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How to Spend \$2.8 Trillion

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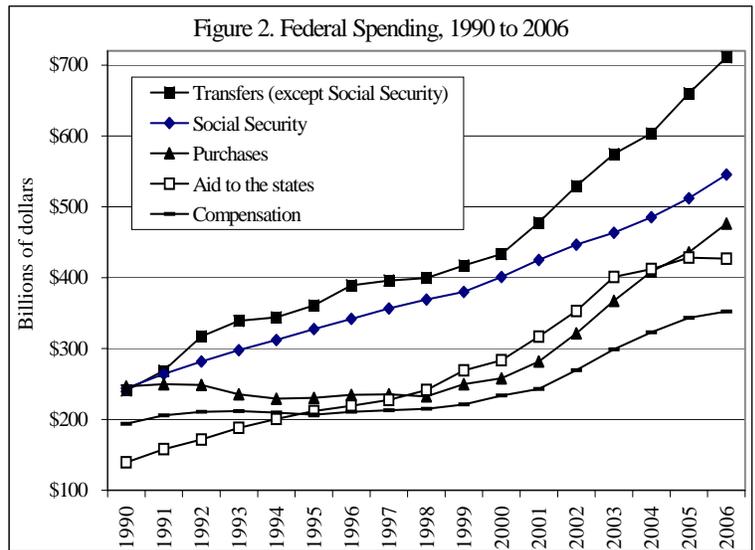
The federal budget includes a vast array of programs within hundreds of agencies. But when boiled down, government spending consists of just five basic activities: paying workers, buying goods and services, transferring wealth to favored groups, subsidizing state and local governments, and paying interest on debt.

Figure 1 shows these components of the \$2.8 trillion federal budget in 2006.¹ Transfer payments, such as Social Security benefits, are the largest spending activity at \$1.26 trillion, or 45 percent of the budget. Purchases of goods and services are 17 percent of the budget, aid to the states is 15 percent, compensation costs for federal workers are 13 percent, and interest paid is 10 percent.²

The U.S. Constitution authorizes the federal government to hire workers and purchase items needed to carry out basic enumerated functions. It generally does not create a federal role in transfers of wealth or aid to the states, yet those two activities now account for 60 percent of all federal spending.

Federal Spending Growth since 1990

During the 1990s, growth in the federal budget was somewhat restrained, but since 2000 most types of



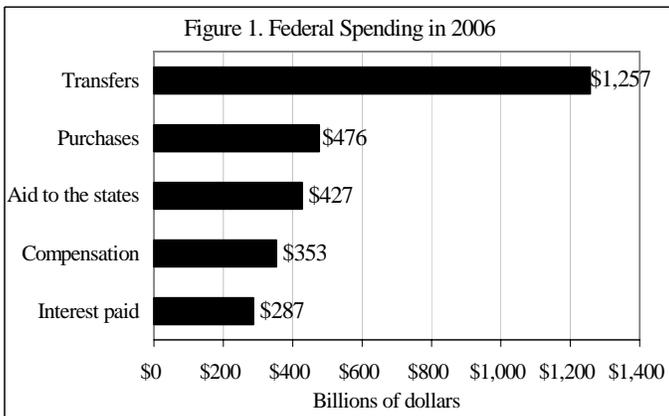
Source: Author, based on BEA data; 2006 is estimated.

spending have soared, as shown in Figure 2. Transfers (except Social Security) grew slowly in the late 1990s but are now spiraling upward. Purchases (or procurement) were steady at about \$250 billion during the 1990s but are now closing in on \$500 billion. The costs of wages and benefits for federal workers were steady at about \$210 billion during the 1990s, but costs then soared to \$353 billion by 2006. Aid to the states has grown rapidly since 1990, but growth has slowed since 2003.³

Estimates for 2006 indicate that federal purchases have doubled since 1998, aid to the states has doubled since 1995, and transfers (except Social Security) have doubled since 1994. Total federal spending has grown at an annual average rate of 6.7 percent this decade, compared to 3.8 percent during the 1990s, as shown in Table 1.⁴

Are Spending Increases Only in Defense?

Some politicians are saying that recent spending increases are simply the result of the growing defense



Source: Author's estimates based on U.S. Bureau of Economic Analysis (BEA) data.

budget. Table 1 shows that defense spending has, indeed, grown rapidly because of increased purchases of weapons and supplies and the soaring costs of military pay.

