

The United States Capital Structure



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The U.S. federal government is arguably the largest issuer of safe debt in the roughly \$28 trillion of marketable Treasury debt. These Treasuries are backed by the full faith and credit of the United States Treasury. There is no specific source of revenue that is earmarked to pay back these Treasuries, unlike, say, municipal bonds that are backed by toll revenue. How safe are these promises, really?

Owners of Treasuries don't benefit from seniority the way corporate bondholders might. There's no bankruptcy procedure for sovereigns. The 14th Amendment, Section 4, does say that the validity of the public debt "shall not be questioned" but the amendment protects the *validity* of the debt; it doesn't create payment priority over tax revenues. No statute clearly requires Treasury to prioritize principal and interest over other legal obligations. ¹

The coupon and principal of Treasuries are fixed only in dollar terms. There is no indexation, except for TIPS (Treasury Inflation-Protected Securities), but those make up only a small fraction of the total outstanding stock of Treasuries. Nonetheless, the contract prevents the U.S. from inflating the real value of the obligation away. Treasury is making promises to bondholders that are nominally risk-free, or close to it, [but they're definitely not risk-free in real terms.](#)

The US federal government has many claimants, not just bondholders. It has made promises to 67 million Social Security recipients, 65 million Medicare enrollees and roughly 80 million Medicaid beneficiaries. All of this falls under the heading of mandatory spending, a catch-all label for all the promises that the federal government has made to recipients of Social Security, Medicare, Medicaid, and other transfer programs. ² The funds needed for mandatory spending do not have to be approved by Congress every year.

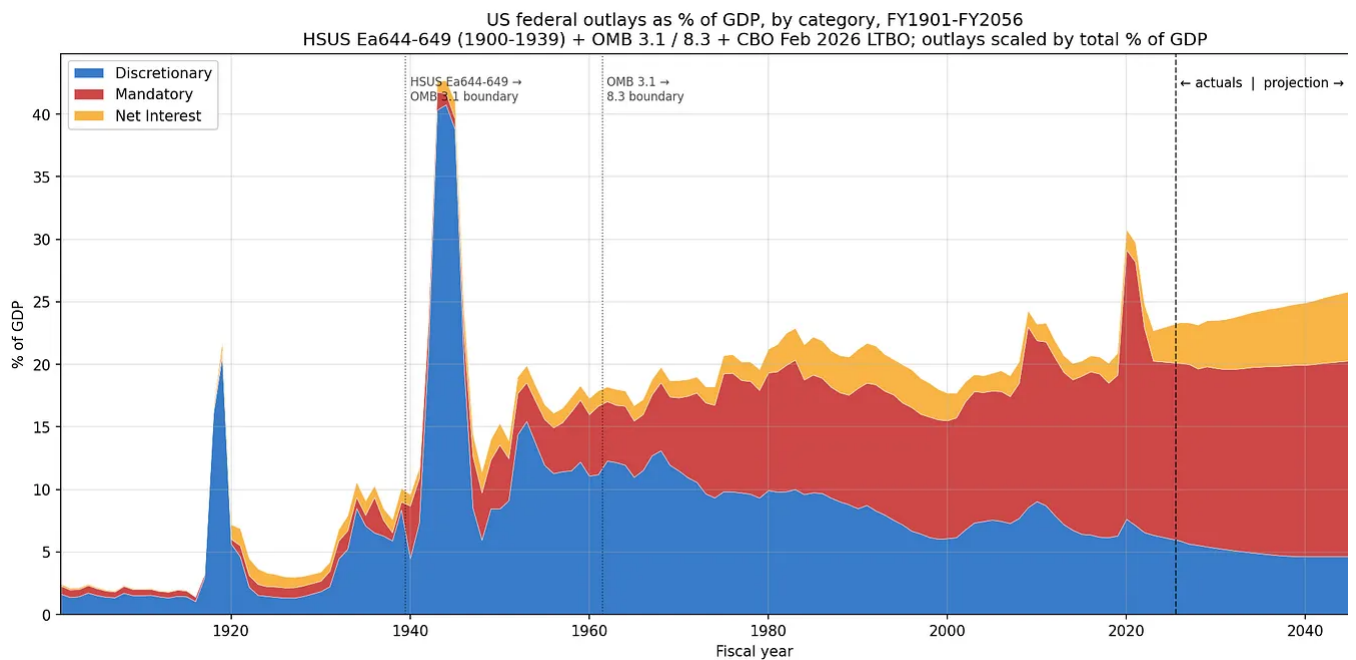


Figure 1. Discretionary spending, mandatory spending, and net interest as a percent of GDP for the federal government

