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Debt Limit Analysis

JULY 2011

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- **Congress does not raise the debt limit before recessing on August 5, 2011**
- **Estimates for daily receipts and payments constructed from publicly available data from Daily Treasury Statements**

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

If we pass the X Date, and Treasury is forced to “prioritize” its payments to avoid a debt default:

2. What would be the effects on government operations?

3. What would be the market risks?

- **The US hit the debt ceiling on May 16, and Treasury then began tapping into \$232 b of emergency borrowing authority – referred to as “extraordinary measures” – to allow for a few additional months of fully-funded government operations**
- **As Treasury Secretary Geithner wrote on May 2,**
 - *“These extraordinary measures would allow the Treasury to extend borrowing authority until about Aug 2.”*
- **This indicates that by Aug 2, Treasury will have completely utilized all of its \$232 b in emergency borrowing authority, leaving only two sources from which to continue funding government operations:**
 - Remaining cash on hand (including any leftover funds from the emergency \$232 b)
 - Daily cash inflows (federal revenues received each day)

- **The X Date is the date after which Treasury can no longer pay all of its bills**
- **In other words, the remaining two funding sources (cash on hand and daily incoming cash flows) are insufficient to pay for all government obligations after the X date**
 - After the X Date, bills must be paid solely out of incoming cash flows, which will not be able to cover all government obligations

Layer #1



Layer #2



Layer #3



Extraordinary Measures:

- \$232 b in emergency borrowing authority
- Allows Treasury to borrow an additional \$232 b in cash
- Can use this money to continue funding government as long as the \$232 b lasts

Began May 15 and will run out Aug 2



Cash On Hand:

- Once “extraordinary measures” are exhausted, Treasury will have a limited amount of remaining cash on hand
- Treasury can draw from this remaining supply of cash to continue funding the government, but it is a finite amount that cannot be replenished

Allows for full funding of obligations for a short additional amount of time

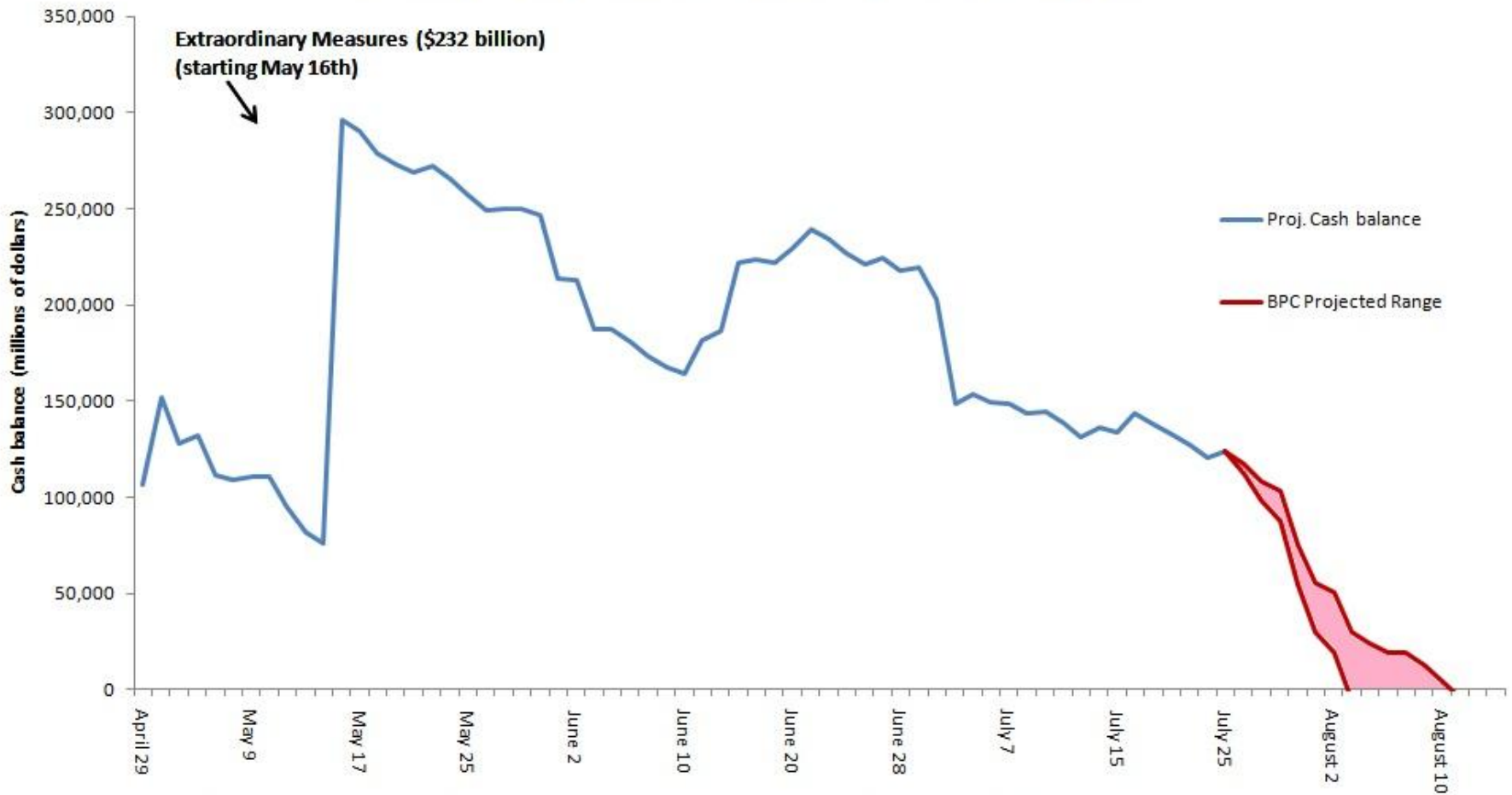


Daily Cash Flows:

- Once “extraordinary measures” and cash on hand are exhausted, Treasury will only have daily revenue flows with which to fund the government
- These daily inflows are often insufficient to cover all obligations

Allows partial funding of obligations thereafter

Treasury Cash Balance - April 29th, 2011 to "X Date"



For simplicity, Treasury "extraordinary measures" occur in one lump sum on May 16, and generate \$232 b in cash

- **Our analysis also shows that the X Date will fall between August 2 and August 10**
- **The 14th Amendment does not provide a reasonable basis for challenging the constitutionality of the debt ceiling**
 - The Administration will not attack the debt ceiling on this basis
- **Treasury has no secret bag of tricks to finance government operations past the X Date**
 - Treasury will not attempt to “firesale” assets during a crisis
 - Other ideas are impractical, illegal and/or inappropriate (gold loans, IOUs)



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Prioritization

- **There is no precedent; all other debt limit impasses have been resolved without passing the X Date**
 - Treasury has never failed during a debt limit impasse to meet any payment obligation
- **The government shutdown of 1995 – 96 does not provide a precedent:**
 - Mandatory spending continued without interruption
 - Defense, Transportation, Treasury, and legislative branch spending was fully appropriated
 - Disruption of government services was modest

- **Rating agencies:**
 - **S&P:** “[If you] prioritize payments ... you would have to contract your payments in a massive way overnight [creating a] very sharp negative fiscal impulse.” (4/18/11: Credit Watch Negative)
 - **Fitch:** “If the debt ceiling is not raised ... and timely and full payment of its obligations, including Treasuries, is not secure, the U.S. sovereign rating will be placed on Rating Watch Negative.”
 - **Moody’s:** “ ...the probability of a default on interest payments [is] low but no longer de minimis. An actual default, regardless of duration, would fundamentally alter Moody’s assessment ... and an Aaa rating would likely no longer be appropriate.”
- **Bernanke concurs:**
 - “[Going past the X Date] would no doubt have a very adverse effect very quickly on the recovery. I’m quite certain of that.”

- **Treasury would have to choose from well over 80 million monthly payments so that 40-45% of bills are not paid**
 - Inflows and outflows do not match up well and are quite “lumpy,” as our daily analysis shows
- **The reality would be chaotic:**
 - Unfair results, unanswered questions
 - Treasury picking winners and losers
 - Public uproar
 - Intense global media focus
- **We assume that prioritization will happen after August 2, either passively or actively**
 - If the Administration is unable to find legal authority to prioritize, it will pay the bills in the order in which they are due, when and as cash is available to do so

Two areas of risk evaluation:

- Effect on Federal Government operations
 - Month of August
 - Day by day analysis
- Market Risk



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August 2011 Analysis

Month/Year	Inflows	Outflows	Deficit	Business Days
August 2009	173,254	316,299	143,045	21
August 2010	194,280	342,381	148,101	22
August 2011*	203,327	362,674	159,348	23
Truncated (3 rd – 31 st) August 2011*	<u>172,400</u>	<u>306,713</u>	<u>134,312</u>	21

All numbers are pro forma for the exclusion of net debt issuance

* BPC Projections (in millions of dollars)

If you choose to pay...

Program	Cost
Interest on Treasury Securities	\$29.0 b
Social Security Benefits	\$49.2 b
Medicare / Medicaid	\$50.0 b
Defense Vendor Payments	\$31.7 b
Unemployment Insurance Benefits	\$12.8 b

For a total of **\$172.7 billion**

Then you can't fund these programs, worth **\$134 b...**

Program	Cost
<i>Military Active Duty Pay</i>	\$2.9 b
<i>Veterans Affairs Programs</i>	\$2.9 b
<i>Federal Salaries + Benefits</i>	\$14.2 b
<i>Dep. of Education (e.g., Pell grants, special ed. programs)</i>	\$20.2 b
<i>Food/Nutrition Services + TANF</i>	\$9.3 b
<i>Dep. of Labor (e.g., training and employment services)</i>	\$1.3 b
<i>Dep. of Justice (e.g., FBI, federal courts)</i>	\$1.4 b
<i>Dep. of Energy (e.g., energy research, national nuclear programs)</i>	\$3.5 b
<i>Health and Human Services Grants</i>	\$8.1 b
<i>Federal Highway Administration</i>	\$4.3 b
<i>Environmental Protection Agency</i>	\$0.9 b
<i>IRS Refunds</i>	\$3.9 b
<i>Small Business Administration</i>	\$0.3 b
<i>Federal Transit Administration</i>	\$1.3 b
<i>HUD Programs (e.g., housing assistance for the poor)</i>	\$6.7 b
<i>Other Spending</i>	\$52.8 b

Inflows: ----- **\$172.4 b**

Outflows: ----- **\$306.7 b**

Running Total:

• Interest on Treasury Securities:	\$29.0 b	
• Social Security Benefits:	+ 49.2 b	<i>78.2 b</i>
• Medicare/Medicaid:	+ 50.0 b	<i>128.2 b</i>
• Defense Vendor Payments:	+ 31.7 b	<i>159.9 b</i>
• Unemployment Insurance Benefits:	+ 12.8 b	<i>172.7 b</i>
• Military Active Duty Pay:	+ 2.9 b	<i>175.6 b</i>
• Veterans Affairs Programs:	+ 2.9 b	<i>178.5 b</i>
• IRS Refunds:	+ 3.9 b	<i>182.4 b</i>
• Food/Nutrition Services + TANF:	+ 9.3 b	<i>191.7 b</i>
• Federal Salaries + Benefits:	+ 14.2 b	<i>205.9 b</i>
• Small Business Administration:	+ 0.3 b	<i>206.2 b</i>
• Education Department:	+ 20.2 b	<i>226.4 b</i>
• Housing and Urban Development Programs:	+ 6.7 b	<i>233.1 b</i>
• Other Spending*:	+ 73.6 b	<i>306.7 b</i>
TOTAL	306.7 b	306.7 b

*e.g., Justice, Labor, General Services Administration, Commerce, NASA, Health and Human Services, Energy, EPA, Interior, Federal Transit Administration, Federal Highway Administration, AID, etc.

