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# Debt Limit Analysis

SEPTEMBER 2013

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**1. What is the first date on which Treasury will not have sufficient cash to pay all of its bills in full and on time (the “X Date”)?**

**If we reach the X Date, and Treasury is forced to “prioritize” its payments to avoid a debt default:**

**2. What would be the effects on government operations?**

**3. What would be the market risks?**



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# Extraordinary Measures

- **The U.S. hit its debt limit on May 19.**
- **The Treasury Secretary then began tapping into emergency borrowing authority – referred to as “extraordinary measures” – to allow for an additional period of fully-funded government operations.**
- **As of August 31, 2013, approximately \$108 billion in extraordinary measures remained available for use.**

- **Example: Federal Employees' Retirement System G-Fund**
  - Federal employees invest some retirement assets in government bonds.
  - Treasury may temporarily reduce the amount of debt held by this fund, thereby freeing up room under the debt limit.
  - This allows Treasury to issue additional securities to the public and raise cash to pay federal obligations.
  - After the debt limit is increased, Treasury must fully reimburse the retirement fund for the principal and interest.

EXTRAORDINARY MEASURES AVAILABLE	As of May 19	Remaining as of Aug 31
Do not reinvest the Federal Employees' Retirement System G-Fund	\$159 billion	<b>\$49 billion</b>
Do not reinvest the Exchange Stabilization Fund	\$23 billion	<b>\$23 billion</b>
Do not make new investments to the civil service and postal retirement funds	\$121 billion	<b>\$36 billion</b>
<b>Total</b>	\$303 billion	<b>\$108 billion</b>

Note: The totals indicate *available* measures during the debt limit event following May 19, 2013. Treasury may not employ all available measures. Treasury also has measures available (not listed) that assist with cash flow and debt management, but do not extend the date on which Treasury would begin to default on federal obligations absent an increase in the debt limit (the "X Date").

Sources: Government Accountability Office; Congressional Research Service; May 20, 2013 Treasury FAQ sheet; Treasury Direct Government Account Statements

- **As of the end of August, approximately \$108 billion in extraordinary measures remained.**
- **They won't buy much more time:**
  - September is a "good" month for the federal government's finances, as quarterly tax payments are due and there are no irregular, large payments.
  - October, in contrast, is a "bad" month for federal government's finances, largely due to roughly \$75 billion in military retirement prefunding requirements due on October 1.

- **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)

# 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 Congress does 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**

