2025 US Debt Ceiling Showdown

The Price of a Deal

Policymakers are staking their positions on a US debt ceiling compromise, meaning raising, suspending, or repealing the debt limit may come at the cost of federal spending cuts. This report explores what comes next now that mandatory and discretionary federal government spending, along with their defense and nondefense components, are probably all on the table.

Key Insights

- The red sweep (i.e., GOP control over both houses of Congress and the White House) does not guarantee smooth sailing for key pieces of legislation in 2025, including for the debt limit.
- Like any other political party, the Republican party is heterogeneous, and there will not be unanimity on every issue. Indeed, the cost of doing fiscal business may be spending cuts. Mandatory and discretionary outlays for defense and nondefense items are on the table.
- While revenue raisers, including select tax hikes, widening the tax base, and closing loopholes, should also be a part of debt reduction strategy, they are currently not a part of the debate.
- Cutting waste and generating efficiencies can lower costs and increase productivity. However, significant federal spending reductions to programs that are critical for economic functioning, financial market stability, and social well-being might be highly disruptive and materially weigh on the US economy over the short run.
- Still, Democrats and some Republicans are likely to ask for material concessions to cutting federal programs and some tax reform in exchange for a deal on the debt limit.

Cuts and Concessions May Be the Costs of a Deal

Figure 1

What might the 2025 US debt ceiling episode look like?

Timing & Options

- January 2025
  - ✓ Jan 1 – 2023 suspension ends
  - ✓ Jan 2 – New limit set at Jan 1 amount
  - ✓ Jan 14-23 – Extraordinary Measures begin
- X-date timing
  - ✓ Very Early – April or May 2025
  - ✓ Early – June 2025
  - ✓ Late – September 2025
- Debt ceiling options
  - ✓ Repeal (unlikely outcome)
  - ✓ Raise
  - ✓ Suspend (done repeatedly)
  - ✓ Default (never occurred, deserves moderate risk assessment)

Scenarios

- Suspension or raise the limit
  - ✓ 11th hour, no budgetary changes, no impact on the economy
  - ✓ 11th hour, no budgetary changes, sovereign debt downgrade, minor impact on the economy
  - ✓ 11th hour, yes budgetary changes, spending cuts, weighs on the economy
  - ✓ 11th hour, yes budgetary changes, spending cuts, sovereign debt downgrade, deepens weight on the economy
- No suspension or raising of the limit
  - ✓ Sovereign debt default
  - ✓ Instant global financial crisis
  - ✓ Instant US recession
  - ✓ Instant global recession

Source: The Conference Board, January 2025

What Will It Cost to Raise the Limit?

The price of fiscal business may be steep

Given the heterogeneity of the Republican members of Congress, suspending the debt limit may come at a cost that would likely be in the form of federal spending cuts.

Cuts could come from mandatory outlays (spending that does not require an annual vote from Congress), discretionary outlays (spending directed by prior law or voted in the annual appropriations process), and supplemental appropriations (e.g., emergency disaster relief).

