Montreal Economic Institute
Ideas for a More Prosperous Nation

ViewPoint

on the increase of the U.S. debt ceiling

by Germain Belzile, Director of Research at the MEI | August 2011

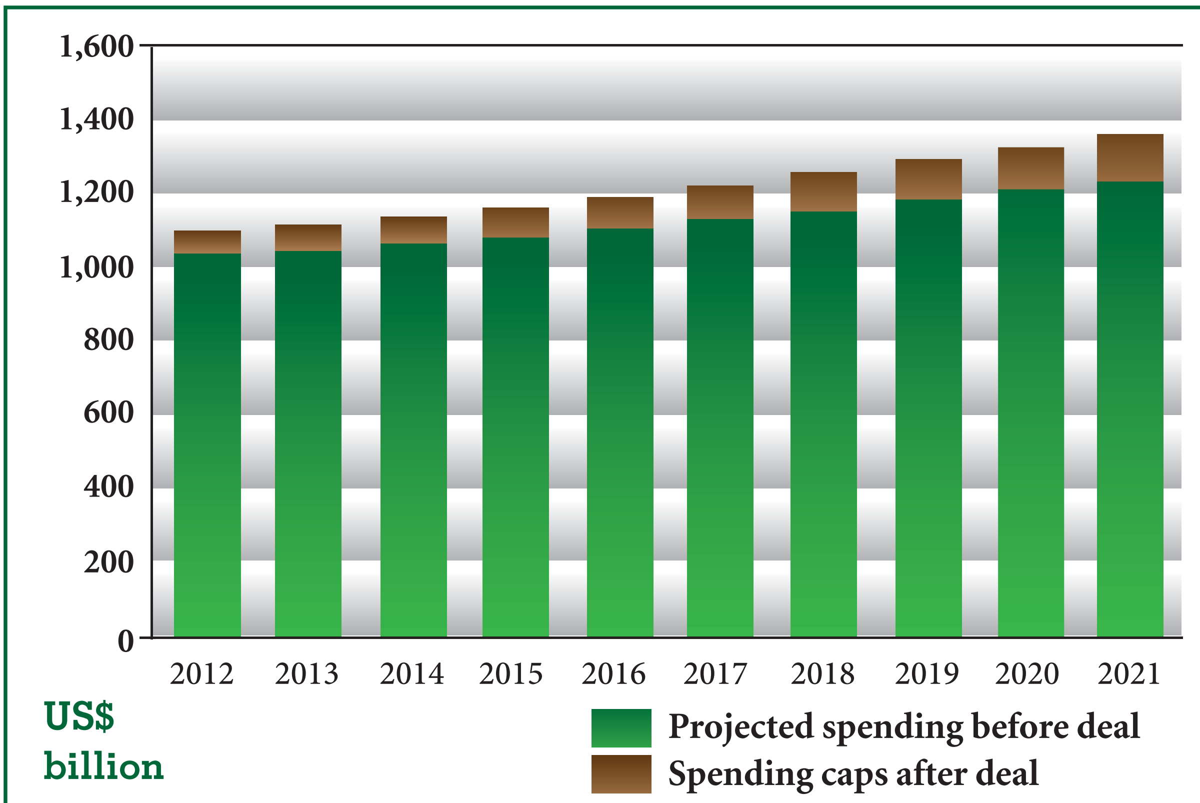
The deal adopted by the U.S. Congress and signed by President Obama on August 2, 2011 will see the federal debt ceiling in the United States raised by at least $2.1 trillion from its current limit of $14.3 trillion. The agreement has been criticized by a number of commentators, who believe that it represents a "capitulation" to "extremists"[1] who insist on balancing the budget without raising the fiscal burden.

Yet an analysis of the agreement shows that even if all the cuts contained in it were indeed enacted, they would not prevent the U.S. federal debt from continuing to grow. They might not even be deep enough to keep the most important rating agencies from downgrading the U.S. federal government's credit rating.[2]

So what are the cuts all about? They are in fact made up of caps to limit the federal government's "discretionary" spending (which must be approved each year) for the next ten years. The Congressional Budget Office, a non-partisan organization, has evaluated their impact by comparing these caps to projections of spending increases made before the agreement. As we can see in the figure below, discretionary spending will continue to rise in current dollars, even if it does so at a slower pace than was predicted before the deal.[3]

In addition to this first round of deficit reduction totalling $917 billion over ten years, the agreement stipulates that a bipartisan committee will have to propose additional measures with an aim to reducing the deficit by $1.5 trillion more over the same period

U.S. federal government **discretionary spending** (2012-2021)

