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Politics, Economics, and the Debt Ceiling

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Abstract

Since the early 20th century, the Federal Government has chosen a self-imposed statutory limit on federal debt which has been increased, and occasionally reduced, in sporadic intervals. This paper uses a regression model to examine the time interval between changes in the statutory debt limit and whether the date of the next increase is pushed beyond the next national election. Results show the length of the extension and the likelihood that the ceiling limit lasts beyond the next election is significantly higher under when Republicans have enough seats in congress to exert some influence over policy. However, both the time an increase lasts and the likelihood an increase lasts beyond the next election are reduced when Republicans have a sufficient number of seats to exert influence and the economy is in a recession. This suggests that incumbents in both parties are inclined to push a controversial debt limit vote beyond elections if possible unless Republicans believe they can make political points during a recession.

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1. Introduction

Although Congress has always maintained oversight for the federal debt, the first aggregate debt limit was put into law on July 20, 1939 (Austin & Levit, 2013). The debt limit is the total nominal amount of money that the United States government is statutorily allowed to borrow and is composed of publicly held debt (accumulated through the sale of treasuries) and privately held debt (accumulated when debt is issued to governmental accounts that have surpluses). Since inception, the debt limit has increased seventy-four times for a nominal increase of more than \$16 trillion over the past 70 years.¹ The research presented below examines how the intersection of political and economic conditions is related to the length of time an increase lasts and finds that increases tend to be shorter when Republicans have a sizeable minority in the House of Representatives and the economy is in recession. This is contrary to the behavior of a Republican minority during periods of growth.

By forcing Congress and the President to take visible action, the debt limit provides congress with a tool to control, or at least bring up for discussion, federal spending levels. To the extent that Federal spending exceeds Federal revenues over time the government's debt increases. If the debt reaches the statutory limit it might undermine the Treasury's ability to make interest payments on Treasury securities and in the extreme lead to default. Many critics of political brinkmanship point out that Federal revenues are easily sufficient to make interest payments and a default is more political than economic in cause. Regardless, reaching the statutory limit will impair the ability of the Federal government in one form or another. One should note that financial markets begin to price in disruptions even before the limit is reached with rates increasing along with uncertainty (McCormick, 2013). Levit et. al. (2013) assert that the "brinkmanship" of 2011 and 2013 added to uncertainty and led to worse outcomes than if the debt ceiling had been raised earlier. Third quarter growth in 2011 (1.4%) was markedly slower than preceding and subsequent quarters. Moreover, the Treasury Department (2013) developed a report relating the debt limit impasse in August 2011 to a decline in consumer confidence, small business optimism, the S&P 500 index, and a rise in the equity market volatility index, the "VIX". These indicators did not return to their prior levels until several months after the debt ceiling was raised. In addition, bond and mortgage spreads increased following the debate. One should note that while the Treasury highlighted the coincident nature of the data, they did not attempt to estimate the specific effects on these markets. Regardless, it is probable that the uncertainty surrounding the increase in the limit had some negative effect on markets. While the negative consequences would make it seem a foregone conclusion that the debt limit will always be extended or raised, the size of an increase and period an increase lasts that is not so certain.

2. Debt Limit Background

Congress has continued the practice of voting on the debt limit, despite the limit's questionable effectiveness. Kowalcky and LeLoup (1993) believe that there are three underlying motives for the vote: managerial oversight, demonstration of partisan and ideological differences, and "must pass" legislation. The early existence of the debt limit was dominated mainly by managerial oversight. Congress's involvement was focused on the Treasury's explanations for the need to increase borrowing and counseled on the country's rate of spending. Congress has also used the debt limit vote as a platform to express partisan and ideological

¹ The number of times the ceiling has been raised depends on how one counts. We define an increase as legislation increasing the debt ceiling but do not count multiple increases from the same legislation following benchmarks or time frames.

differences. The minority party often acts based on electoral concern, while the majority party is tasked with running and funding the government. The debt limit vote offers little political gain for those who vote in favor of the increase, and is a potential liability in the next election. The research presented below expands on this motive and suggests republicans in the minority are more likely to use a debt limit vote for partisan purposes during a recession. The final congressional use, as suggested by Kowalcky and LeLoup, for the debt limit vote is its “must pass” status. The fact that the debt limit “must” be increased allows for controversial amendments to be attached and passed, whether or not they are relevant to the bill.

