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A Binding Debt Limit: Background and Possible Consequences

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SUMMARY

In September 2024, gross federal debt was about $35.3 trillion. Debt limit episodes have been a recurring feature of federal fiscal policy since 2001, when federal budget deficits returned after four years of surpluses. The main statutory debt limit covers nearly all—99.9%—of federal debt. Persistent federal deficits imply that federal debt and its statutory limit will remain a recurrent issue for Congress. The Fiscal Responsibility Act (P.L. 118-5) suspended the debt limit through January 1, 2025. The following day, the limit will be reset.

When the Treasury Secretary cannot issue special Treasury securities to certain federal retirement accounts, she may invoke statutory authorities to use *extraordinary measures*. The U.S. Treasury's headroom under the debt limit—meaning remaining borrowing capacity, extraordinary measures, and cash balances—has usually allowed it to meet federal obligations for several months after the invocation of those authorities. Extraordinary measures essentially convert debt subject to the statutory limit into implicit IOUs that are not subject to the limit. After the 1985 debt limit episode, a 1986 law formalized those authorities.

During the 1995-1996, 2011, and 2013 episodes, the prospect that Treasury's headroom could be exhausted—resulting in a binding debt limit—and that Treasury would be left unable to pay all of its obligations on time caused serious concerns in financial markets. This report analyzes possible consequences of a binding debt limit and possible policy options. A binding debt limit is distinct from an appropriations lapse that would leave federal agencies without the legal authority to commit funds to carry out their operations. If cash balances and funds available through extraordinary measures were exhausted, then the debt limit would bind. Treasury could then no longer issue new federal debt nor pay all federal obligations on time. Some state governments have delayed payments when under extreme fiscal pressure. Payment delays impose involuntary borrowing upon creditors, contractors, grantees, and others. Past Treasury officials expressed doubt that federal financial operations could transition to a regime of payment delays.

During the 2011 and 2013 debt limit episodes, Treasury, Federal Reserve, and other federal financial regulatory officials engaged in contingency planning exercises to simulate operations and decisionmaking during a binding debt limit event. Federal Reserve officials also developed draft circulars and draft communications that might have been deployed. Some communications from Treasury officials stressed that principal and interest payments on federal securities would be paid. CRS, however, is not aware of evidence that Treasury or White House officials have approved contingency plans or the official issuance of action plans to prioritize certain payments. Financial organizations have also explored such scenarios.

An Administration may possess some fiscal tools to delay or prioritize federal outlays during times of extreme fiscal stress, such as a binding debt limit. The Impoundment Control Act of 1974 (ICA; P.L. 93-344) authorizes the President, the Office of Management and Budget (OMB), or an agency head to impound—that is, to preclude obligation or expenditure of budget authority in some circumstances. For instance, deferral—the temporary withholding or delaying of the obligation or expenditure of budget authority—is one form of impoundment that might slow the pace of federal outlays. The ICA, among other restrictions, generally bars the use of discretion to effect "policy" impoundments. OMB's process of apportionment—the release of budget authority to federal agencies—also might help delay or prioritize spending. During the 1995 debt limit episode, the Clinton Administration reviewed legal authorities to use these budgetary tools, but reached no firm conclusions.

A binding debt limit that led to federal payment delays or failures to pay principal and interest on Treasury securities could disrupt financial markets, which in turn could affect economic activity more broadly. Treasury securities play a central role in repo lending, which major financial institutions use to reallocate liquidity. Repo—short for repurchase agreements—was a key transmission channel of financial stress during the 2007-2009 financial crisis. Some economists estimate that payment delays caused by a binding debt limit would seriously damage the financial markets and the U.S. economy.

The definition of a federal *default* has become contentious. Some have suggested that Treasury could avoid default by prioritizing some payments and delaying others. Others contended that such a strategy would raise serious legal and operational difficulties. Members have introduced several bills over the past decade to prioritize some categories of federal spending during a binding debt limit event. Other proposals would change the structure of the debt limit or eliminate it completely. Some would allow the President to raise the debt limit, subject to a resolution of disapproval. In any case, Article I of the Constitution, which establishes the legislative power of the purse, places the ultimate responsibility for maintaining the federal government's creditworthiness in Congress's hands.

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Introduction

Over the past few decades, when federal debt has approached its statutory limit and Congress has indicated reluctance to modify, concerns have arisen that the debt limit might hinder the U.S. government's ability to meet its financial obligations. This report examines the consequences of federal debt reaching its statutory limit.

First, the report explains the federal government's debt structure, federal debt management, and administrative measures available to policymakers. The report then reviews historical events in which the prospect of a binding debt limit became salient. The report also describes financial tools available to the U.S. Treasury when federal debt is near its limit and what *could* happen if Treasury exhausted its capacity to issue debt, its cash balances, and resources available through extraordinary measures. The U.S. Treasury would then have to rely on incoming receipts or other sources of funds to meet federal obligations, while delaying at least some payments.[1] Payment delays or disruptions of markets in Treasury securities could adversely affect government operations as well as the functioning of financial markets and the economy. Finally, this report briefly considers the future relationship between fiscal policy and the debt limit. An appendix describes interactions of the Social Security trust funds and the Treasury.

The Bipartisan Budget Act of 2019 (BBA 2019; P.L. 116-37; H.R. 3877), enacted on August 2, 2019, suspended the debt limit until July 31, 2021. The limit was raised by $480 billion on October 14, 2021 (P.L. 117-50) and raised again in December 2021 by $2.5 trillion (P.L. 117-73) to its current level of just under $31.4 trillion. The Fiscal Responsibility Act (FRA; P.L. 118-5) suspended the debt limit through January 1, 2025. On the following day, the limit will be reinstated and raised to a level that accommodates the net increase in Treasury debt since enactment of the FRA.[2] Following past practice, the Treasury Secretary would then invoke authorities to use extraordinary measures to meet federal obligations.

Some Definitions

Defining terms related to the debt limit in a consistent way can help avoid ambiguity. Key terms are defined below:

- The *statutory debt limit* (31 U.S.C. §3101) requires that the total face value of debt obligations backed by the U.S. government not exceed an amount set by law. The statutory debt covers about 99.9% of federal debt.[3] Debts of a few other

[1] U.S. General Accounting Office (now the Government Accountability Office and hereinafter GAO), *Debt Ceiling: Analysis of Actions During the 2003 Debt Issuance Suspension Periods*, GAO-04-526, May 2004.

[2] FRA, §401(b). Also see discussion on the interpretation of this clause in the section below on "Suspensions and Limits on Treasury Cash Balances."

[3] Treasury currently defines "Total Public Debt Subject to Limit" as "the Total Public Debt Outstanding less Unamortized Discount on Treasury Bills and Zero-Coupon Treasury Bonds, old debt issued prior to 1917, and old currency called United States Notes, as well as Debt held by the Federal Financing Bank and Guaranteed Debt." Approximately 0.1% of total federal debt is not subject to the debt limit. See Office of Management and Budget (OMB), *FY2020 Budget*, *Analytical Perspectives*, ch. 4, pp. 36-41. Treasury bills, which have a maturity of a year or less, are sold on a discount basis. When a Treasury bill is issued and sold, the purchase price differs from the face value, that is, the amount redeemed upon maturity. The difference between the purchase price and the face value—the discount—serves as an interest payment to the purchaser. How the debt limit statute accounts for those discounts depends on whether the purchaser can redeem the bill before its maturity.

federal agencies, such as the Tennessee Valley Authority (TVA) and the Federal Financing Bank (FFB), are subject to separate limits.[4]

- The debt limit has been *suspended* several times since 2013. In those cases, a law specifies that the statutory debt will not apply until a given date, when the limit will be reinstated at a level to accommodate borrowing during the suspension.
- The Treasury Secretary can declare a *debt issuance suspension period* (DISP) by notifying Congress that she has invoked authorities to use *extraordinary measures* when the debt limit begins to hinder Treasury's ability to issue debt securities to the Civil Service Retirement and Disability Fund (CSRDF) or the Postal Service Retiree Health Benefit Fund (PSRHBF).[5]
- The declaration of a DISP is here considered to start a *debt limit episode*.
- Extraordinary measures give Treasury access to financial resources that add to its *headroom* under the debt ceiling—defined as unused borrowing capacity, cash balances, and amounts made available through extraordinary measures.[6] *Extraordinary measures* can keep the debt limit from binding for several months.
- The Treasury Secretary has other authorities, such as suspending the issuance of State and Local Government Series securities, using U.S. dollar balances of the Exchange Stabilization Fund (ESF), and exchanging securities with the Federal Financing Bank.
- If Treasury's headroom were to shrink to zero, it would face a *binding debt limit*.

The Structure of Federal Debt

In September 2024, gross federal debt was about $35.3 trillion. The structure of federal debt affects how Treasury manages federal debt and can affect the timing of critical points in debt limit episodes. Federal debt can be divided into *debt held by the public* and *intragovernmental debt*.

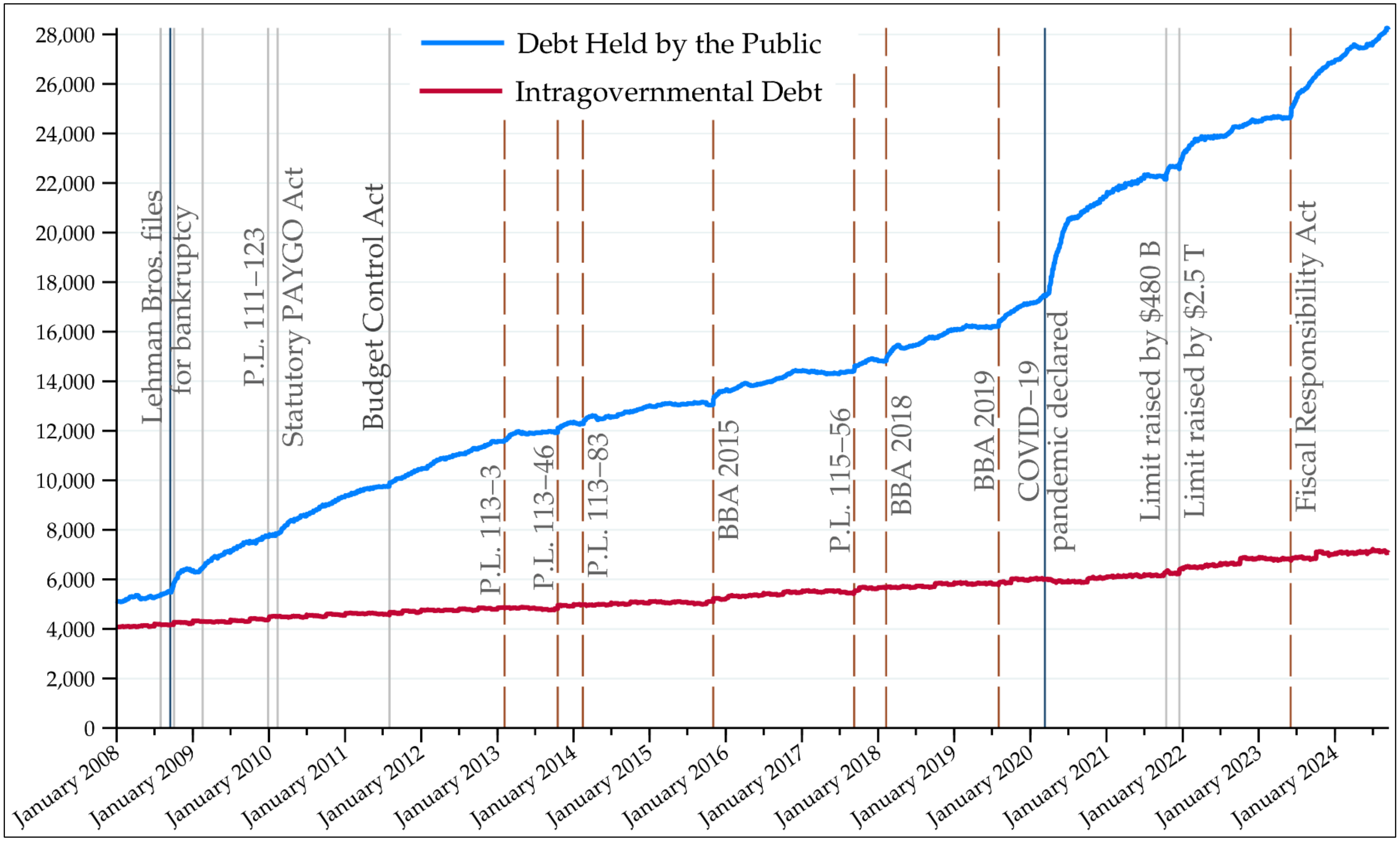
Figure 1 shows trends in both debt categories since 2006. **Figure 2** shows the structure of federal debt at the end of December 2022 and highlights funds linked to extraordinary measures.

[4] FFB debt is limited to $15 billion, and TVA debt is limited to $30 billion. See OMB, *FY2025 Budget, Analytical Perspectives,* ch. 21, pp. 262-263.

[5] 5 U.S.C. §8348(j). Related extraordinary measures are described below. Treasury is able to create the most headroom through use of CSRDF-related extraordinary measures.

[6] The frequency of debt limit episodes in the past two decades has led some to suggest that the word "extraordinary" in the term *extraordinary measures* is less than fully descriptive.

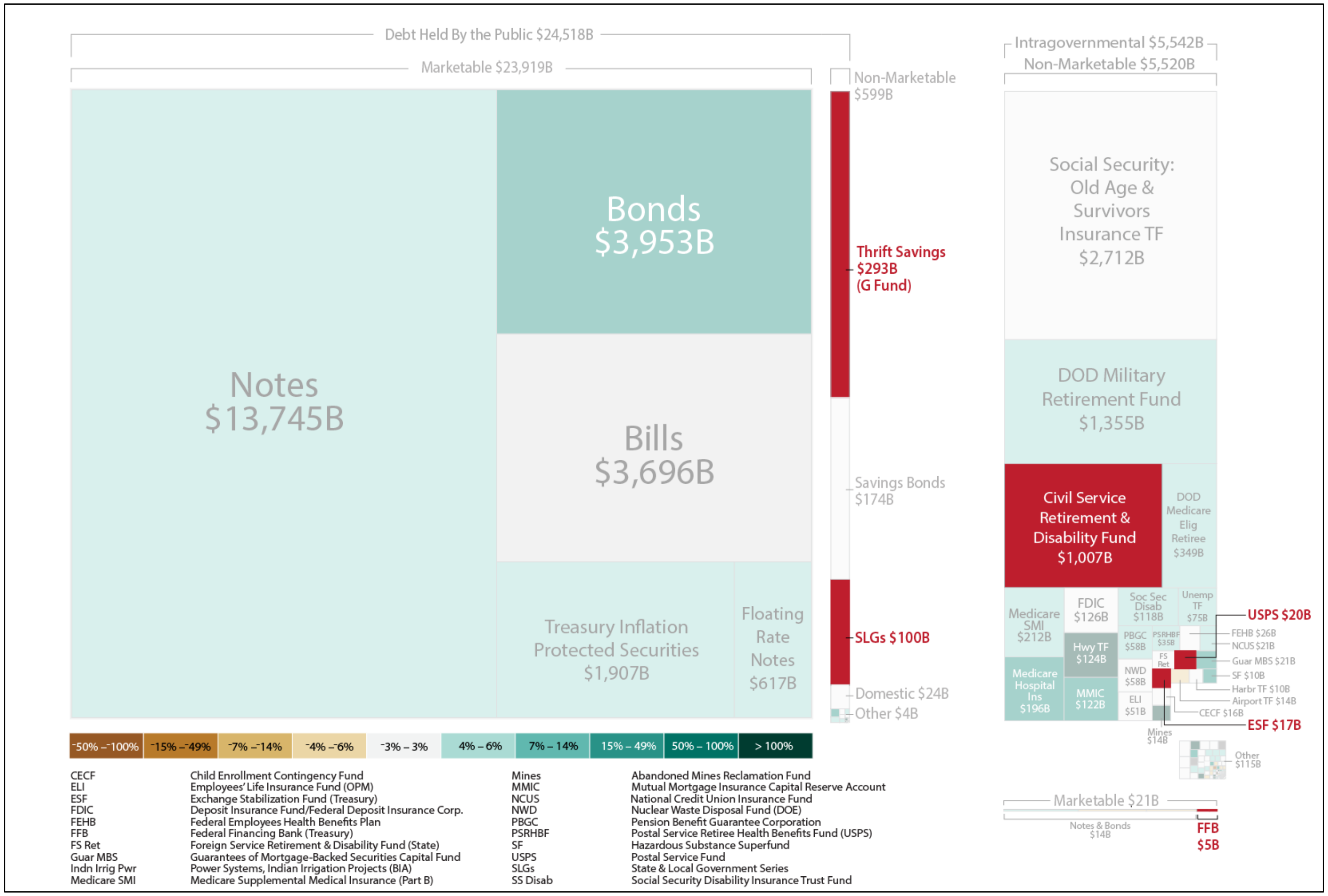
Figure 1. Federal Debt, 2006-2024, in $Billions



Source: CRS calculations based on *Daily Treasury Statement* data.

Notes: During the 2007-2009 financial crisis, the debt limit was raised five times. The Budget Control Act of 2011 was used to raise the debt limit three times. The start dates of debt limit suspensions are indicated with vertical dashed lines.

Figure 2. Federal Debt Linked to Extraordinary Measures, December 2022



Source: Areas are proportionate to amounts of debt outstanding. Blue/green areas have increased since December 2019; tan/brown areas have decreased. Treasury bills mature in one year or less. Notes have maturities of 1 to 10 years. Bonds have maturities over 10 years. Savings Bonds item includes other savings securities.

Notes: CRS calculations based on U.S. Treasury data available at https://fiscaldata.treasury.gov/static-data/published-reports/mspd-entire/MonthlyStatementPublicDebt_Entire_202212.pdf.

Intragovernmental Debt

Treasury also issues special Treasury securities to various federal trust funds and other accounts that are subject to the debt limit. Debt held in government accounts, known as *intragovernmental debt*, totaled $7.2 trillion in July 2024.[7] Federal debt issued to trust funds accounts for the bulk of that debt. Those trust funds include those associated with Social Security, Medicare, Unemployment Compensation, federal retirement, and many smaller trust funds. Other government accounts not classified as trust funds also hold smaller amounts of federal debt.[8] Nearly all—over 99.9%—of intragovernmental debt is nonmarketable and thus cannot be sold or traded.

Trust funds' special Treasury securities accrue interest, which is paid at set intervals in the form of additional special securities. Interest payments for large trust funds, such as the Social Security trust funds, can present challenges to Treasury's debt management operations during debt limit episodes, as those special securities are subject to the debt limit.

Debt Held by the Public

Treasury sells debt securities to obtain cash to fund annual deficits and expansions of the government's portfolio of loans, such as those provided to farmers and students, as well as to roll over old debt—that is, to retire old debt using proceeds of new debt issues.[9] The total of debt sold outside of the federal government is known as *debt held by the public*. In September 2024, that amounted to $28.2 trillion, including about $4.4 trillion in Treasury securities purchased by the Federal Reserve on secondary markets.[10] Over 97% of debt held by the public is issued by Treasury through auctions run with the help of the Federal Reserve Bank of New York, which acts as the federal government's fiscal agent.[11]

Trust Fund Programs that Run Surpluses Lend to the Treasury

When a trust fund or similar account collects more in payroll taxes, contributions, and other revenues than it pays out in benefit payments and other outlays, that surplus is invested in special Treasury securities.[12] When a trust fund surplus is exchanged for a Treasury security, that fund effectively lends money to the rest of the government.[13] That implicit lending reduces what the federal government must borrow from the public.

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[7] U.S. Treasury, *Daily Treasury Statement*, September 17, 2024, https://fiscaldata.treasury.gov/static-data/published-reports/dts/DailyTreasuryStatement_20240917.pdf.

[8] OMB, *FY2025 Budget, Analytical Perspectives*, Table 21-5, https://www.whitehouse.gov/wp-content/uploads/2024/03/ap_21_tables_fy2025.xlsx.

[9] For details, see OMB, *FY2025 Budget, Analytical Perspectives*, Table 21-2, https://www.whitehouse.gov/wp-content/uploads/2024/03/ap_21_borrowing_fy2025.pdf.

[10] Board of Governors of the Federal Reserve System, "Assets: Securities Held Outright: U.S. Treasury Securities: (TREAST)," https://fred.stlouisfed.org/series/TREAST. Also see U.S. Treasury, *Daily Treasury Statement*, https://fiscaldata.treasury.gov/datasets/daily-treasury-statement/operating-cash-balance.

[11] U.S. Treasury, *Monthly Statement of the Public Debt*, June 2024, https://fiscaldata.treasury.gov/static-data/published-reports/mspd-entire/MonthlyStatementPublicDebt_Entire_202406.pdf.

[12] GAO, *Federal Trust and Other Earmarked Funds Answers to Frequently Asked Questions*, GAO-01-199SP, January 2001, pp. 17-18. Most trust funds and special funds receive interest payments, although exceptions exist. A few funds can invest in marketable Treasuries and private-sector securities, although those holdings are relatively small.

[13] More precisely, revenues are collected by the Treasury General Fund and the relevant trust fund is credited with a special Treasury security of equivalent value. OMB, *FY2024 Budget, Analytical Perspectives*, pp. 259, (continued...)

When benefit payments exceed payroll and other revenues, a trust fund runs a deficit and the process outlined above is reversed. Fund holdings of Treasury securities are exchanged for cash to pay outlays, which reduces the stock of federal debt. To supply a fund with cash to pay outlays, however, Treasury must obtain funds through borrowing from the public or from a surplus of revenues over outlays. The **Appendix** details how Treasury debt operations interact with Social Security trust funds.

Debt and Cash Management

Treasury manages the issuance and redemption of bills, notes, and other securities to ensure that federal obligations can be met in a timely and efficient manner.

Day-to-Day Treasury Operations

At the start of each business day, Treasury officials find receipts in Treasury's Federal Reserve accounts and have a set of scheduled payments to make.[14] Payroll taxes and other earmarked receipts are credited to federal trust funds through issuance of special Treasury securities. Social Security beneficiaries, federal salaries, and military contractor payments are typically paid on a set monthly routine. The Treasury auctions securities when it needs to increase its cash balances. Maturing securities or scheduled interest (coupon) payments to bondholders are financed using cash balances or by rolling over maturing debt into new Treasury securities.[15]

Structuring Federal Debt to Minimize Debt Service Costs

Modern debt management aims to pay obligations on time while minimizing borrowing costs and mitigating various risks.[16] Short-term debt securities, such as Treasury bills, are generally cheaper to issue and provide greater flexibility. Longer-term debt securities, such as Treasury notes, generally carry higher yields, but help ensure that future debt service costs remain stable.[17] Cash management bills, which can be issued on less than a week's notice, provide the Treasury with a more flexible, albeit more expensive, debt instrument to buffer short-term fluctuations.[18]

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https://www.whitehouse.gov/wp-content/uploads/2023/03/ap_22_funds_fy2024.pdf. Trust fund assets are generally held in the form of special Treasury securities. The National Railroad Retirement Investment Fund, which holds some equity securities, is an exception.

[14] The *Daily Treasury Statement* provides a summary of Treasury cash balances, receipts, payments, and debt totals every business day. U.S. Treasury, *Daily Treasury Statement*, https://fiscaldata.treasury.gov/datasets/daily-treasury-statement/operating-cash-balance. Click on "Published Reports" link to download most current *Statement*.

[15] Agencies other than the U.S. Treasury have issued a relatively small amount of federal debt.

[16] See International Monetary Fund and the World Bank, *Guidelines for Public Debt Management*, March 21, 2001, http://www.imf.org/external/np/mae/pdebt/2000/eng/. Some economists have argued that Treasury debt management objectives should include macroeconomic aims, so that Treasury debt policy decisions would not offset Federal Reserve debt portfolio strategies intended to aid economic recovery. Treasury officials have declined to embrace that approach. See Robin Greenwood et al., *Government Debt Management at the Zero Lower Bound*, Brookings Institution working paper, September 30, 2014, https://www.brookings.edu/wp-content/uploads/2016/06/30_government_debt_management_zlb.pdf.

[17] Treasury bills typically have maturities of less than one year. Treasury notes have maturities that range from 2 years to 10 years. When short-term Treasuries carry higher yields than longer-term debt, the yield curve (which plots yields against maturities of various Treasuries) is said to have inverted, which many macroeconomists regard as a harbinger of an economic downturn.

[18] GAO, *Treasury Has Refined Its Use of Cash Management Bills but Should Explore Options That May Reduce Cost Further*, GAO-06-269, March 30, 2006, https://www.gao.gov/products/GAO-06-269.

