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In the 245 years since the signing of the Declaration of Independence, the United States has never once defaulted on its debt. But all that could change on October 18 if Congress does not raise the debt ceiling. Should that happen, there's a very real possibility that the U.S. would be unable to pay its bills – or at least, have to prioritize which bills it pays and which it does not.

Now, I know what you're thinking. "The debt ceiling? *This* again?" And yes, it's true. Just like in 2011, and again in 2013, our legislature is once again confronted with a debt ceiling crisis of its own making. Unfortunately, the debt ceiling is not some arcane Congressional procedure. If the US *were* to default on its debt – more on that in a minute – then it would likely have a very real impact on the stock market, the economy, and even people's individual finances.

This is a story that will likely dominate the news more and more in the coming weeks. And as we get closer to that October 18 deadline I mentioned, it may prompt more uncertainty in the markets, which have already been volatile of late. But as I always like to say, nothing in life is to be feared, just understood…and planned for. So, to help you prepare for the spate of headlines coming our way, let's do a Q&A on the debt ceiling. Here are some of the most common questions I've been getting from clients on the subject. (Based on very recent news, the debt ceiling deadline will likely be extended until December, but the key points and concerns remain the same).

1. What is the debt ceiling?

Many people think that the debt ceiling is a cap on how much total money our government can spend, but it's not. This is actually an important point. In truth, the debt ceiling is "the total amount of money that the United States government is authorized to *borrow* to meet its existing legal obligations."[1]

Now, what are these existing legal obligations? It's a massive list, including everything from Social Security and Medicare benefits to tax refunds, interest payments on our national debt, military salaries, and debt to anyone who owns U.S. government bonds.

The debt ceiling, then, is the legal limit to what the government can borrow to pay for money *it has already spent* (or committed to spending). In this case, Congress needs to raise the debt ceiling to pay the bills it has incurred over the past several years.

2. Why doesn't the debt ceiling limit government spending?

To understand this, we must understand the difference between government **spending** and government **borrowing**. The two are not interchangeable.

First, let's look at what government spending actually is. When Congress passes a law, the government must spend money to enact it. There are two types of legislation used to get that money. Sometimes Congress authorizes a law, but the authorization doesn't contain provisions to *fund* the law. A separate piece of legislation, known as an **appropriations bill**, is required. This is where Congress separately *appropriates* money for the new law. These appropriations must be renewed, usually on an annual basis, for the law to remain funded. This sort of thing is known as **discretionary spending**, because Congress decides *upon its own discretion* whether to continue funding the law.

Other laws fall under the umbrella of **mandatory spending**. When a new law is enacted that *does* contain the authority for funding, then Congress is required to fund the law perpetually until the law expires (assuming the law has an expiration date). Social Security and Medicare, for example, fall under mandatory spending.

Now, here's the important part. Sometimes Congress doesn't have the money to pay for the laws it previously enacted, especially the larger mandatory programs. But Congress can't simply not pay for them. A law is a law, and Congress is legally obligated to find the money to fund them. So, in those cases, Congress must *borrow* the money it is compelled to spend. That's the difference between borrowing and spending, and the debt ceiling *only* applies to the former. It limits how much the government can borrow to cover what it has already spent.

3. This seems so complicated and unnecessary! Why do we even have a debt ceiling anyway?

The United States is actually one of the few countries to have a debt ceiling. Ours originated in 1917, during World War I.[2] To put it simply, Congress was tired of having to approve borrowing every time the government needed money. Think of it like having a massive family meeting every time someone in your extended family wants to borrow a few bucks. So, Congress decided to grant approval to any borrowing so long as it didn't exceed a specified amount. Thus, the debt ceiling was born.

For most of the past hundred years, raising the debt ceiling was a fairly uncontroversial process. In fact, the ceiling has been raised or suspended nearly 80 times since 1960 alone.[3] But over the decades, as Congress has become more partisan, and politics has become more of a blood sport, the debt ceiling has transformed into a political football. At various times, both Republicans and Democrats have tried to delay raising the debt ceiling or block it altogether. They do this to either wring political concessions or paint the other party as being fiscally irresponsible.

I know. It's frustrating.

4. Okay, so what's happening on October 18 (or in December)?

This is the date that Janet Yellen, the Secretary of the Treasury, has indicated the government will run out of money. After that point, per her recent testimony to Congress, "…we expect Treasury would be left with very limited resources that would be depleted quickly. It is uncertain whether we could continue to meet all the nation's commitments after that date."[4]

This essentially gives Congress four options:

- Drastically raise taxes to make up the difference in spending and revenue, so that the Treasury no longer *needs* to borrow money. This is politically impossible and will not happen.

