Hitting the Debt Ceiling

What does it mean?

and

Why should we care?

NATIONAL PRIORITIES PROJECT

Bringing the Federal Budget Home

Debt vs. Deficit

What is a deficit?

Occurs when government spending is greater than revenues in a given year

What is debt?

Debt is the total amount that the government owes

Debt increases when the federal budget has a deficit

The federal debt is comprised of *public debt* and *debt held by federal accounts*, such as Medicare and Social Security

Why Borrow?

Governments borrow to provide for public services when their revenues are not great enough

Examples:

- World War II
- Bush Administration – funded Iraq & Afghanistan wars & instituted tax cuts
- Obama Administration– federal stimulus and decreased tax revenue from rise in unemployment during recession

What if revenues are greater than spending?

Since 1901, there have been 31 annual surpluses. The longest period was during the 1920s boom. These surpluses have allowed the U.S. to pay down its debt.

Early History of the Debt

1791 – earliest records of the debt were during the Revolutionary War, when it was over $75 million

War of 1812 – debt rose from $45.2 million in 1812 to $119.2 million in 1815

January 1835 – Pres. Andrew Jackson reduced the debt to zero (the only time in US history)

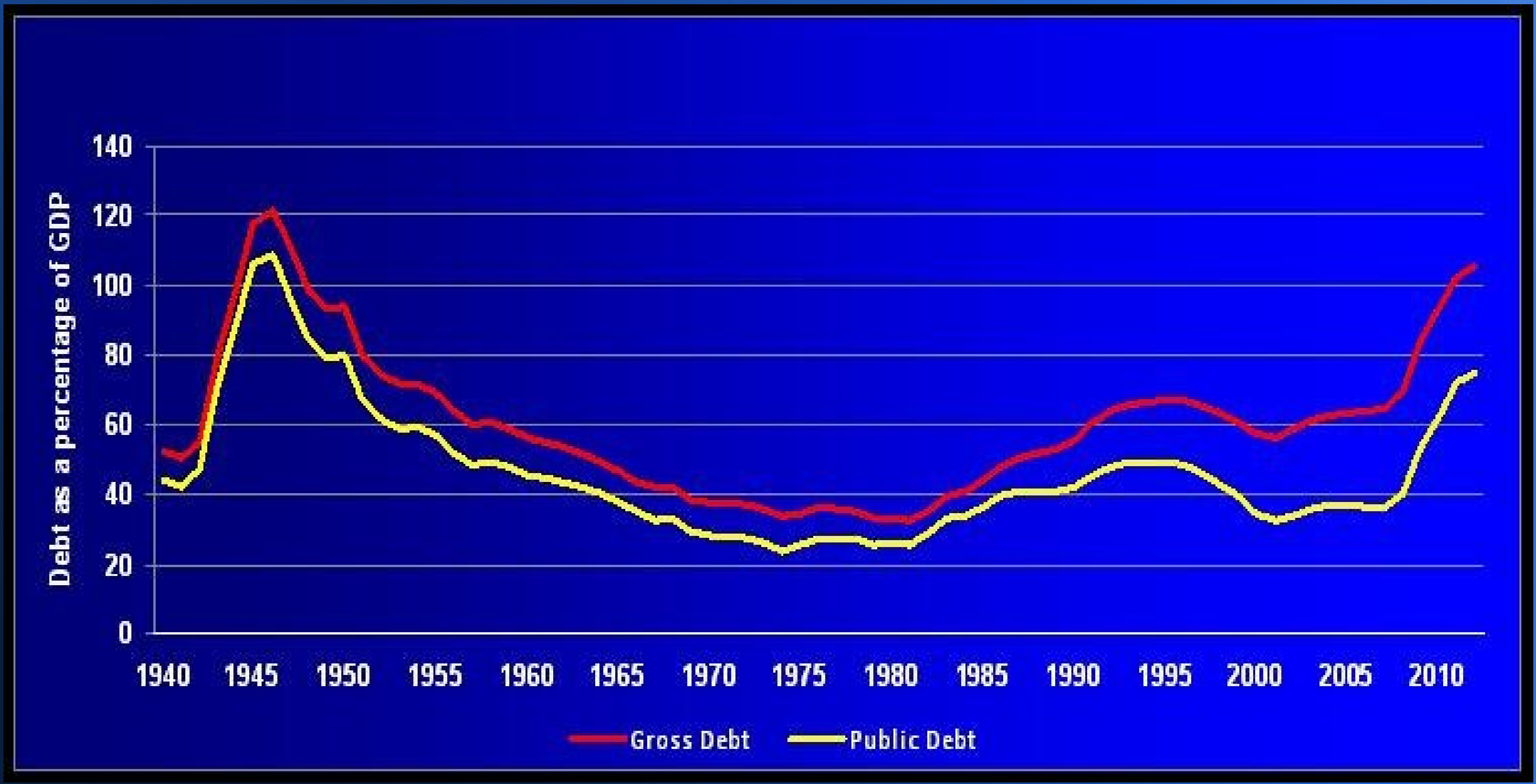
Civil War – debt was $65 million in 1860, grew to $1 billion in 1863 and had reached $2.7 billion following the war

