Reduced Government Spending and Your Investments

By: www.ProfitableInvestingTips.com

Eventually the United States needs to reduce its national debt by taxing more, spending less, or both. To a degree, spending by the US government would be expected to go up along with inflation and a growing economy. Unfortunately, government spending has outpaced the nation's ability to pay every year since the end of the Clinton administration and, before that, the early years of Nixon's presidency. Interest on the national debt threatens to become a larger cost than other major parts of the budget. To the degree that belt tightening is chosen as a way to solve this problem, we need to look at reduced government spending and your investments.

Debt Limit Crisis Number 79 Since 1960

According to the Department of the Treasury, this is the seventy-ninth time since 1960 that the US has exceeded or threatened to exceed its statutory debt limit. This has always been resolved before an actual default happened. The situation has now arisen thirty times with Democratic presidents and 49 times with Republican presidents. Today we are again seeing Congress and the President haggling over raising the ceiling on United States debt. This is an old story that goes back to before WWII when the idea of a ceiling on US debts was first put into law.

President Biden's argument is that the US should pay its debts first and then negotiate any necessary budget reductions and/or tax increases. House of Representative Speaker McCarthy insists that any agreement to raise the debt ceiling must include legislation now to reduce Federal spending. A real worry at this point in time is that politics will get in the way of a practical solution and result in a **US debt default**. When the crisis has been dealt with the solution will have investment repercussions that will last much longer than the current debt limit crisis.

Government Spending and Aggregate Demand

When the US has been creeping toward a recession Congress has often spent money to "stimulate" the economy. Increased spending on an area like defense commonly produces more jobs, more wages, and even more tax revenue. Likewise, decreased government spending tends to slow the economy. The term used by economists is **aggregate demand**, which is the sum total demand for all goods and services in an economy. When aggregate demand falls too far, the economy shrinks over successive quarters and we have a recession. This is one of the risks of trying to fix the US debt problem through budget cuts alone.

What Items Get Cut in Order to Balance the Budget?

This is always the crux of the argument (along with possible tax increases) when there is a fight over the budget. Discretionary spending is targeted in the Republican bill passed by the House of Representatives.

Specific items include grants for schools that serve large shares of low-income students, servicemember pay, weapons programs, money to fund research on cancer and other life-threatening diseases, and rental assistance to house millions of poor and disabled. These are items passed by appropriations bills. Spending on Medicare and Social Security is spared. Forgiveness of student loans payments, much of the Biden program for green energy would get the ax. Work requirements would be increased for Medicaid, food stamps, etc.

Meanwhile, Biden and Democrats who control the Senate will want higher taxes on people making more than $400,000 a year and a rollback on **Trump tax cuts**.

How Budget Cuts Will Affect Investments

To the extent that dramatic budget cuts slow the economy or even cause a recession, a wide range of investments will be affected. We can probably leave out defense because no one is talking about cutting defense spending. Tech companies may have more layoffs but their stock prices may or may not suffer. Consumer stocks would suffer to the extent that budget cuts bring on a recession. They will also suffer to the extent that the pain of budget cuts is borne by the poor, sick, and elderly as opposed to those with high salaries, savings, stock portfolios, and/or trust funds.

To the extent that Republicans succeed in rolling back Biden's agenda, changes will affect bringing computer chip production back to America, fixing infrastructure, transitioning to electric vehicles, and accelerating renewable energy production. Companies from Tesla to Ford, Intel to IBM, Commonwealth Fusion Systems to Helion Energy Inc. to Zap Energy Inc. (nuclear fusion research) will be affected. Add any of the US companies working on innovative ways to bring strategic mineral production and processing back to the USA or companies involved in fixing bridges, airports, or transit systems.

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