COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET



# Q&A: Everything You Should Know About the Debt Ceiling
## Updated: October 2, 2013

While it is incredibly disappointing that elected officials in Washington failed to avoid a government shutdown, attention is quickly turning towards raising the federal debt ceiling, which currently stands at $16.699 trillion. The Treasury Department projects it will run out of borrowing authority on October 17th, at which point it will only have $30 billion left on hand, and would run out of cash soon after – between October 22nd and October 31st according to the Congressional Budget Office. The following is a short primer on the debt ceiling and on the ways to responsibly address it while also dealing with unsustainable federal borrowing going forward.

## What is the debt ceiling?

The debt ceiling is the legal limit on the total level of federal debt the government can accrue. The limit applies to almost all federal debt (certain types of debt are exempt, but are quite small in value), including the debt held by the public and what the government owes to itself through various accounts such as the Social Security and Medicare trust funds. The debt ceiling applies to both debt held by the public as a result of borrowing necessary to finance deficits, and debt owed to trust funds. As a result, the debt subject to limit increases both as a result of annual budget deficits financed by borrowing from the public and increases in government trust fund balances invested in Treasury bills. The current debt subject to limit of more than $16.7 trillion is composed of nearly $12 trillion in debt held by the public and slightly more than $4.7 trillion in debt held by government accounts. Most economists feel debt held by public is the more relevant measure of the economic impact of government debt.

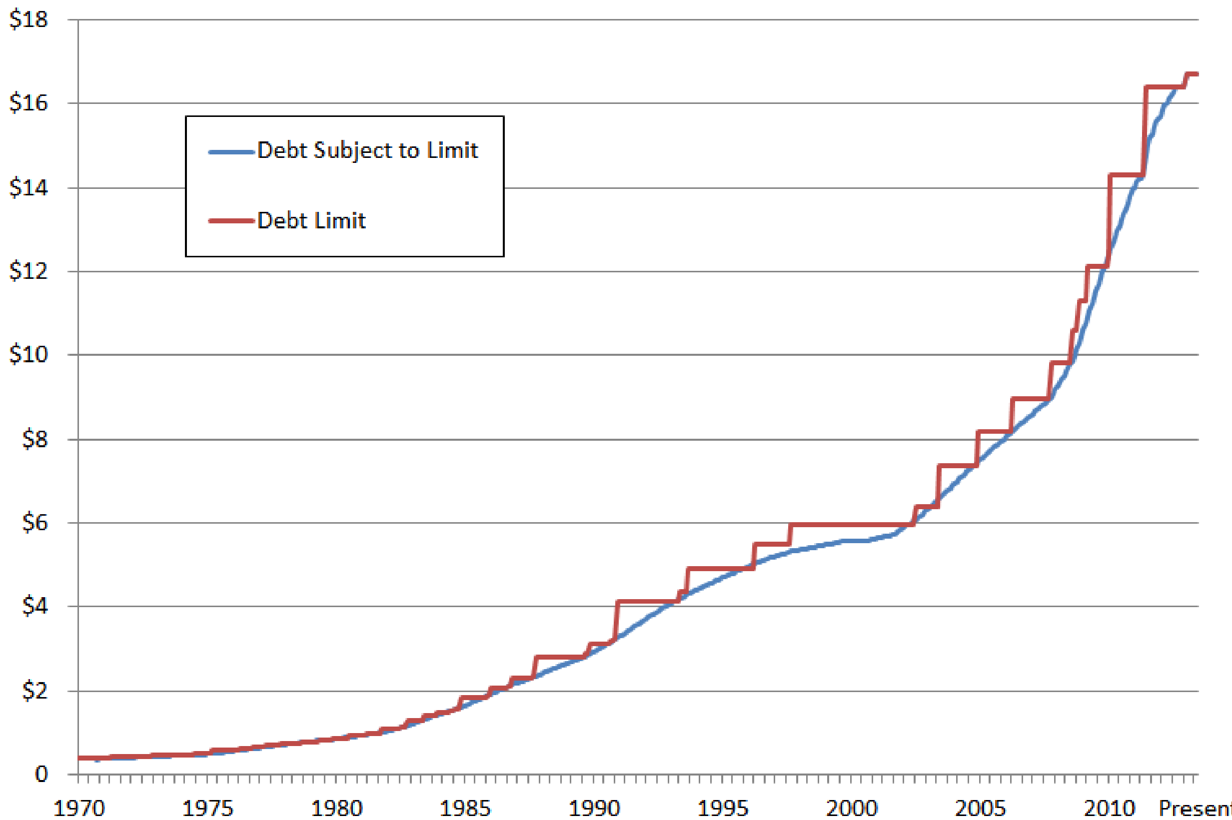
## When was the debt ceiling established?

