

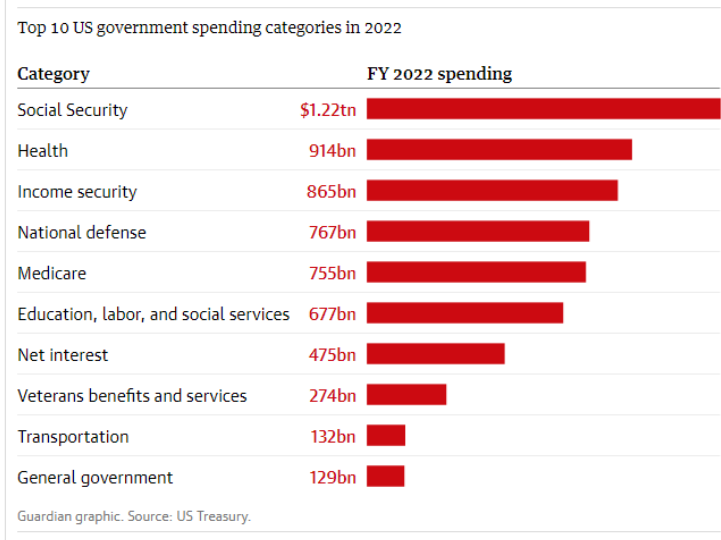
# Debt Ceiling Dynamic

**Discourse is the common practice and expectation in US politics.** In recent months, we have been inundated by the media with the threat of US debt defaults. Relevant dialogue in Congress had reached a boiling point. US Treasury Secretary, Janet Yellen, publicly expressed the possible financial Armageddon that may occur if the Treasury were to be handcuffed and unable to pay the bills. If my memory serves me correctly, the term used to define a possible outcome was “economic calamity”. This can be aptly described as a cocktail of unsustainable unemployment rates, reduced retirement benefits, and an increase in global borrowing costs (to name a few). X-date, otherwise known as the tentative default date, was anticipated to be early June if President Biden and the Republican House Speaker, Kevin McCarthy, could not reach a compromise. This was no simple task given the longstanding divide on either side of the partisan line. Biden supports increasing the legal borrowing limit, while the Republicans endorse a deal that includes spending cuts to reduce future deficits. The Biden Administration and the Democrat-controlled Senate were pushing for a no-strings-attached suspension of the limit to establish their continued package of student debt relief and clean energy subsidies. However, the Republican controlled House of Representatives would only agree to raise the debt limit by another 1.5 trillion (yes, trillion) if it could reduce the deficit by 4.8 trillion over 10 years, through repealing key Biden Administration strategies (Vogt, 2023). Fortunately, an agreement was reached and the buzzer beater was a “meet halfway” for both sides of Congress.

## What does this all mean?

If we look at a general concept in personal finance, spending more than you make will always result in adding debt to your own balance sheet. While this might seem oversimplified, this universal notion can be applied to the most influential economy in the world: if the US Government spends more than it makes, borrowing money is necessary to cover expenses. However, borrowing funds is not a bottomless solution and the US is thus faced with how to address the issue of limiting their debts. Recently, there has been a lot of talk about a bipartisan solution to the current debt limit. This debt limit would be considered synonymous to a “crutch” for the US government to meet its obligations such as salaries for federal employees, military personnel, social security benefits, and medical coverage. Although it might seem counterintuitive, borrowing to fund obligations approved by Congress and the President is essential for a well functioning democracy. The Government has a fiscal responsibility to keep the US economy afloat because the viability and strength of the United States fiscal and financial system has a broader ripple effect globally. **At what point do**

**officials in US Treasury draw the line and agree that increasing debt levels cannot be the continued tactic to “kick the can down the road”?**



