

Options for Defense and Other Domestic Spending

Although much of the debate about the federal budget focuses on the projected growth in costs for Medicare, Medicaid, and Social Security, they are only three of a vast number of federal programs and activities. Hundreds of other programs—large and small—touch the lives of almost all Americans and implicitly reflect views about federal roles and responsibilities that are often highly contested. The total of spending on these programs is higher than that for Medicare, Medicaid, and Social Security combined and under current policies is projected to remain so until 2014.

Although we group all of these spending programs under the single heading of “defense and other domestic spending,” that heading hardly captures the range and diversity of the important public missions they represent. They include enormous expenditures for the military services and weapons, intelligence gathering, and homeland security. They include disability payments and health care for veterans and members of the military; emergency aid in the wake of disasters; a panoply of programs supporting education, training, and income support for the unemployed; and other services to expand opportunity or provide care. They include a host of efforts to improve transportation, the natural environment, manage national parks and forests, protect consumers and foster orderly markets, and aid particular industries and sectors. The range of tools used in this array of programs is similarly diverse, including grants to state and local government, payments to individuals, and extension or guarantees of credit and insurance. The recent downturn has both added to the list of programs and augmented their scale, temporarily increasing their combined spending from less than 10 percent of gross domestic product (GDP) in 2007 to

more than 16 percent in 2009—largely because of economic stabilization and recovery initiatives.

SPENDING CATEGORIES AND TRENDS

The vast majority of spending for defense programs, which includes such related functions as intelligence, has to be appropriated on an annual basis—that is, it is “discretionary.” In 2008, approximately 57 percent of spending on “other domestic” programs (i.e., nondefense programs other than Medicare, Medicaid, and Social Security) was discretionary. The remaining 43 percent was set by permanent law—that is, it was “mandatory.”

Most mandatory programs are so-called “entitlements” that provide payments or other benefits to people eligible by law to receive them. Examples include food stamps, benefits for disabled veterans, federal spending on unemployment compensation, cash refunds from the Earned Income Tax Credit, and federal civilian and military employee retirement payments. Examples of non-entitlement mandatory spending include Temporary Assistance to Needy Families and some payments to farmers and for deposit insurance.

The domestic discretionary category is very broad and diverse. It includes the federal judicial system; homeland security; commerce-related activities; education, training, and employment, low-income housing aid, and other social service programs; science research and development, space exploration, and other technology programs; energy assistance; natural resource protection and other environmental programs; and transportation.¹

Debates About Spending

In addition to being diverse, the domestic components of this category are often controversial. The value of domestic spending is very much in the eye of the beholder. Arguments about excess federal spending often center on items in this category that are regarded as wasteful, either because the program’s purposes are not valued (or are regarded as obsolete) or because the programs are not believed to be effective in achieving their stated ends. Critics may argue, for example, that programs providing support for low-income people are excessively generous or encourage dependency, and that domestic spending includes unnecessary and sometimes unproductive subsidies to interested business or industry groups. They would say that politics seldom lead to efficient allocation.

On the other side of the debate, proponents of domestic spending stress that it includes useful public investments (even as skeptics may take issue with the word “investment”) as well as essential services. Advocates contend that many domestic appropriations build economic capacity through

infrastructure investment, new technology, education, and strengthened rule of law. Advocates argue that low-income support programs are not only appropriately compassionate but maintain health and help develop productive skills. When much of the federal government was shut down by a funding crisis in the mid-1990s, many Americans felt inconvenienced or even seriously hurt by the absence of routine services they previously took for granted—such as the processing of passports, and open and staffed national parks.

