PAGE ONE Economics®

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# Understanding the Federal Budget

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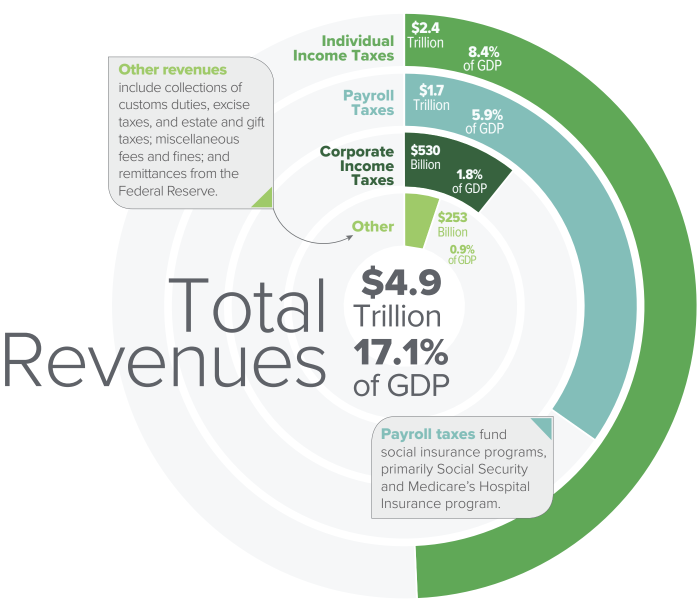
> "The way I've always governed my life as far as fiscal policy goes is I'm smart enough to know that I'm dumb about it."
> —Dennis Miller

A trillion of anything is a lot no matter what's being measured—gallons, miles, or dollars. So it's easy to get overwhelmed when reading about the U.S. federal government's budget and **fiscal policy**. Those numbers can quickly reach proportions that are hard to comprehend.

In practice, however, the government's budget is very similar to one used by a small business or maybe even your own personal finances. This article describes in simple terms how the large flows of money coming into and going out of the government can be easily understood.

## How Does the Government Acquire Income?




NOTE: U.S. federal government toal revenue in 2024 was $4.9 trillion—17.1% of GDP.

SOURCE: Congressional Budget Office.

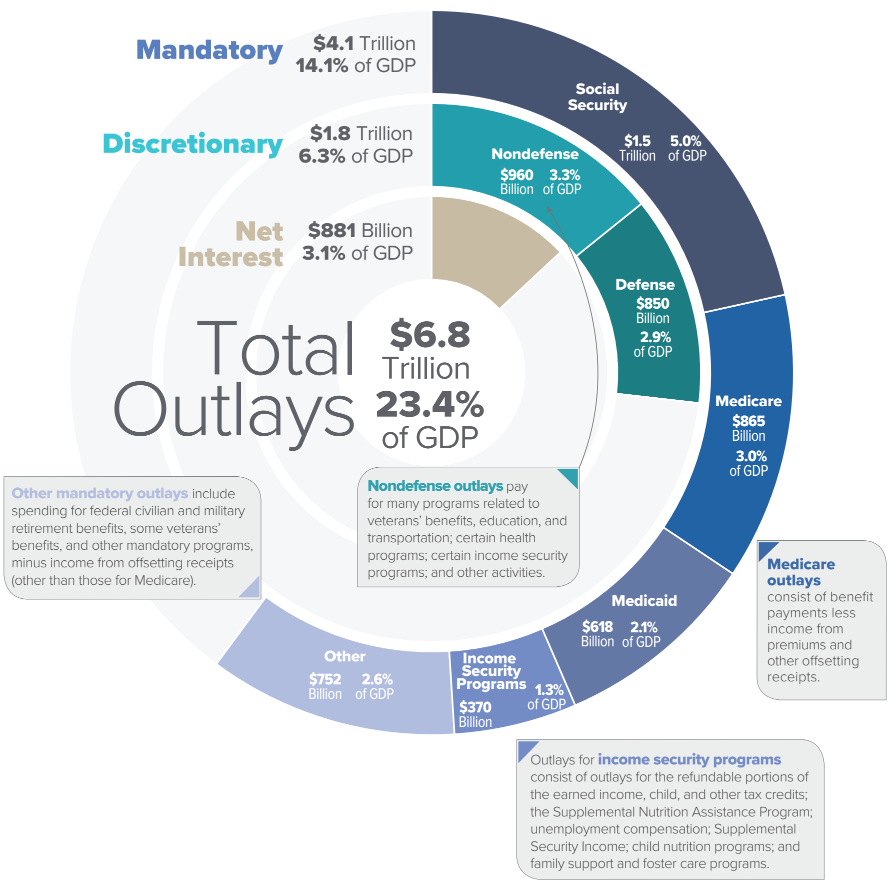
First, let's examine the money the government receives annually. According to the [Congressional Budget Office (PDF)](#) graphic, the federal government collected a total of $4.9 trillion in 2024. Almost half of that came from individual income tax collections, which are due on April 15 each year. Another third of that total revenue, approximately $1.7 trillion, came from payroll taxes paid by both employers and employees to the government. Corporations and businesses gave the government about 10% of its revenue through business income taxes. The remaining $250 billion, or 5%, was collected by the government through other revenue sources such as tariffs, fines, excise taxes, and estate taxes. This is the total annual income for the government.

