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REPORT BY THE

Comptroller General

OF THE UNITED STATES

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A New Approach To The Public Debt Legislation Should Be Considered

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Twice in the last 2 years, the Congress did not pass legislation extending a temporary increase of the public debt limit until after it expired. Although the delays lasted for relatively short periods, they resulted in unnecessary costs, such as increased interest expense, and disruption of government borrowing programs.

Yet another delay--longer than those in the past--when the current temporary ceiling expires could produce consequences much more serious. The Federal Government would be forced to default on most of its obligations in a short time, including maturing securities and employees' salaries.

The Treasury has proposed a way to avoid many of these problems by tying the debt limit to the new congressional budget process. The proposal has merit, and GAO recommends that the Congress develop such an approach.

The Chairman, House Ways and Means Committee asked GAO to make this study of the impact of the delays on the management of Federal funds and programs. He asked that we consider particularly the cost increases from emergency cash management actions and adverse effects on the savings bond program and the government securities market.

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SEPTEMBER 7, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-138524

The Honorable Al Ullman
Chairman, Committee on Ways and Means
House of Representatives

HSE04180

Dear Mr. Chairman:

On June 7, 1979, you asked us to study the impact that delays in the enactment of legislation for the temporary public debt ceiling would have on the management of Federal funds and programs. This report responds to your request and describes the undesirable conditions that developed during the relatively short delays in 1978 and 1979. It also provides insight into the possible adverse effects that a longer delay might cause in the future.

Because of the problems caused by the timing and recent use of temporary ceilings, this report recommends that the Congress change its approach to adjusting public debt limits.

The reporting deadline specified in your request did not allow sufficient time to obtain formal comments on the report. We have, however, obtained informal comments from Federal Reserve Board and Treasury Department officials who generally agreed with the report's contents.

As arranged with your office, unless you publicly announce its contents earlier, we will not distribute copies of the report for 30 days from its date. At that time we will send copies to interested parties and make copies available to others who request them.

Sincerely yours,

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE HOUSE WAYS
AND MEANS COMMITTEE

A NEW APPROACH TO PUBLIC DEBT CEILING LEGISLATION SHOULD BE CONSIDERED

DIGEST

The Congress has attempted to control the size of the public debt over the last several years by authorizing only temporary debt increases which expired in a year or less. Apparently, this method allows the debt limit to be increased but later changed as more accurate data on receipts, disbursements, and required borrowing becomes available.

However, advantages that may have been achieved by this method are being offset by costs and undesirable conditions that develop when extensions of the temporary increase are delayed. Additional costs and complications of Treasury and Federal Reserve operations resulting from the 1978 and 1979 delays were unnecessary.

Passage of the legislation was inevitable because without it the Federal Government's ability to operate was jeopardized. Debt ceiling increases were needed simply to allow financing of deficit budgets which already had been approved. Fortunately, the delays were sufficiently short to avoid more serious problems.

The present temporary ceiling is $430 billion and expires September 30, 1979. With the permanent ceiling of $400 billion, the total limit is $830 billion. At July 31, 1979, the outstanding debt subject to the limit totaled $807 billion.

The temporary ceiling carries an extremely undesirable feature. It must be extended before the expiration date; otherwise, the ceiling reverts to the permanent level. This precludes the Treasury from borrowing money to refund maturing securities and to pay the Government's other legal obligations.

In the past few years, the Congress has not passed temporary debt ceiling extensions until after the specified expiration date. The two most recent delays occurred in August 1978 and April 1979, when the ceiling reverted to the permanent level for 3 days and 2 days, respectively.

Although of limited duration, these reversions caused undesirable conditions resulting in substantial costs, both measurable and unmeasurable, to the Government and to the public. For example:

--The Treasury was forced to postpone several securities auctions planned to raise about $22.7 billion and consequently had to pay an additional $4 to $11 million to borrow the same amount of money. Some additional operating costs also resulted. (See pp. 5-7.)

--The Federal Reserve had to take action in the open market to offset serious declines in the Treasury's cash balance. This action resulted in about $101,000 to $112,000 in additional interest costs. (See pp. 7-9.)

--The Treasury had to withdraw its funds from interest-bearing accounts at commercial banks to provide needed cash. This cost the Treasury between $51,000 and $66,000 in interest income. (See p. 9.)

--The Treasury had to suspend the sales of government savings bonds; Treasury's operating costs increased by about $17,000 for actions related to the suspensions and buyers may have been confused about the suspensions. (See p. 10.)

--Various government trust funds could not be issued interest-bearing securities for the cash the Treasury had used. As a result, the funds failed to earn about $1.8 million in interest income to which they were entitled. (See pp. 10-11.)

--The Treasury redeemed $2.7 billion of the exchange stabilization fund's securities to reduce the amount of the outstanding debt and to enable the Treasury to borrow $2.6 billion from the Federal Reserve. Although taken to satisfy legitimate cash needs, the actions circumvented the intent of the debt ceiling. Furthermore, because the exchange stabilization fund was not immediately provided with funds for reinvestment, it lost about $1.3 million in interest. (See pp. 11-12.)

The Treasury also considered selling securities from the trust funds but later concluded that it would be improper. GAO agrees. (See p. 12.)

Future delays could be more serious if they are for longer periods. If a delay occurs when the present temporary ceiling expires on September 30, the Treasury would have about $15 billion in cash--enough to last 3 days. In the past, the Treasury could have borrowed some cash from the Federal Reserve System just before the temporary ceiling expired, but a recent law may have restricted this convenient and quick source of money. (See pp. 14-15.)

