Outlook

Debt Limit Deal Is In Place, But Budget Deficit Is Still A Multi-Decade Challenge For US Government

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Even with the new spending restraints in the debt limit deal that cut borrowing by USD 1.5 trillion, the US government's deficits are still on course to keep climbing to record levels over the next few decades.

The projections are a sign that the two-year truce between President Joe Biden and House Speaker Kevin McCarthy, R-Calif., might be only a pause before a far more wrenching set of showdowns over the federal budget.

The Congressional Budget Office said Tuesday that the agreement would reduce spending by USD 1.3 trillion and interest payments by USD 188 billion over 10 years. But that sum is too modest to fully offset the growing costs of Social Security, Medicare and Medicaid.

Both Biden and McCarthy ruled out any cuts to Social Security and Medicare, two programs that benefit older voters, before their teams even began their budget talks. That omission reflects the politics around two popular programs as Democrats and Republicans prepare for next year's presidential election.

It also means the agreement finalized on Sunday keeps the risk of ever-escalating debt on the table, setting up the possibility of another bruising battle when the debt limit needs to be raised again in 2025.

"You should think of this as one step," said Marc Goldwein, senior vice president at the Committee for a Responsible Federal Budget. "The question is, can they take the next step after that?"

Lawmakers know there are difficult choices ahead and that the only way through them likely involves some combination of deep spending cuts, broad tax hikes and major changes to the retirement income and health care programs that consume an ever-growing share of federal spending.

Mandatory spending — which includes Social Security, Medicare and Medicaid — already account for the majority of government spending. That category is equal in size to 14 per cent of US gross domestic product, and the CBO expects it will grow to 15.6 per cent by 2023. By contrast, discretionary spending was 6.5 per cent of gross domestic product last year and was already projected to fall to 6 per cent within 10 years.

Goldwein said he's optimistic that leaders in both parties will find ways to reduce the growth in spending for health care programs. Social Security will also face a reckoning as its trust fund will be unable to pay out full benefits within a decade.

But some budget experts saw the deal as more focused on optics than sustainability.

"This debt limit agreement is shaking out to be a political face-saving deal without much substance in terms of changing the US debt trajectory," said Romina Boccia, director of budget and entitlement policy at the libertarian Cato Institute.

The agreement, which still has to be approved by Congress, would hold discretionary spending essentially flat for the coming year, while allowing increases for military and veterans accounts. Spending growth would be capped at 1 per cent for 2025, essentially a cut given the likely rate of inflation.

Some Democratic allies see the deal as problematic because it cedes ground to Republicans who want to use the debt limit fight as an opportunity to press their policy aims, despite the risk of a default.

"Looking forward, we must find a path to abolish the debt ceiling and end the absurd debt ceiling hostage-taking that Republicans engage in when they can use it as a bludgeon against a Democratic president," said Sharon Parrott, president of the Center on Budget and Policy Priorities, a liberal think tank.

Other economic analysts took issue with GOP suggestions that the US was already hamstrung by debt, even though investors continue, for the moment, to buy Treasury notes. While total federal debt — including money the government owes itself — exceeds USD 31 trillion, the US economy possesses more than USD 143 trillion worth of non-financial assets in a sign that the current debt loads are manageable.

"It is simply not true that the United States is broke and on the verge of a debt and deficit crisis," said Joe Brusuelas, chief economist at the consultancy RSM US.

But even if there isn't an immediate reckoning over debt, there is a long-term problem that the talks purposefully ignored. The president challenged Republicans to shield Social Security and Medicare from cuts at his State of the Union address in February. GOP lawmakers jeered him for suggesting they would dare to cut the programs, leading Biden to declare, "We've got unanimity."

Biden specifically hailed the bipartisan agreement on Sunday for protecting Social Security and Medicare, while saying the agreement that must pass the House and Senate would prevent a possibly catastrophic default that could occur on June 5.

"This is a deal that's good news," the president said, "for the American people."

House members received a specific briefing in March indicating that entitlement programs would drive up the debt. CBO director Phillip Swagel gave a presentation showing that publicly held debt would more than double to 195 per cent of gross domestic product in 2053. The key challenge is that an aging population means that programs for older people have costs that exceed tax revenues.

Swagel provided 17 policy options for reducing the debt, six of which were tax hikes that could raise trillions of dollars over 10 years. Tax increases have been a nonstarter with Republicans, while Democrats have generally shied away from reductions to benefits.

His slide deck included this warning: "The longer action is delayed, the larger the policy changes would need to be."