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Congress Must Suspend or Raise the Debt Limit

By Paul N. Van de Water

Lawmakers of both parties must make an important decision in coming days: Will they take steps to protect the full faith and credit of the United States, or will they allow this nation to default for the first time in its history, deeply damaging an economy still digging out from a pandemic and recession?

The public debt stands at its statutory limit of \$28.4 trillion, which took effect on August 1 after the expiration of a temporary suspension of the debt limit enacted in 2019. Since then the Treasury has continued borrowing to finance government operations by using “extraordinary measures,” such as suspending and redeeming investments in certain federal trust funds.¹ Unless Congress suspends or raises the debt limit, however, the Treasury’s cash balances and extraordinary measures will likely be exhausted sometime in October, and the federal government will face a default on its legally binding obligations.² At that point, the Treasury would be unable to borrow to cover ongoing government operations required by law and could be forced to limit cash outlays to the amount of revenue coming into the Treasury each day.

Raising the debt limit does not authorize new spending or tax cuts; it merely acknowledges *past* budgetary decisions and allows the federal government to meet its legal obligations. As the Government Accountability Office (GAO) states, “The debt ceiling does not control the amount of debt. Instead, it is an after-the-fact measure that restricts the Treasury’s ability to borrow to finance the decisions already enacted by Congress and the President.”³

Indeed, virtually all of the debt that will be incurred in coming months will stem from legislation enacted under previous Congresses and administrations. That includes bipartisan bills, such as the 2020 CARES Act to address the pandemic and its economic fallout; legislation passed during Republican administrations, such as the 2001, 2003, and 2017 tax cuts, which had large costs that weren’t offset; and bills passed during Democratic administrations, such as the extension of the

¹ Department of the Treasury, *Description of the Extraordinary Measures*, August 2, 2021, <https://home.treasury.gov/system/files/136/Description-of-Extraordinary-Measures-Aug2021.pdf>.

² Janet L. Yellen, Letter to the Honorable Nancy Pelosi, Department of the Treasury, September 8, 2021, https://home.treasury.gov/system/files/136/Debt-Limit-Letter-to-Congress_20210908_FINAL-Pelosi.pdf. Other organizations have somewhat different estimates.

³ Government Accountability Office, *Federal Debt Has Reached its Ceiling. What Does That Mean?* September 8, 2021, <https://www.gao.gov/blog/federal-debt-has-reached-its-ceiling-what-does-mean>.

Bush tax cuts. For much of the past four decades, control of the White House and Congress was split between the parties, and budget and tax decisions were often made on a bipartisan basis.

Some policymakers claim to oppose suspending or raising the debt limit out of concern that the Build Back Better legislation now before Congress would add dramatically to the debt, but the measure's *net* cost — that is, its cost including its revenue increases and spending cuts, which is what matters when assessing the impact on the debt — is far less than its oft-cited gross cost.⁴ The infrastructure package before Congress also costs less than is frequently cited because some of the spending in the bill is already in the budget baseline.

For the Build Back Better legislation, the President supports and Congress is pursuing a robust set of revenue increases and health care savings to offset most or all of its cost.⁵ This is similar to the approach taken in the Affordable Care Act, which offset the cost of its health coverage expansions with revenue increases and spending cuts, and it stands in sharp contrast to the 2001, 2003, and 2017 tax cuts, which added substantially to the deficit and debt.

Successive administrations and Congresses have made legally binding commitments that direct the federal government to fund various services and benefits. If unable to borrow, the federal government would need to impose a sharp, massive spending reduction totaling roughly *\$1.2 trillion just in fiscal year 2022*. This amounts to a reduction of about 30 percent over the course of the year for every federal program except Social Security, Medicare Hospital Insurance, and interest.⁶ Protecting some programs from cuts would require even greater cuts elsewhere.

These reductions would have a wide-ranging impact across the United States, leaving households, businesses, and nonprofits unable to pay their bills while they wait for payments they are legally owed. To cite just a few examples:

- Highway contractors might not be paid promptly, which would make it hard for them to buy construction materials and pay their workers.
- Head Start agencies might not get paid on time, which would leave them without the money to pay their staff and possibly leading them to shut down.
- Military service members could see their pay delayed — for weeks and months, not just a few days.