If you choose to pay...

Program	Cost
Interest on Treasury Securities	\$29.0 b
Social Security Benefits	\$49.2 b
Medicare / Medicaid	\$50.0 b
Food/Nutrition Services + TANF	\$9.3 b
HUD Programs (e.g. housing assist. for the poor)	\$6.7 b
Veterans Affairs Programs	\$2.9 b
Unemployment Insurance Benefits	\$12.8 b
Special Education Grants	\$3.6 b
Tuition Assistance	\$10.4 b

For a total of **\$173.9 billion**

Then you can't fund these programs, worth **\$132.8 b...**

Program	Cost
<i>Military Active Duty Pay</i>	\$2.9 b
<i>Defense Vendor Payments</i>	\$31.7 b
<i>Federal Salaries + Benefits</i>	\$14.2 b
<i>Dep. of Education</i>	\$6.2 b
<i>Dep. of Labor (e.g., training and employment services)</i>	\$1.3 b
<i>Dep. of Justice (e.g., FBI, federal courts)</i>	\$1.4 b
<i>Dep. of Energy (e.g., energy research, national nuclear programs)</i>	\$3.5 b
<i>Health and Human Services Grants</i>	\$8.1 b
<i>Federal Highway Administration</i>	\$4.3 b
<i>Environmental Protection Agency</i>	\$0.9 b
<i>IRS Refunds</i>	\$3.9 b
<i>Dep. of Interior</i>	\$1.2 b
<i>Federal Transit Administration</i>	\$1.3 b
<i>Centers for Disease Control</i>	\$0.5 b
<i>Other Spending</i>	\$51.4 b

Inflows: ----- **\$172.4 b**

Outflows: ----- **\$306.7 b**

Running Total:

• Interest on Treasury Securities:	\$29.0 b	
• Social Security Benefits:	+ 49.2 b	<i>78.2 b</i>
• Medicare/Medicaid:	+ 50.0 b	<i>128.2 b</i>
• Food/Nutrition Services + TANF:	+ 9.3 b	<i>137.5 b</i>
• Housing and Urban Development Programs:	+ 6.7 b	<i>144.2 b</i>
• Veterans Affairs Programs:	+ 2.9 b	<i>147.1 b</i>
• Unemployment Insurance Benefits:	+ 12.8 b	<i>159.9 b</i>
• Special Education Grants	+ 3.6 b	<i>163.5 b</i>
• Tuition Assistance	+ 10.4 b	<i>173.9 b</i>
<hr style="border-top: 1px dashed red;"/>		
• Defense Vendor Payments:	+ 31.7 b	<i>205.6 b</i>
• Military Active Duty Pay:	+ 2.9 b	<i>208.5 b</i>
• IRS Refunds:	+ 3.9 b	<i>212.4 b</i>
• Federal Salaries + Benefits:	+ 14.2 b	<i>226.6 b</i>
• Other Education Department:	+ 6.2 b	<i>232.4 b</i>
• Other Spending*:	+ 73.9 b	<i>306.7 b</i>
TOTAL	306.7 b	306.7 b

*e.g., Justice, Labor, General Services Administration, Commerce, NASA, Health and Human Services, Energy, EPA, Interior, Federal Transit Administration, Federal Highway Administration, AID, etc.

- ***Housing/Urban Development*** – **\$6.7b total**
 - Rental assistance: **\$3.9 billion**
 - Public Housing Fund (operates and maintains public housing areas for 1.2 million American households): **\$900 million**

- ***Dep. of Education*** – **\$20.2b total**
 - Federal Pell grants (tuition assistance for qualifying college students): **\$10.4 billion**
 - Special education state grants: **\$3.6 billion**

- ***Food and Nutrition Services*** – **\$6.7b total**
 - Food stamps, Child nutrition programs, and the Women, Infants, and Children program: **\$6.7 billion**

To create your own scenario, visit this link, which we developed jointly with Bloomberg Government:

[Try It Yourself](http://bit.ly/pAorgl)

<http://bit.ly/pAorgl>

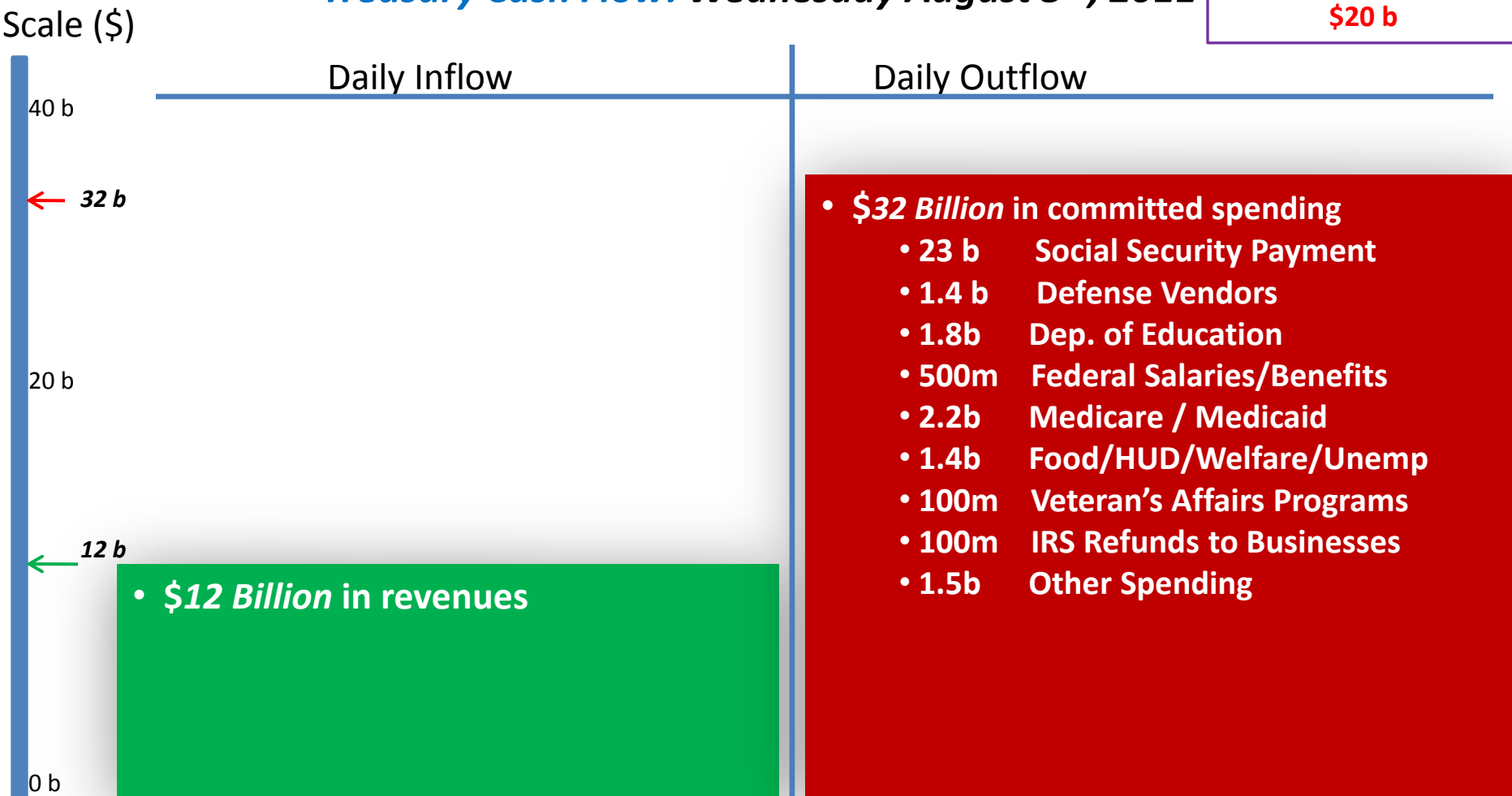


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Daily Analysis: August 3rd – 15th, 2011

Treasury Cash Flow: Wednesday August 3rd, 2011

Running Cash Deficit:
\$20 b

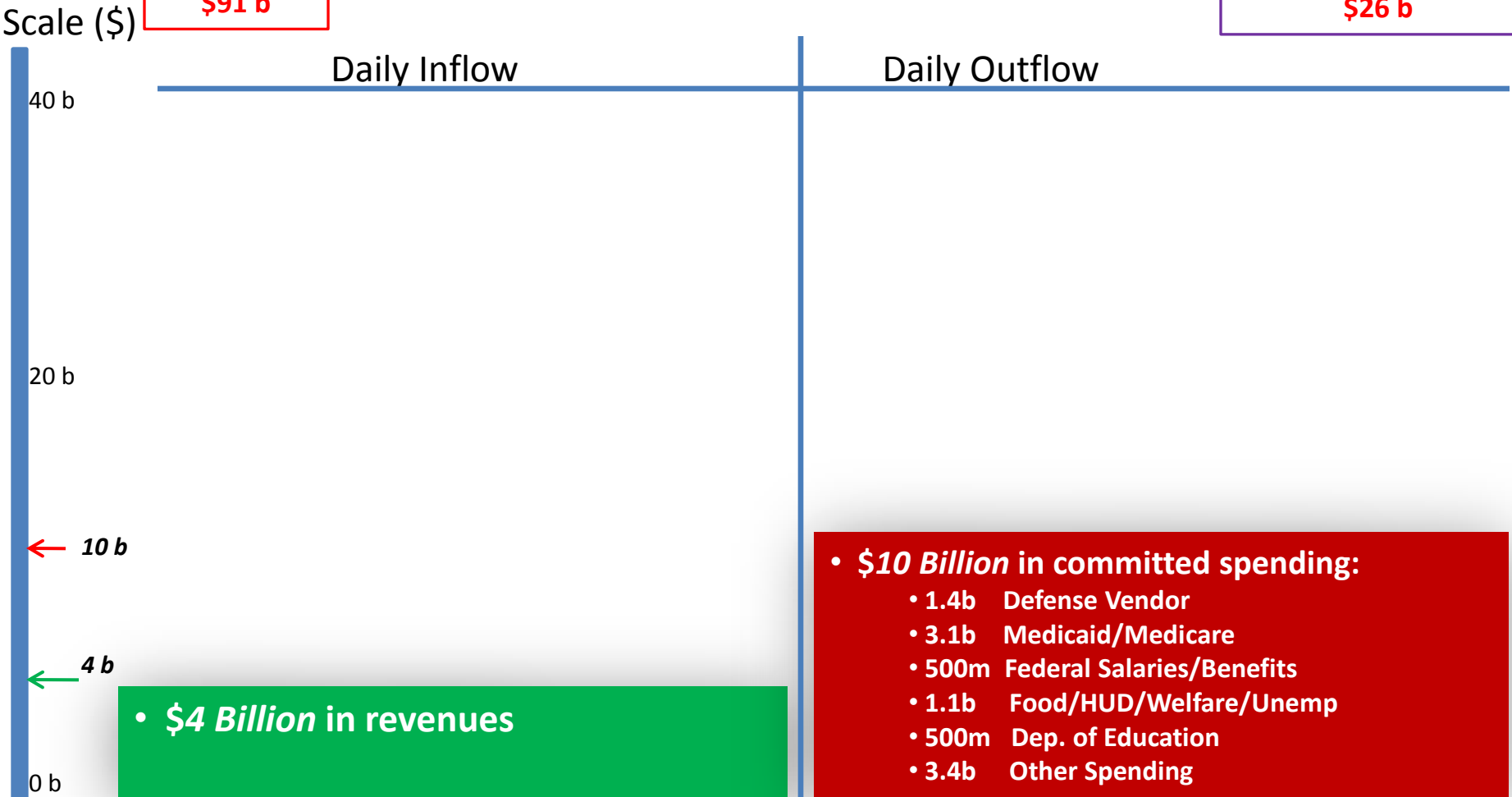


Note: all daily figures assume zero cash balance on Aug 3; numbers may be off slightly due to rounding

