Debunking the US National Debt Problem: A Political Dilemma

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A FOREWORD

The debt issue is not an easy topic to discuss. It takes people down a treacherous path as it's normally analyzed using political/ideological lenses. We are going to do as much as we can to avoid such a treacherous path and concentrate on the economic aspects of the debt discussion. We will get into the political/ideological ramifications of the discussion but without taking sides on whether one side is 'right' versus the other being 'wrong.' If our predicament were a fundamentally political issue, Machiavelli would have argued that neutrality was not the best approach to handle it, but in many ways, our issues are fundamentally economic issues, and yes, neutrality or an objective analysis is possible and, in fact, a desirable approach to deal with the subject.

Having said this, the policy implications of this discussion will, in due time, take us into the political realm as the title above has clearly given our conclusion away! The potential consequences of the choices we make as a country regarding the debt are going to be fundamentally political in nature and should not be underestimated, especially given the political environment in Washington DC. We will argue that those choices are part of our broken social contract, a contract that we probably need to work on and reform, so it can work to our country's citizens advantage.

KEY TAKEAWAYS

The problem with the US debt is not one of ability to pay but one of willingness to pay. The problem is not that the US cannot pay its debt, the problem is that the US political system is unwilling to commit itself to putting the US primary deficit on a sustainable path.

Every year, the US records whether it collects more in taxes than it spends (a fiscal surplus) or if it collects less than it spends (a fiscal deficit), etc. In general, the US government spends more than it collects in taxes, and it seldom records a fiscal surplus.

The risks of a default from a mismatch between tax revenues in local currency and borrowing in foreign currency (which is the most common default avenue) is, for all intent and purposes, zero for the US.

The deficit is what adds to the US debt every quarter or every year. The debt, on the other hand, is said to be a 'stock' variable, that is, it is the accumulation of those deficits over time.

SOME DEFINITIONAL ISSUES

Everybody has a different definition of the US debt and many times these definitions are used interchangeably. Today, the news is that the US debt is almost $36.2 trillion. Is this good, bad, not so good, not so bad? Before answering these questions, we need to clarify some concepts. Two concepts are important for us to distinguish. The first one is that of 'gross debt,' which hit the $36.2 trillion mark and includes debt held by the US government, and what is called 'US government debt held by the public,' which is approaching $29 trillion. Debt held by the public is the debt that is owed to those individuals and institutions outside the federal government. That is, debt held by the public does not include intragovernmental debt. In general, the debt held by the public should be the one markets should be concerned with, not the overall debt, as the latter includes intragovernmental debt.

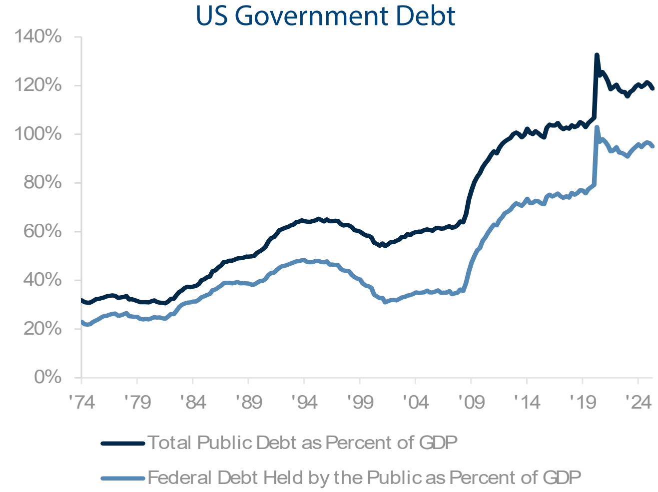
"Intragovernmental debt is debt that one part of the government owes to another part. In almost all cases, it is debt held in government trust funds, such as the Social Security trust fund. These debts represent assets to the part of the federal government that owns them (i.e., Social Security), but liabilities to the parts of the government that issue them (the Treasury Department)."[1] As such, they have no net effect on the government's overall finances. Therefore, since there is virtually no risk of default for this part of the debt—the only component of the debt that could default is that held by the public.

