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Debt Limit Analysis:

Everything You Need to Know in 40 Slides

Updated: August 2021

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SUMMARY OF FINDINGS

- In August 2019, policymakers enacted a bipartisan budget agreement that suspended the federal debt limit for two years.
- On August 1, 2021, the debt limit was reinstated at roughly $28.4 trillion—a level covering all borrowing during the suspension—which the government immediately ran up against.
- At that point, the Treasury secretary deployed emergency borrowing authority—known as "extraordinary measures"—to continue fully funding government operations.
- If Congress does not raise or further suspend the debt limit, BPC projects that the Treasury Department (Treasury) will most likely be unable to meet its financial obligations at some point in Fall 2021 (what we call the "X Date").

THE BASICS

- **The debt limit is…**

  …the maximum amount that Treasury is allowed to borrow;

  …set by statute (Congress must act to change it); and

  …inclusive of most debt issued, whether held by the public (such as Treasury bills and savings bonds) or intragovernmental (such as debt held by the Social Security trust funds).

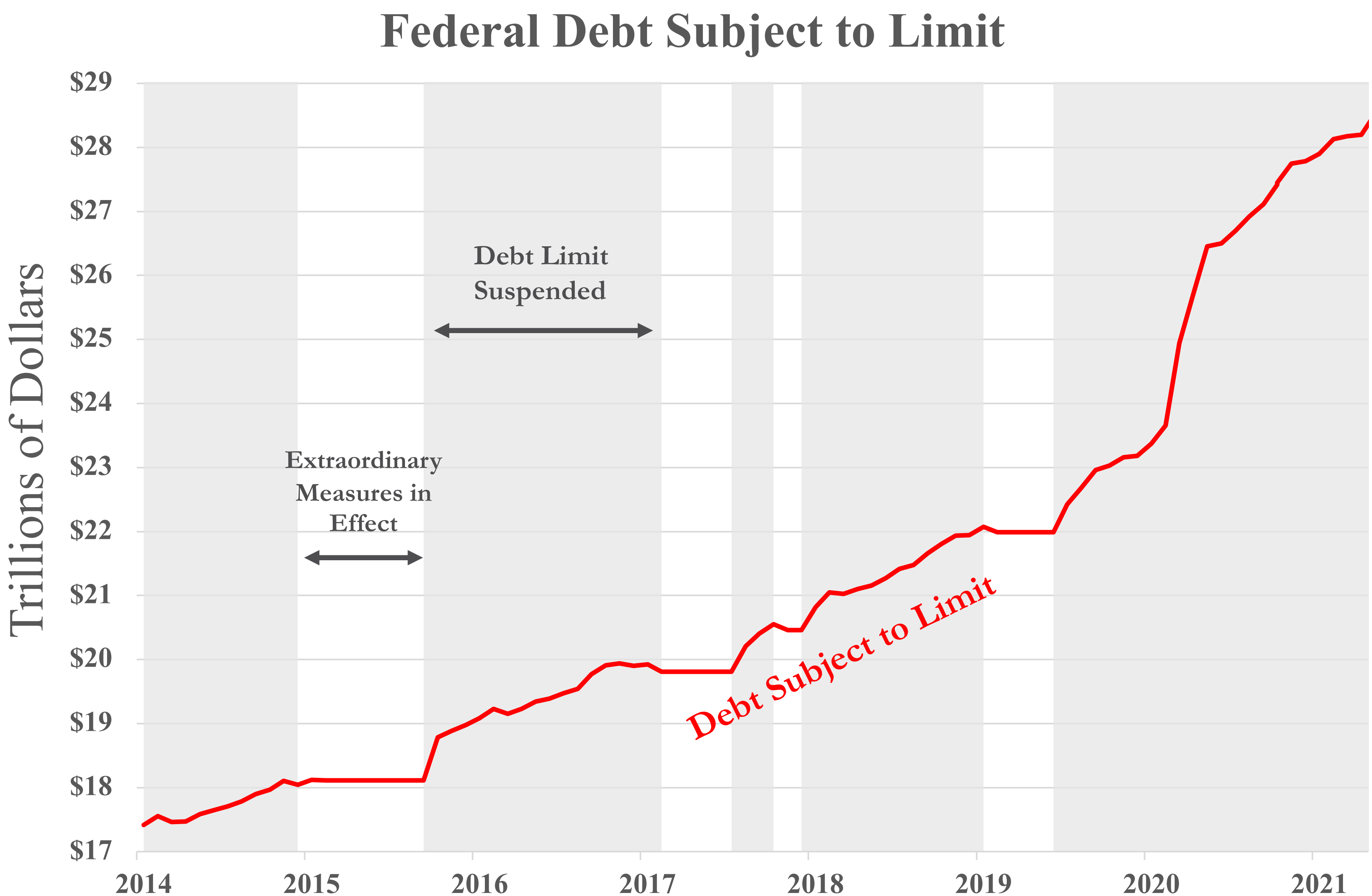
- **Because the federal government is running a deficit, Treasury needs to borrow from the public (i.e., domestic and foreign investors) to cover its obligations. The debt limit restricts its ability to do so.**

- **Extending the debt limit does not authorize new spending—rather, it enables the federal government to pay its bills and spend what Congress has already approved.**

HISTORY

- **First set by Congress in 1917, the debt limit has a 100+ year history.**
  - Prior to World War I, Congress maintained tight control over federal borrowing and authorized each issuance of public debt.
  - The first debt limit was implemented to give the Treasury Department **more, not less**, flexibility to manage federal finances.
- **Since then, congresses led by both parties have repeatedly raised and suspended the debt limit to accommodate additional borrowing.**
- **In recent years, the issue of the debt limit has grown increasingly political, and debt limit brinkmanship has damaged the creditworthiness of the U.S. government and increased borrowing costs for its taxpayers.**

RECENT HISTORY



RECENT HISTORY

2011

Hours to Deadline

On August 2, 2011, with hours to act and after months of deadlocked negotiations, the Budget Control Act authorizes a debt limit increase to $16.4T. S&P, citing the political brinkmanship, downgrades the U.S.'s credit rating from AAA+ to AAA.

2013

Day to Deadline

Just one day before Treasury's deadline, the Continuing Appropriations Act suspends the debt limit until February 7, 2014. GAO concludes that borrowing costs increased by tens of millions of dollars, which taxpayers bore through higher interest rates on Treasury securities.

2017

Weeks to Deadline

Weeks from the deadline, a three-month budget deal suspends the debt limit until December 8, 2017. Analysts worry an October payment to the Military Retirement Trust Fund could have triggered a default. The limit reinstates in December at $20.5T.

2018

Month to Deadline

On February 9, 2018, about a month before Treasury's deadline, the Bipartisan Budget Act suspends the debt limit until March 2, 2019. The debt limit is reinstated in March 2019 at $22T.

2019

Month to Deadline

On August 2, 2019, about a month before the estimated deadline, the Bipartisan Budget Act suspends the debt limit until August 1, 2021. Congress is prepared to head into summer recess without action when BPC's projection accelerates negotiations.

WHERE THINGS STAND

- **A two-year suspension of the debt limit enacted by the Bipartisan Budget Act of 2019 expired on August 1, 2021.**

- **On August 1, the debt limit was reinstated at approximately $28.4 trillion.**
  - While the debt limit was suspended, there was no limit on how much Treasury could borrow to finance government operations.
  - When the suspension ended, the debt limit was reinstated at a level covering all obligations incurred during the suspension period, meaning that the federal government was immediately back up against its debt limit.

