EconoFact Chats: The Economics, Politics, and History of the Debt Ceiling
William Gale, Brookings Institution
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I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
The United States government could default on its obligations by June 1st if Congress does not raise or suspend the debt ceiling. In a letter to Congress, Secretary Janet Yellen wrote, 'given the current projections, it is imperative that Congress act as soon as possible to increase or suspend the debt limit in a way that provides longer-term certainty that the government will continue to make its payments.' House Republicans say that they are unwilling to raise the debt limit without getting deep spending cuts. They passed the Default on America Act that would reduce the coming year's budget by at least $142 billion from the current fiscal year, and cap discretionary spending increases to 1% per year for the next decade. Senate Majority Leader Chuck Schumer used the acronym "DOA" to say that this bill is dead on arrival in the Senate. President Biden said that he is unwilling to negotiate over the full faith and credit of the United States. What is the debt limit or the debt ceiling and why do we have one? Is it routine to have these kinds of fights over raising the debt limit? And if it is not raised, what are the likely consequences? To address these issues, I am very happy to welcome back to EconoFact Chats Bill Gale of the Brookings Institution. Bill is widely recognized as one of the country's top experts on public finances. He is the author of the book, 'Fiscal Therapy: Curing Americans' Debt Addiction and Investing in the Future.' Bill, welcome back to EconoFact Chats.

William Gale
Thank you very much, Michael.

Michael Klein
So, let's start with some basics. What's the difference between the government debt and the government deficit?

William Gale
The deficit is the annual difference between spending and revenues. So if the government raises $100 in revenues and pays $170 in spending, the deficit is $70

during that year. The debt is the total cumulative deficits that have arisen over time. So if it's $70 a year for 10 years, then the debt is $700.

Michael Klein
There aren't any laws in this country that prevent the deficit from reaching a certain level, but there is a debt limit for the federal government in the United States.
Can you describe what the debt limit also known as the debt ceiling is?

William Gale
Sure. The debt limit, the debt ceiling puts a constraint on the total amount of debt that the government can issue. It's a legal concept of debt, not an economic concept of debt, which we'll talk about, but what it does is limit formal debt issuance by the Federal government. The limit is currently $31.4 trillion, and we are at that limit already, and the Treasury is doing what are called extraordinary measures to keep the government from defaulting.

Michael Klein
So, the debt limit is for money that's already been appropriated, right?

William Gale
That's right. The arguments about the debt limit and the debt ceiling are not proposals or arguments for or against new spending. Raising the debt ceiling is necessary or suspending the debt ceiling is necessary just to pay the bills that Congress has already authorized the government to spend. It's not well understood, but the government cannot spend money unless Congress authorizes that spending. Oddly enough, when Congress does authorize spending, it does not at the same time authorize the government to finance that spending. So, Congress can tell the government, can pass a law that says we require the government to spend $100, but we're not going to give the government any way to pay for that $100. And what they do is then raise the debt ceiling periodically so that the government can pay for each of those $100 spending requirements.

Michael Klein
So, it's a little bit like if I spent money using my credit card, but then when the bill comes due, I say, well, you know, I don't authorize myself to pay for the money that I've already spent, that I agreed to spend using my credit card.

William Gale
Exactly. Raising the debt ceiling is again an issue of paying for spending that Congress has already authorized and the government has already done, but Congress hasn't given them a way to pay for that spending yet.

Michael Klein
So, it's a little weird, right? I mean, it's like using the analogy of the credit card, it's like I go out and I spend money and then I say, oh, well, you know, I shouldn't have spent this money, so I'm not going to pay for it. So how did the debt ceiling come about? It's not in the constitution.

William Gale
Originally, way back in the 1790s, Congress had to authorize every issuance of debt that the government wanted to provide. And that went on for over 100 years. And then in World War 1, the debt requests from the government were so intense and frequent that Congress switched to passing an overall limit on the amount of debt the government could issue rather than trying to approve each issue. So, since World War 1, the debt limit has been raised over 100 times, 78 times since 1960, about once a year this century. It's a common occurrence. It happens under Democratic and Republican administrations and Congresses. It's a major opportunity for one party to demagogue the other. But so far in our history, it's always been passed or suspended when that was the needed action.

Michael Klein
Do any other countries have a similar debt ceiling or debt limit?

William Gale
The only country I'm aware of that has a debt limit is Denmark, but it's much, much higher than their existing debt. It's not a political issue. And it's simply not used the way our debt limit is used.

Michael Klein
So, Bill, you had an EconoFact memo from 2019. And in that, you point out the issue that there's debt that the government owes to the public and a portion of the debt that some parts of the government owe to other parts of the government. Which of these is used in the debt limit rule?

