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Report to Congressional Requesters

August 1996

DEBT CEILING

Analysis of Actions During the 1995-1996 Crisis

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The Honorable William V. Roth, Jr.
Chairman
Committee on Finance
United States Senate

The Honorable Bill Archer
Chairman
Committee on Ways and Means
House of Representatives

Your November 9, 1995, and April 25, 1996, letters asked us to review the Executive Branch's actions when Treasury reached the statutory debt limit of $4.9 trillion established in 1993. This report discusses our analysis of Treasury's actions during the 1995-1996 debt ceiling crisis related to investments and redemptions in federal trust funds and the restoration of losses incurred. As agreed, we separately provided to the Committees' staffs a compilation of requested source documents.

We are sending copies of this report to the Ranking Minority Members of the Senate Committee on Finance and the House Committee on Ways and Means and the Chairmen and Ranking Minority Members of the Senate and House Appropriations and Budget Committees. We also are sending copies to the Secretary of the Treasury and the Director of the Office of Management and Budget. Copies will be made available to others upon request.

This report was prepared under the direction of Gregory M. Holloway, Director, Governmentwide Audits who can be reached at (202) 512-9510. Other major contributors are listed in appendix I.

Gene L. Dodaro
Assistant Comptroller General

Executive Summary

Purpose

The Congress has traditionally imposed a limit on the size of the federal government's public debt by establishing ceilings (debt ceiling) on the amount of Treasury securities that can be outstanding. In the past 50 years, the Congress has enacted about 60 temporary and permanent increases in the debt ceiling. On August 10, 1993, the Congress raised the debt ceiling to $4.9 trillion. This debt ceiling was reached in the fall of 1995, but was not raised until March 29, 1996, when it was set at $5.5 trillion.

The intervening period, beginning on November 15, 1995, when the Secretary of the Treasury declared a debt issuance suspension period, became known as the 1995-1996 debt ceiling crisis. Treasury took several actions during this period to raise funds to meet federal obligations without exceeding the debt ceiling. GAO was asked to (1) determine the chronology of these actions and (2) provide financial and legal analyses of them.

Background

The public debt is composed primarily of Treasury securities, which include bills, notes, and bonds that Treasury issues to raise cash to finance government operations and invest trust fund receipts. On October 31, 1995, most (about 75 percent) of the $4.9 trillion public debt was Treasury securities held by the public. The remaining debt was Treasury securities held by federal trust funds, which totaled about $1.3 trillion as shown in table 1.

Table 1: Trust Funds Which Hold Treasury Securities

Dollars in billions

Fund	Securities held at October 31, 1995
Federal Old Age and Survivors Insurance Trust Fund[a]	$ 445
Civil Service Retirement and Disability Trust Fund (Civil Service fund)	348
Federal Hospital Insurance Trust Fund	128
Department of Defense Military Retirement Fund (Military Retirement Fund)	121
Unemployment Trust Fund	47
Federal Disability Insurance Trust Fund[a]	35
Bank Insurance Fund	22
Government Securities Investment Fund (G-Fund)	21
Employees Life Insurance Fund	16
Federal Supplementary Medical Insurance Trust Fund	14
National Service Life Insurance Fund	12
Railroad Retirement Account	12
Airport and Airways Trust Fund	11
Highway Trust Fund	8
Exchange Stabilization Fund[b]	3
Other Government Trust Funds	82
Total	**$1,325**

[a]Social Security trust funds.

[b]The Stabilization Fund (31 U.S.C. 5302) is commonly referred to as the Exchange Stabilization Fund.

Although these securities represent a loan from one part of the government to another, they count against the debt ceiling.

When a debt ceiling is reached, Treasury is unable to issue additional Treasury securities without adding to the public debt and exceeding the debt ceiling. Treasury is also unable to discharge its normal trust fund investment and redemption responsibilities.

Treasury can avoid exceeding the debt ceiling by not issuing Treasury securities for trust fund receipts or reinvesting maturing Treasury securities. Also, when government trust funds redeem Treasury securities to pay for benefits and expenses, the debt subject to the debt ceiling is lowered, and thus, Treasury can sell additional securities to the public to raise cash.

During the debt ceiling crisis in 1985, Treasury was unable to follow its normal trust fund investment and redemption polices and procedures. Specifically, it suspended investing certain trust fund receipts and redeemed some Treasury securities issued to one trust fund earlier than normal to pay fund benefits. Subsequently, the Congress provided the Secretary of the Treasury with statutory authority to take certain types of actions for the Civil Service fund and the G-Fund to prevent Treasury from exceeding the debt ceiling. Specifically, the Secretary of the Treasury has been provided the following statutory authorities.

1. Redemption of securities held by the Civil Service fund. In subsection (k) of 5 U.S.C. 8348, the Congress authorizes the Secretary of the Treasury to redeem securities or other invested assets of the Civil Service fund before maturity to prevent the amount of public debt from exceeding the debt ceiling.

5 U.S.C. 8348(k) also provides that, before exercising the authority to redeem securities of the Civil Service fund, the Secretary must first determine that a "debt issuance suspension period" exists. 5 U.S.C. 8348(j) defines a debt issuance suspension period as any period for which the Secretary has determined that obligations of the United States may not be issued without exceeding the debt ceiling.

The statute authorizing the debt issuance suspension period and its legislative history are silent as to how the Secretary should determine the length of a debt issuance suspension period. Specifically, 5 U.S.C. 8348(j)(5) states

"the term 'debt issuance suspension period' means any period for which the Secretary of the Treasury determines for purposes of this subsection that the issuance of obligations of the United States may not be made without exceeding the public debt limit."

2. Suspension of Civil Service fund investments. In subsection (j) of 5 U.S.C. 8348, the Congress authorizes the Secretary of the Treasury to suspend additional investment of amounts in the Civil Service fund if such investment cannot be made without causing the amount of public debt to exceed the debt ceiling. This subsection of the statute instructs the Secretary on how to make the Civil Service fund whole after the debt issuance suspension period has ended.

3. Suspension of G-Fund investments. In subsection (g) of 5 U.S.C. 8438, the Congress authorized the Secretary of the Treasury to suspend the issuance of additional amounts of obligations of the United States to the G-Fund if such issuance cannot be made without causing the amount of public debt to exceed the debt ceiling. The subsection contains instructions on how the Secretary is to make the G-Fund whole after the debt ceiling crisis has ended.

Also, during the 1995-1996 debt ceiling crisis, the Congress provided the Secretary of the Treasury authority to issue securities that did not count toward the debt ceiling. Specifically, on February 8, 1996, Public Law 104-103 provided Treasury with the authority to issue securities in an amount equal to the March 1996 social security payments. This statute provided that the securities issued under its provisions were not to be counted against the debt ceiling until March 15, 1996, which was later extended to March 30, 1996. In addition, on March 12, 1996, the Congress enacted Public Law 104-115, which exempted government trust fund investments and reinvestments from the debt ceiling until March 30, 1996.

Results in Brief

During the 1995-1996 debt ceiling crisis, Treasury used its normal investment procedures for 12 of the 15 major government trust funds included in our review. These 12 trust funds accounted for about $871 billion, or about 65 percent, of the $1,325 billion of Treasury securities held by government trust funds on October 31, 1995.

Treasury departed from its normal procedures in handling the investments and redemptions for the remaining three major trust funds (Civil Service fund, G-Fund, and Exchange Stabilization Fund) and took other actions to stay within the $4.9 trillion debt ceiling established in August 1993. These departures and other actions were proper and consistent with legal authorities the Congress has provided to the Secretary of the Treasury.

First, regarding the Civil Service trust fund, Treasury

- redeemed about $46 billion in Treasury securities held by the Civil Service fund before they were needed to pay benefits and trust fund expenses and
- suspended the investment of $14 billion in Civil Service fund receipts.

In exercising the authority to redeem Civil Service fund Treasury securities, the Secretary of the Treasury determined that a debt issuance suspension period existed, as required by 5 U.S.C. 8348(k). Treasury's

General Counsel advised the Secretary that he could determine that a debt issuance suspension period existed based on the actions of the Congress and the President and the resulting impasse. The General Counsel further advised that the impasse made it unlikely that a statute raising the debt ceiling could be enacted before the next election.

