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DEBT CEILING PRIMER

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TOPLINE POINTS

- ★ The federal budget is on an unsustainable fiscal path, and Congress must address the long-term viability of the current fiscal situation.
- ★ Congress must raise the debt ceiling. Default cannot occur and a balanced budget this year is not feasible.
- ★ For every dollar of debt ceiling increase, three dollars of near-term deficit reduction is appropriate. Given the current political environment, a principle of one dollar of deficit reduction for each dollar of debt ceiling extension should be realizable.
- ★ Options include a freeze on non-defense discretionary spending, cancelling the administration's student loan forgiveness, opening more federal land to mineral leases, and reimposing work requirements on social benefits.

Introduction

On Thursday, Jan. 19, 2023, the U.S. Department of Treasury reached the statutory debt limit and has engaged in its now ordinary set of "extraordinary measures," likely extending its ability to fully fund the government until the beginning of June. Many Americans hear this news but don't quite understand what the debt ceiling is or why Congress needs to act. In fact, this is a rare moment when Congress is forced to confront the unsustainable fiscal path our country is currently on. History shows us that Congress has often paired debt ceiling extensions with spending reforms that improved fiscal discipline. Given that the amount of federal debt outstanding now exceeds total U.S. economic output per year (gross domestic product, or GDP), it is more important than ever to rein in excess federal spending and enact strict budget rules that will avoid a fiscal crisis.

What is the debt ceiling?

Until World War I, Congress approved each debt issuance made by the U.S. government. In light of the need for funds during the war, Congress instead granted a maximal borrowing authority to the Treasury Department, and this became known as the "debt ceiling." Since then, Congress has regularly increased the total amount of allowable debt or suspended the debt ceiling for a finite length of time. For instance, Congress suspended the debt ceiling from August 2019 to July 2021. As a result, they were not called upon to increase it during the COVID-19 pandemic. Most recently, the debt ceiling was raised by $2.5 trillion in December 2021 to a total of $31.4 trillion. The federal government reached that $31.4 trillion mark on Jan. 19, 2023.

Because the government has reached the ceiling, the Treasury Department can only issue new debt in amounts equal to the existing debt that comes due, thereby maintaining the total amount of debt outstanding. While "extraordinary measures" means that they will not make some payments such as government retirement investments, the result is that the Treasury can only continue to pay bills out of tax receipts that come in or from the cash balance they have on deposit with the Federal Reserve. However, since the federal government will run a deficit of approximately $1 trillion this fiscal year, tax receipts are insufficient to cover all approved spending, and cash balances are expected to be exhausted on approximately June 5, 2023.

What options does the government have to address our Nation's financing needs?

The current situation has created three possible options regarding how to meet our ongoing financing needs. First, Congress could raise the debt ceiling. Second, it could immediately balance the budget—thus making further borrowing unnecessary. Or third, the U.S. could default. Arguably, default is unconstitutional, as the 14th Amendment states "the validity of the public debt of the United States...shall not be questioned." Additionally, defaulting would call into question the credibility of the United States government and wreak havoc on financial markets, which would jeopardize the financial security of the American people. The United States provides the world's reserve currency, which lowers our interest rates and facilitates our national security policy that is carried out through financial sanctions. Other countries would quickly take note if we were to default. Default has never happened, and the consequences would likely be catastrophic. For those reasons, Congress must make clear that default is not an option. That leaves immediately balancing the budget and raising the debt ceiling as the only options.

Unsustainable Fiscal Path

Some would argue that the solution is obvious—we should immediately live within our means and balance the budget right now. The challenge is that, while Congress and the Administration have made promises to the American people that the country cannot afford without a drastically higher tax burden, immediately reducing spending to match current revenues without the benefit of a transition period or the opportunity to redesign programs to improve their performance would require deep and disruptive cuts to programs that Americans have already planned for in their daily lives. According to the Congressional Budget Office (CBO) forecast from September 2022, projected receipts this fiscal year are expected to total $4.89 trillion (18.6% of GDP), and spending is expected to be $5.87 trillion (22.4% of GDP), resulting in a deficit of $984 billion. Immediately balancing the budget means sharp reductions in federal benefits, federal employment, and federal investments, sharp increases in taxes, and/or large sales of federal assets. Ultimately, spending must be brought in line with revenues.

