The US Federal Debt

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Sons in Retirement, Branch 54

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Outline

- **First: A Budget Overview**
- **The Debt**
- **Important Points About the Debt**
- **How to Think About the Debt**
- **Summary**

First: A Budget Review

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What Does the US Govt. Budget Look Like?

2024 Budget Summary (in Trillions)

Revenue			Outlays	
Income Taxes	$2.4		Mandatory	$4.1
Payroll Taxes	$1.7		Discretionary	$1.8
Corporate Taxes	$0.5		Interest	$0.9
Other	$0.3			
Total	$4.9		Total	$6.8

Budget Deficit: $1.8 Trillion

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Source: https://www.cbo.gov/publication/60053

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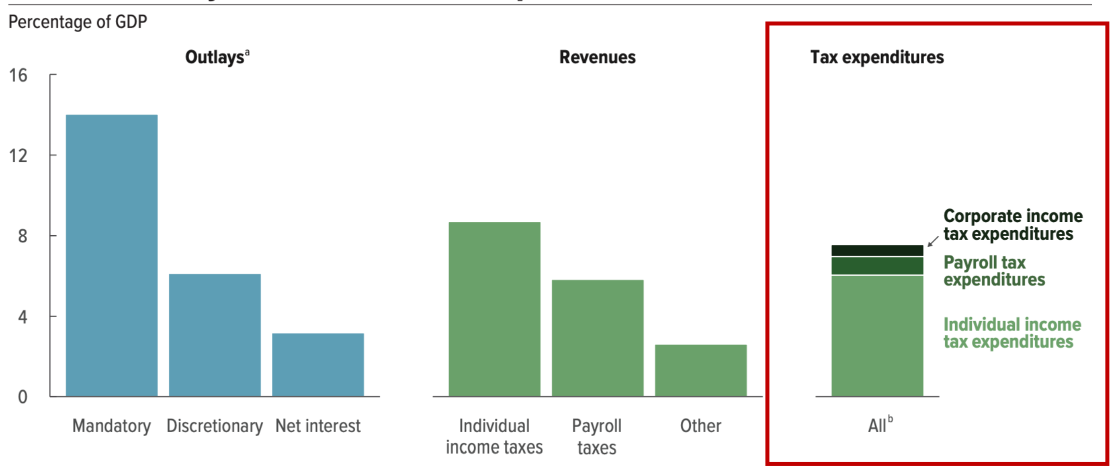
But There is More to The Budget!

Estimated Outlays, Revenues, and Tax Expenditures in Fiscal Year 2025



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Source: https://www.cbo.gov/system/files/2025-01/60870-Outlook-2025.pdf

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What Are Tax Expenditures?

Largest Individual Income Tax Expenditures	Budgetary Cost in 2024 (Billions of $)
Exclusion of pension contributions and earnings and individual retirement arrangements*	395
Exclusions of and reductions on dividends and long-term capital gains**	283
Exclusion of employer contributions for medical insurance and care	218
Child Tax Credit (CTC)	127
Subsidies for insurance purchased through health benefit exchanges	114
Earned Income Tax Credit (EITC)	67
20-percent deduction for certain pass-through income	63
Step-up basis of capital gains at death	62
Total	**1,329**

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Source: https://www.pgpf.org/article/chart-pack-individual-taxes/

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And Now: The Debt

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WHAT IS THE NATIONAL DEBT TODAY?

$38,117,955,529,070

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Source: Peter G. Peterson Foundation, National Debt Clock

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Of Debt, Deficits, and Surpluses

- **FLOW**
  - ***Deficit***: The excess of outlays over revenues in a year.
  - ***Surplus***: The excess of revenues over outlays in a year.

- **STOCK**
  - ***Debt***: The accumulation of debt over time.
    - The sum of all past deficits and surpluses.

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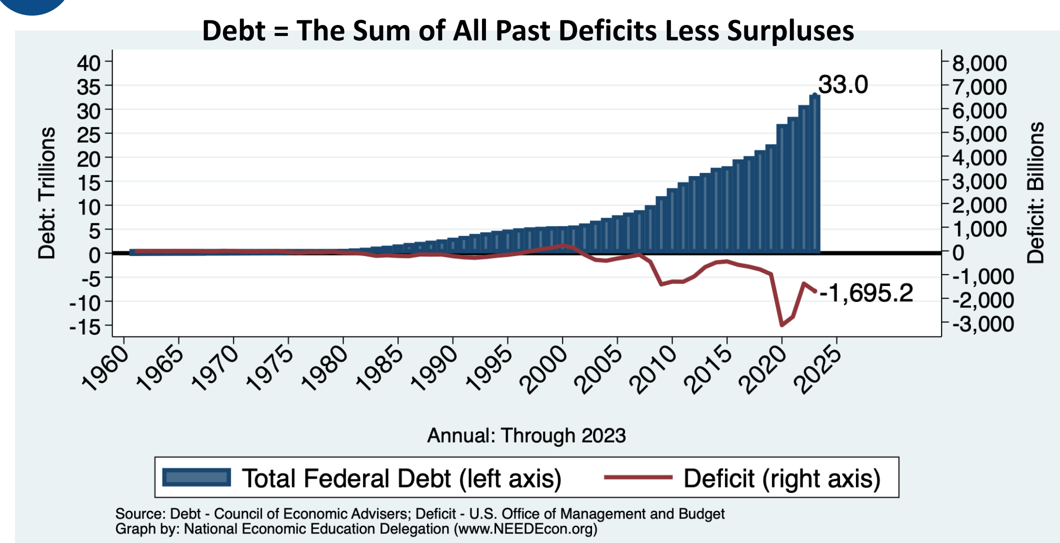
Debt vs. Deficit



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Major Takeaways: Talking Points

- **The debt is not currently a significant problem.**
- **The current trajectory of federal debt is unsustainable.**
- **We must enact plans to reduce future deficits.**
  - These are driven by Medicare and Social Security spending.
- **The longer we postpone action, the greater the probability of a "fiscal crisis."**

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How Does the US Government Borrow?