It is also convenient to distinguish between the deficit and the debt because people seldom know the difference between these two concepts. In purely economic terms, the deficit is what is called a 'flow' variable, and it is measured per year or quarter. The deficit is what adds to the US debt every quarter or every year. The debt, on the other hand, is said to be a 'stock' variable, that is, it is the accumulation of those deficits over time. It is also important to note that whenever we talk about this topic, an important concept is what is called the 'primary balance,' (this could be a deficit or a surplus) which is the difference between what the government receives in revenues every period minus what the government spends every period (be it quarterly or annual, etc.) excluding interest payments on already held US debt per period. This primary balance is what markets should be watching because the interest paid on the debt is not controlled by the US government. If we continue to post a primary deficit, as the CBO (Congressional Budget Office) estimates, it could put our country's finances on an unsustainable path, especially if the cost of refinancing this debt continues to increase.

WHAT A DIFFERENCE 25 YEARS, AND 3 CRISES, MAKE!

We remember the 2000 presidential campaign when one of the biggest topics was that we needed a 'lockbox' to secure the future of Medicare. At the same time, in October of 2001, the US Treasury announced the discontinuance of the 30-year bond as well as the inflation-adjusted 30-year bond (i.e., TIPS) because there was no need to finance the US debt at such long periods. At the time, market pundits were concerned that this action by the US Treasury was going to make it very hard to price long-term risks because of the inability to have a long-term 'risk-free' instrument to use as a proxy for measuring risk. In 2000, the US debt stood close to $5.8 trillion or about 54% of GDP, while US debt held by the public stood at $3.4 trillion (or about 32%) and was on a declining path as a percentage of GDP due to the fiscal surpluses recorded at the end of the 1990s and early 2000s.

US Government Debt



Source: FactSet as of 10/31/2025

However, the increase in the fiscal deficits, and thus, the increase in debt after September 11 and the 2001 recession pushed the US Government fiscal deficit higher and pushed the US Treasury to reintroduce the 30-year Treasury bond in 2006. The increase in the fiscal deficits that followed during the Great Recession and, more importantly, during the COVID-19 pandemic, has pushed the US debt to very high levels in nominal terms as well as in terms of GDP.

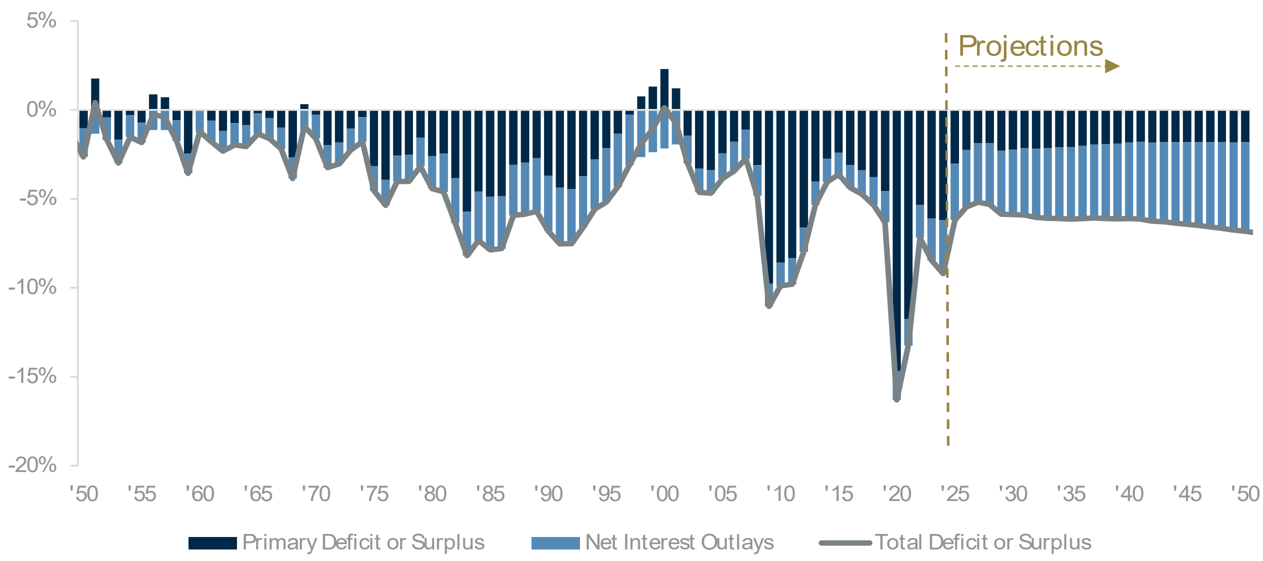
FISCAL DEFICITS ACCORDING TO THE CBO

The debt increases through the accumulation of fiscal deficits, which are the flow variables. Every year, the US records whether it collects more in taxes than it spends (a fiscal surplus) or if it collects less than it spends (a fiscal deficit), etc. In general, the US government spends more than it collects in taxes, and it seldom records a fiscal surplus. In fact, the US hasn't recorded a fiscal surplus since 2001.

