

AVOIDING A US GOVERNMENT DEBT DEFAULT: ISO SIX GOP HOUSE MEMBERS, IF IT COMES TO THAT

Among the consequences of the narrow Republican majority in the House, highlighted last week by the chaos surrounding the election of Kevin McCarthy as Speaker (see my previous briefing note, available [here](#)), is the threat of a default by the US government if the “debt ceiling” is not increased. The chaos last week in the House suggests that negotiations over the debt ceiling could be the most consequential and fraught since 2011, when a last minute deal was reached to avoid a default on US government debt.

It's Friday the 13th, and today Treasury Secretary Janet Yellin warned in a [letter](#) to House and Senate leadership that she expects that the federal government will hit the debt limit on January 19 and that, absent an increase by Congress in the statutory cap, a government default could occur as early as early June.

I explore below what this potential crisis is all about and why its effects could be so damaging.

What is the debt ceiling?

The federal government spends more than it receives in revenues, yielding a budget deficit. The government borrows to fund that deficit, creating federal debt. While there is no requirement that the federal government balance its budget, there is a ceiling on how much the government can borrow (via the issuance of US Treasury securities) to meet its obligations. As a result, Congress periodically must raise the limit on how much the government can borrow. That limit is known as the debt ceiling.

The debt ceiling obviates the need for the Treasury Department to request authority each time from Congress to issue debt. Note that increasing the debt limit does not authorize any new spending; it only allows the United States to finance its existing obligations. Note too that the debt ceiling is separate from the federal government spending authority, which needs to be renewed by September 30 (FYE), failing which the government shuts down.

Federal debt currently stands at around \$31.377 trillion (*see* [Estimate](#) published by the Peter G. Peterson Foundation), which includes around \$24.5 trillion in outstanding federal debt, and close to \$6.9 trillion in debt that the government has borrowed from itself. That increasing debt reflects rising healthcare costs (which represents close to a fifth of the economy), reduced tax revenues relative to spending, demographics (namely, an aging population, which has placed pressure on Social Security, Medicare and Medicaid) and the pandemic.

The debt limit was last [raised](#) by Congress in 2021 by \$2.5 trillion to \$31.381 trillion. Historically, increasing the debt limit was routine Congressional business. According to [Treasury](#), since 1960, Congress has acted 78 times to permanently raise, temporarily extend or revise the definition of the debt limit (49 times under Republican presidents and 29 times under Democratic presidents). Congress has never failed to increase the limit when necessary, and the US government has never before defaulted on its obligations. According to a [post](#) for the Bipartisan Policy Center, in the past ten years, the US government narrowly missed a potential default seven times, including twice in 2021.

Is a default the same as a government shutdown?

No. In a government shutdown, federal agencies must discontinue all non-essential functions until new funding legislation is passed. In effect, the government is unable to pay employees and contractors. Essential services continue, as do mandatory spending programs.

How soon will the debt ceiling be reached?

As noted above, in her letter, Secretary Yellen projects that the outstanding federal government debt will reach the statutory limit on January 19. Once the limit is reached, Treasury needs to start “taking extraordinary measures to prevent [a default].” Secretary Yellen states that Treasury believes X-Day (the day the federal government runs out of cash and is unable to meet all of its obligations on time and in full) will be reached in early June. This is earlier than what commentators had been predicting (*see, e.g.* [projection](#) of the Bipartisan Policy Center), which coalesced around the end of the summer or early third quarter. This obviously is a moving target, which heightens the risks around brinkmanship.

Note that the extraordinary measures merely delay X-Day as the spending is already legally obligated. Once the measures are exhausted, either the limit is raised or the United States goes into default on its obligations.

What happens if the ceiling is breached?

There are a range of adverse consequences to consider. Note that even the perception of the threat of a default can have serious negative repercussions, which can last for years.

The first is the potential impact on financial markets (equity, debt and foreign currency) if the brinkmanship gets too close to X-Day. In 2011, the brinkmanship caused business and consumer confidence to plummet, job growth slowed and the financial markets were rattled – US government debt was downgraded by S&P (the first time in history), the equity markets fell, indexes measuring volatility spiked, corporate costs of borrowing and mortgage rates surged, and credit risk spreads widened. (See [The Effects of Brinkmanship](#).) Just playing around with the debt ceiling increase in 2011 caused, according to the Government Accountability Office, borrowing costs to increase by \$1.3 billion in FY 2011, which the Bipartisan Policy Center [extrapolated](#) ultimately cost an additional roughly \$19 billion over ten years (for debt with longer terms).

An actual breach would be much worse. On X-Day, the government would be unable, among other things, to pay the salaries of the military and civilian federal employees, fund Social Security benefits, make interest payments to holders of government bonds or provide tax refunds. This would not be a cliff-edged default, but rather a rolling one based on what payments the Administration chooses to prioritize or delay, and available cash flow. The government would continue to bring in tax revenue, but its largest source of funding, the issuance of US Treasury securities, would be shut down. Writing in 2017, S&P Global Chief Economist Beth Ann Bovino [warned](#) that “a default by the U.S. government on its debts would be worse than the collapse of Lehman Brothers in 2008, devastating markets and the economy.” Secretary Yellen, in her [letter](#) today, reiterated that Congress must act. Failure to meet the government’s obligations, she noted, “would cause irreparable harm to the US economy, the livelihood of all Americans, and global financial stability.”

