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Debt Limit Analysis

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1. When will the federal government next reach its statutory borrowing limit?

2. At that point, what legal actions does Treasury have at its disposal for continued funding of government operations?

3. What is the date after which Treasury will not have sufficient cash to pay ALL of its bills (the "X Date")?

4. What costs were incurred by the American taxpayer due to elevated interest costs from the debt limit standoff of 2011?

- **<u>Debt Limit</u> = A statutory limitation on the amount that the federal government is allowed to borrow to finance its obligations**

  - Has been raised dozens of times since it was instituted in 1917, including under every president since FDR

  - Currently set at $16.394 trillion by the Budget Control Act of 2011

Methodology & Assumptions

- Reviewed financial data from the Treasury Department
  - Daily + Monthly Treasury Statements
  - Monthly Statement of the Public Debt
- BPC projected monthly operating cash flow using:
  - Historical financial data
  - CBO estimates of revenue/spending growth
  - Adjustments for anticipated issues (e.g., expiration of payroll tax holiday, sale of AIG stock)
- Estimated Extraordinary Measures
  - Available measures detailed by GAO and Congressional Research Service reports

BPC ASSUMPTIONS

- Congress will patch the Alternative Minimum Tax as it has in the past
- Income tax withholding tables will not change
- Sequestration will not go into effect
- Medicare payments to physicians will not be cut 27%
- Extended unemployment insurance benefits will be allowed to expire
- The payroll tax holiday will be allowed to expire
- Miscellaneous tax provisions (e.g., R&D credit) will be extended

"Wild Cards" – elements of uncertainty that could impact BPC's projections – are listed on slide 24

Reaching the Debt Limit

Layers of Defense Against Default

The Treasury Department has multiple means that can be used to pay the nation's bills. If the debt limit is reached and Congress does not act in time, however, all of these layers of defense will be breached and the nation will default on its obligations.

