

"Congress has already passed and the President has already signed legislation that increases spending or decreases revenues. Those decisions have already been made," - Susan Irving, director for federal budget issues at the Gov't Accountability Office.

↳ In that sense, much of the political rhetoric is misleading because the money has already been committed and lawmakers are arguing over whether to pay the bill, according to the Congressional Budget Office Director.

↳ Politics permeates the whole debate. For instance, lawmakers who want to make it an issue may push for a small increase so the debate comes up again soon. Others may want a bigger increase so they don't have to revisit the debate for awhile.

## National Debt Limit and Related Concerns

No one knows for sure what will happen if the US hits the debt limit, since it has never happened before.

↳ The going assumption is that no good can come of it. This can be a problem since the government borrows to make up the difference between what it spends and what it takes in. It uses that money to help fund operations and pay creditors.

### What is the debt ceiling exactly?

A cap set by Congress on the amount of debt the government can legally borrow.

↳ The cap applies to debt owed to the public (ie, anyone who buys US bonds) plus debt owed to federal government trust funds such as for Social Security and Medicare. The first limit was set in 1917.

### How is the ceiling determined?

Based on policies in place, such as the \$858 billion tax cut compromise passed in December 2010, lawmakers determine how much the government will have to borrow over a given period of time. They then set the debt limit accordingly.

### Why does Congress even bother to set a debt limit?

In theory, the limit helps Congress control spending.

↳ Every time the debt limit needs to be raised, lawmakers and the president are forced to take stock of the country's fiscal direction.

↳ Some argue, though, that the debt limit is ineffective in controlling spending and deficits. They say the right forum for that is the debate over the federal budget: Every year, lawmakers are supposed to decide how much money should be spent.

↳ The problem, of course, is that Congress can vote to bypass the obligation to set a spending target, as it did in 2010.

### Will reaching the debt ceiling cause a government shutdown?

↳ Not necessarily. A government shutdown occurs if lawmakers fail to appropriate money for federal agencies and programs.

↳ By contrast, if the debt ceiling is breached, the US would still have revenue coming in (taxes) that could be used to fund the government.

↳ If it can't borrow, the government will need to raise taxes or cut spending to continue to meet its obligations in full.

### What will happen if the debt limit is reached?

The Treasury Department estimates US borrowing could hit the debt ceiling if Congress fails to act. Plus there are steps the Treasury Department can take to postpone this day.

↳ Treasury would be prohibited from borrowing more money (ie, can't sell bonds).

↳ The Treasury could hold on to any cash/gold/funds and what little credit remains. Among other things, it would eliminate unneeded borrowing associated with certain obscure programs such as the Exchange Stabilization Fund and state and local debt programs.

↳ The Treasury could call in money from "relatives", in this case the Federal Reserve. During the financial crisis, Treasury created a special program to borrow money on the Fed's behalf; that borrowing now totals \$200 billion.

↳ The Treasury temporarily wound this program down the last time the US got close to the debt ceiling.

↳ The Treasury could issue IOU's (which don't officially count as debt) to friendly creditors who have no choice but to accept them.

↳ Prior secretaries of the Treasury did this with two retirement funds for government employees, both of which were later made whole.

↳ The Treasury could look for assets that are easy to sell.

↳ Due to the financial crisis, Treasury now owns a sizeable investment portfolio, including stakes in auto companies, banks and other financial institutions.

↳ The Treasury could sell the nation's gold reserves, which is the largest concentration of gold in the world (about 1/3<sup>rd</sup> of the gold stockpiles held by all countries).

↳ The Treasury has 261.5 million ounces of gold in its reserves, worth \$288 billion

↳ With the gold standard abandoned, why doesn't the government sell off its reserves to put that money into the economy or pay off debt? There are lots of reasons, ranging from the psychological to the practical.

↳ "If we started selling gold from our official reserves, it would be recognized as a sign of weakness for the dollar; America's relatively large gold holdings provide some psychological benefit to our currency."

↳ Treasury holds onto the gold due to its fluctuating price. It was worth \$42/ounce in 1973, \$275/ounce in 2002, \$1,100/ounce in 2011. There is a fear of selling now when the country may get more for it in the future.

↳ Significantly, a sale of the government's gold would be especially poorly timed now, since foreign central banks are lining up to add gold to their reserves. As a result, experts say a mass-sale of gold would mostly end up in other nation's coffers.

↳ That could spell disaster for the US government, which is trying to finance its economic rescue packages by selling record amounts of debt to foreign countries in the form of Treasury securities. As gold holdings take up a larger percentage of foreign reserves, Treasury holdings could be reduced.

↳ The Treasury must keep making payments on the public debt, rolling over the outstanding principal (original payment owed) and paying interest.

↳ Interest payments are relatively small, averaging about \$20 billion per month, and paying them on time is essential to America's enviable position in world capital markets. To miss even one is and should be unthinkable.

↳ Other creditors would have to wait. Treasury would defer payments to some groups of creditors,

↳ Perhaps including Social Security beneficiaries, Medicare providers, military personnel, weapons vendors or taxpayers expecting refunds.

# National Debt, Federal Deficit and the Surplus

## Federal Deficit

↳ Spending more money than you take in

## National Debt (Public Debt)

↳ The cumulative total of all annual deficits combined

Several government agencies provide budget and debt data and analysis. These include

↳ the Government Accountability Office (GAO),

↳ the Congressional Budget Office (CBO),

↳ the Office of Management and Budget (OMB),

↳ the US Treasury Department.