World War I – debt increased to $22 billion to fund American involvement

World War II – debt rose from $51 billion in 1940, before the war, to $270 billion in 1946 following the war

History of Deficits & Surpluses 1940-2012

History of Debt
1940-2012



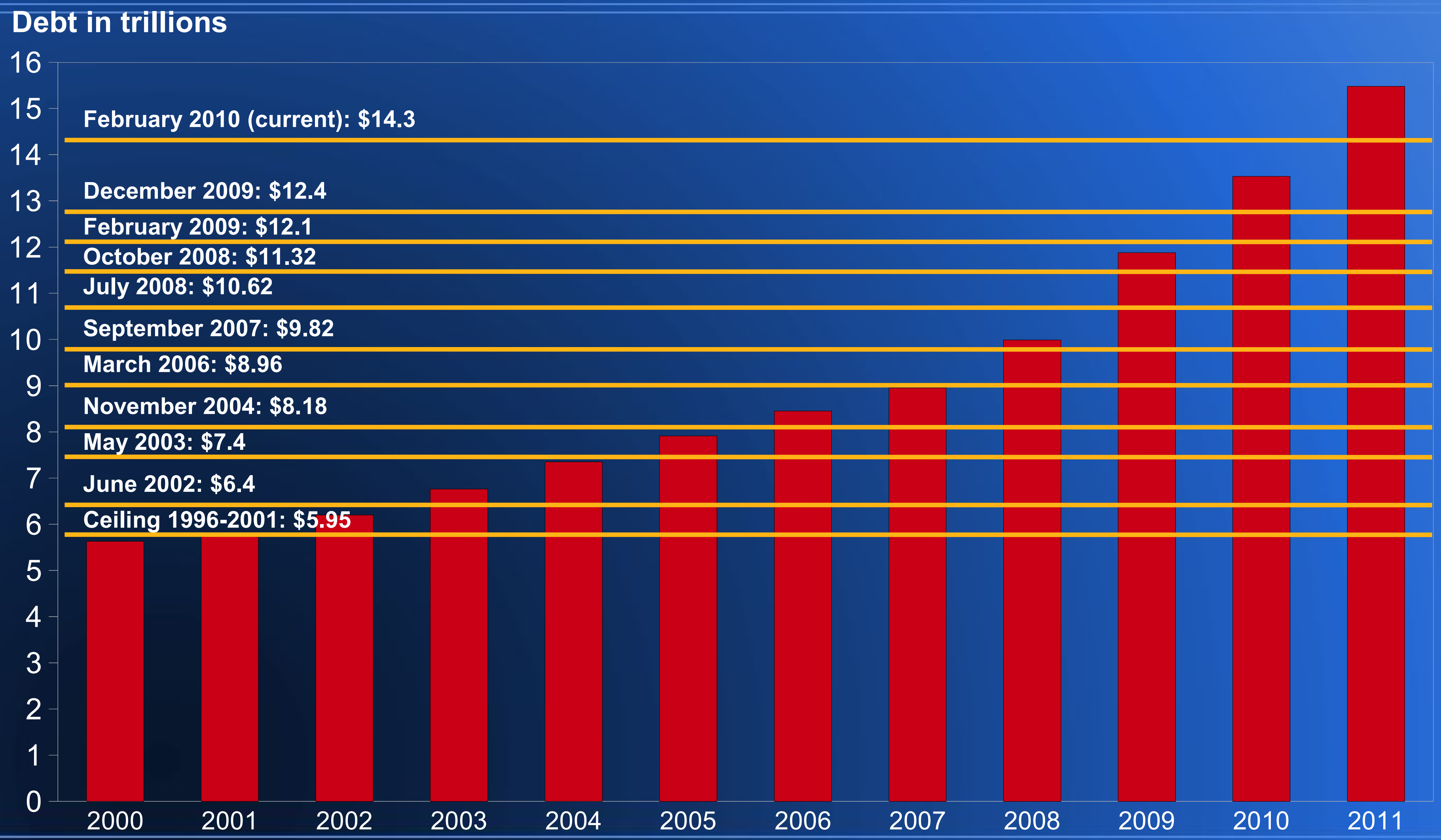
The Debt Ceiling

Debt Ceiling – a cap on the total amount that the Treasury can borrow which is set by Congress

