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RESEARCH SUMMARY

US Federal Budget Restraint in the 1990s: A Success Story

Many have declared it impossible to cut federal government spending as a share of the economy, particularly in a time of divided government. They're wrong—it can be done. The proof is hidden in plain sight: it's called the 1990s.

A new study published by the Mercatus Center at George Mason University reviews the example of the 1990s to debunk some of Washington's most frequently cited reasons why spending cannot be cut now. The economic and budgetary lesson from the decade is clear: it is possible to reduce federal government spending as a percent of Gross Domestic Product (GDP) by cutting some spending and restraining the growth of the rest. The political lesson equally clear: divided government may make spending cuts more difficult, but it does not render them impossible.

Below is a brief overview. To view the paper in its entirety and learn more about the author, David R. Henderson, a professor of economics at the Naval Postgraduate School and former senior economist for the President's Council of Economic Advisers, please see "US Federal Budget Restraint in the 1990s: A Success Story."

KEY POINTS

Despite divided government for 8 of the 10 years of the 1990s, federal spending was cut from 21.9 percent of GDP to 18.2 percent, amounting to an economically significant 17 percent reduction in the share of the economy spent by the federal government.

- Most of the cuts—61.2 percent of the reduction in total spending—occurred in national defense, primarily due to the end of the Cold War. Over the decade, defense spending dropped from 5.2 percent of GDP in 1990 to 3.0 percent in 2000, and these cuts reflected a broad consensus among Republicans and Democrats.
- Net interest had the second-highest level of reduction in spending. The decline in federal debt—from a peak of 49.5 percent of GDP in 1993 to 35.1 percent in 2000—led to falling interest payments, which dropped from 3.2 percent of GDP in 1990 to 2.3 percent in 2000.

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Domestic spending—defined as all spending other than defense, international affairs, and net interest—fell slightly as a percent of GDP.

- Although the decline from 13.2 percent to 12.8 percent of GDP was small, it was significant that this spending—which includes the major entitlements, Medicare, Medicaid, and Social Security—did not rise.
- Medicaid eligibility had expanded through the 1980s, and the program's spending rose in the first half of the 1990s. After 1995, however, Medicaid stayed relatively flat. Spending on Medicare actually declined as a percent of GDP in the later years of the decade, partly due to reforms adopted in 1997.
- Social Security—the largest of the three programs—peaked at 4.6 percent of GDP in 1993, then fell over the rest of the decade to 4.2 percent. The decrease resulted from demographics—the baby boomers had not yet started retiring—not from changes in the program. Now that the baby boom retirements have started, that demographic pattern will not repeat.

Yet with this pattern of government spending reductions, the economic results defied what many expected: the cuts did not impair growth.

- To be sure, growth was low during the early 1990s, but the spending cuts continued even as the economy strengthened through the rest of the decade. Growth in the second half of the 1990s, while the spending cuts were ongoing, averaged 4.0 percent.
- Nor did employment suffer. The unemployment rate reached 7.8 percent in 1992, but then fell through the rest of the decade, to 4.0 percent in 2000. Much of the decline resulted from the booming economy of the late 1990s, but unemployment dropped even through the defense spending cuts of 1992 through 1995.