Second, Treasury exchanged about $8.6 billion of Treasury securities held by the Civil Service fund for non-Treasury securities held by the Federal Financing Bank (FFB). The non-Treasury securities used in the exchange had been issued by the Postal Service and the Tennessee Valley Authority. The laws authorizing these entities to issue securities state that they are lawful investments of federal trust funds (39 U.S.C. 2005(d)(3) and 16 U.S.C. 831n-4(d)). FFB redeemed the Treasury securities it received from the Civil Service fund to repay borrowings from Treasury, which allowed Treasury to raise additional cash from the public.

Third, Treasury suspended some investments and reinvestments of the G-Fund's receipts and maturing securities. Daily during the crisis, Treasury determined the amount of funds that the G-Fund could invest without exceeding the debt ceiling and suspended the investment of the remaining funds.

Fourth, on several occasions, Treasury did not reinvest some of the maturing Treasury securities held by the Exchange Stabilization Fund, which was established to help provide a stable system of monetary exchange rates. 31 U.S.C. 5302, gives the Secretary of the Treasury the sole discretion for determining when, and if, excess funds for the Exchange Stabilization Fund will be invested.

Fifth, Treasury issued some securities that were temporarily exempted from being counted by Public Law 104-103 and Public Law 104-115. These exemptions allowed Treasury to (1) raise $29 billion to pay March 1996 Social Security benefits and (2) in March 1996, invest $58.2 billion from government trust fund receipts and maturing securities.

Although these actions prevented the debt ceiling from being exceeded during the 1995-1996 debt ceiling crisis, the government incurred about $138.9 billion in additional debt that would normally have been considered subject to the debt ceiling. Also, several of these actions resulted in interest losses to certain government trust funds. Treasury has fully restored the Civil Service fund's $995 million and the G-Fund's $255 million interest losses, under 5 U.S.C. 8348(j) and 5 U.S.C. 8438(g), respectively. Treasury cannot restore the Exchange Stabilization Fund's $1.2 million interest loss without special legislation.

GAO's Analysis

Normal Procedures Used for Most Trust Funds

Between November 15, 1995, and March 28, 1996, Treasury followed its normal investment and redemption policies for most of the trust funds reviewed. For example, during this period, Treasury invested about $156.7 billion and redeemed about $115.8 billion of Treasury securities on behalf of the Social Security funds and invested about $7.1 billion and redeemed about $6.8 billion of Treasury securities on behalf of the Military Retirement Fund.

Actions Affecting the Civil Service Fund

The Secretary's actions affecting the Civil Service fund were to (1) redeem securities before needed to pay the fund's benefits and expenses (5 U.S.C. 8348(k)), (2) suspend investment of the fund's receipts (5 U.S.C. 8348(j)), and (3) exchange Treasury securities held by the fund for non-Treasury securities held by FFB.

The redemption of securities before needed to pay trust fund benefits and expenses involved about $46 billion. This decreased the amount of debt subject to the debt ceiling until Treasury issued a like amount of securities to the public for cash. The significant actions relating to the early redemptions follow.

- On November 15, 1995, the Secretary determined that a debt issuance suspension period existed. On February 14, 1996, the Secretary extended the initial 12-month debt issuance suspension period to 14 months.
- About $39.8 billion of the Civil Service fund's Treasury securities were redeemed earlier than needed to pay fund benefits and expenses between November 15 and November 30, 1995. Between February 15 and February 20, 1996, an additional $6.4 billion in Treasury securities held by the Civil Service fund was redeemed. Treasury based these redemptions on (1) the 14-month debt issuance suspension period determination made by the Secretary (November 15, 1995, through January 15, 1997) and (2) the estimated monthly Civil Service fund benefit payments.

The suspension of the investment of Civil Service fund receipts in Treasury securities involved about $14 billion. Between November 15, 1995, and March 29, 1996, the Civil Service fund had about $20 billion in receipts, which in all but one case, Treasury invested using its normal policies and procedures. The exception involved the Civil Service fund's December 31, 1995, receipt of a $14 billion semiannual interest payment on the fund's securities portfolio. The significant actions involving these uninvested receipts follow.

- The Secretary determined that investing these funds in additional Treasury securities would have exceeded the debt ceiling and, therefore, under 5 U.S.C. 8348(j) suspended the investment of these receipts.
- During the debt ceiling crisis, about $6.3 billion of the Civil Service fund's uninvested receipts were used to pay for the fund's benefits and expenses. This action was in accordance with policies and procedures Treasury developed in 1989 stemming from prior debt ceiling crises.

The exchange of Treasury securities held by the Civil Service fund for non-Treasury securities held by FFB involved about $8.6 billion. The non-Treasury securities owned by the FFB that ultimately were exchanged had been issued by the Postal Service and the Tennessee Valley Authority.

Before making the exchange, however, Treasury had to determine (1) which non-Treasury securities were eligible for the exchange and (2) how to value the securities so that the exchange was fair to both the Civil Service fund and FFB. These determinations involved the following.

- The law governing the Civil Service fund does not specifically identify which securities issued by an agency can be purchased. However, the laws authorizing the Postal Service and the Tennessee Valley Authority to issue securities state that these securities are lawful investments of the federal trust funds (39 U.S.C. 2005(d)(3) and 16 U.S.C. 831(n-4)(d)).
- To compute the value of each portfolio, Treasury considered (1) the current market rates for outstanding Treasury securities at the time of the exchange, (2) the probability of changing interest rates, (3) the probability of the agency paying off the debt early, and (4) the premium that the market would provide to a security that could be redeemed at par regardless of the market interest rates. Also, Treasury obtained the opinion of an independent third party to determine whether its valuations were accurate. By having an independent verification of the value of the

exchanged securities, Treasury helped to ensure that both the Civil Service fund and FFB were treated equitably in the exchange.

FFB redeemed the Treasury securities it received in this exchange transaction to repay some of its borrowings from Treasury. This reduced the amount of outstanding Treasury securities, and thus, allowed Treasury to raise additional cash from the public.

Other Actions to Stay Under the Debt Ceiling

In other actions, the Secretary (1) suspended G-Fund investments (5 U.S.C. 8438(g)), (2) suspended reinvestment of some of the Exchange Stabilization Fund's maturing Treasury securities, and (3) issued securities not counted toward the debt ceiling (Public Laws 104-103 and 104-115).

First, between November 15, 1995, and March 18, 1996, the Secretary did not fully invest G-Fund receipts. As with the Civil Service fund, the Secretary is authorized to suspend G-Fund investments during periods when obligations of the federal government cannot be issued without exceeding the debt ceiling.

Initially, on November 15, 1996, when the Secretary determined a debt issuance suspension period, the G-Fund held about $21.6 billion of Treasury securities maturing on that day. In order to meet its cash needs, Treasury did not reinvest about $18 billion of these securities. Then, throughout the debt ceiling crisis, the amount of the G-Fund's receipts that Treasury invested changed daily. The amount invested was limited by the amount that could be invested and still remain under the debt ceiling.

Second, on several occasions between February 21 and March 12, 1996, Treasury did not reinvest some of the maturing Treasury securities held by the Exchange Stabilization Fund. The Exchange Stabilization Fund was created to help provide a stable system of monetary exchange rates. The Secretary is authorized by 31 U.S.C. 5302 to invest balances of the Fund that are not needed for program purposes in obligations of the federal government. The Secretary has the sole discretion for determining when, and if, the excess funds will be invested.

Third, the Congress passed legislation allowing Treasury to issue some Treasury securities that were temporarily exempted from being counted against the debt ceiling. Specifically, these exempted securities involved the following situations.

