

## “Limiting” the Federal Debt

*To restrain spending by the executive branch, the Founding Fathers gave the “power of the purse” to the Congress. By enacting “entitlements” (mandates to spend money without a specific appropriation), Congress has essentially abdicated this role, leaving the debt limit as the ultimate constraint on spending. Although this ceiling has proven quite porous, it has been more useful than no ceiling at all.*

Last March, President Clinton signed a bill that increased the legal limit on the Federal debt from \$4.9 trillion to \$5.5 trillion. This legislation followed a months-long standoff between the Republican Congress and the President over raising the old limit, which the actual outstanding debt threatened to exceed last November. Although no investors lost interest or

principal, the U.S. Treasury briefly defaulted on its securities then, in an effort to remain below the ceiling. This limited default generated much publicity and controversy over the possibility of a more serious default, but Treasury Secretary Robert Rubin managed to avoid this by resorting to various accounting maneuvers that enabled the Government to continue

its financing operations without breaching the debt ceiling.

This was by no means the first time the issue of raising the Federal debt ceiling has arisen. There have been statutory limits on Federal debt for most of U.S. history. Before World War I, the Congress usually authorized a specific amount of debt for each issue. In later years, the limit developed into a ceiling on the total amount of most Federal debt outstanding.

Establishing a limit on the amount of debt that the Government may incur perhaps indicates good intentions or wishful thinking on the part of the Congress. The “ceiling” is not what it seems to be, however. As shown in the table below, the Congress has frequently changed the statutory debt ceiling. The latest increase was the third since 1990 and the *twenty-first*

### Statutory Changes in the Debt Ceiling Since 1940

Date	Type of Change	Amount of New Ceiling (Billions of Dollars)	Date	Type of Change	Amount of New Ceiling (Billions of Dollars)
June 25, 1940	Increase	49	March 27, 1978	Extension of temp. increase	752
February 19, 1941	Increase	65	August 1, 1978	Decrease	400
March 28, 1942	Increase	125	August 3, 1978	Temporary increase	798
April 11, 1943	Increase	210	April 1, 1979	Decrease	400
June 9, 1944	Increase	260	April 2, 1979	Temporary increase	830
April 3, 1945	Increase	300	September 29, 1979	Temporary increase	879
June 26, 1946	Decrease	275	May 30, 1980	Extension of temp. increase	879
August 28, 1954	Temporary increase	281	June 6, 1980	Extension of temp. increase	879
June 30, 1955	Extension of temp. increase	281	June 28, 1980	Temporary increase	925
July 9, 1956	Decrease	275	December 19, 1980	Increase	935.1
February 26, 1958	Temporary increase	280	February 7, 1981	Temporary increase	985
September 2, 1958	Increase	288	September 30, 1981	Temporary increase	1,079.8
June 30, 1959	Increase	295	June 28, 1982	Temporary increase	1,143.1
June 30, 1960	Decrease	293	September 30, 1982	Temporary increase	1,290.2
June 30, 1961	Temporary increase	298	May 26, 1983	Increase	1,389
March 13, 1962	Temporary increase	300	November 21, 1983	Increase	1,490
July 1, 1962	Temporary increase	308	May 25, 1984	Increase	1,520
May 29, 1963	Temporary increase	309	July 6, 1984	Increase	1,573
August 27, 1963	Extension of temp. increase	309	October 13, 1984	Increase	1,823.8
November 26, 1963	Temporary increase	315	November 14, 1985	Temporary increase	1,903.8
June 29, 1964	Temporary increase	324	December 12, 1985	Increase	2,078.7
June 24, 1965	Temporary increase	328	August 21, 1985	Increase	2,111
June 24, 1966	Temporary increase	330	October 21, 1986	Temporary increase	2,300
March 2, 1967	Temporary increase	336	May 15, 1987	Temporary increase	2,320
June 30, 1967	Increase	358	July 30, 1987	Extension of temp. increase	2,320
July 1, 1968	Temporary increase	365	August 10, 1987	Temporary increase	2,352
April 7, 1969	Temporary increase	377	September 29, 1987	Increase	2,800
June 30, 1970	Temporary increase	395	August 7, 1989	Temporary increase	2,870
March 17, 1971	Temporary increase	430	November 8, 1989	Increase	3,122.7
March 15, 1972	Temporary increase	450	August 9, 1990	Temporary increase	3,195
July 1, 1972	Extension of temp. increase	450	October 2, 1990	Extension of temp. increase	3,195
October 27, 1972	Temporary increase	465	October 9, 1990	Extension of temp. increase	3,195
July 1, 1973	Extension of temp. increase	465	October 19, 1990	Extension of temp. increase	3,195
December 3, 1973	Temporary increase	475.7	October 25, 1990	Extension of temp. increase	3,195
June 30, 1974	Temporary increase	495	October 28, 1990	Temporary increase	3,230
February 19, 1975	Temporary increase	577	November 5, 1990	Increase	4,145
June 30, 1975	Extension of temp. increase	577	April 6, 1993	Temporary increase	4,370
November 14, 1975	Temporary increase	595	August 10, 1993	Increase	4,900
March 15, 1976	Temporary increase	627	March 29, 1996	Increase	5,500
June 30, 1976	Temporary increase	700			
October 1, 1977	Decrease	400			
October 4, 1977	Temporary increase	752			

