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The Debt Limit: The Need to Raise It After Four Years of Surpluses

Philip D. Winters
Analyst in Government Finance
Government and Finance Division

Summary

The statutory debt limit applies to over 99% of all federal debt, both that held by the government accounts (which are mostly federal trust funds) or by the public (any individual or entity that is not the federal government). The government's overall surplus or deficit affects only the change in debt held by the public; changes in debt held by government accounts result from surpluses or deficits credited to the accounts themselves and the government's accounting practices.

Federal debt subject to limit reached the current statutory debt limit in mid-May 2002 in spite of the four previous fiscal years (1998-2001) of overall government surpluses. The surpluses reduced federal debt held by the public but had no effect on the ongoing increases in federal debt held by federal government accounts, such as the Social Security, Medicare, Transportation, and Civil Service trust funds.

In the fall of 2001, the Administration indicated that the government would likely have a deficit in FY2002, increasing the chances that the debt limit would be reached substantially sooner than previously forecast. As a result, in December 2001, the Administration asked Congress to increase the current $5.95 trillion debt ceiling by $750 billion. The growth in the expected deficit for the year has been reflected in the accelerated growth in debt held by the public. The Treasury indicated (May 14) that it will run out of alternative financing options by late June, possibly leading to a government default. (This report will be updated as events warrant.)

The statutory debt limit applies to almost all federal debt.[1] It applies to federal debt held by the public, that is debt held outside the federal government itself, and to federal debt held by the government's own accounts, almost all of which are federal trust funds such as Social Security, Medicare, Transportation, and Civil Service. The government's

[1] When measured on a similar basis, less than one percent of total federal debt is excluded from debt limit coverage. At the end of April 2002, total federal debt was $5.952 trillion; debt subject to limit was $5.915 trillion, 99.4% of the total debt.

overall surpluses or deficits determine the change in debt held by the public. Debt held in government accounts, on the other hand, is unaffected by the government's overall budget balance. The increases or decreases in debt held by government accounts are the product of government accounting practices and the reported surpluses (or deficits) of the accounts holding the debt.

Nearing or reaching the debt limit interferes with the Treasury's normal ability to finance federal activities or meet government obligations. If the Treasury cannot issue new debt (the effect of reaching the limit), the government may be unable to obtain the cash needed to pay its bills (when the government is operating with a deficit). The Treasury may also be unable to invest the surpluses of designated government accounts (the federal trust funds) in federal debt as generally required by law. In either case, the Treasury is in a bind; it is required by law to continue meeting the government's legal obligations, but the debt limit may keep it from issuing debt that would allow it to do so.

The primary factor generating the current pressure on the debt limit is the $853 billion growth in federal debt held by the government's own accounts over the last four years (FY1998 through FY2001). Over the same four years, debt held by the public fell by $448 billion (see Table 1).[2] The combination raised the total debt subject to limit by $405 billion between the end of fiscal year 1997 and the end of fiscal year 2001, moving it within $220 billion of the existing $5.95 trillion statutory debt limit.[3] During FY2002, debt subject to limit has increased by $217 billion, divided between an increase of $117 billion in debt held by government accounts and an increase of $100 billion in debt held by the public (through May 31, 2002).

On April 4, 2002, the Treasury, to avoid exceeding the limit, used authority provided through legislation to suspend reinvestment of government securities (debt) in the G-Fund of the federal employees' Thrift Savings Plan. The Treasury exchanged between $5 billion and $35 billion in federal securities for the same amount of credit balances. This action lowered the amount of debt subject to limit and allowed the Treasury to sell debt to the public for cash necessary to pay the government's bills. On April 16, after the influx of the April 15th tax revenues, the Treasury "made whole" the G-Fund by restoring all the debt not invested over this period and crediting the fund with interest it would have earned on that debt.[4] (As the Treasury awaited the influx of tax payments due on April 15, the debt subject to limit stood at $5,949,975 million, less than $25 million below the limit.) By the end of April and after the tax payments in mid-April, debt subject to limit

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[2] Until 2001, government publications did not divide debt subject to limit into the portions held by the public and held by government accounts. This discussion and the table use CRS calculated amounts that approximate the amounts of debt subject to limit held in these two categories for fiscal years prior to 2001.

[3] The debt limit was last increased on August 5, 1997, as part of the Balanced Budget Act of 1997 (P.L. 105-33). The limit was raised from $5.5 trillion to $5.95 trillion.

[4] For a short discussion of the Treasury's previous uses of its short-term ability to avoid breaching the debt limit, see CRS Report 98-805, *Public Debt Limit Legislation: A Brief History and Controversies in the 1980s and 1990s*, by Philip Winters; for a comprehensive report see the GAO report, *Debt Ceiling: Analysis of Actions During the 1995-1996 Crisis*, Aug. 1996, GAO/AIMD-96-130.

fell to $35 billion below the limit. At the end of May, the debt subject to limit was $15 *million* below the statutory limit.

Table 1. Components of Debt Subject to Limit, FY1996-FY2002
(in billions of dollars)

End of Fiscal Year (or period)	**Debt Limit**	**Debt Subject to Limit**		
		Total	**Held by Government Accounts**	**Held by the Public**
1996	$5,500.0	$5,137.2	$1,432.4	$3,704.8
1997	5,950.0	5,327.6	1,581.9	3,745.8
1998	5,950.0	5,439.4	1,742.1	3,697.4
1999	5,950.0	5,567.7	1,958.2	3,609.5
2000	5,950.0	5,591.6	2,203.9	3,387.7
2001	5,950.0	5,732.6	2,435.3	3,297.3
FY1997 to FY2001	–-	405.0	853.4	-448.5
April 30, 2002	5,950.0	5,914.8	2,549.4	3,365.4
May 31, 2002	5,590.0	5,950.0	2,553.4	3,396.6

Source: U.S. Department of the Treasury, Financial Management Service, *Treasury Bulletin*, June 2001 and March 2002. *Daily Treasury Statement* April 30 and May 31, 2002. CRS calculations.

