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THE CURRENT: What's happening with the debt ceiling (again)?

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PITA: You're listening to The Current, part of the Brookings Podcast Network. I'm your host, Adrianna Pita.

Congress reconvenes this week after the U.S. reached its debt ceiling last Thursday. Secretary Janet Yellen announced that the Treasury will engage in extraordinary measures to prevent the U.S. from defaulting on its debt, pushing the crisis point back by a few months. But it remains to be seen how and when Congress will take action. In a recent Twitter Spaces conversation, Brookings experts David Wessel, Bill Gale, Molly Reynolds and Wendy Edelberg explain the debt ceiling. The economic ramifications of default and what's likely in Congress with the new Republican House majority.

Now over to David Wessel, who's hosting the Twitter Spaces.

WESSEL: Welcome, everyone. I'm David Wessel and director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. And we're joined by three of my colleagues today to talk about something which seems to be the topic du jour, the federal debt ceiling. Bill Gale is a colleague of mine in Economic Studies and has written extensively on fiscal policy and is involved with our Tax Policy Center. Wendy Edelberg is director of the Hamilton Project and then Molly -- also in Economic Studies – and Molly Reynolds is in our Government Studies program and is an expert on Congress.

We'd love to hear your questions about the debt ceiling. We've talked about it to death already, but there seem to be still a lot of interest and for good reason. So I think we're going to start by, I'm going to start by asking Bill Gale, can you just explain the terms here? Bill, what is the debt ceiling? Why did we hit it? And what is all this talk about extraordinary measures that the Treasury secretary has deployed?

GALE: Thanks, David. There's a legal limit on how much the government can borrow in debt markets. It's called the debt ceiling or the debt limit. Before World War One, Congress had to approve every time the government wanted to borrow money. Then in World War One, they couldn't because they needed to borrow so much, they consolidated it into one overall limit. And since then it's been raised continually, you know, almost 80 times since 1960, more than 20 times since the year 2000.

The debt limit is a funny issue. It really shouldn't exist. It really should be that when Congress authorizes a certain amount of spending, it authorizes the government to borrow money or to raise money to pay for that spending. But that's not how the law is written. The government can authorize, can require the government to spend money, but at the same time not tell them that they can raise the money through debt. So what happens is occasionally, as the government does what Congress tells it to do, it bumps up against the debt limit and then Congress has to raise the debt limit separately.

So currently we're at a point where the government is officially at the limit. There are a number of extraordinary measures that you mentioned that the government can take to postpone the day of reckoning, the day when it has to default on something. But this would be things like, there are normally contributions to government worker pension accounts that the government makes, and those can be temporarily diverted to address what debt would otherwise issue. But there's only a couple of months' worth of those. And ultimately, we're going to have to raise the debt limit, suspend the debt limit, or change the rules about the debt limit.

EDELBERG: David, you're muted.

WESSEL: Basically the issue is that the U.S. government spends more than it takes in. And when you do that, you have to borrow. And the government is borrowing because of laws that Congress has passed that set the terms of spending and taxes. So there's – lots of people use different analogies. The one I like is, you bought all this stuff on the credit card, the bill comes, and you say, well, I don't feel like paying it.

But Wendy, let's say that Congress doesn't do what it's always done in the past. And we get to the point probably sometime late spring, early summer, where the U.S. Treasury simply doesn't have enough cash to meet all its obligations. It can't pay the interest on the debt and pay Social Security and Medicare and pay federal employees and pay federal contractors and all that. So what happens then and what are the consequences?

EDELBERG: So it really is easiest to think about the U.S. Treasury having a bank account that it can draw checks on. And the idea here is that if the debt ceiling binds, then Treasury is completely limited in what checks it can write by how much it got in revenues and deposited into its account. And so obligations for all the kinds of things that you just described are estimated to exceed revenues for the next year by about 1 trillion dollars.

So if Treasury can't borrow, what that would mean is that payments in an average month would have to be cut by 20%. But that cut could be as much as twice as large as that in some months, because some months see particularly low tax revenues typically. So, June is a big revenue month. It's a time when a lot of people make quarterly payments, but revenues are typically quite low in July. So what this means is that there's going to be some day, perhaps in July. Some Wednesday, let's say, where Treasury is going to be required to make, let's say, five and a half billion dollars' worth of payments. And it's only going to have, let's say, three and a half billion dollars in its bank account.

The worst of all of the very bad outcomes, I think, is if Treasury then says, you know what? We can't make any payments, including interest on the debt. And I think that would have to be interpreted as a default on the debt, which I think would trigger very, very significant reactions, not just in U.S. financial markets, but globally. I think the effects would be pretty cataclysmic.

