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Debt Ceiling State of Play

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OUR VIEW	Politicians, pundits, and the news media are sounding alarms because Washington hit its borrowing limit on January 19th. The Treasury Department is taking extraordinary measures to ensure the United States does not default on its debt, but this will only buy the Federal government a few months before Congressional action is needed. Treasury Secretary Yellen has estimated these extraordinary measures will prevent a default until June 5th, seemingly giving Congress five months to act. Although Yellen stated that this forecast is "subject to considerable uncertainty," and called for urgency. Historically, raising the debt ceiling is a frequent, routine, and bipartisan procedure (without conditions), but as of late, it has evolved into a process with risky political maneuvering and complex economic calculations. What started as a procedural vote has become a vigorous, robust debate about the nation's approach to fiscal responsibility - and the stakes couldn't be higher. While we agree that the circumstances surrounding the debt ceiling in 2023 are politically and procedurally complex, we still believe there is ample time for the executive and legislative branches to reach a deal and avoid a default. Below we provide an overview of why raising the debt ceiling in 2023 may be more challenging than in prior years, as well as the consequences of default, potential legislative and administrative solutions, and a brief overview of the 2011 debt ceiling crisis.
118TH CONGRESS: IS THIS TIME REALLY DIFFERENT?	Securing the speakership proved to be a daunting task for now-Speaker McCarthy (R-CA) mainly because of objections and obstacles thrown up from the far-right contingent of the Republican party, but after four days and 15 rounds of voting, McCarthy prevailed in a 216-212 vote. To become Speaker, McCarthy had to make concessions and rule changes to secure the support of far-right members. Two of these concessions, which were a part of the rules package agreed to by the Republican conference, tie McCarthy's hands and substantially complicate the process of raising the debt ceiling. • The first rule that complicates the process states that any move to raise the debt ceiling must be accompanied by spending cuts. In a statement, White House press secretary Karine Jean-Pierre repeated what President Biden has previously said, that "raising the debt ceiling is not a negotiation." According to reports, Biden Administration officials are meeting with moderate House Republicans in hopes that they will support a clean debt limit extension (more below). The White House and House Republicans seem to be at an impasse over tying spending cuts to the debt ceiling, and yet, neither side has shown any sign of acquiescing to the other's demands. One glimmer of hope was a recent agreement by Speaker McCarthy and President Biden to "speak" regarding the debt ceiling. Timing for this discussion is unclear. While not framed as a negotiation, it indicates a willingness to discuss each side's position on the issue. • The other concession that holds Speaker McCarthy accountable to hardline conservative demands is the rule that gives one House lawmaker the ability to propose a motion to "vacate the chair" and force a vote to remove McCarthy at any given time. Historically, we've seen how this rule can significantly weaken a Speaker's ability to negotiate with the Senate and the executive branch. It also gives credibility and leverage to some of the more extreme members of the House Republican caucus. If McCarthy can successfully craft a deal on the debt ceiling, it must have the stamp of approval from the conservative Freedom Caucus, and its more radical members, who were key McCarthy holdouts during his race for Speaker. One of the biggest internal House Republican battles will be related to the type of spending to propose as cuts. At this juncture, it seems like conservative House Members are focused on lowering overall spending caps and not cutting entitlement programs. While McCarthy secured the speakership, his inability to win in the first round of voting demonstrates division within the Republican conference. This factor, coupled with the fact that the Republican House

