) establish a limit on overall spending; (2) present a full picture of future obligations in the budget; (3) bring the President into the budget process, mainly by giving the budget resolution the full force of an act of Congress; and (4) strengthen the enforcement of budget decisions.

Facts and Figures

■ Entitlement programs that unfairly obligate future taxpayers, including middle-class entitlements like Medicare, are growing at unsustainable rates, and the result could be huge tax increases for future generations.

■ Between 2004 and 2006, tax revenues are projected to rise by an unprecedented \$420 billion. This 22 percent jump—the largest two-year surge since 1976–1978, when soaring inflation and bracket creep steeply increased tax revenues—is partly the result of the 2001 and 2003 tax cuts, which increased incentives to work, save, and invest. Letting the tax cuts expire would harm businesses, families, and the economy. Moreover, history shows that any new revenues would just go to new spending.

■ President Bush's 2007 budget request proposes freezes or near-freezes in most non-defense discretionary programs. However, these programs represent less than one-fifth of federal spending and cannot yield the savings needed. Entitlement spending is projected to nearly double over the next decade. Medicare is expanding by 9 percent annually, Medicaid by 8 percent annually, and Social Security by 6 percent annually.

■ Earmarked pork-barrel projects have increased nearly 1,000 percent over the past 10 years, diverting limited federal resources to low priorities and frivolous projects, circumventing the competitive award process, pre-empting state and local decision making, and increasing the risk of questionable budgeting practices. Using transportation funds

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to restore theaters and housing assistance funds to build nature centers are just two of the many examples that violate the general principles of good budgeting and honest accounting.

■ It is a myth that social spending has already been slashed and contains no available savings. From 2001 through 2006, education spending will have leaped 137 percent, health research and regulation will have increased by 78 percent, and anti-poverty spending will have surged by 39 percent to reach a record 16 percent of the federal budget.

■ Lawmakers still cling to the antiquated budget process created back in 1974. Successive Congresses have punched this process full of holes, and federal spending has correspondingly tripled. The current budget process provides no workable tools to limit spending, no restrictions on passing massive costs on to future generations, and no incentive to bring all parties to the table early in the process to set a framework.

■ Comprising two-thirds of all federal spending and growing by 7 percent annually, mandatory spending can no longer be taken off the table during the budget process. Spending caps have kept discretionary spending under control in the past and can work for mandatory programs as well.