- **The Treasury secretary declared a debt issuance suspension period on August 2, enabling the use of extraordinary measures.**

Source: Bureau of Economic Analysis

Layers of Defense Against Default

Treasury has multiple means that may be used to pay the nation's bills. If the debt limit is reached and policymakers do not act in time, however, 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

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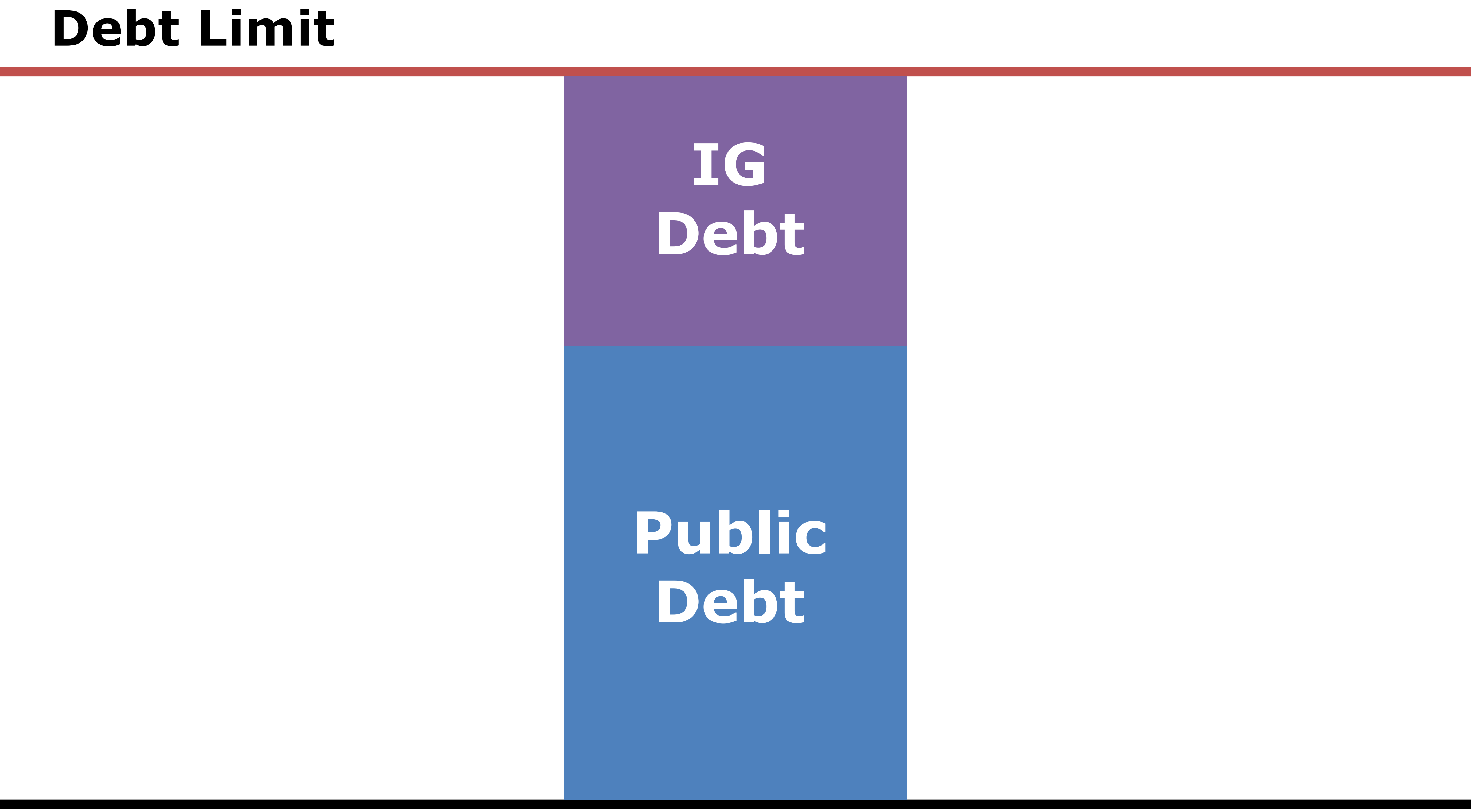
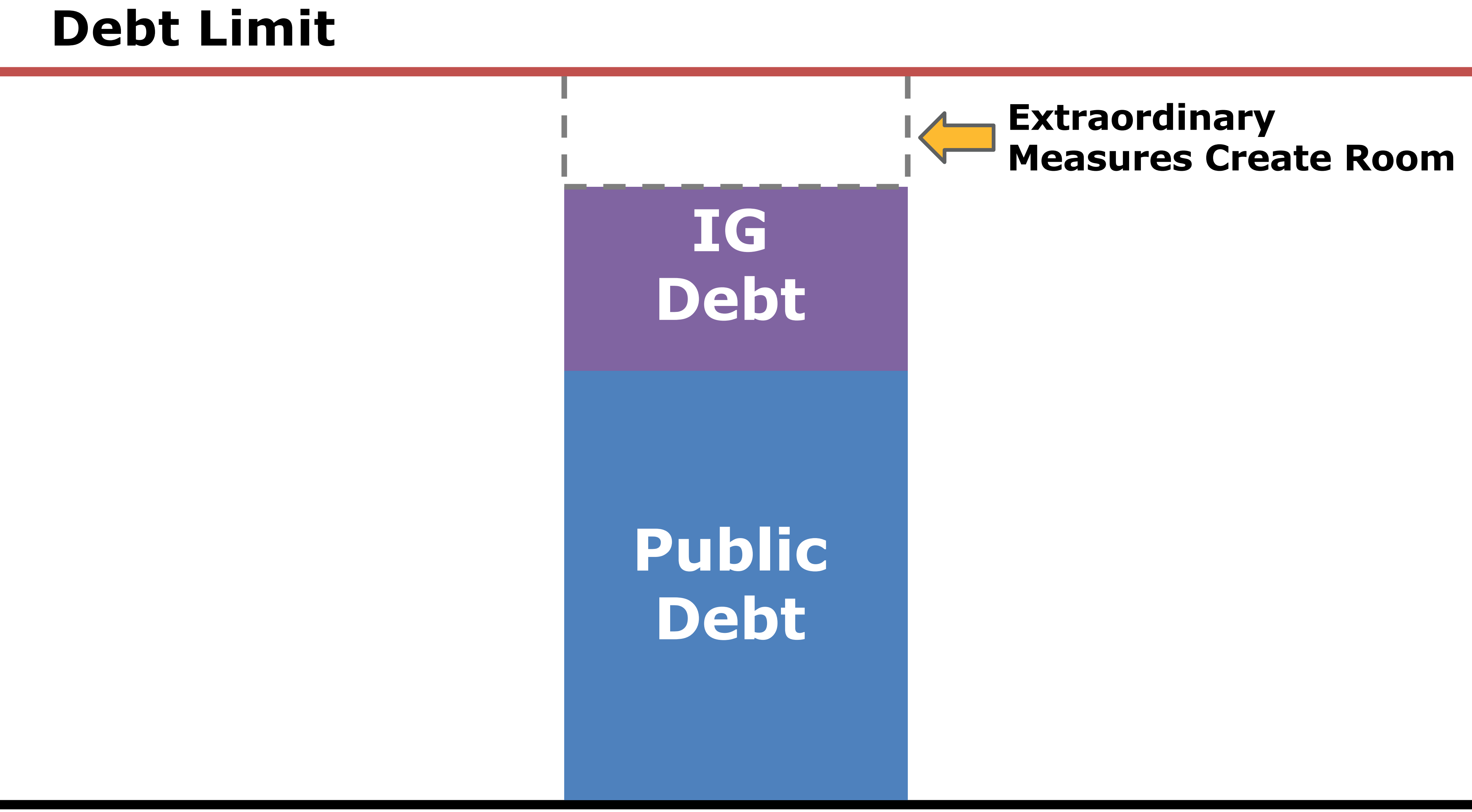
How Do Extraordinary Measures Work?

