HOOVER INSTITUTION

Limiting Federal Spending Growth to Balance the Budget

John F. Cogan

INTRODUCTION

In August, the United States government announced that the national debt had reached $40 trillion. The bond market responded with a sharp rise in long-term bond rates. Washington lawmakers responded with a yawn. Despite the bond market's warning signs, lawmakers from both political parties continue to outspend federal budget revenues.

Restraining the growth in federal spending to bring the deficit down is paramount if future generations are to have the economic opportunity that past generations experienced. Increasing public debt to finance expenditures that mainly subsidize current consumption will eventually lead to lower wages, more rapid inflation, and a stagnating standard of living for most Americans. Moreover, the continually higher public debt raises a moral question, too often ignored, of whether one generation should impose its debts on a subsequent generation. At the nation's beginning, Thomas Jefferson answered this question with a definitive no.[1]

Americans understand the dangers of failing to bring the federal budget deficit down. In an April 2025 poll, more than three-quarters of Americans agreed that "the federal debt [was] growing at an unsustainable pace" and that "Congress should make reducing the federal deficit a priority."[2] Most Washington lawmakers and others also understand the danger of failing to act. But they believe that the spending cuts needed to significantly reduce the deficit are too harsh and will undermine the social safety net.

This essay addresses this widely shared concern by showing that with modest and sustained federal spending restraint and moderately higher economic growth, the budget can be balanced within a reasonable length of time. Neither harsh budget cuts nor higher tax rates are necessary.

The modest spending restraint we analyze limits the *average* future value of federal entitlement benefits *per recipient* to today's levels, after adjusting for inflation. For medical care entitlement programs, this means limiting the increase in the *average* federal payment *per enrollee* in Medicare, Medicaid, and the Affordable Care Act (ACA) to the growth in the economy-wide

A Hoover Institution Essay

November 2026

cost of health services, which tends to grow faster than consumer prices. For Social Security and other cash assistance programs and for other in-kind benefit entitlement programs, this means limiting the increase in the *average* benefit for future *recipients* to the growth in consumer prices. Importantly, the spending limitations would not cut the purchasing power of future entitlement benefits below the level received by current recipients. The spending restraint policy also limits the growth in federal discretionary programs to the rate of inflation.

The reason that these limitations slow the growth in federal spending is the underappreciated fact that, in their absence, federal payments per recipient will rise faster than inflation. For example, the typical new Social Security beneficiary fifteen years from now will receive an inflation-adjusted monthly benefit that is 21 percent higher than the typical new beneficiary in 2026, even if they have the same lifetime earnings. Federal payments on behalf of the typical Medicare enrollee fifteen years from now will be about 50 percent higher after adjusting for the rapidly rising cost of medical care services.

The spending limitation does not necessarily require freezing every recipient's real benefit. To achieve the limitation, Congress could change benefit formulas and/or raise the retirement age for current or future Social Security recipients. Congress could modify health insurance premiums, cost-sharing arrangements, and healthcare provider reimbursement levels and raise Medicare's retirement age. Congress could increase benefits for some individuals substantially in real terms while it reduces or slows the growth in benefits for others.

The spending limitations do not obviate the need for entitlement reform. To the contrary, given the underlying structure of most entitlement programs, limiting the growth in their average benefit requires changing eligibility and/or benefit rules.

Using the budget projections and assumptions from the Congressional Budget Office (CBO), the spending limitations would reduce the annual growth in federal spending from its currently projected rate over the next fifteen years from 4.3 percent to 2.9 percent. The fiscal impact of this reduction is significant. Under CBO's current assumption of relatively weak future economic growth of 1.8 percent per year, the fiscal restraint would reduce the projected federal budget deficit by two-thirds in fifteen years, to a manageable 2.3 percent of gross domestic product (GDP). It would balance the budget in twenty years. Achieving a balanced budget within twenty years would allow the current generation to re-establish Jefferson's principle of intergenerational fiscal responsibility.

Faster economic growth would shorten the time to reach a balanced budget. In combination with the spending limitations, revenues from an economy growing at 2.5 percent per year, its average growth over the past thirty years, would produce a balanced budget in fifteen years. The debt burden on the economy would begin to shrink in five years, declining to 92 percent of GDP in fifteen years and to 72 percent in twenty years.

The analysis shows that achieving a balanced budget doesn't require draconian cuts in politically sensitive entitlement programs. It requires a long-term policy of limiting the growth in

federal spending to just under 3 percent per year. This rate of spending increase can be viewed as a goal. Limiting the growth in average future entitlement benefits per recipient to inflation is only one way to accomplish this goal. Its value lies mainly in demonstrating that deep cuts in entitlement programs are not necessary to balance the budget. This author would prefer that balance be achieved by reforms that would return Social Security and Medicare to their original, and less costly, purpose of preventing old-age poverty.

Whatever the alternative chosen, it is important that the spending restraint plan be a credible commitment to deficit reduction. A credible plan that has lawmakers' sustained commitment, by reducing long-term interest rates and lowering expectations of higher future taxes, will raise near-term economic growth. In doing so, it will make lawmakers' job of deficit reduction easier both mathematically and politically.

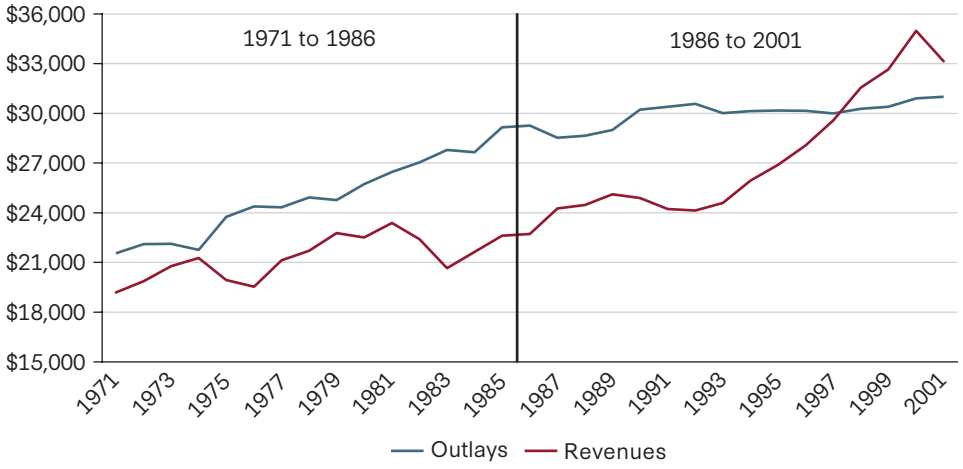
To motivate our analysis, section 2 briefly describes a time in the recent past when a combination of spending restraint and economic growth produced a balanced budget. From the mid-1980s to the late 1990s and early 2000s, this combination gradually transformed a large federal budget deficit into a budget surplus. The circumstances during this time period were different from today's, but the magnitude of deficit reduction achieved is the same as the amount needed to eliminate today's deficit. Section 3 presents the current CBO budget outlook and explains the sources of its projected growth in spending. Section 4 describes the spending limitations. Section 5 presents estimates of the impact of spending restraint and higher economic growth on the budget. Section 6 offers some concluding observations.