- The Secretary notified the Congress that, unless the debt ceiling was raised before the end of February 1996, Social Security and other benefit payments could not be made in March 1996. To ensure that these benefits would be paid on time, on February 8, 1996, the Congress provided Treasury with the authority to issue securities which would not count against the debt ceiling until March 15, 1996, in an amount equal to March 1996 Social Security payments. This authority allowed Treasury to issue about $29 billion of securities to the public. These securities were issued on February 23, 1996. The exemption for excluding them from counting against the debt ceiling was later extended to March 30, 1996.
- On March 12, 1996, the Congress enacted legislation that exempted government trust fund investments and reinvestments from the debt ceiling until March 30, 1996. Under this statute, between March 13 and March 29, 1996, Treasury issued about $58.2 billion in Treasury securities to government trust funds as investments of their receipts or reinvestments of their maturing securities.

Government Debt Increased and Fund Losses Were Restored

The level of the public debt is determined by the government's prior spending and revenue decisions along with the performance of the economy. In 1979, we reported[1] that debt ceiling increases were needed simply to allow borrowing adequate to finance deficit budgets which had already been approved. The 1995-1996 debt ceiling crisis provides an illustration of this. Although actions taken during the debt ceiling crisis to issue and redeem Treasury securities allowed the government to pay the government's obligations while staying under the $4.9 trillion debt ceiling, the government's debt which normally would be considered part of this ceiling, increased by $138.9 billion—the amount necessary to finance those obligations during this period. The $138.9 billion is comprised of the following:

- $46.2 billion associated with the early redemption of Treasury securities held by the Civil Service fund,
- $8.6 billion resulting from the exchange of agency securities held by FFB for Treasury securities held by the Civil Service fund,
- $29 billion in Treasury securities issued to ensure timely payment of March 1996 social security benefit payments,
- $58.2 billion in Treasury securities issued to invest government trust fund receipts and reinvest maturing securities that did not count against the debt ceiling, and

[1] A New Approach to the Public Debt Legislation Should Be Considered (FGMSD-79-56, September 7, 1979).

- $0.5 billion for the restoration of interest that would have been invested prior to March 29, 1996, had normal procedures been used.

These amounts are reduced by $3.6 billion, which is the difference between the outstanding debt subject to the debt ceiling on November 15, 1995, and on March 28, 1996.

When Treasury departed from its normal investment and redemption polices and procedures during the 1995-1996 debt ceiling crisis, the Civil Service fund, the G-Fund, and the Exchange Stabilization Fund incurred interest losses. In accordance with 5 U.S.C. 8348(j) and 5 U.S.C. 8438(g), Treasury restored the interest losses to the Civil Service fund and G-Fund, respectively, once the Congress raised the debt ceiling. The Exchange Stabilization Fund lost $1.2 million in interest that cannot be restored without special legislation.

Agency Comments

GAO requested oral comments on a draft of this report from the Secretary of the Treasury or his designee. On August 22, 1996, Treasury officials provided GAO with oral comments that generally agreed with the report's findings and conclusions.

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Appendix

Tables

Abbreviations

FFB	Federal Financing Bank

Introduction

The federal government began with a public debt of about $78 million in 1789. Since then, the Congress has attempted to control the size of the debt by imposing ceilings on the amount of Treasury securities that could be outstanding. In February 1941, the Congress set an overall ceiling of $65 billion on all types of Treasury securities that could be outstanding at any one time.

This ceiling was raised several times between February 1941 and June 1946 when a ceiling of $275 billion was set and remained in effect until August 1954. At that time, the Congress imposed the first temporary debt ceiling which added $6 billion to the $275 billion permanent ceiling. Since that time, the Congress has enacted numerous temporary and permanent increases in the debt ceiling. Although most of this debt is held by the public, about one fourth of it or $1.325 trillion, as of October 31, 1995, is issued to federal trust funds, such as the Social Security funds, the Civil Service fund, and the G-Fund.

The Secretary of the Treasury has several responsibilities relating to the federal government's financial management operations. These include paying the government's obligations and investing trust fund receipts not needed for current benefits and expenses. The Congress has generally provided the Secretary with the ability to issue the necessary securities to the trust funds for investment purposes and to borrow the necessary funds from the public to pay government obligations.

Under normal circumstances, the debt ceiling is not an impediment in carrying out these responsibilities. Treasury is notified by the appropriate agency (such as the Office of Personnel Management for the Civil Service fund) of the amount that should be invested (or reinvested) and Treasury makes the investment. In some cases, the actual security that Treasury should purchase may also be specified. These securities count against the debt ceiling. Consequently, if trust fund receipts are not invested, an increase in the debt subject to the debt ceiling does not occur.

When Treasury is unable to borrow as a result of reaching the debt ceiling, the Secretary is unable to fully discharge his financial management responsibilities using the normal methods. On various occasions over the years, normal government financing has been disrupted because Treasury had borrowed up to or near the debt ceiling and legislation to increase the debt ceiling had not yet been enacted. These situations are commonly referred to as debt ceiling crises.

In 1985 the government experienced a debt ceiling crisis from September 3 through December 11. During that period, Treasury took several actions that were similar to those discussed in this report. For example, Treasury redeemed Treasury securities held by the Civil Service fund earlier than normal in order to borrow sufficient cash from the public to meet the fund's benefit payments and did not invest some trust fund receipts.[1] In 1986 and 1987, following Treasury's experiences during prior debt ceiling crises, the Congress provided to the Secretary of the Treasury statutory authority to use the Civil Service fund and the G-Fund to assist Treasury in managing its financial operations during a debt ceiling crisis.

Statutory Authorities

The following are statutory authorities provided to the Secretary of Treasury that are pertinent to the 1995-1996 debt ceiling crisis and the actions discussed in this report.

1. Redemption of securities held by the Civil Service fund. In subsection (k) of 5 U.S.C. 8348, the Congress authorizes the Secretary of the Treasury to redeem securities or other invested assets of the Civil Service fund before maturity to prevent the amount of public debt from exceeding the debt ceiling.

5 U.S.C. 8348(k) also provides that, before exercising the authority to redeem securities of the Civil Service fund, the Secretary must first determine that a "debt issuance suspension period" exists. 5 U.S.C. 8348(j) also defines a debt issuance suspension period as any period for which the Secretary has determined that obligations of the United States may not be issued without exceeding the debt ceiling.

The statute authorizing the debt issuance suspension period and its legislative history are silent as to how the Secretary should determine the length of a debt issuance suspension period. Specifically, 5 U.S.C. 8348(j)(5) states

"the term 'debt issuance suspension period' means any period for which the Secretary of the Treasury determines for purposes of this subsection that the issuance of obligations of the United States may not be made without exceeding the public debt limit."

[1] Civil Service Fund: Improved Controls Needed Over Investments (GAO/AFMD-87-17, May 7, 1987) and Opinion on the legality of the plan of the Secretary of the Treasury to disinvest the Social Security and other trust funds on November 1, 1985, to permit payments to beneficiaries of these funds (B-221077.2, December 5, 1985).

2. Suspension of Civil Service fund investments. In subsection (j) of 5 U.S.C. 8348, the Congress authorizes the Secretary of the Treasury to suspend additional investment of amounts in the Civil Service fund if such investment cannot be made without causing the amount of public debt to exceed the debt ceiling. This subsection of the statute instructs the Secretary on how to make the Civil Service fund whole after the debt issuance suspension period has ended.

3. Suspension of G-Fund investments. In subsection (g) of 5 U.S.C. 8438, the Congress authorized the Secretary of the Treasury to suspend the issuance of additional amounts of obligations of the United States to the G-Fund if such issuance cannot be made without causing the amount of public debt to exceed the debt ceiling. The subsection contains instructions on how the Secretary is to make the G-Fund whole after the debt ceiling crisis has ended.

4. Issuance of securities not counted toward the debt ceiling. On February 8, 1996, the Congress provided Treasury with the authority (Public Law 104-103) to issue securities in an amount equal to March 1996 social security payments. This statute provided that the securities issued under its provisions were not to be counted against the debt ceiling until March 15, 1996, which was later extended to March 30, 1996. On March 12, 1996, the Congress enacted Public Law 104-115 which exempted government trust fund investments and reinvestments from the debt ceiling until March 30, 1996.

