



# Trends in Discretionary Spending

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## Summary

Discretionary spending is provided and controlled through appropriations acts, which fund many of the activities commonly associated with such federal government functions as running executive branch agencies, congressional offices and agencies, and international operations of the government. Essentially all spending on federal wages and salaries is discretionary.

FY2008 federal spending accounted for just over a fifth (20.9%) of the U.S. economy, nearly equal to its average share of gross domestic product (GDP) since FY1962. While discretionary spending was the largest component of federal spending until the mid-1970s, mandatory spending now accounts for about 3% more of GDP than discretionary spending.

From FY1962, when discretionary spending accounted for 47.2% of total outlays, to FY2008, discretionary spending's share of federal outlays has fallen by almost a fifth. Over time, discretionary spending has fallen as a percentage of GDP because it has grown slower than the overall economy. Rapid growth of entitlement outlays and slower growth in defense spending relative to other federal spending are two major causes of the long-term fall in discretionary spending's share of federal spending.

Discretionary spending is often divided into defense, domestic discretionary, and international outlays. Defense and domestic discretionary spending compose nearly all of discretionary spending. In FY1962, discretionary spending equaled 12.3% of GDP, with defense spending making up 9.0% of GDP. In FY2008, total discretionary spending fell to 7.9% of GDP with defense spending totaling 4.3% of GDP. However, over the last six years, military spending has increased sharply. On average, from FY1999 to FY2008, defense outlays grew 8% per year in real terms, while non-defense discretionary outlays grew 2.5% per year in real terms.

Increases in discretionary spending are likely over the next several fiscal years due to the current economic turmoil and resulting federal intervention to stimulate the economy. Over the long term, projected future growth in entitlement program outlays may put severe pressure on discretionary spending unless policies changes are enacted or federal revenues are increased.

This report will be updated annually.

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## What Does Discretionary Spending Include?<sup>1</sup>

Discretionary spending is provided in, and controlled by, annual appropriations acts, which fund many of the routine activities commonly associated with such federal government functions as running executive branch agencies, congressional offices and agencies, and international operations of the government.<sup>2</sup> Essentially all spending on federal wages and salaries is discretionary.<sup>3</sup>

Discretionary spending is often contrasted with mandatory, or direct, spending. Mandatory spending includes federal spending on entitlement programs, the Food Stamp program, and other spending controlled by laws other than appropriation acts.<sup>4</sup> Spending levels for mandatory programs are generally controlled by eligibility criteria and size of the eligible population.

## Budget Authority and Outlays

The distinction between outlays and budget authority is important to understanding the federal budget and, particularly, discretionary spending. Appropriations legislation, which controls discretionary spending, grants budget authority to accomplish specific ends. Budget authority is what federal agencies can legally spend. Budget authority has been compared to funds deposited into a checking account, which then can be used for specified federal purposes. Outlays are disbursed federal funds. Therefore, an outlay is not recorded until the federal government disburses appropriated funds to purchase goods and services.

**Table 1** illustrates the different categories of federal spending (i.e., mandatory and discretionary spending) by contrasting the type of budget authority needed for specific purposes.

**Table 1. Categories of Federal Spending**

	Budget Authority Provided by Law Other than Appropriation Acts	Budget Authority Provided by Appropriation Acts
Entitlement	Medicare Social Security	Appropriated Entitlements (e.g., veterans' compensation, Medicaid, TANF) Food Stamps (with caveats)
Not an Entitlement	Salaries for Members of Congress Mandatory non-entitlements (e.g., Forest Service payments to states)	Discretionary Spending <sup>a</sup> (defense, non-defense domestic discretionary, and international)

**Source:** Compiled by CRS.

a. Discretionary spending programs. See discussion in text.

<sup>1</sup> This report was originally written by Philip Winters, who has retired from CRS.

<sup>2</sup> Annual appropriations acts fall within the jurisdiction of the House and Senate Appropriations Committees.

<sup>3</sup> Exceptions exist. For example, salaries for Members of Congress, the President, and federal judges are classified as mandatory spending, as are essentially all federal retirement and disability costs. Direct spending is controlled by committees with legislative jurisdiction.