- **It issues debt.**
  - Treasury marketable securities:
    - Treasury bills, notes, and bonds
    - TIPS: Treasury inflation-protected securities
    - Savings bonds
- **Who buys the debt?**
  - Other federal agencies
  - Individuals and businesses
  - State and local governments
  - Foreign governments and individuals
  - Federal Reserve

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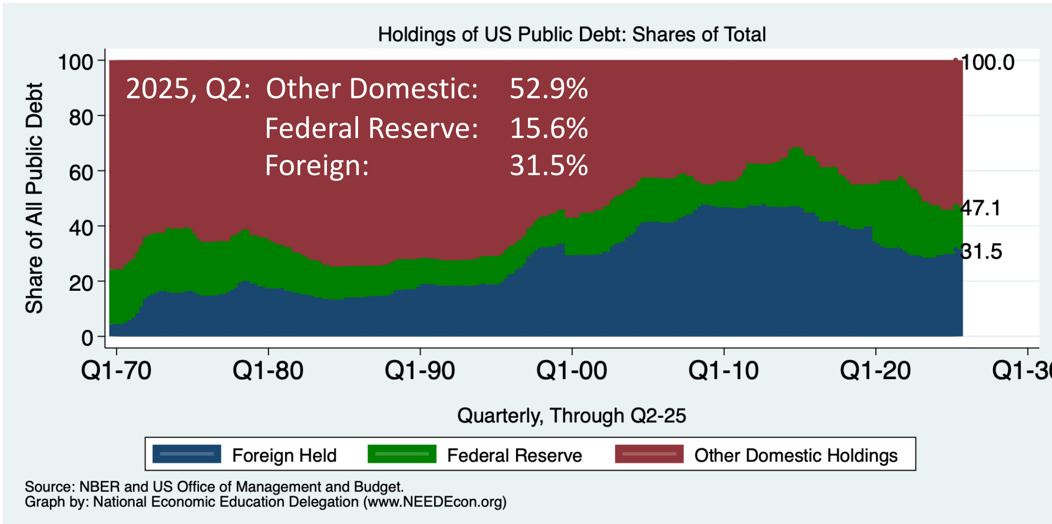
Trends in US Debt Holdings Over Time



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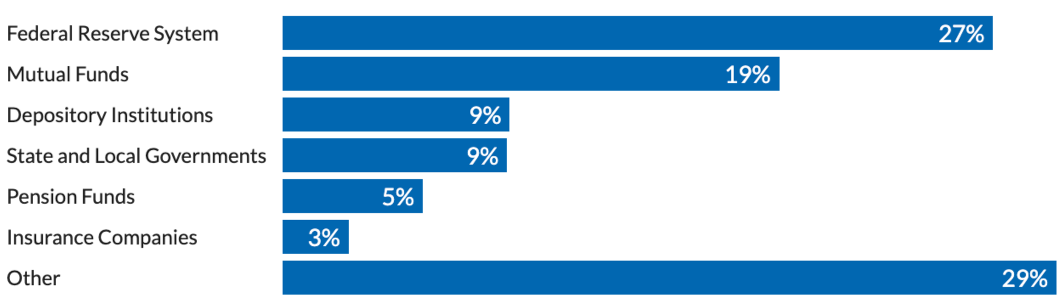
The Federal Reserve owns about a third of domestically held debt

% of Debt Held by the Public Owned by Domestic Creditors



Source: U.S. Department of the Treasury • Embed • Download image

Notes: Data are through December 2023. The Other category is made up of U.S. Savings Bonds and Other Investors.

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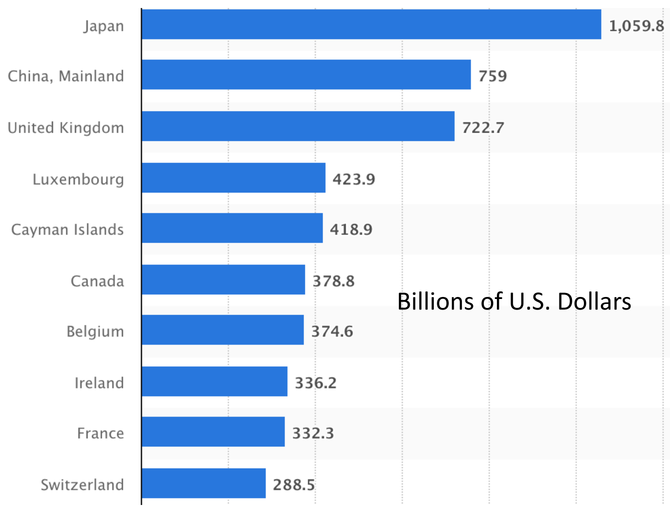
Who Holds Debt to Foreigners, Dec. 2024



Foreign ownership is relatively recent
– in 1990 foreign ownership was less than 20%
– peaked at 40+%
– now is 31.5%

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Source: https://www.statista.com/statistics/246420/major-foreign-holders-of-us-treasury-debt/

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Why Do Foreign Investors Buy US Treasuries?

- **Market for Treasuries is the deepest, most liquid capital market in the world.**
- **The US economy has a history of political and economic stability.**
- **The dollar is the largest international reserve currency.**
  - Most trade transactions (e.g., oil) are quoted in dollars.
  - 54% of international trade involves the dollar.
  - 88% of foreign exchange transactions involve the dollar.
  - With some exceptions, foreign governments borrow in dollars.