- Drastically cut spending to make up the difference. (Not going to happen either, for the same reasons as above. Furthermore, neither of these two actions could be done before the October 18 or December deadline.)
- Raise the debt ceiling.
- Default on what it owes.

As of this writing, the Democrats, being in power, want to raise the debt ceiling. The Republicans do not and are essentially daring Democrats to do it on their own. To do this, though, Democrats would have to use an extremely complicated procedure called **budget reconciliation**. Normally, it requires 60 votes to raise the debt ceiling, meaning some Republicans would have to sign on. Using reconciliation, Democrats could do it with their simple 50 vote majority. But this would be an untested and extremely time-consuming process. It also wouldn't look good politically.

To be clear, most experts expect the debt ceiling to be raised some way, somehow, before the October 18 or December deadline. Either Republicans will cave, or Democrats will, but it will get done. That's what happened in 2013 and 2011, despite all the 11th hour drama – because both parties know the ramification of *not* acting. On the other hand, as we say in the financial industry, *past performance is no guarantee of future results.* So, let's look at what the ramifications would be if the US were to default on its debt.

5. What happens if the debt ceiling isn't raised and the government defaults?

To be honest, no one entirely knows for sure. That's because it's never happened before. However, we can make some educated guesses. To be honest, they don't look good.

Deep breath here…

For starters, seniors could stop receiving Social Security payments, or at least experience delays. Families could stop receiving Child Tax Credit Payments, or at least experience delays. Members of the US military would stop receiving paychecks, as would federal employees. Veterans' benefits would be delayed. Food assistance for the hungry, homeless, poor, and malnourished could stop. Funding for victims of the recent hurricanes and wildfires could stop. Funding to combat the COVID-19 pandemic could dry up.[5]

As if those aren't bad enough, the effects of a default would also extend to the broader economy – and the markets. The country's credit rating would probably be downgraded, as it was in 2011. Because bondholders wouldn't be paid, the value of their bonds would drop, leading to simultaneously higher yields. This could lead to dramatically higher interest rates, which would make it harder for people to pay their mortgages and credit card payments. All this would shock the stock market, too.

Earlier in September, Moody's Analytics, one of the top economic researchers in the world, estimated that the country would fall into another recession if the debt ceiling weren't lifted.[6] Up to six million jobs could be lost. Unemployment would skyrocket back to 9%. $15 trillion in household wealth could be wiped out. All while we are still recovering from the *last* recession.

There are no two ways about it. It's a grim picture.

Now, again: Most experts, and politicians for that matter, *do not expect this to happen.* But it could. Right now, Congress is playing a game of "chicken" – and that's not what we elected our legislature to do.

That means that we, as private citizens and responsible investors, need to be what Congress is not: Prepared.

6. So, what do we do about this?

What you can do, is simple. First, prepare yourself mentally and emotionally for a spate of scary-sounding headlines. Second, remember that my team and I are keeping a close eye on things.

This is what we see: Uncertainty dominates. No one knows exactly what will happen. But I don't believe in making decisions based off uncertainty. I don't believe in making decisions based on fear. Again, we've heard this song and dance before. Rather than assuming the worst, we'll just keep paying attention. We'll monitor your investments *and* Washington as closely as possible. That way, nothing will take us by surprise. If we feel your investments should be "moved to higher ground", we'll let you know immediately.

Of course, if you have any questions or concerns, let me know! I'd love to talk with you and put your mind at ease. In the meantime, we'll keep doing what we do best: Planning ahead, keeping the big picture in mind, and being proactive. As always, thank you for the trust you've placed in us. Please let us know if there is ever anything we can do for you!

Sincerely,

Robert G. Elliott, CFP
Vice President

[1] "Debt Limit," *U.S. Department of the Treasury,* https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit

[2] "United States debt ceiling," *Wikipedia,* https://en.wikipedia.org/wiki/United_States_debt_ceiling

[3] "Statement by Janet L. Yellen before the Committee on Banking, Housing, and Urban Affairs," *United States Senate,* September 28, 2021. https://www.banking.senate.gov/imo/media/doc/Yellen%20Testimony%209-28-21.pdf

[4] "Yellen warns Oct. 18 could be breaking point for U.S. debt," *Politico,* September 28, 2021. https://www.politico.com/news/2021/09/28/treasury-janet-yellen-debt-limit-514472

[5] "What the debt ceiling is and why you should care about it," *ABC News,* September 29, 2021. https://abcnews.go.com/Politics/debt-ceiling-care/story?id=80288518

[6] "Playing a Dangerous Game With the Debt Limit," *Moody's Analytics,* September 21, 2021. https://www.moodysanalytics.com/-/media/article/2021/playing-a-dangerous-game-with-the-debt-limit.pdf