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THE DEBT CEILING DILEMMA*

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Global investors watch America anxiously

In late December, the U.S. technically reached its debt ceiling of approximately $16.4 trillion, with the federal government taking what Treasury Secretary Timothy Geithner called "extraordinary measures" to avert a default.[1]

Even as House GOP leaders announced plans Friday to approve a three-month increase in the federal debt limit, tension remains - and that tension could provoke a debt ceiling battle on Capitol Hill reminiscent of the impasse of 2011 later this year.[2]

President Obama has again presented a debt ceiling hike as an essential move needed to pay America's bills. House Republicans do not want to see a long-term increase in the debt limit without corresponding spending cuts, and some conservatives have characterized the Obama administration's warnings as more posturing than fact.

A new plan to deal with critical fiscal deadlines

Sometime between February 15 and March 15, the federal government's borrowing capacity will (in theory) be exhausted. March 1 now represents the start of the "sequester" – the automatic spending cuts detailed in the 2011 deficit accord. On March 27, a six-month measure passed to fund federal government operations expires.[3]

Last week, House Majority Leader Eric Cantor (R-VA) unveiled a plan for a three-month extension of the debt limit, which would offer Congress additional time to pass a budget. Under the plan, Senators and Representatives would work without pay if Congress failed to approve a budget within the three-month window. Any further extension of the debt ceiling window would be contingent on Democrats approving significant federal spending cuts.[2]

Will an extended battle be averted?

Hopefully so – prolonging the debt ceiling fight into spring could do far more economic damage than that threatened by the fiscal cliff. In a recent *Wall Street Journal* commentary, Princeton University economist Alan Blinder envisioned a 6% GDP contraction "if the government hits the debt ceiling at full speed" in 2013, as a forced 26% cut in federal outlays would result. An outright drop off the fiscal cliff, in Blinder's view, would have reduced U.S. growth by 4.5%.[4]

A true default could invite a harsh recession – jobless benefits could be reduced or curtailed, and Social Security checks and pay to soldiers could even be delayed. Consumer spending could decrease along with federal tax revenues.[4]

The risk of an outright default may be overblown

Addressing the media on January 14, the President seemed to hint that the government would prioritize interest payments on Treasuries over other debt obligations in a worst-case scenario. Some congressional Republicans have called for such prioritization in a crisis – that is, the Treasury simply making selective payments on what America owes first, with other debts to be addressed later. The question is, would that be enough to preclude another downgrade by the major credit ratings firms? (Beyond that question, there is an issue of legality: President Obama lacks a distinct legal authority to prioritize certain debt payments over others.)[5]

Is the White House overstating the threat?

Some conservatives believe so. As Cato Institute fellow Michael D. Tanner recently noted, the federal government will owe somewhere around $38.1 billion in interest payments between February 15 and March 15. If it doesn't pay them, it will default. Almost unpublicized, however, is the federal government's projected receipt of $277 billion in taxes and other revenue within that same interval.[6]

That isn't enough to fuel the $452 billion in federal spending stipulated between February 15 and March 15, but it would be enough to pay the interest on the debt and keep Medicare, Social Security and service member payments on track. About $500 billion in debt will mature between February 15 and March 15 – but the federal government routinely rolls over such debt rather than paying it off, swapping new debt for maturing debt.[6]

Multiple solutions have been suggested

In addition to the GOP proposal, some "quick fixes" for the issue have been suggested, some bordering on the sensational.

House Minority Leader Nancy Pelosi (D-CA) would like to see the President invoke the 14th Amendment to the Constitution to raise the debt limit – specifically Section 4, which reads "The validity of the public debt of the United States...shall not be questioned." The White House has rejected that idea.[7]

Citing a clause in the Coinage Act of 1996, a Georgia lawyer named Carlos Mucha has proposed that the Treasury Secretary authorize the U.S. Mint to make a $1 trillion platinum coin which could be deposited at the Federal Reserve. Mucha claims that the Fed could credit the account of the U.S. government for that $1 trillion and solve the whole problem in one fell swoop. The Treasury has rejected the idea.[8]

The GOP proposal announced on January 18 could be a step toward a bipartisan compromise on the debt limit – which hopefully will occur before summer arrives.

* This commentary is presented with minor modifications from material prepared by MarketingLibrary.Net Inc.,

Citations.

1 – www.latimes.com/business/money/la-fi-mo-debt-limit-geithner-treasury-boehner-obama-20130114,0,5318272.story [1/13/13]
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