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Controlling Federal Spending: Using Past Budgets as Guides for Spending Restraint

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Americans are starting to understand that the rapid rise in federal spending and the associated increase in federal deficits is a matter of great concern. As the federal debt amasses, credit markets are expected to be increasingly wary of U.S. Treasury securities, with the possibility of debt downgrades and the associated unwelcome events. It is also well recognized that there are limits to the effectiveness of raising taxes to close deficits. Higher levels of taxation generate incentives that lead to reductions in economic activity and lower overall tax revenue. To avoid these undesired outcomes, federal spending should be addressed as the means for deficit reduction by using past budgets to help forecast for FY 2012.

RESEARCH FINDINGS

- The true cost of government to the private sector is the level of government spending, regardless of how it is financed. If the government spends $3 trillion, that means it acquires and allocates $3 trillion worth of resources that come from the private sector. Regardless of its method of finance, when government spends, that means there is $3 trillion less available in the private sector to produce goods and services. Thus, we consider deficit reduction via spending restraint. Tax revenue will increase simply by virtue of recovery from the recession and not by tax rate increases.

- The importance of forecasting to FY 2012 is that it is far enough in advance to plan for and implement, yet soon enough to send a strong signal to credit markets of the U.S. government's commitment to the soundness of its securities. Rolling back spending to fiscal 2000 and 2008 levels are worthwhile benchmarks since fiscal 2000 was one of the last years with a budget surplus and fiscal 2008 was the last year before the recent rapid increase in spending and deficits. With stimulus spending to conclude soon, TARP spending completed, economic recovery presumably in sight, and the winding down of the wars in Afghanistan and Iraq, it is reasonable to consider how we might return federal spending to a level emulating the approximately balanced 2000 budget or, more modestly, returning to pre-recession levels. However, projections for the 2012 budget continue to show an elevated level of spending.

- By using the FY 2000 budget we can simulate projected FY 2012 budgets with modification for necessary spending increases due to the events that have happened since 2000.

	2012	2012	2012	2012
	OMB Projection	Simulation A	Simulation B	Simulation C
Total Expenditure	3,755.0	3,411.1	3,203.7	3,099.4
Total Revenue	2,926.0			
surplus/deficit	-828.0			
Discretionary	1,301.3	1,197.3	1,163.7	1,103.4
Defense	676.4	676.4	642.8	642.8
Non-Defense	624.9	520.9	520.9	460.5
Mandatory	2,106.7	1,915.8	1,742.0	1,698.0
Social Security	761.5	761.5	700.9	700.9
Medicare	500.9	500.9	441.7	441.7
Medicaid	273.7	273.7	219.7	219.7
Other Mandatory	570.6	379.7	379.7	335.7
Net interest	342.9	298.0	298.0	298.0

Source: Author's computations and http://www.gpoaccess.gov/usbudget/fy11/hist.html for budget figures.

- Simulation A: Emulates FY 2000 for two components of the budget: the non-defense discretionary spending and other mandatory spending. It assumes spending the same share of GDP as FY 2000 on these categories. It also assumes net interest as the CBO projects. While leaving all other spending as in the OMB projection, this generates a spending level of $3,411.1 billion; about $340 billion less than OMB projects.

- Simulation B: Considers other values for defense, Social Security, Medicare, and Medicaid. It assumes the following: defense spending is kept at its 2008 level plus inflation; Social Security and Medicare grow to keep real spending per senior citizen the same as in 2008; Medicaid grows only enough to keep real spending per capita the same as in 2008. This, in combination with the assumptions in simulation A, yields a spending level of $3,203.7 billion; about $550 billion less than the OMB projection.

- Simulation C: Modifies simulation B in the following way: it maintains non-defense discretionary spending and other mandatory spending at their real, per capita values as in 2000. This results in a simulated spending level of $3,099.4 billion for fiscal 2012; about $650 billion less than OMB projects. Moreover, this level of spending generates a budget that is nearly balanced since OMB projects 2012 tax revenue at $2,926 billion.

- Overview of Simulations: Budget simulations B and C indicate less spending on Social Security and Medicare than OMB projects. For Social Security, this likely involves increasing the age for full eligibility, changing the formula for cost-of-living adjustment, and reducing the additional benefits for spouses. Regarding Medicare, steps such as increasing the age for eligibility, modestly increasing premiums, co-pays, and deductibles, and use of health insurance vouchers might be used. Reforms similar to the latter also might be instituted for Medicaid, along with more extensive use of managed care.

Full Report of Research Findings

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http://mercatus.org/sites/default/files/publication/Controlling%20Federal%20Spending.Garen_.pdf

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