The Debt Ceiling Debate - Why You Should Care

This is part 2 of a multipart look at the so-called economic recovery, the current congressional debates on Obamacare and the debt ceiling, and how these things will impact your household as we move into 2014.

September 26, 2013 - In our last article we focused on the debate currently going on in congress over Obamacare and the continuing resolution to fund the federal government. As soon as that debate is over, congress will begin to focus on the "debt ceiling". There is a lot of rhetoric being bandied about by both sides on this topic. At the same time, the general public appears to be disinterested in the debate. But the results of any final agreement will affect "personal economies" of every single American.

Tweet

```
(function() {
var s = document.createElement('SCRIPT'), s1 = document.getElementsByTagName('SCRIPT')[0];
s.type = 'text/javascript';
s.src = 'http://widgets.digg.com/buttons.js';
s1.parentNode.insertBefore(s, s1);
})();
```

```
 (function() {
   var po = document.createElement('script'); po.type = 'text/javascript'; po.async = true;
   po.src = 'https://apis.google.com/js/plusone.js';
   var s = document.getElementsByTagName('script')[0]; s.parentNode.insertBefore(po, s);
 })();
```

What is the debt ceiling?

In simple terms, the debt ceiling is the amount of money the federal government can legally borrow under current law. The current debt ceiling is $17 Trillion. Federal borrowing will exceed that amount in about two more weeks.

The easiest way to think about the debt ceiling is that it is like the borrowing limit on a credit card. Once you hit the limit, you have to pay off some of your debt before you can spend any more money. That's about where the similarity ends though.

In the case of a credit card, the bank determines how much you can borrow. At some point, if the bank believes that you have overextended yourself, the bank can (and often will) reduce the amount of credit that you have available.

If your credit card actually functioned like the debt ceiling, every time you hit your credit limit you could simply increase the limit and continue to borrow. That decision would be yours and not up to the bank.

Who determines the debt ceiling?

Congress, which is also responsible for spending the money that is borrowed, sets the debt ceiling.

Why is the debt (and debt ceiling) important?

Just as with a credit card, when the government borrows money it has to pay interest on the amounts borrowed. The more you pay in interest, the less you have to spend on other things. As long as you keep your borrowing at reasonable levels, you shouldn't have any trouble paying your bills. But if you get overextended, making your payments can be a real struggle.

In 1976, the United States turned 200 years old and the national debt was $653 Billion. There is no doubt that that's a lot of money but it took us 200 years to get to that point. At the same time, it was only 35% of Gross Domestic Product (GDP).

In the last 37 years, congress has increased the debt by 25 times the 1976 level. And by the end of this year, there are projections that show the government's debt will exceed GDP.

Looking at this information using the credit card example, think of the national debt as the amount you owe on a card and GDP as your income. If the amount you owe on a credit card exceeds the total amount of money that you make in a year, repayment is going to be a lot more difficult than if you only owe 35% of what you make annually.

Any credit card borrower who has ever become overextended knows that at some point they are going to have to make some very difficult choices. Either cut back now and try to get out of debt or keep spending and eventually face the unpleasant consequences which could include bankruptcy.

What are the arguments being used in the debate?

Those who want to increase the debt ceiling without doing anything about spending are making the argument that if the ceiling isn't increased, the government won't be able to pay its bills. If you really think about it, that's a ridiculous argument because the only reason that congress decided to increase the debt the last time is because we couldn't afford to pay our bills then. It's an argument that goes something like this: The only solution to the current national debt is to get deeper into debt. Try making that argument to your bank the next time you go over your credit limit.

Those who want to reduce the debt argue that if we don't make some tough choices now, we could be facing a financial disaster later on. But the truth of the matter is that the national debt is now so large that there may only be one way for the government to reduce it. That would be by using inflation as a tool to reduce the debt. Given the way that the FED is currently calculating inflation, that does appear to be part of the strategy at this time.

What if congress doesn't agree to increase the debt ceiling?

That's not a likely scenario. As large as the debt is right now, the political fall-out for not increasing the debt ceiling is probably too much for most members of congress to bear. A more likely scenario that congress will raise the debt ceiling but that the House of Representatives will insist on deep spending cuts in a variety of government programs. This is exactly what happened the last time the debt ceiling was increased and it resulted in spending cuts known as "sequestration".

How does any of this impact me personally?
There are three ways that this will impact all Americans.

First, deep spending cuts are likely to reduce the amount of government services that are available to everyone. How you will be impacted is probably dependent upon which government services you actually use, if any.

Second, if the federal government and the FED do work together to use inflation as a method to reduce the debt, any money you earn will buy less. It is actually a form of taxation that is much less apparent than a tax increase and which most people don't understand. That makes inflation a very attractive tool for politicians because they don't have to vote on any new taxes.

Third, if congress and the White House can't agree on some form of plan to get the debt and spending under control, there is the very real possibility that the dollar could eventually collapse.

For all of these reasons, every American should be watching this debate closely.
To read part 1 of this series, click here.

byJim Malmberg
Note: When posting a comment, please sign-in first if you want a response. If you are not registered, click here.
Registration is easy and free.
Follow me on Twitter:

Follow ACCESS