BIPARTISAN POLICY CENTER

Debt Limit Analysis

MARCH 2015

SUMMARY OF FINDINGS

- **The debt limit will be reinstated on March 16, 2015.**

- **The Treasury Secretary will then begin tapping into emergency borrowing authority – known as extraordinary measures – to allow for an additional period of fully-funded government operations.**

- **If policymakers do not act on the debt limit, BPC estimates that these extraordinary measures will be exhausted sometime during the 4th quarter of 2015 (between October 1 and December 31).**
  - Why so long from now? Because the deficit has declined substantially, more extraordinary measures are available, and the time period of this debt limit event is more favorable for government finances.

THE BASICS

- **The debt limit is:**
  - the maximum amount that Treasury is allowed to borrow;
  - set by statute (Congress must act to change it); and
  - covers most debt issued, whether held by the public (such as Treasury bills and savings bonds) or intragovernmental (such as debt held by the Social Security trust funds).

- **The debt limit was temporarily suspended from February 18, 2014 until March 16, 2015, when it will be reinstated at a higher level than before.**

- **Total public debt subject to limit was about $18.1 trillion on February 28, 2015.**
  - In comparison, the U.S. gross domestic product (GDP) was $17.4 trillion at the end of 2014.

Sources: Daily Treasury Statement and Bureau of Economic Analysis

REACHING THE DEBT LIMIT – WHAT IT MEANS

Layers of Defense Against Default

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

ISSUE NEW DEBT TO THE PUBLIC IN TRADITIONAL MANNER

Debt Limit Reached

EXTRAORDINARY MEASURES

EM Exhausted

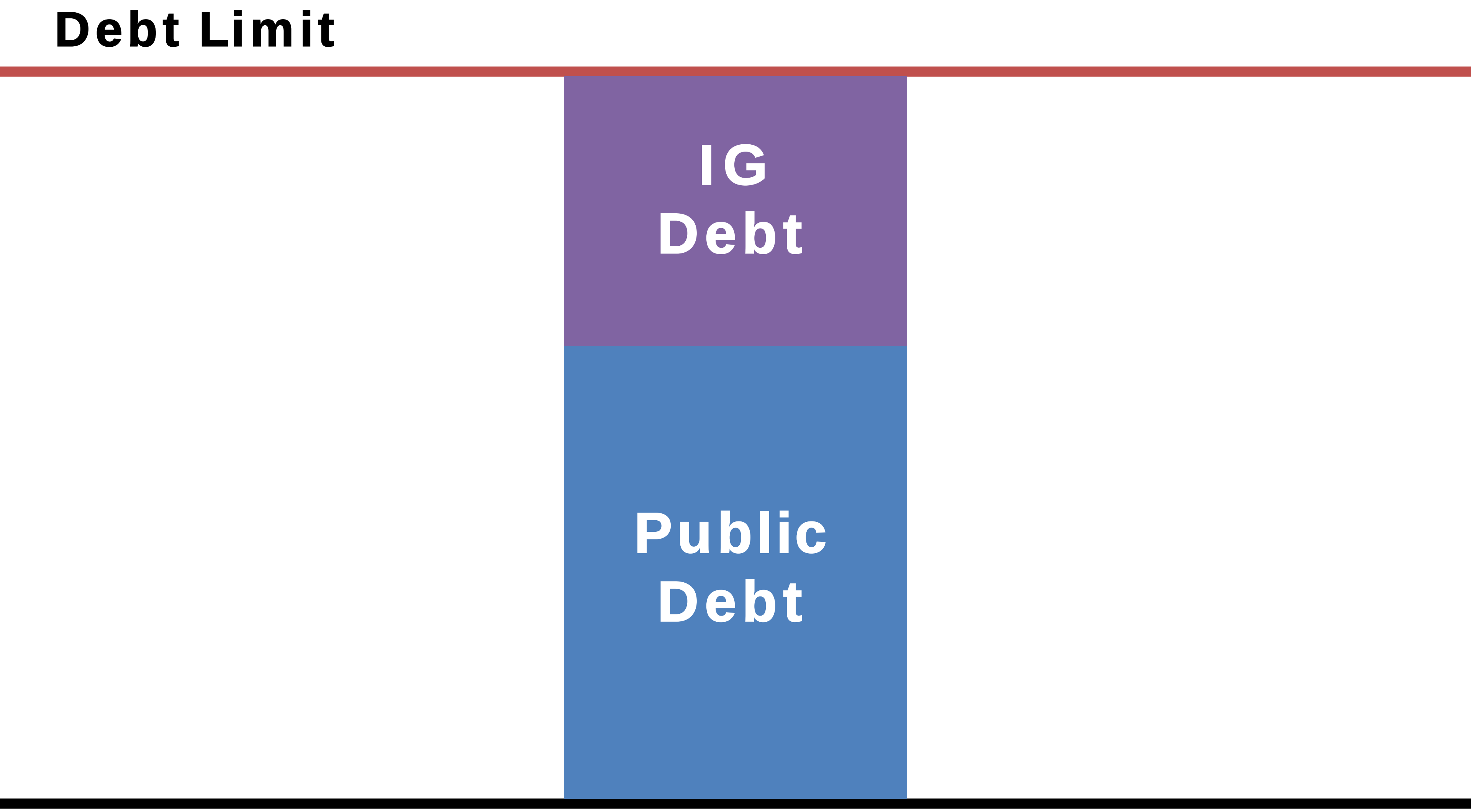
DAILY REVENUE AND CASH ON HAND

The X Date

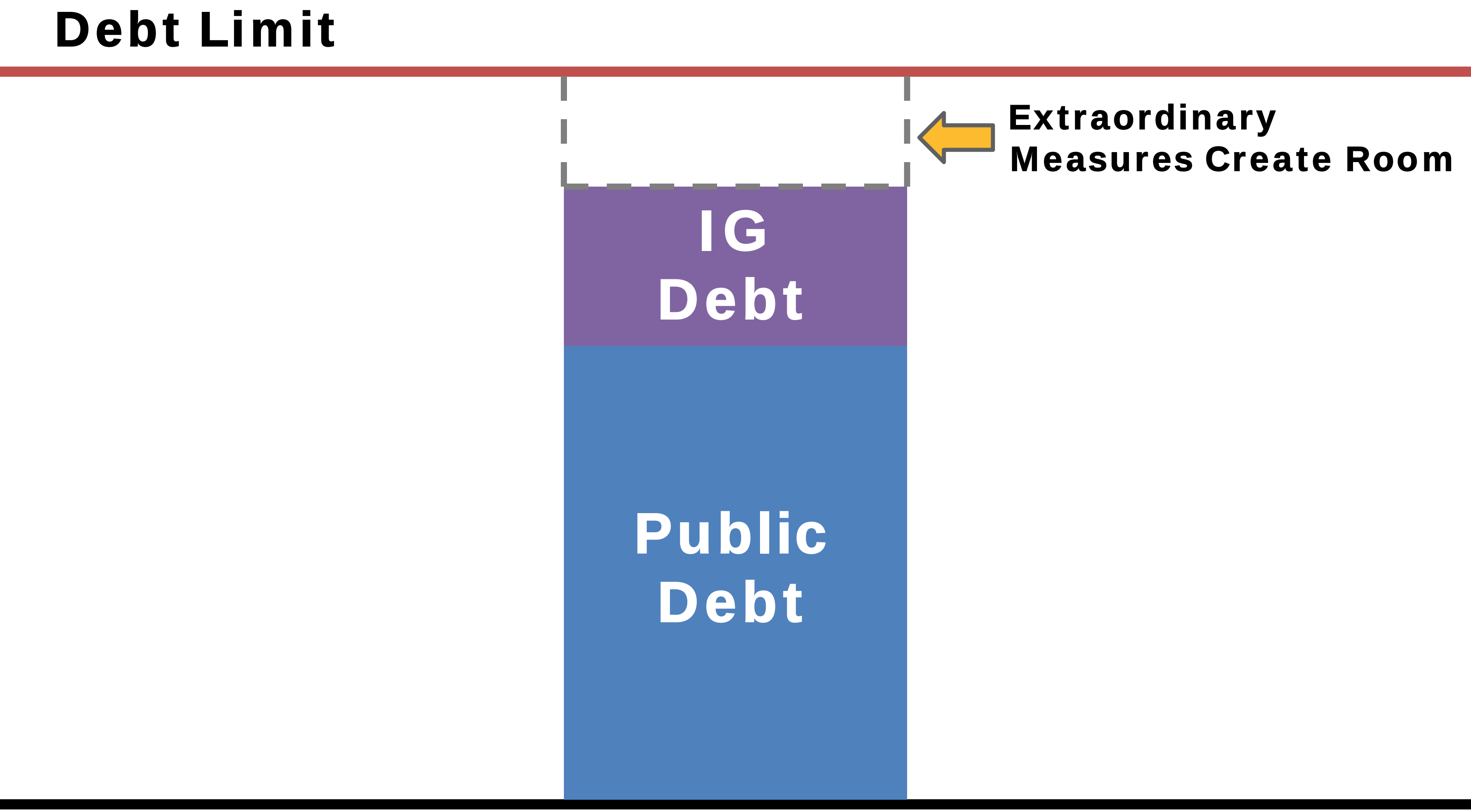
DEFAULT ON FINANCIAL OBLIGATIONS

How Do Extraordinary Measures Work?

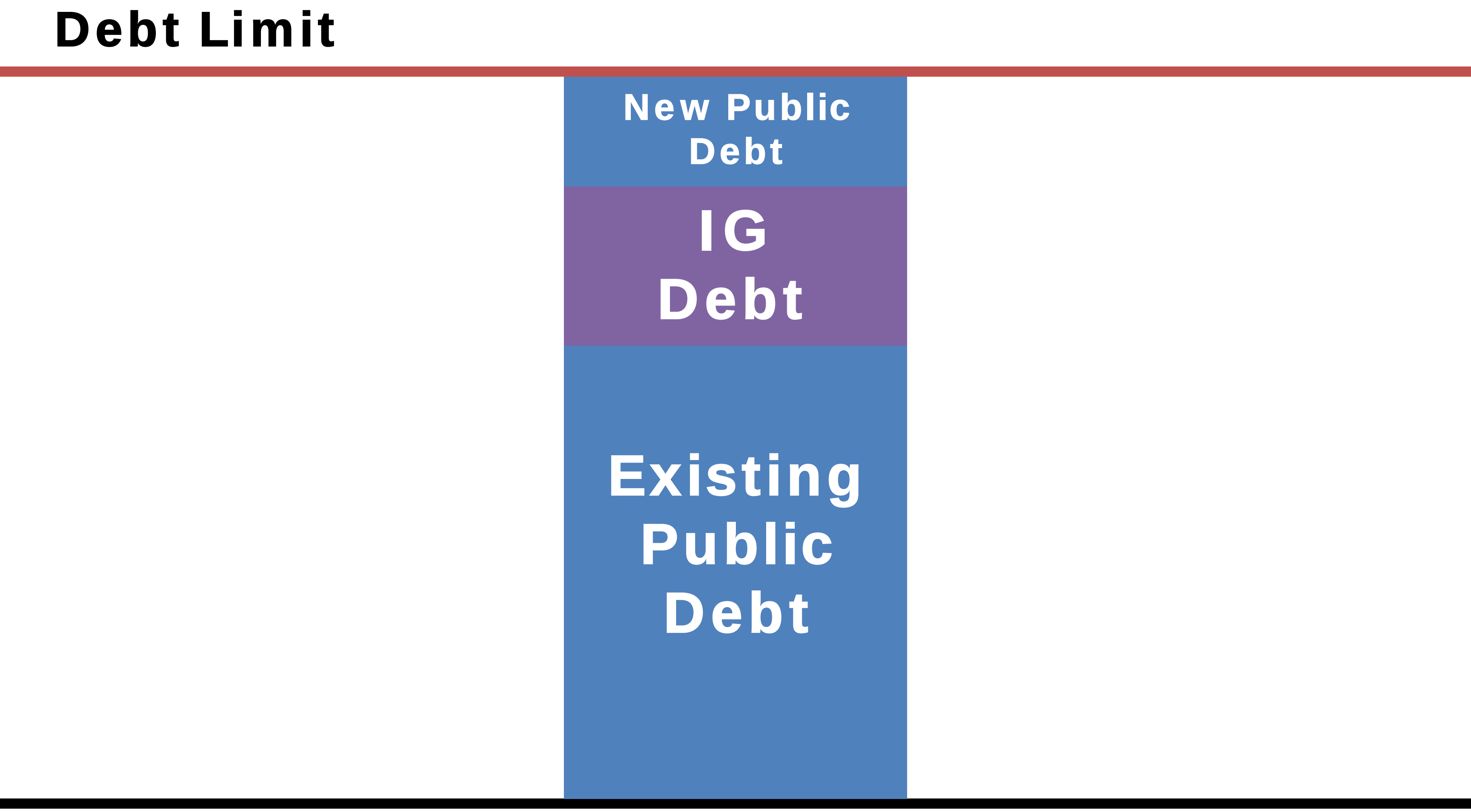
Both intragovernmental (IG) and public debt count toward the limit.