Without circumventing the ceiling on the public debt, the Treasury can take only limited emergency action to raise cash in anticipation of another delay. It estimates that the debt will be about $8.5 billion below the present ceiling on September 30 and this amount could be prematurely borrowed before the temporary ceiling expires. This action could cost about $9.4 million for only a few additional days' cash supply. Although the Treasury could offset this cost by investing the borrowed cash in interest-bearing bank accounts, it is doubtful that the entire amount could be invested in such a short time. (See p. 16.)

After the Treasury's cash is depleted, a default on government obligations would become a reality as both Federal Reserve and commercial banks would stop cashing government

checks. A default would have devastating effects on the economy and the public welfare, preventing the payment of such things as salaries and pensions of some of the Nation's work force. The Congress has long recognized the potential for these adverse effects. (See pp. 17-18.)

The Congress should consider a new approach to enacting public debt ceiling legislation. Current efforts to increase the ceiling basically duplicate congressional efforts to comply with the Congressional Budget and Impoundment Control Act of 1974 under which the Congress passes resolutions setting forth recommended levels for receipts, disbursements, and the public debt. Further, GAO sees no advantage in classifying over half of the public debt as temporary when estimates show the public debt will continue to rise in the next 3 years. (See pp. 19-23.)

RECOMMENDATIONS TO THE CONGRESS

To avoid the problems associated with the present approach to the temporary debt ceiling increases, the Congress should:

--Make the current amount of the temporary ceiling a permanent ceiling and consider any future substantive increases as permanent unless the debt can clearly be reduced within a reasonable time.

--Develop an approach to adjusting the public debt ceiling that would take advantage of the Congressional Budget and Impoundment Control Act of 1974, similar to the proposal that the Treasury has made. Under that proposal, the recommended debt limit established in the Congress budget resolutions would become the legal debt ceiling.

AGENCY COMMENTS

GAO discussed this report with Treasury officials who agreed with the facts presented in this report.

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ABBREVIATIONS

ESF exchange stabilization fund

GAO General Accounting Office

CHAPTER 1

INTRODUCTION

In September 1979, the Congress will be asked to act on legislation to increase the total amount of Federal Government securities that may be outstanding at one time to finance the public debt. The legislation would increase the current $830-billion public debt ceiling, an amount comprising a $400-billion "permanent" ceiling and a $430-billion "temporary" ceiling. The legislation also would extend the current expiration date of the temporary ceiling beyond September 30, 1979.

While the Congress has acted favorably on legislation to increase and extend the temporary ceiling, it has not always done so promptly. In recent years such legislation has not always been enacted before congressionally mandated expiration dates. In such instances, the ceiling reverts to the permanent amount, as was the case in August 1978 and April 1979. At those times, the expiration dates passed and the ceiling reverted to $400 billion for periods ranging from 2 to 3 days.

On June 7, 1979, the Chairman of the House Committee on Ways and Means asked us to study the impact of the Congress allowing the temporary ceiling to expire. The request specified that the study be based on actions taken in 1978 and 1979 when the ceiling expired for a short period. This report responds to the Chairman's request.

ORIGIN OF TEMPORARY PUBLIC DEBT CEILING

The Federal Government began with a national, or public, debt of about $78 million in 1789. Since then, the Congress has attempted to control the size of the public debt by imposing ceilings on the amount of securities that might be outstanding at any time. These ceilings are now specified in the Second Liberty Bond Act of 1917, as amended (31 U.S.C. 757b).

The 1917 act originally contained a public debt ceiling of about $11 billion which placed a $7.5-billion ceiling on bonds and a $4-billion ceiling on certificates of indebtedness. The Congress continued setting ceilings on the various types of Federal securities that could be issued to finance the public debt until February 1941. At that time, an amendment to the act set an overall ceiling of $65 billion on all types of securities that could be outstanding at any one time. This was a permanent ceiling because it was authorized for an unspecified period of time.

The public debt ceiling was increased on several occasions between February 1941 and June 1946, when a permanent ceiling of $275 billion was set and remained in effect until August 1954. At that time, the Congress imposed the first temporary ceiling on the public debt of $6 billion which expired on June 30, 1955. Through March 1, 1971, other temporary increases were approved which, in most cases, were eventually included in the permanent ceiling.

In March 1971, the Congress passed the most recent increase to the permanent debt ceiling, raising it to $400 billion. At the same time, action was taken to provide a temporary ceiling of $30 billion. In explaining these actions, the legislative history (Senate Report No. 92-28, Public Law No. 92-5) states:

> "In providing the (total) debt limitation of $430 billion, the bill increases the permanent debt limitation from $380 billion to $400 billion, since, given the deficits for the fiscal years 1971 and 1972, it is obvious that for a number of years to come the debt subject to statutory limitation will not be below $400 billion."

Since March 1971, the Congress has passed only temporary--1 year or less--increases to the public debt ceiling. Earlier legislative histories of such actions usually cited uncertainties of budget receipts, outlays, and the required public debt ceiling level as the reasons for providing only temporary increases. Some histories also suggested that the permanent ceiling would be increased when more reliable data became available. However, no reasons were given in recent histories for continuing the temporary ceiling, which was increased to $430 billion in April 1979.

APPROACH TO FINANCE THE DEBT

Before the Second Liberty Bond Act of 1917 was passed, the Congress took an active role in efforts to finance the public debt. For example, it established interest rates to be paid, specified the types of securities to be sold, and sometimes even set the dates that securities would become due. The congressional role has diminished over the years and the Treasury Department now has full authority over financing of the public debt. The Treasury makes decisions on the types and frequency of security sales, and these decisions can affect the Federal Reserve Board's regulation of the money supply. Within its authority the Treasury uses several different approaches to raise needed money.

