U.S. PUBLIC DEBT IN TEN BULLETS

1. Any (fully sovereign) government that is the issuer of its own domestic currency does not have to "earn" money to pay its domestic currency debts the way we do.

2. To pay our debts, we use what is called "legal tender". We know counterfeiting currency is a crime. So we have to make it through earning incomes, or borrowing, or selling assets. Money is an overnight credit in the hands of its holder.

3. When a (fully sovereign) government obtains its currency of issue (money) from us, it obtains the same money it has issued. Thus, it gets nothing it cannot issue itself: government "borrowing" is <u>not</u> the same operation as private borrowing.

4. When government that issues its own currency "borrows" money from a private entity, it receives the money previously issued in exchange for a "Treasury security", also called a "debt instrument". Thus, government does this: Replace an overnight credit (that holders can use on demand to pay liabilities to the government or to other private entities) with another credit, a Treasury security, that can't be used to make payments until maturity. Private entities (wishing to earn an interest on an asset that they know they can sell quickly if needed) agree on buying it. ***In the simplest terms: If I use $1,000 of my balance in a bank account to buy a Treasury security, I am exchanging a credit of $1,000 that I could use to pay my taxes or settle liabilities with other private entities now, for a security that gives me the right to receive a contractually defined amount of money plus interest at some contractually defined future dates.***

5. True: Governments can deliberately set a variety of limits on how much money they can "borrow". In the U.S., this limit is dictated by an article of the U.S. code. The logic, as odd as it may be, is to set a limit on the amount of money that private entities are allowed to convert into Treasury securities. In other words, if the government has reached the limit, no new Treasury securities can be offered and thus private entities cannot exchange any more money for them. Thus, contrary to what is commonly believed, this does not cause a government shutdown or a default on federal "borrowing" instruments.

6. Governments, however, can also set limits on their own spending. In the U.S., the Fed cannot offer the Treasury an overdraft: thus, if the Treasury cannot fund its spending with tax revenue or selling "debt instruments", it cannot spend. Imposing the limit is a political decision that might cause a government shutdown or a default.

7. Consequently a government shutdown or a default is also an event that may only be caused by a self-inflicted refusal to make payments. Private entities do face situations where rising debt can force them to either retrench spending, or default on their debt. By contrast, governments with rising debt face an utterly different alternative: honor or refuse to pay their obligations.

8. Other examples of self-imposed constraints include: a gold standard system (when the money issued must not exceed some proportion of gold reserves), a currency board (when the money issued must not exceed some proportion of foreign currency reserves). The only constraint that makes sense is to adapt the size of the difference between spending and taxes so that it does not cause excess aggregate demand on existing production capacity, thus causing inflation.

9. In the end (and not that this has any real possibility of happening with the current primary dealer system in place), what do you think would happen if the U.S. government faced a situation where interest payments come due for $ 1 million, and the Treasury has a zero balance on its Fed account? Would the U.S. government declare a default and voluntarily destroy $ 1 million of private financial wealth to all holders of U.S. securities in the U.S. and abroad, or would the U.S. Congress let the Treasury run an overdraft and pay the bills?

10. Before you answer, consider that

    i) the default option brings brutal financial and political damage,

    ii) raising the limit is technically and functionally simple, fair, and bearing no consequences on real standard of living.