However, the table shows that nondefense spending is also growing rapidly. Transfer payments have grown at an annual average rate of 7.1 percent since 2000. Nondefense purchases—everything from paper clips to computers and consulting services—have grown at 8.4 percent this decade, compared to 3.9 percent during the 1990s. Compensation for nondefense federal workers grew briskly during the 1990s at a 4.8 percent rate, but even more briskly this decade at 5.9 percent.

A final note is that because the federal budget was balanced during fiscal years 1998 to 2001, interest costs were reduced sharply. Lower interest outlays have partly offset the rise in other spending in recent years.

Table 1. Federal Spending, 1990s and 2000s

Type of Spending	Spending in Billions of Dollars			Average Annual Growth	
	1990	2000	2006	1990s	2000s
Transfers	\$485	\$834	\$1,257	5.6%	7.1%
Social Security	\$244	\$401	\$546	5.1%	5.3%
Other transfers	\$241	\$433	\$711	6.0%	8.6%
Purchases	\$247	\$258	\$476	0.4%	10.8%
Defense	\$185	\$167	\$329	-1.0%	11.9%
Nondefense	\$62	\$91	\$147	3.9%	8.4%
Aid to the states	\$140	\$284	\$427	7.3%	7.1%
Compensation	\$194	\$234	\$353	1.9%	7.1%
Defense	\$135	\$139	\$219	0.3%	7.8%
Nondefense	\$59	\$95	\$134	4.8%	5.9%
Interest paid	\$238	\$283	\$287	1.8%	0.2%
Total federal spending	\$1,302	\$1,893	\$2,800	3.8%	6.7%

Source: Author, based on BEA data; 2006 is estimated.

Cutting Spending in Four Easy Steps

With today's large budget deficits and looming cost increases in programs for the elderly, spending cuts are desperately needed. Reformers can look to the main types of spending to find budget savings.

Transfers. Transfers are the largest and fastest-growing type of spending. Congress should cut all types of transfers including Social Security benefits, health care spending, and business subsidies. Transfers produce a mirage that the government is creating a net flow of income to the people, but the reality is that every dollar of spending comes from taxes on current and future workers, savers, and small businesses. Those taxes get cycled

through the sausage factory on Capitol Hill and redirected to favored groups, but the nation is worse off because of the economic damage done and wasteful bureaucracy created.

Purchases. Federal procurement has been subject to much waste and scandal. Contracts for defense, energy, and technology projects often go overbudget, inventories are poorly managed, and health programs are subject to huge overbilling problems. Many reforms are needed, including privatizing activities such as energy research, cutting low-priority weapons programs, and making procurement data more accessible for public scrutiny.

Aid to the States. About 800 federal programs provide subsidies to state and local governments. These range from the giant Medicaid to obscure programs such as boating safety, forestry assistance, and arts in education. Federal aid creates huge bureaucracies at all three levels of government and imposes heavy regulation on what should be autonomous local activities.⁵ Recent scandals involving homeland security grants are typical of the widespread and deep-seated waste in aid programs for the states.

Compensation. Federal compensation has risen much faster than private-sector compensation in recent years.⁶ In 2005, average wages and benefits for federal civilian workers were \$106,579, which was double the average for U.S. private-sector workers of \$53,289.⁷ To begin getting compensation costs under control, a federal wage freeze should be put into effect and federal benefits scaled back.

¹ All figures are calendar year and based on data from the U.S. Bureau of Economic Analysis, National Income and Product Accounts (NIPA), Tables 3.2, 3.9.5, 3.10.5, and 3.11.5. See www.bea.gov/bea/dn/nipaweb. Figures for 2006 are estimated on the basis of the percentage change of data items from the second quarter of 2005 to the second quarter of 2006.

² Total federal spending in this bulletin is the NIPA "total expenditures" amount. Spending categories are based on NIPA data as follows: transfers include transfer payments, less aid to the states, plus subsidies; purchases include intermediate goods and services purchased, plus gross investment, less some minor adjustments; aid to the states includes capital transfer payments. Interest is interest payments, not net interest.

³ The slower growth is partly due to the shift of federal prescription drug coverage from Medicaid to the new Medicare drug plan and related state "clawback" payments.

⁴ Note that the faster spending growth of the 2000s occurred even though inflation is slightly lower this decade than last.

⁵ Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005), Chapter 8.

⁶ Chris Edwards, "Federal Pay Outpaces Private-Sector Pay," Cato Institute Tax & Budget Bulletin no. 35, May 2006.

⁷ See NIPA Tables 6.2D, 6.5D, and 6.6D.