The Daily Dish

What If the Federal Government Hits the Debt Limit?

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Eakinomics: What If the Federal Government Hits the Debt Limit?

Eakinomics has been telling readers all year that raising or suspending the debt limit is one of the two things that Congress actually has to do this year (the other being a deal on funding the government that gets rid of the budget caps). But what would happen if Congress actually failed? (Imagine that, our Congress failing to do its job!) Fortunately, AAF's Gordon Gray spells it out in his new insight, appropriately titled "What If the Federal Government Hits the Debt Limit?"

Since March, the U.S. Treasury has been using its "extraordinary measures" (largely raiding federal employee retirement programs) to keep the federal government under the current debt limit. Treasury Secretary Mnuchin recently advised Congress that its ability to continue to do so would be exhausted in a little over a month, requiring Congress to raise or suspend the current limit. If it did not, Treasury would be unable to borrow from anyone. By definition, then, the only source of payments would be the incoming cash flow from taxes, withholding, tariffs (can't forget them in this day and age), fees, and so forth.

Since the United States is running a deficit that approaches $900 billion annually, that incoming cash flow will not be enough to cover all the usual outlays. Treasury will have to prioritize some payments over others; this scenario is thus called prioritization of payments. The top priority will be the dollars needed to cover interest and principal on Treasury securities. If these payments are made successfully, the Treasury would avoid outright default on the debt. Good, as far as it goes.

But *something* has to go unpaid, which means that the United States will be in contractual default to someone. Default is default, and the credit-worthiness of the United States would be impaired for the future. (This comes on top of the additional costs that accrue for violating the prompt payments law.) It is not a pretty picture.

The scenario thus far is the good news version of prioritization. The reality is fraught with a lot more risks because revenues do not flow evenly into the Treasury and payments do not flow evenly out. It would be extraordinarily difficult for the Treasury to manage the cash flows and never come up short at a key moment.

Prioritized payments is best thought of as one of those textbook possibilities that has no place the real world. What if the federal government hits the debt limit? Disaster.