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The Corner

Some Thoughts on Threats Of Imminent Default Coming from Treasury

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Yesterday, I was reading this piece from January by *Bloomberg News* reporter Rebecca Christie and noticed this:

> Treasury Secretary Timothy F. Geithner said lawmakers must raise the federal borrowing limit in the first quarter of 2011 or risk a default on U.S. debt and a loss of access to global credit markets.
>
> A failure to act would cause "catastrophic damage to the economy, potentially much more harmful than the effects of the financial crisis of 2008 and 2009," Geithner said in a letter to Speaker of the House John Boehner, Senate Majority Leader Harry Reid and all other members of Congress. Lawmakers should act before a default becomes "imminent" because damage from even a short-term disruption "would last for decades."

If I am reading correctly, the secretary is saying that Congress *must* raise the debt ceiling by the end of March 2011 or the U.S. may default on its debt.

Then, I read this piece from April 14:

> "Starting at the end of May, we start to run on fumes. And that's not something you want to do for an economy that's coming out of this severe a crisis," Geithner said.
>
> The Treasury can buy about eight weeks through accounting measures. But by early July, it will run out of options.

For months the secretary has been talking about how past a certain date we would default for sure. So I went back and looked at Treasury press releases of the last year and made this table. It shows how the date of our "imminent default if the debt ceiling wasn't raised" has been moved back over time from March 31 to August 2. Does it mean that when Secretary Geithner says he *can't*, he really means that he *won't*, or that he *would rather not*?

Date of Announcement	Projected date of Reaching the Debt Limit	Link to Press Release
1/6/2011	3/31/2011 - 5/16/2011	http://www.treasury.gov/connect/blog/Pages/letter.aspx
3/1/2011	4/115/2011 - 5/31/2011	http://www.treasury.gov/press-center/press-releases/Pages/tg1084.aspx
4/4/2011	5/16/2011	http://www.treasury.gov/connect/blog/Pages/letter-to-congress.aspx
5/2/2011	8/2/2011	http://www.treasury.gov/connect/blog/Documents/FINAL%20Debt%20Limit%20Letter%2005-02-2011%20Boehner.pdf

I have said it, and I will say it again, the United States should not consider defaulting on its debt, nor should it put itself in a position where it has to postpone payment to contractors or "manage" other non-debt obligations because it doesn't have money (I am very much in favor of the government reducing its activities by a lot and shrinking the number of people it has to pay). Neither, however, should Congress be forced to raise the debt ceiling under false pretenses. Jason Fichtner and I have calculated that the United States has enough expected cash flow (tax revenue) and assets on hand to avoid either of these unattractive options until at least the end of the current fiscal year in September, perhaps even longer. Fichtner and I list some options here.

One obvious option is to use tax revenue to pay interest on the debt. During the remainder of fiscal year 2011, the Treasury Department will receive $1.114 trillion in tax revenue. That is more than enough to continue paying the $105 billion in interest costs we owe between April and September 2011. Yet, the Treasury Department claims that it can't prioritize debt payments because it would represent a "failure by the U.S. to stand behind its commitments." That seems like an example of the secretary using the word *can't* when he really means *won't*.

In fact, as the *Wall Street Journal* notes:

> The Republican Study Committee, a powerful group of House conservatives, wrote Mr. Geithner Thursday asking how he came up with the Aug. 2 deadline. Underlying some of these challenges is a suspicion that the deadline was created for political reasons, to apply pressure on Republicans to relent on spending cuts.

Thankfully, financial markets don't seem worried for now. I may be wrong, but I think investors may suspect that Treasury could be bluffing and that it likely has more legroom that it claims. They probably also assume that lawmakers will ultimately raise the debt ceiling when they absolutely have to. But before they do, they will get a commitment that will put the country back on track — or at least some changes that signal to investors that we are serious about reforming autopilot programs like Social Security and Medicare.

Cato Institute's Jagadeesh Gokhale makes a different but interesting argument. He suggest that a voluntary technical default from Congress's failure to increase the debt limit could be positive if promoted as "a

temporary suspension of fiscal operations to promote a more prudent fiscal course." Why positive?

> How might investors really view this ersatz U.S. debt crisis? If some lawmakers' refusal to vote for increasing the debt limit without also passing prudential fiscal policies resulted in a technical U.S. default, it would demonstrate their significant political strength.
>
> Might that not actually induce investors to buy long-term U.S. debt — reducing long-term interest rates and improving the U.S. investment climate?
>
> Indeed, investors should be fearful of the opposite: an increase in the debt limit without a serious challenge from reform-minded lawmakers. This only signals business as usual for U.S. fiscal affairs.

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