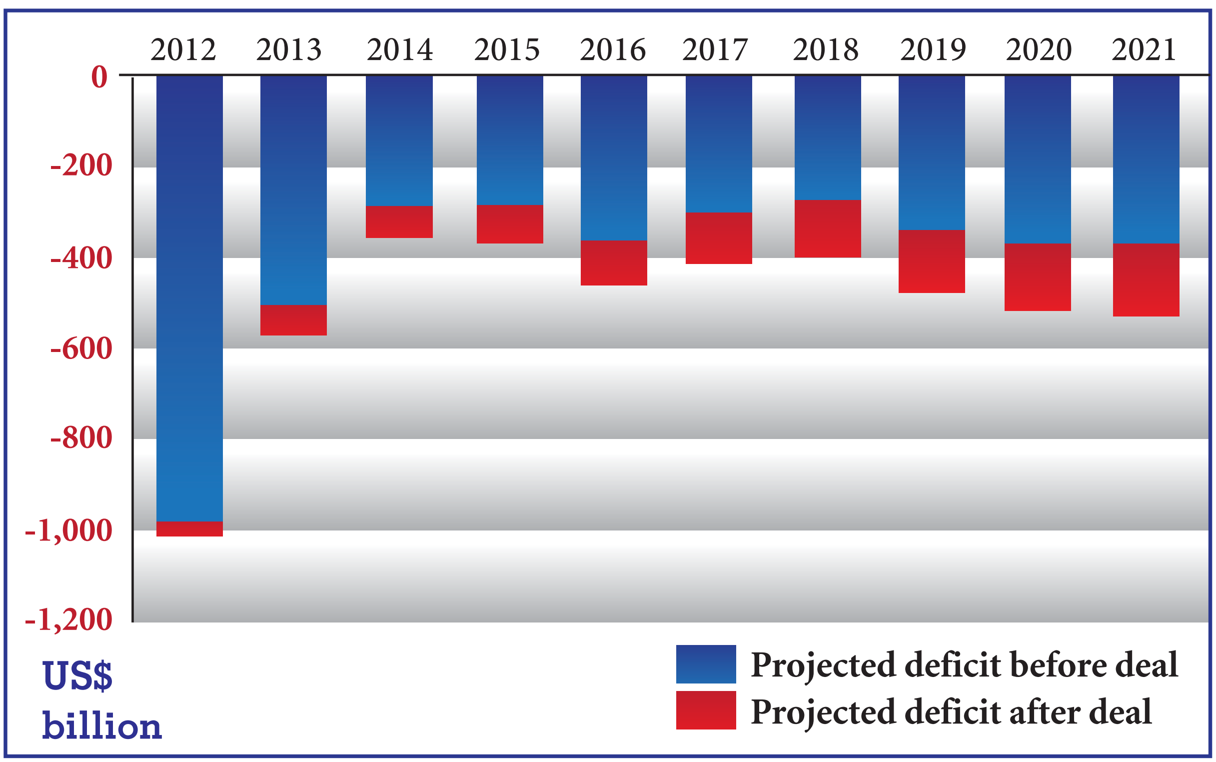


Congressional Budget Office, *CBO Analysis of August 1 Budget Control Act*, August 2011, Table 1 (spending caps are based on budget authority).

(again relative to previous projections), failing which certain automatic cuts will be triggered. While these amounts might seem impressive, they are far from sufficient to offset the $5 trillion of deficits forecast for the next ten years[4] prior to the deal (see figure below). Since despite these cuts, the government will continue to rely on massive borrowing, we must conclude that the cuts are too modest to stop the considerable increase of the U.S. federal debt projected in the coming years.

Moreover, discretionary spending represents just over a third of the U.S. federal budget. Even if it were entirely abolished, the government would still have posted a deficit in 2011. Other spending, called "mandatory" (i.e., spending that does not need to be approved each year), is largely used to pay for social programs like medical care for low income people (*Medicaid*) and for the elderly (*Medicare*) as well as the public retirement plan (*Social Security*). Without an overhaul of these programs, balancing the U.S. government's budget and making its public finance sustainable will prove very difficult.

U.S. federal government **deficit** (2012-2021)



Note: Does not take into account the second round of cuts whose size and distribution from year to year have yet to be determined.
Source: Author's calculations based on Congressional Budget Office, *CBO Analysis of August 1 Budget Control Act*, August 2011, Tables 1 and 3; Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2012*, April 2011, p. 14.

1. See: Agence France-Presse, "La presse américaine juge durement l'accord sur la dette," *Cyberpresse*, August 1, 2011.
2. See: Agence France-Presse, "Moody's, S&P et Fitch : trois regards sur la dette américaine," *Cyberpresse*, August 3, 2011.
3. It is possible that spending will decrease as a share of GDP, if economic growth surpasses spending growth. However, looking at the current situation of the U.S. economy, there are good reasons not to be overly optimistic.
4. Author's calculations based on: Congressional Budget Office, *CBO Analysis of August 1 Budget Control Act*, August 2011, Tables 1 and 3; Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2012*, April 2011, p. 14. This amount is based on the "March 2011 Adjusted Baseline" and excludes in particular the funds that will be spent on the wars in Iraq and Afghanistan.