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The Debt Ceiling: An Explainer

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 on the total amount of debt that can be outstanding at one time. A debt ceiling does not constrain federal spending or the amount we need to borrow; it simply restricts Treasury's ability to honor financial commitments previously made by Congress and the President. Failure to keep the debt ceiling on pace with borrowing needs could jeopardize the full faith and credit of the United States by preventing Treasury from paying interest on or redeeming Treasury Bonds as well as other financial commitments including Medicare, Medicaid, and Social Security, veterans, and other benefits.

In recent years, voting on the debt ceiling has often been fraught with controversy, with legislation to increase it held up to force action on other matters. This is despite the fact that the threat of default is enough to impact financial markets, increasing government borrowing costs. Currently, the debt ceiling is suspended until December 8th, when it will be reinstated at the level of debt at the time. Treasury will be able to use "extraordinary" measures to continue normal operations for some period after that.

If Congress does not act before Treasury is 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. The limit has increased fairly steadily since then.

The debt ceiling does not affect the amount we need to borrow or federal spending. 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.

Development of Debt Limit Legislation

Debt limit legislation has usually – but not always – been initiated by the House. Over the years, it has been considered under normal legislative procedures, under the reconciliation process, and through the Gephardt (or Hastert) Rule, which triggered House passage of a debt increase resolution upon passage of a budget resolution conference report (this rule is no longer in effect)[1].

The debt limit has been increased as free-standing legislation or as a provision in a broader budget package. Its 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 current sequester-level discretionary caps.

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. Once, Congress authorized the President to increase the ceiling on his own, subject to congressional disapproval resolutions. The last five increases have taken the form of temporary suspensions of the limit, with the limit later being set at the level of debt existing on the date the suspension expires.

The debt limit is currently set at $19.8 trillion, the level of debt when a temporary suspension lapsed on March 16. It is currently suspended until December 8, and on that date it will increase to the level of then outstanding debt.

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

[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.

revenues and outgoing spending. It thus can vary significantly. If the Secretary has to resort to extraordinary measures in December, it is expected default will be deferred until sometime next year.

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 increased. 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 in order to raise the cash to redeem the bonds held in the trust funds.

Relevance of Debt Ceiling

There is a debate about whether the debt ceiling is useful or needed. Some argue that the debt ceiling is outmoded, 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. Others argue that Congress should retain control over the debt ceiling as a matter of Congressional prerogative. Eliminating the debt ceiling would prevent members of Congress from trying to use a threat to the full faith and credit of the United States to force passage of other legislation, and would allow fiscal debates to take place without the threat of a looming financial crisis. Supporters and opponents of eliminating the debt ceiling generally have different perspectives about whether this would be a desirable outcome.