Debt Maturing:
\$91 b

Treasury Cash Flow: Thursday August 4th, 2011

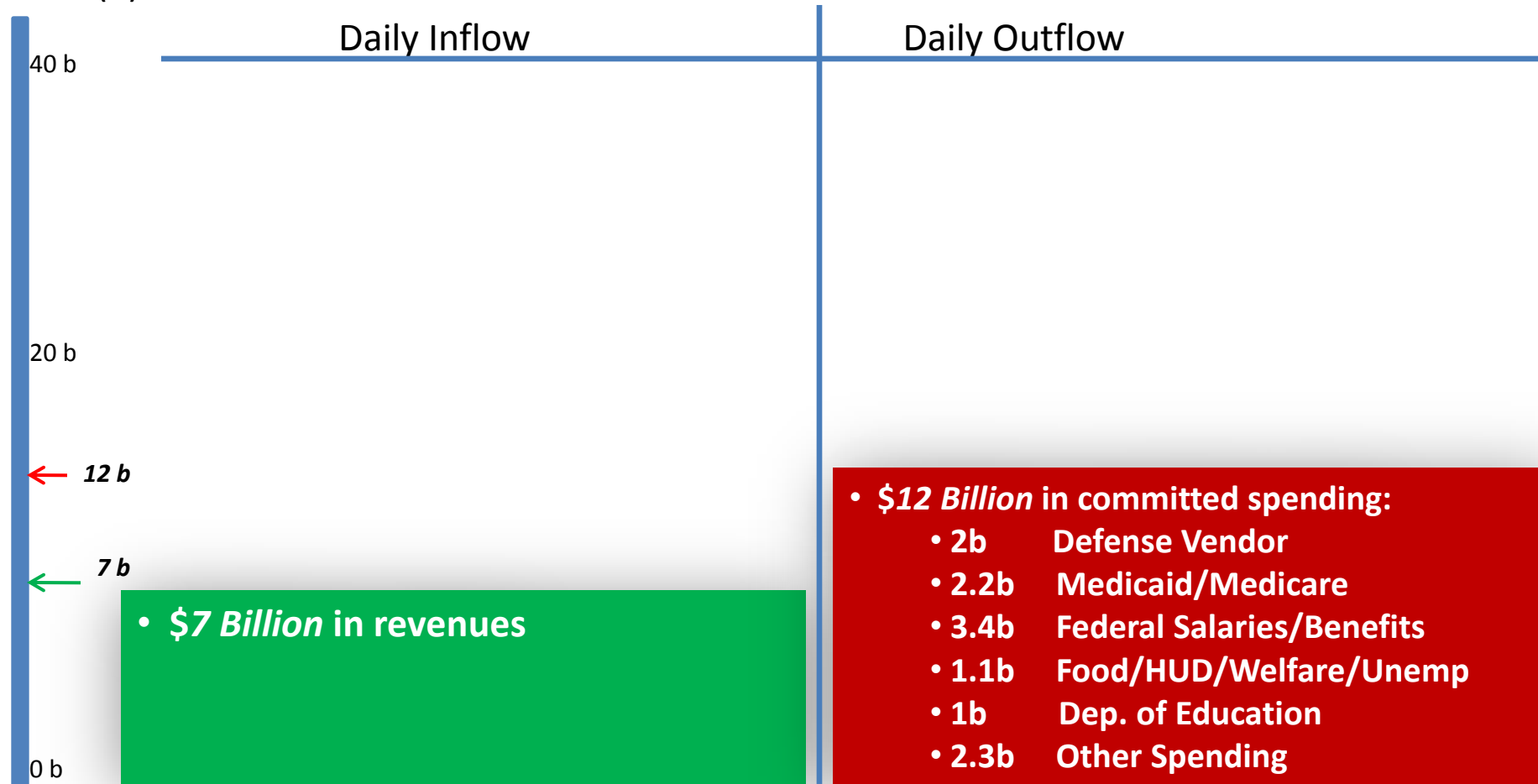
Running Cash Deficit:
\$26 b



Treasury Cash Flow: Friday August 5th, 2011

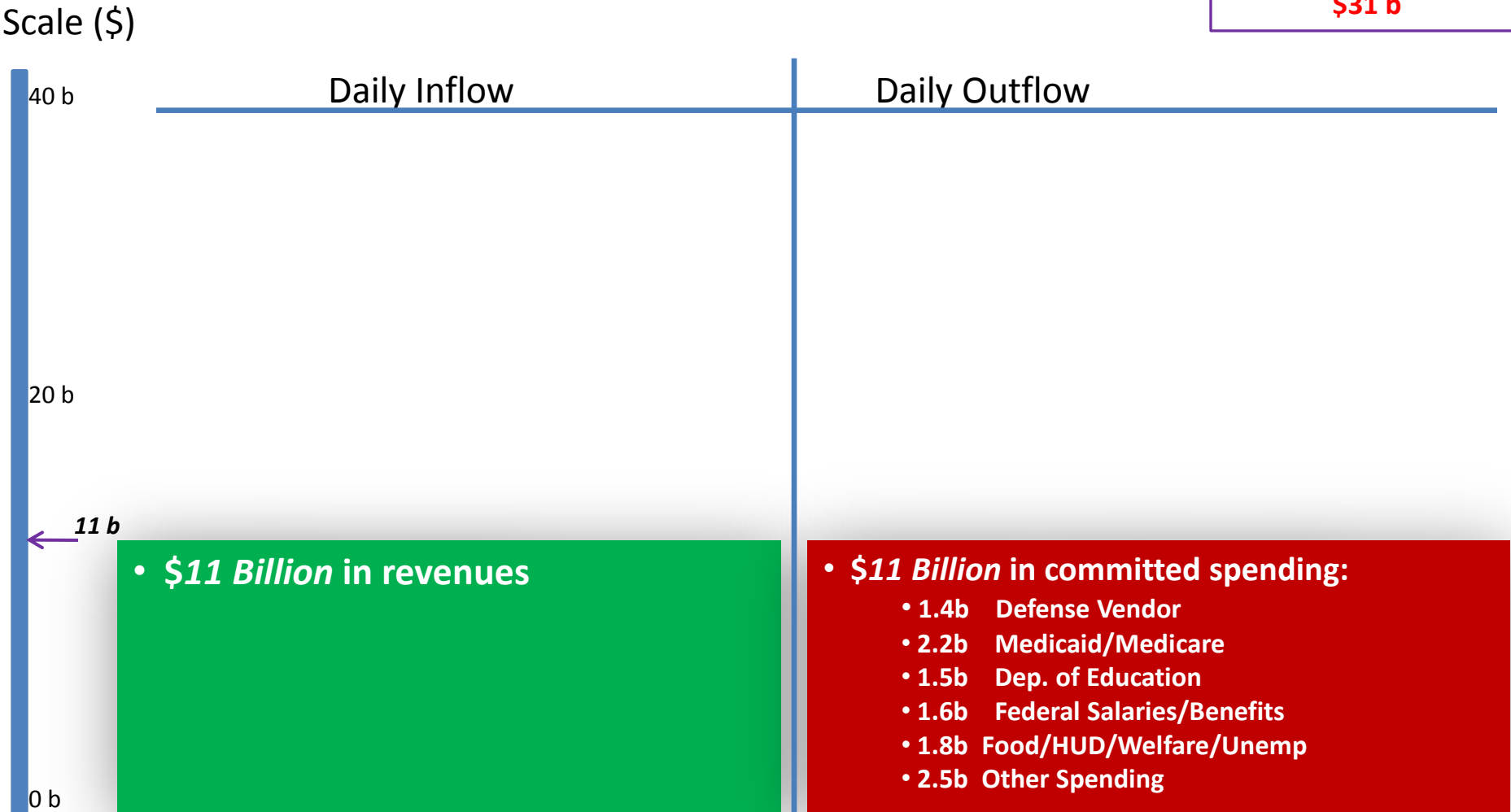
Running Cash Deficit:
\$31 b

Scale (\$)



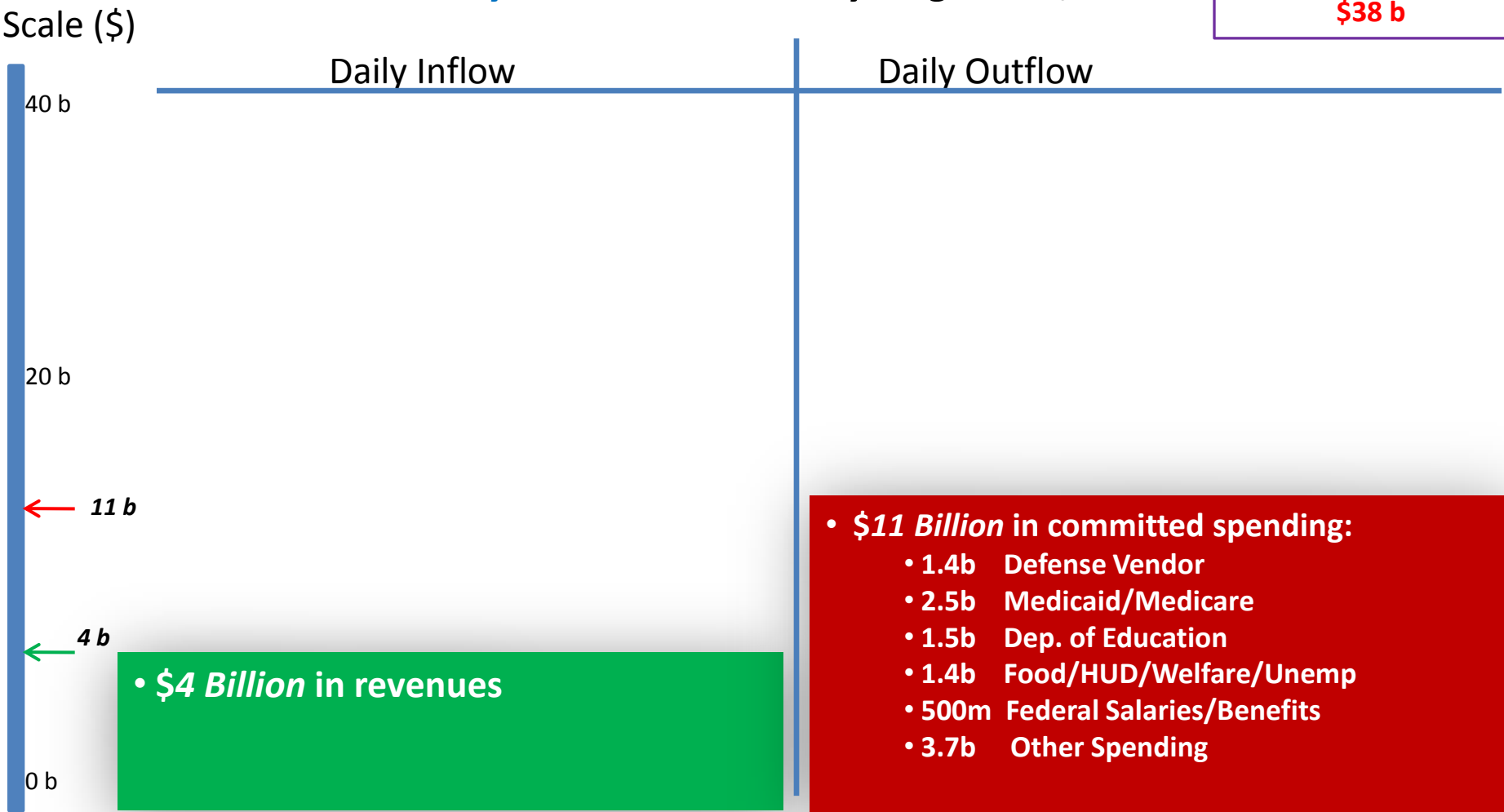
Treasury Cash Flow: Monday August 8th, 2011