The major challenge confronting policymakers is that approximately 70% of federal spending is deemed mandatory. In addition to interest on the debt, this includes programs such as Social Security, Medicare, Medicaid, and food stamps (SNAP). As the Baby Boomer generation moves further into retirement age, these programs will continue to grow, both as a percentage of the budget and a percentage of the economy.

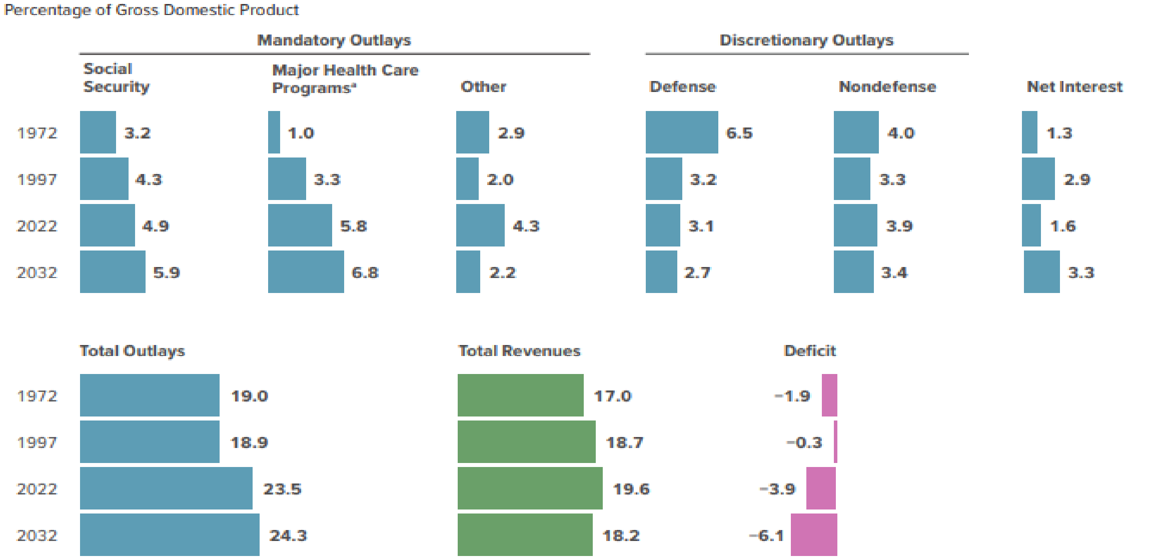
For instance, Social Security benefits are forecast to be 5.0% of GDP in 2023, rising to 5.8% of GDP in 2030 (amounting to $1.96 trillion). Likewise, Medicare is forecast to grow from 3.9% of GDP in 2023 to 4.9% of GDP just seven years later ($1.67 trillion). Between 2023 and 2030, Medicaid accounts for another 2.1% to 2.3% of the nation's output. Due to changing demographics, Social Security and Medicare both face fiscal insolvency. The Congressional Budget Office recently estimated that the Social Security Trust Fund will be exhausted in 2033. Medicare's Hospital Trust Fund is expected to deplete its trust fund balance in 2028.

Within the approximately 30% of federal spending that is considered "discretionary," national defense is forecast to cost $795 billion (3.0% of GDP) in 2023 and non-defense discretionary spending is estimated to be $963 billion (3.7% of GDP). At a time of rising aggression by Russia and potential threats from China, it is not desirable to reduce the portion of our national output devoted to defense spending.

The Congressional Budget Office's "Budget and Economic Outlook: 2022 to 2032" Figure 1-4 shows the change in both discretionary and non-discretionary spending over the last 50 years compared to the forecast for the next ten years, all as a percentage of GDP. It further shows the significant implications for total spending and deficits for those same time periods.

