

# GAO Highlights

Highlights of [GAO-15-476](#), a report to the Congress.

## Why GAO Did This Study

GAO prepared this report as part of its continuing efforts to assist Congress in identifying and addressing debt management challenges related to delays in raising the debt limit. This report examines the effect of delays in raising the debt limit in 2013 on (1) the broader financial system and (2) Treasury debt and cash management and (3) examines alternative approaches to delegating borrowing authority that could minimize future disruptions. To address these objectives, GAO interviewed Treasury officials and market participants across different sectors and analyzed financial market data. GAO also hosted a private online forum where experts provided input on different proposals.

## What GAO Recommends

To avoid disruptions to the Treasury market and to help inform fiscal policy debate in a timely way, Congress should consider alternative approaches that better link decisions about the debt limit with decisions about spending and revenue at the time those decisions are made, such as those described in this report. However, if Congress chooses to continue to temporarily suspend the debt limit, it should consider providing Treasury with more flexibility than provided under the current approach, which effectively requires Treasury to return its cash balance to roughly the same level it was immediately prior to the suspension.

Treasury agreed with GAO's findings regarding the effects of the debt limit on financial markets and indicated that it saw advantages in the alternative approaches described in this report.

View [GAO-15-476](#). For more information, contact Susan J. Irving at (202) 512-6806 or [irvings@gao.gov](mailto:irvings@gao.gov).

July 2015

## DEBT LIMIT

### Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches

## What GAO Found

During the 2013 debt limit impasse, investors reported taking the unprecedented action of systematically avoiding certain Treasury securities—those that matured around the dates when the Department of the Treasury (Treasury) projected it would exhaust the extraordinary measures that it uses to manage federal debt when it is at the limit. For the affected Treasury securities, these actions resulted in both a dramatic increase in rates and a decline in liquidity in the secondary market where securities are traded among investors. In addition, there were also unusually low levels of demand at the relevant auctions and additional borrowing costs to Treasury. Treasury securities are one of the lowest cost and widely used forms of collateral for financial transactions, and because of this, disruptions to the Treasury market from the 2013 debt limit impasse extended into other markets, such as short-term financing.

Investors told GAO that they are now prepared to take similar steps to systematically avoid certain Treasury securities during future debt limit impasses. Market participants with whom GAO spoke said market reaction to future impasses could be more severe, in part because of changes in market practices since the financial crisis and in part because of contingency plans that many investors now have in place. Separately, there was an effort across the financial sector to develop a contingency plan to address the potential of a delayed Treasury payment, although industry groups emphasized that even a temporary delay in payment could undermine confidence in the full faith and credit of the United States and therefore cause significant damage to markets for Treasury securities and other assets. This would affect not only institutions, but also individuals.

While increased rates on Treasury securities in the secondary market affect the amount of return on investment for private investors, changes in the rates paid at Treasury auctions affect the amount that Treasury—and ultimately the American taxpayer—pays in interest on federal debt. GAO's analysis indicates that the additional borrowing costs that Treasury incurred rose rapidly in the final weeks and days leading up to the October 2013 deadline when Treasury projected it would exhaust its extraordinary measures. GAO estimated the total increased borrowing costs incurred through September 30, 2014, on securities issued by Treasury during the 2013 debt limit impasse. These estimates ranged from roughly \$38 million to more than \$70 million, depending on the specifications used.

Recently, Congress has temporarily suspended the debt limit. At the end of past debt limit suspensions, Treasury sharply reduced its cash balance to match the cash that it had on hand just prior to each suspension to ensure that it complied with legal limitations. Treasury reduced its cash balance in part by reducing the amount of Treasury bills outstanding, which can be disruptive to markets that transact in Treasury bills. Further, maintaining low levels of cash, even temporarily, conflicts with Treasury's new policy to hold more cash to mitigate the risk that Treasury will be unable to access funding markets due to unforeseen events—such as natural disasters—as recommended by the Treasury Borrowing Advisory Committee. Managing cash balances at a prudent level is consistent with standards for internal control on responding to risk.

Through interviews of budget and policy experts and an interactive web forum, GAO identified three potential approaches to delegating borrowing authority. Each option met the criteria of (1) minimizing disruptions to the market and (2) linking decisions about debt to decisions about spending and revenue at the time that those decisions are made. All of the options also maintain congressional control and oversight over federal borrowing.

### **Option 1: Link Action on the Debt Limit to the Budget Resolution**

This is a variation of a previously used approach under which legislation raising the debt limit to the level envisioned in the Congressional Budget Resolution would be spun off and either be deemed to have passed or be voted on immediately thereafter.

### **Option 2: Provide the Administration with the Authority to Increase the Debt Limit, Subject to a Congressional Motion of Disapproval**

This is a variation of an approach contained in the Budget Control Act of 2011. Congress would give the administration the authority to propose a change in the debt limit, which would take effect absent enactment of a joint resolution of disapproval within a specified time frame.

### **Option 3: Delegating Broad Authority to the Administration to Borrow as Necessary to Fund Enacted Laws**

This is an approach used in some other countries: delegate to the administration the authority to borrow such sums as necessary to fund implementation of the laws duly enacted by Congress and the President. Since laws that affect federal spending and revenue that create the need for debt already require adoption by the Congress, Congress would still maintain control over the amount of federal borrowing.

### **Option 1: Link Action on the Debt Limit to the Budget Resolution**

Possible design outcomes include

- making clear the relationship between spending and revenue decisions in the budget resolution and the debt implied by those decisions;
- giving Congress the ability to take more immediate action to affect debt by incorporating changes to revenue and spending at the time that Congress passes its annual budget plan; and
- minimizing potential disruptions to the market by shifting the timing of the debate so that it occurs before debt is already at the limit;

Design issues to consider include (1) how should the debt limit be linked to the budget resolution and how would voting occur, and (2) how should this policy account for legislative and economic changes not included in the budget resolution.

### **Option 2: Provide the Administration with the Authority to Increase the Debt Limit, Subject to a Congressional Motion of Disapproval**

Possible design outcomes include

- preserving Congress's ability to directly debate the current trajectory of federal debt;
- reducing the likelihood of market disruption and damage to the economy by changing the results of a lack of congressional action from a potential default to a debt limit increase;
- being viewed by some as insufficiently linking congressional decisions about spending and revenue to the impact on debt.

Design issues to be considered include (1) should Congress specify criteria or require accompanying explanatory information for proposed debt limit increases and, if so, what should they be; and (2) how should Congress structure the vote on a joint resolution of disapproval, including how much time Congress should be afforded to debate and pass a motion of disapproval before a change to the debt limit takes effect.

### **Option 3: Delegating Broad Authority to the Administration to Borrow as Necessary to Fund Enacted Laws**

Possible design outcomes include

- removing the dangers that accompany the fear of default by the U.S. government by ensuring Treasury has the authority it needs to borrow to fund all previously authorized spending;
- permitting flexibility with respect to changes in the economy and legislation; and
- being viewed by some as having not enough focus on the link between spending and revenue decisions and the level of debt incurred.

Design issues to be considered include (1) what form should congressional oversight of Treasury debt management take in light of this delegation of authority; and (2) what reports might be required from Treasury, and at what frequency.