



Issue Paper #1



# Investing in Children

By

C. Eugene Steuerle and Gillian Reynolds, The Urban Institute and  
Adam Carasso, The New America Foundation



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1025 F Street, NW, Suite 900 Washington, DC 20004  
(202) 552-2000 [www.PartnershipforSuccess.org](http://www.PartnershipforSuccess.org)

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## **Abstract**

Because of concerns over the different influences of the government budget on the rate of economic growth and the well-being of each succeeding generation, we chart U.S. federal spending on investment in total and for children from 1965 to 2017. Five major categories can be considered—some more so than others—to be investment or to have investment components: education and research, work supports, social supports, physical capital, and defense investment. Relative to domestic spending, the most direct investment – education and research – for the nation as a whole, and crucially for children fell over the 1970-2006 period though with some recent rebounds. More important, projections of current policies show that overall government investment and especially investment in children are threatened to decline in relative and sometimes absolute importance, squeezed out mainly by faster, automatically growing programs that tend to favor consumption. These data raise the question of what relative priority the government should place on investment, and particularly investment in children. Other research, particularly on absolute and relative effectiveness of all programs, is necessary to answer that question.

## Executive Summary

A society spends its money in two ways: increasing current consumption and investing in the future. Investment has long been recognized as a primary driver of economic growth and, in an increasingly knowledge-based economy, investment in human capabilities rises in ever-greater importance relative to investment in physical plant and equipment. But how much is our federal government currently investing, and how does that total compare to the past? Given some evidence that the returns to investment in human capability are often highest in the early years of life, how heavily does the federal government invest in our children? And, do mounting budgetary pressures threaten these levels of investment?

This report charts the patterns of federal investment from 1965 to the current period, along with projections to 2017, based on five categories of programs that arguably constitute “investment” or potentially contain at least some investment component:

1. *education and research* tallies direct investment in people and infrastructure (e.g., primary and secondary education and research and development);
2. *work supports* capture programs that expand labor supply or support work effort, potentially building human capital (e.g., the earned income tax credit and child care);
3. *social supports* describe those programs that for the most part promote basic needs consumption, including health care, food, and housing; while not normally considered investment, they may contain some investment component as they also bolster family members’ ability to work or remain in school;
4. *physical capital* sums up all acquisition of equipment, construction, and rehabilitation (e.g., building highways and rehabilitating housing projects); and
5. *defense investment* includes physical and capital investment programs that improve security for all citizens.

The Office of Management and Budget (OMB) considers only categories 1, 4, and 5 to be investment. How much each of these five categories directly contributes to economic growth is debatable, but we present data on all categories for the sake of completeness and to allow readers to make their own judgments. Many of our conclusions, however,—in particular, about the future decline in federal investment if the federal budget remains on its current course—hold under almost any definition of investment.

### The History of Federal Investment, 1965–2006

Assessing the *relative* budgetary emphasis placed by the federal government on investment requires comparisons to gross domestic product (GDP) and overall federal spending. In the case of the latter, we sometimes distinguish between total federal spending and domestic federal spending (excluding defense and international spending).

Relative to GDP or domestic spending, we found that total federal investment and children's federal investment followed an up-and-down pattern over the 1965–2006 period, tending to rise somewhat during the late 1960s or early 1970s, decline thereafter, and then rebound starting in the late 1980s. The expenditure around the space program in the 1960s and 1970s, increased defense research spending during the Vietnam War and through the 1980s, and the enactment of many new education programs for children powered the rise in investment during the first third of the period. The dramatic falloff in spending on physical capital and infrastructure, the cessation of the Apollo program, and the failure to index education programs to inflation or enact new ones caused the dip in the middle third of the period. And finally, the renewed expansion in children's education programs, the rise in work support and social support programs, and the uptick in defense research around the War on Terror drove the rebound in investment over the last third. But the particular drivers and whether federal investment for the nation or for children wound up higher or lower in 2006 than in 1965 depends on the investment series and measure in question.

Projections of current policies show that both government investment in children and overall government investment will decline, squeezed out by faster, automatically growing consumption programs that largely go to the elderly. Some highlights of our findings follow.

- In 2006, spending on federal programs with some potential investment component—that is, broadly measured to include social supports—was \$646.1 billion, or 5.0 percent of GDP. The portion of those programs that went to children was \$206.9 billion, or 1.6 percent of GDP.
- Total investment programs broadly measured broke down as follows: 1.3 percentage points to *education and research*, 0.3 points to *work supports*, 1.3 points to *social supports*, 0.7 points to *physical capital*, and 1.3 points to *defense investment*.
- Federal investment in children (under age 19) broke down as follows: 0.4 percentage points for *education and research*, 0.3 points for *work supports*, and 0.9 point for *social supports*.
  - Broadly measured, investments in children made up roughly 54 percent of total investment in *education and research*, *work supports*, and *social supports*;
  - Narrowly measured (e.g., without employment or social supports), children's investments made up 29 percent of total *education and research* investment.
- Total federal investment in *education and research* declined from 14.1 to 7.9 percent of domestic spending over the 1965–2006 period. By contrast, investments for children under this category grew from 1.5 to 2.3 percent of domestic spending.

- For *work supports* only, total federal investment and children’s investment increased from nothing in 1965 to around \$40 billion in 2006 largely because of the introduction of the EITC and child care entitlement to states.
- *Social supports* increased the most of any category over the 1965–2006 period. By 2006 it was the largest contributor to both total and children’s investment. (Again, although this category contains some potential investment component, these expenditure programs were enacted in no small part to provide minimum consumption levels to the population.) As a share of domestic spending, total spending in this area grew from 3.4 to 8.3 percent, while spending for children grew from 2.6 to 5.6 percent.
- *Physical capital* fell from 12.9 percent of domestic spending in 1965 to 4.4 percent in 2006.

### **The Scheduled Future of Federal Investment if Current Policies Are Extended, 2007 to 2017**

The following projections are based on the continuation of current policies. We largely rely on the baseline projected by the Congressional Budget Office (CBO). The CBO baseline assumes mandatory programs (largely health and retirement) will continue to grow automatically (often faster than GDP) while the remaining discretionary programs will grow little or not at all in real terms. Some key findings appear below.

- Federal investment of almost every type is scheduled to decline, whether as a percentage of GDP or of domestic spending.
- *Education and research* will fall from 7.9 to 6.2 percent of domestic spending; the children’s portion will drop from 2.3 to 1.8 percent of domestic spending.
- Total federal investment in *work supports* will decline from 2.0 to 1.3 percent of domestic spending and, for children, from 1.9 to 1.3 percent of domestic spending.
- For *social supports*, total federal investment and children’s investment appears scheduled to remain roughly unchanged over the next 11 years, falling slightly from 8.3 to 8.1 percent and 5.6 to 5.5 percent of domestic spending, respectively.
- The drop-off in federal investment is starkly revealed when future additions to spending, rather than total spending patterns, are isolated. Largely due to rising federal revenues that reflect economic growth—even with no legislated tax increase—total domestic spending is scheduled to jump \$647 billion in real terms between 2006 and 2017. Of that increase, **almost nothing** is scheduled for investment in children or in total, outside of health care. In fact, **investments in children through education and work supports combined are scheduled to decline in real dollars spent**, and not simply to decline relative to GDP or total domestic expenditures.

No matter what definition of investment is used, it is clear that investment does not seem to be a priority of the federal government, and investment levels are forecasted to wane in the near future. Investment in children faces a similar and even bleaker outlook.



## Introduction

The term “investment” popularly conjures up stock or mutual fund purchases. But investments can take many forms. Broadly speaking, an investment is the use of resources to increase future production output or income rather than to finance current consumption.

To ensure long-term economic growth and rising standards of living, nations require investments in human capital, basic research and science, plants and equipment, and national infrastructure. Some of this investment represents more of a social good than a private good. That is, because many types of investment provide benefits to society, voters sometimes ask the government to interfere to garner those benefits. Societal benefits from research, for instance, often spread among many households, but companies and individuals engaged in research often do not garner the gains they provide to others nor, sometimes, even find the means to cover their costs. Poorer parents, in turn, often cannot afford quality education for their own children, even though all of society may benefit from a better-educated citizenry. Further, when in the modern economy government becomes large, extracts resources through taxation, and spends much on consumption, it may without intention reduce societal investment unless it takes some offsetting measures. In sum, a vital issue for government policy is how well government revenues are spent and invested and how they affect overall well-being not just now but for the future and for future generations.

