WHY CONGRESS NEEDS TO ABOLISH THE DEBT LIMIT

February 11, 2022

The Constitution grants Congress the sole authority to borrow on behalf of the United States. To ensure the United States can pay its bills on time, Congress delegated this authority to the Executive Branch but placed a ceiling, or limit, on the total amount of debt that can be outstanding at one time. But this policy mechanism, known as the **debt limit or debt ceiling**, has no effect on federal spending or the amount we need to borrow; it only restricts the Treasury Department's ability to honor financial commitments previously made by Congress and the President. If Congress were to ever allow the debt ceiling to lapse and Treasury was forced to default, the consequences for the U.S. economy and the American people would be severe, widespread, and painful.

Despite this risk to our nation, the debt limit has become a political chip, used as leverage – sometimes by the minority party, sometimes by a faction of the majority party – to force action on other policies. Even the threat of a default on the debt limit has significant consequences for financial markets, government borrowing costs, and the average household. It has become a dangerous political game, in which every threat of default comes with the chance of actually defaulting – and the negative effects cannot be overstated. A breach of the debt limit would roil financial markets, destroy business access to capital, stop payments to critical government programs that support retirees, veterans, and children, and threaten the entire U.S. economy.

So, what good is this policy? In short, it's not. The United States is the only major industrialized nation to have a debt limit, and there is no evidence to show that it has ever actually constrained borrowing, influenced fiscal decision-making, or spurred any useful reforms. The mere existence of this policy has potentially catastrophic consequences for all Americans, while providing no benefit to our nation. It must be abolished now.

JUST A NEAR DEFAULT CAN HAVE MAJOR CONSEQUENCES

The debt limit sets a maximum cap on the amount of debt that Treasury can issue, regardless of how much funding in excess of revenues Congress has legally authorized. When authorized deficit spending begins to approach the debt limit, Treasury must use so-called “extraordinary measures,” to avoid hitting the debt limit. These can include suspending some investments in federal employee retirement funds and changing the timing of cash-out on some investment vehicles.

The occurrence of extraordinary measures alone can create increased costs for the government. For example, in the 2011 debt limit crisis, Treasury incurred an additional **$1.3 billion** in costs over the fiscal year from these maneuvers alone. Additionally, approaching the debt limit creates uncertainty in markets, and investors may demand increased returns to compensate for this risk. Indeed, the Government Accountability Office (GAO) **found** that in the 2013 debt limit crisis, Treasury securities set to mature around the end of extraordinary measures saw an increase in rates and a decrease in liquidity. **In total**, this led to an increased borrowing cost for the government between $38 to $70 million.

Further, during this 2011 debt limit crisis without actual default, S&P downgraded U.S. government debt from a AAA rating to AA+.

WHAT WOULD A BREACH OF THE DEBT LIMIT MEAN?

While even approaching the debt limit has costs for the government, a full breach of the debt limit would be catastrophic. A breach would occur in a situation where Treasury runs out of extraordinary measures before Congress increases, suspends, or abolishes the debt limit. While it is impossible to know with certainty the consequences of a breach, some broad strokes are clear. First, it would mean that Treasury would be unable to make full payments on promised obligations. This would include payments to Social Security, Medicare, Medicaid, nutrition benefits, military salaries and retirement, defense contractors, law enforcement, unemployment insurance and others – in total approximately **80 million** payments a month. Forcing Treasury to spend only what is covered by revenues would lead to an immediate **40 percent cut** in government spending. Depending on how long it would take Congress to raise the debt ceiling under this scenario, Americans and those who are entitled to these benefits could go days or weeks without getting them. This could have ripple effects throughout the economy, as it jeopardizes the ability for families, veterans, retirees, and others to pay rent, buy groceries and medication, or run their businesses.

Second, a breach of the debt limit would almost certainly cause immediate financial market dysfunction. Financial markets would likely respond to this uncertainty by demanding higher interest rates on government securities, thus increasing rates throughout financial markets. This means that consumer products like car loans and mortgages would also become more expensive – hurting the pocketbooks of working Americans. This market chaos would likely spill over into global markets as well and could create financial crises around the world. The 2008 financial crisis started in the U.S. but triggered a global meltdown because of the interconnectedness of our financial system. A financial crisis triggered by U.S. default would almost certainly send similar – or even larger – shock waves through global markets.

Third, default would threaten the status of U.S. government debt as the safest asset in the world. The U.S. currently enjoys status as the global reserve currency, but the inability to pay our debts on time – especially in the conditions of a long debt limit stalemate – could threaten this standing and provide an opportunity for a global competitor, such as China, to step in and take our place at the top of the global economy. Just look at 2011, when S&P **downgraded** U.S. government debt from a AAA rating to AA+ during our near default. A full breach would certainly lead to another downgrade and thus increased borrowing costs. Additionally, the dollar would likely face a significant loss in value, causing potential price increases for consumers. This means that every household in America would ultimately pay the price for more expensive borrowing, from a crisis created by Congress.

It would take years to recover from even a short default. Families would suffer from lost benefits and increased prices, and markets would likely take years to restabilize. Simulations predict that a brief default would lead to **millions of jobs** lost, with Great Recession-levels of **job loss** projected in a long impasse.

THESE SELF-INFLICTED CRISES CONTINUE TO REOCCUR

Over the last decade, raising the debt limit has become even more difficult due to increased partisan divides. In both 2011 and 2013, Congress created serious and self-inflicted debt limit crises that nearly led to default. In the years since, there has often been a political impasse when it comes time to raise or suspend the limit again. Just last year in August 2021, the debt limit was reinstated to $28.4 trillion to cover spending approved under the Trump Administration, after being temporarily suspended through the Bipartisan Budget Act of 2019. It took Congress months to reach an agreement to increase the debt limit, exposing markets and consumers to uncertainty and increased risk. Concerningly, there is no evidence to suggest that Congress will be able to avoid creating a crisis the next time we approach the debt limit. But each case of brinksmanship brings us closer to a real default.

Though some politicians try to argue otherwise, raising the debt limit only gives Treasury permission to pay bills on money that has already been spent – it does not create more spending or increase the deficit. And while it may seem like a harmless, if archaic, policy tool, its existence threatens the health of our economy and society. While Congress has always increased the debt limit to date, it has always created – at least the potential for – unnecessary uncertainty. In the future, an impasse may not be solved as easily, or at all. This fiscal policy tool gives us no benefits as a country but does give us everything to lose. To remove that risk entirely, it must be abolished.

On Wednesday, February 16, 2022, the Budget Committee will examine the ways in which the existence of the debt limit is detrimental to our national and economic well-being. Expert witnesses will include:

- **Dr. Laura Blessing**, Senior Fellow, The Government Affairs Institute at Georgetown University
- **Ms. LaJuanna Russell**, Founder and President of Business Management Associates, Inc and Chair, Small Business Majority
- **Dr. Louise Sheiner**, Robert S. Kerr Senior Fellow in Economic Studies and Policy Director for the Hutchins Center on Fiscal and Monetary Policy, The Brookings Institution
- ***Additional witness to be announced.***