CUTTING FEDERAL SPENDING

Congress should

- cut federal spending from 24 percent to 18 percent of gross domestic product and balance the budget by 2032;
- cut aid-to-state programs for education, housing, transportation, welfare, and other activities;
- end corporate welfare, including subsidies for agriculture and energy businesses;
- privatize postal services, passenger rail, electric utilities, air traffic control, and other activities that should be funded in the marketplace;
- convert Medicaid to a block grant and limit spending growth;
- reduce the growth in Medicare and transition to a system based on savings, competition, and choice; and
- reduce the growth in Social Security and transition to a system based on private accounts.

Federal spending is soaring, deficits are chronic, and government debt is reaching all-time highs relative to the size of the economy. Rising spending and debt are undermining growth and may push the nation into an economic crisis. The solution is to downsize most federal agencies by cutting and terminating harmful and unneeded programs. This chapter proposes specific cuts that would balance the budget and reduce dangerously high debt levels.

In recent decades, the federal government has expanded into many areas that should be left to state and local governments, businesses, charities, and individuals. That expansion is reducing freedom and creating a top-down bureaucratic society that is alien to American traditions. The COVID-19 pandemic prompted Congress to borrow and spend more than $5 trillion on relief programs, but lawmakers should now be retrenching as the crisis subsides.

The flood of deficit-financed pandemic spending is contributing to today's high inflation. The Hoover Institution's John Cochrane argues that pandemic spending was "an immense fiscal helicopter drop. People are spending the money, driving prices up. . . . The economy didn't need demand-side stimulus." To control inflation, we should slash deficit spending and tighten monetary policy. Without spending cuts, Cochrane says we could enter a vicious cycle: "The central bank raises rates to fight inflation, which raises the deficit via interest costs, which only makes inflation worse."

Federal debt held by the public has almost tripled as a share of gross domestic product (GDP)—from 35 percent in 2007 to 98 percent in 2022. At $24 trillion, the debt totals more than $180,000 for every household in the nation. With accumulated debt so high, the risk of an economic crisis has increased. Each percentage point rise in the average borrowing rate on $24 trillion of debt creates $240 billion in increased annual interest costs.

Experts do not know what level of government debt will precipitate a crisis, but many empirical studies find that economic growth slows when debt tops about 90 percent of GDP. Combined U.S. federal and state government debt is about 140 percent of GDP, which is substantially higher than the average of 100 percent in the Organisation for Economic Co-operation and Development member nations.

Federal policymakers should change course. They should cut spending and debt to reduce interest costs and support economic growth. The Congressional Budget Office (CBO) projects that under current law, federal spending will rise from 21.9 percent of GDP in 2024 to 24.3 percent by 2032 and federal debt will rise from 96 percent of GDP to 110 percent over that period. The plan presented here would balance the budget by cutting spending to 18.1 percent of GDP by 2032 while reducing debt to 80 percent of GDP.

Many policymakers believe that cutting government spending would hurt the economy, but they are mistaken. Retaining more resources in the private sector would be a net gain for the economy because markets have mechanisms to allocate resources to productive uses, whereas government allocations are guesswork. Markets are innovative and constantly fixing mistakes, whereas governments are rigid and often don't fix failed policies for years.

Federal spending cuts would revive growth by shifting resources from lower-valued government activities to higher-valued private activities. And cuts would enhance personal liberties by dispersing power from Washington and allowing individuals and communities to make more of their own choices.

