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Highlights

Highlights of GAO-11-203, a report to the Congress

February 2011

DEBT LIMIT

Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market

Why GAO Did This Study

GAO has prepared this report to assist Congress in identifying and addressing debt management challenges. Since 1995, the statutory debt limit has been increased 12 times to its current level of $14.294 trillion. The Department of the Treasury (Treasury) recently notified Congress that the current debt limit could be reached as early as April 5, 2011, and the Congressional Budget Office (CBO) projects that under current law debt subject to the limit will exceed $25 trillion in 2021.

This report (1) describes the actions that Treasury traditionally takes to manage debt near the limit, (2) analyzes the effects that approaching the debt limit has had on the market for Treasury securities, and (3) describes alternative mechanisms that would permit consideration of the link between policy decisions and the effect on debt when or before decisions are made. GAO analyzed Treasury and market data; interviewed Treasury officials, budget and legislative experts, and market participants; and reviewed practices in selected countries.

What GAO Recommends

To avoid potential disruptions to Treasury markets and help inform fiscal policy decisions in a timely way, Congress should consider ways to better link decisions about the debt limit with decisions about spending and revenue.

Treasury provided technical comments on a draft of this report, which GAO incorporated as appropriate.

View GAO-11-203 or key components.
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What GAO Found

The debt limit does not control or limit the ability of the federal government to run deficits or incur obligations. Rather, it is a limit on the ability to pay obligations already incurred.

While debates surrounding the debt limit may raise awareness about the federal government's current debt trajectory and may also provide Congress with an opportunity to debate the fiscal policy decisions driving that trajectory, the ability to have an immediate effect on debt levels is limited. This is because the debt reflects previously enacted tax and spending policies.

Delays in raising the debt limit create debt and cash management challenges for the Treasury, and these challenges have been exacerbated in recent years by a large growth in debt. In the past, Treasury has often used extraordinary actions, such as suspending investments or temporarily disinvesting securities held in federal employee retirement funds, to remain under the statutory limit. However, the extraordinary actions available to the Treasury have not kept pace with the growth in borrowing needs. For example, unlike the past, the amount potentially provided by the extraordinary actions for 1 month in fiscal year 2010 was less than the monthly increase in debt subject to the limit for most months of the year. As a result, once debt reaches the limit, Congress will likely have less time than in prior years to debate raising the debt limit before there are disruptions to government programs and services. This trend is likely to continue given the long-term fiscal outlook.

Failure to raise the debt limit in a timely manner could have serious negative consequences for the Treasury market and increase borrowing costs. Also, some of the actions that Treasury has taken to manage the amount of debt near the limit add uncertainty to the Treasury market. In the past, Treasury has postponed auctions and dramatically reduced the amount of bills outstanding, which compromised the regularity of auctions and the certainty of supply on which Treasury relies to achieve the lowest borrowing cost over time. GAO's analysis suggests that borrowing costs modestly increased during debt limit debates in 2002, 2003, and most recently in 2010.

In addition, managing debt near the debt limit diverts Treasury's limited resources away from other cash and debt management issues at a time when Treasury already faces challenges in lengthening the average maturity of its debt portfolio.

Observers and participants suggested improving the link between the spending and revenue decisions that drive debt and changes in the debt limit. Better alignment could be possible if decisions about the debt level occur in conjunction with spending and revenue decisions as opposed to the after-the-fact approach now used. This practice, which is similar to practices used in some other countries, might facilitate efforts to change the fiscal path by highlighting the implications of tax and spending decisions on changes in debt.