Backgrounder
Published by The Heritage Foundation
No. 1710
December 3, 2003

$20,000 per Household: The Highest Level of Federal Spending Since World War II

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The 2003 fiscal year mercifully concluded on September 30. Reckless spending by Congress and the President made it a year in which:

- Government spending exceeded $20,000 per household for the first time since World War II,
- The federal budget expanded by $353 billion over its 1998 level,
- Defense and the attacks on September 11, 2001, accounted for less than half of all new spending since 2001,
- Mandatory spending reached its highest level in history, and
- Spending increased despite net interest costs plummeting by $110 billion.[1]

This paper examines the colossal expansion of the federal government since 1998. That year, a temporary tax revenue boom brought the first budget surplus in over a quarter-century. Abolishing the budget deficit also eliminated one of the most effective arguments for spending restraint, and the spending floodgates swung wide open. By 2001, the budget surplus was quickly evaporating because tax revenues, back to their historical levels, could no longer keep pace with runaway spending. The 9/11 terrorist attacks then necessitated new spending on national security. But by that point fiscal responsibility was a distant memory, and lawmakers steadfastly refused to balance these new high-priority security costs with savings elsewhere in the budget. As 2003 closes, the nation finds itself bur-

Talking Points

- In 2003, federal spending exceeded $20,000 per household for the first time since World War II.
- The federal budget has expanded by $353 billion over its 1998 level, led by sharp increases in defense, education, health, farm subsidies, unemployment benefits, and dozens of small, lower-priority programs.
- Defense and the 9/11 attacks account for just 45 percent of all new spending since 2001.
- Mandatory spending has reached the highest level in U.S. history.
- These total spending increases occurred despite net interest costs plummeting by $110 billion.

This paper, in its entirety, can be found at:
www.heritage.org/budget/bg1710.cfm

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
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Washington, DC 20002–4999
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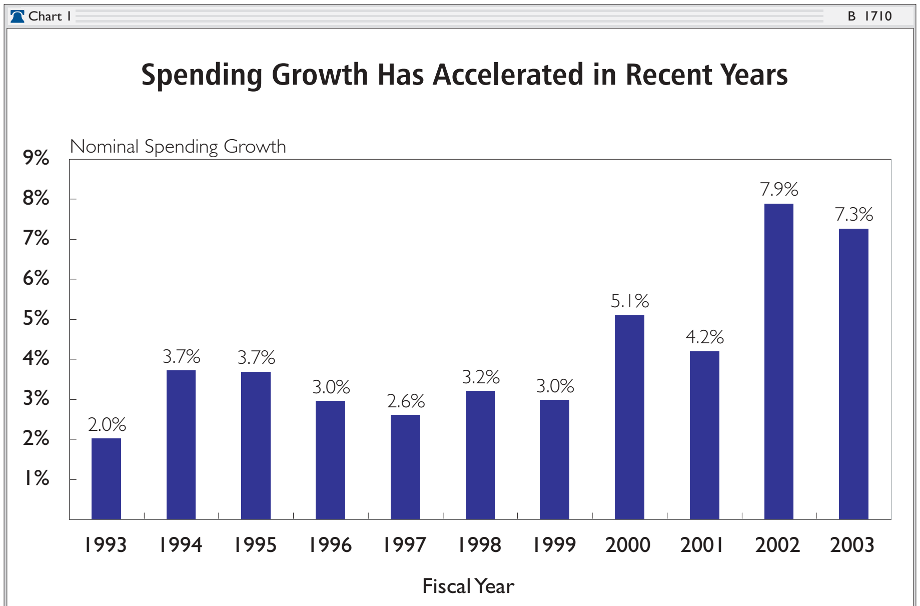
dened by runaway federal spending and massive looming structural budget deficits.



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Treasury Department.

Overall Spending

Federal spending grew by 7.3 percent in 2003, slightly slower than the 7.9 percent growth rate in 2002. The slower growth rate is encouraging; yet, Chart 1 shows that government is still growing significantly faster than it did in the 1990s. In fact, the 7.6 percent average annual growth over the past two years more than doubled the 3.4 percent average annual growth from 1993 to 2001.[2]

The total amount of federal spending—$2,156,536,000,000—is too large to fully comprehend (in $1 bills, it would stack halfway to the moon, weigh 10 times as much as the Sears Tower, and blanket the state of New Jersey). A more relatable statistic is federal spending per household, which allows families to measure the costs and benefits of government in their own lives. Throughout the 1990s, real federal spending remained slightly under $18,000 per household. From 1998 through 2003, federal spending jumped by $2,500 to reach $20,300 per household—marking the first time since World War II that federal spending has topped $20,000 per household (see Chart 2 and Table 1).[3]