<sup>4</sup> For more information, see CRS Report RL33074, *Mandatory Spending Since 1962*, by D. Andrew Austin and Mindy R. Levit.

Outlay data are used to assess the macroeconomic effects of the federal budgets, while budget analysis of specific federal programs is typically based on budget authority, because that is what Congress controls most directly. Congressional appropriations, which grant budget authority for specific purposes, are not always tightly linked to changes in outlays in the following year. While budget authority can be granted for a single year, some appropriations (such as for many military construction projects) provide budget authority for multiple years, or indefinitely. Thus outlays that flow from an appropriated sum might be spread over several fiscal years, implying that budget authority totals will differ from outlay totals for a single fiscal year.<sup>5</sup>

## Trends in Discretionary Spending

The composition of the federal budget has changed dramatically since the early 1960s. Over time, the share of total discretionary spending in federal spending has fallen, while the share of mandatory spending has increased. Discretionary spending accounted for 67.5% of total outlays in FY1962, but only an estimated 38.1% of total outlays in FY2008.<sup>6</sup> Mandatory spending, by contrast, rose from 26.1% of total outlays in FY1962 to 53.7% in FY2008.

In contrast to the longer term trends, between FY1999 and FY2008, discretionary spending grew more quickly than mandatory spending. After falling for three decades between the late 1960s and the late 1990s, discretionary spending increased 5.1% a year in real terms on average from FY1999 to FY2008. Over the same period, the share of discretionary spending as a proportion of federal outlays grew from 33.6% in FY1999 to 38.1% in FY2008.

## How has the Composition of Discretionary Spending Changed?

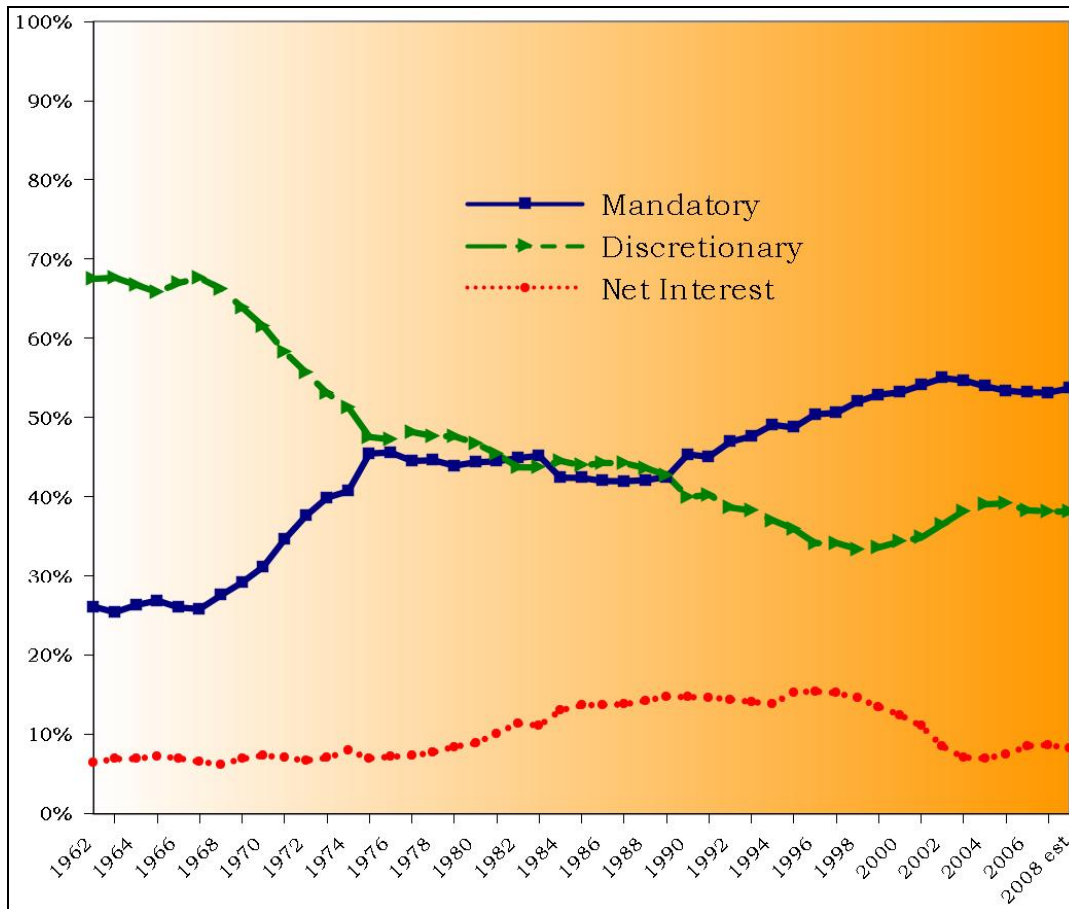
In FY1962, discretionary spending comprised 67.5% of total outlays, with mandatory spending and net interest accounting for 26.1% and 6.5%, respectively. Discretionary spending as a share of total outlays reached its peak in FY1963. By FY2008, discretionary spending fell to an estimated 38.1% of total outlays. Mandatory spending accounted for an estimated 53.7% of total outlays, with net interest at 8.2% in FY2008. **Figure 1** shows discretionary spending, mandatory spending, and net interest payments in relation to total outlays since 1962.