	majority is one of the slimmest in modern history, complicates debt ceiling negotiations considerably (McCarthy can only afford to lose four Republican votes). Additionally, at least as of now, Senate Republicans are not actively working on a potential solution. This week, Senate Minority Leader McConnell (R-KY) stated that any debt limit solution would come from negotiations between Speaker McCarthy and President Biden. While Senate Republicans are not engaging in the debt limit issue yet, Sen. Joe Manchin (D-WV) met with Speaker McCarthy yesterday to discuss the looming threat of default. Manchin has publicly urged the White House to engage in negotiations with House Republicans, and while Manchin's discussions with Speaker McCarthy may not move the needle — at least in the near term — we see them as notable.
2011 DEBT CEILING CRISIS & THE IMPLICATIONS OF DEFAULT	In the last 40 years, the U.S. has raised the debt ceiling 45 times, and despite several close calls, the country has never defaulted on its debt, and we expect this trend to continue. That said, even a hint of instability in U.S. creditworthiness could lead to turmoil in the markets, like when the U.S. faced a debt ceiling crisis in 2011 and had its credit rating downgraded by Standard & Poor's from AAA to AA+. **2011 Debt Ceiling Crisis** In 2011, the U.S. government was in a similar position regarding raising the debt ceiling – a Democrat was in the middle of his first term in the White House (President Obama), Democrats controlled the Senate, and Republicans had retaken the majority in the House in the midterm elections, at that time aided by the emergence of the Tea Party. Prior to that, due to the Great Recession, federal spending had increased substantially. Additionally, between 2008 and 2010, Congress raised the debt ceiling from $10.6 trillion to $14.3 trillion without issue. In 2011, the economy showed early signs of recovery as the federal debt again approached its limit, but with control of the House, fiscal conservatives utilized the need to increase the debt limit that year to highlight the country's growing debt and push for spending cuts. This was the first time that raising the debt ceiling was not a formality and became the subject of partisan debate. But up against the brink of a default, Congress and President Obama were able to resolve the debt ceiling crisis through the Budget Control Act of 2011 (BCA), which was passed and signed into law on August 2, 2011. The BCA raised the debt ceiling by $2.4 trillion in two phases, which was enough to cover the nation's borrowing needs until 2013. The first phase included discretionary spending cuts of $917 billion over 10 years, split evenly between defense and domestic spending. The second phase created a Joint Select Committee on Deficit Reduction (super committee) of 12 members of Congress tasked to identify $1.2 trillion in savings over 10 years through a mix of spending cuts and revenue increases. If the super committee failed to reach an agreement (which they did), automatic across-the-board spending cuts would go into effect starting in 2013, known as the sequester. 2013 also was the year when raising the debt ceiling again became the subject of negotiations on spending cuts. However, given all the similarities, we believe today's present debt ceiling scenario closely resembles this first debt ceiling debate of 2011. **The Risks of Default** A default on the debt would have myriad negative implications for the U.S. and the global economy. We would see a credit rating downgrade, as we saw in 2011, as well as a sell-off in the stock markets (particularly for publicly traded companies linked to the federal government), higher interest rates, a potential recession, and uncertainty in money markets, among other potentially detrimental economic effects. **Treasury Market** Last year, the SEC and Treasury started rulemakings to transform the U.S. Treasury market. We believe a debt ceiling standoff could cause delay in these rulemakings due to the likely market impact of a default. Both agencies may be skittish about finalizing changes to the Treasury market when it is already under substantial stress. Agencies may decide to hold off on finalizing any proposals until after the debt ceiling is lifted.
POTENTIAL DEBT CEILING OUTCOMES	We continue to believe that Congress and the Administration will strike a deal on the debt ceiling, even if it goes down to the eleventh hour as it did in 2011. That said, the window for negotiating is narrowing rapidly due to monetary policy and fiscal policies like President Biden's federal student loan payment pause. Unfortunately, between now and the April 15th deadline for income tax returns, we anticipate a great amount of noise but little progress on a deal. April 15th will provide additional insights on expected tax

	receipts and solidify the "X" date. Below, we overview different potential outcomes of this latest debt ceiling skirmish. **2011/2013 Type of Debt Ceiling Deal** Republicans are demanding reductions in spending in exchange for a deal on the debt ceiling. While the White House has renounced this idea, it is the most likely outcome given its historical precedent in both 2011 and 2013. And unless the White House takes an unprecedented and legally risky unilateral path (some options described below), House Republicans hold significant leverage, as a default would not reflect well on anyone in control in Washington (clearly an understatement). With moderate Senators like Sen. Manchin already publicly expressing an interest in coming to a bipartisan solution to raise the debt ceiling, it would be hard to imagine a bipartisan deal coming to fruition without spending cuts of some kind. Additionally, Manchin floated the idea of creating "rescue committees" for government programs like Medicare and Social Security to ensure their solvency. Manchin introduced similar bipartisan legislation during the 117th Congress with Sen. Romney (R-UT). This type of committee would eerily mirror the supercommittee created by the bipartisan BCA of 2011, which ultimately failed to reach an agreement on spending cuts. **Other Legislative Solutions** • *Problem Solvers Caucus Proposal*: A bipartisan group of lawmakers, known as the Problem Solvers Caucus, is actively working on addressing the U.S. debt ceiling, according to the group's co-chairs, Reps. Fitzpatrick (R-PA) and Gottheimer (D-NJ). The proposal would replace the current federal debt limit, currently set at $31.4 trillion, with a rule limiting debt to a share of national economic output. • *H.R. 415*: On January 20th, Rep. Bill Foster (D-IL) introduced legislation that would repeal the national debt ceiling. The bill, entitled the "End the Threat of Default Act," is cosponsored by 42 Democratic members of the House as of January 23rd. This idea has been proposed previously but has not received much traction, with President Biden saying in the past that he doesn't support such efforts to abolish the debt limit. • *Short-Term Extensions*: Congress could pass a short-term extension of the borrowing limit, like the small debt ceiling raise passed only a few years ago in 2021, the last time the U.S. government hit the debt ceiling. But that extension only provided approximately six weeks of additional funding ability, as Congress had to negotiate a longer-term debt ceiling raise, which is the limit we are running up to this year. This could be a viable option if the April 15th tax receipt estimates point to an early "X" date. **Prioritizing Payments** House Republicans have proposed a contingency plan if Congress cannot agree on the debt ceiling. The proposal calls for prioritizing payments in the event of a default. While a draft legislative proposal was circulated last week, that plan has been rejected by Treasury Secretary Yellen, who says the Treasury Department does not have the "systems" to prioritize different payments. In prior Congresses, Rep. McClintock (R-CA) has introduced a bill to prioritize payments in the event of a default, and in 2015 the House passed Rep. McClintock's prioritization bill, with nine Republicans voting no (though none of those Republicans are still in Congress). Rep. McClintock reintroduced his prioritization bill, H.R. 187, on January 9th. **Bypassing Speaker McCarthy** A lengthy procedure in the House of Representatives, known as a discharge petition, could effectively bypass Speaker McCarthy and bring a vote on the debt ceiling to the House floor without the Speaker's consent. While unlikely, this path would require a handful of moderate House Republicans (5) to join forces with Democrats, as well as reach the 60-vote threshold in the Senate. Discharge petitions are hardly ever successful and require 218 signatures (a majority) to successfully bring items to the House floor for a vote. Moreover, there are several ways for Speaker McCarthy and his allies to thwart a discharge petition before it ripens. For example, the Speaker could instruct the committee that is being "discharged" by the discharge petition (usually the Rules Committee) to amend the measure to make it more conservative and report it out, which would moot the discharge petition and force the entire time-consuming process to start over again.

