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NON-DEFENSE DISCRETIONARY PROGRAMS WILL FACE SERIOUS PRESSURES UNDER CURRENT FUNDING CAPS

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President Obama and Congress achieved $1.5 trillion in discretionary program cuts over the next ten years primarily by setting tight caps on annual discretionary funding in the Budget Control Act (BCA) of 2011.[1] Congress adhered to those caps in 2012 in writing its appropriations bills for that year, but has yet to enact final appropriations for 2013.[2] As part of their deliberations over how to craft a long-term deficit-reduction plan, policymakers may be tempted to cut discretionary funding — and particularly discretionary funding outside the Pentagon — even further. They should not do so, for they do not have room to make such cuts without threatening the government's ability to provide crucial benefits and services and perform core public functions.

Non-defense discretionary (NDD) programs encompass most of the activities that the federal government performs, from supporting education to maintaining national parks to funding biomedical research to helping low-income families afford housing. (NDD excludes mandatory or entitlement programs such as Social Security, Medicare, and veterans' compensation.)

We estimate that, with the funds available under the caps, the federal government will fall about $350 billion short over the next ten years of delivering the same level of benefits and services for NDD programs as it did in 2012. This is because: (1) the costs of a number of key programs, especially VA medical care, are projected to grow substantially, and (2) Congress relied on certain temporary savings measures to meet the 2012 caps that it cannot repeat in the future. Furthermore, it would take an additional $265 billion over the next ten years to account for general population growth, which affects NDD programs ranging from Head Start to home-delivered meals for the

[1] The $1.5 trillion in funding cuts is measured from the level of funding available at the end of 2010, when the Bowles-Simpson and Rivlin-Domenici deficit reduction plans were issued. Specifically, the figure represents the difference between CBO's projection of defense and non-defense discretionary (NDD) funding at that time and CBO's current projection of such funding if Congress adheres to the BCA caps. Because CBO's projection of discretionary funding as of the end of 2010 extended only through 2020, we extrapolate it two years, to 2022, to cover the current ten-year budget window, 2013-2022. Similarly, because the BCA caps covered 2012 through 2021, we extrapolate the caps one year, to 2022. See CBPP, *Congress Has Cut Discretionary Funding By $1.5 Trillion over Ten Years: First Stage of Deficit Reduction Is in Law*, November 8, 2012, http://www.cbpp.org/files/9-25-12bud.pdf.

[2] Congress has enacted a temporary "continuing resolution" for 2013 that goes through March 27, 2013.

elderly. In total, it would require $615 billion above what the caps allow to maintain the same level of benefits and services *per person* as in 2012.

Policymakers thus will have to exact steep cuts in NDD to fit within the caps. Going *below* the caps and imposing even deeper cuts in NDD funding would put the government even further behind in providing 2012-level benefits and services over the coming decade and could jeopardize the well-being of millions of Americans.

Six Reasons Why Policymakers Should Not Go Below the NDD Caps

The caps for NDD provide $65 billion more in funding over the next decade than needed to accommodate the 2012 funding level adjusted for inflation. Some policymakers thus may conclude that they can reduce the NDD caps significantly and still maintain appropriate levels of benefits and services. That's not the case, however, for two basic reasons.

First, the actual 2012 funding level was not necessarily satisfactory for that year to begin with. Total non-defense funding in 2012 was already about 9 percent below the 2010 level, adjusted for inflation.[3] At the 2012 level, Social Security offices closed early and some agencies fell behind in processing and reviewing benefit claims.

Second, and far more important in dollars, many NDD programs will face significant pressures for additional funding beyond inflation increases that will overwhelm this potential savings. Below are six examples of areas that will need funding increases beyond the rate of inflation to maintain 2012-level benefits and services. In total, they add up to about $680 billion of additional funding over the next decade. So, while the caps are $65 billion *above* the 2012 funding level adjusted for inflation, they are $615 billion ($680 billion minus $65 billion) *below* what is needed to provide 2012-level benefits and services per person over the next decade. (The caps are $350 billion below what is needed to provide 2012-level benefits and services if one ignores the effects of growth in the U.S. population.)

This gap between the amount of NDD funding that the caps will allow and the amount that is needed to maintain current levels of benefits and services starts in 2014 and grows each year, reaching $120 billion, or 17 percent, in 2022.

1. **VA medical care.** Funding for VA medical care has risen 8.5 percent per year since 1999, on average, and these funding needs are likely to continue rising at a similar rate in the years ahead. There are two main causes: health care costs across the economy are rising faster than general inflation and a growing share of veterans are elderly and thus more expensive to treat.

    - The per-person cost of health care across the U.S. health care system is expected to grow at about 5 percent per year in the coming decade, substantially faster than projected inflation, which averages 2.1 percent per year.

[3] The 2010 levels reflect no Recovery Act funding, which was provided in 2009. Also, 2010 funding represents the level at the time of the Rivlin-Domenici and Bowles-Simpson recommendations, before the deficit reduction efforts initiated by the 111th Congress and is therefore the right benchmark for measuring discretionary cuts to date.