Note: For the fiscal years 1996 through 2000, the amounts held by government accounts and held by the public are approximations. The Treasury began producing this split into holders of debt subject to limit in their publications in 2001. The numbers in the table showing this split for 1996 through 2000 were calculated by subtracting Federal Financing Bank debt (an arm of the Treasury; its debt is not subject to limit) from total debt held by government accounts to approximate the amount of that debt subject to limit (it remains too large even with this adjustment). This adjusted amount was then subtracted from total debt subject to limit to produce an approximate measure of debt held by the public subject to limit. Because the amount held by government accounts is too large, the resulting measure of debt held by the public subject to limit is too small. The approximations in the table are accurate enough to reveal the pattern of change in the two categories over the six years shown.

The Administration, recognizing in the fall of 2001 that the deterioration in the budget outlook and continued growth in debt held by government accounts could lead to the debt limit being reached sooner rather than later, in early December asked Congress to raise the debt limit by $750 billion to $6.7 trillion. As the debt has moved closer to the limit over the last six months, the Administration has repeatedly requested that Congress adopt an increase in the debt limit and warned Congress of the consequences of not raising the limit.

The Current Situation

By mid-May 2002, federal debt subject to limit effectively reached the current statutory limit of $5,950 billion. For the second time this year, the Treasury took extraordinary actions to avoid defaulting on government obligations. The previous brush with the debt limit took place in early to mid-April. The Treasury is again using its available statutory authority to temporarily avoid the possibility of defaulting on the government's obligations. This earlier episode was short-term and resolved itself with the large tax payments received on and after April 15.

The situation that began in mid-May is more serious. It requires the Treasury to resort to the financing actions used earlier and possibly additional actions not yet used. The situation cannot be relieved without an increase in the debt limit. On May 14, the Treasury issued another request to Congress to raise the debt limit or some other statutory change that allows the Treasury to issue new debt. The Treasury, in a news release, stated that, "absent extraordinary actions, the government will exceed the statutory debt ceiling no later than May 16."[5] The release went on to state that "a 'debt issuance suspension period' will begin no later than May 16 .... [This] allows the Treasury to suspend or redeem investments in two trust funds, which will provide flexibility to fund the operations of the government during this period."[6] By reducing the amount of federal debt held by these government accounts (and replacing it with non-interest bearing, non-debt instruments), the Treasury can sell debt to the public, providing the cash needed to finance federal activities or issue debt to other federal trust fund accounts as required by law. The Treasury also stated that these "extraordinary" actions will suffice only, at most, through June 28, 2002. By mid- to late-June, without an increase in the debt limit, the Treasury indicated that it would need to take other actions to avoid breaching the ceiling.[7] By the end of June and into the first days of July with large payments and other obligation due, the Treasury stated that it would be out of all available options to issue debt and fulfill government obligations. The situation could put the government on the verge of defaulting on those obligations.

Congress has taken action over the last two months that may lead to an increase in the debt limit. The House-passed supplemental appropriations for FY2002 (H.R. 4775; May 24, 2002) included, after extended debate, language allowing any eventual House-Senate conference on the legislation to add an increase in the debt limit. The Senate did not add debt-limit-increase language to its version of the supplemental appropriations bill, S. 2551 (incorporated as an amendment to H.R. 4775, June 3, 2002). The Senate leadership has indicated a strong reluctance to include a debt limit increase in the supplemental appropriation bill. Instead, the Senate adopted a bill, S. 2578, raising the debt limit by $450 billion (to $6.4 trillion) without debate on June 11. A $450 billion increase in the debt limit would provide enough borrowing authority for government operations through at least the rest of calendar year 2002 and possibly into the summer of 2003. With the Treasury stating that the government could begin defaulting on its obligations about June 28, the House has tentatively indicated it may consider debt limit legislation the week of June 24. What form this would take or the amount of the increase remain uncertain.

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[5] U.S. Department of the Treasury. Treasury News. *Treasury Statement on the Debt Ceiling*, May 14, 2002.

[6] Ibid.

[7] As of June 21, 2002, the Treasury has postponed an auction of securities but has not announced any other actions.

Concluding Comments

The growth in debt held by government accounts since the last debt limit increase (in August 1997) has been the primary, but not the only, cause of the current need to raise the debt limit. The re-emergence of government deficits in FY2002 reversed the fall in debt held by the public resulting from the government's surpluses in the four previous years, contributing to the need to raise the debt limit now rather than sometime in the future. Since the beginning of FY2002, debt held by government accounts has increased by $117 billion while debt held by the public has increased by $100 billion.

Pressure to raise the debt limit over the last 50 years generally came from growth in debt held by the public as the government needed to borrow from the public to finance deficits. Growth in debt held by government accounts in the past, particularly before the 1983 changes to Social Security, was usually a relatively minor, but not insignificant factor in the growth of total debt subject to limit. In the current instance, in spite of an expected deficit and the resulting increase in debt held by the public, the increases in debt held by government accounts over the last four to five years (and continuing this year) have driven the increases in debt subject to limit and are the primary cause of the current need to increase the debt limit.