



## Q&A: Everything You Should Know About the Debt Ceiling

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Attention is turning towards raising the federal debt ceiling, which will be reinstated on March 16, 2017 as the debt approaches \$20 trillion. At that time, the Treasury Department will begin using accounting tools at their disposal, called "[extraordinary measures](#)," to avoid defaulting on the government's obligations. However, the Congressional Budget Office (CBO) estimates that these measures will be exhausted by this fall, and the debt ceiling will need to be raised. If not, Treasury will be unable to continue paying the nation's bills.

### What is the debt ceiling?

The debt ceiling is the legal limit on the total amount of federal debt that the government can accrue. The limit applies to almost all federal debt, including the roughly \$14.4 trillion of debt held by the public and the roughly \$5.5 trillion the government owes itself as a result of borrowing from various government accounts, like the Social Security and Medicare trust funds. As a result, the debt continues to increase due to both annual budget *deficits* financed by borrowing from the public and from trust fund *surpluses*, which are invested in Treasury bills with the promise to be repaid later with interest.

### When was the debt ceiling established?

Prior to establishing the debt ceiling, Congress was required to approve each issuance of debt in a separate piece of legislation. The debt ceiling was first enacted in 1917 through the Second Liberty Bond Act and set at \$11.5 billion to simplify the process and enhance borrowing flexibility. In 1939, Congress created the first

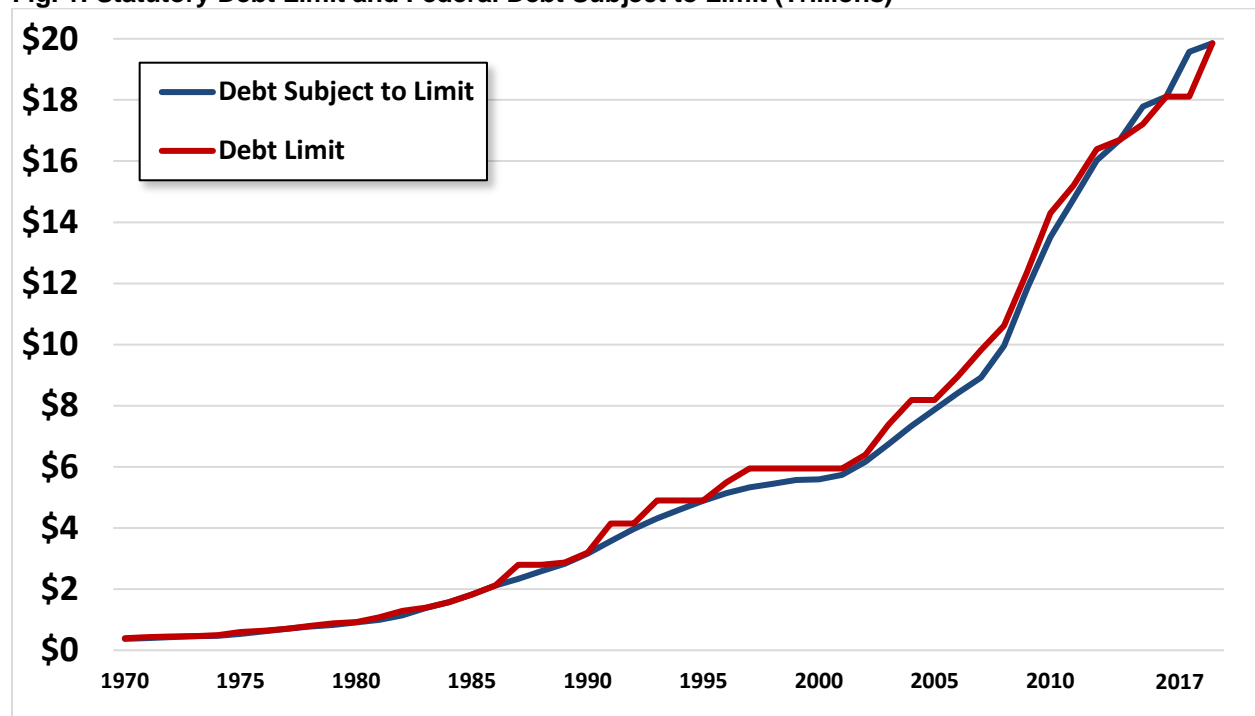


aggregate debt limit covering nearly all government debt and set it at \$45 billion, about 10 percent above the total debt at that time.

## 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 was increased from less than \$1 trillion to nearly \$3 trillion. Over the course of the 1990s, it was doubled to nearly \$6 trillion, and in the 2000s it was again doubled to 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 by an additional \$2.1 trillion to \$16.39 trillion. Lawmakers have since suspended the debt limit four times between February 2013 and March 16, 2017, when it will be reestablished at its current level of \$19.86 trillion.

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



Sources: Office of Management and Budget, Treasury Department. (Does not show debt limit suspensions since 2013, which is why the debt subject to limit sometimes appears over the limit)

## Why is Congress debating this now?

The debt ceiling was temporarily suspended under the Bipartisan Budget Act of 2015, but it will be reinstated on March 16, 2017. When the debt ceiling is reinstated, it will be raised to current debt levels – \$19.86 trillion – meaning that the U.S. Government cannot issue any new debt.