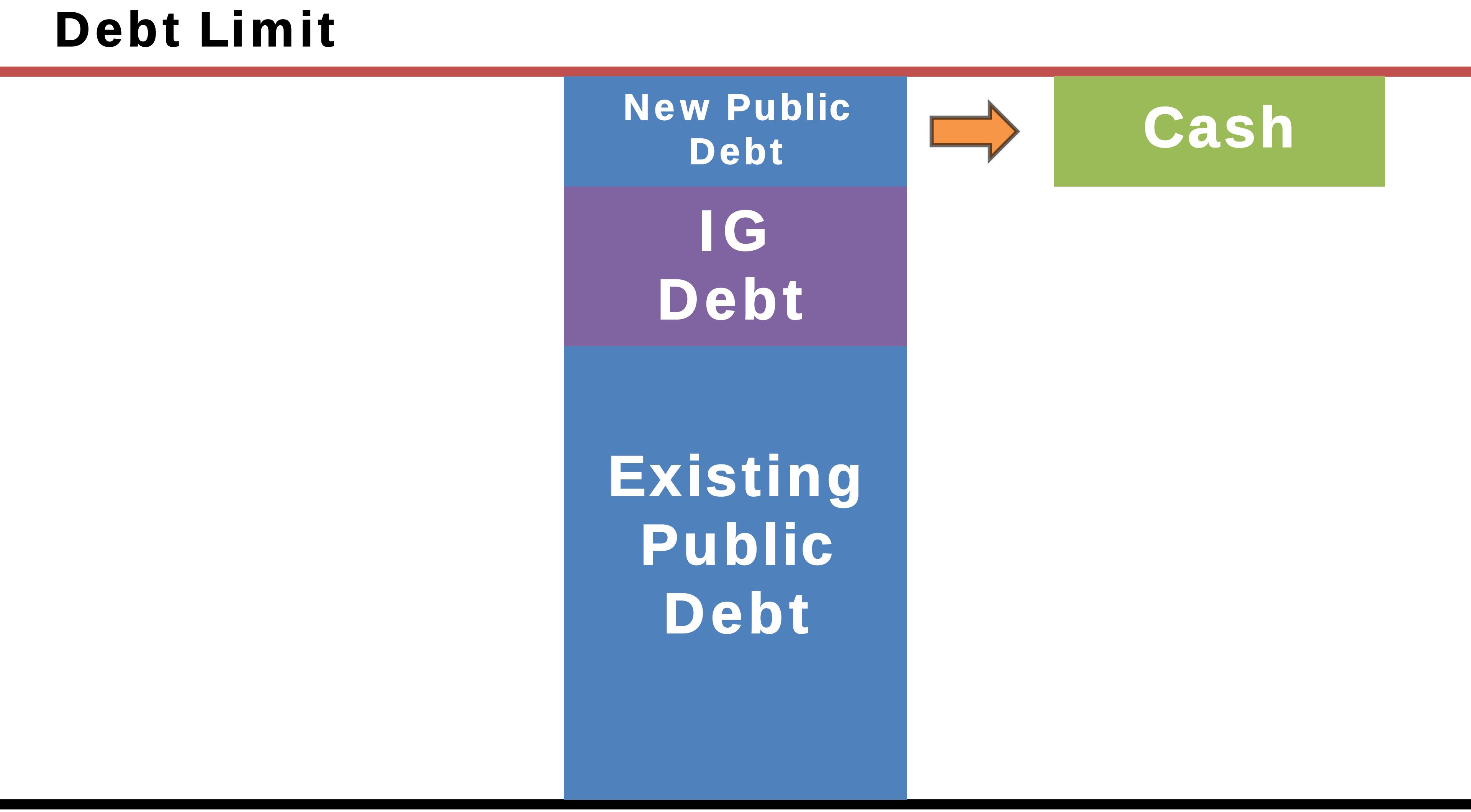
Treasury reduces intragovernmental debt using Extraordinary Measures…