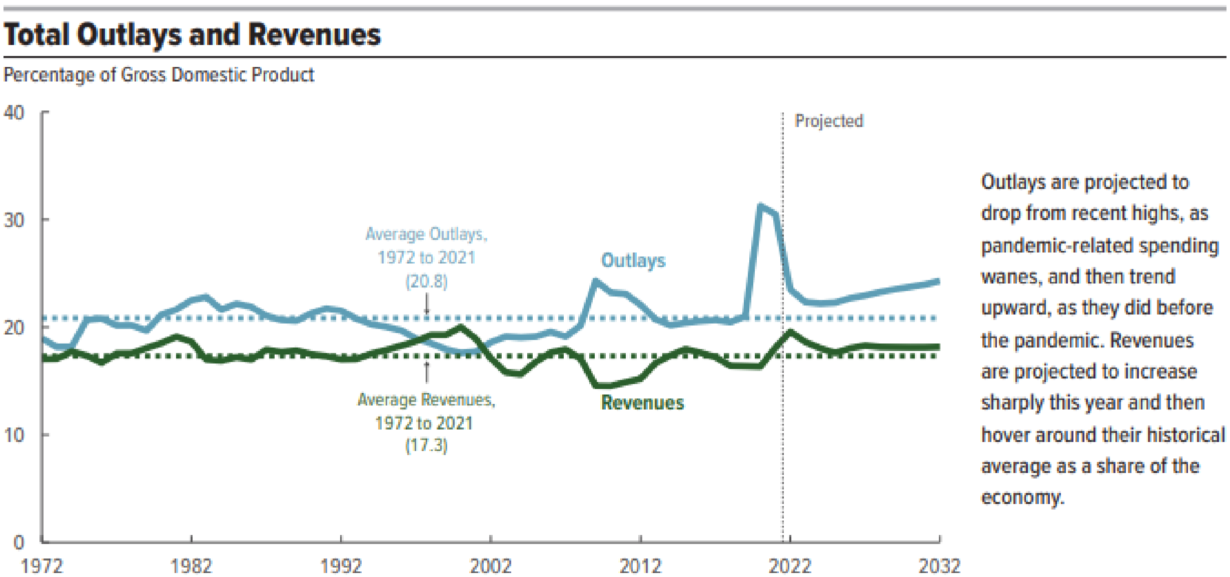
CBO's Baseline Projections of Outlays and Revenues, Compared With Actual Values 25 and 50 Years Ago

Percentage of Gross Domestic Product



Overall, federal spending is expected to be 23.5% of national output in 2022, rising to 24.3% by 2032. Of this total federal spending, 15.4% of GDP currently covers spending on Social Security, federal healthcare programs, defense spending, and interest on the debt. In 2032, those four items are expected to comprise 18.7% of GDP. This compares to average total federal spending equivalent to 20.4% of GDP between fiscal years 2015 and 2019.

In contrast, federal revenues are forecast to decline from their current 18.6% of GDP down to 18.1%. For context, that compares to the 17.3% of GDP that revenues averaged in the years from 1972 to 2021. Even though the tax code is realizing higher revenues as a share of national output than it has averaged over the preceding 50 years, the massive growth in spending means that deficits will grow from 3.8% of GDP in 2023 to 5.6% of GDP in seven short years. These historical figures and current projections are shown in CBO's figure below:



Such large, perpetual deficits are not sustainable. For that reason, the Financial Report of the U.S. Government explicitly states that the federal budget is on "*an unsustainable fiscal path.*" The United States does not have unlimited borrowing capacity, despite what liberal proponents of the nostrums of Modern Monetary Theory may want. As federal debt grows, bondholders will rightly become more concerned that the only way the government will fulfill its promises is to print money to repay them.