⁴ Sharon Parrott, *Evaluating BBB Requires Considering Sound Fiscal Metrics and Merits of Investments*, CBPP, August 31, 2021, <https://www.cbpp.org/research/federal-budget/evaluating-bbb-requires-considering-sound-fiscal-metrics-and-merits-of>

⁵ Sharon Parrott, *House “Build Back Better” Legislation Would Advance Economic Justice and Racial Equity*, CBPP, September 17, 2021, <https://www.cbpp.org/press/statements/parrott-house-build-back-better-legislation-would-advance-economic-justice-and>.

⁶ The Social Security and Medicare Hospital Insurance programs operate through trust funds whose balances are invested in Treasury securities. Cutting those programs' spending would reduce borrowing from the public but increase trust fund balances and therefore not reduce the amount of outstanding securities subject to the debt limit. Conversely, paying their benefits does not increase debt subject to limit. In the event of a debt limit impasse, however, the Treasury has indicated that these programs would still face delays in payments, presumably because of difficulties in making the necessary debt transactions balance out on a daily basis.

- Veterans receiving compensation or pensions and low-income households receiving SNAP benefits could see their benefits held up, also for weeks or months, even as they need to pay their bills and put food on the table.
- State and local governments would face reductions in federal grants-in-aid, ranging from the federal share of states' Medicaid costs to federal funding for education. Deep reductions in these grants would cause serious fiscal problems for states, as federal grants account for nearly a third of state spending nationally. The risk is especially great given that states continue to face unusually high costs in responding to the pandemic and the hardships it has caused.

These sudden spending cuts — totaling 5 percent of gross domestic product (GDP) — would represent a serious blow to the economy even in the best of times. But at this moment, when the economy is just finding its footing after a short but deep contraction during the pandemic, cuts of this magnitude would certainly drive the economy back into recession. And without the ability to borrow, the federal government would have no way to increase spending to mitigate the ensuing hardship. The kinds of steps taken during the Great Recession and the pandemic to help families make ends meet and avoid a downward economic spiral would be unavailable unless and until the debt ceiling were raised.

The debt the nation has incurred is neither unaffordable nor a substantial drag on the economy. Interest rates are low, and the United States can borrow money on very favorable terms. Interest, the cost of financing the debt, is now only about 1½ percent of GDP. While some argue the debt is too high, forcing the federal government to cut or delay payments and shaking financial markets' confidence that the federal government will pay its bills on time is not an appropriate way to address that concern. Both parties have supported raising the debt ceiling in recent years to avoid default; most recently, during the Trump Administration, Democrats joined Republicans to suspend the debt limit three times.

Debt Limit Suspension or Increase Needed to Meet Existing Commitments

In the fiscal year from October 1, 2021 through September 30, 2022, the federal government's spending obligations will exceed projected revenues by about \$1.2 trillion under current law, the Congressional Budget Office (CBO) estimates.⁷ The government would need to borrow roughly that amount from the public to pay its bills even if policymakers enacted no further deficit-increasing measures. That is, simply meeting current commitments for national defense, veterans' benefits, Medicare and Medicaid, interest on the debt, and other federal activities would require increasing the debt by \$1.2 trillion during fiscal year 2022.

Because the most recent debt limit suspension expired on July 31, suspending or raising the debt limit would now be required regardless of who sat in the White House or controlled Congress.

Protecting the full faith and credit of the U.S. government by suspending or raising the debt limit should not be a partisan issue. Since the start of the Reagan Administration, the same party has

⁷ Congressional Budget Office, *An Update to the Economic and Budget Outlook: 2021-2031*, July 1, 2021, <https://www.cbo.gov/publication/57218>.

controlled the White House, Senate, and House for only 11 out of 41 years.⁸ Nonetheless, through all that time, the President and Congress have come together many times to suspend or raise the debt limit and avoid a government default. During the Trump Administration, for example, Congress suspended the debt limit three times on a bipartisan basis, despite deep partisan differences over budget policy. Even though Democrats strongly opposed the December 2017 tax legislation — which included large tax cuts that were far from fully offset and were passed on a party-line vote using the reconciliation process — many joined with Republicans to pass debt limit suspensions in February 2018 and August 2019.