William Gale
Well, I mentioned earlier that this is a legal definition of debt, not an economic definition of debt. So, one of the many strange things about the debt limit debate is that the debt limit applies to debt that one part of government owes another part of government. So, for example, what happens is if Social Security runs a surplus or Medicare runs a surplus, that raises the amount of debt that the debt limit refers to. That seems ridiculous because the government's getting in more revenues than it's paying out. So how is it raising debt? Well, Social Security takes the surplus and gives it to the Treasury Department. And the Treasury Department issues a bond to Social Security. By the way, Social Security giving it to the Treasury Department is what's

euphemistically known as ‘building up the trust fund.’ So Social Security gives the surplus to Treasury. Treasury gives a bond to Social Security and says, we owe you this money. And that bond counts as part of the debt that applies to the debt limit, even though it's just one part of government paying another part of government or owing money to another part of government. So of the $31.4 trillion in debt, almost $7 trillion of it, that is between 20 and 25 percent of that debt, is simply debt that one part of government owes another part of government. So, it's kind of like, no one if they took $10 out of their right pocket and put it in their left pocket would say, “oh, my left pocket owes my right pocket $10 now, therefore, I have debt of $10.” But that's how the government accounting rule works. And I mean, it's at best, it's silly. At worst, you know, it's counterproductive and dangerous.

Michael Klein
And in fact, now it's counterproductive and dangerous because it's bringing us to this precipice, which we wouldn't have approached if we were looking at net debt instead of gross debt, correct?

William Gale
That's correct. That's exactly right.

Michael Klein
So, the debt limit has come up several times this year. And each time Secretary Yellen has given some provisional dates of when we would reach what's called the X-date, the time when the government would start defaulting on its payments. Why do these dates change?

William Gale
Basically, because the Treasury Department predicts how much tax revenue is coming in on a daily, weekly, or monthly basis. And they predict how much spending is going out. And neither of those items are certain. With tax revenues, for example, the Treasury pretty much knows how much it's getting from taxes on wages, because those wages are withheld and reported, that those taxes are withheld and reported. But taxes on capital gains, for example, the Treasury may not have a good estimate of how much capital gains there are going to be, and therefore how much revenue is going to come in on, you know, before April 15, or this year April 18. But because of the uncertainty, there's guesswork about when the X-date is.

Michael Klein
And you mentioned before that the Treasury undertakes what are called extraordinary measures to forestall the X-date. What are some of these?

William Gale
It's important to emphasize these extraordinary measures are not only legal, they're necessary to avoid default. But it's things like borrowing money from a pension fund, basically. So, there's a pension fund for government workers, right? And Treasury can borrow money from that when the government hits the debt limit. And so, it borrows money, and then when the debt limit is raised, it pays the money back. I mean, yes, it's ridiculous that the United States government, the largest financial institution in the entire world, has to resort to stuff like that. But this is the system that we have.

Michael Klein
When I served in government in 2011, there was a furloughing of non-essential employees. And I was, I have to say, a little dismayed to learn I was non-essential. Is this something linked to the approaching debt limit, or was it something else?

William Gale
It was something else. The government shutdowns are very different from debt defaults. The government shuts down if Congress has not passed a budget. Because with no budget, there's no authority to pay government workers and provide government services. With a debt default, the government's obligations, all the obligations, would be subject to default. It might be that the government does not pay bondholders. It might be that it doesn't pay social security recipients on time. It might not pay doctors and Medicare or Medicaid on time. If the government hits the X-date and there's no action, then some government payments will not be made. And that will constitute a default, whether it's bondholders or to other people.

Michael Klein
So, if that happens and I was a government bondholder, I'd be pretty worried. And the possibility of that happening would force me to require a higher interest rate in order to hold a government bond. Do you see any evidence that interest rates are rising as a consequence of this? Or that if it does in fact happen, do you think interest rates on government bonds would spike and end up costing the government more to be able to finance its debt?

William Gale
Historically, as debt limit showdowns have reached their apex, interest rates have gone up in 2011 and 2013, for example, and a few years ago as well. If there were an actual default, we don't know exactly what would happen, but we do know what happened in the late 70s where a computer error led to a temporary unintentional partial default on one tranche of government debt. I think the debt got paid a week later than it was supposed to. And that spooked investors, and ended up costing the government about $40 billion in today's dollars in terms of higher interest rates. And if

that's what a temporary unintentional partial default would do, you can only imagine what an intentional substantial default would do, not just to government interest rates, but to all financial markets which build off of interest rates. A lot of interest rates in the market are key to treasury rates. So if treasury rates go up because of this default risk, then other interest rates will go up too.

Michael Klein
So that's a pretty dire prediction of what would happen. And I guess that's shared by many others, if you read the press about what the possible consequences would be of a failure to raise the debt limit. What else do you see happening if we hit the debt ceiling and there isn't a resolution of this problem?

William Gale
It's hard to know. I mean, the people have estimated that it would cause a recession. It's unclear how deep, because it's unclear how broad and lasting the default would be. But US treasuries are the anchor of the world financial system. So, pulling out that anchor can't do anything good for the US, for Main Street or Wall Street or the rest of the world.

Michael Klein
Do you think that just even if we don't have the default, if some agreement is reached, these kinds of shenanigans will ultimately loosen that anchor, will make the US Treasury bill market not the anchor for the world as a whole, but in fact will sort of change the entire world financial system?