1. HISTORICAL PRECEDENT

Balancing the budget requires reducing the budget deficit from its current level of 5.8 percent of GDP to zero. Many individuals believe that a reduction of this magnitude is beyond the plausible reach of Congress. Yet, the budget deficit has been reduced by this amount before. From the mid-1980s to the late 1990s–early 2000s, the federal budget deficit was reduced from 6 to 7 percentage points of GDP to small surpluses. The historically large deficit reduction was achieved by a combination of policies to slow the growth in federal spending and to increase the growth in the economy. The domestic and international circumstances during this unique period were different from today's, and the specific policies used to achieve a balanced budget were different from the spending limitations considered herein.[3] Nevertheless, the earlier period shows that deficit reduction of the magnitude required to balance the budget in fifteen to twenty years can be accomplished by pursuing a combination of spending restraint and pro–economic growth policies.

In reviewing this earlier period, we will focus on the years 1984 to 1999. The choice of this particular time frame is solely for expository convenience. Regardless of which starting year from 1984 to 1986 is chosen and which ending year from 1999 to 2001 is chosen, the roles played by economic growth and spending restraint are essentially the same.

FIGURE 1 The federal budget before and after 1984 (per household, in 2026 dollars)



Notes: Author's calculations derived from the Office of Management and Budget (OMB) Historical Tables. Dollars are inflation adjusted using Congressional Budget Office (CBO) historical economic data for the personal consumption expenditures (PCE) price index.

In 1984, the recovery from the deep 1981–83 recession was well underway. That year, the federal budget deficit stood at 4.7 percent of GDP, lower than it had been both in the previous and the succeeding years. In 1999, the federal budget registered a surplus equal to 1.3 percent of GDP, and it was a full percentage point larger in 2000. A 6.0 percentage point of GDP change in the fiscal balance achieved from 1984 to 1999 would be sufficient to eliminate the 2026 budget deficit and create a small budget surplus.

Figure 1 shows the trends in federal spending and revenues during this fifteen-year period and compares them to trends during the prior fifteen years. The data in figure 1 are in constant 2026 dollars per US household rather than as a percentage of GDP. The latter measure, which is more commonly used by economists, provides important insights into the behavior of revenues and expenditures over long periods of time. But to individuals who are relatively unfamiliar with the magnitude and growth of GDP, the measure can mask important changes in federal budget trends. Throughout this essay, we will use constant dollars per US household as the main measure of government revenues spending and debt. The dollar measure is constant 2026 dollars unless otherwise specified.

The years 1984–99 were a particularly strong period of economic growth. Over the fifteen years, inflation-adjusted GDP grew at an exceptionally strong 3.1 percent annual rate. The growth was even stronger during the latter half of the 1980s, 3.7 percent, and during the latter half of the 1990s, 3.8 percent. The mild recession in 1990–91 brought the overall growth rate for the entire period down to its 3.1 percent level.

The strong economic growth was the product of several factors, some of which were under direct US control and others not. For most of the period, the US government followed a pro-growth economic policy. Federal income tax rates were lowered, key parts of the economy were deregulated, tariffs were reduced, and sound monetary policy kept the growth of

consumer prices at a moderate pace.[4] Events outside the US, especially China's shift to a market economy that accelerated throughout the fifteen-year period and India's economic liberalization in the 1990s, expanded US international trade.

The growing US economy produced a rapid rise in federal revenues. Over the fifteen-year period, real federal revenues per US household rose at a 2.7 percent annual rate (5.4 percent in nominal dollars). In 1999, revenues per household were $32,656; 51 percent higher than they were in 1984.

Real federal spending per US household rose by only 0.6 percent over the 15-year period (3.3 percent in nominal dollars). In 1999, federal spending per US household was $30,411, only 10 percent higher than it was in 1984. The increase is the smallest during any fifteen-year period dating back at least to the early 1960s.

The Soviet Union's collapse contributed to the slowdown by reducing the need to maintain the nation's armed forces at Cold War levels. By 1999, the defense budget had been reduced in real terms per household by 31 percent from its level at the beginning of the decade. But the moderate growth in total federal spending was only partly due to the decline in defense spending. Nondefense spending, the major portion of which was entitlement program spending, grew at an annual real rate of 1.7 percent per household. This growth rate was a sharp reduction from its 3.2 percent growth rate during the prior fifteen years.

The combination of rapidly rising revenues from pro-growth policies and slowly growing outlays from modest spending restraint produced a remarkable turnaround in the federal government's financial position. In 1984, the federal government added $6,000 per US household to the publicly held debt. In 1999, it reduced the publicly held debt by $2,245 per household.

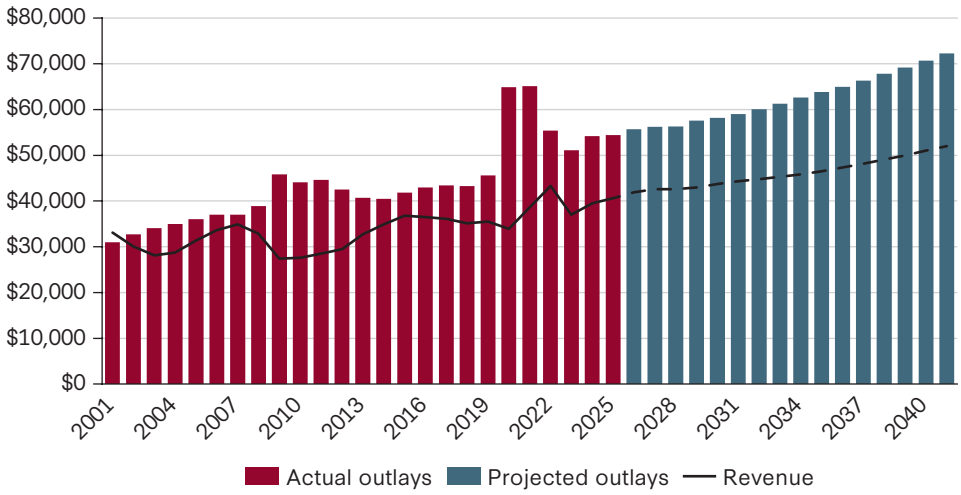
2. THE RECENT PAST AND THE BUDGET OUTLOOK

The federal government reversed course in the early 2000s and began its long string of consecutive budget deficits. Since then, its rapidly growing spending has annually outstripped its slowly growing revenues.