Treasury's choice of debt structure also reflects demand-side preferences.[19] Investors are willing to pay more for a mix of short- and long-term securities that matches their own financial needs. Higher prices at federal debt auctions imply lower yields and debt servicing costs.

Uncertainties that might unsettle financial markets reduce bidders' willingness to pay for securities. Treasury has therefore sought to issue Treasury bills and notes on a "regular and predictable" schedule to reduce uncertainty about the supply of securities and their terms.[20] During debt limit episodes, however, maintaining a regular and predictable schedule of debt issuance, particularly for short-term bills, becomes more challenging.[21] Treasury then typically relies more heavily on cash management bills, which are not issued on a set auction schedule.

Fluctuations in Federal Revenues and Outlays

Federal debt levels fluctuate throughout the year, reflecting the separate timing of revenues and outlays, whether or not the government has an annual surplus or deficit. On some days revenues that Treasury collects exceed outlays, particularly near dates when taxes are due. Given substantial federal deficits, however, outlays more often exceed revenues. The timing of tax collections, outlays, and interest payments to large federal trust funds affects the timing of debt limit episodes.

Treasury personnel use predictions of outlay and revenue flows, debt instruments, and cash management strategies to ensure that financial resources are sufficient to meet obligations and possible contingencies, while minimizing borrowing costs.[22] While payroll and benefit payments are largely predictable, other flows, such as tax payments, are harder to estimate in advance.

How Much Cash Does Treasury Need?

Aside from seasonal fluctuations in outlays and receipts, Treasury's debt and cash management strategies also must plan for emergencies. Carrying higher cash balances gives Treasury greater capacity to operate normally in the face of emergencies, but requires issuing additional debt and higher debt service costs. The U.S. Government Accountability Office (GAO) and the Treasury's outside advisors have noted the benefits of preparing for severe adverse events. The possibility exists that during a debt limit episode Treasury's typical cash and debt management tools could be restricted, narrowing its ability to respond to contingencies.[23]

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[19] Extreme market conditions may also affect Treasury's cash management strategies. See Paul J. Santoro, "The Evolution of Treasury Cash Management during the Financial Crisis," *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, vol. 18, no. 3 (2012), https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci18-3.pdf.

[20] Kenneth D. Garbade, "The Emergence of 'Regular and Predictable' As a Treasury Debt Management Strategy," *Economic Policy Review*, Federal Reserve Bank of New York, vol. 13, no. 1 (March 2007), https://www.newyorkfed.org/medialibrary/media/research/epr/07v13n1/0703garb.pdf.

[21] For example, GAO found that the reduction of Treasury cash balances ahead of the end of debt limit suspensions disrupted markets in short-term Treasury securities. See GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 2015, http://www.gao.gov/products/GAO-15-476.

[22] See U.S. Treasury, Office of Inspector General, *Response by the Chair of the Council of Inspectors General on Financial Oversight and Inspector General of the Department of the Treasury*, OIG-CA-12-006, August 24, 2012, https://oig.treasury.gov/sites/oig/files/Audit_Reports_and_Testimonies/Debt%20Limit%20Response%20(Final%20with%20Signature).pdf. The report stated that, according to the Treasury, "the margin of error in these estimates at a 98% confidence level is plus or minus $18 billion for 1 week into the future and plus or minus $30 billion for 2 weeks into the future."

[23] The following section, which discusses a 2021 legal opinion, treats those concerns in more detail.

A 2006 GAO report, noting disruptions caused by the attacks of September 11, 2001, recommended that Treasury consider implementing two levels of emergency financing facilities. A line of credit with "appropriate financial institutions" and the ability to make private sales of cash management bills would provide a first level of funding. New statutory authority to authorize the Federal Reserve to lend directly to the Treasury during a wide-scale disruption would serve as a backup funding facility and a second level of emergency funding.[24]

In May 2015, following recommendations of the Treasury Borrowing Advisory Committee, Treasury chose to maintain higher cash balances.[25] That prudential measure was intended to ensure that Treasury could meet federal obligations even if its market access were disrupted for a week or so. Then-Treasury Secretary Jacob Lew noted that an event of the scale of "Hurricane Sandy, September 11, or a potential cyber-attack disruption" might cause a lapse in market access.[26] If Treasury's cash balances during the later stages of a debt limit episode were at minimal levels, unforeseen contingencies might present challenges to federal financial operations. After 2015, outside of debt limit episodes, cash balances often remained in the $300 billion to $400 billion range, as shown in **Figure 3**.[27]

Just after the March 2020 COVID-19 pandemic declaration, then-Treasury Secretary Steven Mnuchin raised cash balances to unprecedented levels to allow rapid disbursement of CARES Act (P.L. 116-136) payments. Cash balances later fell, but have since mostly remained above pre-pandemic levels, apart from debt limit episodes. In the late stages of a debt limit episode, Treasury's cash balances can fall to relatively low levels. On Friday, June 2, 2023—the day before enactment of the Fiscal Responsibility Act (P.L. 118-5), which closed that debt limit episode—Treasury's cash balances stood at $23 billion.[28]

This cash management policy of maintaining higher cash balances does not by itself affect the date when a fixed debt limit might constrain Treasury's ability to meet federal obligations because a $1 increase in cash balances is counterbalanced by a $1 decrease in remaining borrowing capacity under the debt limit.

[24] GAO, *Debt Management: Backup Funding Options Would Enhance Treasury's Resilience to a Financial Market Disruption*, GAO-06-1007, September 26, 2006, http://www.gao.gov/cgi-bin/getrpt?GAO-06-1007. A World War II-era authority that allowed the Federal Reserve to make limited emergency loans to the Treasury expired in 1981.

[25] U.S. Treasury, "Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association," May 6, 2015, https://home.treasury.gov/news/press-releases/jl10043.

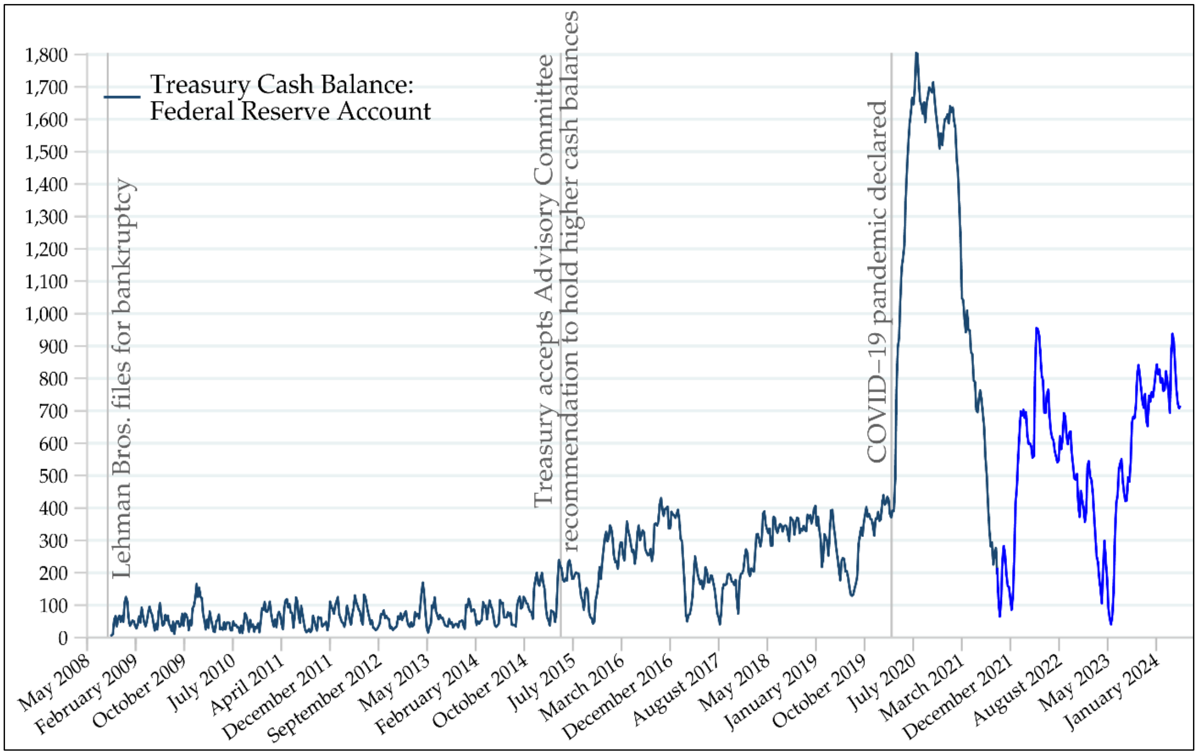
[26] Treasury Secretary Jacob Lew, letter to House Speaker John A. Boehner and other Members of Congress, September 10, 2015, https://home.treasury.gov/system/files/276/Treasury-Letter-to-Congress-091015.pdf.

[27] The rebuilding of Treasury's cash balances following a debt limit episode presents another policy issue. After the 2019 debt limit episode concluded, the replenishment of Treasury's cash balances, in combination with other events, arguably contributed to strains in financial market liquidity. In late September 2019, rates for overnight repo borrowing, a key liquidity channel for major financial institutions, briefly rose from just over 2% to 10%, before the Federal Reserve acted to restore normal levels of liquidity. Treasury's replenishment of cash balances after a mid-December 2021 debt limit increase (P.L. 117-73), however, had no apparent effect on overnight borrowing rates. See Cale Tilford et al., "Repo: How the Financial Markets' Plumbing Got Blocked," *Financial Times*, November 26, 2019, https://ig.ft.com/repo-rate/.

[28] U.S. Treasury, *Daily Treasury Statement*, June 2, 2023, https://fiscaldata.treasury.gov/static-data/published-reports/dts/DailyTreasuryStatement_20230602.pdf.

Figure 3. Treasury Cash Balances, October 2008-June 2024

$Billions of current dollars



Source: CRS calculations based on *Daily Treasury Statement* data: https://fiscal.treasury.gov/reports-statements/dts/index.html. Data formats changed after April 15, 2022 (blue line).

Notes: Earlier data exclude certain other smaller cash assets, such as Tax and Loan accounts.

Suspensions and Limits on Treasury Cash Balances

If cash balances were elevated while a debt limit suspension were in effect, however, that could extend the time that Treasury could continue to meet federal obligations after the lapse of the suspension and the subsequent reset of the debt limit. For that reason, since Congress began using the debt-limit-suspension approach in 2013, several debt limit suspensions have included provisions designed to limit Treasury's cash balances.[29] For instance, the Fiscal Responsibility Act of 2023 (P.L. 118-5, §401(c)) stated that

> [t]he Secretary of the Treasury shall not issue obligations during the [suspension] period … for the purpose of increasing the cash balance above normal operating balances in anticipation of the expiration of such period.

That provision is paired with a requirement that

> An obligation shall not be taken into account [in determining the new debt limit after the suspension lapses] unless the issuance of such obligation was necessary to fund a commitment incurred pursuant to law by the Federal Government that required payment before January 2, 2025 [i.e., the day after the debt limit suspension lapses].

Those provisions might have two aims. First, a large cash balance that accrued when the debt limit was suspended might postpone the critical date on which Treasury would no longer be able

[29] CRS Insight IN11829, *Debt Limit Suspensions*, by D. Andrew Austin.

to meet all federal obligations on time after the limit is reinstated. Such a postponement might affect negotiations among Members of Congress and the executive branch over terms of resolving a debt limit episode. Second, a larger cash balance held at the end of a debt limit suspension could lead to a higher debt limit when the limit is reset. Carrying a minimal cash balance, as noted above, could leave Treasury with limited means to respond to emergencies and uncertainties.

A 2021 Department of Justice Office of Legal Counsel (OLC) memorandum considered similar debt limit suspension provisions in the Bipartisan Budget Act of 2019 (BBA 2019; P.L. 116-37).[30] The memorandum noted that Treasury had "reduced its cash balances considerably" near the end of debt limit suspension periods. That reduction, in Treasury's view, was

> not based on any formal understanding that a statute required this result, but rather on an 'informal view' that a higher cash balance might be 'construed to suggest that Treasury had issued …. securities that were not necessary to fund commitments that required payment before the debt limit was reimposed.[31]

Treasury, however, was concerned that reducing cash balances in 2021 would "would carry significant and unprecedented risks" related to the COVID-19 pandemic. OLC concluded that "Treasury may fairly anticipate uncertainty and commit a prudential buffer of funds to meet the government's future obligations. We thus agree with [Treasury's] view that issuing debt pursuant to Treasury's prudential cash practices is a funding of 'commitments.'"[32] Moreover, the OLC held that the BBA 2019 debt limit provisions did not "prevent Treasury from applying to the forthcoming debt limit the debt it plans to issue to provide a prudential buffer of funds."[33]

Debt Management During Debt Limit Episodes

When the level of federal debt nears its legal limit, Treasury faces constraints that complicate federal financial operations. During debt limit episodes, the end-of-day federal debt totals are typically held $25 million below the statutory limit—a narrow margin relative to the trillions in outstanding federal debt or the tens of billions in outlays disbursed in a typical day—until the debt limit episode is resolved.[34]

A debt limit episode heightens risks facing Treasury debt managers.[35] Preserving Treasury's ability to respond to unforeseen contingencies requires adaptations in the structure of federal debt. Treasury typically shifts debt operations toward flexible short-term instruments, such as cash management bills during debt limit episodes.[36] Debt limit episodes, according to GAO, increase demands on Treasury staffers' time and divert resources from other priorities.[37]

[30] U.S. Department of Justice, Office of Legal Counsel, *Treasury's Cash Balance and the August 1, 2021 Debt Limit*, Memorandum Opinion for the Acting General Counsel Department of the Treasury, slip opinion, July 8, 2021, https://www.justice.gov/olc/media/1346916/dl?inline.

[31] Ibid., pp. 2, 9.

[32] Ibid., pp. 12-13.

[33] Ibid., p. 2.

[34] See Table IIIC in Daily Treasury Statements issued during debt limit episodes, such as for May 4, 2023, https://fsapps.fiscal.treasury.gov/dts/files/23050400.pdf.

[35] Various GAO reports discussed below highlight increased operational and financial risks during debt limit episodes.

[36] GAO, *Treasury Has Refined Its Use of Cash Management Bills but Should Explore Options That May Reduce Cost Further*, GAO-06-269, March 30, 2006, https://www.gao.gov/products/GAO-06-269.

[37] GAO, *Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs*, GAO-12-701, July 2012, https://www.gao.gov/assets/files.gao.gov/assets/gao-12-701.pdf.

Treasury Secretary's Power to Use Extraordinary Measures

When Treasury cannot invest payroll deductions from federal civil service and postal service employees in Treasury securities without breaching the debt limit, the Treasury Secretary may declare a debt issuance suspension period to invoke authorities to use extraordinary measures.[38] Once the Treasury Secretary does so, resources of the trust funds for civil service and postal service retirement and disability benefits can be used to meet federal obligations, within certain limits. Extraordinary measures essentially convert debt subject to the statutory limit into implicit IOUs that are not subject to the limit.

Federal Retirement Funds Comprise Bulk of Extraordinary Measures

After declaring a DISP, the Treasury Secretary can use payroll deductions that would normally be invested in the CSRDF or the PSRHBF.[39] In addition, when securities held by those funds mature, funds are not rolled over into new securities, but those funds can also be used to meet other federal obligations. During a DISP, the Treasury Secretary can also redeem or sell securities held by those funds before their maturity dates, though that amount is limited to what would be needed to pay civil service benefit payments during the DISP.[40] Additional provisions enable the use of federal employees' Thrift Savings Plan (TSP) investments in Treasury securities, known as the G Fund.[41]

Underinvesting or disinvesting certain government funds provides headroom under the debt limit. By freezing or reducing CSRDF, PSRHBF, and TSP holdings of government securities—which count as intragovernmental debt subject to the debt limit—Treasury can sell more debt to the public, providing cash to pay federal obligations. Federal debt totals do not reflect what is owed to those funds, which must be paid back when a debt limit episode concludes.

Other Extraordinary Measures

The Treasury Secretary also can use some other resources to meet federal obligations during debt limit episodes, although these are much smaller in scale. The Treasury Secretary has broad authority to use dollar holdings within the Exchange Stabilization Fund[42] to pay other federal

[38] The DISP is defined in clause (j) of 5 U.S.C. §8348, which governs the CSRDF. 5 U.S.C. §8909a(c) requires that investments in the Postal Service Retiree Health Benefit Fund be administered "in the same manner."

[39] The Treasury Secretary must specify a time period for the DISP, which sets limits on the amount of funds that can be used. The DISP can be extended. See 5 U.S.C. §8348(k)(2).

[40] In a March 2019 FAQ, Treasury stated that the "PSRHBF does not have daily receipts or investments." The FAQ also estimated that the redemption of CSRDF securities for the DISP from March 4, 2019, through June 5, 2019, would generate $22 billion in headroom. U.S. Treasury, "Frequently Asked Questions on the Civil Service Retirement and Disability Fund," March 5, 2019, https://home.treasury.gov/system/files/136/CSRDF-PSRHBF-FAQs-03_05_19.pdf. CBO has estimated that suspending CSRDF investments yields about $3 billion per month. Suspending interest payments, normally paid as additional Treasury securities at the end of June and at the end of December, would yield about $13 billion in each instance. Congressional Budget Office (CBO), *Federal Debt and the Statutory Limit*, February 2019, https://www.cbo.gov/system/files/2019-02/54987-debt-limit.pdf.

[41] 5 U.S.C. §8348(h). At the end of June 2019, the G Fund had $237 billion in assets, held in short-term Treasury securities. Federal Retirement Thrift Investment Board, "June 2019 Performance Review," July 12, 2019, available as a ZIP file at https://minutes.frtib.gov/.

[42] The Gold Reserve Act (P.L. 73-87) established the Exchange Stabilization Fund and gave the Treasury Secretary broad authority over its use. See Gary Richardson, Alejandro Komai, and Michael Gou, "Gold Reserve Act of 1934," Federal Reserve History website, November 22, 2013, https://www.federalreservehistory.org/essays/gold_reserve_act.

obligations.[43] Treasury securities held by the Federal Financing Bank can be exchanged for non-Treasury securities to free up headroom under the debt limit.[44] The FFB, however, has its own debt limit of $15 billion. Given the FFB's existing debt holdings, however, this strategy in recent years could provide about $5 billion or less in headroom.[45]

Treasury Secretaries typically suspend sales of state and local government series securities (SLGs) shortly before declaring a DISP. This does not create immediate headroom under the debt limit, but avoids debt issuance that would reduce it. As outstanding SLGs mature, though, Treasury gains headroom. Recent restrictions on municipal finance have reduced the attractiveness of SLGs to state and local governments, which has reduced issuances of SLGs.[46]

After resolution of a debt episode, the Treasury Secretary must repay lost interest income to each of those funds and report to Congress and GAO on the use of extraordinary measures. GAO typically issues a report assessing Treasury's actions during the debt limit episode.[47] Those reports have noted that debt limit constraints have hindered Treasury fiscal operations and appear to have increased federal borrowing costs.[48]

Debt Limit Could Hinder Treasury Operations

When the level of federal debt nears its statutory limit, Treasury's debt management operations become subject to constraints that complicate the process of ensuring federal obligations are paid on time. GAO has found that debt limit episodes have put considerable strain on Treasury offices responsible for debt and cash management.[49] As headroom under the debt ceiling diminishes, those strains increase.

The debt limit constrains Treasury debt operations in two ways. First, the debt limit constrains issues of new debt used to manage short-term cash flows or to finance gaps between receipts and outlays. If Treasury's capacity to borrow were thus exhausted and if cash balances eroded, then the government would soon lack the cash needed to pay its bills on time. Second, the debt limit could also prevent the government from investing surpluses of designated government accounts, such as the Social Security trust funds.

When Treasury's headroom under the debt limit falls to low levels, the federal government's ability to pay its bills on time could be put at risk—as reflected in financial market reactions during some recent debt episodes.[50] As noted above, a serious external disruption in financial

[43] The ESF held $15.3 billion in Treasury debt at the end of August 2024. U.S. Treasury, *Monthly Statement of the Public Debt,* August 2024, https://fiscaldata.treasury.gov/static-data/published-reports/mspd-entire/MonthlyStatementPublicDebt_Entire_202408.pdf.

[44] GAO, letter to Rep. John J. LaFalce, October 30, 1985, https://www.gao.gov/products/438925. Note that the same GAO code (B-138524) also refers to an opinion sent to Sen. Packwood referenced elsewhere.

[45] The August 2019 *Monthly Statement of the Public Debt* reported FFB holdings of almost $9 billion. During a debt limit episode, that level of debt could provide about $6 billion in debt limit headroom through exchanges of debt with the CSRDF.

[46] CRS Report R41811, *State and Local Government Series (SLGS) Treasury Debt: A Description*, by Grant A. Driessen and Jeffrey M. Stupak.

[47] For details, see 5 U.S.C. §8348(l) and GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 9, 2015, https://www.gao.gov/products/GAO-15-476.

[48] For example, GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 2015, https://www.gao.gov/assets/680/671286.pdf.

[49] GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203, February 22, 2011.

[50] These are discussed in detail below; see "Potential Economic and Financial Effects."

markets—such as Hurricane Sandy in 2012 or the attacks of September 11, 2001—could diminish Treasury's fiscal capacity for a time. How Treasury officials would respond to disruptions during a debt limit episode is unclear.

Treasury officials have typically informed Congress, sometimes in general and at other times in more specific terms, when the debt limit might cause payment delays or disruptions.[51]

Debt Limit Could Present Treasury with Conflicting Mandates

During a debt limit episode, Treasury can deploy its cash balances and resources available through extraordinary measures to meet federal obligations when daily outlays run ahead of receipts. If the debt limit became binding—as would happen if cash balances and extraordinary measures were exhausted—then two potentially inconsistent requirements would confront Treasury. First, Treasury must pay the government's legal obligations and invest trust fund surpluses. Second, the statutory debt limit would then prevent Treasury from issuing the debt to raise cash to pay obligations or making trust fund investments.[52] While no Treasury Secretary has faced that scenario, the near prospect of such a scenario has unsettled financial markets at times.[53] The following section of this report reviews some of those episodes.

Treasury Actions in Select Debt Limit Episodes

To date, the modern debt limit has not yet prevented Treasury from paying all federal obligations. During debt limit episodes in 1985, 1995-1996, 2002, 2003, 2011, 2013, 2014, 2015, 2017, 2019, 2021, and 2023, however, Treasury took extraordinary measures to avoid reaching the debt limit and to meet the federal government's other obligations. During some episodes, bond market prices signaled concerns that the Treasury might not pay obligations on time.

In 2011 and 2013, components of the Federal Reserve System considered possible responses to a binding debt limit. The distinction between the roles of the Federal Reserve and Treasury is discussed in a later section.

This section outlines the 1985, 1995-1996, 2011, and 2013 episodes, in which significant new strategies were employed or when financial markets viewed federal payment disruptions as possible. The section also includes a brief summary of the 2021 and 2023 debt limit episodes. Some note that particularly contentious debt limit episodes have taken place when partisan control of the presidency and Congress was divided and after large increases in federal debt levels, as was the case in 1996, 2011, and 2013.[54] Other CRS products describe these debt limit episodes in more detail.[55]

[51] See CRS Report R43389, *The Debt Limit Since 2011*, by D. Andrew Austin.

[52] See generally 31 U.S.C. §§3321 et seq. for the Treasury Secretary's duty to pay obligations. Regarding trust fund investments, see, for example, 42 U.S.C. §401 (Social Security Trust Funds), 5 U.S.C. §8348 (Civil Service Retirement and Disability Trust Fund), and 5 U.S.C. §8909 (Postal Service Retiree Health Benefit Fund).

[53] See JP Morgan Chase, "The Domino Effect of a US Treasury Technical Default," U.S. Fixed Income Strategy Group Brief, April 19, 2011. Also see Fitch Ratings, "Thinking the Unthinkable—What if the Debt Ceiling Was Not Increased and the US Defaulted?," June 8, 2011.

[54] Alec Phillips and Tim Krupa, "Raising the Debt Limit: Probably Not Soon, Probably Not Easy," Goldman Sachs US Economic Analyst brief, December 5, 2022.

[55] See CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin. For a discussion of earlier debt limit increases, see out-of-print CRS Report 98-805 E, *Public Debt Limit Legislation: A Brief History and Controversies in the 1980s and 1990s*, by Philip D. Winters (available to congressional clients upon request).