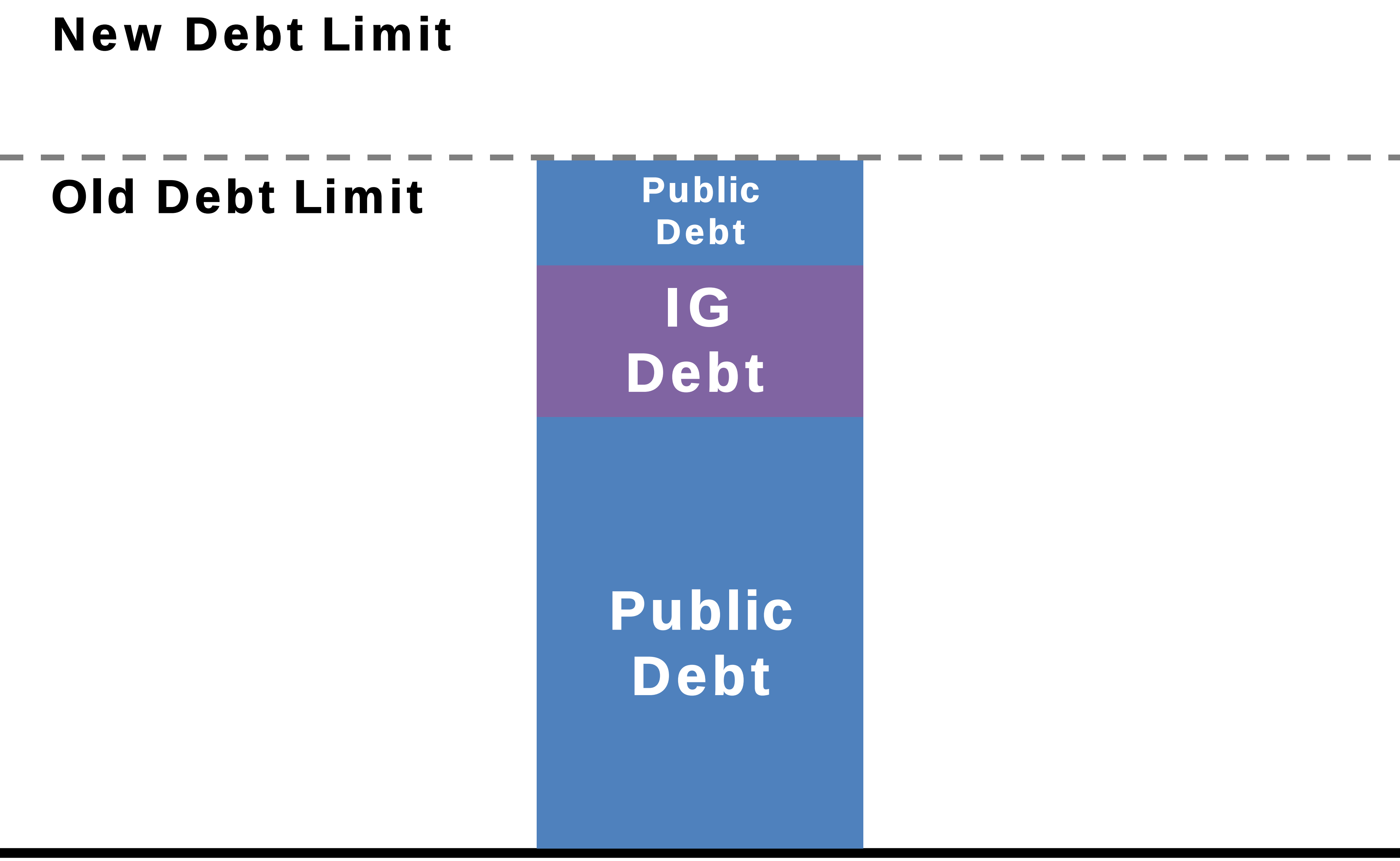
…to issue more debt to the public.



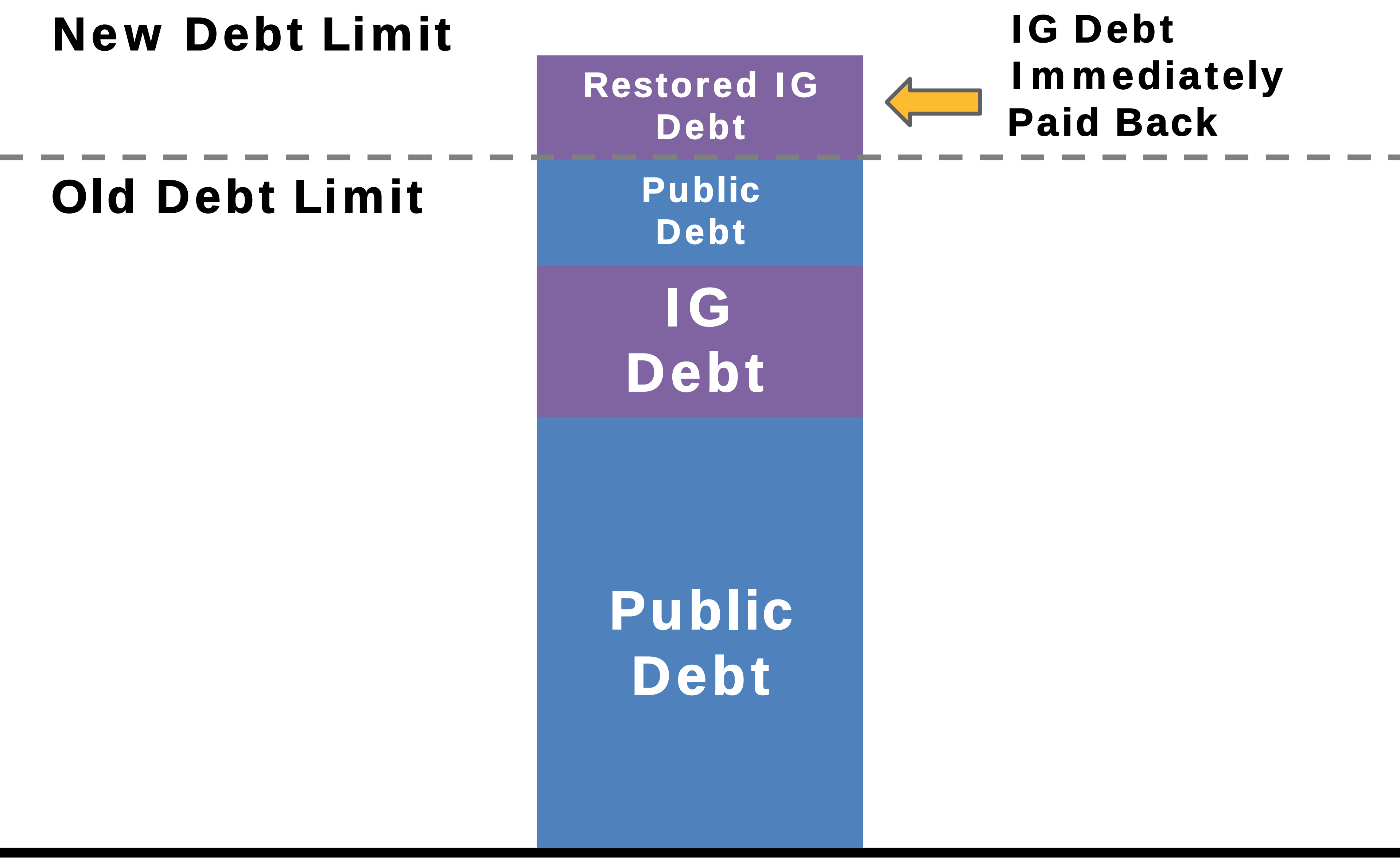
Issuing debt raises cash to pay bills.



When the debt limit is increased…



…extraordinary measures are immediately restored.