Running Cash Deficit:
\$31 b



Treasury Cash Flow: Tuesday August 9th, 2011

Running Cash Deficit:
\$38 b



- **\$11 Billion in committed spending:**
 - 1.4b Defense Vendor
 - 2.5b Medicaid/Medicare
 - 1.5b Dep. of Education
 - 1.4b Food/HUD/Welfare/Unemp
 - 500m Federal Salaries/Benefits
 - 3.7b Other Spending

Treasury Cash Flow: Wednesday August 10th, 2011

Running Cash Deficit:
\$47 b

Scale (\$)

Daily Inflow

Daily Outflow

40 b

20 b

← 19 b

← 10 b

• \$10 Billion in revenues

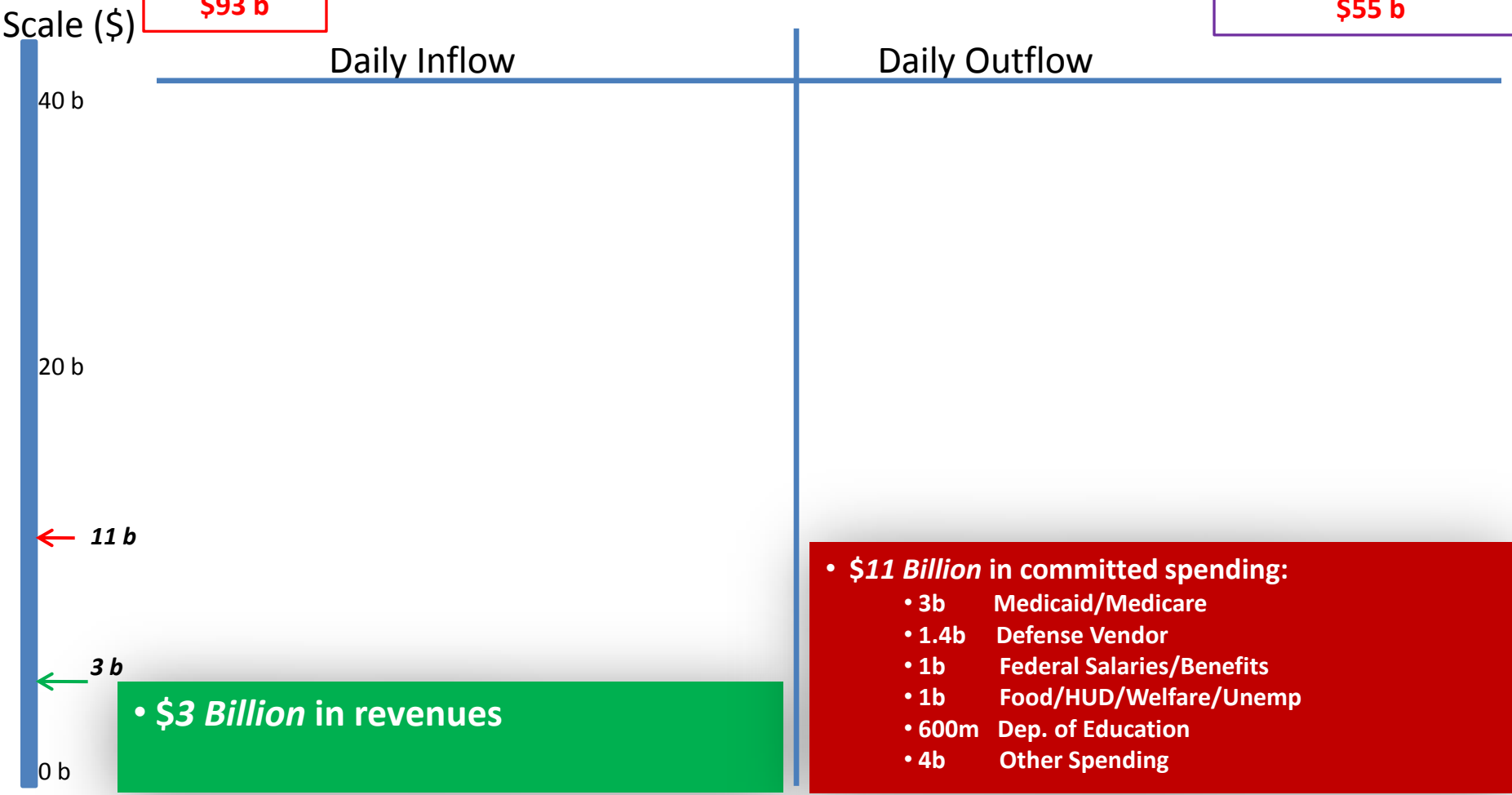
• \$19 Billion in committed spending:

- 8.5b Social Security
- 1.4b Defense Vendor
- 2.2b Medicaid/Medicare
- 1.4b Food/HUD/Welfare/Unemp
- 800m Dep. of Education
- 500m Federal Salaries/Benefits
- 4.2b Other Spending

Debt Maturing:
\$93 b

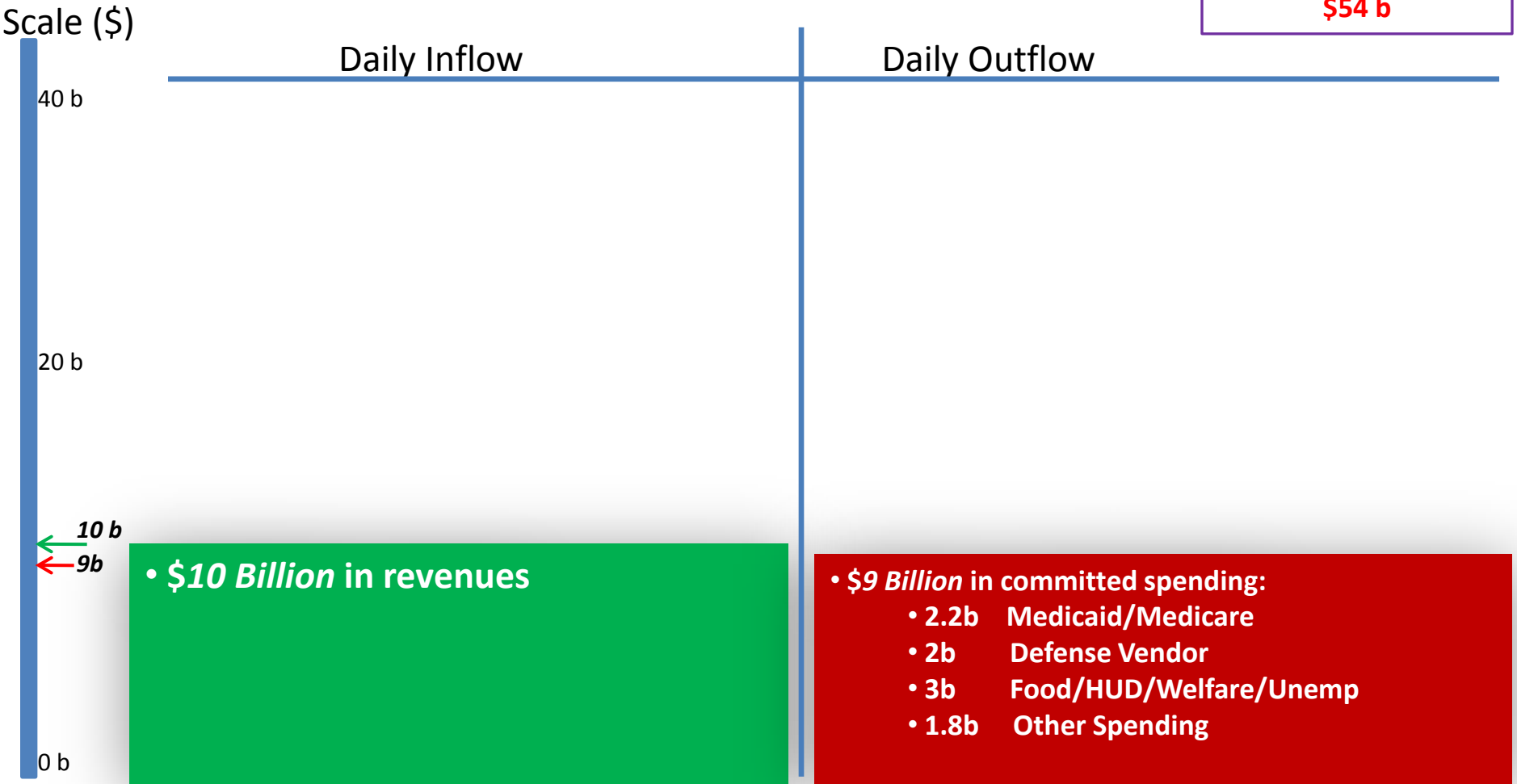
Treasury Cash Flow: Thursday August 11th, 2011