- First debt ceiling was set in 1917
- Congress has raised the ceiling 74 times since 1962 including 10 times since 2001

Current debt ceiling is $14.3 trillion, set in February 2010

The Debt Ceiling

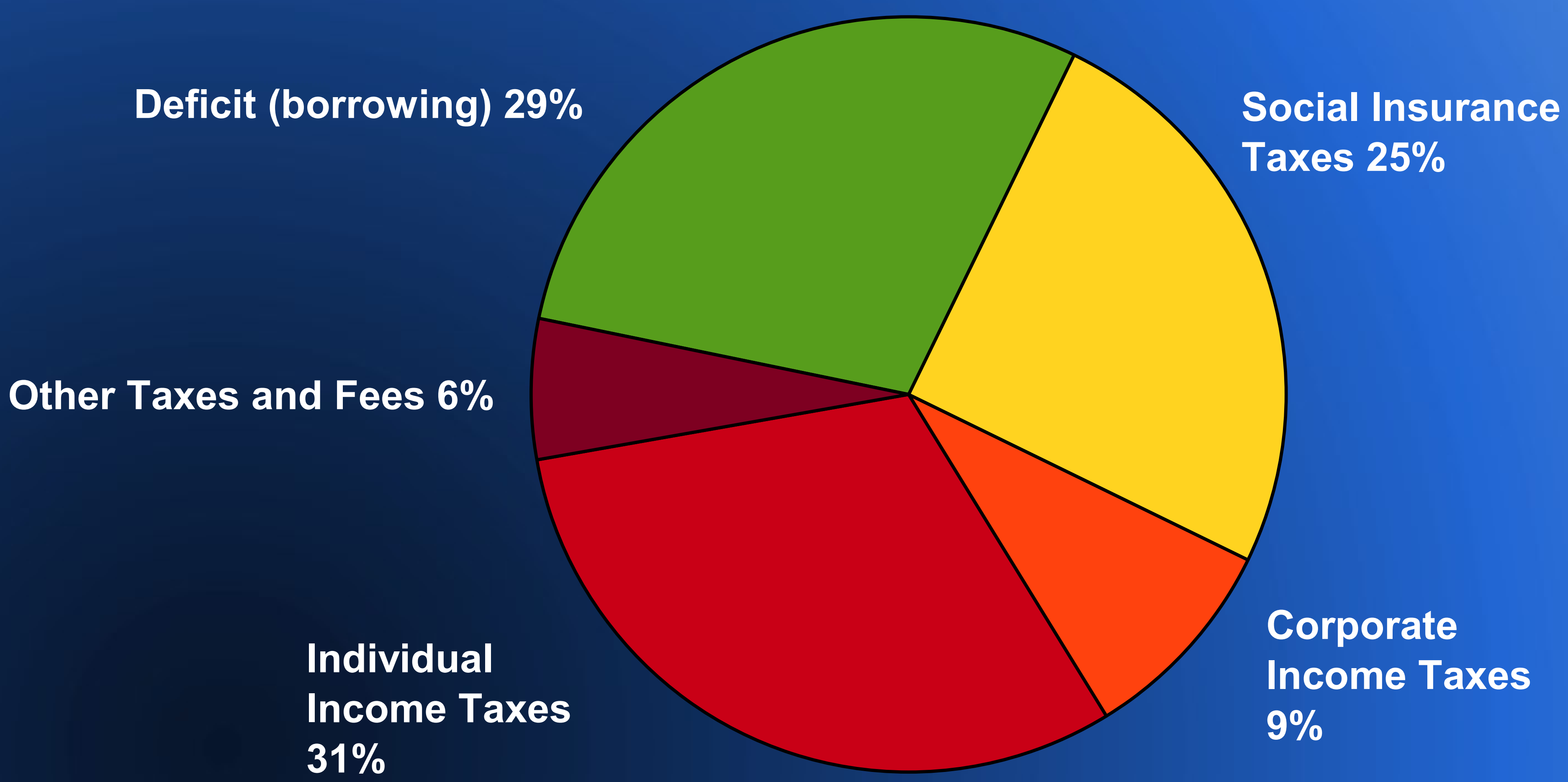


What happens if current ceiling isn't raised?