WHAT IS THE X DATE?

- **X Date: The first day on which Treasury has exhausted its borrowing authority and no longer has sufficient funds to pay all of its bills in full and on time.**

  - In other words, if the debt limit has not been raised by the X Date, the federal government will begin defaulting on some of its obligations.

  - After the X Date, bills must be paid solely out of incoming cash flows, which will be insufficient to cover all government spending.

- **BPC estimates that the X Date will most likely occur during the 4th quarter of 2015 (between October 1 and December 31).**

MAJOR SOURCES OF UNCERTAINTY

- **Strengthening / weakening economy**
  - Revenues have been stronger this year than last, reflecting increased employment and a stronger economy. This trend could either accelerate or reverse.
- **Volatility in the timing of revenue**
  - Revenue is the most volatile part of the federal government's cash flows. It varies from month-to-month and from day-to-day, making it impossible to predict an exact X Date.
  - Certain types of revenue, such as the quarterly tax payments due in April, June, and September, are especially volatile.

THE BIG THREE EXTRAORDINARY MEASURES

1. The G-Fund of the Thrift Savings Plan

- Each day, Treasury may temporarily reduce the amount of debt held by this fund, which holds government bonds for federal employee retirement accounts.

2. The Civil Service Retirement and Disability Fund (CSRDF)

- Treasury may postpone new investments in this pension fund. The CSRDF measure is most useful in June, September, and December, when major interest credits and reinvestments of maturing securities occur.

3. The Exchange Stabilization Fund (ESF)

- Each day, Treasury may temporarily reduce the amount of debt held by this fund, which is used to facilitate foreign exchange transactions.

For more information, see the Government Accountability Office's 2012 report on the debt limit and extraordinary measures.

WHY WILL EXTRAORDINARY MEASURES LAST SO LONG IN 2015?

- **More extraordinary measures will be available**
  - In June of 2015, securities in the CSRDF (the pension fund for civil servants) are scheduled to mature. During extraordinary measures, Treasury is not required to reinvest these securities or credit interest to the fund, which will reduce debt subject to the limit.

- **The deficit has been decreasing**
  - Revenue growth, in particular, has been strong in recent years as the economic recovery has picked up steam. With lower deficits, extraordinary measures cash-on-hand and last longer.

- **Timing of debt limit reinstatement**
  - Most tax refunds are paid in February and early March. Reinstatement of the debt limit in mid-March avoids depleting extraordinary measures on the heavy cash outflows during the height of tax-refund season.

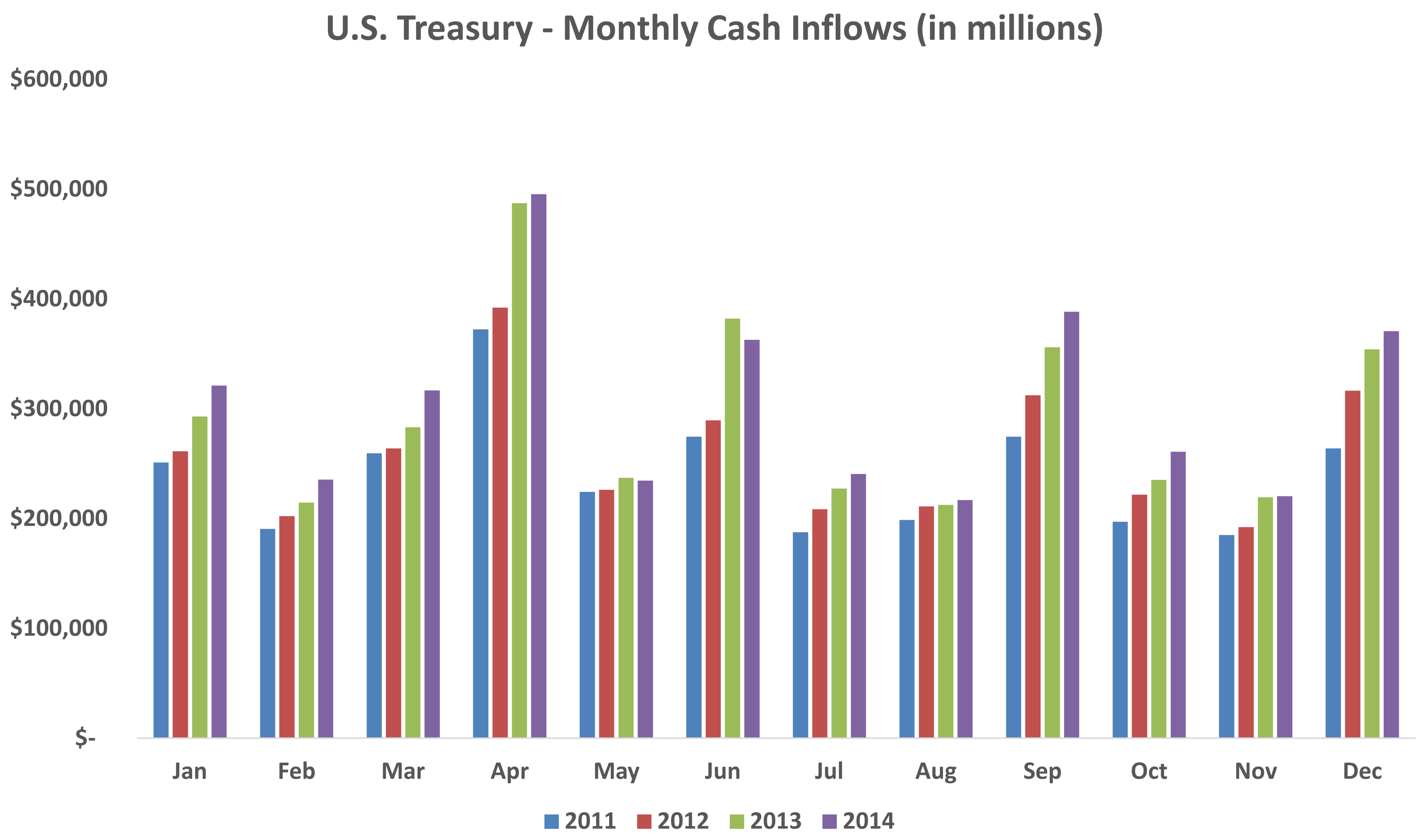
MORE EXTRAORDINARY MEASURES THIS TIME

EXTRAORDINARY MEASURES AVAILABLE	Early 2014	2015 (estimated)	Difference
Do not reinvest the Federal Employees' Retirement System G-Fund	$173 billion	$194 billion	**$21 billion**
Do not reinvest the Exchange Stabilization Fund	$23 billion	$23 billion	**$0**
Do not make new investments to the civil service and postal retirement funds	$2 billion	$140 billion	**$138 billion**
Total	$198 billion	$357 billion	**$159 billion**

Notes: The totals indicate *available* measures. Additional measures within the civil service and postal retirement funds will become available on 12/31/2015; they are not included in these totals because the X Date could occur before then. These totals only include the value of extraordinary measures that can be used to extend the X Date. Treasury has additional measures available that assist with cash flow and debt management.