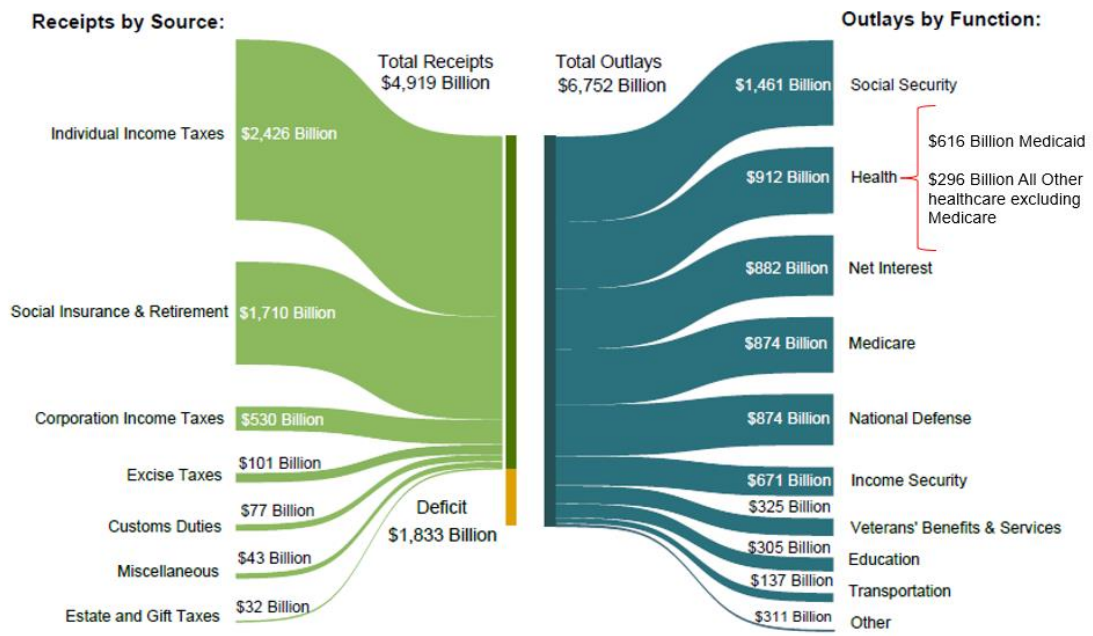
Democrats will also want concessions to align with a debt ceiling increase and spending cuts, which might include giving up some spending items in exchange for increasing others or demanding more revenues.

Elimination of some programs might cause inconveniences to select groups or impact small swaths of households and businesses. However, deep cuts to programs that are critical for economic functioning, financial market stability, and social well-being might be highly disruptive and materially weigh on the US economy over the next few years.

Figure 2

Spending cuts are on the table to pay for raising debt ceiling

Cumulative Receipts, Outlays, and Surplus/Deficit: FY 2024



Note: Income security includes unemployment benefits, the Supplemental Nutrition Assistance Program, Supplemental Security Income, Temporary Assistance for Needy Families, certain federal retirement programs (other than Social Security), housing assistance, and refundable tax credits (payments that exceed taxes owed).
Source: US Treasury and The Conference Board, 2025

Low-hanging fruit: cuts to discretionary outlays

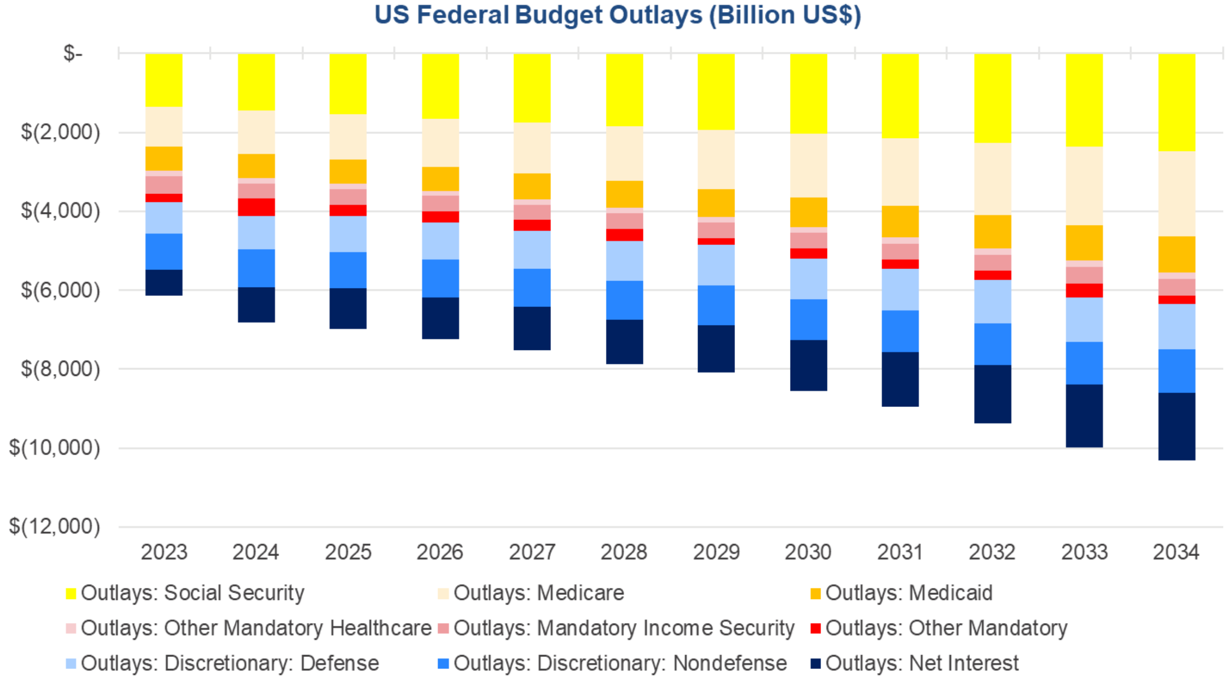
Discretionary outlays are an easy target for spending cuts because they encompass hundreds of programs that may not be essential for basic government functioning, economic activity, or social well-being. Currently the federal government spends roughly US$848 billion on discretionary defense outlays and US$948 billion on discretionary nondefense outlays.