At the start of the 20th century, the U.S. federal government was tiny. See Figure 1. At least in peacetime. Things are quite different now. Today, federal government spending accounts for about 23% of GDP, and that's set to increase to around 26% over the next 30 years. Approximately 60% of federal spending today is mandatory. That's roughly 13.7% of GDP. Social Security, Medicare, and Medicaid are the big drivers. Mandatory spending is projected to increase to 16.4% of GDP 30 years from now. That's mostly the result of the U.S. population aging. With the introduction of Social Security in the thirties and Medicare and Medicaid in the sixties, the federal government was transformed over the past 100 years into a giant pension insurance company with a small army.

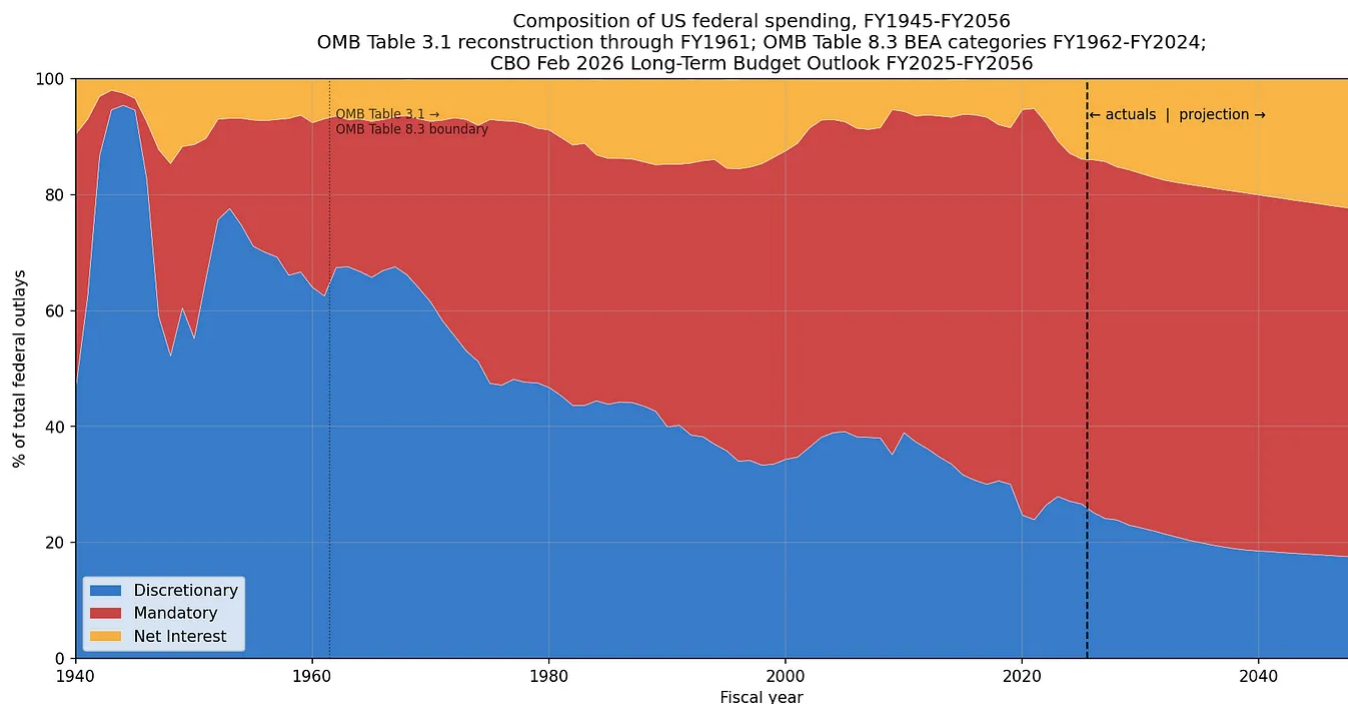


Figure 2. Composition of U.S. Federal Spending

Only 27% of federal spending today is discretionary spending, including defense. That's roughly 6.2% of GDP, and the remainder, 14%, is net interest spending. Interest paid on that stack was about \$880 billion in 2024 — 3.2% of GDP. Projects net interest to rise to 6.9% of GDP by 2056, more than doubling and overtaking the entire discretionary budget sometime in the early 2040s. That's shown in Figure 2.