One approach is to auction interest-bearing securities in the open market. The Federal Reserve is the Treasury's agent for selling marketable securities. As shown below, as of July 31, 1979, such securities accounted for a substantial amount of the $807-billion debt, and they mature over a period ranging from several days to 40 years.

Security	Maturity	Amount (Billions)
Treasury bills	up to 52 weeks	$159.9
Treasury notes	1 to 10 years	278.3
Treasury bonds	10 years or more	68.8
Total		$507.0

Another approach is to issue nonmarketable, interest-bearing securities. These types of securities include U.S. savings bonds, Treasury notes and bills held by foreign governments, and various trust funds managed by the Government. As of July 31, 1979, nonmarketable securities accounted for $300 billion of the debt, including $164 billion issued to the trust funds. The period of maturity can be as long as 40 years, and some securities issued to the foreign governments can be redeemed on as little as 2 days' notice.

The Treasury faces a formidable task each year in raising money to finance the public debt. About one-third of its securities mature each year and must be refunded. Also, the Treasury must sell additional securities to finance any Federal budget deficit. The Treasury estimates that it must borrow around $300 billion through marketable and nonmarketable securities to satisfy fiscal 1980 refunding and new cash needs.

SCOPE OF REVIEW

The Chairman of the House Committee on Ways and Means requested that we consider the impact that delays in extending the debt ceiling would have on the management of Federal funds and programs. Specifically, we were asked to consider the possibility of

--increases in costs from any emergency cash management procedures,

--disruptions to the savings bond program,

--distortions to the market for government securities, and

--consequences of any protracted period of reversion to the permanent debt ceiling.

The Chairman asked for a report on the study by early September 1979 which gave us less than 3 months to review and report on a very complex issue. Therefore, we had to limit our study to generally recognized areas where cost increases, both measurable and unmeasurable, would result from delays in extending the temporary ceiling. These areas included those specified in the Chairman's request and others identified in congressional committee reports and in Treasury Department correspondence.

Our study relied heavily on information, especially financial data, furnished by the Treasury Department and Federal Reserve officials. To the extent possible within the time frame for completing our work, appropriate steps were taken to verify the accuracy and completeness of the information provided to us. Our efforts included discussions with investment and banking officials in the private sector on such unmeasurable adverse effects from the delays as public confusion and loss of confidence in government securities.

The study was performed primarily in Washington, D.C., where we reviewed applicable records and the legislative history related to actions on the ceilings. We also interviewed Treasury and Federal Reserve officials to clarify policies and obtain information on the impact of debt ceiling expirations.

CHAPTER 2

UNDESIRABLE CONDITIONS FROM PAST

CONGRESSIONAL DELAYS ON DEBT CEILING LEGISLATION

As previously mentioned, the most recent congressional delays in passing public debt ceiling legislation occurred in August 1978 and April 1979. During these delays, the debt limit reverted to the permanent level for 3 and 2 days, respectively. Although these delays were of limited duration, they caused a number of undesirable conditions to develop, and as discussed below, these conditions resulted in considerable cost to the Government, both measurable and unmeasurable.

SECURITY AUCTION DELAYS INCREASED INTEREST AND OTHER COSTS

The Treasury raises some money for government operations through the auction of securities. The most recent delay forced the postponement of several scheduled auctions of $22.7 billion in securities. As a result, the Treasury incurred costs of about $44,700 to destroy and replace dated securities, but more importantly, it eventually had to pay from $4 million to $11 million more in interest to borrow the same amount of money.

These auctions were originally scheduled to take place in March and early April 1979, with the securities to be delivered to the successful bidders in early April. Not knowing whether the new debt legislation would be enacted by April 1, however, the Treasury could not assure delivery of the securities. Immediately after the new temporary increase in the debt ceiling was enacted on April 2, the Treasury rescheduled the auctions and raised sufficient funds for continuing government operations.

Based on a New York Federal Reserve Bank analysis, which we verified, the Treasury appears to have incurred between $4 million and $11 million in additional interest costs as a result of postponing the auctions. Federal Reserve Bank officials attributed the additional costs largely to a rise in market interest rates in early April. This change in market conditions apparently was caused by inflation and other factors rather than by the securities auction postponements. Regardless of the reason for the higher rates, the fact remains that the delay precluded the Treasury from auctioning the securities on schedule and at a time when lower interest rates prevailed.

The additional interest costs are based on a comparison of the actual auction prices and the prices which the Treasury may have received had the auctions been held as originally scheduled. At least two different assumptions can be used in estimating the latter. One is that the Treasury would have received prevailing market prices, at the time the sales were originally scheduled to occur, on outstanding Treasury issues with the same or similar maturities. As shown in table 1, this approach shows that the Treasury may have paid an additional interest cost of about $11 million.

Table 1

Prices of Securities in Auctions Postponed Until Passage of the Debt Ceiling: Original Versus Final Auction Dates

Security (millions)	Possible price on original auction date (1)	Final auction price (2)	Gain or loss (2)-(1)	Gain (loss) (millions)
$6,005, 23-day cash management bill	99.392	99.370	-.022	($ 1.321)
$3,001, 76-day cash management bill	97.994	97.970	-.024	(.720)
$3,001, 91-day bill	97.596	97.575	-.021	(.630)
$3,003, 182-day bill	95.202	95.199	-.003	(.090)
$3,344, 52-week bill	90.769	90.719	-.050	(1.672)
$2,881, 2-year note	99.689 [9-5/8% coupon]	99.903	+.214	6.165
$1,500, 9% reopened bond due Feb. 15, 1994	99.625	98.790	-.835	(12.525)
TOTAL				($10.793)

The other assumption is that the postponements, announced in advance of the original auction dates, may have had some effect on market prices. To make allowances for that possibility, market prices were used that prevailed on the days before the postponements were announced. As shown in table 2, this alternative approach shows that the additional interest costs still amounted to over $4 million.