Figure 2 shows the trends in annual federal spending and revenues per household (as a reminder, in constant 2026 dollars) from the last year the federal budget was in surplus, 2001, to 2026 and the official CBO projection for the next fifteen years. From 2001 to 2026, federal spending per household grew at an annual rate of 2.3 percent, three times faster than the annual 0.8 percent per year increase in federal revenues per household. The growth in federal spending during the last seven years is especially noteworthy. The seven-year increase in per-household spending accounts for 40 percent of the twenty-five-year increase.

The sharp rise in 2009–10 and even sharper rise in 2020–21 reflect the federal government's response to the Great Recession and the COVID-19 pandemic, respectively. After each

FIGURE 2 Federal deficits (per household, in 2026 dollars)



Notes: Author's calculations derived from CBO's 2026 projections. Dollars are inflation adjusted using CBO projections for the PCE price index.

emergency, real spending declined, but not to its pre-emergency level. The upward ratchet in spending after emergencies is a repeat of patterns seen in previous decades.

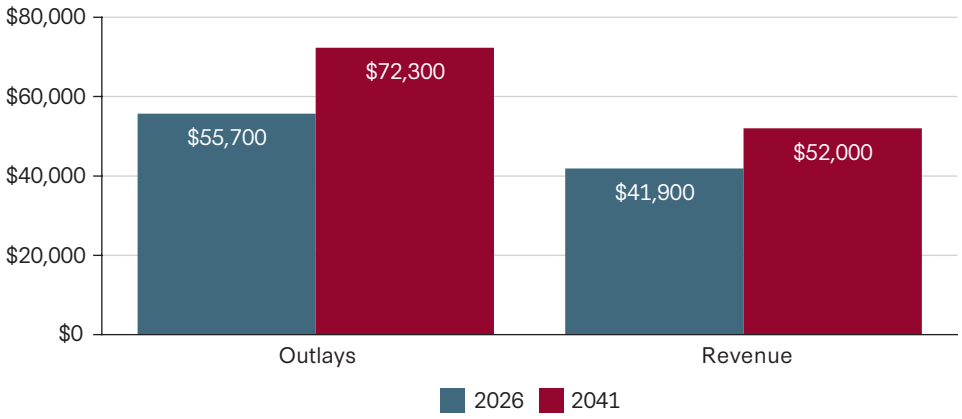
By 2025, the federal government was spending $54,600 per household, 75 percent more than it had in 2001. The federal government was collecting $40,600 per US household in taxes, 23 percent more than it had in 2001.

The years of spending excess have produced a remarkable deterioration in the federal government's fiscal condition. This year, the federal government is on track to run a $2 trillion budget deficit, the twenty-fifth annual budget deficit in a row. The outstanding public debt has now reached 100 percent of GDP. On a per-household basis, the public debt now stands at $240,000.

The future promises more of the same, but at an accelerated rate. Federal spending is projected to rise faster than revenues, resulting in ever-increasing federal budget deficits. According to the CBO, fifteen years from now the average federal tax burden per US household will have risen from $40,600 to $52,000 (see figure 3). The revenue increase is mainly a result of a growing economy, which increases income levels that are subject to taxation, and to a lesser extent higher personal income tax rates as individuals move into higher tax brackets.

CBO projects that real federal spending will rise by even more, from $55,600 to $72,300 per household (see figure 3). The excess of spending over revenue means that the federal government will be required to borrow $20,000 per household in 2041 to finance its expenditures. The public debt outstanding will soar from its current level of $228,000 to $435,000 per household.

FIGURE 3 Revenue and outlays (per household, in 2026 dollars)



Notes: Author's calculations derived from CBO's 2026 projections. Dollars are inflation adjusted using CBO projections for the PCE price index.

Regardless of whether the deficits and debt are measured per household or as a percentage of GDP, the deficit in fifteen years will surpass levels reached during the depths of the Great Recession; only the COVID-era budget deficit was higher in this century. Similarly, the outstanding public debt will rise to a new all-time high. CBO projects these dire outcomes even though it assumes a full-employment economy that will grow continuously without an intervening economic recession.

How should policymakers address the deficit problem? Higher taxes on top of the projected increase in taxes per household is not the answer. Closing the budget gap today with an across-the-board proportionate tax increase on all households and businesses would require a 39 percent increase in every tax on the federal statute books. The combined federal payroll tax rate on employees and employers would rise from 15.2 to 21.3 percent. The higher payroll tax rate combined with a higher federal income tax rate would raise the average middle-class household's tax rate to 37 percent, a rate that approaches the highest marginal income tax in current tax code. The top federal tax rate would climb to 56.7 percent. Delaying action will only raise the required tax increase even higher. For example, waiting fifteen years rather than acting now would require a 73 percent tax hike on the typical household. That increase would tax away nearly all the projected growth in household earnings. A household's posttax disposable income would be only 0.2 percent higher than today.[5]

Any attempt to close the budget gap by taxing the income of the rich is doomed to failure. Based on the most recent IRS data (2023), a 100 percent tax on every dollar of household income above $1 million would still leave the 2026 budget deficit at over $500 billion and a much larger deficit if the confiscatory tax was delayed fifteen years.[6]

Tax increases required to finance the current spending level would be counterproductive regardless of whom they are levied on, since they would reduce economic activity. Moreover,

all the estimates provided above are "static" calculations. They assume no change in economic behavior. Since higher tax rates discourage work and investment and encourage tax avoidance and evasion, the actual revenue increase would be far less owing to a smaller economy, a shrinking tax base, and less revenue from that base. Thus, lawmakers would have to raise tax rates even higher or adopt a new tax system, such as a value-added tax.

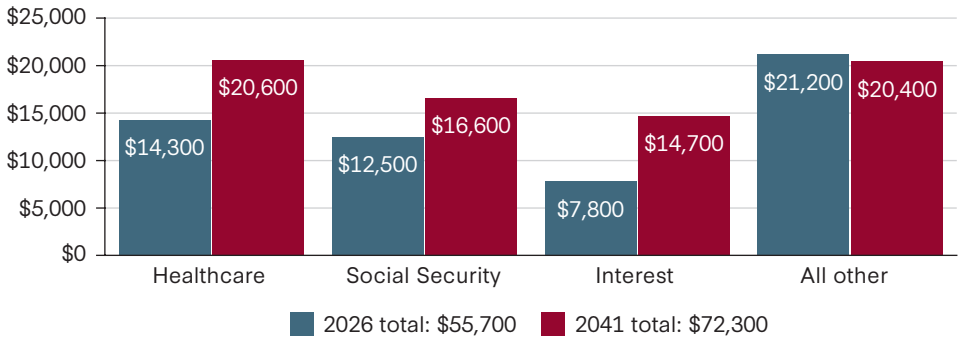
Moreover, recent work in macroeconomics has shown that closing the budget gap with spending cuts rather than with tax increases would cause less harm to the economy.[7] But immediate spending cuts to achieve a balanced budget would be wrenching. If the reductions were put into effect this year, a 29 percent reduction in every federal program, including Social Security, Medicare, and national defense, would be required to balance the budget. Postponing cuts for fifteen years would increase the required reduction to 35 percent.