As a reminder, the fiscal deficit is composed of two parts: the first part is what is called the 'primary deficit' which is tax revenues less spending in the current year while the second part is what the US government owes in interest payments on previously accumulated debt. In the graph below we can see a Congressional Budget Office (CBO) estimate of how big interest on the debt is going to be if their estimate on the yield on government paper comes to fruition. In a typical year, the US pays interest on the debt and finances the additional debt by issuing US Treasury bills, notes, and bonds, depending on financial engineering to minimize interest costs.

[1] https://www.crfb.org/papers/qa-gross-debt-versus-debt-held-public

The Fiscal Deficit and CBO Projections



Source: RJ Economics, Congressional Budget Office. Data as of 10/31/2025

According to the CBO, and under "current law," which means that it is estimated assuming that there are no changes in laws that establish tax collection rates as well as what the US government needs to pay for all government programs, the US is expected to generate a primary fiscal deficit as a percentage of GDP as far as the eye can see. On top of that, it estimates the cost of the current US debt, i.e., interest payments, to continue to increase as a percentage of GDP during the foreseeable future.

Although the debt as a percentage of GDP came down over the last several years after peaking during the COVID-19 pandemic recession due to the increase in inflation (see graph on the previous page), as inflation continues to slow down during the next several years, the US needs to look for a real solution to its debt sustainability problem.

This is the reason why the solution to the US debt problem has to come through a political decision that would probably require an agreement on slowing down the growth rate of government expenditures, increasing tax rates and/or tax revenues, or a combination of both: a slowdown in the growth in expenditures and higher tax revenues. If we don't change the path of the primary deficit, we could enter into an unsustainable path where it will become more difficult to change the trajectory of the debt.

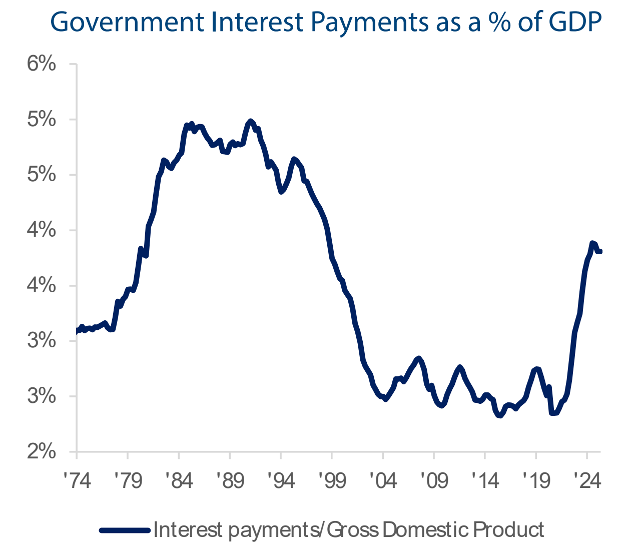
INTEREST RATES ARE AN IMPORTANT DETERMINANT OF THE DEBT DISCUSSION TODAY

When interest rates were very low, economists had very few issues arguing that it was a good time for the US government to borrow. Today, the tables have turned, and economists are recommending caution with the forward path of primary deficits.

Of course, the argument wasn't that the US government should borrow just because interest rates were very low; the country was facing the Great Recession at one point and then the COVID-19 pandemic, and borrowing at such low interest rates to minimize the effects of these two crises was something textbook economics would have recommended, irrespective of whether one believes that the decisions, and the magnitude of them, were correct or not from a fiscal sustainability perspective. The CBO estimates that, under current law, the US is going to continue to report a fiscal deficit, and thus, something needs to be done to enable a more sustainable path for the growth rate of US debt.

Bear in mind that although many in the news media argue that the US is at risk of not being able to pay its debt, what they should be saying is that, at some point in time, the US may not be able to pay the interest on its debt or issue new debt to refinance payments coming due on the debt at every period, as countries normally do not 'pay back' their debt, they refinance it and, over time, grow out of it. However, it is easier and cheaper to roll over debt when interest rates are low than in the current high interest rate environment.

The biggest issue today is that interest rates on refinancing our debt plus the added interest we have to pay on financing new primary deficits (which will become part of the stock of debt) is no longer 1%. It has more than tripled and is putting a lot of stress on the government budget, as many programs are determined by law (about two-thirds of expenditures) and cannot be unfunded. Meanwhile, about a third of the pie is called 'discretionary spending' and no politician wants to see their portion of that discretionary chunk curtailed.