What is the relevance of the narrow GOP House majority?

In order to win the Speakership, Kevin McCarthy had to appease a group of ultraconservative hardliners. Among other concessions, the Speaker reportedly has pledged not to support an increase in the debt ceiling (a “clean” increase) unless Congress enacts discretionary spending cuts or fiscal reforms to reduce the debt. Democrats are unwilling (and Senate Republicans likely will be unwilling) to countenance cuts to Social Security or Medicare as the price of increasing the debt ceiling. If the Speaker fails to live up to his concessions, he risks being removed by the Republican caucus, in a vote that under rules adopted Monday can be triggered by a single member of the House (of either party, but in this case, likely one of the ultraconservatives).

The Washington Post is [reporting](#) this evening that, as part of the non-public deal reached to allow Kevin McCarthy to become Speaker, House Republicans are preparing a contingency plan that would direct the Treasury Department how to prioritize payments in case the country reaches an unprecedented turning point in its modern history – a breach of the debt limit. This may be further gamesmanship, but the consequences of even proposing such a plan, which by definition will have identify which federal spending programs get funded and which do not, will further polarize the country. It will be an ugly choice.

Since the plan is only effective if enacted into law (that is, it must past the Democratic-controlled Senate and not be vetoed), this probably should be seen as one more element of the performative politics to which we know we are to be treated for the next two years. But this is not a game; the idea that bondholders, for example, would be prioritized at the expense of critical programs will do little to calm the markets. Ultimately, it is binary, either the full faith and credit of the government of the United States is sacrosanct or it is not.

How can the debt ceiling be increased?

The Administration hopes that a sufficient number of moderate Republicans can be persuaded to vote with the Democrats to increase the ceiling. The consequences of a federal default in the run-up to the 2024 elections could backfire on Republicans, though some suggest that the failure to increase the debt ceiling could successfully be laid at the doorstep of the White House. This is extremely high-stakes poker.

The legislative process necessary to do an end run around intransigence is the so-called “discharge motion” (under Rule XV(2) of the [Rules of the House of Representatives](#) (for the 118th Congress)), which would allow legislation (in this case, to increase the debt ceiling) to bypass the process (by which the Speaker sets the floor schedule in conjunction with the House Rules Committee), and go directly to the floor of the House for a majority vote. Democrats would need six Republicans (to get to 218 votes, so long as the VA-04 seat remains vacant, thereafter five) willing to risk opprobrium by their vote to prevent a debt default. The challenge with the discharge motion is that it was not designed to deal with an issue that could have real time deadlines. Discharge motions have a 30-*legislative* day time lag while the legislation sits in committee, followed by a seven-legislative day waiting period. It then goes to the floor on the second or fourth Monday after the seven days lapse.

This entire process could likely take a few months as the 30 *legislative* days alone could cover at least two months in the actual calendar.¹

CONCLUDING THOUGHTS

This really should be a non-issue (as it has largely been historically, and as it in no way authorizes new spending), but unfortunately the increase in the debt ceiling is being weaponized. The increase is to fund obligations that have already been approved by Congress – this about past spending. Tying the increase to future spending cuts or reforms is, as Treasury Secretary Jack Lew [noted](#) in testimony in 2013, irresponsible, and “prioritization of payments” involves a perilous choice between our citizens and our economy. It represents a retreat from core American values that we honor all of our commitments.

And, yet, the ultraconservatives, flexing their newly found legislative muscle, might be willing to risk a parade of horrors – from market crashes to erosion of the full faith and credit of the United States. The danger is that even brinkmanship can have profound market consequences. One need only look at the consequences of the ill-advised, catastrophic mini-budget announced, and then quickly retracted, by then UK Prime Minister Liz Truss and her Chancellor to understand what happens when market forces are unleashed. The 2011 harms are another example. Either Speaker McCarthy can find the courage to override the objections of the ultraconservatives, and risk his Speakership (unless, for example, he has negotiated a grace period before the motion to vacate can be triggered) or the more sensible must explore the discharge process, and given the time involved, they must get started now.

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¹ Dylan Matthews, [writing](#) in Vox, summarized a few other workarounds, including among others the issuance of a platinum coin with a denomination for example of \$1 trillion authorized by the Treasury Secretary under a [1997 law](#), which would be placed on deposit at the Federal Reserve and against which Treasury could buy back an equivalent amount of government debt, and declaration by President Biden that he is ignoring the debt ceiling as unconstitutional under the 14th Amendment, which provides in part that “the validity of public debts of the United States ... shall not be questioned.”

Neither of these appears in the cards, per the [statement](#) on Monday by White House Press Secretary Karine Jean Pierre in response to a question about executive action in respect of the debt ceiling, including minting the platinum coin (“we’re not considering any measures that would go around Congress. ... This is a fundamental congressional responsibility, and Congress must act. Both Republicans and Democrats in Congress have repeatedly raised the debt ceiling, including three times under the last President”). In 2021, Secretary Yellen had [called](#) the trillion platinum coin “a gimmick.” Congress must show “that the world can count on America paying its debts.”