Neither of these approaches is economically sound or politically viable. There is a realistic alternative policy: a combination of slowing the growth in government spending, primarily by slowing entitlement expenditures, and enacting policies that promote stronger economic growth.

3. THE DRIVERS OF RISING FEDERAL DEBT

Figure 4 shows how government spending is currently distributed among four major categories and how much more the CBO expects spending on each category to increase over the next fifteen years. The federal government currently spends a remarkable $26,800 per US household on Social Security and federal healthcare programs (consisting mainly of Medicare and Medicaid). These two categories account for 48 percent of total government spending. Nearly $8,000 is spent per household on interest payments on the federal debt, and $21,200 is spent on all other activities combined. We should note that spending on national defense, which is contained in this last category, is only $6,600 per household and constitutes only 12 percent of total federal spending.

FIGURE 4 Outlays by budget category (per household, in 2026 dollars)



Notes: Author's calculations derived from CBO projections. Dollars are inflation adjusted using CBO projections for the PCE price index.

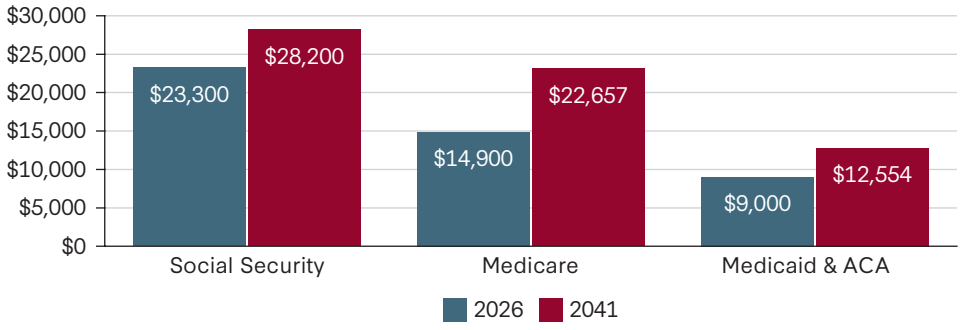
As shown in the figure, the drivers of future spending growth are from just three sources: federal healthcare programs (Medicare, Medicaid, and ACA subsidies), Social Security, and rising interest payments.[8]

Combined, these three categories account for more than the entire projected increase in federal spending per household that was shown in figure 3. Per US household, federal healthcare spending is projected to rise by 44 percent, or $6,300. Social Security spending per household will rise by 33 percent, or $4,100. Interest payments on the growing national debt will rise by 89 percent per household, or $6,900. The rest of the federal budget will decline by $800 per household over the next fifteen years.

Interest payments will consume a growing share of federal tax collections. Currently, they consume 33 percent of personal and corporate income tax revenue. By 2041, nearly half of all personal and corporate income tax revenue will go to finance interest payments on the accumulated public debt. Thus, almost half of the income tax burden borne by taxpayers fifteen years from now will be devoted to paying the interest cost on the excess spending of earlier generations. These tax dollars are not going to be available for financing national defense and other federal responsibilities.

Many observers believe that the projected spending growth in Social Security and Medicare expenditures is primarily due to the growing population of senior citizens. But this is only partly true. The growth in inflation-adjusted spending per recipient plays an even more important role. As shown in figure 5, in fifteen years the annual inflation-adjusted Social Security benefit paid to the typical recipient will be $4,900 higher (21 percent) than the benefit received by current recipients. This increase is due to Social Security's use of wage-indexing to determine benefits to future retirees. The number of recipients is expected to increase by only 19 percent

FIGURE 5 Social Security and healthcare outlays (per recipient, in 2026 dollars)



Notes: Author's calculations derived from CBO projections, OASDI Trustees Report, and Medicare Trustees Report. Social Security is inflation adjusted using CBO projections for the PCE price index. Medicare, Medicaid, and the ACA are inflation adjusted using CBO projections for the medical PCE price index to 2036 and extrapolating them to 2041 based on the growth in the medical PCE relative to the PCE. Medicaid and the ACA are based on 2026 CBO insurance estimates. We assume Medicaid and ACA enrollment grow at CBO's assumed population growth after 2036.

over the same period. Thus, the increase in the number of recipients accounts for slightly less than half of the total increase.[9]

The expected growth in the number of Medicare enrollees accounts for even a smaller percentage of the growth in Medicare spending. CBO projects the number of Medicare enrollees to increase by only 18 percent between 2026 and 2041. As shown in figure 5, Medicare payments per enrollee, after adjusting for the rise in economy-wide healthcare costs, are expected to increase by about 52 percent ($7,800) over the same period.[10] Thus, the growing elderly population accounts for only about one-quarter of the increase in total real Medicare payments.[11]

Medicaid and the ACA together are projected to spend $3,500 (39 percent) more per enrollee.[12]

The higher healthcare expenditure per enrollee is largely a consequence of a greater volume of services and increasing use of resource-intensive (i.e., more diagnostic) tests and treatments per enrollee.

4. THE BUDGET IMPACT OF SLOWING THE GROWTH IN SPENDING

Rising Social Security and federal healthcare program expenditures per recipient means that lawmakers have an opportunity to restrain total spending without reducing the average inflation-adjusted benefits received by future recipients or, in common parlance, without cutting benefits. This section demonstrates how much limiting the growth in federal spending per recipient to inflation can reduce the budget deficit over the next fifteen years.

Table 1 shows the spending limitations on each major federal spending category. The growth in Social Security and other cash assistance benefits per recipient is limited to annual increases in the PCE price index, the Federal Reserve's preferred measure of inflation. This limitation, or a limitation based on any measure of inflation, means that future retirees will receive less in monthly benefits than they are currently promised. But the purchasing power of their benefits would remain the same as those received by today's recipients.

For Medicare, Medicaid, the ACA, and other federal health programs, the growth in health-care reimbursements per enrollee is limited to annual increases in the cost of medical care as measured by the PCE for healthcare services.[13] The use of this measure of the cost of healthcare services incorporates increases in healthcare costs, which typically rise faster than the general level of prices.[14] Thus, the limitation we impose allows future beneficiaries of these programs to receive the same amount of healthcare services as current recipients, as best as they can be measured by official government statistics.

TABLE 1 KEY PROGRAM GROWTH LIMITS

Budget category	Growth assumption
Social Security	Baseline growth in recipients + PCE price index
Healthcare programs	Baseline growth in recipients* + PCE price index for healthcare services
Other mandatory programs	PCE price index†
Discretionary spending	PCE price index

*Growth in Medicare recipients is from the Medicare Trustees Report. Medicaid and ACA enrollment is set to population growth.

