EPIC Explainer: The 2025 Fiscal Cliff

2025 will bring the most consequential set of fiscal policy decisions in modern American history. $5 trillion in new debt is coming. Lawmakers must act to prevent an economic crisis as major fiscal challenges continue to stack up in 2025.

What Makes 2025 a Fiscal Cliff Year?

In 2025, several key fiscal inflection points will come to a head in a short period of time. In total, EPIC's President and CEO Paul Winfree – who first identified the 2025 fiscal cliff – expects about **$5 trillion in new debt to hit in 2025 if current policy is continued**.

The implications of this new debt are massive. Already, federal debt sits at levels not seen since post-World War II. As new debt piles on, fiscal space will erode; this means the government will not have the financial room to respond to emergencies and pursue policy initiatives without compromising economic stability. EPIC has estimated that the country will begin running out of fiscal space in the next 15 years, threatening a debt spiral and the ability to manage future crises. **To prevent this, Congress must *reduce* the primary deficit by $2.1 trillion over the next decade.**

The Debt Limit

The debt limit is the maximum amount the Treasury is statutorily allowed to borrow to fund the federal government's operations. The debt limit applies to all borrowing authorized to meet existing legal obligations (*i.e.*, Social Security, tax refunds, interest payments). The limit is currently suspended until January 1, 2025, under the Fiscal Responsibility Act. When it is reinstated, the Treasury will use extraordinary measures to extend the X-Date (the date by which the debt limit must be increased to allow the government to pay its obligations on time).

Congress will have to increase the debt limit as early as June 2025, and almost certainly before the 2025 August recess, to allow the Treasury to have maximum borrowing authority.

Preventing The Largest Tax Increase in History

Several key provisions of the 2017 Tax Cuts and Jobs Act are set to expire in 2025, including the individual rates, increased standard deduction, small business passthrough deduction, and more. An extension and reforms will be necessary to prevent tax increases on Americans and support a broader pro-growth economic agenda.

Most of the major TCJA provisions will expire at the end of 2025.

Discretionary Spending Caps

The Fiscal Responsibility Act established caps for both defense and non-defense discretionary spending for fiscal years 2024 and 2025. The enacted deal does not establish enforceable discretionary spending caps for fiscal year 2026 and beyond. This means Congress will have to negotiate a new deal to reach a topline spending level – the 302(a) allocation – for the FY 2026 appropriations bills.

The 302(a) should be included in the FY 2026 budget resolution. Congress will need agreement on discretionary spending levels to write the appropriations bills and enact them before the end of the FY 2025 fiscal year on September 30, 2025.

Completing FY 2025 Appropriations

The Continuing Resolution enacted in December extended FY 2025 appropriations until March 14, 2025. The full-year FY 2025 topline discretionary spending levels are capped by the Fiscal Responsibility Act. If another continuing resolution is in effect on April 30, 2025, alternative caps allowing higher non-defense and lower defense levels would be enforced.

The Continuing Resolution expires on March 14, 2025.

Farm Bill

The Farm Bill reauthorizes nutrition assistance and farm subsidy programs. Food Stamps and other welfare programs make up about 80% of the $1.4 trillion ten-year baseline cost of the Farm Bill programs, with crop insurance, commodity subsidies, conservation, and other subsidy programs comprising the remaining 20% of the cost. Promoting opportunity by strengthening Food Stamp work requirements and closing loopholes will be a priority.

The Continuing Resolution extended the authorization for Food Stamps through October 1, 2025, while farm subsidy programs are authorized through December 31, 2025.

Obamacare Subsidies

The Affordable Care Act created the Premium Tax Credit (PTC), a refundable tax credit that acts as a federal subsidy to artificially lower the cost of Obamacare premiums. Ultimately, the PTC drives up health care costs overall. The American Rescue Plan Act (ARPA) expanded eligibility for Obamacare subsidies to those over 400% of the federal poverty level (FPL). In 2024, 400% of the FPL for a family of four amounts to $124,800. ARPA expanded the PTC to subsidize plans for families making much more than that – in some cases, the subsidies could go to families making as much as $599,000. This expansion was then extended by the Inflation Reduction Act.

Expanded PTCs are set to expire December 31, 2025.

State and Local Funding

Following the COVID-19 pandemic, major spending bills included hundreds of billions of dollars to state and local governments, including through the ARPA's Coronavirus State and Local Fiscal Recovery Fund. These dollars have been used to prop up state programs (including wasteful projects) and pay the salaries of local bureaucrats. Since the funds have been made available, about 20% of all new jobs created were state and local government jobs. In a normal, healthy economy, less than 10% of new jobs are state and local government jobs. In 2025, state and local governments – in particular, mayors – are likely to make requests to Congress for additional funding. These demands will be made even though state rainy day funds have doubled and state and local rainy day funds have increased 24% since 2020.

Even under Treasury's new rule, all SLFRF funding must be obligated by states before January 1, 2025, and spent by December 31, 2026.

Reconciliation

At the same Congress is navigating the components of the Fiscal Cliff, it will also be focused on using the budget reconciliation process to advance important priorities. While there are no pre-established inflection dates for reconciliation, the process requires significant time and effort.