



CHAIRMEN

BILL FRENZEL
JIM NUSSLE
TIM PENNY
CHARLIE STENHOLM

PRESIDENT

MAYA MACGUINEAS

DIRECTORS

BARRY ANDERSON
ROY ASH
CHARLES BOWSHER
STEVE COLL
DAN CRIPPEN
VIC FAZIO
WILLIAM GRADISON
WILLIAM GRAY, III
WILLIAM HOAGLAND
DOUGLAS HOLTZ-EAKIN
JIM JONES
LOU KERR
JIM KOLBE
JAMES MCINTYRE, JR.
DAVID MINGE
MARNE OBERNAUER, JR.
JUNE O'NEILL
PAUL O'NEILL
RUDOLPH PENNER
PETER PETERSON
ROBERT REISCHAUER
ALICE RIVLIN
CHARLES ROBB
MARTIN SABO
ALAN K. SIMPSON
GENE STEUERLE
DAVID STOCKMAN
JOHN TANNER
LAURA TYSON
GEORGE VOINOVICH
PAUL VOLCKER
CAROL COX WAIT
DAVID M. WALKER
JOSEPH WRIGHT, JR.

SENIOR ADVISORS

ELMER STAATS
ROBERT STRAUSS

**Responsible Approaches to Increasing the Debt Limit
February 8, 2011**

In the coming months, Congress will have to raise the debt limit. The federal debt is currently \$14.100 trillion, only \$194 billion away from the current debt ceiling of \$14.294 trillion. In anticipation of the coming Congressional debate, the Treasury Department has estimated that the debt limit will be reached between April 5 and May 31.

There is no question: the debt ceiling must be increased. Failure to do so would lead to economic calamity. Moreover, no practical set of spending cuts can reduce deficits fast enough in order to avoid hitting the debt ceiling.

Yet, while Treasury Secretary Geithner has said that a "failure to increase the [debt] limit would be deeply irresponsible," so too would be failure to address our nation's fiscal challenges. On our current path, the continued accumulation of debt will lead to a fiscal and economic crisis regardless of what happens to the debt ceiling. Therefore, raising the debt ceiling without at least beginning to address this issue would simply be postponing the inevitable.

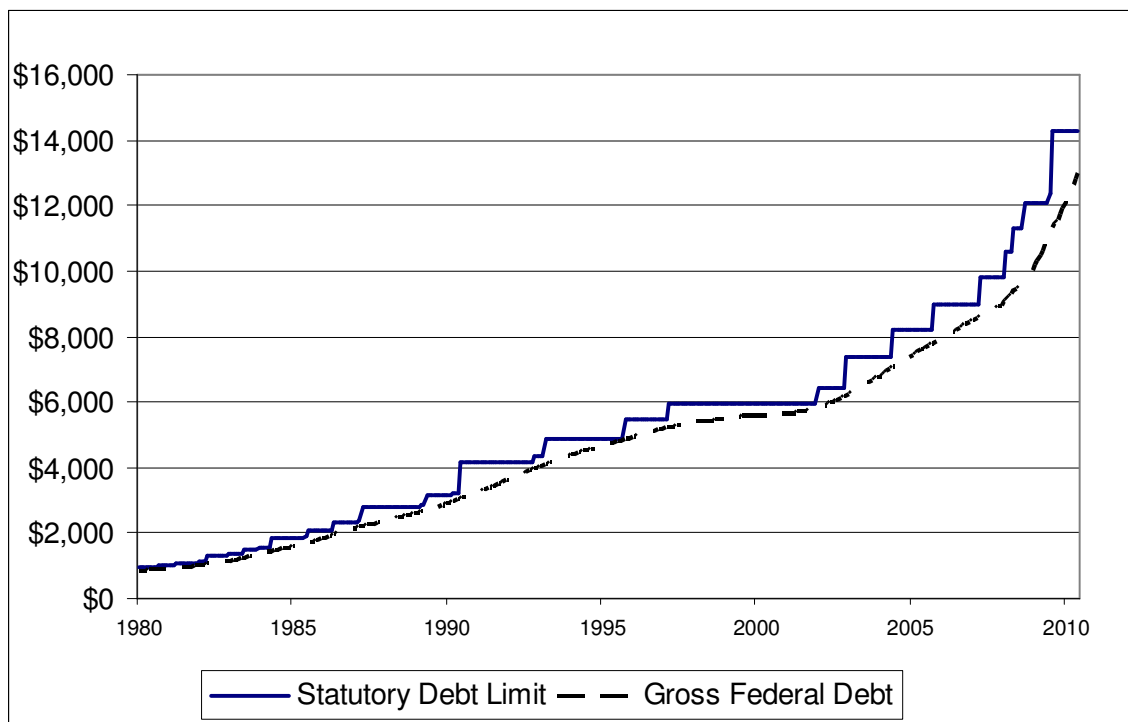
The most recent debt ceiling increase, signed in February 2010, included the statutory PAYGO law and indirectly led to the creation of the Bowles-Simpson Deficit Commission. The next long-term increase in the debt ceiling must go further and should be accompanied by a mechanism or plan to stabilize the debt over the medium-term. Additionally, while the debt ceiling will have to be increased, the amount of the increase should be dependent on the strength of the fiscal restraints tied to it.

Though Congress must not shirk the responsibility to increase the debt ceiling (and keep in mind, it already passed the policy changes that made this increase necessary), CRFB would strongly discourage the passage of any long-term debt ceiling increase that does not offer concrete steps to improve the nation's debt trajectory.