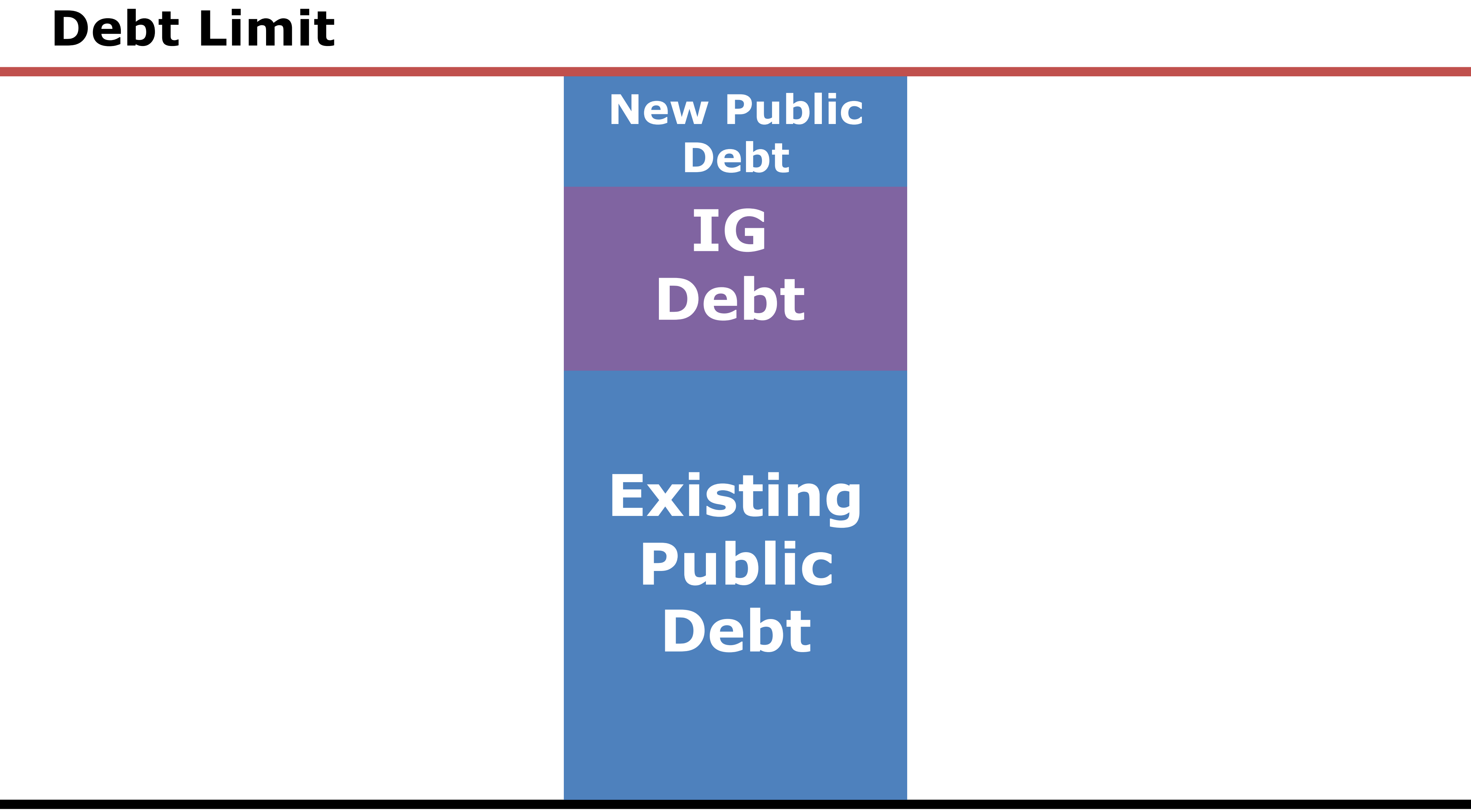
Both intragovernmental and public debt count toward the limit.



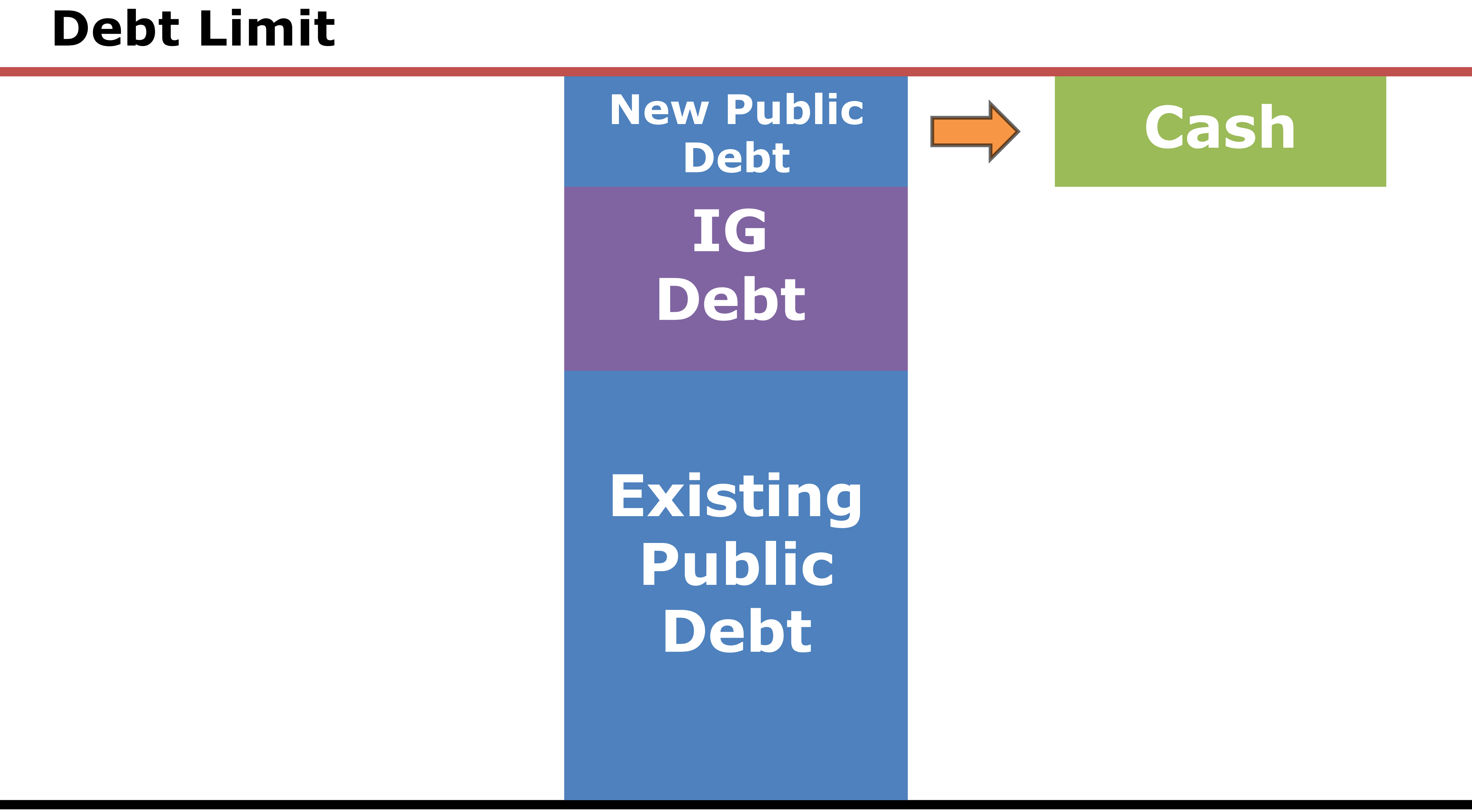
Treasury reduces certain types of debt using extraordinary measures…



