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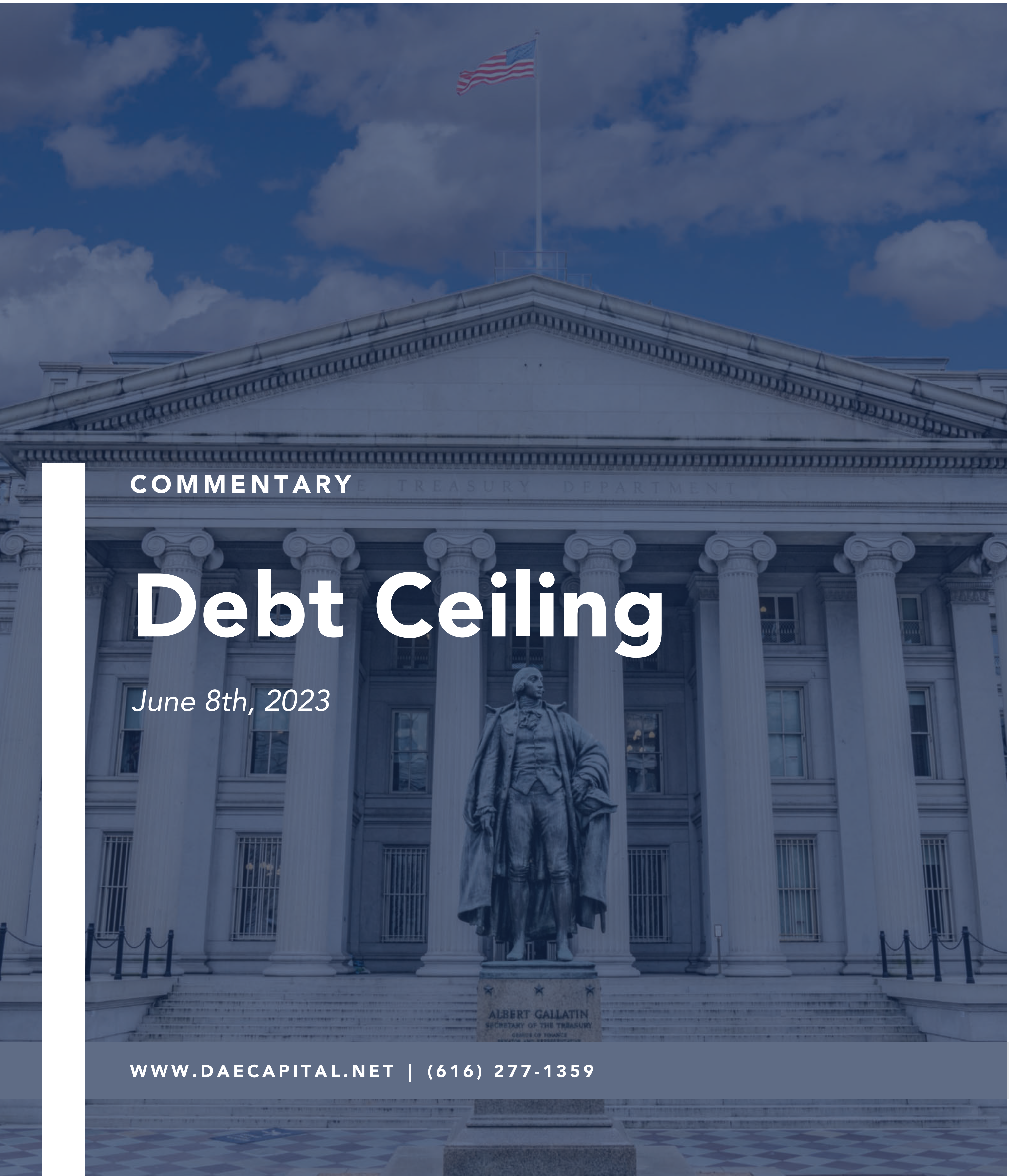



COMMENTARY

# Debt Ceiling

*June 8th, 2023*

# A New Law is Passed

The Fiscal Responsibility Act of 2023 finally became law after an intense and lengthy negotiation process among House Republicans and the White House. Most importantly, this new legislation will help the United States avert default by increasing the debt ceiling, the approved borrowing limit given to the US Treasury Department. Even though time ran right down to the minute, in the end, the government reassured the Country that it would not break its future promises.