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<sup>5</sup> While federal officials often have some discretion to choose how quickly appropriated funds are spent, they face constraints imposed by legislation designed to protect Congress's power of the purse. According to the Anti-Deficiency Act, a federal official cannot spend government money beyond what is available through appropriations or a fund by law. See General Accountability Office, *Antideficiency Act Background*, available at <http://www.gao.gov/ada/antideficiency.htm> for code citations and explanations. The Congressional Budget Act and Impoundment Control Act of 1974 (P.L. 93-344) limits the ability of federal officials to withhold or delay spending of appropriated funds without Congressional approval.

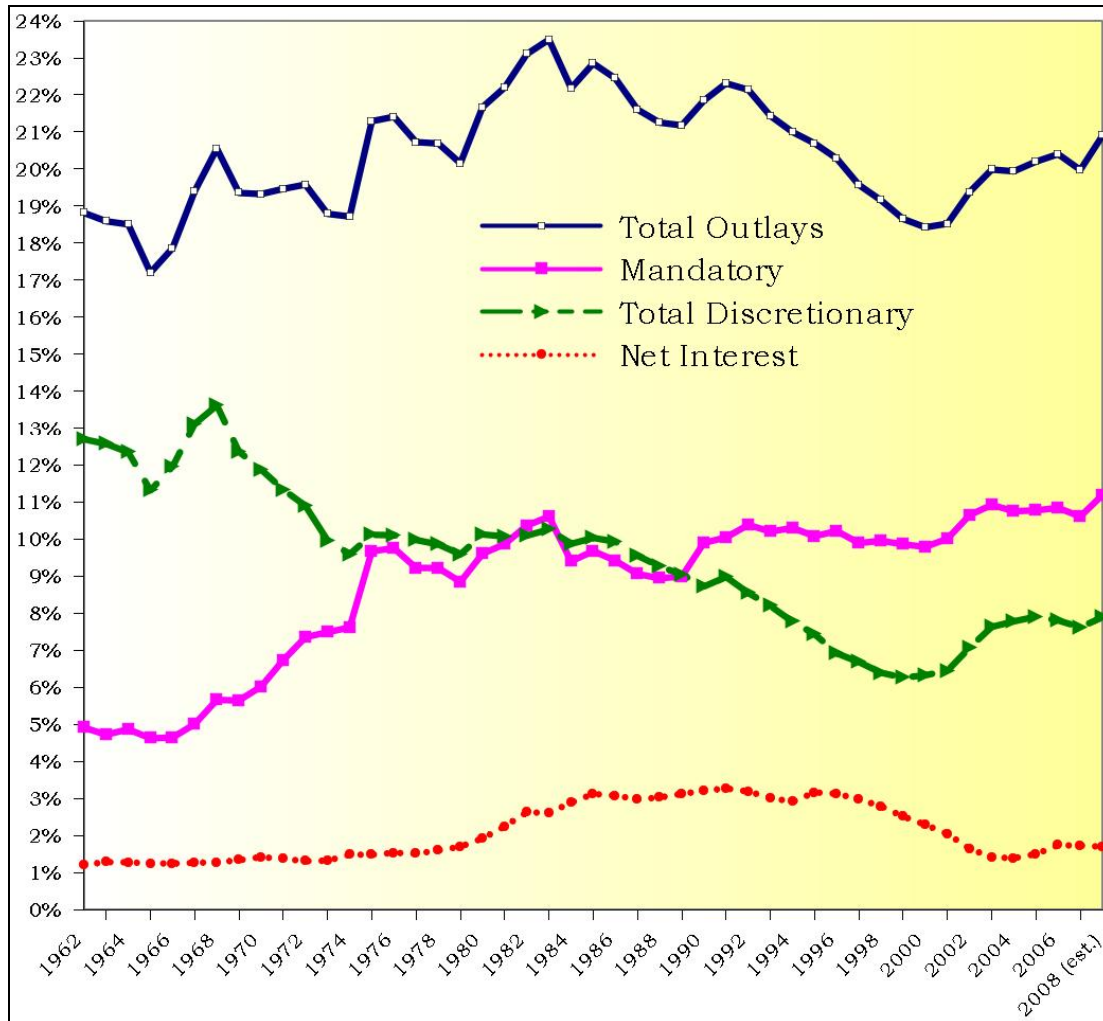
<sup>6</sup> CBO figures for discretionary and mandatory spending and their components are used in all calculations. The Bureau of Economic Analysis GDP deflator is used to adjust for inflation.

