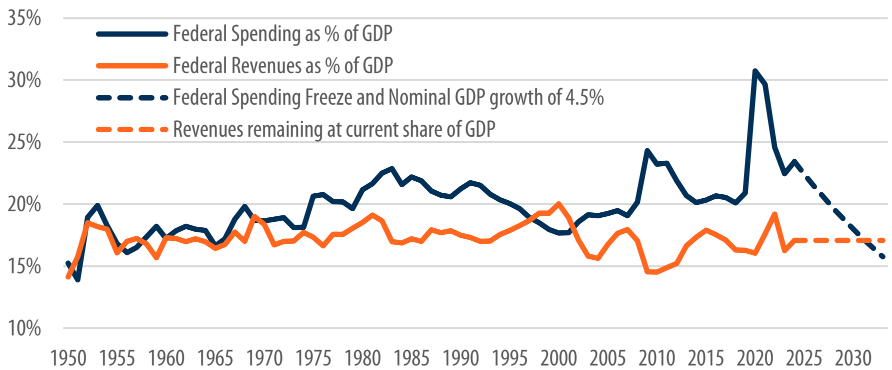
November 21, 2024

Is There Room to Cut? Examining Federal Spending Part 2

Today marks the second installment in our series focused on identifying opportunities to reduce government excess. With President Trump's campaign promise to shrink the size of government still resonating, the pressing question is: What kinds of policy changes would be needed to cut spending or even freeze it at current levels? The United States has not experienced a budget surplus since 2001, and the fiscal landscape has changed significantly since then. In this edition of "Three on Thursday," we take a data-driven approach to explore whether even just freezing federal spending is a feasible goal and what it would take. Below, we present three key charts that provide deeper insights into federal expenditures.

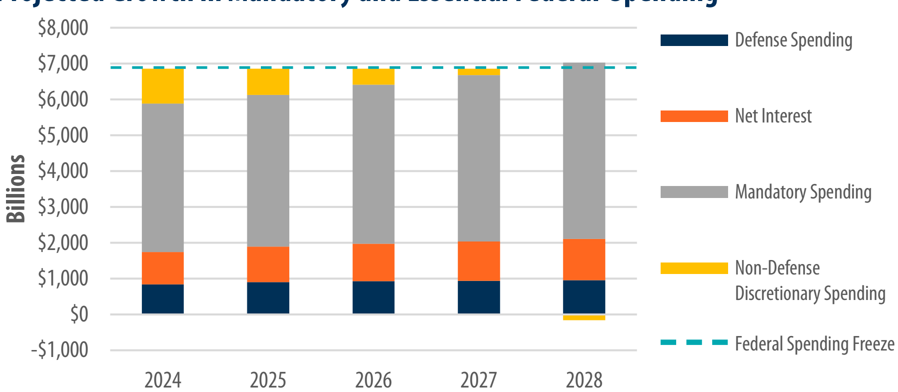
Balancing the Budget with Federal Spending Freeze



Source: Office of Management and Budget, Bureau of Economic Analysis, First Trust Advisors. Fiscal year data 1950-2024. Dotted lines are projections given 4.5% GDP growth.

The federal government has run deficits exceeding a trillion dollars annually for the past five years, but the root of the issue lies not in revenue but in spending. If federal spending could be frozen at its current elevated level for the next seven and a half years, the budget could theoretically reach a surplus—provided Nominal GDP (a combination of real growth and inflation) grows at an annual rate of 4.5% and revenues remain consistent with their current share of 17.1% of GDP. However, this scenario oversimplifies the complexity of the federal budget. The real question is: What kind of spending cuts would this require?

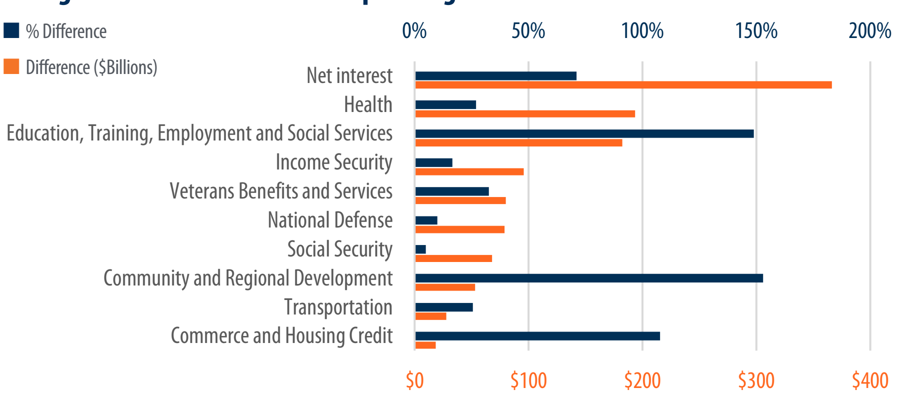
Projected Growth in Mandatory and Essential Federal Spending



Source: Office of Management and Budget, First Trust Advisors. Fiscal year (FY) data 2024-2028.

Cutting government spending today presents a significant challenge—not only because it would require near-unanimous support from Republicans but also due to the nature of federal expenditures. The majority of government spending is tied up in mandatory programs or areas often treated as essential, such as defense spending and interest payments on the national debt. Together, these mandatory and essential expenses accounted for nearly 86% of total federal spending in FY 2024, a share projected to continue rising through FY 2028. If spending were frozen at FY 2024 levels and these programs continued at their expected growth rates, all non-defense discretionary spending would effectively be eliminated by FY 2028. This reality underscores a tough truth: for the newly proposed Department of Government Efficiency to not only freeze but actually reduce spending, it would require making substantial cuts to mandatory programs—an ambitious and politically fraught undertaking.

Change in Actual 2024 Federal Spending vs. Pre-Pandemic 2024 CBO Estimates



Source: Office of Management and Budget, Congressional Budget Office ("CBO"), First Trust Advisors. Fiscal year 2024 data. Pre-pandemic 2024 estimates as-of January 2020.

Where should the Department of Government Efficiency begin? A good starting point is comparing current spending to pre-COVID Congressional Budget Office (CBO) projections for FY 2024. Pandemic-related spending was meant to be temporary, yet many programs remain far above expected levels. The biggest deviation is Net Interest, which offers little room for cuts. However, Health spending is $193 billion higher, primarily due to $187 billion in excess Medicaid grants to states, while Education, Training, Employment, and Social Services (ETES) is $182 billion over, mostly from $156 billion in unexpected costs in the Federal Direct Student Loan Program.