Prior Reports on Debt Ceiling Crises

We have previously reported on aspects of Treasury's actions during the 1985 and other debt ceiling crises. Those reports are:

1. A New Approach to the Public Debt Legislation Should Be Considered (FGMSD-79-58, September 7, 1979).

2. Opinion on the legality of the plan of the Secretary of the Treasury to disinvest the Social Security and other trust funds on November 1, 1985, to permit payments to beneficiaries of these funds (B-221077.2, December 5, 1985).

3. Civil Service Fund: Improved Controls Needed Over Investments (GAO/AFMD-87-17, May 7, 1987).

4. Debt Ceiling Options (GAO/AIMD-96-20R, December 7, 1995).

5. Social Security Trust Funds (GAO/AIMD-96-30R, December 12, 1995).

6. Debt Ceiling Limitations and Treasury Actions (GAO/AIMD-96-38R, January 26, 1996).

7. Information on Debt Ceiling Limitations and Increases (GAO/AIMD-96-49R, February 23, 1996).

Objectives, Scope, and Methodology

Our objectives were to

- develop a chronology of significant events relating to the 1995-1996 debt ceiling crisis,
- evaluate the actions taken during the 1995-1996 debt ceiling crisis in relation to the normal policies and procedures Treasury uses for federal trust fund investments and redemptions, and
- analyze the financial aspects of the departures from the normal policies and procedures and assess their legal basis.

To develop a chronology of the significant events involving the 1995-1996 debt ceiling crisis, we obtained and reviewed applicable documents. We also discussed Treasury's actions during the crisis with Treasury officials.

To evaluate the actions taken during the 1995-1996 debt ceiling crisis in relation to the normal policies and procedures Treasury uses for federal trust fund investments, we obtained an overview of the procedures used. For the 15 selected trust funds, which are identified in chapter 3, we examined the significant transactions that affected the trust funds between November 1, 1995, and March 31, 1996. In cases where the procedures were not followed, we obtained documentation and other information to help understand the basis and impact of the alternative procedures that were used.

Although Treasury maintains accounts for over 150 different trust funds, we selected for review those with investments in Treasury securities that exceeded $8 billion on November 1, 1995. In addition, we selected the Exchange Stabilization Fund because Treasury used this fund in previous debt ceiling crises to help raise cash and stay under the debt ceiling. The funds we examined accounted for over 93 percent of the total securities held by these 150 trust funds as of October 31, 1995, and March 31, 1996.

To analyze the financial aspects of Treasury's departures from its normal polices and procedures, we (1) reviewed the methodologies Treasury developed to minimize the impact of such departures on the federal trust funds, (2) quantified the impact of the departures, and (3) assessed whether any interest losses were properly restored.

To assess the legal basis of Treasury's departures from its normal policies and procedures, we identified the applicable legal authorities and determined how Treasury applied them during the debt ceiling crisis. Our evaluation included those authorities relating to (1) issuing and redeeming Treasury securities during a debt issuance suspension period and restoring losses after a debt ceiling crisis has ended, (2) the ability to exchange Treasury securities held by the Civil Service fund for agency securities held by the FFB, and (3) the use of the Exchange Stabilization Fund during a debt ceiling crisis.

We also compiled and analyzed applicable source documents, including executive branch legal opinions, memos, and correspondence. We have provided these documents to the Committees' staffs.

We performed our work between November 9, 1995, and July 1, 1996. Our audit was performed in accordance with generally accepted government auditing standards. We requested oral comments on a draft of this report from the Secretary of the Treasury or his designee. On August 22, 1996, Treasury officials provided us with oral comments that generally agreed with our findings and conclusions. Their views have been incorporated where appropriate.

Chronology of Events

On August 10, 1993, the Congress raised the debt ceiling to $4.9 trillion, which was expected to fund government operations until spring 1995. In early 1995, analysts concluded that the debt ceiling would be reached in October 1995. This set the stage for the 1995-1996 debt ceiling crisis, which was resolved on March 29, 1996, when Congress raised the debt ceiling to $5.5 trillion.

The major actions taken by the Congress and the Executive Branch involving the 1995-1996 debt ceiling crisis are shown in table 2.1.

Table 2.1: Chronology of 1995-1996 Debt Ceiling Crisis Events

Date	Event
June 29, 1995	The Congress passed the Conference Report on the 1996 Budget Resolution, which called for a $5.5 trillion debt ceiling in order to fund government operations through fiscal year 1997.
July 17, 1995	The Secretary of the Treasury wrote to the congressional leadership calling for an increase in the debt ceiling before October 31, 1995.
September 18, 1995	The Secretary of the Treasury wrote to the congressional leadership urging an increase in the debt ceiling separate from the resolution of the budget debate.
October 17, 1995	Treasury announced that it would reduce by $7 billion the October 23, 1995, auction of 13-week Treasury bills in order to stay under the debt ceiling on October 31, 1996. Treasury also suspended foreign add-ons,[a] and the issuance of State and Local Government Series Treasury securities.
November 1, 1995	Treasury called back about $2.4 billion in Treasury cash balances from eight large banks. According to Treasury officials, these funds were received between November 2 and November 8, 1996.
November 6-8, 1995	Treasury postponed auctions of 3- and 10-year notes and 52- week bills.
November 10, 1995	The Congress passed a bill that increased the debt ceiling by $67 billion through December 12, 1995. The bill would have repealed the Secretary's authorities contained in 5 U.S.C. 8348 and 5 U.S.C. 8438. The authorities allow the Secretary to use the Civil Service fund and G-Fund to help discharge his financial management responsibilities during a debt ceiling crisis. This was vetoed on November 13, 1995.
November 15, 1995	The Secretary of the Treasury declared a 12-month debt issuance suspension period. This allowed Treasury to prematurely redeem Treasury securities held by the Civil Service fund and not reinvest a portion of the G-Fund. As a result, Treasury issued securities to the public to raise the cash needed to pay $24.9 billion in interest due on the public debt. (See chapters 4 and 5.)
November 30, 1995	The Congress passed the Balanced Budget Act of 1995. This increased the debt ceiling to $5.5 trillion. On December 6, 1995, the President vetoed this bill.
December 31, 1995	Treasury did not have sufficient room under the debt ceiling to invest about $14 billion in Civil Service fund receipts. The receipts were associated with semiannual interest payments made on trust fund holdings. (See chapter 4.)

(continued)

Date	Event
January 22, 1996	The Secretary of the Treasury notified the Congress that unless the debt ceiling was raised prior to February 15, 1996, Treasury would (1) suspend reinvestment of about $3.9 billion in the Exchange Stabilization Fund, (2) exchange about $9 billion of agency securities held by FFB for Treasury securities held by certain government trust funds, and (3) extend the debt issuance suspension period for 2 months and redeem about $6.4 billion of Treasury securities held by the Civil Service fund earlier than normal. In the letter, the Secretary stated that "I want to emphasize that we will have no other options that are both legal and prudent." (See chapters 4 and 5.)
February 8, 1996	The Congress authorized Treasury to issue about $29 billion of securities prior to March 1, 1996, in order to ensure that the March Social Security payments could be made (Public Law 104-103). These securities, when issued, would not count against the debt ceiling until March 15, 1996. (See chapter 5.)
February 14, 1996	The Secretary (1) authorized the suspension of reinvestment of maturing Treasury securities in the Exchange Stabilization Fund, (2) authorized the exchange of agency securities held by FFB for Treasury securities held by the Civil Service fund, and (3) extended the debt issuance suspension period by 2 months and authorized the redemption of an additional $6.4 billion of Treasury securities held by the Civil Service fund earlier than normal. (See chapters 4 and 5.)
February 23, 1996	Treasury issued about $29 billion of securities that did not count against the debt ceiling in accordance with Public Law 104-103. (See chapter 5.)
March 12, 1996	Public Law 104-115 was enacted which authorized Treasury to invest trust fund receipts in Treasury securities which did not count against the debt ceiling until March 30, 1996. In addition, it extended the exemption of the securities issued under Public Law 104-103 from counting against the public debt ceiling until March 30, 1996. (See chapter 5.)
March 29, 1996	The debt ceiling was raised to $5.5 trillion and Treasury began to restore the losses incurred by the Civil Service fund and G-Fund. (See chapter 6.)
June 30, 1996	Treasury completed the restoration of the losses incurred by the Civil Service fund. (See chapter 6.)

