Polaris Wealth Advisers, LLC
2013 Market Commentary

Polaris Educational Series

February 2013

The Debt Ceiling

Background:

- Constitution gives Congress the power to control spending and borrowing.
- Federal Law requires Congress to authorize the government to borrow any money that is needed to pay for programs that Congress has passed.
- The notion of a debt ceiling was first introduced during World War I. It was meant to provide the Treasury easier means to operate by not requiring Congress to vote on every new issuance of debt, for things that had already been approved.
- The Treasury has periodically bumped against pre-set debt limits over the years.
- The debt ceiling has been raised dozens of times (under Democrat and Republican Presidents), typically with little or no fanfare.
- In 2011, the debt ceiling became the central battle theme between Republicans, who had taken control of the House in the 2010 elections, and President Obama. Republicans refused to raise the debt ceiling limit without a deficit-reduction package, as part of the deal. The impasse was resolved in July 2011 when both parties agreed to the Budget Control Act
- Technically, we hit the debt ceiling of $16.4 trillion on December 31, 2012. If not for "extraordinary measures" taken by Treasury Secretary Geithner, the government would not be operating right now.
- At the time, the government determined that they could continue to operate until February 15th using these extraordinary measures.
- On February 4th, President Obama signed the "No Budget, No Pay" Act of 2013, suspending the debt ceiling limit until May 18th.

Why It Matters:

The debt ceiling negotiations have become very political. The Republicans want the country to be fiscally responsible, at any cost. The Democrats don't want to cut spending for fear of sending the country into another recession. In my humble opinion, the solution is found somewhere in between. Either way you look at it, we have to address our Debt to GDP. In other words, we must look at how much we as a country have in debt versus how much we produce each year as a country. Our debt to GDP continues to be a major long-term concern. The chart below shows you the percentage of government debt held, as a percentage of Gross Domestic Product (GDP). For clarification, public debt (in red) is marketable debt (i.e. – U.S. Treasuries, Municipal Bonds, etc.). The total government debt (in blue) includes "intra-government holdings," including social security and medicare trust funds.

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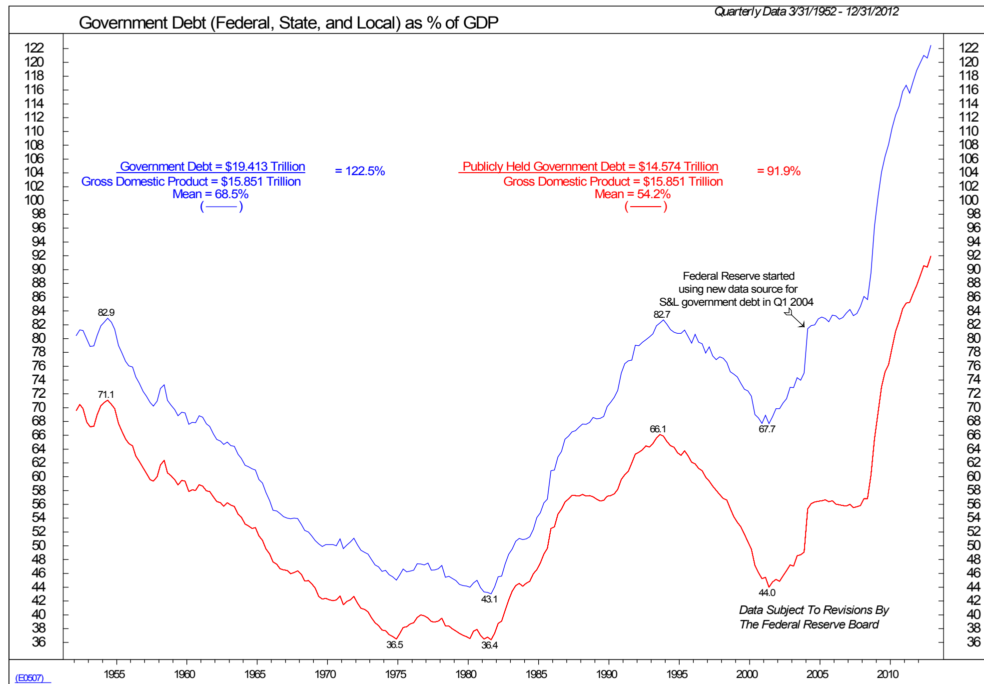
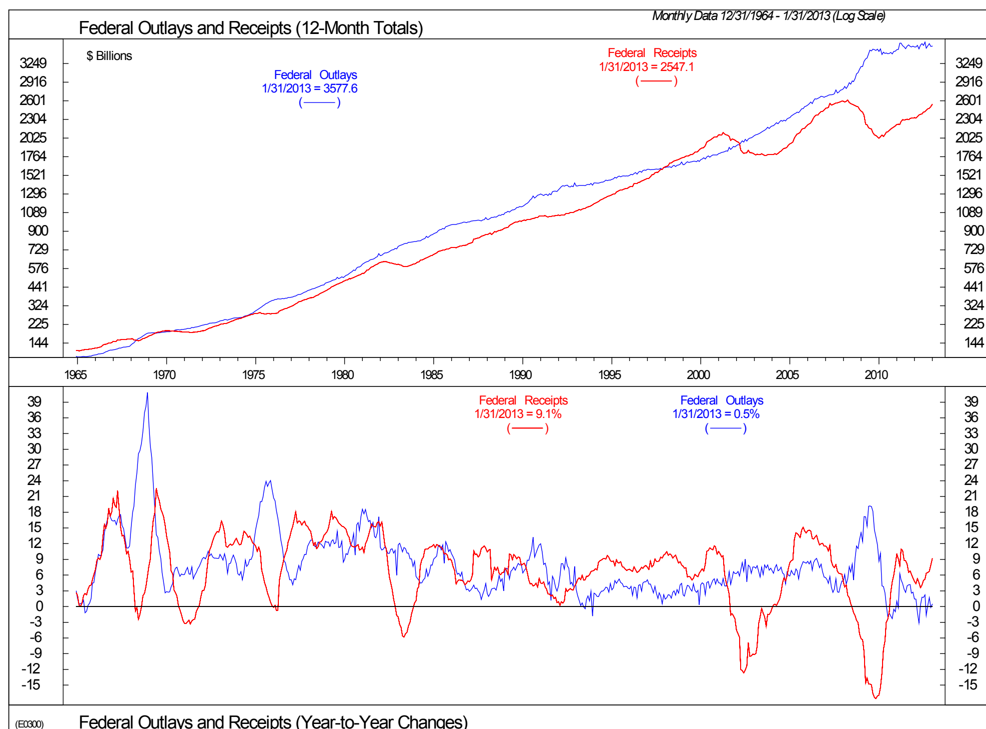