Social Security beneficiaries

About 67 million recipients in 2024. Outlays of 5.2% of GDP in 2025, rising to 6.0% of GDP by the mid-2030s as the boomer cohort fully passes through, then leveling off (CBO LTBO). Two features distinguish the Social Security claim from the bondholder claim. First, the promises made to Social Security claimants are statutory, not contractual. They can be changed by an act of Congress. In addition, they're indexed to the CPI. A recipient's real benefit stream is protected against inflation in a way that a nominal bond is not.

Medicare beneficiaries

About 65 million enrollees in 2024. Net outlays of 3.3% of GDP in 2025, projected rise to 5.5% of GDP by 2056 (CBO LTBO). Medicare's claim has the same statutory entitlement character as Social Security but with an additional feature: the benefit is indexed implicitly via medical-cost growth. The federal government has committed *paying for the medical services delivered*. The real value of the Medicare claim is therefore tied to a price index — medical-care inflation — that has historically run above CPI by 1–2 percentage points per year. Like Social Security, Medicare benefits have not been cut in any significant way since the program's enactment in 1965.

Medicaid

Federal share of about 2.7% of GDP in 2025, projected to be essentially flat at 2056 (CBO LTBO). This is the major mandatory-health line item that *isn't* on a growth path as a share of GDP — partly because Medicaid is means-tested and benefits don't ramp up with population aging the way Medicare's do.

If you're a lawyer, you might argue that bondholders are the most protected claimants. See, for example, the 14th Amendment. Congress cannot unilaterally change coupon and principal payments on Treasuries, but it can do so for Social Security, Medicaid, and Medicare payments. Practically speaking, there's a good case to be made that transfer recipients are the most senior claimants of the U.S. Politically, it's very difficult to default on these promises. Demographics play a role here. These transfer recipients are mostly older Americans, and as the U.S. population has aged, they have come to represent a powerful voting bloc. That's why Social Security is typically referred to as the third rail of American politics.

If you buy into that notion, then these retirees collecting Social Security and Medicare checks, the boomers, effectively sit at the top of the US capital structure. If you apply the analogy with the corporate capital structure, then these beneficiaries are effectively the most senior bondholders. They own the safest tranche.³ (See the [paper on redistribution risk](#) by Gómez-Cram, Kung, Zeke and myself as an example.)

The Treasury's annual balance sheet — who claims federal resources, and how they get funded
Flows as % of GDP, FY2025 budget baseline vs FY2056 CBO LTBO projection

