TEN HAAGEN
Financial Group

Investments & Financial Planning

191 New York Ave., Huntington, NY 11743
Tel: 631.425.1966 • Fax: 631.425.7621
E-mail: wiseinvesting@tenhaagen.com
www.tenhaagen.com

July 28, 2011

Dear Clients and Friends:

As August 2 approaches, you'll likely hear increasingly urgent debate over the nation's debt ceiling. That's the approximate date by which the Treasury estimates it will no longer be able to borrow under the current $14.3 trillion limit. Treasury officials have warned that if the Treasury can no longer borrow money, the U.S. might default on its existing obligations--in other words, be unable to make payments it already owes, whether those be for Treasury securities or government programs.

President Obama, Treasury Secretary Timothy Geithner, and Federal Reserve Chairman Ben Bernanke have warned that not raising the debt limit would have severe consequences. Leaders of both parties have said that the issue must be addressed, and have put forward proposals for tying any increase to tackling the country's budget deficit. However, they differ on how to begin to reduce that deficit. While the debate is taking place right now, here are some answers to frequently asked questions that might help you understand the issues involved.

What is the debt ceiling?

The debt ceiling represents a limit on the amount the U.S. Treasury is allowed to borrow to manage the national debt (the total amount currently owed by the U.S. government). Before World War I, Congress often approved the terms of individual debt instruments issued by the Treasury to pay for spending authorized by Congress, including maturities, interest rates, and the types of financial instruments used. Eventually, members decided in 1939 to set an overall limit on the total amount the Treasury could borrow to pay the nation's bills without congressional authorization.

An increase in the debt limit does not authorize additional governmental spending; only Congress can approve future spending. However, Treasury officials have said that if the limit is not raised, the government would not be able to pay bills that have already been incurred. According to the Congressional Research Service (an arm of Congress), the debt ceiling has been increased 78 times since 1960 (10 times just since 2001), under both Democratic and Republican administrations. The national debt has two aspects. Debt held by the public occurs when investors buy debt instruments sold by the Treasury to finance budget deficits and pay bills; it represents almost two-thirds of the current debt. Debt held by government accounts is created when the Treasury borrows from government accounts such as the Social Security, Medicare, and Transportation trust funds.

What would happen if the debt ceiling isn't raised?

There's no way to know the precise or full impact, since a default on the country's obligations is unprecedented in U.S. history. However, the Treasury is responsible for payment of a broad range of obligations that include not only Treasury bonds, notes, and bills, but also Social

Security and Medicare benefits, military salaries, interest on the current national debt, and tax refunds, to name only a few.

191 New York Ave., Huntington, NY 11743
Tel: 631.425.1966 • Fax: 631.425.7621
E-mail: wiseinvesting@tenhaagen.com
www.tenhaagen.com

Technically, the $14.3 trillion ceiling was exceeded in May. However, the Treasury has been able to use certain accounting measures to temporarily extend the nation's ability to borrow.

Bond rating agencies have already warned that an interruption in or curtailing of payments owed by the U.S. government would harm the nation's credit rating, which is currently among the highest in the world. If that happened, or if the country actually had to default or foreign investors would likely demand higher interest rates for buying Treasury securities.

Those higher interest rates would increase the country's borrowing costs, making the national debt problem even worse in the long term. They might also result in higher interest rates for other, nongovernmental loans such as mortgages, which some observers worry could hamper economic recovery. And even if there were technically no default, the mere absence of an agreement that addresses the issue before August 2 would likely raise the global anxiety level substantially.

Haven't we survived government shortfalls in the past?

Governmental funding gaps have occurred more than a dozen times in the last three decades, according to the Congressional Research Service. The most recent was in 1995-1996, when the failure of the Clinton administration and the Republican-led Congress to reach agreement on a spending bill led to a temporary government-wide shutdown. However, never in the country's history has it failed to pay its legal obligations--one reason why Treasury securities have historically been considered one of the safest investments in the world.

If you have questions or concerns, please feel free to contact me directly.

Sincerely,

Jon L. Ten Haagen, CFP, RPC
Registered Investment Advisor

JLTH/GR

Content provided by Forefield.