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THE DEBT CEILING: ASSETS AVAILABLE TO PREVENT DEFAULT

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The debt ceiling, or the legal limit the federal government may borrow, is set currently at $16.4 trillion.[1] In his latest report, Secretary of the Treasury Timothy Geithner predicts that the United States will need to increase the debt ceiling sometime between February 15, 2013, and early March 2013.[2] The Congressional Research Service estimates the federal government will have to issue an additional $700 billion in debt above the current statutory limit to finance obligations for the remainder of FY2013.[3]

WHERE WE ARE

Congress is currently considering whether it should raise the debt ceiling. This is not new territory. Congress has raised, extended, or revised the definition of the debt ceiling 78 separate times since 1960,[4] including 11 times in the past 11 years.[5] However, raising the debt ceiling for the 12th time in as many years without recognizing and correcting systemic problems would have consequences beyond merely tapping revenue and assets to meet FY2013 budget commitments. Continuing to pass debt ceiling increases without proper spending reforms would be irresponsible.[6]

So, too, is it irresponsible to signal to the international community that a default on the debt obligations owed by the US government is possible while Washington works through whether it will raise the debt limit before or after it formulates a plan to reduce government spending.

WHAT'S AT STAKE

Default must be avoided at all costs and should not be an option on the table. Raising the debt ceiling without a commitment to improve our long-term debt problem has adverse consequences as well. Recently, the rating agency Fitch warned the US government that while it wants the debt ceiling to be raised, it also wants the government to come up with a credible medium-term deficit-reduction plan.[7] Without it, the agency could downgrade the US credit rating by the end of this year. Other rating agencies have also warned the United States of the negative consequence of not dealing with the country's long-term debt. The optimal outcome would be to raise the debt limit while Congress and the President pass a credible plan to reduce near- and long-term spending at the same time.

Until this happens, the United States need not risk defaulting on its debt, as the Treasury Department has the legal authority to prioritize interest payments on the debt above all else, thus avoiding a default. Further, if an agreement to control spending and raise the debt limit is not reached, the Treasury Department's legal authority allows for the prioritization of any obligation, whether that means delaying payments to contractors

[1] "Government – Debt Subject to Limit," last modified December 3, 2012, http://www.treasurydirect.gov/govt/charts/charts_debt.htm.
[2] Timothy Geithner, "Letter to Speaker John Boehner on the Debt Limit," January 14, 2013, http://www.treasury.gov/connect/blog/Documents/1-14-13 Debt Limit FINAL LETTER Boehner.pdf.
[3] Mindy R. Levit et al., *Reaching the Debt Limit: Background and Potential Effects on Government Operations* (Washington DC: Congressional Research Service, January 4, 2013). http://www.faSorg/sgp/crs/misc/R41633.pdf.
[4] "Debt Limit," US Department of Treasury, accessed January 24, 2013, http://www.treasury.gov/initiatives/pages/debtlimit.aspx.
[5] Office of Management and Budget, *Budget of the United States* (Washington, DC: OMB, 2013), Historic Tables 7.1, 7.2, and 7.3, http://www.whitehouse.gov/omb/budget/historicals.
[6] All three of the major credit rating agencies have expressed concern over the US level of deficits and debt.
[7] Jeannette Neumann, "Fitch Unveils Two Possible Routes to Downgrading U.S. Debt Rating," *Wall Street Journal*, January 15, 2013, C3.

or managing other obligations. But Congress should not be forced to raise the debt ceiling under false pretenses.

By our calculations, the United States has enough expected cash flow (tax revenue) and assets on hand to avoid either of these unattractive options until at least the end of the current fiscal year in September, perhaps even longer. Managing payments in this manner is by no means optimal, and Treasury officials have indicated that this will be difficult due to payment automation. That said, it is important to recognize the options that are available to prevent a default. While Washington has difficult choices to make, defaulting on its debt obligations is not one of them and should not be a consideration in the current or foreseeable discussion about how to handle the debt limit or reduce long-term government spending.

REAL INSTITUTIONAL REFORM

The heated rhetoric about whether Congress should raise the debt ceiling obscures the federal government's real problem: an unprecedented increase in government spending during the past 10 years has created a fiscal imbalance.[8] No matter what Congress decides to do about the debt ceiling, the United States must implement institutional reforms that constrain government spending and return it to a sustainable fiscal position.

