TA Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

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The debt ceiling matters

Many economists find that the drama that surrounds the risk of government shutdowns and the debt ceiling is unnecessary. Politicians have lifted it 78 times and plan to raise it again in the future. Therefore, many argue that it is time to question its very existence.

The U.S. federal debt stands at $36 trillion and rising, and the new limit will add a further $1.5 trillion. However, this argument misses the point. If the debt limit did not exist, the government would have raised debt even faster.

Negotiating the debt ceiling is essential to curb the interventionist aspirations of some governments, which could lead to even faster increases in deficit spending. Imagine other administrations spending as much as they wanted.

Today, we would witness a significantly higher U.S. federal debt and a decline in the purchasing power of the U.S. dollar.

The important element of the latest proposal is a commitment to raising the debt ceiling by $1.5 trillion early in 2025, added to a $2.5 trillion reduction in mandatory spending.

This proposal holds significant relevance as the primary cause of debt accumulation is the escalation of expenditure obligations beyond the direct control of the government.

By increasing efficiency and cutting administrative costs, the U.S. can significantly reduce mandatory spending without compromising service quality.

Debt will soar in the next 10 years

The Congressional Budget Office's projections of mandatory expenditure for the 2025–2034 period total $51.4 trillion. This means that the United States could enter a debt crisis and a likely erosion of the world reserve currency status of the U.S. dollar even if administrations limit the discretionary spending part of the budget.

According to the CBO report, debt will soar in the next ten years "as increases in interest costs and mandatory spending outpace decreases in discretionary spending and growth in revenues." Furthermore, the CBO expects an aggregate primary deficit in the 2025–2034 period of $7.4 trillion.

Authorities with monetary sovereignty, like the U.S., cannot issue unlimited debt and expect the world to ignore it. The government has three limits when it comes to issuing debt.

Fiscal limit: The United States government raises taxes, but the receipts barely keep up with the increase in expenditures. As a result, the deficit and debt continue to rise, raising concerns about the nation's solvency. No revenue measure can even begin to cover the annual deficit, indicating a clear breach of this limit.

Budget limit: Despite low interest rates and Federal Reserve easing, the interest expense portion of the budget surges, posing an insurmountable burden. The annual interest expense approaches $1 trillion, surpassing the defence budget.

Inflationary limit: Despite being the world's reserve currency and leading in technology and energy production, the U.S. has experienced cumulative inflation in the past four years exceeding 20.5%, and the latest core PCE index figures indicate persistent and concerning inflation.

America needs a pro-growth strategy

If the United States does not reduce its spending, it could potentially lose its status as the world's reserve currency, as more central banks are abandoning Treasury securities in favour of gold, and international investors are buying fewer federal bonds.

The last available figure shows a decline in global foreign demand for Treasuries from 100% of net issuances less than twenty years ago to less than 20%.

The United States needs this $2.5 trillion cut in mandatory spending to avoid the destruction of the purchasing power of the currency- Daniel Lacalle

As the world demands less federal debt and loses confidence in the solvency of the U.S. government, more debt, which means more money printing, will be eroding the purchasing power of the U.S. dollar and making all citizens poorer.

Loss of confidence in the solvency of the government comes from the evidence that public finances have become unsustainable. Those who argue that it doesn't matter because it hasn't happened yet are misinterpreting history and statistics.

It's akin to driving at 200 mph on a highway and thinking, "We haven't killed ourselves yet; let's accelerate."

The United States needs this $2.5 trillion cut in mandatory spending to avoid the destruction of the purchasing power of the currency, the loss of confidence in the U.S. public finances, and, ultimately, the collapse of the dollar as the world reserve currency.

America needs a pro-growth strategy focused on strengthening the private sector and the productive economy and a real chainsaw approach to public spending.

In Argentina, president Javier Milei has demonstrated that a government can transition from a significant deficit to a fiscal surplus within a month, effectively reducing debt, bolstering public finances, and simultaneously combating inflation and poverty.

Reducing expenditure, debt, and deficit is not just a logical priority; it is urgent if the U.S. wants to remain as the world leader with the most desired currency.