Such increases in the money supply are inflationary, as we observed during 2021. The Biden Administration's spending in the so-called "American Rescue Plan" was entirely debt-financed, and the Federal Reserve greatly increased the money supply over the last three years, effectively printing money to fund that spending. With trillions of dollars more in circulation chasing essentially the same amount of output, prices inevitably rose and the American people suffered the worst inflation in 40 years. If our deficits continue at forecast, investors will anticipate further money supply growth and raise the interest rate required on federal borrowing. This will escalate deficits even further, resulting in a debt spiral that would have catastrophic consequences for the American economy.

One of the only times Congress weighs in on the unsustainable nature of our fiscal situation is during the debt ceiling vote. As mentioned earlier, 70% of spending is mandatory and requires no appropriation by Congress. Only the discretionary component is authorized regularly by Congress and when done through the normal process, it is accomplished via 12 separate spending bills. Congress may or may not pass a budget, but that is not binding and does not have force of law. Thus, the only time Congress meaningfully votes on our "unsustainable fiscal path" is when they authorize a higher debt level. As such, Congress has an obligation to consider the long-term viability of the current fiscal situation when it debates another debt ceiling extension.

The Current Debt Ceiling Debate

If history is our guide, the debt ceiling will be raised. It is impractical that the budget will be balanced immediately this year and we are not going to default. Therefore, Congress will end up increasing the debt ceiling. The only question confronting lawmakers is whether it will be accompanied by an effort to return to a fiscally sustainable path.

Historically, debt ceiling increases have been moments in which Congress made significant budgetary progress. Congress increased the debt ceiling 60 times since 1978. Of those, 29 would be considered "clean" in that they were stand-alone bills with no other provisions. The other 31 were packaged with additional legislation, sometimes including spending and budget reforms.

In fact, many of the significant attempts to realize fiscal discipline accompanied debt ceiling increases. As the Committee for a Responsible Federal Budget has documented, legislation in 1985, 1987, 1990, 1997, 2010, and 2011 increased the federal government's borrowing limit while implementing deficit reduction. For instance, the 1990 Omnibus Budget Reconciliation Act included deficit reduction of approximately $500 billion as part of raising the debt ceiling by $915 billion. The Budget Control Act of 2011 authorized a $2.1 trillion increase in the borrowing limit along with $917 billion in deficit reduction, almost entirely coming from discretionary spending limits. The White House may take a my-way-or-the-highway approach by demanding a stand-alone debt ceiling increase, but history shows that restoring some semblance of fiscal discipline is a commonplace activity when authorizing an increase in the government's debt limit. In recent polling, only 24% of those surveyed think Congress should raise the debt ceiling without spending cuts.

What should Congress do?

As Congress negotiates the debt ceiling increase it will pass this spring, it should take into account the dire fiscal predicament that America is facing and the grim reality that delay and denial are not viable strategies to ensure economic prosperity for future generations. Thus, **the America First approach is to pair every dollar of debt ceiling increase with *even more* than that in near-term deficit reduction**. Given the enormity of the fiscal gap, an appropriate target would be *three dollars of near-term deficit reduction for every one dollar of debt ceiling increase*. Such implementation would mean that in exchange for $2 trillion more in the debt limit, there would be $6 trillion in deficit reduction over the next ten years. Absent bold action, out-of-control spending promises to grow the federal government and divert scarce resources from individuals, small businesses, and communities who know best how to manage their affairs. Tackling trillion-dollar annual budget deficits requires significant spending reductions that start now. Spending caps many years in the future rarely result in actual spending reductions and therefore do little to slow our debt growth.

However, given the current political environment, realizing this amount of deficit reduction may be unachievable. At a minimum, the principle of one dollar of deficit reduction for each dollar of debt ceiling extension should be feasible. If the federal government is going to increase its borrowing by roughly $2 trillion over the next two years (the current forecast), then Congress should enact a binding package of $2 trillion in deficit reductions that will occur within the next 10 years.

It is important that these reductions start immediately. We cannot accumulate another $15 trillion in debt held by the public in the next 10 years (the current forecast) absent consequences. We therefore cannot punt all of the reductions to the out years. A serious plan requires real reductions that begin right away.