Given these obvious concerns, it only makes sense to try to track the “investment budget”—the amount of money the government allocates to investment activities. This report charts how different categories of federal investment have fared in recent history and, perhaps more important, how the sums and proportions within each category are scheduled to change if current policies are continued.

Investment in children is given special attention. Since children have their entire lives in front of them, investments in them require long timetables for payoffs relative to such other investments as enhancements to infrastructure and the capital stock. Unlike investment in plant and machinery, which depreciates over time, investment in human capital may even appreciate if passed from generation to generation.

Another reason to give special attention to children is evidence showing that investments made earlier in people’s lives may produce higher rates of return than similar expenditures elsewhere. We do not claim that *every* dollar invested in children necessarily yields higher returns than dollars invested elsewhere, only that this potential calls for special attention to early investment in children. Economists and government policymakers have increased their emphasis over the past decade on quantifying the impacts of different private and government investments—as well as various policy interventions—on individuals’ and the nation’s economic well-being. Along these lines,

more research is needed to quantify the effectiveness of the different government investment programs included here.<sup>1</sup>

Several caveats concerning the scope and intent of our analysis are in order. We considered it vital to focus on the investment portion of the U.S. budget in the context of real federal dollars spent and the share of such investment relative to GDP and other domestic uses. Still, much further research would be quite valuable. To this end, we

- do not consider state and local government programs (while noting also that federal programs may just substitute for or displace state and local monies that would go for the same purpose).<sup>2</sup>
- provide no assessment of the effectiveness or adequacy of any particular investment program.
- do not attempt to calculate just what portion of programs largely aimed at providing work or social support could qualify as true investment.
- do not report investment net of depreciation. For many items examined here, such as education and research, there are few data, if any, on how to measure depreciation. Even where consistent time-series of federal investment data might include some depreciation factors at very aggregate levels, they are not readily available for the many individual programs examined here. In the end, readers should note that the government's *net* investment would be lower than the gross amounts reported here.
- do not consider tax expenditures.<sup>3</sup> Some of the major efforts at supporting investment operate through the tax system, largely in subsidies for pensions and housing—though these are seldom directed at children.<sup>4</sup>

Also worth noting but not assessed further in this study are these four matters:

- Federal spending for children often targets low-income families or children who are disabled, have significant health concerns, or are generally at risk. While this

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<sup>1</sup>For examples, see Julia Isaacs, “Cost-Effective Investments in Children,” Budgeting for National Priorities Paper (Washington, DC: Brookings Institution, January 2007); Isabel Sawhill, ed., *One Percent for the Kids: New Policies, Brighter Futures for America’s Children* (Washington, DC: Brookings Institution Press, 2003); the work of Jon Baron and others at the Coalition of Evidence-Based Policy, <http://www.evidencebasedprograms.org/>; and “The Science of Early Childhood Development” from the National Scientific Council and the Center on the Developing Child at Harvard University (2007) [www.developingchild.net](http://www.developingchild.net).

<sup>2</sup>At times, federal-state program designs encourage clever use of cost-sharing arrangements that that can decrease or increase investment.

<sup>3</sup>The refund component of the earned income tax credit and similar programs are considered by the government to be direct outlays rather than tax expenditures, and are included in our analysis of expenditures.

<sup>4</sup>As currently designed, the bulk of these tax subsidies goes to higher-income households regardless of the presence of children, but they, too, deserve some attention as part of the government’s overall investment policy.

makes such spending more progressive, at times it also tends to segregate children by class (e.g., federal funding for Head Start versus state and local funding for primary and secondary education).

- The returns to government investment programs for children potentially include not just increases in productivity, but also longer and healthier lives, fewer expenses for special needs, lower rates of incarceration or use of corrections facilities, and other social returns.
- Just like private investment efforts, public investment efforts should be directed to where they produce the highest return. Therefore, a rigorous analysis of the returns from government investment programs requires comparisons to the returns from other government programs, investment or not. Noteworthy is that many programs with no real investment component and some that do contain investment components—even when valuable and desirable for other reasons—may still produce a negative rate of return in terms of output or income. For instance, in enhancing current consumption, programs may simultaneously discourage people from developing their human capital (i.e., through work or education) or gaining new skills.
- In making budgetary choices, even investment programs that are only moderately successful may provide far superior growth relative to programs with negative returns (whatever other good they may achieve). This implies that, even in the absence of high-quality data with which to measure the worth of every government program, there still may be clear-cut opportunities to shift the federal budget in a more growth-oriented direction.

## Methodology and Background

Measuring past federal investment and, particularly, investment in children and projecting this investment into the future presents challenges. When it comes to classifying government spending as consumption or investment, the lines are not entirely clear. Lawmakers have multiple intentions when creating programs. For instance, while the primary intention of a health care program may be to provide a more enjoyable, less painful, and longer life, the program may also increase the productivity and future output of those expected to work in the future.

With this in mind, we have designated five categories of government investment efforts: *education and research*, *work supports*, *social supports*, *physical capital*, and *defense investment*. Each category contributes to economic growth but varies in how directly it does so. We apply these categories to the federal budget as a whole.

*Education and research* provide direct investment in people and infrastructure and are intended to enhance economic growth directly by contributing to human capital, the stock

of knowledge, and technology (e.g., primary and secondary education and research and development).

*Work supports* are partly intended to enhance the labor supply or support work effort, potentially building human capital (e.g., the earned income tax credit [EITC] and child care).

*Social supports* are intended to increase current consumption of health care, food, and housing. However, they might be considered investment if they also bolster family members' ability to work, stay in school, and become responsible citizens (e.g., non-elderly Medicaid, food stamps, and housing assistance).<sup>5</sup>

*Physical capital* includes acquisition of equipment, construction, and rehabilitation (e.g., building highways and rehabilitating housing projects).

*Defense investment* takes the form of physical and capital investment programs that improve security for all citizens (e.g., procurement of equipment for national defense), but it is not included in children's investment.

Only *education and research*, *physical capital*, and *defense investment* meet the criteria for the classical definition of investment. The numbers we derive for these three categories, when added together, come close to those generated by the Office of Management and Budget for its estimation of the investment portion of the federal budget.<sup>6</sup>

While data on investment outlays are readily available for the population at large, isolating investments made on behalf of children is more difficult. We first define children as those under age 19 who are residents of the United States. Since children receive funds from many programs that are often directed to the entire household, the task is to decide which programs (and which parts thereof) should count as investment in children. To count, a program must provide spending where

- the investment goes entirely to children (e.g., primary education);
- the investment increases with the inclusion of children in the application for the benefit (e.g., Medicaid, food stamps, or low-rent public housing); or
- children are necessary to qualify for any benefits (e.g., TANF or Head Start).

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<sup>5</sup> Some might prefer even further breakdowns of investment from the five categories presented here. For instance, there is an argument that some social investments are more investment-oriented than others. Take children's preventive health. Unfortunately, it is extremely difficult to separate out "preventive" or "critical" children's health expenditures—or mothers' prenatal health care for that matter—from total federal health spending on families with children.

<sup>6</sup> OMB does suggest that "a 'social investment' perspective might broaden the coverage of investment... to include programs such as childhood immunization, maternal health, certain nutrition programs, and substance abuse treatment, which are designed in part to prevent more costly health problems in future years" similar to our *social supports* category (OMB, *Budget of the U.S. Government FY 2008, Analytical Perspectives*, Section 7: Federal Investment Spending and Capital Budgeting, p. 143).

The amount of federal investment in children is defined here as equaling the amount going to the family with children less the amount they would receive, if any, in the absence of children. We exclude from children’s investment programs (but not from total investment, where appropriate) those programs that are not in any way targeted toward children, such as general science research. After all, households without children could equally enjoy these benefits. Following this logic, we include *physical capital* and *defense investment* in total investment but not in investment in children. Excluded from investment programs are those designed almost purely to help people sustain levels of consumption, particularly at the time of retirement or withdrawal from the workforce. (The specific programs we examined are shown in table 1, while the largest programs, grouped in dollar terms, appear in table 2 in the next section.)

