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# Debt-Limit Update: New Budget Committee and Treasury Forecasts

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## A Debt-Limit Primer

A number of factors put a check on federal government spending, including the debt limit, which is the least appreciated constraint. Given that the government is moving toward another debt-limit debate later this fall, this *Budget Bulletin* reviews the bones and mysteries of this fiscal regulator.

The debt limit is the maximum dollar amount in debt that the U.S. Department of the Treasury can issue to the public and to other federal government entities combined. This limit is created by legislation and signed into law. The U.S. Code provides the principal legal authority for the debt limit at title 31, subtitle III, chapter 31, subchapters I and II.

In February 2014, the government permitted the Treasury to issue new debt as needed until March 15, 2015, after which time no additional debt could be incurred. The amount borrowed during this so-called debt-issuance-suspension period was added to the previous debt limit of $17.212 trillion to set the new limit of $18.113 trillion (the Temporary Debt Limit Extension Act, Public Law 113-83, February 15, 2014).

By statute, the Treasury counts toward the limit nearly all debt issued to the public and intragovernmental holdings, with publicly held debt clearly representing the largest portion. As of July 31, 2015, marketable and nonmarketable debt that is subject to the limit and held by the public equaled $13.120 trillion. Of this amount, the public held $8.3 trillion in Treasury notes with a maturity date of between 2 and 10 years.

The other part of the debt that counts toward the limit is intragovernmental holdings, which the Treasury has incurred largely by borrowing from trust funds. The government automatically converts surpluses of the funds into loans to the Treasury for use in other activities. For example, the Social Security Old-Age and Survivors Insurance trust fund has loaned the Treasury $2.782 trillion, and the civil service retirement and disability fund holds an IOU from Treasury of $719 billion. As of July 31, 2015, this sum of all intragovernmental holdings subject to the debt limit equaled $4.992 trillion.

**Debt-Issuance Suspension and "Extraordinary Measures"**

Readers can see that the sum of publicly held and intragovernmental debt is dangerously close to the debt limit. Indeed, that sum is $18,112,975,000,000, just $25 million below the limit. While that appears too close for comfort, Treasury has been functioning with a $25 million margin since March of this year. How has it performed this seeming fiscal magic? Accounting tools: Treasury can continue to pay all its bills with that small cushion, even without higher borrowing authority, by using "extraordinary measures."

Extraordinary measures are financial tools developed by Treasury that allow the department to pay the bills while the government considers raising the debt ceiling. These devices delay payment of certain obligations, giving Treasury "headroom" under the limit. How much headroom does Treasury need? That depends on the cash flow it requires each month that would otherwise have been supplied by issuing debt. The average amount of debt increased by $63 billion between 2013 and the beginning of 2015, but that average has fallen to $33 billion per month in 2015 thanks to stronger revenue growth this year than in the past two. This lower borrowing rate means extraordinary measures go further than in past debt-issuance-suspension periods.

Even so, the total produced by the special accounting instruments from March through the end of this year likely will be less than $200 billion. Thus, the current Budget Committee forecast is for extraordinary measures to be completely exhausted between the end of October and the middle of November, depending on the expected flow of revenues and outlays.

A comprehensive statement regarding extraordinary measures is found in an April 4, 2011, letter from Treasury Secretary Timothy Geithner to the Senate and House leadership. The four principal extraordinary measures are:

- **Suspend the issuance of State and Local Government Series (SLGS) Treasury securities.** This action preserves, rather than creates, headroom under the limit, since the issuance of these securities would become a liability of the Treasury and count under the debt limit. Treasury issued an average of $9 billion in SLGS securities each month in 2014.

- **Declare a debt-issuance-suspension period and take certain actions in the civil service retirement and disability fund and the Postal Service retiree health benefits fund.** Once the secretary of the Treasury determines that the debt limit has been reached, he or she is empowered by statute to cease issuing Treasury securities in exchange for retirement fund investments. This action preserves headroom. In addition, the secretary can redeem certain existing investments, which provides cash for Treasury operations. The Congressional Budget Office reported in August 2015 that Treasury issues about $2 billion in securities each month to these funds, that interest and amortization payments on the unfunded liabilities of the civil service fund will equal $36 billion on September 30, 2015, and that semiannual interest payments are about $15 billion. The next payment is due at the end of this year.
- **Suspend daily investment of the Thrift Savings Plan (TSP) G Fund.** The G Fund is one of the TSP funds in which federal employees can invest a portion of their salaries. The fund invests in Treasury securities that count against the debt limit. Congress has empowered the secretary of the Treasury to suspend reinvestment of all or part of the G Fund when investment of the fund would cause the debt limit to be breached. This suspension immediately creates headroom under the limit, and federal employees are made whole after the government raises the debt limit. Treasury has been reducing these reinvestments since February, when the monthly total stood at $193.9 billion. The department can suspend the remaining $40.2 billion posted in July for additional room under the limit.
- **Suspend daily investments in the Exchange Stabilization Fund (ESF).** Treasury uses the ESF fund to clear its transactions in foreign currencies. The dollar balances in the fund are held in securities that mature each day. Suspension of the daily balance of $23 billion immediately creates that much headroom under the debt limit.

**Timing of Action to Raise the Limit**

These and a small number of other special accounting tools have allowed Treasury to pay the government's bills and to service federal debt for many months. Still, there is a growing likelihood that between the end of October and the middle of November, extraordinary measures will become insufficient to maintain payments, requiring government action. This forecast depends on no large, unexpected bills coming due and no sudden drop in the flow of revenues occurring in the meantime. To confirm this outlook, Treasury Secretary Jacob Lew sent a letter to congressional leaders on October 1 cautioning that the department "is likely to exhaust its extraordinary measures on or about Thursday, November 5."

New research from academics and the Government Accountability Office strongly indicates that the movement toward expiration is accompanied by an increase in the government's cost of issuing new debt. It works this way: Securities brokers and money-market managers constantly create financial products that include relatively risk-free Treasury bills, notes, and bonds. These Treasury products serve as collateral or hedges in transactions that require an asset whose value

is little affected by risk. For financial products that mature in or near the time when the federal government might not be able to pay all its bills, the Treasury asset no longer appears risk-free. Because it no longer has a more-or-less-certain value, brokers search for something else to anchor their products. As a result, the demand for Treasury products falls, and the yield that Treasury must guarantee buyers rises. This dynamic increases the costs to the Treasury, thus aggravating the nation's fiscal condition.

These costs stem solely from the mere threat of default, but there are additional potential costs to be considered from an actual failure of the Treasury to service its debt or to pay its bills. The only Treasury default of the past 100 years, a technical default from late April through early May of 1979, demonstrates the risks involved. Word processing equipment at Treasury failed in mid-April of that year, which prevented the payment of interest on Treasury securities maturing at the end of the month. This purely technical default led to a 60-basis-point increase in Treasury interest rates, which lasted for nearly a year after the resumption of interest payments.

It is nevertheless reassuring that Treasury has so many debt-limit tools at its disposal and so much experience using them. As a result, U.S. citizens and foreign observers can be reasonably certain that every measure will be taken to pay the country's bills on time. Indeed, the United States has a near-perfect record doing so even when borrowing authority has expired.