†Other mandatory programs are divided into refundable tax credits, Supplemental Security Income, Supplemental Nutrition Assistance Program, Unemployment Compensation, other income security programs, civilian retirement, military retirement, Veterans Affairs, and other mandatory spending.

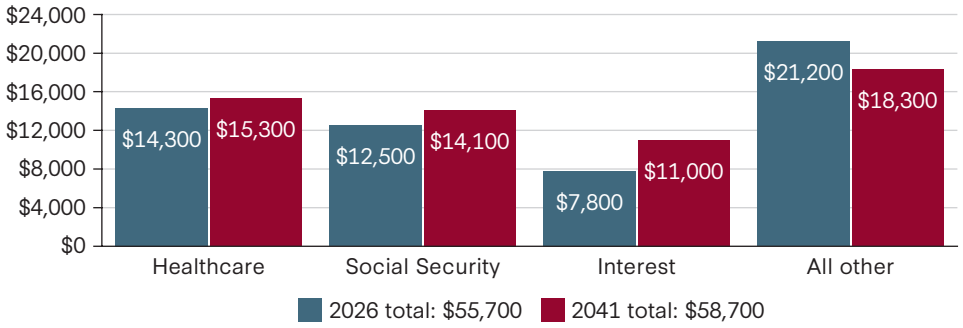
It may seem unlikely that merely slowing the growth of these four programs would yield meaningful budget improvements. But together they account for 56 percent of total federal noninterest spending in 2026. As we noted earlier, the number of Social Security recipients will increase by 19 percent. If the growth in Social Security benefits per recipient were held to inflation (as measured by the PCE), inflation-adjusted total Social Security expenditures would, therefore, increase by 19 percent.[15] The CBO forecasts that PCE inflation-adjusted federal revenues over the same period will increase by 34 percent, nearly twice as rapidly.

Similarly, the main source of the projected increase in Medicare expenditures is the increase in payments per enrollee after adjusting for the increase in healthcare costs. As noted earlier, the number of Medicare enrollees is expected to increase by 18 percent. If the rise in Medicare payments per enrollee were limited to the growth in the cost of healthcare services, PCE inflation-adjusted total Medicare spending would increase by 19 percent, still much less than the 34 percent projected increase in PCE inflation-adjusted revenues.

The number of Medicaid and ACA recipients is expected to decline by 13 percent, primarily due to the 2025 Reconciliation law. Limiting the growth in payments per enrollee to the growth in the cost of healthcare services would cause these programs' total inflation-adjusted spending to also increase by less than the inflation-adjusted growth in federal revenues.

Per recipient, benefit payments by the remaining entitlement programs would also be limited to the growth in inflation. This limitation allows the number of recipients of programs such as veterans disability compensation, SNAP and child nutrition subsidies, student financial aid,

FIGURE 6 Outlays with stylized spending restraint (per household, in 2026 dollars)



Notes: Author's calculations derived from CBO projections. Dollars are inflation adjusted using CBO projections for the PCE price index.

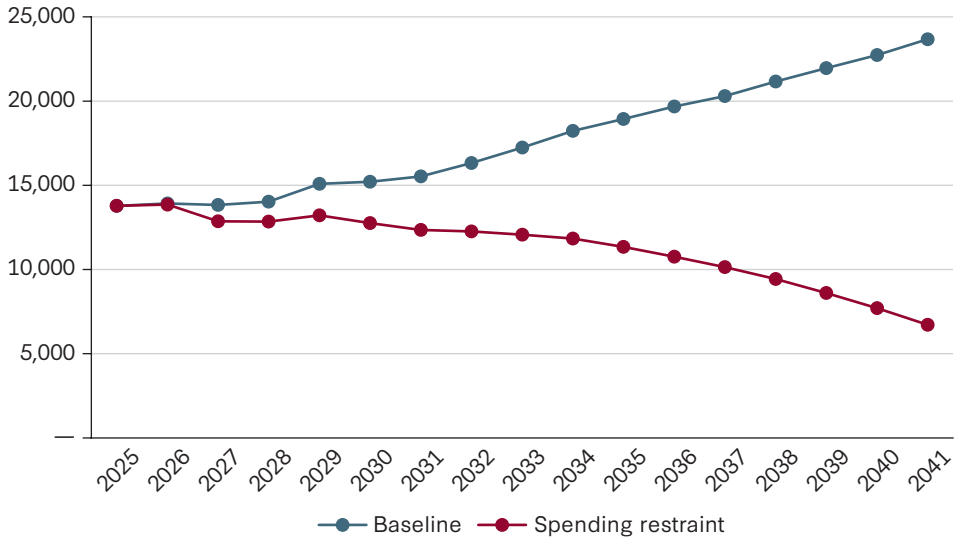
unemployment benefits, and federal retirement assistance to change according to the CBO forecasts. Similarly, spending on discretionary programs would be limited to the growth in the PCE price index.

The effect of the spending limits is dramatic. Noninterest spending per household would nearly flatline in real terms over the next fifteen years. Real noninterest spending would rise only from $46,900 to $47,600 per household. Figure 6 summarizes how spending by major program categories would change under our scenario. Per household, Social Security and healthcare spending would rise, but by far less than under CBO's forecast. All other programmatic spending would fall in real terms. Interest payments on the debt, however, would continue to grow, rising by $3,300 per household.

There is a particularly strong case for holding the inflation-adjusted value of Social Security and Medicare benefits received by the typical recipient at their present levels. Currently, the present value of the two benefits combined for a married couple at age 65 (Medicare's eligibility age) is $1.36 million. In fifteen years, it is projected to increase to $1.79 million, a $440,000 increase in 2026 dollars. Additionally, both Social Security and Medicare's Hospital Insurance program are facing insolvency in the next decade. The slower growth in Social Security benefits is a good way to begin addressing its financial problem. But it wouldn't be sufficient to avoid the benefit reductions that will occur unless Congress takes additional action.[16] The slower growth in Medicare benefits, on the other hand, would prevent the Medicare Hospital Insurance Trust Fund from becoming exhausted in the early 2030s.

Figure 7 shows the trend in federal budget deficits with the spending limitations in place during the next fifteen years and compares it to CBO's current projection of deficits. As the figure shows, the spending limitations would put the federal government's finances on a fiscally prudent path. The budget deficits would decline steadily, rather than increase. In fifteen years, the spending limitations would reduce the budget deficit per household to $6,715. In the absence of the spending limits, the deficit per household would be three times higher, $20,261. Expressed as a percentage of GDP, the deficit would fall to 2.3 percent in fifteen years, rather than rise to 7 percent.

FIGURE 7 Federal budget deficits (per household, in 2026 dollars)



Notes: Author's calculations derived from CBO's 2026 projections.

