Written by **Bob Adelmann** on February 5, 2015

U.S. Government's Interest Costs to Quadruple in 10 Years

On Tuesday, the *Wall Street Journal* reported that the federal government will be paying $800 billion annually just to service the interest on its massive debt by 2025, up from just over $200 billion currently. By 2021, those interest costs will equal what the government is projected to be spending on national defense, and on non-defense (so-called "discretionary" items), and will greatly exceed those two budget items just by 2025. The *Journal* also noted that "non-discretionary" items (so-called "mandatory" expenditures) will continue their inexorable march upward, from $2 trillion currently to more than $4 trillion by 2025.

Surprisingly, few eyebrows were raised over the announcement, with most commentators ignoring it or passing it off as unworthy of their attention. The *Journal* study was based on White House numbers that estimated interest costs to be less than three percent of the country's gross domestic product (GDP), a rounding error in the grand scheme of things.

When asked what impact these huge increases would have on the government's budget, Josh Zumbrun, a former Federal Reserve reporter for Bloomberg and a Washington correspondent for *Forbes* magazine, said those impacts will soon be felt: "Defense and nondefense discretionary spending will be squeezed. Anyone who doesn't want to see that happen in the next decade needs some combination of higher revenue, much faster economic growth, or cuts to entitlement programs."

Higher revenues through additional taxes appear to be out of the question given the scorn heaped upon the president's latest budget announced this week. Besides, going back to 1981, government revenue from taxes has remained consistently between 16 and 18 percent of GDP, with the only exception being in 2000 when they approached 20 percent and then, owing to tax cuts, dropped in a straight line over the next five years to just over 14 percent. It's safe to conclude that taxpayers will not allow the government's take to exceed that historical average.

As far as faster economic growth is concerned, the Fed has been pumping up the economy with cheap (nearly free) money for years, with precious little to show for it except bubbles in the stock and bond markets.

And with cuts to "entitlement" programs such as Social Security, Medicare, Medicaid (and now ObamaCare) resuming their roles as the "third rails" of politics, there is unlikely to be any substantial movement there.

How long can this go on? After all, at some point interest rates will have to return to "normal" with budget-busting implications, won't they? As recently as 2000, lenders were charging the U.S. government more than six percent interest. With debt more than tripling (from $5.6 trillion in 2000 to $18 trillion today), shouldn't interest rates already be climbing to reflect the increased risk of default?

No. Instead, interest rates have dropped to just 2.42 percent last year, making the funding of government deficits not only possible but manageable and, to spendthrifts such as the president and his supporters, an irresistible temptation.

Isn't the *Journal's* report a precursor to the United States turning itself into Greece? That argument was floated a few years ago, but the comparison isn't valid. Unemployment in Greece is over 25 percent, reflecting a seven-year-long recession that has shrunk the country's gross domestic product by a quarter. And the austerity is likely to continue as the new Greek government appears to be on the verge of cutting a conciliatory deal with Eurozone lenders over its bailouts. Thankfully, the numbers here, though unimpressive, are vastly better than those in Greece.

Can't the U.S. economy be compared to a family that has habitually overspent, using home equity loans and credit cards? Not according to Zumbrun:

> A lot of people want to make this analogy between individuals and the government. Economists think this is a really bad analogy. The U.S. government is 238 years old and isn't planning to retire one day. If you were going to live forever, and bring in revenue forever, and issue bonds in money that you print [in your basement], then you'd have a much more similar situation. But you don't, and so the logic of personal finance [compared to government finance] doesn't apply.

What about balancing the budget? Isn't that a prudent thing to do? After all, the U.S. government hasn't had a surplus since 2001. Zumbrun was equally blunt:

> I don't think … that governments ever need to pay off their debt…. The goal is for the government to [remain] a going concern. With that in mind, the only thing the government needs to do is hold its debt at a sustainable level. If your interest payments are stable at [say] 3% or less of the economy … there's no reason you couldn't carry this debt forever.

The credit rating agency Standard & Poor's (S&P) downgraded U.S. sovereign debt in 2011 over just these sort of concerns, stating in its announcement that "the fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics."

Then two years later, thanks to that Budget Control Act, S&P reversed its downgrade: "We are revising the rating outlook [from negative] to stable to indicate our current view that the likelihood of a near-term downgrade of the rating is [now] less than one in three."

Even the usually fiscally responsible *Financial Times* published a fanciful study suggesting the possibility that, despite all of the demographic, political, and financial challenges, the U.S. government might actually print a surplus over the next few years.

Perhaps the reason the *Journal's* revelations that the U.S. government is increasingly painting itself into a fiscally impossible corner didn't raise more eyebrows is that, compared to its peers, the Untied States is the cleanest dirty shirt in the hamper.

But as Nick Timiraos, the *Journal's* economic correspondent, put it: "If current patterns hold, then the next president, especially if he or she serves a second term, could really face some tough choices."

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics.*