Table 2

Prices of Securities in Auctions
Postponed Until Passage of the Debt Ceiling:
Day Before Postponement Versus Final Auction Dates

Security (millions)	Possible price on day before postponement (1)	Final auction price (2)	Gain or loss (2)-(1)	Gain (loss) (millions)
$6,005, 23-day cash management bill	99.389	99.370	-.019	($1.141)
$3,001, 76-day cash management bill	97.994	97.970	-.024	(.720)
$3,001, 91-day bill	97.614	97.575	-.039	(1.170)
$3,003, 182-day bill	95.243	95.199	-.044	(1.321)
$3,344, 52-week bill	90.699	90.719	+.020	.669
$2,881, 2-year note	99.654 [9-5/8% coupon]	99.903	+.249	7.174
$1,500, 9% reopened bond due Feb. 15, 1994	99.3125	98.790	-.5225	(7.838)
TOTAL				($4.347)

TREASURY CASH DECLINE FORCED OFFSETTING FEDERAL RESERVE ACTIONS

As a result of a serious decline in the Treasury's cash balance during the 1979 delay, excessive cash reserves developed in the commercial banking system and the Federal Reserve had to undertake open-market operations to absorb them. This action, which was necessary in carrying out Federal Reserve monetary policy, may have cost the Government an additional $101,000 to $112,000 in interest costs. In addition, it complicated the Federal Reserve's operations in carrying out general monetary policies.

Current Treasury policy calls for maintaining a stable \$3-billion balance in its account at the Federal Reserve and keeping the remaining funds in numerous accounts with commercial depositary institutions where the funds can earn interest. Wide fluctuations in the Treasury's Federal Reserve account balance, which is closely monitored by the Federal Reserve, can significantly affect the amount of cash reserves in the banking system. When payments to the Federal Government are transferred from commercial banks to the Treasury's account at the Federal Reserve, the reserve base of the banking system declines. Unless the Federal Reserve replenishes the base by making offsetting, open-market purchases of government securities or unless changes in other independent factors provide an offset, general monetary conditions are tightened.

In the reverse case, when Treasury balances at the Federal Reserve decline as the Government makes disbursements; funds are transferred back to the private banking system and the reserve base is expanded. Unless the Federal Reserve sells government securities in the open market to drain reserves from the system (or other factors provide an independent offset), general monetary conditions are eased. The latter situation arose as a result of the most recent delay, when the Treasury's cash balance declined to less than \$500,000 on April 3, 1979.

Although it is difficult to attribute a specific action to a change in one of the many variables affecting bank reserves, Federal Reserve officials said that the decline in the Treasury's cash balance in early April 1979 caused the Federal Reserve to sell securities in the open market. This action can be viewed as a borrowing from the private sector which was initiated because the Treasury could not borrow directly in the market after the debt ceiling had lapsed. Because the Treasury could not borrow, its cash balance declined and reserves were released into the banking system. The Federal Reserve acted to offset this unwanted reserve increase by selling securities which the Federal Reserve agreed to repurchase at a specified time and price. The interest paid on those securities reduced the net interest income the Federal Reserve would otherwise have earned on its security portfolio and returned to the Treasury. Thus, the Treasury in effect pays the interest cost whether it borrows directly and holds its Federal Reserve balance at the \$3-billion level, or whether the balance declines (because of the ceiling lapse) and forces the Federal Reserve to take action.

The Treasury's cash balance at the Federal Reserve declined about \$2.4 billion from its normal average, and the

Federal Reserve's securities were outstanding for 4 days. To determine whether the Government experienced a gain or loss on the transaction, the interest rate paid on the securities sold by the Federal Reserve (9.95 percent) must be compared to the rate which the Treasury would have paid had it been able to maintain its cash balance by carrying out the necessary borrowing. As previously mentioned, the latter rate can vary depending on the assumptions made, and it is difficult to establish precisely because it is hypothetical. Assuming the Treasury would have paid an average rate comparable to those prevailing in the market at the time the auctions were originally scheduled to take place, the rate would have been 9.53 percent. Because that rate is less than that paid on the securities sold by the Federal Reserve, the estimated additional interest cost is $112,000.

Taking an alternative approach and assuming that the Treasury would have paid a rate comparable to those prevailing in the market before the postponements were announced, the rate would have been 9.57 percent. The estimated additional interest cost using that rate is $101,000. Federal Reserve officials, who provided the rationale for our computations, achieved similar results from their analysis.

WITHDRAWAL OF FUNDS FROM COMMERCIAL BANKS CAUSED INTEREST LOSS

To pay its obligations during the 1979 delay, the Treasury withdrew its funds from its interest-bearing accounts at commercial banks. Because the interest rate accruing on the deposited funds was greater than the interest it would have paid to borrow, the Treasury lost from $51,000 to $66,000 in interest income.