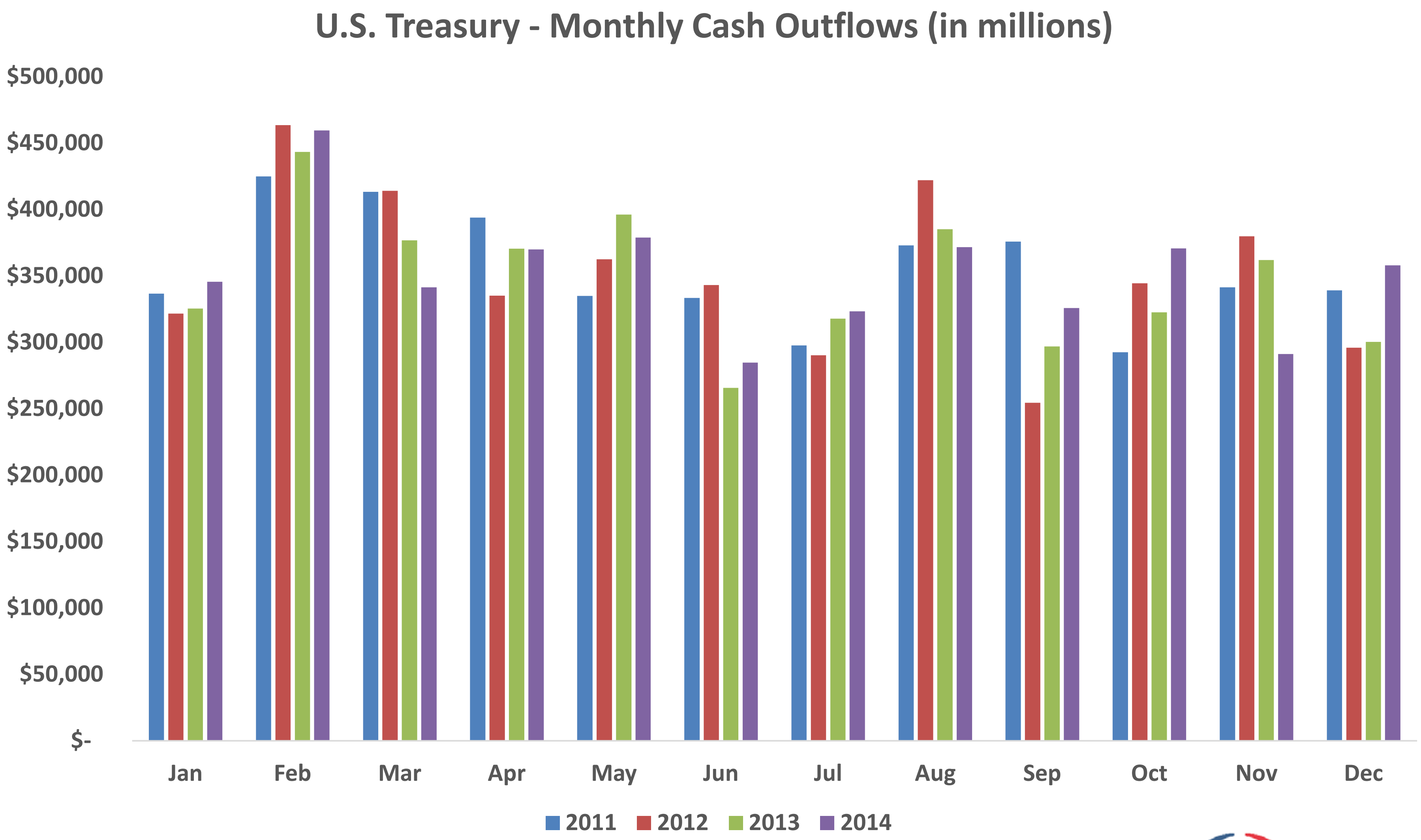
Sources: Government Accountability Office; Congressional Research Service; Treasury Direct Government Account Statements