For that amount of government, Americans paid $16,780 per household in federal taxes in 2003—a staggering tax burden indeed, but only the beginning. Federal revenues are still $3,520 per household less than federal spending. That difference represents the per-household cost of the $374 billion budget deficit. Since all federal spending must eventually be paid for in taxes, the $3,520 per household represents higher future taxes that must be collected to fund the full $20,300 per household that Washington spent in 2003.

The reality that all spending must eventually be paid for in taxes cannot be overemphasized. Despite its current popularity, the "big-government conservative" model of coupling tax relief with rapid spending increases is not sustainable in the long run. If Washington continues to spend $2,500 per household more than it did in the 1990s, then taxes must eventually rise by $2,500 per household per year. Budget deficits can delay, but not ultimately avoid, the tax collector. Permanently higher levels of spending require permanently higher taxes.

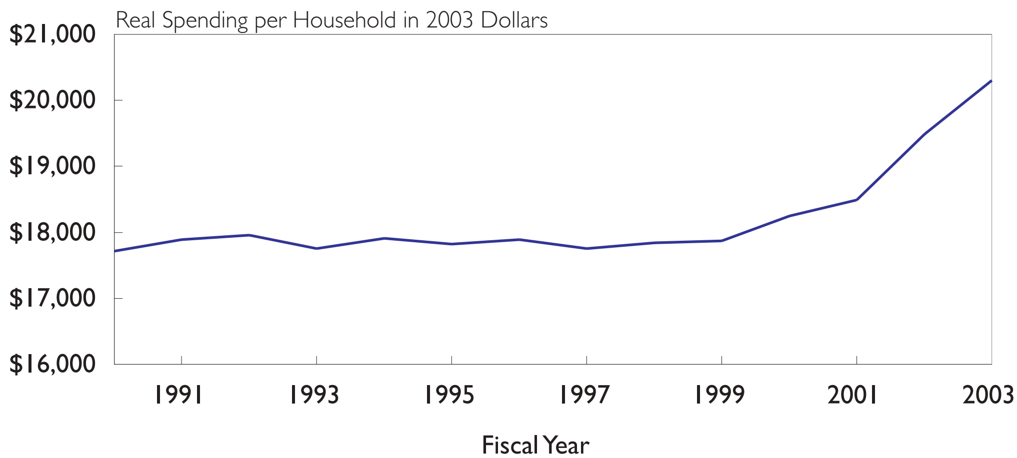
Where the Money Went

Table 2 shows that real federal spending surged by $353 billion between 1998 and 2003. Defense and Social Security combined for nearly half of that increase, which is not surprising given their historically large budgets. However, they did not grow as fast as other categories. For example:

1. Unless otherwise noted, all spending totals are in inflation-adjusted 2003 dollars. Calculations were made using data provided by the Office of Management and Budget and the U.S. Department of the Treasury.
2. These one-year growth rates are in nominal dollars.
3. Spending per household totals were calculated by The Heritage Foundation using Office of Management and Budget data as well as population totals provided by the U.S. Bureau of the Census.

Chart 2 B 1710

Washington Now Spends More Than $20,000 per Household



Source: Heritage Foundation calculations based on data from the Office of Management and Budget, the U.S. Department of the Treasury, and the U.S. Census Bureau.

Table 1 B 1710

Federal Spending Has Topped $20,000 per Household Four Times in American History

Rank	Year	Federal Spending per Household
1	1944	$26,445
2	1945	$25,572
3	1943	$23,370
4	**2003**	**$20,301**

All amounts are in constant 2003 dollars.