[a]Purchases of U.S. government securities made by foreign central banks and international organizations through the New York Federal Reserve Bank.

Normal Investment and Redemption Procedures Used for Most Trust Funds

Our analysis showed that, during the 1995-1996 debt ceiling crisis, Treasury used its normal investment and redemption procedures to handle the receipts and maturing investments and to redeem Treasury securities for 12 of the 15 trust funds we examined. These 12 trust funds accounted for about 65 percent, or about $871 billion, of the $1.3 trillion in Treasury securities held by the federal trust funds on October 31, 1995. The trust funds included in our analysis are listed in table 3.1.

Table 3.1: Trust Funds for Which Normal Investment and Redemption Procedures Were Used

Dollars in billions

Fund	Securities held on October 31, 1995
Federal Old Age and Survivors Insurance Trust Fund[a]	$445
Federal Hospital Insurance Trust Fund	128
Military Retirement Fund	121
Unemployment Trust Fund	47
Federal Disability Insurance Trust Fund[a]	35
Bank Insurance Fund	22
Employees Life Insurance Fund	16
Federal Supplementary Medical Insurance Trust Fund	14
National Service Life Insurance Fund	12
Railroad Retirement Account	12
Airport and Airways Trust Fund	11
Highway Trust Fund	8
Total	**$871**

[a]Social Security trust funds.

Trust funds which are allowed to invest receipts, such as the Social Security funds, normally invest them in nonmarketable Treasury securities. Under normal conditions, Treasury is notified by the appropriate agency of the amount that should be invested or reinvested, and Treasury then makes the investment. In some cases, the actual security that Treasury should purchase is also specified.

When a trust fund needs to pay benefits and expenses, Treasury is normally notified of the amount and the date that the disbursement is to be made. Depending on the fund, Treasury may also be notified to redeem specific securities. Based on this information, Treasury redeems a fund's securities.

Between November 15, 1995, and March 28, 1996, Treasury followed its normal investment and redemption policies for all of the trust funds shown in table 3.1. For example, during this period, Treasury invested about $156.7 billion and redeemed about $115.8 billion of Treasury securities on behalf of the Social Security funds and invested about $7.1 billion and redeemed about $6.8 billion of Treasury securities on behalf of the Military Retirement Fund.

The departures from normal investment and redemption procedures involving the other three trust funds (Civil Service fund, G-Fund, and Exchange Stabilization Fund), which held over $370 billion of Treasury securities on October 31, 1995, or about 28 percent of the Treasury securities held by all federal trust funds at that time, are discussed in chapters 4 and 5.

Actions Related to the Civil Service Fund

During the 1995-1996 debt ceiling crisis, the Secretary of the Treasury redeemed Treasury securities held by the Civil Service fund and suspended the investment of some Civil Service fund receipts. Also, Treasury exchanged Treasury securities held by the Civil Service fund for non-Treasury securities held by the FFB.

Statutory Authority Exercised to Redeem Treasury Securities Before Needed to Pay Trust Fund Benefits and Expenses

Subsection (k) of 5 U.S.C. 8348 authorizes the Secretary of the Treasury to redeem securities or other invested assets of the Civil Service fund before maturity to prevent the amount of public debt from exceeding the debt ceiling. The statute does not require that early redemptions be made only for the purpose of making Civil Service fund benefit payments. Furthermore, the statute permits the early redemptions even if the Civil Service fund has adequate cash balances to cover these payments. During November 1995 and February 1996 the Secretary of the Treasury redeemed about $46 billion of the Civil Service fund's Treasury securities before they were needed to pay for trust fund benefits and expenses.

Table 4.1 shows an example of the use of this procedure during the 1995-1996 debt ceiling crisis.

Table 4.1: How Redeeming Securities Earlier Than Normal Raises Cash

Date	Action	Effect on Treasury's cash	Effect on outstanding debt
November 15, 1995	Treasury redeems $11.9 billion of trust fund securities for benefit payments earlier than normal	None[a]	Reduces debt by $11.9 billion
November 15, 1995	Treasury issues $11.9 billion of securities to the public for cash	Increases cash by $11.9 billion	Increases debt by $11.9 billion

[a]When a trust fund redeems securities, Treasury promises to honor the instruments used to pay for the trust fund's benefits and expenses when they are presented for payment. Normally, to raise the cash necessary to honor these payments, Treasury issues securities to the public.

Determining Debt Issuance Suspension Period

Before redeeming Civil Service fund securities earlier than normal, the Secretary must first determine that a "debt issuance suspension period" exists. Such a period is defined as any period for which the Secretary has determined that obligations of the United States may not be issued without exceeding the debt ceiling. The statute authorizing the debt issuance suspension period and its legislative history are silent as to how to determine the length of a debt issuance suspension period.

On November 15, 1995, the Secretary declared a 12-month debt issuance suspension period. On February 14, 1996, the Secretary extended this period from 12 to 14 months.

The Secretary, in the November 15, 1995, determination, stated that a debt issuance suspension period existed for a period of 12 months "[b]ased on the information that is available to me today." A memorandum to the Secretary from Treasury's General Counsel provided the Secretary a rationale to support his determination. The memorandum noted that based on the actions of the Congress and the President and on public statements by both these parties, there was a significant impasse that made it unlikely that a statute raising the debt ceiling could be enacted. Furthermore, the positions of the President and the Congress were so firm that it seemed unlikely that an agreement could be reached before the next election, which was 12 months away.

The Secretary extended the debt issuance suspension period by 2 months on February 14, 1996. Treasury's General Counsel again advised the Secretary concerning the reasons underlying the extension and noted that nothing had changed since November to indicate that the impasse was any closer to being resolved. The General Counsel further reasoned that it would take until January 1997 for a newly elected President or a new Congress to be able to enact legislation raising the debt ceiling.

Determining the Amount of Treasury Security Redemptions

On November 15, 1995, the Secretary authorized the redemption of $39.8 billion of the Civil Service fund's Treasury securities, and on February 14, 1996, authorized the redemption of another $6.4 billion of the fund's Treasury securities. The total, $46 billion of authorized redemptions was determined based on (1) the 14-month debt issuance suspension period determination made by the Secretary (November 15, 1995, through January 15, 1997) and (2) the estimated monthly Civil Service fund benefit payments. Treasury considered appropriate factors in determining the amount of Treasury securities to redeem early.

About $39.8 billion of these securities were redeemed between November 15 and 30, 1995. Then, in December 1995, Treasury's cash position improved for a few days, primarily because of the receipt of quarterly estimated tax payments due in December. This inflow of cash enabled

Treasury to reinvest, in late December 1995, about $21.2 billion in securities that had the same terms and conditions as those that were redeemed in November. However, because of Treasury's deteriorating cash position, these securities were again redeemed by the end of December. Finally, between February 15 and 20, 1996, an additional $6.4 billion in Treasury securities held by the Civil Service fund were redeemed.

Statutory Authority Used to Suspend Investment of Receipts

Subsection (j) of 5 U.S.C. 8348 authorizes the Secretary of the Treasury to suspend additional investment of amounts in the Civil Service fund if such investment cannot be made without causing the amount of public debt to exceed the debt ceiling. Between November 15, 1995, and March 29, 1996, the Civil Service fund had about $20 billion in receipts.

In all but one case, Treasury used its normal investment policies to handle the trust fund's requests to invest these receipts. The exception involved the trust fund's December 31, 1995, receipt from Treasury of a $14 billion semiannual interest payment on the fund's securities portfolio. The Secretary determined that investing these funds in additional Treasury securities would have caused the public debt to exceed the debt ceiling and, therefore, suspended the investment of these receipts.