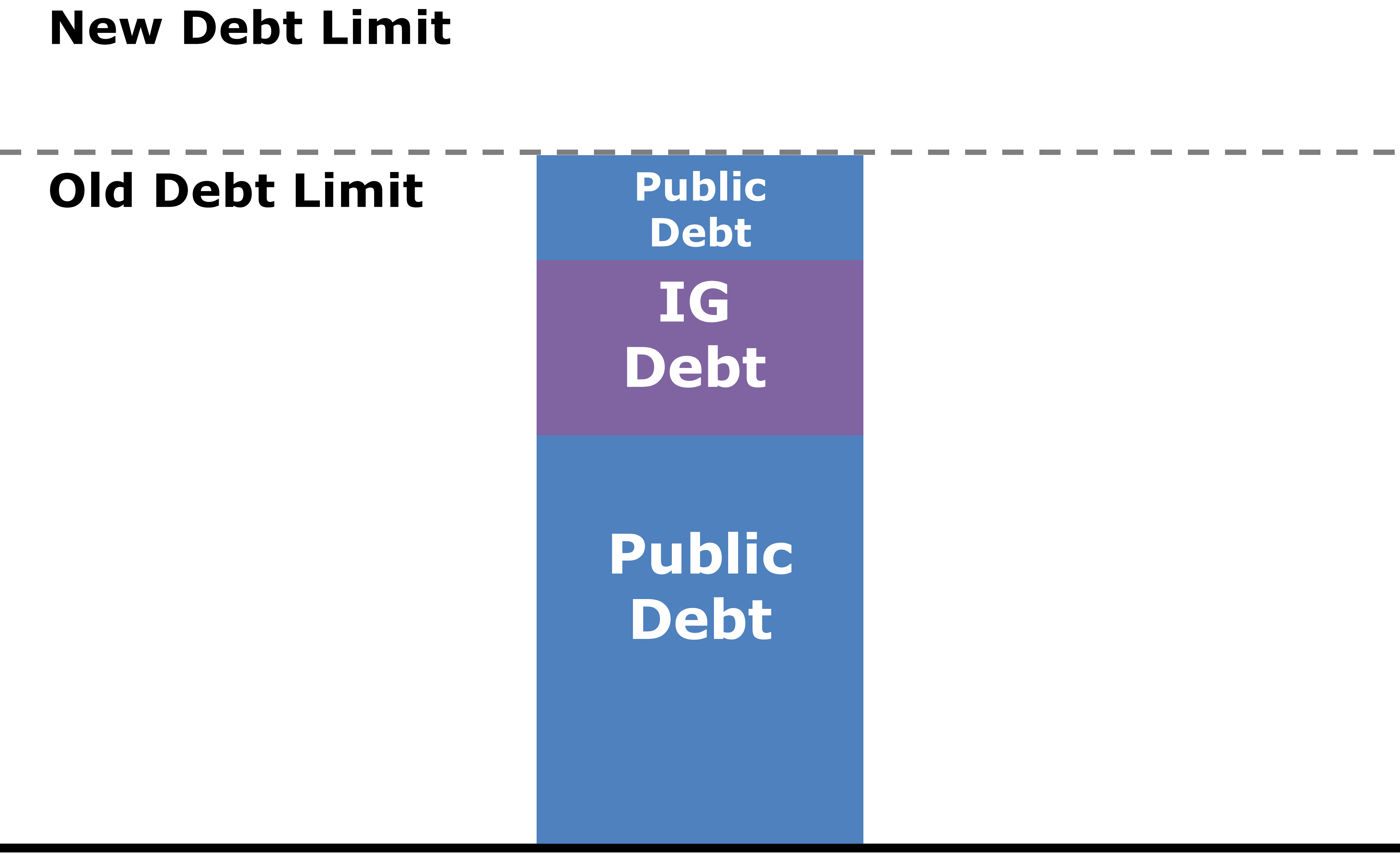
…to issue more debt to the public.



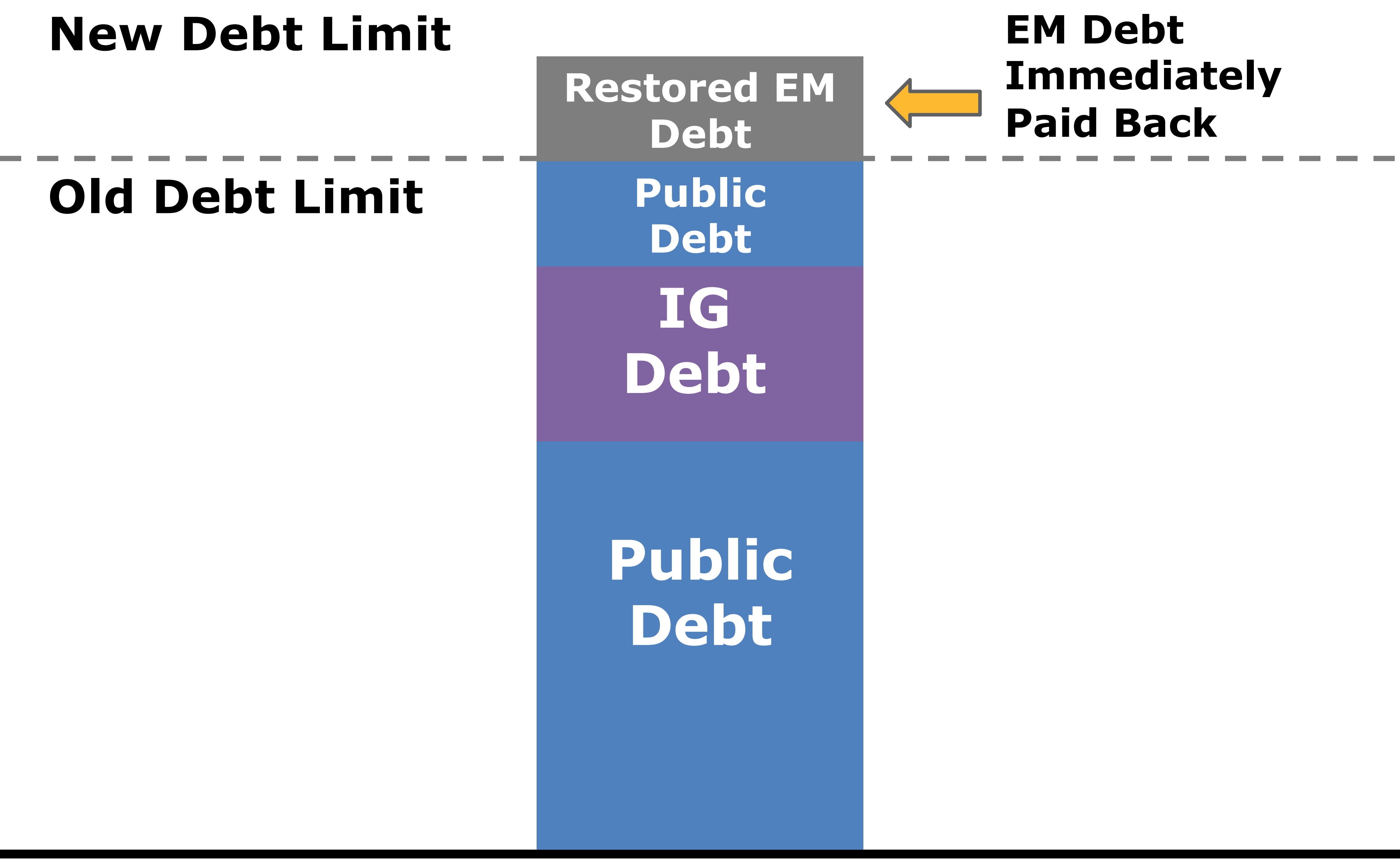
Issuing debt raises cash to pay bills.



When the debt limit is increased…



…extraordinary measures are immediately restored.



THE BIG THREE EXTRAORDINARY MEASURES

1. **The G-Fund of the Thrift Savings Plan**
   – Each day, Treasury may temporarily reduce the amount of debt held by this fund, which holds government bonds for federal employee retirement accounts.

2. **The Civil Service Retirement and Disability Fund (CSRDF)**
   – Treasury may postpone new investments in this pension fund. The CSRDF measure is most useful in June, September, and December, when major interest credits and reinvestments of maturing securities typically occur.

3. **The Exchange Stabilization Fund (ESF)**
   – Each day, Treasury may temporarily reduce the amount of debt held by this fund, which is used to facilitate foreign exchange transactions.

For more detail on extraordinary measures and how they work, see this primer.

EXTRAORDINARY MEASURES

Example: Federal Employees' Retirement System G-Fund

- Federal employees with savings in the Thrift Savings Plan 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.
- No impact on federal employees' retirement savings.

EXTRAORDINARY MEASURES UPDATE

EXTRAORDINARY MEASURES AVAILABLE	March 2019 (estimated)	August 2021 (estimated)	Difference
Do not reinvest the Federal Employees' Retirement System G-Fund	$230 billion	**$293 billion**	+$63 billion
Do not reinvest the Exchange Stabilization Fund	$22 billion	**$12 billion**	-$10 billion
Do not make new investments to the civil service and postal retirement funds	$151 billion	**$49 billion**	-$102 billion
Shift funds from the Federal Financing Bank	$5 billion	**$7 billion**	+$2 billion
Total	$408 billion	**$361 billion**	-$47 billion

Notes: Totals indicate all *available* measures over the entire anticipated debt issuance suspension period. These totals only include the value of extraordinary measures that can be used to extend the X Date. Treasury has additional measures available that assist with cash flow and debt management. Figures may not add due to rounding.