↳ These agencies have all reported that the federal government is facing a series of critical long-term financing challenges.

Debt History The United States has had public debt since its inception.

↳ Debts incurred during the Revolutionary War and under the Articles of Confederation led to the first yearly reported value of \$75,463,476 in 1791.

↳ Over the following 45 years, the debt grew, briefly contracted to zero by 1835 under President Andrew Jackson but then quickly grew into the millions again.

↳ The first dramatic growth spurt of the debt occurred because of the Civil War.

↳ The debt was just \$65 million in 1860, but passed \$1 billion in 1863 and had reached \$2.7 billion following the war.

↳ The debt slowly fluctuated for the rest of the century, finally growing steadily in the 1910s and early 1920s to roughly \$22 billion as the country paid for involvement in World War I.

↳ The buildup and involvement in World War II plus social programs during the F.Roosevelt and Truman presidencies in the 1930s and '40s caused a sixteenfold increase in the gross debt from \$16 billion in 1930 to \$260 billion in 1950.

↳ After this period, the growth of the gross debt closely matched the rate of inflation where it tripled in size from \$260 billion in 1950 to around \$909 billion in 1980.

↳ Gross debt in nominal dollars quadrupled during the Reagan and Bush Sr presidencies from 1980 to 1992. The Public debt quintupled in nominal terms.

↳ In nominal dollars the public debt rose and then fell between 1992 and 2000 from \$3T in 1992 to \$3.4T in 2000.

↳ During the administration of President Bush Jr, the gross debt increased from \$5.6 trillion in January 2001 to \$10.7 trillion by December 2008, rising from 58% of GDP to 70.2% of GDP.

The national debt is broken down into 2 main categories

↳ Securities held by the public

↳ Marketable securities

↳ Non-marketable securities

↳ Securities held by government accounts

The U.S. government is committed under current law to mandatory payments for programs such as Medicare, Medicaid and Social Security.

The US debt in the hands of foreign governments was 25% of the total in 2007

↳ Compared to 13% in 1988.

↳ The largest foreign owners of US Treasury Securities (July 2010)

↳ China – owns 20.8% of all foreign owned securities

↳ Japan – 20.2%

↳ United Kingdom – 9.2%

↳ Oil Exporting Countries (15 countries) – 5.5%

↳ Caribbean Banking Centers (7 countries) – 3.7%

↳ Brazil – 4.0%

↳ Hong Kong – 3.3%

↳ Russia and Taiwan – 3.2% each

## Recent additions to the public debt of the United States

There is a significant difference between the reported budget deficit and the change in debt. The key differences are: 1) The Social Security surplus, which reduces the "off-budget" deficit often reported in the media; and 2) Non-budgeted spending, such as for the Iraq and Afghanistan wars.

The debt increased by approximately \$550 billion on average each year during the 2003-2007 period, but then increased over \$1 trillion during FY 2008.

## **Debate regarding a "danger level" of debt**

Economists debate the level of debt relative to GDP that signals a "red line" or dangerous level, or if any such level exists.

↳ Economists Kenneth Rogoff and Carmen Reinhart reported that 90% of GDP represents this danger level. "Seldom do countries simply 'grow' their way out of deep debt burdens."

↳ Economist Paul Krugman disputed the existence of a solid debt threshold or danger level, arguing that low growth causes high debt rather than the other way around.

↳ He points out that in the US the only period of debt over 90% of GDP was after World War II when "when real GDP was falling, not because of debt problems, but because wartime mobilization was winding down and Rosie the Riveter was becoming a suburban housewife."

↳ Ben Bernanke stated "Neither experience nor economic theory clearly indicates the threshold at which government debt begins to endanger prosperity and economic stability. But given the significant costs and risks associated with a rapidly rising federal debt, our nation should soon put in place a credible plan for reducing deficits"

**There is also a second debate regarding whether debt held by the public (a lower amount) or gross debt (a larger amount) is the appropriate measure to use in evaluating the debt burden, measured as a percent of GDP.**

↳ Krugman argued that the debt held by the public is the right measure to use, while Reinhart has testified that gross debt is the right figure.

↳ The Several economists support the use of the lower debt held by the public figure as a more accurate measure of the debt burden.

↳ This second debate relates to the economic nature of the intragovernmental debt that represents the difference between the two debt figures. As of April 30, 2010 the public debt was \$8.4 trillion (59% GDP) and the gross debt was \$12.9 trillion (90% of GDP), using a \$14.3 trillion GDP estimate. The difference is the \$4.5 trillion intra-governmental debt, mainly represented by the Social Security Trust Fund.

What would be affected by a government shutdown?

Veteran services...from health and welfare to finance and travel

National parks and museums would shut down and lose revenue from patrons

Issuance of passports

Social security...new claims were not processed

Furlough of hundreds of thousands of federal employees; wouldn't receive a paycheck; neither will government contractors

Federal funds to states would be cut off

Federal agencies would suspend work on more than 3500 bankrupt cases.

Canceled recruitment and testing of federal law enforcement officials

President has the discretion of keeping certain government functions operating, especially if they are essential to the nation...army

Post office not affected

Air traffic controlled not affected

Federal prison staff not affected

FEMA not affected