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IN FOCUS

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The Debt Limit

Overview

The debt limit places a statutory constraint on the amount of money that Treasury may borrow to fund federal operations. The debt limit is currently suspended, and scheduled to be reinstated on March 1, 2019, at a level precisely accommodating federal borrowing at that point. Congress may debate the merits of various debt limit modifications in advance of that date or later if "extraordinary measures" are implemented to prevent a binding debt limit. This *In Focus* provides background information and discusses recent legislative activity.

More information on the debt limit can be found in CRS Report R41633, *Reaching the Debt Limit: Background and Potential Effects on Government Operations*, by D. Andrew Austin et al.; CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin; and CRS Report R44383, *Deficits and Debt: Economic Effects and Other Issues*, by Grant A. Driessen.

Rationale and Role of the Debt Limit

The Constitution allows Congress to restrict the amount of federal debt that may be incurred as part of its "power of the purse." Under current law Congress exercises this power through the federal debt limit, which is codified at 31 U.S.C. §3101. Debt subject to limit is more than 99% of total federal debt, and includes debt held by the public (which is used to finance budget deficits) and debt issued to federal government accounts (which is used to meet federal obligations).

Federal debt increases when total expenditures exceed total receipts (producing a budget deficit). Expansion of the federal lending portfolio, through programs like college student loans, also increases federal debt levels. Periods of sustained debt increases bring debt levels near the debt limit. CBO's January 2019 baseline projected that the debt subject to limit will be $28.0 trillion at the end of FY2024 and $33.7 trillion by the end of FY2029; debt held by the public is forecasted to equal $22.1 trillion and $28.7 trillion in those respective years.

The federal debt limit acts as a check to ensure that recent revenue and expenditure trends meet the approval of Congress. However, federal collection and spending decisions affecting debt levels may have been agreed to by Congress and the Administration well in advance of debt limit deliberations. Some past debt limit legislation has linked debt limit increases with fiscal policy proposals such as budget enforcement measures.

Options for Congress

When debt levels approach the statutory debt limit, Congress can choose to (1) leave the debt limit in place; (2) increase the debt limit to allow for further federal borrowing; (3) maintain the current debt limit and require the implementation of "extraordinary measures" that will postpone (but not prevent) a binding debt limit; or (4) temporarily suspend or abolish the debt limit. Some have suggested that the Fourteenth Amendment may grant the President authority to ignore the statutory debt limit. Previous Administrations and many representatives of the legal community have rejected that argument as an alternative to debt limit legislation.

Inaction or Delayed Action: Potential Consequences

The combination of a binding debt limit and continued budget deficits would leave Treasury with conflicting directives. As with any borrower, the government is obliged to pay its bills, and yet a binding debt limit would prevent Treasury from doing so in a timely fashion. Possible consequences of a binding debt limit include, but are not limited to, the following:

- reduced ability of Treasury to borrow funds on advantageous terms, thereby further increasing federal debt;
- substantial negative outcomes in global economies and financial markets caused by anticipated default on Treasury securities or failure to meet other legal obligations;
- acquisition of interest penalties from delay on certain federal payments and transfers; and
- downgrades of U.S. credit ratings, which could negatively impact capital markets.

Possible economic and fiscal consequences of the debt limit are not confined to scenarios where the debt limit is binding. Protracted deliberation over raising the debt limit may also affect the U.S. financial outlook if it changes household and business behavior. A number of observers have suggested that debate over the debt limit which preceded the passage of the Budget Control Act in August 2011 reduced economic expansion in the second half of that year.

> "Because the debt ceiling impasse contributed to the financial market disruptions, reduced confidence and increased uncertainty, the economic expansion [in 2011] was no doubt weaker than it otherwise would have been." – U.S. Treasury, *The Potential Macroeconomic Effect of Debt Ceiling Brinkmanship*, October 2013.

Increasing the Debt Limit

Increasing the debt limit to accommodate further borrowing allows federal operations to continue as they otherwise would have. Increasing the debt limit reduces the likelihood of experiencing potential consequences associated with a binding and near-binding debt limit.

One issue for Congress to consider is the size of any potential debt limit increase. Larger increases in the debt limit allow more time to enact changes that adjust budgetary trends, but could reduce the effect of the debt limit on budgetary discussions if policymakers feel less constrained by the new debt limit level. Smaller debt limit increases potentially offer a greater role for the debt limit legislation in budgetary policy discussions, but may lead to more frequent debt limit activity.