Source: FactSet as of 10/31/2025

This is why we argue that the problem with the payment of our 'debt' is a political rather than an economic issue. The US does not have the problem other countries have, which is that they borrow in US dollars (or euros or yens) but their government revenues are denominated in the domestic currency. Thus, when the country faces a balance of payments crisis and is pushed to devalue the currency, the country has to go into debt default because it can no longer pay the interest on its debt to foreign lenders.

> The risks of a default from a mismatch between tax revenues in local currency and borrowing in foreign currency, which is the most common default avenue, is for all intent and purposes zero for the US.

This does not mean that the US may not get in trouble, and it may be pushed into default anyway. According to the PENN WHARTON Budget Model[2] from the University of Pennsylvania, "Under current policy, the United States has about 20 years for corrective action after which no amount of future tax increases or spending cuts could avoid the government defaulting on its debt whether explicitly or implicitly (i.e., debt monetization producing significant inflation). Unlike technical defaults where payments are merely delayed, this default would be much larger and would reverberate across the U.S. and world economies." Of course, it will not be wise to wait 20 years to figure out whether this PENN Wharton Budget Model's estimations are correct or not and we should start looking for a solution as soon as possible.

Another potential avenue toward default could occur at any point in time and the US has little ability, other than putting its house in order, to prevent it. This avenue could be triggered in the highly unlikely case that local as well as international capital markets close down and stop financing US debt. Although this is a highly unlikely event, considering the alternatives available for capital flows today, it is not an impossible event, and the probability is not zero.

DIFFERENCE BETWEEN ABILITY AND WILLINGNESS TO PAY

In 2011, Standard & Poor's credit downgrade was predicated not on the US government's ability to pay, but on the inability of the US political system to agree on a debt sustainability path and was done during an episode of a government shutdown. Events like a government shutdown could potentially trigger a confidence crisis in the US willingness to pay its debts. Recall that we said 'willingness' rather than 'ability' to pay its debts.

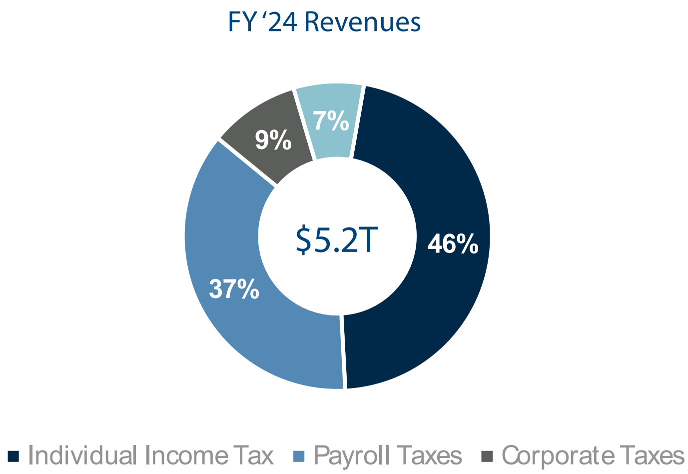
This difference is very important for all intents and purposes. As we said before, in 2011, Standard & Poor's did not downgrade the US debt rating because it said that the US was not able to pay its debt; it downgraded it because it said that the US political system was unwilling to take the necessary steps to make the US debt sustainable. And this was at a time when the debt was $14 trillion. Today, as the debt has increased to nearly $36.2 trillion (~$29 trillion for the debt held by the public), the same question is being asked. The same argument holds true today. There is no issue with the US government being able to pay its debt, the issue has to do with the willingness of the political system to put aside its issues and agree on a path that would make the US debt sustainable.

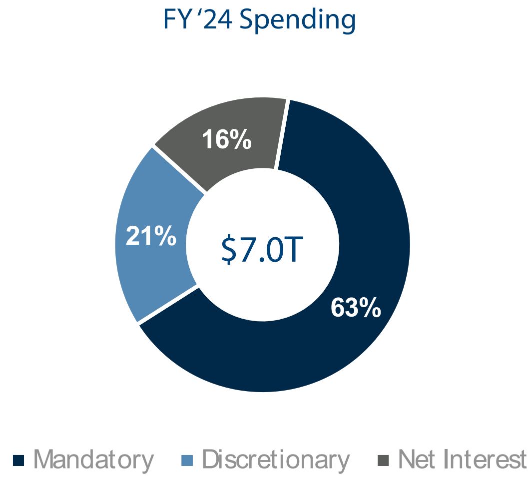
> The problem is not that the US cannot pay its debt, the problem is that the US political system is unwilling to commit itself to putting the US primary deficit on a sustainable path. The problem with the US debt is not one of ability to pay but one of willingness to pay.