In summary, the spending limitations would reduce the projected 2041 budget deficit by about two-thirds. While this is a significant reduction, the spending limitations alone are not enough to balance the budget in fifteen years. However, balancing the budget could be achieved in twenty years if the spending limitations were kept in place.

5. THE EFFECT OF ECONOMIC GROWTH

The federal budget's financial condition depends crucially on the rate of future economic growth. Economic growth increases federal revenue from existing taxes on higher wage earnings, capital incomes, and business profits. By raising incomes, economic growth also reduces the cost of welfare programs as more individuals are lifted out of poverty. Thus, strong and sustained growth can substantially improve the federal budget's condition.

How much of a difference can higher economic growth make in reducing the magnitude of future budget deficits and in slowing the growth in the public debt? To answer this question, we use a budget model that closely approximates the results of CBO's model. The model provides estimates of the magnitude of revenue changes associated with alternative levels of economic activity. However, it does not incorporate changes in income-transfer program expenditures from changes in economic growth. Thus, reductions in the budget deficit from higher growth come exclusively from higher revenues and the interest savings from reduced federal borrowing due to higher revenues.

The CBO projects that real GDP growth over the next fifteen years will average 1.8 percent. This growth rate is the basis for the spending and revenue projections presented in the preceding sections. The CBO-assumed growth rate is low compared to recent US experience,

but perhaps not unreasonably so. The economy grew at an average annual rate of 2.4 percent during the last ten years, 2.0 percent during the last twenty years, and 2.5 percent during the last thirty years. But given the aging of the US population, the increasing economic burden of federal budget deficits on the economy, and the highest tariff rates since the 1940s, it is not unreasonable to expect the economy to grow at less than these historical rates.

On the other hand, achieving a higher economic growth than 1.8 percent per year is certainly within reason, especially if the right set of pro-growth policies, such as those pursued in the 1980s and 1990s, are put in place.

We consider the budget impact of two alternative economic growth rates over the next fifteen years. The first assumes that the economy will grow at its thirty-year average of 2.5 percent per year. The second assumes a 2.8 percent growth rate, one percentage point higher than the CBO's currently assumed rate. This aggressive growth rate could be justified if the optimistic forecasts of artificial intelligence's productivity benefits are borne out.

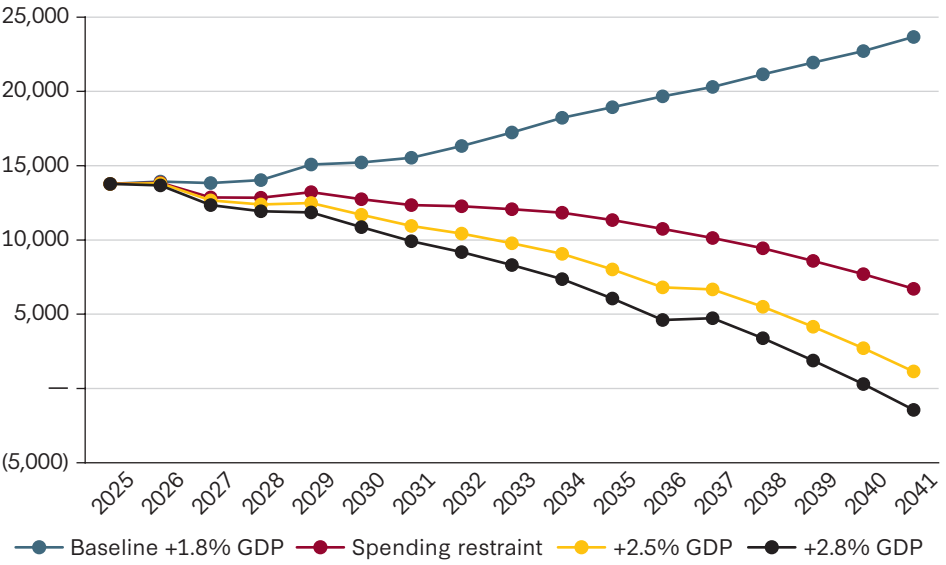
Are these higher growth rates possible? CBO's pessimistic growth forecast can be divided into two parts. First, CBO expects employment growth to average just 0.3 percent per year between 2026 and 2041. Yet, there is considerable room for employment to grow. One in every seven men ages 25–54, and one in every five men in the same age range who have a high school education or less, are neither working nor looking for work. Employment ratios for both groups were much higher in the 1960s, prior to the rapid expansion of disability and other programs with large work disincentives. Reforming these programs to encourage more work could help raise US employment growth.

Second, CBO projects that labor productivity—the average output per worker—will grow more slowly than it has in recent history. Annual productivity growth is projected to fall from 1.5 percent today to 1.3 percent by 2040. It was higher in earlier periods. Ten-year productivity rates reached 2 percent or higher in the 1950s and 1960s and the 1990s. A sustained period of 2 percent annual labor productivity growth—due to an increase in capital investments or large productivity improvements from pro-growth economic policies and from widespread adoption of artificial intelligence tools that meet optimistic expectations—would raise GDP growth considerably.

While lawmakers should not count on large increases in productivity or employment growth to occur without a change in policy, they should understand that pro-growth tax reforms that focus on reducing tax rates on work and investment, and regulatory changes that remove costly rules that discourage innovation, risk-taking, and investment, can raise economic growth as they did in the 1980s and 1990s.

Figure 8 shows how the budget picture improves when higher economic growth is combined with the policy of restraining spending growth. The figure shows deficits per household in 2026 dollars assuming implementation of the spending limitations under three alternative economic

FIGURE 8 Federal budget deficits with stylized budget restraint and GDP growth (per household, in 2026 dollars)



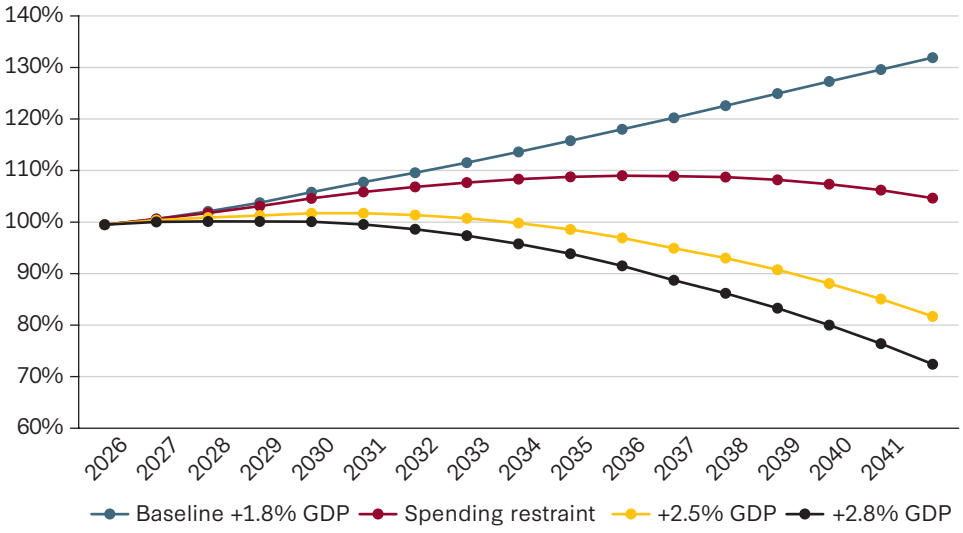
Notes: Author's calculations derived from CBO's 2026 projections.

