Opinion **US budget**

The drip-drip US debt crisis

Rising deficits and debt-servicing costs no longer seem to have the power to restore prudence

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Make no mistake, the US is suffering a debt crisis. It is, of course, not an acute emergency like Argentina's multiple defaults this century or Greece's woes in the 2010s, but it has the characteristics of a chronic disaster that everyone can see coming but the administration never does enough to avoid.

The most relevant measure of US federal government debt, that held by the public, has risen from $3.4tn in 2000 to $32.3tn now, or a rise from 33.7 per cent to more than 100 per cent of GDP in just over 25 years. More importantly, the burden of servicing that debt has doubled, from 11 per cent of tax revenues in 2000 to 21.5 per cent in the first 10 months of the current fiscal year. Because long-term borrowing costs are high, the US Treasury is increasingly financing the debt with short-term borrowing and the president is again pressuring the Federal Reserve to cut interest rates to make the numbers look better. This is the slippery slope of a slow-burn debt crisis.

With the US on a path to continue running deficits close to 6 per cent a year, even at full employment, the debt-to-GDP ratio is set to rise every year, increasing the call on tax revenues to service that debt and the pressure on the Fed to lower interest rates. The likelihood is not that this process ends in default or runaway inflation, but an ever-worsening problem for someone in future to solve. As I recently argued, rising deficits and debt-servicing costs no longer have the power to restore fiscal prudence.

Before examining solutions, it is worth asking why the US fiscal position has deteriorated so much this century. Since 2000, when the federal government ran a surplus of 2.3 per cent of national income, primary public spending (excluding net debt interest) has risen from 15.5 to 19.9 per cent of GDP. All of this increase can be accounted for by spending on services for an ageing population — social security, Medicare and veterans' programmes.

On the tax side, revenues have fallen from 20 per cent to 17.2 per cent of GDP over the same period, partly a result of a cyclical peak in revenues at the end of the last millennium and partly the result of tax cuts. First came the Bush tax cuts, which were made permanent on a mostly bipartisan basis during the Obama administration, and then came the 2017 Trump tax cuts. The Centre for American Progress estimates that had the 1990s tax system remained intact, US public debt would be stable now, with a prospect of it declining in the decades ahead.

US federal spending has increased and tax revenues have fallen since 2000

Share of GDP (%)

FINANCIAL TIMES

Source: CB

In the face of the fundamental long-term forces of rising age-related spending and unaffordable tax cuts, the inadequate recent response from the US administration has been a combination of bluster and panic.

Last week, Treasury secretary Scott Bessent promised again to focus on deficit reduction, but his talk has lost any credibility at this stage. Significant spending cuts were attempted by the now-disbanded Department of Government Efficiency and failed, while Donald Trump's One Big Beautiful Bill Act spent the money raised by tariffs and no other tax increases are planned.

Where Bessent has taken steps to lower US government borrowing costs, such as proposing to swap a tiny slice of long-dated US debt with short-dated equivalents, they have been small, giving a sense of someone with few options. Having promised 3 per cent annual growth and a 3 per cent deficit, Bessent's current record stands at roughly 2 per cent and almost 6 per cent respectively.

Faster growth would help with tax revenues, but would also probably increase interest rates, so the US has no sure-fire means of escaping its drip-drip debt crisis without significant spending cuts or tax increases. It does not need to eliminate the deficit, but does need to put debt back on a downward path, which almost certainly requires a balanced primary deficit — a metric that excludes net interest costs — something the US has not achieved since 2007 and not on a sustained basis since the 1990s.

Since cutting spending on pensions and healthcare for the elderly is difficult and undesirable, this and future US administrations should look at raising revenues in the least damaging way. The US has significantly cut tax rates for the richest this century, so some reversal of those would be likely and justified from a left-leaning president and Congress. But a valuable exercise in tax options and trade-offs, produced by the Tax Foundation, highlights the potential significant costs to growth and efficiency from narrow measures such as wealth taxes and tariffs. Its analysis suggests, not unreasonably, that broad-based rises in taxes on income or spending are best for raising large amounts of revenue to fund broad-based government programmes.

Other countries with similar difficulties would require different remedies. With its already high levels of taxation and healthy population that retires early, France needs first to encourage later retirement by cutting entitlements. The UK, which has already increased taxes sharply on those with high incomes, needs to ensure revenue raising is widely applied.

Meanwhile, financial markets are looking to the US for leadership, but it is absent. The instinct of this administration is to seek to talk its way out of its debt crisis rather than address the issues. While it denies there is a problem and tinkers around the edges, the drip-drip debt crisis will continue to build.

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