## Magnitudes of Uncertainty

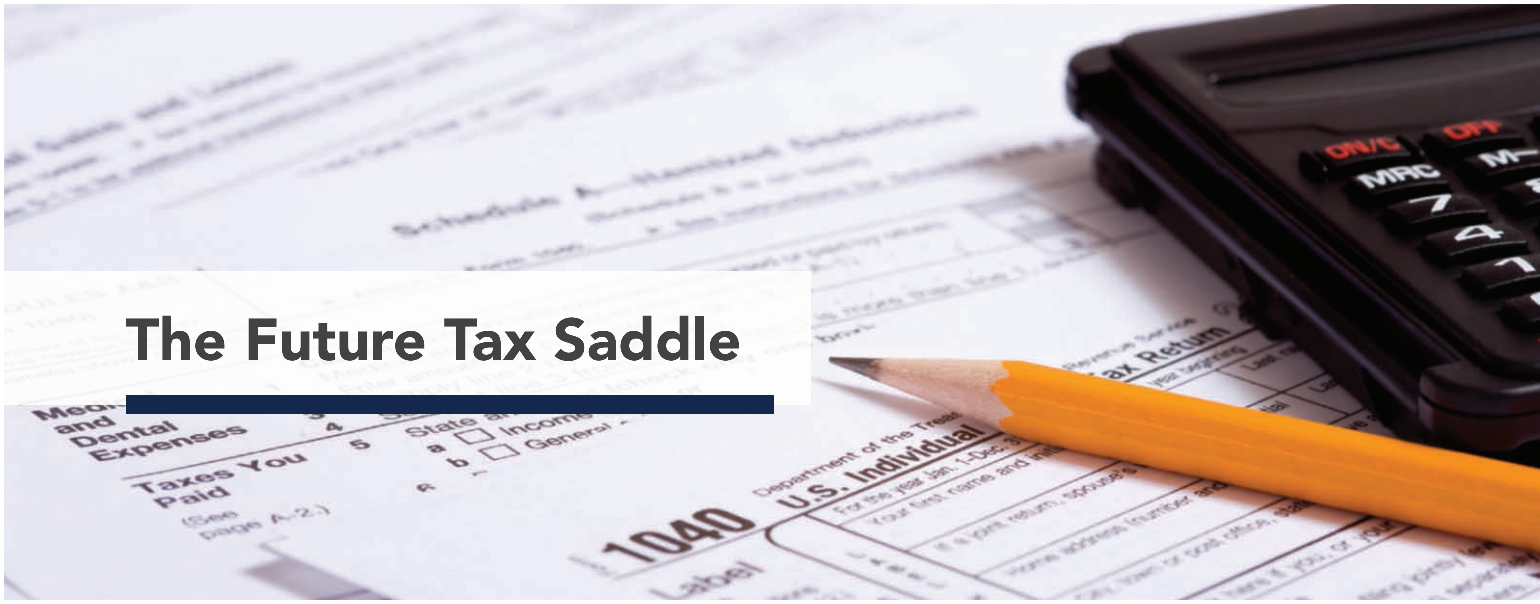
In the entire history of the debt ceiling since 1917, the United States has never defaulted. But, without a doubt, the global payments system would experience serious challenges if the US ever missed a debt payment. Moreover, global finance depends on the safety and stability of US debt markets since creditors accept US debt securities as high-quality collateral to backstop risks on various financial loans.

Depending on the scope and size of a US default, global incomes would decline, global savings would shrink, and the US dollar would destabilize. In addition, the White House recently published, on whitehouse.org, that a protracted default could have led to 8.3 million lost jobs, annualized growth losses of -6%, and unemployment topping 5% without a resolution on the debt ceiling.

## A Night on Capitol Hill

Lawmakers worked well into the night on May 31 to pass a bill that the Senate could vote on. The bill passed in the House 314-117 and proceeded to the Senate, passing 63-36. Once the bill arrived at the White House, the President signed it into law. Interestingly, more House Democrats voted for the bill than House Republicans, even though Speaker of the House Kevin McCarthy (R-CA) led discussions with the White House.

