Q&A: Bringing the debt ceiling down to our level

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Much ado about the debt ceiling the past couple months. As the issue plays on (and on and on) in the news cycle, a reset is in order. Let's get to the nuts and bolts of an issue that—believe it or don't—can be

understood even by the numbers-averse among us.

In the following Q&A, UCR News addresses the basics and calls on two UCR experts—economist Marcelle Chauvet and political scientist Indridi Indridason—for the more nuanced stuff.

Q: What's a debt ceiling?

UCR News: The government spends more than it brings in through taxes and other revenue. So it must borrow money. A debt ceiling is a limit Congress places on the amount of money the federal government can borrow to pay its bills. It now owes $31 trillion, and the borrowing cap is $31.381 trillion.

Q: What do the respective political parties want to do about the debt ceiling?

UCR News: Democrats say Congress must raise the debt ceiling to pay existing bills—spending already approved by Congress. Republicans counter that continuing to raise the debt ceiling perpetuates a cycle of more spending and borrowing. And so the GOP wants a raise in the debt ceiling to be tied to spending cuts.

Q: With Democrats and Republicans in a stalemate, the question has been raised whether the president has power to raise the debt limit without congressional approval. That power may be provided by the 14th amendment, a section of which reads: 'The validity of the public debt of the United States, authorized by law... shall not be questioned.' Does the

14th amendment argument hold?

Indridason: The 14th amendment reads like the president has the authority to do so—or, in fact, that there really is no other option than to keep servicing the debt. Do I think we would be better if Biden took that option? Probably. It doesn't seem like a good idea to give any political party an opportunity to hold the economy hostage. While chances are that the debt ceiling will be lifted in time, negotiating over the role of government with the risk of default in the background is probably not conducive to rational decision-making. So "taking the 14th" could represent a solution to not just this but future debt ceiling crises—if the courts side with the 14th amendment.

On the other hand, now that the 14th amendment argument seems to have gained some traction, maybe that is enough. That is, the threat to invoke the 14th amendment might be enough to discourage parties in the future from taking the debt hostage or, perhaps, result in more moderate demands. If that is the case, 'taking the 14th' now might leave us worse off, if the courts do not side with the 14th amendment.

Q: The U.S. spending deficit and battles over the debt ceiling are a constant. Does that translate to high risk for lenders, or do they just assume the U.S. is always going to pay its bills?

Chauvet: The U.S. debt (Treasury bond) is considered a safe heaven, one of the safest assets in the world. However, the constant struggles regarding the debt ceiling do cause some (minor) stress in the market, and investors reassess the risk of default, even if it is a very small probability event. Standard & Poors downgraded the U.S. debt in 2011 due to the battles regarding the debt ceiling around that time. Since then the U.S. debt has been more costly to the U.S. government (higher yield)

compared to the German debt (Bunds). Thus, the debt ceiling discussions do increase the higher risk premium even if in a minor way. Lenders do assume that the debt will be paid, though. The probability of default is very very small, but it is higher than zero, so the risk increases even if just by a small amount.

Q: What are the longer-term impacts—if a couple months or more goes by and the debt ceiling isn't raised?

Chauvet: This would cause instability, volatility in the markets, speculations. But the market does expect that the debt ceiling will eventually be raised. This event is mostly a political bargaining between the parties. There is no substantial longer term impact if the discussions on the debt ceiling are prolonged, although in the past the government went without paying employees and some contractors for a short time in 2011—one of the reasons why it triggered the downgrading of the U.S. debt. The government will probably be more cautious in not letting the situation get to this point again, as the debt risk premium could increase again.

Q: The United States' debt of $31 trillion is six times what it was at the start of the 21st century, and increasing by $1.3 trillion per year. What's up?

UCR News: Since 2000, Congress has borrowed money to finance wars, pay for tax cuts, pay for Social Security and Medicare, and take emergency measures to survive two recessions. The government during the George W. Bush administration borrowed to pay for wars in Iraq and Afghanistan without raising taxes or issuing war bonds (which add less debt because the interest is lower). That trend continued during the

Obama administration. And Obama made a deal with Republicans to make Bush administration tax cuts in 2001 and 2003 permanent. In 2018, tax cuts from the Trump administration kicked in.

Q: Do tax cuts lead to raising the national debt?

Indridason: Tax cuts do lead to greater national debt if not accompanied by equally large (or larger) cuts in government spending.

Q: What kind of changes would have to happen to halt the spending deficit? Can it continue to increase indefinitely, or is crash-and-burn inevitable at some point?

Chauvet: The spending deficit would not halt but reduce smoothly, so that it does not have a large negative impact on the economy during a time in which the economy is weakening with the increase in interest rates, high inflation, decreasing real income. However, the deficit will need to be reduced soon. Taxes will eventually need to be increased and/or government spending decreased. Note that inflation is already a tax on consumers (seigniorage), and the debt is being reduced in real terms with the high inflation.

Provided by University of California - Riverside

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