**Figure 1. Components of Federal Spending as a Percentage of Total Outlays, FY1962 – FY2008**



**Source:** OMB data, CRS calculations. Data for FY2008 are estimated.

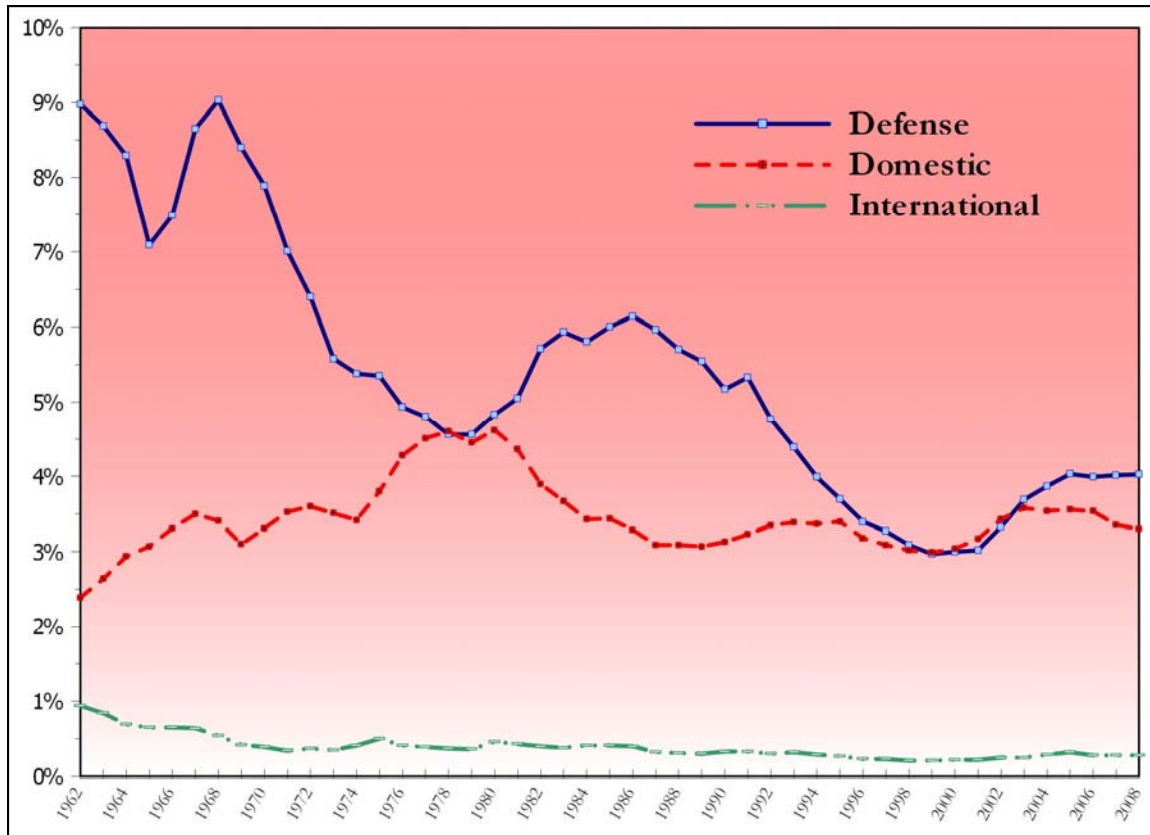
Another way to look at the changing composition of discretionary spending is to examine it as a share of GDP. Measuring budget components as a share of GDP compares their size to the economy as a whole. **Figure 2** shows components of federal spending as a percentage of GDP since FY1962. While discretionary spending was the largest component of federal spending until the mid 1970s, mandatory spending now accounts for about 3% more of GDP than discretionary spending. Medicare and Medicaid have continued to grow faster than overall federal spending, contributing to the majority of the increase in mandatory spending over this period. Social Security spending, the other large component of mandatory spending, has been relatively stable in the last decade when measured as a share of GDP.