Uninvested Receipts Were Used to Pay Benefits and Expenses

During the debt ceiling crisis, about $6.3 billion of the Civil Service fund's uninvested receipts were used to pay for the trust fund's benefits and expenses. Normally, government trust funds that are authorized to invest in Treasury securities do not have uninvested cash—all of a trust fund's receipts that are not needed to pay for benefits and expenses are invested.[1] In the case of the Civil Service fund, when a redemption is necessary, Treasury's stated policy is to redeem the securities with the shortest maturity first. Should a group of securities have the same maturity date, but different interest rates, the securities with the lowest interest rate are redeemed first.[2]

During previous debt ceiling crises, Treasury's actions resulted in uninvested cash.[3] The uninvested cash not only required restoring lost

[1]Because Treasury securities are issued in $1,000 increments, an agency may have less than $1,000 uninvested at any given point in time. Although the fund may have less than $1,000 of uninvested cash, the fund is considered fully invested.

[2]In this report, we refer to this policy as "redeeming securities with the lowest interest rate first."

[3]Civil Service Fund: Improved Controls Needed Over Investments (GAO/AFMD-87-17, May 7, 1987).

investment interest but also affected the normal method Treasury uses to determine securities to redeem to pay for trust fund benefits and expenses.

Accordingly, in 1989, Treasury developed policies and procedures for determining when uninvested trust fund cash should be used to pay trust fund benefits and expenses and used these policies during the 1995-1996 debt ceiling crisis. Overall, Treasury's policy continued to be to redeem the securities with the lowest interest rate first. However, in making this determination, uninvested cash is treated as though it had been invested in Treasury securities. These procedures are presented in table 4.2.

Table 4.2: Procedures Used to Determine When Uninvested Cash Should Be Used to Pay Fund Benefits and Expenses

Event	Action
Treasury decides not to invest trust fund receipts.	Treasury determines how the uninvested receipts would have been invested and the date the funds would have been invested. For example, the receipts might have been invested on December 31 in a 6-percent security maturing on June 30, 1996.
Trust fund benefits and expenses need to be paid.	Treasury determines the securities with the lowest interest rate and redeems the amount necessary to pay the trust fund's benefits and expenses, which is essentially Treasury's normal redemption policy. In making this determination, the uninvested cash is considered as having been "invested."
"Securities" with the lowest interest rate are comprised of actual securities and uninvested cash.	Once the securities that should be redeemed are identified, Treasury then determines the actual "investment dates" for each investment. (This includes the uninvested cash.) In accordance with its normal procedures, the earliest investment is redeemed first to make benefit and expense payments.

The following illustrates how this policy was implemented. On January 2, 1996, Treasury needed about $2.6 billion to pay fund benefits and expenses for the Civil Service fund. To make these payments, it redeemed or used

- $43 million of the fund's Treasury securities which carried an interest rate of 5-7/8 percent and matured on June 30, 1996;
- $815 million of the fund's Treasury securities which carried an interest rate of 6 percent and matured on June 30, 1996 (these securities were redeemed first since the $815 million had been invested prior to December 31, 1995); and
- $1.7 billion of uninvested cash since the uninvested cash, if normal procedures had been followed, would have been invested on December 31, 1995, in 6 percent securities maturing on June 30, 1996.

Treasury Securities Exchanged for Non-Treasury Securities Held by FFB

On February 14, 1996, about $8.6 billion in Treasury securities held by the Civil Service fund were exchanged for agency securities held by FFB. FFB[4] used the Treasury securities it received in this exchange to repay some of its borrowings from Treasury. Since the Treasury securities provided by the Civil Service fund had counted against the debt ceiling, reducing these borrowings resulted in a corresponding reduction in the public debt subject to the debt ceiling. Thus, Treasury could borrow additional cash from the public.

Selecting and Valuing the Securities Exchanged

The decision to exchange Treasury securities held by the Civil Service fund for non-Treasury securities held by FFB required Treasury to determine (1) which non-Treasury securities were eligible for the exchange and (2) how to value the securities so that the exchange was fair to both the Civil Service fund and FFB. Treasury's objective was to ensure that the securities that were exchanged were of equal value and that the Civil Service fund would not incur any long-term loss.

Regarding the first issue, the law governing the Civil Service fund does not specifically identify which securities issued by an agency can be purchased. However, the laws authorizing the Postal Service and the Tennessee Valley Authority to issue securities state that these securities are lawful investments of the federal trust funds (39 U.S.C. 2005(d)(3) and 16 U.S.C. 831n-4(d)).

Regarding the second issue, the Treasury securities held by the Civil Service fund and the non-Treasury securities held by FFB had different terms and conditions; thus complicating the task of valuing the securities. For example, most of the Treasury securities held by the Civil Service fund mature on June 30 of a given year and can be redeemed at par when needed to pay benefits and expenses. None of the agency securities held by FFB, and selected by Treasury for the exchange transaction, matured on June 30 and, if redeemed[5] before maturity, the redemption price would be based on market interest rates.

[4]FFB was established, in part, to eliminate the need for agencies to issue securities in the public market. It lends funds to and purchases securities issued by certain federal agencies, such as the Postal Service and the Tennessee Valley Authority, to finance their operations. Since Treasury borrows to provide funds to FFB, the agency debt to FFB are translated into debt subject to the debt ceiling. On September 30, 1995, the FFB's assets were about $87 billion.

[5]If these securities are needed to pay benefits and expenses before maturity, then the Civil Service fund would "redeem" them by selling them back to FFB.

Because the effects of these differences can be significant, a methodology was needed to determine the proper valuation for the securities that would be exchanged. Therefore, Treasury used a generally accepted methodology to compute the value of each portfolio. Examples of factors used in this methodology include (1) the current market rates for outstanding Treasury securities at the time of the exchange, (2) the probability of changing interest rates, (3) the probability of the agency paying off the debt early, and (4) the premium that the market would provide to a security that could be redeemed at par regardless of the market interest rates.

Treasury obtained the opinion of an independent third party to determine whether its valuations were accurate. Our review of the consultant's report showed that the consultant (1) identified the characteristics of each security to be exchanged, (2) reviewed the pricing methodology to be used, (3) calculated the value of each security based on the pricing methodology, and (4) reviewed the terms and conditions of the exchange agreement. The consultant concluded that the exchange was fair. Due to the complexity of the consultant's computations and the large number of securities exchanged, we did not independently verify the consultant's conclusion. The factors included in Treasury's methodology and the consultant's analysis were appropriate for assessing the exchange.

Conclusions

Treasury's actions during the 1995-1996 debt ceiling crisis involving the Civil Service fund were in accordance with statutory authority provided by the Congress and the administrative policies and procedures established by Treasury. These actions helped the government to avoid default on its obligations and to stay within the debt ceiling. Specifically, we conclude the following:

- Based on the information available to the Secretary when the November 15, 1995, and February 14, 1996, debt issuance suspension period determinations were made, the Secretary's determinations were not unreasonable.
- Treasury considered appropriate factors in determining the amount of Treasury securities to redeem early.
- The Secretary acted within the authorities provided by law when suspending the investment of Civil Service fund receipts.
- Treasury's policies and procedures regarding the uninvested funds are designed primarily to facilitate the restoration of fund losses when Treasury does not follow its normal investment and redemption policies

and procedures. They also provide an adequate basis for considering the uninvested receipts in determining the securities to be redeemed to pay Civil Service fund benefits and expenses during the debt ceiling crisis.

- The agency securities used in the exchange between the Civil Service fund and FFB were lawful investments for the Civil Service fund. In addition, by having an independent verification of the value of the exchanged securities, Treasury helped to ensure that both the Civil Service fund and FFB were treated equitably in the exchange.

Other Actions to Stay Within the Debt Ceiling

In addition to the actions involving the Civil Service fund, during the 1995-1996 debt ceiling crisis, the Secretary of the Treasury (1) suspended the investment of G-Fund receipts and (2) did not reinvest some of the Exchange Stabilization Fund's maturing securities. Also, the Congress authorized Treasury to issue selected securities that were temporarily exempted from being counted against the debt ceiling. These actions also assisted Treasury in staying under the debt ceiling.