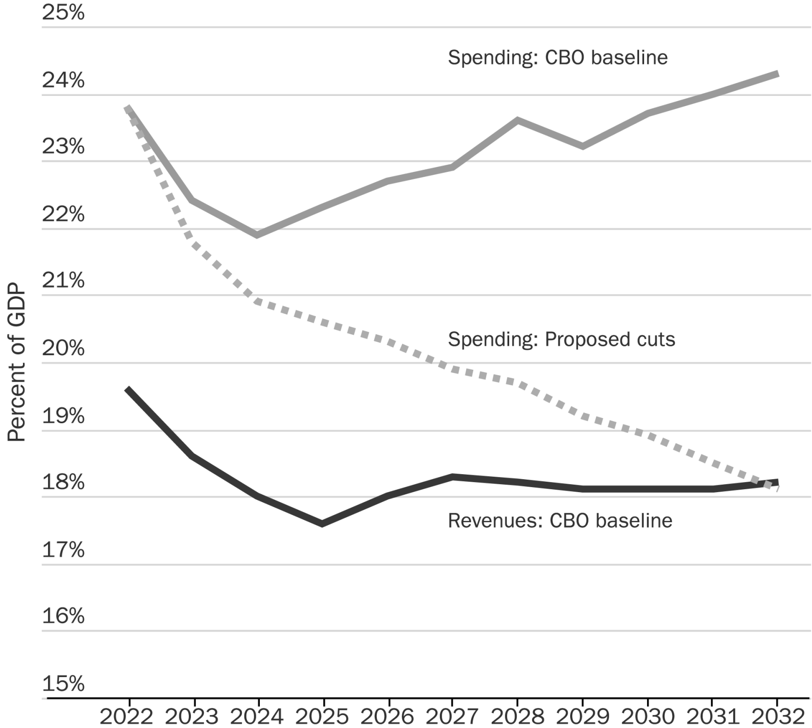
The plan proposed here includes a menu of possible spending reforms. These and other reforms are discussed further at DownsizingGovernment.org.

Spending Cut Plan

The starting point for the spending reform plan is the CBO's baseline projections. Figure 1 shows CBO projections from May 2022 for revenues and

Figure 1

Projected federal revenues and spending, percent of GDP, 2022–2032



Sources: Author's calculations and "The Budget and Economic Outlook: 2022 to 2032," Congressional Budget Office, May 25, 2022.
Note: CBO = Congressional Budget Office; GDP = gross domestic product.

spending as a percentage of GDP. The gap between the two lines is the federal deficit, which is expected to grow if no reforms are made.

The figure shows projected spending under the reform plan proposed here. Under the plan, spending would decline from 23.8 percent of GDP in 2022 to 18.1 percent by 2032, which would balance the budget that year. Spending reductions would be phased in over 10 years and by 2032 would total $2.3 trillion annually, including reduced interest costs.

The CBO revenue baseline assumes that the individual tax cuts under the 2017 Tax Cuts and Jobs Act expire as scheduled after 2025. If Congress pursues spending reforms, it would create budget room to extend the 2017 tax cuts while still reducing deficits. Extending the tax cuts would also be an opportunity to simplify the tax code by eliminating special breaks and flattening the tax-rate structure.

Table 1 shows proposed reforms to Social Security and health care programs, which would generate rising savings over time. The table shows the annual

Table 1

Proposed federal budget cuts, health care and Social Security

	Spending reform	Annual savings in 2032 (in billions of dollars)
Health care		
	Limit Medicare growth to GDP growth	$499.0
	Block-grant Medicaid and grow at 2%	$161.0
	Repeal ACA exchange subsidies	$105.0
	Cut non-Medicaid state health grants by 25%	$43.0
	Total cuts	$808.0
Social Security Administration		
	Limit Social Security retirement growth to GDP growth	$306.0
	Cut Social Security Disability Insurance by 25%	$55.0
	Cut Supplemental Security Income by 25%	$19.0
	Total cuts	$380.0
Total annual savings		**$1,188.0**

Source: Author.

Note: ACA = Affordable Care Act; GDP = gross domestic product.

savings compared with the CBO baseline in 2032. Table 2 shows cuts to programs other than Social Security and health care. These cuts would total $611 billion annually, but the plan assumes that one-tenth of the cuts would be phased in each year over the coming decade. Most values in Table 2 are estimated spending in 2022, but (where applicable) extra pandemic-related spending was excluded so that the values better reflect typical spending levels.

These reforms are deeper than the savings from “duplication” and “waste” that policymakers often mention. We should cut hundreds of billions of dollars of “meat” from federal departments, not just the obvious “fat.” If the activities that are cut are useful to society, then state governments or private organizations should fund them. The following sections discuss subsidies, aid to the states, entitlement programs, privatization, and defense spending.