The first iteration of the debt ceiling was established in 1917 and set at $11.5 billion under the Second Liberty Bond Act. Prior to this, Congress was required to approve each issuance of debt separately. The ceiling was enacted to simplify the process and enhance borrowing flexibility. In 1939, Congress created the first aggregate limit covering nearly all government debt and set it at $45 billion, about 10 percent above the total debt at that time.

## How much has the debt ceiling grown?

Since it was established, Congress and the President have increased the debt ceiling roughly 100 times. During the 1980s, the debt ceiling increased from less than $1 trillion to nearly $3 trillion. Over the course of the 1990s it doubled to nearly $6 trillion, and in the 2000s, it doubled again to well over $12 trillion. The Budget Control Act of 2011 automatically raised the debt ceiling by $900 billion and gave the President authority to increase the limit (subject to a Resolution of Disapproval) by an additional $1.2 trillion, to $16.394 trillion. In February of 2013, lawmakers temporarily suspended the debt ceiling through May of 2013, resulting in a de facto increase of about $305 billion and bringing the debt ceiling to its current level of $16.699 trillion.

### Fig. 1: Statutory Debt Limit and Federal Debt Subject to Limit (Trillions)




*Sources: Treasury Department, Office of Management and Budget*

## Why is Congress debating this now?

The president signed the No Budget, No Pay Act into law on February 4, 2013, which temporarily suspended the statutory debt limit until May 18, 2013. At that point, the debt ceiling was automatically raised to $16.699 trillion to cover new borrowing since suspension. Since May of this year, the Treasury has been employing "extraordinary measures" to avoid breaching the debt ceiling (see more about this below). These extraordinary measures are likely to last through mid- to late-October, at which time a formal debt limit increase or suspension will be necessary.

## Can breaching the debt ceiling be avoided without Congressional action?

The Treasury Department can use a variety of accounting tricks known as "extraordinary measures" to postpone the need to raise the debt ceiling. For example, it can prematurely redeem treasury bonds held in federal employee retirement savings (and replace them later plus interest), halt contributions to certain government pension funds, or borrow from money set aside to manage exchange rate fluctuations in order to buy time. While these actions are within the Treasury's authority, they do not make for very good policy, and can have negative economic, financial, and political consequences. Some believe the Treasury Department could buy even more time by engaging in other, unprecedented actions, such as selling large amounts of gold, minting a special large-denomination coin, or invoking the fourteenth amendment in order to override the statutory debt limit. Whether any of these tools is truly available is in question – the Obama Administration has ruled out all three – and the potential economic and political consequences of each of these options are unknown.

## What happens if the debt ceiling is breached?

Once the government hits the debt ceiling and exhausts all available extraordinary measures, it is no longer allowed to issue additional debt. At that point, the government must rely on its remaining cash on hand and incoming receipts to pay all obligations. However, when the federal government is in a period of running annual deficits – as is the case today – incoming revenues to the federal government are insufficient to cover all of the government's obligations, be it salaries for federal civilian employees and the military, utility bills, veterans' benefits, or Social Security payments, to name a few. Between October 18th and November 15th, for example, the Bipartisan Policy Center estimates that approximately 32 percent of the government's obligations would have to go unpaid, if relying only on incoming receipts to pay bills. Instead of or in addition to failing to meet these obligations, the government could also potentially default on regular interest payments on the debt.

A default, or even the perceived threat of a default, could have serious negative economic implications. An actual default would roil global financial markets, as both domestic and international markets depend on the relative economic and political stability of U.S. debt instruments and the U.S. economy. Interest rates would rise as demand for Treasuries would account for the increased risk of default, with demand for Treasury bills dropping as investors stop or scale back investments in Treasury securities if they are no longer considered a 100% safe investment. Bipartisan Policy Center has estimated, based on GAO data, that the 2011 debt limit debate led to higher interest rates on Treasuries issued during the standoff based on concerns about a potential default, which will cost the federal budget an estimated $19 billion over 10 years. The impact of an actual default would have a far greater and longer lasting impact on interest rates on Treasuries than concerns about a potential default during a temporary standoff.