Running Cash Deficit:
\$55 b



Treasury Cash Flow: Friday August 12th, 2011

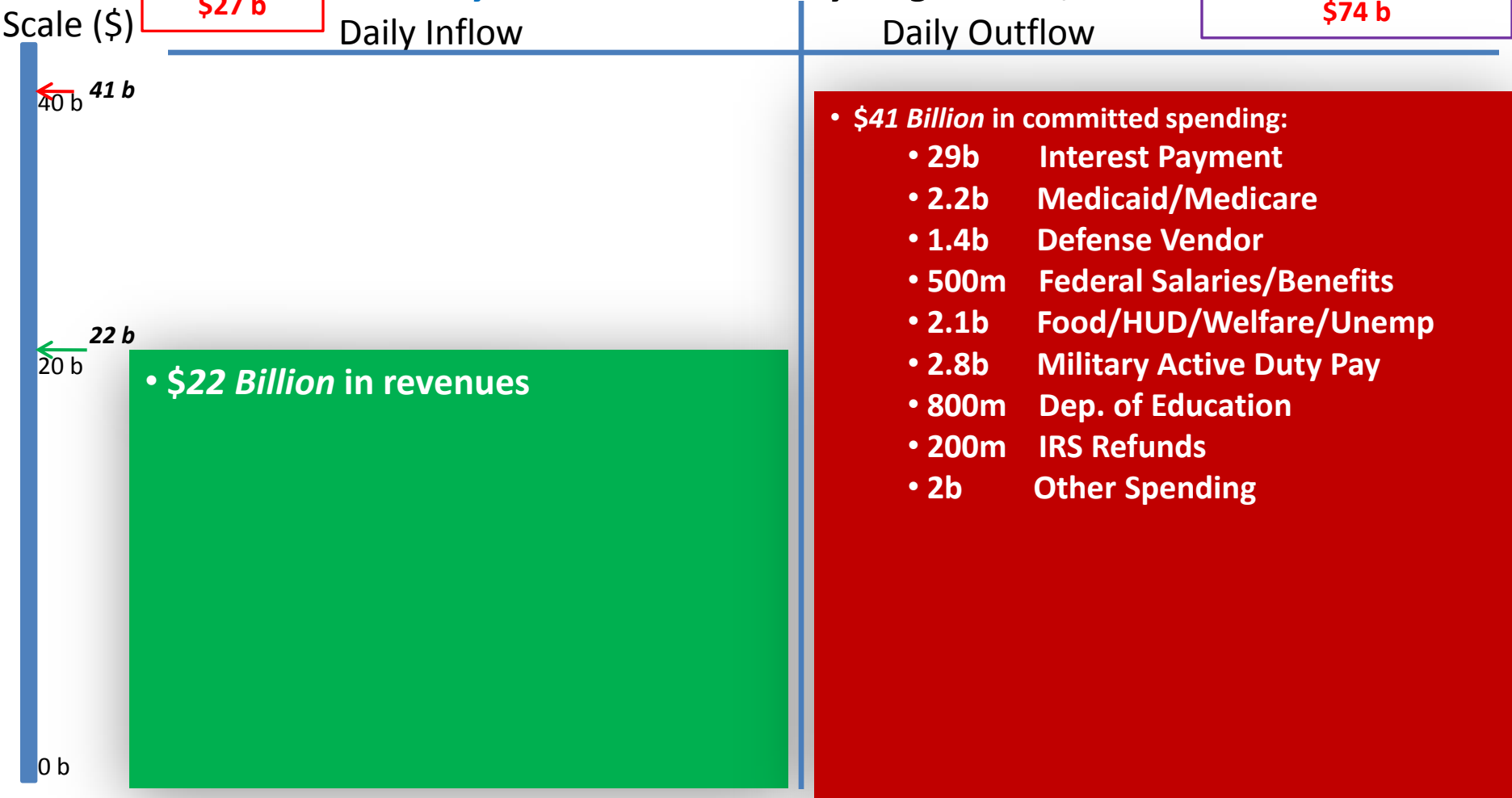
Running Cash Deficit:
\$54 b



Debt Maturing:
\$27 b

Treasury Cash Flow: Monday August 15th, 2011

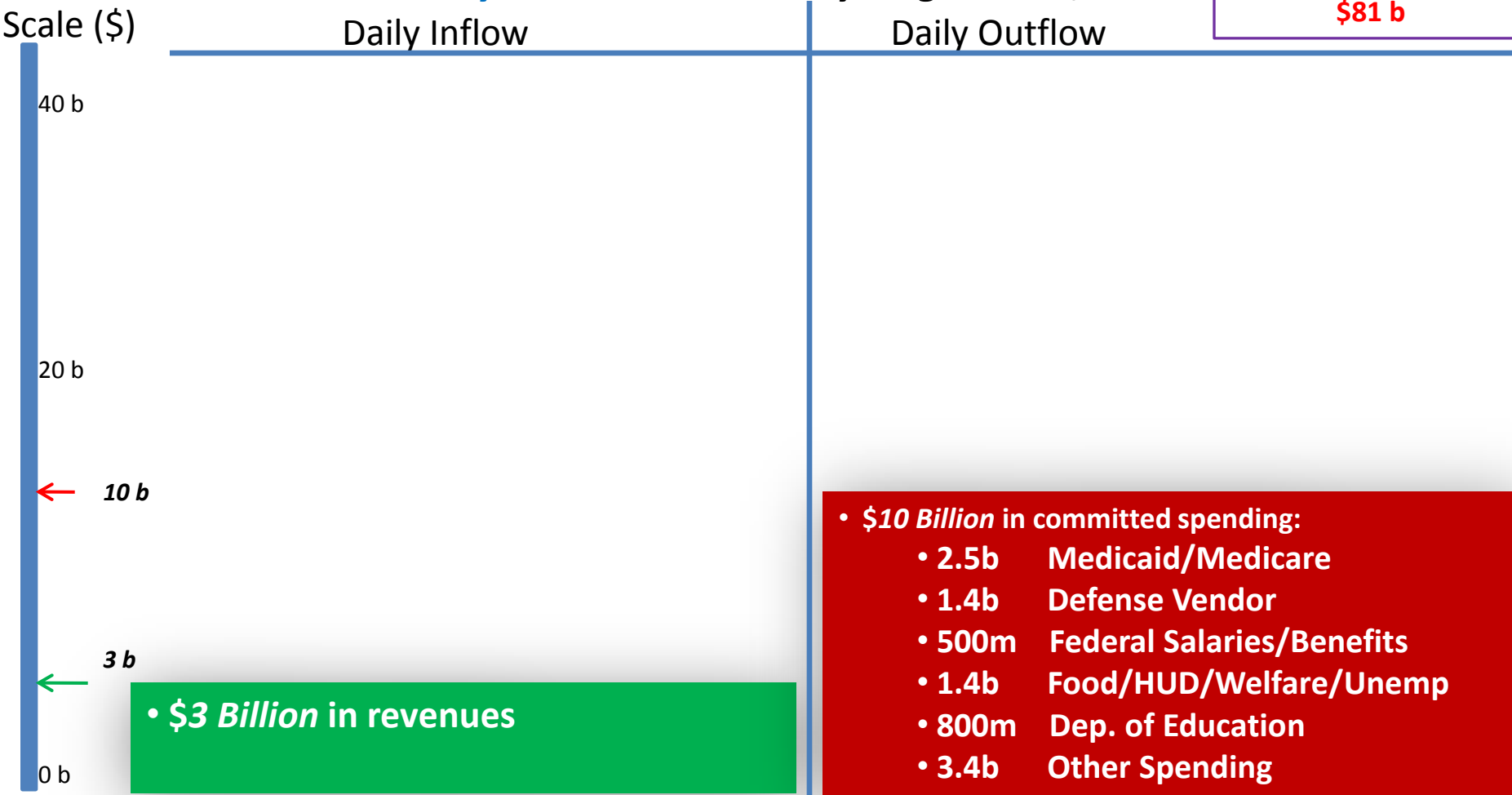
Running Cash Deficit:
\$74 b



Treasury Cash Flow: Tuesday August 16th, 2011

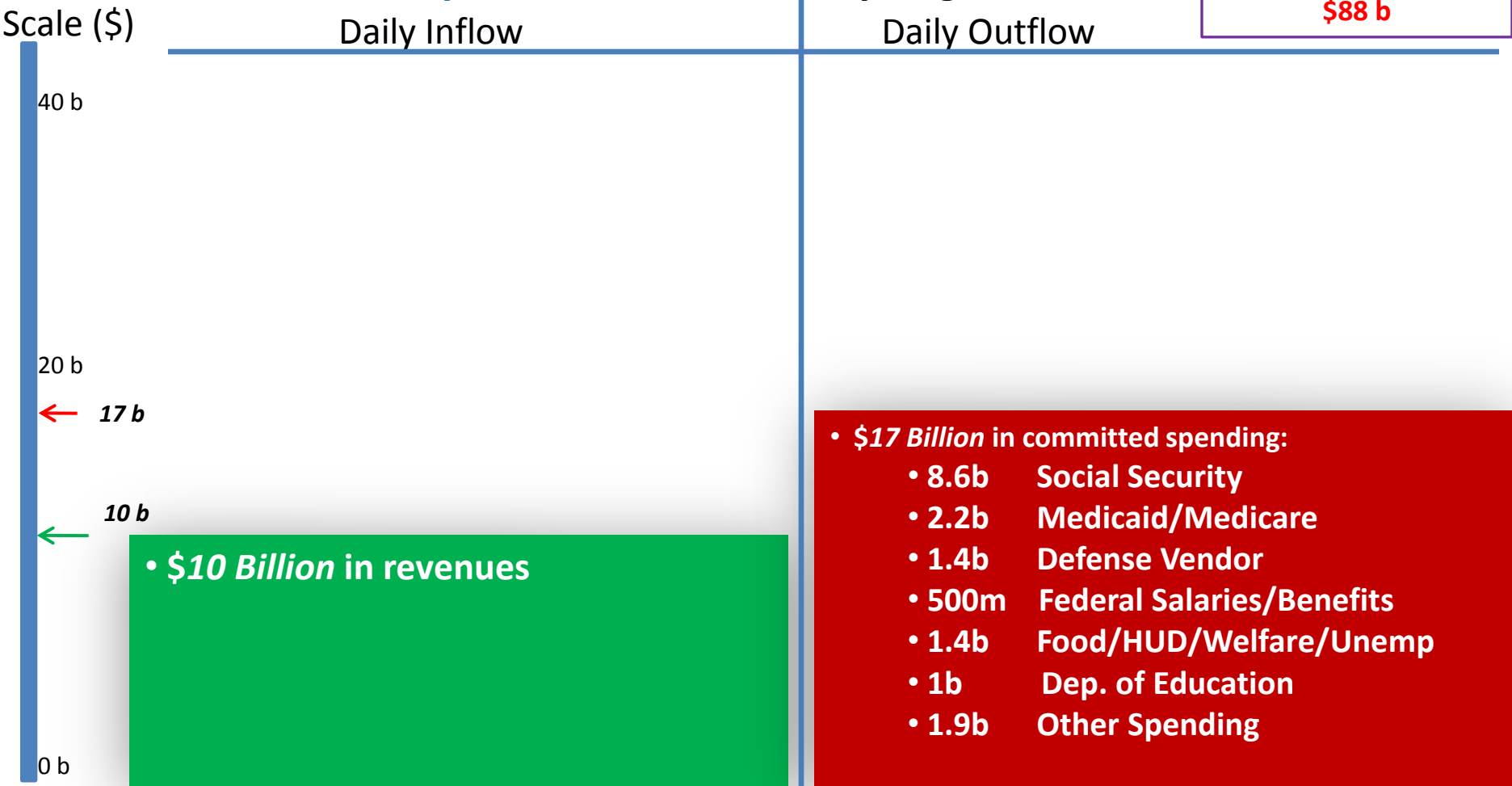
Running Cash Deficit:

\$81 b



Treasury Cash Flow: Wednesday August 17th, 2011

Running Cash Deficit:
\$88 b



Debt Maturing:
\$87 b

Treasury Cash Flow: Thursday August 18th, 2011

Running Cash Deficit:
\$96 b

Scale (\$)