**Figure 2. Components of Federal Spending as a Percentage of GDP, FY1962-FY2008**

**Source:** OMB data, CRS calculations. Data for FY2008 are estimated.

Because of the decline in discretionary spending as a percentage of total outlays and the resulting increase in the share of mandatory spending over time, controlling the federal budget may have become more difficult for Congress. In other words, because mandatory spending is set automatically, less money is available to allocate to other government agencies and programs unless revenues rise or Congress modifies eligibility requirements and benefits of mandatory spending programs.

In addition to these measures of spending, CBO also subdivides discretionary spending into defense, domestic, and international categories. **Figure 3** shows these categories of discretionary spending as a share of GDP over the period FY1962-FY2008. Defense spending, 73% of total discretionary spending in FY1962, accounted for 53.8% of discretionary spending in FY2008. In terms of GDP, discretionary defense spending fell from 9.5% GDP in FY1968 to 4.3% in FY2008. Over the same period, domestic and international discretionary spending have changed less dramatically as a percentage of GDP. Domestic discretionary spending did increase in the 1970s but has since fallen, remaining closer to its period average.

**Figure 3. Discretionary Outlays by Type, FY1962-FY2008**

Source: CBO and OMB data, CRS calculations. Data for FY2008 are estimated.

## Discretionary Defense Spending

Since the late 1960s, defense spending grew more slowly than federal spending in other areas. Some contend that defense expenditures as a proportion of GDP should be expected to fall over the long term because the cost of defending the nation depends on factors that are largely independent of economic growth.

Defense spending increased sharply in the mid-1960s as the United States' involvement in Vietnam deepened. After large-scale withdrawals of American troops from Vietnam began in 1969, defense spending as a share of GDP fell for the next decade. The Soviet invasion of Afghanistan prompted the Carter Administration, and then the Reagan Administration, to boost military expenditures resulting in an increase in defense spending during the early 1980s. After the Berlin Wall was opened in November 1989 and communist governments in central and eastern Europe collapsed, defense spending as a share of GDP dropped to historically low levels, providing what some called a "peace dividend." Defense spending again rose after the attacks of September 11, 2001, and wars in Afghanistan and Iraq began.

Increased defense spending accounts for 75.6% of the increase in discretionary spending in the past decade. Discretionary defense spending increased 8% a year in real terms on average



between FY1999 and FY2008.<sup>7</sup> Discretionary defense spending, which had fallen to 3% of GDP by the late 1990s, rose sharply to 4.0% of GDP in FY2005, and reached an estimated 4.3% of GDP in FY2008. Defense spending increases, however, were concentrated in the past six years, while non-defense discretionary spending has grown more gradually. The trajectory of future defense discretionary spending depends in large part on the scale of future operations in Iraq and Afghanistan.