I think Treasury would probably avoid that by making those interest payments, but then having to figure out what to do about all of the other payments. And someone who is, you know, a counterparty to the U.S. government and absolutely expects to be paid on that Wednesday, someone's not going to get paid. And so that's either going to be a Social Security recipient, a hospital or doctor who treated a Medicaid or a Medicare patient, a defense contractor, federal workers. Someone's on the other side of those transactions. So financial markets are still going to care. We're going to see a jump in interest rates. We're going to see the stock market reacting and maybe very significantly reacting. And then there's going to be just the real basic effects of, let's say, a Social Security recipient not getting the money on the third of the month and then not being able to make their rent payment the following day.

WESSEL: Right. So I think there is a big question about what happens immediately after we cross this line. How quickly do the markets react? Do the markets expect that Congress will come to its senses? Or is there a bigger sense of alarm? I remember way back in 2008 when the House of Representatives voted down the TARP plan to help rescue the banking system in the middle of that crisis. It was a shock that Congress didn't approve this thing that President Bush had proposed and Democratic leaders had agreed to. The market reacted so severely that Congress came back and very quickly did what everybody with any brains thought needed to be done. Although some of them lived to regret it.

So, Molly, I think the question that goes around Washington a lot is, okay, we know that there's always a showdown over the debt ceiling and each party wants the other party to take responsibility for raising it. And it becomes fodder for campaign ads. And nobody remembers that President Trump raised the debt ceiling, but so forth. I think the big question is, is this time different? Is the polarization in Congress, the very close majority that Speaker McCarthy has in the House suggests that this time will be the time they can't do the 11th hour deal?

REYNOLDS: It's a great question, David. And I think one thing that's really important to remember is that, so if you want to think that the last time we had a really big, major showdown over the debt limit was 2011, Congress has changed quite profoundly in the intervening 12 years. And I don't just mean the politics and the polarization. I also mean literally. The literal people in the U.S. House of Representatives are largely not the same as they were in 2011. Only 22% of House Republicans were here in 2011 and only about 30% of House Democrats. And so to the extent that we would hope that folks sort of lived through that experience and wouldn't want to repeat it, they're simply not the same people. And on top of that, for some Republicans who look back at 2011, they say, well, we, you know, went up to the cliff and we had a showdown and we got the Budget Control Act out of that. And, you know, we can talk about whether the Budget Control Act was – had its intended effects. But I think for many, for many Republicans, they see that as actually something that was a win for Republicans.

And so it's sort of taking that context and then adding the fact that the Republican conference has, you know, continued to move farther to the right since then. And there is this sense among some, particularly House Republicans, that, you know, we need to make really big spending cuts. And if this is the opportunity to do it, then that's how they should proceed.

And then the last thing I'll say that's, I think, different and we'll sort of see how different, is the fact that Kevin McCarthy, who's now the speaker of the House, after a tortured week-long process, you know, he has not had to lead a conference as the speaker through something like this before. And so whether he is willing to stand up to some elements of his conference to cut a deal that allows everyone to save some face and avoid, as Wendy put it, the worst possible outcomes, That just remains to be seen.

WESSEL: I see. So, Bill, of course, the Republicans want to use the debt ceiling as a lever to get some concessions from the administration and the Democrats that would reduce the federal deficit going forward. They seem to be allergic to tax increases, so they're thinking about spending cuts. Some of the Republicans are talking like, we got to control entitlements, which means benefit programs like Social Security and Medicare and Medicaid and so forth. Somebody on the audience asks – notes – that President Trump has been tweeting to his fellow Republicans, “Don't mess with Social Security and Medicare,” and asks, “Do we think the Republicans in Congress will listen to him?” So I wonder what you think about, what if you were talking – what should we think about if we want to control the federal debt and deficit, as many people do eventually? What do we need to do? Can you do it without touching benefits? And is Trump crazy to think we can do it without touching Social Security and Medicare?

GALE: Well, the first thing to note is that letting the government default would make whatever long term fiscal situation we have worse, not better. It would raise interest rates and make it more expensive for the government to resolve the long-term fiscal shortfalls. In terms of how to do that, obviously, that's a complicated question. There are many answers. Certainly reform of Social Security and Medicare, two of the biggest programs and two of the items of spending growth are vitally important. I don't know that you want to make the changes under the gun of a debt limit increase. Certainly in 1983 when we made the changes, it was a very long, drawn-out effort. But also, you know, these programs have a revenue side as well as the spending side. So fixing Social Security or fixing Medicare doesn't just mean cutting spending on those things. It could well mean raising revenues, either the targeted revenues that currently fund those programs or general revenues.