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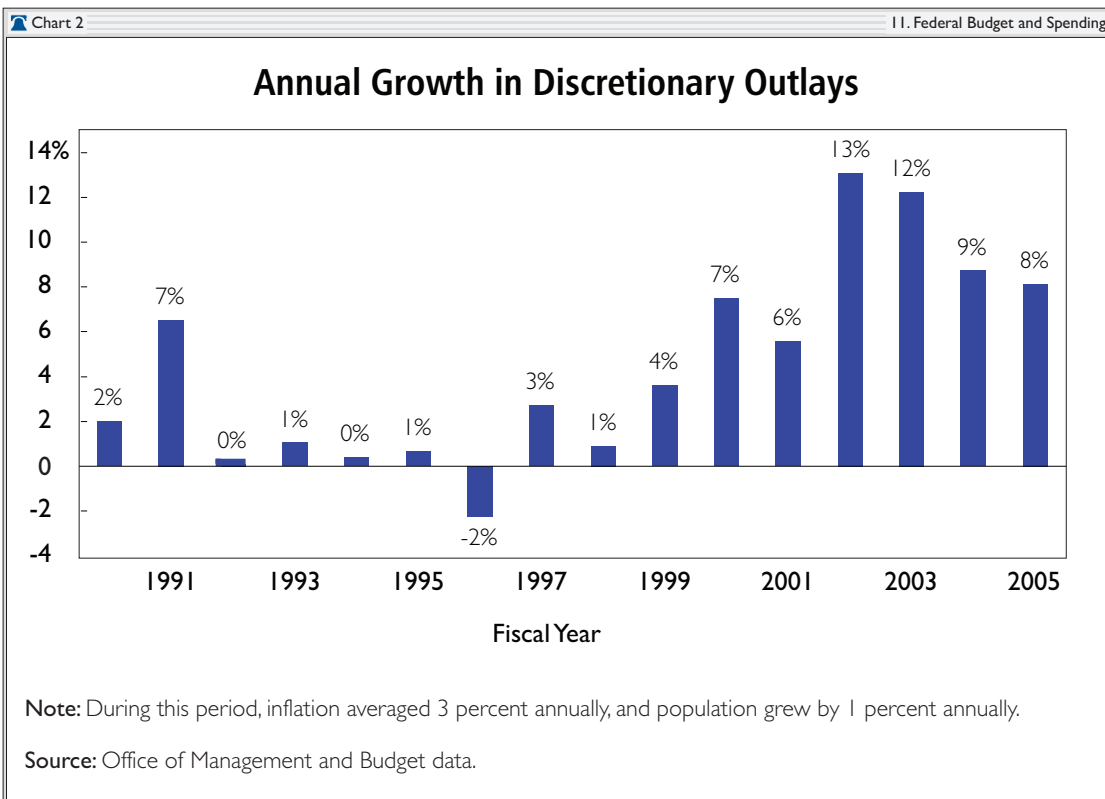
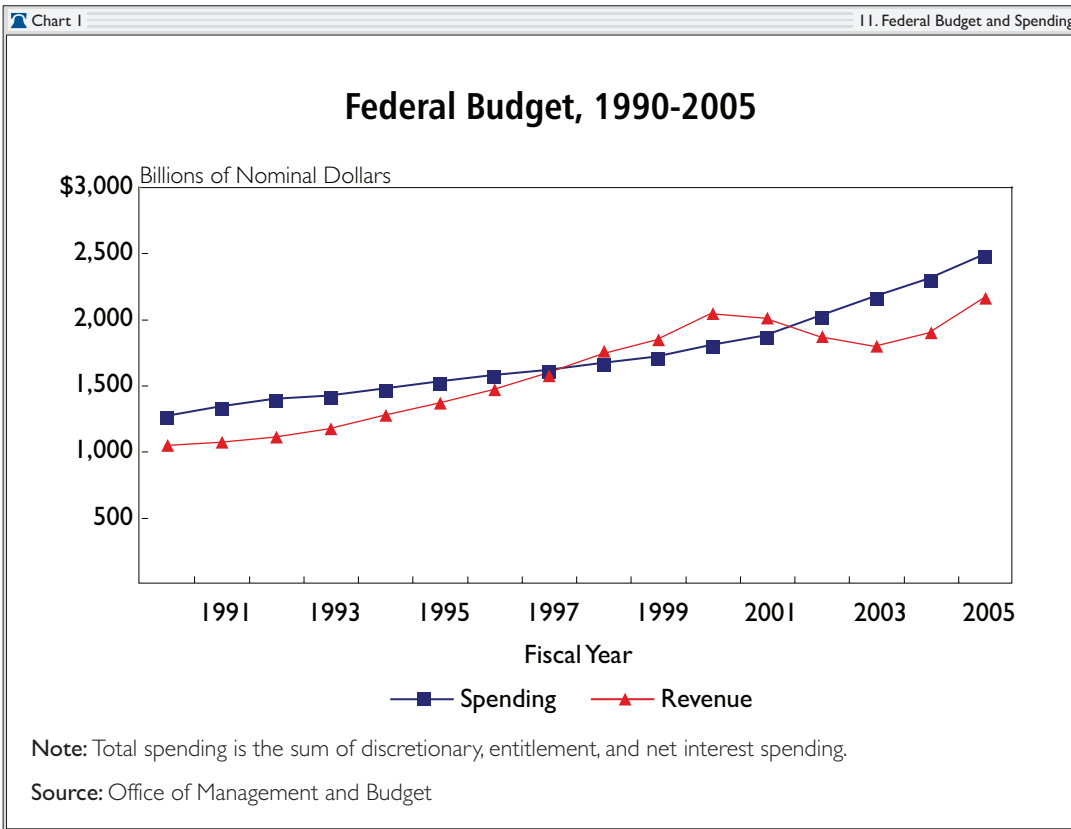


