



The Federal Debt Ceiling

There has been much debate and discussion in our nation's capital about the federal debt ceiling recently.

It all began when the U.S. Department of the Treasury on December 26, 2012 announced that the federal government was poised to reach the current statutory debt limit of approximately \$16.4 trillion by year's end and would have to turn to what it called "extraordinary measures" to meet its daily cash needs.

The Treasury Department estimated that these extraordinary measures – mostly borrowing from federal trust funds and disinvesting other accounts to temporarily bring debt below the limit – would only provide enough cash for the government to pay its bills until sometime between February 15 and March 1. If the debt ceiling had not been raised or suspended by then, the federal government would have been unable to pay all its bills on time and been in both default on the interest payments on its debt coming due and in technical default on contracts and other obligations.

That crisis was averted for the time being when legislation suspending the debt ceiling was enacted on February 4, 2013. This allowed the federal government to keep borrowing money through mid-May. If further action is not taken at that point, the Treasury could again turn to the same extraordinary measures it used between the date the debt ceiling was reached in December and when the suspension was enacted. This should provide enough funding for the government to pay all its bills through approximately the middle of July.

In the past, the legislation needed to increase the debt ceiling usually has been treated as a formality. According to a 2011 report to Congress by the Government Accountability Office, "The debt limit does not control or limit the ability of the federal government to run deficits or incur obligations. Rather, it is a limit on the ability to pay obligations already incurred."¹

Prior to the last session of Congress, legislation to increase the debt ceiling had been routinely approved. This changed in 2011, when Congress and the Obama Administration were unable to agree on spending reductions that some in the House and Senate insisted be included in the legislation. That debate eventually

¹ Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market, U.S. Government Accountability Office, GAO-11-203, Feb 22, 2011, <http://www.gao.gov/assets/320/315843.pdf>.

led to an agreement in August of that year that included some immediate spending cuts, the creation of the Joint Select Committee on Deficit Reduction to consider additional deficit reductions, and automatic additional spending cuts (known as a sequester) – now set to begin to take effect on March 1 – that are the result of the Joint Select Committee’s failure to reach agreement.

The debt ceiling that was approved in the summer of 2011 is the one that has now been reached – and suspended – until May 18.

In a January 14 letter to Congress, Treasury Secretary Timothy Geithner urged lawmakers to raise the legal limit on the nation’s debt or risk “irreparable” economic harm. The following day, Fitch Ratings warned that failure to raise the debt ceiling in a “timely manner” would prompt it to formally review the U.S.’s AAA credit rating, which influences the nation’s borrowing costs.

There is no precedent for this situation and there is no agreement on what will happen when Congress revisits the issue later this year. The key points are as follows:

1. The federal government’s ability to borrow and the legal obligation created by existing appropriations laws that it spend money are independent requirements. The president is legally required to spend as specified in the appropriations regardless of whether the government has the cash to make the payments. Spending cuts are not automatic if it does not have adequate cash.
2. As a result, if further action is not taken by the time the cushion provided by the extraordinary measures expires in July, the government could find itself issuing checks that are not honored by financial institutions. Alternatively, the financial institutions could decide to honor the checks under the assumption that the government eventually will be able to borrow again.
3. All of the key players in the federal government’s reimbursement process – the departments and agencies that incur obligations, the Treasury that issues the checks, and the Federal Reserve that acts as the government’s pay agent – have said that they have no ability to prioritize payments already in the system. There is, for example, no way to decide to pay interest on the debt instead of Social Security payments or federal employees’ salaries.
4. The Office of Management and Budget does have the ability to slow spending that has not yet begun using the “apportionment” process. However, under the provisions of the Congressional Budget and Impoundment Control Act, the executive branch cannot delay payments indefinitely without getting the approval of Congress.
5. The president has no legal authority to raise taxes or cut spending on his own

because the U.S. Constitution specifically gives that authority to Congress, with the president having veto power over the legislation it adopted. At the president's direction, federal departments and agencies could delay hiring, cancel contracts and slow down projects, however.

6. A failure to increase the debt ceiling likely would roil financial markets. Some economists believe that investors would demand higher interest rates to compensate for the increased uncertainty.
7. A failure to increase the debt ceiling could also cause a downgrade to the U.S. government's credit rating. This would be similar to what happened in August 2011 when Standard and Poor's lowered the AAA rating because of the political problems involved with reaching a debt ceiling agreement.
8. The most likely scenario if the debt ceiling isn't raised is that government payments will be slowed until the cash exists to liquidate the obligations. This almost certainly would include tax refunds.