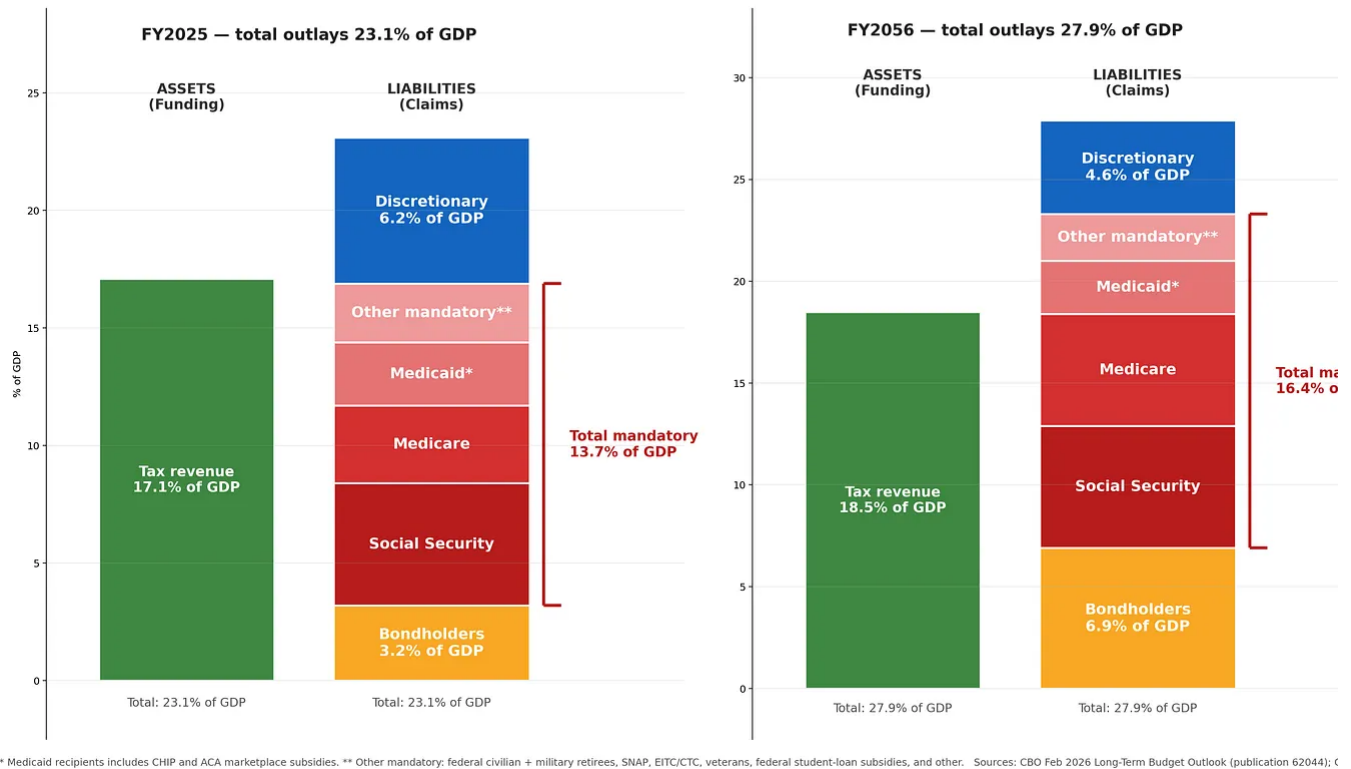


Figure 3.

In that scenario, the owners of the Treasuries, the bondholders, sit at the bottom capital structure rather than the top. The Treasury owners end up with the riskiest tranche, absorbing adverse fiscal shocks through either surprise inflation or fiscal repression, or a combination of both. And there is a lot of risk to be absorbed. So, that, take a look at Figure 3. All those mandatory spending promises shown on the liability side represent super-safe promises, but the tax revenue, shown in green on the asset side of the ledger, is quite risky. Tax revenue goes down dramatically in bad times, so the risk on the asset side of the U.S. doesn't just disappear. It's going to have to be absorbed by the riskiest tranche on the liability side, which, if we're correct, is held by the bondholders. COVID was a great example of this. Owners of U.S. Treasury securities lost about 15% in real terms.

It's not great to wake up and realize that you're at the bottom of the capital structure. That's part of what's happening to government bondholders in the US and around the world right now.

Sources for figures: CBO February 2026 Long-Term Budget Outlook (publication 62 for 2025–2056 projections and CBO eval-projections GitHub repository for historical actuals through 2025, both used in the Government Spending post. Treasury Bulletin marketable Treasury debt outstanding. SSA and CMS annual statistics for beneficiary counts.

- 1 Interest on the public debt is paid through a permanent, indefinite appropriation. Interest payments are automatic, but that doesn't mean these represent a secured claim on tax revenue. If the government runs out of cash, must it pay bondholders first?
 - 2 Mandatory/direct spending is governed by standing authorizing law — eligibility rules, benefit formulas — rather than set year by year. The money flows automatically as long as people meet the criteria, and the only way to change the amount is to amend the underlying authorizing statute. Discretionary spending, by contrast, is budget authority provided and controlled by the annual appropriations acts; if Congress doesn't appropriate, it doesn't happen.
 - 3 In most standard macro models, the bondholders and transfer recipients are essentially the same, and so these fiscal shocks are not priced. However, in the real world, bondholders are concentrated. Not everybody participates in the bond market. Bond ownership is concentrated. As a result, fiscal risk is priced. See the [paper on fiscal redistribution risk](#) by Gómez-Cram, Kung, Lustig, and Zeke as an example of this.
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DeLorean  1d

Raise corporate taxes, IRS fully funded, tax on wealth, social security tax cut-off is raised, etc. solutions that could be implemented to pay back the debt and fund universal healthcare, child etc.

The United States is not broke. The wealthy and big business (not mutually exclusive) have high tax policy, it's not complicated.

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6 replies



Mikael P 17h

I don't think inflation can cover the US budget deficit for long when so many government liabilities are linked to it. In the end, bondholders will finance the deficit, and even if they got kicked around during the COVID inflation wave, they're going to have more influence than pensioners, who don't fix anything.

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