On the defense side, differences of opinion as to the budgetary implications of true security are often intense. We do not know when hostilities may emerge or what future threats will materialize. At the most aggregate level, defense spending is much like purchasing insurance; there is always uncertainty as to how much is enough (perhaps more so than in other parts of the budget), especially given the costs. This uncertainty is exacerbated because some defense spending—such as that for major new weapons systems—is often supported (at times against the best advice of military and civilian experts) because it serves a domestic constituency whose jobs depend on it.²

But the issues also run to a deeper level of detail. Programs that would provide defense against a national adversary in a conventional kind of conflict may or may not prove useful in an asymmetric war against terrorism. Specific policies, such as the war in Iraq, fuel intense arguments over spending priorities. Questions regarding the allocation of a given level of spending among new hardware, maintenance and supplies, troop levels, and human resources can be controversial. In this chapter, we present a wide range of alternative levels of defense spending, reflecting not only conflicting views about the best use of defense resources, but also fundamental differences regarding the role of the United States in preserving world peace.

Defense and other domestic spending is not projected to grow as a share of GDP under the study baseline. Indeed, it is projected to fall significantly as a percentage of GDP over the next decade before stabilizing at a level more than 2 percentage points lower than in 2008. Nevertheless, it can be argued that further spending reductions (relative to the baseline) are appropriate. To the extent that fiscal sustainability is addressed through spending reductions, finding all of the needed savings in health care and Social Security will be difficult and, in any event, may take some considerable time to achieve. Savings in defense and other domestic programs may therefore be necessary. Putting all spending programs on the table is also consistent with the notion of “shared sacrifice,” which may be an important political element in fashioning a responsible fiscal program for the future. Some may also assert that the growth in the large entitlement programs reflects such urgent needs that cutting other areas of the budget, along with raising taxes, is necessary to accommodate it.

The counterargument is that cutbacks in defense and other domestic

programs, which are already slated in the baseline to grow slower than the economy and much slower than other parts of the budget, could threaten important national objectives. Even if ineffective or low-priority programs are targeted for the greatest cuts, if spending slows too rapidly it will be difficult for the government to accommodate needs related to population growth, to make new investments needed for future growth, and to deal with potential new international and environmental challenges. Given that defense and other domestic spending is not the driving factor behind the projected fiscal crisis, difficult choices for the actual cost drivers—Medicare, Medicaid, Social Security—are necessary and inevitable. Distracting attention from the large entitlement programs (as well as revenue needs) could be counterproductive. Tough decisions in those areas, on the other hand, could allow additional resources to be allocated to important defense and other domestic needs.

Consistent with the notion that there can be multiple paths to fiscal sustainability, this chapter discusses options for defense and other domestic spending that run the gamut from deep cuts to significant expansions (all relative to the study baseline). As with other policy discussions in this report, these options are meant to be illustrative and not exhaustive.

Spending Trends

Both the defense and other domestic components of this category of spending grew in real terms from 1962 to 2008. However, as Figure 7-1 shows, defense spending is now a much smaller share of the economy than in 1962, when it was over 9 percent of GDP. Over the same period, other domestic spending rose just slightly as a percentage of GDP.

Under the study's baseline projections (see Chapter 1), overall defense and other domestic spending falls to 8.6 percent of GDP by 2019 and re-

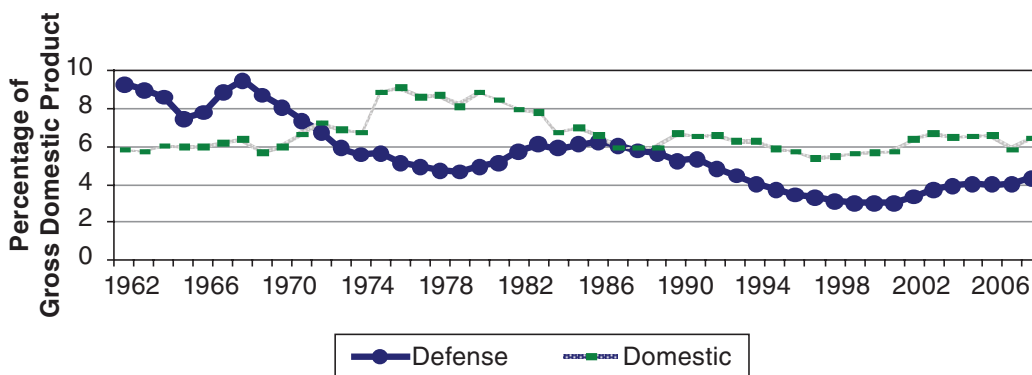


FIGURE 7-1 Defense and other domestic spending as a percentage of GDP, 1962-2008.

mains at approximately that level from 2020 on. This is approximately the same share of the economy it held in 1998, when it was at its lowest share of GDP in the post-1962 period.