Hubbard (2012) suggests that although empirical evidence shows only modest crowding out of private investment by federal debt owing primarily to higher real interest rates, there remain a couple concerns. The first of these concerns is that cumulative increases in the federal debt are so large that they can lead to large increases in real interest rates, even though the estimated effect of debt on interest rates is relatively small. Another of Hubbard's concerns is that the current, 2012, trajectory of government spending creates the real possibility that the United States will levy higher taxes, reducing capital formation, economic growth, and living standards. Reinhart and Rogoff (2010) found that a ratio of ninety-percent debt-to-GDP or greater leads to median growth rates falling by one percent and that average growth falls by even more. Although later flaws were found in Reinhart and Rogoff's work, it stimulated debate among economists and the public. The response to their findings underscores the increasing importance of the Federal debt in the national political discussion. The objective of the research presented in this paper is to examine how political and economic conditions affect the length of time an increase in the debt limit lasts.

3. Model and Data

A utility maximizing politician is assumed to make decisions maximizing his chances of being re-elected. While some may consider increasing the debt limit necessary, it is a potential political liability. Incumbent politicians are assumed to avoid voting on the debt limit until the last minute and, if politically possible, increase the limit such that it will last until after the next election. To analyze the effect of party distribution and economic conditions on changes in the debt limit, data on changes in the limit, political party representation, and macroeconomic conditions were collected. The United States Treasury provided the data on the nominal debt limit and dates of change. The data on presidential party and congressional party composition were collected from the United States Senate, House of Representatives, and White House websites. The start and end dates for recessions were provided by the National Bureau of Economic Research. In addition, data on times of war were collected from the Congressional Research Service and include: World War II, Vietnam, the Persian Gulf War, and the recent conflicts in Afghanistan and Iraq. Summary statistics are presented in Table 1.

Using the data collected, we estimated the following model:

$$\text{Beyond Election}_i = \alpha + \beta_1 \text{Single Party}_i + \beta_2 \text{Dem Pres}_i + \beta_3 \text{Reps over 185}_i + \beta_4 \text{Years until Election}_i + \beta_5 \text{Recession}_i + \beta_6 \text{War}_i + \beta_7 \text{Reps over 185} \times \text{Recession}_i + \beta_8 \text{Pres elec Yr}_i + \varepsilon_i,$$

where *beyond election* is a binary variable set to one if the increase in the limit is large enough such that the next increase is not until after the next election. A similar model is estimated using the number of days between increases (*days increase lasted*) as the dependent variable. The model using *beyond election* is estimated using a probit regression and the model using *days*

Table 1: Summary Statistics

| Variable | N | Mean | Std. Dev. | Min | Max |
|----------------------------|----|-------|-----------|-------|------|
| Past election | 74 | 0.432 | .499 | 0 | 1 |
| Days increase lasted | 73 | 338.1 | 408.7 | 8 | 2985 |
| Single party | 74 | 0.405 | .494 | 0 | 1 |
| Democrat president | 74 | 0.392 | .491 | 0 | 1 |
| Republicans over 185 | 74 | 0.378 | .488 | 0 | 1 |
| Years till election | 74 | 0.862 | .571 | 0.003 | 1.97 |
| Recession | 74 | 0.257 | .440 | 0 | 1 |
| War | 74 | 0.432 | .499 | 0 | 1 |
| Presidential Election Year | 74 | 0.243 | .432 | 0 | 1 |

increase lasted as the dependent variable is estimated using ordinary-least-squares with heteroskedasticity robust standard errors.

A single political party controlled the House of Representatives, Senate, and White House (*single party*) for thirty out of the seventy-four increases (40.5%). It is expected that *single party* will be positively related to the longevity of an increase as a party in control of all three legislative branches will want to extend the debt limit to avoid dealing with it again during their term. Democratic presidents (*Democrat president*) presided for almost forty percent (39.2%) of the increases and the Democratic Party was in control of all three branches of the legislative branch for almost ninety percent of those increases (89.7%). The Republicans held only a minority in the House for most of the period examined, however they held over 185 seats in the House (*Republicans over 185*) twenty-eight times; 38% of the increases. The threshold of 185 Republicans in the House of Representatives was chosen because a sizable minority may have considerable influence over the legislative process when votes are not exactly down party lines. Furthermore, a sizeable minority may also be perceived by voters to have some political control and, thus, the same political liability for the debt as the majority party.

The likelihood that an increase lasts beyond the next election is assumed to decline as the time until the next election (*years until election*) increases. In addition, it is assumed that voters pay more attention in a presidential election year, (*presidential election year*) and that political behavior may be influenced by the additional attention. However, there is no *a-priori* reason to assume the attention will cause politicians to lift the ceiling by more or less.

In addition, the nature of the debt limit vote may change as political and economic conditions intersect. For example, politicians may need to increase the limit in order to follow a Keynesian policy prescription during recessions (*recession*), or, as tax revenues decline, more deficit financing may be required to avoid pro-cyclical spending cuts. In addition, expenditure requirements during *war* may necessitate increased government spending. However, while increases in spending would cause increases to last for shorter periods, *ceteris paribus*, incumbent politicians may use the events to politically justify larger increases in the limit. Thus, we have no priors about the relationship between these variables and the duration of an increase in the limit.