Actions in 1985

Sharply rising deficits that followed tax cuts and defense-spending increases pushed federal debt close to its statutory limit in 1985. In addition, after Greenspan Commission recommendations to modify Social Security were adopted in 1983, holdings of the two Social Security trust funds of special Treasury securities—which are subject to the debt limit—grew.[56] That trend pushed federal debt toward its limit even when the federal government ran on-budget surpluses.

A debt limit episode began in September 1985 when Treasury informed Congress that federal debt had nearly reached its statutory debt limit and that the Treasury Secretary would use extraordinary measures to meet the government's cash requirements. This debt limit episode led to the formalization of some of these extraordinary measures. Treasury delayed public debt auctions and used various internal transactions involving the Federal Financing Bank.[57] The debt limit constrained Treasury from issuing new government securities to the CSRDF, the Social Security trust funds, and several smaller trust funds. Treasury also redeemed some Social Security trust funds' assets ahead of their scheduled maturity dates.[58] Premature redemption of these securities created room under the debt ceiling for Treasury to borrow enough to pay other obligations, including November 1985 Social Security benefits.[59] The debt limit was temporarily increased on November 14, 1985 (P.L. 99-155), and permanently increased on December 12, 1985 (P.L. 99-177), from $1,824 billion to $2,079 billion.

The Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177), often known as the Gramm-Rudman-Hollings Act (GRH), changed congressional budget enforcement mechanisms. In particular, GRH set targets for deficit reduction that were to be enforced by sequestration provisions.[60]

Following the 1985 debt limit crisis, Congress subsequently authorized Treasury to alter its normal investment and redemption procedures for civil service and postal service retirement and disability trust funds during a debt limit episode, but barred use of Social Security trust fund

[56] The National Commission on Social Security Reform was appointed in September 1981 and issued a report in January 1983 (see Social Security Administration, *Report of the National Commission on Social Security Reform*, January 1983, https://www.ssa.gov/history/reports/gspan.html). Commission Chairman Greenspan had led the Ford Administration's Council of Economic Advisers and later served as the chair of the Federal Reserve. Commission recommendations were incorporated into the Social Security Amendments of 1983 (P.L. 98-21; see Social Security, "Summary of P.L. 98-21," https://www.ssa.gov/history/1983amend.html).

[57] The U.S. Department of Justice (DOJ) opined that those transactions were legal. DOJ, "Transactions Between the Federal Financing Bank and the Department of the Treasury," Memorandum Opinion, February 13, 1996, https://www.justice.gov/file/20096/download. See also GAO, *Opinion B-138524*, October 30, 1985, https://www.gao.gov/products/438925. GAO concluded that "although some of the Secretary's actions appear in retrospect to have been in violation of the requirements of the Social Security Act, we cannot say that the Secretary acted unreasonably given the extraordinary situation in which he was operating."

[58] *New York Times*, "How U.S. Manipulated Social Security Funds," November 4, 1985, https://www.nytimes.com/1985/11/04/us/how-us-manipulated-social-security-funds.html. For details, see GAO, *Treasury's Management of Social Security Trust Funds During the Debt Ceiling Crises*, GAO/HRD-86-45, December 5, 1985, https://www.gao.gov/assets/hrd-86-45.pdf.

[59] Treasury also redeemed some of the Social Security trust funds' holdings of long-term securities to reimburse the General Fund for cash payments of benefits in September through November 1985. During this period, Treasury was unable to follow its normal procedure of issuing short-term securities to the trust funds and then redeeming short-term securities to reimburse the General Fund when it paid Social Security benefits.

[60] The main sponsors of the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA) were Senator Phil Gramm, Senator Warren Rudman, and Senator Ernest Hollings.

resources.[61] Both P.L. 99-155 and P.L. 99-177 required Treasury to restore any interest income lost to the trust funds as a result of delayed investments and early redemptions.

Actions in 1995-1996

During 1995, President Bill Clinton and House Speaker Newt Gingrich set out sharply divergent fiscal policy goals. Speaker Gingrich, in a September 1995 speech, "threatened today to send the United States into default on its debt … to force the Clinton Administration to balance the budget on Republican terms," according to media reports.[62] He vowed not to schedule a vote on increasing the debt limit unless an agreement to balance the budget were reached that included, among other terms, steep decreases in federal health program spending. In anticipation of debt limit constraints, Treasury officials in spring 1995 began to plan debt management strategies, including disinvestment of various trust funds.[63]

As federal debt neared its statutory limit in late 1995, Treasury once again used nontraditional methods of financing, some of which were used during the 1985 episode, including drawing from resources of federal civilian retirement funds and the Exchange Stabilization Fund (ESF).[64] In December 1995, the House passed a bill (H.R. 2621; 104th Congress) to restrict the Treasury Secretary's authority to use extraordinary measures, although the Senate declined to act on the measure.

In early 1996, Treasury announced its cash reserves would not cover Social Security benefit payments in March 1996 because it was unable to issue new public debt.[65] In March 1996, Congress then authorized Treasury to borrow enough to enable March 1996 benefit payments and exempted those securities from the debt limit for a limited time (P.L. 104-103 and P.L. 104-115).

In 1996, Congress passed P.L. 104-121 to increase the debt limit and, among other provisions, reaffirm Congress's understanding that the Secretary of the Treasury and other federal officials are not authorized to use Social Security and Medicare funds to manage federal debt, except as necessary to provide for the payment of benefits or the programs' administrative expenses.

[61] §6002 of the Omnibus Budget Reconciliation Act of 1986 (OBRA 1986; P.L. 99-509).

[62] David Sanger, "Gingrich Threatens U.S. Default If Clinton Won't Bend on Budget," *New York Times*, September 22, 1995, https://www.nytimes.com/1995/09/22/business/gingrich-threatens-us-default-if-clinton-won-t-bend-on-budget.html. Also see Clay Chandler, "Gingrich Vows No Retreat on Debt Ceiling Increase," *Washington Post*, September 22, 1995, https://www.washingtonpost.com/archive/politics/1995/09/22/gingrich-vows-no-retreat-on-debt-ceiling-increase/9f7c9620-e6aa-489e-8ace-3ebb27e349bc.

[63] Joint Economic Committee Republicans, "Planned Gridlock: The Clinton Administration Plan to Block Debt Limit and Balanced Budget Legislation," October 1996, https://www.jec.senate.gov/public/_cache/files/3f828d0c-d519-475b-8857-b94bce1aa4d4/planned-gridlock—october-1996.pdf.

[64] Treasury's Exchange Stabilization Fund (ESF) was created to promote exchange rate stability and counter disorderly conditions in the foreign exchange market, although it has been used for other purposes at times. See archived CRS Report RL30125, *The Exchange Stabilization Fund of the U.S. Treasury Department: Purpose, History, and Legislative Activity*, by Arlene E. Wilson (available to congressional clients upon request).

[65] Under normal procedures, Treasury pays Social Security benefits from the General Fund and offsets this by redeeming an equivalent amount of the trust funds' holdings of government debt. To pay Social Security benefits, and depending on the government's cash position at the time, Treasury may need to issue new public debt to raise the cash needed to pay benefits. Treasury may be unable to issue new public debt, however, because of the debt limit. If the Treasury lacks cash on hand, Social Security benefit payments may be delayed or jeopardized. See CRS Report RL33028, *Social Security: The Trust Funds*, by Barry F. Huston.

Actions in 2011

The 2007-2008 financial crisis and the subsequent Great Recession of 2007-2009 led to a sharp increase in federal debt, as falling incomes depressed federal tax revenues and increased the number of households eligible for social insurance benefits. The American Recovery and Reinvestment Act (ARRA; P.L. 111-5) and other measures enacted to stimulate economic activity increased federal outlays and cut taxes, resulting in further increases in federal debt levels.

As the economy began to recover in 2010, some Members of Congress, among others, expressed concerns about the federal government's fiscal situation and showed interest in reaching a wide-ranging agreement to put government finances on a more sustainable basis.[66] Others argued that imposing austerity measures could endanger a fragile economic recovery. Negotiations between President Barack Obama and congressional leaders ran from early 2011 until a legislative package that capped discretionary spending and raised the debt limit was enacted in early August 2011.[67] In January 2011 then-Treasury Secretary Geithner notified Congress that Treasury would take actions used during past episodes to avoid reaching the debt limit.[68] In another letter to Congress on May 2, 2011, he reiterated that the debt limit would be reached no later than May 16, 2011, but that the use of extraordinary measures would extend Treasury's ability to meet commitments through August 2, 2011.[69]

On May 16, 2011, Secretary Geithner notified Congress that he had declared a DISP and would use extraordinary measures to create additional room under the debt ceiling to allow Treasury to continue funding government operations.[70] Between May 16, 2011, and August 2, 2011, Treasury prematurely redeemed securities of the CSRDF and did not invest receipts of the CSRDF and the PSRHBF. Treasury also suspended investments in the Exchange Stabilization Fund and the Government Securities Investment Fund (G Fund) of the federal TSP.

The debt limit was increased on August 2, 2011, as part of the Budget Control Act of 2011 (BCA; P.L. 112-25), from $14,294 billion to $14,694 billion. The BCA provided for two additional debt limit increases. After the initial increase on August 2, 2011, the debt limit was increased again on September 21, 2011, from $14,694 billion to $15,194 billion, and again on January 27, 2012, from $15,194 billion to $16,394 billion.[71] Federal retirement funds used during extraordinary

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[66] Gail Russell Chaddock, "House GOP Wants $74 Billion in Budget Cuts: Draconian or Only a Start?," *Christian Science Monitor*, February 3, 2011, https://www.csmonitor.com/USA/Politics/2011/0203/House-GOP-wants-74-billion-in-budget-cuts-Draconian-or-only-a-start.

[67] For two versions of those negotiations, see Peter Wallsten et al., "Obama's Evolution: Behind the Failed 'Grand Bargain' on the Debt," *Washington Post*, March 17, 2012, p. A1, http://www.washingtonpost.com/politics/obamas-evolution-behind-the-failed-grand-bargain-on-the-debt/2012/03/15/gIQAHyyfJS_story.html; and Matthew Bai, "Obama vs. Boehner: Who Killed the Debt Deal?," *New York Times Magazine*, March 28, 2012, p. MM22, http://www.nytimes.com/2012/04/01/magazine/obama-vs-boehner-who-killed-the-debt-deal.html.

[68] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 6, 2011, https://home.treasury.gov/secretary-geithner-sends-debt-limit-letter-to-congress-2.

[69] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. John A. Boehner, Speaker of the House, May 2, 2011, https://home.treasury.gov/secretary-geithner-sends-debt-limit-letter-to-congress.

[70] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, May 16, 2011, https://web.archive.org/web/20110626130646/http://www.treasury.gov/connect/blog/Documents/20110516Letter%20to%20Congress.pdf.

[71] CRS Report R43389, *The Debt Limit Since 2011*, by D. Andrew Austin. Prior to the third debt limit increase, investments in the Government Securities Investment Fund (G Fund) of the Federal Thrift Savings Plan were suspended from January 17 to January 27, 2012. The G Fund was made whole on January 27, 2012. Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 17, 2012, https://home.treasury.gov/system/files/276/011712TFGLettertoReid.pdf.

measures were made whole as required by law.[72] The BCA also reestablished statutory caps on discretionary spending for the period FY2012-FY2021.

Actions in 2013

In late 2012 and 2013, continued differences in fiscal policy views and opposition to the implementation of the 2010 Patient Protection and Affordable Care Act (PPACA; P.L. 111-148) led to two debt limit episodes.[73] The first episode was resolved in May 2013, while the second episode—entwined with a 17-day appropriations lapse and government shutdown—was resolved in mid-October 2013. Debt limit constraints and appropriations lapses are distinct issues, although when a debt limit episode extends to the last few months of a fiscal year, those issues can arise together in fiscal negotiations, as in October 2013.

On December 26, 2012, then-Secretary Geithner declared that a DISP would begin on December 31, 2012, and Treasury employed extraordinary measures to meet federal payments.[74] On February 4, 2013, the No Budget, No Pay Act of 2013 (P.L. 113-3) suspended the debt limit through May 18, 2013, marking the first time that Congress used the suspension approach to resolve a debt limit episode.[75] On May 19, 2013, the debt limit was reinstated and raised to $16,699 billion, a level that accommodated borrowing incurred during the suspension period.[76] A DISP was declared on May 20, 2013, allowing Treasury to employ a refreshed set of extraordinary measures.[77]

On October 1, 2013, the first day of FY2014, an appropriations lapse began, in part resulting from disagreements over funding for Patient Protection and Affordable Care Act programs (PPACA; P.L. 111-148) and broader fiscal policies.[78] On the same date, Treasury notified Congress that, according to its estimates, extraordinary measures would be exhausted "no later than October 17,

[72] Letter from Richard L. Gregg, Fiscal Assistant Secretary, Department of the Treasury, to the Hon. John A. Boehner, Speaker of the House, August 24, 2011, https://home.treasury.gov/system/files/276/G-Fund-Letters.pdf; and Letter to the Hon. Harry Reid, Senate Majority Leader, January 27, 2012, https://home.treasury.gov/system/files/276/Debt-Limit-CSRDF-Report-to-Reid.pdf.

[73] Jonathan Weisman and Ashley Parker, "Republicans Back Down, Ending Crisis Over Shutdown and Debt Limit," *New York Times*, October 16, 2013, https://www.nytimes.com/2013/10/17/us/congress-budget-debate.html.

[74] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, December 31, 2012, https://home.treasury.gov/system/files/276/Sec-Geithner-Letter-to-Congress-12-31-2012.pdf. Also see Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. John A. Boehner, Speaker of the House, January 15, 2013, https://home.treasury.gov/system/files/276/1-15-2013-G-Fund-Debt-Limit-Letter.pdf.

[75] CRS Insight IN11829, *Debt Limit Suspensions*, by D. Andrew Austin.

[76] P.L. 113-3 provided for the debt limit to be increased on May 19, 2013, "to the extent that—(1) the face amount of obligations issued under chapter 31 of such title and the face amount of obligations whose principal and interest are guaranteed by the United States Government (except guaranteed obligations held by the Secretary of the Treasury) outstanding on May 19, 2013, exceeds (2) the face amount of such obligations outstanding on the date of the enactment of this Act. An obligation shall not be taken into account under paragraph (1) unless the issuance of such obligation was necessary to fund a commitment incurred by the Federal Government that required payment before May 19, 2013."

[77] Letter from Jacob J. Lew, Secretary of the Treasury, to the Hon. John A. Boehner, Speaker of the House, May 20, 2013, https://home.treasury.gov/system/files/276/Debt-Limit-Letter-2-Boehner-May-20-2013.pdf.

[78] Jonathan Weisman and Ashley Parker, "Republicans Back Down, Ending Crisis Over Shutdown and Debt Limit," *New York Times*, October 16, 2013, https://www.nytimes.com/2013/10/17/us/congress-budget-debate.html. Also see Eric Krupke, "How We Got Here: A Shutdown Timeline," *NPR*, October 17, 2013, https://www.npr.org/sections/itsallpolitics/2013/10/16/235442199/how-we-got-here-a-shutdown-timeline.

2013."[79] On that date, the debt limit was suspended through February 7, 2014, as part of the Continuing Appropriations Act, 2014 (P.L. 113-46).

Economists from the Federal Reserve Bank of Boston (Boston Fed) noted falling demand for Treasury bills maturing near the projected mid-October 2013 exhaustion of extraordinary measures, which had secondary effects on commercial paper rates and money market funds. Those effects dissipated soon after the end of the debt limit episode.[80]

Actions in 2021 and 2023

The 2021 episode, which led to two increases in the debt limit in October and December 2021, had less dramatic effects on financial markets than the 2013 episode.[81] During a panel discussion, former Federal Reserve officials and senior financial executives suggested that perceived risks affected some Treasury bills, but had little effect on other market segments, due to the assessment that a last-minute deal would be reached to resolve that debt limit episode.[82] The discussion also described more recent understandings of how Treasury, the Federal Reserve System, and major financial institutions would handle a binding debt limit.

During the 2023 debt limit episode, some Treasury bill yields and credit default swap (CDS) prices on U.S. debt rose, but volatility across financial markets did not rise as in some previous episodes.[83] The 2023 episode was resolved on June 3, 2023, with enactment of the Fiscal Responsibility Act (P.L. 118-5), which suspended the debt limit through January 1, 2025.

Observations from Past Actions

During these debt limit episodes, Treasury Secretaries used extraordinary measures to meet federal obligations and avoid major financial disruptions. The magnitude of the extraordinary measures used in the 2011, 2013, and 2015 debt limit episodes was markedly larger than that of the measures used in episodes in the preceding decade, as **Figure 4** indicates.[84]

Benefit payments and other outlays occurred largely on schedule and trust funds were made whole once these episodes ended.[85] No federal retirement payments were delayed or reduced as a result of debt limit operations.

The episodes elevated stresses on Treasury operations and heightened concerns in financial markets that Treasury securities might not be risk-free assets. A 2015 GAO report found that

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[79] Letter from Jacob J. Lew, Secretary of the Treasury, to the Hon. John A. Boehner, Speaker of the House, October 1, 2013, https://home.treasury.gov/system/files/276/Treasury-Letter-to-Congress_100113.pdf.

[80] Ali Ozdagli and Joe Peek, *Cliff Notes: The Effects of the 2013 Debt-Ceiling Crisis*, Federal Reserve Bank of Boston, Public Policy Briefs, no. 13-9, November 2013, https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/economic/ppb/2013/ppb139.pdf. Also see discussion preceding Figure 1 in CRS Report R43389, *The Debt Limit Since 2011*, by D. Andrew Austin. Yields for Treasury bills maturing in fall 2013 rose sharply before that debt limit episode was resolved, but fell to more normal levels afterward.

[81] CRS Insight IN11702, *The Debt Limit in 2021*, by D. Andrew Austin.

[82] Brookings Institution, "The Debt Limit: What If…," webinar transcript, October 5, 2021, https://www.brookings.edu/wp-content/uploads/2021/10/es_20211005_debt_limit_transcript.pdf.

[83] David Mericle, "A Retrospective on 10 Questions for 2023," *Goldman Sachs US Daily*, December 22, 2023.

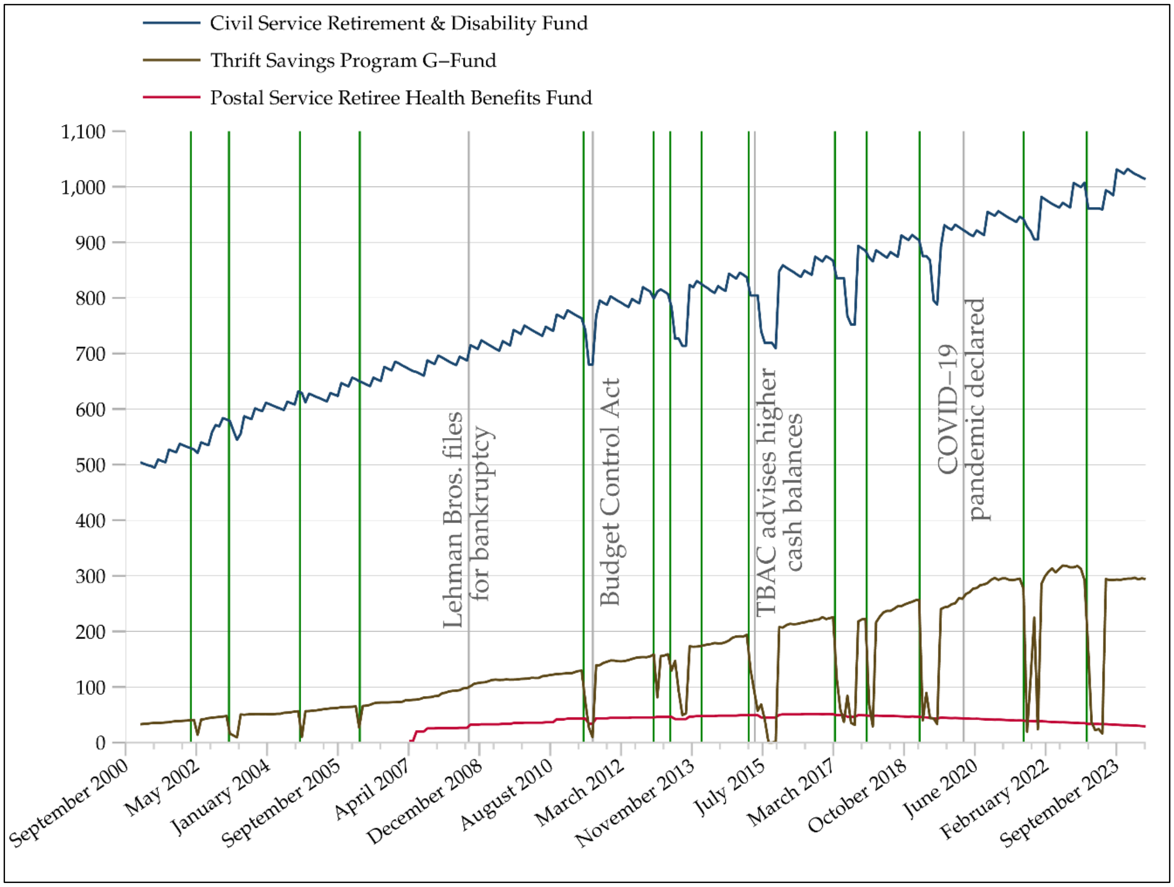
[84] Ivan Vidangos, "The Federal Debt-Limit Standoff of 2013 in the Financial Accounts of the United States," Federal Reserve Board of Governors, *FEDS Notes*, April 21, 2014, https://doi.org/10.17016/2380-7172.0016. Debt limit episodes between 1996 and 2011 drew less upon extraordinary measures.

[85] For a discussion of how debt limit episodes affected Treasury's cash management practices and borrowing costs, see GAO, *Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203, February 2011, pp. 10-18.

some investors avoided holding certain Treasury securities during the 2013 episode and estimated that debt limit concerns raised federal borrowing costs by tens of millions of dollars. A later section in this report discusses debt limit episodes and federal borrowing costs. That GAO report also noted that financial market participants worried that future debt limit episodes could lead to "more severe" consequences.[86] The following section analyzes possible consequences of a binding debt limit.

Figure 4. Value of Treasuries Held by Funds Used for Extraordinary Measures

$Billions, 2001-2024



Source: CRS calculations based on *Monthly Statement of the Public Debt* data.

Notes: Changes in values during debt limit episodes mainly reflect use of extraordinary authorities, although other factors may play minor roles. Vertical green lines indicate start of debt issuance suspension periods for the Thrift Savings Program G-Fund. The Postal Service Retiree Health Benefits Fund was established in December 2006 by P.L. 109-435. Extraordinary measures were not used before debt limit increases in 2007, 2008, 2009, and 2010. See GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203, February 2011, https://www.gao.gov/assets/gao-11-203.pdf.

Government Operations and a Binding Debt Limit

If the federal government were to reach the debt limit and Treasury were to exhaust its alternative strategies for remaining under the debt limit, so that its capacity to borrow and its cash reserves

[86] GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 9, 2015, https://www.gao.gov/assets/680/671286.pdf.

were exhausted—here termed a *binding debt limit*—the federal government then could rely only on incoming revenues to finance obligations. The binding debt limit would then confront various policymakers with several difficult options. This section discusses some administrative and logistical issues that a binding debt limit would raise.

This report offers no predictions of how Congress, the President, the Office of Management and Budget (OMB), Treasury, other federal agencies, and financial markets would react to extreme fiscal stress resulting from a binding debt limit. Nevertheless, a consideration of potential consequences of binding debt limit scenarios might inform policy options.

If the debt limit were to became binding, the federal government could not meet all its obligations on time unless daily receipts consistently outran outlays. In times of high federal deficits, outlays, on average, outrun receipts. Some federal payments to creditors, vendors, contractors, state and local governments, beneficiaries, and other entities would be delayed or limited. Officials would need to decide on a payment strategy, such as paying obligations in the order they are received, or, alternatively, to prioritize which obligations to pay, while other obligations would go into an unpaid queue. Decisions or contingency plans would determine what administrative and data processing structures would be employed to support those decisions. A binding debt limit, aside from any direct effects on financial markets, would hinder Treasury's capacity to respond to other unanticipated adverse events.

Reactions of financial markets and federal beneficiaries could also constrain options available to federal policymakers. Moving federal payments from a pay-when-due basis to paying when funds become available could have lasting economic and financial consequences on federal programs and the federal government's future ability to borrow at attractive rates. Even though many financial firms developed contingency plans in case Treasury payments were delayed, concerns remained that disruptions in Treasury payments or operations due to debt limit constraints could seriously damage capital markets and the reputation of the U.S. government.[87] If investors determined that the federal government had defaulted by not paying obligations on time, that could affect their willingness to hold federal securities or to accept those securities as collateral.