Note: An “increase” is a permanent change in the debt ceiling, while a “temporary increase” is one that was usually scheduled to expire in a year or less.

since 1940. During this period Congress also has approved *dozens* of “temporary increases.” These are higher ceilings that are set to expire in a given period, usually less than a year and sometimes just a few days, but which invariably are extended or superseded by newer, higher ceilings.

Several times these “temporary” debt limits have been allowed to expire, or, as happened last fall, the outstanding debt has verged upon reaching the legal limit, and the Treasury has been forced to postpone the issuance of new securities and take other administrative actions. The situation last fall was exceptional primarily because it took months rather than days for the Congress to resolve the problem by establishing a new limit after the old ceiling became inadequate.

That the Treasury could successfully finance the Government’s deficits for 4 months without increasing the debt at all, thus managing to keep it slightly below the ceiling, raises further doubts about value of setting a legal limit. The “ceiling” evidently is quite porous.

One reason is that the debt that is counted toward the limit includes a large

portion of debt that is held in Government accounts rather than by the public. This Government-held debt consists mainly of special nonmarketable securities held in the trust funds maintained for Social Security and other programs. It thus represents an internal obligation of one Government agency to another. The Treasury creates, manages, and retires this debt outside the constraints of the marketplace.

Among other things, this enables Treasury officials to keep total outstanding debt below the legal limit by managing this internal debt in unusual ways, such as swapping trust fund IOUs for new IOUs that do not count toward the debt limit (as the Treasury did last year). Government-held debt now amounts to \$1.3 trillion, or roughly one fourth of total debt subject to the statutory limit — which suggests the Treasury has ample opportunity to engage in similar maneuvers in the future when the debt again approaches its ceiling.

The willingness of Congress to increase the debt ceiling, and the demonstrated ability of the Treasury to circumvent it, have led some observers to conclude that a formal limit on the debt is

meaningless. Nevertheless, a limit on the Federal debt seems advisable, ephemeral as that limit may be, because in establishing it Congress and the President, in effect, acknowledge that an increasing debt is cause for concern. When deficit spending pushes the amount of debt toward the limit, it becomes both a barrier and a warning. The Treasury’s efforts to avoid hitting the limit are not costless, and they do not eliminate uncertainty in the financial markets over the possibility of a default. When the limit is increased, politicians, policymakers, and the public are made more aware that deficit spending has pushed the nominal value of the Government’s debt obligations to a new high.