Moreover, the debt limit is neither effective nor appropriate for trying to limit federal deficits and borrowing. By the time the debt limit is reached, virtually all of the spending and tax policies that determine the federal government’s near-term borrowing needs have already been enacted. The Congressional Research Service puts it this way: “The need to raise (or lower) the limit during a session of Congress is driven by previous decisions regarding revenues and spending stemming from legislation enacted earlier in the session or in prior years.”⁹ And CBO writes: “Voting separately on the debt is ineffective as a means of controlling deficits because the decisions that necessitate borrowing are made elsewhere. By the time the debt ceiling comes up for a vote, it is too late to balk at paying the government’s bills without incurring drastic consequences.”¹⁰

Failing to Raise Debt Limit Would Have Devastating Consequences

If Congress fails to suspend or raise the debt limit in a timely manner, and in the absence of additional extraordinary measures, the Treasury would be unable to borrow money, except to refinance maturing securities. That means that it could not meet all the government’s legal obligations; it could pay only as much as it collected in revenues — on a day-to-day or week-to-week basis.¹¹ The spending cuts necessary to achieve this result would be massive.

Avoiding a \$1.2 trillion increase in debt subject to limit would require reducing fiscal year 2022 spending for every federal program except Social Security, Medicare Hospital Insurance, and interest by about 30 percent over the course of the year. In months with low revenue inflows, the required reductions would be even greater.¹² If lawmakers protected some programs, such as national defense or veterans’ benefits, they would need to cut other programs far more deeply. The Treasury might effectuate these cuts through imposing ever increasing delays in payments, but receiving eight veterans’ benefit checks instead of twelve in a year, eight-twelfths of the payments owed on a construction project, or eight-twelfths of the SNAP nutrition benefits for which a family is eligible, as just a few examples, would still amount to a cut of about 30 percent.

⁸ U.S. House of Representatives, *Party Government Since 1857*, <https://history.house.gov/Institution/Presidents-Coinciding/Party-Government/>.

⁹ Mindy R. Levit *et al.*, *Reaching the Debt Limit: Background and Potential Effects on Government Operations*, Congressional Research Service, March 27, 2015, p. 21, <https://sgp.fas.org/crs/misc/R41633.pdf>.

¹⁰ Congressional Budget Office, *Federal Debt and Interest Costs*, May 1993, p. 43, https://www.cbo.gov/sites/default/files/103rd-congress-1993-1994/reports/1993_05_federaldebtandinterest.pdf.

¹¹ Kathy Ruffing and Chad Stone, *Separating the Debt Limit from the Deficit Problem*, CBPP, January 2013, <https://www.cbpp.org/research/separating-the-debt-limit-from-the-deficit-problem-0>.

¹² Goldman Sachs estimates that the required reductions could amount to 40 percent in October and November 2021. See Alec Phillips, *The Debt Limit Looks Riskier Than Usual*, Goldman Sachs Economic Research, September 13, 2021.

Failure to honor the government’s obligations in full would have devastating consequences — for households that count on federal services and benefits, for federal civilian and military employees, for financial markets, and for the economy. And for states and localities: federal funding accounts for nearly a third of state spending nationally, so cuts in federal grants-in-aid would seriously strain their budgets.

Some cuts — both those affecting states and those directly touching individuals — would be particularly problematic now, as the country continues to confront the pandemic and its economic fallout:

- Funding for Medicaid, the largest source of federal aid to states, and public health would be at risk of cuts, despite the critical need for health care during the pandemic.
- Disaster aid in response to hurricanes, floods, fires, and other natural disasters could be delayed, leaving communities without desperately needed assistance.
- Food and housing assistance and monthly Child Tax Credit payments could become badly delayed with missed payments over the course of the next year, even though millions of families report being unable to meet basic expenses such as food and rent.¹³ With the expiration of the federal eviction moratorium, the consequences of evictions alone could be severe.

More broadly, a reduction of \$1.2 trillion (5 percent of GDP) in federal spending over the next year would deal a crippling blow to the economy. Such a large, sustained drop in spending, combined with the adverse effects of default on financial markets and interest rates, would create a sharp drag on economic growth, plunge the nation back into recession, and drive up unemployment. That, in turn, would increase federal spending obligations and reduce revenues, leaving the federal government with even more debt after the debt limit impasse is over. Moreover, the tools used to reduce the severity and length of the Great Recession and the economic fallout from the pandemic — such as direct relief to households and businesses — would be effectively unavailable: even if policymakers enacted such measures, the Treasury would be unable to make those payments. And when policymakers ultimately relented and suspended or increased the debt limit, the federal actions needed to dig out of the deep recession would be even larger and more costly.

