HITTING THE DEBT CEILING: What does it mean?

Talking points for webinar, presented by National Priorities Project, May 2011

Slide One: Hitting the Debt Ceiling: What does it mean and why should we care?

There has been much discussion lately about our country's debt and what it means for our economy. Congress will vote soon on whether to raise the debt ceiling. This webinar will explain the debt, the debt ceiling and why raising it is important for our economy.

Slide Two: Debt vs. Deficit

What is a deficit?

A deficit occurs when the government spends more than it receives in taxes in a given year.

The total national debt is the *sum* of the debt held by the *public* and debt *held by federal accounts*

What is *public debt*?

Public debt is the amount that the government has borrowed over the years to finance annual deficits.

Public debt is the value of federal securities sold to the public.

Public debt is held by international investors including other governments, domestic private investors, the Federal Reserve, and state and local governments.

What is *debt held by federal accounts*?

Debt held by federal accounts is the result of surpluses in federal government accounts that have been invested in Treasury securities.

This type of debt is held primarily in trust funds, such as Social Security, Medicare and the Civil Service Retirement Trust Fund .

Source:
Government Accounting Office, Federal Debt Basics website
http://www.gao.gov/special.pubs/longterm/debt/debtbasics.html

Slide Three: Why Borrow?

Deficits are necessary for governments to provide public services when revenues are not sufficient to fund all services. Historically, deficits have increased due to wartime spending and economic downturns.

As debt increases, so too does the interest owed. The government must pay interest on the national debt to keep it current. Paying only the interest does not pay down the debt (principal). To reduce the debt, government must run surpluses and use them to pay off the principal.

Source:
Office of Management and Budget, Budget of the United States Government FY2012, Public Database Revenues for 2012, Table 1.1 Summary of Receipts, Outlays, Surpluses and Deficits: 1789-2016

Slide Four: Early History of the Debt

Debt is not new. It's been a part of the U.S. economy from the beginning. The debt has grown primarily due to wartime spending and economic recessions.

The reduction of the debt to zero under President Jackson was an anomaly in our country's history. Jackson eliminated the central bank at the time and returned its assets to the U.S. government which created a surplus great enough to pay off the debt.

Sources:
Bureau of the Public Debt, Department of the Treasury History website,
http://www.publicdebt.treas.gov/history/history.htm

Office of Management and Budgdet, Budget of the United States Government FY2012, Public Database Revenues for 2012, Table 7.1 Federal Debt at the End of the Year: 1940-2016

Slide Five: History of Deficits and Surpluses

The U.S. ran large budget deficits during WWII with small post-war surpluses.

In the 1980s, deficits began to increase under President Reagan who decreased tax rates and increased military spending. In the mid to late 1990s, our nation experienced budget surpluses under President Clinton, due to tax increases on the wealthy and increased tax revenues from the "dot com" asset bubble.

Under President George W. Bush, the U.S. saw increased deficits largely due to his administration's tax cuts for the wealthiest Americans and the middle class, as well as the emergency supplemental bills used to fund the U.S. wars in Iraq and Afghanistan from 2001 to 2010.

The recent recession has increased the size of the deficit inherited by President Obama. The combination of lower tax revenues, due to higher unemployment, and the expansion of needbased programs, such as Food Stamps, Medicaid and unemployment insurance, has caused the deficit to increase.

Source:
Office of Management and Budget, Budget of the United States Government FY2012, Public Database Revenues for 2012, Table 1.1 Summary of Receipts, Outlays, Surpluses and Deficits: 1789-2016

Slide Six: History of Debt

It is common to measure the size of the debt as a percentage of Gross Domestic Product (GDP). GDP is the total income or output of a country. The Debt to GDP ratio is similar to a liability to assets ratio for an individual. It tells us how much a country owes vs. how much it can produce.

Note: Debt is the accumulation of many years' deficits while GDP is the output of a country in a given year.

Historically this ratio has been in the 20-60% of GDP range. The ratio was largest during WWII when it increased to more than 120% of GDP. This was due to the huge deficits the government ran to fuel the war effort.

Today it is around 100%, implying that our debt is approximately the same size as our annual output. As the size of the debt grows, the government must make larger interest payments with money it could otherwise be using to fund public programs.

Source:
Office of Management and Budget, Budget of the United States Government FY2012, Public Database Revenues for 2012, Table 7.1 Federal Debt at the End of the Year: 1940-2016

Slide Seven: The Debt Ceiling

The debt ceiling is similar to the limit on a personal credit card. Raising the limit allows the government to continue to borrow.

> "The debt limit does not control or limit the ability of the federal government to run deficits or incur obligations. Rather, it is a limit on the ability to pay obligations already incurred."
> ~ Government Accountability Office (GAO) report *Debt Limit*

In other words, the debt comes from past years' deficits. It needs to be raised even if the current deficit is cut. Just because there is a debt ceiling, this doesn't prevent the government from running deficits. They are two entirely different things.

More importantly, the discussion in Washington over whether to raise the debt ceiling is misleading because political parties are confounding the debt and deficit issues and using this to force concessions and spending cuts. Analysts agree that the ceiling must be raised; otherwise we run the risk of government default.

