Myth: The Sky Will Fall if the Debt Ceiling Isn't Raised

For instance, on Sunday the new Speaker of the House, John Boehner, explained [on *Fox News*] that the Republicans would push for spending cuts regardless of the imminent coming of the debt ceiling, and he was then pilloried by a Fox News writer. Boehner said:

> If the president is going to ask us to increase the debt limit, then he's going to have to be willing to cut up the credit cards. I think our team has been listening to the American people. They want us to reduce spending, and there is no limit to the amount of spending that we're willing to cut.

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Afterward an anonymous writer for *Fox* launched into unreality by explaining that only the Congress can approve taking on more debt: "If it doesn't approve raising the ceiling, then the U.S. will default on its loans and lose its standing as the globe's most reliable bet." As Erick Erickson of Redstate.com exclaimed, "There is no other way to put this than *it is an out and out lie!"* (Emphasis added.)

Just because the bank has pulled the credit cards from the government (to expand on Boehner's analogy) doesn't mean the government won't have the money to continue making the minimum payments, as noted by newly elected Senator Pat Toomey (R-Pa.) during an interview with Neil Cavuto:

> The debt service, [the] interest on our debt, is about 6 percent of everything the federal government has to pay. So we would be taking in enough revenue to cover more than 10 times all the interest we owe. There is no reason we would have to default on our interest obligations….

Now, there are vendors who would have to wait to be paid. There are probably employees of the federal government who would have to wait to get paid. This [would result in] lots of dislocation. I am not suggesting that this is a desirable path, but I am suggesting that we have to get serious about getting our budget under control.

President Clinton used the same falsehood to frighten Congress when it threatened to refuse to raise the debt ceiling. As the *Economist* noted, "In early 1996, Bill Clinton warned that because the debt ceiling had not been raised, Social Security cheques might be late. This scared Congress into passing [an] increase in the debt ceiling."

It's helpful to note and understand the difference between hitting the debt ceiling, and defaulting. When the debt ceiling is hit in 49 days, the U.S. government will not be able to issue any new debt securities. But it most certainly will have the income to pay the interest due on its existing debt, and will also be able easily to "roll over" debt issues that are coming to maturity.

Default, on the other hand, is changing the terms of the deal midstream. Since a debt instrument is a contract, any failure to keep any part of the contract, puts it into default. It could be something as simple as delaying an interest payment, or by failing to renew the contract at its maturity date. For example, any change to the promise to pay benefits from a pension plan, puts that contract into default. It may, of course, be "cured" by the other parties to the contract agreeing with the changes.

But such a difference doesn't deter writers such as those at the *Economist* who asked, rhetorically,

> How can the world's most powerful economy not pay its bills on time? Even a brief default on Treasury debt would be unprecedented, with widespread systemic ramifications. Would banks around the world have to classify Treasury holdings as non-performing? Would money-market mutual funds break the buck? Would all federal entities lose their AAA-credit rating? Would the Federal Deposit Insurance Corporation's ability to backstop the nation's banks come into question? Would foreign central banks start to shift out of dollars?

Felix Salmon at Reuters provides clarity here: If the debt ceiling were reached but not raised, "It stands to reason that just about any other form of government spending would get cut before [Treasury Secretary] Tim Geithner dreamed of defaulting on [its] risk-free bonds."

Putting this into proper perspective then means that if the ceiling were reached without extension, life in the debt markets would likely continue much as it did before. Measures of risk, such as the stock market's volatility index and increases in interest rates on government bonds, have remained subdued. Professionals who trade these markets daily are unconcerned. So to use the ceiling as a call for compromise by those recently elected to Congress to stop government spending beyond its means is more than a little disingenuous. If those members who made those promises actually keep them, and begin to force the government genie back into its constitutional bottle, then risk premiums based upon concerns about the country's ability to pay its bills will likely remain quiescent, and may even decline further.