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Fiscal Facts

The U.S. Debt Limit

Frequently Asked Questions

What is the federal debt?

If the federal government does not collect enough revenue to pay for all its spending obligations, it must borrow to make up this shortfall; the federal debt is the accumulation of such borrowing in our nation's history. Federal debt includes all securities—including bills, notes and bonds—issued by the U.S. Department of the Treasury and other government agencies.

There are several different ways to measure federal debt:

- **Publicly-held Debt** includes all federal debt held by private investors—including individuals, corporations and foreign governments. As of June 24, publicly-held debt totaled \$9.74 trillion.
- **Intragovernmental Debt** includes the debt that Treasury owes to

accounts within the federal government. Much of this debt results from surplus in the Social Security trust fund, which is required by law to be invested in federal securities.¹ Intra-governmental debt amounted to \$4.61 trillion as of June 24.

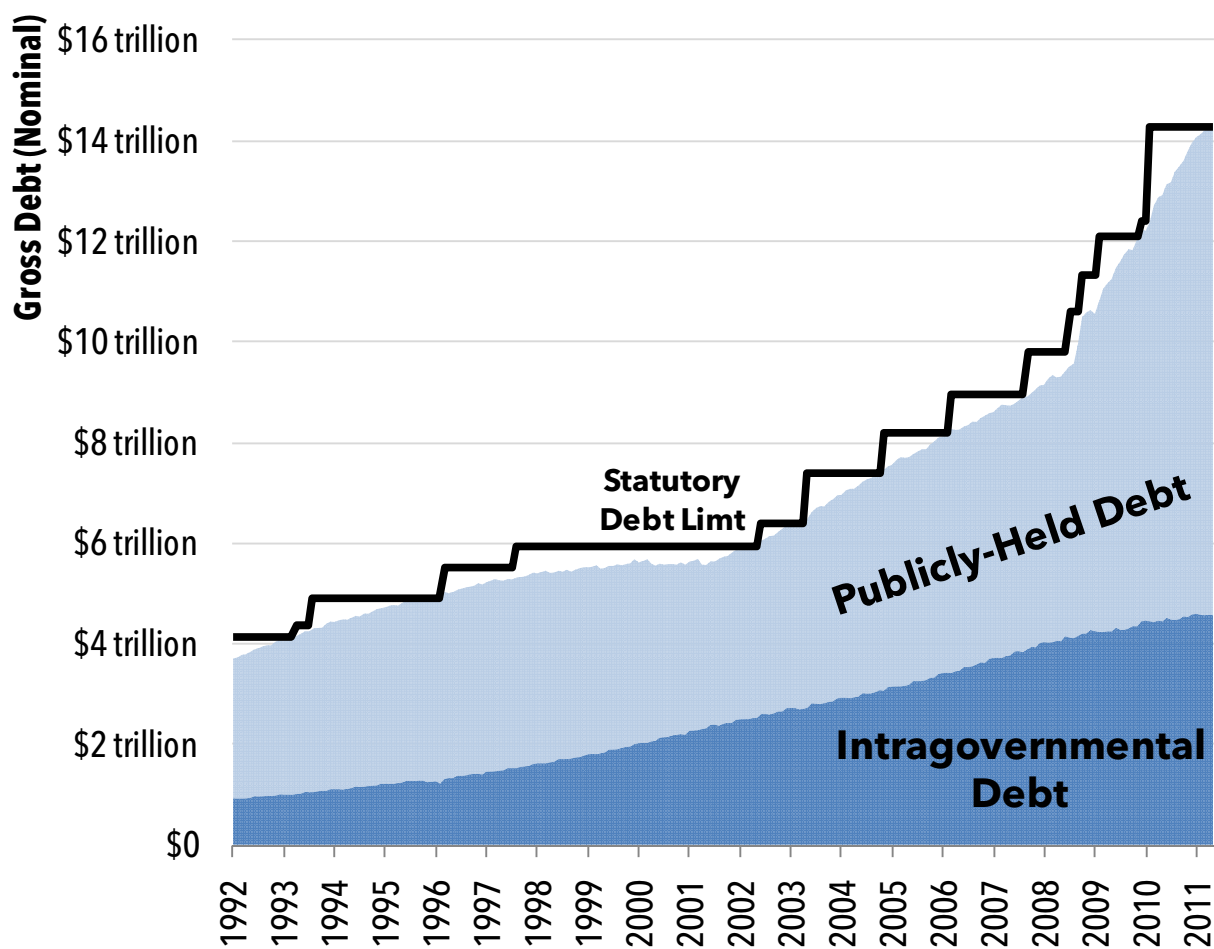
- **Gross Debt** is the sum of publicly-held and intragovernmental debt. Since May 16, gross debt subject to the debt limit has totaled \$14.294 trillion.