Source:
"Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market", GAO-11-203 February 22, 2011

Slide Eight: The Debt Ceiling

The slide shows historical increases in the debt ceiling enacted by Congress in response to the increasing national debt.

In the past, Congress's vote on the debt ceiling was a routine matter. It increased the debt ceiling in order to keep the government functioning. This is the same today.

All the different budget proposals currently being discussed will cause the level of debt to increase. While they reduce annual deficits by different amounts, none of them actually produce surpluses in the short-term. We need a budget surplus to reduce the debt.

Note: Two budget proposals were introduced in response to President Obama's budget for FY2012, one by House Budget Chair Paul Ryan and the other by the Congressional Progressive Caucus (CPC). The CPC's budget forecasts a surplus of $30 billion in 2021 while Rep. Ryan's budget does not project a surplus until 2040.

Sources:
Austin, D. Andrew and Mindy R. Levit, "The Debt Limit: History and Recent Increases," Congressional Research Service, January 28, 2010 and Department of Treasury
"The Path to Prosperity: FY2012 Budget Resolution", House Committee on the Budget, Chairman Paul Ryan (WI)
Fieldhouse, Andrew, "The People's Budget: A Technical Analysis", EPI Working Paper #290, April 2011

Slide Nine: What happens if current ceiling isn't raised?

In the short run, if the current debt ceiling is not raised, the Treasury could pay the interest on the debt first to avoid default before funding other federal programs. Monthly government receipts are greater than the monthly interest owed, so there is enough cash to at least cover interest payments. This means, however, that other government programs could lose funding, such as Social Security checks and soldiers' paychecks.

Slide Ten: Sources of Federal Government Income

The following are the projected revenue sources for FY2012

- Borrowing: 29%
- Individual income taxes: 31%
- Corporate income taxes: 9%
- Social insurance (payroll) taxes: 25% (a portion paid by the employee and a portion by the employer)
- Other taxes and fees: 6%

Individuals are the greatest contributors between income and payroll taxes.

Why do corporations pay such a small percentage? Historically, this has not been the case. Until the 1980s, corporations paid at least 40% of their profits in taxes. Today, they pay around 25%, even though the official rate is 35%. In 2010, if corporations had paid 40%, this would have produced an additional $230 billion in revenues.

Source:
Office of Management and Budget, Budget of the United States Government FY2012, Public Database Revenues for 2012

Slide Eleven: What happens if current ceiling isn't raised?

If the government defaults, it can't pay the interest on treasury bonds and other government securities. Treasury bonds will be down graded which will lessen their appeal for new investors and will impact investors who already hold these assets.

Note: Treasury bonds are backed by the U.S. government so they are considered a risk-free investment.

Slide Twelve: Who holds the debt?

The largest portion of the debt, 67%, is owned by the public while 33% is held in federal accounts, like social security and federal employee retirement trust funds.

Source:

Office of Management and Budget, Budget of the United States Government FY2012, Public Database Revenues for 2012, Table 7.1 Federal Debt at the End of the Year: 1940-2016

Slide Thirteen: Debt Held in Federal Accounts

Debt held in federal accounts is the debt that is held by the federal government itself. The largest portions are held by Social Security (which holds 57% of this type of debt) and the Civil Service Retirement Trust Fund (which holds 17%).

When these trust funds have surpluses, they invest in treasury securities because these types of assets are considered risk-free. When these accounts need more money than they take in, the trust funds cash in these securities.

Source:

GAO, Debt Basics
http://www.gao.gov/special.pubs/longterm/debt/debtbasics.html
GAO, Financial Audit: Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Federal Debt

Slide Fourteen: Debt Held by the Public

Of the public-owned portion of the debt, 47% is held internationally by both private investors and central banks of other countries, 36% by private domestic investors, 9% by the Federal Reserve and 8% by state and local governments.

The Federal Reserve's holdings are counted in the public debt portion because the Federal Reserve is independent of the government. The Fed buys and sells treasury securities as part of its open market operations, which is one way that it controls interest rates in the economy.

In terms of the countries that comprise the 47%, China holds the most ($1.1 trillion), followed by Japan ($800 billion), Middle East oil exporting countries ($173 billion), Russia ($168 billion), Brazil ($164 billion) and Taiwan ($152 billion).

Source:
GAO, Ownership of Federal Debt website
http://www.gao.gov/special.pubs/longterm/debt/ownership.html
Federal Reserve, Flow of Funds Accounts of the United States, Third Quarter 2010

Slide Fifteen: The Current Debate

The real question is not if Congress votes to increase the debt ceiling but when. The longer it waits, the more the credibility and credit worthiness of the United States government will be threatened. The ceiling must be increased in order to keep the U.S. government and economy functioning.

Source:
Department of the Treasury, Debt to the Penny website
http://www.treasurydirect.gov/NP/BPDLogin?application=np

Slide Sixteen: Summary

To recap, the federal debt and annual deficits are two different things. Deficits add to the debt while surpluses reduce the debt.

The debt is the result of past deficit spending.

The debt ceiling is a legal limit on borrowing set by Congress. It does not determine whether an annual budget will be balanced or run a deficit or surplus. Instead, it serves as the total cap on borrowing.