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IN FOCUS

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Deficits, Debt, and the Debt Limit in 2025

The Constitution empowers Congress with the authority to manage federal spending, revenues, and borrowing through its “power of the purse.” Deficit outcomes represent the difference between total federal spending and revenues, and add to debt levels that necessitate federal borrowing. This In Focus summarizes federal deficit and debt characteristics, trends, and related economic policy issues, and also discusses the statutory debt limit.

Fundamental Properties

The federal government incurs a budget deficit when outlays (total outgoing payments) exceed revenues (monies collected). If revenues are greater than outlays, the government incurs a surplus. Deficits are measured over the course of the fiscal year, which runs from October 1 through September 30. Deficits tend to decline in periods of relatively high economic growth due to both increased revenues (through a rise in earnings and subsequent tax payments) and reduced outlays (through a decline in demand for unemployment benefits and other programs), with opposing changes leading to increased deficits in lower growth periods.

Federal debt represents the accumulation of government borrowing from private citizens, institutions, domestic, and foreign governments. Debt levels increase when there are budget deficits, net outflows for federal credit programs, or increases in intragovernmental debt (debt that is held in federal government accounts). The debt measurement generally of most interest to economists is publicly-held debt, which excludes intragovernmental debt. The Department of the Treasury manages federal debt, with an objective of borrowing at the least cost to the taxpayer over time while maximizing transparency.

Changes in federal debt, primarily caused by deficits and surpluses outcomes, reflect implicit policy choices concerning the distribution of government activity across generations. Net interest payments measure inflows and outflows on interest from the federal debt and are included in deficit and surplus outcomes.

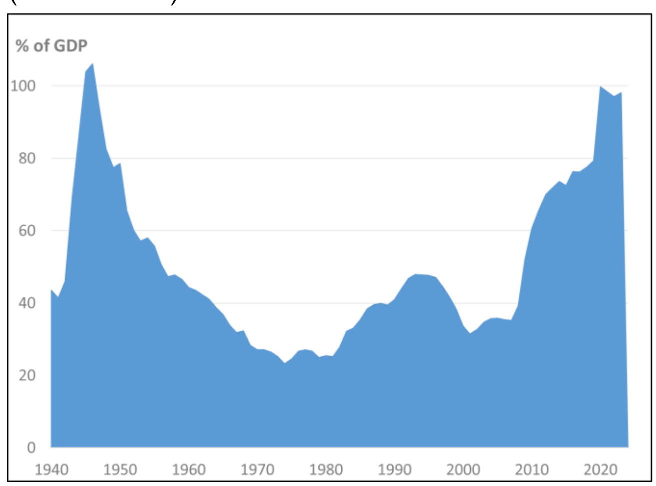
Increases in real debt in one period may constrain the choices available in later periods. In some cases, rising real debt may also lead future generations to bear the financial cost of choices made by previous generations without being able to express opinion on the relative benefit of those choices. Large and persistent debt levels may also reduce public confidence in the government’s ability to fulfill its borrowing obligations, which could increase long-term borrowing costs.

Historical Outcomes and Current Outlook

The federal budget has produced deficits since FY2001. The historic economic shocks and ensuing federal responses to the Great Recession and COVID-19 pandemic generated the five largest real federal deficits since World War II, with real deficits averaging 9% of gross domestic product (GDP) in FY2009-FY2011 and 14% of GDP in FY2020-FY2021. The average real deficit in other years since FY2001 (3.2% of GDP), however, still exceeded the average from FY1973 through FY2001 (2.5% of GDP).

Following a period of decreases in debt as a share of economic output, debt levels have grown in recent decades, as shown in **Figure 1**. Publicly held debt was 98% of GDP at the end of FY2024, roughly triple the value recorded at the end of FY2001 (32% of GDP).

Figure 1. Publicly Held Debt, FY1940-FY2024
(As a % of GDP)



Source: Congressional Budget Office
Notes: Values taken at the end of the fiscal year.

The June 2024 Congressional Budget Office (CBO) forecast projects consistently high deficit increases in its 10-year budget window, with deficit values ranging from 5.5% of GDP to 7.1% of GDP in the FY2025-FY2034 period. Increases in real outlays (through rising mandatory spending commitments) and net interest obligations (through increased real interest rates) are the largest drivers of increased outlays, while relatively flat revenue totals assume that certain temporary tax provisions enacted as part of P.L. 115-97 (often referred to as the Tax Cuts and Jobs Act: TCJA) expire as scheduled. Debt levels are projected to increase to 122% of GDP by the end of FY2034.