Years reported are fiscal years, and investment amounts are normally expressed as shares of GDP or of domestic spending. “Spending” indicates both direct outlays from the budget and the refundable portion of tax credits. That is, we follow the logic of the budget itself in defining expenditures as including the refundable portions of credits but not those that offset taxes. This was necessary, in part, for consistency in reporting on the expenditure patterns of the federal government.

Our analysis primarily uses data from the *Budget of the United States Government* (FY 2008 and past years) and its appendices, historical tables, and special analyses for historical data and projections. For projections, we also use CBO’s *Budget and Economic Outlook, FY 2008–17*, and some assumptions of our own. Much of the quantitative effort in this report has gone to estimating the portions of programs, like Food Stamps or Medicaid, that go just to children. Where these calculations require going beyond budget documents, the most frequently used sources are the House Ways and Means Committee’s Green Book (various years), reports from the agencies that administer the programs, and discussions with agency staff. (See the appendix to this report for some more detail on our allocation methodology. For program-by-program detail on data sources and allocation assumptions, see our data appendix, a separate publication.)

Finally, note that the projections for the future are not *our* projections of what will actually occur—in some cases, they present an impossible budget scenario—but, instead, projections that derive from extending current policies (or trends in the case of discretionary spending) as projected by CBO. The President’s budget also contains very similar projections of current law. While legislators can move off this path through additional legislation, such action often requires taking away from household benefits that have been “promised” by previous Congresses and enacted into law.

**Table 1. Programs for Children Examined in This Study by Investment Type**

**Education and Research:**

Dependents' Schools Abroad, Impact Aid, Vocational (and Adult) Education, Education for the Disadvantaged—formerly Grants for the Disadvantaged, School Improvement, Indian Education, English Language Acquisition—formerly Bilingual and Immigrant Education, Special Education—formerly Education for the Handicapped, Emergency School Assistance (Civil Rights), Education Reform: Goals 2000, Domestic Schools, Reading Excellence, American Printing House for the Blind, Gallaudet University, Institute for Education Sciences—formerly Education Research, Statistics, and Improvement, Innovation and Improvement, Safe Schools and Citizenship Education, Head Start, Job Corps, Manpower Development and Training Act (MDTA) Institutional Training, MDTA On-the Job-Training (OJT), Neighborhood Youth Corps, JOBS/WIN, Mainstream, Comprehensive Employment and Training Act (CETA), Youth Employment and Training Programs, Summer Youth Employment, Young Adult Conservation Corps (YACC), Job Training Partnership Act (JTPA), School-to-Work, Youth Offender Grants, Youth Opportunity Grants, and Workforce Investment Act (WIA) Youth Formula Grants.

**Work Supports:**

Earned Income Tax Credit (EITC), Child Care and Development Block Grant, Child Care Entitlement to States, Aid to Families with Dependent Children (AFDC) Child Care, Transitional Child Care, At-Risk Child Care.

**Social Supports:**

Temporary Assistance for Needy Families (TANF)—formerly AFDC, Child Support Enforcement, Emergency Assistance, Food Stamp Program, Child Nutrition, Special Milk, Special Supplemental Food for Women, Infants and Children (WIC), Commodity Supplemental Food, Low Income Home Energy Assistance, Low-Rent Public Housing, Section 8 Low-Income Housing Assistance, Rent Supplement, Rental Housing Assistance, Medicaid (for non-disabled children), Maternal and Child Health (Block Grant), Immunization, National Institute of Child Health and Human Development (NICHD), Sudden Infant Death Syndrome, Healthy Start, Emergency Medical Services for Children, State Children's Health Insurance Program (SCHIP), Adolescent Family Life, Universal Newborn Hearing, Abstinence Education, Birth Defects/Developmental Disabilities, Child Welfare Services, Child Welfare Training, Child Welfare Research, Violent Crime Reduction Programs, Foster Care, Adoption Assistance, Independent Living, Juvenile Justice, and Promoting Safe & Stable Families —formerly Family Preservation and Support.

## A Portrait of Past Investment

As is the case in charting most expenditure items in the federal budget over time, it is hard to measure the relative importance attached to particular items simply by looking at the dollar amounts spent. Hence, this study frequently compares the levels of investment or of domestic investment as a **share of GDP** and as a **share of domestic spending**, to tease out the importance attached to investment relative to the economy and other domestic efforts. (Domestic investment as a share of domestic spending, of course, leaves out defense and international spending from both numerator and denominator.)

First, we consider current federal investment levels to determine the importance of each investment category. Next, we examine trends over time to bring changing national

priorities into relief. In both sections, we derive total investment and investment in children as shares of domestic spending to see how they rank relative to other federal spending priorities and to each other.

## The Current Picture

In 2006, spending on federal programs that, broadly estimated, might contain some investment component amounted to 5 percent of GDP, or \$646.1 billion. Federal investment in children, broadly estimated, was 1.6 percent of GDP. Total domestic (nondefense) investment spending was 22.6 percent of domestic spending; investment spending for children was 9.8 percent.

Narrowly defined, investment is a much smaller portion of current spending for both the total population and for children. For the total population, 1.3 percent of GDP went to *education and research*, 0.7 percent to *physical capital*, and 1.3 percent to *defense investment* in 2006. Broadening the definition liberally, an additional 0.3 percent went to *work supports* and 1.3 percent to *social supports*. From the narrowest definition including only *education and research* and *physical capital investment* (but excluding *defense investment*, *work supports*, and *social supports*) to the widest definition of investment, including everything, total investment outlays account for 2.0 to 5.0 percent of GDP. The broadest category has seen its growth in recent decades most affected by the expansion of social welfare programs such as Food Stamps, TANF, and Medicaid, but this is the category for which total expenditures do not fall easily into the investment mix.

The picture is somewhat similar for children. For investment in children alone, 0.4 percent of GDP went to *education and research*, 0.3 percent to *work supports*, and 0.9 percent to *social supports*. Combined, investment in children made up between 0.4 and 1.6 percent of GDP.

Most existing children's investment programs have remained "on the books" for a while and have even grown substantially in real absolute terms, but they have also often grown—or shrunk—in relative ways. Table 2 shows the major children's programs by investment category in 1965 and 2006. In 1965, Impact Aid was the only significant program over \$500 million in the *education and research* category. The AFDC program, Child Nutrition, and Maternal and Child Health drove *social support* spending, and there were no major programs that fit our *work supports* category. By 2006, the landscape had changed significantly. Education for the Disadvantaged and Special Education had risen to the top, along with Head Start and School Improvement under *education and research*; several of the largest federal aid programs—the EITC in particular, but also child care entitlements to states and Child Care and Development Block Grants<sup>7</sup>—had arisen under the *work supports* category; and in-kind benefit programs like Medicaid, Section 8 Low-Income Housing, and Food Stamps had surpassed traditional cash assistance programs like AFDC/TANF under the *social supports* category.

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<sup>7</sup> We do not include the child tax credit here or in this analysis because the bulk of its benefits go to the middle and upper classes, and the benefit itself acts more as a tax adjustment for family size—that is, an enhancement of the dependent exemption that has failed to keep pace with living standards over time—than an inducement to work or a social support per se.

