

Budgets And Governing

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The leaders of the House and Senate have come up with a new budget deal, and many people aren't happy. It still needs passing by January 19th, or else the government, evidently, may shutdown. We doubt that this will happen, but the fight over government spending seems to drag on year after year after year.

It's not hard to understand why. Non-defense spending by the federal government (including entitlements like Social Security) has climbed dramatically.

- 10% of GDP in the 1960s
- 14.8% of GDP in 2001
- 15.2% of GDP in 2007
- 17.8% of GDP in 2019
- And now, projected at roughly 22% of GDP over the next 5 years, after peaking at 27.7% in 2020

In other words, non-defense spending now consumes more than twice as much GDP every year as it did 60 years ago. It's share of GDP is up 45% from just before the Great Recession, and it's up 24% from the year before COVID. Government continues to take more and more of what the private sector produces, and it is heading for annual deficits of about \$2 trillion.

The Great Recession and COVID were one off-events. Yet somehow, government spending never returned to pre-crisis levels following either. And because politicians have not been punished at the ballots for such unconstrained spending – or the resulting deficits – they have had little incentive to alter course.

This is why budget battles have turned consistently ugly in recent years. Repeated threats to not raise the debt ceiling or shut down the government because a budget can't be agreed on have become commonplace. An ever-changing mix of politicians who want to see spending controlled face heavy pressure from every direction that they must go along to get along. But they still fight. And fight they should.

Total debt has ballooned at the same time the Fed lifted artificially low interest rates to fight the inflation that poor policies created, causing net interest expenses to skyrocket. In 2020, the net interest expense was \$332.6 billion. In the past twelve months, it has totaled \$730.4 billion. The Congressional Budget Office expects net interest expenses to rise to above \$1 trillion per year after 2028. Lunacy.

While many think all the US has to do is raise tax rates, history suggests eliminating deficits this way is virtually impossible. The last period the budget was balanced was between 1998 and 2001. During those years, tax receipts averaged an all-time record of 19.4% of GDP, while total spending averaged just 18%.

This was the tail end of a miraculous period in modern US history. Starting with Ronald Reagan, and continuing through Bill Clinton, government spending fell as a share of GDP. The less government spends, the more there is left for private sector growth. Economic growth boomed, and that growth boosted tax receipts.

When spending gets too high, economic growth slows, as do tax receipts. Last year, the CBO's budget forecast overestimated tax receipts by 11%, and underestimated spending by 9%. The bigger government gets, the more likely this happens year after year.

Back in the 1980s and 1990s, when the US was cutting spending, real GDP grew an average of 3.2% per year. In the past two years, in spite of historically large Keynesian deficits, real GDP has averaged just 1.7%.

We understand that the make-up of Congress creates difficulties for those who want to cut spending. But calling them names and accusing them of not being able to govern perpetuates the problem. Out of control spending, and huge deficits as far as the eye can see, are the real failure in governance.



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