

Underneath the Noise, Budget Deficit Progress!

Over the past two and one-half decades the federal government has buried taxpayers under a mountain of debt, now approaching \$38 trillion.

During this time the key problem has been spending, not a lack of tax revenue. Over the past 25 years, taxes have remained relatively stable as a share of GDP, while spending continued to rise. We estimate that spending was 23.2% of GDP in the year ending September 30 (Fiscal Year 2025) versus 17.7% in 2000. In other words, the reason we have a debt problem is because we have a spending problem.

That's the bad news, and it means policymakers still have a very long way to go before we can claim our fiscal house is in order. But just because the overall budget picture remains bleak doesn't mean we shouldn't recognize improvements when they happen, and there is some progress.

The Congressional Budget Office recently estimated that budget deficit for the year that ended on September 30 (FY 2025) came in at \$1.809 trillion, slightly smaller than the \$1.817 trillion of FY 2024. Although that's only an improvement of \$8 billion in dollar terms, there are reasons for at least some modest hope on the deficit.

First, we project that nominal GDP grew 4.8% in FY 2025, which means that even if the deficit remained roughly the same in dollar terms, it declined relative to GDP. After clocking in at 6.3% of GDP in FY 2024, it looks like it was 6.0% in FY 2025. That may seem like only a minor improvement, just 0.3 percentage points of GDP, but it's a shift from the expansion of the deficit in the prior two years. It's movement in the right direction.

Second, the decline in the deficit this past year would have been larger were it not for a calendar-related issue. In particular, two years ago (in 2023) October 1st fell on a Sunday and so \$72 billion in federal payments (spending) that normally would have been made that day were instead made on Friday September 29, 2023. That shift changed the budget math because September 29 was still in FY 2023. This artificially held down official spending in FY 2024 making the deficit appear smaller than it really was. In addition, due to natural disasters in 2023, some taxpayers were allowed to postpone tax payments. This boosted revenue in FY 2024 by about \$70 billion. In other words, the

actual reduction in the deficit for FY 2025 was really closer to \$150 billion, not \$8 billion.

Third, although total federal spending was up \$228 billion last year (after adjusting for the timing issue discussed above), the gain was due to factors largely outside the control of the new President and Congress, at least in the short term. Spending on Social Security, Medicare, and Medicaid were up a combined \$245 billion in FY 2025. Meanwhile, interest payments on the national debt were up \$80 billion. In addition, the Environmental Protection Agency, under the direction of the former President, shoveled out \$20 billion in extra payments in the waning days of his Administration, which was included in FY 2025. By contrast, other categories of spending – outside those entitlements, interest, and unusual EPA payments – declined \$117 billion. When is the last time you remember that happening?

Fourth, due to weather-related disasters, some revenue that normally would have occurred in FY 2025 is being postponed into FY 2026. In other words, while the CBO says federal receipts were up 6% versus last year, the gain would have been more like 8% in the absence of disaster-related deadline changes.

Again, none of this means we are anywhere close to having the debt or deficit situation under control. A deficit of 6.0% of GDP is still unsustainable. Moreover, the Supreme Court may throw the whole budget situation for a loop if it declares recent tariffs illegal. Expect a ruling early next year.

The current shutdown and political brawl over emergency additions to Medicaid spending during COVID is extremely important for maintaining this progress. Government spending had been on a one-way escalator, with each so-called crisis (2008 and then COVID) permanently lifting spending to a larger and larger share of GDP.

Somehow the angst over budget deficits has disappeared. We remember when deficits were all anyone talked about. Remember ABC's Sam Donaldson screaming at President Reagan about the size of the deficit?

Lately, the angst and screaming has been about cutting spending, not reducing the deficit. The good news is that progress is being made. And it's important to recognize that budget progress when it happens even if more needs to be done. So, here's a thumbs up for the progress that has been made in FY 2025, with fingers crossed that this progress is just the beginning.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-15 / 7:30 am	Empire State Mfg Survey – Oct	-1.9	-8.7		-8.7
10-16 / 7:30 am	Philly Fed Survey – Oct	10.0	0.7		23.2