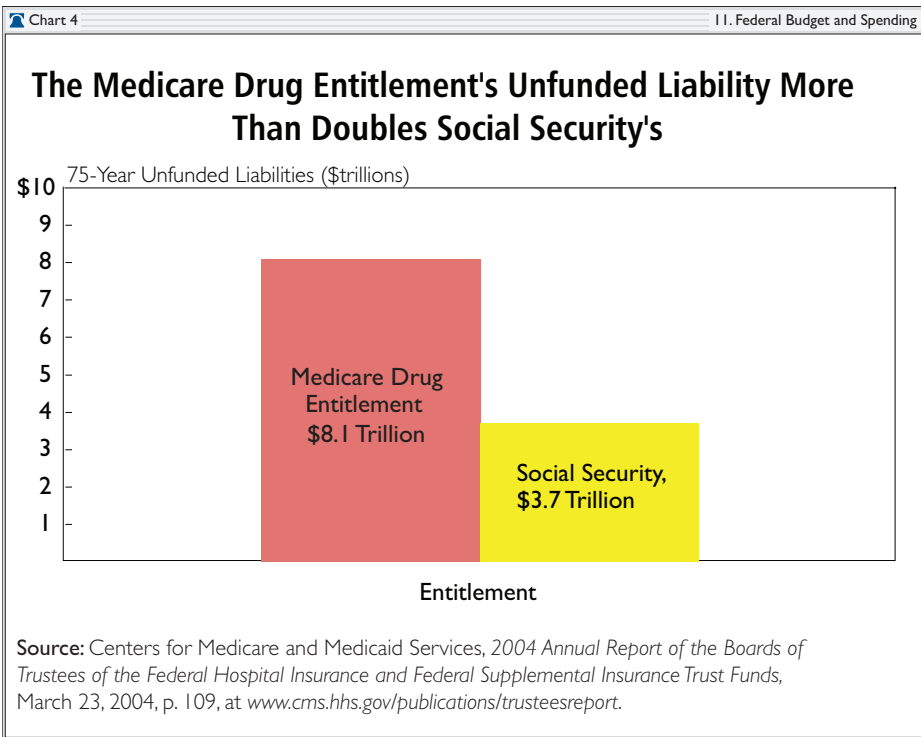
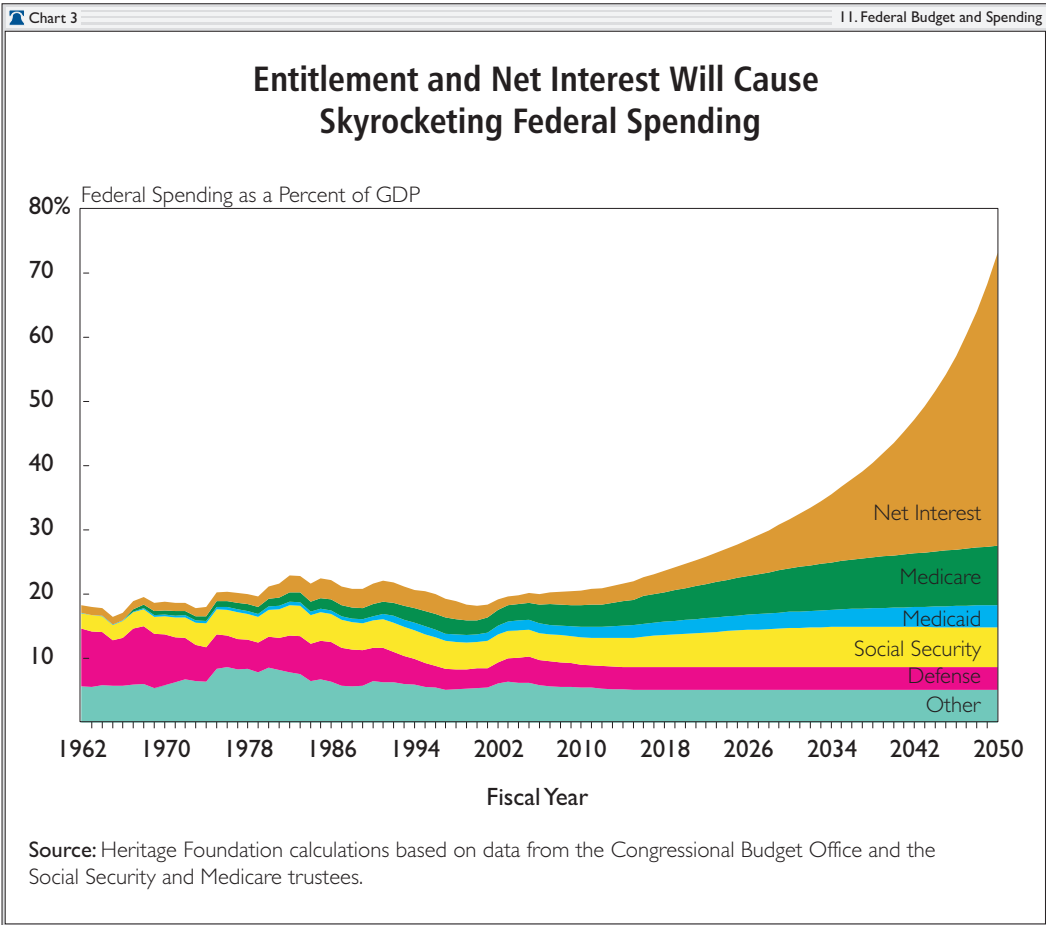
Table 1 11. Federal Budget and Spending