Although the limit on the Federal debt is fictitious in a sense, because it can be and often has been changed by the legislative body that established it, it serves a useful purpose. Its effect on appropriations and spending is mainly through its psychological influence and is not measurable, but it probably to some extent restrains them. Without the limit, the Federal debt would probably be even higher than it is now. □

## Book Review

*Aging and Old Age*, by Richard A. Posner, Chicago, The University of Chicago Press, 1996, 363pp. with Index, \$29.95, hardbound.

The author is Chief Judge of the Seventh Circuit and Senior Lecturer at the University of Chicago Law School. He is a leader of the study of law and economics (we reviewed an earlier work, *The Economics of Justice*, in our December 1987 *Economic Education Bulletin*).

Judge Posner believes that “...economics can provide a unifying perspective in which to view the whole range of social problems concerning the elderly.” And he goes on to show why and how this is so. Some of his arguments are fairly dense, and some readers may find his approach somewhat single-minded (one reviewer, a retired Harvard Chaplain, complained that Posner “focuses on losses [from the aging process], while largely ignoring possibilities for development in later life”).

The judge does begin by discussing the aging process itself and how the elderly have fared in other times and cultures, drawing on fields as diverse as biology, demography, anthropology, and history. But the bulk of the work is devoted to the analyses of behavior, using the tools of economic analysis. Judge Posner clearly delights in this. He ponders all sorts of issues and behaviors and

often comes up with contrarian conclusions — such as the notion that readily available physician-assisted suicide could serve to decrease the suicide rate among the elderly.

His fundamental point is that “The evidence that there really is a process called aging that...generates palpable and often occupationally relevant differences between older and younger persons is more compelling than any evidence thus far advanced to demonstrate occupationally relevant differences in the fundamental capacities of men and women, whites and blacks, or persons who differ in their sexual orientation.” He concludes, therefore, that the elderly are “not a victim class,” and he shows why laws against “ageism” have been ineffectual at best, and actually may have worked against the interests of the elderly.

On the other hand, Judge Posner rejects the view that the elderly are “pampered parasites,” and, in the biggest surprise of the book, he views the future financing of Social Security and Medicare as problems that can be solved with relatively minor adjustments.

We believe that the Judge underestimates the difficulty of the adjustments (decreasing benefits, raising taxes and/or the deficit, or even relaxing immigration restrictions) that will eventually have to be made. It would appear that the author’s “model building” (largely based on the notion of “multiple selves” — especially

the “young self” and the “old self”) leads him accept the proposition that Social Security Taxes paid during working years somehow finance benefits in retirement. This is, in fact, a pretense of politicians, masquerading as insurance executives. As a “pay-as-you-go” system, Social Security simply taxes one group to pay another. The prospective macroeconomic consequences of continuing on the current basis (which, among other things, generates the largest transfers to those in the least need) are simply too large to be ignored.

He does criticize Medicare for giving the elderly more care than they really want (on the incontestable grounds that if the elderly were simply given the cash that Medicare costs, they would spend part of it on non-medical items), and he suggests ways that research monies could be better spent.

However his major conclusion is that better medical care has pushed back “the boundary between middle age and old age. For the over 65 population this means that: “...low-value, high-medical-cost years are being transformed into high-value, low-medical cost years at the same time that years of the first sort are being tacked on at the end of life. When all the costs and benefits are reckoned in, there is no solid basis for concluding that the aging of the population has been or in the foreseeable future will be a source of *net* diminution in the overall welfare of the American People.” □









## BUSINESS-CYCLE CONDITIONS

*The business-cycle outlook appears quite favorable — especially for President Clinton. The leading indicators continue to expand, all six of the coincident indicators are at new highs, and, as indicated by recent new highs in the stock market, worries over inflation and rising interest rates appear to be subsiding. All this, and the lowest unemployment rate in 7 years, should make President Clinton tough to beat in November.*

Among our twelve primary leading indicators, three reached new highs in our latest appraisal of business-cycle conditions. They are *new orders for consumer goods and materials*, *contracts and orders for plant and equipment*, and the *ratio of manufacturing and trade sales to inventories* (the first two of these series are reported in constant dollars, as are all other dollar-denominated series). All three are appraised as clearly expanding. Although not at new highs, the base data for both the *index of new housing permits* and the *index of common stock prices* increased, and both series remain appraised as clearly expanding. If the stock market continues to expand as it has during the first half of September, the constant-dollar stock price series should hit a new high next month.