Other domestic spending represented 5.9 percent of GDP in 1962 and 6.4 percent in 2008. With the exception of a brief period in the 1970s, it has stayed between 5.4 and 7 percent of GDP. In 2009 it spiked to around 12 percent of GDP because of the economic downturn of 2008-2009 and the policy response to it. The American Recovery and Reinvestment Act of 2009 includes spending for (among other things) infrastructure, credit support for defaulting homeowners, and extended unemployment and health benefits. Spending also was swelled temporarily by extraordinary interventions to stabilize financial markets, the government's assumption of responsibility for Fannie Mae and Freddie Mac, and aid to floundering banks and auto companies.³ If the economy recovers as projected, other domestic spending will fall back to about 6 percent of GDP in 2010 and then drift down to just over 5 percent of GDP by 2019, remaining around that level from 2020 on. That percentage would be lower than the lowest figure for domestic spending in the post-1962 period, a 5.4 percent share in 1997.

Defense spending represented 4.3 percent of GDP in 2008. In the study baseline, declining troop levels and growth with inflation put it at 3.4 percent of GDP by 2019 (which was about its share in 2002), a level at which it remains from 2020 on.

FOUR OPTIONS

As noted above and throughout this report, the costs that are driving the budget toward unsustainability are (primarily) those for health care and (secondarily) Social Security. The savings that can be achieved in those programs will determine whether there will be more or less room for spending in the rest of the budget at a given level of revenues. Similarly, a willingness to tax more (or less) will leave more (or less) room for all categories of spending. Therefore, a variety of approaches to defense and other domestic spending could be consistent with the goal of putting the federal budget on a sustainable path. The four spending paths discussed below are illustrative of the plausible range of possibilities, at least in terms of level and categorical composition; see Figure 7-2. The rationale for allocating spending, for each option, across subcategories (defense, domestic discretionary, other mandatory) is discussed in Appendix D.

The lowest illustrative option would put spending 20 percent below the baseline by 2019 and hold it at approximately that level thereafter. This would require reductions of a depth unprecedented in modern U.S. history, straining the bounds of political feasibility. Such reductions would mean that many familiar domestic programs would be scaled back or eliminated,