Real institutional reforms, as opposed to one-time cuts, would change the trajectory of fiscal policy and put the United States on a more sustainable path. Such reforms could include:

1. **A constitutional amendment to limit spending.** The inability of lawmakers to constrain their own spending makes spending limits enforced through the US Constitution preferable.[9]

2. **Meaningful budget reforms that limit lawmakers' tendency to spend.** In the absence of constitutional rules, budget rules should have broad scope, few and high-hurdle escape clauses, and minimal accounting discretion.[10]

3. **The end of budget gimmicks.** Creative bookkeeping is at the center of many countries' financial troubles. Congress should end abuse of the emergency spending rule, reliance on overly rosy scenarios, and all other gimmicks and institute a transparent budget process.[11]

4. **A strict cut-as-you-go system.** This system should apply to the entire federal budget, not just to a small portion of it. There should be no new spending without offsetting cuts.[12]

5. **A BRAC-like commission for discretionary spending.** Commissions composed of independent experts often tackle intractable political problems successfully.[13]

6. **Annual real spending caps.** If Congress cuts one cent out of every dollar it currently spends and did that for the next five years, the budget would be balanced before the end of the decade.[14]

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[8] Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022* (Washington, DC: CBO, August 2012), http://cbo.gov/publication/43539.
[9] David M. Primo, "Constitution is Only Way to Cut US Deficit," Bloomberg.com, February 24, 2011.
[10] David M. Primo, "Making Budget Rules Bite*," Mercatus on Policy* 72 (Arlington, VA: Mercatus Center at George Mason University, 2010), http://mercatuSorg/sites/default/files/publication/MOP72_Making%20Budget%20Rules%20Bite_web.pdf.
[11] Veronique de Rugy, "Budget Gimmicks or the Destructive Art of Creative Accounting." Mercatus Working Paper. Arlington, VA: Mercatus Center at George Mason University, June 2010, http://mercatuSorg/sites/default/files/publication/Budget_Gimmick_WP1030.pdf.
[12] Veronique de Rugy and David Bieler, "Is PAYGO a NO-GO?" *Mercatus on Policy* 73 (Arlington, VA: Mercatus Center at George Mason University, 2010), http://mercatuSorg/sites/default/files/publication/MOP73_PAYGO_web.pdf.
[13] Jerry Brito, "The BRAC Model for Spending Reform," *Mercatus on Policy* 70 (Arlington, VA: Mercatus Center at George Mason University, 2010), http://mercatuSorg/sites/default/files/publication/The%20BRAC%20Model%20for%20Spending%20Reform.pdf.
[14] Jason J. Fichtner, "The 1 Percent Solution." Mercatus Working Paper. Arlington, VA: Mercatus Center at George Mason University, February 2011, http://mercatuSorg/sites/default/files/publication/One%20Percent%20Solution.Ficthner_1.pdf.

REVENUE AND ASSETS AVAILABLE TO FUND FY2013 COMMITMENTS

At the time of this publication, it appears Congress will suspend the debt ceiling and thus provide additional borrowing authority until May 19, 2013.[15] At such time, unless further borrowing authority is authorized, Congress will again have to consider voting for an extension of the debt ceiling. If Congress then decides to delay raising the debt ceiling (an option that we feel is not advisable, given the opportunity to both raise the debt ceiling and pass spending reductions through the regular budget process as the rating agencies and others have advised), the United States will not default on its debt obligations. If the government reaches the debt ceiling and the Treasury is no longer able to issue federal debt, the federal government could reduce spending, increase federal revenues by a corresponding amount to cover the gap, or find other funding mechanisms.

Treasury has several financial management options to continue paying the government's obligations. These include (1) prioritizing payments;[16] (2) taking financial steps, including permitting the suspension of investments in, and the redemption of securities held by, certain government trust funds or postponing the sale of nonmarketable debt;[17] (3) liquidating roughly $2.2 trillion of assets to pay government bills;[18] and (4) using the Social Security Trust Fund to continue paying Social Security benefits.[19]

PRIORITIZING PAYMENTS

The Secretary of the Treasury has long-standing authority to prioritize payments and does not have to pay bills in the order in which they are received. The US Government Accountability Office found that "the Secretary of the Treasury has the authority to determine the order in which obligations are to be paid should the Congress fail to raise the statutory debt ceiling and revenues are inadequate to cover all required payments. There is no statute or other basis for concluding that the Treasury must pay outstanding obligations in the order they are presented for payment. Treasury is free to liquidate obligations in any order it determines will best serve the interests of the United States."[20]

According to a report by the Department of the Treasury's Inspector General (IG), during the 2011 debt ceiling crisis the Treasury "considered a range of options with respect to how Treasury would operate if the debt ceiling was not raised." Further, the report notes that Treasury officials told the IG that "…organizationally they viewed the option of delaying payments as the least harmful among the options under review" and that "…the decision of how Treasury would have operated if the U.S. had exhausted its borrowing authority would have been made by the President in consultation with the Secretary of the Treasury."[21]

