**The US debt row**

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Saturday, May 20, 2023

As US President Joe Biden prepares to reengage in negotiations with House Speaker Kevin McCarthy and other influential Republicans on the critical issue of the debt ceiling to find common ground amidst a landscape riddled with challenges, constitutional experts warn of the potential ramifications should they fail to forge an agreement on this matter.

The stakes are high. Inaction or an impasse in these deliberations will catapult the US perilously close to defaulting on its debt obligations. Such a once-unthinkable scenario will have far-reaching consequences, reverberating across financial markets worldwide and threatening to upend the delicate balance of the global economic order.

The intricate negotiations taking place within the hallowed halls of Congress carry severe implications for the US and the world. The outcome will determine whether the US treads on the path of fiscal responsibility or inches closer to the precipice of default. US President Biden’s leadership and the engagement of McCarthy and other congressional leaders will be pivotal in charting a course forward that avoids the impending danger.

The eyes of the world are fixed on this crucial juncture, cognizant of the potential reverberations that could ensue from the failure to reach a consensus. Their ability to rise above political divides and find common ground will determine not only the economic fate of the US but also its standing on the global stage. The world awaits the outcome with bated breath, hopeful for a resolution that will avert financial calamity and reaffirm the strength and resilience of America’s democratic institutions.

If the US defaults on its debt, it will significantly diminish the dominance of the US dollar in the global financial landscape and weaken the country’s ability to shape international affairs. Adding to Washington’s woes, the unresolved banking crisis and the intensifying bipartisan struggle over the debt ceiling further exacerbate the situation, with small and medium-sized banks facing a potential ‘death spiral’ and a subsequent economic slowdown.

As the world’s largest economy that leverages the strength of the dollar, economic problems plaguing the US can have negative ramifications for other countries. Can a US debt default unleash a ‘financial atomic bomb’? The US has seen an atypical pattern in the last few years, where the two major political parties engage in high-stakes brinkmanship when it comes to the debt ceiling. What was once a procedural formality has now evolved into a formidable challenge, as bipartisan agreement on this critical matter becomes increasingly elusive with each passing year.

The debt ceiling, once a routine legislative procedure, has now morphed into a battleground for partisan disputes and ideological clashes. Gone are the days when raising the debt ceiling was viewed as a routine step to ensure the continued functioning of the government and the fulfilment of its financial obligations. Instead, it has become a contentious point of contention, emblematic of the broader political divide that permeates the Capitol Hill.

In 2011, when the US was last perceived to be teetering on the brink of default, negotiations pushed the limits of time, with a compromise agreement reached just hours before the deadline. This agreement entailed $900 billion in spending cuts spread over a decade.

However, even temporary delays in reaching a resolution carry significant consequences. The 2011 standoff left an indelible mark on the country’s financial landscape. It triggered a downgrading of the US credit rating, causing tremors in the stock market and shaking investor confidence. The repercussions extended beyond the realm of financial markets, impacting the Americans directly, who faced an additional burden of at least $1.3 billion in elevated borrowing costs during that year alone.

One may ponder why the debt limit engenders such deep divisions and contentiousness among policymakers. The answer lies in the complex interplay of political ideology, fiscal responsibility and divergent views on government spending. US President Joe Biden and Democrats in Congress have been pushing for an increase in the government’s borrowing limit of $31.4 trillion without any conditions since the start of the year. However, Republicans, who hold a slim majority in the House of Representatives, insist on establishing new spending limits for the future before approving further payments to cover previously authorized expenditures.

Also, the debt limit debate intersects with broader partisan dynamics, reflecting the deep political polarization that characterizes contemporary American politics. It has become an arena for power struggles, with each party using the issue as leverage to advance its policy agenda and extract concessions from the opposition. The intricate nature of the debt limit issue makes it susceptible to political posturing, brinkmanship and last-minute negotiations.

The consequences of failing to reach an agreement on time are grave, with potential disruptions to financial markets, increased borrowing costs and damage to the global economy. The Republican Party has adopted a relatively atypical strategy, driven by a conviction that the current trajectory will inevitably result in economic and societal devastation. For many Republicans, this approach is seen as a necessary measure to create a potential crisis for US President Biden and Democrats. These divergent perspectives on the debt limit reflect deeper ideological divisions between the two parties, shaping their respective approaches to fiscal responsibility and the role of government in society.

This heightened level of polarization and gridlock has cast a shadow of doubt over the ability of Congress to effectively address the country’s fiscal challenges. As the debt ceiling looms overhead, the consequences of a failure to reach a timely agreement become increasingly grave, with potential implications for the stability of the economy and the wellbeing of the American people. The US finances its budget deficit by issuing bonds, and the debt ceiling is the limit imposed by Congress on how much the federal government can borrow to meet its financial obligations.

Reaching the debt ceiling signifies that the borrowing capacity of the US Treasury Department has been exhausted. Raising the debt ceiling allows the federal government to issue new debt to repay old obligations. The current US debt ceiling stands at approximately $31.4 trillion. This limit was breached in January, prompting the Treasury Department to employ “extraordinary measures” to avoid defaulting on its debt. The failure to legislate an increase in the debt ceiling will plunge the US back into a state of default.

If the US were to default on its debt obligations, the repercussions would be severe, encompassing a range of undesirable outcomes. Among the potential consequences are the downgrading of treasuries, resulting in diminished trust and confidence in US government bonds. This, in turn, would lead to elevated borrowing rates for American consumers, corporations, and the government itself. Global investors may opt to sell off their dollar-denominated assets, causing the value of the dollar to depreciate in foreign exchange markets. Stock markets would likely experience a sharp decline, with negative implications for investors and the overall economy.

The situation could be exacerbated if a rush to close positions occurs simultaneously, straining the central counterparty clearing house – the essential infrastructure that supports the financial system – potentially leading to its collapse. The potential fallout from a US default underscores the criticality of reaching an agreement to avert such a dire scenario. While these are viewed as short-term consequences, the US could also suffer permanent economic losses and a diminished ability to shape global affairs if a debt default occurs.

The US’s position of economic strength, bolstered by the dominance of the dollar, provides several advantages in managing its foreign debts. Repayment in its own currency affords American companies a distinct advantage in global trade and finance, as they face less vulnerability to currency fluctuations compared to their foreign counterparts.

Additionally, the prevalence of dollar denominations in international trade facilitates a significant concentration of power in the hands of the US government. This is exemplified by the utilization of dollar-denominated sanctions as a political tool against other nations.

In the intricate dance of political negotiations, the urgency surrounding the debt ceiling looms large, casting a shadow of uncertainty over the American economic future. According to Moody’s Analytics, the consequences of prolonged discord between the two parties could be severe: stock prices will fall by nearly one-fifth, the economy will shrink by more than four per cent, and more than seven million jobs will be lost in the wake of this fiscal impasse.

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