In past episodes, Congress and the President have avoided major economic or financial disruptions by changing the debt limit to accommodate continued borrowing and normal fiscal operations. The prospect of future disruptions, however, may affect the plans and behavior of households, businesses, financial markets, and foreign governments, among others.[88] As long as federal outlays outpace federal revenues, continuing deficits and rising debt levels will induce additional debt limit episodes on a regular basis.

Treasury, Federal Reserve, and other federal officials have conducted exercises (described in a later section) to assess consequences of a binding debt limit, which suggests the development of detailed contingency plans. Whether federal financial systems could be modified to implement contingency plans without encountering significant disruption is unclear. Whether senior Treasury or White House officials have approved or would approve such plans is also unclear.

The federal government has more experience with appropriations lapses, which occur when funding provided through the annual appropriations process lapses and is not extended.[89]

[87] GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 9, 2015, https://www.gao.gov/assets/680/671286.pdf.

[88] Douglas Dillon, Treasury Secretary under President John Kennedy, blamed the 1957 debt limit episode for a following recession. See Douglas Dillon, "Key Areas in Current Economic Policy," Federal Reserve Bank of New York, *Monthly Review*, June 1963.

[89] CRS Report RS20348, *Federal Funding Gaps: A Brief Overview*, by James V. Saturno.

Although appropriations lapses are sometimes linked to debt limit episodes, they present different challenges.

Debt Limit Episodes and Lapses in Appropriations Are Distinct[90]

A scenario in which a binding debt limit hinders Treasury's ability to pay the federal government's bills presents different challenges than a lapse in appropriations. If the debt limit became binding, federal agencies would retain authority to obligate funds to further their programs, even if Treasury might have difficulty in paying those obligations when they fell due. With a lapse in appropriations, some agencies would no longer have authority to make some obligations.

In 1995, the Congressional Budget Office contrasted a scenario in which the debt limit was reached and not raised with a substantially different situation, in which the government must shut down due to lapse in appropriations.

> Failing to raise the debt ceiling would not bring the government to a screeching halt the way that not passing appropriations bills would. Employees would not be sent home, and checks would continue to be issued. If the Treasury was low on cash, however, there could be delays in honoring checks and disruptions in the normal flow of government services.[91]

In other words, a binding debt limit does not circumscribe an agency's ability to obligate funds within the limits of its budget authority provided by statute. By contrast, if Congress and the President do not enact interim or full-year appropriations for one or more agencies, those agencies lack the legal authority to make obligations on behalf of the U.S. government for activities supported by such annual appropriations.[92] In that case, agencies must shut down affected, nonexcepted activities, with immediate effects on government services.[93]

Could Treasury Prioritize Payments?[94]

Whether Treasury could prioritize some payments and delay others depends on its legal authority and its operational capacities. A strategy to prioritize some payments and delay others might encounter both legal and logistical difficulties.

If a delay in raising the debt limit were to prevent Treasury from meeting all obligations on time, whether the distinction between different types of spending would be significant or whether the need to establish priorities would disproportionately affect one type of spending or another is unclear. Whether distinctions among different types of obligations, such as contracts, grants, benefits, and interest payments, would prove to be significant is also not clear. Moreover, whether payments mandated by court settlements, constitutional requirements, or other legal requirements would or could receive priority is unclear. Failure by the federal government to make payments required by court settlements could, at least in principle, reopen litigation.

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[90] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

[91] CBO, *The Economic and Budget Outlook: An Update*, August 1995, p. 49.

[92] Some agencies receive mandatory funding through user fees or other means that allow continuation of some operations during an appropriations lapse.

[93] During a funding hiatus, the Antideficiency Act nevertheless allows an exception for agencies to incur obligations for emergencies involving the safety of human life or the protection of property. For a discussion, see CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, coordinated by Clinton T. Brass.

[94] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

Federal Reserve System and Treasury Responsibilities Differ

Federal Reserve System decisions also would affect Treasury's options, particularly regarding the potential capacity to prioritize payments. The Federal Reserve Act (FRA; 12 U.S.C. 391) charges the Federal Reserve to act as fiscal agent for the federal government. The Federal Reserve Bank of New York (NYFed) holds the Treasury General Fund account, through which most federal financial operations are conducted. Federal Reserve accounts are settled each day, a process that involves several of the Reserve Banks and several payment systems, including the FedWire system administered by the NYFed, which handles wholesale transactions among major financial institutions. Therefore, any potential decision to prioritize federal payments would have major effects on the Federal Reserve and the NYFed.

Treasury and the Federal Reserve[95] coordinate closely on managing federal finances, but have different responsibilities and roles that would affect their responses to situations of extreme financial or fiscal stress, such as a proximate binding debt limit. The Federal Reserve's governance and funding are structured to promote its policy independence.[96] The Treasury Department, as part of the executive branch, is answerable to the President, and as it obtains funding through the annual appropriations process, is accountable to Congress as well.

The separation of responsibilities that assigns fiscal policy to the executive branch and Congress and monetary policy to the Federal Reserve is said to allow the latter to operate decisively in markets without political approval and to enhance its credibility.[97]

No Overdrafts at the Federal Reserve for Treasury

The Federal Reserve has allowed some private counterparties to accrue intraday overdrafts, in part to support the liquidity of the market for Treasury securities, which play a key role in global financial operations.[98] Overdraft facilities have not been provided for Treasury, however, as that would challenge the Federal Reserve's independence.[99]

Those tensions between maintaining policy independence and mitigating volatility in public debt markets were present when, during World War II, the Federal Reserve gained the authority to

[95] The Federal Reserve System consists of a Board of Governors and 12 Reserve Banks. The Fed acts as a central bank, conducting monetary policy, operating payment and settlement systems, and regulating certain financial institutions, as well as acting as the federal government's fiscal agent. See James McBride, Anshu Siripurapu, and Noah Berman, "What Is the U.S. Federal Reserve?," Council on Foreign Relations, August 15, 2024.

[96] For instance, the Federal Reserve System finances are independent of the annual appropriations process. The length of terms of the Federal Reserve Governors also promotes the Federal Reserve's independence from other parts of the federal government.

[97] Marvin Goodfriend, "Why We Need an 'Accord' for Federal Reserve Credit Policy: A Note," Federal Reserve Bank of Richmond, *Economic Quarterly*, winter 2001, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/2001/winter/pdf/goodfriend.pdf.

[98] Once the Federal Reserve began charging a fee for overdrafts in 1994, major broker-dealer firms devised other ways of financing securities transactions. Daniela Gabor, "How RTGS Killed Liquidity: US Tri-Party Repo Edition," *Financial Times* Alphaville blog, October 11, 2019, https://ftalphaville.ft.com/2019/10/11/1570799976000/How-RTGS-killed-liquidity—US-tri-party-repo-edition/.

[99] An OMB memorandum mentions a November 9, 1983, letter sent by then-Federal Reserve Chairman Paul Volcker to the Treasury Secretary regarding debt limit contingencies. Volcker stated that "Federal Reserve Banks may disburse funds upon order of the Treasury only against deposits in the Treasury account; if deposits are inadequate to cover the checks received, the Fed would have no alternative other than to refuse or delay payment in whole or in part; in the absence of instructions from Treasury, the Fed would delay all payments until sufficient balances are available to honor all payment orders reaching it on a particular day." OMB, "Background Material on Prior Debt Ceiling Crises," memorandum from Roz Rettman to Bob Damus, August 2, 1995, pp. 7-11, https://clinton.presidentiallibraries.us/items/show/27030.

extend emergency loans to Treasury.[100] That authority, used briefly during some debt limit episodes as late as 1979, lapsed in 1981.[101]

Extending credit to the Treasury, by permitting an overdraft or by other means, could undermine the Federal Reserve's credibility in two ways. First, allowing Treasury to borrow directly from the Federal Reserve likely would be seen as allowing the executive branch to monetize part of the federal debt. If allowed, some public expenditures would be financed by Treasury borrowing through an authority empowered to print money, rather than by Treasury collecting revenues or borrowing from the public through market operations.

Second, extending credit to the Treasury would undercut the congressional control of debt and its powers of the purse. The Federal Reserve Act (12 U.S.C. 355(1)), which among other aims sought to insulate the Federal Reserve from political pressures,[102] requires that the Federal Reserve purchase Treasury securities on the open market, in which prices are set by forces of supply and demand, rather than by the Treasury itself.[103] Moreover, an overdraft of the Treasury General Fund account could add operational challenges to the Federal Reserve's settlement processes in the event of a breach of the debt limit.[104]

Communications among Federal Reserve staff and draft planning documents underlined the importance of avoiding an overdraft of the Treasury. One draft memorandum developed during the 2013 debt limit episode noted that Federal Reserve Banks "are not authorized to extend credit to [the U.S. Treasury]" and that the Federal Reserve System "will take all best efforts to avoid [end-of-day] overdrafts, recognizing that this risk cannot be brought to zero."[105]

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[100] Public Debt Act of 1942 (56 Stat. 189). Also see Kenneth D. Garbade, *Direct Purchases of U.S. Treasury Securities by Federal Reserve Banks*, Federal Reserve Bank of New York Staff Report no. 684, August 2014, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr684.pdf. In 1979, such loans were made subject to the debt limit, which limited their utility during debt limit episodes (P.L. 96-18).

[101] CRS Report R45011, *Clearing the Air on the Debt Limit: Platinum Coins, the Fourteenth Amendment, and More*, by D. Andrew Austin and Sean M. Stiff, section on "Responses to Debt Limit Lapses in the 1970s."

[102] Then-Governor of the Federal Reserve Board Marriner Eccles, who was intimately involved in the drafting of the 1935 act, stated that the measure was designed "to place responsibility for the exercise of three existing, but badly set up, monetary powers in one body removed from the pressures of partisan, political or private banker influences." See Marriner Eccles, "Statement on Title II of the Banking Act of 1935 as reported by the Banking and Currency Committee of the Senate," Federal Reserve Board press release, July 3, 1935, https://fraser.stlouisfed.org/title/446/item/7643.

[103] Until 1981, the Federal Reserve was authorized to purchase a limited quantity of Treasury securities directly from the Treasury. See P.L. 96-18 and Kenneth D. Garbade, "Direct Purchases of U.S. Treasury Securities by Federal Reserve Banks," *Federal Reserve Bank of New York Staff Reports*, no. 684, August 2014, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr684.pdf.

[104] An October 18, 2013, Federal Reserve email noted the need to prepare information for financial institutions on the possibility of deferred ACH (automatic clearing house) transactions, suspended principal and interest payments, treatment of Treasury bills as collateral for discount window lending, rejected FedWire transfers, and suspended settlement of Treasury checks and money orders that could result from an extreme debt limit scenario. U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, pp. 68-69, http://financialservices.house.gov/uploadedfiles/debt_ceiling_report_final_01292015.pdf.

[105] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, pp. 227-231, http://financialservices.house.gov/uploadedfiles/debt_ceiling_report_final_01292015.pdf.

Does Treasury Have Authority to Prioritize?[106]

Some have argued that prioritization of payments can be used by Treasury to avoid a default on selected federal obligations by paying interest on outstanding debt before other obligations.

In earlier years, Treasury officials and GAO considered prioritization of payments possible. In a 1970 hearing on the debt limit, then-Treasury Secretary David M. Kennedy called a binding debt limit an "unthinkable situation." When asked if a Treasury Secretary would in that case have any discretion about whom to pay, Kennedy stated that "we would have to pay the hardship cases, the widows and the orphans, so to speak, and I think all of our soldier boys would get their pay."[107]

In 1985, GAO wrote to then-Chairman Bob Packwood of the Senate Finance Committee that it was aware of no requirement that Treasury must pay outstanding obligations in the order in which they are received.[108] GAO concluded that "Treasury is free to liquidate obligations in any order it finds will best serve the interests of the United States." In any case, if Treasury were to prioritize, it is not clear what the priorities might be among the different types of spending.[109]

In later years, Treasury officials have maintained that the department lacks formal legal authority to establish priorities to pay obligations, asserting, in effect, that each law obligating funds and

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[106] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

[107] Testimony of Treasury Secretary David M. Kennedy, in U.S. Congress, Senate Committee on Finance, *$395 Billion Debt Limit*, hearing, June 18, 1970, 91st Cong., 2nd sess., p. 39, https://www.finance.senate.gov/download/1970/06/18/395-billion-debt-limit.

> Chairman Russell Long: Now, I think that it might be well for the record if you would tell us what happens in the event that Congress passes no law. What will happen then when the Government is no longer able to pay its debts because we are officially bankrupt by act of Congress
>
> Secretary Kennedy: That is an unthinkable situation, Mr. Chairman.
>
> Chairman Long: It is a very silly thing, in my judgment, but what happens if that occurs?
>
> Secretary Kennedy: I understand what it means. We will be up against the hard fact of being over the debt limit on June 30. That means then that we can't borrow money to pay our bills.
>
> Chairman Long: Well, can you pay money?
>
> Secretary Kennedy: If we have money in the till, but to the extent we have our cash balance we can use that up. It seems to me what we would be in the market, well, we are in the market every week, we are in the market for Treasury bills which are rolled over, and no buyer would accept our bills if we put them out, if we decided to go ahead anyway and take the burden of this, the market would say they would be illegally issued and so they wouldn't buy them. We would not then pay our bills.
>
> Chairman Long: Would you have any discretion about whom you pay and whom you would not pay?
>
> Secretary Kennedy: Well, I think that there we have a real problem in that we would have to pay the hardship cases, the widows and the orphans, so to speak, and I think all of our soldier boys would get their pay.
>
> Chairman Long: In other words, you would try to pay the boys on the battlefield even though you couldn't pay the boys in the barracks.
>
> Secretary Kennedy: That is right.

[108] Letter from GAO to Chairman Bob Packwood of the Senate Committee on Finance, GAO B-138524, October 9, 1985, https://www.gao.gov/products/128353.

[109] While CRS has found no list of established payment priorities were the debt limit to become binding, in 2013 OMB prepared a list of excepted functions that the government should continue to conduct during a government shutdown caused by a lapse in enacting appropriations. These priorities are based on a distinction between functions deemed essential and thus excepted, such as providing health care or air traffic control, and those deemed non-excepted. If a binding debt limit made establishing payment priorities necessary, the Secretary of the Treasury might seek guidance from this list of essential functions. For OMB's guidance on what activities are essential during a shutdown, see Sylvia Burwell, "Memorandum for the Heads of Executive Departments and Agencies," Office of Management and Budget, September 17, 2013, https://obamawhitehouse.archives.gov/sites/default/files/omb/memoranda/2013/m-13-22.pdf. See also this report's section entitled "Debt Limit Episodes and Lapses in Appropriations Are Distinct."

authorizing expenditures stands on an equal footing.[110] In 2011, a senior Treasury official stated that prioritizing certain types of payments over other U.S. legal obligations was "unworkable" and "unacceptable" and "would merely be default by another name."[111]

In an August 2012 letter, the Treasury Inspector General reported that, "Treasury officials determined that there is no fair or sensible way to pick and choose among the many bills that come due every day. Furthermore, because Congress has never provided guidance to the contrary, Treasury's systems are designed to make each payment in the order it comes due."[112] In other words, Treasury would have to make payments on obligations as they come due.

The two positions of Treasury and GAO suggest different interpretations of silence in statute with respect to a prioritization system for paying obligations. On the one hand, GAO's 1985 opinion posits that silence in statute with regard to prioritization simply leaves the determination of payment prioritization to the discretion of the Treasury Department. Conversely, Treasury has asserted that the lack of specific statutory direction operates as a legal barrier, effectively preventing it from establishing a prioritization system.

Could Treasury Prioritize Payments If It Had Authority?

If Treasury did have a clear legal authority to prioritize payments of some categories of federal obligations, operations challenges would likely remain. Aside from legal considerations, Treasury objections to prioritizing broad categories of obligations, as noted above, rested on practical concerns related to how federal payment systems operate.

The federal government operates three main payment systems: the Department of Defense (DOD) Disbursing Offices, the Treasury's Bureau of the Fiscal Service, and the Treasury's Financial Management Service.[113] The Fiscal Service handles payments related to Treasury securities through the FedWire system, in cooperation with the NYFed, which acts as the Treasury's fiscal agent.[114] The Financial Management Service handles other non-DOD payments.[115] While the

[110] U.S. Congress, Senate Committee on Finance, *Increase of Permanent Public Debt Limit*, S.Rpt. 99-144, September 26, 1985. For more information, see out-of-print CRS Report 95-1109, *Authority to Tap Trust Funds and Establish Payment Priorities if the Debt Limit is Not Increased*, by Thomas J. Nicola and Morton Rosenberg (available to congressional clients upon request to CRS).

[111] Neal Wolin, Deputy Secretary of the Treasury, "Treasury: Proposals to 'Prioritize' Payments on U.S. Debt Not Workable: Would Not Prevent Default," January 21, 2011, at https://web.archive.org/web/20110729191307/http://www.treasury.gov/connect/blog/Pages/Proposals-to-Prioritize-Payments-on-US-Debt-Not-Workable-Would-Not-Prevent-Default.aspx.

[112] Eric M. Thorson, Inspector General, Department of the Treasury, letter to Senator Orrin G. Hatch, OIG-CA-12-006, August 24, 2012, p. 6, https://oig.treasury.gov/sites/oig/files/Audit_Reports_and_Testimonies/OIG-CA-12-006.pdf.

[113] Defense Secretary Lloyd J. Austin III stated that payment delays due to debt limit constraints would adversely affect veterans, federal contractors, and servicemembers. Secretary of Defense Lloyd J. Austin III, "Economic Consequences of Default on National Security and Military Families," press release, October 6, 2021, https://www.defense.gov/News/Releases/Release/Article/2802266/statement-by-secretary-of-defense-lloyd-j-austin-iii-on-the-economic-consequenc/.

[114] Federal Reserve Board of Governors, *Annual Report 2021*, "Payment System and Reserve Bank Oversight," https://www.federalreserve.gov/publications/2021-ar-payment-system-and-reserve-bank-oversight.htm.

[115] Credit Suisse Fixed Income Research, "US Interest Rate Strategy Weekly," September 26, 2013. Also see Cardiff Garcia, "Raise Your Hand If You Know How the Treasury's Payment Systems Work… Anyone?" *Financial Times* Alphaville Blog, October 6, 2013.

structure of U.S. payment systems is well documented,[116] some details are considered sensitive information.[117]

Treasury Officials Have Contended That Prioritization Is Impracticable[118]

Treasury officials have repeatedly stressed that their financial management systems are designed to make each payment in the order it comes due.[119] Then-Treasury Secretary Lew testified at a hearing before the Senate Finance Committee in October 2013 that

> We write roughly 80 million checks a month. The systems are automated to pay because for 224 years, the policy of Congress and every president has been we pay our bills. You cannot go into those systems and easily make them pay some things and not other things. They weren't designed that way because it was never the policy of this government to be in the position that we would have to be in if we couldn't pay all our bills.[120]

A Treasury Assistant Secretary discussed this type of broad prioritization in a May 2014 response to questions posed by then-Chairman Jeb Hensarling of the House Committee on Financial Services. Treasury Assistant Secretary Alastair Fitzpayne stated that in a situation in which the debt limit made it impossible to pay all federal obligations on time, it might be technologically possible for Treasury and NYFed to continue to make principal and interest payments for federal securities, while other payments made through other systems were delayed or left unprocessed. Fitzpayne warned "this approach would be entirely experimental and create unacceptable risk to both domestic and global financial markets."[121]

A Federal Reserve expert on payment systems suggested that the Federal Reserve could handle prioritization of payments, if given sufficient lead time. That expert also stressed that "until you have developed the procedures and tested the procedures, your comfort level is pretty low."[122]

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[116] Committee on Payment and Settlement Systems, Bank of International Settlements (BIS), *Payment, Clearing and Settlement Systems in the United States*, November 2012, https://www.bis.org/cpmi/publ/d105_us.pdf. Also see Alexandra Merle-Huet, *Overview of the U.S. Payments, Clearing and Settlement Landscape*, Federal Reserve Bank of New York, May 11, 2015, https://www.newyorkfed.org/medialibrary/media/banking/international/03.Overview-US-PCS-landscape-Merle.pdf.

[117] Letter from Randall DeValk, Acting Assistant Secretary for Legislative Affairs, to Chairman Jeb Hensarling, House Committee on Financial Services, May 26, 2015, appendix 36 (pp. 291-294) in U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016.

[118] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

[119] Eric M. Thorson, Inspector General, Department of the Treasury, letter to Senator Orrin G. Hatch, OIG-CA-12-006, August 24, 2012, pp. 5-6, https://oig.treasury.gov/sites/oig/files/Audit_Reports_and_Testimonies/OIG-CA-12-006.pdf. In prior decades, GAO found that some federal payments were not paid on time, and some others were paid early, which were traced mostly to agency receiving and acceptance procedures. See GAO, "Actions to Improve Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars," letter B-204733, October 8, 1981, http://gao.gov/assets/140/135325.pdf.

[120] U.S. Congress, Senate Committee on Finance, *The Debt Limit*, hearing, 113th Congress, 1st sess., October 10, 2013. Transcript available on CQ.com at http://www.cq.com/doc/congressionaltranscripts-4359941.

[121] Letter from Alastair M. Fitzpayne, Assistant Secretary for Legislative Affairs, to Chairman Jeb Hensarling of the House Committee on Financial Services, May 7, 2014, http://www.cq.com/pdf/4473840.

[122] Federal Open Market Committee (FOMC), "Conference Call of the Federal Open Market Committee on August 1, 2011," transcript, at p. 15, https://www.federalreserve.gov/monetarypolicy/files/fomc20110801confcall.pdf. The expert, Louise L. Roseman, was director of the Federal Reserve Board's Division of Reserve Bank Operations and Payment Systems.

Some Members of Congress Contended That Prioritization is Possible

One report issued by a pair of House committees in 2016 contended that Treasury has the capacity to prioritize payments of principal and interest on Treasury securities.[123] A report issued by majority staff of the House Committee on Financial Services in February 2016 examined Treasury contingency plans and joint exercises among Treasury, the Federal Reserve, and other agencies, and contained extensive appendices documenting correspondence between House Members on the one hand and Treasury and Federal Reserve officials on the other.[124] Those joint exercises are discussed in this report's section on "Joint Treasury and Federal Reserve Exercises." In a letter discussing the 2011 debt limit episode, the Treasury Inspector General noted that

> Ultimately, the decision of how Treasury would have operated if the U.S. had exhausted its borrowing authority would have been made by the President in consultation with the Secretary of the Treasury.[125]

Who Would Approve Prioritization?

No contingency plans for prioritization are publicly known to have been approved at the highest levels of government. Secretary Lew, in a December 2013 hearing, stated that "the question of prioritization is fundamentally a policy question," and that "whether or not that decision can be made is fundamentally a Presidential decision."[126] No presidential order or federal rule is known to have been issued to approve prioritization.

Treasury and Federal Reserve Contingency Planning

Managing and mitigating risks is an integral part of any large financial institution, no less so for federal agencies responsible for core fiscal operations.[127] During the 2011 and 2013 debt limit episodes, Treasury and Federal Reserve officials analyzed contingencies related to debt limit episodes and the possibility of a binding debt limit. Treasury, Federal Reserve, and other federal agency officials also conducted tabletop exercises and discussions to assess possible consequences and market reactions as well as to understand interactions among key offices.[128]

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[123] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, p. 7, http://financialservices.house.gov/uploadedfiles/debt_ceiling_report_final_01292015.pdf. Also see U.S. Congress, House Committee on Financial Services, *Annual Testimony of the Secretary of the Treasury on the State of the International Financial System*, hearings, 113th Cong., 1st sess., December 12, 2013, Serial 133-55 (Washington: GPO, 2014).

[124] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016..

[125] Eric M. Thorson, Inspector General, Department of the Treasury, letter to Senator Orrin G. Hatch, OIG-CA-12-006, August 24, 2012, p. 4, https://oig.treasury.gov/sites/oig/files/Audit_Reports_and_Testimonies/OIG-CA-12-006.pdf.

[126] U.S. Congress, House Committee on Financial Services, *Annual Testimony of the Secretary of the Treasury on the State of the International Financial System*, hearings, 113th Cong., 1st sess., December 12, 2013, Serial 133-55, p. 29 (Washington: GPO, 2014).

[127] Steve Marlin, "US Treasury CRO on Credit Risk, TARP and Cyber Threats," Risk.net, October 7, 2016, https://www.risk.net/risk-management/credit-risk/2473356/interview-us-treasury-cro-on-credit-risk-tarp-and-cyber-threats.