## What Does the Government Spend Its Money On?

Clearly, the government collects an enormous amount of money. But it also spends an enormous amount, sometimes called **expenditures** or outlays. There are three main categories of how the government spends its money.

The biggest spending category by far is **mandatory spending**. This is for legislative programs such as Social Security, Medicare, unemployment benefits, and the Supplemental Nutrition Assistance Program (SNAP). These programs have been created by Congress and cannot be reduced without changing current law, and they are outside the scope of the annual appropriations process negotiated by elected officials. The Congressional Budget Office reported that in 2024, mandatory spending made up $4.1 trillion of the $6.8 trillion—or approximately 60%—of what the federal government spent that year.

After mandatory spending, the second largest category is **discretionary spending**. This outlay in fiscal policy is debated and set through annual budget procedures before the government's fiscal year begins each October 1. Discretionary spending is generally described as having two major segments: defense spending and non-defense spending. Total discretionary spending makes up about 26% of total government expenditures, [according to the Congressional Budget Office](https://www.cbo.gov).




The third spending category is interest payments the government must pay on its debt. Think of this as paying just the minimum interest fees on credit card debt without paying down the principal. In 2024 the United States paid $881 billion, or about 13% of its overall annual spending, on net interest payments, as shown in the graphic.

NOTE: U.S. federal government toal outlays in 2024 was $6.8 trillion—23.4% of GDP.

SOURCE: Congressional Budget Office.

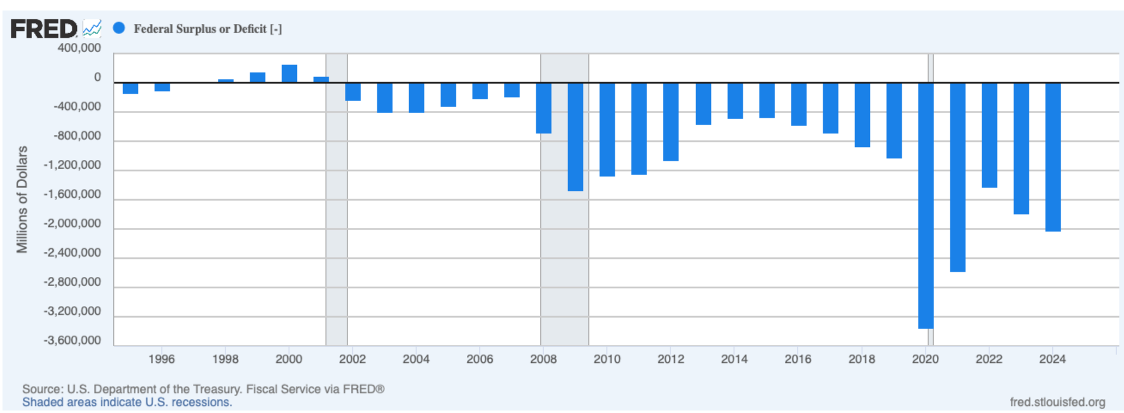
## Annual Deficits, Total Debt, and Fiscal Policy

