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THE DEBT CEILING

*Many Americans don't want it to be raised.
Could our economy hold up if it isn't?*

Presented by Gary Mastrodonato, CEA

Congress must think (and act) fast. In the middle of May, the national debt limit of \$14.3 trillion will be reached. This means the federal government must increase the debt ceiling sufficiently to cover U.S. obligations through the end of 2012. It will undoubtedly happen, but not before a loud round of partisan politics is finished.¹

What does the public think? In April, a CBS News poll showed that 63% of Americans opposed raising the debt ceiling. Polls often ask simple yes-or-no questions, and the respondents may not have understood the consequences here. If the debt ceiling isn't raised, America will end up defaulting.²

What would default mean? Picture something like the Wall Street downturn of 2008-2009 happening again ... but in a broader context.

As Treasury Secretary Timothy Geithner explained succinctly in a letter to Senate Majority Leader Harry Reid (D-NV), a default would mean that “the Treasury would be prevented by law from borrowing in order to pay obligations the Nation is legally required to pay, an event that has no precedent in American history.” A default would limit, halt or impact Social Security and unemployment benefits, veterans' benefits, federal worker salaries and payments to members of the armed forces.³

These aren't the only calamities that would happen. America sells Treasuries to finance its federal government operations, and other nations and investors have bought them with absolute confidence - we haven't defaulted since 1933. A default would elevate borrowing costs across the board. It would act like a tax. You would see higher interest rates, with implicit damage to equity prices and home values. The ripple from this could hurt retirement savings, consumer spending and investment.⁴

Moreover, a default would shatter the conviction other nations have in our political framework. It might be decades before we could count on cheap debt again.

GOP's memo to Obama: no higher debt limit unless we cut trillions. The President is adamant about raising the debt ceiling. On May 9, Speaker of the House John Boehner (R-OH) said it could only happen if “significant” cuts to the federal budget could be made: “We're not talking about billions here. We should be talking about cuts in trillions if we're serious about addressing America's fiscal problems.”¹

The GOP leadership does not want to see emergency tax increases. Addressing the Economic Club of New York, Boehner said that “raising taxes is off the table” because “it will have a devastating impact on our economy.” On May 7, Senate Minority Leader John Kyl (R-AZ) requested that revisions to the tax code to address the deficit be kept “totally off the table” as such moves would only amount to backhanded tax hikes.⁵

“We do not have a revenue problem; we have a spending problem,” Boehner noted. “Let’s address the spending problem.”⁵

How would privatizing Medicare help? House Budget Committee Chairman Paul D. Ryan (R-WI) claims that his controversial plan to privatize Medicare by 2022 would save the federal government \$5.8 trillion over the next ten years. Ryan’s proposed voucher system would assign \$8,000 annually to a typical 65-year-old for purposes of buying a private health plan. (The voucher amount would vary per person, with richer and/or healthier seniors getting less.)⁶

The non-partisan Congressional Budget Office disagrees and says out-of-pocket medical costs would double for seniors through Ryan’s plan. The CBO estimates that with this voucher system, the typical 65-year-old would pay about \$12,510 out-of-pocket each year for medical care above the \$8,000 of “premium support” provided. In contrast, it says that under the current Medicare structure, the same 65-year-old would pay \$6,150 out-of-pocket in 2022 (providing Medicare payments to doctors are not greatly reduced).⁶

How long before this impasse gives way to agreement? It could take days, it could take weeks. “I am guarded in my optimism,” House Majority Leader Eric Cantor (R-VA) remarked on Bloomberg Television this week. Secretary Geithner claims that the federal government could use “extraordinary measures” to keep borrowing money into the beginning of August. Noting that there was “no hard date” to hike the debt limit, Boehner said that “allowing America to default would be irresponsible. But it would be more irresponsible to raise the debt ceiling without simultaneously taking dramatic steps to reduce spending and reform the budget process.”



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