William Gale
That's a good question. Politicians are definitely playing with fire when they refuse to raise the debt ceiling and practice this brinkmanship on the debt ceiling. And I don't know how much latitude they have, but it just seems like a bad idea given the key role of the US in the world financial system, the key role of the financial system in the US itself, and the benefit the government gets from being able to pay low interest rates relative to all other assets.

Michael Klein
So, have you found yourself storing up canned goods lately?

William Gale
Not yet.

Michael Klein
Okay. Well, I might start stockpiling them in my basement. What can be done, Bill? I've heard a range of possible options, if it seems all too likely, there isn't a congressional

compromise. People have even spoken about the Treasury minting a trillion-dollar coin and then using it to pay its bills. I guess that'd be like a really big coin. Would that work?

William Gale
Actually, it doesn't have to be big. It just has to have a trillion dollars stamped on it. So, there's a quirk of the law that says the Treasury can print coins, can mint coins of any denomination if they're made of platinum. It was enacted in the 1990s with coin collectors in mind and stuff like that. But it's a loophole for the purpose of the debt ceiling, but nobody wants to use it. Treasury Secretary Janet Yellen has said she didn't want to use it. The Fed certainly, if the Treasury minted it, they would deposit it with the Fed, the Federal Reserve. And the Fed certainly wants nothing to do with this, that this is politicians' problems. They don't want to get sucked in. In terms of sort of logical solutions, the obvious thing would either be to eliminate the debt ceiling, to suspend it, or simply to create the rule that if Congress authorizes spending of a certain amount, it automatically authorizes the government to raise the money to pay for that spending. Those would be real solutions. There's another solution out there that is tricky, and that is the government apparently could issue consols. Consols are infinitely live bonds. They never come due. The government just pays interest on them every year. But since they never come due, they would actually not count toward the debt limit according to articles I've read. I'm not a lawyer, but according to articles I've read, that would work. So, the government could issue these infinitely live bonds like Great Britain has in the past. But again, these solutions that create something new out of old cloth might face intense political resistance. And the best thing to do would be either to eliminate or suspend the ceiling, or just say that when Congress authorized its spending, it also authorizes the financing of that spending.

Michael Klein
When you talk about the trillion-dollar coin, and then the Treasury giving it to the Federal Reserve and getting money in exchange, that seems very fanciful. But in fact, some governments more or less do the same thing, right? They monetize the deficit. They just print money to pay their bills. So you end up eventually, like Weimar Germany or Argentina with hyperinflations in that case.

William Gale
Yeah, I think technically you're correct. I think we're extremely far away from anything like that. The US government has the resources to pay its debt for decades. There's no reason, there's no economic reason for there to be a debt emergency or a debt crisis. There's only this political reason, which is politicians refusing to raise the debt ceiling.

Michael Klein
So Bill, some people listening to this might think, well, it is kind of a crazy thing, but there should be ways to rein in government spending, because Congress will always sort of find ways to spend money to appease their constituents. Are there any good rules out there for reining in government spending, or is that something that's just kind of an incorrect way to think about things?

William Gale
I won't say it's incorrect, but it's only half of the problem. The deficits get created by imbalances between taxes and spending. So it's not just that spending might be considered high, it's that taxes are considered low. It's sort of like asking which side of the scissors does the cutting. It's the combination of the two that creates deficits and then that builds up the debt. More generally, in terms of safeguards, there used to be a rule that tax changes had to be self-financing. Entitlement changes like social security or Medicare or Medicaid had to be self-financing. That is if you, for example, if you raised Medicaid spending, you had to raise taxes to pay for it, for example. Discretionary spending was subject to overall caps. So, Congress had those caps on in the 90s, and to some extent in this century, but they got abandoned at various points. The other Republicans wanted to cut taxes. Both sides sort of gave in on the spending constraints. In COVID, for example, we needed to substantially boost the economy. So, there are rules that Congress could enact, but almost any rule that Congress can create, Congress can eliminate as well.

Michael Klein
So, it's not like these are coming down from Sinai and are immutable, but in fact, what will happen is they'll put a rule in place and the experiences is, then they'll remove it. So, it looks good for a while, but then they change it as situations change.

William Gale
That's right. And the more drastic the rule, the less likely it is that it's ever going to be enforced. For example, you'll find people saying right now, well, maybe we should have a balanced budget amendment. Well, that's fine if you're willing to tell me how you're going to raise taxes or cut spending to get to a balanced budget. And usually, people don't. They just say, well, we want this principle, but we don't want to sort of explain to voters exactly how we're going to get there.

Michael Klein
So, it's like St. Augustine said, ‘God, make me virtuous, but not yet.’

William Gale
That is not a bad characterization of the current policy.

Michael Klein
Well, we've had some theological discussion here, Bill. And I hope that the discussion that we've had about the debt ceiling is not too prescient in that we're actually going to see the kind of disruptions that you were describing. And I thank you very much for your discussion because it'll help people understand just what's at stake and what's behind all of this. Thanks for joining me, Bill on EconoFact Chats.

William Gale
Thanks very much.

Michael Klein
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