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US federal budget crosses grim milestone as interest payments overtake defense spending

Story by Rick Newman • 8h • 4 min read

The United States has long had the world's biggest defense budget, with spending this year set to approach $900 billion.

Yet this spending is rapidly being eclipsed by the fastest-growing portion of federal outflows: interest payments on the national debt.

For the first seven months of fiscal year 2024, which began last October, net interest payments totaled $514 billion, outpacing defense by $20 billion. Budget analysts think that trend will continue, making 2024 the first year ever that the United States will spend more on interest payments than on national defense.

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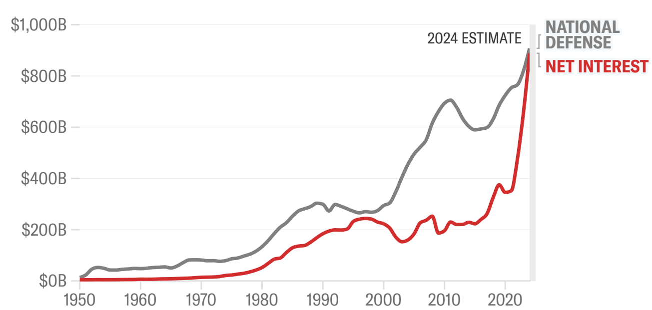
Interest payments on federal debt are set to overtake defense this year as the third-largest category of spending.



SOURCE: OFFICE OF MANAGEMENT AND BUDGET yahoo!finance

Just two years ago, interest payments were the seventh-largest federal spending category, behind Social Security, health programs other than Medicare, income assistance, national defense, Medicare, and education.

Interest is now the third-biggest expenditure after Social Security and health. And not because any of the other programs are shrinking. While most government expenditures grow modestly from year to year, interest expenses in 2024 are running 41% higher than in 2023.

Interest payments are ballooning for two obvious reasons.

The first is that annual deficits have exploded, leaving the nation with a gargantuan $34.6 trillion in total federal debt, 156% higher than the national debt at the end of 2010.

In the 1990s, the average federal deficit was $138 billion per year. In the 2000s, it was $318 billion. In the 2010s, it was $829 billion. Since 2020, the annual deficit has swelled to $2.24 trillion, largely due to pandemic-related stimulus measures in 2020 and 2021. The projection for 2024 is a $1.5 trillion shortfall.

As a percentage of GDP, the annual deficit has nearly doubled in just 10 years, from 2.8% in 2014 to a projected 5.3% in 2024. So there's just a lot more borrowing to pay interest on.

The government is also paying more to borrow as interest rates have shot up over the last two years. Like consumers buying homes and cars, Uncle Sam benefits from cheap money when rates are low and bears a heavier burden when rates are high.

From 2010 through 2021, the average interest rate on all Treasury securities sold to the public was just 2.1%, which helped keep total interest payments manageable.

But in 2022, the Federal Reserve started jacking up rates to tame inflation, and the government now pays an average interest rate of 3.3%. So, the amount of borrowed money keeps going up, and the cost of borrowing that money is rising too.

More taxpayer money going to interest expenses will eventually leave less money for everything else, and at some point, the Treasury won’t be able to borrow its way out of the problem anymore.

It's an unsustainable situation, which could lead investors to lose faith in the government’s creditworthiness and demand even higher rates to buy Treasurys.

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The urgency of the problem, however, is open to debate.

At the recent Milken Institute conference in Los Angeles, luminaries such as billionaire investor Ken Griffin and former House Speaker Paul Ryan warned of a looming debt crisis if the government’s interest costs continue to mushroom. But many prominent financiers also touted the United States as the best destination in the world for investment, despite all its problems.

And many predictions of a debt crisis when interest expenses were a lot lower have so far turned out to be wrong.

Two people who seem unperturbed by America’s debt burden are President Joe Biden and former President Donald Trump, the two leading candidates in this year’s race for the White House. Neither is making deficit reduction a focus of his presidential campaign.

Biden does have a plan of sorts. He'd raise taxes on businesses and the wealthy and use some of that revenue to trim annual deficits. But Biden also wants to spend more on social programs, which could offset any savings.

Trump says he'd encourage more oil and natural gas drilling, which would somehow produce a windfall of tax revenue that would pay down the debt. But there's no obvious way that would happen, no matter how much drilling takes place.

Besides, both men have presided over a huge run-up in the national debt.

The national debt rose by $7.8 trillion during Trump's four years as president and $6.8 trillion during Biden's first three years and four months.

Earlier this year, the Committee for a Responsible Federal Budget helped Yahoo Finance analyze who's responsible for the national debt, and the blame falls more or less equally on administrations of both parties borrowing to finance wars, tax cuts, spending programs, and stimulus measures during recessions.

When the time does arrive to fix the debt, the inevitable solution will be a mix of spending cuts and tax hikes that will make a lot of people unhappy.

Which reveals the real reason no politician wants to address the problem — everyone hopes it'll be the guy after them.

Rick Newman is a senior columnist for Yahoo Finance. Follow him on Twitter at @rickjnewman

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