Because government spending is projected to significantly exceed revenues this year and beyond, the government will not be able to avoid further increasing the debt ceiling. However, through



the use of so-called “extraordinary measures,” the government can shift funds around and thus continue to pay its obligations on a temporary basis. Treasury Secretary Steven Mnuchin [has already indicated](#) he will begin the use of these extraordinary measures. High levels of tax collection in April will also generate temporary surpluses and thus delay the need to raise the debt ceiling.

According to CBO, however, all borrowing authority including the amount freed up through extraordinary measures will be exhausted sometime in the fall. Independently, the Bipartisan Policy Center [estimates](#) this “X Date” will occur in October or November. After this “X Date”, the U.S. can only pay obligations with incoming receipts, forcing the Treasury to delay and/or miss many payments. A formal debt limit increase or suspension will be necessary to avoid default.

### **What are extraordinary measures?**

When the debt limit is reached, the Treasury Department uses a variety of accounting maneuvers, known as [extraordinary measures](#), to avoid defaulting on the government’s obligations. For example, in the past, Treasury has prematurely redeemed Treasury bonds held in federal employee retirement savings accounts (and replaces them later with interest), halted contributions to certain government pension funds, suspended state and local government series securities, and borrowed from money set aside to manage exchange rate fluctuations. The Treasury Department first used these measures in 1985, and they have been used on at least 11 occasions since then.

### **Can hitting the debt ceiling be avoided without Congressional action?**

The Treasury Department’s use of extraordinary measures merely delays when debt will reach the statutory limit. Spending in excess of incoming receipts has already been legally obligated; that spending will push debt beyond the ceiling. There is no plausible set of changes that could generate the instant surplus necessary to avoid having to raise or suspend the debt ceiling.

Some believe the Treasury Department could buy 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 to override the statutory debt limit. Whether any of these tools is truly available is in question, and the potential economic and political consequences of each of these options are unknown. Realistically, once extraordinary measures are exhausted, the only option to avoid defaulting on our nation’s obligations is for Congress to change the law to raise or suspend the debt ceiling.

### **What happens if the debt ceiling is hit?**

Once the government hits the debt ceiling and exhausts available extraordinary measures, it is no longer allowed to issue debt and soon after will run out of cash-on-hand. At that point, given that the federal government is running annual deficits, incoming receipts will be insufficient to pay all of the millions of daily obligations as they come due. Therefore, the federal government will have



to at least temporarily default on many of its obligations, from Social Security payments and salaries for federal civilian employees and the military to veterans' benefits and utility bills, to name a few.

A default, or even the perceived threat of a default, could have serious negative economic implications. An actual default would roil global financial markets and create chaos, 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 and demand for Treasuries would drop as investors stop or scale back investments in Treasury securities if they are no longer considered a perfectly safe investment, increasing the risk of default. Even the threat of default during a standoff increases borrowing costs; the Government Accountability Office (GAO) [estimated](#) that the 2011 debt ceiling standoff raised borrowing costs by a total of \$1.3 billion in Fiscal Year (FY) 2011, and the 2013 debt limit impasse [led to](#) additional costs over a one-year period of between \$38 million and more than \$70 million.

If interest rates for Treasuries increase substantially, interest rates across the economy would follow, 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 holdings of Treasuries would decline as the value of Treasuries dropped, potentially tightening the availability of credit as seen most recently in the Great Recession of 2008.

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

A shutdown occurs when Congress fails to pass appropriations bills that allow agencies to obligate new spending. As a result, during a shutdown the government temporarily stops paying employees and contractors who perform government services. However, many more parties are not paid in a default (see [Q&A: Everything You Should Know About Government Shutdowns](#)). A default occurs when Treasury does not have enough cash available to pay for obligations that have already been made. In the debt ceiling context, a default would be precipitated by the government exceeding the statutory debt limit and being unable to pay all of its obligations to its citizens and creditors. Without enough money to pay the bills, any of its payments are at risk, including all government spending, mandatory payments, interest on our debt, and payments to U.S. bondholders. While a government shutdown would be disruptive, a government default could be disastrous.

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

Although policymakers have often enacted “clean” debt ceiling increases, Congress has also coupled 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, although causality has moved in both directions. On some occasions, the debt limit has been used successfully to help prompt deficit reduction, and in other instances,



Congress has tacked on debt ceiling increases to deficit reduction efforts. For example, the 2011 Budget Control Act was enacted along with a debt ceiling increase, as was the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act of 1985.

In nearly 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. Similarly, 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.

The Appendix contains further discussion of provisions attached to debt ceiling legislation, including bills in 1993, 1997, 2013, and 2015.

### **What should policymakers do?**

Policymakers should work promptly to raise or suspend the debt ceiling. Failing to raise the debt ceiling would be disastrous. It would result in severe 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 national debt would also have serious negative consequences; rising debt could ultimately stunt economic growth, reduce fiscal flexibility, and increase the cost burden on future generations. Thus, lawmakers should consider accompanying a debt ceiling increase with measures to begin addressing the debt.