The U.S. government has increased its debt from $8.9 trillion at the end 2007, to over $16.4 trillion at the end of 2012. This was due to multiple years of excessive deficits. The revenue received by the government (the red line) has dropped from $2.568 trillion to $2.469 trillion in 2012. Our spending (the blue line), on the other hand, has gone from $2.73 trillion to $3.793 trillion over the same time period. In other words, we lost $100 billion in Federal income, but we increased Federal spending by over $1 trillion per year. Obviously, we can’t continue down this path indefinitely.



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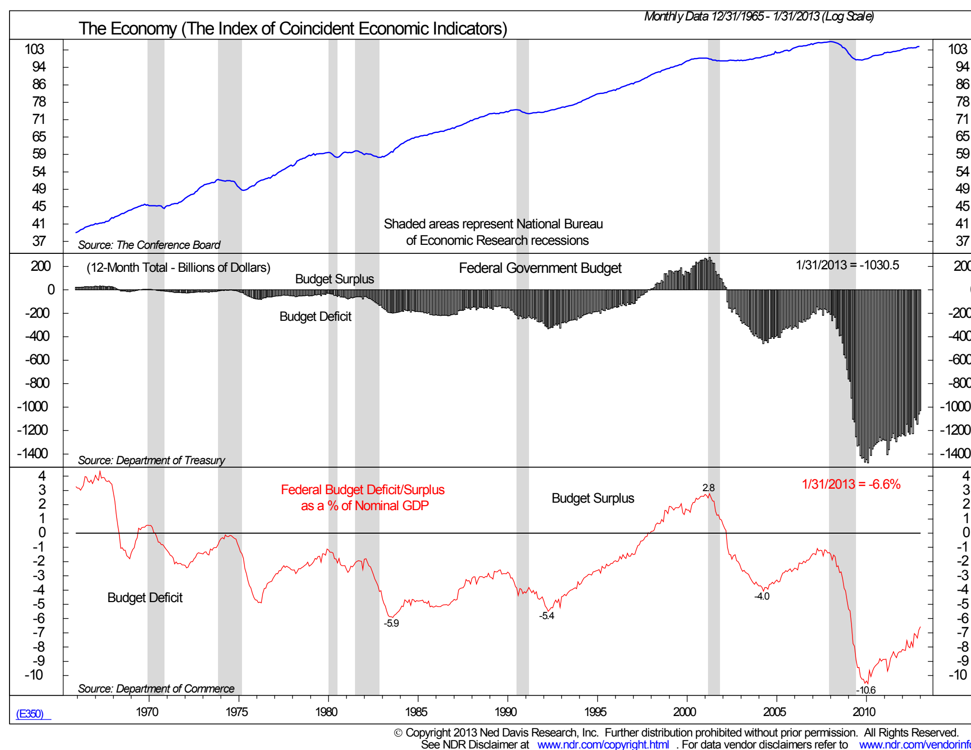
The gap between the red line (what we are making) and the blue line (what we are spending) is what is known as our deficit. As seen below, our deficit has grown from $162 billion annually in 2007, to $1.324 trillion in 2012 (grey area in the middle band). While our net deficit has now narrowed to $1.05 trillion per year, it still represents 6.8% deficit to GDP (the red line in the lower band).



This is an improvement from where we were at the end of 2009 when we peaked at a $1.4 trillion and a 10.6% deficit to GDP. Historically, however, we have not been at this high of a deficit to GDP since World War II. A large fiscal debt burden has negative implications for long-term economic growth. As our debt continues to grow, a larger percentage of our government's budget is forced to service this debt. It could also impact investors trust in our ability or willingness to meet our financial obligations. This could lead to further downgrades in U.S. Treasury bonds, causing the government to pay higher interest for its debt obligations. Furthermore, a high debt to GDP ratio impairs the government's ability to respond adequately to future economic or financial crises.

As you have read, the Debt Ceiling is very intertwined with government spending. Our next article will discuss the demographics of our government spending and the upcoming automatic spending cuts.

As always, we welcome any feedback. We look forward to hearing from you soon.

Sincerely,
Jeff

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