Background on the Debt Ceiling

The modern debt ceiling was first created in 1939 and was set at \$45 billion (the debt at the time being \$40.4 billion). Since then, the debt ceiling has been adjusted nearly 100 times. These increases have ranged both in size and in length. About a quarter of all debt ceiling increases have lasted longer than a year, with the longest increase – back in 1946 – lasting over 6 years. On the other hand, nearly 30 percent of debt ceiling increases have lasted less than three months, the shortest lasting for only one day – September 30, 1981. Over the past 10 years, the debt ceiling has been increased ten times—from \$5.950 trillion in 2002 to \$14.294 trillion in 2010. The most recent debt ceiling increase raised the limit by \$1.9 trillion.

Fig 1. Statutory Debt Limit and Gross Federal Debt (Billions)



The fact that increases have happened often should not suggest that they are easy. Many members of Congress find increasing the debt limit distasteful, and debate over raising the debt ceiling often proves contentious. At times, this has caused complications for the federal government. When a vote on the debt ceiling nears, the Treasury can take any of a number of exceptional measures to postpone the date of reckoning. These include suspending reinvestment of government securities in federal retirement plans, delaying debt auctions, suspending the sale of State and Local Government Series Treasury bonds, and selling dollar holdings in the exchange stabilization fund. These measures can impose additional costs and inconveniences to the government and create increased

uncertainty for markets. Despite this, they have been used a number of times by both parties, including in 1995-1996, 2002, 2003, and 2006.

While the debt ceiling has at times been problematic, it has also served as an important opportunity to foster some level of fiscal restraint. In 1985, Congress linked the debt ceiling increase to the passage of the Balanced Budget and Emergency Deficit Control Act of 1985—better known as Gramm-Rudman-Hollings – a law which set up specific deficit targets and backed them up with the threat of sequestration. Additionally, in 1987 the debt ceiling increase was linked to further reforms of that legislation.

Congress also used the debt ceiling to help foster fiscal responsibility in 2010, with many Members refusing to pass more than a short-term increase in the debt ceiling without the enactment of statutory PAYGO and the establishment of a statutory commission to examine the nation’s long-term fiscal problems. In the end, the debt ceiling increase did include the statutory PAYGO law, and though the debt ceiling increase ultimately passed in 2010 did not include the commission, it was accompanied by a promise by the President to set up an executive commission. The resultant National Commission on Fiscal Responsibility and Reform reported its recommendations late in 2010.

Regardless, Congress must enact - and always has enacted - debt ceiling increases at the end of the day. Though politicians may have kicked and screamed about spending or deficits, the consequences of not raising the debt ceiling are simply too severe.

A Way Forward

This year’s debt ceiling increase promises to be one of the more contentious debates. A significant number of members oppose an increase in the debt limit without severe domestic spending reductions; some have even vowed to oppose a debt ceiling increase under any circumstances. Meanwhile, the White House has argued for an increase in the debt ceiling with no fiscal strings attached. A stalemate that leads the United States to the brink of default would, of course, be disastrous. However, failing to use this opportunity to begin addressing our precarious fiscal situation would also be a mistake.

There is a reasonable middle ground between refusing to raise the debt limit and raising it without regard to the implications of our ever-growing debt. An increase in the debt ceiling should be accompanied by a plan to bring the deficit under control or a credible process to move us in that direction.

Only short-term debt ceiling increases should be passed until a credible plan can be negotiated. The fiscal deal should not be hashed out in frantic eleventh hour negotiations; instead, a plan of what will be included as part of the debt ceiling increase

should be announced well in advance of the point at which the country will be close to the debt limit – likely this April. This earlier resolution, along with any progress in improving the fiscal conditions of the country, will reassure credit markets, rather than provoke them as a showdown certainly would.

Enacting a comprehensive fiscal plan could take significant negotiation (although the bipartisan plan which came out of the Fiscal Commission would be an ideal starting point). Accordingly, it may be appropriate to pass a short-term debt ceiling increase to give Congress and the President the opportunity to agree on the plan's details.

Alternatively, a credible and enforceable budget process reform bill could be enacted into law. One idea would be to offer instructions and a fast-tracked process to the relevant Congressional Committees to find deficit reduction in specified areas (health care, tax reform, agriculture, etc). A process that accomplishes the same ends already exists for discretionary spending – discretionary spending caps. Moreover, as with these caps, the instructions elsewhere could be enforced with various sequesters.

An additional idea would be to set in place more general aggregate targets, such as ones for spending and revenues, deficits, or as the Peterson-Pew Commission on Budget Reform recommended, for debt. Ideally, such targets would require the President and Congress to enact the policies necessary to stabilize the debt below 60 percent of GDP in the next decade or so. These aggregate targets could be enforced by the threat of automatic across-the-board spending cuts and tax increases which would be triggered in the event they were not met.

A final idea of something along the lines of a budget summit also could be acceptable, but only if such a summit results in policymakers moving the country toward a more sustainable fiscal path.

* * *

Members of Congress must not play games with a debt limit increase, nor should they give themselves a free pass on avoiding the tough decisions that are necessary to deal with our mounting debt. Congress and the White House have a golden opportunity this spring to negotiate a comprehensive plan which puts the budget and the economy on the right path. This would demonstrate to the credit markets and the world that not only are we serious about meeting our financial obligations today, but that we are serious about meeting them tomorrow. As a result, the need to increase the debt ceiling should not be seen as a showdown between parties, but as an opportunity to improve our fiscal future.