ISSUE NEW DEBT TO THE PUBLIC IN TRADITIONAL MANNER

Debt Limit Reached

EXTRAORDINARY MEASURES

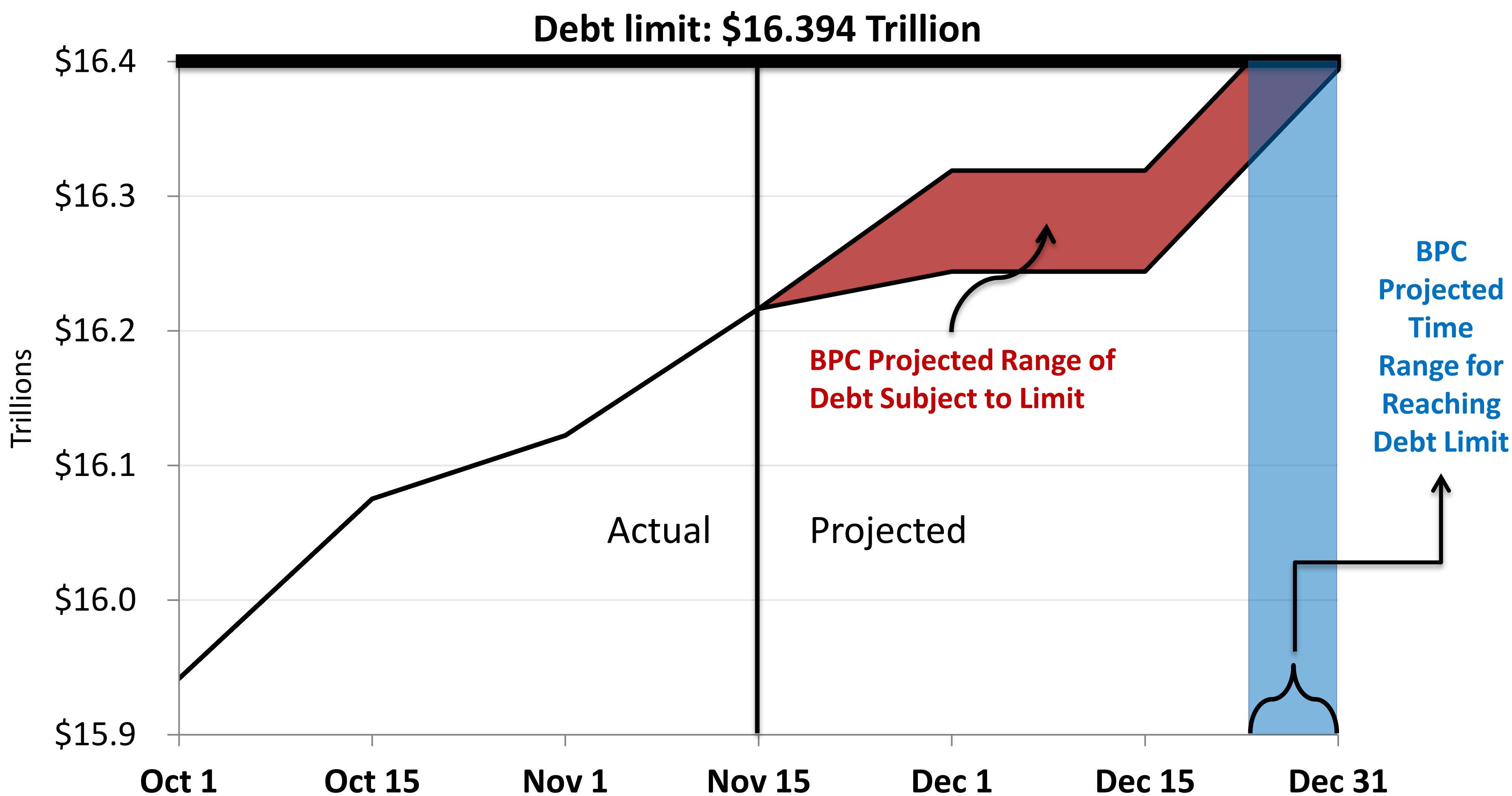
EM Exhausted

DAILY REVENUE AND CASH ON HAND

The X Date

DEFAULT ON FINANCIAL OBLIGATIONS

2012 DEBT SUBJECT TO LIMIT (NET OF CASH ON HAND)



Note: The graph depicts debt subject to limit net of cash on hand in order to represent Treasury's "room to maneuver" under the debt limit.

Sources: Daily Treasury Statements, Congressional Budget Office spending and revenue projections (August 2012), BPC Projections

- **BPC estimates that the debt limit will be reached and Extraordinary Measures will begin in the last week of December**
  - Substantial interest on intra-governmental debt (including the Social Security and Medicare trust funds) is due on 12/31/2012

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Extraordinary Measures

- **As the U.S. approaches the debt limit and exhausts its traditional borrowing authority, the Treasury Secretary will begin to use Extraordinary Measures**
  - Extraordinary Measures are legal financial maneuvers that allow the Treasury to raise additional cash to meet government obligations
- **Once the debt limit is reached, the Secretary will declare a Debt Issuance Suspension Period (DISP)**
  - Some Extraordinary Measures can only be used once a DISP has been declared
- **Extraordinary Measures are limited; they won't last forever**

- **Example: Federal Employees' Retirement System G-Fund**

  - Federal employees invest some retirement assets in government bonds
  - Treasury may temporarily reduce the amount of debt held by this fund, thereby freeing up room under the debt limit
  - This allows Treasury to issue additional securities to the public and raise cash to pay federal obligations
  - After the debt limit is increased, Treasury must fully reimburse the retirement fund for the principal and interest

EXTRAORDINARY MEASURES AVAILABLE	BPC ESTIMATE
Do not reinvest the Federal Employees' Retirement System G-Fund	$154 billion
Do not reinvest the Exchange Stabilization Fund	$23 billion
Do not reinvest interest payments and cash receipts to Civil Service Fund and Postal Fund	$21 billion
Do not reinvest maturing securities in the Civil Service Fund and Postal Fund	Not Applicable in Dec. 2012
Total	**$197 billion**

Note: The totals indicate *available* measures. Treasury may not employ all available measures. Treasury also has measures available (not listed) that assist with cash flow and debt management, but do not extend the date after which Treasury would default on federal obligations absent an increase in the debt limit (the "X Date"). Column does not add due to rounding.