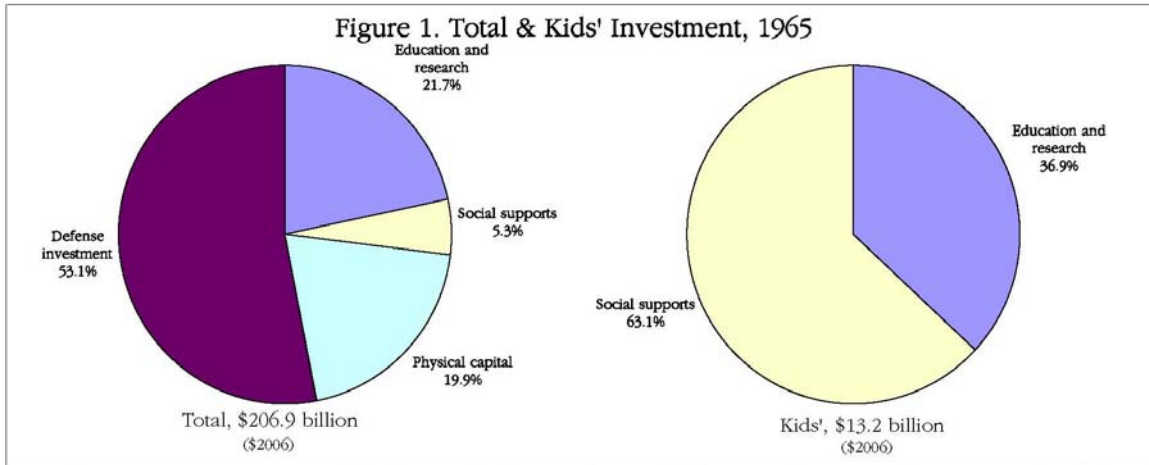
## Snapshots

In 1965, *defense investment* made up the largest share of total federal investment, 53.1 percent. *Education and research* followed with 21.7 percent. *Physical capital* followed with about 19.9 percent. Because many *social support* programs, which were to proliferate in the 1965–2006 period, had not yet come into being, those programs made up only 5.3 percent. None of the programs we categorized as *work supports* had appeared yet (see figure 1, left). By contrast, *social supports* claimed the lion’s share of investment programs for children, or 63.1 percent, while the remaining 36.9 percent went to *education and research* (see figure 1, right).

	1965		2006	
	Millions of 2006 dollars	Percentage of category	Millions of 2006 dollars	Percentage of category
<b>Education and Research</b>				
Impact Aid	1,802	36.9%	Education for the Disadvantaged	14,696 30.4%
Neighborhood Youth Corps	499	10.2%	Special Education	11,836 24.5%
Head Start	494	10.1%	Head Start	6,851 14.2%
Bureau of Indian Affairs Schools	479	9.8%	School Improvement	5,797 12.0%
Vocational (and Adult) Education	419	8.6%	Vocational (and Adult) Education	1,162 2.4%
Dependents' Schools Abroad	376	7.7%	Impact Aid	1,141 2.4%
School Improvement	371	7.6%	Dependents' Schools Abroad	1,045 2.2%
<b>Work Supports</b>				
None	-	0.0%	EITC: refundable portion	35,081 87.0%
			Child care entitlement to states	3,060 7.6%
			Child Care and Development Block Grant	2,192 5.4%
<b>Social Supports</b>				
AFDC/TANF	6,094	68.9%	Medicaid (non-disabled kids)	30,085 24.5%
Child Nutrition	919	10.4%	Section 8 Low-Income Housing Assistance	18,218 14.8%
Maternal and Child Health (Block Grant)	566	6.4%	Food Stamp Program	17,463 14.2%
Special Milk	446	5.0%	Child Nutrition	12,422 10.1%
NICHHD	144	1.7%	AFDC/TANF	11,871 9.7%
Food Stamp Program	88	1.0%	SCHIP	5,451 4.4%
Juvenile Justice	51	0.6%	Special Supplemental Food for Women, Infants, and Children	5,060 4.1%

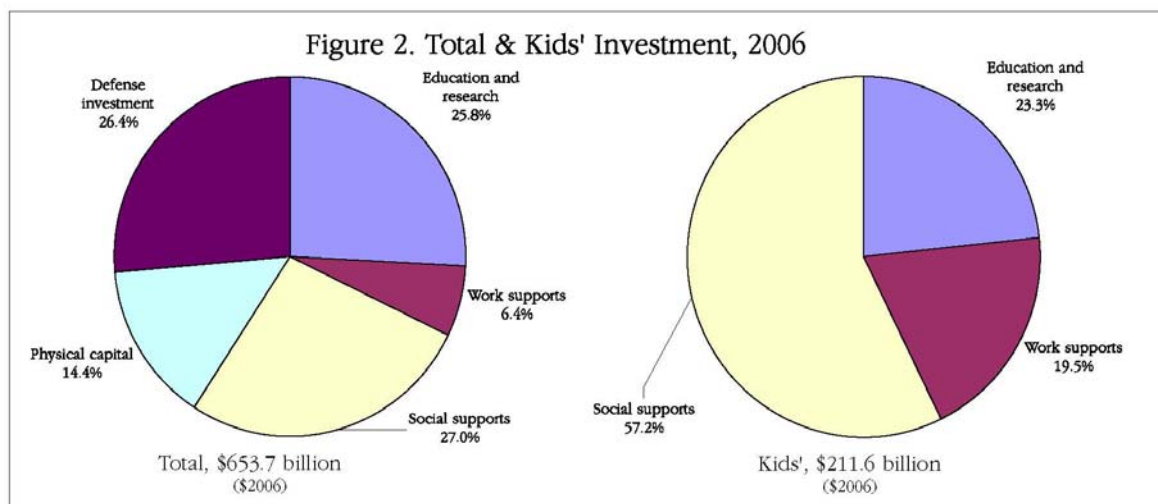
Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Health Care Financing Review* 2005.





Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from Federal Budget: Analytical Perspectives, various years; Appendix, various years; Historical Tables, various years; Health Care Financing Review 2005. Note: numbers may not sum to one due to rounding

By 2006, *defense investment*, *education and research*, and *social supports* each commanded roughly similar shares (between 25.8 and 27.0 percent) of overall investment, while *physical capital* had shrunk somewhat to 14.4 percent and *work supports* appeared at 6.4 percent (see figure 2, left). Children's investment patterns changed little in one sense over the intervening 40 years: *social supports* still commanded about a 60 percent share (57.2 percent to be exact), but the introduction of the major *work support* programs such as the EITC and the various child care block grants had reduced the relative investment share of *education and research* to 23.3 percent (see figure 2, right).



Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from Federal Budget: Analytical Perspectives, various years; Appendix, various years; Historical Tables, various years; Health Care Financing Review 2005. Note: numbers may not sum to one due to rounding

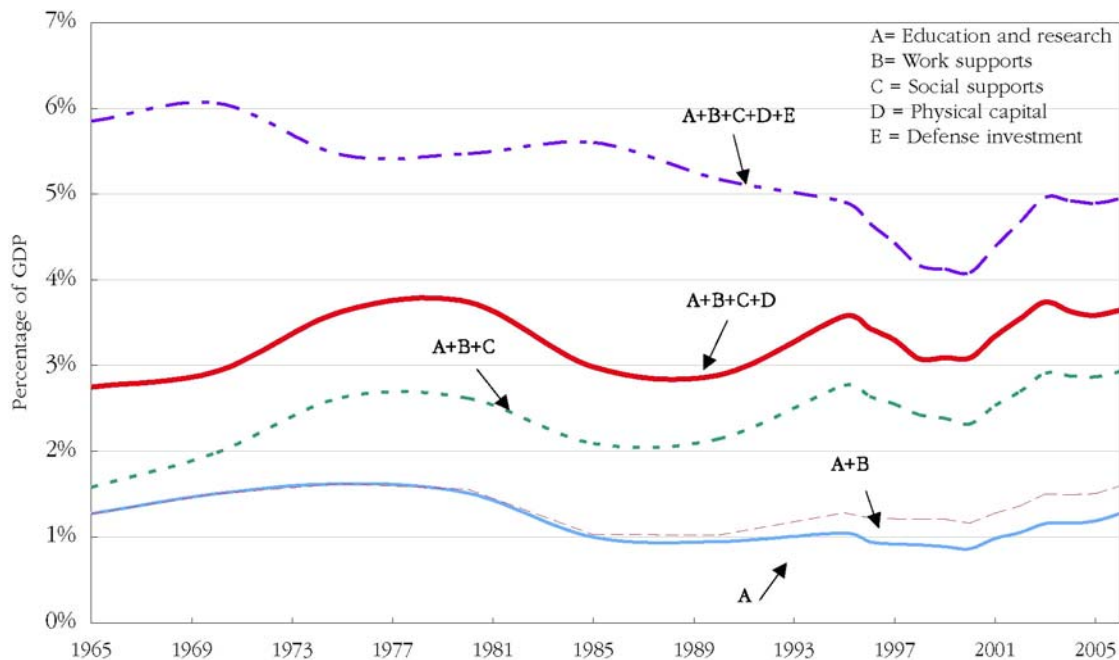
It appears that investment in children at the federal level has always been fairly targeted, but in very different ways: funds now go predominantly to low-income or disabled children or their families, while in earlier periods many funds compensated local areas for the costs of educating military children. No federal education effort of any significant size can be considered *broadly* to invest in helping all children attain their potential, although some portions of programs such as School Improvement or Education Reform: Goals 2000 sometimes set goals that are less finely targeted on limited populations and perhaps encourage better measures of progress.

