Hitting the Federal Debt Ceiling

That bump you just felt was the U.S. Treasury running up against the federal debt ceiling of $14.3 trillion. It happened on May 16 and was, as all the proponents of raising the ceiling warned, supposed to precipitate the greatest economic catastrophe in history.

You say you didn't feel a thing? Well, that's only because our benevolent Treasury Secretary, Timothy Geithner (left), managed to implement "extraordinary measures" to stave off the calamity until August 2, at which time there will, he insists, be no saving not just America but the entire world. Those "extraordinary measures," by the way, amount to not "issuing and reinvesting government securities in certain government pension plans," explains Robert Wenzel of EconomicPolicyJournal.com.

Just what is the debt ceiling? Theoretically, it is the maximum amount of the debt the Treasury is permitted to issue. Practically, it is a smokescreen designed to make voters think Congress is serious about tackling the problem of deficit spending. As Geithner never tires of reminding us, "Congress has always acted when called upon to raise the debt limit. Since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit." In other words, given the choice between reining in spending and going further into debt, Congress has invariably chosen the latter.

In a recent letter to Sen. Michael Bennet (D-Colo.), Geithner reiterated the disasters that he believes could befall us if the debt ceiling is not increased: forced spending cuts; higher interest rates; "a sharp decline in household wealth"; an increased federal debt burden; a global economic crisis; and "a double dip recession." The hyperbole is so thick you can cut it with a Ginsu knife — and still slice a tomato.

The fact that Geithner has found ways to put off the inevitable collision of deficit spending and the debt limit proves that raising the limit is not nearly as urgent as Geithner and other Democrats would have us believe. As Michael Tanner of the Cato Institute pointed out in January:

> While Congress has never before refused to raise the debt ceiling, it has in fact frequently taken its time about doing so. In 1985, for example, Congress waited nearly three months after the debt limit was reached before it authorized a permanent increase. In 1995, four and a half months passed between the time that the government hit its statutory limit and the time Congress acted. And in 2002, Congress delayed raising the debt ceiling for three months…. In none of those cases did the world end.

Republicans, therefore, can afford to wait this battle out, hoping the Obama administration blinks first and concedes to "cuts of trillions, not billions" of dollars — the price House Speaker John Boehner (R-Ohio) demanded in exchange for GOP acquiescence on raising the debt ceiling. Their resolve should also be strengthened by the fact that public opinion is on their side. A May 5–8 Gallup poll found that 47 percent of Americans are opposed to raising the debt ceiling, while only 19 percent are in favor of it. (The other 34 percent weren't paying attention enough to have an opinion on the subject.)

Suppose, however, that the two sides reach an impasse and the debt ceiling, for the first time in history, remains fixed. Then what? Geithner is correct that it "would force the United States to default on [its legal] obligations," but is that necessarily a bad thing?

One can be relatively certain that Geithner would not choose to forego any debt service payments, thereby costing the United States its coveted AAA bond rating. (On the other hand, making it more difficult for the federal government to go into future debt would surely have its benefits.) Thus, all of Geithner's concerns about increased interest rates on Treasury bonds — and the resultant higher rates for other public and private debts — and global financial "panic" resulting from default on U.S. bonds are misplaced.

If anything, the government's refusal to take on more debt should encourage investors that they will be repaid because their debtor has finally taken control of his borrowing addiction. "In that event," wrote *The New American*'s Bob Adelmann, "it is possible that interest rates might even recede, reflecting a lower risk of default than at present, which would reduce the government's borrowing costs — a nice bonus."

Given that debt service is likely to continue under any circumstances, if the debt ceiling is not raised, the only remaining option is to start cutting other spending — with a machete, not a scalpel. This would require attacking not just easy but relatively insignificant targets like pork barrel projects and foreign aid but also enormously expensive and unconstitutional entitlements like Social Security and Medicare.

Geithner maintains that such an outcome "would likely push us into a double dip recession." It would certainly have its ill effects, but nothing that the free market (which would be freer because of the reduction in government) and the highly charitable American people could not handle.

Moreover, the notion that cutting government spending would be a net negative for the economy is not borne out by history. Consider the depression of 1920-21, one of which most Americans have never heard because (a) it was so brief and (b) it refutes the conventional Keynesian wisdom that government spending can lift the economy out of recession. Thomas E. Woods, Jr., author of *Rollback: Repealing Big Government Before the Coming Fiscal Collapse*, writes:

> The economic situation in 1920 was grim. By that year unemployment had jumped from 4 percent to nearly 12 percent, and GNP declined 17 percent. No wonder, then, that Secretary of Commerce Herbert Hoover — falsely characterized as a supporter of laissez-faire economics — urged President Harding to consider an array of interventions to turn the economy around. Hoover was ignored.

Instead of "fiscal stimulus," Harding cut the government's budget nearly in half between 1920 and 1922. The rest of Harding's approach was equally laissez-faire. Tax rates were slashed for all income groups. The national debt was reduced by one-third. The Federal Reserve's activity, moreover, was hardly noticeable. As one economic historian puts it, "Despite the severity of the contraction, the Fed did not move to use its powers to turn the money supply around and fight the contraction." By the late summer of 1921, signs of recovery were already visible. The following year, unemployment was back down to 6.7 percent and was only 2.4 percent by 1923.

As President, Hoover finally got his chance at spending the economy out of the doldrums. His successor's "New Deal" merely expanded on Hoover's "stimulus." The combined result: a deep depression that lasted over a decade and a half, ending only after federal spending declined precipitously in the wake of World War II, confounding all the "experts" who were certain that government spending equals economic growth.

Even supposing, however, that Geithner is correct that massive spending cuts would be highly detrimental to the U.S. economy, the fact is that these cuts are going to be forced upon us sooner or later. As Tanner explained, "Unless we do something, federal spending is on course to consume 43 percent of GDP by the middle of the century. Throw in state and local spending, and government at all levels will take 60 cents out of every dollar produced in this country. Our economy will not long survive government spending at those levels." Which is worse: short-term pain from cutting spending now or a complete collapse of the economy later?

The Constitution and common sense both dictate that the U.S. government stop going ever more deeply into debt and cut itself down to size so that it can pay off the existing debt and live within its means. Isn't it better to make the tough choices now than to have them forced upon us under far worse circumstances in the years to come?