Source: U.S. Treasury Department, Description of Extraordinary Measures

CASH ON HAND

- **On the final business day of the debt limit suspension (July 30, 2021), Treasury held a cash balance of $459 billion. This was based on:**

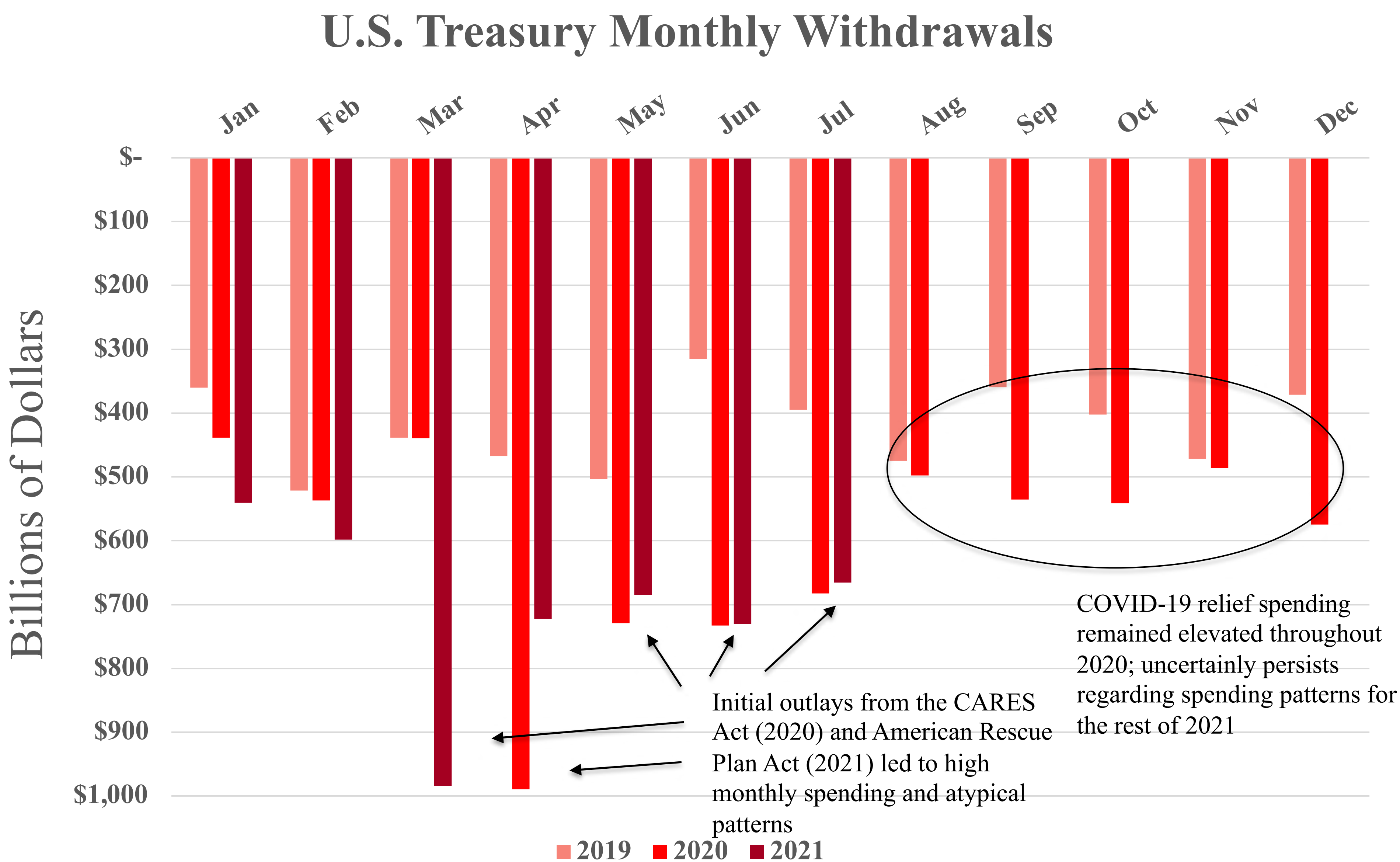
  - Treasury's interpretation of its authorities and obligations under the Bipartisan Budget Act of 2019, which last suspended the debt limit.

  - Treasury's cash management policies, which include its 2015 policy to hold a level of cash sufficient to cover one week of outflows in the Treasury General Account.

AFTER EXTRAORDINARY MEASURES

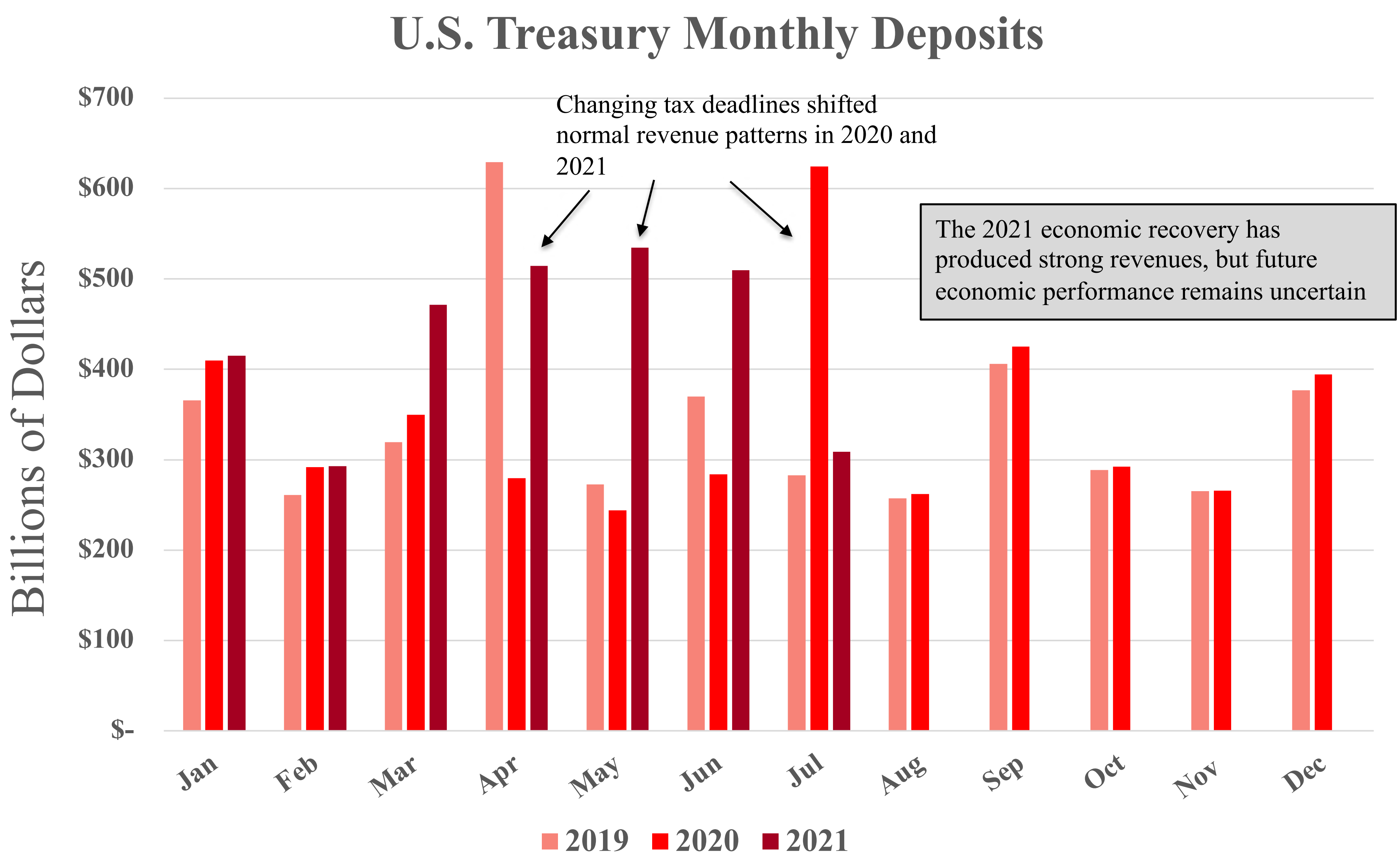
- **Once Treasury has utilized all its emergency borrowing authority, only two sources will remain from which to continue funding government operations:**
  - Residual cash on hand
  - Daily cash inflows (i.e., federal revenues received each day)

