Insight

The United States Breaches $36.1 Trillion Debt Ceiling

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Executive Summary

- The Fiscal Responsibility Act of 2023 suspended the debt ceiling, which is the legal limit on the amount of debt the federal government can accumulate, through January 1, 2025; on January 2, the debt limit was reinstated at the amount of debt outstanding – $36.104 trillion
- Upon reinstatement of the debt ceiling, the Department of the Treasury would normally begin using accounting maneuvers known as extraordinary measures to temporarily keep the federal government from defaulting on its debt; yet a scheduled redemption of nonmarketable securities held in a federal trust fund associated with Medicare payments kept the amount of debt outstanding below the debt limit and the need for extraordinary measures at bay until January 21 when the debt limit was breached.
- In the period between the reinstatement of the debt ceiling and the exhaustion of extraordinary measures, Congress must pass legislation that either raises or suspends the debt limit to avoid a default.
- This insight provides a brief refresher on what the debt ceiling is, what happens now that it's been hit, and the negative consequences of a debt ceiling impasse.

Introduction

According to the most recent projections from the Congressional Budget Office, the United States will run a federal budget deficit of $1.9 trillion in fiscal year (FY) 2025, following a $1.8 trillion deficit in FY 2024, and a $1.7 trillion deficit in FY 2023. To finance the deficit plus any additional borrowing to pay for new spending or tax cuts, the Department of the

Treasury regularly auctions off debt. That debt is subject to a statutory limit, also known as the debt limit or the debt ceiling. From time to time, Congress raises or suspends the debt limit to accommodate the additional borrowing needed to finance the nation's growing budget deficits.

The Fiscal Responsibility Act of 2023 (FRA) suspended the debt ceiling through January 1, 2025; on January 2, the debt limit was reinstated at the amount of debt outstanding: $36.104 trillion. Upon reaching this deadline, the Treasury would normally begin using accounting maneuvers known as extraordinary measures to temporarily keep the federal government from defaulting on its debt. Yet a scheduled redemption of nonmarketable securities held in a federal trust fund associated with Medicare payments kept the amount of debt outstanding below the debt limit and the need for extraordinary measures at bay until January 21 when the debt limit was breached. In the period between breaching the debt ceiling and the exhaustion of extraordinary measures (what is known as the "X-date"), policymakers will need to enact legislation that either raises or suspends the debt limit to avoid a default.

Raising or suspending the debt limit is generally unpopular, and policymakers from both parties often do so begrudgingly after extended negotiations. These negotiations have been characterized by excessive brinksmanship that puts at risk the Treasury's ability to pay the nation's bills as they come due. Policymakers have generally waited until the 11th hour to act on the debt ceiling, and this time is likely no different.

What Is the Debt Limit?

The debt ceiling, also known as the debt limit, is the legal limit on the amount of debt the federal government can accumulate. It was first enacted in 1917, and set at $11.5 billion, as part of the Second Liberty Bond Act, when Congress gave the executive branch more flexibility to borrow as the United States entered World War I. Under the law, Congress no longer had to authorize every new debt issue in a separate piece of legislation; the Treasury could borrow as long as total borrowing was under the debt limit. In 1939, Congress established the first aggregate debt ceiling that covered nearly all government debt and set it at $45 billion. Since the debt ceiling restricts the federal government's ability to borrow, it restricts its ability to pay the obligations it's already incurred. Of note, the debt limit has no direct impact on the federal government's ability to run budget deficits or limit future obligations.

Federal debt subject to the limit applies to almost all federal debt, with the exception of certain *de minimis*accounting measures and relatively small tranches of other obligations. That is, it covers nearly all of the $28.9 trillion of debt held by the public and the $7.4

trillion of debt that the federal government owes itself, known as intragovernmental debt, as a result of borrowing from various government accounts such as the Social Security and Medicare trust funds. As a result, the national debt continues to rise because of both annual budget deficits that are financed by borrowing from the public and from federal trust fund surpluses, which are invested in Treasury securities with the promise to be repaid later with interest.

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What Are Extraordinary Measures?