[128] In a tabletop exercise key personnel are assigned roles and responsibilities in various simulated emergency situations as a means to evaluate potential strategies, risks, and outcomes.

The emails and other documents from the Federal Reserve published in the 2016 House committee staff report mentioned above provide a partial view of discussions in 2013 regarding debt limit contingencies.[129] Those materials also give an indirect perspective on Treasury's views. In particular, Treasury communications typically stressed the need to meet principal and interest payments. That view could be based on anticipated reactions of capital markets to delays in principal and interest payments that could greatly complicate federal debt management.

Contingency Planning at the Federal Reserve Open Market Committee

Federal Reserve Open Market Committee (FOMC) meetings in 2011 and 2013 discussed how federal financial operations might be handled were the debt limit to become binding. Transcripts of those meetings document concerns of Federal Reserve officials, and indirectly, views of Treasury personnel. In recent years, FOMC transcripts have been released five years after a meeting.

The FOMC oversees the Federal Reserve's interactions with financial markets that implement its monetary policies. Other monetary policy instruments, such as discount window policies, are controlled by the Federal Reserve Board of Governors. Although the FOMC, NYFed, and Federal Reserve Board of Governors coordinate closely with Treasury, Federal Reserve officials have stressed the importance of their policy independence and that their statutory objectives of price stability and full employment are distinct from Treasury's legal obligations.

July 2011 Federal Reserve Memorandum

In response to questions raised in previous FOMC meetings, two senior Federal Reserve staff drafted a memorandum in July 2011 that laid out what operational steps the Federal Reserve System might take if confronted with a binding debt limit causing a "technical default on Treasury securities."[130] Some steps would have relied on existing authorities granted by the FOMC to the NYFed's Open Market Trading Desk, which trades with major financial institutions to support Federal Reserve monetary policies. Other steps would have needed approvals from individual Reserve Banks, the Federal Reserve Board of Governors, or the Treasury Secretary.

The memorandum recommended that the Federal Reserve view Treasury securities experiencing a delay in principal or interest payments due to a binding debt limit in the same manner as other Treasury securities, in order to underline the view that all those securities retained the backing of the U.S. government's full faith and credit. The memorandum also suggested that swaps of privately held defaulted Treasuries for Federal Reserve owned non-defaulted Treasuries would allow major financial institutions to continue their regular activities.

The memorandum also explored some extraordinary options to remove defaulted Treasuries from the market, such as obtaining Treasuries through outright purchases rather than through swaps. The discussion of those options prefaced by the caveat that

> the FOMC could consider policy responses that involve outright operations aimed specifically at defaulted Treasury securities. These options would be warranted if the FOMC determined there was a need to escalate its support of market functioning as much as possible in response to a technical default on Treasury securities. However, such an

[129] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016.

[130] William English and Brian Sack, "Potential Policy Responses to the Debt Ceiling," memorandum to the Federal Open Market Committee, July 19, 2011, https://www.federalreserve.gov/monetarypolicy/files/FOMC20110719memo01.pdf.

> approach would insert the Federal Reserve into a political situation and could raise questions about its independence from debt management issues faced by the Treasury. Thus, the staff assumes that the FOMC would not be interested in pursuing these options, but they are presented for completeness.

Emergency FOMC Meeting in August 2011

An emergency FOMC meeting on August 1, 2011—shortly before Congress passed the BCA—discussed legislative developments and financial market behavior, and outlined contingency plans.[131] A Federal Reserve expert on payment systems outlined the three assumptions on how Treasury would operate if the debt limit were to bind.

> The first one is that principal and interest on Treasury securities would continue to be made on time. The second one is that other payments may be delayed. The third principle is that any payments that were made would be settled as usual.
>
> So how do you implement those three principles? With respect to the first, the principal on Treasury securities that are maturing would be funded by having auctions that would roll over those maturing securities into new issues, so the new issues would be able to fund the redemption of the maturing securities. With respect to interest payments, the way the Treasury planned to ensure that it would be able to pay interest payments timely by holding back other government payments and accumulating sufficient cash balances in its Fed account to pay upcoming coupon payments. The implication of this approach would be that the Treasury would be delaying non-P&I payments even on days when it may have ample balances in its Fed account to have been able to make those payments if it had so chosen. Instead, the Treasury would be conserving that cash to be able to ensure that it would be able to pay future-dated interest payments. Then, to ensure that payments made would settle as usual, the Treasury would not submit any ACH files to the Reserve Banks for processing unless it was certain that it would have sufficient balances on the settlement date to settle those transactions. Similarly, for checks, the Treasury would not mail checks out to the intended recipients until it was sure that it would have sufficient balances in its account to fund the presentment of those checks once they came back to the Fed. And for Fedwire funds transfers, the Treasury would not make funds transfers unless it had sufficient balances in its Fed account to do so.[132]

Rolling over maturing bills would require additional cash because bills are sold on a discount basis. Thus, the proceeds of new bill auctions would be less than what would be paid on maturing bills, especially if a binding debt limit raised yields on Treasury securities.

That expert also stated

> These, at least, are current procedures that have been codified into a special operating circular that was developed jointly by the Reserve Banks, the staff here at the Board, and at the Treasury, and has been approved by the Treasury as reflecting what it would like the Reserve Banks to do as its fiscal agents if it ever came to that.[133]

Subsequent discussion in that meeting, however, suggested that Treasury contingency planning had been "quite fluid" and might be modified.[134]

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[131] FOMC, "Conference Call of the Federal Open Market Committee on August 1, 2011," transcript, https://www.federalreserve.gov/monetarypolicy/files/fomc20110801confcall.pdf.

[132] Ibid.

[133] Ibid., at p. 11.

[134] Ibid., at p. 13.

Joint Treasury and Federal Reserve Exercises

One exercise was held on March 16, 2011, and a second on April 9, 2013, both during the early stages of debt limit episodes in those years.[135] Other planning exercises may have been held in previous years as well. Participants included senior officials from Treasury, the NYFed, and the Federal Reserve Board of Governors, as well as senior personnel responsible for various federal payment and settlement systems.

Scenarios in Debt Limit Exercises

The March 2011 exercise was based on a "contrived, yet plausible scenario" that would require the Federal Reserve, in consultation with Treasury, to invoke special debt ceiling crisis procedures.[136] The scenario was premised on an impasse among policymakers preventing the timely enactment of a debt limit modification. During a series of planned stages, participants walked through procedures and consultations that would be taken in the course of the day that the debt limit became binding.

The April 2013 exercise was based on a similar scenario. The exercise started with a simulated conference call among Treasury and Federal Reserve officials, which in the scenario's timeline was to occur the evening before the debt limit was to bind.

Treasury and Federal Reserve Communications During 2013

The FOMC indicated in an October 16, 2013, discussion that "in the event of delayed payments on Treasury securities," discount window and other operations would proceed "under the usual terms."[137] Some interpreted that statement to imply that the Federal Reserve would be "prepared to backstop the Treasury market in the event of a political deadlock."[138] Such events might pose uncomfortable choices between mitigating financial market disruptions and maintaining the Federal Reserve's policy independence.

The NYFed issued a description of contingency plans in December 2013 in the event of Treasury payment delays, but warned that such measures "only modestly reduce, not eliminate, the operational difficulties posed by a delayed payment on Treasury debt. Indeed, even with these limited contingency practices, a temporary delayed payment on Treasury debt could cause significant damage to, and undermine confidence in, the markets for Treasury securities and other assets."[139]

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[135] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, http://financialservices.house.gov/uploadedfiles/debt_ceiling_report_final_01292015.pdf.

[136] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, Appendix 2.

[137] Federal Reserve, "FOMC Minutes for October 29-30, 2013 Meeting," section on "Videoconference meeting of October 16," p. 11, http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20131030.pdf.

[138] Wrightson ICAP, "Debt Ceiling Outlook," *Money Market Observer*, January 27, 2014.

[139] Federal Reserve Bank of New York, Treasury Market Practices Group, *Operational Plans for Various Contingencies for Treasury Debt Payments*, December 23, 2013, https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/Operations_Contingency_Plans.pdf.

Extending Maturities Seen As Most Likely Option If Debt Limit Binds

Major financial institutions and some former federal officials have viewed an extension of maturities as the most likely option if Treasury faced a binding debt limit.[140] Treasury could announce a one-day extension of maturities for notes or bonds scheduled to mature on the following day, thus delaying payment of principal and interest.[141] That one-day maturity extension could be repeated until the debt limit was resolved. Otherwise, if a note or bond matured, the security would drop from trading systems, blocking sales or transfers, which would then greatly complicate responses to the technical default, especially for Treasuries lent through repo arrangements. To a large extent, the extension-of-maturities strategy would let financial markets and Federal Reserve operations proceed as normally as possible, so long as bondholders viewed full payment as imminent.

How the maturity extension option would affect repo arrangements is less clear, as most repo contracts operate on a day-by-day basis as agreed among counterparties. Some state that money market funds (MMFs) would not be required by Rule 2a-7 (17 CFR §270.2a-7) to dispose immediately of a defaulted asset.[142] That rule, however, requires MMFs to dispose of defaulted securities in an orderly manner, unless the MMF's board determines that action would not be in the best interests of the fund and its shareholders.[143] Diversification of MMF assets would limit the effect of technical defaults on a small proportion of Treasuries. A technical default on some Treasuries might complicate payments among private parties because those who had expected payment from the Treasury could be hindered in meeting obligations to others. Moreover, while the Treasury, the Federal Reserve, and major financial institutions appear to have considered contingency plans, other components of the financial system could have difficulty facing direct or indirect consequences of a technical default on Treasuries.[144]

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140 Christopher Tufts, "The Impact of a Technical Default by the U.S. Treasury," J.P. Morgan Asset Management, May 22, 2023, https://am.jpmorgan.com/us/en/asset-management/liq/insights/liquidity-insights/updates/impact-of-a-1technical-default-by-the-u-s-treasury/#. Also see Securities Industry and Financial Markets Association (SIFMA), "Delay in Treasury Payments: Discussion of Scenarios," January 2018, https://www.sifma.org/wp-content/uploads/2018/01/Disruption-in-Treasury-Payments-January-25.pdf. Also see Brookings Institution, "The Debt Limit: What If…," webinar transcript, October 5, 2021, https://www.brookings.edu/wp-content/uploads/2021/10/es_20211005_debt_limit_transcript.pdf.

141 Treasury securities are issued under terms of the Uniform Offering Circular, which could be modified on short notice. That may provide Treasury some flexibility on terms of payment. In recent years substantive changes in that circular are infrequent. Amending the circular to allow extended maturities would likely be seen as a departure from Treasury's commitment to maintaining a "regular and predictable" debt management policy. The current Treasury securities circular is here: U.S. Treasury, "Uniform Offering Circular," https://www.treasurydirect.gov/laws-and-regulations/auction-regulations-uoc/. Also see discussion in section below entitled "Possible Federal Reserve and Treasury Responses."

142 Christopher Tufts, "The Impact of a Technical Default by the U.S. Treasury," J.P. Morgan Asset Management, May 22, 2023.

143 "Money Market Funds and Credit Ratings on US Treasury Securities: FAQs," Investment Company Institute, October 17, 2013, https://www.ici.org/faqs/faq/mmfs/faqs_mmfs_treasury_secs.

144 One study reported that 43% of all banking systems were powered by COBOL, a computer language developed in the 1950s. Prem Mangesh Mundekar and Divakar Jha, "Importance and Application of COBOL in Banking Sectors," *International Journal of Advanced Research in Science, Communication and Technology*, vol. 2, no. 9 (June 2022), https://ijarsct.co.in/Paper5405.pdf. GAO has noted that modifying programs based on COBOL is difficult because finding experienced COBOL programmers has been difficult for decades. GAO, *Information Technology: Agencies Need to Develop and Implement Modernization Plans for Critical Legacy Systems*, GAO-21-524T, April 27, 2021, https://www.gao.gov/assets/720/714078.pdf. Some institutions dependent on COBOL systems for payment processing may be less than nimble in modifying programs to address consequences of a technical default on Treasuries.

Administrative Measures

Apart from measures possibly available to Treasury and the Federal Reserve, the President and OMB might have other budgetary tools to address extreme fiscal stress.

For instance, a 1953 debt limit confrontation with Congress prompted the Eisenhower Administration to urge agency heads to "take every possible step progressively to reduce the expenditures of your department"[145] and then to sell $500 million in gold to avoid breaching the debt limit.[146] During another debt limit episode in 1957, Eisenhower ordered the Pentagon to limit its outlays enough to avoid breaching the debt limit.[147] Since that time, Pentagon and other federal financial systems and procedures have changed substantially, as have laws governing budget execution.

Setting payment priorities through administrative means under current federal budget law would likely raise concerns. Choices made by the President, OMB, the Treasury Secretary, or other agency officials to set priorities among federal obligations and expenditures where statutory authority to prioritize was unclear or nonexistent could prompt concerns similar to those that gave rise to budgetary reforms adopted in 1974.

Impoundment and Prioritization[148]

Another perspective on prioritization relates to the Impoundment Control Act of 1974 (ICA), as amended.[149] The term *impoundment* refers to actions by the President, OMB, an agency head, or any officer or employee to withhold budget authority from obligation or expenditure. One type of impoundment action, *deferral*, refers to a temporary withholding or delaying of the obligation or expenditure of budget authority provided for projects or activities. Through the establishment of several statutory processes and restrictions, the ICA generally prohibited "policy" impoundments. A policy impoundment might be, for example, a decision not to spend funds appropriated by Congress because a given federal activity may not be favored by a President or agency official. Under the ICA, budget authority may be deferred only for certain reasons, including to provide for contingencies.[150] The relationship between prioritization associated with a debt limit impasse,

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[145] President Dwight D. Eisenhower, "Letter to Heads of Departments and Agencies Concerning Further Economies in Government," August 11, 1953, https://www.presidency.ucsb.edu/documents/letter-heads-departments-and-agencies-concerning-further-economies-government.

[146] Joseph J. Thorndike, "Can Debt Ceiling Debates Be Useful? History Says Maybe," *Tax Notes*, August 27, 2013.

[147] Bernard Nossiter, "Speed-Up of Defense Spending Seen Taking Shape as Boost to Economy," *Washington Post*, June 30, 1958.

[148] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

[149] Title X of the Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344; 88 Stat. 297, at 332, and subsequently amended; 2 U.S.C. Chapter 17B, §681 et seq.). The act grew out of extended conflict over spending priorities between Congress and the Richard M. Nixon Administration, including over "policy" impoundments, where the Administration sought to avoid spending funds associated with disfavored programs. The act generally has been interpreted as being intended to protect congressional budget decisions and priorities, as manifest in statutes, from deviations by the President, OMB, and agency officials. For discussion, see Allen Schick, *Congress and Money: Budgeting, Spending, and Taxing* (Washington, DC: Urban Institute, 1980), pp. 17-49, 401-412.

[150] The Impoundment Control Act of 1974 (ICA) established a mechanism for the President, the Director of OMB, the head of an agency, or any officer or employee to propose deferrals, for which the President is required to transmit a special message to each chamber of Congress with certain information. In addition, a deferral may not be proposed for any period of time extending beyond the end of the fiscal year in which the special message is transmitted. 2 U.S.C. 684(b) states "[d]eferrals shall be permissible only (1) to provide for contingencies; (2) to achieve savings made possible by or through changes in requirements or greater efficiency of operations; or (3) as specifically provided by law. No officer or employee of the United States may defer any budget authority for any other purpose."

on the one hand, and the ICA, on the other, is that prioritization could be characterized as undertaking some spending but, due to lack of cash, deferring other spending.

In the event of a debt limit impasse, if the prioritization appears to disfavor certain programs, issues similar to those that gave rise to the ICA might resurface. These issues could include the balance of power between Congress and the President over spending priorities and the potential for use of prioritization in ways that Congress might not intend.[151] For example, if spending for a program that uses one-year funds were deferred until the end of a fiscal year, when the underlying budget authority expires, the deferral might constitute a functional equivalent of a rescission (cancellation of budget authority).[152] A 1995 internal OMB memorandum that was publicly released with papers of former White House Associate Counsel and current Supreme Court Justice Elena Kagan indicates that OMB and the Department of Justice had grappled with some of these issues in the past without coming to firm resolution.[153]

Could OMB Use Apportionment to Prioritize Payments?[154]

A question may be raised whether statutory authority for the President—as delegated to OMB—to apportion or reapportion budget authority (i.e., the authority to incur obligations) might be used to delay expenditures and, in effect, to establish priorities for liquidating obligations using funding that Congress has granted in appropriations, contract, and borrowing authority. For the executive branch, the President is required by statute to "apportion" these funds (e.g., quarterly) to prevent agencies from spending at a rate that would exhaust their appropriations before the end of the fiscal year.[155] If OMB were to use statutory apportionment authority to affect the rate of federal spending, its ability to do so would be constrained by the ICA.[156] As noted earlier, the ICA does not flatly prohibit the President from withholding funds, but establishes procedures for the President to do so, via formal requests to Congress either to defer (i.e., delay) spending until later

[151] For related discussion, see Laurence H. Tribe, "Guest Post on the Debt Ceiling by Laurence Tribe," *Dorf on Law* (blog), July 16, 2011, http://www.dorfonlaw.org/2011/07/guest-post-on-debt-ceiling-by-laurence.html. Also see Neil H. Buchanan and Michael C. Dorf, "How to Choose the Least Unconstitutional Option: Lessons for the President (and Others) From the Debt Ceiling Standoff," *Columbia Law Review*, vol. 112, no. 6 (October 2012), pp. 1175-1243, https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2016&context=facpub.

[152] See related discussion in Neil H. Buchanan and Michael C. Dorf, "How to Choose the Least Unconstitutional Option: Lessons for the President (and Others) From the Debt Ceiling Standoff," *Columbia Law Review*, vol. 112, no. 6 (October 2012), pp. 1199-1206.

[153] See OMB, "Background Material on Prior Debt Ceiling Crises," memorandum from Roz Rettman to Bob Damus, August 2, 1995, pp. 4-5, as paginated within the document, which is available as pp. 7-11 of a PDF file at https://clinton.presidentiallibraries.us/items/show/27030. The OMB memorandum's author and recipient were senior career officials at OMB at the time. Elena Kagan, from whose files the memorandum was obtained, now serves as Associate Justice of the U.S. Supreme Court. In 1995-1996, she served as Associate White House Counsel under President Clinton. The Clinton Library website provides access to certain records from Justice Kagan's time in the Office of White House Counsel.

[154] Clinton T. Brass, Specialist in Government Organization and Management, coauthored material in this section of the report.

[155] 31 U.S.C. §1512, a provision of the Antideficiency Act, for example, states that appropriations for a definite period must be apportioned by such things as months, activities, or a combination of them to avoid obligation at a rate that would indicate a necessity of a deficiency or supplemental appropriations for the period. While apportionment commonly is used to control the rate at which agencies are allowed to *obligate* funds such as by placing orders and signing contracts, the text of §1512 also provides that it may be used to control the rate at which agencies *expend* funds.

[156] See 2 U.S.C. §§681-692. During the period leading up to enactment of the (ICA), the Nixon Administration used apportionment authority as a tool ultimately to limit outlays to conform to the President's budgetary priorities. Several lawsuits were brought to challenge the President's authority not to obligate or expend amounts that Congress had appropriated.

or to rescind (i.e., cancel) the budget authority that Congress had granted previously.[157] Although the use of apportionment authority in the event of a debt limit crisis might delay the need to pay some obligations, such use would not appear to allow obligations to remain unpaid.

Potential Effect on Federal Operations and Costs Borne by Others[158]

If the debt limit were to become binding—meaning that borrowing capacity, cash reserves, and extraordinary measures were all exhausted—and if no measure were enacted to modify the limit, the flow of incoming revenues would then limit federal outlays. Under normal circumstances, Treasury has the financial resources to meet all federal obligations as they come due. Normal disbursement operations do not distinguish between discretionary outlays (funded through the annual appropriations process) and mandatory (funded in other ways) spending.[159] The specific impacts of delayed payment would depend upon the nature of the federal program or activity for which funds are to be paid.

Payment Delays Are a Form of Borrowing from Creditors and Beneficiaries

When a government delays paying its obligations, in effect it borrows from vendors, contractors, beneficiaries, other governments,[160] or employees who are not paid on time. In some cases, delaying federal payments incurs interest penalties. For instance, the Prompt Payment Act directs the government to pay contractors interest penalties if payments are sent after the required due dates.[161] The Internal Revenue Code requires the government to pay interest if tax refunds are delayed beyond a certain date.[162] Those interest rates are calculated using formulae based on an average of yields on short-term Treasuries plus specified add-ons.

The English economist A. Cecil Pigou noted that when a government compels private individuals to lend it funds, that forced loan could, in economic terms, be seen as a combination of a voluntary loan at market rates plus a tax equal to the excess cost to the individual of extending credit to the government.[163] Such forced loans thus reduce stated public debts by imposing an

[157] Generally, funds that have been proposed for rescission may be withheld from obligation for 45 days of continuous legislative session (excluding periods of more than three days when Congress is not in session). The funds must be released unless Congress has enacted a joint resolution rescinding the funds. Congress sometimes responds to presidential rescission requests by acting on bills to rescind different budget authorities from the ones that the President has proposed. Congress, as a matter of law, has the final say on these matters because rescissions proposed by the President do not take effect unless Congress enacts legislation canceling the funds.

[158] This section was chiefly authored by Clinton T. Brass, Specialist in Government Organization and Management.

[159] Discretionary spending is provided in, and controlled by, annual appropriations acts, which fund many of the routine activities commonly associated with such federal government functions as running executive branch agencies, congressional offices and agencies, and international operations of the government. Mandatory spending includes federal government spending on entitlement programs as well as other budget outlays controlled by laws other than appropriations acts. Mandatory spending also includes appropriated entitlements, such as Medicaid and certain veterans' programs, which are funded in annual appropriations acts. Interest payments, while usually reported separately in budget documents, are technically a form of mandatory spending. For more information, see CRS Report RS20129, *Entitlements and Appropriated Entitlements in the Federal Budget Process*, by Bill Heniff Jr.

[160] For example, because federal, state, and local government finances are linked by various intergovernmental transfers, late payment or nonpayment of federal obligations to states could affect the budgets and finances of local governments, such as school districts, counties, and municipalities.

[161] 31 U.S.C. §3902. The Prompt Payment Act generally requires federal agencies to pay interest on any payments they fail to make by the date(s) specified in a contract or within 30 days of a receipt of a proper invoice. See the section titled "The Prompt Payment Act" in archived CRS Report R41230, *Legal Protections for Subcontractors on Federal Prime Contracts*, by Kate M. Manuel, which is available to congressional clients upon request.

[162] 26 U.S.C. §§6611, 6621.

[163] A. C. Pigou, *A Study in Public Finance*, (London: Macmillan, 1929), pp. 256-257.

implicit tax that appears in no public account, thereby reducing explicit public debt service costs while raising the true costs of carrying that debt.[164]

Evaluating the costs of such forced loans using market interest rates may underestimate their true societal costs. Individuals, nonprofit organizations, and small businesses typically cannot access credit on the same terms and costs as the federal government. Moreover, many households are credit constrained, meaning that they lack savings or the ability to borrow at reasonable interest rates, restricting their ability to smooth out the effects of income shocks. According to one 2007 estimate, 31% of U.S. households faced credit constraints.[165] A 2018 Federal Reserve survey found that almost 40% of households would struggle to pay an unexpected expense of $400.[166]

While the costs of such forced loans may be hidden, they are unlikely to be negligible. A study of European Union governments found that payment delays increased the probability of firms exiting markets, especially for smaller firms.[167] On the other hand, the U.S. government's Quickpay reform of 2011—which directed agencies to pay small contractors within 15 days—led to higher employment among firms, although effects were weaker in low underemployment areas.[168]

If the federal government paid some obligations in arrears—that is, if payments were delayed until sufficient receipts were collected—a backlog of unpaid bills would accumulate. According to a 2012 Treasury Inspector General report, Treasury officials viewed delayed payments as the "least harmful" of available options were borrowing capacity and cash balances exhausted.[169] The nature of federal payment schedules implies that payment backlogs could build up rapidly after Treasury cash balances were exhausted. For example, according to Treasury estimates during the 2013 debt limit episode, Treasury's borrowing capacity would have been exhausted on October 17. An independent analysis found that Treasury's cash balances would have lasted until October 30 or 31, but payments due on November 1—totaling about $70 billion—would immediately put payments a week behind schedule.[170]

Potential Effects on Programs Linked to Trust Funds

If Treasury delayed investing a federal trust fund's revenues in government securities, or redeemed a federal trust fund's holdings of government securities prematurely, the affected trust

[164] For an argument that forced loans in the form of payment delays would violate constitutional mandates, see Michael C. Dorf and Neil H. Buchanan, "Borrowing by Any Other Name: Why Presidential 'Spending Cuts' Would Still Exceed the Debt Ceiling," *Columbia Law Review Sidebar*, vol. 14 (2014), at pp. 62-64, http://columbialawreview.org/borrowing-by-any-other-name_buchanan-and-dorf/.