Discretionary nondefense outlays are potentially low-hanging fruit for cuts due to many “pet” or “white elephant” projects and “bridges to nowhere” that may benefit only a small segment of the US population. However, many programs and outlays are exceedingly critical for economic functioning, financial market stability, and social well-being, including funding for air traffic control, homeland security, financial market regulation, disease control, and food for children.

Discretionary defense outlays may be in focus as there is desire to “find savings” or “cut waste” among both Republican and Democratic members of Congress. The Congressional Budget Office (CBO) has proposed options for reducing the discretionary portions of the Department of Defense (DoD) by cutting the number of combat troops and advising allies to provide for their own defense, as well as replacing some military personnel with civilian employees and capping basic pay increases for military service members. The CBO also proposed options for retiring the Air Force's F-22 and B-1B fighter forces, canceling the Army's Future Long-Range Assault Aircraft and the DoD's Long-Range Stand Off Weapon, and ceasing to build the Navy's Ford-Class Aircraft Carriers.

Figure 3

Mandatory outlays will grow faster than discretionary outlays ahead



Source: Congressional Budget Office and The Conference Board, 2025

However, reducing discretionary outlays alone will not achieve the sizable spending cuts necessary to reduce debt as a share of GDP from about 100% now to 70%—the International Monetary Fund's recommended target for the US. Meanwhile, net interest on the public debt will rise from about US$892 billion in FY2024 to US$1.71 trillion in FY2034. The amount of debt service is dependent upon the Fed's federal funds rate and how much Congress allows debt to increase, and thus it cannot simply be cut or ignored.

Mandatory spending cuts are also in view

Mandatory spending cuts will be needed for Congress to materially reduce annual federal budget deficits and public debt. Discretionary spending will rise from roughly US$1.79 trillion in FY2024 to US$2.26 trillion in FY2034, while mandatory spending will increase from around US$4.12 trillion currently to US$6.35 trillion a decade from now.

Mandatory spending on entitlements, including Social Security (public pension program), Medicare (public health program for senior citizens), and Medicaid (public health care for lowand moderate-income people who are not senior citizens), will expand the fastest over the next decade and constitute the lion's share (about 70%) of all mandatory outlays. However, changes to these programs will be difficult as proposals to cut or reform them tend to be political lightning rods.

This leaves the other 30% of mandatory outlays vulnerable to cuts. However, many of these programs are also extremely popular, including the Children's Health Insurance Program (CHIP); veterans programs; deposit insurance for bank accounts; civilian and military retirement programs; and a host of income security programs including the Earned Income Tax Credit (EITC) for low-income tax filers; Child Tax Credit; unemployment benefits; Supplemental Nutrition Assistance Program (SNAP), which provides food benefits to low-income families; National Flood Insurance; and Supplemental Security Income (SSI), which provides payments to people with disabilities and older adults with little or no income.