You don't have to be an economist to see that, if the U.S. government spent more money ($6.8 trillion) than it took in ($4.9 trillion), its budget was not in balance. It is not unusual for a government to spend more than it earns each year, but it can become problematic.

Unlike an individual managing personal debt, the government views its debt responsibilities in a different way. This is because it's assumed that the country—its government and economy—will always be there and honor its financial obligations. Congress and the Treasury must always pay its existing bonds when they mature and are redeemed by the holder, as well as pay the interest on the debt, which is calculated annually. The problem enters when the debt becomes very large; an increasingly larger percentage of the budget must be allocated to interest payments—money that could be used to fund other programs if the debt were smaller.

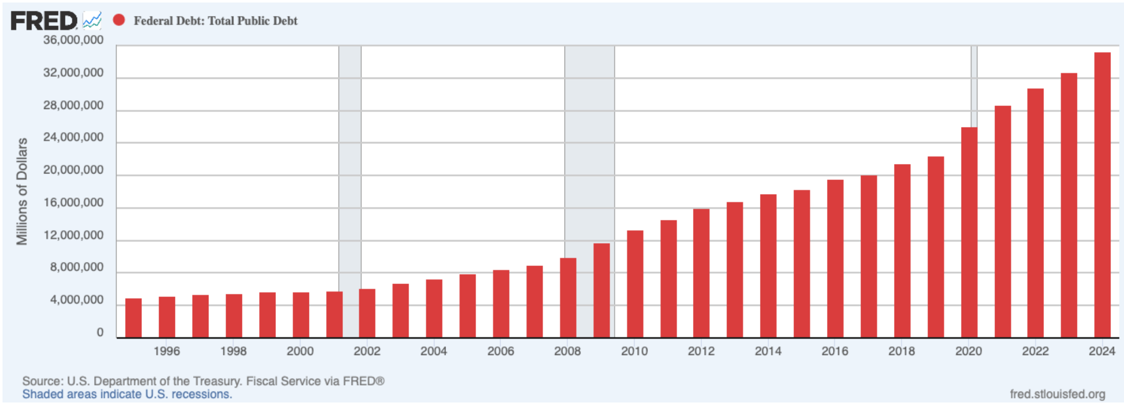
In 2024 the federal government ran an annual deficit of $1.9 trillion. To account for that extra spending, the U.S. Treasury issued **bonds** to raise money from investors with the promise the government will pay the face value of that bond plus a little more in interest. This works as an incentive to savers who view the government as a trustworthy source that honors its obligations.

If a national government runs annual deficits over multiple years, those deficits are added to the country's total national debt. Examine the two FRED® graphs below sourced from U.S. Treasury Department data. The first shows the federal government's annual surplus or deficit since 1995. In 2020, the year of the COVID-19 pandemic, the government spent far more than it took in, which is understandable considering the crisis of that time. But the trend overall has been for the U.S. to habitually operate fiscal policy using deficit spending.




SOURCE: Federal Surplus or Deficit, U.S. Department of the Treasury, Fiscal Service via FRED, Federal Reserve Bank of St. Louis; accessed October 1, 2025.

The second graph shows the annual sum of U.S. deficit spending added to its total national debt over that same time, 1995 to early 2025. The total government debt in the past 30 years has grown from $5 trillion to $35 trillion. As mentioned above and reported by the Congressional Budget Office, in 2024 the government paid $881 billion, or about 13% of all federal spending, on interest payments. That number will continue to increase, as mentioned in a nonpartisan budget analysis by the Committee for a Responsible Federal Budget, to become the largest line item of government spending by 2051.



