

Understanding the US Debt Problem

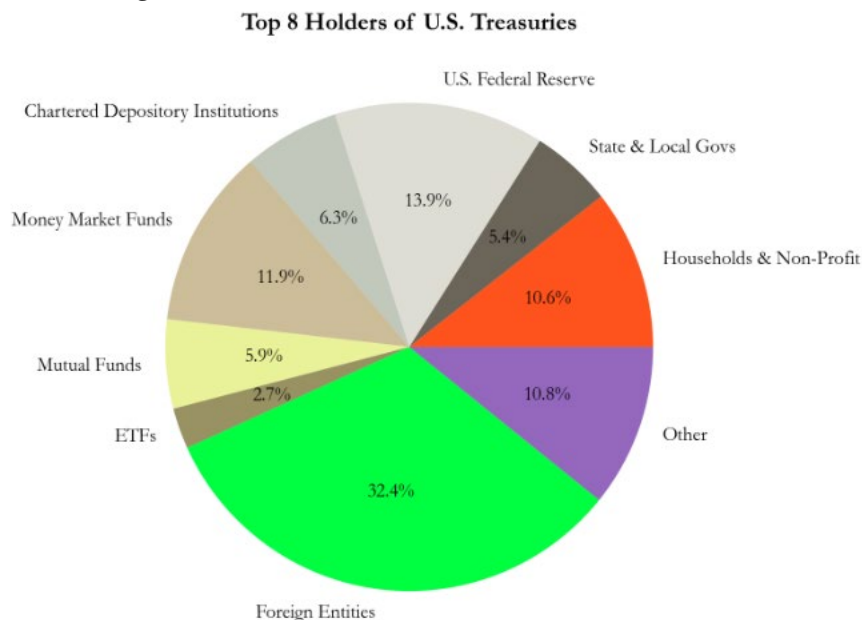


August 2026

The U.S. government has accumulated more debt than at any point in its history, and the danger is no longer hypothetical. Stories about the debt circulate constantly, but many focus on the wrong crisis. A government that borrows in a currency it issues can make its payments; that is not the comfort it sounds like. The real questions are more troubling: how fast borrowing costs rise, who is still willing to lend, what happens when the economy weakens, and whether any realistic political path can close the gap before markets force one.

The Fear that Doesn't Hold up

You have likely heard some version of this: foreign governments hold a huge share of U.S. debt, and one day they will dump it and send interest rates soaring.



IRON Financial | Data: US Federal Reserve Bank of St.Louis | 2026-03-31

Foreign investors do hold roughly a third of U.S. government debt — Japan is the largest at about \$1.2 trillion, followed by the United Kingdom and China. The holdings are real - the scenario is not.

First, these sellers would harm their own remaining holdings. Nobody sells hundreds of billions of dollars of bonds in an afternoon; unwinding a position of that size takes months. Every block sold, pushes the price down on everything not yet sold — setting fire to your own portfolio to inconvenience someone else.

Second, sellers would have to invest the proceeds somewhere else. Selling means buying something else, and nothing is big enough to absorb the full amount. European and Japanese government bonds are a fraction of the size; the gold market is smaller still and cannot easily settle global trade. The Treasury market is large precisely because there is no substitute for it.