- Korean and Vietnam veterans are reaching the ages at which they become much more expensive.

- Employed Vietnam veterans are reaching retirement age and are likely to choose VA care (if they are eligible for it) over Medicare because VA care would cost them less.

If VA health care funding grows at its historical rate of 8.5 percent per year, that will add about $255 billion in costs beyond the cost of keeping pace with inflation.

(The need for increased VA health funding is not due to the *number* of veterans, which has declined over the past decade and is projected to continue doing so. And while injured veterans returning from the Iraq/Afghanistan wars have put some upward pressure on VA medical care, the Congressional Budget Office (CBO) finds that the cost of patients from those wars accounted for only 4 percent of total VA medical care costs in 2010 and that those patients cost about half as much per patient as other veterans.[4])

Table 1

Upward and Downward Pressures on the NDD Caps

Covers 2013-2022*; cumulative total in billions of dollars

Major upward pressures:	
Veterans' medical costs that exceed inflation	255
Pell Grants' artificially low funding base	50
One-time savings: CHIP "performance bonus fund"	60
Assisted housing	30
Expiring special public health funding	20
Subtotal, specific programs	*415*
Population growth	265
TOTAL major upward pressures	**680**
Downward pressure: caps are above inflation-adjusted 2012 funding	-65
NET upward pressure	**615**

*We extend the caps one year, to 2022, to be consistent with the current ten-year budget window.

2. **Pell Grants.** Funded mostly by discretionary appropriations, Pell Grants help low-income students pay for college. The discretionary appropriation for Pell Grants was artificially low in 2012 because Congress provided temporary funds — outside of the regular appropriations process — to help cover the program's discretionary funding needs. But this pot of temporary funding largely disappears at the end of 2013. So, even though the *full costs* of the discretionary portion of the program are expected to grow more slowly than inflation over the next ten years,

[4] CBO, *Potential Cost of Health Care for Veterans of Recent and Ongoing U.S. Military Operations, July 27, 2011*, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/123xx/doc12315/07-27-va_healthcare.pdf.

the Pell Grant discretionary appropriation will need to grow much *faster* than inflation starting in 2014 to make up for the loss of temporary funding.

If the Pell Grant discretionary appropriation grows only with inflation from the artificially low 2012 funding level, the program will face a funding shortfall of about $50 billion over the next decade.[5] In other words, an additional $50 billion will be needed to maintain Pell Grant award levels without cutting students from the program.

3. **Exhaustion of one-time savings.** Historically, Congress has met tight discretionary caps in part by obtaining savings in mandatory programs through special provisions of appropriations bills. Such savings are credited against discretionary caps, so they can offset ongoing funding for discretionary programs.

   Most such savings policies can be repeated year after year, but one big source of such savings — unused bonus funds in the Children's Health Insurance Program (CHIP)'s Performance Fund — will no longer continue to build up after the end of 2013. The loss of this source of one-time savings will raise, by about $60 billion, the net cost of maintaining NDD funding at its 2012 value adjusted for inflation over the remainder of the decade.

4. **Assisted housing.** The Section 8 assisted housing programs help low-income households — especially those with children or elderly persons or persons with disabilities — by limiting their rent payments for low-cost private housing units to 30 percent of household income. To continue serving the same number of low-income families over the next decade (which would still leave about three-fourths of eligible households *without* assistance due to funding limitations), the programs will require about $30 billion more funding than the growth allowed by inflation because of these special factors:

   - The Department of Housing and Urban Development (HUD) bases the amount of rent that Section 8 assistance can cover on the "fair market rent," or the cost of a modest apartment in the local private rental market. Since rents and utility costs in the private market tend to grow faster than overall inflation, so does the cost of rental assistance per household. (Low-income recipients' incomes typically fail to keep pace with rising rental costs, so their contribution of 30 percent of their income covers a shrinking share of those costs.)

   - Several decades ago, when HUD signed the original contracts with private owners to participate in the "project-based" part of Section 8, Congress provided enough funding to make rental assistance payments throughout the contracts' 20- to 40-year terms. As the contracts began to expire in the mid-1990s, however, Congress directed HUD to replace them with contracts funded annually through appropriations. This process, which is expected to continue as the rest of the long-term contracts expire over the next decade, raises the program's annual *funding* needs even though it has very little effect on the program's actual level of *spending* each year.

   - Part of the fiscal year 2012 funding for Section 8 assisted housing came from program reserves and other funding provided before 2012. This pool of reserve funds is now drying up, so policymakers will need to offset the loss of such funds by providing new funding to

[5] Based on CBO March 2012 Pell Grant program cost estimates and CBO August 2012 inflation projections.

prevent a reduction in the number of families assisted.