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Important Points:

- Not all debt is created equal.
- What is the right measure of the debt?

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Not All Debt Is Created Equal

- **Some debt can reduce the availability of investment funds to other borrowers.**
  - Often referred to as "crowding out" private investment.
- **IntRAgovernmental debt is (important) bookkeeping.**
  - This debt **DOES NOT** crowd out private investment.
- **Debt held by the public.**
  - This debt **MIGHT** crowd out private investment.
- **Most analyses of debt focus on federal debt held by the public.**

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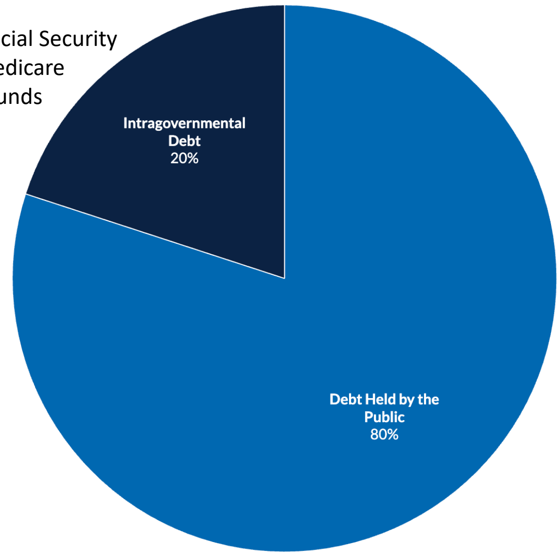
U.S. Publicly Held Debt, June, 2025



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Source: PGPF.org

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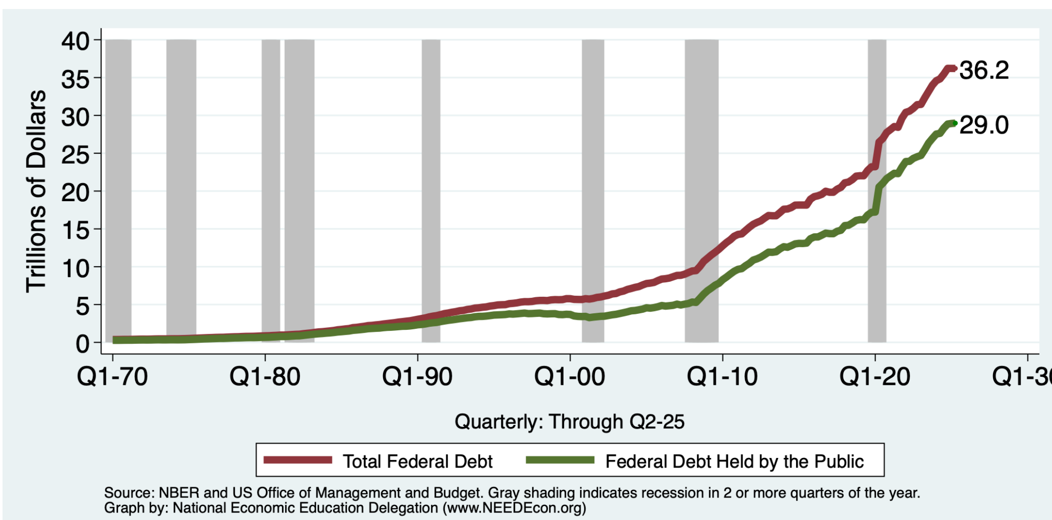
Two Measures of the Debt



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The All-Important *Relative* Debt

- **CBO analyzes the debt *relative* to GDP because:**
  - To the extent that debt and deficits have burdens, these burdens depend on the size of the debt ***relative*** to the size of the economy.

	Total Public Debt	Relative Debt Debt/GDP
United States	$30.5 Trillion	95%
Greece	$0.215 Trillion	170%

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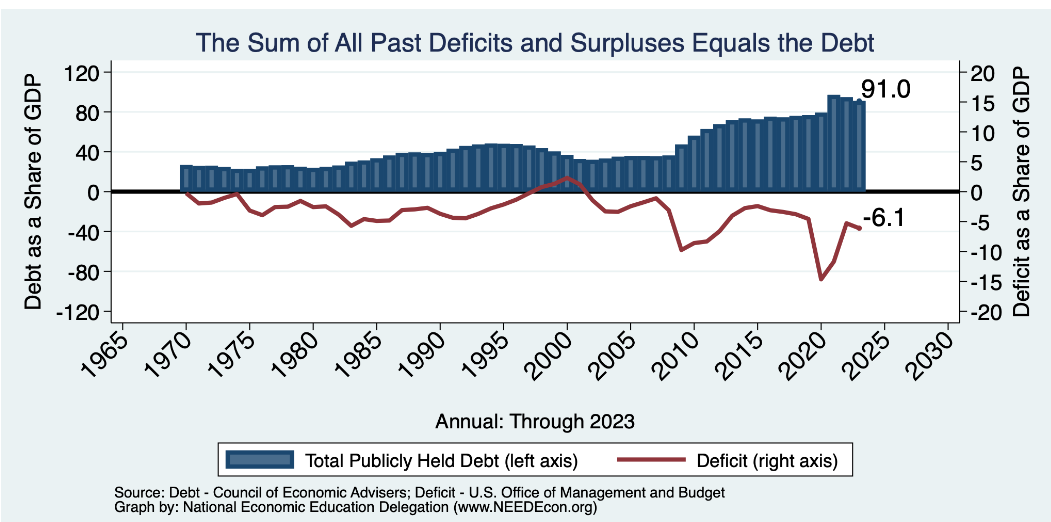
Relative Debt and Deficit