Size of the World's Largest Government Bond Markets

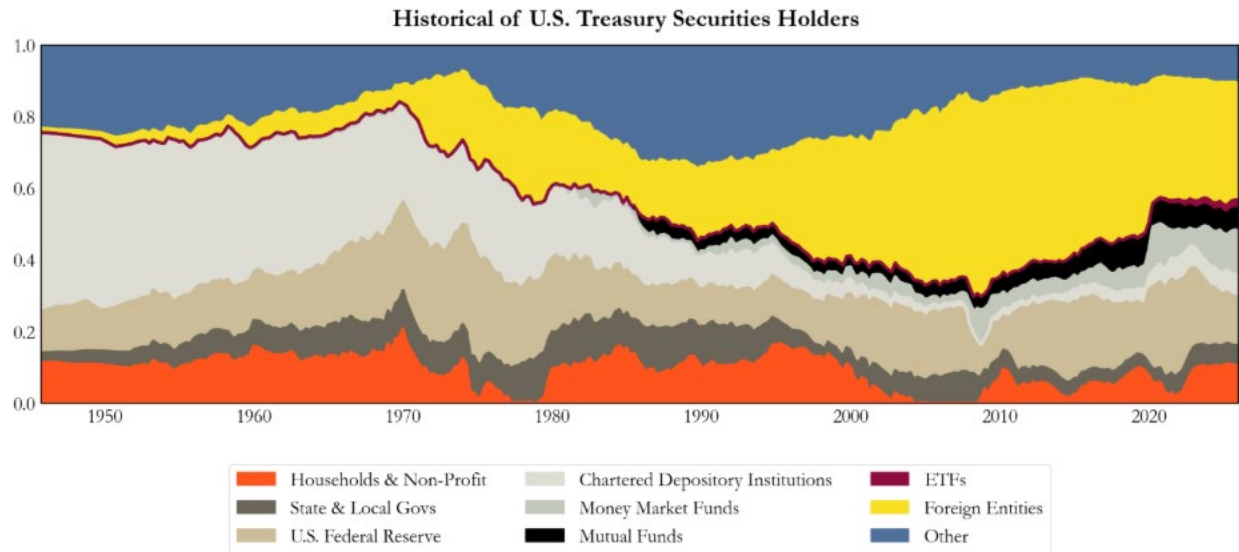
(Approximate Outstanding Government Debt Securities, USD Trillions)



Source: OECD, Global Debt Report 2026; European Central Bank (ECB); Bank of Japan; U.S. Department of the Treasury.

The figures are rounded estimates of outstanding government debt securities converted to U.S. dollars.

Third, central banks and sovereign funds have been net sellers for years, and their share of U.S. debt has shrunk for a decade. Yet total foreign holdings kept rising in dollar terms — from roughly \$7.7 trillion at the end of 2021 to about \$9.2 trillion four years later. If foreign entities reduce their allocation to U.S. treasuries, private investors absorb the difference — but likely only at higher yields.



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The Real Risk is a Change in The Buyers' Character

For about thirty years, the largest buyers of U.S. debt were foreign central banks. They were not really investors: they bought for policy reasons, held to maturity, and were not price-sensitive. They were the most reliable customers imaginable, and they made large deficits feel cheap.

That buyer group has been shrinking. Taking its place are money market funds, hedge funds, exchange-traded funds and ordinary savers — buyers who behave in the opposite way. They compare returns, demand to be paid competitively, and walk away when something better appears.

Here is the part that should worry investors: nobody has to refuse to buy Treasuries for the problem to bite. The strain is first reflected in price, not in headlines — a few extra hundredths of a percentage point demanded at auction, or a small gap between the yield investors expected and the yield they received. Those unglamorous numbers can drift for years, and by the time they look dramatic, the fiscal damage has already compounded.

In normal conditions there is no cliff to point at, which is why this gets overlooked. Borrowing costs rise not because of a crisis but because the customer base now negotiates. Two players steady the short end — the Federal Reserve, buying Treasury bills again since late 2025, and money market funds, now the dominant buyer of short-dated debt. Both help. But both buy short, which quietly nudges the government toward short-term borrowing.

The Cushion is Smaller

Today, even with low unemployment and the economy expanding, the government collects only roughly 76 cents for every dollar it spends. That is the alarming part: this is what the budget looks like in good times.