5. **Expiring health reform funding.** The Affordable Care Act (ACA) provided some temporary mandatory funding to supplement discretionary funding in areas such as community health centers, home visiting programs for pregnant women and newborns, and the National Health Service Corps. To maintain these activities at 2012 levels after the ACA funding runs out in a few years will require roughly $20 billion over the decade.

6. **Population growth.** Even if NDD funding for other programs keeps pace with projected inflation, this does not cover the 10 percent growth of the U.S. population projected over the decade. Many NDD programmatic needs are related to the size of the population: grants to school districts; direct benefits such as WIC, Head Start, child care, health centers, job training, and home-delivered meals for the elderly; collecting tax returns; enforcing laws and regulations; processing passport requests; and administering Medicare, Social Security, and SSI. True, some costs are unrelated to population growth, such as biomedical and scientific research and space exploration. But various other costs could grow *faster* than the population due to pressures that population growth may create — e.g., maintaining national parks and air traffic safety.

   To cover inflation plus population growth for the programs other than VA medical care and Pell Grants,[6] by 2022 those programs would need to be 10 percent above the level that would suffice merely to cover inflation. The difference amounts to about $265 billion of NDD funding over the period 2013-2022 for those programs.

In addition to these six factors, there will be pressure for increases in non-defense discretionary funding above inflation because of needed increases in the size and pay of the federal workforce. The 2012 funding level for civilian pay was low in part because pay rates were frozen in 2011 and 2012 and most federal agencies did not fill vacancies this year; as a result, the federal work force shrank through attrition. Agencies can work shorthanded for a while, but not for a decade, and merely increasing the 2012 funding level by inflation would not make up for the earlier losses. Shrinking the NDD caps further would likely force continued attrition and pay freezes, which could seriously degrade the quality of the civil service and its ability to do its required duties.

The upward funding pressures explained in the six points detailed above total $680 billion over the decade, as shown in Table 1. So even if one disregards the issues related to pay freezes and attrition, just adhering to the *existing* NDD caps may well cause serious damage to the programs discussed above — or to other NDD programs if policymakers cut them further to accommodate the specific needs described above.

Thus, the fact that the NDD caps for 2013-2022 are $65 billion above the 2012 NDD funding level adjusted to reflect inflation does *not* mean that policymakers could reduce the caps by $65 billion and still maintain 2012-level benefits and services. Even at the current cap levels, NDD programs face net upward pressures of $615 billion.

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[6] The estimates of needs for VA medical care and Pell Grants take account of the projected size of the beneficiary population. The estimate for assisted housing does not since it is based on the cost of providing assistance to the same number of households as in 2012. The population adjustment here, therefore, includes an adjustment in assisted housing costs to reflect the general increase in the U.S. population.

Appendix

Table 2 shows the cap figures we use in this analysis.[7] The formal caps were created by law and are split between defense and non-defense discretionary (NDD) programs in 2013 through 2021. There are no caps for 2022, but the budget window that President Obama's budget and the congressional budget plan use extends through 2022. We therefore calculated a comparable cap figure for 2022 by assuming that the 2021 NDD cap of $590 billion would grow by 2.1 percent in 2022, the same cap growth rate that applied in 2021.

The second row of the table, based on actual NDD funding for 2012, shows what would happen if that funding level grew with the Consumer Price Index (CPI) over the decade. The 2012 funding level of $487.1 billion reflects $505.9 billion in gross NDD funding *minus* $18.8 billion of savings from changes in mandatory programs enacted in appropriations bills and credited towards adhering to the caps.[8]

The third row reflects the difference between the caps and the 2012 level inflated. The difference totals $65 billion over ten years.

Table 2

Caps on Non-Defense Discretionary Funding and Projection of Actual 2012 Funding

Dollars in billions

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	TOTAL
NDD Caps	501	510	520	530	541	553	566	578	590	602	5,491
Actual 2012 NDD funding as scored by CBO, projected to grow with CPI inflation	494	502	512	523	534	547	559	572	585	599	5,426
Difference	7	8	8	7	7	6	7	6	5	4	65

[7] We exclude costs that are outside the formal caps: costs for wars, disasters, program integrity, and emergencies. Program integrity funding refers to specific, limited amounts that supplement normal funding for the Social Security Administration and the Centers for Medicare & Medicaid Services to conduct continuing reviews of disability determinations and to control Medicare fraud, respectively. Studies have proven that supplemental funding for these purposes more than pays for itself by reducing mandatory spending. (Technically, such additional discretionary funding triggers upward adjustments to the formal caps.)

[8] The components of the 2012 funding level reflect a combination of OMB and CBO estimates. CBO's August 2012 estimate of $505.9 billion in NDD funding (excluding items outside the caps, as noted in footnote 2) did not include the mandatory savings attributed to appropriations bills. Rather, CBO had shifted (or "rebased") those mandatory changes to the mandatory side of the budget and rolled them into the total spending figures for the mandatory programs in question. This makes CBO's estimates of those mandatory savings unavailable. Consequently, we rely on OMB estimate of $18.8 billion for those mandatory savings.