Statutory Authority Allowed Suspension of G-Fund Investments

Subsection (g) of 5 U.S.C. 8438 authorizes the Secretary of the Treasury to suspend the issuance of additional amounts of obligations of the United States to the G-Fund if such issuance cannot be made without causing the amount of public debt to exceed the debt ceiling. Each day, between November 15, 1995, and March 18, 1996, Treasury determined the amount of funds that the G-Fund would be allowed to invest in Treasury securities and suspended the investment of G-Fund receipts[1] that would have resulted in exceeding the debt ceiling.

On November 15, 1995, when the Secretary determined a debt issuance suspension period, the G-Fund held about $21.6 billion of Treasury securities maturing on that day. In order to meet its cash needs, Treasury did not reinvest about $18 billion of these securities. Until March 19, 1996, the amount of the G-Fund's receipts that Treasury invested changed daily depending on the amount of the government's outstanding debt.

Although Treasury can accurately predict the result of some of these factors affecting the outstanding debt, the result of others cannot be precisely determined until they occur. For example, the amount of securities that Treasury will issue to the public from an auction can be determined some days in advance because Treasury can control the amount that will actually be issued. On the other hand, the amount of savings bonds that will be issued and of securities that will be issued to, or redeemed by, various government trust funds are difficult to predict.

Because of these difficulties, Treasury needed a way to ensure that the government's trust fund activities did not cause the debt ceiling to be exceeded and also to maintain normal trust fund investment and redemption policies. To do this, each day during the debt ceiling crisis, Treasury

[1]The G-Fund normally invests in Treasury securities which mature the next business day.

- calculated the amount of public debt subject to the debt ceiling, excluding the funds that the G-Fund would normally invest;
- determined the amount of G-Fund receipts that could safely be invested without exceeding the debt ceiling and invested this amount in Treasury securities; and
- suspended investment of the G-Fund's remaining funds.

For example, on January 17, 1996, excluding G-Fund transactions, Treasury issued about $17 billion and redeemed about $11.4 billion of securities that counted against the debt ceiling. Since Treasury had been at the debt ceiling the previous day, Treasury could not invest the entire amount ($21.8 billion) that the G-Fund had requested without exceeding the debt ceiling. As a result, the $5.6 billion difference was added to the amount of uninvested G-Fund receipts and raised the amount of uninvested funds for the G-Fund to $7.2 billion on that date. Interest on the uninvested funds was not paid until the debt ceiling crisis ended.

Exchange Stabilization Fund's Maturing Investments Not Reinvested

On several occasions between February 21 and March 12, 1996, Treasury did not reinvest some of the maturing securities held by the Exchange Stabilization Fund. Because the Fund's securities are considered part of the government's outstanding debt subject to the debt ceiling, when the Secretary does not reinvest the Fund's maturing securities, the government's outstanding debt is reduced.

The purpose of the Exchange Stabilization Fund is to help provide a stable system of monetary exchange rates. The law establishing the Fund authorizes the Secretary to invest Fund balances not needed for program purposes in obligations of the federal government. This law also gives the Secretary the sole discretion for determining when, and if, the excess funds will be invested. During previous debt ceiling crises, Treasury exercised the option of not reinvesting the Fund's maturing Treasury securities, which enabled Treasury to raise additional cash and helped the government stay within the debt ceiling limitation.

Legislation Enacted to Issue Securities Not Counted Toward the Debt Ceiling

In other actions to stay within the debt ceiling, the Congress passed legislation allowing Treasury to issue some Treasury securities that were temporarily exempted from being counted against the debt ceiling.

Exempting Securities Issued to Ensure Social Security Benefit Payments

During January 1996, Treasury's cash position continued to deteriorate. The Secretary notified the Congress that, unless the debt ceiling was raised before the end of February 1996, Social Security and other benefit payments could not be made in March 1996.

Under normal procedures, monthly Social Security benefits are paid by direct deposit on the third day of each month.[2] Because checks take a period of time to clear, Treasury only redeems securities equal to the amount of benefits paid by direct deposit on this date. The securities necessary to pay the benefits made by check are redeemed on the third and fourth business day after the payments are made. This sequencing is designed to allow the fund to earn interest during the average period that benefit checks are outstanding but not cashed (the so-called "float period"). For Social Security payments, the check float period is about 3.6 days.

According to Treasury officials, they may need to raise the actual cash needed to pay these benefits several days before the payments are made since the check float is an average. For example, some checks may clear the next business day while others may clear several days after the securities are redeemed. Under normal conditions, this is not a problem since Treasury is free to issue the securities to raise the necessary cash without worrying about when the trust fund securities will be redeemed.

To ensure that these benefits would be paid on time, on February 8, 1996, the Congress provided Treasury with the authority (Public Law 104-103) to issue securities in an amount equal to the March 1996 Social Security payments. Further, this statute provided that the securities issued under its provisions were not to be counted against the debt ceiling until March 15, 1996, which was later extended to March 30, 1996.

The special legislation did not create any long-term borrowing authority for Treasury since it only allowed Treasury to issue securities that, in effect, would be redeemed in March 1996. However, it allowed Treasury to

[2] If the third day is a weekend or holiday, then the payment date is moved up to the first business day preceding it.

raise significant amounts of cash. This occurred because March 15, 1996—the date initially established in the special legislation for which this debt would be counted against the debt ceiling—was later than the date that most of the securities would have been redeemed from the trust fund under normal procedures.

On February 23, 1996, Treasury issued these securities. Following normal redemption policies, Treasury redeemed about $29 billion of Treasury securities from the Social Security fund for the March benefit payments. Since the majority of the Social Security fund payments are made at the beginning of the month, by March 7, 1996, Treasury had redeemed about $28.3 billion of the trust fund's Treasury securities. This lowered the amount of debt subject to the limit, and Treasury was able to issue securities to the public for cash or invest trust funds receipts—as long as they were issued before March 15, 1996. Therefore, Treasury could raise an additional $28.3 billion in cash because of the difference in timing between when the securities could be issued (March 15, 1996) and when they were redeemed to pay fund benefits and expenses. According to Treasury officials, during the 1995-1996 debt ceiling crisis, this flexibility allowed Treasury to raise about $12 billion of cash. The remaining capacity was used to invest trust fund receipts.

According to Treasury officials, this was the first time that Treasury had been provided with this kind of authority during a debt ceiling crisis. Providing this legislation was important because during a debt ceiling crisis, Treasury may not be free to issue securities in advance to raise the necessary cash.

Without this legislation, Treasury would have had at least the following three choices, of which only the first would have been practical.

- Trust fund securities could have been redeemed earlier than normal. This action was used in the 1985 debt ceiling crisis to make benefit payments for the Social Security and Civil Service funds. In exercising this option, securities could have been redeemed on the same day that a like amount of securities were issued to the public for cash; these issues would have had no effect on the amount of debt subject to the debt ceiling. However, since the securities would have been redeemed earlier than normal, the trust fund would have lost interest income. In the case of the Social Security funds, such a loss could not be restored without special legislation.

- The government could have not paid the benefits. This option would have resulted in the government not meeting an obligation, which it has never done.
- Treasury could have issued additional securities, which would have caused the debt ceiling to be exceeded, in violation of the law, and raised legal issues concerning the validity of the securities as obligations of the United States. According to Treasury officials, Treasury has never issued securities that would cause the debt ceiling to be exceeded. We reviewed Treasury reports and confirmed that, at least since July 1, 1954, that this statement was correct.

Exempting Some Government Trust Fund Investments and Reinvestments

On March 12, 1996, the Congress enacted Public Law 104-115 which exempted government trust fund investments and reinvestments from the debt ceiling until March 30, 1996. Under the authority provided by this statute, between March 13 and March 29, 1996, Treasury issued about $58.2 billion in Treasury securities to government trust funds as investments of their receipts or reinvestments of their maturing securities. In addition, using its normal redemption policies, Treasury redeemed significant amounts of Treasury securities, which counted against the debt ceiling, held by various government trust funds to pay for benefits and expenses. Thus, Treasury was provided the ability to raise significant amounts of cash because these actions reduced the amount of public debt subject to the debt ceiling.