## **Discretionary Non-defense Spending**

Trends in domestic non-defense discretionary spending are less dramatic. Non-defense spending supports the largest number of federal agencies and programs, including foreign affairs, science and technology research, natural resources, energy, education, and numerous others. None of the individual programs within the non-defense discretionary category have approached 1% of GDP since FY1962. Most of these programs spent less than 0.5% of GDP during that period.

Domestic non-defense discretionary spending, 2.5% of GDP in 1962, rose to a peak of 4.8% in 1980. Domestic non-defense discretionary spending's share of GDP fell during the Reagan Administration, reaching 3.1% of GDP in FY1987.<sup>8</sup> Since then it has fluctuated between 3.0% and 3.7% of GDP. CBO estimates that FY2008 domestic non-defense discretionary spending will account for 3.7% of GDP.

## **Discretionary International Spending**

Discretionary spending for international programs since FY1962 has averaged 0.4% of GDP, reaching its peak of 1.0% of GDP in FY1962. Since that time, international spending has generally trended downward. Between FY2001 and FY2008, spending on international programs rose from 0.2% of GDP to 0.3% of GDP. The majority of the funding in this category in recent times has been devoted to diplomatic missions, foreign aid, and international finance.

Although discretionary spending has increased rapidly in the past half decade, spending in some government departments and agencies has grown very slowly or has been cut, while spending in other areas has expanded rapidly. Funding for defense and emergency and disaster management increased sharply in the wake of hurricane Katrina, boosting overall discretionary spending further. In recent years, disaster funding has dropped sharply, allowing non-defense spending as a share of GDP to fall as well.

## **The FY2009 Budget and Beyond**

Congress and the President will begin dealing with budget issues in early 2009. Due to the transition to the Obama Administration, however, budget details might be unavailable in early February, thus effectively compressing the Congressional budget cycle and shortening the time available for Congress to review budget proposals. New shocks to the financial system and the

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<sup>7</sup> FY2008 data are estimated. Defense discretionary spending includes enacted supplemental requests.

<sup>8</sup> For a summary of Reagan-era spending changes, see David Stockman, *The Triumph of Politics* (New York: Harper&Row, 1986), pp. 401-411.

economy may present Congress with new demands for federal responses. Federal spending tied to means-tested social programs has been increasing due to rising unemployment, while federal revenues will likely fall as individuals' incomes drop and corporate profits sink. Funding requests for military operations in Iraq and Afghanistan will likely continue. New policies and requests, if implemented, could affect discretionary spending levels in FY2009.

In his final budget submission, President Bush's FY2009 budget called for limiting growth in defense and non-defense discretionary spending during the five years FY2009-FY2013. The proposals would reduce total discretionary spending in dollars, in real terms, as a share of GDP, and as a percentage of total federal spending over the five-year period. The 110<sup>th</sup> Congress enacted few of these proposed cuts in discretionary spending.

In President Bush's budget proposal, discretionary defense spending would rise from \$549.2 billion in FY2007 to \$670.7 billion in FY2009. After FY2009, proposed defense outlays fall, although this is largely due to the omission of war costs. Continuing current levels of war funding over the coming five years would slow the fall in defense spending as a percentage of GDP. The Bush Administration projected a fall in discretionary defense spending to 3.1% of GDP in FY2013.<sup>9</sup> The Bush Administration has made a priority of holding down growth in "non-security" discretionary spending.<sup>10</sup> After rising slightly in FY2008 and FY2009 from \$493 billion in FY2007, the Bush Administration proposed decreases in non-defense spending by FY2013.

## Current Situation

Most non-defense discretionary spending programs are now operating under a continuing resolution through March 6, 2009. With the inauguration of the new President, budgetary priorities may change as the new Administration and Congress confront ongoing financial and economic challenges while facing the need to complete funding for the remainder of FY2009 and begin consideration of the FY2010 budget. Given the current state of the economy, significant increases in discretionary spending, at least over the next several years, are likely.