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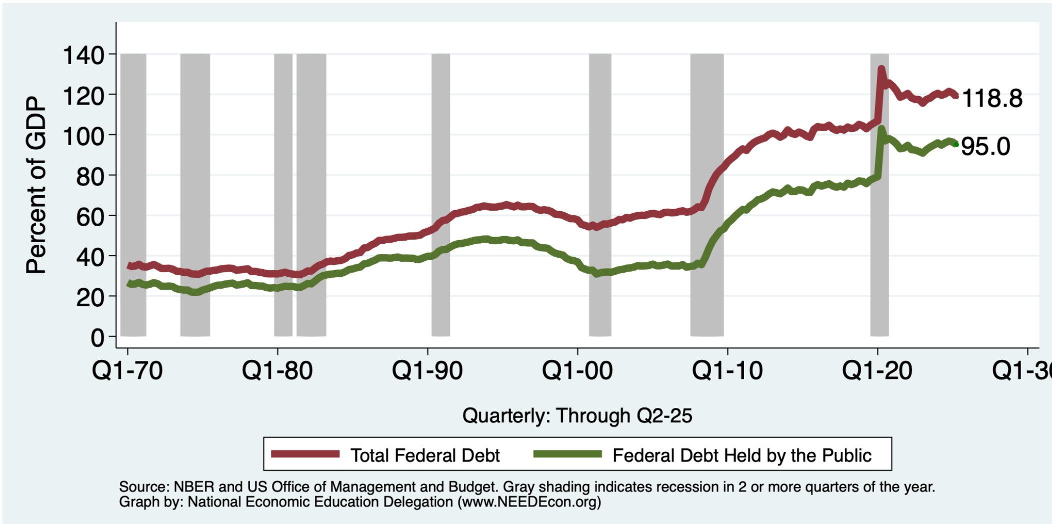
Two Measures of RELATIVE Debt



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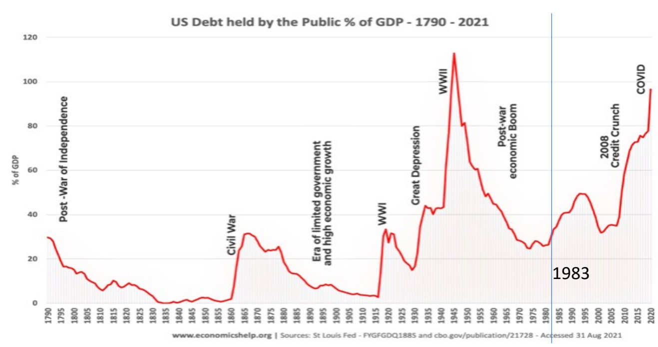
Key Points About US Relative Debt



1. **Relative debt peaked during World War II, followed by a long decline.**
2. **Prior to 1983, relative debt rose purposefully (wars and recessions) and then fell.**
3. **Relative debt has been and is expected to rise for the next 30 years w/o a strategic purpose.**

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Debt Dynamics

- **Surprising (?) Facts**
  - From 1945 to 1979, relative debt fell from 110% of GDP to 25% of GDP.
  - During this period, the federal budget was in surplus only 8/35 years!

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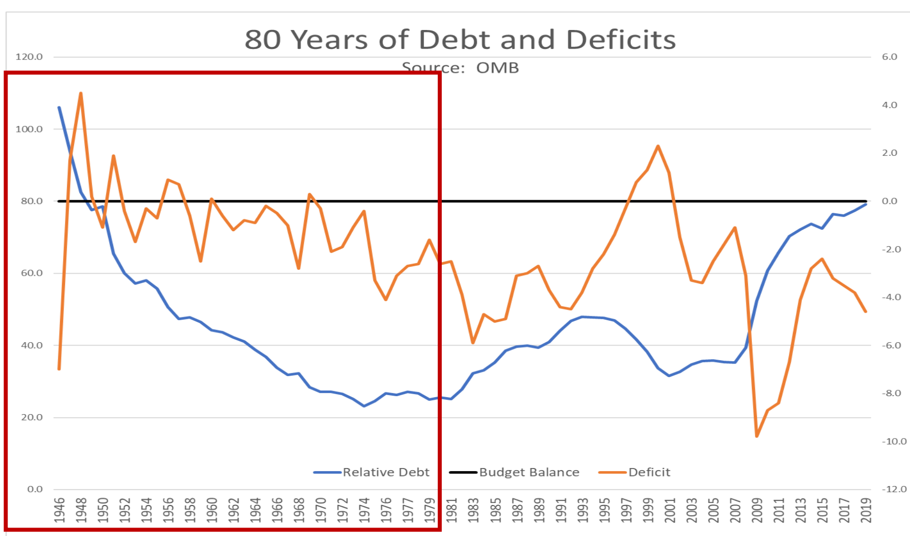
The Post-WWII Fall in Relative Debt



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Debt Dynamics

- **Surprising (?) Facts**
  - From 1945 to 1979, relative debt fell from 110% of GDP to 25% of GDP.
  - During this period, the federal budget was in surplus only 8/35 years!
- **Relative debt is a fraction: Debt/GDP; fractions fall if:**
  - The ***numerator*** falls (budget surplus)
  - The ***denominator*** rises (nominal GDP growth)
  - The ***denominator*** grows faster than the ***numerator:***
    - ***If GDP growth is greater than the interest rate on borrowing.***
  - ***CAN still run deficits and reduce the relative debt.***

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An Almost Free Lunch

- **If the interest rate is *less* than the growth rate of GDP, then the contribution from the primary budget can be positive, hence…**
- **Debt to GDP can be stabilized with a (small) primary *deficit*.**

