Joint Economic Committee

CHAIRMAN ROBERT F. BENNETT

Economic Policy Research

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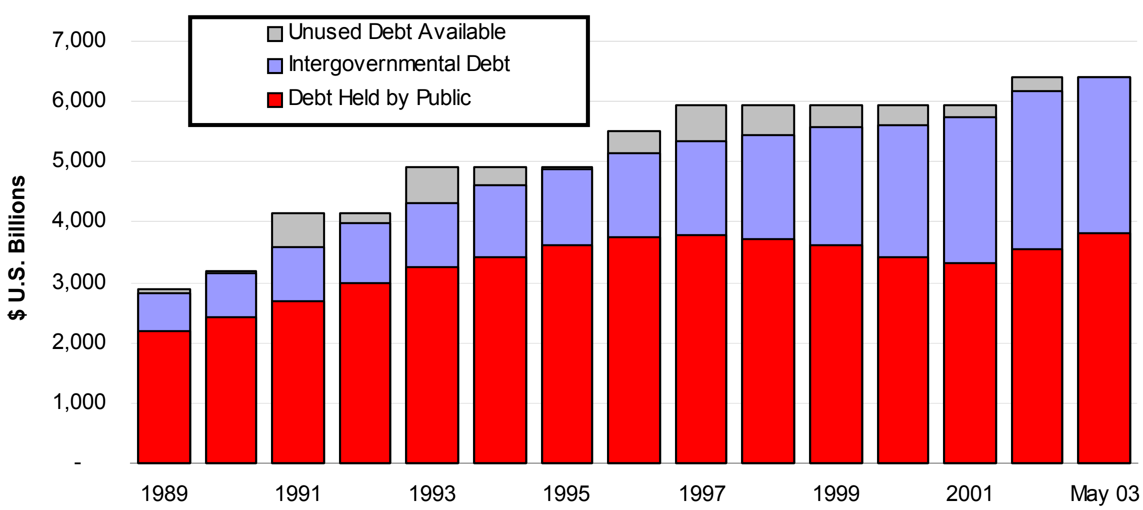
ECONOMICS OF THE DEBT LIMIT

In order to meet its operational obligations, the U.S. Treasury Department requires authorization from Congress to raise the debt limit, currently set at $6.4 trillion. The U.S. has been up against the debt ceiling since February 20, utilizing accounting maneuvers to avoid default, most of which are now exhausted. The conference report for the FY2004 budget resolution (H.Con.Res. 95) prescribed an increase in the debt limit of $984 billion and automatic House passage of a bill increasing the debt limit by that amount (H.J.Res. 51). The Senate passed the debt limit bill without any amendments.

- *Raising the debt limit is necessary to pay for programs that Congress has already authorized.* The government has to issue new debt because of declines in tax revenues and increases in spending. Tax revenues have declined because of the weak economy, declining stock prices, and, to a lesser extent, recently-enacted tax relief. Spending increases reflect the U.S. response to terrorism and international threats, as well as increases elsewhere in the budget.

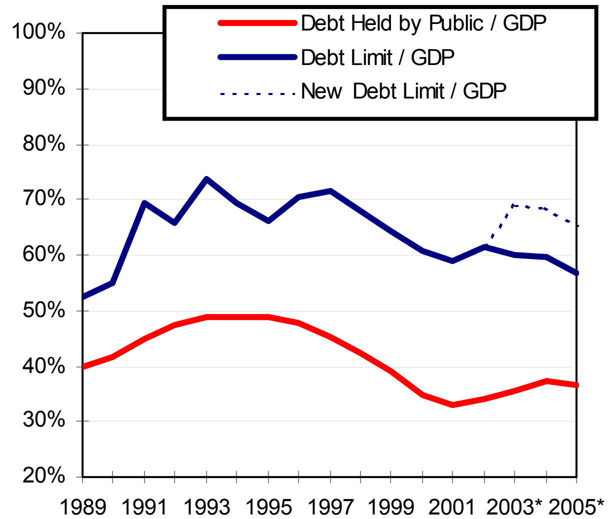
- *Raising the debt limit is also necessary because of the growing Social Security Trust Fund.* The debt limit applies not only to the publicly held debt, but also to the debt held by the Social Security Trust Fund and other government funds. Such intergovernmental debt now accounts for about 40 percent of the total *debt subject to limit*. Accumulating Social Security Trust Funds automatically drive up the debt subject to limit. For example, in FY1999 and FY2000 an on-budget surplus existed yet the debt subject to limit still increased. During those two years, Social Security surpluses were saved which contributed to a reduction in publicly held debt of $311.3 billion, yet the debt subject to limit increased $152.2 billion.