[165] Charles Grant, "Estimating Credit Constraints Among U.S. Households," *Oxford Economic Papers*, vol. 59, no. 4 (October 2007), pp. 583-605, https://ssrn.com/abstract=1154397. The estimate was based on analysis of 1988-1993 expenditure and household finance data.

[166] Federal Reserve Board of Governors, "Report on the Economic Well-Being of U.S. Households in 2018," website, May 2019, https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-dealing-with-unexpected-expenses.htm.

[167] Maurizio Conti et al., "Governments' Late Payments and Firms' Survival: Evidence from the European Union," *Journal of Law and Economics*, vol. 64 (August 2021), pp. 603-627.

[168] Jean-Noël Barrot and Ramana Nanda, "The Employment Effects of Faster Payment: Evidence from the Federal Quickpay Reform," *Journal of Finance*, vo. 75 (June 2020), pp. 3139-3173. See also Jacob Lew, "Accelerating Payments to Small Businesses for Goods and Services," OMB memorandum, September 14, 2011, https://obamawhitehouse.archives.gov/sites/default/files/omb/memoranda/2011/m11-32.pdf.

[169] Letter from Eric M. Thorson, Chair, Council of the Inspectors General on Financial Oversight, to Sen. Orrin G. Hatch, Ranking Member, Committee on Finance, August 24, 2012, p. 4.

[170] Alec Phillips and Kris Dawsey, "The Debt Limit: How, When, and What If," *Goldman Sachs US Daily*, October 6, 2013.

fund would lose interest income, which could worsen the financial situation of the affected trust fund and accelerate an insolvency date.[171] As noted earlier (see "Actions in 1995-1996"), Congress passed P.L. 104-121 to prevent federal officials from using the Social Security and Medicare trust funds for debt management purposes, except when necessary to provide for the payment of benefits and the programs' administrative expenses. Under P.L. 99-509, Treasury is permitted to delay investment in the TSP's G Fund and the CSRDF, as well as to redeem assets of the CSRDF before maturity. The law, as noted above, requires Treasury to make these funds whole after resolution of a debt limit episode. The government maintains a number of other trust funds whose finances could potentially be harmed by delayed investment or early redemption in the absence of similar actions to make the trust funds whole after a debt limit impasse has ended.

The Definition of Federal Default Is Contested

In private debt contracts the term *default* is normally defined by specific clauses that cover events such as failure to pay on time, failure to act, or failure to deliver. Documents that govern issues of Treasury securities, by contract, carry no provisions that define default. What would count as a default by the federal government, therefore, is unclear and has been an object of contention. In particular, some Members have contended that prioritizing some federal payments—such as principal and interest on Treasury securities—might avoid default. Other Members have argued that the delay in payment of other federal obligations would constitute default.

What Is Default?

Bond contracts and associated paperwork can run to thousands of pages, covering various terms and contingencies, including default provisions. Default provisions typically are adapted to the needs of involved parties and their relationship.[172] For instance, a contract may allow a lender, bondholder, or other creditor to force a restructuring of debt or securities, to transfer some control of the debtor company, or to void specified obligations of the creditors. Debt acceleration, which in the event of default allows creditors to demand immediate repayment of unpaid balances of debt, is another common bond contract provision.

Questions have been raised regarding what constitutes a legal "default" by the government. Some proponents of a prioritization system suggest that the term *default* applies only if the government fails to pay interest on debt obligations held by third parties. Opponents of prioritization appear to argue that the term *default* applies not only to a failure to pay third-party debt holders, but also to the failure by the government to meet any obligation authorized by law, which would include a failure to fund an appropriated program, pay federal salaries or benefits, or pay an amount owed on a federal contract. No general statutory definition of the term *default* exists. *Black's Law Dictionary* defines the term as "the failure to make a payment when due,"[173] which, if accepted as the governing definition, would not appear to distinguish between various types of government obligations.

Aside from technical definitions, financial markets' perceptions of what constitutes a default, or a real threat of default, may be more relevant when assessing the potential impacts of not raising the debt limit. For example, predicting how financial markets would react if the federal

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[171] For information about the balances of all federal trust funds, see archived CRS Report R41328, *Federal Trust Funds and the Budget*, by Mindy R. Levit.

[172] Ningzhong Li, Yun Lou, and Florin P. Vasvari, "Default Clauses in Debt Contracts," *Review of Accounting Studies*, vol. 20 (August 2015), pp. 1596-1637.

[173] Bryan A. Garner and Henry Campbell Black, *Black's Law Dictionary*, 7th ed. (St. Paul, MN: West, 2009), p. 428.

government prioritized payments on debt obligations above other obligations, thus postponing payments on other legal obligations, would be difficult. While disruptions of Treasury security markets would likely cause immediate distress in financial markets, payment delays might spur some to impute elevated credit risks to the federal government, which, in turn, would affect decisions to invest in federal government Treasury securities.[174]

Credit Rating Agencies Have Their Own Definitions of Default

Third parties may also develop their own definitions of default. For example, credit rating agencies track compliance with contract terms so that client firms can assess risks of dealing with contracting parties. Those judgments on compliance are not necessarily based directly on contract terms. Credit rating agencies can make their own judgments on what constitutes a default. In the credit default swap (CDS) market, whether a "credit event" has occurred is determined by committees that rely on set external guidelines, rather than terms of bond contracts.[175] Decisions of credit rating agencies or CDS determinations may affect portfolio decisions of banks, mutual funds, and other investors.

Treasury Securities Carry No Contractual Definition of Default

No contract, administrative, or legislative text spells out events that would constitute default on federal obligations.[176] Treasury securities are sold on terms specified in Treasury's Uniform Offering Circular (UOC),[177] which makes no mention of payment delays or default. Any discussion of potential default by the U.S. government on obligations related to Treasury securities therefore could not be based on contractual terms, although the body of contract law could be applied.

Commercial and international debt instruments often contain cross-default provisions, which specify that a default on one debt obligation will trigger an acceleration of the maturities of other debt obligations.[178] Treasury securities, having no default clauses, lack cross-default provisions. A delay in the payment of principal or interest on some Treasury securities therefore would not necessarily affect the status of other Treasury securities.[179] Payment delays, however, may affect how market participants perceive Treasuries and what they are willing to pay for them.

The lack of a contractual definition and the absence of modern precedents leaves room for divergent views on what would constitute a federal default. The next section outlines some differences in views among Members of Congress in recent years. Financial market participants

[174] The potential effects of reaching the debt limit on financial markets are discussed in the section titled "Potential Economic and Financial Effects."

[175] CRS Report R41932, *Treasury Securities and the U.S. Sovereign Credit Default Swap Market*, by D. Andrew Austin and Rena S. Miller.

[176] For additional discussion, see CRS Report R44704, *Has the U.S. Government Ever "Defaulted"?*, by D. Andrew Austin. The federal government does spell out what default means for student borrowers and other recipients of federal loans. For instance, see Federal Student Aid, Understanding Delinquency and Default, https://studentaid.ed.gov/sa/repay-loans/default.

[177] U.S. Treasury, "Uniform Offering Circular," https://www.treasurydirect.gov/laws-and-regulations/auction-regulations-uoc/. In earlier years, specific circulars set terms for Treasury securities.

[178] Lee C. Buchheit, "How to Negotiate Cross-Default Clauses," *International Financial Law Review*, vol. 12, no. 8 (August 1993), pp. 27-29.

[179] SIFMA, "Delay in Treasury Payments: Discussion of Scenarios," January 2018, https://www.sifma.org/wp-content/uploads/2018/01/Disruption-in-Treasury-Payments-January-25.pdf.

would make their own judgments. Others affected by payment delays would also have to choose how to respond, although probably less immediately than financial markets.

Views on Prioritization and Default

While debt limit episodes have sometimes set the stage for energetic discussions of fiscal policy, the need to avoid a federal default has been a widely supported aim. In some recent debt limit episodes, the meaning of federal default has itself become an object of contention.

Debt Policy Debates in 2011

During the debate over the debt limit in 2011, the Obama Administration and Congress maintained sharply divergent views on implications of debt policy and consequences of not paying federal obligations on time.

Members of the Administration stated that default would be unavoidable if the debt limit were not raised, and that the consequences of a federal default would be serious. Secretary Geithner's letter of January 6, 2011, provided Treasury's views on the "consequences of default by the United States." The letter described, among other things, federal payments that would be "discontinued, limited, or adversely affected."[180] The letter also said a short-term or limited default on legal obligations would cause "catastrophic damage to the economy."[181]

Austan Goolsbee, then-chairman of the White House Council of Economic Advisers, elaborated, saying that a default would cause "a worse financial economic crisis than anything we saw in 2008."[182] Secretary Geithner, in his letter to Congress, added, "Default would have prolonged and far-reaching negative consequences on the safe-haven status of Treasuries and the dollar's dominant role in the international financial system, causing further increases in interest rates and reducing the willingness of investors here and around the world to invest in the United States."[183] Neal Wolin, then-Treasury Deputy Secretary, wrote that proposals to prioritize payments on the national debt above other legal obligations would not avoid default and would bring the same economic consequences Secretary Geithner described.[184] Secretary Geithner also wrote that President Obama wanted to work with Congress to address the federal government's fiscal position with particular attention to addressing "medium- and long-term fiscal challenges."[185]

Other policymakers contended that default could be avoided by prioritizing certain categories of payments. On January 26, 2011, Senator Patrick Toomey introduced one bill (S. 163) that would have required Treasury to prioritize the principal and interest on debt held by the public if the debt limit were reached. He introduced a second bill (S. 1420) that would have prioritized payments for principal and interest on debt held by the public, Social Security benefits, and pay

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[180] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 6, 2011, p. 4.

[181] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 6, 2011, pp. 1, 3.

[182] ABC News *This Week*, "Transcript: White House Adviser Austan Goolsbee," January 2, 2011, http://abcnews.go.com/ThisWeek/week-transcript-white-house-adviser-austan-goolsbee/story?id=12522822.

[183] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 6, 2011, p. 4.

[184] Neal Wolin, Deputy Secretary of the Treasury, "Treasury: Proposals to 'Prioritize' Payments on U.S. Debt Not Workable; Would Not Prevent Default," January 21, 2011, http://www.treasury.gov/connect/blog/Pages/Proposals-to-Prioritize-Payments-on-US-Debt-Not-Workable-Would-Not-Prevent-Default.aspx.

[185] Letter from Timothy F. Geithner, Secretary of the Treasury, to the Hon. Harry Reid, Senate Majority Leader, January 6, 2011, p. 4.

and allowances for members of the Armed Forces on active duty. Senator Toomey contended that the measure would "take this risk off the table and try to provide some clarity to markets and to senior citizens who are savers and who have invested their savings in Treasurys."[186] The previous day, Senator Toomey said that the Obama Administration's warnings were "scare tactics" that were "meant to intimidate Members of Congress into voting for a debt limit increase without the underlying reforms and spending cuts that the President resists."[187] Both S. 163 and S. 1420 were placed on the Senate Legislative Calendar, with no further actions having been taken.

Divergent Views on Default in 2015 Markup of Prioritization Legislation

In September 2015, a House Ways and Means Committee markup of a similar prioritization measure (H.R. 692; 114th Congress) highlighted the divergence of views regarding the meaning of default.[188] Some Members stated that only a failure to make principal and interest payments linked to Treasury securities would constitute default.[189] Other Members stated that a binding debt limit that would hinder the Treasury Secretary's ability to meet federal obligations on time would be tantamount to default. A summary of other measures to prioritize some federal payments or to address the debt limit in other ways is in the section entitled "Legislative Proposals Regarding the Debt Limit".

Potential Economic and Financial Effects

A binding debt limit would not only hinder federal finances and operations, but could also trigger severe economic and financial consequences. A 1979 GAO report noted that a federal default caused by a binding debt limit could harm the economy, the public welfare, and the government's ability to market future securities.

> It is difficult to perceive all the adverse effects that a government default for even a short time would have on the economy and the public welfare. It is generally recognized that a default would preclude the government from honoring all of its obligations to pay for such things as employees' salaries and wages; social security benefits, civil service retirement, and other benefits from trust funds; contractual services and supplies, and maturing securities.... At a minimum, however, the government could be subject to additional claims for interest on unredeemed matured debt and to claims for damages resulting from failure to make payments. But even beyond that, the full faith and credit of the U.S. government would be threatened. Domestic money markets, in which government securities play a major role, could be affected substantially.[190]

International authorities have also noted their concerns about consequences of a binding debt limit. Then-IMF Managing Director Christine Lagarde said in September 2013 that the uncertainty about whether the debt ceiling would be raised "can create volatility, instability, and

[186] Sen. Patrick Toomey, *Congressional Record*, vol. 157 (July 28, 2011), pp. S4996-S4997.

[187] Sen. Patrick Toomey, *Congressional Record*, vol. 157 (July 27, 2011), pp. S4936-S4937.

[188] H.R. 692 (114th Congress) would have allowed the Treasury Secretary, once federal debt had reached its limit, to issue special bonds that would not be counted against the limit. Proceeds of those special bonds would then have been used to pay principal and interest on federal debt held by the public or the Social Security trust funds.

[189] U.S. Congress, House Committee on Ways and Means, *Default Prevention Act*, 114th Cong., 1st sess., September 18, 2015, H.Rept. 114-265 (Washington: GPO, 2015).

[190] GAO, *A New Approach to the Public Debt Legislation Should be Considered*, FGMSD-79-58, September 1979, pp. 17-18, http://archive.gao.gov/f0302/110373.pdf.

as a result, it should be avoided by any means."[191] In 2023, an IMF spokesperson said that the IMF was "concerned about the severe repercussions for both the US economy, but also the global economy."[192]

A binding debt limit, as noted above, could induce some investors to reassess the credit risks associated with federal debt. Treasury securities have traditionally been viewed as a safe harbor investment. A federal failure to pay obligations on time could lead to investors demanding higher interest rates for Treasury securities and could also impair the government's ability to borrow in the face of economic downturns or unforeseen contingencies.

The Debt Limit and Possible Financial Contagion

If the debt limit were to become binding, the consequences for financial markets might depend on prospects for a timely resolution of the debt limit episode, on how Treasury managed operations, and on the extent to which federal payments were delayed or disrupted. Predicting the effects of a binding debt limit on the financial institutions and conditions would be difficult because prices of assets traded in financial markets depend heavily on interpretations of the implications of current events as well as on future expectations. Although some debt limit episodes have stressed Treasury resources and sparked concerns in the financial sector, the statutory debt limit has not become binding since it was established in 1917. Thus, a binding debt limit would be a novel event, without modern American precedent.[193]

If the debt limit did become binding, so that Treasury had to rely on incoming cash to pay its obligations, a significant portion of government spending would go unpaid when federal revenues did not keep pace with outlays. Removing a portion of government spending from the economy would leave behind significant economic effects and would affect gross domestic product (GDP) by definition, all other things being equal.[194] Further, if the government failed to make timely payments to individuals, service providers, and other organizations, these persons and entities would also be affected. Even if the government continued to pay interest and principal on federal securities, whether creditors would retain confidence in the government's willingness to pay its obligations is unclear. If creditors lost this confidence, the federal government's interest costs would likely increase substantially.

In April 2011, the Treasury Borrowing Advisory Committee sent a letter to Secretary Geithner expressing its views on the impact on financial markets if the debt ceiling were not raised.[195] The

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[191] "A Check on the Global Economy with IMF Head Lagarde," *National Public Radio*, September 23, 2013, transcript available at http://wfae.org/post/check-global-economy-imf-head-lagarde.

[192] "IMF Briefing US Debt Ceiling / G7," International Monetary Fund, May 11, 2023, https://mediacenter.imf.org/news/imf-briefing-us-debt-ceiling—g7/s/4aed5dc0-44e2-4d68-a51b-0c072c3347c8.

[193] Several states and two territories have defaulted on bonds. William B. English, "Understanding the Costs of Sovereign Default: American State Debts in the 1840's," *American Economic Review*, vol. 86, no. 1 (March 1996), pp. 259-275; Arthur Grinath, III, John J. Wallis, and Richard E. Sylla, *Debt, Default, and Revenue Structure: The American State Debt Crisis in the Early 1840s*, NBER Historical Paper 97, March 1997. Illinois, Indiana, Maryland, and Pennsylvania defaulted temporarily; Arkansas, Louisiana, and Michigan partially repudiated their debts; Mississippi and the Florida Territory completely repudiated their debts. For a discussion of southern states that repudiated debt in the post-Reconstruction era, see William A. Scott, *Repudiation of State Debts in the United States*, (New York: Crowley, 1893), p. 276. Those states were Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia.

[194] GDP = consumption + investment + government spending + (exports - imports). If government spending declines, then GDP will also decline by definition, all else equal.

[195] The Treasury Borrowing Advisory Committee is a group of senior representatives from investment funds and banks that presents its observations on the overall strength of the U.S. economy and makes recommendations on technical (continued...)

letter warned that any delay by Treasury in making an interest or principal payment could trigger "another catastrophic financial crisis." Further, the committee described several potential consequences stemming from a Treasury default on its obligations, including a downgrade of the U.S. credit rating, an increase in federal and private borrowing costs, damage to the economic recovery, and broader disruptions to the financial system. Finally, the committee also warned that a prolonged delay in raising the debt limit could have negative consequences on the market before the time when default would actually occur.[196] In May 2023, the committee urged Congress "to raise or suspend the debt limit with all due haste" and warned that "failing to do so is reckless and is already disrupting Treasury market functioning, increasing costs to the taxpayer, and constraining economic growth."[197]

Analysis of economic history suggests that financial crises often lead to economic downturns.[198]

Treasury Market Turmoil and Structural Changes

Treasury securities trade in the world's largest and most liquid market for government securities.[199] That market experienced significant turmoil in March 2020, after COVID-19 was declared a pandemic, and again in March 2023, after the failure of two mid-sized banks. In both cases, trading conditions soon normalized, although concerns remained that severe shocks could lead to unexpected negative consequences for public finances.[200]

Policymakers in the United States and elsewhere have proposed changes in the structure of markets for Treasuries and other central government debt instruments, such as requiring central clearing of some transactions.[201] Central clearing means that a central counterparty—such as a clearinghouse—acts as the seller to the buyer and as the buyer to the seller. Idiosyncratic counterparty risks for buyers and sellers are thereby replaced by guarantees of the central counterparty. This also allows netting of trades, which shrinks financial institutions' balance sheets.[202] Fees to support the central counterparty may increase costs of some trades.

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debt management issues to the Treasury Department. More on the Treasury Borrowing Advisory Committee can be found at https://home.treasury.gov/policy-issues/financing-the-government/quarterly-refunding/treasury-borrowing-advisory-committee-tbac.

[196] Letter from Matthew E. Zames, Chairman of Treasury Borrowing Advisory Committee, to Timothy F. Geithner, April 25, 2011, https://home.treasury.gov/system/files/276/Geithner_Debt_Limit_Letter_4_25_11E.pdf.

[197] U.S. Treasury, "Report to the Secretary of the Treasury from the Treasury Borrowing Advisory Committee," press release, May 2, 2023, https://home.treasury.gov/news/press-releases/jy1461.

[198] Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different* (Princeton, 2009), ch. 14.

[199] Michael Fleming, "How Has Treasury Market Liquidity Evolved in 2023?" Federal Reserve Bank of New York, *Liberty Street Economics* (blog), October 17, 2023, https://libertystreeteconomics.newyorkfed.org/2023/10/how-has-treasury-market-liquidity-evolved-in-2023/.

[200] For instance, the market for the United Kingdom's government bonds experienced turmoil in September 2022, after a "mini-budget" proposing lower taxes and more borrowing was released. Some pension funds suffered significant losses on derivatives contracts tied to that market. David Milliken, Dhara Ranasinghe, and Tommy Wilkes, "UK Bonds and Pound at Centre of Storm as Tax Shock Hammers Confidence," Reuters, September 23, 2022, https://www.reuters.com/markets/europe/uk-bonds-pound-centre-storm-tax-shock-hammers-confidence-2022-09-23/. Also see Richard Partington, "Bank Confirms Pension Funds Almost Collapsed Amid Market Meltdown," *Guardian*, October 6, 2022, https://www.theguardian.com/business/2022/oct/06/bank-of-england-confirms-pension-funds-almost-collapsed-amid-market-meltdown.

[201] Yuliya Baranova et al., "Central Clearing and the Functioning of Government Bond Markets," Bank of England, *BankUnderground* (blog), September 14, 2023, https://bankunderground.co.uk/2023/09/14/central-clearing-and-the-functioning-of-government-bond-markets/.

[202] In the simplest case, netting means that two counterparties settle contracts by paying the difference in amounts (continued...)

The Securities and Exchange Commission (SEC) issued a final rule on clearing of Treasuries in December 2023.[203] Current and former Federal Reserve officials argue that wider clearing of Treasuries and collection of a wider set of trading data would enhance market stability and resilience.[204]

Credit Ratings for the U.S. Government

Credit ratings on federal securities provide some evidence on how financial markets may view the effects of a binding debt limit. Two of the three major credit ratings agencies downgraded the U.S. government's rating to one notch below AAA, while the third put that rating on a negative watch.

On August 5, 2011, shortly after the 2011 debt limit episode was resolved by enactment of the BCA (P.L. 112-25), the credit rating agency S&P downgraded the United States' sovereign credit rating from AAA to AA+.[205] S&P not only expressed concerns about the federal government's fiscal outlook, but also cited "political brinksmanship" in debt ceiling negotiations, which raised the issue of a hypothetical federal default, as a factor in its decision. Technical errors found in the S&P downgrade analysis sparked criticism.[206] The two other major credit rating agencies did not follow S&P's downgrade in 2011, although both expressed concerns about the federal government's fiscal outlook.[207]

The credit rating agency Fitch warned of a possible downgrade in August 2017[208] and again in November 2021,[209] stating on the latter occasion that the U.S. government's debt ceiling compounded "weak governance … increasing debt levels and ongoing risks to public finances" and risks of "political brinksmanship." Fitch also noted that "prioritising debt service payments over other obligations if the limit is not raised—if legally and technically feasible—may not be

owed, rather than gross amounts. For instance, if Bill owes Al $10, and Al owes Bill $11, a net payment of $1 from Al to Bill would settle obligations. For more complex arrangements, see Gabriella Rosenberg, Maria Carmen del Urquiza, and David Miller, "What is Netting? How Does Netting Work?" presentation, Conference on Netting of OTC Financial Contracts in Latin America and the Caribbean, Mexico City, November 9-10, 2000, https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/Millerspresentationonnetting.pdf.

[203] U.S. Securities and Exchange Commission, "Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities," December 13, 2023, https://www.sec.gov/rules/2022/09/standards-covered-clearing-agencies-us-treasury-securities-and-application-broker.

[204] Bill Dudley, "Three Things to Prevent a Treasury Market Meltdown," *Bloomberg*, November 16, 2023, https://www.bloomberg.com/opinion/articles/2023-11-16/us-treasury-market-be-prepared-for-the-flood. Also see Michael S. Barr, Speech at the 2023 U.S. Treasury Market Conference, November 16, 2023, https://www.federalreserve.gov/newsevents/speech/barr20231116a.htm.

[205] Standard & Poor's, "United States of America Long-Term Rating Lowered To 'AA+' Due To Political Risks, Rising Debt Burden; Outlook Negative," August 5, 2011, https://web.archive.org/web/20110809073342/http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563.

[206] Robin Harding, Aline van Duyn, and Telis Demos, "S&P Cuts US Debt Rating to Double A Plus," *Financial Times*, August 6, 2011.

[207] Moody's Investors' Service, "Moody's Confirms US Aaa Rating, Assigns Negative Outlook," August 2, 2011, http://www.moodys.com/research/Moodys-confirms-US-Aaa-Rating-assigns-negative-outlook?lang=en&cy=global&docid=PR_223568#. Also see "Text: Fitch on U.S. Debt, Sovereign Rating," Reuters, August 2, 2011, http://www.reuters.com/article/2011/08/02/us-text-fitch-idUSTRE7714M620110802.

[208] Fitch Ratings, "Fitch: Debt Limit, Government Funding to Test US Policy Makers," August 23, 2017, https://www.fitchratings.com/site/pr/1028190.