Higher interest rates for Treasuries would increase interest rates across the economy, affecting car loans, credit cards, home mortgages, business investments, and other costs of borrowing and investment. The balance sheets of banks and other institutions with large holding of Treasuries would decline as the value of Treasuries dropped, potentially tightening the availability of credit.

### How does a shutdown differ from a default?

In a shutdown, government temporarily stops paying employees and contractors who perform government services, whereas the list of parties not paid in a default is much broader (See Q&A: Everything You Should Know About Government Shutdowns). In a default, the government exceeds the statutory debt limit and is unable to pay on time some of its obligations to its citizens or creditors. Without enough money to pay its bills, any of its payments are at risk—including all government spending, mandatory payments, interest on our debts, and payments to U.S. bondholders. Whereas a government shutdown would be disruptive, a government default could be disastrous.

## How are lawmakers proposing to address the debt ceiling?

President Obama and most Congressional Democrats have called for a "clean" debt ceiling increase, meaning that no other policies are attached to the increase. The President has stated clearly that he will not negotiate on the debt ceiling. Most Republicans, on the other hand, have previously called for accompanying a debt ceiling increase with deficit reduction (sometimes in a dollar for dollar proportion), changes to the Affordable Care Act, or other policies. Speaker Boehner recently suggested that the House of Representatives would pass a one year debt ceiling increase which included a one-year delay of the Affordable Care Act, a process for tax reform, several relatively modest deficit reduction measures, and a wide-ranging set of Republican-preferred policies that are unrelated to the budget.

### Have policymakers used the debt ceiling to pursue deficit reduction in the past?

Although policymakers have often enacted "clean" debt ceiling increases, Congress has coupled such increases with other legislative changes on many occasions. In a number of cases, Congress has attached debt ceiling increases to budget reconciliation legislation and other deficit-reduction policies or processes.

Indeed, most of the major deficit-reduction agreements made since 1980 have been accompanied by a debt ceiling increase. Causality has moved in both directions, though – on some occasions, the debt limit has been used successfully to help prompt deficit reduction; in other instances, Congress has tacked on debt ceiling increases to deficit-reduction efforts.

Notably, however, in virtually all instances in which a debt limit increase was either accompanied by deficit reduction measures or included in a deficit reduction package, lawmakers have generally approved temporary increases in the debt limit to allow time for negotiations to be completed without the risk of default. For example, Congress approved a modest increase in the debt limit in December 2009 while negotiations over Statutory PAYGO and establishment of the National Commission on Fiscal Responsibility and Reform were ongoing. During the negotiations and consideration of the 1990 budget agreement Congress approved six temporary increases in the debt limit before approving a long term increase in the limit as part of the reconciliation bill implementing the deficit reduction agreement.

Further discussion regarding past uses of the debt ceiling can be found in the Appendix to a recent CRFB paper, *What We Expect from the Upcoming Fiscal Discussions*, which is included in this document.

## What should policymakers do?

Failing to raise the debt ceiling would be disastrous, and would surely, and rapidly, result in severely negative consequences that experts are not capable of fully knowing in advance. Even threatening a default or taking the country to the brink of default could have serious negative repercussions. Importantly, though, failing to control the debt could ultimately stunt economic growth, reduce fiscal flexibility, and increase the burden on future generations. But the latter should not be sought by bringing America close to the brink of default. If lawmakers wish to accomplish deficit reduction, they should at least pass temporary increases of the debt limit to avoid nearing the brink.

Given these facts, Congress and the President must raise the debt ceiling – and they should do so as soon as possible. Yet they should also pursue a deficit reduction plan which would ideally replace the sequester, reform the tax code to make it simpler and raise more revenue, slow the growth of entitlement programs, and put the debt on a clear downward path relative to the economy. CRFB has described this strategy in more detail in our recent paper, *What We Expect from the Upcoming Fiscal Discussions*.

Although the need to raise the debt ceiling can serve as a useful moment for taking stock of our fiscal state, lawmakers should enact a comprehensive deficit reduction plan without jeopardizing the full faith and credit of the U.S. government.