Ignoring the previous peak in *initial claims for state unemployment insurance*, it would be at a new high as well. It sometimes is useful to ignore a previous peak when it becomes clear that it is not associated with a change in the series' cyclical trend, but instead may reflect a temporary reversal associated with a "growth cycle" or an anomalous fluctuation that is not of a cyclical nature. The series remains appraised as probably expanding.

A cyclical trend for the 3-month percent *change in sensitive materials prices* finally is emerging. For the past 4 months it was unclear whether this rather volatile series was expanding or contracting. Now, it seems that it may be expanding. The base data have increased for the past 3 months, and the moving average has increased for 6 consecutive months. The series' cyclical trend had been indeterminate; it is now appraised as probably expanding. The *M2 money supply*, a broad measure of money, and the *average workweek in manufacturing*, unchanged from last month at 41.7 hours per week, are both appraised as probably expanding as well.

*Vendor performance*, the percentage of purchasing managers reporting slower deliveries from their suppliers, is the only remaining leading indicator without an apparent cyclical trend. At 51.7 percent, slightly more purchasing managers are reporting slower deliveries from their sup-

pliers than are reporting faster deliveries. Slower deliveries are usually associated with a growing economy.

The *M1 money supply* and the 3-month percent *change in consumer debt*, which both have established clearly contracting trends, continue to decline and remain appraised as clearly contracting.

Overall, 82 percent (9 out of 11) of the leading indicators with apparent cyclical trends are expanding. The cyclical score, AIER's purely mathematical assessment of the leading indicators, rose this month to 68. Charts 1 and 2 show AIER's percent of leaders expanding and the cyclical score, respectively. The charts show downturns in 1995 that turned out to be false signals of recession — the economy did slow, but did not contract. The recent rebound in these two series suggests that the business outlook is now quite favorable.

All six of the primary roughly coincident indicators reached new highs. *Nonagricultural employment* increased by 250,000. With the exception of the mining industry, which lost 2,000 jobs, this increase was shared across the board. Payrolls increased by 6,000 in the construction industry, 25,000 in the manufacturing sector, and 221,000 in the service sector. The *index of industrial production*, increased 0.5 percent, despite a 0.6 percent decrease in the output of consumer goods. *Personal income in manufacturing*, *manufacturing and trade sales*, the *ratio of civilian employment to population*, and *gross domestic product* (quarterly) all continue to expand as well. Overall, 100 percent (6 out of 6) of the coincident indicators are expanding.

Two of the primary lagging indicators reached new highs; *commercial and industrial loans* and the *ratio of consumer debt to personal income*. Although in hindsight every series is either expanding or contracting, there are no discernible cyclical trends at present among the remaining four laggings. The *average duration of unemployment* (inverted) fell slightly to 17.1 weeks (this is plotted as an increase in the accompanying set of charts). *Manufacturing and trade inventories* continues to drift sideways, as does the 12-month