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

Table 2 B 1710

Since 1998, Mid-Size Federal Programs Have Grown at the Fastest Rates

Spending Category	Total Spending* 1998	2003	Spending Increase Amount	Percent	Percent of Total $353 Billion Increase
National Defense	$293,033	$405,109	$112,076	38%	32%
Social Security	413,932	465,843	51,911	13%	15%
Medicaid	110,502	160,560	50,058	45%	14%
Various Income Security Programs	150,062	183,990	33,928	23%	10%
Medicare	210,475	243,370	32,895	16%	9%
Unemployment Compensation	24,091	55,842	31,751	132%	9%
Other Health Programs	32,974	59,725	26,751	81%	8%
Education	33,780	57,967	24,187	72%	7%
International Affairs	14,309	26,817	12,508	87%	4%
Veterans Assistance	45,606	57,299	11,693	26%	3%
Air Transportation	11,594	23,151	11,557	100%	3%
Justice Administration	25,038	35,510	10,472	42%	3%
Agriculture	13,323	23,440	10,116	76%	3%
Community and Regional Development	10,671	20,497	9,826	92%	3%
Highways and Mass Transit	28,385	36,478	8,094	29%	2%
General Government	17,031	24,343	7,311	43%	2%
Other Spending	105,879	123,867	17,987	17%	5%
Net Interest	263,193	153,194	-110,000	-42%	-31%
Total Outlays	**1,803,879**	**2,157,000**	**353,121**	**20%**	**100%**

* All amounts are in millions of 2003 dollars.

Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Treasury Department.

- **Unemployment Compensation** payments jumped 132 percent to $56 billion. Much of this increase was automatically triggered by rising unemployment claims during the 2001–2002 recession. Additional spending resulted when Congress and President Bush enacted several bills extending un-employment benefits to workers beyond their typical 13-week limit. (See Chart 3.)
- **Education** spending surged by 78 percent, from $34 billion to $58 billion. Nearly all of this growth took place between 2001 and 2003, as the No Child Left Behind Act was being implemented. Most of the new spending was for aid to K–12 schools (including special education funding), which jumped from $19 billion to $32 billion. An $8 billion hike in college student financial aid dominated the rest of the spending increase. (See Chart 4.)
- **Health Programs** (other than Medicare and Medicaid) leaped 81 percent, from $33 billion to $60 billion. The National Institutes of Health's budget, which expanded from $14 billion to $23 billion, was the main contributor. The new State Children's Health Insurance Program (S-CHIP) added $4 billion in new annual spending, and other public health programs accounted for the rest of the increase. (See Chart 5.)
- **Agriculture** spending increased by 76 percent to $23 billion. Farm spending actually peaked at a record $39 billion in 2000 after Congress overreacted to a slight dip in crop prices by passing a series of massive "emergency" payments. The budget-busting 2002 Farm Bill assured that farm subsidies would not drop back to their 1998 level, even though the farm economy has improved. (See Chart 6.)

Lawmakers have also substantially increased spending for air transportation (100 percent), community and regional development (92 percent), and international affairs (87 percent), but a significant portion of those spending hikes resulted from the 9/11 attacks.

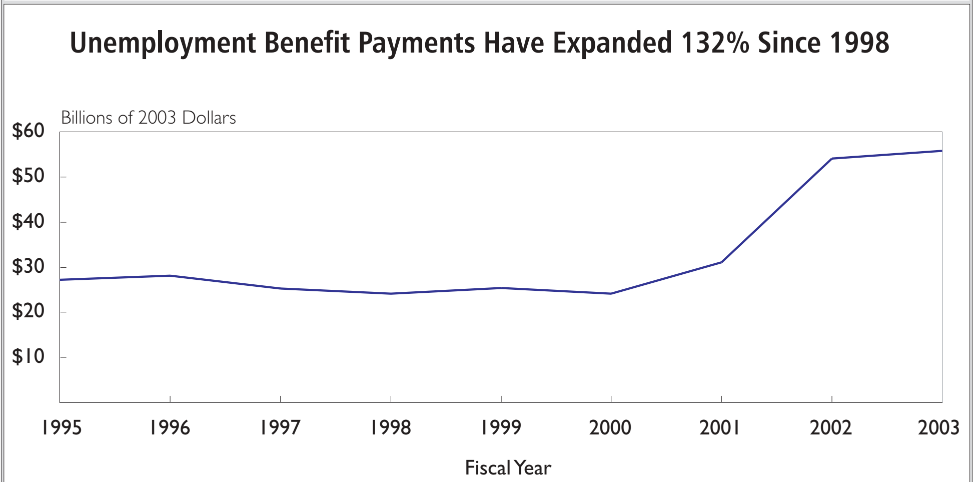
The Role of Defense and 9/11

Any analysis of recent spending trends must take into account the budgetary effects of the 9/11 attacks. Certainly, Americans want Washington to spend whatever resources are necessary to prevent further terrorist attacks. Lawmakers know this, which is why they have been classifying everything from levitating trains to farm subsidies as "defense" or "homeland security." A more evenhanded examination reveals that most new federal spending is not related to defense and the 9/11 attacks.