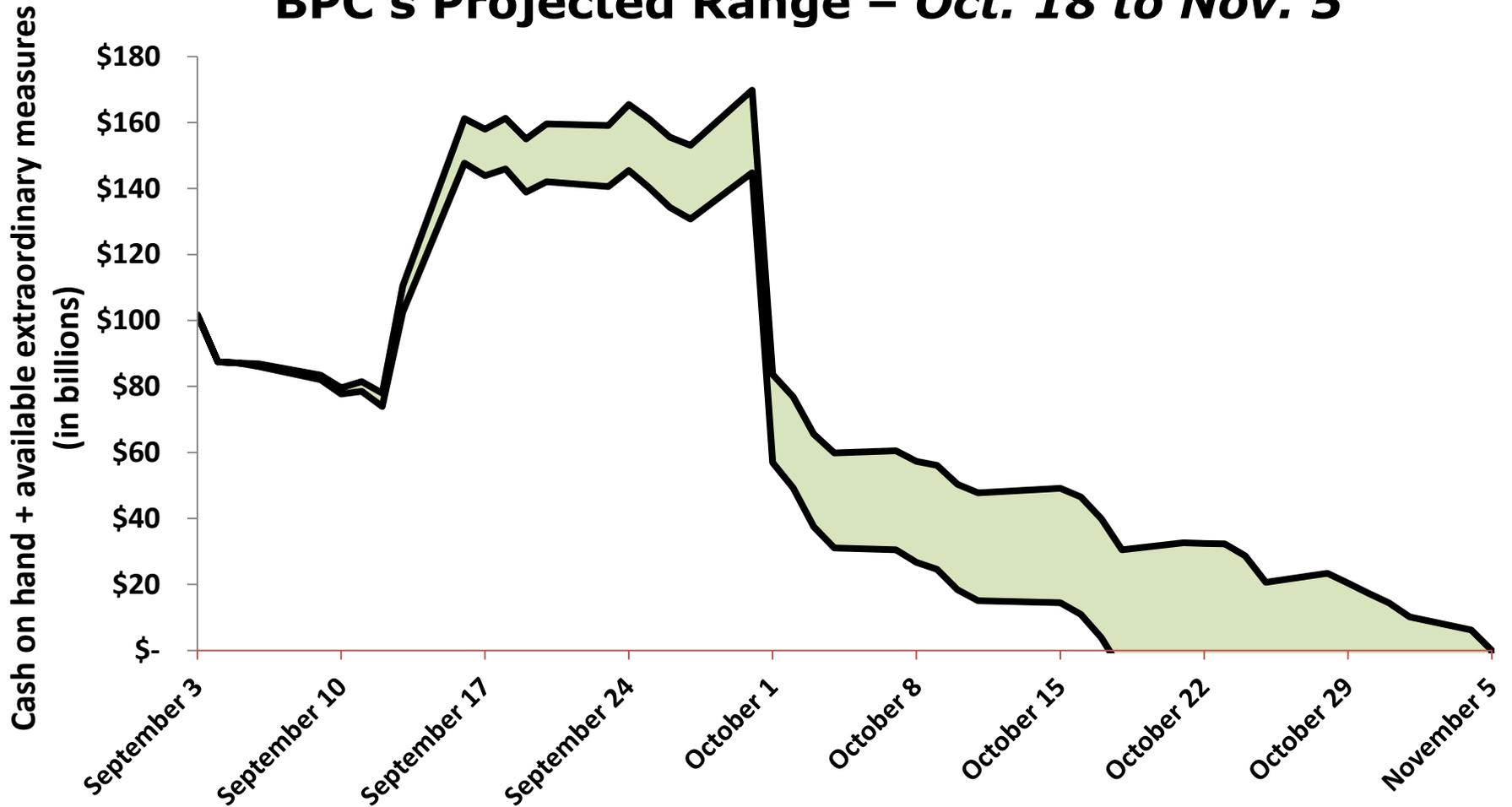


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# The “X Date”

- **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 not be able to cover all government spending.
- **BPC estimates that the X Date will occur between October 18 and November 5.**

### BPC's Projected Range – Oct. 18 to Nov. 5



Note: The projections above are subject to substantial uncertainty and volatility resulting from economic performance, cash flow fluctuations, and other factors.

Source: Bipartisan Policy Center Projections based off of Treasury's Daily, Monthly, and Direct Government Account Statements



- **Strengthening/weakening economy**
  - Above and beyond the expiration of the payroll tax cut, revenues have been stronger this year than last, reflecting increased employment and a stronger economy. This trend could either strengthen or weaken.
  
- **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 mid-September, are especially volatile.

- **Income Tax Payments Due Mid-September**
  - The expected revenue spike in mid-September is related to quarterly estimated tax payments, which are due on September 16, 2013.
  
- **Military Retirement Benefit Accrual on October 1**
  - On the first day of the new fiscal year, the value of military retirement benefits (including pensions and healthcare) earned during the year by currently serving members of the military must be accrued.
  
  - This will result in an approximately \$75 billion increase in intragovernmental debt, which counts toward the debt limit.

Date	Major Events & Payments	BPC Estimate
Mid-September	Quarterly tax payments ( <i>due September 16</i> )	~\$100 billion, paid over several days
September 30	Fannie Mae/Freddie Mac dividends due	\$15 billion
September 30	Additional extraordinary measure becomes available (postponing scheduled investments in the Civil Service Retirement Fund)	\$32 billion
October 1	Current funding for discretionary spending programs expires	--
October 1	Military retirement benefits accrual, which will increase intragovernmental debt	\$75 billion
October 1	Interest payment on public debt	\$6 billion
October 15	Interest payment on public debt	\$2 billion

# MAJOR EVENTS & TRANSACTIONS – OCT. 18 THROUGH NOV. 15

Date	Major Events & Payments	BPC Estimate
<b>October 18</b>	<b>Beginning of BPC’s projected X-Date range</b>	--
October 23	Social Security benefit payment	\$12 billion
October 24	Large rollover of outstanding federal debt <i>(no immediate net cost to government)</i>	\$57 billion
October 31	Large rollover of outstanding federal debt <i>(no immediate net cost to government)</i>	\$115 billion
October 31	Interest payment on public debt	\$6 billion
November 1	Medicare payment to providers & private plans	\$18 billion
November 1	Social Security benefit payment	\$25 billion
November 1	Military active pay, retirement, and veterans benefits payments	\$12 billion
November 1	Supplemental Security Income benefit payment	\$3 billion
<b>November 5</b>	<b>End of BPC’s projected X-Date range</b>	--
November 14	Social Security payment	\$12 billion
November 15	Interest payment on the debt	\$29 billion