growth assumptions: the current CBO assumption of 1.8 percent per year, 2.5 percent per year, and the more aggressive assumption of 2.8 percent per year.[17]

Under the CBO assumed 1.8 percent growth rate, as we noted earlier, spending restraint alone (the red line) reduces the projected deficit by two-thirds in fifteen years, to about $6,711 (2.3 percent of GDP). If the economy were to grow at 2.5 percent per year (the yellow line), the budget deficit would fall under 3 percent of GDP in nine years and below 2 percent of GDP in twelve years, and the budget would essentially be balanced in fifteen years. At that point, the projected deficit would be $1,090 (0.3 percent of GDP), a balanced budget within any reasonable forecast range. If economic growth reached 2.8 percent per year (the black line), the combination of the spending limitations and higher revenues from economic growth would balance the budget by 2040.

Figure 9 shows the debt path under the same three economic growth scenarios. Here, the debt as a percent of GDP is used as the measure. This measure, rather than a dollar measure, is preferred since it reflects the debt relative to a nation's productive capacity, which reflects its ability to repay the debt. As we noted earlier, without the spending limitations and with the economy growing at 1.8 percent per year, the federal budget is on an upward and accelerating path. With the spending limitations, the debt rises more slowly and begins to decline in less than a decade. By 2041, the debt is 104 percent of GDP, only slightly above its current level. With the spending limitations in place and with annual economic growth at 2.5 percent, the debt as a percentage of GDP begins to decline in five years. The spending limitations with 2.8 percent per year economic growth starts shrinking the debt as a percent of GDP immediately and in fifteen years reduces the debt to 72 percent of GDP.

FIGURE 9 Federal debt with stylized budget restraint and GDP growth (percent of GDP)



Notes: Author's calculations derived from CBO's 2026 projections.

6. CONCLUDING THOUGHTS

This essay addresses the concern that the federal budget cannot be balanced without large tax increases or deep cuts in social-safety-net entitlement programs. The essay shows that a balanced budget can be attained within a reasonable time period without reducing the real value of federal entitlement benefits and with stronger economic growth. Limiting the growth in cash entitlement benefits per recipient to consumer price inflation and the growth in healthcare entitlement spending per recipient to the growth in economy-wide healthcare costs would restrain the growth in federal spending to 2.9 percent per year. The spending limitation would reduce the budget deficit by two-thirds in fifteen years and balance the budget in twenty years. Improving economic growth to its average growth rate during the past thirty years would produce a more rapid decline in deficits and close the remaining one-third of the budget deficit to balance the budget in fifteen years. These outcomes can be achieved if Congress takes two actions. First, Congress must act soon to prevent the inflation-adjusted value of entitlement benefits from increasing. In the absence of congressional action, the average inflation-adjusted Social Security benefit per recipient and the average Medicare payment per enrollee are projected to rise by 21 percent and 52 percent, respectively. Second, Congress must put in place the tax and regulatory measures necessary to maintain strong economic growth.

Because the spending limitation is a "no cuts in benefits" approach to balancing the budget, it is likely to be politically attractive in some quarters. However, the spending limitation considered herein does require structural changes in both programs. Such changes involve politically difficult choices. For Social Security, they involve abandoning the program's nearly fifty-year-old wage-indexing method of determining monthly benefits for future retirees. For

Medicare, they involve significantly modifying the delivery of federally financed healthcare services. Such a modification necessarily moves away from the existing approach of the government setting reimbursement rates to fundamentally alter incentives of providers and patients to use healthcare services more efficiently. As difficult as these choices are, the alternatives, which include large tax hikes, higher inflation, and rising interest rates—and ultimately lower standards of living—are far worse.

Holding the real value of entitlement benefits per recipient at its current level is only one of many ways of restraining federal spending. However, it is not an approach I prefer. The federal government already spends 45 percent of the noninterest budget directly on senior citizens. Social Security and Medicare, though well-intentioned, have grown beyond their original goal of preventing old-age poverty into middle-class entitlements. Similarly, welfare and disability benefits, along with their large work disincentives, have been extended well beyond the poverty population into the general population. Additionally, the federal government has taken on far too many activities that were once the responsibility of state and local governments, and it has conducted them poorly. Restoring entitlement programs to their original and far less costly safety-net purposes and returning financial responsibility for certain activities to state and local governments should be paramount in plans to balance the budget. These actions would make room in the federal budget for higher national defense spending. The defense budget has already fallen to a dangerously low level given the national security threats posed by China, Russia, and non-state actors around the globe.

Whatever specific plan is chosen, it should be kept in mind that today's fiscal imbalance is the product of decades of excessive spending. Returning to fiscal balance need not, and probably cannot, be achieved overnight. A future date to balance the budget must be chosen and a credible and sustainable plan to achieve it be put in place soon.

ACKNOWLEDGMENTS

I thank Daniel Heil, former policy fellow at the Hoover Institution and currently special adviser to the chairman of the Federal Reserve Board, for his exceptional work on all aspects of this essay, especially for developing the budget model from which the essay's estimates are derived. Also, I thank Michael Boskin, David Brady, Tom Church, David Koitz, Charles Palm, and Jessica Riedl for helpful comments on an earlier draft. In addition, I would like to thank the Hoover Institution's Tennenbaum Program for Fact-Based Policy and Center for Revitalizing American Institutions for their support.

NOTES

1. Thomas Jefferson, letter to James Madison, September 6, 1789, https://founders.archives.gov/documents/Jefferson/01-15-02-0375-0003.

2. Hoover Institution Fiscal Policy Initiative, "New Poll: What Americans Need to Know About the Trump Tax Cuts," Hoover Institution, April 23, 2025, https://www.hoover.org/news/new-poll-what-americans-need-know-about-trump-tax-cuts.

3. There is no comparable period in the twentieth and twenty-first centuries in which deficits have been reduced by this magnitude, other than the fifteen years commencing during World War II or its immediate aftermath.

4. On tax policy, the Reagan administration's 1981 tax cuts reduced personal income tax across the board by 25 percent, and the 1986 tax reform reduced income tax rates further, simplified the income tax code, and broadened the tax base. Although George H. W. Bush and Bill Clinton raised tax rates on upper-income taxpayers, tax rates throughout the 1990s remained well below those in effect before the 1981 tax cuts. The top income tax rate prior to the 1981 reductions was 70 percent. After the Bush and Clinton tax increases, the top rate was 39.6 percent.