Even if the Treasury prioritized payments of interest on the debt over its other legal obligations, the government’s inability to pay all its bills would constitute what the Treasury has characterized as “default by another name.”¹⁴ It would raise serious doubts about the nation’s creditworthiness, sap the confidence of domestic and foreign lenders, call into question the dollar’s place as a reserve currency, and increase federal borrowing costs.

The country has never defaulted, but past failures to raise the debt ceiling in a timely fashion have taken a measurable toll. GAO has found that previous debt limit impasses have disrupted the

¹³ CBPP, *Tracking the COVID-19 Economy’s Effects on Food, Housing, and Employment Hardships*, updated September 10, 2021, <https://www.cbpp.org/research/poverty-and-inequality/tracking-the-covid-19-economys-effects-on-food-housing-and>.

¹⁴ Neal Wolin, *Treasury: Proposals to “Prioritize” Payments on U.S. Debt Not Workable; Would Not Prevent Default*, Department of the Treasury, January 21, 2011, <https://www.treasury.gov/connect/blog/pages/proposals-to-prioritize-payments-on-us-debt-not-workable-would-not-prevent-default.aspx>.

Treasury debt market, caused a decline in liquidity for certain securities, and added to federal borrowing costs, even though none of these episodes ultimately triggered a default.¹⁵ An actual default would almost surely send interest rates up as lenders demanded a higher rate of return for investing in Treasury securities. This is one reason that, during a 2011 showdown over the debt limit, the *Financial Times* wrote, “Sane governments do not cast doubt on the pledge to honor their debts — which is why, if reason prevailed, the debt ceiling would simply be scrapped.”¹⁶

It is important to note that a government default is distinct from, and vastly more disruptive than, a partial government shutdown, which occurs when Congress fails to enact funding for certain annually appropriated programs. In a shutdown, spending continues for most mandatory programs, such as Social Security, Medicare, refundable tax credits, and military pensions, as well as for programs with unused funding from previously enacted appropriations. The impact of a shutdown is serious — services that people depend on are disrupted and businesses suffer — but the consequences of a default are far larger. In a default, virtually all federal programs would be at risk of large, immediate reductions or delays in spending, and the financial markets would be thrown into turmoil. This year, the need to enact continuing appropriations and to suspend or increase the debt limit happen to coincide, but they’re two very different things.

Debt Not a Problem in the Short Run

Some say they oppose raising the debt limit because they believe the debt is too high, but the United States can afford the amount that the federal government has borrowed. Federal interest payments — which are the inescapable cost of debt — are low and are expected to remain below average for many years because of low interest rates.

Today’s low interest rates indicate that rising debt is neither overheating the economy nor crowding out private investment in physical or human capital. They also suggest that the economy can support a higher debt as a share of the economy than was appropriate when interest rates were much higher. Interest costs will rise when interest rates return to more normal levels, but the new normal will likely be marked by lower interest rates than the historical average, according to CBO and other economists.¹⁷

As noted earlier, the infrastructure bill before Congress would cost less than is often reported, and the Build Back Better legislation will be entirely or largely paid for. Moreover, under the present circumstances it is reasonable to add modestly to the debt to help finance these important investments, which would expand the economy, broaden opportunity, narrow racial and ethnic disparities, and build toward a more equitable nation. In any event, these measures should be debated on their merits when the legislation is considered, and opposition to them is no excuse to reject suspending or raising the debt limit and meeting the federal government’s existing obligations.

¹⁵ Government Accountability Office, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, July 2015, <https://www.gao.gov/assets/gao-15-476.pdf>.

¹⁶ *Financial Times*, “Raising the roof on America’s debt,” May 8, 2011.

¹⁷ Paul N. Van de Water, *Latest CBO Projections Show Federal Interest Payments to Remain Low for Several Years*, CBPP, February 24, 2021, <https://www.cbpp.org/blog/latest-cbo-projections-show-federal-interest-payments-to-remain-low-for-several-years>.