The prospect of the Senate passing legislation for mandatory spending cuts through "regular order" is more remote. This would require all GOP senators plus several Democratic senators to agree to cuts in order to achieve a filibuster-proof 60-vote majority in the Senate. Hence, a special legislative tactic called reconciliation is a likely path for Republicans.

Fast-tracking a debt ceiling lift and spending cuts is possible but risky

The quickest route to raising the debt ceiling and passing spending cuts to offset it might be through a special legislative process called budget reconciliation. Reconciliation allows for expedited changes in revenues, mandatory outlays, and the debt limit that limit the amount of time for debate, prevent inclusion of nonbudgetary items, and allow the Senate to pass a bill with 51 votes instead of the typical filibuster-proof 60 votes.

Reconciliation, which is allowed only once per fiscal year, has been a powerful tool for Congress to fast-track legislation when there is a mandate (i.e., one political party controls both chambers of Congress and the White House). Notably, reconciliation was used to pass the Tax Cuts and Jobs Act of 2017 and the Inflation Reduction Act of 2022.

In the current instance, a reconciliation bill in FY2025 might include raising the debt ceiling by US$1.5 trillion in exchange for US$2.5 trillion in mandatory spending cuts. However, news reports state that some Republican senators are skeptical about the feasibility of using reconciliation to rush through a debt ceiling deal given the narrow majorities the GOP holds.

Additionally, reconciliation does not allow for reductions in discretionary spending nor for the Senate to make changes to Social Security if a senator raises the Byrd Rule and the Senate parliamentarian sustains the objection. In FY2024, discretionary spending summed to about US$1.79 trillion, or 26% of total federal government outlays. In FY2024, Social Security represented about US$1.46 trillion, or 32% of total mandatory outlays and 21% of total outlays.

Additional pieces of legislation would be needed to address discretionary and Social Security spending, which would likely also be difficult given the political sensitivity of Social Security and the unwillingness of policymakers to cut discretionary spending that benefits their voters.

DOGE may influence debt ceiling negotiations

Still, some policymakers are signaling that everything may be on the table regarding spending cuts to achieve fiscal goals, especially given early support among an increasing number of congresspeople for the Department of Government Efficiency (DOGE).

DOGE is an external advisory committee to the government, not a government agency, and might possibly be ultimately structured as a federal advisory committee (FAC). A FAC files for a charter with the federal General Services Administration to advise an agency or policymaker in the federal government; hundreds of them are currently associated with government agencies.

DOGE would not be unique in its goals to reduce federal spending and create efficiencies given numerous past congressional fiscal commissions and recommendations from think tanks and government entities including the CBO and the White House Office of Management and Budget (OMB). Nonetheless, it likely will play a material role in influencing decisions leading to reductions in government spending and public debt during the new administration.

DOGE could potentially adopt recommendations issued annually by the nonpartisan CBO, which produces solutions for deficit and debt reduction including spending cuts for discretionary and mandatory programs, *as well as* revenue raisers. The Conference Board has and continues to advocate for thoughtful spending cuts and entitlement reform, as well as tax reform that would increase revenues, including by broadening the taxpayer base and closing tax loopholes.

DOGE could also lean on recommendations delivered annually by the OMB, which produces spending and revenue recommendations from the executive branch. However, it is highly likely that the new administration's budget will focus primarily on spending cuts, and the administration may even advocate for additional tax cuts, which would further reduce federal government revenues.

DOGE architects are reportedly considering crowdsourcing ideas for which government functions, agencies, or expenditures should be cut. Potentially, expenditures that are favored by interest groups or popular among the general public might be spared, according to recent soundings from DOGE leaders in news reports.

Still, as DOGE will serve in an advisory capacity to the president, and he is reluctant to cut entitlement programs, there may be limitations to its success beyond deregulation.

About the Author

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