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# Prioritization

- **President Obama has stated that the 14<sup>th</sup> Amendment does not provide a reasonable basis for challenging the constitutionality of the debt ceiling:**
  - *“My lawyers...are not persuaded that [the 14<sup>th</sup> Amendment] is a winning argument.”*
  - Press Secretary Jay Carney: *“The 14<sup>th</sup> Amendment [does not give] the president the power to ignore the debt ceiling – period.”*
- **Treasury has stated that it has no secret bag of tricks to finance government operations past the X Date.**
  - Treasury will not attempt to “firesale” assets during a crisis.
  - Other ideas are deemed impractical, illegal, and/or inappropriate (platinum coins, IOUs).

- **There is no precedent; all other debt limit impasses have been resolved without reaching the X Date.**
  - Treasury has never failed during a debt limit impasse to meet a payment obligation.
  
- **Chairman Bernanke:**

***"[Going past the X Date] would no doubt have a very adverse effect very quickly on the recovery. I'm quite certain of that."***

- **If we reach the X Date, Treasury might either prioritize payments or make full days' worth of payments once they receive sufficient revenues to cover all of a day's obligations.**
  - Interest on the federal debt would likely be prioritized in either scenario – it is paid on a separate computer system (FedWire).
  
- **Scenario # 1: Pay some bills, but not others**
  - Treasury might attempt to prioritize some types of payments over others. Prioritized payments would be made on time, others would not.
  - **This option may not be possible to implement using Treasury's current financial systems.** It would involve sorting and choosing from *nearly 100 million* monthly payments.

**If the X Date arrives on October 18 (the beginning of the BPC range):**

- Treasury would be about \$106 billion short of paying all bills owed between October 18 and November 15 (20 business days).
- Approximately **32%** of the funds owed for the period would go unpaid.
- **The reality would be chaotic:**
  - Unfair results, unanswered questions
  - Treasury picking winners and losers
  - Public uproar
  - Intense global media focus

## If you choose to pay...

Program	Cost
Interest on Treasury Securities	<b>\$35 b</b>
Medicare / Medicaid	<b>\$69 b</b>
Social Security Benefits	<b>\$49 b</b>
Military Pay and Retirement	<b>\$10 b</b>
Education Programs	<b>\$12 b</b>
Defense Vendors	<b>\$28 b</b>
Food Stamps/HUD/TANF/Unemployment	<b>\$20 b</b>

For a total of **\$222 billion**

(total does not add due to rounding)

Then you can't fund these programs, worth **\$106 billion**.

Program	Cost
<i>IRS Tax Refunds</i>	<b>\$4 b</b>
<i>Veterans Benefits</i>	<b>\$4 b</b>
<i>Federal Salaries + Benefits</i>	<b>\$24 b</b>
<i>Health and Human Services Grants</i>	<b>\$7 b</b>
<i>Supplemental Security Income</i>	<b>\$3 b</b>
<i>Other Spending, including:</i> <ul style="list-style-type: none"> <li>- <i>Department of Justice (FBI, federal courts)</i></li> <li>- <i>Department of Energy</i></li> <li>- <i>Federal Highway Administration (road construction)</i></li> <li>- <i>Federal Aviation Administration (air traffic control)</i></li> <li>- <i>Environmental Protection Agency</i></li> <li>- <i>FEMA and National Flood Insurance Program</i></li> </ul>	<b>\$64 b</b>

Note: This scenario is presented purely for illustrative purposes and simplifies the situation. There are a number of caveats to its feasibility (some of which are mentioned elsewhere in this presentation), including the fact that revenues and obligations are lumpy, such that even if all of the payments on the previous slide could be afforded from the vantage point of aggregate figures for the covered period, the specific cash situation on particular days would make certain payments unaffordable.

- **On a day-to-day basis, handling *all* payments for important and popular programs (e.g., Social Security, Medicare, Medicaid, Defense, military active duty pay) will quickly become impossible.**
- **Economic disruption:**
  - Immediate **32%** cut in federal spending would affect broader economy
  - Many service providers unpaid
  - Individuals not receiving government checks
  - Widespread uncertainty as decisions are made day-by-day

- **The Treasury Department’s Office of Inspector General (OIG) released a report in 2012 on post-X Date strategies that Treasury was considering in the summer of 2011.**
  - Some senior Treasury officials were skeptical of the prioritization scenario for two reasons:
    - 1) Choosing to pay certain obligations before others would be of questionable legality
    - 2) Given the sheer number of daily payments and Treasury’s computerized payment system, prioritization would require a massive overhaul and reprogramming of these operations that may be impossible
- **One other mechanical possibility for the prioritization scenario is that Treasury (via the Office of Management and Budget) would instruct agencies to withhold processing of certain groups or types of bills so as to prevent them from entering Treasury’s system.**
  - BPC does not know the feasibility of this approach.

