Institute for Youth in Policy

The Debt Ceiling

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Executive Summary

Fiscal spending is perhaps the single greatest piece of Congress' agenda in any given year. Congressional discourse regarding caps on spending caps have brought about a plethora of instances when the federal government halted operations. The conversation regarding the debt ceiling is an imperative one as congressional purchasing power is the primary driver of all areas of American policy. Moreover, this brief seeks to thoroughly analyze the affirmative and negative stance on the existence of a debt ceiling. After comparing both viewpoints, this brief will attempt to provide a policy recommendation for Congress regarding the existence and extent of a debt ceiling.

Introduction

- The debt ceiling has been used by partisan actors throughout the 21st century.
- If the debt ceiling is reached without an increase, the Treasury Department has to resort to its contractual obligations in chipping away from its bonds, increasing the chance that payments to bondholders will be delayed.

Modern precedents regarding congressional debates have been politically dramatic. Despite its bipartisan history, the debt ceiling has been a center for partisanship since the opening of the century. Take two instances, then Senator Joe Biden and fellow Democrats refused to increase the debt ceiling during George W. Bush's presidency in protest of the Iraq War. In the next administration, Republicans sought to make spending cuts in attempts to choke out Obama's Affordable Care Act in 2013 which ultimately led to a government shutdown. Today, President Biden attempts to lift the debt ceiling to fund his administration's federal programs. One of the only bipartisan agreements on the debt ceiling in the past decade was when Trump tentatively abolishing the debt ceiling to sidestep a major political showdown before the 2020 election.

Political bickering regarding the debt ceiling originates from the two party's economic stances. Democrats, who primarily abide by fiscal interventionism, advocate for a higher debt ceiling in order to maximize social welfare and fiscal policy. In addition, the Democrats' stance on maximal government intervention prompts additional economic spending such as subsidies. Conversely, Republicans, who primarily abide by supply-side economics, tend to direct government spending into bolstering economic positions of corporations. Additionally, free market economists advocate for a lower debt ceiling to minimize government intervention entirely.

Outside of the realm of economics and politics, however, lurking variables in investments and faith in the U.S. government must be considered when determining the debt ceiling. For instance, if national spending surpasses the ceiling due to the failure of increasing the debt ceiling, the Treasury Department has to resort to its contractual obligations in chipping away from its bonds, according to Treasury Secretary Janet Yellen. The results of this are detrimental as chipping away from bonds results in a higher chance of delayed payments to bondholders. This would ultimately decrease the propensity of investors and banks to invest in bonds which would impact the Federal Reserve's open market operations, which is the primary course of action in both expansionary and contractionary monetary policy. As a result, the discussion of the debt ceiling is integral outside of the realm of politics as its effects are volatile and impactful.

Policy Analysis - Pros

- The debt ceiling is designed to force Congress to consider a spending limit when creating new policy.
- Without the debt ceiling, an unconstrained Congress could spend beyond its means, forcing tax increases and inflation in the long run.
- The debt ceiling limits government intervention, creating a space for private entrepreneurship.

The first side of this debate that will be introduced is the side which advocates for a debt ceiling. It must first be noted that a debt ceiling can be placed at any number and the number it is placed at can have different effects, however; this analysis will solely focus on the concept of a debt ceiling alone. The arguments that will be presented which favor the debt ceiling are the increase in debt and taxation that would occur if the debt ceiling was not upheld, as well as the ability to restructure the economy for sustainability which is provided by the debt ceiling.

To begin, it must be understood that without a debt ceiling there would be an increase in debt which leads to long term, negative economic outcomes. The reason the debt would increase is because the president and Congress would be able to push any legislation without the worry of a spending limit. It can be assumed that the government would spend more if they could by looking at the numerous times in history the debt ceiling has been raised or called to be raised by government officials. This fact is illustrated by the Mercatus Center, that explains between 1980 and 2012 the debt ceiling was raised 35 times during which the ceiling had been raised over 15 trillion dollars throughout that time period. Along with this, the study also shows a proportional increase in debt to the debt ceiling raises which again reinforces the idea that without the debt ceiling, debt would likely increase rampadantly at unprecedented rates. But why does debt matter? The main point of emphasis regarding increased debt is that it undermines foreign trust in the US dollar thus making it more expensive for federal and private financing within international markets. This is admitted by the Congressional Budget Office when they say, "A growing debt burden could … undermine confidence in the U.S. dollar, making it more costly to finance public and private activity in international markets." Increased debt comes through an increase in fiscal spending and with an increase in fiscal spending there is more US dollars that are available thus increasing inflation. This inflation would be the main reason that there is less confidence in the American dollar and this lack of confidence would lead to people on foreign markets demanding higher payments than before as insurance. There are other implications of a rise in debt but this seems to be one of the most prominent effects.