To be sure, political advantage should not be sought by threatening default, and the debt ceiling must be raised or suspended as soon as possible. Lawmakers must not jeopardize the full faith and credit of the U.S. Government. At the same time, the need to raise the debt ceiling can serve as a useful moment for taking stock of our fiscal state and to pursue deficit-reducing tax reform, entitlement reform, or spending reductions.

### **What are the options for improving the debt ceiling?**

Increasing the debt limit requires frequent and often contentious legislative action. While a number of increases have been used to enact fiscal reforms, many increases are not necessarily tied to fiscal health. For instance, debates regarding the debt limit often take place after the policies producing the debt have already been put in place. The debt limit also measures gross debt, which means that even if the budget was balanced, the debt ceiling would still have to be raised if surpluses accumulated in government trust funds like Social Security.



In [\*The Better Budget Process Initiative: Improving the Debt Limit\*](#), we suggested reforms to the debt ceiling, grouped in four major categories:

- Linking changes in the debt limit to achieving responsible fiscal targets, so that Congress would not need to increase the debt ceiling if fiscal targets are met
- Having debate about the debt limit when Congress is making decisions on spending and revenue levels, not after those decisions have been made
- Applying the debt limit to more economically meaningful measures, such as debt held by the public or debt as a share of GDP
- Replacing the debt limit with limits on future obligations

### Where can I learn more?

- Committee for a Responsible Federal Budget – [Understanding the Debt Limit](#)
- Bipartisan Policy Center – [Debt Limit Analysis](#)
- The Treasury Department – [Frequently Asked Questions About the Public Debt](#)
- Government Accountability Office – [Debt Limit: Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs](#)
- Government Accountability Office – [Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches](#)
- Congressional Budget Office – [Federal Debt and the Statutory Limit, March 2017](#)
- Congressional Research Service – [Reaching the Debt Limit](#)
- Congressional Research Service – [The Debt Limit](#)



## 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 to have a balanced budget by 1991, with across-the-board cuts in spending by sequestration designed as an enforcement mechanism. Although the deficit reduction goals under GRH were not fully achieved, the experience gained under the act contributed to the development of more workable and effective procedures five years later.

**The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987:** This bill, also known as Gramm-Rudman-Hollings II, was passed to correct constitutional deficiencies in the 1985 Gramm-Rudman-Hollings Act. Like its predecessor, GRH II attached a deficit reduction measure to the increased debt limit, requiring automatic sequester if deficits did not meet annual targets.

**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 it also contained nearly \$500 billion in deficit reduction over the next five years. Additionally, it created enforcement procedures in the Budget Enforcement Act (BEA), which helped lead to budget surpluses in the late 1990s. The BEA also 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 to implement the budget agreement were ongoing.

**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.

**Line Item Veto Act of 1996:** The Line Item Veto Act of 1996 gave the President authority to veto specific provisions in legislation that increased the federal deficit, increased entitlement spending over the baseline, created tax benefits, or allocated discretionary budget authority. This practice, known as a line-item veto, was ruled unconstitutional by the Supreme Court for violating the separation of powers clause by allowing the President to amend a statute without Congress voting on it. While the 1996 line-item veto was found unconstitutional, other versions of it have been presented, including one by President Bush that would have allowed him to cancel spending obligations using his existing rescission authority.

**Balanced Budget Act of 1997:** The Balanced Budget Act of 1997 included a \$450 billion debt limit increase that, thanks to the surpluses of the late 1990s and early 2000s, was enough to cover debt 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. In exchange for the debt limit increase, this legislation included a budget process reform that reinstated 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 (also known as the Simpson-Bowles commission).

**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, without which budget sequestration would begin in 2013 as a consequence of the Super Committee failing to succeed. The Super Committee did not produce such legislation, resulting in today’s budget sequestration. 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 18, 2013 and then set an automatic “catch up” on May 19 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 resolution be agreed to jointly, which is necessary to pass a single Congressional budget.).

**Default Prevention Act of 2013:** The Default Prevention Act of 2013 ended a 16-day partial shutdown of the federal government by funding the government through January 15, 2014 and suspending the debt ceiling until February 7, 2014. This agreement set up a bicameral budget conference to reconcile budgets for FY 2014 and provided for an automatic “catch up” on February 7. On that date, the debt ceiling was reinstated at the current level of borrowing, resulting in a *de facto* increase of about \$500 billion and bringing the debt ceiling to \$17.2 trillion.

**Bipartisan Budget Act of 2015:** This bill suspended the debt limit through March 15, 2017 and provided an automatic “catch up” to account for borrowing up to that point that will effectively raise the debt limit by \$1.8 trillion to its current level of \$19.86 trillion. The bill also enacted “sequester relief” by raising the statutory caps on defense and non-defense discretionary spending for FY 2016 and FY 2017 ([partially offset](#) by mandatory savings) and averted insolvency of the Social Security Disability Insurance Trust Fund by reallocating payroll tax revenues.