TEMPORARY MEASURES

Relying on any of the following sources of funds or increasing the debt ceiling without reducing existing budget commitments illustrates the irresponsible path the country is on and the urgent need for institutional spending reform. Nonetheless, the following assets could be used as a temporary measure to allow Congress and the administration to negotiate spending reductions and institutional reforms to the budget process to ensure the nation is put back on a sound fiscal path. To be clear, the list below presents the range of possible options available to Congress: they may well be neither good nor desirable options.

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[15] H.R. 325, 113th Cong. (2013), http://www.gpo.gov/fdsys/pkg/BILLS-113hr325ih/pdf/BILLS-113hr325ih.pdf.

[16] Jason Fichtner and Veronique de Rugy, "The Debt Ceiling: What is at Stake?" Mercatus Research. Arlington, VA: Mercatus Center at George Mason University, April 2011, http://mercatuSorg/publication/debt-ceiling-what-stake.

[17] Jason Fichtner and Veronique de Rugy, "The Debt-limit Debate." *Mercatus on Policy* 91 (Arlington, VA: Mercatus Center at George Mason University, May 2011), http://mercatuSorg/publication/debt-limit-debate.

[18] Jason Fichtner and Veronique de Rugy, "The Debt Ceiling: What is at Stake?" According to the Treasury Department's 2010 Financial Report of the US Government, September 30, 2010, TARP had $179.2 billion in gross outstanding direct loans and equity investments valued at $142.5 billion.

[19] Note: The Social Security Trust Funds can only be used to pay Social Security benefits. See: Glenn Kessler, "Can President Obama keep paying Social Security benefits even if the debt ceiling is reached?" *The Fact Checker*, July 13, 2011, http://www.washingtonpost.com/blogs/fact-checker/post/can-president-obama-keep-paying-social-security-benefits-even-if-the-debt-ceiling-is-reached/2011/07/12/gIQA9myRBI_blog.html; Public Law 104-121, http://www.gpo.gov/fdsys/pkg/PLAW-104publ121/pdf/PLAW-104publ121.pdf.

[20] US Government Accountability Office, Letter to Senator Bob Packwood, October 9, 1985. http://redbook.gao.gov/14/fl0065142.php.

[21] Department of the Treasury, Office of Inspector General, Letter to Senator Orrin G. Hatch, OIG-CA_12_006, August 24, 2012. http://www.treasury.gov/about/organizational-structure/ig/Audit Reports and Testimonies/Debt Limit Response Final with Signature.pdf.

Future Expected Cash Flow ($2.6 Trillion)

According to the Congressional Budget Office,[22] the federal government is estimated to collect $2.6 trillion in tax revenue over FY13.

That alone would be enough to cover interest on the debt ($218 billion), thereby avoiding any technical default of the US government on its debt obligations to Social Security ($809 billion), Medicare ($581 billion), and Medicaid ($267 billion), and it would leave approximately $725 billion for other priorities.

Liquidating Existing Assets ($1.9 Trillion)

The Department of the Treasury has financial measures at its disposal to fund government operations temporarily without having to issue new debt. These include:

1) nonrestricted cash on hand: $50.2 billion (the total operating balance of the United States Treasury as of January 14, 2013)[23]

2) suspension of the daily reinvestment of Treasury securities held by the Exchange Stabilization Fund: $23 billion[24]

3) restricted cash and other monetary assets (gold, international monetary assets, foreign currency): $121.1 billion (adjusted for market valuation of gold, upwards of $500 billion)[25]

4) TARP assets: $63.1 billion in gross outstanding direct loans and equity investments (as of September 30, 2012)[26]

5) the Federal Reserve: unknown, but estimated by Secretary Geithner to be insignificant[27] (Special programs at the Treasury may borrow money on the behalf of the Federal Reserve, and this borrowing would not count toward the debt ceiling.)