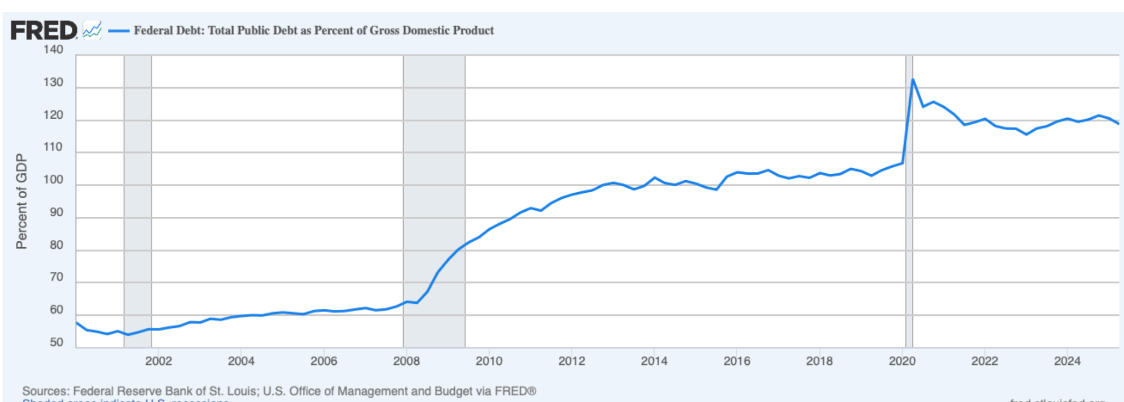

SOURCE: Federal Debt: The Total Public Debt, U.S. Department of the Treasury, Fiscal Service via FRED, Federal Reserve Bank of St. Louis; accessed October 1, 2025.

Conversely, if a government collects more revenue than it spends, it runs what is known as an annual surplus and can elect to pay down the total debt—not just the minimum interest payments mentioned earlier. In the United States the last annual government surplus was in 2001.

An ever-increasing national debt can put upward pressure on interest rates, sometimes referred to as the **crowding out** effect; this is not just for Treasury bonds but for all interest rates that average Americans pay on a regular basis.

A wide range of economists have expressed concerns about the fiscal policy of the United States over the past 25 years. With the current trajectory, as each successive year's deficit adds to total debt, the government will be forced to spend increasing amounts on its minimum debt interest payments. One nonpartisan report by the U.S. Government Accountability Office in February 2025 estimates that by 2027 the national debt will reach historically high levels when compared with real gross domestic product (GDP) and will double further in the next 20 years.

Policy experts such as those at the National Bureau of Economic Research debate the merits of policies that could reduce the debt burden, such as increased government revenue and reduced discretionary—and maybe even mandatory—spending.




SOURCE: Federal Debt: Total Public Debt as Percent of Gross Domestic Product, U.S. Office of Management and Budget via FRED, Federal Reserve Bank of St. Louis, accessed October 1, 2025.

Another mechanism that can affect debt, beyond taxing and spending choices, is economic growth. This can be measured by the debt-to-GDP ratio: If GDP were to grow at the same rate as or even faster than the government's total debt, then this measure of debt would stop escalating. Consider the FRED graph using data from the U.S. Office of Management and Budget above.

Since 2010 the total public debt as a percentage of GDP dramatically increased, with further acceleration due to the COVID-19 pandemic. However, that percentage declined slightly after 2020 and has remained relatively stable, albeit elevated, as the decade continues. If economic growth increases and government deficit spending and total debt remain steady, the possibility of necessary increases in government tax revenues or spending cuts is reduced.

## Conclusion

As U.S. fiscal policy discussions continue, the sheer size of the numbers you see in the news can be overwhelming. But it helps if every American citizen remembers that, when it comes to our national fiscal policy, the basic mechanics of how money comes into and flows out of the government are no different from how businesses and individuals budget their money.