Table 2

Proposed federal budget cuts, discretionary programs and other entitlements

Department	Spending reform	Annual savings in 2032 (in billions of dollars)
Department of Agriculture		
	End farm subsidies	$33.5
	End food subsidies	$145.6
	End rural subsidies	$5.8
	Total cuts	$184.9
Department of Commerce		
	End telecom subsidies	$3.6
	End economic development subsidies	$1.5
	Total cuts	$5.1
Department of Education		
	End K–12 aid to states	$30.0
	Cut college student aid by 50%	$45.9
	Total cuts	$75.9
Department of Energy		
	End subsidies for renewables	$2.7
	End subsidies for fossil fuels, nuclear power, and electricity	$4.1
	Privatize power marketing administrations	N/A
	Total cuts	$6.8
Department of Homeland Security		
	Devolve TSA airport screening to airports	$5.3
	Devolve FEMA activities to the states	$24.8
	Total cuts	$30.1
Department of Housing and Urban Development		
	End rental assistance	$40.2
	End community development subsidies	$19.0

(continued)

	End public housing subsidies	$8.1
	Total cuts	$67.3
Department of the Interior		
	Reduce net outlays by 50% through spending cuts, privatization, and user charges	$10.0
Department of Justice		
	End state/local discretionary grants	$2.6
Department of Labor		
	End employment and training services	$4.9
	End Job Corps	$1.7
	End trade adjustment assistance	$0.5
	End Community Service for Seniors	$0.4
	Total cuts	$7.5
Department of Transportation		
	End urban transit subsidies	$21.7
	Cut highway aid that exceeds fuel tax revenues	$19.0
	Privatize air traffic control (federal fund savings)	$2.1
	Privatize Amtrak and end rail subsidies	$7.0
	Total cuts	$49.8
Department of the Treasury		
	End refundable earned income tax credit	$57.1
	End refundable child tax credit	$29.0
	End refundable AOTC	$3.3
	Total cuts	$89.4
Other savings		
	Repeal Davis-Bacon labor rules	$12.0
	Cut foreign aid by 50%	$12.3
	Cut NASA budget by 50%	$11.7
	Cut federal civilian compensation costs by 10%	$33.2

(continued)

	End the Small Business Administration	$1.1
	End EPA state/local grants	$3.7
	End aid for the Corporation for Public Broadcasting	$0.5
	Privatize the Corps of Engineers (Civil Works)	$7.0
	Privatize the Tennessee Valley Authority	N/A
	Privatize the U.S. Postal Service	N/A
	Total cuts	$81.5
Total annual savings		**$610.9**

Source: Author.
Notes: AOTC = American Opportunity Tax Credit; EPA = Environmental Protection Agency; FEMA = Federal Emergency Management Agency; TSA = Transportation Security Administration; NASA = National Aeronautics and Space Administration; N/A = not available.

Subsidies to Individuals and Businesses

The federal government funds more than 2,300 subsidy programs, more than twice as many programs as in the 1980s. The *scope* of federal activities has expanded in recent decades along with the *size* of the federal budget. The federal government subsidizes farming, health care, school lunches, broadband, rural utilities, energy, rental housing, aviation, passenger rail, public broadcasting, job training, foreign aid, urban transit, space exploration, and many other activities.

Each subsidy damages the economy by requiring higher taxes or debt. Each subsidy generates a bureaucracy, spawns lobby groups, and encourages even more groups to demand handouts. Individuals, businesses, and nonprofit groups that become hooked on federal subsidies become tools of the state. They lose their independence, have less incentive to work and innovate, and shy away from criticizing the government.

Table 2 includes cuts to subsidies in agriculture, commerce, energy, foreign aid, housing, and other activities. These cuts would not eliminate all unjustified subsidies in the budget, but they would be a good start. Government subsidies are like an addictive drug, undermining America's traditions of individual reliance, voluntary charity, and entrepreneurialism.

Aid to the States

Under the Constitution, the federal government was assigned specific limited powers, and most government functions were left to the states. Unfortunately, policymakers and the courts have mainly discarded constitutional federalism in recent decades. With “grants-in-aid” programs, Congress has pursued many activities that were traditionally reserved to state and local governments. Grant programs are subsidies that are combined with federal regulatory controls to micromanage state and local activities. Federal aid to the states was $721 billion in 2019 and was distributed through more than 1,300 separate programs. Congress boosted aid by hundreds of billions of dollars during the COVID-19 pandemic in 2020 and 2021.