As households are forced to cut expenditures during recessions, or choose to during times of elevated economic uncertainty, the political pressure on Congress to follow a more balanced budget also increases. The heightened public awareness of financial matters and fiscal deficits provides an opportunity for a minority party to vote against an increase for political gain. Kowalcky and LeLoup (1993) suggest that the Republican Party is more likely to vote against

increases based on the claim that increasing the statutory debt limit leads to more borrowing. However, incumbents in a sizeable minority may be perceived as “Washington insiders” by voters who attribute political liability to them in a manner similar to the majority. Thus, one would expect a sizeable minority to act in a manner similar to the majority and downplay the debt limit debate; unless the minority believes conditions are right to make political gains from opposition behavior. The interaction term, *republicans over 185 * recession*, will identify if increases in the debt limit differ when there is a sizable Republican minority and the economy is in recession.

4. Results

Estimation results for the model above are presented in Table 2. In both the *beyond election* estimation, shown in the first column, and the *days increase lasted* model, shown in the second column, we find that both *Republicans over 185* and *Reps over 185 * recession* are statistically significant. When the threshold number of Republicans is achieved in the House of Representatives, the debt limit is more likely to be pushed beyond the next election and is more likely to last a longer number of days unless the economy is in recession. This suggests that politicians believe voters view a sizeable minority as having power and responsibility similar to that of the small majority. Thus, the sizeable minority may act similar to the majority and vote to push off controversial votes. However, for both models, the interaction term *Reps over 185 * recession* is negatively correlated with the dependent variable. This negative coefficient suggests that when the large minority threshold is met and the economy is in recession, the debt limit increase is more likely to be reached before the next election and is more likely to last a shorter number of days than when the country is not in recession. One possible reason for this is that during recessions, House Republicans believe that making the debt limit part of the election narrative will increase their chances of re-election against a Democratic opponent perceived to be responsible for the deficits.

It is also worth noting that *years until election* is negatively related to *beyond election* meaning the probability an increase lasts beyond the election declines as the time till election increases. However, *years until election* has at most a marginally negative effect on the number of days an increase lasts. Thus, increasing the debt limit such that it lasts beyond the next election may be difficult to do when the election is still in the distant future. Also of interest are the non-results for *recession* and *war* for both dependent variables. One could assume that during times of war and recession, federal spending increases and thus the debt limit would expire sooner and before the next election. This does not appear to be the case. One possible explanation for this is that the debt limit is increased by a larger amount, offsetting the faster rate at which the debt expands so that the two increases cancel out any effect on duration.

Table 2: Estimation Results

| | Beyond Election | Days Inc. Lasted |
|-----------------------------------|----------------------|---------------------|
| <i>Single Party</i> | 0.829 (1.05) | -229.6 (-1.12) |
| <i>Democratic President</i> | 0.904 (1.21) | 398.4* (1.74) |
| <i>Republicans over 185</i> | 2.394*** (3.12) | 460.1** (2.42) |
| <i>Years Until Election</i> | -3.097*** (-4.38) | -126.6 (-1.08) |
| <i>Recession</i> | -0.436 (-0.59) | 17.38 (0.15) |
| <i>War</i> | -0.449 (-1.10) | 12.99 (0.19) |
| <i>Reps over 185 x Recession</i> | -1.815* (-1.83) | -477.9** (-2.17) |
| <i>Presidential Election Year</i> | -0.119 (-0.23) | -162.0 (-1.52) |
| <i>Constant</i> | 1.354** (2.22) | 326.5*** (3.25) |
| <i>N</i> | 74 | 73 |
| <i>R²</i> | 0.516 | 0.287 |

t statistics in parentheses

* $p < .10$, ** $p < .05$, *** $p < .01$

5. Conclusion

The debt limit has come under increased public scrutiny over the past few years as the level of federal debt, private and public, has approached and surpassed annual gross domestic product. This is evidenced by the public and media reaction to the Reinhart and Rogoff findings and subsequent flaws in these findings. As the federal debt increases, so will the scrutiny and political importance of votes to increase the statutory limit. This study contributes to the literature by examining increases in the debt limit relative to political and economic conditions. Our results show that longevity of increases in the debt limit are determined at the intersection of political and economic conditions. In particular, House Republicans with a sizeable minority act similarly to the Democratic majority unless the economy is in recession. During recessions, minority Republicans with enough influence are likely to approve only small increases in order to ensure the debt limit remains part of the election narrative. Such behavior suggests that during recessions, Republicans believe they can maximize their chances of re-election by tagging Democrats in the majority with the negative connotations of increasing the national debt limit. As economic conditions change, so does the political calculus.

6. References

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