The US debt ceiling explained

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FAQ | **May 24, 2023**

As the debate over raising the debt ceiling continues, I'm getting a lot of questions about what the debt ceiling is, how it's related to the budget process, what might happen if we reach the X-date without a deal, and potential ways to resolve the conflict. Below, I answer the questions I'm hearing most often.

What is the debt ceiling?

The debt ceiling is the legal limit on the total amount of federal debt that the US government can have outstanding. It was devised in 1917 as a remedy for Congress having to approve each debt issuance in a separate piece of legislation; it allowed for the issuance of individual bonds without congressional approval, under a certain debt limit (with caps for different debt categories). It was intended to make the process of debt issuance easier and provide the US government with greater flexibility. Congress went one step further in 1939, aggregating all debt covered under one debt ceiling.

How is the debt ceiling related to the budget?

The debt ceiling is a separate law from the federal budget law, which sets out spending and expected funding from tax revenue — a separation that is unique among major economies. The debt ceiling can conflict with the budget law depending mainly on economic growth, employment, and inflation, which drive tax revenue and spending along with the budget law itself. Variations across the budget and debt ceiling laws can put the US Treasury in a bind — should it faithfully execute the budgeted spending and violate the debt ceiling, or honor the debt ceiling, which can mean holding back on other spending commitments?

How fast has the debt ceiling grown?

The debt ceiling increased from $45 billion in 1939 to $1 trillion in the early 1980s. By the late 1980s, it was nearly $3 trillion and kept growing from there. By the late 1990s, it was nearly $6 trillion, and it rose to $12 trillion by the end of the 2000s. Today, it stands at $31.381 trillion

Has raising the debt ceiling always been this politically charged?

The debt ceiling has been raised more than 100 times since the end of World War II, under Republican and Democratic administrations, and it was long seen as a routine task. However, it has become more divisive in recent years, with a number of disputes around debt ceiling increases. We saw a big debate over the debt ceiling in 2011, which prompted Standard & Poor's to downgrade the credit rating of the United States government for the first time in the country's history and resulted in the Budget Control Act of 2011.

For a period beginning in 2013, we have seen less political acrimony around the debt ceiling, with lawmakers suspending the debt limit rather than increasing it by a specific dollar amount. Then in 2021, the debt limit was increased (not suspended) twice. That formally increased the debt ceiling limit to $31.381 trillion. That was the last time the debt ceiling was increased.

When did the current debt ceiling standoff begin?

The debt ceiling of $31.381 trillion was reached in January 2023. Since then, the federal government has not been able to issue any new debt. And so that is when the federal government began to implement "extraordinary measures" in order to pay its obligations in full and on time. These extraordinary measures mostly involve reducing Treasury investment in various federal investment funds — specifically government employee health-related funds and the "Exchange Stabilization Fund," which is rarely used to intervene in financial markets when there is a shock or crisis. However, these extraordinary measures will only work temporarily.

What is the "X-date"?

The X-date is when the US government will have exhausted its extraordinary measures and will be unable to pay its obligations in full and on time. It is an estimate, and that estimate has changed due to tax revenues (receipts were lower than expected) and other factors. The Treasury Secretary has stated that the danger point will arrive at the beginning of June.

We believe that there could be a bit more wiggle room than that, extending into mid-June, when the next round of quarterly tax payments is due. Plus, there is the possibility under legislation that maturities and interest from the federal investment funds that are being used for the temporary extraordinary measures mentioned above, could also provide additional time; the payments on June 30 are estimated at $143 billion and could conceivably tide the government over into July.

How has the debt ceiling situation played out since January?

The Biden administration refused to negotiate with Republicans until they could come to the table with concrete proposals as a starting position for bargaining. In late April, the Republican-controlled House of Representatives did pass legislation suspending the debt ceiling or raising it by $1.5 trillion, in exchange for a total of $4.8 trillion in budget cuts over a 10-year period. That's when the negotiations really began, so there is little time left to reach an agreement before the US reaches the X-date.

What happens if the US reaches the X-date without increasing the debt ceiling?

The federal government would be forced to prioritize payments since it would not have enough money to meet all its obligations. It could delay salaries for federal employees (including members of the military), as well as payments to vendors and other so-called "discretionary spending" items that are approved by Congress through the budget appropriation process on an annual basis.