REVENUES ARE UP STRONGLY



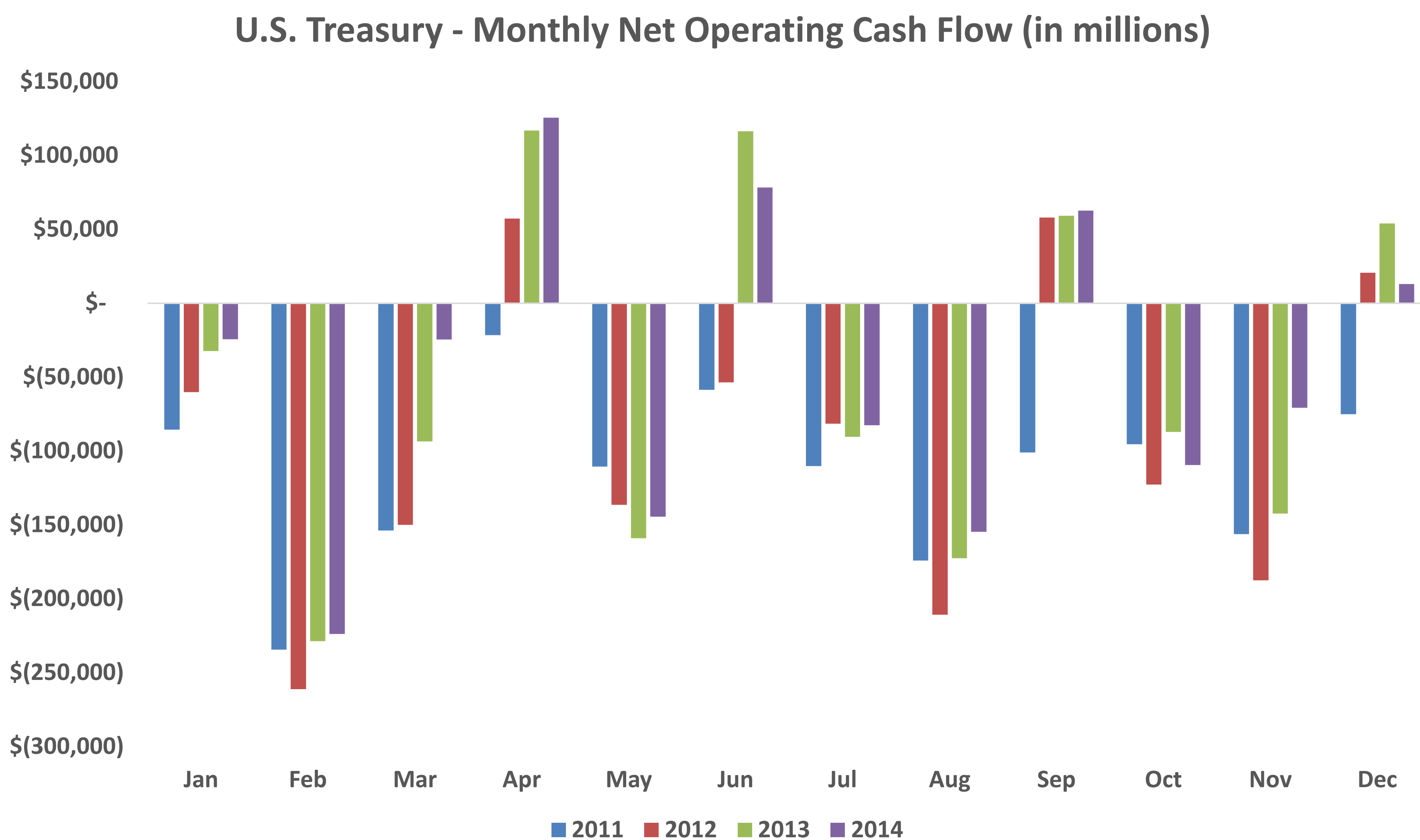
Source: Daily Treasury Statements

EXPENDITURES HAVE BEEN ROUGHLY FLAT



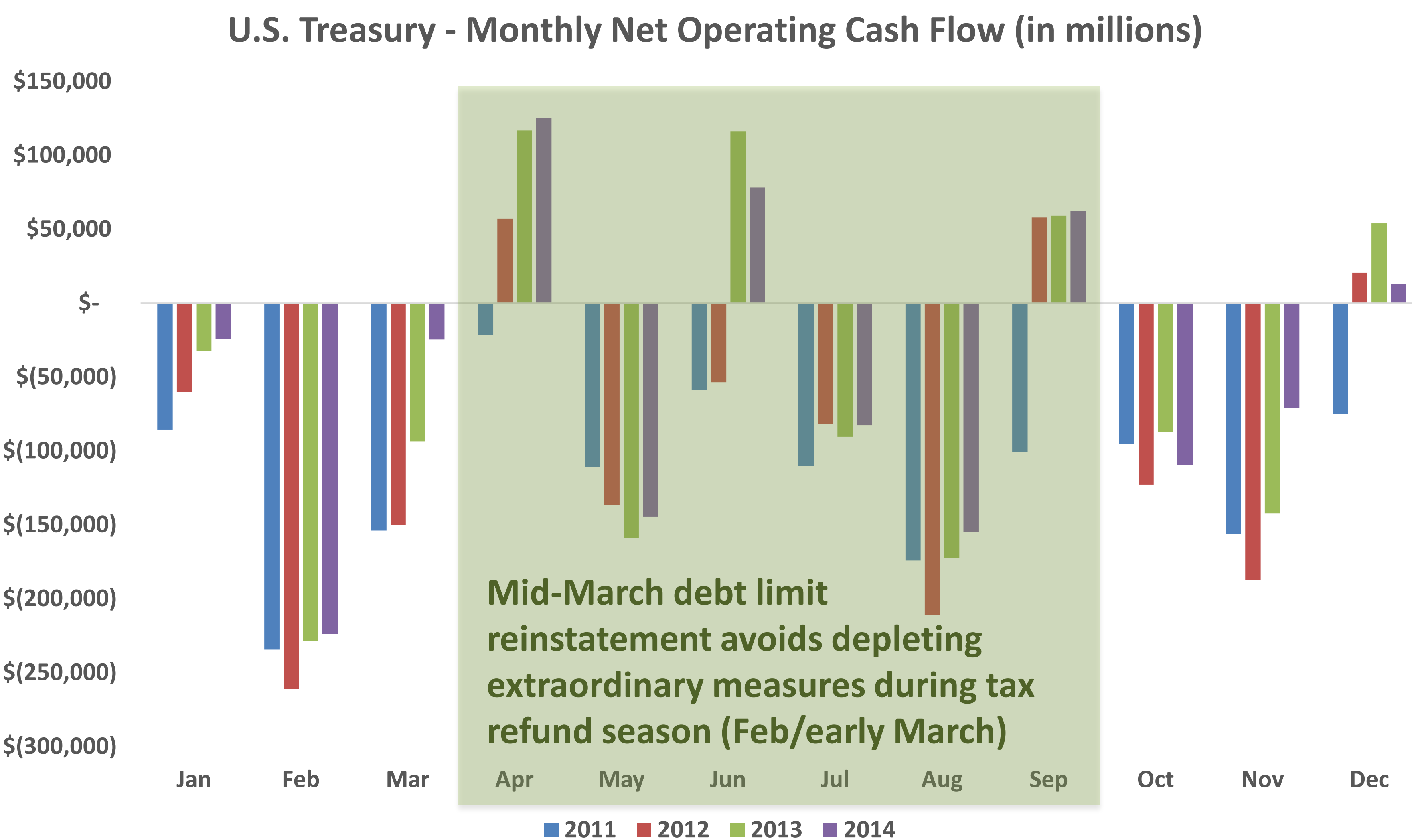
Source: Daily Treasury Statements

THE DEFICIT HAS BEEN DECLINING

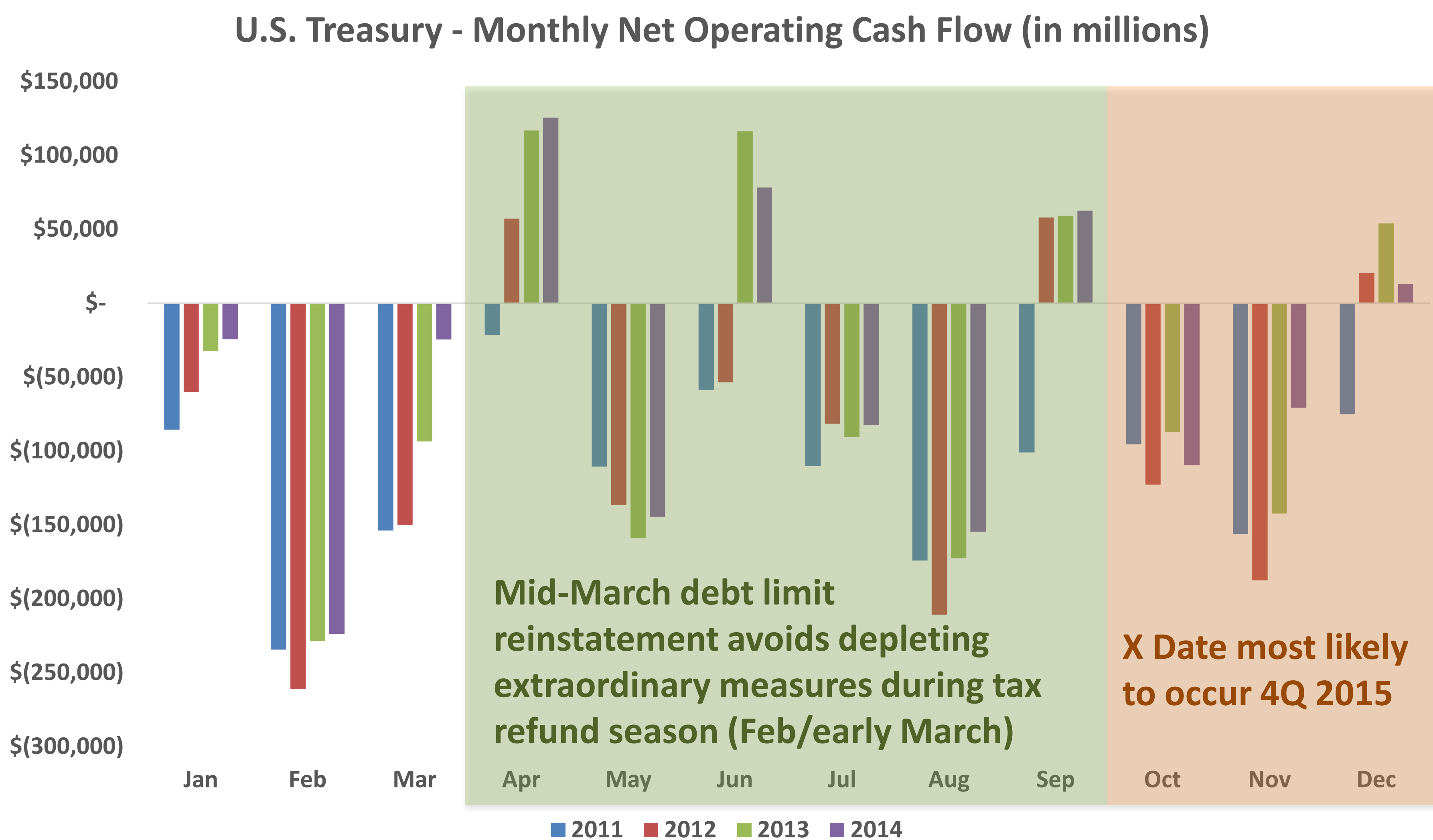


Source: Daily Treasury Statements

TIMING IS MORE FAVORABLE



TIMING IS MORE FAVORABLE



AFTER EXTRAORDINARY MEASURES

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

Market Risk

THE RISKS ARE REAL

Treasury securities are normally considered safe and liquid. They are treated as the foundation of the global financial system because of the perception that the risk of default is negligible.

- **Potential market disruption**
  - In 2013, Fidelity's money-market funds refused to hold any U.S. government debt maturing in late October and early November (the period surrounding the projected X Date in that year).
  - A worst-case scenario would be the failure of a Treasury auction to attract enough buyers to roll over maturing U.S. government debt.

THE RISKS ARE REAL

The Government Accountability Office on Treasury securities, market risk, and how to reduce it:

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

- "As we have also previously reported, delays in raising the debt limit can create uncertainty in the Treasury market. To avoid such uncertainty and the disruption to the Treasury market that it creates as well as to help inform the fiscal policy debate in a timely way, we have suggested in our February 2011 and July 2012 reports related to the debt limit that Congress should consider ways to better link decisions about the debt limit with decisions about spending and revenue at the time those decisions are made."

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

THE RISKS ARE REAL

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

THE RISKS ARE REAL

- **Market risks beyond the X Date:**
  - Treasury market, interest rates
  - Potential for serious equity market reaction (401(k)s, IRAs, other pensions)
  - Our economy
  - The global financial system
- **No guarantee of the outcome; risks are risks**

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Potential Actions on the Debt Limit

IF THE DEBT LIMIT IS SUSPENDED AGAIN…

- **…for one year and reinstated on March 16, 2016,**
  - BPC estimates the new debt limit would be approximately $18.9 trillion, about $700 billion higher than on March 16, 2015.
- **…for two years and reinstated on March 16, 2017,**
  - BPC estimates the new debt limit would be approximately $19.6 trillion, about $1.5 trillion higher than on March 16, 2015.

Note*:* Long-range projections are subject to significant uncertainty. These estimates assume that a variety of expired tax provisions are extended and that Medicare physician-fee-schedule payment rates are not cut, all without offsetting near-term savings.

Methodology & Assumptions

BPC METHODOLOGY

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

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

- Assumptions: Fiscal Year 2016 budget is funded at sequestration levels. No major shocks (e.g., recession, natural disaster, new overseas conflict) that could materially affect government finances.

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