INVESTORS.com
POWERED BY INVESTOR'S BUSINESS DAILY

POLITICS

# U.S. Debt Near Ceiling, But Sky Won't Fall Right Away

By DAVID HOGBERG, INVESTOR'S BUSINESS DAILY
Posted 05/04/2011 01:48 PM ET

A protester in Irvine, Calif., resets numbers in a debt clock representing the country's more than $14 trillion national debt during a demonstration... View Enlarged Image

If Congress doesn't lift the debt ceiling by mid-May, the sky won't fall, at least not right away. The Treasury has several ways to forestall a federal default. Yet today's massive deficits limit how long these measures can be used.

The national debt is expected to hit the $14.3 trillion legal ceiling by May 16. Treasury Secretary Tim Geithner has urged Congress to act to avoid a government default that would have "catastrophic economic consequences that would last for decades."

But House GOP leaders are insisting on coupling any increase in the debt limit with spending cuts and reforms of the budget process. Some Republicans are now contemplating raising the debt ceiling in two-month intervals to give them more leverage.

Even some Senate Democrats are threatening to vote against raising the debt ceiling without spending reform.

Sen. Mark Pryor of Arkansas vows not to vote without a "real and meaningful commitment to debt reduction." Other Democrats expressing reservations include Kent Conrad, N.D.; Amy Klobuchar, Minn.; Mark Udall, Colo.; and Joe Manchin, W.Va.

During the budget battles between President Clinton and congressional Republicans, the debt limit was reached in November 1995, but Congress didn't increase it until March 1996. During that time, the Treasury suspended issuance of bonds to the Civil Service Retirement and Disability Trust Fund. It also suspended issuance to the "G Fund," the bond fund for federal employees who participate in the 401(k)-type Thrift Savings Plan.

Yet back then the deficit was about $205 billion, 2.2% of gross domestic product. The Congressional Budget Office estimates that this year's deficit will reach $1.4 trillion and 9.5% of GDP.

That means additional strategies could be employed.

**Treasury's Tool Kit**

"The Treasury could begin delaying payments to government contractors or delaying things like construction projects," said Dean Baker, co-director of the liberal Center for Economic and Policy Research.

Politics limit which payments can be delayed.

"We know interest on the debt will be paid," said Dan Mitchell, senior fellow at the libertarian Cato Institute. "We know (as a political matter) that Social Security checks will get sent out. And we know soldiers will get paid. That puts a big squeeze on everything else."

Even with a bigger tool kit, Treasury's tricks can only work for so long.

"The rate of borrowing limits the extent to which you can shuffle things around," Baker said. "When you are borrowing $100 billion a month, the time between when you hit the limit and when it really becomes binding is much shorter today."

Geithner has suggested the Treasury can keep the government from hitting the ceiling only until early August. Veronique de Rugy and Jason Fichtner, in a paper for George Mason University's free-market Mercatus Center, say the U.S. could avoid a crisis through at least September.

"Right now there is a lot of political showmanship," Baker said. "But if it got to the point that we were on the verge of default, the major banks could go down, so you'd have JPMorgan (JPM), Goldman Sachs (GS) and others calling up Congress and the White House saying, you've got to work this out. And I'm confident they would work it out."

Yet even if it never gets to that point, markets could have an adverse reaction to a long fight.

"A long fight creates uncertainty in financial markets," Mitchell said, "particularly since we can expect Geithner and (Federal Reserve Chairman Ben) Bernanke will probably fans the flames in an effort to stampede Republicans into surrendering."