The withdrawals totaled about $3.5 billion for 4 days. If the debt ceiling had not lapsed, the Treasury would have continued to borrow, thus enabling it to maintain its deposits at private banks. As already mentioned, the Treasury would have paid interest rates to borrow from 9.53 to 9.57 percent if its borrowings were not postponed. According to Federal Reserve information, the Treasury was receiving an average rate of about 9.7 percent on its bank deposits in early April. Therefore, because the Treasury could not borrow to maintain its cash balances with commercial banks, it sustained a net interest loss of from $51,000 to $66,000. Again, the difficulty in estimating what the Treasury's borrowing costs might have been precludes our developing a precise figure.

SAVINGS BOND SUSPENSIONS CAUSED CONFUSION AND ADDITIONAL COSTS

As it had with other securities, the Treasury was forced to suspend the sale of savings bonds during the delays, and as a result, incurred about $17,000 in additional operating costs. Also, there was evidence of confusion among some issuing agents and buyers, but we were unable to determine whether the suspensions had affected bond sales.

The Treasury sells about $8 billion of savings bonds a year through more than 40,000 issuing agents. About 60 percent of bond sales are made through payroll savings plans and the remainder are sold over the counter by banks and other financial institutions. On July 31, 1979, about $80 billion of these bonds were outstanding.

During the August 1978 delay, individual notices were sent to the issuing agents notifying them of the suspension. The estimated cost of printing and distributing the notices was $17,198. Although the Treasury also announced the bond sales suspension during the 1979 delay, individual notices were not sent. Treasury officials assumed that the Congress would enact the new debt legislation before the notices could reach the issuing agents.

The Treasury received letters and inquiries indicating that some issuing agents and bond purchasers became confused when the suspensions were announced. A number of factors, however, prevented us from determining whether the suspensions and the resulting confusion had any impact on sales. First, it is not known exactly when the various issuing agents stopped, and later resumed, bond sales. Second, no accurate count of daily bond sales was available. Treasury officials said that deductions for bonds sold through payroll savings plans were continued and that over-the-counter sales would have been more likely to have suffered any adverse effects. Third, over the past year bond redemptions have exceeded sales as interest rates on other investments have become more attractive and people change their savings habits. Finally, no sound means exist for assessing the intangible effects of the suspensions, such as the impact on the public's level of confidence in the savings bond program.

TRUST FUNDS PREVENTED FROM EARNING INTEREST

Various laws require the trust funds' cash surpluses to be invested in nonmarketable government securities since the Government actually uses such surpluses in its day-to-day

operations. The August 1978 delay prevented the Treasury from issuing securities to various government trust funds for the surpluses it used. As a result, the funds were prevented from earning about $1.8 million in interest.

The trust funds are used to account for the receipts and disbursements of certain individual programs, such as social security, civil service retirement, and Federal Savings and Loan Insurance. The Secretary of the Treasury has varying degrees of fiduciary responsibility over the funds, whose surpluses generally are required to be invested in nonmarketable government securities.

According to Treasury data, the trust funds had $4.8 billion available for investment in the first 2 days of August 1978. Treasury officials estimated that the trust funds lost at least $1.8 million in interest because new securities could not be issued. The officials said that the loss may have been greater; some agencies, knowing that interest could not be paid during the delay, may not have immediately requested the Treasury to invest their trust fund receipts as they normally would have. They pointed out, however, that the trust funds' loss was a savings to the Treasury's general fund, and that the Treasury has no authority to reimburse the trust funds for the losses.

Treasury officials stated that no such loss occurred during the 1979 delay. New debt legislation was enacted on the first business day of the month which was also the first day on which trust fund surpluses were available for investment after the ceiling expired.

EXCHANGE STABILIZATION FUND USED TO CIRCUMVENT DEBT CEILING

Before the last delay, the Treasury redeemed $2.7 billion of securities held by the exchange stabilization fund (ESF) to reduce the amount of debt outstanding and to enable the Treasury to borrow $2.6 billion from the Federal Reserve. This action, taken to deal with a serious problem, in effect caused the ESF to lose an estimated $1.3 million in interest.

The ESF was established to stabilize the exchange value of the dollar (31 U.S.C. 822a). In addition to authorizing expenditures from the fund, the Secretary of the Treasury is authorized to invest in direct obligations of the United States any portions of the fund which are not required to stabilize the dollar. Such obligations are counted as part of the debt that is subject to the ceiling.

On March 31, 1979, when the redemption took place, the outstanding public debt was barely under the $798-billion debt limit which expired on that date. Treasury officials said that ESF securities were redeemed to provide sufficient room below the ceiling to borrow new funds from the Federal Reserve.

The Treasury was able to maintain the outstanding debt at basically the same level and yet generate new cash because of the way the transaction was handled. Treasury officials said that although the ESF account was credited for the amount of the redemption, the account did not actually receive cash and the funds were not available for investment. Treasury officials estimated that the ESF lost about $1.3 million in interest for the 2 days the account was disinvested, but they added that the Treasury's general fund saved interest expense in about the same amount. As soon as the new debt legislation was passed on April 2, the ESF was issued $2.7 billion in new government securities.

Although the disinvestment of the ESF did not result in any additional cost to the Government, some question remains concerning the propriety of the Treasury's action. A Treasury official said that as administrator of the ESF, the Secretary is responsible for seeing that the fund receives all earnings to which it is entitled. We recognize that the prospect of a delay in debt ceiling legislation placed the former Secretary in a difficult position regarding his responsibility to the ESF versus his responsibilities for financing government operations. The disinvestment of the ESF, however, may not have been appropriate because it denied the fund the opportunity to earn interest and represented a circumvention of the intent of the debt ceiling.