## Where can I learn more?

- Committee for a Responsible Federal Budget – Understanding the Debt Limit
- Committee for a Responsible Federal Budget – *The Bottom Line*
- Committee for a Responsible Federal Budget – Debt Ceiling Tracker 2013
- Committee for a Responsible Federal Budget – *What We Expect from the Upcoming Fiscal Discussions*
- Bipartisan Policy Center – Debt Limit Analysis
- Congressional Budget Office – Federal Debt and the Statutory Limit, September 2013
- Government Accountability Office – Debt Limit: Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs
- The Treasury Department – Debt Limit Resources

## Appendix: Examples of How Debt Ceiling Has Been Used in the Past

**The Gramm-Rudman-Hollings Act in 1985**: The Gramm-Rudman-Hollings Act (GRH) in 1985 raised the debt limit by $175 billion and also set a target for a balanced budget in Fiscal Year (FY) 1991, with across-the-board cuts in spending by sequestration designed as an enforcement mechanism. Although the deficit-reduction goals under GRH were not achieved, the experience gained under the act contributed to the development of more workable and effective procedures five years later.

**Omnibus Budget Reconciliation Act of 1990:** The Omnibus Budget Reconciliation Act (OBRA) of 1990 raised the debt limit by $915 billion, the largest increase up until that point, but also contained nearly $500 billion in debt reduction over the next five years and enforcement procedures in the Budget Enforcement Act (BEA), which helped lead to the budget surpluses in the late 1990s. The BEA created adjustable limits for separate categories of discretionary spending and the pay-as-you-go (PAYGO) procedure that required tax cuts or increases in mandatory spending to be offset. Congress approved six temporary increases in the debt limit while negotiations were ongoing and Congress was considering legislation implementing the budget agreement.

**Omnibus Budget Reconciliation Act of 1993:** The Omnibus Budget Reconciliation Act of 1993 raised the debt limit by $600 billion, an increase that lasted for about two and a half years. OBRA '93 was the second major deficit reduction package of the 1990s, also containing nearly $500 billion in deficit reduction over five years. The agreement extended the original spending caps from 1990 and raised taxes on high earners, among other reforms.

**Balanced Budget Act of 1997:** The Balanced Budget Act of 1997 included a $450 billion debt limit increase which, thanks to the surpluses of the late 1990s and early 2000s, enabled it to last until 2002. At the time, the legislation called for about $125 billion of net deficit reduction over five years and $425 billion over ten years. It did so mainly through reductions in health care spending via provider payment reductions and increased premiums. The Act also created a few new programs -- Medicare+Choice (later renamed Medicare Advantage or Medicare Part C) and the State Children's Health Insurance Program (SCHIP).

**Statutory PAYGO Act of 2010:** The Statutory PAYGO Act of 2010 contained a debt limit increase of $1.9 trillion, the largest nominal increase ever enacted until that point in time. The legislation also reinstituted statutory PAYGO procedures that require tax cuts and mandatory spending increases to be fully offset (with some exemptions). Informally, the agreement to raise the debt ceiling also led to the creation of a National Commission on Fiscal Responsibility and Reform, to which President Obama later appointed Erskine Bowles and former Senator Al Simpson as co-chairs.

**Budget Control Act of 2011**: The Budget Control Act (BCA) gave the President the authority to increase the debt limit in tranches – subject to a Congressional motion of disapproval – by a total of $2.1 trillion. The BCA also contained $917 billion in deficit reduction over ten years, primarily through caps on discretionary spending. In addition, the bill established the Joint Committee on Deficit Reduction ("Super Committee") to produce deficit-reduction legislation of at least $1.2 trillion in savings, with budget sequestration to begin in 2013 as the enticement for the Super Committee to succeed. The bill also required Congress to vote on a Balanced Budget Amendment, which it did not pass.

**No Budget, No Pay Act of 2013:** Lawmakers enacted the No Budget, No Pay Act in early February 2013, which temporarily suspended the debt ceiling through May 18th, 2013 and then set an automatic "catch up" on May 19th that allowed for a $300 billion increase in the debt ceiling. The agreement would have also withheld the pay of Members of Congress if no budget resolution was passed in each House (though there was no requirement that the resolutions being agreed to jointly, which is necessary to go forward with the budget process).