The Debt Ceiling: An unnecessary showdown

by L'Asia Brown
Interim Photo Editor

This summer, for the first time in his term, President Barack Obama was tasked with raising the debt ceiling. The nation witnessed a near political brawl over a usually laconic process. A Republican-controlled House refused to cooperate with a Democrat-controlled Senate; hence, the US was almost brought to economic disaster as a deal was approved by Congress at almost the very last minute.

This type of government action was virtually unfamiliar to the new generation. What is the debt ceiling? Why does it need to be raised? How does this affect me? All types of questions were being asked as legislators quarreled at the economy's expense.

A Bit of History

The debt ceiling is the limit to which the federal government may borrow money. In the early 20th century, legislators would vote on taking out loans each time it was necessary. To streamline the process, Congress passed a measure, the Second Liberty Bond Act of 1917 that would act as a general borrowing limit. This limit would permit the government to borrow, without votes, up to the respective limit to which funds were necessary. For example, Congress might approve a debt limit of $2 trillion, although the U.S. might only need to borrow $750 billion.

The U.S. is the only industrialized nation with a debt ceiling. Other modernized countries borrow funds as their leaders deem necessary.

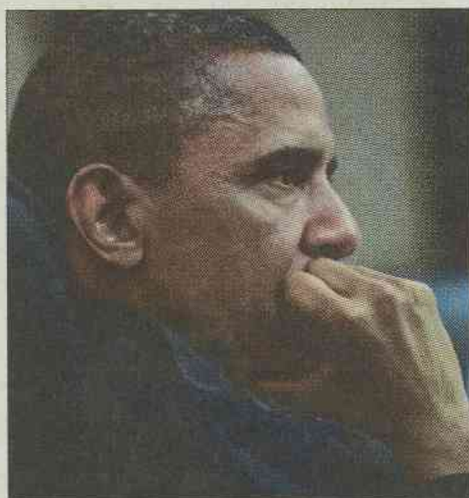

photo courtesy of www.whitehouse.gov

Why Borrow More?

In May, the federal government breached the debt ceiling, meaning it had borrowed the maximum authorized amount of $14.3 trillion.

To continue paying its bills, employees & military salaries, entitlements to veterans and seniors, and many more financial responsibilities the debt ceiling had to be raised by August 2 to prevent what some analysts said would be an economic meltdown. Had a deal not been agreed upon, the government would've been forced to operate on a cash-only basis, using a cash reserve of about $74 billion to pay a select amount of obligations.

Raising the Debt Ceiling

Because the president is not able to use his executive powers to sign bills that regulate funds, it was up to Congress to formulate and pass legislation detailing cuts and revenues, similar to a personal budget plan, to help get the government's affairs back on track.

In the end, a bill that did not include new revenue sources was agreed upon by Congress. Although the U.S. debt, in relation to its economy, is the highest it's been in 50 years, lack of compromise and organization in Congress gave the president two choices: reject the deal with the most support and risk not raising the ceiling by the deadline, or accept a deal that contained more Republican-favored clauses and cuts and dodge a possible economic tailspin. Obama signed the bill to avoid an economic catastrophe.

The End-Result

The new legislation makes some of the steepest cuts since President Eisenhower's leadership in the 1950s. Though cuts to federal education are included in the estimated $2 trillion slashed from spending, an additional $17 billion in funds were allocated to the Pell Grant program for low-income students. This does come at a sacrifice for graduate students, who will no longer receive the in-school subsidy on subsidized loans, reported by eSchoolNews.com. They will now have to pay the interest that accumulates on their loans, even while they're still attending school.

The debt ceiling showdown was an example of the perils ideological governance can cause. Having been raised several times by most Congresses, the ceiling was never a great controversial matter until Obama sought to raise it. According to the White House Office of Management and Budget, only former President Truman did not raise the debt limit.

In a short address to the nation prior to the debt ceiling's resolve, Obama outlined the importance of raising the debt ceiling.

"Raising the debt ceiling does not allow Congress to spend more money. It simply gives our country the ability to pay the bills that Congress has already racked up," he said. "In the past, raising the debt ceiling was routine. Since the 1950s, Congress has always passed it, and every president has signed it. President Reagan did it 18 times. George W. Bush did it seven times. And we have to do it by next Tuesday, August 2nd, or else we won't be able to pay all of our bills."

Part of the reason behind the bicker that lasted for weeks was the inclusion of a revenue source in the bill. While most Democrats in the Senate and House advocated for ending Bush-era tax breaks, rookie House Republicans, in their loyalty to the Tea-Party, opposed all stipulations to raise taxes. Their claim was that higher taxes would stifle corporations' ability to create jobs for the American public.

The U.S.'s credit rating: Why did S&P lose faith?

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Dissatisfied with Congress's latest debt ceiling deal and constant posturing, several agencies including Standard & Poor's have downgraded the US credit rating.

For the first time in history on August 5 S&P lowered the nation's long-term sovereign rating to "AA+" from "AAA." A shorterm rating of "A-1+" was also affirmed with S&P.

These actions have affected global markets. Within hours of the news, Asian, European and U.S. markets began plummeting. Stocks lost the most value within days, since some of the worst occurences during 2008's economic disaster.

Before it happened, many Americans didn't even know the U.S. government *had* a credit rating or any record of financial accountability. How does the U.S. government's credit enable or prohibit it from doing both domestic and international business? Will the downgrade affect individual credit scores, assets, investments or debt?

There are many credit rating agencies around the world, in most sovereign nations. Out of the hundreds that exist, only 10 are Nationally Recognized Statistical Rating Organizations (NRSROs). Those ten are acknowledged by the U.S. Securities and Exchange Commission as being credible and qualified enough to provide their "opinions on the creditworthiness of an entity and the financial obligations (such as, bonds, preferred stock, and commercial paper) issued by an entity."

These firms are: A&M Best Company, Inc., DBRS Ltd., Egan-Jones Rating Company, Fitch, Inc., Japan Credit Rating Agency, Ltd., Kroll Bond Rating Agency, Ltd., Moody's Investors Service, Inc., Rating and Investment Information, Inc., Realpoint LLC, and Standard & Poor's Rating Services. Out of the 10, only Egan-Jones and S&P have lowered the government's credit, with Weiss Ratings being the first U.S. based non-NRSRO to downgrade the nation's score.

Fitch, Moody, and S&P are amongst the most popular.

According to a statement released by S&P, the downgrade happened because of two main factors: discontent with the debt ceiling deal and distrust of the current American political system and ability to effectively govern in terms of economic policy.

"The fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics," said S&P's report. "More broadly, the downgrade reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011."

The lowering of the US's credit rating does not directly affect personal credit ratings. A person whose credit score was 710 before the nation's downgrade, won't see a drop in their score. According to some analysts, the downgraded credit rating will have little to no longterm effects.

An August 8 Huffington Post story suggested that if trends similar to what happened when Japan's credit rating was lowered in 2000 come to fruition, the U.S. could possibly benefit. Securities and bonds will see little to no damage on interest rates, the article suggests.

"Even with a downgrade, I think the market would assume the safest asset you could buy in a portfolio was still Treasuries," said Rick Rieder, the chief investment officer at New York-based BlackRock Inc.

Domestic and international markets operate within suspicions, not actual credit ratings. Forbes' Tim Worstall commented, "The move in the rating is simply confirming what the market already believes." With exception to stocks' nose-dive immediately hearing news of S&P's downgrade, the market's behavior reflected the economic cynicism long before Egan-Jones and S&P acted.

All in all, economists believe there is little reason to worry. Credit ratings of other nations, including Japan and Austrailia, have caused little casualty to their domestic economies.