The Budget, the National Debt, and the Challenge of Reining It All In

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Congress will vote this week on a spending bill that's expected to significantly increase the national debt only days after Moody's Ratings announced it had lowered the sovereign debt rating of the United States to Aa1, citing failure by lawmakers "to reverse the trend of large annual fiscal deficits and growing interest costs."

Current Fiscal Situation

The budget deficit for fiscal year (FY) 2024 was $1.8 trillion, up from $1.7 trillion in 2023, and the third largest annual deficit on record behind only the pandemic years of 2020 ($3.1 trillion) and 2021 ($2.8 trillion). For the first half of fiscal year 2025, the deficit was $1.3 trillion, up roughly $250 billion from the same period a year ago. *The scary thing is that this is happening during a period of economic expansion and low unemployment.*

As of today, the total national debt is approaching $36.9 trillion, almost doubling since 2016 and quadrupling over the past 18 years. The Congressional Budget Office (CBO) reported in January that the nation's debt is expected to rise by another $23.9 trillion over the next decade, assuming the 2017 Tax Cuts and Jobs Act expires. *That is not the plan*. The current budget proposal being debated in Congress will extend the 2017 tax cuts while adding several tax benefits promised during the Trump campaign. If passed into law, the spending bill would add an *additional* $4 trillion to the national debt through 2034.

Both parties have a long-term interest in containing the rapid rise in spending. However, the invoice for massive pandemic relief remains unpaid, and soaring costs of an aging population will only increase in the years to come. Adding to the obligation stack is increased military and homeland security spending, and the ballooning cost of interest on the debt.

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Mandatory vs. Discretionary Spending

In FY 2024, the U.S. government took in $4.9 trillion in revenue with approximately 50% coming from federal income tax, 35% from payroll taxes, and 10% from corporate taxes. On the expense side, the government spent $6.8 trillion. The problem is, $4.1 trillion of this spending amount is considered "mandatory" while almost $900 billion represents annual interest payments.

Roughly 75% of mandatory spending covers Social Security, Medicare, and Medicaid. The cost of these benefit programs has soared over the past decade, *primarily because the U.S. population has gotten older.* This demographic shift had been widely anticipated for decades and will continue to weigh heavily on future budgets. The CBO projects that by 2055, Social Security, Medicare, and Medicaid for the elderly will account for over 50% of all federal spending.

Assuming mandatory spending will be largely unaffected (with the exception of any alleged waste or fraud the Department of Government Efficiency manages to uncover),

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that leaves $1.8 trillion in "discretionary" spending as the primary source for targeted cuts. However, almost half of discretionary spending is allocated to military outlays, which are expected to rise. The remaining targets for reduction include public health, education, transportation, veterans' benefits, and income security programs, all of which would normally be considered essential. Budgets for these programs have remained flat in real terms for six decades.

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The 2017 Tax Cuts and Jobs Act (TCJA) was expected to pay for itself, but an analysis by the *Brookings Institute* in early 2020 showed the amount of tax revenue collected in FY2018 was $275 billion lower than the CBO projection made before the tax cuts were signed into law. It's arguable whether failing to extend the TCJA would result in a correspondingly worse outcome, but as federal debt levels rise relative to GDP, economic growth is certain to be further restrained.

Demographics will push mandatory spending higher over the next decade while interest costs will rise along with the bloated national debt. This suggests deficits will only increase, making future tax hikes inevitable. The question is whether bills will be paid by the generations that incurred the debt, or *their children*.

Market Indications as of 1:35 P.M. Central Time

DOW	Down -670 to 42,007 (HIGH: 45,014)
NASDAQ	Down -173 to 18,969 (HIGH: 20,174)
S&P 500	Down -79 to 5,861 (HIGH: 6,144)
1-Yr T-bill	current yield 4.13%; opening yield 4.10%
2-Yr T-note	current yield 4.01%; opening yield 3.96%
3-Yr T-note	current yield 4.00%; opening yield 3.94%
5-Yr T-note	current yield 4.14%; opening yield 4.06%
10-Yr T-note	current yield 4.58%; opening yield 4.48%
30-Yr T-bond	current yield 5.08%; opening yield 4.96%