WESSEL: So, Wendy, you have a lot of experience in the Congressional Budget Office. And I'm curious what you think about, so something has to happen for Congress to get its hands around the rising federal debt. It may not be urgent to do today, but we know we can't do it forever. What do you think it will take to get us to the point of dealing with our long-term fiscal things? And is it, are the Republicans right that you have to create a crisis to do it?

EDELBERG: So. I don't think that they're right that you have to create a crisis to do it. And I think there's no logical connection between the debt ceiling and the crisis being manufactured around paying for obligations that stem from past spending and revenue laws, ones already on the books. There's no logical connection between that and the very hard political choices about future tax and spending policy, you know, what changes we want to make going forward.

The issue about – you know, so I'm often asked, like, why can't we just get – the answers to how to fix the fiscal situation going forward are so obvious, why can't we just get all the politicians in a room, lock them in until they, you know, finally see the light and make these changes? Or maybe differently, why can't we get the politicians out of the way and just have the technocrats make the obvious changes? Well, the thing is that there's no shortage of ideas of how to change our fiscal trajectory. The questions are hard political ones. And so, you know, Bill was absolutely right that making these difficult decisions with a gun to your head is not helpful. What we need to do is decide as a country – where I think there are significant political disagreements – what we want our federal government to do for us, what we value, and then make sure that we are willing to pay for it. Those you know, I think the politicians are actually doing probably doing somewhat of a decent job of representing the deep political divisions in the country that we haven't really figured this out as a nation. So these are hard, hard questions. And, you know, we need to commit to it as a country, and politicians need to reflect that commitment.

WESSEL: Thanks. So, somebody asks, what are the consequences for not raising the debt limit for everyday Americans? I'm gonna take that one.

I think if it's just 48 hours, it may be some turbulence in financial markets and it may not make dollars and cents difference to everyday Americans, but it could mean that the federal government has to pay more to borrow short term. And if people begin to lose confidence in the U.S. Treasury long term, and that affects us all as taxpayers. And if it goes on for a long time, as Wendy said, some people aren't going to get their benefit checks, some workers aren't going to be paid and so forth. The problem with trying to do really precise scenarios for this is that we have never done this before. And so we can't be sure that there won't be some huge disruption that we can't oversee. I think the problem here is that, or the argument is that, there's no reason to do this. It's like shooting yourself in the head because you have a headache and that just doesn't make any sense.

Molly, do you have thoughts on the question that Wendy and I have been discussing? What will it take for Congress to stop complaining about the debt and maybe think about some long-term policy changes?

REYNOLDS: Yeah, it's a good question. And I tend to agree with Wendy that there's no logical connection between the debt limit and making long-term changes that are necessary to ensure the more permanent fiscal health of the country. And I think that in the context, again, I think here our experience from 2011 is illustrative, which is to say that to the extent that Congress in 2011, to use the debt limit to create a mechanism that would ask them to make hard fiscal choices, it didn't work. You know, the mechanism that came up with as part of the Budget Control Act, the supercommittee worked and worked and worked, did not come to an agreement, made no changes. And so I think that should also just more generally remind us that, you know, big budget agreements are only as good as the political will that exists to stick to them. And I think negotiating under the threat of default is not the, not opportune conditions to create some sort of agreement where there would actually be political will to stick to it over the long term.

WESSEL: So, Bill, you hear a lot of stuff about people think that the Biden administration could somehow do an end run around Congress. There's talk that the president could use some language in the Constitution that says that "the faith and credit of the U.S. shall never be challenged." There's talk about issuing a trillion-dollar coin and then going to the, depositing at the Fed. And the Fed then gives the government a trillion dollars in cash so they don't have to borrow. Do you think there's anything, practically, realistically, legally, that the Treasury and the White House could do to avoid getting bitten by the debt ceiling? Or do you think this is all wishful thinking?

GALE: I would not doubt that there was some legal maneuver. I don't know if the trillion-dollar coin itself works or something else, but the consequences of the government defaulting are so big that certainly no rock will go unturned, no stone will go unturned in terms of trying to figure out ways to deal with it.