Sources: Government Accountability Office, Congressional Research Service

- **In 2011, Extraordinary Measures lasted from May 16 until August 1**

- **They won't buy as much time as they did last summer**

    - February is a "bad" month for the federal government's finances

    - Fewer measures available

- **February typically has very high federal expenditures**

  - Many tax refunds are paid in February
  - Taxpayers expecting large refunds are likely to file early

Cash Outflow	Amount in February 2012
IRS Tax Refunds	$112 billion
Medicare and Medicaid	$62 billion
Social Security Benefits	$55 billion
Interest on Debt	$33 billion
Defense Vendor Payments	$27 billion

- **Extraordinary Measures will not raise as much cash in 2012/2013 as they did in 2011**
  - Largely due to the fact that in 2011, an additional measure was available - maturing debt within civil service and postal retirement funds was not rolled over
  - These funds do not have debt that matures during the projected upcoming DISP

The "X Date"

- **BPC defines the "X Date" as the date after which Extraordinary Measures have been exhausted and cash on hand is insufficient to pay all of the federal government's bills in full and on time**
  - In other words, without an increase in the debt limit, the federal government will begin defaulting on some of its financial obligations on the day after the X Date
- **BPC estimates that the X Date will occur in February 2013**

Treasury Cash Flow: ***February 2012***

Monthly Cash Deficit: **$261 b**

Monthly Inflows	Monthly Outflows
$202 Billion **in revenues**	***$464 Billion*** **in spending:** • $112b IRS Tax Refunds • $62b Medicare and Medicaid • $55b Social Security Benefits • $33b Interest on Debt • $27b Defense Vendor Payments • $26b Education Programs • $14b Federal Salaries •$125b Other Spending

Note: This past February's cash flows provide a rough estimate of the challenge of meeting the federal government's obligations in February 2013 without the ability to issue net new debt to the public. Numbers may not add due to rounding.