THE TREASURY CONSIDERED USING OTHER TRUST FUNDS TO CIRCUMVENT THE CEILING

The Treasury considered selling securities from various trust funds during the 1978 delay. Although this could have helped the Treasury meet government obligations in the absence of authority to incur new debt, the trust funds would have lost interest on the amount of securities sold. The former Treasury Secretary eventually decided that this type of action was improper, a conclusion with which we agree.

In late July 1978, auctions were held as scheduled even though the securities were not to be issued until after the temporary debt ceiling increase expired. The Treasury then replaced some of the trust funds' nonmarketable securities with marketable securities. If new debt legislation had not

been enacted, the Treasury planned to issue the trust funds' securities in place of those auctioned. The securities also could have been sold to generate cash. Treasury officials said that in either case, the trust funds would have lost interest. They emphasized that because the debt legislation was enacted in time, the trust funds' securities were not used and that no interest was lost.

In our opinion, using the trust funds in this manner and thus preventing them from earning interest would be inconsistent with the Treasury Secretary's fiduciary responsibilities to handle the trust funds in the best interest of the beneficiaries of the trusts. Key Treasury officials agree and will advise the Secretary not to take such action in anticipation of future delays.

CHAPTER 3

FACTORS FOR CONSIDERATION ABOUT

PROTRACTED CONGRESSIONAL DELAYS

ON FUTURE DEBT CEILING LEGISLATION

The Chairman's request asked for our views on the impact of any protracted delay in enacting the public debt ceiling legislation. Because economic conditions at the time the ceiling expires will have an impact on the number of days that the Treasury can operate without serious consequences, this question is best answered by considering the conditions that will prevail when the present ceiling expires at the end of September 1979.

The Treasury estimates that it will have enough cash on hand to operate through October 3. In past years, the Federal Reserve System could have loaned the Treasury money before the ceiling expired. However, as a result of recent legislation, this source of cash borrowing may have been severely restricted. The Treasury's other option would be to raise cash by issuing securities in the market before the ceiling expires. This action, which could increase overall costs, would provide only enough cash to last a couple of days and then the Government would default on a number of its obligations. The adverse effects of a default have been pointed out in several congressional committee reports issued since 1967.

ESTIMATED CASH BALANCE SUSTAINS OPERATIONS FOR ONLY A FEW DAYS

In July 1979, the Treasury estimated that it would have a beginning cash balance of about $15 billion on October 1. This balance, plus the estimated revenue collections, will permit the Treasury to operate only through October 3. The Treasury's estimate considers the amounts needed to refund maturing securities and to finance any difference between revenue collections and disbursements--the operating deficit--to meet current operating needs. The following table shows the Treasury's July estimate of its cash balance through October 5.

	Cash disbursements		
	Refunding of maturing debt	Operating deficit	Ending cash balance
	(Billions)		
Oct. 1	$5.9	$2.9	$6.2
Oct. 2	-	+0.1	6.3
Oct. 3	-	2.8	3.5
Oct. 4	5.9	+0.3	-2.1
Oct. 5	-	3.1	-5.2

The Treasury's cash estimates normally involve a degree of uncertainty that requires frequent revisions as more precise information becomes available. Moreover, its estimated beginning cash balance for October was made before the present recessionary trends in the economy became fully apparent. Thus, the actual balances may differ somewhat from the estimated balances. However, these were the best estimates available at the time our review was completed.

RECENT LAW RESTRICTS FLEXIBILITY TO DEAL WITH DELAYS

In past years, the Treasury could borrow cash from the Federal Reserve System when the Congress delayed extending the public debt ceiling. The System could lend up to $5 billion just before the ceiling expired if the need for cash became apparent. Any such amounts were subject to the debt ceiling. A recent law, however, may have limited the Treasury's ability to borrow cash directly from the Federal Reserve under such circumstances.

The law in question is Public Law 96-18, passed by the Congress in June 1979. It effectively requires that in routine circumstances, the Treasury should borrow securities from the Federal Reserve and sell them in the open market to meet its short-term cash needs; only in unusual and exigent circumstances may the Treasury borrow cash directly from the Federal Reserve. Neither the law nor the legislative history clearly defines unusual and exigent circumstances. Thus, the determination of what constitutes such circumstances seems to rest largely within the discretion of the System's Board of Governors.

Some Treasury officials believe that borrowing in anticipation of a delay in debt ceiling legislation may not meet the intent of the law. According to a Federal Reserve official, the System's Board of Governors has not yet considered this question and would make a decision based on the specific circumstances existing at a given time. Even if

such borrowing is permissible by law, it is limited to $5 billion, an amount that would provide enough cash to operate only a few days.

EMERGENCY ACTION OFFERS
ONLY A FEW DAYS' SUPPLY OF CASH

Treasury officials said that in dealing with future congressional delays in passing the debt ceiling legislation, they will not take any action to raise cash that would circumvent the existing ceiling. Of the two major actions that will be considered, only one would increase the Treasury's cash balance and enable operations to extend a few days beyond October 3. Both actions could potentially increase the Treasury's net interest costs.

One action would be to call in funds from the Treasury's tax and loan accounts with commercial banks to increase the amount the Treasury has available in its Federal Reserve account. As previously mentioned, this action by itself decreases the amount of reserves in the banking system. If the Treasury holds the money in its Federal Reserve account, the Federal Reserve might have to buy securities in the open market to increase the reserves in the system. Such market dealings can result in a gain or loss depending on the interest rates involved. If the Treasury spends the funds, the money would be returned to the banking system and, other things being equal, no Federal Reserve action would be required.