- **Scenario # 2: Make all of each day's payments together once enough cash is available**

- Treasury might wait until enough revenue is deposited to cover an entire day's payments, and then make all of those payments at once.

(For example, upon reaching the X date, it might take two days of revenue collections to raise enough cash to make all of the payments due on day one. Thus, the first day's payments would be made one day late. This, of course, would delay the second day's payments to a later day.)

- In the 2012 OIG report, some senior Treasury officials stated that they believed this to be the most plausible and least harmful course of action.
- Since debt operations are handled by a separate computer system, these payments could likely still be prioritized under this scenario.

## Illustrative Potential Payment Delays (assuming an Oct. 18<sup>th</sup> X Date)

Payment	Due Date	Delayed Until
Medicare and Medicaid Payments to Providers	October 18	October 21
Unemployment Insurance	October 21	October 23
Social Security	October 23	October 25
Tax Refunds	October 24	October 28
Food Stamps	October 25	October 30
Defense Vendor Payments	October 25	October 30
Social Security	November 1	November 13
Veterans Benefits	November 1	November 13
Military Active Pay	November 1	November 13

Note: These projections incorporate a set of assumptions, including (for illustrative purposes) that the X Date occurs at the beginning of the BPC estimated window (October 18); that Treasury enters the X Date with \$4 billion of cash on hand; that interest payments are prioritized and paid on time; and that federal trust fund operations continue as normal.

Source: Bipartisan Policy Center projections off of Daily Treasury Statements



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# Market Risk

- **The Government Accountability Office (GAO) issued a report detailing additional costs to taxpayers as a result of the delayed 2011 debt limit increase.**
  - A substantial cost to taxpayers stemmed from elevated interest rates on U.S. securities issued in 2011 prior to when the debt limit was increased in August.
  - GAO conducted an economic analysis to estimate the resulting change in interest rates.
  - For Fiscal Year 2011, GAO estimated additional interest costs to taxpayers of \$1.3 billion.

- **The cost of the event to the federal government, however, continues to accrue because many of the bonds issued during that period remain outstanding.**
  - BPC extended GAO's methodology to analyze the long-term cost to taxpayers stemming from the elevated interest rates.
  - Estimate of the ten-year cost to taxpayers of the 2011 debt limit standoff = **\$18.9 billion**

- **Treasury must “roll over” well over \$370 b in debt that will mature this year during the Oct 18 – Nov 15 period.**
  - When a Treasury security matures, Treasury must pay back the principal plus interest due. Under normal circumstances, Treasury would simply “roll over” the security.
  - As one security matures, the principal and interest for that security would be paid for with cash from the issuance of a new security.

- **In a post-X Date environment, this operation may not run as smoothly.**
  - Two elements of market risk:
    - Treasury will have to pay higher interest rates to attract new buyers.
    - It is possible, if unlikely, that not enough bidders would appear, forcing Treasury to either use cash on hand to pay off securities that came due or, in a worst-case scenario default on the debt.
  - The 2012 Office of Inspector General’s report found that there was substantial concern about this issue among Treasury officials during the 2011 debt limit event.

## Debt Maturing Between October 18 and November 15

Date	Amount
October 24	\$58 billion
October 31	\$115 billion
November 7	\$54 billion
November 14	\$79 billion
November 15	\$63 billion
<b>Total</b>	<b>\$370 billion</b>

Note: Does not include estimates of 4-week maturities that have yet to be auctioned. Numbers do not add due to rounding.

