How to Deal With the Debt Limit

By James A. Baker III
808 words
17 June 2011
The Wall Street Journal
J
The Wall Street Journal - Print and Online
CTGWSJ
A17
English

If the United States does not address its looming debt crisis, the cost of servicing the national debt will spiral out of control. The annual interest bill, according to a recent Congressional Budget Office report, will increase four-fold to $916 billion by 2020. This year, we will spend 70% less on debt payments than we do on defense. In nine short years, we are expected to spend 8% more.

Washington so far has been unable or unwilling to make the tough choices required to put us on the road toward fiscal sanity. And it is unlikely that a grand bargain will emerge prior to the 2012 election. Nonetheless, our country can still take three short-term steps to bolster confidence in the bond markets and prevent a rise in interest rates that will damage our fragile recovery.

Step No. 1 is to raise the debt limit in a way that generates confidence in the markets. That means including a restraint on spending.

To accomplish this, the debt limit should be increased by an amount sufficient to service the U.S. debt for six months, provided that the proceeds from the increase are used to service debt obligations. Doing this would eliminate the argument that a U.S. default will end Western civilization as we know it. And we should also increase the debt limit by an additional amount sufficient to cover the federal government's anticipated borrowing needs for the next six months. But we must do so only if the administration and Congress agree to a cap on total spending that will be enforced by sequestering spending from specific programs or by cuts across the board -- and only if, in addition, agreed-upon amounts and types of projected spending are eliminated. Special care here should be taken not to agree to waivers, exceptions or exemptions that could be used to defeat the purpose of the cap, sequester or across-the-board cuts.

We'll have to repeat the process twice a year until a comprehensive budget fix is reached. The caps should aim at achieving a historical ratio of spending to GDP of 20.6%. The debt-limit increase should not exceed the six-month period, because it is only when the debt limit has to be increased that Congress will be forced to muster the political will to enact enforceable spending restraint.

Of course, the best way to permanently reduce spending would be to enact a balanced-budget amendment to the Constitution requiring a supermajority in both houses of Congress to run an annual deficit, raise tax rates, or increase the debt ceiling. Unfortunately, the chances of enacting such a constitutional amendment are slim.

Step No. 2 is to take a page from Ronald Reagan's playbook in 1986 and restructure our convoluted tax code by reducing loopholes and lowering marginal rates. Business responded when the Reagan administration and a Democratic House overhauled the tax system this way. It would respond again today if given the chance. But, as in 1986, any changes in 2011 must be revenue-neutral so as to avoid turning the discussions on tax reform into a heated debate over aggregate levels of taxes and expenditures. Otherwise, with a divided government, the effort will fail.

Step No. 3 is for Congress and the White House to fully embrace free trade. With the dollar at low levels, consumers in other countries have an appetite for products with a "Made in the USA" label. To encourage them, we should give more than lip service to the currently pending free trade agreements with Colombia, South Korea and Panama. The White House should stop stalling after two and a half years of inaction and send them up to Congress for a vote.

In the long run, much more will be needed to correct America's fiscal woes. We must solve long-term funding shortfalls in entitlements such as Medicare, Medicaid and Social Security. And at some point we will have to start thinking about ways to raise revenue. But as President Reagan taught us, the very best way to do that is by increasing economic activity with pro-growth economic policies -- lower tax rates, less regulation and more free trade.

With the Federal Reserve ending its purchase of bonds later this month, the Treasury must rely even more on China, Saudi Arabia, Japan and other countries to invest in our securities. The cost of these borrowings will ultimately increase if the U.S.

is not seen to be dealing with its fiscal problems. We must demonstrate to the American people as well as the world that our leaders are doing so.

Mr. Baker was President Ronald Reagan's secretary of the Treasury from 1985-88.