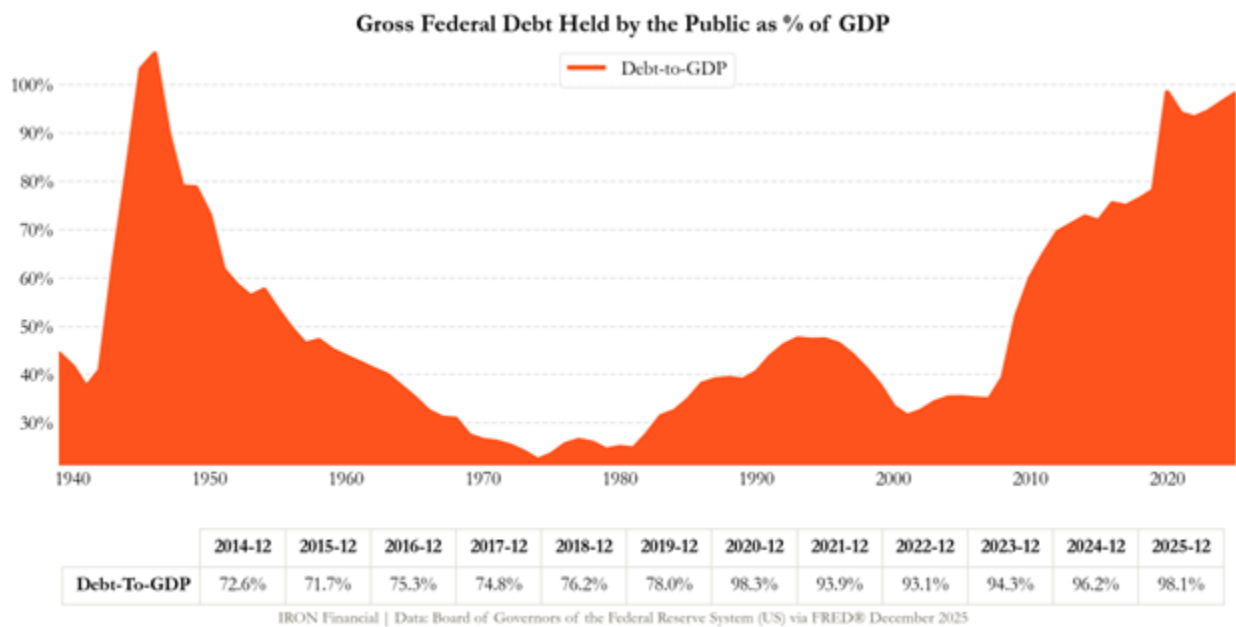
That matters because of what recessions do. They hit both sides at once - revenue falls as people lose jobs and profits shrink, while spending rises automatically through unemployment insurance and other support. Historically, that has knocked ten to twenty points off the coverage figure.

That is where the problem resides - The United States used to enter a recession collecting around 85 to 95 cents per dollar spent, and a bad downturn dragged it into the low 70s. Where past recessions bottomed out is now roughly where an expansion sits.

Start at 76 cents, subtract the revenue lost to a normal recession, and the country lands near 55 to 60 cents — deficits near or above 10% of the economy. That would arrive at whatever interest rates prevail at the worst possible moment, when investors are already most sensitive to risk and the government has the least room to maneuver.

Recessions do a third thing — and this one does not reverse. Interest on the debt now runs above \$1 trillion a year - more than the entire defense budget and second only to Social Security. It consumes roughly 20.8% of federal revenue. That is not just a large line item; it is a fiscal trapdoor. The 1980s burden came from high interest rates on a small debt stock, and it melted away as rates fell for twenty years. Today's burden is a low rate on a very large stock, with no equivalent tailwind. We face the inverse, and the arithmetic is far less forgiving.

Four Paths Out



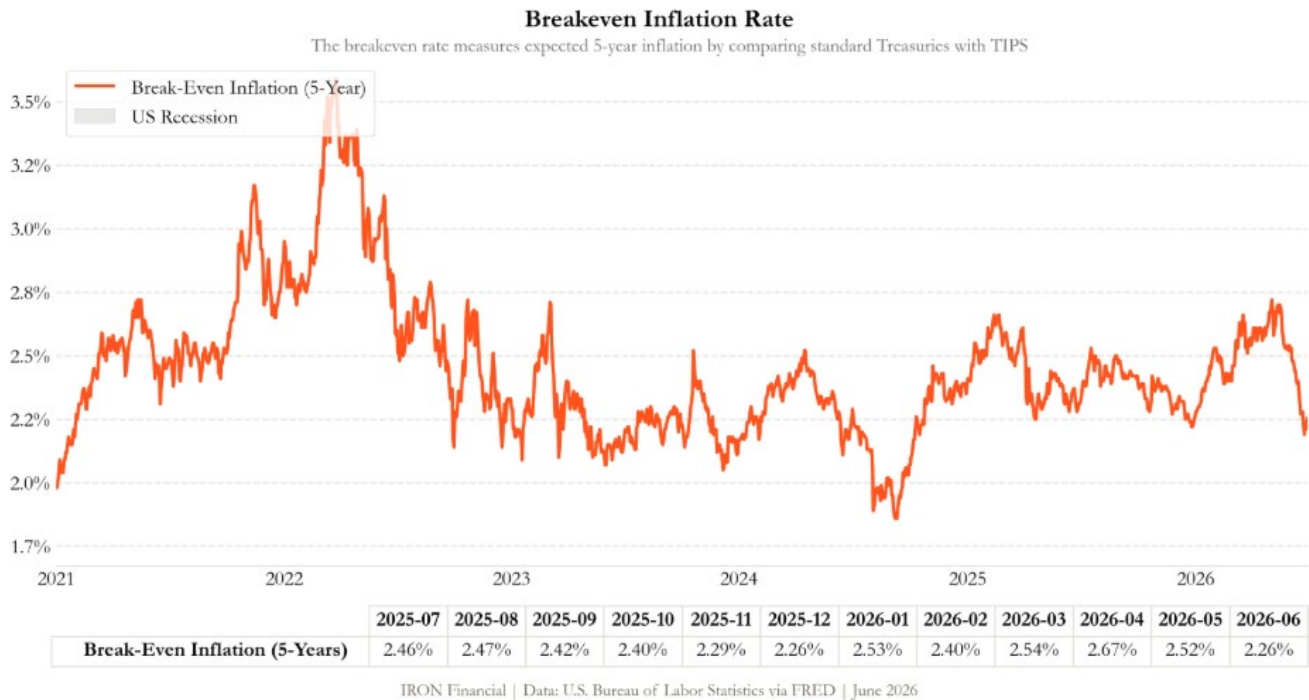
At roughly 100% of GDP, the debt ratio holds steady only when the deficit matches nominal growth — about 5% today, from 2% real growth plus 3% inflation. The deficit is near 6.4%. The difference is about 1.4% of GDP, a little over \$450 billion a year. That is the gap that has to close, and there are only four off-ramps. None is easy, none is painless, and waiting makes each one harsher.

