Center for American Progress

The Debt-Ceiling Crisis

Why It Matters to Millennials

Gurwin Ahuja October 10, 2013

Over the past few weeks, there has been a lot of talk about debt ceilings, shutdowns, deficits, and fiscal policy. The debt ceiling, in particular, is a very complex issue with a lot of financial jargon, but the outcome of the current debt-ceiling debate is absolutely critical to the economic well-being of Americans, notably Millennials.

This issue brief translates that financial jargon to break down the basics of the debt-ceiling debate and its impact on young Americans.

What is the debt ceiling?

The U.S. federal government, for most of American history, has spent more money than it takes in. To make up the difference between what the government spends and collects in revenues, it takes on debt—that is, borrows money.

The debt ceiling represents the legal limit on the total amount of debt the government can incur. Before the debt ceiling, Congress approved each piece of debt that the Treasury could issue. The debt ceiling was created during World War I to allow the executive branch flexibility in managing its finances and to allow Congress to focus on legislation concerning the war.

Denmark is the only other country that has a debt ceiling and recently raised its debt limit incredibly high so that the government has ample authority to borrow.[1]

Why do we need to raise the debt ceiling?

If the United States reaches its borrowing limit, Congress must raise the debt ceiling so that the Department of the Treasury—tasked with the job of borrowing and paying off debt—can continue borrowing. The government borrows by selling Treasury bills and bonds, also known as Treasuries, to investors. The interest rates on Treasuries reflect their riskiness to investors. If they are perceived to be very risky, the interest rates will be high; if they are perceived to be safe, their interest rates will be lower. Treasuries are widely viewed as the safest investment in the world; thus, interest rates for Treasuries are very low.

A critical point to note: Raising the debt ceiling does not mean the government will spend more, and not raising the debt ceiling does not mean the government will spend less. Raising the debt ceiling simply gives Congress the authority to pay for previous spending. If Congress does not raise the debt ceiling, the government will not be able to pay its bills on time, and the United States will default on its obligations, forcing Congress to stop key programs such as student loans and job training. A default will cause investors to lose faith in the government and demand higher rates on Treasury bonds, creating economic chaos.

Congress has never failed to increase the debt ceiling since its creation in 1917. To do so would be financially irresponsible. As Federal Reserve Chairman Ben Bernanke described it, not raising the debt ceiling is "like a family saying, 'Well, we're spending too much—let's stop paying our credit card bill.'"[2]

Why would we want to raise the debt ceiling if we already have a big debt crisis?

Once again, the debt ceiling does not affect whether the government will spend more or less; it just gives Congress the authority to pay for spending to which it has already committed to pay. As far as the debt crisis, the amount the United States borrows has actually stabilized.

A common measure economists use to see if a country has the ability to pay back its debts is the debt-to-GDP ratio. The higher a country's debt-to-GDP ratio is, the less likely it is that the country will pay back its debt. The United States' debt-to-GDP ratio, however, is projected to decrease over the next 10 years.[3]

What happens if we do not raise the debt ceiling?

If Congress fails to raise the debt ceiling, it is very possible that the United States could enter another recession—potentially a depression. The government actually reached the debt ceiling on May 19,[4] but the Treasury Department has been using "extraordinary measures"—basically taking cash from other places, such as federal employee pensions—that allow the federal government to pay the bills. On October 17, the Treasury's "extraordinary measures" will be exhausted, and Congress will need to raise the debt ceiling.[5]

Not raising the debt ceiling and forcing a default would have extreme consequences. The global financial system relies on U.S. debt—that is, Treasuries—to be the safest in the world. Thus, the borrowing rate on Treasuries is intertwined with the global economy in myriad ways. At the most basic level, this borrowing rate is used as a benchmark for interest rates on common financial products in the United States such as mortgages and auto loans.

A spike in interest rates on Treasury bonds because of a default would limit businesses and consumers from borrowing and could raise their current borrowing costs. A default could also cause retirement accounts that hold a significant amount of Treasuries to collapse, and it would be more costly for the government to pay down its debt.[6] What's more, a default would force the United States to immediately make drastic cuts in crucial government programs, which could delay or stop payments to people who receive Social Security, Medicare, Medicaid, and veterans' benefits.

Even the threat of default deeply harms the economy. During the debt-ceiling debate in 2011, consumer confidence tanked, the Dow Jones Industrial Average fell 2,000 points, and the United States lost its perfect credit rating for the first time in history.[7] According to Larry Summers, former Treasury secretary and Distinguished Senior Fellow at the Center for American Progress, an actual default would lead to "a cascade that makes Lehman Brothers look like a very small event."[8]

Former President Ronald Reagan said it best when discussing the impact of breaching the debt ceiling: "The full consequence of a default—or even the serious prospect of default—by the United States are impossible to predict and awesome to contemplate."[9]

How did we get to this point?