Government can dramatically reduce spending or increase taxes in order to create a balanced budget

Since borrowing is projected to account for 29% of the government's revenue, this will entail radical cuts in critical programs

Sources of Federal Government Income (FY2012)

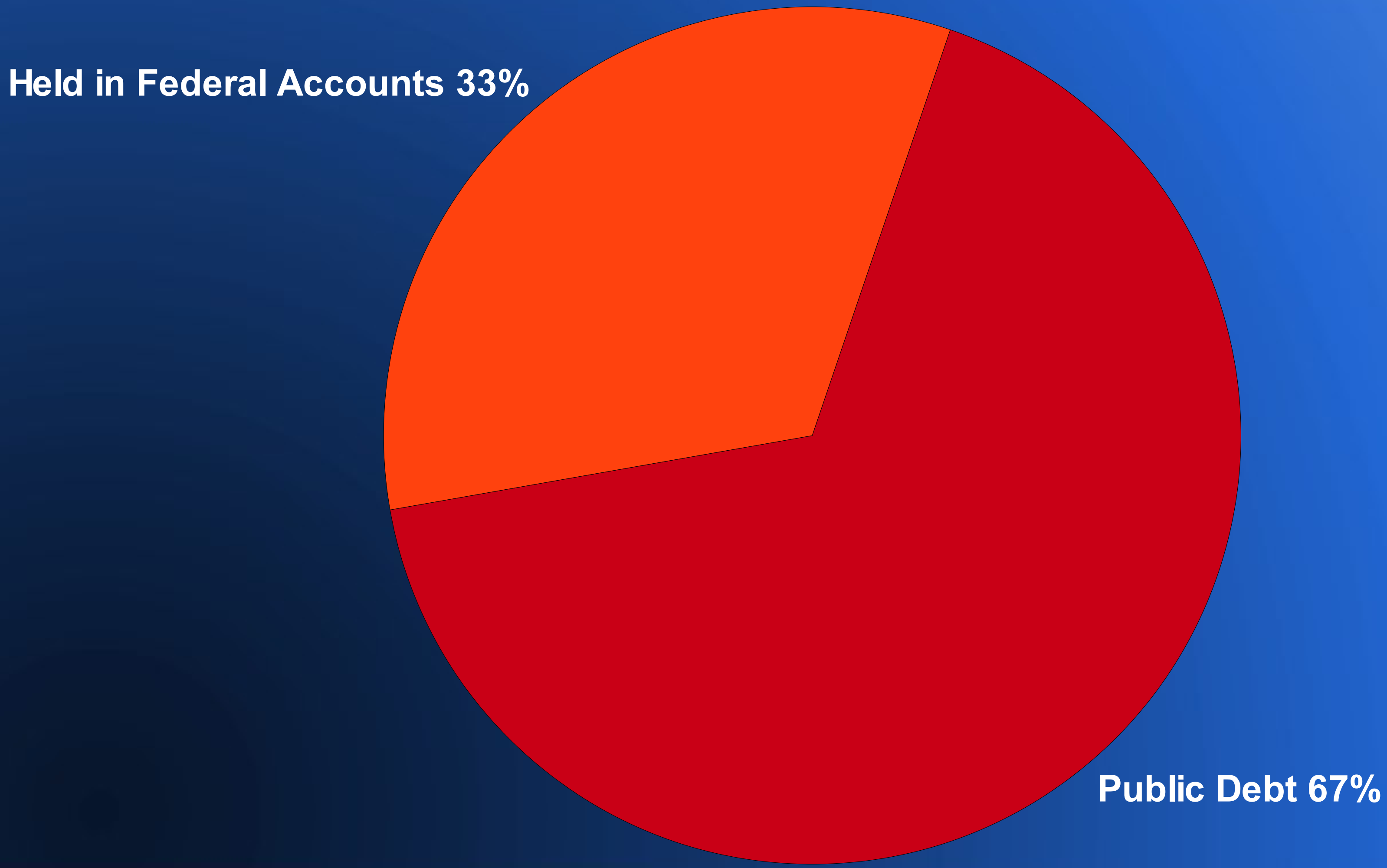


What happens if current ceiling isn't raised?