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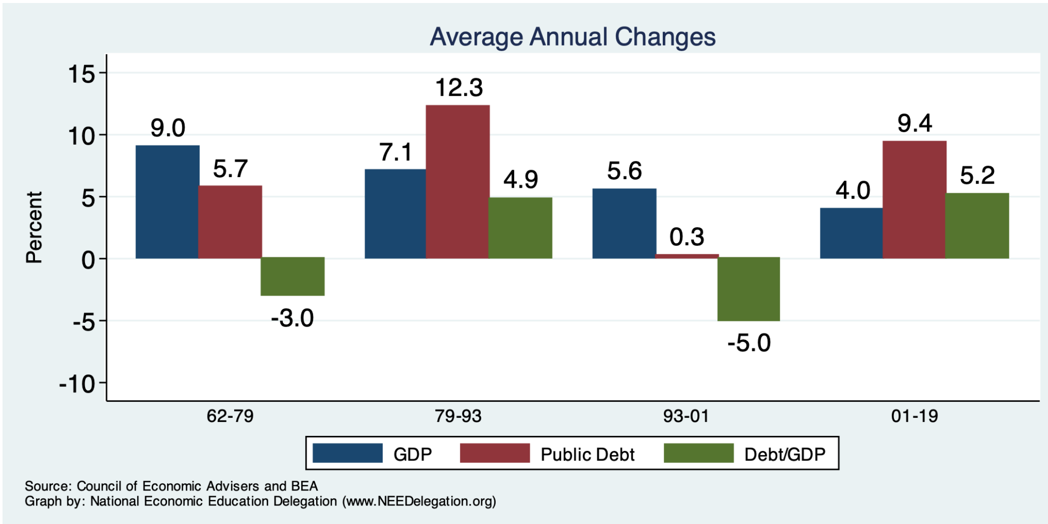
The Arithmetic of Changes in Relative Debt



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Is Stabilizing Relative Debt Good Enough?

- **This means that the absolute level of the debt would continue to increase.**
- **Yes, it probably is good enough.**
  - It is a reflection of the economy's ability to support the debt.
  - Stability will avoid bond market scares.
- **More on this later.**

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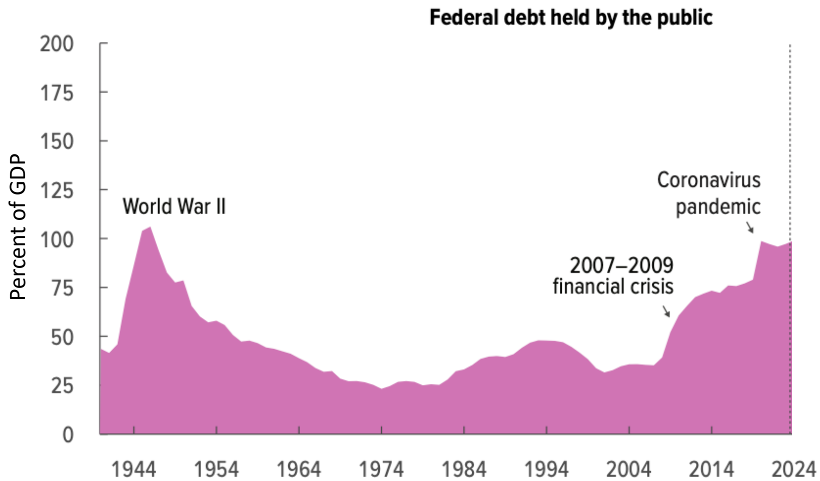
But Let's Think About Today



Data source: Congressional Budget Office. See www.cbo.gov/publication/59711#data.

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Why Has the Federal Debt Risen So Much?

- **Expenditures UP:**
  - Social Security
  - Health-care costs
  - Economic stimulus
    - **In particular, during the Great Recession & COVID.**
  - Military engagements overseas

- **Revenues DOWN:**
  - Declining income tax revenues
    - Stagnant wages
    - **Tax cuts**
  - Social security
    - Declining revenues

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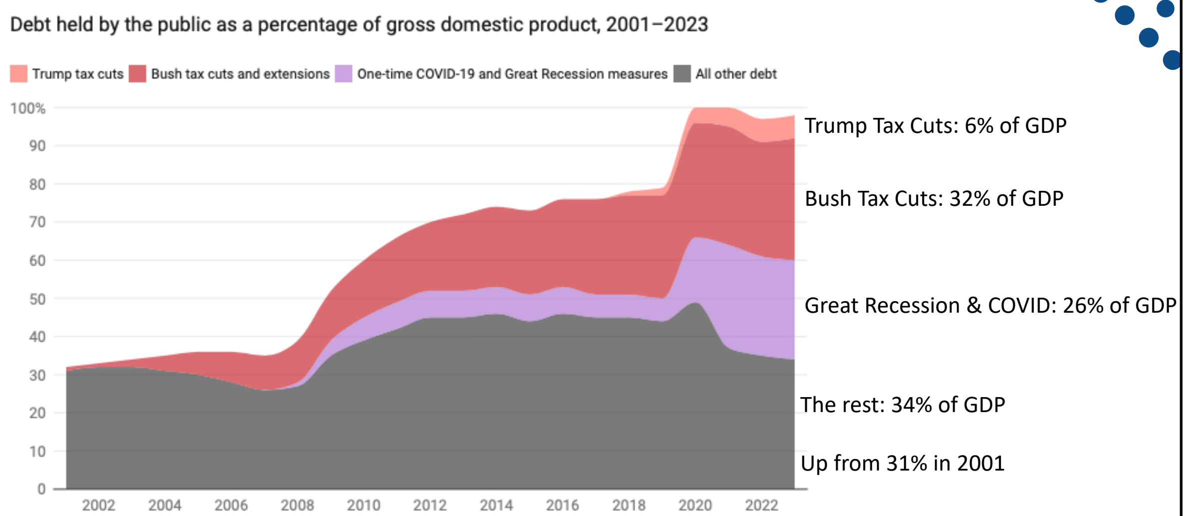
Tax Cuts Have Driven The Debt Increases



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Thinking About Today….