### Statistical Indicators of Business-Cycle Changes

Change in Base Data				Primary Leading Indicators	Cyclical Status		
May	Jun.	Jul.	Aug.		Jul.	Aug.	Sep.
-	-	-		M1 money supply	-	-	-
-	+	-		M2 money supply	+?	+?	+?
+	+	+		Change in sensitive materials prices	?	?	+?
+	+ <sup>r</sup>	+		New orders for consumer goods	+	+	+
+	-	+		Contracts and orders for plant and equipment	+	+?	+
-	-	+		Index of new housing permits	+	+	+
+	-			Ratio of manufacturing and trade sales to inventories	+	+	+
+	+	-	+	Vendor performance	?	?	?
+	+	-	+	Index of common stock prices (constant purchasing power)	+	+	+
+	+	-	+	Average workweek in manufacturing	+?	+?	+?
+	-	+		Initial claims for unemployment insurance (inverted)	?	+?	+?
-	-	-		Change in consumer debt	-	-	-
<i>Percentage expanding cyclically</i>					78	80	82
<b>Primary Roughly Coincident Indicators</b>							
+	+	+	+	Nonagricultural employment	+	+	+
+	+	+	+	Index of industrial production	+	+	+
+	+	+		Personal income in manufacturing	-?	+	+
+	-			Manufacturing and trade sales	+	+	+
+	+	+	+	Civilian employment to population ratio	+	+	+
+	+			Gross domestic product (quarterly)	+	+	+
<i>Percentage expanding cyclically</i>					83	100	100
<b>Primary Lagging Indicators</b>							
+	-	+	-	Average duration of unemployment (inverted)	+?	?	?
-	-			Manufacturing and trade inventories	+?	?	?
-	+	+		Commercial and industrial loans	+	+?	+
nc <sup>f</sup>	-	+		Ratio of consumer debt to personal income	+	+	+
+	-	-		Change in labor cost per unit of output, manufacturing	?	?	?
nc	+	+	-	Composite of short-term interest rates	?	?	?
nc No change. <sup>f</sup> Revised.					<i>Percentage expanding cyclically</i>		
					100	100	100

Under "Change in Base Data," plus and minus signs indicate increases and decreases from the previous month or quarter and blank spaces indicate data not yet available. Under "Cyclical Status," plus and minus signs indicate expansions or contractions of each series as currently appraised; question marks indicate doubtful status when shown with another sign and indeterminate status when standing alone.

Chart 1  
Percentage of AIER Leaders Expanding

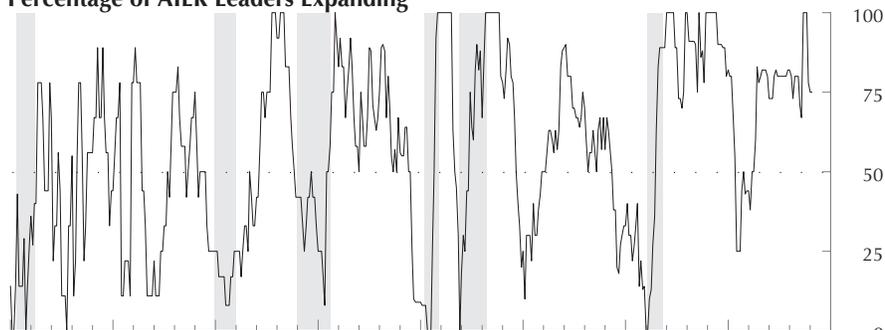


Chart 2  
Cyclical Score of AIER Leaders

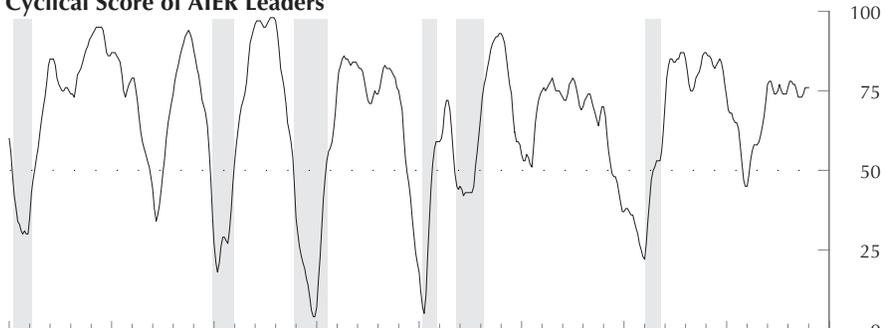
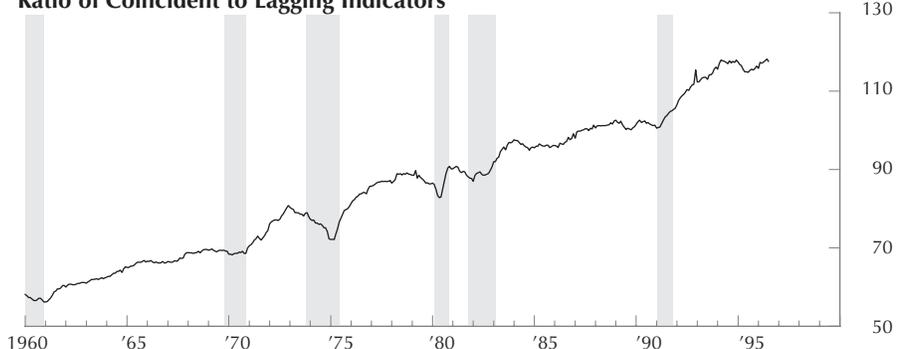