What is the debt limit?

The debt limit (also called the debt ceiling) is established in law and limits the amount of gross debt that the federal government can issue.² First enacted in 1917 as a condition of allowing the government to issue bonds

Figure 1

U.S. Gross Debt and the Statutory Debt Limit, 1992–2011



SOURCE: Pew analysis of U.S. Treasury data.

NOTES: Publicly-held debt includes all U.S. Treasury securities held by non-federal entities. Intragovernmental debt includes all U.S. Treasury securities held by the federal government.

during World War I, the debt limit has been increased throughout the past century; according to the Government Accountability Office (GAO), the debt limit has been raised 74 times since 1962, including 10 increases in the past decade.³ The debt limit is currently set at \$14.294 trillion dollars (see

Figure 1).

Have we reached the debt limit?

On May 16, 2011, Secretary of the Treasury Timothy Geithner announced that the government had reached its statutory debt limit. However, despite

reaching the limit, the federal government can take various actions to prolong its ability to borrow. For example, the Treasury can draw down its cash balances to avoid issuing new debt. In addition, the Treasury can suspend investments and redeem securities in certain accounts, including the Civil Service Retirement and Disability Fund and the Government Securities Investment Fund, which provides the government with additional funds to meet its obligations. These and other measures will enable the government to not exceed the debt limit until about August 2 (according to Treasury estimates).

What is a default?

According to the Treasury, a default occurs when the federal government is unable to meet any of its legal obligations because of a lack of funds—including payments to holders of federal debt, salaries for federal employees, tax refunds, payments to recipients of Social Security and Medicare as well as many other commitments.⁴ If the federal government reaches the debt ceiling and its obligations continue to exceed revenues, it eventually will be unable to make some payments.

A 1985 GAO study concluded that if the government cannot meet all its required payments, the Treasury might have some flexibility in deciding which obligations to pay first.⁵ A recent report

by the Congressional Research Service (CRS) suggests that the Treasury could potentially continue to meet its debt obligations while delaying payments to individuals, service providers or state and local governments. However, CRS acknowledges that under such a scenario, it is unclear whether creditors might lose faith in the government's ability to meet its obligations even if it continues to make debt payments, which could result in sharply higher interest costs.⁶ The Treasury contends that “prioritizing” payments to debt holders over other commitments would not prevent a default, since not meeting any legal obligation would still be seen as a “failure by the U.S. to stand behind its commitments” and would result in the same negative economic consequences.⁷

Has the government ever defaulted on its debt?

According to the GAO, the federal government has never defaulted on its securities because “cash has been available to redeem them upon maturity or demand.”⁸ Some experts point out that there have been isolated instances (in 1790, 1933 and 1979) in which the government restructured debt or did not make some interest payments in a timely manner.⁹ Research has concluded that even these temporary defaults had meaningful, if short-lived, consequences, including spikes in short-term interest rates.¹⁰

Has the government ever been this close to a default?

Several times throughout the past decade—including 2002, 2003, 2004, 2006 and 2009—the federal government came within weeks of reaching the statutory debt limit. The Treasury took special measures to avoid exceeding the debt ceiling, including redeeming securities held in government funds and suspending payments to federal retirement accounts.

