CHAPTER

4

The Long-Term Outlook for Other Federal Noninterest Spending

In 2015, almost half of the federal government's spending will go toward programs and activities other than the major health care programs (Medicare, Medicaid, the Children's Health Insurance Program, and the subsidies for health insurance purchased through exchanges), Social Security, and net interest. That spending—referred to in this report as other federal noninterest spending—includes outlays for discretionary programs, which are funded through the annual appropriation process, and outlays for mandatory programs other than the major health care programs and Social Security, which are usually funded according to laws that set eligibility and payment rules.[1] Mandatory spending in this category also includes the refundable portions of the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit, which are recorded in the budget as outlays.

Under the broad assumptions used for this analysis, the Congressional Budget Office projects that other federal noninterest spending would drop from a total of 9.1 percent of gross domestic product (GDP) in 2015 to 7.4 percent in 2025 and then to 6.9 percent in 2040:

- Discretionary spending, which equals an estimated 6.5 percent of GDP in 2015, would fall to 5.1 percent of GDP by 2025; for its extended baseline, CBO assumed that discretionary spending would remain fixed at its percentage of GDP in 2025 (see Figure 4-1).
- Mandatory spending other than that for the major health care programs and Social Security would decrease from 2.6 percent of GDP this year to 2.3 percent in 2025. For its extended baseline, CBO assumed that such spending—other than the portion related to refundable tax credits—would continue to fall relative to GDP at the same rate that occurred over the 2020–2025 period. (Refundable tax credits are estimated as part of the revenue projections, which are described in Chapter 5.) Putting those pieces together, other mandatory spending is projected to equal 1.8 percent of GDP in 2040.

Other Federal Noninterest Spending Over the Past 50 Years

During the past 50 years, federal spending for everything other than the major health care programs, Social Security, and net interest has averaged 12 percent of GDP. Such spending equaled 13 percent of GDP in 1965, stayed between 12 percent and 15 percent from 1966 through 1987, and fell to around 8 percent in the late 1990s and early 2000s. By 2003, such spending had moved up to 10 percent of GDP, remaining close to that level through most of the first decade of the 2000s. It then spiked to 14 percent of GDP in 2009, before receding to 9 percent in 2014.

Discretionary Spending

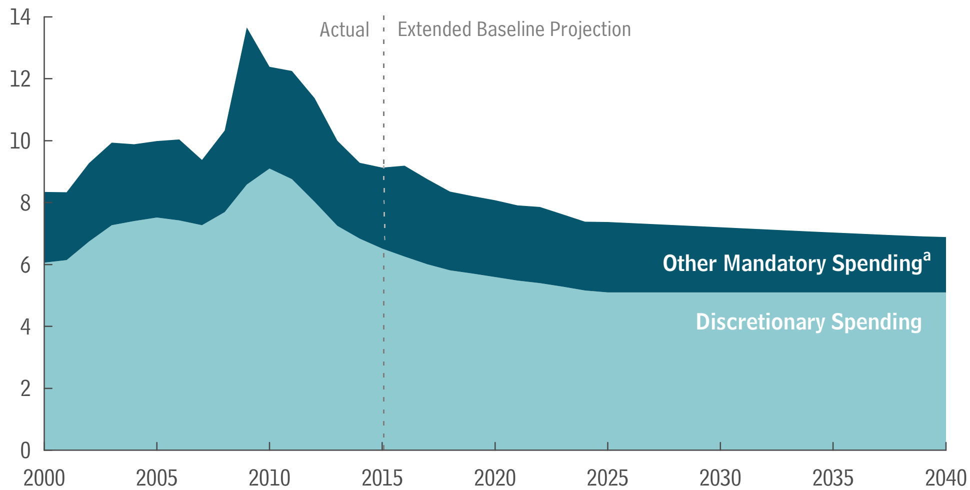
A distinct pattern in the federal budget since the 1970s has been the diminishing share of spending that occurs through the annual appropriation process. Between 1965 and 2014, discretionary spending declined from 66 percent of total federal spending to 34 percent. Relative to the size of the economy, that spending decreased from 10.9 percent of GDP to 6.8 percent.

1. For a description of the activities included in various categories of federal spending, see Congressional Budget Office, *The Budget and Economic Outlook: 2015 to 2025* (January 2015), Box 3-1, www.cbo.gov/publication/49892.

Figure 4-1.

Other Federal Noninterest Spending

Percentage of Gross Domestic Product



Other federal noninterest spending in CBO's extended baseline falls by 25 percent relative to gross domestic product between 2015 and 2040. Nearly two-thirds of that drop stems from the projected decline in discretionary spending over the next decade.

Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period.

a. Other mandatory spending is all mandatory spending other than that for the major health care programs, Social Security, and net interest. It includes the refundable portions of the earned income and child tax credits and of the American Opportunity Tax Credit.

About half of discretionary spending is devoted to national defense and is administered primarily by the Department of Defense (DoD). That department's spending falls mostly into three broad categories:

- Operation and maintenance, which supports the day-to-day activities of the military, the training of military units, the majority of costs for the military's health care system, and compensation for most of DoD's civilian employees;
- Military personnel, which covers compensation for uniformed service members, including pay, allowances for housing and food, and related activities, such as moving service members and their families to new duty stations; and
- Acquisition, which includes procurement, research, development, testing, and evaluation of weapon systems and other major pieces of equipment.

Fifty years ago, in 1965, defense discretionary spending equaled 7.2 percent of GDP. It dropped below 5.0 percent of GDP in the late 1970s but averaged 5.9 percent during the defense buildup from 1982 to 1986 (see Figure 4-2). After the end of the Cold War, outlays for defense fell again relative to GDP, reaching a low of 2.9 percent at the turn of the century. Such outlays climbed again in the 2000s, mainly as a result of spending on military operations in Iraq and Afghanistan. Defense spending averaged 4.6 percent of GDP from 2009 through 2011, before falling to 3.5 percent in 2014.

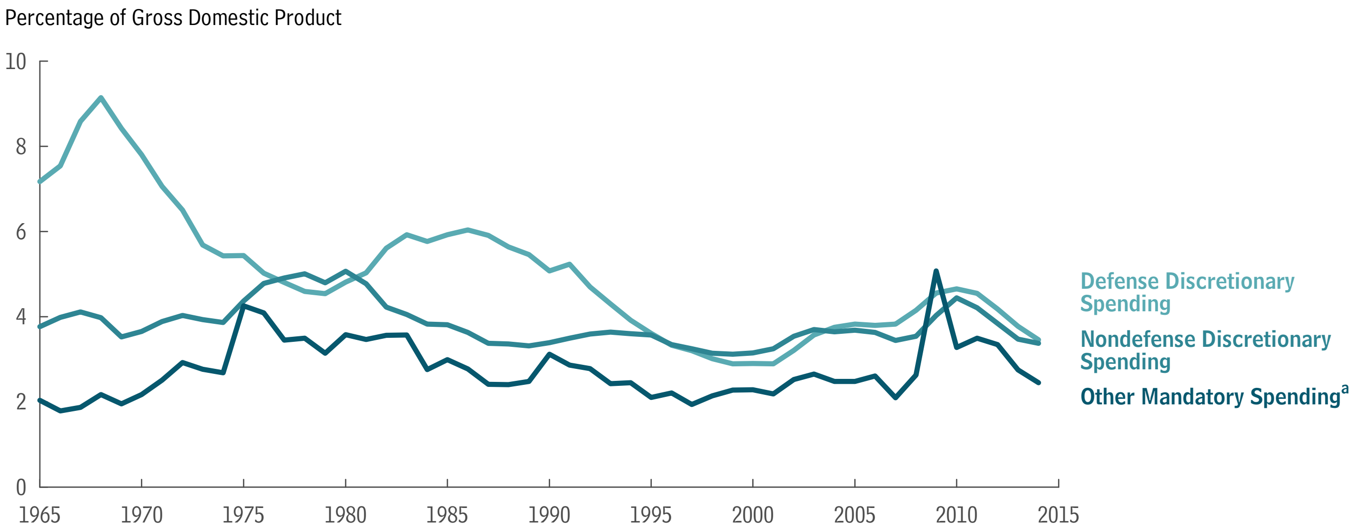
The rest of discretionary spending is for nondefense purposes. It covers a wide array of federal investment and other activities, including the following:

- Education (excluding student loans), training, employment, and social services;
- Transportation, including highway programs, transit programs, and airport security;
- Housing assistance;
- Veterans' health care;
- Health-related research and public health programs;
- Administration of justice, including federal law enforcement, criminal justice, and correctional activities;

Figure 4-2.

Other Federal Noninterest Spending, by Category, 1965 to 2014

Other federal noninterest spending is now about 30 percent lower as a percentage of gross domestic product (GDP) than it was in 1965. Lower defense discretionary spending—which is half the size it was, relative to GDP, in 1965—accounts for most of that reduction.



Source: Congressional Budget Office.

a. Other mandatory spending is all mandatory spending other than that for the major health care programs, Social Security, and net interest. It includes the refundable portions of the earned income and child tax credits and of the American Opportunity Tax Credit.

- International affairs, including international development, humanitarian assistance, peacekeeping, nuclear nonproliferation, and the operation of U.S. embassies and consulates; and

- Activities and programs in other areas, including natural resources and the environment, science, and community and regional development.

