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Debt ceiling exaggerated

By: Michael D. Tanner – January 15th, 2013

Sometime in the next 30 to 60 days the federal government will reach the legal limit on its ability to borrow, setting up the next potential budget crisis in Washington. The debt is currently $16.4 trillion, technically in excess of the statutory limit, and the Treasury Department has been using "extraordinary measures," such as delaying payments to federal retirement programs, in order to push back the final day of reckoning.

But Treasury's ability to push off the deadline is almost spent, and unless Congress authorizes an increase in the debt limit, we will face yet another financial cliff. With Republicans in Congress calling for spending reductions as the price for increasing the debt limit, and President Obama insisting that he will not negotiate on the issue, we may soon be looking back on the fiscal-cliff deal as a model of relative comity.

Unfortunately, much of what we are being told about the debt limit and the upcoming fight is simply untrue. For example, President Obama warns that failing to increase the debt ceiling would "force the government to default on its obligations." Not so.

There are two parts to the obligations subject to the debt ceiling: that part of the principal maturing during the time in question and the interest payments that the federal government must make on its debt. Between Feb. 15 and March 15 of this year, the federal government will owe roughly $38.1 billion in interest payments. Failure to make those payments would indeed result in default. However, the federal government will also collect an estimated $277 billion in taxes and other revenue over that same period, meaning there will be more than enough money available to make those interest payments.

True, the federal government would not have enough revenue to continue spending the $452 billion that it otherwise would over that period. It would have to prioritize its expenditures until the debate was resolved. But there would be, for example, enough money to afford the interest on the debt, military salaries, Social Security and Medicare, with at least $90 billion left over for other things.

As far as the principal goes, roughly $500 billion in debt will mature within the window between Feb. 15 and March 15. Of course, the federal government does not actually pay off this debt (if it did, our debt would be going down rather than up) but rolls it over, substituting new debt for the maturing debt. As outgoing Treasury secretary Timothy Geithner testified in 2011, "Under normal circumstances, investors who hold Treasuries purchase new Treasury securities when the debt matures, permitting the United States to pay the principal on this maturing debt." Since there is no net new debt as a result of the rollover, the new securities do not run afoul of the debt ceiling.

The president also claims that the debt-ceiling debate is about whether "Congress should pay the tab for a bill they've already racked up." Wrong again.

As noted above, we are not actually paying the bills we've already run up but simply rolling over the borrowing on those bills and paying interest on our debts. Moreover, those bills amount to the $16.4 trillion we owe as of this month. Interest payments can also justifiably be considered part of past debts, and those payments will amount to roughly $220 billion this year. Even if we raised the debt ceiling to accommodate those interest payments – something that is not strictly necessary, as discussed above – that would mean a new debt ceiling of just $16.6 trillion for this year. The administration is seeking an increase to $18.5 trillion, which would theoretically allow borrowing through 2014.

The administration wants an increase in the debt ceiling beyond current debt and interest payments in order to accommodate additional spending and borrowing for this year and next. True, there is a certain element of hypocrisy to Congress's appropriating money for this year and then refusing to carry out the borrowing necessary to pay for it. But there is nothing wrong with Congress's forcing government not to spend money that it had planned on spending.

Don't get me wrong – failure to raise the debt limit would not be a good thing. Financial markets would likely react badly. We could even see another downgrade of the U.S.'s credit rating. Increased uncertainty would further slow economic growth. Unknown potential consequences abound.

But none of this would be worse than a failure to take meaningful action to reduce the debt, federal spending, and the growth of government. If we want to see more credit downgrades, market turmoil, and slow growth, all we need do is continue on our present course.