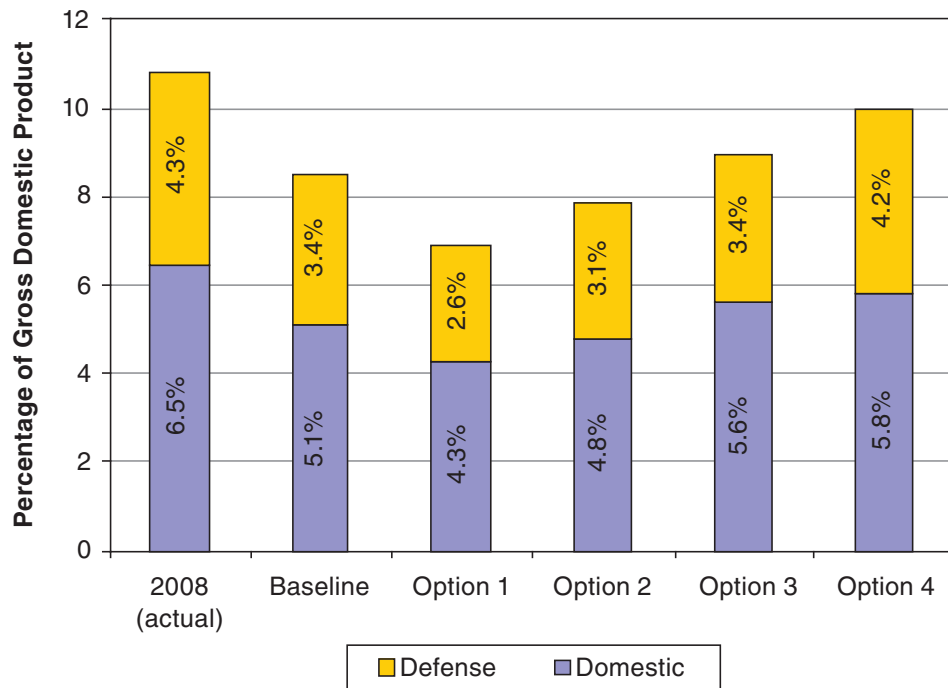


FIGURE 7-2 Defense and other domestic spending as a share of GDP in 2019 under four options.

NOTE: Tables D-1, D-2, and D-3 in Appendix D present further spending details for the defense, domestic discretionary, and other mandatory subcategories.

certain federal responsibilities would be turned over to state and local governments, and the nation's capacity for military intervention would be curtailed.

At the other end, the highest spending option would put spending 16 percent above the baseline by 2019 and hold it at approximately that level thereafter, making room for major new public investments and other program expansions (not all which of may be productive, of course), creating a robust capacity to deal with future military challenges, and potentially make it easier to respond to now-unforeseen emergencies or opportunities. Although spending would be well above the baseline in that year, it would still be lower as a percentage of GDP than in 2008. This option may nevertheless be politically challenging, given all of the other pressures and constraints affecting the budget.

The two options intermediate to the lowest and highest spending ones illustrate additional ways of apportioning resources within the defense and other domestic spending category. The first intermediate option (Option 2) cuts spending by 8 percent relative to the baseline by 2019 and holds it at around that level (as a share of GDP) thereafter, whereas the second

intermediate option (Option 3) expands it by 5 percent and holds it at approximately that share of GDP after 2019.

Option 1: Cut Spending by 20 Percent

Option 1 makes deep cuts to defense and other domestic spending, putting overall spending 20 percent below the study baseline by 2019 and, at 6.9 percent of GDP, considerably below the 8.6 percent share of 2008. This represents a reduction (relative to the baseline) of approximately \$361 billion in 2019—one that has no precedent in modern U.S. history. Domestic spending falls to 4.3 percent of GDP, well below its 5.4 percent share of 1997 and the 5.1 percent share projected in the baseline. Defense spending falls to 2.6 percent of GDP, an unprecedentedly low level of spending that is well below the baseline projection of 3.4 percent for that year. It is also below the 3 percent share of 1999-2001, which was the lowest share in the post-1962 period.

Cutting spending on any program is always politically contentious. This option would impose substantial pain on virtually all defense and other domestic programs. Based in part on published analyses, it illustrates ways of reducing or eliminating spending for programs that may be regarded by some as ineffective, unproductive, or not essential to the purposes of the federal government. The option also calls for further unspecified cuts in order to achieve additional necessary savings. Reductions of this magnitude have not been feasible to date and are likely to be achieved only if deficit reduction—accompanied by strong skepticism about federal spending—becomes a national priority.

The committee's illustrative choices to achieve such deep cuts come in three parts: (1) to eliminate or substantially reduce program spending in specified domestic areas, (2) to require additional unspecified cuts in other domestic areas, and (3) to redefine defense needs.

Elimination of or Substantial Reductions in Specified Domestic Programs

Option 1 makes substantial cuts to domestic programs through three broad illustrative policy changes.

The first policy change is devolution, which would combine cuts in federal grant programs with delegations of authority to state and local governments (see Appendix D for details). A number of social service, elementary and secondary education, and employment and training programs would be folded into block grants providing greater responsibility and control to states and localities, who (some would argue) might better manage those functions.⁴ However, their combined funding would also be reduced by

50 percent, which would require states and localities to come up with additional funds and use resources more effectively in order to maintain the same level of activity; they may or may not be able to do this. Examples of affected programs include those for special education, training and employment services, and aging services.