COVID-19 HAS INCREASED SPENDING



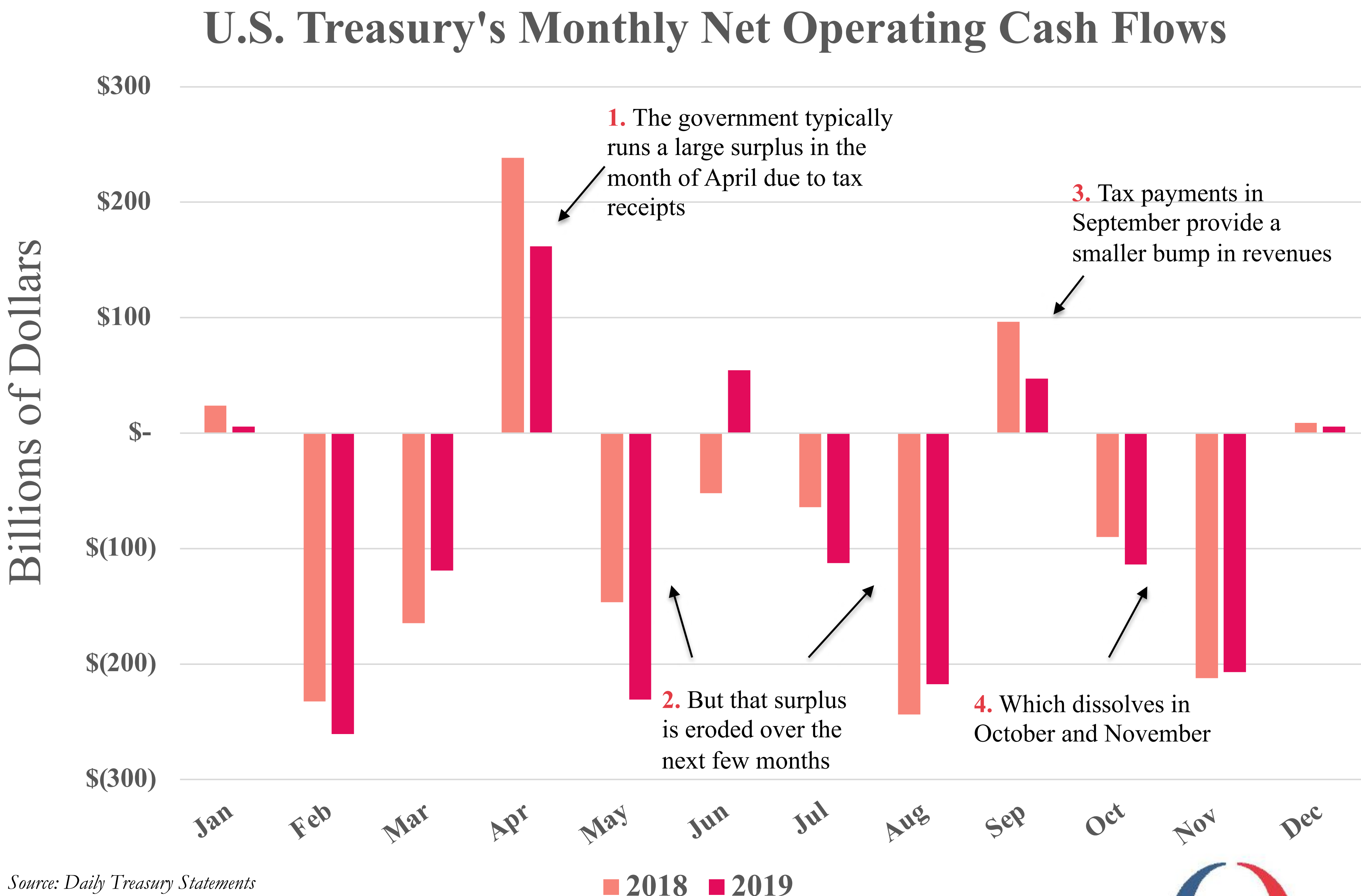
Source: Daily Treasury Statements

REVENUE UNCERTAINTY IS GREATER THAN USUAL



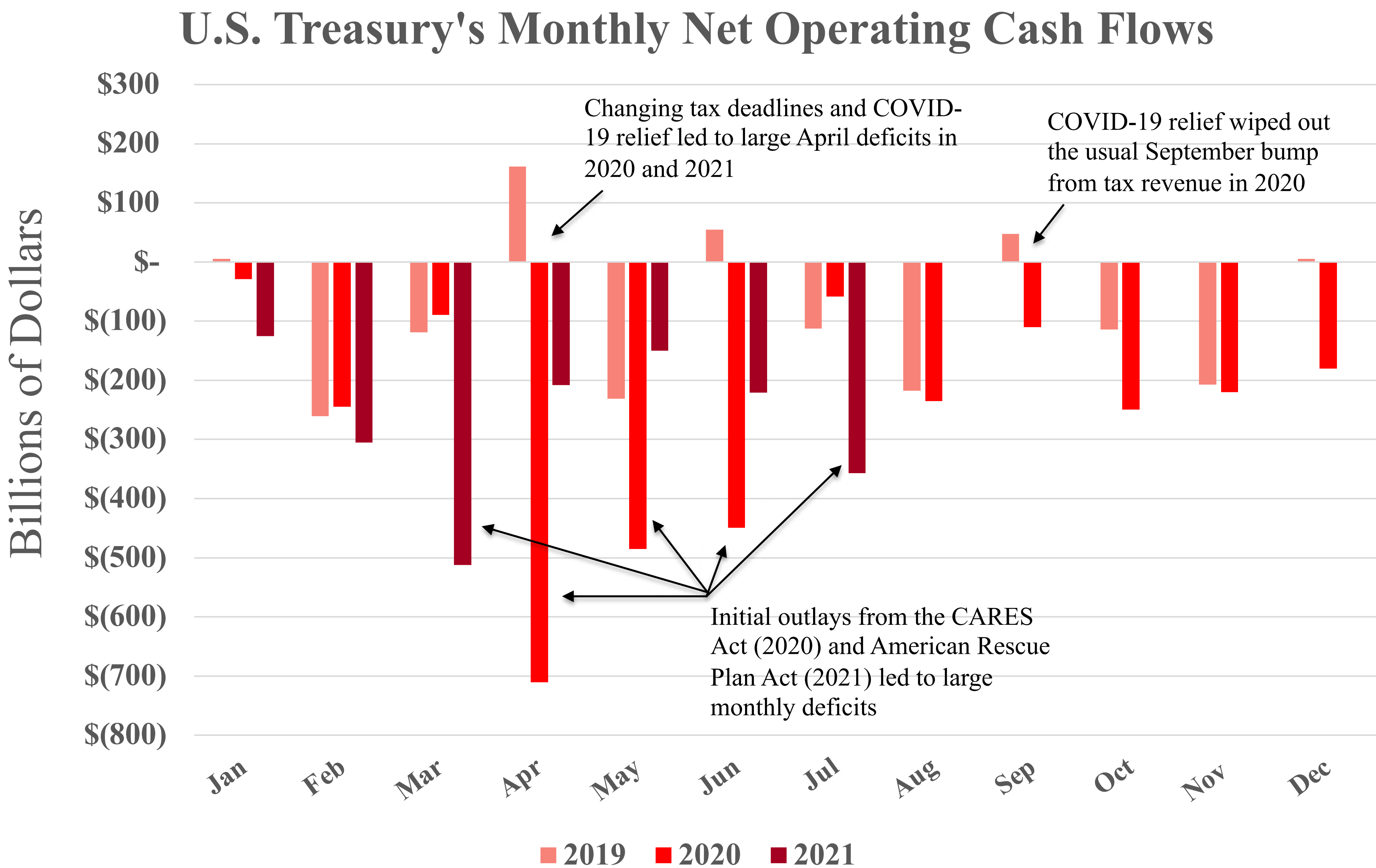
Source: Daily Treasury Statements

CASH FLOWS ARE USUALLY CYCLICAL



Source: Daily Treasury Statements

COVID-19 HAS INCREASED VOLATILITY

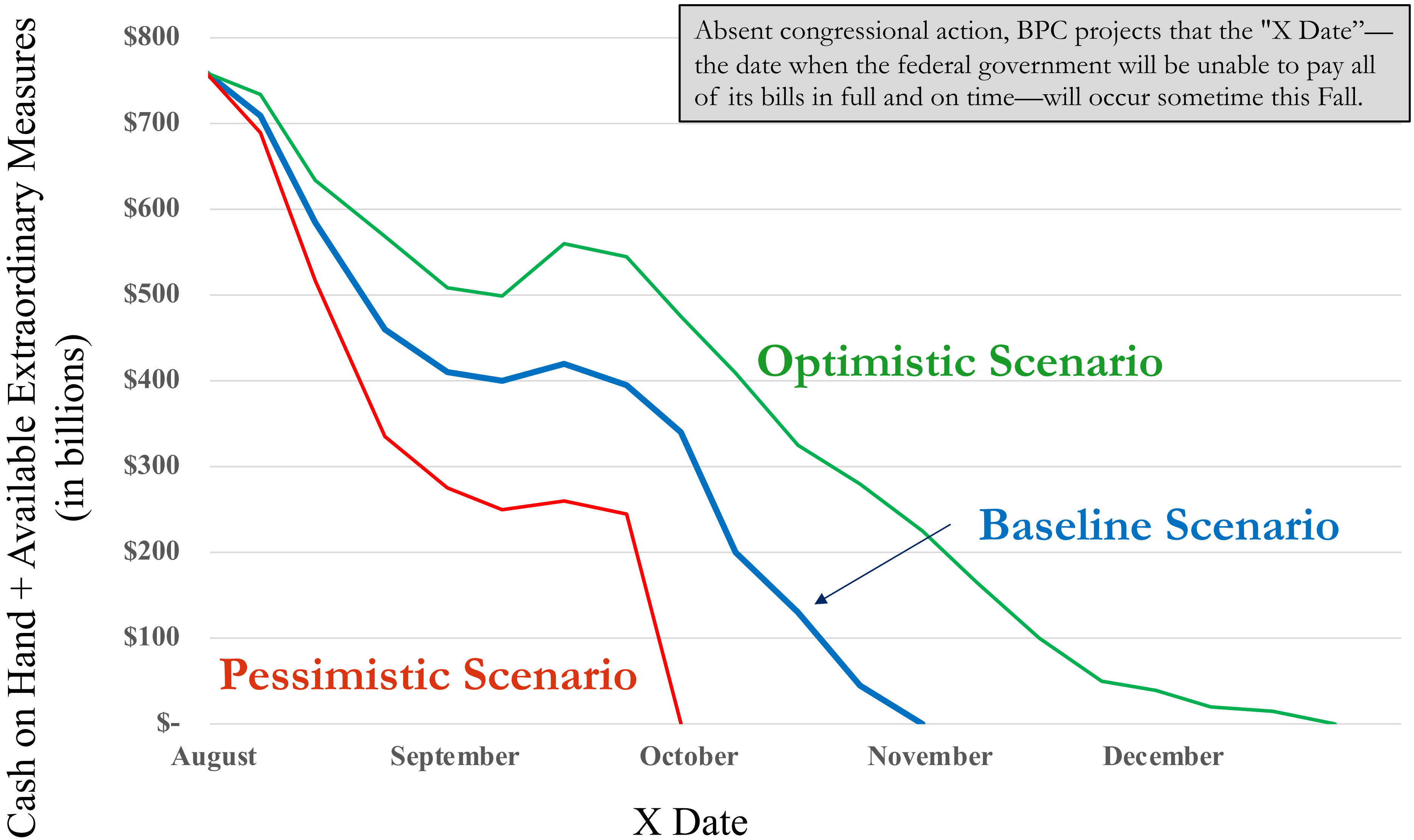


Source: Daily Treasury Statements

WHAT IS THE "X DATE"?

- **X Date: The first day on which Treasury has exhausted its borrowing authority and no longer has sufficient funds to meet all of its obligations in full and on time.**
  - In other words, if the debt limit has not been extended by the X Date, the federal government will begin defaulting on some of its obligations.
  - After the X Date, bills must be paid solely out of incoming cash flows, which will generally be insufficient to cover all government spending.
- **BPC projects that the X Date will most likely occur sometime in Fall 2021, although this date could arrive sooner in the event of higher than expected spending or lower than expected tax revenues.**
- **No one—not even the Treasury secretary—can know precisely when the X Date will arrive.**

WHEN IS THE "X DATE"?



Notes: The projections above are subject to substantial uncertainty and volatility resulting from economic performance, cash flow fluctuations, and other factors. Extraordinary measures are reflected at the time that they are expected to become available. Dates shown are 1st of month. All three lines reflect cash on hand plus available extraordinary measures, or in other words, remaining room under the debt limit.

TRADITIONAL SOURCES OF UNCERTAINTY

- **Timing of Revenue**

