

# THE DEBT CEILING: AN EXPLAINER

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The Constitution grants Congress the sole authority to borrow on behalf of the United States. It has delegated that authority to the Executive Branch but placed a ceiling, or limit, on the total amount of debt that can be outstanding at one time.

Currently, the debt ceiling is slightly below \$31.4 trillion. That limit is expected to cover federal borrowing needs until the early part of 2023, with the precise date depending on actual federal spending and revenue levels over the coming year. Treasury will be able to use “extraordinary measures” to continue normal operations for some period after that.

The debt ceiling does not constrain federal spending or the amount we need to borrow; it simply restricts the Treasury Department’s ability to honor financial commitments previously made by Congress and the President. Failure to set the debt ceiling at the level necessary to meet borrowing needs could jeopardize the full faith and credit of the United States by preventing the Treasury from paying the government’s bills. This could take the form of failing to pay interest on, or redeem, Treasury Bonds when due, or failing to make scheduled payments for vital programs such as Medicare, Medicaid, Social Security, or veterans benefits.

In recent years, voting on the debt ceiling has often been fraught with controversy, with legislation to increase it held hostage to force action on other matters, or simply to gain political advantage. These disputes have occurred despite the fact that raising the debt ceiling is necessary to cover previous spending already approved by Congress, and even the threat of default is enough to impact financial markets, increasing government borrowing costs.

If Congress were to ever allow the debt ceiling to lapse and Treasury was forced to default, the consequences would be severe. Interest costs throughout the world would likely increase. Investors would demand higher rates on future Treasury bonds, increasing the interest costs to taxpayers. There would likely be ripple effects throughout the financial system that would increase interest rates on mortgages, student loans, car loans, credit cards, and other debt. A long impasse could prompt a financial crisis and ultimately threaten the US Dollar’s central role in the global financial system. All of this could trigger a severe economic depression, bringing job losses and serious hardship to millions of families in the United States and around the world.

## CREATION OF THE DEBT CEILING

Congress used to exercise its borrowing authority by passing legislation to allow borrowing for specific purposes, often directing details of debt issues such as interest rates, maturities, and type of financial instruments. As the debt grew, Congress began providing the Treasury Secretary with greater leeway. Legislation enacted in 1917 to help finance the costs of World War I gave Treasury greater flexibility and first placed a limit – or “debt ceiling” – on combined debt issues. However, that legislation retained separate borrowing limits for some previous issues. Subsequent amendments to the 1917 law increased Treasury’s flexibility and, by 1941, the modern debt ceiling was in place. Congress has regularly increased the limit since then.

The debt ceiling does not affect federal spending or the amount we need to borrow. Those levels are determined by previous spending and tax decisions by Congress. Instead of limiting future debt, failure to increase the debt ceiling would make Treasury unable to honor existing commitments and execute the laws already passed by Congress, forcing a default.

## DEVELOPMENT OF DEBT LIMIT LEGISLATION

Legislation to increase the debt limit has usually – but not always – been initiated by the House. Over the years, this has occurred under normal legislative procedures, under the reconciliation process, and through the Gephardt (or Hastert) Rule, which triggers automatic House passage of a debt increase resolution upon passage of a budget resolution conference report. Under the version of this Rule in effect for the 117th Congress, House passage of a budget resolution (not necessarily a conference report) triggers House passage of a resolution suspending the debt limit through the end of the fiscal year covered by the resolution [1].

The debt limit has been increased as free-standing legislation or as a provision in a broader budget package. It’s must-pass nature has often attracted amendments in search of a vehicle or as sweeteners to attract votes for passage. In particular, debt limit increases have often been accompanied by budget process changes. Some of these have proved counterproductive to an effective budget process, such as the Budget Control Act’s **irresponsibly low discretionary caps** for 2014 through 2021 that led to drawn-out funding fights and the under-resourcing of many important government services.

Debt limit legislation has taken multiple forms. There have been straightforward increases, temporary increases, and temporary exemptions to allow Social Security checks to go out. In 2011, Congress temporarily authorized the President to increase the ceiling on his own, subject to congressional disapproval resolutions. In recent years, the debt limit has been addressed through temporary suspensions of the limit. Such legislation resets the debt ceiling dollar amount at the level of debt outstanding on the date the suspension expires. However, the two increases enacted last year raised the ceiling by specific amounts, to its current level of \$31.381 trillion.

## **USE OF EXTRAORDINARY MEASURES**

When the debt limit is reached, the Treasury Secretary is authorized to use a number of extraordinary measures to create some headroom under the limit and continue operations while avoiding a default on the debt. Those measures include reducing cash balances held by the Treasury, temporarily suspending investment of federal employee retirement contributions, and disinvesting securities held by federal employee retirement accounts. Those measures can buy additional time for Congress to act and have been used routinely in recent years. The amount of time that can be provided by these measures depends on the rate of incoming revenues and outgoing spending. Therefore, it can vary significantly, particularly if extraordinary measures are exhausted near the date of significant federal spending payments or deadlines for tax payments.

These measures are reversed after the debt ceiling is increased, but a debt ceiling impasse does impose some costs on the Treasury. The General Accounting Office has found that investors are reluctant to purchase securities that mature around the time of a potential debt ceiling crisis, reducing demand for Treasury debt and increasing the interest rates Treasury must pay to attract investors. Because Treasury bonds are seen as the safest investment in the world, they are also used in many private-sector transactions, and a debt ceiling crisis affects other financial markets and increases the costs to some investors.

## **DEBT PRIORITIZATION: ANOTHER FORM OF DEFAULT**

Some in Congress have suggested that Treasury act to further delay default when the debt ceiling is reached by prioritizing its payments so that it pays interest due on the national debt while delaying other payments until cash is available or the debt ceiling is increased. However, Treasury has indicated that it does not have the technical capacity to take such action.

Further, many in financial markets would see this as another form of default since Treasury, while continuing to pay interest on the debt, would be failing to honor other financial commitments required by law. Such action by the Treasury would also raise constitutional separation of powers concerns as Treasury would be selecting which spending commitments enacted by Congress to honor. Even self-funded programs with large trust fund balances, such as Social Security, are not protected, as Treasury would not be able to issue new debt to raise the cash needed to redeem the bonds held in the trust funds to pay scheduled benefits.

## RELEVANCE OF DEBT CEILING

There is a debate about whether the debt ceiling is useful or needed. Some argue that the debt ceiling is outdated, given the central role that Treasury debt now plays in the global financial system and that we now have a formal congressional budget process that gives Congress a regular opportunity to review and modify overall fiscal policy. Eliminating the debt ceiling would prevent Members of Congress from threatening the full faith and credit of the United States and holding our economy hostage in order to force action on other legislation, and it would allow fiscal debates to take place without the threat of a looming financial crisis. Others argue that Congress should retain control over the debt ceiling as a matter of Congressional prerogative.

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[1] The Senate never had a version of the Gephardt Rule. It responded in different ways to House resolutions passed under this rule, sometimes passing them, sometimes ignoring them, and sometimes amending them, requiring another House vote on a revised resolution.

*This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and may not necessarily reflect the views of all members.*