Chart 3  
Ratio of Coincident to Lagging Indicators



percent change in manufacturing labor costs per unit of output. The composite of short-term interest rates decreased to 5.35 percent in August from 5.44 percent in July. Overall, 100 percent (2 out of 2) of the primary lagging indicators with apparent cyclical trends are expanding.

Oftentimes, the lagging indicators are ignored in the assessment of the economy, because, by definition, changes in their cyclical trends usually follow rather than precede cyclical changes in the overall economy. However, these indicators play an important role in assessing business-cycle conditions. They provide confirmation that a business-cycle turning point has occurred. If decreases in the leaders and coinciders suggest a recession has begun but the laggings continue to expand cyclically, the reversal of the trend of general business activity may be short-lived and, therefore, not a bona fide cyclical contraction.

The laggings also can be considered "leading indicators of the leading indica-

tors." They can be useful in assessing which way the leading indicators are likely to head, because they often provide the first evidence of the imbalances and bottlenecks in the economy that typically choke off economic growth. For example, the recent increase in the ratio of debt to personal income, one of our lagging series, may be a sign that consumers are overburdening themselves with debt. If so, we would expect consumer purchases and eventually new orders for consumer goods and materials, one of our leading indicators, to decrease.

One useful indicator of possible im-

balances in the economy is the ratio of the composite coincident index to the composite lagging index. The two component series of this ratio were calculated by the Commerce Department for many years but are now calculated by the Conference Board every month. If the Conference Board's lagging index (which is based on many of the same lagging indicators analyzed by AIER) increases faster than its coincident index, the ratio will decline. This is a sign that imbalances are developing in the economy. On the other hand, if the composite coincident index increases faster than the composite lagging index, this ratio will increase. (AIER uses a similar approach to measure imbalances within the manufacturing sector, by using the ratio of a coincider (manufacturing sales) to a lagger (inventories) as one of our leading indicators.) Chart 3 shows the ratio of the Conference Board's composite coincident index to its composite lagging index. As the chart indicates, this ratio peaked in December 1994, then decreased for 7 months. This peak occurred 1 month prior to a peak in the composite leading index. In 5 out of the past 8 expansions, the ratio peaked before the composite leading index, and it peaked an average of 4.6 months in advance. However, it peaked after the composite leading index during the other three expansions (an average of 6 months after). It should be noted that our chart reflects all historical revisions to each of the statistical series included in the composite indexes; in some cases, the ratio behaved quite differently based on the data originally published.

Still, despite some false signals (most recently in 1995), during the past eight recessions the ratio of the coincident index to lagging index has never missed a recession. On average, the ratio has peaked 16 months prior to the beginning of a recession, although in 1990 it peaked a mere month before the recession began in July (according to the data available then).

Although the ratio decreased this month, it is not clear that this marks a reversal in the series' recent upward trend. This evidence, in addition to the information provided by AIER's indicators, suggests there are few signs of imbalances in the economy that could hinder further economic expansion. □

#### PRICE OF GOLD

	1994	1995	-- 1996 --	
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