The U.S. Debt: Who Will Blink First?
By Craig Phillips

Is there a chance of a United States default? If the two parties in D.C. cannot agree on a bi-partisan solution by August 2nd, it looks as if a technical default may be in the cards. Typically, a gridlock in Washington might be something that is good for a country. The less the government actually does, the less it can mess up, right? However, when there are as many pressing issues to be dealt with as there are now, gridlock may prove to be the worst thing for our nation.

CNN Senior Political Analyst David Gergen has worked with both Republican and Democratic parties in the past. David recently spoke to a conference for financial advisors in Salt Lake City. According to Gergen, both Republicans and Democrats agree that the debt problem is the issue; the disagreement is how to deal with it. Republicans want the tax rates to stay the same and to make up the difference in spending cuts. Democrats want to raise taxes on the affluent while keeping cutting spending far less than their Republican counterparts would like. Something does need to be done soon.

According to economists Ken Rogoff and Carmen Reinhart, financial crises tend to follow a particular pattern and this pattern can be crippling to an economy. A financial crisis will typically lead a Keynesian influenced government to throw money at the problem until it stops. So much money is spent trying to prevent the economy from derailing that the financial crisis then becomes a fiscal crisis. Now, the government is concerned with a crippling a load of debt and is left wondering how it can pay it back.

Rogoff and Reinhart suggest that a nation is headed towards a danger zone with 60% of GDP in total debt. By the time a nation has passed 100% of GDP in total debt, it is well into the danger zone. Economic growth is estimated to drop by a full percentage point at a minimum and interest rates will rise as creditors become less likely to loan to you. The lower growth and higher rates of borrowing will lower tax revenues making it harder to pay down the debt and the nations is stuck in a vicious cycle of slow growth for years to come.

Last year, the U.S. reached the 60% of GDP level. It is on track to possibly eclipse the 100% of GDP within the next decade. Both parties would like to avoid this scenario. Republicans would like to reduce government spending to 21% of GDP from its current level of 25%. Democrats would like to cut spending, but not nearly that much; the difference would be made up from increases in taxes.

There are several bi-partisan committees working to come up with an acceptable solution. One committee, lead by Erskine Bowles (D) and Alan Simpson (R) has mapped out a way to reduce government debt by $4 trillion. This plan proposes cuts in spending by $2 for every $1 increase in tax revenues. There is another committee chaired by Vice President Joe Biden that is also holding meetings to come up with an alternate solution. Lastly, there was a third committee entitled the "Gang of 6" that were working towards an alternate proposal but that has mostly fallen apart.

The debt ceiling of August 2nd is fast approaching and the government is currently working on deferred payments to the government employees pension plans. This deadline makes negotiations even more difficult as parties are pressured to have a deal worked out by then. If no deal is worked out and a debt ceiling increase is voted down, we will have a technical default on the U.S. debt. A default on the U.S. debt could create a loss of confidence in the U.S. dollar; however, it would likely not be viewed as grave as the situation facing Europe right now as individuals would realize that our current state of default is simply a political tie up and not so much an inability to pay.

There are some Republicans in Congress who do not feel it in a large issue if negotiations extend beyond the August 2nd "deadline," and they feel they may even having more political leverage as the deadline gets closer. Gergen calls this "the most serious issue in Washington in the last 30-40 years." He sees a stronger America ahead if Congress is able to address this debt issue responsibly, however, he is concerned that the political risk of action may persuade Congress and the White House to push this out passed the 2012 election so it can be someone else's problem.