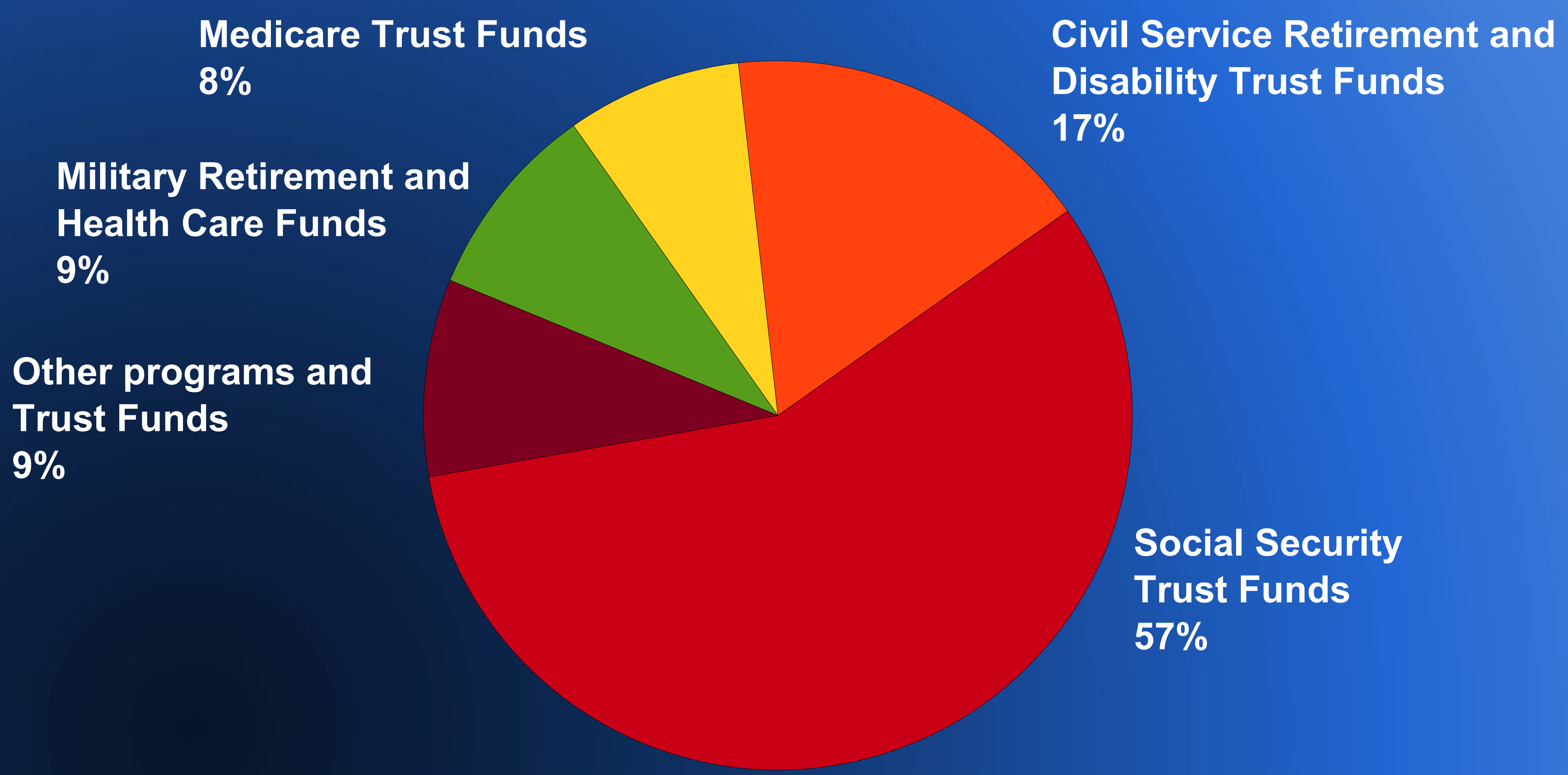
Government can default on its debt – not pay the principal or interest – this has never happened in history

Since over 60% of the debt is held by the public, including the central banks of other countries, this could destabilize the global economy