The second policy change would be to remove commercial subsidies and reduce “low-value” activities. This option selectively draws on a list of potential budget savings identified by the Congressional Budget Office (2009b) to illustrate the sorts of cuts that might be made.⁵ This option would reduce the federal government’s role in subsidizing particular activities or sectors of the economy for which the private sector arguably could do a better job. For example, many trade promotion and foreign market development programs would be eliminated, along with subsidized financing vehicles such as the Overseas Private Investment Corporation and the Export-Import Bank. User fees for subsidized benefits and services would also be increased. Some have argued that these programs were created at the behest of private interest groups and use public resources largely for those groups’ private gain. Similarly, this option would curtail federal spending on activities that may be judged to have relatively low social returns. Payments to producers of certain agricultural commodities, funds for money-losing timber sales, and funding for beach replenishment come under this heading. The caveat, of course, is that what constitutes a low-value activity is often in the eye of the beholder.⁶

The third policy change is to use a smaller inflation adjustment in indexed programs. The standard consumer price index (CPI) may overstate the effect of inflation on households because it does not account for the adjustments that people make in their spending patterns to compensate for changes in the relative prices of different goods and services.⁷ The Bureau of Labor Statistics has calculated an alternative measure of inflation, called the chained CPI, which does reflect such consumer behavior.⁸ A chain-linked CPI for cost-of-living adjustments for indexed programs would reduce the growth of benefits for a number of the other mandatory programs, chiefly federal civil service and military retirement, veterans cash disability benefits, railroad retirement, and Supplemental Security Income. The Congressional Budget Office furnished the committee with an estimate of the savings that would result by 2019 from using a chain-linked CPI for cost-of-living adjustments for indexed programs.⁹

Additional Unspecified Cuts in Domestic Programs

The specified cuts discussed above would put domestic spending approximately 7 percent below the baseline by 2019. However, reaching the target for this option would require still further cuts. Accordingly, addi-

tional unspecified cuts (which could be similar in kind to the sorts of specified cuts discussed above and described in Appendix D) would also have to be imposed; these would reduce domestic discretionary spending by another 9 percent, leaving it 16 percent below the baseline by 2019.

A Redefinition of Defense Needs

In this option, defense spending would be sharply reduced from 4.3 percent of GDP in 2008 to 2.6 percent of GDP by 2019, remaining at approximately that level from 2020 on. This would be below the lowest share of GDP consumed by the military between World War II and now (which was about 3 percent), but higher in real terms than the combined amount spent by U.S. allies in the North Atlantic Treaty Organization (NATO).

The military would have to reallocate funds to match real wage growth in the economy (keeping in mind the cyclical nature of labor markets) and pay for rising health care costs (8 percent of the current defense budget goes for health care, a proportion that is projected to rise in line with the growth of other health spending). Personnel compensation and support for those who serve (and their families) is and has been the highest priority of defense policy over the last five Administrations, with costs rising significantly faster than the overall defense budget. If this priority—which now accounts for nearly half the cost of defense—is to be maintained under this low-spending option, the capacity to modernize or replace weapon systems will be virtually eliminated, and only minimal new investments in research and development and facility construction will be possible. Reductions of this magnitude, while preserving essential funds to adequately support the military forces, will eventually result in demands to recapitalize weapon systems and equipment and increase the operating costs necessary to maintain existing assets at any acceptable state of readiness.

With such reductions, U.S. defense forces would retain the ability to mount rapid deployments, although those deployments would be very small and of short-term duration. The funding levels implied in this option would not provide the capacity to engage in a mission of the size, scope, and duration of the current Afghanistan campaign, and would not support more than one emergency response at any given time.