## Trends Over Time

### Share of GDP

Regardless of definition, total domestic federal investment as a share of GDP over the 1965–2006 period displayed the same fundamental pattern: peaking around 1975–1980, bottoming out in the late 1980s, and then resurging somewhat in the late 1990s and early 2000s. Figure 3 graphs these trends by investment category—each curve represents the addition of another category, with the top curve representing total investment including work and social supports.

Figure 3. Federal Investment by Type of Investment (% of GDP)

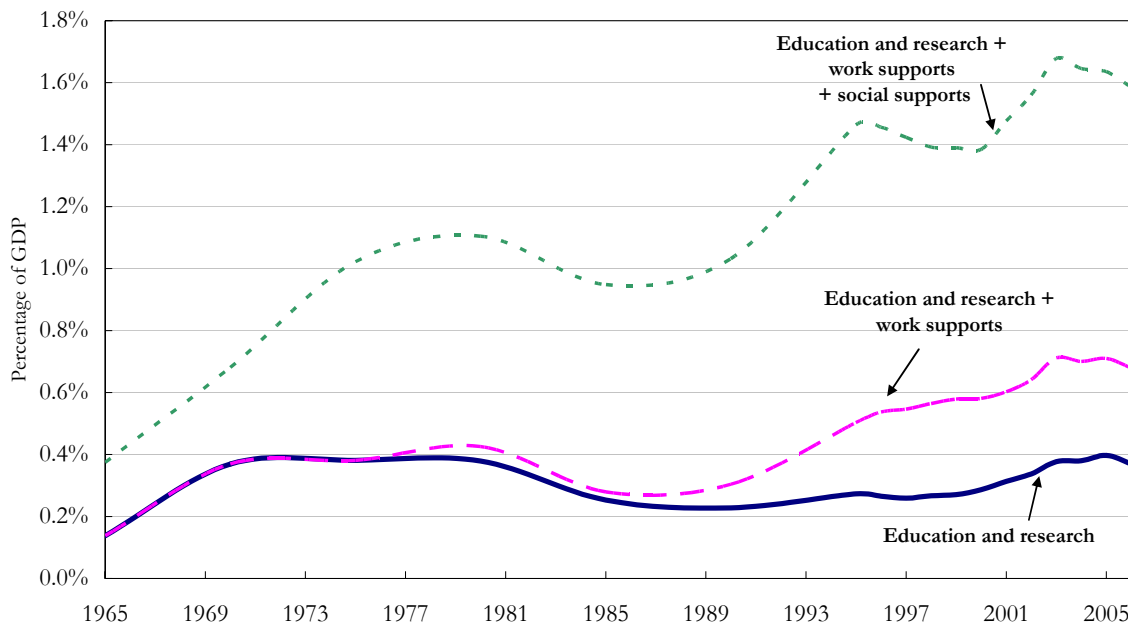


Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

*Defense investment* (included in the top line of figure 3) generally waned over most of the 40 years examined here, with some modest increases after 2000. The rise of space exploration—including the Apollo moon launches, planetary probes, and development of the space shuttle—powered the *education and research* category to its peak in the mid-1970s. But the discontinuation of the Apollo program and other space exploration cutbacks eroded the relative importance of this investment-related appropriation relative to the economy. Meanwhile, the enactment and rapid expansion of large-but-targeted education programs like Impact Aid, Special Education, and Education for the Disadvantaged drove rising federal investments in children through the 1970s into the early 1980s, at which point they became less of a priority for spending new federal revenues, and they, too, leveled out or eroded in relative importance.

Federal investment in children shows the same pattern as total investment before including work supports and social supports as possible additions to the investment budget.

**Figure 4. Federal Kids' Investment by Type of Investment (% of GDP)**



Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

Under *work supports*, the earned income tax credit (EITC) appeared in 1975, the child care and development block grant in 1995, and Child Care Entitlement to States in 1997. These programs represented a basic shift in the philosophy underlying social welfare programs—a move from programs that subsidized basic needs and consumption to programs that subsidized work. Again, we are not assessing the success of any

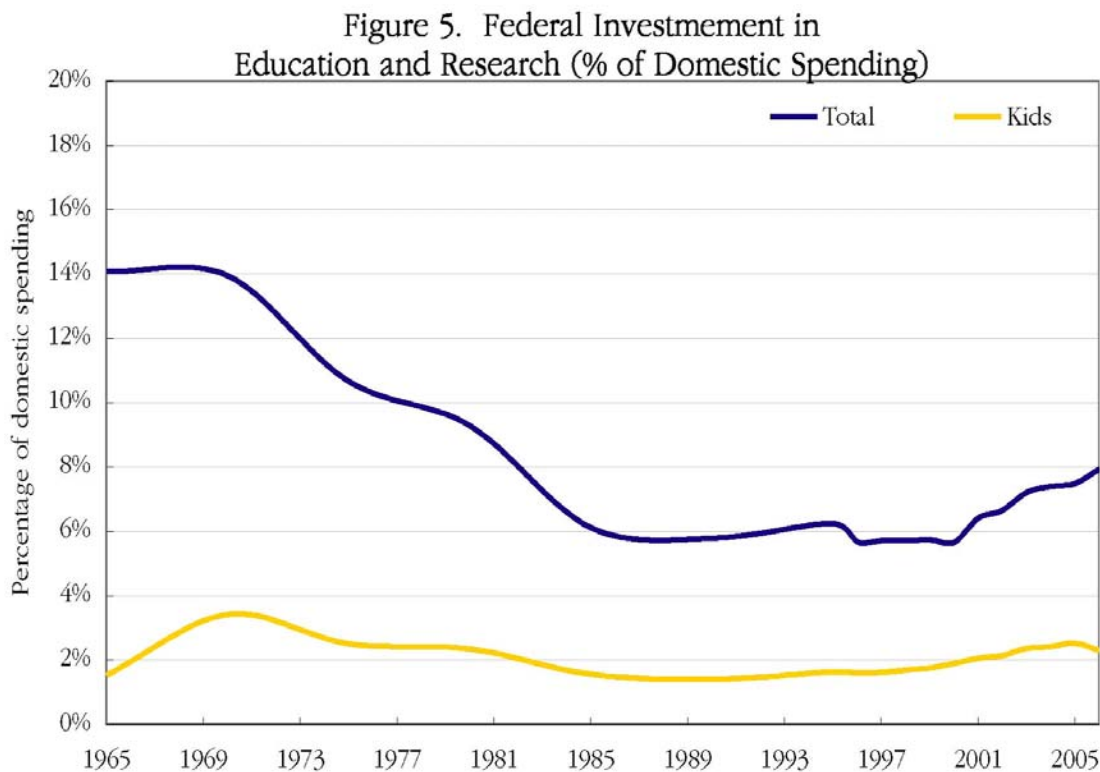
investment program here, only noting that programs encouraging or requiring work effort have a different focus than programs aimed almost purely at increasing levels of consumption, however worthy either goal.

Within *social supports*, Medicaid was enacted in 1965 and SCHIP was created in 1997. We include social safety net medical programs in this potential investment category since some portion of that spending forestalls mortality and debilitating illnesses or injuries to children or their working parents. Under existing program design, the explosive growth in medical costs over time tends to raise spending for the health components of social supports even in the absence of new legislation and helps explain the widening gap between the *education and research + work supports + social supports* curve and the other two curves in figure 4. Again, we do not assess the value of the investment here, much less the value of such high-cost health care.