## Glossary

**Bond:** A certificate of indebtedness issued by a government or corporation.

**Crowding out:** A condition where government enters the loanable funds market and thereby increases the interest rate beyond what is feasible for private sector borrowing.

**Discretionary spending:** Government spending authorized by Congress on an annual basis.

**Expenditure:** Money spent to buy goods and services.

**Fiscal policy:** Spending and taxing policies of the federal government to influence the economy.

**Mandatory spending:** Government spending required by current law.

## References

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Congressional Budget Office. "The Federal Budget in Fiscal Year 2024: An Infographic." March 2025.

Dynan, Karen and Elmendorf, Douglas. "Putting US Fiscal Policy on a Sustainable Path." Working Paper 33751, National Bureau of Economic Research, May 2025.

U.S. Department of the Treasury and Bureau of Fiscal Service. "How Much Has the U.S. Government Spent This Year?" FiscalData.Treasury.gov, fiscal year 2025.

U.S. Government Accountability Office. "America's Fiscal Future." Accessed October 1, 2025.

**Name**________________________________________ **Period**________

## Reading Q&A

# Understanding the Federal Budget

**After reading the article, complete the following:**

1. What was the primary reason for the increase in U.S. government debt during the COVID-19 pandemic?
    a. A significant increase in government spending to address the crisis
    b. A decrease in government revenue due to lower tax collections
    c. An increase in interest rates on government bonds
    d. A reduction in mandatory spending

2. What is the projected trend for U.S. government interest payments by 2051?
    a. They will decrease significantly.
    b. They will become the largest line item of government spending.
    c. They will remain stable at 13% of federal spending.
    d. They will be eliminated through surplus budgets.

3. What impact does an increasing national debt have on interest rates?
    a. It lowers the interest rates for all loans.
    b. It stabilizes interest rates for Treasury bonds.
    c. It puts upward pressure on interest rates.
    d. It has no effect on interest rates.

4. Which of the following best describes the term "crowding out"?
    a. The government reduces its own spending to make room for private-sector growth.
    b. Government borrowing increases interest rates, making it difficult for the private sector to borrow.
    c. The private sector borrows at lower rates than the government.
    d. The government invests in infrastructure to support private-sector growth.

5. What is the fiscal policy approach that the U.S. government has predominantly used in the past 25 years?
    a. Running annual surpluses to pay down debt
    b. Habitually operating fiscal policy using deficit spending
    c. Maintaining a balanced budget with no deficit or surplus
    d. Increasing mandatory spending while lowering discretionary spending

6. How can economic growth influence the need for changes in government tax revenues or spending cuts?
   a. By increasing the total debt regardless of its growth rate
   b. By reducing the debt-to-GDP ratio if growth exceeds an increase in debt
   c. By increasing the debt-to-GDP ratio if growth exceeds an increase in debt
   d. By eliminating the need for any government borrowing

7. What is the significance of the year 2001 in the context of the federal government's budget?
   a. The U.S. government ran its last annual surplus.
   b. The U.S. government reached its highest deficit.
   c. The U.S. government restructured its debt repayment plan.
   d. The U.S. government reduced discretionary spending significantly.

8. What is the difference between discretionary and mandatory spending?
   a. Discretionary spending is directed by the president; mandatory spending must come from Congress.
   b. Discretionary spending is allocated only for foreign aid; mandatory spending must be spent within the borders of the United States.
   c. Discretionary spending is negotiated by Congress every year as part of the budget process; mandatory spending is set from previous legislation.
   d. Discretionary spending is for defense spending; mandatory spending is for non-defense spending.

9. When the federal government runs an annual deficit, it usually raises money to pay its obligations by issuing
   a. tax refunds.
   b. bonds.
   c. stock.
   d. currency.

10. The total sum of multiple years of budget deficits is known as the
    a. trade deficit.
    b. tax differential.
    c. mandatory spending total.
    d. total national debt.