In 1965, nondefense discretionary spending amounted to 3.8 percent of GDP. Such spending remained close to 4 percent of GDP, on average, for the following decade but averaged almost 5 percent of GDP between 1976 and 1981. From 1984 to 2008, nondefense discretionary spending stayed between 3 percent and 4 percent of GDP. More recently, funding from the American Recovery and Reinvestment Act of 2009, as well as other funding associated with the federal government's response to the 2007–2009 recession, helped push nondefense discretionary spending above 4 percent of GDP from 2009 through 2011. Such spending dropped back to 3.4 percent of GDP in 2014.

Other Mandatory Spending

Mandatory spending other than that for the major health care programs and Social Security includes the following programs and activities:

- Civilian and military retirement, including benefits paid to retired federal civilian and military employees, and benefits paid to retired railroad workers;

- Earned income, child, and other refundable tax credits, for which payments are made to taxpayers for whom the credit exceeds their tax liability;

- Veterans' benefits, some of which are available to veterans only (such as housing, readjustment, disability compensation, and life insurance), and others of which are sometimes also available to dependents or survivors (such as educational assistance, pensions, dependency and indemnity compensation, and burial benefits);

- Food and nutrition programs, including the Supplemental Nutrition Assistance Program, (formerly known as the Food Stamp program), and child nutrition programs;

- Unemployment compensation;
- Supplemental Security Income; and
- Family support and foster care, including grants to states that help fund welfare programs, Temporary Assistance for Needy Families, foster care, and child support enforcement.

Other mandatory spending is net of various offsetting receipts, which are payments collected by government agencies from other government accounts or from the public in businesslike or market-oriented transactions and are recorded in the budget as negative outlays (that is, credits against mandatory spending). A significant share of offsetting receipts goes to the Medicare program (mostly in the form of premiums paid by beneficiaries) and is combined with Medicare outlays in this report (see Chapter 2 for more information). Other offsetting receipts come from the contributions that government agencies make to federal retirement programs, the proceeds from leases to drill for oil and natural gas on the Outer Continental Shelf, payments made to the U.S. Treasury by Fannie Mae and Freddie Mac, and other sources.

Other mandatory spending averaged about 2.5 percent of GDP from the mid-1960s through the mid-1970s. It then increased to about 3.5 percent of GDP, on average, from the mid-1970s through the early 1980s. It was generally lower from the mid-1980s to 2008, averaging about 2.5 percent of GDP. In 2009, however, other mandatory spending roughly doubled, to 5.1 percent of GDP, because of the financial crisis and recession and the federal government's response to them. As the economy has improved and the increases in spending related to the financial crisis and recession have waned, other mandatory spending has declined sharply relative to the size of the economy, falling to 2.5 percent of GDP in 2014.

Long-Term Projections of Other Federal Noninterest Spending

Under CBO's extended baseline, all federal spending apart from that for the major health care programs, Social Security, and net interest is projected to total 7.4 percent of GDP in 2025 and 6.9 percent in 2040. Those figures represent the lowest amounts relative to the size of the economy since the 1930s.

Discretionary Spending

Projections of discretionary spending for 2015 through 2025 come from CBO's most recent 10-year baseline budget projections, which were published in March.[2]

Through 2021, most discretionary appropriations are constrained by the caps put in place by the Budget Control Act of 2011 (as amended); for 2022 through 2025, CBO assumed that those appropriations would equal the 2021 amount, with increases for projected inflation. Funding for certain purposes, such as war-related activities, is not constrained by the Budget Control Act's caps; through 2025, CBO assumed, such funding would increase each year at the rate of inflation, starting from the current amount. Under those assumptions, outlays from discretionary appropriations are projected to decline from 6.5 percent of GDP this year—already well below the 50-year average of 8.8 percent—to 5.1 percent in 2025 (see Table 4-1). That 2025 amount would be the smallest share of discretionary spending relative to GDP in more than half a century (since at least 1962, the first year for which comparable data are available). Defense discretionary spending would equal 2.6 percent of GDP in 2025, and nondefense discretionary spending would equal 2.5 percent of GDP. Each of those amounts would also be the smallest as a share of the economy in at least five decades.

CBO's baseline and extended baseline are meant to be benchmarks for measuring the budgetary effects of legislation, so they mostly reflect the assumption that current laws remain unchanged. However, after 2021—when the caps established by the Budget Control Act are due to expire—total discretionary spending will not be constrained by current laws but instead will be determined by lawmakers' future actions. With no basis for predicting those actions, CBO based its long-term projections of discretionary spending on a combination of the baseline projections through 2025 and historical experience.