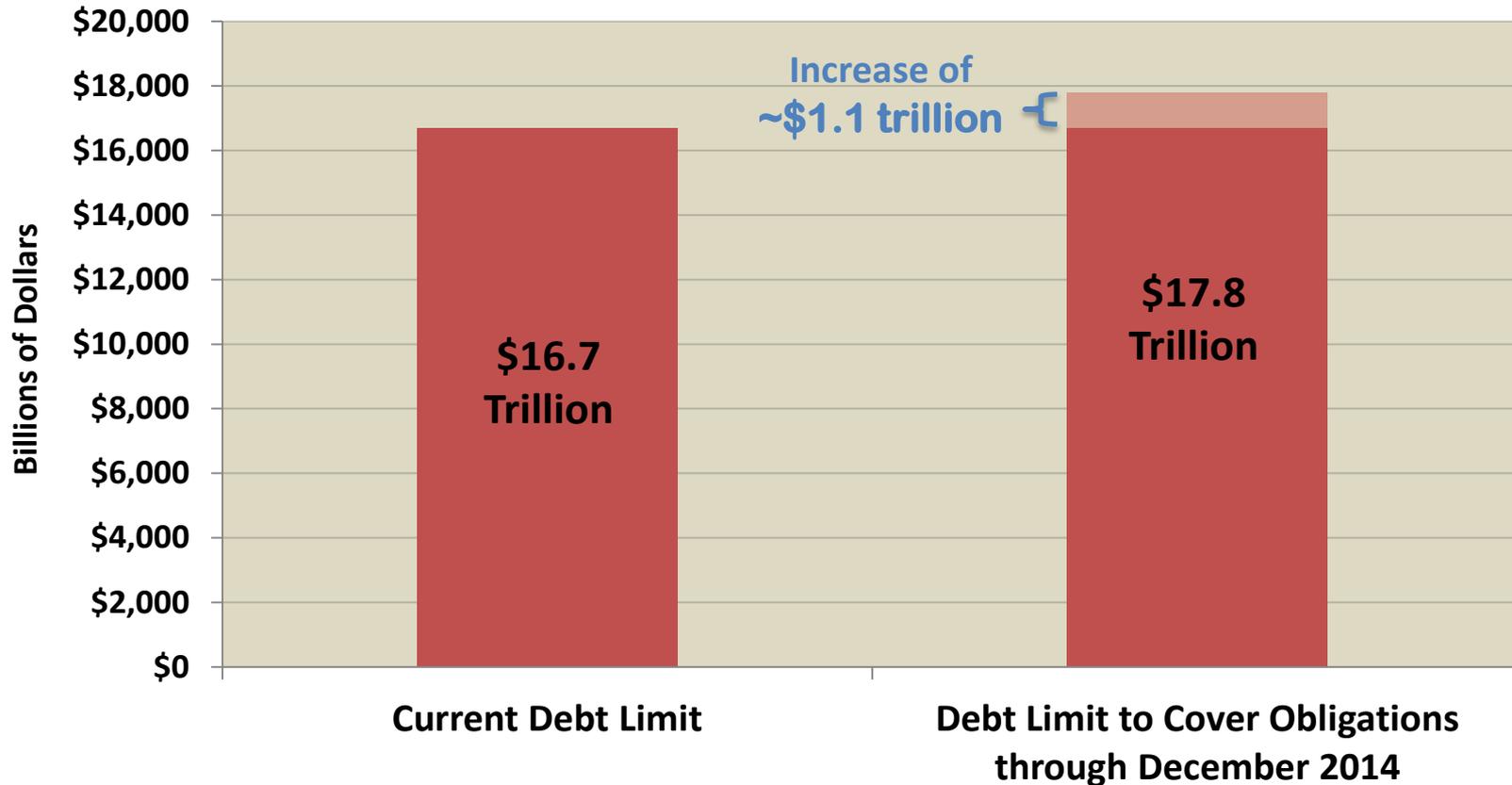
Source: TreasuryDirect

- **Additional borrowing costs for the federal government from delay in increasing the debt limit.**
- **Additional rating agency downgrades are possible.**
  - 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 another downgrade.
  - S&P downgraded in 2011 and reaction was not severe.
  - But there is uncertainty about effects of another downgrade since many funds are prohibited from holding non-AAA securities.

- **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**

## Roughly what would the debt limit need to be to get through 2014\*?



\*The estimates in the chart above assume that sequestration continues to take effect, war spending declines as scheduled, Medicare physician payments are frozen at 2013 levels (the “Doc Fix”), and the “tax extenders” in the American Taxpayer Relief Act of 2012 are extended permanently. Given that the time frame is far in the future, this estimate is subject to significant uncertainty.

Source: Congressional Budget Office, Bipartisan Policy Center projections

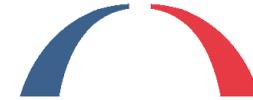


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# Methodology & Assumptions

- Reviewed financial data from the Treasury Department
  - Daily + Monthly Treasury Statements
  - Monthly Statement of the Public Debt
  - Government Account Statements
  
- Projected daily operating cash flow and change in intragovernmental debt using:
  - Historical financial data
  - CBO analysis of spending growth
  - Adjustments for anticipated issues (e.g., GSE dividends, extraordinary measures that become available on certain dates)
  
- Assumption: FY14 budget is funded at sequestration levels

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