Option 2: Cut Spending by 8 Percent

Option 2 is less stringent than Option 1. It would cut overall defense and other domestic spending by 8 percent relative to the study baseline, putting it at 7.9 percent of GDP in 2019 and keeping it at approximately that level from 2020 on. This represents a reduction (relative to the baseline) of approximately \$144 billion in 2019.

This option would leave defense spending at 3.1 percent of GDP a decade from now (at around the 2008 level, excluding war-related spending) and domestic spending at 4.8 percent of GDP. As with Option 1, this option assumes that it is possible to target most cuts to less effective or lower priority programs, while perhaps increasing the productivity of what remains. Although these reductions are politically ambitious by any historical standard, they are sufficiently less onerous than those under Option 1 that there is no need to rely on unspecified cuts; see Appendix D for details.

Domestic Programs

The treatment of domestic programs in this option would be the same as in Option 1, with two exceptions:

1. Federal funding for programs block-granted under the devolution option (see Appendix D for details) would be cut by approximately one-third, rather than one-half.
2. There would be no unspecified cuts in domestic programs.

Defense Programs

In this option, defense spending would be reduced to 3.1 percent of GDP by 2019—lower than the baseline level of 3.4 percent, but markedly higher than the 2.6 percent in Option 1. Spending for defense would be slightly above the 3 percent share of the post-Cold War, pre-9/11 period of 1999-2001. Sustaining the present personnel and support policy emphasis would likely maintain the national capacity for rapid military deployment but have implications for defense-related investment, research and development, and construction projects that are similar to Option 1, albeit less pronounced.

Option 3: Increase Spending by 5 Percent

This “pro public investment” option expands overall category spending relative to the baseline. Spending would reach 9 percent of GDP by 2019 and remain at approximately that level from 2020 on. This spending level, by way of comparison, falls in between the 9.2 percent share in 1996 and the 8.8 percent share in 2001.

In sharp contrast to Options 1 and 2, this option assumes that effective public-sector investments that produce long-term economic growth and social benefits can be identified and are worth pursuing. Domestic spending is expanded to 5.6 percent of GDP (at around the 1999 share), an increase of approximately 10 percent relative to the study baseline; this translates

to an increase of approximately \$99 billion in 2019. Defense spending follows the study baseline, falling from 4.3 percent of GDP in 2008 to 3.4 percent by 2019.

Domestic Programs

In a number of program areas, expanded spending might be considered an investment in assets that yield economic growth and produce social benefits. This option considers three such areas: human capital development, research and development funding, and infrastructure (see details in Appendix D). These expansions are only indicative of what might be done. For instance, there are a variety of ways to expand early childhood education. Although this option refers to proposals to expand Head Start, the same result might be accomplished by encouraging or permitting public schools to offer pre-kindergarten programs or other forms of preschool programs. The committee's examples merely highlight some of the possibilities.

The American Recovery and Reinvestment Act of 2009 (ARRA) also included numerous activities designated as public-sector investments, temporarily boosting spending for this category starting in 2009. Some of the new spending suggested by Option 3 (and Option 4) may echo the content of ARRA. In contrast to ARRA, however, the expansions in this option are intended to be permanent and focused on long-term returns rather than short-term stimulus.

Defense Programs

Defense spending would follow the study baseline, declining from 4.3 percent of GDP in 2008 to 3.4 percent in 2019 (at its 2002 level) but growing with the economy thereafter. In comparison with Options 1 and 2, force reductions would be smaller and weapons modernization would be more extensive. This would make it possible to sustain present levels of personnel and personnel support and permit more gradual declines in defense-related investment, research and development, and construction.

Option 4: Increase Spending by 16 Percent

This option takes the most expansive view of the appropriate roles and responsibilities of the federal government. Spending would reach 10 percent of GDP by 2019 (close to the 9.9 percent share of 2007 and well above the baseline level of 8.6 percent in 2019) and remain at approximately that level from 2020 on.