Daily Inflow

Daily Outflow

40 b

20 b

← 11 b

← 3 b

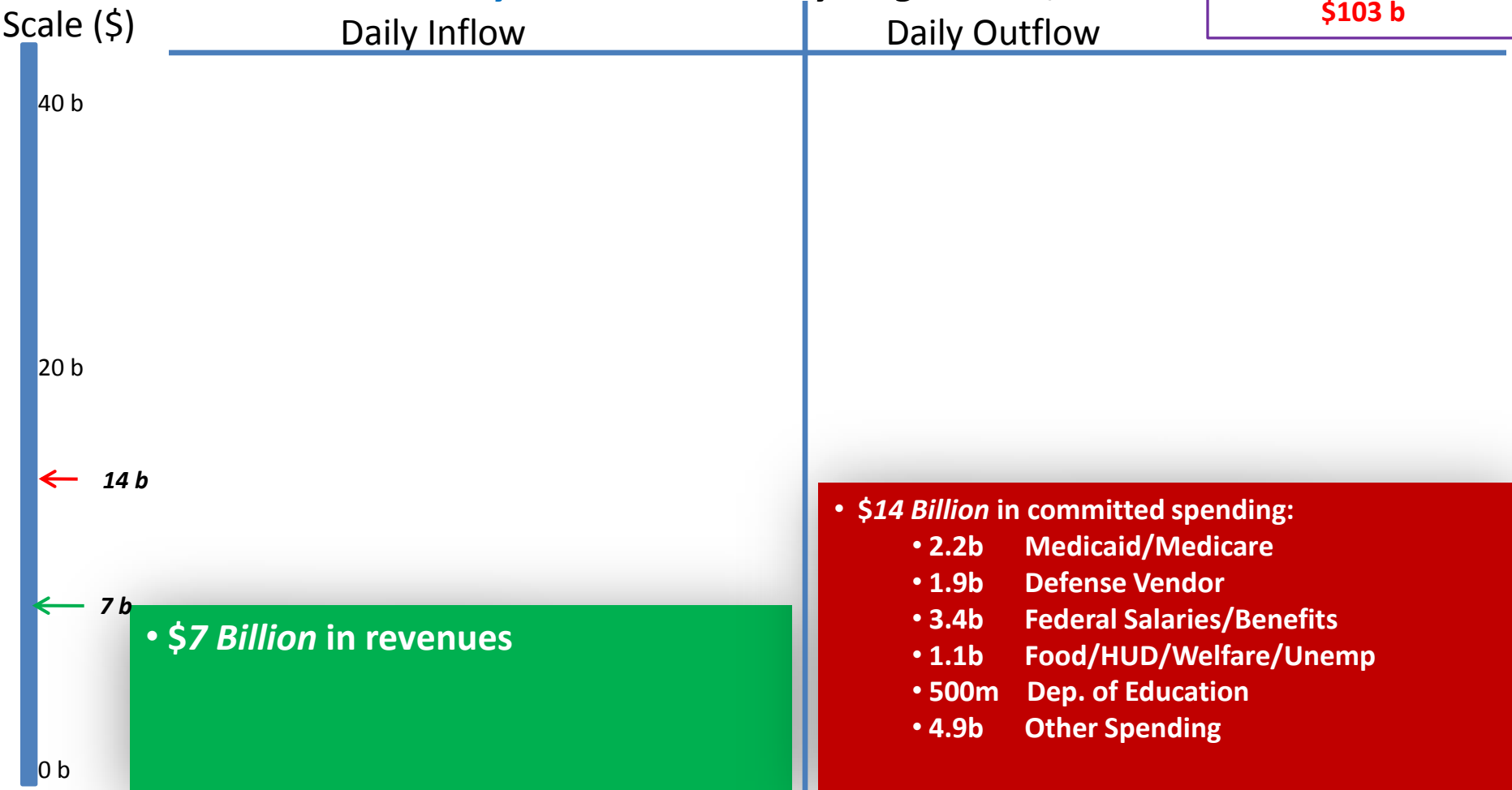
0 b

• **\$3 Billion in revenues**

- **\$11 Billion in committed spending:**
 - 3b Medicaid/Medicare
 - 1.4b Defense Vendor
 - 500m Federal Salaries/Benefits
 - 1.1b Food/HUD/Welfare/Unemp
 - 600m Dep. of Education
 - 4.4b Other Spending

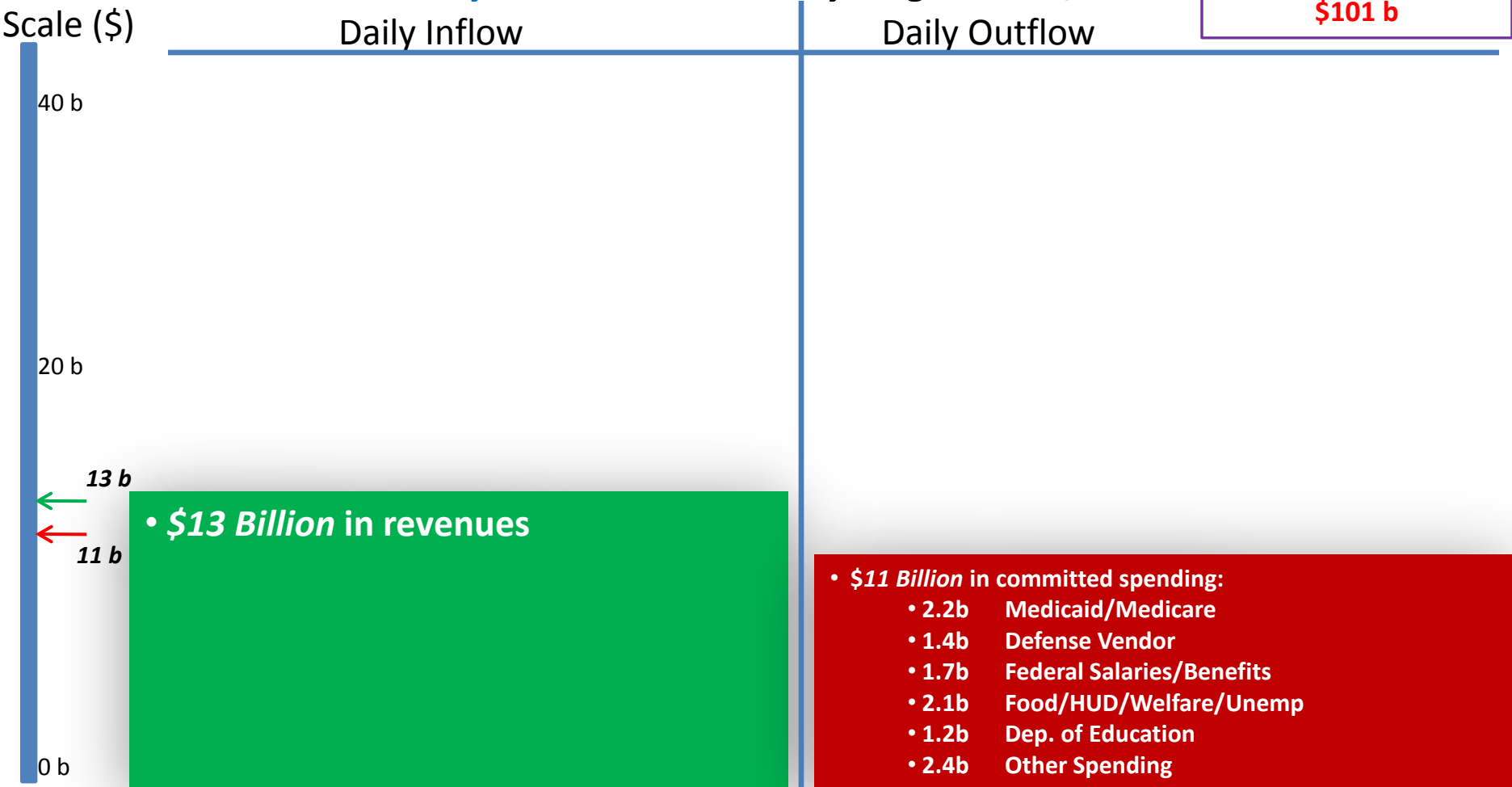
Treasury Cash Flow: Friday August 19th, 2011

Running Cash Deficit:
\$103 b



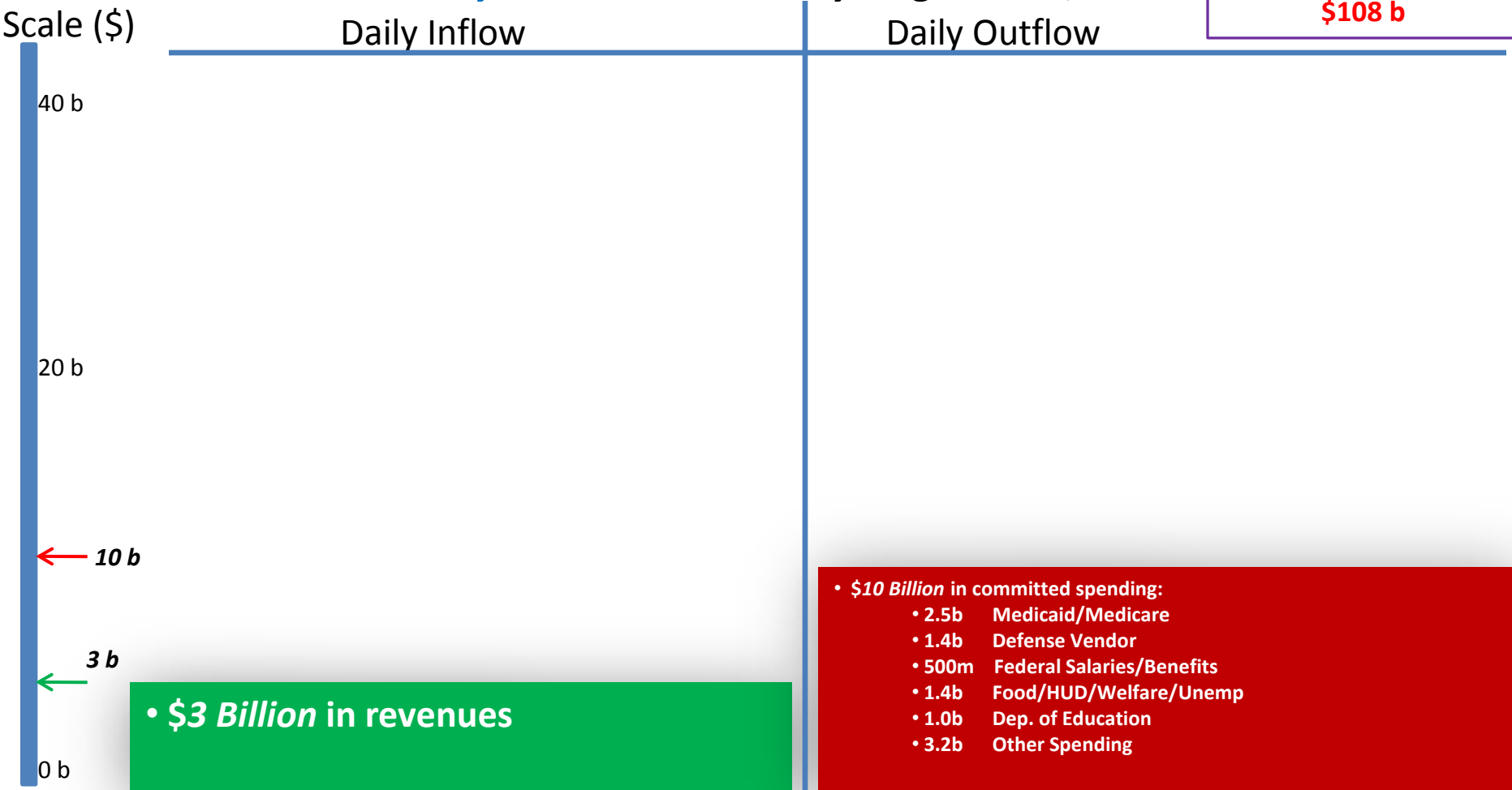
Treasury Cash Flow: Monday August 22nd, 2011