Specifically, after 2025, CBO's extended baseline incorporates the assumption that discretionary spending remains at the percentage of GDP projected for 2025—in other words, such spending grows at the same pace as the economy. In CBO's judgment, projecting a continued decline in discretionary spending as a share of GDP beyond 2025 would not provide the most useful benchmark for

2. See Congressional Budget Office, *Updated Budget Projections: 2015 to 2025* (March 2015), www.cbo.gov/publication/49973.

Table 4-1.

Other Federal Noninterest Spending Projected Under CBO's Baseline

Percentage of Gross Domestic Product

	2015	2025
Discretionary Spending		
Defense	3.2	2.6
Nondefense	3.3	2.5
Total	**6.5**	**5.1**
Other Mandatory Spending		
Civilian and military retirement	0.9	0.8
Nutrition programs	0.5	0.4
Refundable tax credits[a]	0.5	0.3
Veterans' benefits	0.5	0.4
Unemployment compensation	0.2	0.2
Supplemental Security Income	0.3	0.3
Offsetting receipts	-0.9	-0.5
Other	0.6	0.5
Total	**2.6**	**2.3**
Total, Other Federal Spending	**9.1**	**7.4**

Source: Congressional Budget Office.

Note: Other federal spending is all spending other than that for the major health care programs, Social Security, and net interest.

a. The earned income and child tax credits and the American Opportunity Tax Credit.

considering potential changes to discretionary programs, for several related reasons: First, discretionary spending has been a larger share of economic output throughout the past 50 years than it is projected to be in 2025. Second, nondefense discretionary spending has been higher than 3.0 percent of GDP throughout the past five decades and has shown no sustained trend relative to GDP. Third, defense spending has equaled at least 2.9 percent of GDP throughout the past five decades and has shown no trend relative to GDP in the past two decades. Conversely, projecting an increase in discretionary spending as a percentage of GDP beyond 2025 would require CBO to select a specific percentage, which the agency does not have a clear basis for doing. As a result of those considerations, CBO assumed for the extended baseline that discretionary spending would remain the same as a share of GDP after 2025 as CBO projects for 2025 in the 10-year baseline.

Other Mandatory Spending

In constructing its baseline projections, CBO assumes that mandatory programs will operate as they do under current law, which includes the automatic spending cuts put in place by the Budget Control Act.

In CBO's most recent baseline projections, total mandatory spending other than that for the major health care programs and Social Security is estimated to be 2.6 percent of GDP this year and to rise to 2.9 percent of GDP in 2016, primarily because of lower offsetting receipts. Such spending then declines in subsequent years, to 2.3 percent of GDP by 2025.[3]

Most of the projected decline in other mandatory spending relative to GDP through 2025 occurs because the number of beneficiaries for some of the programs is expected to decline relative to the size of the population as the economy expands and because average payments per beneficiary are projected to decrease relative to average income. For example, income thresholds for eligibility for some large income support programs, such as Supplemental Security Income and the Supplemental Nutrition Assistance Program, generally rise with prices, whereas income usually rises more rapidly—especially with the strengthening of the economy that CBO anticipates during the next several years. As a result, CBO expects, the number of beneficiaries in some programs will rise more slowly than the population or even decrease over the next 10 years. Furthermore, average payments under some large programs are often indexed to inflation and therefore tend to grow more slowly than income.

A small part of the decline between 2015 and 2025 stems from a projected reduction in spending for the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit. Outlays for the refundable portions of those credits are projected to decrease from 0.5 percent of GDP in 2015 to 0.3 percent in 2025. About one-third of the decrease stems from the scheduled expiration of the American Opportunity Tax Credit and temporary increases in the earned income and child tax credits at the end of calendar year 2017, and about two-thirds is because, as income grows, the amounts of various credits that people qualify for decrease.

3. See Congressional Budget Office, *The Budget and Economic Outlook: 2015 to 2025* (January 2015), p. 16, www.cbo.gov/publication/49892.

For the years beyond 2025, CBO projected outlays for the refundable portions of the earned income and child tax credits as part of its long-term revenue projections (discussed in Chapter 5). The remainder of other mandatory spending was not projected in detail after 2025 because of the number of programs involved and the variety of factors that influence spending on them. Instead, CBO used an approximate method to project spending for those programs as a group, assuming that such spending would decline as a share of GDP after 2025 at the same rate at which it is projected to fall between 2020 and 2025. As benefits for some programs decline further relative to average income under current law, the benefits available to people many years in the future would differ markedly from what they are today.

Under the assumption that some benefits decline relative to average income, mandatory spending other than that for the major health care programs, Social Security, and refundable tax credits would decrease from 2.0 percent of GDP in 2025 to 1.6 percent by 2040. Including spending on those tax credits, other mandatory spending would equal 1.8 percent of GDP in 2040.