  - Revenue is always the most volatile part of the federal government's cash flows, varying from month-to-month and from day-to-day. Certain types of revenue, such as the quarterly tax payments due in June and September, are especially unpredictable.

  - Revenues for January through May 2021 came in $300 billion above expectations according to the Congressional Budget Office, owing to higher than anticipated corporate and personal income tax payments. If revenues revert to expectations, the risk of an X Date in early Fall would rise.

- **Major Changes in Policy (e.g., emergency spending)**

  - Major fiscal policy decisions can alter Treasury cash flows, and therefore, the X Date. For example, in the past, emergency spending on natural disasters has accelerated the X Date's timing.

COVID-19 SOURCES OF UNCERTAINTY

- **COVID-19 Relief Disbursement or Policy Changes**
  - Treasury still has funds from the American Rescue Plan Act and other COVID-19 relief initiatives to disburse. The timing of these payments injects further volatility into Treasury cash flows.
  - As the economy continues to recover, policy changes related to support for state and local governments, small business assistance, supplemental unemployment insurance benefits or other COVID-19 relief efforts could substantially impact Treasury's available cash.

- **COVID-Related Changes in Economic Conditions**
  - If economic conditions change dramatically, spending and revenue flows can be greatly impacted, thereby affecting the X Date.
  - The emergence of the Delta variant poses additional risks to recovery.
  - Accelerations or slowdowns in the post-COVID recovery could significantly affect the X Date. For example, higher-than-expected quarterly tax payments in September could delay the X Date, but if the recovery slows and revenues decline, the X Date could arrive earlier than forecast.