- **Do we have:**
  - A spending problem?
  - A revenue problem?
  - Both?

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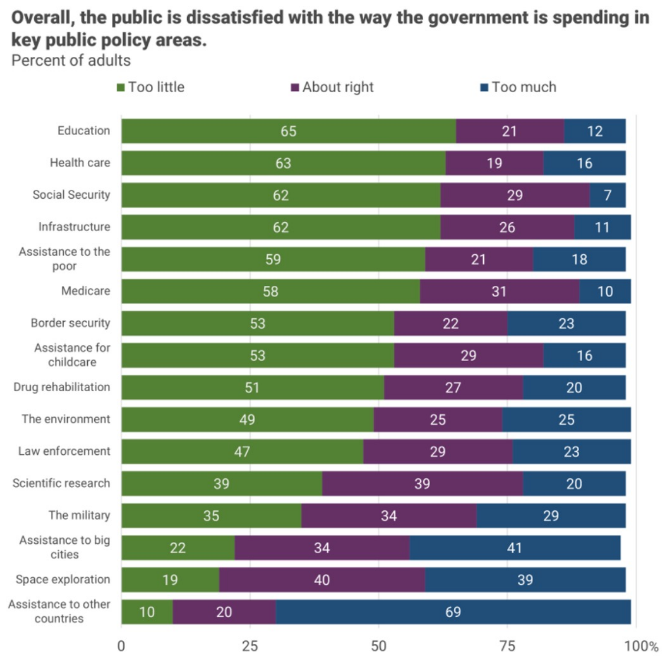
There is very little enthusiasm for cutting anything.



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Source, NYTimes, Paul Krugman, "**Why We Should, but Won't, Reduce the Budget Deficit**"

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Thinking About Today….

- **Do we have:**
  - A spending problem?
  - A revenue problem?
  - Both?

- **Not much support for it being a spending problem.**

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How To Address the Debt?

- **The question isn't taxes vs spending cuts.**
- **The question is:**
  - **Who should bear the burden of solving the problem?**
    - Spending cuts will mean primarily lower-income households.
    - Tax increases will mean primarily high-income households.
    - Soc Sec benefit cuts (age limit, actual payments, etc.) will mean primarily lower-income households.

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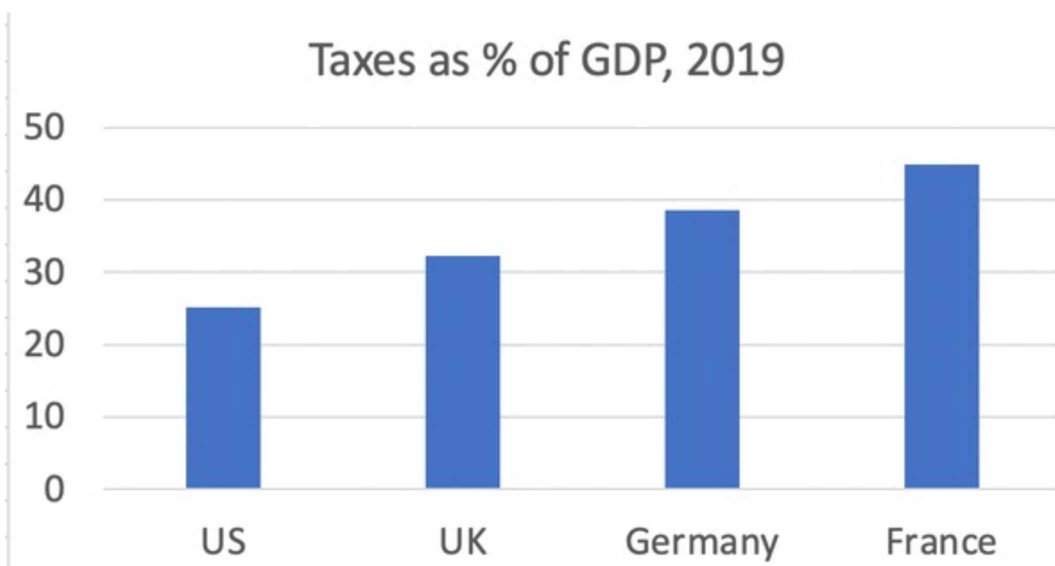

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Source, NYTimes, Paul Krugman, "**Why We Should, but Won't, Reduce the Budget Deficit**"

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Can't Stop…Thinking About Tomorrow

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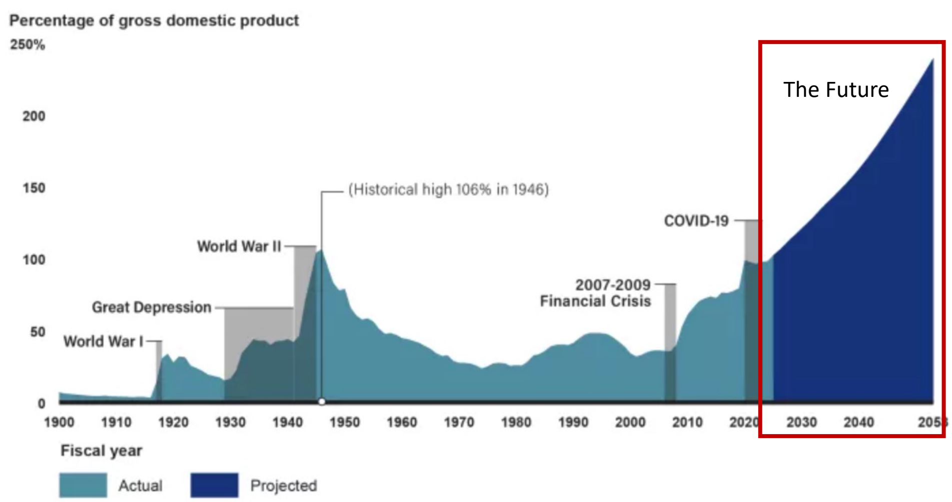
Now Let's Think About Today and the Future