From 2001 through 2003, the federal budget expanded by $296 billion, of which:

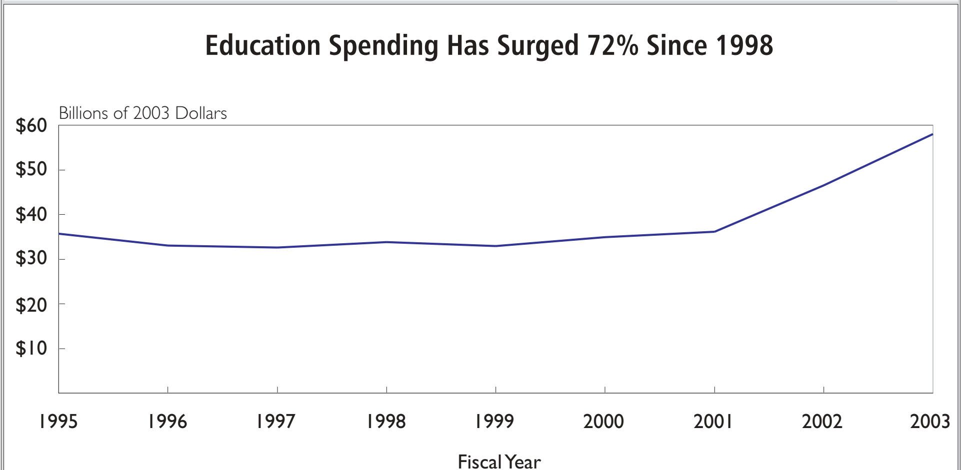
- $100 billion (34 percent) was for defense;
- $32 billion (11 percent) was for 9/11-related spending for homeland security, compensating

Chart 3 B 1710



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Department of the Treasury.

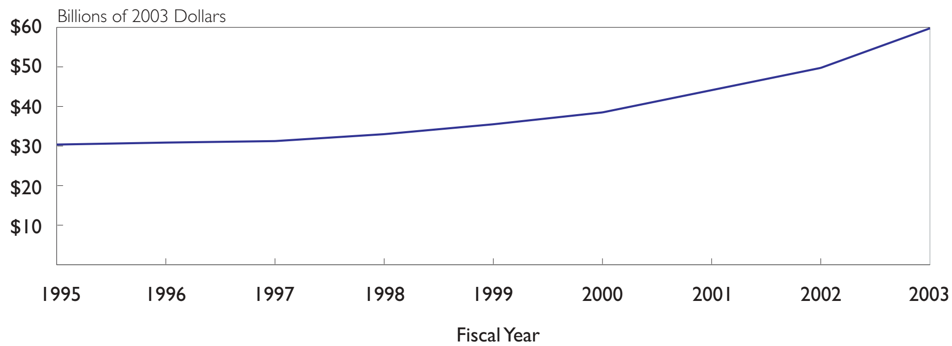
Chart 4 B 1710



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Department of the Treasury.

Chart 5 B 1710

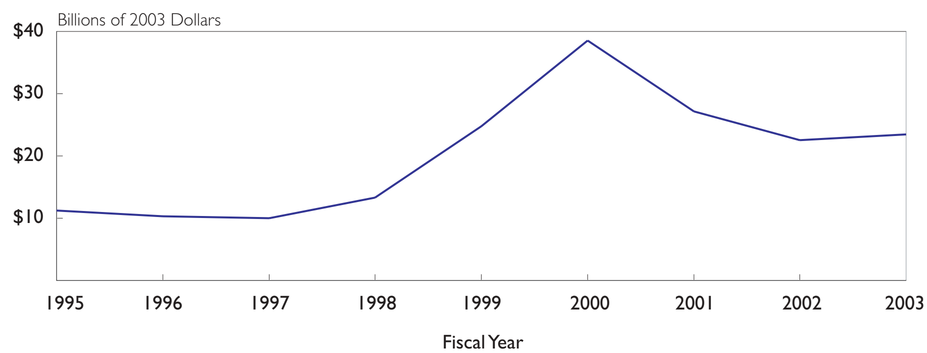
Health Spending Outside of Medicare and Medicaid Is Up 81% Since 1998



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Department of the Treasury.

Chart 6 B 1710

Despite Recent Decreases, Agriculture Spending Remains 76% Above 1998 Levels



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Department of the Treasury.

