

# Fixing the crack in the ceiling



Wealth  
Management

April 17, 2023

Global Portfolio Advisory Committee

By almost any measure, the debt ceiling has been a costly failure. We think a new mechanism can be created to clarify the policy trade-offs and reduce costly politics.

Uncertainty around raising the debt ceiling has led to repeated bouts of market volatility, higher government borrowing costs, and potentially years of slower growth, according to academic studies and Government Accountability Office reports.

At the same time, the ceiling has failed to contain the U.S. debt; while it's arguably true that most spending reductions in the past 30 years were a result of debt ceiling negotiations, those wins were, at best, temporary. The record-setting U.S. national debt now exceeds the annual GDP, will soon exceed the record post World War II levels of debt-to-GDP, and is on pace to reach 135% of GDP by 2040, according to the non-partisan Congressional Budget Office.

Now that the U.S. is hitting the debt ceiling once more, the U.S. Department of Treasury has again turned to "extraordinary measures" to fund daily operations. These accounting maneuvers have their limit, and we think Congress will eventually need to pass legislation to avoid an eventual default. As we have [previously discussed](#), we see essentially no chance the U.S. will default on its debt, but we are concerned about the potential for damaging brinkmanship leading up to eventual resolution.

Discontent with the current state of the debt ceiling has led to numerous calls for reform—within Congress and in the financial press. We agree that a reformed ceiling would be advantageous for the U.S., but we see significant flaws with many of the current proposals. We believe a better reform program is attainable, and we sketch out what we see as the key characteristics of an effective and politically acceptable debt ceiling mechanism.

## Current leading approaches

There are three general strains of debt ceiling proposals in the press: abolition; measurement changes; and procedural changes. Each approach has merit, but the drawbacks, in our view, far exceed any incremental improvement.

Abolishing the debt ceiling, for example, makes sense in theory: the legislation hasn't worked and it clearly isn't necessary, since only one other developed economy has a debt ceiling. But repeal is a political non-starter. It would expose supporters to charges of wastefulness and not caring about the economic burden on future generations, and has, we believe, no chance of passage. We think repeal would also send a terrible signal to creditors; it's difficult for the U.S. to credibly claim debt restrictions are unwarranted given the current trajectory of borrowing.

Other proposals center on how we measure the debt, with the most common looking to limit debt as a percentage of GDP instead of an absolute dollar amount. Again, the theory here appears impeccable; sustainability of debt is clearly a function of the economy's size and linking the two is logical, in our opinion.

The problem, however, is two-fold. First, since a ceiling breach would still lead to default, the politics of the ceiling would again trend toward brinkmanship. Furthermore, by introducing a second variable—the size of the economy—the new measure would actually increase the potential for a debt crisis. If the U.S. economy were to contract sharply—such as we saw during the Global Financial Crisis and early in the pandemic—the debt-ceiling limit could be triggered. Layering a potential political crisis onto a broader economic crisis would be dangerously counter-productive, in our view.

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Discontent with the debt ceiling is nothing new and procedural changes have often been the focus of practicing politicians. This was seen most notably in the aftermath of the 2011 debt ceiling crisis, when Senate Minority Leader Mitch McConnell discussed transferring control of the ceiling to the president from Congress. The legislature could override the president's decision, but only with a hard-to-reach two-thirds majority. Shifting decision-making to an individual from an institution would raise accountability, but we believe it mainly adjusts the relative power of the president and Congress in debt ceiling negotiations. The incentives to use the debt ceiling to score political points would remain, as would the threat to the global economy.

### **A better approach**

We believe it's possible to craft a better approach to debt ceiling reform.

To start, it has to remove the potential for government default. The threat of default is worse than useless: failing to repay debt is such a catastrophic outcome that it makes the ceiling toothless—since authorizing more debt is always better than default in the short term—but it's simultaneously an irresistible bargaining chip for politicians. The system tends to extract maximum harm before inevitably opening the spending spigot.

It's not a hard problem to fix, in our opinion. Budgets can, and should, include a provision that authorizes the Treasury to raise any debt necessary to fund the approved and budgeted programs. This was the U.S. system from the late 1970s to the mid-1990s, and it worked.

With default off the table, we think there needs to be a different consequence for hitting the debt limit. One approach we believe has merit focuses on clarifying the policy tradeoff required to reduce U.S. borrowing.

Under this framework, reaching the debt limit would require House and Senate leadership to present the full Congress with sufficient program cuts and/or tax hikes to bring the national debt back to the prior limit; if approved, the plan goes to the president for signature, just like any other bill. If the leadership plan is either rejected by Congress or successfully vetoed by the president, the debt limit is suspended for two years, at which time the process repeats. If congressional leaders ignored their responsibility and failed to present a debt reduction plan, across-the-board spending cuts would kick in until the debt level is reduced to the previous ceiling.

There are numerous details to define, of course, but this structure is essentially a mandatory, biannual check-up on the nation's finances and a re-evaluation of its tax, debt, and spending priorities.

### **Check-ups in action**

The current national debt is at the \$31.4 trillion statutory limit. Under the proposed structure, House and Senate leaders would need to present a plan to the full Congress with spending cuts and/or tax increases of \$2.5 trillion; if enacted, these would take the national debt back to its prior limit. This plan represents a choice for government leaders: a new, debt-reducing fiscal policy for the United States, or grow the debt to fund business as usual.

From there, the normal legislative process takes over, and individual Representatives and Senators go on the record with their views. If the debt rollback budget passes Congress, it goes to the president and, if signed, the U.S. would be on track to reduce its national debt. If the proposal fails in Congress or is successfully vetoed, the debt limit is suspended for two years, with the standard budgeting process determining a new limit. The process then repeats at the end of two years. The only punitive measure in this structure is if the congressional leadership fails to present a timely plan; in that case, mandatory across-the-board spending cuts of \$2.5 trillion over a five-year period would begin.

### **Accountability not accounting gimmicks**

Compared to existing debt-ceiling legislation, this framework may appear weak; it doesn't threaten a global financial catastrophe. But by making the requirements and consequences realistic, we believe the proposed changes would considerably strengthen the effectiveness of the legislation. It would bring clarity and accountability to U.S. borrowing, traits that we think have been missing for too long in the fiscal discourse.

Many commentators, in our view, look to the debt ceiling to act as a magic bullet that can save the United States from its own folly. We believe that is a dangerously unrealistic approach. Instead, we believe that political accountability for decision making is required. Reform should be designed to force Congress to choose between specific spending cuts and tax hikes on the one hand and allowing more borrowing on the other. Voters would then have the ultimate word at the ballot box.

## Author

### Atul Bhatia, CFA

Fixed Income Portfolio Strategist

atul.bhatia@rbc.com; RBC Capital Markets, LLC

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