Option 4 expands defense spending by approximately 24 percent relative to the baseline, putting it at 4.2 percent of GDP (close to its 4.3 percent

share in 2008), and it increases domestic spending by approximately 14 percent relative to the baseline, putting it at 5.8 percent of GDP (slightly below its 5.9 percent share in 2007). This option leaves defense and other domestic spending close to the 9.9 percent share of GDP it held in 2007.

Domestic Programs

Domestic spending is expanded to 5.8 percent of GDP (at around the 1996 share), an increase of approximately 14 percent relative to the study baseline; this translates into an increase of \$141 billion in 2019. This option would incorporate the new spending programs of Option 3 (see Appendix D for details) and also allow for other expansions, potentially positioning the federal government to better meet unforeseeable contingencies and emergencies.

Defense Programs

This option expands defense spending by approximately 24 percent relative to the baseline, putting it at 4.2 percent of GDP in 2019 and keeping it approximately at that level from 2020 on. This is slightly below the 2008 level of 4.3 percent (which includes temporary war spending) but well above the baseline level of 3.4 percent. The Defense Department would be able to maintain current force sizes while paying for higher health care costs and keeping up with real wage growth. This option would help sustain the priority for a strong all-volunteer force adequately supported. The military also would have substantial funds for modernization, permitting U.S. forces to replace old weapons and incorporate new technology. These actions would, with near certainty, maintain the current technological superiority enjoyed by the United States. This option would permit the military to prepare for future peacekeeping or protection activities and maintain the ability to engage in large and protracted deployments or prevent another country from becoming a near-peer competitor.

CONCLUSION

Although all four defense and other domestic spending options reduce defense and other domestic spending as a share of GDP compared with its level in 2008, only two of the options would require reductions in spending relative to the baseline rate of growth.

The ability of the budget to support the more generous options will depend on the choices that are made with regard to the three major entitlement programs (see Chapters 5 and 6) and the level of revenues (see Chapter 8). Chapter 9 presents illustrative combinations—consistent with fiscal

sustainability—of the policy options discussed in these chapters. As will be seen, the higher defense and other domestic spending options discussed in this chapter are plausible only if they are combined with options to significantly reduce the growth of Medicare, Medicaid, and Social Security spending. Even then, such combinations will require federal revenues to be at levels much higher than the norm of recent decades.

NOTES

1. Although labeled “domestic” here for convenience, this category also includes spending for international programs, such as those for diplomacy and foreign assistance. However, in 2008, international programs accounted for just 4 percent of the spending under this label.
2. While Congress has put a stronger spot light on “earmarks” in an effort to curb such parochial, constituency-based practices, the aggregate effect on the budget in the most aggressive instances of earmarks has been typically less than 1 percent of total appropriations.
3. The timing of these outlays will depend on recording decisions by the Congressional Budget Office and the Office of Management and Budget. It appears that the bulk of costs for the Troubled Asset Relief Program (TARP) and capital assistance to Fannie Mae and Freddie Mac, among other interventions, will be recorded in the 2009 deficit.
4. Devolution might also increase disparities among state and local governments, since certain federal grants would play less of an equalizing role.
5. The committee adjusted for the minor overlap between the programs targeted for devolution and the programs selected from the Congressional Budget Office (2009b) report.
6. The report (Congressional Budget Office, 2009b) from which the committee identified illustrative budget savings contains arguments for and against each of the options.
7. For example, when the price of apples rises, the standard CPI registers that fact as an unalloyed loss of well-being. However, consumers can recoup some of that loss by switching their consumption to oranges or something else; the standard CPI does not capture that effect. See Johnson et al. (2006) and Gordon (2006) for a technical discussion of biases in the CPI.
8. A chained CPI uses spending data from more than one time period to account for substitution behavior on the part of consumers (see Cage et al., 2003).
9. Total savings would amount to \$31.3 billion dollars by 2019. The chained CPI is also used in one of the committee’s illustrative Social Security options (see Chapter 6 of this report) and in one part of the simplified tax alternative to the current-tax structure (see Chapter 8).