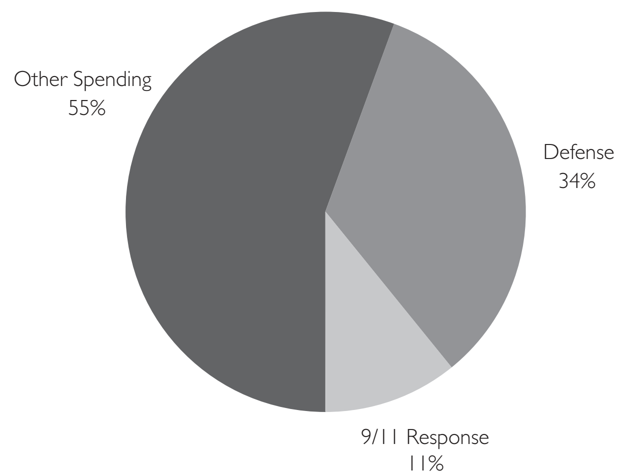
victims, rebuilding New York, and international assistance and security; and

- $164 billion (55 percent) was unrelated to defense and the 9/11 attacks (see Chart 7).[4]

What would federal spending look like if the defense budget and all 9/11-related costs were excluded? Chart 8 shows that the portion of the budget unrelated to defense and 9/11 grew by 11 percent from 2001 through 2003—the largest two-year increase in a decade. Thus, not only did Congress and the President refuse to cut unrelated programs to fund the war on terrorism, but they also actually *accelerated* their growth rates. Although a convenient scapegoat, defense and other 9/11-related costs do not sufficiently explain why government is expanding so rapidly.

Chart 7 B 1710

Defense and 9/11 Account for Less Than Half of All Spending Increases Since 2001



Source: Heritage Foundation calculations based on data provided by the Office of Management and Budget and the Congressional Budget Office.

Mandatory Spending

In 2003, mandatory spending reached its highest level in United States history. After holding between $8,000 and $9,000 per household through most of the 1990s, mandatory spending surged to a record $11,144 per household in 2003, marking the first time that mandatory spending reached 11 percent of the gross domestic product.

Mandatory programs are those whose annual spending totals are not set annually, such as Social Security, Medicaid, and most welfare programs. Policymakers decide who is eligible for a program and what the benefit formula will be. For the next several years, total spending is determined by how many eligible individuals enroll in the program and where they fit in the benefit formula. Consequently, policymakers reject blame for mandatory spending trends that many of them did not vote to create. But elected officials are not forbidden from changing these spending formulas whenever they see fit. In fact, lawmakers have a responsibility to keep mandatory spending levels in tandem with the nation's evolving priorities.

Instead of pulling back these entitlement programs, Congress and the President expanded them. As stated earlier, lawmakers enacted large expansions in farm subsidies and unemployment benefits. They also failed to reform—and in 2003, increased funding for—Medicaid, the costs of which have jumped 45 percent since 1998. Social Security and Medicare grew by just 13 percent and 16 percent, respectively, in what is the calm before their coming budgetary storm.

The coming crisis in Social Security and Medicare is staggering. These programs will be able to finance themselves through payroll taxes until approximately 2015, when the costs of funding retiring baby boomers will overwhelm the generation still in the workforce. The tax increase needed to fund the Medicare shortfall is projected to reach $1,500 per household by 2020, and nearly $3,000 per household by 2030. Funding the Social Security shortfall will require additional taxes nearly as large as those for Medicare, and neither the payroll tax nor any of these coming tax increases will be set aside for the worker paying all the taxes. All of it will fund current retirees.

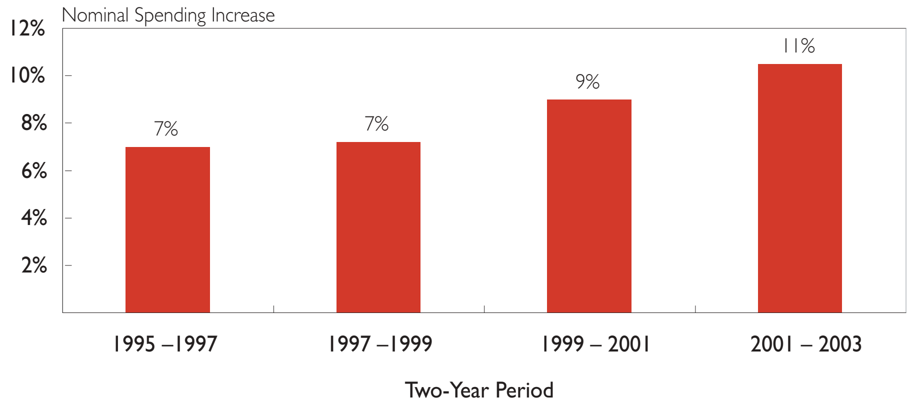
Lawmakers' solution to this coming calamity has been to pile yet another entitlement on top of these,