This is arithmetic rather than opinion, and any real outcome is some blend of the factors below:

1. **Spend less or tax more.** The only route anyone directly controls, and the only one requiring a vote. The last surplus was in 2001. An adjustment of \$450 billion is about 6% of federal spending — arithmetically modest, but politically enormous and unprecedented in recent history. Worse, demographics push in the opposite direction, widening the deficit each year while the willingness to act keeps shrinking.
2. **Pay a lower real interest rate.** The Federal Reserve sets short rates, and demand for short-dated government debt has become unusually insensitive to price: bank liquidity rules, money market funds, the Fed buying bills again, and since 2025 stablecoins, which must hold their reserves in Treasury bills of 93 days or less. However, this shift applies only at the front of the curve. None of it funds long-term borrowing, and savers with alternatives leave when real returns turn negative enough.

3. **Grow faster.** Closing the gap this way requires roughly 1.4 points of extra real growth, sustained for years. AI investment is currently delivering about that much — but investment is not productivity. A data center adds to GDP the moment it is built, regardless of whether it ever raises output per hour. And if real productivity does arrive, it lifts interest rates with it, because capital earns more. What matters is growth measured against the rate, and a boom moves both sides at once.

4. **Inflate above what lenders charge.** Only inflation above the priced rate transfers anything, and that price is published: the breakeven rate, the gap between yields on ordinary and inflation-protected Treasuries. Bonds sold in 2021 at breakeven levels near 2% have since met inflation averaging about 4.5% — a real transfer, and much of why the ratio has drifted rather than climbed. Inflation-protected bonds are supposed to be immune by design, short-dated debt reprices within months, and lenders adjust what they charge. Nonetheless, there is always the risk of the government changing how the consumer price index is calculated.



None of the above closes the gap alone, and the likely path is a little of each while the ratio drifts higher. Nothing in the arithmetic sets a level at which this stops. What ends it is investors demanding more in return — and by then the choice may no longer be whether to adjust, but how painful the adjustment has become. For investors, the implication is direct: if money printing and inflation become part of the escape route, prudent portfolios should not rely only on fixed claims in a debasing currency. They should include exposure to assets capable of growing income over time, so purchasing power has a chance to keep pace as the dollars value is diluted.

The Bottom Line: The Compounding Fiscal Trap

The U.S. debt issue is not an impending, sudden shock caused by foreign nations dumping Treasuries, but a slow, compounding fiscal squeeze. As price-sensitive private investors replace central banks and interest costs cross \$1 trillion annually, the government is running out of a fiscal cushion. With all four potential exit routes facing severe political or economic bottlenecks, the debt burden will likely be managed through gradual dollar dilution, making income growing real assets essential for long-term purchasing power.