The second problem that needs to be outlined is the increase in taxation that would occur if the debt ceiling were eliminated. As discussed previously, without the debt ceiling the government would likely spend an unprecedented amount of money. However, the government knows they cannot spend that money without redeeming some for the sake of preventing hyper inflation i.e. taxation. Some may see this and believe that inflation would thus not be a worry which is not true. Although no focus will be put on inflation, it is crucial to understand that the government can redeem some money to prevent hyperinflation. However, they are incapable of redeeming the exact amount of money they put into the economy thus leaving hundreds of millions of bills to circulate thus leaving room for inflation to occur as a result of this fiscal spending. In regards to taxation, when the government needs to raise taxes they are imposing negative effects on the economy. Taxation removes money from the hands of consumers and prevents them from demanding or purchasing the goods they desire which would not only keep them from fulfilling their demand but it also keeps them from benefiting the businesses they would be buying from. On top of this, it takes money out of the hands of entrepreneurs and prevents them from reinvesting that money into capital goods or labor which would allow them to better fulfill demand. Empirically, it is well documented that taxation has negative impacts as shown in the study "Taxation and Growth" in which it talks about the effects of tax cuts and says, "Our results suggest modest effects, on the order of 0.2 to 0.3 percentage point differences in growth rates in response to a major tax reform that changes all marginal tax rates by 5 percentage points and average tax rates by 2.5 percentage points. Nevertheless, even such small effects can have a large cumulative impact on living standards." Another study called "Tax Structure and Economic Growth" also finds a negative correlation between taxation and economic growth which is expressed when they say, "We find that statutory corporate tax rates are significantly negatively correlated with cross-sectional differences in average economic growth rates, controlling for various other determinants of economic growth, and other standard tax variables. In fixed-effect regressions, we again find that increases in corporate tax rates lead to lower future growth rates within countries." Both of these studies reinforce the claims made regarding taxation and thus strengthen the argument for a debt ceiling as with a debt ceiling, taxation would be much lower and the negative impacts would be lessened.

The final argument that will be introduced is that of the ability to sustainably restructure the economy. To sustainably restructure the economy is to build an economy on the foundation of private ownership and entrepreneurship rather than government spending. With a debt ceiling, it is possible to limit government spending to the point in which entrepreneurship can take hold of the economy and be introduced to sectors it was not in before because it was controlled by the government. With decreased fiscal spending, companies that were able to sustain themselves and make good market decisions that benefited consumers would be promoted rather than businesses which relied on government subsidies despite poor decision making. With less federal spending comes less federal employees and thus more workers on the labor market to work in different industries that consumers are actually demanding in. With less federal involvement in the economy they would be forced to eliminate many regulatory structures which burden the economy which would further lead to job growth and economic stimulation in the private sector. This claim is substantiated within a study by the Phoenix Center which finds that a 5% reduction in the federal regulatory budget would lead to a 75% increase in private sector GDP and 1.2 million jobs annually. Overall, a debt ceiling does not necessarily lead to these outcomes, however; it is a realistic method for inciting these outcomes. As stated in the beginning, the effects of the debt ceiling largely depend on how it is used, and therefore the argument for a debt ceiling has to be based on the ways it can be used. It has just been shown that the debt ceiling is capable of creating a myriad of economic opportunities which positively benefit the American society as a whole.

Policy Analysis - Cons

- Partisan bickering over the debt ceiling risks America's full faith and credit.
- The debt ceiling does not meaningfully limit spending increases in new proposals.
- Spending has risen regardless of the debt ceiling.

The debt ceiling is a consistently recurring policy issue that will lay dormant until the party once in opposition has flipped their stance to support their own needs, thus erecting controversy. However, after years and years of watching the debt ceiling fail to serve its theoretical purpose of restraining America's debt, it has become apparent that it is a façade. It has become a threat to national fiscal security as opposed to a monitor or beneficial mechanism. It has become a bargaining chip cap of rhetoric on our nation's economy with only temporary brakes of debate until it is raised.

Arguing to destroy a seemingly necessary restriction on our nation's spending habits seems odd. One might say, "Why not just keep this blockage on spending? That way, we can safely lower our spending packages and finally stop blowing out a deficit, be a more financially secure country, and lower taxes." As conveyed by the Economic Policy Institute, it would hardly take an act of god to flush the economy into recession after a few months of some overdue Treasury Bills. Rather, it is just a natural mechanism. Just like brakes applied leads to a car stopping it is a proper sequence of events. The EPI goes on to state that in addition to hitting the debt ceiling and the nation entering an almost immediate recession, it goes "without assessing damage it would cause from financial market fallouts." Within this simple argument, it is valid in favor of abolishing the debt ceiling based on proximity alone. Simply put, the closer we get to the limit, the more we risk a recession. Not only is the ceiling unnecessary, it has become a sword for either party's congressional control to wield over the executive. This more threatening than beneficial cap on government spending is not only dangerous in its independent state but also since there is a party objective at play.