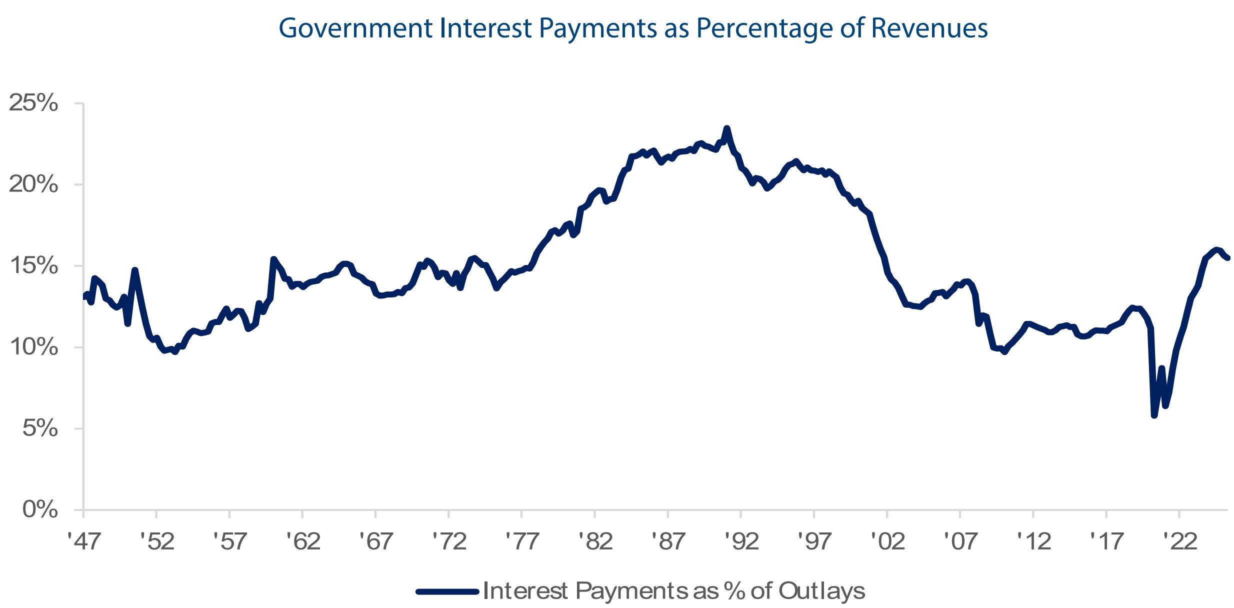
This means that the US political system has to engage in a long-term solution to the debt. Today, about two-thirds of government expenditures are earmarked for non-discretionary, or mandatory, programs. Unless there are changes to current laws regarding those programs, we need to keep on paying those expenditures. This is something much like 'fixed costs' in business parlance: there are no degrees of freedom to change those expenditures in the short-to-medium run while at the same time, any change requires agreement between the parties in Congress.

The rest of government expenditures, or about one-third, are called discretionary expenditures, which the US government could cut but any changes also require agreement between the US Congress and the executive branch.

[2] https://static1.squarespace.com/static/55693d60e4b06d83cf793431/t/6537df62a87c9b2d6a190171/1698160482455/When+Does+Federal+Debt+Reach+Unsustainable+Levels.pdf







Source: FactSet as of 10/31/2025

Another alternative is to increase taxes, but this also needs an agreement between the parties, and today, this is even more difficult.

The third alternative is a combination of both: a negotiated middle ground, reducing expenditures and increasing taxes, which, again, is very difficult in the political environment today and has been for a very long time.

What the US needs today is an agreement that transcends political ideologies, and this is the reason why every credit agency is cutting or downgrading its ratings on US debt — not because the US cannot pay, but because there is no political will to make the necessary changes to make the path sustainable.

For markets, the debt issue is probably a 'black box' but with the potential to disrupt or affect market sentiment. For the US economy, it is probably going to add to growing concerns of a potential slowdown in economic activity because both alternatives, cutting expenditures and/or increasing taxes, will exert downward pressure on the growth rate of the US economy, at least in the short-to-medium term. However, we will all be better off in the longer term if we put our debt on a sustainable path going forward.

All content written and assembled by Raymond James Economics

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