[209] Fitch Ratings, "U.S. Debt Ceiling Challenges Could Pressure GSE Ratings," November 12, 2021, https://www.fitchratings.com/research/banks/us-debt-ceiling-challenges-could-pressure-gse-ratings-12-11-2021.

compatible with 'AAA' status."[210] In August 2023, Fitch downgraded federal credit from AAA to AA+, citing that, among other factors, "repeated debt-limit political standoffs and last-minute resolutions have eroded confidence in fiscal management."[211]

In September 2021, the credit rating agency Moody's warned that a federal default would deal a "catastrophic blow to the nascent economic recovery from the COVID-19 pandemic" and that "global financial markets and the economy would be upended ... even if resolved quickly."[212] In September 2023, Moody's changed its outlook for the federal credit to "negative." Moody's noted the strength of the American economy as one reason for retaining its AAA rating, while warning that "political polarization within U.S. Congress raises the risk that successive governments will not be able to reach consensus on a fiscal plan to slow the decline in debt affordability."[213] Moody's decision did not appear to affect demand for Treasuries.[214]

Credit Default Swap Prices As a Default Probability Indicator

Credit default swaps (CDSs) provide an imperfect indication of financial markets' implicit estimation of the possibility of a default.[215] CDSs are contracts in which one party promises to make a set payment to another party if a third party defaults on debt payments. CDS contracts are tied to independent definitions of default, rather than those in the third party's debt contracts. CDS prices, often referred to as spreads, are typically quoted for one-year and five-year contracts.

If one assumes a set postdefault recovery rate, the CDS price can be mapped into an estimate of the probability of default.[216] Some financial market and federal budget analysts view price trends of U.S. CDSs as an indicator of the risks of a sovereign default by the federal government. Major changes in U.S. CDS prices have reflected events that could have affected the long-term fiscal situation of the U.S. government, such as the September 2008 Lehman Brothers bankruptcy. The thinness of trading in U.S. government CDSs, however, in which relatively small amounts are invested, suggests that inferences about default probabilities are imprecise.

CDSs on sovereign debt may reflect other risks distinct from risks of a sovereign default.[217] Government bonds, as discussed below, commonly serve as collateral in short-term funding arrangements, such as repo contracts. Volatility in public debt markets can reduce the value of government bonds as collateral, which limits leverage and in turn reduces the supply of

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210 Fitch Ratings, "Fitch: Debt Limit, Government Funding to Test US Policy Makers," August 23, 2017.

211 Fitch Ratings, "Fitch Downgrades the United States' Long-Term Ratings to 'AA+' from 'AAA'; Outlook Stable," August 1, 2023, https://www.fitchratings.com/research/sovereigns/fitch-downgrades-united-states-long-term-ratings-to-aa-from-aaa-outlook-stable-01-08-2023.

212 Mark Zandi and Bernard Yaros, "Playing a Dangerous Game With the Debt Limit," September 21, 2021, *Moody's Analytics*, https://web.archive.org/web/20210929041410/https://www.moodysanalytics.com/-/media/article/2021/playing-a-dangerous-game-with-the-debt-limit.pdf. Also see Mark Zandi and Bernard Yaros, "Going Down the Debt Limit Rabbit Hole," *Moody's Analytics*, March 2023, https://www.moodysanalytics.com/-/media/article/2023/going-down-the-debt-limit-rabbit-hole.pdf.

213 Alan Rappeport, "Moody's Changes U.S. Credit Outlook to 'Negative,'" *New York Times*, November 10, 2023, https://www.nytimes.com/2023/11/10/business/moodys-negative-credit-outlook.html.

214 Diccon Hyatt, "Why Investors Shrugged When Moody's Threatened a US Credit Rating Downgrade," Investotopia, November 16, 2023, https://www.investopedia.com/why-investors-shrugged-when-moody-s-threatened-a-us-credit-rating-downgrade-8402370.

215 See CRS Report R41932, *Treasury Securities and the U.S. Sovereign Credit Default Swap Market*, by D. Andrew Austin and Rena S. Miller.

216 A more sophisticated calculation would account for other risks and financial factors.

217 Lorenzo Genito, "Understanding the European Sovereign Debt Crisis Through the Lens of Repo Market Liquidity" (D.Phil. diss., September 2018), University of Warwick, http://wrap.warwick.ac.uk/130505.

liquidity.[218] A significant and growing share of repo contracts are traded through centralized clearinghouses. Clearinghouses may demand margin calls from traders to reflect elevated risk levels, which may force sales of assets, putting downward pressure on asset prices.[219] CDSs on sovereign debt can serve as a hedge against such market turmoil, but also may reflect perceptions of potential market stresses rather than just the probability of sovereign default.[220]

CDS Prices Rose During the 2011 Debt Limit Episode

During the 2011 debt limit episode, which began in May of that year, U.S. CDS prices began to rise dramatically, as **Figure 5** indicates.[221]

Investor concerns became more acute during the summer of the 2011 debt limit discussions, as U.S. five-year CDS prices began to trade in the 50 basis points (bps) to 55 bps range—well above levels in 2012 and 2013, but below levels in the months after the Lehman Brothers investment bank collapsed in September 2008.[222] (100 basis points equal 1%.) Shortly after the 2011 debt limit episode was resolved in August 2011, U.S. government CDS prices peaked at about 63 bps after S&P downgraded the federal government's credit rating.[223] After that point, however, prices for those CDSs fell.[224]

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[218] For instance, in a simple repo transaction a financial company, such as a hedge fund, transfers a Treasury bond to a bank in exchange for a larger amount of cash today. Tomorrow the hedge fund repays the cash along with an interest charge and the bank returns the bond. A bank might be willing to make a short-term repo loan of $100 million backed by $2 million in Treasury bonds, resulting in a leverage ratio of 50 to 1. If Treasury bonds were judged to be riskier assets, the bank might only be willing to lend $80 million on the same amount of bonds. This would increase the hedge fund's cost of liquidity, as it would be able to raise less cash with its asset holdings.

[219] Clearinghouses and securities brokers may allow approved clients to own securities while paying a fraction of the cost, something known as *buying on margin*. The rest of the cost, in effect, is borrowed from the clearinghouse or broker. Clearinghouses typically offer margin transactions for the brief time between initiation of a sale and its clearing. Brokers may offer longer-term arrangements. If the security rises in value, trading profits to the owner are magnified by the margin arrangement, although losses are as well. If losses threaten to wipe out the owner's share of the security's value, the broker or clearinghouse will issue a "margin call" to the owner to either provide additional collateral or forfeit the security. Widespread margin calls can force asset sales that may lead to "fire-sale" dynamics than can destabilize markets.

[220] The section "Have Debt Limit Episodes Raised Federal Borrowing Costs?" discusses an analysis by Federal Reserve economists that attempts to distinguish between sovereign default risk and risks of market disruption.

[221] "The Mother of All Tail Risks," *The Economist*, June 23, 2011. This article is the source for **Figure 5**.

[222] For an analysis of CDS price dynamics during that period, see C. Emre Alper, Lorenzo Forni, and Marc Gerard, *Pricing of Sovereign Credit Risk: Evidence from Advanced Economies During the Financial Crisis*, IMF Working Paper 12/24, January 2012, http://www.imf.org/external/pubs/ft/wp/2012/wp1224.pdf.

[223] U.S. CDS prices, *Bloomberg*, August 15, 2011, https://greenewable.files.wordpress.com/2011/08/usacds815.gif.

[224] As of mid-December 2022, the 5-year US CDS price was about 25 basis points.

Figure 5. U.S. Credit Default Swap Price and Volume Trends in the 2008 Financial Crisis and 2011 Debt Limit Episode

November 2008-June 2011

Source: *The Economist*, June 23, 2011, based on Markit and DTCC data.

Note: 100 basis points equals a percentage point.

In the past five years, U.S. CDS prices largely have remained between 10 and 25 bps, although in late 2022, prices rose as high as 30 bps (**Figure 6**). Although an increase of about 5 bps coincided with the debt limit episode in late 2021, price trends generally track those of other major economies.

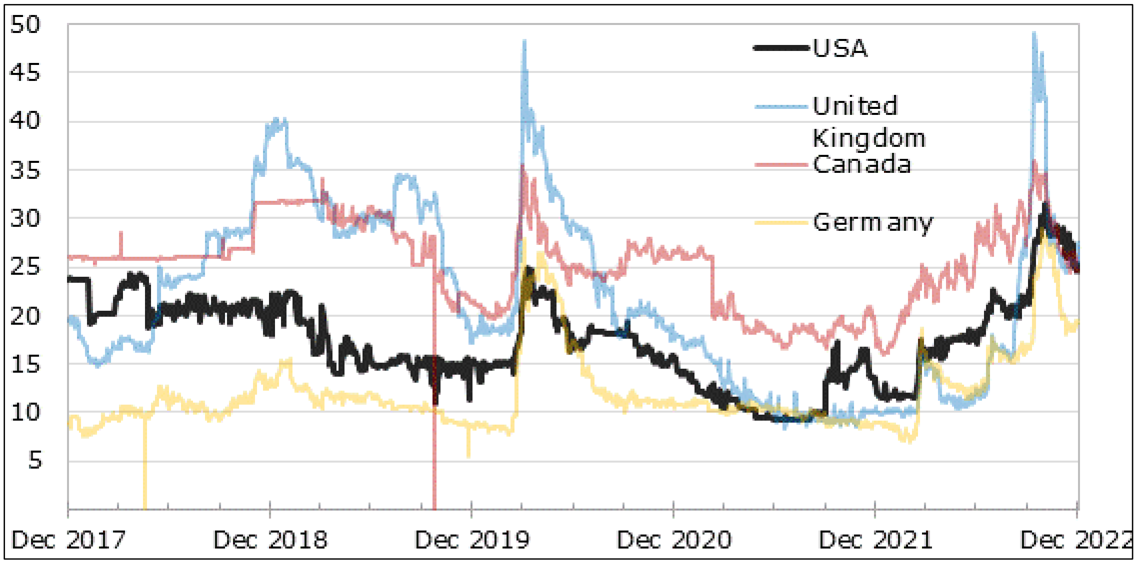
The thinness of the market for U.S. CDSs suggests that some caution is in order when interpreting those prices as an indicator of the likelihood of a federal default. The volume of U.S. CDSs also grew substantially during the 2011 U.S. debt ceiling episode—although those volumes were small compared to sovereign CDS trading volumes for several European countries during that time.[225] Over the past five years, the average notional value of U.S. CDSs was about $38 million, and on average, two trades per business day were cleared.[226]

[225] See, for example, Anjail Cordeiro, "Brazil One-Year CDS Below U.S. on Debt Ceiling, Market Jitters," *Wall Street Journal*, June 15, 2011, http://online.wsj.com/article/BT-CO-20110615-711546.html.

[226] CRS analysis of DTCC data (https://www.dtcc.com/repository-otc-data/). Averages include all U.S. CDS tenors.

Figure 6. CDS Prices for Selected Major Economies

Prices in basis points



Source: CRS calculations based on S&P Capital IQ data for 5-year CDS.

Repo Lending and Shadow Banking

Major financial institutions use collateralized lending arrangements to obtain short-term liquidity. "Repo" lending—short for repurchase agreement—provides a common means of secured lending among financial institutions. *Shadow banking* has been described as a system that provides firms and financial institutions with services akin to traditional banking services through a repo and secured lending arrangements among matched borrowers and lenders.[227]

Treasury securities are used as collateral in a significant share of repo trades. For instance, a hedge fund might agree to sell a Treasury security to a bank for a day in return for the use of a larger amount of cash. At the end of the day, the hedge fund repurchases the Treasury security, thus returning the cash and an implicit interest charge to the bank. The repo agreement allows the hedge fund to leverage its secure assets to fund its operations.

Just as a homeowner can buy a house with a down payment of 5% or 10% using a mortgage that holds the house as collateral, a hedge fund or other financial institution can obtain a high multiple of Treasury securities in cash using repo arrangements. The viability of both mortgages and repos depends on the quality of the collateral and the reputations of lenders and borrowers.

Repo Lending and the Debt Limit

If Treasury were unable to make timely payments, repo funding could become more expensive or could be disrupted,[228] which in turn could result in severe financial dislocation.[229] In particular, if the value of Treasury securities as collateral were diminished by the effects of a debt limit

[227] See Gary Gorton, *Slapped by the Invisible Hand* (Oxford: Oxford University Press, 2010).

[228] For background, see Tobias Adrian et al., *Repo and Securities Lending*, Federal Reserve Bank of New York Staff Report No. 529, revised version February 2013, http://www.newyorkfed.org/research/staff_reports/sr529.pdf.

[229] For details, see testimony from the Senate Banking Committee hearings of October 10, 2013, noted above (footnote 120).

episode, then the supply of liquidity through repo markets would be constrained. If a change in the perceived soundness of Treasury securities were sudden and unexpected, the consequences could be especially severe.

Repo lending rates rose sharply in early August 2011 during the 2011 debt limit episode, but fell to previous levels once that episode was resolved.[230] The potential importance of the repo borrowing channel, in part, stems from two features of modern finance. First, the four largest U.S. banks account for about half of repo lending volumes, according to one recent estimate. Second, repo lending supports leveraging strategies of hedge funds and similar entities.[231] Sudden and unanticipated changes in the perceived soundness of Treasury securities could therefore affect major financial institutions. Some banks, according to media reports, began to refuse to accept Treasury securities maturing in October 2013 during that year's debt limit episode.[232]

One analysis of the use of collateral in financial markets distinguished the role of private assets, such as asset-backed commercial paper securities, and Treasury securities.[233] Researchers concluded that markets are more fragile when collateralized lending is secured by private assets, which carry greater credit risks, than when they are secured by Treasury securities, which serve a stabilizing role. Since the 2007-2009 financial crisis, financial institutions have been holding higher inventories of Treasuries.[234] If a binding debt limit raised the prospect of a federal default, that stabilizing effect could be weakened.

Possible Federal Reserve and Treasury Responses

A draft Federal Reserve circular discussed during the 2011 debt limit episode stated that Federal Reserve banks would continue to accept Treasury securities as collateral, which could help support repo lending during a binding debt limit.[235] A Federal Reserve internal presentation from October 2013 indicates that in the event of a binding debt limit, Treasury was expected to extend the maturity date of maturing Treasury securities to the next business day, which would delay principal and interest payments until sufficient cash was available.[236] That action would also

[230] RBC Capital Markets, *U.S. Economics and Rates Focus*, September 25, 2013.

[231] Fernando Avalos, Torsten Ehlers, and Egemen Eren, "September Stress in Dollar Repo Markets: Passing or Structural*?," Bank of International Settlements Quarterly Review*, December 2019, https://www.bis.org/publ/qtrpdf/r_qt1912v.htm.

[232] Tim Reid and Jonathan Spicer, "U.S. Treasury, Fed Planning for Possible Default—Source," Reuters, October 9, 2013.

[233] Frédéric Boissay and Russell Cooper, "The Collateral Composition Channel," *American Economic Journal: Macroeconomics*, vol. 12, no. 1 (January 2020), pp. 41-75. The authors note stylized facts about shifts in types of collateral used by financial institutions in the years leading up to the financial crisis of 2007-2009 and present a mathematical model with results consistent with those facts.

[234] Basel III capital requirements may explain that increase in holdings of high-quality assets. See Federal Reserve data on Treasury security holdings of security dealers and brokers: https://fred.stlouisfed.org/series/BOGZ1FL663061105A.

[235] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, p. 78.

[236] U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *Staff Report: The Obama Administration's Debt Ceiling Subterfuge: Subpoenaed Documents Reveal Treasury Misled Public In Attempt To "Maximize Pressure on Congress,"* 114th Cong., 2nd sess., February 1, 2016, p. 167. The Treasury Uniform Offering Circular states (31 C.F.R. §356.30) that payments of principal and interest would be made "as specified in the auction announcement." Treasury, however, retains the right (31 C.F.R. §356.33) "to modify the terms and conditions of new securities and to depart from the customary pattern of securities offerings at any time."

prevent the tracking code—known as CUSIP—for affected Treasury securities from being at risk of being frozen, which would hinder repo and other transactions.[237]

Treasury cash management after debt limit episodes could also have more direct effects on the supply of liquidity in financial markets. Bank of International Settlements researchers noted that after resolution of the 2019 debt limit episode in early August, "the U.S. Treasury quickly set out to rebuild its dwindling cash balances, draining more than $120 billion of reserves in the 30 days between 14 August and 17 September alone, and half of this amount in the last week of that period. By comparison, while the Federal Reserve runoff removed about five times this amount, it did so over almost two years."[238] The reduction of those bank reserves, among several other factors, may have contributed to the disruptions in repo lending observed in September 2019.

The Federal Reserve responded strongly to tamp down financial market disruptions, including disruptions in the secondary market for Treasuries, following the declaration of the COVID-19 pandemic in March 2020.[239] That episode suggests that future disruptions in the market for Treasuries would also prompt a vigorous response from the Federal Reserve.

The opacity of the so-called shadow banking system, which relies heavily upon repo financing and related funding strategies, could complicate policy responses to a severe disruption in financial markets that a federal default could credibly engender.[240] Nonbank entities—primary actors in the shadow banking system—play a large and growing role in international finance. While official bodies have sought to adapt statistics and data collection systems to monitor their activities, and while regulators have gained new tools, less information is available on the shadow banking system than for the formal banking sector.[241]

Have Debt Limit Episodes Raised Federal Borrowing Costs?

The market price of a security reflects various risks that could affect the timely payment of principal and interest. When a given security's price rises, its yield falls. Higher yields on securities relative to benchmark rates indicate a perception of increased levels of risk. Yields rose on Treasuries that would have been most vulnerable to payment delays during the 2011 and 2013 debt limit episodes, although yields soon returned near to previous levels. Whether debt limit episodes have had a more subtle and persistent effect on Treasury's borrowing costs is more difficult to determine.

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237 "DTC Chills and Freezes," U.S. Securities and Exchange Commission, Investor Alerts and Bulletins, May 1, 2012, https://www.sec.gov/oiea/investor-alerts-bulletins/ib_dtcfreezes.html. CUSIP is Committee on Uniform Securities Identification Procedures, which issues a unique code for each traded security. Also see SIFMA, "Delay in Treasury Payments: Discussion of Scenarios," January 2018, https://www.sifma.org/wp-content/uploads/2018/01/Disruption-in-Treasury-Payments-January-25.pdf.

238 Fernando Avalos, Torsten Ehlers, and Egemen Eren, "September Stress in Dollar Repo Markets: Passing or Structural*?," Bank of International Settlements Quarterly Review*, December 2019, https://www.bis.org/publ/qtrpdf/r_qt1912v.htm.

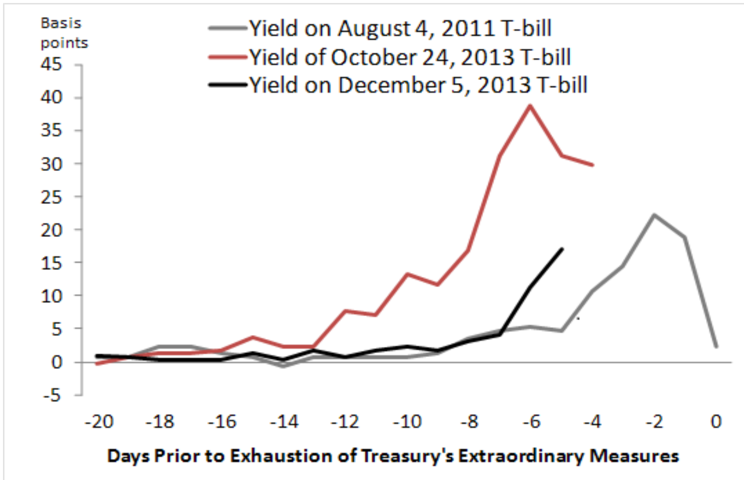
239 Testimony of Federal Reserve Chair Jerome H. Powell, in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, hearing, *Coronavirus and CARES Act*, May 19, 2020, https://www.federalreserve.gov/newsevents/testimony/powell20200519a.htm.

240 For an explanation of the shadow banking system's role in the 2007-2008 financial crisis, see Gary Gorton, *Slapped by the Invisible Hand* (Oxford: Oxford University Press, 2010).

241 Pablo Garcia Luna and Bryan Hardy, "Non-Bank Counterparties in International Banking," *BIS Quarterly Review*, September 2019, https://www.bis.org/publ/qtrpdf/r_qt1909b.htm. Also see Rajdeep Sengupta and Fei Xue, "The Global Pandemic and Run on Shadow Banks," *Federal Reserve Bank of Kansas City Economic Bulletin*, May 11, 2020, https://www.kansascityfed.org/Economic%20Bulletin/documents/8202/eb20sengupta0511.pdf.

Treasury securities have traditionally been viewed as assets free of credit risks, which has allowed Treasury to borrow on attractive terms. In 2011 and 2013, uncertainties about how and when the debt limit would be changed led to sharp increases on yields for some Treasury securities that were to mature shortly after the date when Treasury indicated its borrowing capacity would be exhausted. Heightened yields relative to benchmark rates suggested that some investors considered a federal default or payment delay a possibility. **Figure 7** shows yields in terms of basis points on three Treasury bills that matured near critical dates in 2011 and 2013. One percentage point equals 100 basis points.

Figure 7. Yields on Selected Treasury Bills, 2011 and 2013



Source: Nomura Securities, October 2013. Dates on Treasury bills indicate when they mature.

GAO, in its analysis of the 2011 debt limit episode, concluded that delays in raising the debt limit increased federal borrowing costs by an estimated $1.3 billion in FY2011.[242] Nippani and Smith found that during the October 2013 debt limit episode, yields for four-month Treasury bills increased relative to commercial paper rate benchmarks.[243] Boston Fed economists, as noted above, documented lower demand for some Treasury bills in the 2013 episode and described secondary effects in commercial paper markets and money market funds.[244]

Debt Limit Episodes and Prices of Treasury Securities

A Federal Reserve working paper examined how reactions of financial markets to the 2011 and 2013 debt limit episodes affected prices and yields of Treasury securities relative to the overnight index swap (OIS).[245] In that analysis, Federal Reserve economists attempted to separate the risk of a technical default on some Treasuries from consequences of wider market disruptions. They economists contended that OIS rates—which reflect lending among financial institutions—were

[242] GAO, *Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs*, GAO-12-701, July 2012.

[243] Srinivas Nippani and Stanley Smith, "The Impact of the October 2013 Government Shutdown and Debt Ceiling on U.S. Treasury Default Risk," *Journal of Fixed Income*, vol. 24, no. 2 (fall 2014).

[244] Ali Ozdagli and Joe Peek, *Cliff Notes: The Effects of the 2013 Debt-Ceiling Crisis*, Federal Reserve Bank of Public Policy Briefs, no. 13-9, November 2013, https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/economic/ppb/2013/ppb139.pdf.

[245] David Cashin et al., *Take It to the Limit: The Debt Ceiling and Treasury Yields*, Federal Reserve Board discussion paper 2017-052, March 2017, https://www.federalreserve.gov/econres/feds/files/2017052pap.pdf (hereinafter "Cashin et al., *Take It to the Limit*").

less susceptible to market disruptions than commercial paper rates, which largely reflect transactions among corporate entities. With that approach, they found that Treasury bill yields rose by approximately seven or eight basis points (bps; 100 bps=1%) on average shortly before critical dates for the 2011 and 2013 debt limit episodes.[246] In addition, they estimated that Treasury securities were more broadly affected, with an increase in yields on bonds that peaked at four to five basis points.[247] Those heightened yields, according to their estimates, raised federal borrowing costs by $260 million in 2011 and by $230 million in 2013.[248] After those debt limit episodes were resolved, the elevated spreads quickly dissipated.

Debt Limit Policy Discussions

The persistent recurrence of debt limit episodes has prompted consideration of proposals to direct Treasury responses to a binding debt limit, and of ways to modify the debt limit in a more automatic manner, either by delegating authorities to the executive branch or by tying the limit more closely to other fiscal measures. As long as federal deficits persist, the debt limit will remain on the congressional agenda.[249]

Given the magnitude of the current and projected near-future imbalance between federal outlays and revenues, it has become less than plausible that changes in short-term fiscal and budgetary policy could avoid the need for future legislation to adjust the debt limit. To a large extent, the need to raise (or lower) the limit during a session of Congress stems from legislation enacted in prior years. The Congressional Budget Office (CBO) noted the following in 2010:

> By itself, setting a limit on the debt is an ineffective means of controlling deficits because the decisions that necessitate borrowing are made through other legislative actions. By the time an increase in the debt ceiling comes up for approval, it is too late to avoid paying the government's pending bills without incurring serious negative consequences.[250]

Nevertheless, the consideration of debt limit legislation often provides opportunities to reexamine fiscal and budgetary policy. Consequently, House and Senate action on legislation adjusting the debt limit is often complicated, hindered by policy disagreements, and subject to delay.[251]

Past Concerns over Need to Act on Debt Limit

During debt limit episodes, various Treasury Secretaries have expressed concern, if not alarm, at the prospect of a binding debt limit. During the 2011 and 2013 debt limit episodes, the Obama Administration maintained that not raising the debt limit would have serious consequences. Then-Treasury Secretary Geithner repeatedly asserted that not increasing the debt limit and, therefore, not meeting the country's obligations as a result "would cause irreparable harm to the American

[246] Cashin et al., *Take It to the Limit*, p. 23.