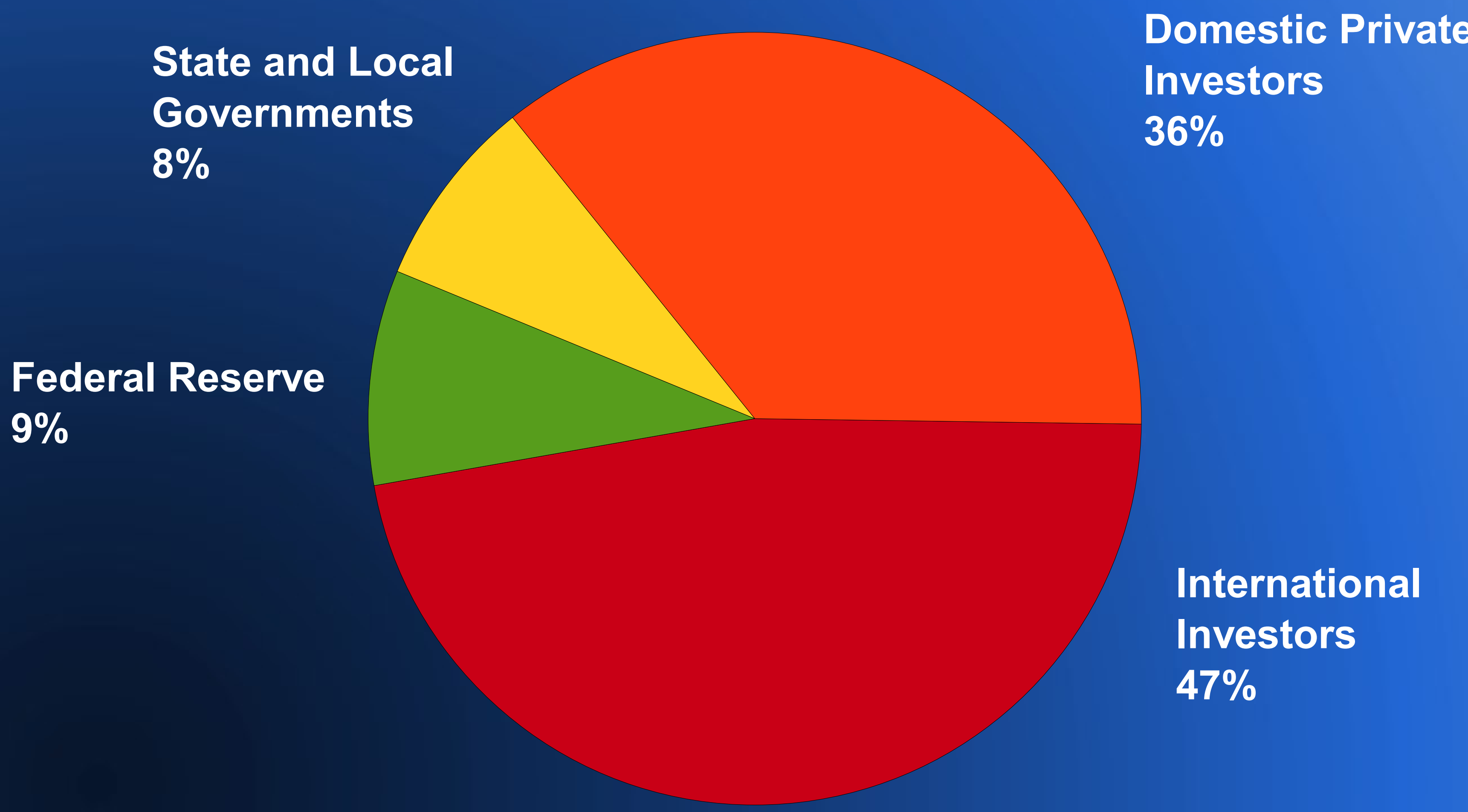
Who Holds the Debt?
(at end of FY2010)



Debt Held by Federal Accounts
(at end of FY2010)



Debt Held by the Public
(at end of FY2010)



The Current Debate

What's happening right now in Congress?

Opponents of raising the debt ceiling say that we cannot continue to add to our debt and that we must enact severe spending cuts in order to reduce deficits. They believe we should tie raising the debt ceiling to significant spending cuts.

Proponents advocate that the threat of government default will have significant consequences for both the U.S. and global economies. They believe that discussions about reducing deficits must be kept separate from whether or not to raise debt ceiling.

Summary

- The federal debt has increased due to past deficits which resulted from a decline in revenues and an increase in government programs and wartime spending.
- The debt ceiling allows the government to borrow up to a certain amount.
- The only way to reduce our debt is through a government surplus.
- There is no legal requirement that raising the debt ceiling be linked to changes in federal fiscal policy, such as deficit reduction.
- While the current budget proposals reduce next year’s deficit by differing amounts, none of them propose a surplus for FY2012.

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