Costs and Market Risk

COSTS PILE UP BEFORE THE X DATE

- **Fed Chairman Jerome Powell on approaching the X Date:**

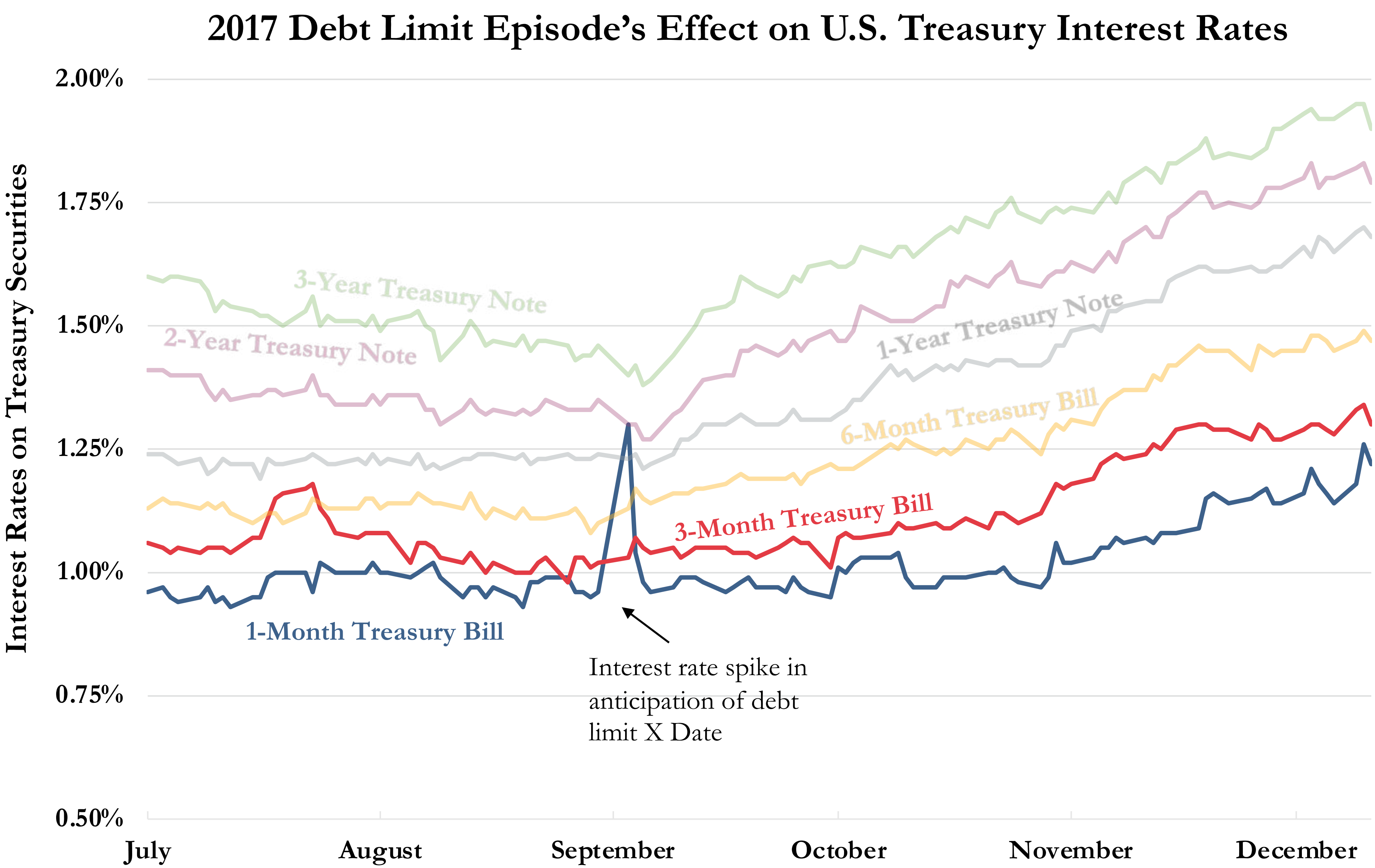
  "The failure to increase the debt ceiling creates a lot of uncertainty … and a lot of distraction."

- **American taxpayers foot the bill for additional borrowing costs that come from delays in extending the debt limit.**

  - In previous years, uncertainty has caused interest rates on some Treasury bills to spike in anticipation of the X Date, resulting in many millions, if not billions, of dollars in added interest costs.

  - In 2013, Fidelity's money-market funds refused to hold any U.S. government debt maturing in late October and early November (the period surrounding the projected X Date in that year).

COSTS PILE UP BEFORE THE X DATE



Source: TreasuryDirect

COSTS PILE UP BEFORE THE X DATE

- **Researchers at the Federal Reserve found that approaching the X Date in 2011 and 2013 increased the government's borrowing costs by hundreds of millions of dollars.**
  - The substantial cost to taxpayers stemmed from elevated interest rates on U.S. Treasury securities issued in 2011 and 2013 leading up to the date when the debt limit was extended.
  - The Government Accountability Office (GAO) conducted a similar study of the 2013 impasse, finding that federal borrowing costs increased by tens of millions of dollars for that year alone, and much more if calculated over the duration of all the debt that was issued.
- **The cost of these impasses to the federal government continues to accrue far beyond the episode itself because many of the securities issued during that period remain outstanding and accruing interest for several years (2, 10, 30, etc.).**

COSTS PILE UP BEFORE THE X DATE

- **State and local governments are negatively impacted by debt limit episodes.**
  - Due to the reinstatement of the debt limit, on July 30, Treasury suspended the issuance of State and Local Government Series (SLGS) securities, which help state and local governments comply with tax regulations.
  - This suspension causes additional expenses and administrative costs for state and local governments, some of which have already been stretched thin by the COVID-19 pandemic.

THE RISKS ARE REAL

- **Treasury securities are normally considered safe and liquid. They serve as the foundation of the global financial system because the risk of default is perceived to be negligible.**

- **GAO on Treasury securities and market risk:**

  "The United States benefits from the confidence investors have that debt backed by the full faith and credit of the United States will be honored. Because Treasury securities are viewed as one of the safest assets in the world, they are broadly held by individuals—often in pension funds or mutual funds—and by institutions and central banks for use in everyday transactions. Treasury securities are also the cheapest and one of the most widely used forms of collateral for financial transactions. In many ways U.S. Treasury securities are the underpinning of the world financial system…[and] delays in raising the debt limit can create uncertainty in the Treasury market."

THE RISKS ARE REAL

- **Crossing the X Date would be <u>unprecedented</u>.**
- **Potential for significant market disruption.**
  - GAO: "Disruptions in the financial sector due to [a] debt limit impasse could ultimately result in…increased costs for providing credit in the economy, either through increases in interest rates or in transaction costs. Consequently, lending in the economy may be reduced, and loans may become more costly. Reducing availability of capital may translate into lower levels of economic activity and growth."
- **The worst-case scenario would be a Treasury auction that fails to attract enough buyers to roll over maturing U.S. government debt.**

Source: Government Accountability Office Audit of the U.S. Government's Consolidated Financial Statements for Fiscal Years 2013 and 2014

THE RISKS ARE REAL

- **Further rating agency downgrades are possible.**
  - S&P downgraded U.S. government debt in 2011. Market reaction at the time was thankfully not severe. But there is uncertainty about the effects of another downgrade, since many funds are prohibited from holding non-AAA securities.
  - Fitch: *"Arrears on [various federal government] obligations would not constitute a default event from a sovereign rating perspective but very likely prompt a downgrade even as debt obligations continued to be met."*
    - **Translation:** If we go past the X Date without a debt limit increase, prepare for a downgrade.

- **Treasury Secretary Janet Yellen on crossing the X Date:**

  "Failing to increase the debt limit would have absolutely catastrophic economic consequences. It would precipitate a financial crisis. It would threaten the jobs and savings of Americans—and at a time when we're still recovering from the Covid pandemic."

THE RISKS ARE REAL

- **The Federal Reserve has previously considered how to respond to a default, with the likely impact ranging from damaging to catastrophic.**

  - The Fed has limited avenues to respond, but it could continue to transact with defaulted Treasury securities and conduct reverse repurchase operations to provide the market with clean Treasuries.
  - As a last result, the Fed would likely move defaulted securities onto its balance sheet.
  - These measures could significantly damage the credibility of the Fed and hamper its ability to respond to future crises.

> *"The institutional risk would be huge. The economics of it are right, but you'd be stepping into this difficult political world and looking like you are making the problem go away."*
>
> \- Fed Chairman Powell on purchasing defaulted securities

THE RISKS ARE REAL

- **Market risks beyond the X Date:**
  - Treasury market, interest rates
  - Equity markets (including 401(k)s, IRAs, and other pensions)
  - U.S. economy, including missed payments to businesses and individuals
  - The global financial system
- **No guarantee of the outcome; risks are risks**

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Methodology & Assumptions

BPC METHODOLOGY

- **Analyze financial data from the Treasury Department**
  - Daily Treasury Statements
  - Government Account Statements

- **Project monthly operating cash flow and change in intragovernmental debt using:**
  - Historical financial data
  - CBO analysis of spending and revenue growth
  - Adjustments for anticipated issues (e.g., extraordinary measures that become available on certain dates)
  - Adjustments for changes in revenue and spending due to COVID-19

- **Assumption:** No major shocks (e.g., new recession, natural disaster, new overseas conflict) that could materially affect government finances.

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