CBO’s June 2024 Long-Term Budget Outlook projects that federal deficits and debt will reach 8.5% and 166% of GDP, respectively in FY2054 (see **Table 1**). Estimates assume current law proceeds as scheduled and average median economic conditions.

Table 1. Federal Budget Outcomes, FY1994-FY2054
(As a % of GDP)

	FY1994	FY2024	FY2054
Outlays	20.4	23.4	27.3
Revenues	17.5	17.1	18.8
Deficit	2.9	6.4	8.5
Publicly Held Debt	48	98	166

Source: CBO Historical Tables (FY1994), Monthly Budget Review (FY2024) and Long-Term Baseline (FY2054).

Economic Effects

Deficits and debt are not inherently harmful to the economy. Borrowing to finance productive investments (e.g., certain infrastructure) and spending (e.g., research and development) can increase the productive capacity of the economy. Deficit spending and targeted tax reductions are policy options to stimulate the economy during a recession. However, persistent federal budget deficits and growing debt like those in CBO's long-term projections can reduce economic growth and constrain future policy options.

The accrual of debt, if financed from domestic sources, reduces long-term national saving and income, and typically lowers the capital investment that leads to productivity growth and higher wages. If debt is instead financed from foreign sources, it increases the trade deficit and future obligations owed to foreign investors. Debt increases also increase the government's interest costs—constraining lawmakers' ability to encourage growth-enhancing investments, such as infrastructure. Finally, debt increases may limit lawmakers' ability to respond to future recessions, natural disasters, or other unforeseen events.

Rising debt levels also increase the risk of a debt crisis, in which investors lose confidence in a country's ability to pay its obligations, interest rates rise, and austerity measures may be called for. Such events have happened outside the United States, in the early 2010s in the Eurozone, for example. The United States has not experienced a similar debt crisis. Estimates for the level of real U.S. federal debt needed to trigger a crisis vary widely. The International Monetary Fund recently found the short- and medium-term risk for the United States for such an event to be low.

The Debt Limit

The debt limit, codified at 31 U.S.C. §3101, places a statutory constraint on the amount of money that Treasury may borrow to fund federal operations. Debt subject to the limit is more than 99% of total federal debt, and includes debt held by the public (which is used to finance budget deficits) and debt issued to federal government accounts (which is used to meet federal obligations).

The Fiscal Responsibility Act of 2023 (P.L. 118-5) suspended the debt limit through January 1, 2025. Under current law, on January 2, 2025, the debt limit will be reinstated at a level matching the debt subject to the limit at that time. Regular legislative modifications to the debt limit have been enacted since the aggregate debt limit was first created in 1917. Congress has approved 103 separate debt limit modifications between the end of World War II and the present to accommodate changes in federal debt.

If action is not taken to prevent a binding debt limit when it is reinstated, the Treasury Secretary may elect to exercise "extraordinary measures" to stay beneath the debt limit. Invocation of extraordinary measures has delayed required action on the debt limit by periods ranging from a few weeks to several months, with the range of delay varying with seasonal fluctuations in spending and revenues and with the overall rate of net borrowing.

The federal debt limit may be viewed as a check to ensure that recent revenue and expenditure trends meet the approval of Congress. However, the federal collection and spending decisions affecting debt levels may have been agreed to by Congress and the Administration well in advance of debt limit deliberations. Some past debt limit legislation has linked debt limit increases with fiscal policy proposals such as budget enforcement measures.

When debt levels approach the statutory debt limit, Congress can choose to: (1) leave the debt limit in place; (2) increase the debt limit to allow for further federal borrowing; or (3) temporarily suspend or abolish the debt limit. Some have suggested that the Fourteenth Amendment may grant the President authority to ignore the statutory debt limit. Previous Administrations and some legal scholars have rejected that argument as an alternative to debt limit legislation.

The combination of a binding debt limit and continued budget deficits would leave Treasury with conflicting directives. As with any borrower, the government is obliged to pay its bills, and yet a binding debt limit would prevent Treasury from doing so in a timely fashion.

Possible consequences of a binding debt limit include, but are not limited to: (1) reduced ability of Treasury to borrow funds on advantageous terms, thereby further increasing federal debt; (2) negative outcomes in domestic and foreign economies and financial markets caused by anticipated default on Treasury securities or failure to meet other legal obligations; (3) acquisition of interest penalties from delay on certain federal payments and transfers; and (4) downgrades of U.S. credit ratings.

Possible economic and fiscal consequences of the debt limit are not confined to scenarios where the debt limit is binding. Protracted deliberation over raising the debt limit can also affect the U.S. financial outlook, if it alters investor sentiment.

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