Source: Congressional Budget Office data and GAO simulation. | GAO-25-107714

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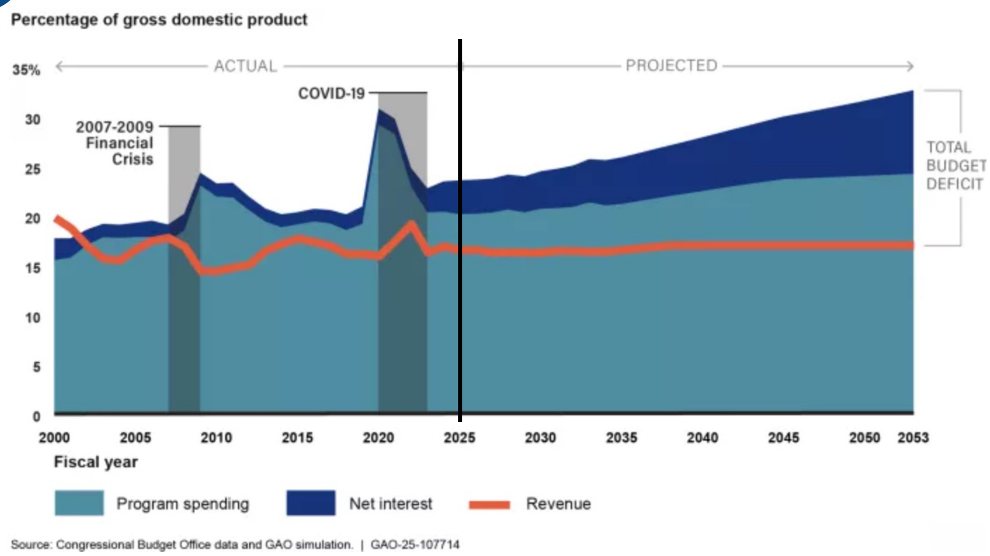
Interest on the Debt is a Growing Problem!



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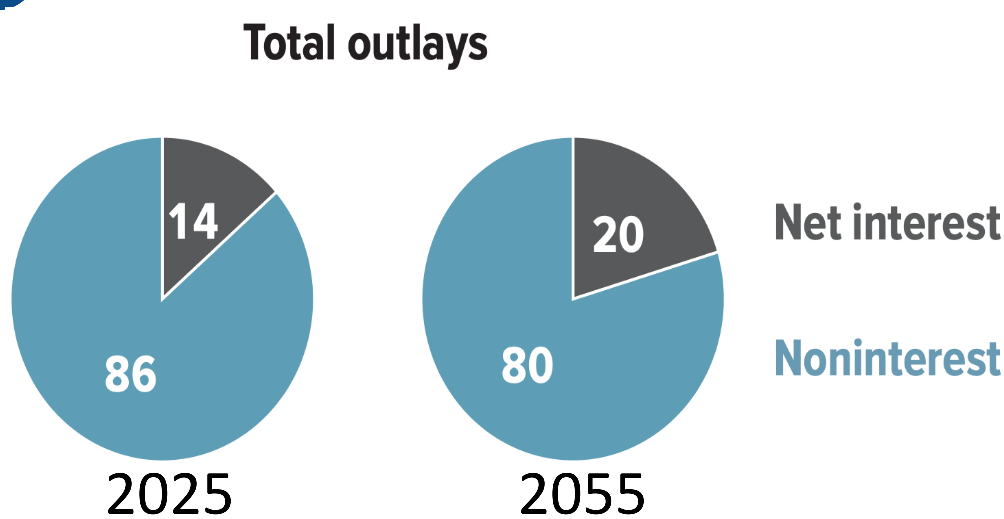
Interest Will Grow as a Share of the Deficit



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Source: CBO 2023 Long Term Budget Outlook

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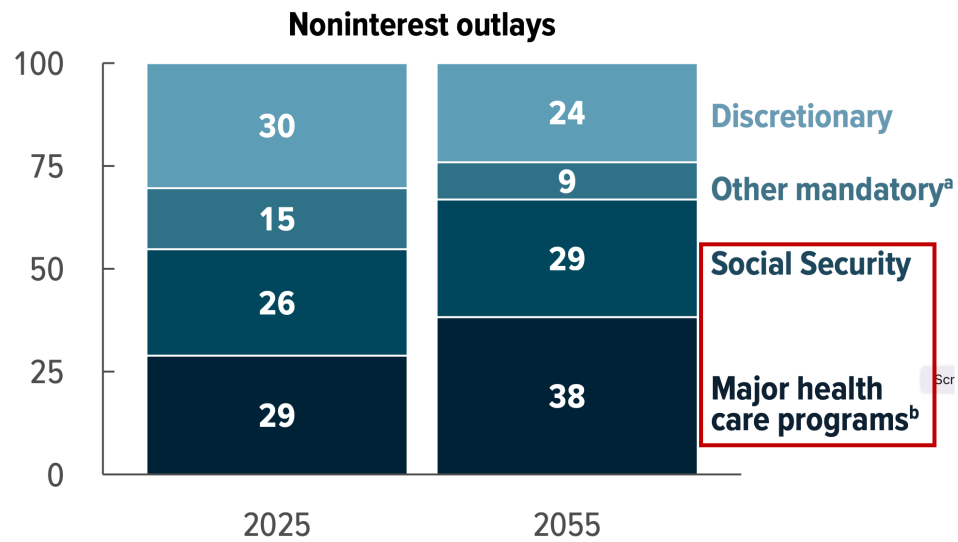
What Are the Primary Drivers Going Forward?