The federal government has responded to this financial turmoil with an extraordinary set of measures. In February 2008, Congress enacted a \$152 billion package (P.L. 110-185, Economic Stimulus Act of 2008) to stimulate consumption that sent refunds to taxpayers and let firms depreciate their capital more quickly. Later in the year, the Federal Reserve created a panoply of lending facilities to provide financial institutions with loans in exchange for various types of collateral. On October 3, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343), which authorized the Treasury Secretary to use \$700 billion (subject to certain Congressional restrictions and notifications) to intervene in financial markets or to inject capital into key financial institutions as part of a Troubled Assets Relief Program (TARP).

In response to economic downturn, federal spending has increased and revenues have decreased. Slow growth is expected for the next few years. As the beginning of the 111<sup>th</sup> Congress

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<sup>9</sup> General Mike Mullen, Chairman of the Joint Chiefs of Staff, noted in an interview that the defense budget was now "just under 4% of GDP," and stated that "... I would see that in the future as an absolute floor." *New York Times*, October 22, 2007. Transcript available at <http://www.nytimes.com/2007/10/22/washington/22mullen-text.html>.

<sup>10</sup> The Bush Administration defined "security" discretionary funding as spending on the Department of Defense, Government-wide Homeland Security activities, and International Affairs.

approaches, many economists believe that another large fiscal stimulus is in order. The size, variety, and complexity of new stimulus in addition to previous federal responses to this turmoil present many challenges to budget analysis. The ultimate costs of these responses and their budgetary impact, especially with regard to discretionary spending levels, will depend on how the economy performs, how well firms with federal credit guarantees weather future financial shocks, and whether the government receives positive returns on its asset purchases.

## **Discretionary Spending in the Long Term**

The annual budget process, and the appropriations decisions in particular, provide Congress with the ability to change, continue, or reverse trends in discretionary spending. If discretionary spending were held constant in real terms, as the CBO baseline presumes, then discretionary spending per capita would decrease as population grows and it would shrink as a share of GDP as the economy grows. On average the U.S. population grew 1% a year and per capita GDP grew 2.25% per year from 1962 to 2005.<sup>11</sup> If those trends were to persist, then holding discretionary spending constant in real terms implies per capita discretionary spending would shrink by 1% a year and discretionary spending as a share of the economy would shrink by 3.25% per year.

Due to the current economic downturn, large-scale fiscal stimulus and aggressive spending measures intended to mitigate systematic risks in financial markets may be needed to limit serious damage to the economy. When economic recovery begins, and as soon as appropriate, many economists and policy makers hope that spending increases used to stimulate the economy will be reversed. At that point, it is suggested that attention turn to deficit reduction.

Over the long run, growth in entitlement spending will present severe fiscal challenges. Recent research on long-term fiscal challenges has focused on continued increases in the per beneficiary cost of health care, as well as the more predictable demographic changes that will occur as the baby boom generation retires. Projections from a variety of sources predict that spending on Medicare and Social Security will increase sharply as a share of GDP in coming decades.<sup>12</sup> CBO projects that Medicare will expand from 5.6% of GDP in 2030 to 14.8% in 2082 and that Social Security will grow from 6.1% of GDP in 2030 to 6.4% of GDP by 2082. Federal Medicaid outlays, 1.4% of GDP in FY2007, are projected to reach 17.6% of GDP in 2050.<sup>13</sup>

Social Security, Medicare, and Medicaid outlays as a proportion of GDP are projected to equal or exceed the present share of federal revenues as a proportion of GDP (17.7% in FY2007) sometime after the middle of the 21<sup>st</sup> century. Maintaining current levels of discretionary spending would then require either substantial tax increases or major changes in those entitlement programs.

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<sup>11</sup> These figures based on CRS calculations derived from CBO and Census Bureau data.

<sup>12</sup> See CBO, “*The Long-Term Budget Outlook*,” December 2007; point 10 of the United States of America—2006 Article IV Consultation, Concluding Statement of the IMF Mission, May 31, 2006; and CRS Report RL33623, *Long-Term Measures of Fiscal Imbalance*, by D. Andrew Austin.

<sup>13</sup> CBO, “*The Long-Term Budget Outlook: An Update*,” December 2007.

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