Insight

Debt Limit Deja vu?

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Top Administration officials predict financial "catastrophe" if an increase in the $14.3 trillion debt limit is not passed quickly, but imminent disaster is unlikely to be realized for one simple reason: the Treasury Department's plans to finesse the debt limit in the near term are undoubtedly already at an advanced stage, as they were at a similar point in the 1995 debt limit impasse. Documents obtained by the Joint Economic Committee of Congress in 1996 show that the Treasury started planning for the debt limit standoff many months in advance, and by June of 1995 had outlined a strategy for managing the debt under an unchanged ceiling through the end of December 1995. This strategy, including a time line of available financing options, was provided in a June 1995 memo to Treasury Secretary Robert Rubin. A similar updated memo almost certainly has been circulated in Secretary Geithner's office well before now.

Given the 1995 memo, there isn't a lot of mystery about the short term options available to the Treasury. These include "carrying lower cash balances," and leaving "monies uninvested in certain trust funds." According to one scenario laid out in this memo, disinvesting in the Exchange Stabilization Fund (ESF), not reinvesting in the G-Fund of the TSP, redeeming $36 billion of securities from the Civil Service Retirement Fund (CSRF), and tapping the Federal Financing Bank (FFB) were envisioned. As the memo explains, "the first choice would be a fund that has overnight investments and has existing statutory restoration of lost interest when the debt limit is raised." Following President Clinton's veto of a measure to increase the debt limit on November 13, 1995, Treasury did indeed use the Civil Service Trust Fund, G-Fund, and Exchange Stabilization Fund to finesse the debt limit along the lines suggested in the June 1995 memo. This memo also suggested that Social Security funds might be "uninvested" to facilitate benefit payments.

While the Treasury Department was carefully and quietly preparing to manage the situation should the debt limit not be increased, the Clinton White House took the public position that if the debt limit were not increased, Congressional Republicans would trigger a disastrous government default. Administration talking points also obtained by the JEC carried the heading, *The Debt Limit: Irresponsible Republican Threats to the Nation's Credit Rating*. As the talking points explained, "If the debt limit is not increased by mid-November, the world will be faced with the spectacle of the United States defaulting on its obligation for the first and only time in history." This attack was put forth even though the White House was informed that the Treasury had been planning to prevent this outcome.

Then, as now, there may be a temptation to mischaracterize a near-term debt limit impasse in a broader and politically charged budget debate. Nonetheless, extremely high levels of current and projected deficit spending — $1.5 trillion in 2011 alone — demand a policy response to address this problem. Unfortunately, as the Congressional Budget Office (CBO) explains, "these projections understate the budget deficits that would occur if many policies currently in place were continued." The CBO also conservatively projects that publicly held federal debt will increase from $9.0 trillion in 2010 to $14.4 trillion in 2016, an increase of 60 percent, leaving the level of this debt measure at 75 percent of GDP and growing.

As discussed, the Treasury has enough options to ensure that the debt ceiling is not a hard constraint in the short term, but even so the debt limit will have to be raised. No less compelling are the grim budget data that clearly show that reducing unsustainable outlay growth and unsustainable levels of deficit spending is also necessary to avert economic disaster.

To read the White House Memo, Click Here.

To read the Treasury Memo, Click Here.