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Source: CBO 2024 Long Term Budget Outlook

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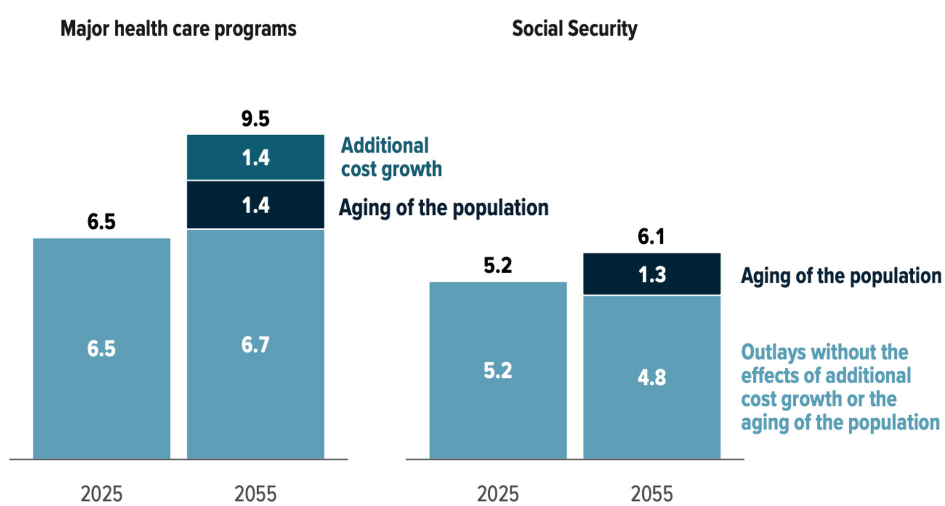
Mostly Healthcare

Percentage of GDP



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How to Think About the Debt

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Perspectives on Increased Debt

- **Does debt impose a burden on future generations?**
  - Does it inevitably have to be paid off? No!
- **Government borrowing crowds out private capital and investments.**
  - Weakened by the ability to borrow from other countries.
- **In time, debt service might crowd out other government spending.**
  - Diminishing policy priorities in the budget.
- **Is it reasonable to borrow at low interest rates for investment?**
  - For example, for infrastructure.

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Not All Borrowing Is Bad!

- **Two good reasons to borrow:**
  1. During a temporary crisis
     1. Recession
     2. War
     3. Pandemic
  2. Productive public investment
     1. Infrastructure
     2. Education

- **These deficits did not and do not permanently increase relative debt.**
  - Great Depression, WWII, Great Recession, COVID
  - Public investment expands GDP and tax revenue

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Is The Debt a Problem Today?

- **Federal government borrows each month with little difficulty.**
- **Very little evidence of "crowding out."**
- **Interest rates are high, but coming down.**
- **So, no, other than the debt ceiling, it's not a problem today.**

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So, Why Worry About it?

- **If debt becomes too high:**
  - Investors might start questioning the creditworthiness of the US government.
    - Problem: Nobody knows how high is too high.
  - It becomes more difficult to borrow in times of crisis.
    - War, severe recession
    - "Fiscal space"
      - Impossible to measure how much we have.
      - Clearly, we have less now than in 2007.
  - Could start to crowd out investment by consumers and businesses.
    - Not currently a problem. No idea if/when it might become one.
  - Could be inflationary.

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So, Why Worry About It?

- **If debt continues to grow:**
  - Interest payments will grow with it.
    - 14% of spending in 2025.
    - 20% of spending in 2055.
    - Less room for using the budget for policy priorities.
    - 31.5% of payments go to other countries.
  - The longer we wait to address it, the harder and more disruptive addressing it will be.

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Growth in Relative Debt

- **Can be scary to….**
  - International investors
  - Bond markets

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What Is a Fiscal Crisis?

- **Increased perception of risk in government debt.**
- **Potential manifestations:**
  - Sudden significant increase in interest rates
  - Plunging exchange rates
- **Why?**
  - Increased expectation of default
- **Potential results:**
  - Dramatic budget reforms may be quickly necessary to stave off actual default.
  - Recession from declines in:
    - investment (interest rates)
    - consumption (interest rates)
    - Government spending
  - Higher interest bill on existing debt

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Other Countries Have Higher Debt Levels

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Source: https://taxfoundation.org/blog/us-debt-compares-to-other-countries/

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Summary

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Major Takeaways: Talking Points

- **The debt is not currently a significant problem.**
- **The current trajectory for the federal debt is unsustainable.**
  - The primary drivers are an aging population, healthcare costs and interest.
- **We must enact plans to reduce the future (primary) deficits.**
  - These are driven by Medicare and Social Security spending.
- **The longer we postpone action, the greater the probability of a "fiscal crisis."**

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Bottom-Line Takeaways

- **Relative debt must be stabilized, so it is imperative to reduce primary deficits.**
- **Given the fiscal challenges of an aging population and climate change, it is better to do this sooner rather than later.**
- **But high debt levels should not deter:**
  - Productive infrastructure investment.
  - Fiscal responses to crises:
    - "When the house is on fire, you don't worry about being in a drought; you just put it out."

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Bottom Bottom Line

- Question is not ***WHETHER*** the US will have to act…
  but ***WHEN***.

- Some combination of the following ***WILL*** be necessary:
  - **Raising taxes**
  - **Cutting spending**
  - **Reining in health-care costs**

- **The longer we wait, the harder it will be!**

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Thank you!

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