Options Congress should consider include returning non-defense discretionary spending to pre-pandemic levels ($661 billion) and keeping it there. This would reduce spending on those activities from the $11.1 trillion that is forecast for the next ten years down to $6.6 trillion, providing $4.5 trillion in deficit reduction. Freezing it at 2022 levels of $962 billion per year would result in $1.5 trillion in deficit reduction over the next 10 years.

A second suggestion is legislation reimposing student loan payments and forbidding the Biden Administration from canceling or modifying student loan payments. That option would potentially provide another $500 billion in deficit reduction. Capping non-defense discretionary spending at 2022 levels while reversing the Administration's student loan giveaways would implement our "feasible" dollar-for-dollar principle. It would provide approximately $2 trillion in deficit reduction that would match a $2 trillion increase in the debt ceiling that would cover estimated deficits for the next two years.

Another viable source of deficit reduction is vastly increasing the amount of federal land available for drilling and mining. The United States achieved energy independence prior to the pandemic because of a sustained increase in domestic oil production. According to the Energy Information Administration, U.S. crude oil production rose from 8.7 million barrels per day in the summer of 2016 to approximately 12 million barrels per day in the summer of 2019. By contrast, domestic drilling in October 2022 (the latest available data) was down more than 400,000 barrels per day compared to what we were extracting in October 2019. We can simultaneously re-achieve energy independence, lower energy prices, refill the strategic petroleum reserve (SPR), and reduce the budget deficit by increasing oil drilling leases on federal land. The additional leases would generate revenues for the government that could be allocated explicitly toward deficit reduction.

One additional way to reduce deficits is to reimpose work requirements for able-bodied, prime-age adults as a condition for social benefits eligibility. With the Nation's labor force participation rate still a full percentage point below where it was at the onset of the pandemic, we are facing a significant labor shortage. Rather than incentivizing people to not work by offering generous healthcare, food, and income support, the federal government should require employment or participation in job training. Not only would this requirement reduce excessive federal spending, increasing employment would also raise income tax and Social Security tax receipts. It also would provide additional encouragement for able-bodied adults to realize self-sufficiency and the dignity of work.

Additional Budgetary Reforms

Congress should also tackle the broken budget and spending process. We are in this position because the previous Congress passed reckless spending packages like the infrastructure bill, the CHIPS Act, and the omnibus spending bill that all increase the debt but did not include a commensurate increase in the debt ceiling. That allowed Members to engage in fiscal mismanagement without bearing responsibility for it. If spending today is worth indebting the nation, then the spending package should authorize the debt implications of it. Congress should enact a rule that any legislation that is deemed by the Congressional Budget Office to increase the debt must include an increase in the debt ceiling commensurate with that estimated incremental debt. Doing so will ensure that Members who are taking credit for the additional spending they authorized will also be on the record for taking actions that are further indebting our Nation.

Congress should not pass a so-called prioritization bill. Prioritization is a process by which Congress states the order in which various spending would take place. An item would only be paid if there were sufficient receipts to pay everything of greater priority than that item and still enough for the one under consideration. Advocates argue that it would ensure that interest payments and Social Security benefits are paid. This is a bad idea because it will still be considered a default if the government purchased an item or employed someone and then refused to make payment for that good or service. If the procured item or job task is not a priority, why are we doing it at all? These low-priority items should be eliminated, not left unpaid.

Conclusion

The debt ceiling will be raised. However, significant deficit reduction is needed to keep our Nation from financial disaster. The current unsustainable fiscal path must be averted and the debt ceiling vote is the only time Congress is forced to confront it. An America First approach would apply the realizable principle that every dollar of debt ceiling increase should be accompanied by a dollar of deficit reduction. Economic prosperity and individual liberty are best accomplished by shrinking the size of government and limiting its activities to those enumerated in the Constitution. The massive increase in federal spending over the last few decades has been accompanied by a decline in both productivity and economic growth. Now is the time to put us on a new path towards responsible fiscal stewardship.

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