6) determination of a "debt issuance suspension period" (This determination would permit the redemption of existing, and the suspension of new, investments of the Civil Service Retirement and Disability Fund (CSRDF).[28]): $798.8 billion (intergovernmental holdings in the CSRDF)[29]

7) redemption of existing investments in other trust funds[30, 31]

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[22] CBO, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022.* Note: For purposes of this analysis, CBO's Alternative Fiscal Scenario is used for revenues, as it most closely aligns with the expected baseline resulting from the American Taxpayer Relief Act of 2012. CBO is expected to release an updated budget baseline incorporating the ATRA on February 4, 2013.
[23] US Department of the Treasury, "Daily Treasury Statement," January 14, 2013, https://www.fmStreaSgov/fmsweb/viewDTSFiles?dir=w&fname=13011400.pdf.
[24] "Daily Treasury Statement" and Timothy Geithner, "Letter to Harry Reid on the Debt Limit," April 4, 2011, http://www.treasury.gov/connect/blog/Documents/FINAL%20Letter%2004-04-2011%20Reid%20Debt%20Limit.pdf. Such a suspension occurred in 1985 and during the debt limit crisis of 1995–1996, and in 2012.
[25] Department of the Treasury, *2012 Financial Report of the US Government* (Washington, DC: 2013), 65, http://www.gao.gov/financial/fy2010/10frusg.pdf. Note: The Treasury owns approximately 261.4 million ounces of gold and marks the value of its gold holdings at $42 per ounce, giving a reported value of $11.1 billion. At a spot market price of $1,500 per ounce, Treasury's gold holdings could be valued near $400 billion. http://www.fmStreaSgov/fr/12frusg/12frusg.pdf.
[26] Ibid.
[27] Geithner, "Letter to Harry Reid."
[28] In September 1985, the Treasury took the step of disinvesting the Civil Service Retirement and Disability Trust Fund, the Social Security Trust Funds, and several smaller trust funds.
[29] Department of Treasury, "Monthly Statement of the Public Debt of the United States," December 31, 2012, http://www.treasurydirect.gov/govt/reports/pd/mspd/2012/opdm122012.pdf.
[30] According to Thomas L. Hungerford, there are about 200 federal trust funds, but most trust funds are relatively small with balances of less than $100 million. The largest trust funds account for over 98% of the balances of all trust funds. "Federal Trust Funds and the Budget." ***Economic Legislation Blog***, http://economic-legislation.blogspot.com/2010/07/federal-trust-funds-and-budget.html.
[31] All trust fund values from the Department of Treasury, "Monthly Statement of the Public Debt of the United States," December 31, 2012, http://www.treasurydirect.gov/govt/reports/pd/mspd/2012/opdm122012.pdf.

- DOD, Military Retirement Fund: $427.9 billion
- DOD, Medicare-Eligible Retiree Health Care Fund: $189.4 billion
- Department of Energy, Nuclear Waste Disposal: $49.8 billion
- FDIC Funds: $37.1 billion
- OPM, Postal Service Retiree Health Benefits Fund: $45.3 billion
- OPM, Employees Life Insurance Fund: $41.2 billion
- DOT, Highway Trust Fund: $13.4 billion
- Pension Benefit Guaranty Corporation Fund: $16.3 billion
- DOL, Unemployment Trust Fund: $20.2 billion
- OPM, Employees Health: $21.3 billion
- Department of State, Foreign Service Retirement and Disability Fund: $17.2 billion
- HUD, Federal Housing Authority Liquidating Account: $5.9 billion
- Other programs and funds: $154.2 billion

8) suspension of investments of any federal government account surpluses in Treasury securities as required by law: $0 (but conserves headroom by not adding to the debt)[32]

9) suspend the issuance of State and Local Government Series Treasury securities: $0 (but conserves headroom by not adding to the debt).[33]

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[32] "In September 1985, the Treasury Department informed Congress that it had reached the statutory debt limit…Treasury took the additional step of 'disinvesting' the Civil Service Retirement and Disability Trust Fund, the Social Security Trust Funds, and several smaller trust funds by redeeming some trust fund securities earlier than usual. Premature redemption of these securities created room under the debt ceiling for Treasury to borrow sufficient cash from the public to pay other obligations, including November Social Security benefits…As a result of the 1985 debt limit crisis, Congress subsequently authorized the Treasury to alter its normal investment and redemption procedures for certain trust funds during a debt limit crisis Such authority was not provided with respect to the Social Security trust funds…In 1996, Congress passed P.L. 104-121 to increase the debt limit and, among other provisions, to codify Congress's understanding that the Secretary of the Treasury and other federal officials are not authorized to use Social Security and Medicare funds for debt management purposes, except when necessary to provide for the payment of benefits or administrative expenses of the programs." Mindy R. Levit et al., *Reaching the Debt Limit: Background and Potential Effects on Government Operations* (Washington DC: Congressional Research Service, January 4, 2013), 4-5, http://www.faSorg/sgp/crs/misc/R41633.pdf.

[33] Geithner, "Letter to Harry Reid."