Sources & Methodology

All figures are from public data, current as of the dates shown. FRED series identifiers are given so every chart can be reproduced.

Who holds the debt

Holder composition. Federal Reserve, Financial Accounts of the United States (Z.1), Table L.210, via Federal Reserve Bank of St. Louis. Data as of 31 March 2026.

Foreign holdings by country. U.S. Treasury, Treasury International Capital (TIC) system, Major Foreign Holders of Treasury Securities. Japan approximately \$1.2tn.

Official vs. private foreign flows. TIC monthly transactions data. Total foreign holdings of roughly \$7.7tn at end-2021 rising to about \$9.2tn four years later, with official institutions net sellers over the period.

Budget and interest

Revenue and expenditures. Bureau of Economic Analysis, NIPA Table 3.2 (Federal Government Current Receipts and Expenditures), via FRED: FGRECPT (current receipts) and FGEXPND (current expenditures).

Interest payments. BEA NIPA Table 3.2, via FRED: A091RC1Q027SBEA (federal current expenditures, interest payments).

Recession shading. National Bureau of Economic Research recession indicators, via FRED: USREC.

Interest above \$1 trillion. Congressional Budget Office, Monthly Budget Review; U.S. Treasury, Monthly Treasury Statement. Net interest has exceeded national defense outlays since fiscal year 2024.

Long-run interest projections. Congressional Budget Office, The Budget and Economic Outlook.

Debt and the economy

Debt-to-GDP. U.S. Treasury and BEA, via FRED: GFDEGDQ188S (gross federal debt as a percent of GDP) and GDP. Debt held by the public crossed 100% of GDP in the first quarter of 2026.

Historical debt ratio, 1960-1974. Office of Management and Budget, Historical Tables; FRED: GFDEGDQ188S.

Budget surpluses and deficit-reduction packages. OMB Historical Tables, Table 1.1. The last surplus was recorded in fiscal 2001; the referenced packages are the Omnibus Budget Reconciliation Acts of 1990 and 1993.

Monetary policy and market structure

Balance sheet and bill purchases. Federal Reserve, FOMC statements and Statement on Longer-Run Goals; New York Fed, Open Market Operations. Runoff concluded in late 2025.

Money market fund holdings. Office of Financial Research, U.S. Money Market Fund Monitor; Investment Company Institute.

Treasury market functioning, March 2020. Federal Reserve Bank of New York, "The Global Dash for Cash in March 2020"; Federal Reserve Board, FEDS Notes on Treasury market functioning.

Breakeven inflation rates. Federal Reserve Bank of St. Louis via FRED: T5YIE (5-year breakeven inflation rate) and DFII5 (5-year inflation-indexed Treasury yield).

Stablecoin reserve requirements. GENIUS Act, July 2025. Permitted reserves are limited to cash, insured deposits, Treasury bills of 93 days or less, and short-dated Treasury repurchase agreements.

AI-related investment. Analyst and consultancy estimates. The national accounts publish no separate line item for AI capital spending, so these figures are derived rather than official.

A Note on Measurement

Two different accounting frameworks appear in public discussion of these numbers, and they do not produce the same answer. The federal budget, used by Congress and the Congressional Budget Office, reports net interest: interest paid less interest received. The national accounts, produced by the Bureau of Economic Analysis and used for the charts here, report interest gross of receipts and additionally include interest paid to federal employee retirement funds together with imputed interest on underfunded pension plans. The national-accounts measure is therefore materially higher, and the gap between the two was much wider in the high-interest-rate era of the 1980s than it is today.

Interest as a share of revenue is reported here on the national-accounts basis at roughly 20.8%, consistent with the chart. On the federal budget basis the comparable figure is near 18.5%, which the Congressional Budget Office notes is above the previous high set in 1991. Readers comparing this paper to budget-based commentary should expect that difference. Neither measure is wrong; they answer different questions and mixing them within a single comparison is the error to avoid.

Government debt is also reported two ways. Gross federal debt includes securities held by federal trust funds; debt held by the public excludes them. The second is the better gauge of borrowing from private markets, since intragovernmental holdings never come to auction. Both are cited above and labelled where used.

Prepared for general education. This is not investment, tax or legal advice, and it is not a recommendation to buy or sell any security. Figures are drawn from public data including the U.S. Treasury, the Congressional Budget Office and the Federal Reserve, and were current as of July 2026.
