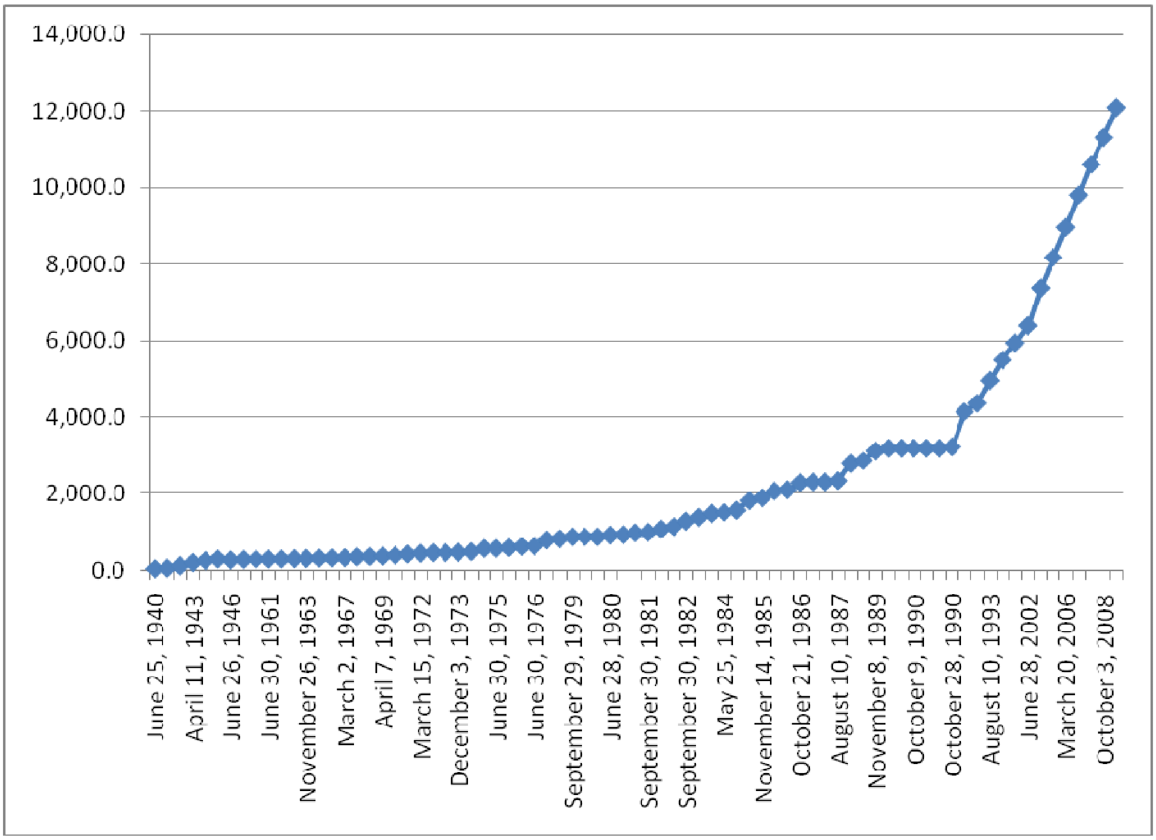
**The Debt Ceiling Debate by** Tapen Sinha, ITAM, Mexico

The Total Public Debt Outstanding of the Federal Government of the United States of America has exceeded US$14 trillion in the middle of 2011. The debt limit of the US Government set by the Congress periodically was set in February 2010 at $14.294 trillion. This limit has not been extended so far. Unless this limit is raised by August 2, 2011, according to the Treasury Secretary Tim Geithner, the Federal Government of the United States has to reduce spending money. The Republicans have refused to raise the limit unless there is a dollar for dollar cut imposed on spending. The Democrats are asking for a tax rise to go with it. This difference has created the impending crisis. The debt limit (in absolute dollars without any regard to the level of the US GDP) has been a feature of the US Federal Government since 1911. Every time the limit is to be raised, the US Congress has to vote for it. Between 1940 and 2010, the limit has been raised almost 80 times (Such a limit does not exist in any other country of the OECD.)