4. These short-term growth rates are in nominal dollars. See Brian M. Riedl, "Most New Spending Since 2001 Unrelated to the War on Terrorism," Heritage Foundation *Backgrounder* No. 1703, November 13, 2003, at *www.heritage.org/Research/Budget/BG1703.cfm*.

without a plan to pay for it. The proposed Medicare drug entitlement would eventually add another $1,125 per household in additional taxes per year.[5] With no entitlement reform plans close to enactment and lawmakers having agreed to anchor another unaffordable entitlement onto future generations, the 2003 record of $11,144 per household in mandatory spending may soon seem comparably *inexpensive*.

Chart 8 B 1710

Spending Increases Excluding All Defense and 9/11- Related Spending



Source: Heritage Foundation calculations based on data provided by the Office of Management and Budget and the Congressional Budget Office.

Discretionary Spending

Even judging lawmakers solely by discretionary spending trends does not make them appear any more frugal. Since 1998, real discretionary spending has jumped 36 percent, from $603 billion to $820 billion. The half of the discretionary budget for defense and 9/11-related costs has surged by 45 percent since 1998. Discretionary spending on programs unaffected by defense and 9/11 has increased 27 percent since 1998.

Chart 9 shows that non-defense discretionary spending has been rising steadily for over a decade. Throughout the 1990s, these non-defense spending increases were balanced by deep defense cuts, leaving discretionary spending levels generally unchanged. The September 11 attacks reversed the downward trend in defense spending and added new costs for homeland security, international security assistance, and rebuilding New York City. Rather than asking non-defense programs to help fund the war on terrorism by sacrificing some of their recent budget increases, lawmakers chose to ramp up the "butter" portion of the budget to match the "guns" portion. As a result, non-defense discretionary spending has reached 3.9 percent of GDP ($3,900 per household) for the first time in nearly 20 years.

The "Interest Dividend"

Spending plummeted in one category. From 1998 through 2003, net interest payments on the national debt dropped from $263 billion to $153 billion. Low interest rates, due more to Federal Reserve policy rather than any deliberate congressional policy, brought the $110 billion in savings. This "interest dividend" is as large as the 1990s "peace dividend" following the end of the Cold War. The interest dividend, however, has gone almost completely unnoticed.

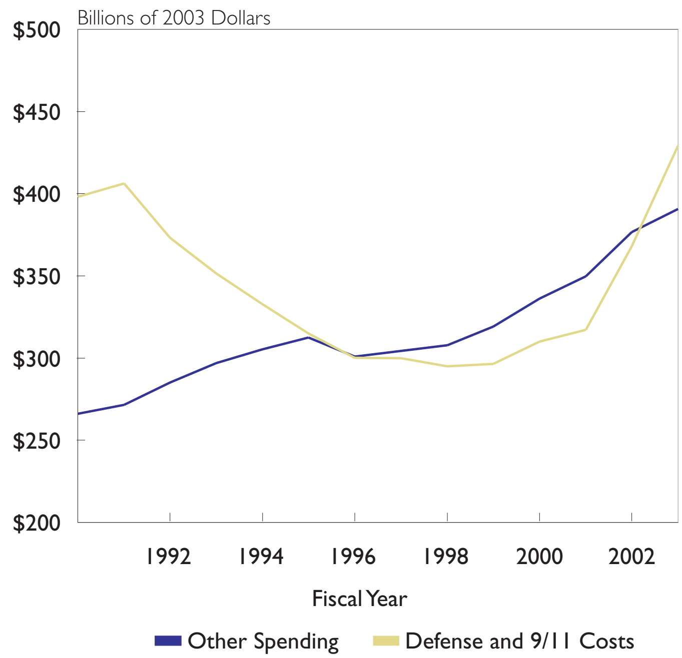
Taxpayers did not notice the interest dividend because they never saw a penny of it. Starting out with such an automatic and painless $110 billion spending cut gave budget cutters the wind at their back for the first time in nearly 50 years. They could have directly returned the interest dividend to the taxpayers with a $1,035 per household tax cut, or they could have used these once-in-a-lifetime savings to restrain the growth of government and pay down the national debt.

