



# LANDMARK

## WEALTH MANAGEMENT

### **The Debt Ceiling and Deficit Spending**

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On January 19, 2023, the outstanding debt of the U.S. government reached its statutory limit, commonly called the debt ceiling. Congress set the current limit at about \$31.4 trillion in December 2021.<sup>1</sup> On the day the limit was reached, Treasury Secretary Janet Yellen instituted well-established "extraordinary measures" to allow necessary borrowing for a limited period. While Yellen projects the extension will last until early June, the Congressional Budget Office (CBO) estimates it may last until sometime between July and September. However, the CBO cautions that if April tax revenues fall short of its projections, the Treasury could run out of funds earlier.<sup>2</sup>

#### **Flexibility vs. Fiscal Fights**

A debt ceiling was first established in 1917 to give the federal government more flexibility to borrow during World War I. Before that time, all borrowing had to be authorized by Congress in precise terms, which made it difficult for the government to respond to changing needs.<sup>3</sup>

The modern debt ceiling, which aggregates almost all government debt under one limit, was established in 1939. Since 1960, it has been raised, modified, or suspended 78 times, mostly with little fanfare. That changed in 2011, when a political battle over the ceiling pushed the Treasury so close to the edge that Standard & Poor's downgraded the credit rating of the U.S. government.<sup>4</sup>

The debt ceiling limits the amount that the U.S. Treasury can borrow to meet financial obligations already authorized by Congress. It does not authorize future spending. However, beginning with the bitter battle of 2011, it has been used as leverage for partisan negotiations over government spending. With the White House and the House of Representatives — which must authorize spending — held by different parties, this year's negotiations could be particularly difficult.

#### **Potential Consequences**

If the debt ceiling is not raised in a timely manner, the U.S. government could default on its financial obligations, resulting in unpaid bills, higher interest rates, and a loss of faith in U.S. government securities that would reverberate throughout the global economy. While it's unlikely that the current situation will lead to a default, pushing negotiations close to the edge can be damaging. It was estimated that the 2011 impasse cost U.S. taxpayers \$1.3 billion in increased borrowing costs in 2011 with additional costs in the following years.<sup>5</sup>

## **The Deficit and the Debt**

Put simply, the federal government runs at a deficit when tax revenues are insufficient to meet spending obligations. Federal spending has outpaced revenue for the last 50 years, except from 1998 to 2001.<sup>6</sup> Annual budget deficits add to the national debt. The national debt began to grow again in 2002 due to tax cuts and increased spending in response to the September 11th terrorist attacks. It has tripled since 2008, driven by reduced tax revenues and stimulus spending during the Great Recession and the COVID-19 pandemic.

The current debt of \$31.4 trillion is the highest in U.S. history.<sup>7</sup> However, measuring the debt as a percentage of gross domestic product (GDP) provides a better comparison over time. More specifically, economists look at debt held by the public — funds the government has borrowed to meet operational expenses and liabilities, primarily through issuing Treasury securities. Interagency debt — funds borrowed from government accounts such as the Social Security trust funds — is also subject to the limit but does not directly affect the economy or federal budget.

At the end of fiscal year 2022 (September 30, 2022), debt held by the public was equivalent to 97% of GDP. In 2019, before the pandemic, it was 79% of GDP, and in 2007, before the Great Recession, it was 35%. Both of these crises caused explosions of the deficit and debt due to lower tax revenues and high spending on government stimulus programs. The last time the debt exceeded current levels was at the end of World War II.<sup>8</sup>

In a new February 2023 analysis, the CBO projected that the debt will rise steadily over the next decade to 118% of GDP in 2033, which would be the highest percentage in U.S. history. The driving forces behind this increase would be higher spending on Social Security and Medicare, and rising interest costs (due to increasing debt and higher rates). If current laws remain unchanged, the debt is projected to grow even more quickly in the next two decades, reaching 195% of GDP in 2053.<sup>9</sup>

## **No Easy Answer**

The only way to change this trajectory is to increase revenue, reduce spending, or both. The rosiest scenario would be decades of high GDP growth that increases revenue at current tax rates, but this seems unlikely. The CBO projects real (inflation-adjusted) GDP growth to average a tepid 1.7% annually over the next decade.<sup>10</sup> Raising tax rates may be necessary, but that is always a difficult political option.

There is also little room to maneuver on the spending side. Only 28% of federal spending is "discretionary," meaning Congress can set amounts through annual appropriations bills, and almost half of that spending goes to national defense, which few leaders would want to cut in the current global climate. The rest is mandatory spending, including Social Security and Medicare (which will account for nearly 36% of federal spending in 2023) and interest on the national debt.<sup>11</sup> While both parties have indicated that Social Security and Medicare are off the table, other mandatory spending could be reduced through Congressional action.

The White House released its budget proposal for FY 2024 in March. President Biden and House Speaker Kevin McCarthy have already begun to discuss the debt ceiling issue. It remains to be seen whether the ceiling can be addressed outside of the budget process or if it will be caught in the crosshairs. In either case, the ceiling must be raised or suspended to maintain U.S. government operations.

## **Concluding Thoughts**

The team at Landmark Wealth Management continues to monitor the debt ceiling situation. While we will likely see short-term political grandstanding and posturing, we believe most members of Congress will want to avoid a debt ceiling crisis, default, or lowering of U.S. standing in the global markets, ultimately leading to a compromised solution. The Senate seems more willing to negotiate. The House of Representatives, while nearly evenly split, will likely find moderate members from both parties willing to compromise, while the extreme factions may be less conciliatory.

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<sup>1</sup> Congressional Budget Office, 2023

<sup>2</sup> Congressional Budget Office, 2023, U.S. Treasury, 2023

<sup>3</sup> Bipartisan Policy Center, 2023

<sup>4</sup> U.S. Treasury, 2023, Bipartisan Policy Center, 2023

<sup>5</sup> U.S. Government Accountability Office, July 23, 2012

<sup>6</sup> U.S. Office of Management and Budget, 2023

<sup>7</sup> U.S. Treasury, 2023

<sup>8</sup> Congressional Budget Office, 2023, U.S. Office of Management and Budget, 2023

<sup>9</sup> Congressional Budget Office, 2023

<sup>10</sup> Congressional Budget Office, 2023

<sup>11</sup> Congressional Budget Office, 2023

## ***About Landmark Wealth Management***

*Landmark Wealth Management is a trusted, independent, registered investment advisory firm dedicated to helping clients reach their financial goals. Our firm works in a fiduciary capacity on behalf of high-net-worth individuals and families, institutions, and non-profit organizations. We focus on portfolio management, retirement planning, tax planning, and estate and generational wealth planning. Our team is credentialed in multiple areas: Certified Financial Planner (CFP), Chartered Financial Analyst (CFA), Certified Public Accountant (CPA), Certified Private Wealth Advisor (CPWA), and Certified Investment Management Analyst (CIMA). The firm is located in Amherst, New York, a suburb of Buffalo.*