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Analysis of today
Assessment of tomorrow

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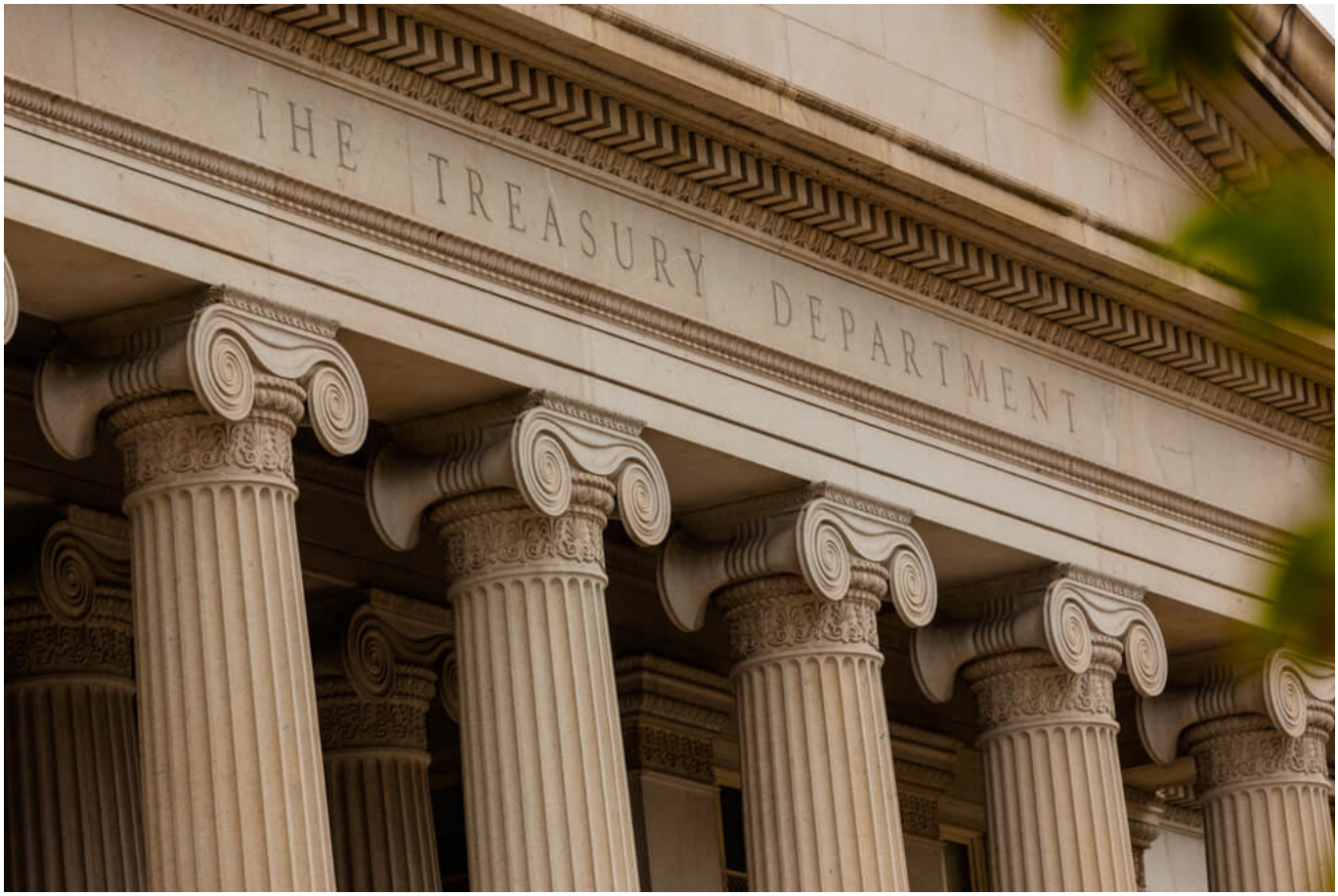
What is the price of Republican populism regarding the debt ceiling?



US public finances are once again entering the crisis zone due to the obstacles in Congress to raise the debt ceiling and thus avoid blocking financing of government obligations. The situation is reminiscent of 2011, when, because of the battle in Congress over the same issue, Standard & Poor's lowered the US government credit rating for the first time in history.

Neither the US economy nor the global economy wants that to happen again, because if the problems with servicing the US government's obligations continue, the consequences for the entire financial system could be very unfavourable.

On the wings of a new majority in the House, Republicans have been rejecting government's demands to raise the debt ceiling and continue borrowing that would enable smooth payment of the government's obligations.

They want the government to cut its spending instead of asking for raising it. "You couldn't just keep borrowing and borrowing and borrowing because what you're doing is you're bankrupting this country and bankrupt these entitlements if we don't change their behaviour today", new House Speaker Kevin McCarthy told Fox News.

An introduction to a protracted crisis

This position of Republicans radiates pure populism, not sincere concern for the state of public finances. During Donald Trump's term, the party voted three times in favour of raising the debt ceiling, while not asking for a cut in government spending.

Republicans want to make the most of their new majority in the House, plunging the Democrat administration into a crisis period that could last a long time. As long as possible and as close as possible to the next presidential elections. But at what cost?

The US reputation at global level will inevitably decline with a new public finances crisis. It will deal with problems that are reserved for developing economies: debt default, ratings downgrade, and postponement of payment of state obligations.

Even worse, if the US government is at risk of a credit rating downgrade, it would mean higher interest rates on government bonds, more expensive borrowing, a loss of investor confidence, a weaker dollar, lower stock markets and more layoffs.

On January 19, US Treasury Secretary Janet Yellen informed Congress that the government had reached the borrowing limit of about 31.4 trillion dollars and requested its unconditional increase, so that the payment of obligations could continue unhindered.

Dangerous redistribution of priorities

However, some Republicans are asking the government to redistribute payments according to priorities, which effectively means that some recipients of public money would be deprived of financial assistance.

This leads to further consequences, when the government finds itself in the impossible position of choosing whether to prioritise payments to veterans, social services, healthcare or foreign creditors.

Making debt payments but not paying for federal operations could also prompt legal challenges, such as from government contractors who might question whether

foreign creditors should get paid before them, Brian Riedl, a senior fellow at the Manhattan Institute told the WSJ.

“You’re telling voters that we’re going to make sure Chinese bondholders get paid before your cousin’s veterans’ healthcare benefit and before your kid’s school lunches”, he said.

President Joe Biden refused to negotiate with Republicans on the terms they have set for the government.

“I will not let anyone use the full faith and credit of the United States as a bargaining chip. We pay our debts”, President Biden said in Virginia on Thursday. The Washington Post wrote that it was a potential preview of what Biden might say on the campaign trail in 2024.

The party conflict over the otherwise routine issue of raising the debt ceiling, initiated by the Republicans, is an introduction to political positioning before the 2024 elections.

Keeping the democratic administration in a problem regarding the payment of government obligations could last for a long time, and could cause political damage to all those who are beneficiaries of public money.

However, the question of how much the new tightening of the debt ceiling will cost the US economy, for the first time in a decade, leads to another question: whether any future administration will have the resources to repair the damage it has caused?

The US is not only the world's largest economy. It is also the most liquid and safest debt market in the world. This new political manoeuvre by the Republicans puts both titles at risk, producing turmoil not only in their country, but also globally.