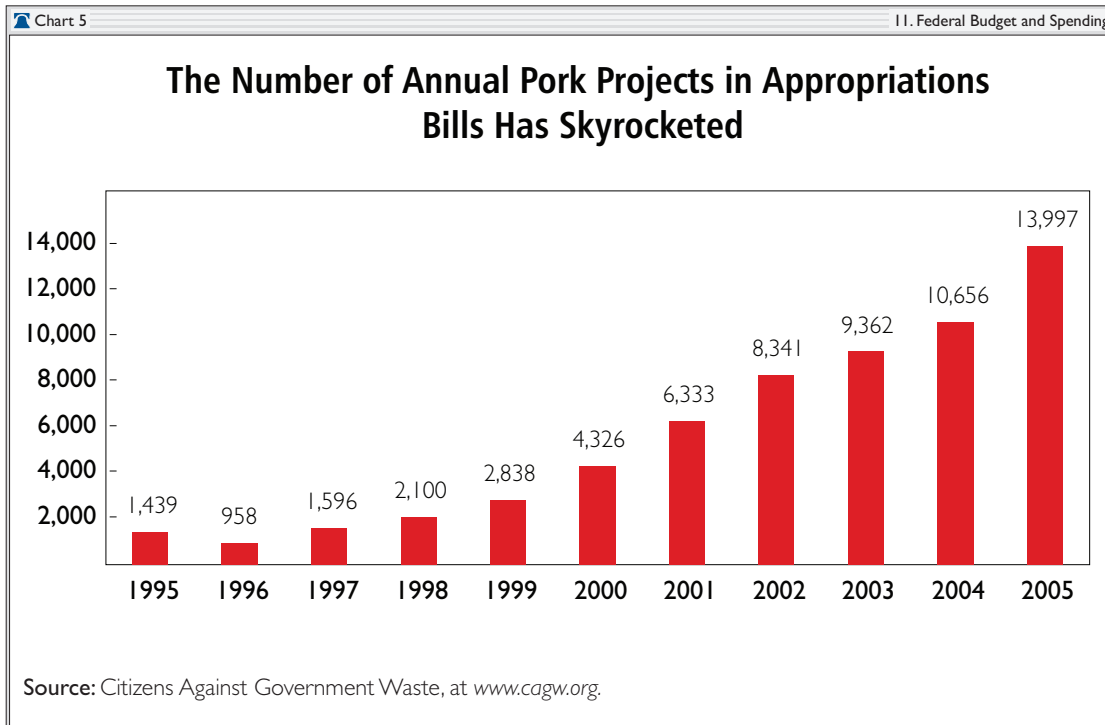
Federal Spending By Category, 2001-2006

Spending Category	Total Outlays in Millions		2001-2006 Increase		
	2001	2006	Amount	Percentage	Avg. Annual
Social Security	\$432,958	\$554,740	\$121,782	28%	5.1%
National Defense	304,882	535,943	231,061	76%	11.9%
Medicare	217,384	342,987	125,603	58%	9.5%
Income Security Programs	152,640	215,690	63,050	41%	7.2%
Medicaid	129,374	192,334	62,960	49%	8.3%
Federal Retirement & Disability	80,972	99,180	18,208	22%	4.1%
Education	35,203	83,480	48,277	137%	18.9%
Veterans Benefits	45,039	70,410	25,371	56%	9.3%
Health Research and Regulation	42,896	76,455	33,559	78%	12.3%
Highways & Mass Transit	35,804	45,783	9,979	28%	5.0%
Justice Administration	30,205	41,342	11,137	37%	6.5%
Unemployment Benefits	30,242	38,554	8,312	27%	5.0%
International Affairs	16,493	34,750	18,257	111%	16.1%
Natural Resources & Environment	25,623	32,731	7,108	28%	5.0%
Farm Subsidies	26,253	26,846	593	2%	0.4%
Community & Regional Development	11,773	52,025	40,252	342%	34.6%
Training, Employment, Social Services	21,940	26,171	4,231	19%	3.6%
General Science, Space & Technology	19,784	23,996	4,212	21%	3.9%
Air Transportation	13,975	18,581	4,606	33%	5.9%
General Government	14,260	19,085	4,825	34%	6.0%
Housing and Commerce	5,739	9,087	3,348	58%	9.6%
General Retirement & Disability Insurance	5,761	7,208	1,447	25%	4.6%