### Share of Domestic Spending

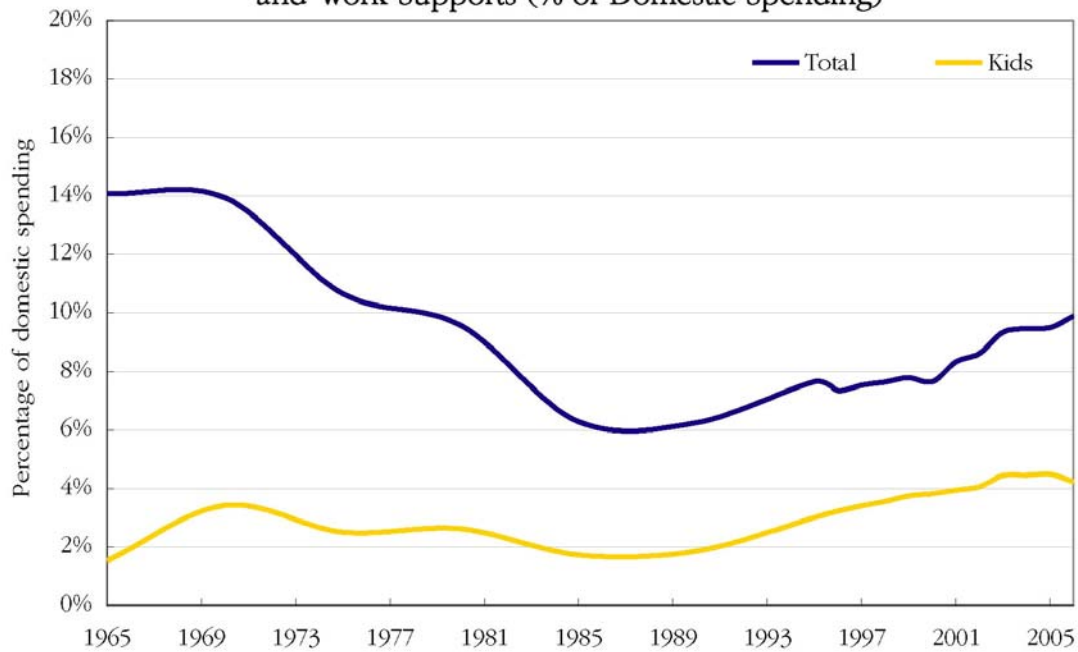
Figures 5, 6, and 7 allow for direct comparison between trends in total investment and trends in investment in children as a share of domestic spending.

These figures show how different national priorities competed for scarce resources as very large amounts of expenditures shifted from the defense to the domestic budget over much of the past few decades. Between 1965 and 2000, defense spending shrunk by



Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

Figure 6. Federal Investment in Education and Research and Work Supports (% of Domestic Spending)



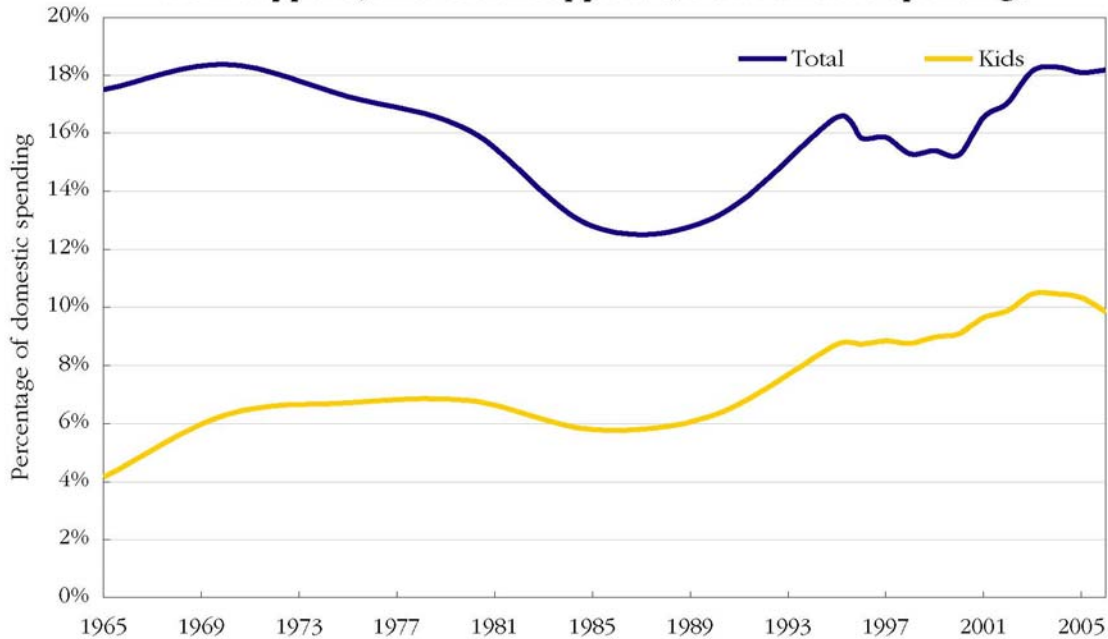
Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

almost two-thirds from 7.4 to 3.0 percent of GDP, while domestic federal spending rose from 9.0 to 15.2 percent of GDP.

Figure 5 captures the failure of federal investment programs to share in this fairly massive expansion in domestic spending. For example, as a share of domestic spending, total investment in *education and research* fell from 14.1 to 5.7 percent between 1965 and 2000, though it has since risen to 7.9 percent by 2006. Investment in children, meanwhile, fell from 3.4 percent of domestic spending in 1970 to 1.4 percent by 1990, then rebounded somewhat to 2.3 percent by 2006.

While figure 4 shows the inclusion of *work and social support* investment categories as propelling increases in the child investment budget as a share of GDP, figures 6 and 7, expressed as percentages of domestic spending, indicate that these same investment categories mainly shore up what would otherwise be an ongoing decline in total and child-related investment expenditures. Note that *social supports*, in particular, may have less investment orientation than *education and research* so the net change likely reflects the importance of investment in the domestic spending budget.

Figure 7. Federal Investment in Education and Research, Work Supports, and Social Supports (% of Domestic Spending)



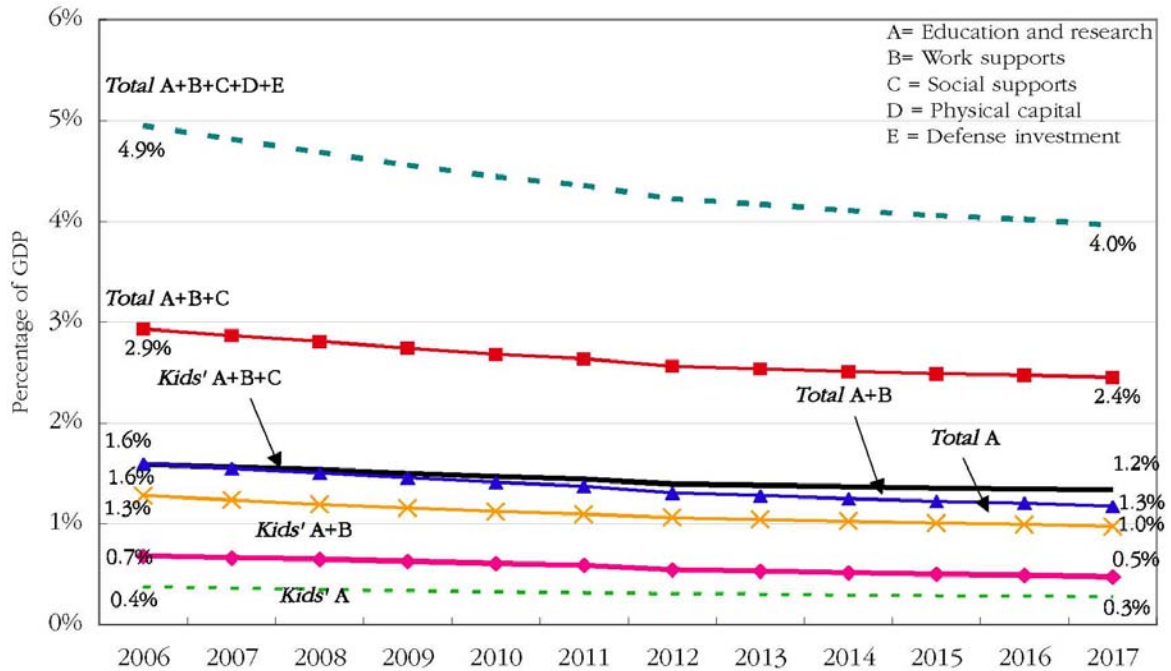
Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

Programs for children take up larger portions of the total domestic investment budget, when broadly defined, partly because work and social support efforts often are geared toward families with children. In 1965, children’s investment was between a third and a half of total investment, depending on the categories included. Over the next 40 years, declines in non-child-related investment coupled with increases in work and social support programs like the EITC, child care, and children’s Medicaid help explain why the two curves move closer together.

