Edi tor’s Note: This is the first in a five-part series of articles on the federal budget aimed at sorting fact from fiction and illuminating some of the underlying issues.

There is a simple reason very few Americans understand exactly where their taxes go: It’s complicated; there are a lot of moving parts.

But understanding the basics of how money flows from your wallet to the thousands of initiatives funded by the federal government is the first step in recognizing the enormous challenge Congress faces in trying to reverse the current national debt, which is now at about $19 trillion and growing.

Over the course of this five-part series, we hope to help you gain a better understanding of where your money goes, how it gets there and how it plays into the delicate tight rope Congress must tread if they ever hope to balance the books.

Although the budget didn’t draw much attention during the presidential campaign, it should come into sharper focus during 2017 as Congress weighs the impact of the new proposed spending and tax initiatives.

The process

While the president gets the headlines, Congress actually dominates the budget process. The president publishes a budget each year, but one should think of it as a request or proposal that reflects the president’s priorities. The U.S. House and Senate typically pass their own spending plans, and then reconcile their competing visions. The resulting document goes to the president to be signed.

Unfortunately, Congress does not always do its job. It neglected to pass a new budget for six years from 2009 through 2014. When Congress can’t pass a budget, it kicks the can down the road with continuing resolutions that basically keep spending at prior levels with only minor adjustments. Finally, in May 2015, Congress managed to approve a new budget that set spending targets for the ensuing two years.

Congress is expected to approve a new budget in 2017 for fiscal year 2018. With control of Congress and the presidency all in the hands of the Republican Party, one might think that they will be able to come together to agree on a new budget; however, we cannot be certain. When the Congress and the presidency were in the hands of the Democratic Party, they did not pass a budget for several years.

Deficits and the debt

When the government spends more in one year than it collects in taxes and fees, as it usually does, the Treasury must borrow to cover the deficit. Over time, those borrowings accumulate, and the associated interest costs grow. It is the large and accelerating growth in the federal debt that is a major threat to our economy.

Research has shown that when a country’s debt rises to about 90% of its gross domestic product (GDP)—the value of all goods and services produced annually—its economy usually starts to slow. Because of its size and stature, the U.S. can probably tolerate a somewhat higher debt-to-GDP ratio, but exceeding that level would certainly be viewed negatively by many economists.
According to a recent projection by the Congressional Budget Office (CBO), the debt is on pace to reach 90% of GDP by 2028 (Exhibit 1). That's actually an improvement from its 2012 report when it projected that the 90% debt level would be reached in 2021. A strengthening economy and higher tax receipts have helped improve the debt situation over the past few years.

Exhibit 2 shows how the last recession and the subsequent slow recovery have been adding to our debt burden. A recession reduces incomes and hence government tax revenues. It also triggers increased government spending on things like unemployment benefits and economic stimulus programs. Normally, the resulting revenue and spending gap shrinks once the economy recovers. But the CBO projects that our annual deficits will grow ever wider as spending continues to rise much faster than tax revenues.

The debt ceiling

There is a legal limit to how much the federal government can borrow (Exhibit 3). This limit can be raised legislatively, and historically it has been, pretty much routinely. But, in recent years, Congress has sometimes let it float for a fixed period of time.

In 2011, some members of Congress used the debt ceiling bill for political leverage. They held up legislation on raising the ceiling until they had received assurance of a $900 billion cut in federal spending. The debt ceiling debate became less of an issue in recent years, particularly after the new two-year budget was signed into law in 2015; however, it cropped up again in March 2017 when debt hit the ceiling again. When constrained by the debt ceiling, the treasury can keep the government running for a while by delaying payments, often referred to as “extraordinary measures.” The latest estimate from the CBO is that Treasury will exhaust its extraordinary measures by autumn.

A note on budget forecasts

Calculating the long-term impact of federal budget decisions is not easy. As the official scorekeeper, the CBO must evaluate laws as they actually exist or have been proposed, even if they are likely to be changed. Its resulting forecasts are referred to as “baseline” or “current law” projections. But the CBO knows some laws are not likely to be implemented, and, therefore, it sometimes publishes a more realistic forecast called the “alternative fiscal scenario,” or “current policy forecast.” The last time the CBO published an alternative fiscal scenario was 2015.
Summary

1. The mounting debt relative to the size of the economy (debt-to-GDP) is the major economic concern.
2. A debt-to-GDP ratio of 90% is considered an economic tipping point.
3. U.S. debt-to-GDP has been accelerated during and directly after the Great Recession, but has slowed during the recovery as the economy improved.
4. Projected future deficits are a function of a growing gap between spending and taxes.

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All information and representations herein are as of May 31, 2017, unless otherwise noted.

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