Running Cash Deficit:
\$101 b



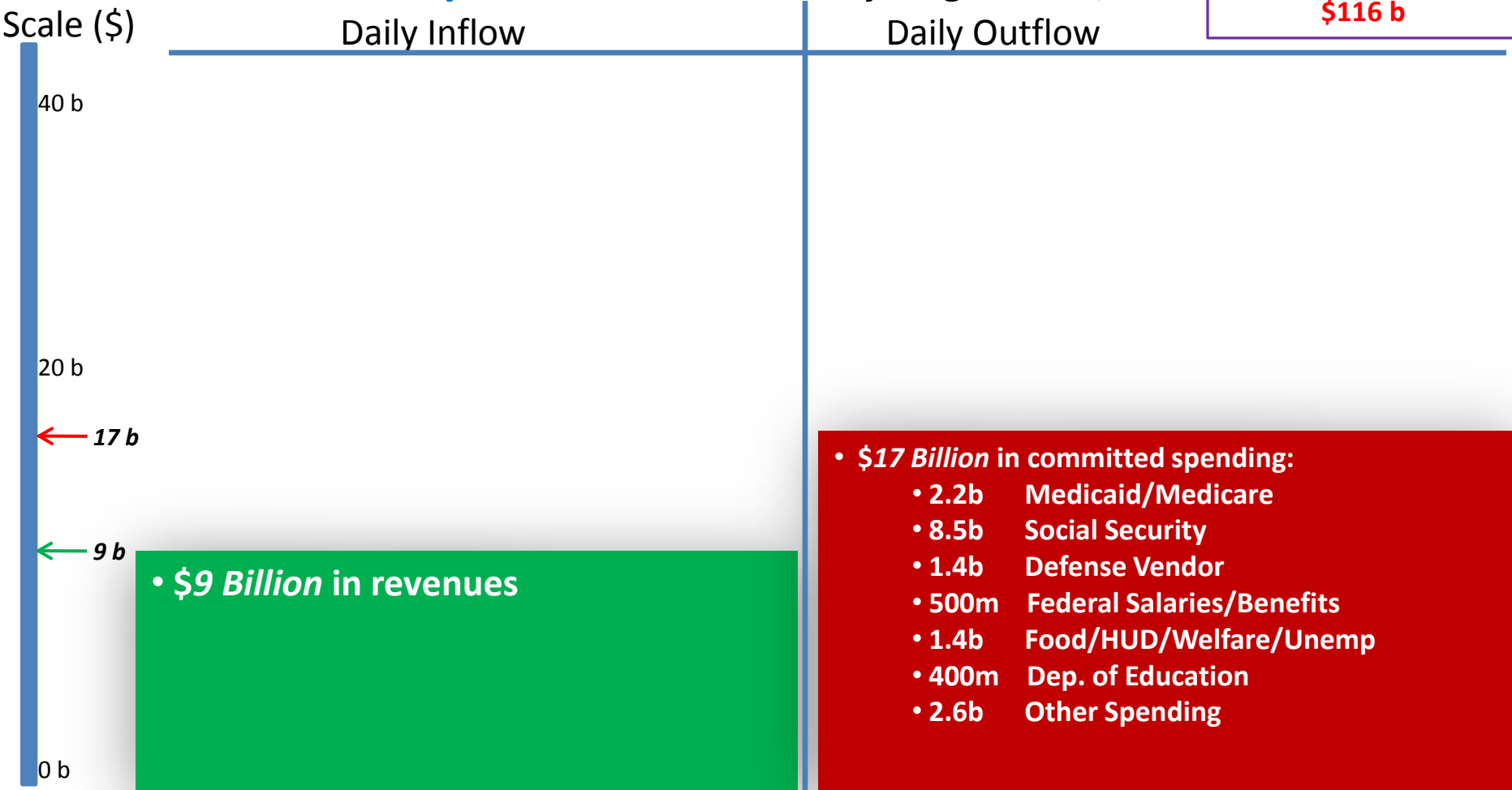
Treasury Cash Flow: Tuesday August 23rd, 2011

Running Cash Deficit:
\$108 b



Treasury Cash Flow: Wednesday August 24th, 2011

Running Cash Deficit:
\$116 b



Debt Maturing:
\$106 b

Treasury Cash Flow: Thursday August 25th, 2011

Running Cash Deficit:
\$125 b

Scale (\$)

Daily Inflow

Daily Outflow

40 b

20 b

← 12 b

← 3 b

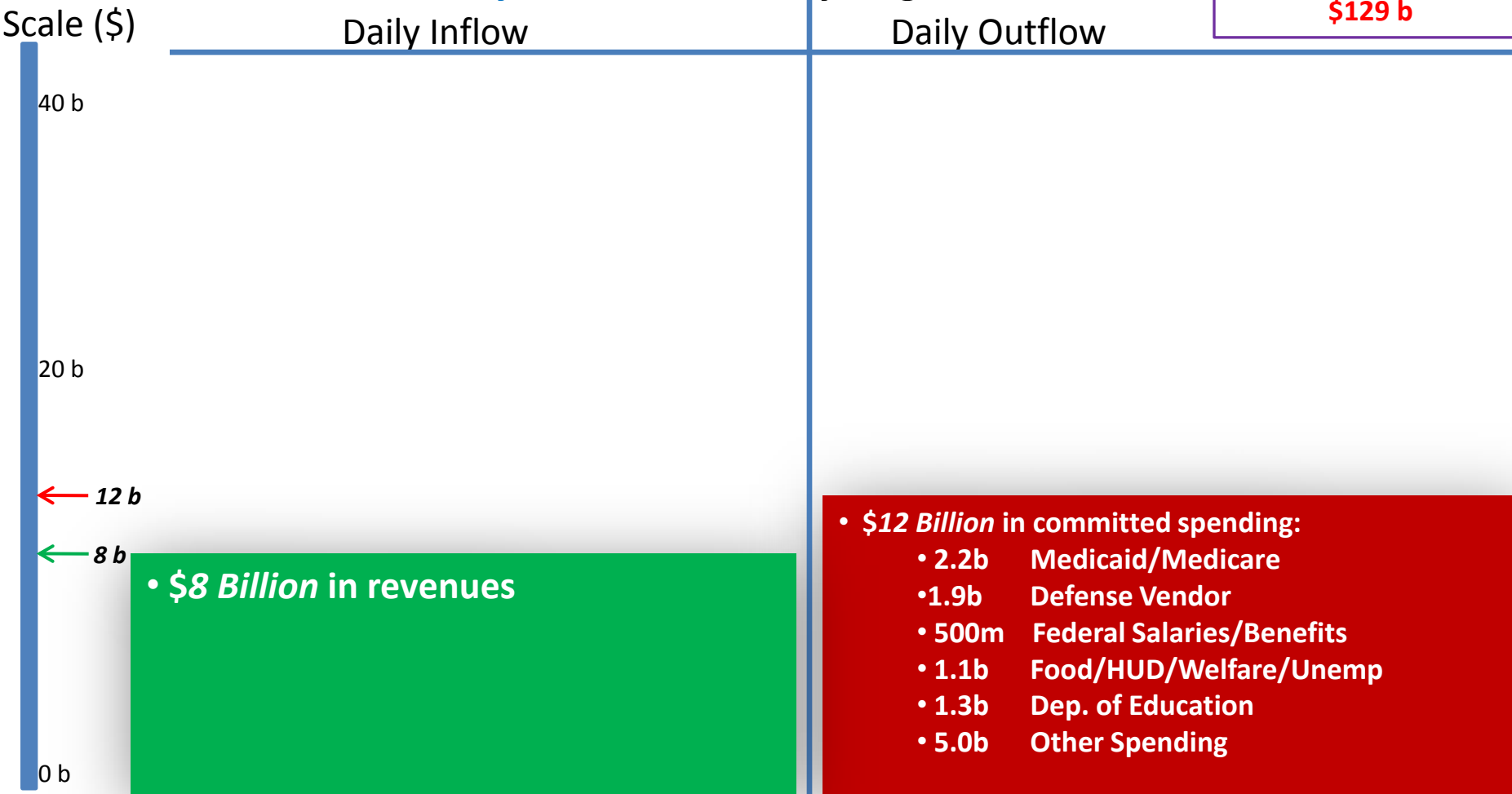
0 b

• **\$3 Billion in revenues**

- **\$12 Billion in committed spending:**
 - 3b Medicaid/Medicare
 - 1.4b Defense Vendor
 - 1b Federal Salaries/Benefits
 - 1.1b Food/HUD/Welfare/Unemp
 - 1.7b Dep. of Education
 - 3.8b Other Spending

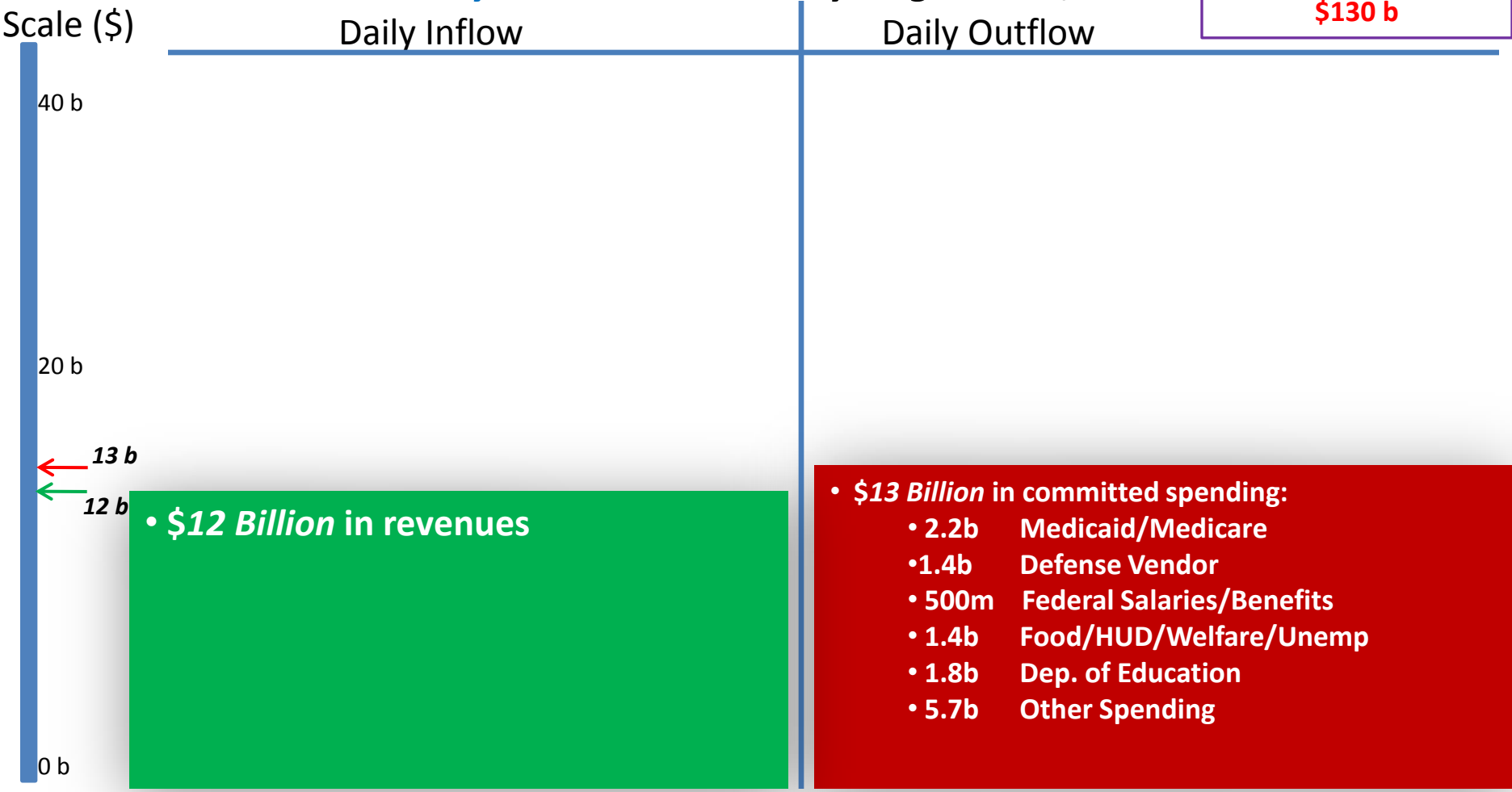
Treasury Cash Flow: Friday August 26th, 2011

