The debt ceiling debate

By Jon Sevenker

In what has become perennial political theater, Congress is now negotiating an increase to the debt ceiling, which is on track to be exceeded as early as June or July. (Spoiler alert: The U.S. actually hit the debt ceiling in January 2023. Since then, the Treasury Department has employed "extraordinary measures" to buy some time.) One party wants a "clean" increase with no tradeoffs, while the other side wants significant spending cuts as part of any deal. In this post, we'll figure out how we got here and the most likely path forward for this high-stakes game of chicken.

What is the debt ceiling? The debt ceiling is a statutory limit on the amount of money that the U.S. government is authorized to borrow to meet its financial obligations. It is a cap on the amount of outstanding federal debt that can be issued by the Treasury Department, and it is set by Congress through legislation. When the debt ceiling is reached, the Treasury Department cannot issue any more debt, and the government must either reduce its spending, increase its revenue, or raise the ceiling to avoid default.

How many times has Congress raised the debt ceiling? Since the creation of the modern debt ceiling in 1939, Congress has raised or revised it over 100 times! The debt ceiling has been a contentious political issue in the past, with some lawmakers using it as a bargaining chip to negotiate other policy goals or to protest the level of government spending. This time is no different.

What happens if Congress doesn't reach a deal to increase the debt ceiling? If the U.S. doesn't reach an agreement to increase the debt ceiling, it could have serious consequences for the economy and financial markets. Without an increase in the debt ceiling, the government would be unable to borrow money to pay for its bills, including salaries for government employees, Social Security and Medicare payments, and interest on the existing debt.

This could lead to a government shutdown, where non-essential government services are suspended, and employees are furloughed without pay. Additionally, the U.S. could default on its debt obligations, which could have severe repercussions for global financial markets. A default could lead to a downgrade of the country's credit rating, higher borrowing costs, and a decline in the value of the U.S. dollar. To avoid these outcomes, the U.S. government has always raised the debt ceiling in the past, even if it sometimes took political wrangling to do so.

What is the most likely outcome? Former Treasury Secretary Larry Summers puts the odds of a technical default at 2%-3%. He goes on to say any default would be quickly remedied. So, while there is a non-zero chance of default, the odds remain small.

Winston Churchill is credited with the saying, "Never let a good crisis go to waste." Unfortunately, this has become the modus operandi for our politicians and media. Looking at it through this lens, the most likely outcome is that this comes down to the wire, with lots of political drama, infighting, and threats. Then Congress strikes a miraculous deal to raise the debt ceiling—yet again—and the media will go on to the next pending disaster. There's too much at stake to have any other result.

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