The Treasury's cash forecast for October 1 includes the amounts expected to be in the tax and loan accounts. During our review it was impractical to determine whether a gain or loss would result from withdrawing those funds or whether the Treasury would lose interest. However, the possible damage to the tax and loan account system, which is an important part of the Treasury's cash management program, should not be overlooked. If the Treasury's withdrawals become too frequent, it is possible that commercial banks will become reluctant to participate in the program.

Another action would be for the Treasury to prematurely raise funds through security offerings in the market. In July 1979, the Treasury estimated that the debt subject to limit would be about $8.5 billion below the current ceiling when it expires on September 30. Securities could be sold for this amount before the ceiling expires. However, the cash would not be needed until about October 4, and the premature borrowing for only 4 days, at the prevailing interest rate of about 10 percent, could increase the public debt interest by about $9.4 million. The Treasury, of course, would take

action to invest the money and earn interest to help offset this increased cost. However, because of the large amount and the short time involved, it is doubtful that the entire amount could be invested. Depending on market conditions, a net gain or loss could result.

DEFAULT BECOMES REALITY AFTER ONLY SHORT DELAY

The Government has never defaulted on any of its securities because cash has been available to redeem them upon maturity or demand. A default on the securities could set in motion a series of actions that could have devastating effects on the economy, the public welfare, and the Government's ability to market future securities.

For example, some foreign sources own almost $10 billion of nonmarketable securities on which payment can be demanded within 2 to 5 days. A default on securities that come due on October 4 could result in payment being demanded on such securities. Federal Reserve officials said that the Federal Reserve Banks would have to stop honoring government checks when the Treasury's cash balance was depleted. Private banks, of course, would realize the necessity of such action and they would take similar action; some may even stop honoring the checks before the balance was depleted.

It is difficult to perceive all the adverse effects that a government default for even a short time would have on the economy and the public welfare. It is generally recognized that a default would preclude the Government from honoring all of its obligations to pay for such things as employees' salaries and wages; social security benefits, civil service retirement, and other benefits from trust funds; contractual services and supplies; and maturing securities. Moreover, government securities would become unattractive investments for the Nation's business firms, banks, and pension funds. Such entities, along with State and local governments, have invested heavily in government securities. They tailor their market activity to securities that will provide the cash flow necessary to meet their disbursement needs. A government default would, in turn, result in these sources defaulting on their obligations for such things as salaries and pensions and would preclude them from making the capital investments necessary for a healthy economy.

Predicting the adverse effect of a default on government operations is also difficult. At a minimum, however, the Government could be subject to claims for additional interest on unredeemed matured debt and to claims for damages resulting

from failure to make payments. But even beyond that, the full faith and credit of the U.S. Government would be threatened. Domestic money markets, in which government securities play a major role, could be affected substantially. This in turn could affect the exchange value of the dollar.

CONGRESSIONAL REPORTS RECOGNIZE THE POTENTIAL FOR ADVERSE EFFECTS

Since 1967, Treasury officials appointed by both Democratic and Republican Presidents have been advising congressional committees of the undesirable conditions that could result from congressional delays on the debt ceiling legislation. Some Members of Congress have been skeptical about any adverse effects, but most Members have recognized the potential problems.

The majority views are set out in several reports issued since 1967 by the House Committee on Ways and Means and the Senate Committee on Finance. Those reports point out the potential for the type of adverse effects that could occur from the delays. For example, in House Report No. 92-814, the Committee on Ways and Means said

> " While there would be no question concerning the legality of the outstanding debt in such a situation, the Treasury Department would be unable to issue any new securities. This prohibition would apply to issues designed to replace maturing issues as well as securities representing new debt.
>
> "As a result, savings bonds could not be issued and payroll savings plans would be disrupted. In addition, the Treasury cash balance would be depleted rapidly. Substantial amounts of Treasury bills become due on a weekly basis. If new bills cannot be issued to replace these issues, the Treasury cash balance would soon be exhausted.
>
> "Once the cash balance is exhausted, the Government would be compelled to delay full payment (or resort to partial payments) of contract obligations, Government salaries, various loan and benefit programs, and grants to States and local governments when they become due."

Our report essentially expands upon the adverse effects mentioned in the Committee report. In some cases, we have shown the substantial amount of dollar costs that have in fact resulted from past delays.

CHAPTER 4

QUESTIONABLE USEFULNESS OF TEMPORARY DEBT CEILINGS AND RELATED APPROACH TO CHANGE IT

The preceding chapters have explored the adverse effects, both actual and potential, resulting from congressional delays on debt ceiling legislation. These adverse effects are related to the procedures for approving the temporary debt ceiling, which is also considered by the Congress in complying with the Congressional Budget and Impoundment Control Act of 1974. Furthermore, classifying over half of the public debt ceiling as temporary has no apparent advantage since limited prospects exist in the next few years for reducing the public debt level.

THE CONGRESS GIVES DUAL CONSIDERATION TO CEILING CHANGES

Since 1917, the Congress has taken separate legislative actions, apart from the budget process, to change the public debt ceiling. For years these actions provided the means by which the Congress considered the entire Federal budget and the resulting deficit. These actions, however, are now largely duplicated by congressional efforts to comply with the Congressional Budget and Impoundment Control Act of 1974.

Before the 1974 Act, the Federal budget was not considered in total by any one congressional committee. Budget totals and resulting surpluses or deficits were simply the product of many different spending and revenue bills emerging from many different appropriations that were passed by the Congress. The resulting deficits were considered during congressional actions on the separate debt ceiling legislation, which the Members believed would provide some congressional control over government spending.

