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The Implications and Fallout of the US Debt Ceiling Crisis

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SYNOPSIS

The recent US debt ceiling crisis revived fears that America's divisive domestic politics are once again distracting it and undermining its foreign policy at a critical juncture in the Asia-Pacific. The crisis has raised questions about the United States' staying power and priorities in the region. ***ADRIAN ANG U-JIN*** writes that the debt ceiling deal between President Biden and Speaker McCarthy does little to address the structural imbalance at the root of the country's debt problem. He expects to see yet another debt ceiling crisis in the coming years.

COMMENTARY

In early May, the White House announced that President Joe Biden would be the first sitting president to visit Papua New Guinea as part of his Asia trip to attend the G7 summit in Japan and the Quad leaders' summit in Australia. The visit was intended to highlight the administration's re-engagement with the Pacific region after decades of neglect, as the United States attempts to counter China's increasing influence. In Port Moresby, Biden was scheduled to have bilateral talks with his hosts, witness the signing of a new Compact of Free Association agreement (COFA) with Micronesia, and meet with 18 leaders from the Pacific Island Forum.

A mounting crisis over the US debt ceiling, however, prompted Biden to cut short his trip. He proceeded to Hiroshima to rally the other G7 countries to toughen measures against Russia and counter China's "economic coercion", and met with the other Quad leaders on the sidelines of the summit, but returned to Washington afterwards for negotiations with congressional Republicans. US National Security Adviser Jake

Sullivan said Biden would arrange another summit of Pacific island leaders later this year.

Déjà Vu All Over Again

The optics of President Biden cutting his Asia trip short are not good and carry a sense of déjà vu. In 2013, then President Barack Obama cancelled his trip to Asia where he had been slated to attend the Asia-Pacific Economic Cooperation (APEC) summit in Bali and the ASEAN-organised East Asia Summit in Brunei so that he could deal with the looming debt ceiling crisis at home. The Obama administration never recovered from that stumble, and its pivot to the Pacific never materialised.

Biden's own debt ceiling crisis revived fears that America's divisive and dysfunctional domestic politics are once again distracting it and undermining its foreign policy at a critical juncture in the Asia-Pacific. The administration has been at pains to convince the region that it is fully committed to its Indo-Pacific strategy, to countering growing Chinese assertiveness, and to bolstering the region's "rules-based order". The "postponement" of Biden's visits to Papua New Guinea and Australia once again raises questions about the country's staying power and priorities.

Questioning American Economic Stewardship

The debt ceiling crisis also raises more questions about the United States' economic stewardship. When Obama cancelled his trip to Asia in 2013, the impasse with congressional Republicans was over whether to increase the country's $16.7 trillion debt ceiling. A decade on, the US debt (excluding intragovernmental loans) stands at $24.5 trillion, which works out to 98% of GDP or $91,189 per capita. The non-partisan Congressional Budget Office (CBO) projects that the public debt will reach 118% of GDP by 2033 – which would be the highest level ever recorded.

The US debt level is so high because the federal government runs persistent budget deficits, averaging annual $1 trillion budget deficits since FY2001 – the last time America had a budget surplus. To finance these deficits, the US government borrows money by selling various securities (bonds, bills, notes, etc.). The statutory debt ceiling is the maximum amount that the Treasury Department is authorised by Congress to borrow. Once that ceiling is reached, Congress must vote to suspend or raise the limit on borrowing or risk defaulting on its debt obligations.

Self-Induced Debt Limit Crises

Since 1960, Congress has raised or suspended the debt ceiling 78 times; it has also done so in a bipartisan fashion – 49 times under Republican administrations and 29 times under Democratic presidents. The "Gephardt Rule" – named after former Democratic representative and Speaker Richard Gephardt, who introduced the rule – stipulated that when the House of Representatives adopted a budget resolution for a fiscal year, the statutory debt limit was also deemed to be passed without the need for a separate vote. The Gephardt Rule, which was adopted in 1979, was repealed at the beginning of the 112th Congress in 2011 by the new Republican-led House.

It is no coincidence that the repeal of the Gephardt Rule has resulted in more acrimonious and debilitating impasses over the raising of the debt ceiling, fuelled by deepening political polarisation. In 2011, the stand-off between Obama and congressional Republicans over raising the debt ceiling brought the country to the brink of default, prompting Standard and Poor's (S&P) to downgrade the United States' top tier AAA credit rating to AA-plus; S&P still retains the downgraded rating for the United States. In May, Fitch placed the United States' AAA credit rating on a negative watch, warning that it could still downgrade the country's credit rating despite the debt ceiling deal between President Biden and Republican House Speaker Kevin McCarthy. Like S&P a decade earlier, Fitch expressed concerns about the recurring brinksmanship and worsening polarisation over the debt ceiling.

Kicking the Can Down the Road

The deal struck by President Biden and Speaker McCarthy – the Fiscal Responsibility Act – suspends the debt limit through 1 January 2025, in exchange for capping discretionary spending for the next two years (though growing defence spending by 3.5%) and adjusting work requirements for certain food assistance programmes. Biden and McCarthy have taken plaudits for averting a debt default, but their deal simply kicks the can down the road – avoiding another debt ceiling crisis until after the 2024 presidential elections.

And there will be another debt ceiling crisis. The deal's touted $1.5 trillion in savings will neither fully materialise, nor will it even come close to altering the debt curve's projected upward trajectory, since it leaves the biggest driver of the debt – mandatory spending on entitlement programmes – untouched. Further, with debt continuing to rise, CBO projects that annual interest costs will rise to $1.4 trillion in 2033 – dwarfing even defence spending.

US President Joe Biden and Speaker of the US House of Representatives Kevin McCarthy recently passed the Fiscal Responsibility Act in a bid to manage the US debt ceiling crisis. However, the deal does little to address the root of the country's debt problem. *Image from Wikimedia Commons.*

The best that can be said about the debt deal is that it avoided a catastrophic default. It did little, however, to address the structural imbalance at the heart of America's chronic debt ceiling crises – insufficient revenues to pay for ever-increasing spending – and to place its finances on a more stable and secure basis. It also did little more than paper over the underlying toxic political polarisation that has turned once-routine debt ceiling negotiations into potentially catastrophic games of chicken. Republican right wingers – thought to be big losers in the debt ceiling deal – have just flexed their political muscle in the House, serving notice that they will not get rolled again.

Conclusion

The crisis will strengthen the hands of critics who argue that the global financial system should not be held hostage to the United States' fiscal profligacy and political recklessness. The Federal Reserve's aggressive rate hikes last year and the collapse of Silicon Valley Bank earlier this year highlight the interconnected nature of the global financial system as well as its susceptibility to contagion emanating from the United States – its epicentre. What happens financially in the United States has ripple effects around the world – very often deleterious ones. The debt ceiling crisis will also add criticism to America's "exorbitant privilege" of having the dollar as the global reserve currency. The dollar's global dominance ensures an easy conversion of dollars into Treasury securities and provides a cheap source of deficit financing. Such a privilege, however, should carry with it a special responsibility for America's political leaders to consider the implications of their actions on the global economy. Failure to do so undermines the trust in the full faith and creditworthiness of the United States and will accelerate moves to "de-risk" and de-dollarise.

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