Running Cash Deficit:
\$129 b



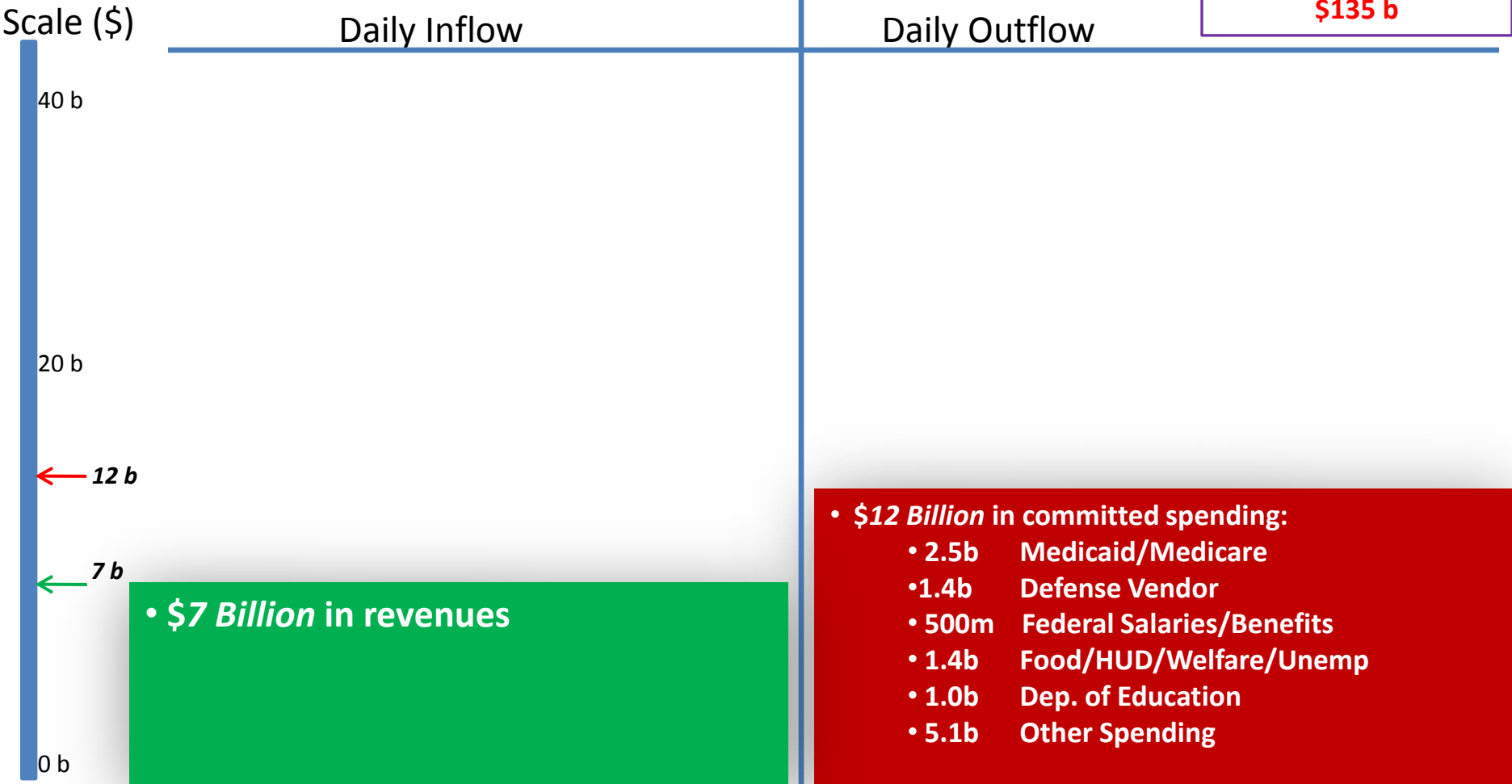
Treasury Cash Flow: Monday August 29th, 2011

Running Cash Deficit:
\$130 b



Treasury Cash Flow: Tuesday August 30th, 2011

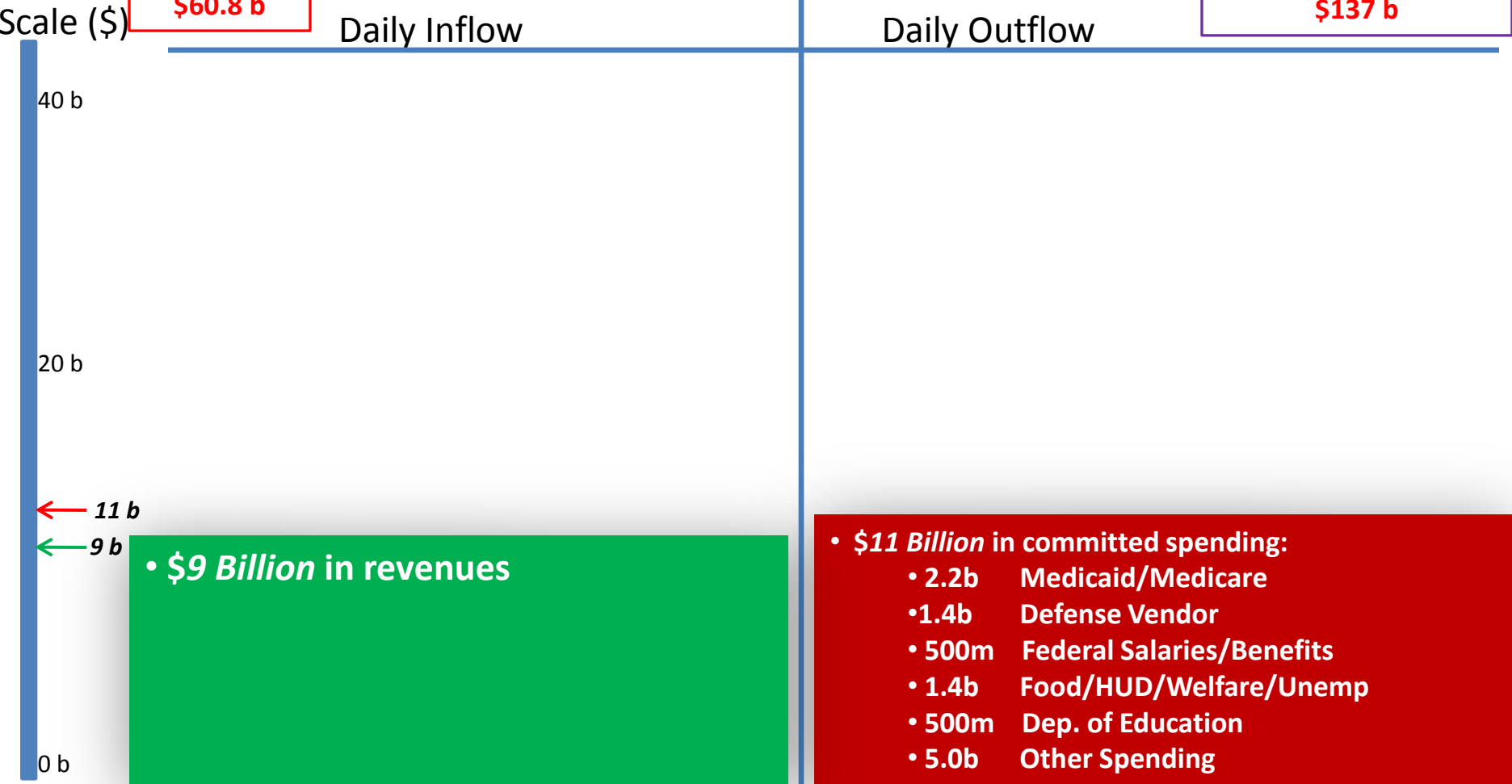
Running Cash Deficit:
\$135 b



Debt Maturing:
\$60.8 b

Treasury Cash Flow: Wednesday August 31st, 2011

Running Cash Deficit:
\$137 b



- **Handling *all* payments for important and popular programs (e.g., Social Security, Medicare, Medicaid, Defense, active duty pay) will quickly become impossible**
- **Economic disruption:**
 - Immediate 44% cut in federal spending would affect broader economy
 - Many service providers unpaid
 - Medicare and Medicaid providers
 - Defense vendors
 - Individuals not receiving government checks
 - Widespread uncertainty as decisions are made day by day



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Market Risk

- **Treasury must “roll over” almost \$500 b in debt that matures during August 2011**
 - When a Treasury security matures, Treasury must pay back the principal plus interest due. Under normal circumstances, Treasury would simply “roll over” the security
 - As one security matures, the principal + interest for that security would be paid for with cash from the issuance of a new security
- **During prioritization, this operation may not run as smoothly**
 - Two elements of market risk:
 - Treasury will have to pay higher interest rates to attract new buyers
 - It is possible, if unlikely, that not enough bidders would appear

Securities Maturing in August 2011

Maturity Date	Amount (billions of dollars)
8/2	12.0
8/4	90.8
8/11	93.3
8/15	26.6
8/18	87.0
8/25	106.0
8/31	60.8
<i>SUM</i>	476.5

Based on actual maturities for all securities, except for our conservative estimates of one month bills to be issued in July 2011

- **If the debt ceiling is not raised by August 2, all three ratings agencies will put the United States on watch for a downgrade, at a minimum (S&P and Moody's already have)**
- **The affects of a single downgrade (by S&P) are uncertain**
- **Even without downgrade, it is likely that rates would increase, perhaps significantly**
 - Less likely, but possible, that Treasury would lose market access during such an unprecedented event and default

Conclusions

- **The risks are real:**
 - The Treasury market, interest rates
 - Level and status of the dollar
 - Our economy
 - The global financial system

- **No guarantee of the outcome; risks are risks**



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