To designate government trust fund investments that were not considered subject to the debt ceiling, Treasury issued special Treasury securities. This enabled Treasury, at the time a trust fund redemption was made, to identify whether the redemption lowered the amount of outstanding debt subject to the debt ceiling.

For example, on March 12, 1996, the Civil Service fund invested about $100 million in Treasury securities that were counted against the debt ceiling and on March 14, 1996, invested about $184 million in Treasury securities that were exempt. Therefore, if on March 19, 1996, using normal procedures, Treasury redeemed the trust fund's Treasury securities to pay for benefits and expenses, it would know whether, or how much of, the redemption reduced outstanding securities subject to the debt ceiling.

A similar determination could also be made for securities that were reinvested. For example, on March 12, 1996, the Postal Service fund had about $1.2 billion in maturing securities that were subject to the debt ceiling. These funds were reinvested in securities that matured the next business day and were not subject to the debt ceiling. As a result, the amount of debt subject to the debt ceiling decreased by this amount, thus enabling Treasury to issue additional securities to the public for cash. On March 14, 1996, this reinvestment matured and was again reinvested. This transaction did not change the amount of securities subject to the debt ceiling because the maturing securities did not count against the debt ceiling when they were issued.

Conclusions

During the 1995-1996 debt ceiling crisis, Treasury acted in accordance with statutory authorities when it (1) suspended some investments of the G-Fund, (2) exercised its discretion in not reinvesting some of the Exchange Stabilization Fund's maturing Treasury securities, and (3) issued certain Treasury securities to government trust funds without counting them toward the debt ceiling.

Government Debt Increased and Most Fund Losses Were Restored

During the 1995-1996 debt ceiling crisis, Treasury did not exceed the $4.9 trillion debt ceiling limitation established in August 1993. However, Treasury's actions during the crisis resulted in the government incurring about $138.9 billion in additional debt that would normally have been considered as subject to the debt ceiling. Several of Treasury's actions during the debt ceiling crisis also resulted in interest losses to certain government trust funds.

Substantial Additional Debt Incurred During Debt Ceiling Crisis

Our analysis showed that, because of several of the actions discussed in chapters 4 and 5, the government incurred about $138.9 billion in debt that Treasury would have normally included in calculating debt subject to the debt ceiling. The methods of financing this additional debt are presented in table 6.1.

Table 6.1: Debt Incurred During 1995-1996 Debt Ceiling Crisis Normally Considered Subject to the Debt Ceiling

Dollars in billions

	Amount
Treasury securities held by the Civil Service fund that were redeemed earlier than normal	$ 46.2
Exchanging Treasury securities held by the Civil Service fund for agency securities held by FFB	8.6
Securities issued to pay the March 1996 Social Security payments	29.0
Investing trust fund receipts and reinvestments that were not counted against the debt ceiling	58.2
Restoration of interest losses that would have been invested prior to March 29, 1996, had normal procedures been used	0.5
Difference between the outstanding debt subject to the limit on November 15, 1995, and March 28, 1996	(3.6)
Total	**$138.9**

It was necessary for Treasury to issue debt to raise the funds necessary to honor authorized government obligations. Consequently, actions by the Congress and Treasury during the 1995-1996 debt ceiling crisis allowed Treasury to avoid defaulting on government obligations while staying under the debt ceiling.

On March 29, 1996, legislation was enacted to raise the debt ceiling to $5.5 trillion, which ended the debt ceiling crisis. The legislation enabled Treasury to resume its normal issuance and redemption of trust fund securities and, where statutorily allowed, to begin restoring the interest losses government trust funds incurred during the debt ceiling crisis.

Passage of this legislation was inevitable; without it, the federal government's ability to operate was jeopardized. The level of the public debt is determined by the government's prior spending and revenue decisions along with the performance of the economy. In 1979,[1] we reported that debt ceiling increases were needed simply to allow borrowing adequate to finance deficit budgets which had already been approved.

Restoration of Trust Fund Losses

Restoring Civil Service Fund Losses

The Civil Service fund incurred $995 million in interest losses during the 1995-1996 debt ceiling crisis. In 5 U.S.C. 8348, the Congress recognized that the Civil Service fund would be adversely affected if Treasury exercised its authority to redeem Treasury securities earlier than normal or failed to promptly invest trust fund receipts. To ensure that the fund would not have long-term losses, the Congress provided Treasury with the authority to restore such losses once a debt ceiling crisis was resolved.

Under this statute, Treasury took the following actions once the debt ceiling crisis had ended.

- Treasury reinvested about $46 billion in Treasury securities which had the same interest rates and maturities as those redeemed during November 1995 and February 1996. We verified that, after this transaction, the Civil Service fund's investment portfolio was, in effect, the same as it would have been had Treasury not redeemed these securities early.
- Treasury issued about $250.2 million in Treasury securities to cover the interest that would have been earned through December 31, 1995, on the securities that were redeemed in November 1995. Treasury issued these securities to replace securities that would otherwise have been issued to the fund if normal investment polices had been followed.
- Treasury issued about $33.7 million in Treasury securities associated with the benefit payments made from the Civil Service fund's uninvested cash balances from January 1996 through March 29, 1996. We verified that, in completing this transaction, Treasury calculated the amount of securities

[1]A New Approach to The Public Debt Legislation Should Be Considered (FGMSD-79-58, September 7, 1979).

that would have been contained in the Civil Service fund's portfolio had normal investment and redemption policies been followed.

Also, between December 31, 1995, and March 29, 1996, the Civil Service fund's Treasury securities that were redeemed early did not earn about $711 million in interest, as required by law. Treasury restored this lost interest on June 30, 1996, when the semiannual interest payment for these securities would have been paid if normal procedures had been followed.

Restoring G-Fund Losses

Between November 15, 1995, and March 29, 1996, the G-Fund lost about $255 million in interest because its excess funds were not fully invested. As discussed in chapter 5, the amount of funds invested for the G-Fund fluctuated daily during the debt ceiling crisis, with the investment of some funds being suspended.

In 5 U.S.C. 8438(g) the Congress recognized that the G-Fund would be adversely affected if Treasury exercised its authority to suspend G-Fund investments. To ensure that the Fund would not have long-term losses, the Congress provided Treasury with the authority to restore such losses once a debt ceiling crisis was resolved.

When the debt ceiling was raised, Treasury restored the lost interest on the G-Fund's uninvested funds. Consequently, the G-Fund was fully compensated for its interest losses during the 1995-1996 debt ceiling crisis.

Exchange Stabilization Fund Losses

During the 1995-1996 debt ceiling crisis, the Exchange Stabilization Fund lost about $1.2 million in interest. As discussed in chapter 5, these losses occurred because Treasury, to avoid exceeding the debt ceiling, did not reinvest some of the maturing Treasury securities held by the Exchange Stabilization Fund.

Treasury officials said that the Fund's losses could not be restored without special legislation authorizing Treasury to do so. They said further that such legislation was not provided during the 1995-1996 debt ceiling crisis. Consequently, without specific legal authority, Treasury cannot restore the Exchange Stabilization Fund's losses. As of August 1, 1996, Treasury had no plans to seek such statutory authority.

Conclusions

During the 1995-1996 debt ceiling crisis, the federal government's debt increased substantially. Under normal procedures, this debt would have been considered in calculating whether the government was within the debt ceiling.

Regarding restoration of the Civil Service fund, Treasury restored the securities that would have been issued had a debt issuance suspension period not occurred and the interest losses. Treasury's restoration actions will eliminate any long-term losses to the Civil Service fund.

Also, Treasury restored the G-Fund's interest losses, ensuring that the G-Fund will not incur any long-term adverse affects from Treasury's actions.

Regarding the Exchange Stabilization Fund, Treasury cannot restore the $1.2 million in interest losses resulting from the Secretary's decision not to reinvest the Fund's maturing Treasury securities without special statutory authority.

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