The 1974 Act was passed to give the Congress better control over government spending. It requires the Congress, before each fiscal year, to adopt concurrent resolutions setting forth what it considers to be appropriate levels of receipts, disbursements, deficit or surplus, and public debt. One resolution is passed before the appropriation process begins, establishing targets toward which the Appropriations Committees are to work. A second resolution is passed which reconciles the Appropriations Committees' actions with the levels set in the first resolution and which must be made consistent with enacted appropriations. These procedures provide a forum

for the Congress to consider the size of the public debt along with expected revenues and spending plans.

Since this process was instituted, each resolution has called for deficit budgets and corresponding increases in the public debt limit. The deficit budgets make increased borrowing a foregone conclusion. Because the resolutions do not have the force of law, legislation must be enacted to increase the debt ceiling so that the approved budgets can be financed. Recently, these adjustments have been made at varying times during the fiscal year. Some opposition to the increases was voiced even though the deficit budgets had been approved and the increases were needed to prevent a government default.

FUTURE OFFERS LIMITED PROSPECTS TO REDUCE DEBT LEVEL

As of August 1979, the Congress was classifying $430 billion, or about 52 percent, of the $830-billion debt ceiling as temporary. This classification offers no apparent advantages since the future seems to offer limited prospects of reducing the debt below the present ceiling.

The Congress recently passed a resolution calling for a balanced budget for fiscal 1981 and 1982. This is largely a goal, and in the meantime, deficit budgets will probably continue to be approved. Some estimates in congressional committee reports have set the ceiling on the public debt at over $959 billion by 1982. Even if the goal of a balanced budget is eventually attained, it will be some time before any substantial reductions in the debt can be made. Trust fund surpluses that must be invested and so-called "off-budget" items, such as the Federal Financing Bank, will continue to exert upward pressure on the debt ceiling. Referring to a large portion of the debt as temporary does not recognize the realities of the size of the public debt that will be with us for years to come.

THE TREASURY'S PROPOSAL PRESENTS A BETTER WAY TO CHANGE DEBT CEILINGS

The Treasury has proposed that legislation be enacted to avoid further delays in enacting debt ceiling legislation and the corresponding problems that are involved. Such a proposal, if enacted, could eliminate the periodic temporary ceiling increases and provide for a single, permanent debt ceiling to be established and adjusted in advance of each fiscal year.

As previously mentioned, the Congress passes concurrent resolutions setting forth the congressional budget and the related public debt level for the Government in advance of each fiscal year. Legislation must be enacted to adjust the debt ceiling because the resolutions lack the force of a law.

The Treasury's proposal provides that the recommended level for the public debt, as set forth in the Congress second concurrent budget resolution, would become the new permanent debt ceiling. A vote for the budget resolution would constitute a vote for the debt ceiling. To give it the effect of law, the portion of the resolution pertaining to the public debt would be sent to the President for his signature. This process would give the Treasury some assurance it would have an adequate debt ceiling to work with throughout the fiscal year. The process of enacting temporary increases in the debt ceiling would no longer be required, unless they were truly temporary.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The Congress has attempted to control the size of the public debt over the last several years by authorizing only temporary debt increases which expired in a year or less. Based on statements in congressional documents, this method was considered advantageous because it allowed the Congress to increase the debt limit and later change it as more accurate data on receipts, disbursements, and required borrowing became available.

The Congress desire to control the public debt has merit. However, any advantages that may have been achieved by employing the temporary increase process are being offset by the costs and undesirable conditions that develop when extensions of the temporary increase are delayed. The additional costs and complications of Treasury and Federal Reserve operations resulting from the 1978 and 1979 delays were unnecessary. Passage of the legislation was inevitable; without it, the Federal Government's ability to operate was jeopardized. The debt ceiling increases were needed simply to allow financing of deficit budgets which had already been approved. Fortunately, the delays were short enough to have avoided any more serious problems.

Because circumstances change, however, there is no guarantee that another delay will not have a greater impact. Important variables are the duration of the delay and the amount of the Treasury's cash on hand at the start of the delay. Enacting new legislation before the current temporary ceiling increase expires on September 30 is critical because historically, October has been one of the Government's largest deficit-spending months. Even though the Treasury may be able to keep the Government afloat financially for a few days after the temporary increase expires, another delay would create unnecessary problems for the Government and the holders of Government securities.

In addition to being an obstacle to the Treasury's borrowing program, the temporary ceiling increase concept has lost its meaning in recent years. The temporary increase has grown to a point where it exceeds the permanent ceiling, and has limited prospects for reduction in the immediate future. Furthermore, assigning an expiration date to the temporary ceiling increase recently has served more as a

source of problems than a means of control. As long as the temporary increase process continues to be used as it has been recently, the possibility of a needless government default will exist.

Finally, the implementation of the Congressional Budget and Impoundment Control Act of 1974 has brought into question the need for the Congress to consider the debt ceiling separately from the budget process. It seems that the two processes can be consolidated without diluting the Congress control over the public debt.

RECOMMENDATIONS TO THE CONGRESS

To avoid the problems associated with the present approach to the temporary debt ceiling increases, we recommend that the Congress:

- --Make the current amount of the temporary ceiling a permanent ceiling and consider any future substantive increases as permanent unless the debt can clearly be reduced within a reasonable time.
- --Develop an approach to adjusting the public debt ceiling that would take advantage of the Congressional Budget and Impoundment Control Act of 1974. A debt ceiling bill could be considered by the Congress simultaneously with its consideration of the second budget resolution, or the debt ceiling bill could be considered immediately following completion of action on the budget resolution. Separate consideration of a debt ceiling bill would thus be required only if unanticipated and unusual circumstances made such consideration necessary before action on the next budget resolution was scheduled.

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