Water Transportation	4,668	7,273	2,605	56%	9.3%
Energy	9	2,621	2,612	29022%	211.1%
Undistributed Offsetting Receipts/Other	-47,011	-68,648	-21,637	46%	7.9%
Net Interest	206,167	220,053	13,886	7%	1.3%
Total Spending	1,863,033	2,708,677	845,644	45%	7.8%

Note: From 2001 through 2006, inflation will have totaled 12 percent, and population will have grown by 5 percent. Numbers for 2006 reflect current OMB estimates. Additional supplemental spending will add to this total.

Source: Heritage Foundation calculations based on Office of Management and Budget data.





This chapter can be read online at issues2006.org/federalespending.

Additional Reading

Brian M. Riedl, “The Myth of Spending Cuts for the Poor, Tax Cuts for the Rich,” Heritage Foundation *Backgrounder* No. 1912, February 14, 2006, at www.heritage.org/Research/Budget/bg1912.cfm.

Brian M. Riedl, “Federal Spending: By the Numbers,” Heritage Foundation *WebMemo* No. 989, February 6, 2006, at www.heritage.org/Research/Budget/wm989.cfm.

Brian M. Riedl, “Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected,” Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, at www.heritage.org/Research/Budget/bg1897.cfm.

Brian M. Riedl, “Restrain Runaway Spending with a Federal Taxpayers’ Bill of Rights,” Heritage Foundation *Backgrounder* No. 1793, August 27, 2004, at www.heritage.org/Research/Budget/bg1793.cfm.