Now that the debt limit has been breached, the Treasury has begun to rely on its cash on hand and a series of accounting maneuvers known as extraordinary measures to avoid defaulting on the federal government's financial obligations. Such measures include a declaration by the secretary of the Treasury of a "debt issuance suspension period" for the Civil Service Retirement Disability Fund and the Postal Service Retiree Health Benefits Fund, which allows the Treasury to suspend new investments and redeem existing investments in the funds earlier than scheduled. In the past, the secretary of the Treasury has also suspended reinvestment in the Government Securities Investment Fund, halted the daily reinvestment of the Exchange Stabilization Fund, and stopped issuing State and Local Government Series Treasury securities savings bonds. While only temporary, extraordinary measures can delay up to several months the restrictions imposed by the debt limit. During the 2023 debt ceiling impasse, for example, extraordinary measures enabled the federal government to continue meeting its financial obligations until the FRA suspended the debt limit on June 3, 2023 (the debt limit was breached on January 19, 2023, and extraordinary measures allowed the federal government to pay its obligations in full and on time for 135 days).

What Happens When the Debt Ceiling is Hit?

Once the federal government has hit its debt ceiling and subsequently exhausted its available extraordinary measures, the Treasury can no longer issue new debt, and it will soon run out of cash on hand. Given large annual budget deficits, incoming revenue would be insufficient to cover the federal government's daily financial obligations. As a result, the Treasury and other federal payment processes would essentially have to reduce payments to the cash inflow of the federal government to ensure that bondholders are paid, and to thus avoid a default on federal securities. This so-called "prioritization" would require deferring the timely payment of other financial obligations, such as Social Security payments, salaries for federal civilian employees and the military, and veterans' benefits.

What Are the Consequences of a Debt Ceiling Impasse?

The need to raise or suspend the debt ceiling is generally branded as essential to avoid defaulting on the nation's debts. While the United States has never defaulted on its debt, policymakers have typically waited until the 11th hour to act on the debt ceiling. A 2013 Treasury study best summarizes the macroeconomic implications of debt-limit brinksmanship:

The United States has never defaulted on its obligations, and the U.S. dollar and Treasury securities are at the center of the international financial system. A default would be unprecedented and has the potential to be catastrophic: credit markets could freeze, the value of the dollar could plummet, U.S. interest rates could skyrocket, the negative spillovers could reverberate around the world, and there might be a financial crisis and recession that could echo the events of 2008 or worse. Political brinksmanship that engenders even the prospect of a default can be disruptive to financial markets and American businesses and families.[1]

The brinksmanship that often surrounds debt ceiling impasses can lead to downgrades of U.S. credit by rating agencies. Two of the three major credit rating agencies – Standard and Poor's and Fitch – have downgraded the United States' credit rating and directly cited political gridlock surrounding the debt ceiling as one of the reasons why. In November 2023, the third major credit rating agency – Moody's – also downgraded the United States' credit rating.

Debt ceiling impasses also negatively affect the world's view of the United States as a reliable partner and investors' perceptions of Treasury securities as safe, stable investments. For example, if U.S. debt is viewed as risky, investors could choose to divert their resources to other markets. This would place upward pressure on the interest rates of Treasury securities. An increase in interest rates across the economy would soon follow, affecting mortgages, car loans, credit cards, businesses investments, and other costs of borrowing and investment in the U.S. economy. And ultimately, interest costs on the national debt would rise.

Conclusion

The reinstatement of the debt ceiling on January 1, 2025, and the subsequent breach of the debt limit on January 21, is the first of several fiscal deadlines policymakers will face in 2025. While the use of extraordinary measures is likely to stave off the threat of default for a few months, policymakers should work promptly to raise or suspend the debt ceiling in advance of the X-date. A failure to act on the debt ceiling would have severe negative consequences for the U.S. economy and the nation’s global standing.

[1]https://www.treasury.gov/initiatives/Documents/POTENTIAL%20MACROECONOMIC%20IMPACT%20OF%20DEBT%20CEILING%20BRINKMANSHIP.pdf