Fig. 1 The Debt Limit and Actual Debt, 1989-present



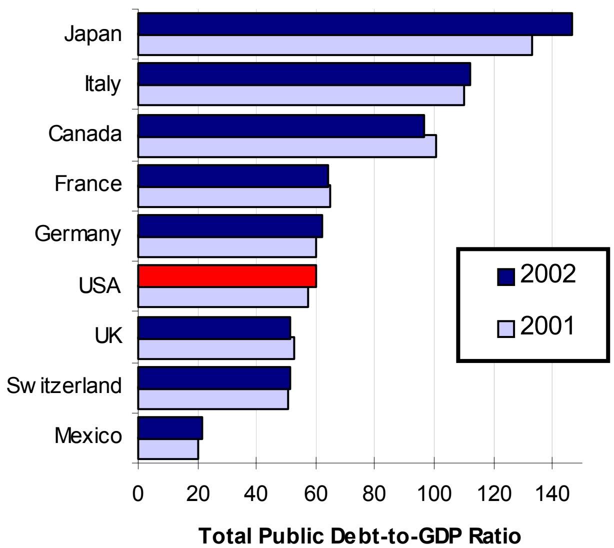
SOURCE: U.S. Treasury and CBO

Fig. 2 Debt & Debt Limit Relative to GDP



SOURCE: U.S. Treasury and CBO
(* indicates GDP forecasts)

Fig. 3 International Debt Comparison



SOURCE: Economist Intelligence Unit

- *Even after the increase, the debt limit will not be unusually high relative to GDP*. The burden of the national debt is best measured by comparing the size of the debt to the size of the economy.[1] As shown in Figure 2, the current debt limit to GDP ratio is lower than it was during most of the 1990s. If Congress increases the limit by $984 billion, the debt limit will still represent less than 70 percent of GDP, below the peaks in the 1990s. If the economy grows as expected, this ratio will decline further in future years.

- *Total debt (publicly held plus inter-governmental) as a percentage of GDP is lower in the U.S. than many other industrialized nations*. Figure 3 shows that the current 60 percent U.S. total debt to GDP ratio is not high in comparison to other industrial economies in Europe, and particularly Canada, Italy, and Japan which are near or above 100%.

- *It is unclear whether the debt limit is a useful tool for promoting fiscal discipline.* The one clear effect of the debt limit is that it forces Treasury to use accounting tricks to avoid default. These maneuvers were controversial when first employed by Treasury Secretary Rubin in 1995, but have now become routine. This financial maneuvering creates unnecessary uncertainty regarding the payment of federal obligations and undermines efforts to promote fiscal transparency.

- *The debt limit is a poor measure of actual government debt.* Economists generally recognize two meaningful measures of the public debt. *Publicly held debt* represents the total amount the government has borrowed from the public and is contractually bound to repay. *Net liability* encompasses publicly held debt plus the amount by which projected future expenses (forecasts of Social Security and Medicare obligations) exceed future tax receipts. The debt limit addresses neither of these measures – it combines the publicly held debt with debt held by the government itself – so it can be misleading and confusing.

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[1] See Joint Economic Committee, "The President's Budget and the Federal Debt," February 11, 2003.