What would be the impact of a default?

Short of a default, the uncertainty surrounding potential missed payments by the government might lead investors to sell federal securities or demand higher interest rates. That could result in financial upheaval as federal borrowing costs spike and demand for U.S. assets falls. In addition, since Treasury securities play a fundamental role as a safe asset in global financial markets, a default (or the anticipation of a default) by the federal government and accompanying rise in interest rates could potentially have wide-ranging impacts on global markets, although the specific effects are unclear. Ultimately, the consequences of a default will depend on how investors respond to uncertainty surrounding the debt limit.

How does the government increase the debt limit?

To increase the debt ceiling, Congress must pass legislation raising the limit

and the president must sign it into law. Policy makers decide both the timing and amount of any increase in the debt limit. It was last raised in February 2010, when it was increased by \$1.9 trillion to its current level of \$14.294 trillion.

What have been the riders on previous legislation to raise the debt limit?

Since the debt limit is an important piece of legislation, policy makers have frequently attached other major legislative items to debt ceiling increases. Most recently, the debt ceiling increase in February 2010 was part of a larger piece of legislation that reinstated pay-as-you-go (PAYGO) rules, which require that the cost of certain new legislation be offset by spending cuts or tax increases. In 2008 and 2009, debt limit increases were tied to major economic recovery legislation, including: the 2008 Housing and Economic Recovery Act, which was designed to inject capital into Fannie Mae and Freddie Mac and ease the mortgage crisis; the 2008 legislation that created the Troubled Assets Relief Program; and the 2009 American Recovery and Reinvestment Act. ■

Endnotes

¹ Office of Management and Budget, Fiscal Year 2012 Budget of the United States Government, *Analytical Perspectives*.

² A small portion of gross federal debt is excluded from debt limit coverage. Debt excluded from the limit includes the unamortized discount on Treasury bills and zero-coupon bonds, debt issued prior to 1917, certain old currency (United States Notes), debt held by the Federal Financing Bank and Guaranteed Debt. On May 27, 2011, total debt was \$14.345 trillion; excluded debt totaled \$51 billion, or less than 0.4% of the total. This means that debt subject to limit totals \$14.294 trillion—which is at the debt limit.

³ Government Accountability Office, *The Debt Limit: History and Recent Increases*, September 8, 2010. Before 1917, Congress generally limited the amount of debt in each issue; that year marked the first time that Congress provided broader authority to issue debt under an aggregate debt ceiling.

⁴ Department of the Treasury, *Debt Limit: Myth v. Fact*, 2011. Accessed at <http://www.treasury.gov/initiatives/Documents/Debt%20Limit%20Myth%20v%20Fact%20FINAL.pdf>

⁵ Government Accountability Office, Letter from GAO to Senate Finance Committee. GAO B-138524. 1985.

⁶ Congressional Research Service, *Reaching the Debt Limit: Background and Potential Effects on*

Government Operations, 2011. See discussion on pages 6-10.

⁷ Department of the Treasury, *Proposals to “Prioritize” Payments on U.S. Debt not Workable, Would not Prevent Default*, 2011.

⁸ Government Accountability Office, *A New Approach to the Public Debt Legislation Should be Considered*, 1979.

⁹ See, for instance: Carmen Reinhart and Kenneth Rogoff, *The Forgotten History of Debt*, February 2008. Accessed at <http://isites.harvard.edu/fs/docs/icb.topic185579.files/Domestic%20Debt%202027.pdf>; and Tax Policy Center, “The Day the United States Defaulted on its Treasury Bills,” May 2011. Accessed at <http://taxvox.taxpolicycenter.org/2011/05/26/the-day-the-united-states-defaulted-on-treasury-bills/>

¹⁰ See, for instance: Terry Zivney and Richard Marcus, “The Day the United States Defaulted on Treasury Bills,” *The Financial Review*, 1989, Vol. 24, Issue 3, pages 475-89.

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