Instead, Congress and the President allocated all $110 billion to new spending and, when that money ran out, spent $353 billion more on top of it (making the actual increase in programmatic spending $463 billion, rather than $353 billion, as Chart 10 shows). Lawmakers acted like a shortsighted employee who responds to an unexpected $1,000 bonus by immediately going on a $4,500 shopping

5. See Brian M. Riedl and William W. Beach, "New Medicare Drug Entitlement's Huge New Tax on Working Americans," Heritage Foundation *Backgrounder* No. 1673, August 13, 2003, at *www.heritage.org/Research/HealthCare/bg1673.cfm*.

Chart 9 B 1710

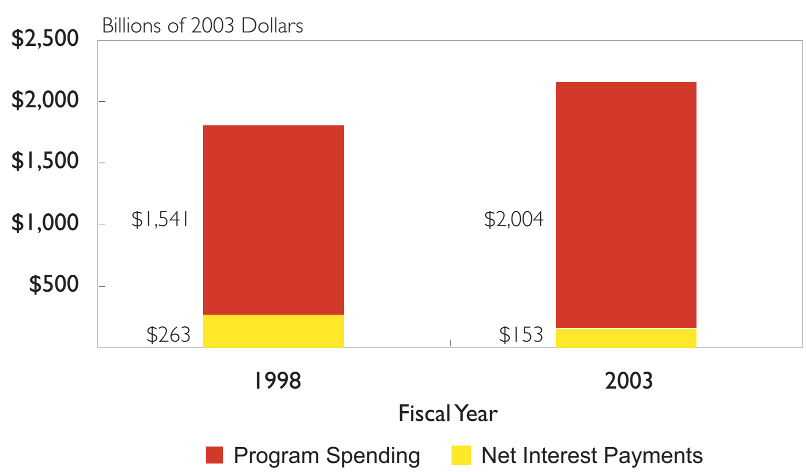
All Types of Discretionary Spending Are Increasing Rapidly



Source: Heritage Foundation calculations based on data provided by the Office of Management and Budget and the Congressional Budget Office.

Chart 10 B 1710

Net Interest Payments Dropped, but Washington Spent the "Interest Dividend"



Source: Heritage Foundation calculations based on data from the Office of Management and Budget and the U.S. Department of the Treasury.

spree, thus ending up $3,500 in debt.

Worse, the interest dividend is likely only temporary. As interest rates rise to normal levels, net interest costs will probably return to their 1998 level. The budget deficit would automatically increase by approximately $100 billion, with no new government benefits to show for it.

Nowhere to Cut?

Several lawmakers have asserted that all new spending is driven by necessities and that no programs could be cut without calamitous consequences. These lawmakers typically em-phasize essential spe-nding on defense and homeland security, as well as popular spending on education, health, and unemployment benefits. In reality, Congress and the President are throwing vast sums of money at *all* types of programs. Lawmakers could easily save taxpayers over $150 billion per year by eliminating:

- $80 billion in corporate welfare;
- $20 billion in pork-barrel projects;
- $50 billion in waste, fraud, and abuse identified by the government's own accountants, and
- $17 billion spent each year, for which the government's own auditors cannot account.[6]

Furthermore, Congress and the President have not even been able to say no to the lower-priority programs in Table 3. Every dollar spent on these programs represents one less dollar for tax relief, national security, or deficit reduction.

Table 3 B 1710

Even Lower-Priority Programs Are Receiving Large Spending Increases

Program	Total Spending* 1998	Total Spending* 2003	Increase
Peanut Subsidies	$0	$1,564	N/A
Denali Commission	0	74	N/A
Presidio Trust	0	33	N/A
Wool and Mohair Subsidies	0	20	N/A
Dairy Subsidies	318	2,456	673%
Soybean Subsidies	152	912	501%
Commerce Dept. Management	61	199	226%
Research & Special Programs Administration	72	193	168%
Rice Subsidies	536	1,366	155%
Inter-American Foundation	4	11	152%
Labor Dept. Management	207	520	151%
Risk Management Agency	1,390	3,331	140%
Architect of the Capitol	174	388	124%
HOPE VI Public Housing Revitalization	259	555	115%
Animal and Plant Health Inspection Service	574	1,170	104%
National Capital Planning Commission	7	13	98%
Agricultural Marketing Service	726	1,433	97%
International Commissions	33	63	92%
Amtrak	522	1,001	92%
Maritime Administration	216	405	87%
Natural Resources Conservation Service	1,001	1,872	87%

*All amounts adjusted for inflation and set in 2003 dollars

Source: Heritage Foundation calculations based on data from the Office of Management and Budget, Department of the Treasury, and Department of Agriculture.