If the debt ceiling were not addressed for long enough, it is even conceivable than in order to keep honoring debt interest payments, the Treasury could delay "entitlements" and other "mandated" spending, notably Social Security payments, which are considered to be set in stone and not negotiated as part of the annual budget process.

The Treasury has not been crystal clear whether it has the technical capacity to prioritize payments, but most members of Congress seem to believe it can and would do so (and we would agree with this view). There hasn't been a modern version of prioritization in the US, though there have been several government shutdowns. However, many other governments across a wide range of emerging markets — including Russia, Venezuela, Argentina, and Pakistan — have repeatedly prioritized payments and run up arrears to employees and suppliers, which suggests that the US Treasury would be able to as well. Alternatively, the US could delay payments on its outstanding debt; this would constitute a default, and it would be the first event of default in the history of the US Treasury.

What are the consequences of a default?

A default would result in a significant downgrade in the credit rating of US government debt. But it could have far greater consequences, rippling through global markets. We would likely see a worse scenario than 2011, with stocks selling off very significantly while there is a flight to perceived quality – likely to gold and "safe haven" currencies such as the Japanese yen. In 2011, there was a flight to US Treasury bonds and the US dollar, but the X-date was never reached and the US certainly did not default on its debt obligations. If there were an actual default, it seems unlikely that there would be a flight to US Treasuries. In our view, gold would probably be a major beneficiary, along with German bunds, possibly UK gilts, Japanese government bonds, as well as the yen and the Swiss franc.

If US debt were downgraded enough, there could be a meaningful increase in yield as US Treasuries sell off – that would be required for the additional risk investors would be taking on. That would in turn increase interest rates on mortgages, credit cards, car loans and business loans. That said, if the US were downgraded by fewer rating notches because the debt ceiling was not raised for some time, but the Treasury prioritized spending, growth and inflation could slow significantly, and bring yields down (largely what happened in 2011).

What is the $1 trillion coin solution?

A proposal was made during the 2011 debt ceiling crisis that the US government could simply mint a $1 trillion coin and send it to the Federal Reserve to pay off debt, thereby making room to issue more debt without having to increase the debt ceiling. This is based on a law that grants the Treasury Department authority to "mint and issue platinum bullion coins" in any denominations they choose. However, US Treasury Secretary Janet Yellen said a trillion dollar coin is not an option because she believes the Federal Reserve would be unlikely to accept it. We also believe this is not a precedent that any responsible government of any country, especially the US, would set. It would open the door to further irresponsible use of monetary and fiscal policies of the kind that have triggered hyperinflations throughout history going all the way back to Roman times, and most recently in Latin America and the former Soviet bloc.

What about using the 14th Amendment to solve this standoff?

There is a provision in the 14th Amendment of the US Constitution which requires the US government to meet its financial obligations: "the validity of the public debt of the United States, authorized by law … shall not be questioned." The idea here is that the White House and Treasury could decide to keep issuing debt in order to honor past obligations. However, the US Constitution also allocates budgetary power to Congress, not the Executive Branch. Thus, using the 14th Amendment to keep issuing debt would certainly face a legal challenge from Republicans and could get caught in the courts for years, so it seems the Biden administration is not interested in utilizing this to resolve the debt crisis, at least not until the X-date is reached without an agreement. Another interpretation of the 14th Amendment is that it rules out default and, because it's in the Constitution, it stands above the budget law — and this together with the need to maintain financial stability means that the Treasury would have to prioritize debt payments.

What is the discharge petition option?

A discharge petition is a parliamentary procedure to bring a bill out of committee and to the floor for a vote — it forces the House to take action on a bill even if the Speaker or the committee it originates from does not want a vote to happen. On May 17, House Democratic leadership filed a discharge petition to move a clean debt ceiling increase out of committee, and 210 Democratic members signed the petition. The problem with using this strategy is that Democrats need 218 signatures, which means they would need to peel off enough Republican votes (at least eight as it now stands) to force a vote on the floor, and thus far all Republican members of Congress have remained aligned with Speaker Kevin McCarthy. In addition, the earliest a discharge petition bill to raise the debt ceiling could be voted on is June 12, which is after the projected X-date.

With contributions from Arnab Das and Jen Flitton

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