Each side of the aisle received concessions, but neither party obtained everything they wanted. Specifically, Congress agreed to new spending limits on discretionary items that go into effect in fiscal years 2024 and 2025. Future sequestration will rescind unobligated funds to address COVID-19 and eliminates additional appropriations given to the IRS. In addition, federal food aid programs will toughen standards to incentivize work. Democrats received from Republicans reassurances that previous appropriations for certain energy projects would not be affected. Some Democrats would have liked to roll back the tax cuts from 2017. However, they would have gained limited Republican support and elected to wait for another time.




## The Future Tax Saddle

After years of loose monetary policies, aggressive federal deficits, and financing forever wars in the Middle East, Americans have started to feel the burnout. The United States has racked up over 31 trillion dollars of debt for future taxpayers to service, with a significant amount of that increase occurring after the recession in 2008. Now that public debt as a percent of GDP has reached 120% and the country has re-experienced inflation, it's no wonder that Americans are worried about debt and spending. Sometimes people talk about government deficits in disbelief, understandably saying no household or business could run their accounts in this way. America's concern is legitimate for so many reasons.

- First, uncontrolled spending and deficits can lead to greater bureaucracy and less accountability. Therefore, sound fiscal policies help to maintain responsibility and prudency inside governments.
- Second, unfettered debt spending will increase the interest expense as a percent of the federal budget, especially since interest rates are higher. The interest obligation as a percent of the federal budget may grow to 14% by 2033. The trend is alarming for two reasons:
  - *First, when the interest expense takes up more of the budget, fewer funds are available to do things that can actually help the economy.*
  - *Second, the US may have to issue new debt to pay the interest expense, creating a negative debt spiral. So far, the US has made interest obligations using the general revenues account. However, if that trend were ever to change, and the US issued debt to service interest costs, the US dollar could lose significant purchasing power.*

## Public Debt is a Policy Tool

The US government has had to raise the debt ceiling numerous times to sustain spending and avoid default. As a result, Americans sense a pattern where legislation required on the debt ceiling has turned into a political tool for both parties to play. The government has shut down several times in the past due to federal budget impasses because of an inability to raise past debt ceilings. For example, recent federal government shutdowns occurred under the Clinton, Obama, and Trump Administrations over disagreements about the White House's federal budget plans. Those past federal budget disputes stopped debt ceiling votes from taking place, leading to tough decisions such as shutting down parts of the government until both sides could find common ground to justify a debt limit increase.

> ***The Biden Administration may have been days away from having to make a crucial decision to either enact a short-term government shutdown or experience a Treasury default. Either way, disputes over the debt ceiling are happening far more frequently than Americans want as public deficits have enlarged.***

As a result of the political theater surrounding the debt ceiling, politicians have debated ways to give the US Treasury unlimited access to issue debt. Their logic centers on the idea that Congress already approves spending once per year when legislating on fiscal-year appropriations. They argue Congress shouldn't have to re-legislate on matters that have already been voted and signed into law. Senator Mitch McConnell (R-KY) was one of the last highly influential politicians to introduce rules that modify how the debt ceiling works. But his ideas did not make it into law and the rules based on how it all began in 1917 still stand. Congress requires a majority vote to raise the debt ceiling, which is probably the preferable checks and balances approach to maintain in government, so why try to change it?

## Further Down the Road

Fortunately, the federal government avoided a shutdown or, worse yet, a financial default, by passing the Fiscal Responsibility Act. But, unfortunately, discussion over the debt ceiling is destined to recycle and reemerge as an issue later. That is because the Fiscal Responsibility Act suspends the debt ceiling until 2025, restoring the US Treasury's ability to borrow and making the nation's debt the next president's problem. Therefore, this law leaves it to the next president and congress to create laws that don't put America further in debt.

Thankfully, Americans have started to pay much more attention as the future tax bill continues to grow for every unborn child. One optimistic takeaway from the latest legislation is that both sides of the aisle recognize that it's time to wean off deficits or risk incredible uncertainty regarding the US currency and global rating. That is why Republicans saw this as a first pass to work with Democrats on spending, and Democrats think they may get some Republican support for raising taxes. Either way, something has to be done because current and non-partisan projections show Social Security going bankrupt by 2033. Of course, there is still enough time and options to change that fate, but it requires a Democracy to find the solutions, which is the responsibility of the American people.

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