The Consequences Of Unrestrained Spending

Increased government spending weighs down the economy and requires taxes that hinder working families' ability to make ends meet. A growing economy requires a base level of government spending on defense and justice to enforce the property rights and rule of law necessary for markets to function. Public goods, such as roads, are often important for facilitating trade and aiding economic growth. Yet, they can be difficult for the private sector to provide without at least minimal government oversight. In such cases, limited government involvement can aid economic growth.

Contrary to the fallacy that government spending stimulates the economy, government spending beyond this base level impedes economic growth for three reasons:[7]

- **Diminishing Effectiveness.** Governments often begin spending on such necessities as defense, law enforcement, and basic public goods.

6. These are called "unreconciled transactions" in the Department of the Treasury's financial reports of the U.S. government.

Empowered by the opportunities for economic growth that these services provide, they mistakenly conclude that they can solve any problem. Consequently, they tend to expand their efforts into services that the market is better equipped to provide, such as education, housing, food, and pensions. With each expansion, the government not only blocks the market from functioning, but also becomes less and less effective itself, until it ultimately becomes a barrier to economic growth.

- **Politics.** Markets use the profit motive to ensure that resources are allocated efficiently. Businesses seeking profits must consistently respond to consumer demand with quality products at low prices. Governments, by contrast, are monopolies with no real profit motive or incentive to spend money efficiently, so policymakers make re-election their "profit" and consequently allocate resources to even the most wasteful programs if they help ensure their return to office. While innovation and evolving with the changing times are required for businesses to survive, they represent an unnecessary risk for politicians who are guaranteed re-election as long as they do not interrupt the flow of government funds to their districts. Hence, while markets helped the Model T evolve into the Porsche and the Apple IIe into the supercomputer, the federal government continues to run many of the same federal agencies—now obsolete—that it established as far back as the 1800s.
- **High Taxes.** Increased government spending makes it difficult for working families to make ends meet. Even when the government funds itself by borrowing money, repaying those loans will eventually require higher taxes. Unless lawmakers pare back the $2,500 per household spending increase since 1998, the average household will eventually have $2,500 less per year to spend on necessities such as health insurance, retirement, housing, and education. Regrettably, many people praise government spending on families without acknowledging that families first had to be taxed—and that the burden of those taxes often outweighs the benefits of the government programs.[8]

  In addition to their high cost, taxes hurt the economy by distorting incentives. Families and businesses work, save, and invest because they expect a financial reward. These productive behaviors also make the rest of the nation wealthier by creating additional economic activity. But burdensome tax rates reduce the financial reward for being productive. Consequently, families and businesses cut back their productive behavior to escape taxes, and the entire economy slows down.

To see the consequences of excessive spending and taxation, one need look no further than Western Europe, where politicians have promised to provide for all of their citizens' needs in exchange for higher taxes and bigger government. Western Europeans have incomes 40 percent below Americans' and unemployment rates twice as high. They also pay 50 percent of their income in taxes.

Conclusion

Budgets are about setting priorities. Each day, millions of households find ways to live within their means. All of them would surely like to spend more money than they have; yet, they understand that separating necessities from unaffordable luxuries, even making unpleasant sacrifices, is required to stay out of the red.

Congress and the President have lacked that belt-tightening discipline. As new spending requirements have emerged, they have refused to set priorities and make sacrifices in programs less vital to the national interest. This lack of discipline has raised

7. This three-category breakdown of the side effects of government spending is from James Gwartney, Robert Lawson, and Randall Holcombe, "The Size and Functions of Government and Economic Growth," Joint Economic Committee, U.S. House of Representative and U.S. Senate, April 1998.
8. Milton Friedman, winner of the Nobel Prize in economics, has argued persuasively that individuals, because they are spending their own money and not someone else's, have better incentives to spend efficiently than do governments. Consequently, allowing families to spend their own money on items such as education and health care will be more effective than having governments tax these families in order to purchase the services for them.

the cost of government to over $20,000 per household for the first time since World War II. In the absence of re-sponsible spending restraint, the economy will struggle under the weight of excessive taxes and runaway federal spending.

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