## Future Investment

Today, many future spending choices have been preempted by several large entitlement programs with very significant built-in growth. That growth is so large that it threatens to absorb almost all of the increase in revenues made possible by economic growth. Accordingly, CBO and OMB make projections of just what “current law” implies for different categories of the budget. These projections do not include any prognostication of how legislators will react to this situation, only what is implied if we stay on the current course.

Figure 8. Future Federal Domestic Investment under Current Law: Total Investment and Kids' Investment (% of GDP)



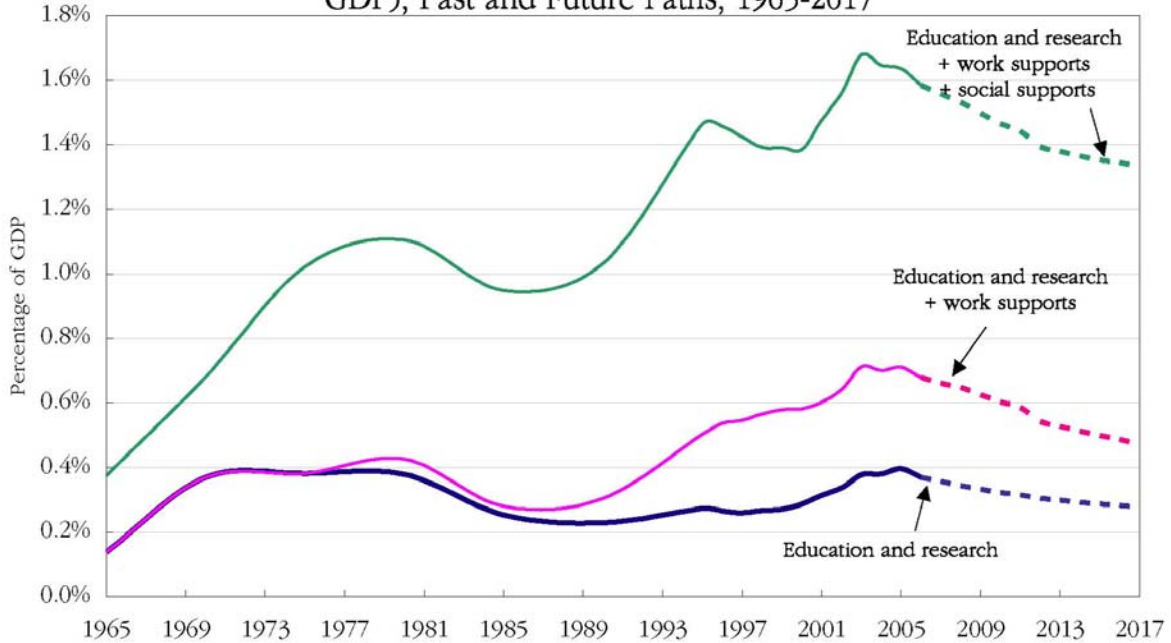
Source: The Urban Institute, 2007. Authors' estimates and projections, based on the *Budget of the U.S. Government FY 2008*, its Appendix, *Analytical Perspectives*, and CBO's *Budget and Economic Outlook, 2008-17*.

**Share of GDP:** By any definition, total and children’s investments are scheduled to decline from 2006 to 2017, using extrapolations of current law from CBO and OMB. Figure 8, for instance, shows that children’s *education and research* is scheduled to decline from 0.4 percent of GDP to 0.3 percent, children’s total investment under the most liberal definition of investment will fall from 1.6 to 1.3 percent, and total investment under the most liberal definition will fall from 5.0 to 4.0 percent—in other words, a fifth less total investment by 2017 relative to the size of the economy.

However, one gets a better graphical appreciation of the looming reversal in federal children’s investment as a percentage of GDP by viewing the complete investment series over time, shown in figure 9. In all three measures of investment, projections indicate that the gains of the past decade will continue to erode over the coming decade, if current policies are not altered. Even while the line representing broad investment (inclusive of social supports) shows the most dramatic dip, investment more narrowly defined (education and education plus work supports) really exhibits the largest relative decline as a fraction of GDP, consistent with what is shown in figure 8.

**Share of Growth:** The future of investment in children, and overall investment for that matter, is far more dramatically demonstrated by considering how future increases in spending are scheduled to be allocated. That is, we focus on the increments to spending rather than total spending.

Figure 9. Federal Kids' Investment by Type of Investment (% of GDP), Past and Future Paths, 1965-2017



Source: C. Eugene Steuerle, Adam Carasso, and Gillian Reynolds, The Urban Institute, 2007. Based on data from *Federal Budget: Analytical Perspectives*, various years; *Appendix*, various years; *Historical Tables*, various years; *Health Care Financing Review* 2005.

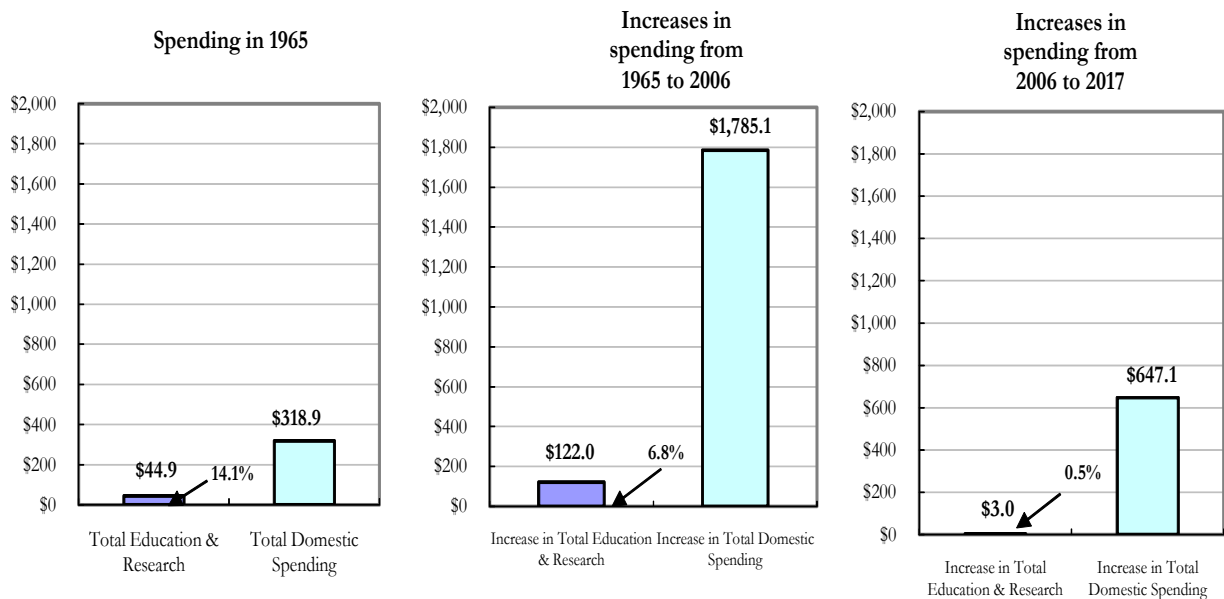
Starting with the total domestic investment budget, as defined by OMB, investment in *education and research* made up about 14.1 percent of total domestic spending in 1965 (figure 10). By 2006, the federal government had increased domestic spending by about \$1.8 trillion, of which *education and research* received \$122 billion, or 6.8 percent of the **increase**. Based on current policies and expected rises in revenues along with economic growth, by 2017 domestic spending will rise by about \$647 billion, but domestic investment in *education and research* will get nearly nothing (\$3 billion, or less than ½ of 1 percent).