Similarly, the Reagan administration deregulated large segments of the economy, including energy, telecommunications, financial services, transportation, and the workplace. These efforts came on the heels of the Carter administration's deregulation of the trucking and airline industries and were followed by further significant deregulation by the Clinton administration. Most notable was the Clinton administration's initiative to keep the internet relatively free from government regulation and its further deregulation of the telecommunications industry. Tariffs were significantly reduced by the Uruguay Round in the 1980s, the North American Free Trade Agreement in 1994, and the Information Technology Agreement in 1996. The certainty created by sound monetary policy practiced during the period was in sharp contrast with the stop-go policies that created high inflation in the 1970s.

5. We estimate posttax income would rise by $300 from 2025 to 2040. In 2024, the median household income was $88,200 (2025 dollars). We estimate real median pretax household income will rise by 18 percent. This estimate is based on CBO projections for earnings growth and the share of earnings below the taxable maximum. The average tax rate for middle-quintile families is from CBO, *The Distribution of Household Income, 2022*, January 21, 2026, https://www.cbo.gov/publication/61911. The average tax rate includes all taxes borne by households (including the economic incidence of corporate taxes, excise taxes, and the employer share of the payroll tax).

6. In 2023, eight hundred thousand tax filers had at least $1 million in adjusted gross income (AGI). They reported $2,543 billion in AGI. They paid $653 billion in taxes with no more than $237 billion paid on income below $1 million (this assumes all filers only claimed the standard deduction and all income was taxed at ordinary rates). That would leave no more than $1,328 billion in untaxed income above $1 million. The 2026 deficit is projected at $1,850 billion. Income tax data are from Internal Revenue Service, Statistics of Income Division, "SOI Tax Stats—Individual Statistical Tables by Size of Adjusted Gross Income: Individual Income Tax Returns Filed and Sources of Income," https://www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income.

7. Christina D. Romer and David H. Romer, "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," *American Economic Review* 100, no. 3 (2010); Alberto Alesina, Omar Barbiero, Carlo Favero, Francesco Giavazzi, and Matteo Paradisi, "The Effects of Fiscal Consolidations: Theory and Evidence," NBER Working Paper 23385 (2017), https://doi.org/10.3386/w23385.

8. The healthcare programs include Medicare, Medicaid, the Children's Health Insurance Program (CHIP), and the ACA's premium subsidies.

9. If the Social Security Administration's projected CPI-W (Consumer Price Index for Urban Wage Earners and Clerical Workers) is used as the deflator, inflation-adjusted benefits per recipient will rise by 15 percent over the same period, accounting for slightly less than half, instead of slightly more than half, of the increase in aggregate inflation-adjusted Social Security expenditures from 2026 to 2041.

10. While the proportion of Medicare enrollees who are age 85 and older is expected to rise significantly over the next fifteen years, the impact of their higher costs on the Medicare program is modest. Using MedPAC 2022 (chart 2-2) data on Medicare by age group and US Census projections of the increase in the share of the age-65-and-older population that is 85 and older, I find that the aging of the population adds about 12 percent to the real cost per enrollee over the fifteen-year period.

11. CBO's decomposition of the growth in Medicare spending from 2027 to 2036 yields similar percentages. CBO, *The Budget and Economic Outlook: 2026 to 2036*, February 2026, 67, https://www.cbo.gov/publication/61882.

12. Enrollment for Medicaid and the ACA is based on 2026 CBO insurance estimates. We assume Medicaid and ACA enrollment grow at CBO's assumed population growth rate after 2036. The 2026 insurance estimates are from CBO, *Federal Subsidies for Health Insurance: 2026 to 2036*, February 2026, https://www.cbo.gov/system/files/2026-02/51298-2026-02-healthinsurance.pdf.

13. The PCE healthcare price index is preferred to the CPI for medical care. The PCE measures the cost of healthcare purchased through insurance and government programs as well as services purchased out of pocket. Thus, it includes the cost of employer-provided and individual insurance, Medicare, and Medicaid. The CPI medical care index includes only medical expenses purchased out of pocket.

14. During the past thirty years, the PCE for healthcare services has risen 12 percent faster than the PCE measure of overall price inflation. The PCE for healthcare services excludes pharmaceutical products. But since pharmaceutical product prices have grown less rapidly than the price of healthcare services, including pharmaceuticals in a measure of healthcare inflation would lower the rate of healthcare price growth.

15. Inflation-adjusted payments would rise by 20 percent if the CPI-W were used to adjust benefits for inflation. The slower growth in benefits would not be sufficient to prevent the Social Security Trust Fund from being exhausted in the early 2030s. But it would be sufficient to make the trust fund solvent over the seventy-five-year horizon as measured by the fund's long-term actuarial balance.

16. But the slower growth in Social Security benefits would be sufficient to make the trust fund solvent over the seventy-five-year horizon as measured by the fund's long-term actuarial balance.

17. I assume the changes in growth would have no effect on interest rates.

The publisher has made this work available under a Creative Commons Attribution-NoDerivs license 4.0. To view a copy of this license, visit https://creativecommons.org/licenses/by-nd/4.0.

Copyright © 2026 by the Board of Trustees of the Leland Stanford Junior University

The views expressed in this essay are entirely those of the author and do not necessarily reflect the views of the staff, officers, or Board of Overseers of the Hoover Institution.

32 31 30 29 28 27 26 7 6 5 4 3 2 1

Preferred citation: John F. Cogan, "Limiting Federal Spending Growth to Balance the Budget," Hoover Institution, October 2026.

ABOUT THE AUTHOR



JOHN F. COGAN

John F. Cogan is the Leonard and Shirley Ely Senior Fellow at the Hoover Institution. Cogan's research is focused on US budget and fiscal policy, federal entitlement programs, and healthcare. His book *The High Cost of Good Intentions* (2017) received the 2018 Hayek Prize.

Synopsis

Many think that balancing the federal budget would require deep cuts in entitlement programs. This paper shows to the contrary that the budget can be balanced within 15 years through modest and sustained federal spending restraint and moderately higher economic growth. Key to this restraint is to limit the growth in the average future value of entitlement benefits per recipient to today's level, after adjusting for inflation and rising healthcare costs.

Hoover Institution
Stanford University
434 Galvez Mall
Stanford, CA 94305-6003
650-723-1754

Hoover Institution
in Washington
1399 New York Ave. NW, Ste. 500
Washington, DC 20005
202-760-3200

Hoover Institution
in Texas
3889 Maple Ave., Ste. 600
Dallas, TX 75219
hoovertexas@stanford.edu

HOOVER INSTITUTION