The theory behind grants-in-aid is that the federal government can operate programs in the national interest to solve local problems efficiently. But the aid system does not work that way in practice. Policymakers usually focus on maximizing subsidies for their states, and they tend to ignore efficiency, program failures, and the need for spending tradeoffs in the overall budget.

Furthermore, federal aid stimulates overspending by state governments, and the regulations tied to aid programs raise state and local costs. Aid undermines government accountability because each level of government blames the other levels for program failures. And aid undermines democratic control because it transfers policy decisions from elected state and local officials to unelected officials in faraway Washington.

The grants-in-aid system serves no important economic purpose, and it should be phased out. The states should fund their own activities. Tables 1 and 2 include cuts to grants for education, health care, highways, housing, justice, transit, and other activities.

Medicare, Medicaid, and Social Security

The growth in major entitlement programs is the main cause of the government’s looming fiscal crisis. The actuaries of Social Security and Medicare estimate that promised but unfunded future benefits are $60 trillion and $103 trillion, respectively, in present value terms. Those costs dwarf the federal debt of $24 trillion. The only good news is that entitlement programs can be, and should be, cut to reduce future costs. Table 1 lists some proposed reforms.

Congress should limit annual spending growth in Medicare to nominal GDP growth. The table assumes that such a limit begins in 2024, which generates growing savings over time compared with the baseline. Reforms that would limit spending growth include raising the retirement age, increasing program deductibles and copays, increasing premiums for Part B, and cutting the program’s improper payment rate.

Congress should also consider major restructuring of Medicare. Cato scholars have proposed moving to a system based on individual vouchers, personal savings, and consumer choice for elderly health care, as discussed elsewhere in this *Handbook*. Such reforms would encourage patients to become more discriminating health care consumers and induce providers to improve quality and reduce costs.

Congress should convert Medicaid from an open-ended matching grant to a block grant while giving the states more flexibility to control costs and tailor the program to local needs. That was the successful approach used for welfare reform in 1996. The plan here would cap the federal contribution to Medicaid at 2 percent annual growth. It would also phase in cuts of 25 percent to non-Medicaid health grants to the states compared with baseline projections.

Congress should limit annual growth in Social Security retirement spending to nominal GDP growth. The table assumes such a limit begins in 2024, which generates growing savings over time. Some reforms that would limit spending growth include raising the normal retirement age and indexing initial benefits to prices rather than wages. The plan would also phase in cuts of 25 percent to the fraud-plagued Social Security Disability Insurance and Supplemental Security Income programs.

Over the longer term, Congress should transition Social Security retirement to a system based on private accounts, as discussed elsewhere in this *Handbook*. Private accounts would increase personal financial security and improve work incentives by converting payroll taxes to account contributions that are personally owned.

Privatization

A privatization revolution has swept the world since the 1980s. Following the United Kingdom's lead, governments in more than 100 countries have transferred thousands of state-owned businesses to the private sector. More than $3 trillion of railroads, energy companies, postal services, airports, and other businesses have been privatized.

Privatization helps spur economic growth. It allows entrepreneurs and markets to reduce costs, improve quality, and increase innovation. It also benefits the environment by reducing the wasteful use of resources we often see in government-run activities.

Despite the global success of privatization, many activities that have been privatized abroad remain in government hands in this country. Federal policymakers should learn from foreign experiences and enact proven reforms here. Table 2 includes the privatization of the air traffic control system, Amtrak, the Army Corps of Engineers, federal electric utilities, and the U.S. Postal Service. Such reforms would produce only modest savings to the federal budget, but they could substantially improve the management and efficiency of these services.

Defense Spending

Under the CBO baseline, national defense spending is projected to fall from 3.1 percent of GDP in 2022 to 2.7 percent by 2032. That would be the lowest level of defense spending relative to GDP since before World War II. Elsewhere in this *Handbook*, Cato's defense and foreign policy experts describe a general policy of restraint and discuss numerous strategies to reduce defense costs.

Conclusion

Without budget reforms, federal debt will rise continuously as a share of GDP in coming years, which will precipitate an economic crisis at some point. Rising debt and deficits are already contributing to inflation and are likely undermining economic growth. The sooner policymakers tackle spending reforms, the better. Numerous foreign leaders have pursued vigorous cost cutting when their government debt started getting out of control, and there is no reason why our leaders cannot do the same.

Suggested Readings

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—Prepared by Chris Edwards