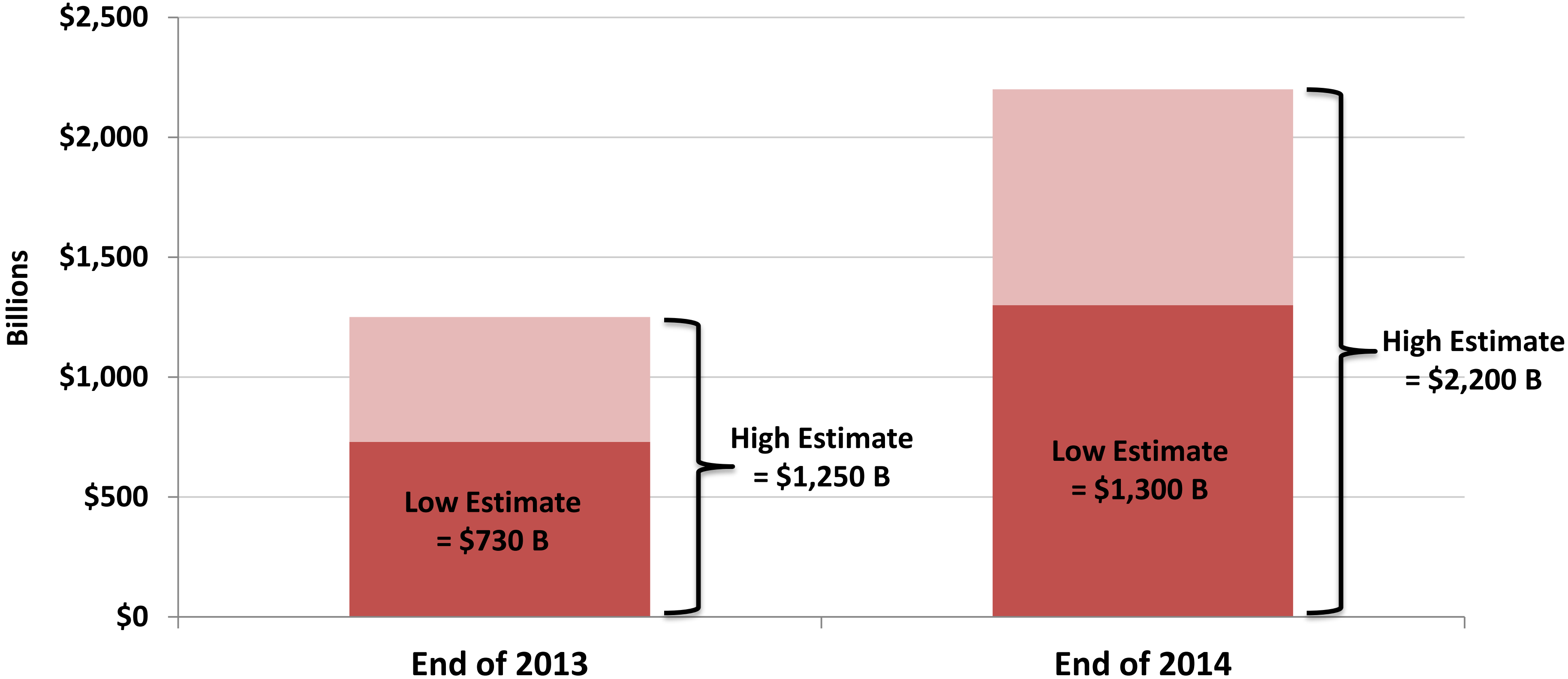
Source: Daily Treasury Statements

- **Fiscal Cliff**
  - Income tax withholding
  - Expiration of Alternative Minimum Tax "patch"
  - Delayed filing season

- **Additional Deficit Spending?**
  - Disaster relief funds
  - "Growth measures" in fiscal cliff deal

- **Economic Uncertainty**
  - Strengthening/weakening economy
  - Monthly fluctuations in spending and revenues

How much would the debt limit need to be increased to get through 2013 or 2014?



Note: All estimates are based on Congressional Budget Office data. The "low estimate" reflects current law except for freezing physician payments at 2012 levels ("Doc Fix"), indexing the AMT to inflation, and applying the scheduled decline in overseas combat operations (OCO) spending. The "high estimate" assumes that the 2001, 2003, 2009, and 2010 tax cuts are extended along with most of the usual tax extenders, the "Doc Fix" and AMT "patch" are applied, OCO spending declines as scheduled, the sequester does not take effect, and the payroll tax holiday and extended unemployment insurance benefits are continued.

Cost of 2011
Debt Limit Event

ONE-YEAR COST OF 2011 DEBT LIMIT EVENT

- **The Government Accountability Office (GAO) issued a report detailing additional costs to taxpayers as a result of the delayed 2011 debt limit increase**
    - A substantial cost to taxpayers stemmed from elevated interest rates on U.S. securities issued in 2011 prior to when the debt limit was increased in August
    - GAO conducted an economic analysis to estimate the resulting change in interest rates
    - For Fiscal Year 2011, GAO estimated additional interest costs to taxpayers of $1.3 billion

TEN-YEAR COST OF 2011 DEBT LIMIT EVENT

- **The cost of the event to the federal government, however, continues to accrue because many of the bonds issued during that period remain outstanding**
  - BPC extended GAO's methodology to analyze the long-term cost to taxpayers stemming from the elevated interest rates
  - Estimate of the ten-year cost to taxpayers of the 2011 debt limit standoff = **$18.9 billion**
  - To put this in perspective, the Congressional Budget Office (CBO) estimates that the "Doc Fix" to prevent the scheduled 27% cut to Medicare physician payments for 2012 cost $18 billion over ten years

- **Additional borrowing costs for the federal government from delay in increasing the debt limit**

- **Additional rating agency downgrades are possible**
  - S&P downgraded last summer and reaction was not severe
  - But there is uncertainty about effects of another downgrade since many funds are prohibited from holding non-AAA securities

- **Market risks beyond the X Date**
  - Treasury market, interest rates
  - Potential for serious equity market reaction (401(k)s, IRAs, other pensions)
  - Our economy
  - The global financial system

No guarantee of the outcome; risks are risks

1. The U.S. is on course to reach its debt limit very soon – likely in the last week of December

2. Treasury's Extraordinary Measures would not last as long as they did last summer

3. The federal government will almost certainly incur rising costs – in the form of higher interest payments on U.S. bonds – as an increase in the debt limit is delayed

4. If the debt limit is not raised, the federal government will likely begin to default on obligations at some point in February 2013

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