"Extraordinary Measures" and Debt Limit Suspension

Invoking the authority to use "extraordinary measures" to stay under the debt limit and temporarily suspending the debt limit both postpone when Congress must act on debt limit legislation. The authority for using such "extraordinary measures," which include suspensions and delays of some debt sales and auctions, underinvestment and disinvestment of certain government funds, and exchange of debt securities for debt not subject to the debt limit, rests with the Treasury Secretary. Invocation of "extraordinary measures" has delayed required action on the debt limit by periods ranging from a few weeks to several months. Temporary suspensions delay the restrictions imposed by the debt limit for a period determined by corresponding legislation, and have been used in lieu of increasing the debt limit to a dollar value in recent years.

Past Debt Limit Activity

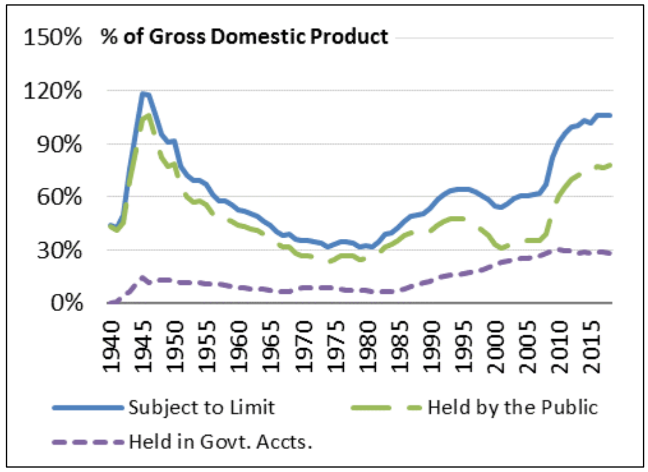
The Bipartisan Budget Act of 2018 (P.L. 115-123) suspended the debt limit until March 1, 2019. Upon reinstatement, the act provides for a debt limit adjustment to accommodate borrowing activity that occurred during the suspension. If action has not been taken to prevent a binding debt limit as the end of the suspension approaches, the Treasury Secretary may elect to exercise "extraordinary measures" to stay beneath the debt limit.

Regular legislative modifications to the debt limit have been enacted since the aggregate debt limit was first created in 1917. Congress has enacted 97 separate debt limit modifications between the end of World War II and the present to accommodate the changes in federal debt levels. Debt held by the public has consistently increased in that time period, except in the period immediately following World War II and between 1998 and 2001 when debt declined due to federal budget surpluses.

Congress has passed 16 separate changes to the debt limit since 2001. Much of the recent increase in the debt is attributable to a rise in debt held by the public. Increases in spending on old-age and retirement programs, lower tax receipts, and federal activities related to the Great Recession all contributed to rising debt levels. Debt held in government accounts has also increased since 2001, as Social Security payroll tax receipts exceeded payments to beneficiaries for much of that period.

Figure 1 shows the debt limit and debt levels as a percentage of GDP from 1940 to 2018. Although nominal debt levels have steadily risen in the postwar period, debt measured as a percentage of GDP (real debt) declined precipitously for several decades following its peak at 118% in 1946, reaching 32% in 1981. Real debt has increased in the recent decades. At the end of FY2018, total debt subject to the limit was 106% of GDP, and publicly held debt was 78% of GDP.

Figure 1. Federal Debt Subject to Limit as a % of GDP, FY1940-FY2018



Source: Office of Management and Budget, Department of the Treasury and Congressional Budget Office. Figure created by CRS.

Notes: Values taken at the end of the fiscal year.

Timing Uncertainties with a Binding Debt Limit

Short-term fluctuations in federal debt levels mean there is substantial uncertainty as to when debt levels will meet or exceed the statutory debt ceiling. Federal debt levels change in response to variation in the timing of payments and collection of receipts. This fluctuation is influenced by changes in the size and timing of incoming and outgoing Treasury payments, and is relatively insensitive to long-term deficit outcomes. Examples include lower debt levels that follow large income tax receipt collections in March and April and higher debt levels caused by interest payments and the issuance of Treasury securities in the middle and end of a given month. Short-term surpluses could extend the amount of time "extraordinary measures" taken by Treasury would delay a binding debt limit, while short-term deficits would have the opposite effect.

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