The debt ceiling is illogical. Since it just continues to rise, as our national spending does on an incomprehensible level, why even bother creating an extra obstacle and task when we know it will rise regardless. Referencing an article from the Cato Institute by David Boaz, "In 1981, after 190 years of federal spending, the national debt was "only" $1 trillion. Now, just 40 years later, it's more than $28 trillion. Traditionally, the national debt as a percentage of GDP rose during major wars and the Great Depression. But there's been no major war or depression in the past 40 years; we've just run up another $27 trillion more in spending than the country was willing to pay for." Just recently, throughout every year of the Trump Administration the debt ceiling was exponentially surpassed, as well as most of the Obama Administration. Collectively, the administrations pushed public debt past levels not seen since World War Two. Additionally, regarding the present within the Biden Administration, we have already reached World War Two spending levels due to the Pandemic Relief. In the year 2000, the total federal spending rested at 1.79 Trillion. Now, in 2021, it is 6.84 Trillion. It is quite ironic that the debt limit does not seem to limit anything. It is just something, when we come close to it, that makes the current administration fret and work on "solutions" for publicity. Eliminating an aspect of our government to avoid recession and government shutdowns by resolving spending through bi-partisan acts seems to be a significantly better alternative than only revisiting the debt problem when we reach the ceiling.

Analysis and Conclusion

- Proponents of the debt ceiling argue that there is no spending limit without a debt ceiling, which could allow the total amount of debt to rise exponentially.
- Opponents of the debt ceiling justify their stance through its failure to substantially limit spending.
- We recommend the construction of a bipartisan congressional committee that specializes in calculating the debt ceiling given economic factors.

The economic outlook primarily justifies an affirmative stance on the existence of the debt ceiling. Specifically, the affirmative primarily argues that there is no spending limit without a debt ceiling, which ultimately means congress can enact any policy. As a result, without the parameters of spending limits, the total amount of debt can rise exponentially. This impact is critical to realize because foreign trust in the American dollar decreases, and as a result, the U.S. government loses leverage in the international market. In addition to this, proponents of a debt ceiling may also argue the inevitability of raising taxational pressure on consumers. The government would realize that its increase in spending due to the absence of a debt ceiling would require a concentrated and dense input of capital. As a result, the government would have to resort to its primary method of earning, which is taxation. However, when consumers are the primary drivers of an economy via purchasing goods and services, the tax increase decreases consumers' purchasing power, which would ultimately shrink the economy.

Conversely, opponents of the debt ceiling may primarily justify their stance by accentuating failed precedents of the ceiling. First, opponents may argue that the debt ceiling value is entirely arbitrary with no economic factors taken into consideration by congress. As a result, this renders the debt ceiling an arbitrarily constructed number that does not consider economic factors. In addition, negations argue how the debt ceiling provides a strict limit for expansionary fiscal policies. Specifically, the existence of parameters in government spending may decrease the magnitude of an expansionary program contrary to its recommended prescription.

Considering all factors and contentions proposed in this brief, we recommend the existence of a debt ceiling with several modifications. First, we justify the existence of a debt ceiling under three critical issues that would arise if dissolved:

1. The U.S. government losing leverage in the international market as a result of the depreciating dollar
2. The loss of purchasing power for average consumers as a result of high taxational pressures
3. The government crowding out the private sector with potential workers as a result of increased government involvement and subsidies in the economy

However, we also do realize that the negation raises addressable concerns. Specifically, the notion that the debt ceiling is an entirely arbitrary number needs to be changed. We recommend the construction of a bipartisan congressional committee that specializes in calculating the debt ceiling given economic factors. This way, we can address the current issues with the debt ceiling while also preserving the benefits.

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Luke Drago is a committed citizen who has actualized his passion for community change with years of experience in leadership, political strategy, public policy, communications, and organizing. He was raised in Charlotte, North Carolina. He studies Politics & History at the University of Oxford and is a college member of St Edmund Hall. Luke has worked on campaigns at every level of government, from local elections to presidential elections. He has been a successful advocate for numerous policy initiatives, including a district-wide school security overhaul and a historic local investment into attainable housing. He is driven by a conviction that public policy can be a powerful mechanism to change lives and shape the future.

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