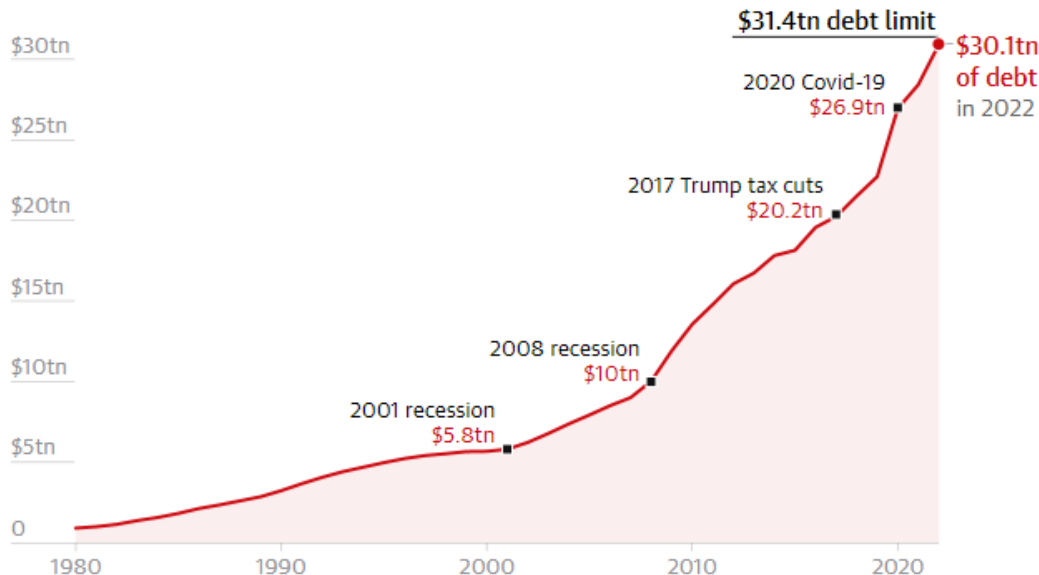
When there is a budget deficit, the remainder needs to be accounted for. When this happens at a national level, the government will sell Treasury securities to corporations, quasi-government agencies and individuals to meet the shortfall. This in turn raises the aforementioned debt level. One seldom hears the term “risky” on an investment backed by the US government. Regardless of where we are in the current interest rate cycle and the subsequent pricing of debt securities, a general rule of thumb stands: when you take on debt from the most well-equipped government in the modern era, there should theoretically be no risk of default.

**The Current Crossroad**

On January 19<sup>th</sup> 2023, the US Government reached its authorized borrowing limit and the Treasury department subsequently engaged in extraordinary measures (i.e. suspending reinvestment of government securities) to fend off a default of its debts (Nam, 2023). President Biden and Democrats kept their foot on the gas, pushing to pass a bill that lifts and suspends the debt limit. Conversely, their Republican counterparts were not willing to budge on their stance to pair spending cuts in conjunction with a debt ceiling hike. This resulted in a continued divide amongst both parties regarding the 31.4 trillion debt ceiling. The balance has been growing year over year and has been raised almost 80 times since 1960 (Aratani, 2023), particularly during leaner years and regressed taxation promised during elections such as the Reagan era. Despite the division, all political officials understand one thing: that the immediacy of cash flow supply is the quick fix.

Continued ...

US government's total debt from 1980 to 2022



Guardian graphic. Source: US Treasury.

## The Deal

As of last week, after a drawn out push-pull resulting in political standoff, an agreement has officially been reached. Ultimately, this deal suspends the national debt limit until 2025. To cater to the Republican side, federal spending will be cut by 1.5 trillion over the decade, primarily by halting some funding and limiting spending by 1% growth (Vogt, 2023). To name a few provisions, capping non defense spending and clawing back some COVID relief. Although this will help prevent economic disaster in the interim, this is not a lasting fix. Given the demographic of the US economy, national debt will likely continue to grow as a percentage of GDP due to baby boomers entering retirement and having a reliance on Social Security and Medicare (Reich, 2023). Both parties will undoubtedly continue to push their respective agendas, with Republicans continuing to advocate for tax cuts on corporations, while the Democrats will push for public safety net investments.

## What can we learn from this?

I will be the first one to admit that this speculative default was a little too close for comfort. This unease only increases when added to the variables of economic headwinds globally that we are collectively attempting to stave. The debt limit has become a political tool for each party to extract compromise from the other by putting the US on the brink of default in an endless loop. The consensus was always that the top of the house would never induce acute and unorderly circumstances to keep a firm stance on their political agendas. This moral guideline became a reality this week, and with their backs against the wall we were able to witness Congress put the country above their respective party lines. Objectively speaking, a settlement of this magnitude should not be reached at the 11<sup>th</sup> hour. At some point too much debt is unhealthy and creates inherit risks. Tripling from 10 trillion to over 31 trillion since

## Continued ...

2008 is a clear indication of the need for future restructuring. Striking a balance of spending for the future and mitigating debt capacity will be the focus for years to come.

As an investor, this situation in the US is just another event to trigger a knee jerk reaction. As we all know, events transpiring in the States can have direct implications to all global investors. Now in the rear-view, the markets will continue to adapt and expand. An essential aspect of maintaining a long-term investment philosophy is understanding that over time capital markets will deliver.

Continued ...

- 1) [\(31\) Debt limit bill would reduce budget deficits by \\$1.5 trillion over a decade, Congressional Budget Office says \(cnn.com\)](#)
- 2) [How the debt ceiling became a game of political chicken that continues to threaten our economy \(yahoo.com\)](#)
- 3) [What's in the debt ceiling deal — and what's not - CBS News](#)
- 4) [Opinion: The biggest lesson from the debt ceiling fight \(msn.com\)](#)
- 5) [Five things the US debt-ceiling deal suggests about the future | Robert Reich | The Guardian](#)
- 6) [What is the US debt ceiling and what would happen if it is not raised? | US economy | The Guardian](#)
- 7) [U.S. hits its debt limit and now risks defaulting on its bills : NPR](#)

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