In terms of the economic effects, it's important to give people a sense of this. In 1979, the government inadvertently defaulted on a small tranche of Treasury debt due to an administrative error or clerical error. I think it was a software problem of some sort. It was temporary. It was obviously inadvertent. It was immediately corrected. It was on a small part of the Treasury debt and still it ended up costing $40 billion in higher interest costs over the next several years. If that's what – that's in today's dollars – if that's what a small unintentional default did, you know, one can only imagine what a universal intentional default would signal to credit markets about the credit-worthiness of Treasury debt. So I think the potential effects are big. And as you said earlier, like, there's just no point. There's no point going down that road.

WESSEL: Wendy, what do you think the Federal Reserve does if we go over the cliff, we reach the point where the Treasury doesn't have enough money to pay the bills and there's a lot of turmoil in the bond market? Do you think the Fed does, as the Bank of England did recently, steps in and tries to calm financial markets, or do you think they say, look, this is a political problem and you guys have to solve it? We can't, we can’t intervene.

EDELBERG: So a critically important part of the Fed's mandate is trying to maintain stability in financial markets. So I think that they will take that seriously and try to take targeted action to keep financial markets from becoming totally unhinged. One complication is that they may well still be, you know, prioritizing bringing down inflation and have very much on their list of things to do, you know, making sure that they are not overstimulating demand. And so you might think under different circumstances that this would be a time for the Fed to just the market with money, you know, and buy lots and lots of treasuries in return for cash. But they will likely be wary about doing too much if it then ignites inflationary concerns. So they're going to be in a difficult spot.

But one thing that I just want to emphasize, if this day comes and the debt ceiling binds, you know, we've talked about whether or not Treasury could do some kind of an end run around this and maybe issue debt anyway, maybe try to deposit a coin with the Fed, maybe prioritize payments. Basically, any decision that's made in that eventuality is going to be legally murky. And I think that means we're going to see lawsuits no matter what Treasury does or doesn't do, which means even if they do your whatever listener thinks is the preferred option to try to keep this all from becoming a crisis, the legal system will also have a say, and that's going to have its own, potentially really bad effects. So don't think that there's some step – I strongly believe that there is, that it's not like there's some step that some actor can take in the absence of the debt ceiling being risen that just makes this problem go away. There's really only one solution to this, and that's raising the debt ceiling.

WESSEL: Thanks, Molly. Let's end on the politics of this. So I sense that the Democrats at this point are saying, the Republicans created this problem by promising some people in the House certain conditions – we don't really know what they are – on raising the debt ceiling, and they're not inclined to negotiate with Republicans at this point. So two questions. One is, do you think that holds or as we get closer, does the Democrats and the administration say, okay, we got to cut a deal here? And secondly, do you think, I think the Democrats think they can blame the Republicans for everything that goes wrong if we breach the debt ceiling and run out of extraordinary measures. Do you think they're right about that?

REYNOLDS: So then the first question, they're going to need to negotiate with Republicans, not just because the House is controlled by Republicans and some amount of the dealmaking Speaker McCarthy made to become Speaker McCarthy involved fiscal and budgetary questions, but also because the Senate exists and Democrats have a majority but not a filibuster-proof majority. And, you know, whatever they're going to, whatever kind of agreement they're going to need to reach in the Senate is going to have to attract some number of Republican votes as well. Obviously, there are more – the kind of bloc of pragmatic Senate Republicans on this question is more sizable, probably, than the bloc of pragmatic – and certainly as a share of the conference – than the bloc of pragmatic House Republicans. But they're going to need to negotiate with Republicans eventually. And so the degree to which they can start thinking about what is a deal that lets everyone save some face, I think they would be well-served to do that.

On the question of blame, you know, I do think that if we went into some of the most dire consequences that Wendy and Bill have outlined, that there would be plenty of blame to go around. I think will also depend on exactly what kind of deal must eventually be cut to avoid those outcomes if we ultimately do that. And so, you know, one of the one of the challenges here with the congressional politics is that, if it proves to be the case that Speaker McCarthy is the principal obstacle to getting a deal to the floor of the House, some of the solutions to that are not especially elegant or fast. And so what I think folks need to be thinking about is sort of contingency planning and what are the possible ways procedural, political, and otherwise that you could get something that, again, allows everyone to save some face through both chambers before it really needs to happen?

WESSEL: Yeah, a good point. Okay. I think we'll leave it there. Thank you, Wendy, Bill and Molly for joining us and Raman for helping to arrange this. And as always, if you want to listen to this again and again and again, we'll post the video. And I'm afraid that we'll be dealing with this question again. I wish it would go away so we could talk about something new and novel, but that doesn't seem to be our fate.

So with that, thank you all, and have a good weekend.