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Even If He Hadn't Said So, We'd Know the President Is Bluffing

Posted: 7/14/11 11:35 AM ET

The president's Wednesday night warning to House Majority Leader Cantor to not "call his bluff" suggests that... well, he's bluffing. But the president has already been playing some transparently thin cards in this game of poker, including his melodramatic -- but highly questionable -- hint that Social Security checks would be interrupted on August 2.

The go-to strategy in a literal train wreck is to jump off a nanosecond just before the collision. The debt-limit debate is more complicated, however, because no one really knows what the effect would be if the deadlock on budget negotiations continues through August 2nd.

Debt-rating agencies may soon downgrade U.S. debt. But does the debt of a country on a fiscal path to borrow and spend 45 percent more than its revenues -- at a time when its debt already equals its annual output -- really warrant a AAA rating? Won't House Republicans really be doing investors a service by revealing a more honest debt rating?

One might argue that the real objective is to shift to a more responsible fiscal path, and that there are better ways of doing so than getting stuck on the debt limit problem. But the very fact that we are on a path of massive fiscal indiscipline -- namely, an unsustainably steep projected increase in government spending -- implies that fiscal rectitude will not happen without a trip to the brink of the precipice. The debt limit offers a policy lever to shift the nation's spending trajectory, and it is only fitting and proper that it should be used it to force the issue.

Regarding a potential "bluff" by the president and high officials of the Treasury and the Federal Reserve: It's only natural that they would sound the most dire of alarms. There is no guarantee that the government would default on its existing contractual debt and that financial markets would tank even if such a temporary technical default were to occur. But the risk of such events is not zero and no high government officials would wish to risk it on their watch.

A hint about whether and how much President Obama might be "bluffing" is his unwarranted warning that Social Security payments could not be guaranteed if the debt limit is not increased. There is every reason to believe that those payments could and would be made in full in August -- and for many more months -- no matter whether the budget deadlock is resolved by August 2nd.

The debt limit encompasses both debt held by the public, and that held in intra-governmental accounts such as Treasury IOU's in the Social Security Trust Funds. Even if the debt limit is reached, Social Security payments covered by incoming payroll taxes would not be delayed. As some observers correctly point out, payroll taxes are insufficient to cover present-law Social Security benefits. But that's true only on an annual basis. Because the payroll tax rate is applied to earnings, those tax withholdings generate more revenues during earlier months of the year than during later ones -- when higher earners' taxable earnings limit is reached and payroll tax collections decline. That means the still quite small annual payroll tax shortfall will not emerge until November or December of this year. Therefore, no Social Security beneficiaries should miss their payments in August.

Even if payroll taxes were to fall short of scheduled benefits on August 3rd, there is a way to ensure that Social Security checks are mailed on time. The Social Security Trust Funds would simply exchange their Treasury IOUs for cash from Treasury, financed out of non-Social Security taxes. This is exactly how they are to be used in the event of a payroll tax shortfall anyway. But this redemption of Trust Fund IOUs would reduce federal debt below the current debt limit. Treasury could then simply issue more public debt to recover the cash -- in effect exchanging debt to the Social Security Trust Funds for debt held by investors.

This information about how to negotiate through the laws governing the debt limit and the Social Security Trust Funds should be common knowledge among experts at Treasury, the Social Security actuaries, and the White House staff. The fact that President Obama feels compelled to demagogue the issue speaks volumes about how much he might really be bluffing.