[247] Cashin et al., *Take It to the Limit*, p. 26.

[248] Cashin et al., *Take It to the Limit*, p. 23.

[249] According to August 2019 CBO baseline projections, the federal budget deficit will average $1.2 trillion between 2020 and 2029. See CBO, *An Update to the Budget and Economic Outlook: 2019 to 2029*, August 21, 2019, https://www.cbo.gov/publication/55551.

[250] CBO, *Federal Debt and Interest Costs*, December 2010, p. 23, http://www.cbo.gov/ftpdocs/119xx/doc11999/12-14-FederalDebt.pdf.

[251] For more information, see CRS Report RS21519, *Legislative Procedures for Adjusting the Public Debt Limit: A Brief Overview*, by Bill Heniff Jr.

economy and to the livelihoods of all Americans."[252] The Trump Administration also expressed general concerns about the need for action on the debt limit. During the 2017 episode, then-Treasury Secretary Mnuchin wrote that "it is critical that Congress act," and in 2018 he "urge[d] Congress to protect the full faith and credit of the United States by action to increase the statutory debt limit."[253] When the Biden Administration faced a debt limit episode in 2021, Treasury Secretary Janet Yellen issued similar warnings.[254]

Economists have expressed concern regarding the consequences of a binding debt limit. In 2011, then-Federal Reserve Chairman Ben Bernanke stated that not raising the debt limit could ultimately lead the nation to default on its debt, with catastrophic implications for the financial system and the economy.[255] He also testified that Congress must work to put a plan in place that would lower the nation's federal debt.

Donald Marron, the former director of the Urban-Brookings Tax Policy Center and a former Acting Director of the CBO, stated in January 2011,

> Geithner is correct that the debt limit must increase. With monthly deficits running more than $100 billion, it's simply unthinkable that Congress could cut spending or increase revenue enough to avoid borrowing more.... Still, I am troubled by any suggestion that the United States might willingly default on its public debt. Doing so would have absolutely no upside.[256]

The chief economist for the credit rating agency Moody's, as noted above, argued in 2021 that a binding debt limit would lead to severe financial and economic harms.[257]

Threat to Financial Stability or Fundamental Power of the Purse?

Many Treasury and Federal Reserve officials have called for eliminating the debt limit on the grounds that it disrupts federal fiscal operations and threatens the stability of U.S. financial markets—if not global markets—as well as that it elevates costs of maintaining federal debt.[258] Others have questioned the need for a debt limit, given that debt levels merely reflect past policy decisions on taxes and spending.[259] GAO also has called for changing congressional procedures to link consideration of debt limit changes with other fiscal policies and recommended delegating

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[252] Letter from Timothy F. Geithner, Secretary of the Treasury, to Speaker John A. Boehner, January 14, 2013, https://home.treasury.gov/system/files/276/1-14-13-Debt-Limit-FINAL-LETTER-Boehner.pdf.

[253] Letters from Steven T. Mnuchin, Secretary of the Treasury, to Speaker Paul D. Ryan, July 28, 2017, and January 30, 2018.

[254] Letter from Janet L. Yellen, Secretary of the Treasury, to Speaker Nancy Pelosi, September 28, 2021, https://home.treasury.gov/system/files/136/Debt-Limit-Letter-to-Congress-20210928-Pelosi.pdf.

[255] Paul Davidson, "Economy Still in a Deep Hole, Bernanke Says," *USA Today*, February 4, 2011.

[256] Donald Marron, "Debt Ceiling: Geithner Won't Let Us Default," *CNNMoney.com*, January 19, 2011.

[257] Mark Zandi and Bernard Yaros, "Playing a Dangerous Game With the Debt Limit," September 21, 2021, *Moody's Analytics*, https://web.archive.org/web/20210929041410/https://www.moodysanalytics.com/-/media/article/2021/playing-a-dangerous-game-with-the-debt-limit.pdf.

[258] Bruce Bartlett, "Why Congress Must Now Abolish Its Debt Limit," *Financial Times*, October 22, 2009, p. 11; Brian C. Roseboro, Assistant Treasury Secretary for Financial Markets, "Remarks to the Bond Market Association's Inflation-Linked Securities Conference," http://web.archive.org/web/20080709100455/http://www.treas.gov/press/releases/js506.htm.

[259] Testimony of Federal Reserve Board Chairman Alan Greenspan, in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 108th Cong., 1st sess., February 11, 2003, https://www.federalreserve.gov/boarddocs/hh/2003/february/testimony.htm.

some fiscal powers to the executive branch.[260] The plausibly dire consequences of a binding debt limit could empower its potential use as a leverage point to obtain legislative advantage while heightening chances of a federal default. The potential for linking policy negotiations with financial brinksmanship, in the eyes of some, justifies abolishing the debt limit.[261]

Attempts to leverage the debt limit for specific policy goals have a mixed record of success. Some debt limit episodes have concluded with enactment of new or revamped budget enforcement policies.[262] In other cases, changes brought by heightening debt limit conflicts have been less evident.[263]

Checks and Balances and the Public Credit

Congress's control over debt policy, as one component of its power of the purse, provides one means of raising fiscal concerns, as well as protecting others of its prerogatives.[264] That power of the purse provides a primary check on the executive branch, working in conjunction with other constitutional checks and balances. Then-Treasury Secretary Alexander Hamilton noted the following about the logic of the constitutional system of checks and balances, which serves to protect the federal government's ability to fulfil its obligations and protect the public credit:

> In delicate and difficult cases whether to issue in good or ill, a suspension of action is far more natural to such a Government than action. It can hardly happen, that all the branches or parts of it can be infected at one time with a common passion, a disposition, manifestly inimical to justice and the Public good; as to prostrate the public Credit by revoking a pledge given to the Creditors. It is far more probable that such a disposition should at one time possess one part, at another time another part. Possessing either part it might be sufficient to obstruct a provision which was to be made. Without possessing all the parts, it could not subvert one, which had been made. The last can scarcely be supposed, except in one of those extraordinary Crises of Nations which confound all ordinary calculation.[265]

The power of such checks, as Hamilton noted, is obstructive. While the difficulty in reaching agreement among various branches or parts of government may inhibit adverse changes, it might also result in a perilous inertia when faced with acute challenges such as an impending binding debt limit.

GAO has highlighted risks posed by an insufficiently prompt response to a looming exhaustion of Treasury resources during a debt limit episode.[266] In its 2015 debt limit report, GAO recommended consideration of three options. First, it suggested linking decisions on the debt

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[260] GAO, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 2015.

[261] Ezra Klein, "Don't Just Raise the Debt Ceiling. Get Rid of it Forever," *Washington Post*, September 26, 2013, https://www.washingtonpost.com/news/wonk/wp/2013/09/26/dont-just-raise-the-debt-ceiling-get-rid-of-it-forever/.

[262] Whether the need to address the debt limit was a driving concern in enacting those budget enforcement measures is not wholly clear. For a tally of debt limit bills that have included other matters, see CRS Report R41814, *Votes on Measures to Adjust the Statutory Debt Limit, 1978 to Present*, by Justin Murray.

[263] David A. Fahrenthold and Katie Zezima, "For Ted Cruz, the 2013 Shutdown was a Defining Moment," *Washington Post*, February 16, 2014, https://www.washingtonpost.com/politics/how-cruzs-plan-to-defund-obamacare-failed—and-what-it-achieved/2016/02/16/4e2ce116-c6cb-11e5-8965-0607e0e265ce_story.html.

[264] Anita S. Krishnakumar, "In Defense of the Debt Limit Statute," *Harvard Journal on Legislation*, vol. 42 (2005), pp. 135-185.

[265] U.S. Treasury, *Report on a Plan for the Further Support of Public Credit*, January 16, 1795, https://founders.archives.gov/documents/Hamilton/01-18-02-0052-0002.

[266] GAO, *Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476, July 9, 2015, https://www.gao.gov/assets/680/671286.pdf.

limit with budget resolutions, a proposal that might be more effective were Congress in the routine of agreeing to budget resolutions in a timely fashion.[267]

A second recommendation suggested that Congress give the executive branch authority to increase the debt limit, subject to a congressional motion of disapproval. The 2011 BCA introduced that mechanism for adopting two of the three debt limit increases it authorized, although similar mechanisms have been employed in other legislation not related to the debt limit. Such resolutions of disapproval, however, are difficult to sustain and would be subject to presidential veto.

The third recommended option was to grant "broad authority to the Administration to borrow as necessary to fund enacted laws," which would effectively end congressional control of debt policy, except to exercise oversight and receive reports.[268] Whether that option would abrogate Congress's Article I responsibilities to control debt policy may be an open question.

Debt Limit, Appropriations, and Fiscal Policies Often Bundled

Legislation to resolve debt limit episodes has often been bundled with other fiscal measures, such as appropriations or changes to budget enforcement procedures.[269] The end stages of several debt limit episodes have often coincided—by accident or by design—with the final stages of the annual appropriations process. The start of the federal fiscal year on October 1 sets a fixed focal point for negotiations. The common use of continuing resolutions to extend funding and government operations, however, has eroded the criticality of that date. Consideration of adjustments to BCA caps on discretionary spending that set topline limits for defense and nondefense spending provides another focal point for fiscal policy discussions.

That a measure resolves a debt limit episode and addresses other matters within the same legislative vehicle need not imply a substantive link between those issues. For instance, if many policymakers view a debt limit measure as a "must-pass" legislative vehicle, the bundling of those issues may reflect procedural convenience. For example, the 1985 legislative package that resolved a debt limit episode and established the Gramm-Rudman-Hollings Act (GRH; P.L. 99-177) might be seen as having been driven by a consensus among congressional leaders on the need to constrain growing budget imbalances.[270]

Conversely, a debt limit measure might have a substantive link with another policy action even if they were passed in separate legislative vehicles. For example, on February 11, 2014, the House passed a measure to suspend the debt limit (P.L. 113-83) and a separate measure (S. 25, P.L. 113-82) that reversed certain changes in military pension inflation adjustments. Some might view the two measures as linked as part of a fiscal agreement.

Some have argued modifications of the debt limit should be considered independently of negotiations over specific budget policy outcomes. In 1995, then-OMB Director Alice Rivlin testified that "[i]t would be irresponsible to bring the Nation to the edge of default, with the financial chaos that would ensue, in order to force a particular result in the budget debate."[271]

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[267] The House adopted rules in January 2019 along those lines. See CRS Report RS21519, *Legislative Procedures for Adjusting the Public Debt Limit: A Brief Overview*, by Bill Heniff Jr.

[268] See summary of CRS Report RS21519, *Legislative Procedures for Adjusting the Public Debt Limit: A Brief Overview*, by Bill Heniff Jr.

[269] See CRS Report R41814, *Votes on Measures to Adjust the Statutory Debt Limit, 1978 to Present*, by Justin Murray.

[270] United Press International, "Dole Says Plan on Deficit is No Panacea," *New York Times*, December 9, 1985, p. 11.

[271] Testimony of OMB Director Alice Rivlin, in U.S. Congress, House and Senate Committees on the Budget, *Effects*
(continued...)

Debt Limit Harder to Fine-Tune Than Other Fiscal Policy Measures

While measures to lift the debt limit have often been combined with other fiscal legislation, the options for addressing the limit are narrow. A decision to modify the debt limit is largely a binary one: either Treasury operations are allowed to revert to normal status or not, although that choice can be structured in more than one way. The size of an increase in the debt or duration of a suspension of the limit help determine the timing of the next debt limit episode, but have no direct effect on other fiscal policy instruments. By contrast, appropriations bills, which specify amounts and conditions on thousands of federal budget accounts, can be finely tuned in countless ways, as can revenue bills.

Legislative Proposals Regarding the Debt Limit

Is the Debt Limit Redundant?

While the accumulation of debt is a mathematical consequence of the spending, lending, and revenue policies that Congress enacts, the legislative processes and division of responsibilities among committees are different for revenue, spending, and debt policy. More specifically, congressional consideration of revenue measures differs in many ways from how Congress considers discretionary spending through the annual appropriations process, which in turn differs from how authorizing committees consider mandatory spending programs. Members of Congress not serving on a revenue or an appropriations committee might have limited opportunities to influence tax and spending measures, but might have greater opportunity to influence debt limit legislation. The arithmetic redundancy of debt and deficits given tax and spending policies need not imply that removal of congressional control of debt policy would leave fiscal policy unaffected.

Debt Policy Proposals in 2011

The 2011 debt limit episode spurred Congress to consider several legislative proposals. Some policymakers advocated setting payment priorities or linking debt limit increases to spending cuts, or to changes in the budget process.

Senator Jim DeMint wrote in an op-ed that a vote to raise the debt limit should be opposed "unless Congress first passes a balanced-budget amendment that requires a two-thirds majority to raise taxes."[272] Representative Tom McClintock and Senator Pat Toomey (as noted earlier) introduced a bill that, in the event of a binding debt limit, would have required Treasury to pay principal and interest on debt held by the public before all other federal government obligations (S. 163/H.R. 421, 112th Congress). In a letter to then-Secretary Geithner, Senator Toomey wrote, "This legislation is designed to maintain orderly financial markets by reassuring investors in U.S. Treasury securities that their investments are perfectly safe even in the unlikely event that the debt limit is temporarily reached."[273] Similarly, Senator David Vitter and Representative Dean Heller introduced legislation that would have required priority be given to payment of all obligations on the debt held by the public and Social Security benefits if the debt limit were to

of Potential Government Shutdown, hearing, 104th Congress, 1st session, September 19, 1995, pp. 6-7, http://www.archive.org/stream/effectsofpotenti00unit.

[272] Senator Jim DeMint, "More Spending is a Threat to America," *Politico*, January 24, 2011, http://www.politico.com/news/stories/0111/48020.html.

[273] Senator Pat Toomey, "Senator Toomey Sends Letter to Secretary Geithner on the Debt Limit," press release, February 2, 2011, http://toomey.senate.gov/record.cfm?id=330828&.

have become binding (S. 259/H.R. 568, 112th Congress). Representative Marlin Stutzman introduced legislation that would have required priority be given to payment of all obligations on the debt held by the public, Social Security benefits, and specified military expenditures in the event that the debt limit was reached (H.R. 728, 112th Congress).

House Approved Prioritization Bill in 113th Congress

During the 2013 debt limit episode, the House approved a prioritization bill, although it was not enacted. On April 30, 2013, the House Ways and Means Committee reported the Full Faith and Credit Act (H.R. 807, 113th Congress). This legislation, as reported by the committee, would have required Treasury to prioritize payments on obligations of debt held by the public and to the Social Security trust funds in the event that the debt limit was reached and to provide weekly reports of these obligations. On May 9, 2013, the House approved this legislation by a vote of 221-207. A similar measure was included as part of proposed legislation to provide for appropriations for a portion of FY2014 via a continuing resolution. The House approved that legislation, including this provision, on September 20, 2013 (H.J.Res. 59, 113th Congress). The final bill enacted into law (P.L. 113-67), however, excluded it.

Debt Limit Bills Referred to Committees in 117th Congress

In the 117th Congress, four sorts of bills were introduced related to the debt limit: those that would have repealed the debt limit, some that would have delegated authority to the executive branch, one that would have prioritized payments in the event of a binding debt limit, and another that would have required Treasury to report on federal debt after an increase in the debt limit. Each of these bills was referred to an appropriate committee, and none saw further legislative action. Similar versions of several of these bills had been introduced in previous Congresses.

On May 18, 2021, Representative Bill Foster introduced the End the Threat of Default Act (H.R. 3305), which would have repealed the public debt limit. Two days later, Senator Brian Schatz introduced a companion measure (S. 1785).[274]

Two measures would have allowed an increase in the debt limit subject to a resolution of disapproval. The Budget Control Act of 2011 (P.L. 112-25, §301) was the first measure to employ that mechanism. Resolutions of disapproval would be subject to a presidential veto, which would require a two-thirds vote in each chamber to override.

On September 23, 2021, Senator Jeff Merkley introduced the Protect Our CREDIT Act (S. 2819), which would have allowed the President to increase the debt limit subject to a congressional joint resolution of disapproval. On February 15, 2022, Senator Dick Durbin introduced the Debt Ceiling Reform Act (S. 3654), which would also have authorized the President to allow further debt to be issued upon a certification sent to Congress. On the same day, Representative Brendan Boyle offered a companion bill (H.R. 6724).

On January 13, 2022, Representative Jodey Arrington introduced the Responsible Budgeting Act (H.R. 6393), which have would have tied an increase in the debt limit to agreement to a budget resolution by extending the Gephardt Rule mechanism to the Senate.[275] If a budget resolution were not agreed to, the President could modify the debt limit upon a certification to Congress, subject to a resolution of disapproval.

[274] The bills would repeal 31 U.S.C. §3101 and related provisions of law.

[275] See CRS Report RL31913, *Debt Limit Legislation: The House "Gephardt Rule"*, by Bill Heniff Jr.

On January 28, 2021, Senator Rand Paul introduced the Default Prevention Act (S. 100), which would have prioritized payments of principal and interest on federal debt, military compensation, Social Security and Medicare benefits, and veterans' benefits. On September 22, 2021, Senator Rick Scott introduced the Full Faith and Credit Act (S. 2809), which would also have prioritized those payments.

Representative Lloyd Smucker introduced the Debt Solution and Accountability Act (H.R. 2110) on March 19, 2021. The bill would have required Treasury to report on federal debt and debt sustainability within 60 days of an increase in the debt limit.

Debt Limit Bills in the 118th Congress

This section notes some bills introduced in the 118th Congress regarding the debt limit. Bills related to proposals and negotiations leading up to the Fiscal Responsibility Act (P.L. 118-5) are not included here.

On January 9, 2023, Representative Tom McClintock introduced H.R. 187, which would permit Treasury to pay principal and interest on federal obligations if the debt limit became binding. The bill was reported by the House Ways and Means Committee on the same day.

On January 20, 2023, Representative Bill Foster introduced H.R. 415, which would repeal the public debt limit. On April 19, 2023, Senator Brian Schatz introduced S. 1190, a similar measure.

On January 25, 2023, Senator Rick Scott introduced S. 82, which would require Treasury to prioritize certain payments if the debt limit became binding.

On February 1, 2023, Senator Jeff Merkley introduced S. 212, which would allow the President to increase the debt limit subject to a congressional joint resolution of disapproval.

On February 6, 2023, Representative David Schweikert introduced H.R. 846, which would require the Treasury Secretary to appear before the House Ways and Means Committee before authorities to use extraordinary measures are invoked.

On February 28. 2023, Representative Lloyd Smucker introduced the Debt Solution and Accountability Act (H.R. 1265). The bill would require Treasury to report on federal debt and debt sustainability within 60 days of an increase in the debt limit.

On March 1, 2023, Representative Randy Feenstra introduced H.R. 1289, which would link debt limit increases to spending reductions over future years. On March 8, 2023, Senator John Barrasso introduced S. 714, a companion measure.

On June 9, 2023, Representative Pflueger introduced H.J.Res. 67, which would set a limit on outlays and require a two-thirds vote of approval for new taxes or debt limit increases. On June 15, 2023, Representative Barry Loudermilk introduced H.J.Res. 75, a similar bill.

On November 29, 2023, Representative Rudy Yakym introduced H.J.Res. 104, which proposes a Constitutional amendment that would initially limit federal debt to 130% of gross domestic product (GDP) and gradually lower that limit over time.

Appendix. Social Security Trust Fund Cash and Investment Management Practices

By law, the Social Security trust funds must be invested in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States (42 U.S.C. §401(d) and 42 U.S.C. §1320b-15).[276] The securities that Treasury issues to the Social Security trust funds count toward the federal debt limit.

Under normal procedures, Treasury immediately credits Social Security revenues (Social Security payroll taxes and individual income taxes) to the Social Security trust funds in the form of short-term, nonmarketable Treasury securities called certificates of indebtedness (CIs). Under the terms of this exchange, when Treasury credits payroll tax and other revenues to Social Security in the form of CIs, the revenues themselves become available in the General Fund for other government operations.

CIs generally mature on the following June 30. Each June 30, any surplus for the year is converted from short-term Treasury securities to long-term, nonmarketable Treasury securities called "special-issue obligations," or "specials."[277] In addition, other special issues that have just matured and those not needed to pay near-term benefits are reinvested in special-issue obligations. Interest income is credited to the trust funds semiannually (on June 30 and December 31) in the form of additional special-issue obligations.[278]

Social Security benefits are paid by Treasury from the General Fund. When Treasury pays Social Security benefits, it redeems an equivalent amount of Treasury securities held by the trust funds to reimburse the General Fund.

Social Security is projected to run a cash deficit through the 75-year forecast period. That is, Social Security's tax revenues are projected to be less than outlays for benefit payments and administration.[279] In a year when Social Security runs a cash flow deficit, Treasury redeems some long-term government securities held by the trust funds. However, Social Security will still need to invest in nonmarketable, short-term government securities to manage short-term cash flows during the periods between receiving revenues and paying benefits (42 U.S.C. §401(a), 42 U.S.C.

[276] Social Security income comes from several sources: (1) payroll taxes paid by workers and employers; (2) federal income taxes paid by some beneficiaries on a portion of their benefits; (3) reimbursements from the General Fund to the trust funds for a variety of purposes; and (4) interest income from trust fund investments. Interest income is paid as a credit from the General Fund to the trust funds, in the form of additional nonmarketable government securities. See CRS Report R45709, *Social Security: The Trust Funds and Alternative Investments*, by Barry F. Huston.

[277] Generally, the trust funds' long-term securities have maturities ranging from 1 to 15 years and normally mature in June of the applicable year.

[278] For a detailed discussion, see Social Security Administration, Office of the Chief Actuary, *Social Security Trust Fund Investment Policies and Practices*, Actuarial Note Number 142, January 1999, http://www.ssa.gov/OACT/NOTES/pdf_notes/note142.pdf (hereinafter cited as "SSA, Actuarial Note Number 142").

[279] Social Security relies on accumulated trust fund assets to help pay benefits and administrative expenses when the program runs a cash deficit. Social Security benefits scheduled under current law can be paid in full and on time as long as there is a sufficient balance in the trust funds. The combined Social Security trust funds are projected to have a positive balance until 2033, when trust fund assets are projected to be exhausted under the intermediate assumptions of the Social Security Board of Trustees. For SSA's projections of Social Security trust fund operations, see Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *2024 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, May 6, 2024, https://www.ssa.gov/OACT/TR/2024/index.html. In addition, see CRS Report RL33028, *Social Security: The Trust Funds*, by Barry F. Huston; and CRS Report R43318, *The Social Security Disability Insurance (DI) Trust Fund: Background and Current Status*, by William R. Morton.

§401(d), and 42 U.S.C. §1320b-15). Investing the trust funds' revenues for even short periods ensures that the trust funds maximize their interest earnings. Social Security will also need to invest in nonmarketable, long-term government securities in June of each year, when short-term and certain long-term trust fund securities mature and amounts not needed to pay near-term benefits are rolled over into long-term government securities, and in June and December of each year, when semiannual interest income is paid in the form of government securities.

Depending on the extent and duration of any future debt limit crisis, and also on Treasury prioritization decisions, Social Security trust fund investment management procedures and benefit payments could be affected because of the requirement that Treasury obligations cannot be issued to the Social Security trust funds if doing so would exceed the debt limit.[280] P.L. 104-121, a 1996 measure that included a debt limit increase, restricts the Treasury Secretary's ability to delay or otherwise underinvest incoming receipts to the Social Security and Medicare trust funds. Delayed issuance of government obligations to the trust funds, or early redemption of some trust fund assets, could accelerate depletion of the trust funds and move up the expected insolvency date, absent congressional action to make the trust funds whole.

Depending on the government's cash position in a given month, Treasury may need to issue new public debt to raise the cash needed to pay benefits. Treasury may be unable to issue new public debt, however, if doing so would exceed the debt limit. If Treasury lacked sufficient cash, Social Security benefit payments could be delayed or jeopardized.

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[280] SSA, Actuarial Note Number 142, p. 3.

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