Whither Speaker McCarthy?
Several conservative hardliners like Reps. Roy (R-TX) and Norman (R-SC) have expressed confidence that Speaker McCarthy will strike an acceptable deal with the White House on spending cuts in exchange for raising the debt ceiling. That said, if Speaker McCarthy falls short or cuts a "bad" deal with Democrats, we could see McCarthy holdouts utilize the motion to vacate and oust him as Speaker. Remember, in 2015, then-Speaker John Boehner resigned because of similar GOP infighting dynamics.

POTENTIAL ADMINISTRATIVE ACTIONS

The United States has never defaulted on its debt, and while the risk of default is higher this Congress than maybe ever before, we still believe the Biden Administration and congressional Republicans will come to a deal on the debt ceiling. That said, we live in extraordinarily partisan and unusual times, so it is possible (albeit unlikely) that a deal is not reached. In this scenario, the Administration may decide to act unilaterally to avert a debt ceiling crisis. These Administrative actions all carry substantial risk and would likely cause subsequent litigation, which also would be potentially disastrous for the economy. Below, we explore three options that the Administration could consider if a deal is not reached. That said, we find these options, and other options floated by the media, such as issuing quasi-debt and invoking the 1974 Impoundment Act (a measure that removed a President's ability to refuse to spend money for Congressionally approved programs), extremely unlikely.

Option 1: Minting a Platinum Coin

- In both 2011 and 2013, commentators on the left advocated for minting a $1 trillion platinum coin to pay off U.S. Treasurys to avoid a default. The idea was ultimately rejected by both the Federal Reserve and the Treasury. The platinum coin loophole is derived from a 1997 law that grants the Treasury Secretary the ability to mint platinum coins of any value. While the media has floated this idea before, Treasury Secretary Yellen has called the prospect of minting a coin a "gimmick" that "compromises the independence of the Fed, conflating monetary and fiscal policy."

Option 2: Invoking the 14th Amendment

- Then-House Minority Leader Nancy Pelosi urged President Obama to invoke the 14th Amendment during the debt ceiling standoff with House Republicans in 2013. Section 4 of the 14th Amendment states that the "validity of the public debt of the United States, authorized by law, including debt incurred for payments of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned." Some constitutional lawyers argue that this section of the 14th Amendment gives the executive the power to render the debt ceiling unconstitutional.

Option 3: Premium Bonds

- A number of commentators have suggested that Treasury could circumvent the debt ceiling by issuing so-called "premium bonds" — i.e., bonds with very low principal and very high interest rates. The debt ceiling statute technically only limits the *principal* amount of Treasury debt outstanding, and does not limit interest obligations, so the idea here would be to issue a series of one-year bonds with a nominal principal amount and one very large interest payment due at maturity. This would allow Treasury to effectively borrow, say, $100 while only using $1 of debt-ceiling-cap space. However, there is no market for these premium bonds at the moment, and it's not clear that investors would be willing to buy premium bonds in sufficient bulk for this to be a viable option.