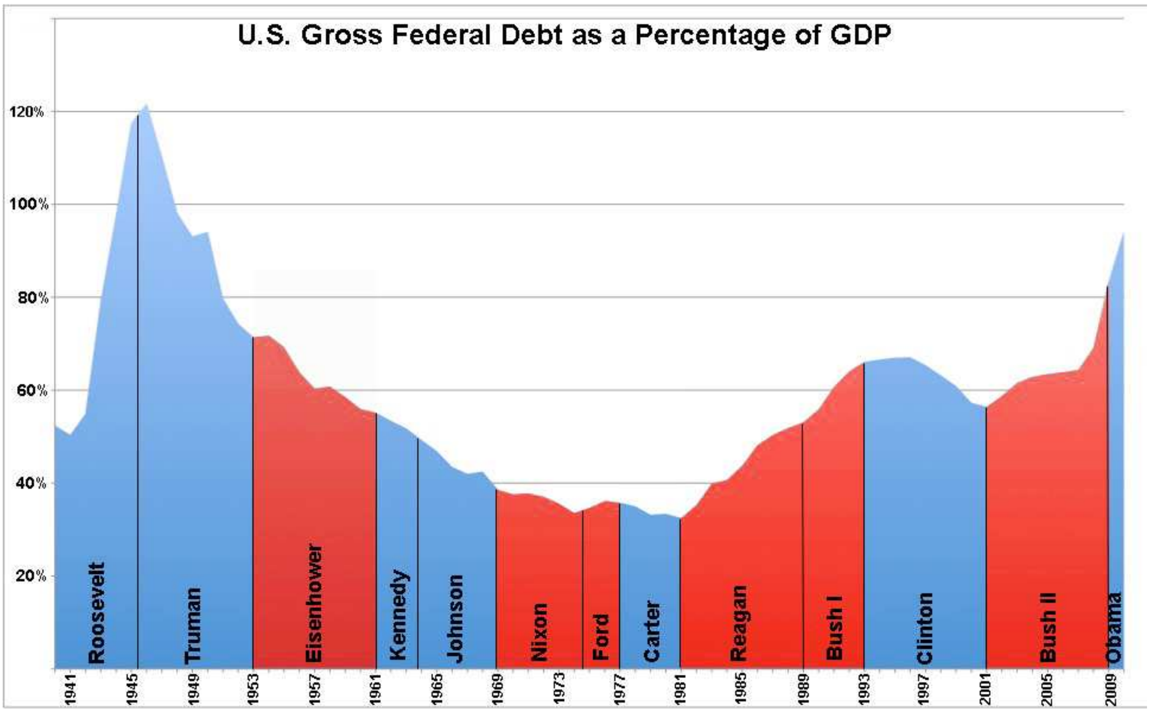
Figure 1: Debt Ceiling in billions of US dollars 1940-2010




In 1979, a powerful member of the House of Representative Richard Gephardt of Missouri proposed setting the debt limit automatically at the level projected by the most recent budget resolution. The rule, allowed for the debt limit to be raised without the House having to take an unpopular stand-alone vote. In 1995, then-majority House Republicans waived the Gephardt rule. They refused to raise the debt limit in a bid to force President Clinton to accept spending cuts - prompting two government shutdowns.

Many commentators from Right Wing Tea Party have been promoting the idea that the debt is about to overtake the size of the GDP and therefore threatens the existence of the United States. Is the large debt really threatening the US economy? To examine that, we have to first understand the difference between stock and flow. GDP measures the income in one given year – a flow concept whereas the value of the debt is measured at a point in time – a stock concept. If my income is $100,000 a year, I borrow $100,000 (to buy an apartment), does that make me bankrupt? Hardly. Most people do exactly that. They pay off the debt over a period of several decades. The same applies to a nation as well. If we examine the history of the US, the debt was far higher in the 1940s. Had high debt been bad for the economy, the 1950s should have been a terrible period for the US economy. The reality was exactly the opposite – the 1950s ushered in an unprecedented era of economic growth with low inflation in the US.

Figure 2: US debt as a percent of GDP 1940-2010




What was the main reason for this current rise in debt? The seed of this problem was sown almost a decade ago with the presidency of George W Bush. He started two wars – one in Iraq and another in Afghanistan. He enacted a tax cut – mainly aimed at high income individuals without any corresponding cut in spending. He also put forth a large increase in

Medicare benefits without any rise in taxes. All of this gathered the pace of the debt rise. The crisis of 2008 meant job losses, lowering the revenue generated. It has also contributed to the rise in debt through rising deficits. If we compare the US debt level with other economies, we see that the US debt is about 100 percent of the GDP. This is exactly the same level of debt that the Government of Singapore has. Nobody in the world is sweating about Singapore.