Adding in *work supports*, additional investment turns into outright disinvestment, since *work supports* are scheduled to decline in real value. Only if we add in *social supports* does the amount go positive—to about \$46 billion (not shown in figures). This is largely due to increases in spending on health care. This “gain,” however, is misleading, since it reflects rises in health costs in general, which is an especially mixed bag for workers and their children. The structure and nature of federal health spending tends to raise costs for health care in general, which, in turn, drives many households out of the private insurance market and more to seek government help.



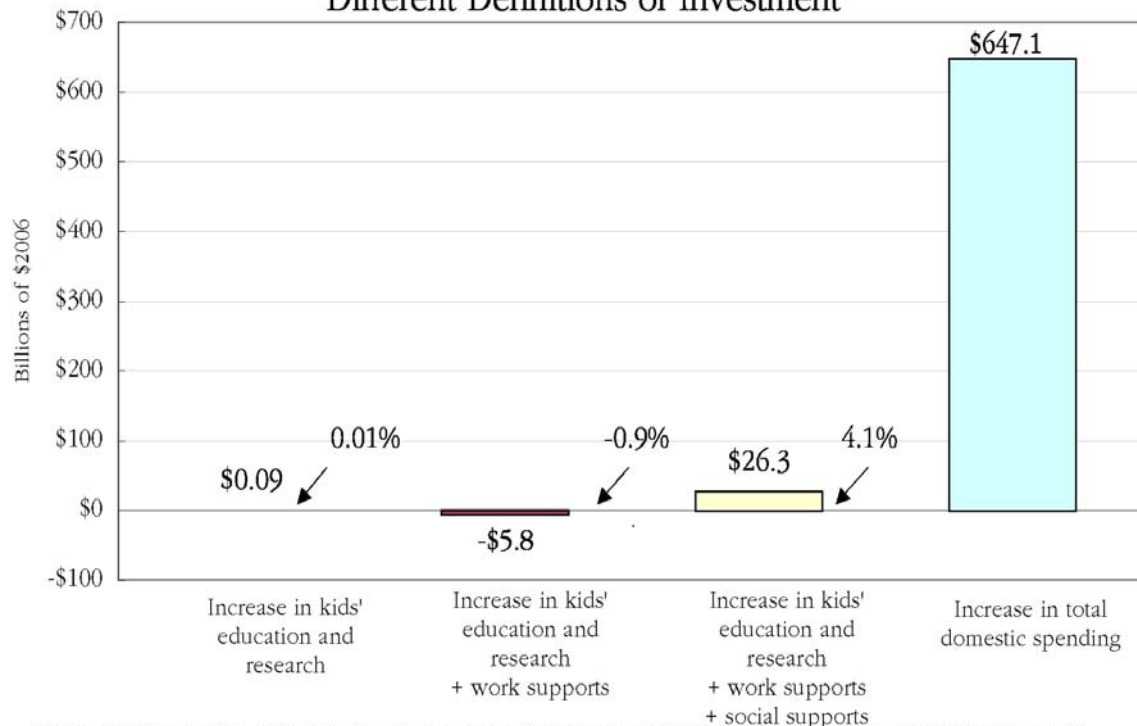
When considering only investment in children, the government’s budget offices project that virtually none of the **additional** \$647 billion in federal domestic spending by 2017 would go for *education and research*. If we add in *work supports*, this share of future resources actually turns negative (figure 11). *Work supports* in the federal budget are not scheduled to grow, in part because they are not indexed for real wage growth, and some people may no longer qualify if their incomes keep up, even partly, with the growth of average real income in the economy. If we include *social supports*, which are dominated by increases in children’s government health benefits, the share of future growth for children’s investments rises to 4.1 percent of the total growth in annual domestic spending, much less than the 11 percent share of the growth that they attained when 2006 was compared to 1965, which, in turn, was less than their share in 1965. In effect, the domestic spending pie is getting larger, thanks mainly to economic growth, but children are scheduled not only to get smaller shares, but almost none of the additional filling. Again, the small growth in *social supports* is due to higher projections of health care costs, so it reflects less a conscious decision to invest in children than a failure to rein in rising health care costs.

**Figure 10. Increments of Federal Investment in Education and Research vs. Total Domestic Spending**  
(Billions of 2006 Dollars)



Source: The Urban Institute, 2007. Authors' estimates and projections, based on the *Budget of the U.S. Government FY 2008*, its *Appendix, Analytical Perspectives*, and CBO's *Budget and Economic Outlook, 2008-17*.

Figure 11. Increase in Kids' Investment 2006-2017 under Different Definitions of Investment



Source: The Urban Institute, 2007. Authors' estimates and projections, based on the *Budget of the U.S. Government FY 2008*, its *Appendix, Analytical Perspectives*, and CBO's *Budget and Economic Outlook, 2008-17*.

### The Future and the Budget Vise

Why should we worry about this projected decline in the importance placed by the federal budget on investment, particularly investment in children? After all, it is only a projection. A few decades ago, before enactment of the large mandatory (entitlement) programs, the budget was largely discretionary. If a projection had been made then that \$647 billion in additional annual revenues would be available in another decade, children's programs would have been competing on a more level playing field. Legislators likely would have allocated those programs some significant share of that increase. We wouldn't have undertaken the type of projections shown here—which indicate how almost all future revenues will be spent before that future has even arrived.

Today, certain programs have large, built-in growth rates. The three major mandatory programs—Social Security, Medicare, and Medicaid—do not require annual appropriations, and the benefits they pay grow *automatically* each year with changes in wages, life expectancy, and medical costs. Wages over the long term track economic growth, and rising life expectancy widens the span of years across which individuals do not work but instead receive government benefits, while medical costs grow markedly (and unsustainably) faster than the economy. As currently scheduled, these three programs will rapidly consume almost all available resources for future domestic

spending. Alternatively, these mandatory budget programs, which already lean heavily toward consumption and contain significant disincentives to work and saving, create pressure for deficit financing. But the higher interest costs that accompany deficits just reduce further the amount of discretion left in the budget.

Certainly, some societal needs may call for greater spending on consumption-oriented programs. For instance, the aging of the population could warrant faster growth in elderly programs. But the budgetary choice should reflect the relative importance of a whole series of factors: the value of investment for growth, the relative needs of all people, the changing physical demands of jobs, the poverty rates of different populations, the incentive and disincentive effects of different policies, and the base of support that government provides already to different populations. Without full consideration of these factors, the case for disinvestment can hardly be said to be established by the relative growth in a single factor such as the number of elderly.

As it now stands, the budget and budget process automatically disfavor investment programs and favor consumption programs. Programs that invest in children, for instance, seldom have built-in real growth, much less growth faster than the economy. Meanwhile, the favored growth programs have little investment component; for instance, many elderly programs do not build up and take advantage of older individuals' talents and abilities but instead discourage work and encourage lengthy periods in retirement.

## Conclusion

The storyline is clear. Investment does not seem to be a priority in the development of the federal budget, and investment in children has been a low priority. Still, recent decades have seen some modest increases in investment in children, but mainly in such areas as work and social supports, which at best contain only partial investment components. Under current projections, both overall investment and investment in children are scheduled to decline significantly from their 2006 levels. The country is not expected to be poorer. On the contrary, over the next decade, annual federal revenues are expected to rise by hundreds of billions of dollars in real terms. Yet almost all those revenues are already earmarked to support consumption and indirectly encourage many individuals to reduce the value of their human capital by withdrawing from the workforce.

Investment by definition means forgoing consumption today to produce a payoff in the future. Reorienting the budget toward investment in children is one way of trying both to increase their future well-being and to give them greater economic capacity to finance the programs that support their parents' and grandparents' consumption needs.

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**For a complete listing of references and data sources used, see the separate data appendix and its reference section, available online at <http://www.urban.org>.**