In 2011, House Republicans used voting against the debt ceiling as a bargaining chip to reduce government spending, which led to the damaging sequester cuts we have today. Today, one faction of the Republican Party in the House of Representatives is jeopardizing the credit of the United States unless their long list of partisan policy demands is met. This list includes delaying the Affordable Care Act, also known as Obamacare; gutting environmental regulations, and overhauling the tax code.[10] President Barack Obama has made it clear that he will not negotiate on jeopardizing the full faith and credit of the United States.

OK, so failing to raise the debt ceiling is really bad. But what does it mean for Millennials?

Young Americans actually have the most to lose if the debt ceiling is not raised. Aside from slower economic growth, here are four specific areas where young Americans would be harmed.

Jobs

The Millennial generation already faces a difficult job market due to the financial crisis. A default could create yet another financial crisis and make matters even worse. Since the United States has never defaulted, the confusion and chaos seen in the 2008 financial collapse will likely be repeated because businesses will be unsure how to react.

Additionally, businesses rely on short-term loans to make payroll and long-term loans to invest in major projects. A collapse in the Treasury bond market would likely freeze these critical lending markets due to higher interest rates, causing businesses to either fire workers because they cannot meet payroll or hire fewer workers because they do not have the capital to take on new projects.

Student loans

If Congress fails to extend the debt ceiling, it is possible that new student loans would not be issued until the debt ceiling is increased. In the long run, the Bipartisan Student Loan Certainty Act of 2013, which Congress passed earlier this year, ties federal student loan rates to interest rates on Treasury bonds. Fortunately, current federal student loan borrowers are locked into their rates for the duration of their loan and their interest rates would not be affected by rising Treasury rates.

But if the government defaults on its debt, causing a rise in Treasury rates, student loan rates would rise for future borrowers beginning on July 1, 2014. That means hardworking students taking out new loans would be facing higher payments and exacerbating our student debt crisis.

Housing

Like student loans, mortgage rates are benchmarked to Treasury rates. A default would increase the cost of borrowing money to buy a house at a time when young Americans are already slow to purchase homes due to high levels of student debt and the jobs crisis.

Decreased public investment

Because Congress would be forced to drastically cut spending, the government would be diverting resources from programs vital to Millennials in health care, infrastructure, and education. A default would stop investment at a point when our country needs more investment to grow our economy.

These examples only skim the surface of how breaching the debt ceiling would impact young Americans. A breach could throw this generation into another recession while it still struggles to recover from the last one. If Congress does not raise the debt ceiling, Millennials will have to deal with the gloomy consequences for years.

Young Americans simply cannot afford for Congress to fail to raise the debt ceiling. They cannot afford an economic shutdown.

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Endnotes

1 Fareed Zakaria, "Fareed's Take: The damage is already done!", CNN Global Public Square blog, July 28, 2011, available at http://globalpublicsquare.blogs.cnn.com/2011/07/28/the-damage-is-already-done/.

2 Amy Klobuchar, "The Economic Costs of Debt-Ceiling Brinksmanship" (Washington: Joint Economic Committee, 2013), available at http://www.jec.senate.gov/public/?a=Files.Serve&File_id=f1f34dc1-775b-4bc5-b1a1-739e963f0277.

3 Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate" (Washington: Center for American Progress, 2013), available at http://www.americanprogress.org/wp-content/uploads/2013/06/FiscalReset.pdf.

4 Congressional Budget Office, "Federal Debt and the Statutory Limit, September 2013" (2013), available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/44608-FederalDebt.pdf.

5 Ibid.

6 U.S. Senate Joint Economic Committee, *Hearing on The Economic Cost of Debt-Ceiling Brinkmanship* 113th Cong., 1st sess., 2013, available at http://www.senate.gov/isvp/?type=live&comm=jec&filename=jec091813.

7 Congressional Budget Office, "Federal Debt and the Statutory Limit, September 2013."

8 The failure of the investment bank Lehman Brothers catalyzed the chain of events that led to the financial crisis in 2008. Fareed Zakaria, "What default would mean for America," CNN Global Public Square blog, July 20, 2013, available at http://globalpublicsquare.blogs.cnn.com/2011/07/20/what-default-would-mean-for-america/.

9 Peter Fenn, "Reagan Explains Why Raising the Debt Ceiling is Necessary," U.S. News & World Report, May 19, 2011, available at http://www.usnews.com/opinion/blogs/Peter-Fenn/2011/05/19/reagan-explains-why-raising-the-debt-ceiling-is-necessary.

10 Jonathan Weisman, "House G.O.P. Raises Stakes in Debt-Ceiling Fight," *The New York Times*, September 26, 2013, available at http://www.nytimes.com/2013/09/27/us/politics/house-gop-leaders-list-conditions-for-raising-debt-ceiling.html?pagewanted=1&_r=2.

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