Treasury Borrowing Advisory Committee

April 30th, 2025

"Congress has acted to raise or suspend the statutory debt limit 78 times since 1960. Concerns about the debt limit (and the process involved in raising or suspending it) have increased Treasury's borrowing costs, disrupted financial markets, and resulted in downgrades to the US sovereign credit rating. In December 2024, GAO published a **report** *highlighting the severe consequences of a potential default and reiterating three options to improve the debt limit process: (1) Linking the debt limit to the budget process; (2) Providing the administration with the authority to increase the debt limit, subject to a congressional motion of disapproval; or (3) abolishing the debt limit and allowing Treasury to borrow amounts necessary for expenditures authorized by law. We would like the Committee to comment on the effect of the debt limit (and the process involved in raising or suspending it) on financial markets. Please also consider the options highlighted by GAO and their potential benefits and costs."*

Summary

- The current approach to the debt limit has had a variety of negative impacts on the global financial system.

- The debt limit has not been an effective governor on national debt levels. In practice, recently it has been used to extract political negotiating leverage.

- Negative impacts on the financial system include higher debt servicing costs, ratings downgrades, increased risk of technical default, financial market disruption, and lost productivity.

- Some reform to the current approach is necessary and should be done alongside a commitment to a sustainable fiscal outlook and governance process.

- Markets would likely welcome reforms that reduce the risk of political brinksmanship while maintaining some oversight over national debt levels.

Review of Current Debt Limit Process and Market Impacts

Review of Current Debt Limit Process

- The debt limit is the total amount of money that the United States government is authorized to borrow to meet its existing legal obligations.[1]
  - The debt limit applies to total debt, as opposed to net debt owed to the public.[2]
  - As of March 2025, intragovernmental debt was approximately $7.2 tr (20% of total debt).[3]

- Congress sets the debt limit in a process that is *separate from (and does not regulate) spending decisions;* it simply limits Treasury's ability to borrow & act on those decisions.

- In theory, the debt limit should promote fiscal responsibility. In practice, more recently, it has been used as a negotiating tool, in part due to increased political polarization.
  - Likely at increased costs to the taxpayer.

What Happens When the Debt Limit is Reached?

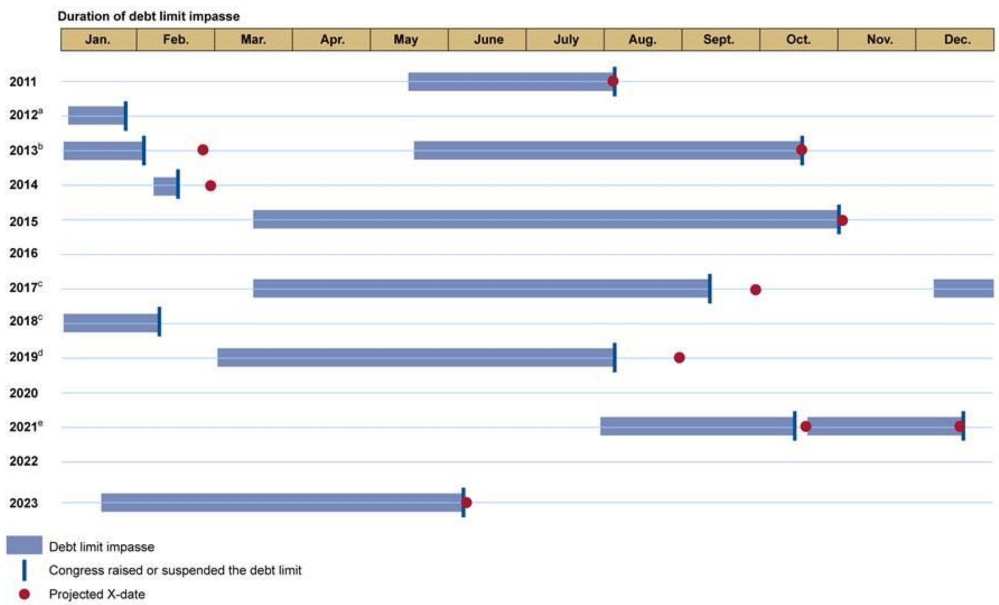
Debt Limit Reached	→	**Extraordinary Measures Used**	→	**X-Date Reached**
Congress fails to raise or suspend the debt limit		e.g. Treasury draws down TGA, Adjusts Investments (CSRDF, G-Fund, ESF)		Government runs out of money and risks default

1. *https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit*
2. *A small portion of total debt is excluded from the debt limit, for example, unamortized discounts on bills and zeros, old debt issued before 1917, old currency called United States Notes, and debt held by the Federal Financing Bank and Guaranteed Debt. Source: treasurydirect.gov*
3. *https://fiscaldata.treasury.gov/datasets/monthly-statement-public-debt/summary-of-treasury-securities-outstanding*

Review of Current Debt Limit Process

- While the debt limit has been used as a political tool on its own, at times it can be tied to the budget appropriations process as well, adding another layer of complexity and interaction with government shutdowns.
- Displayed below, in their report, the GAO reviewed recent debt limit impasses showing the duration and proximity to projected x-dates, many of which were very close.
  - Close calls with the x-date are bad for market functioning and likely increase costs for the taxpayer

Recent Debt Limit Impasses[1]

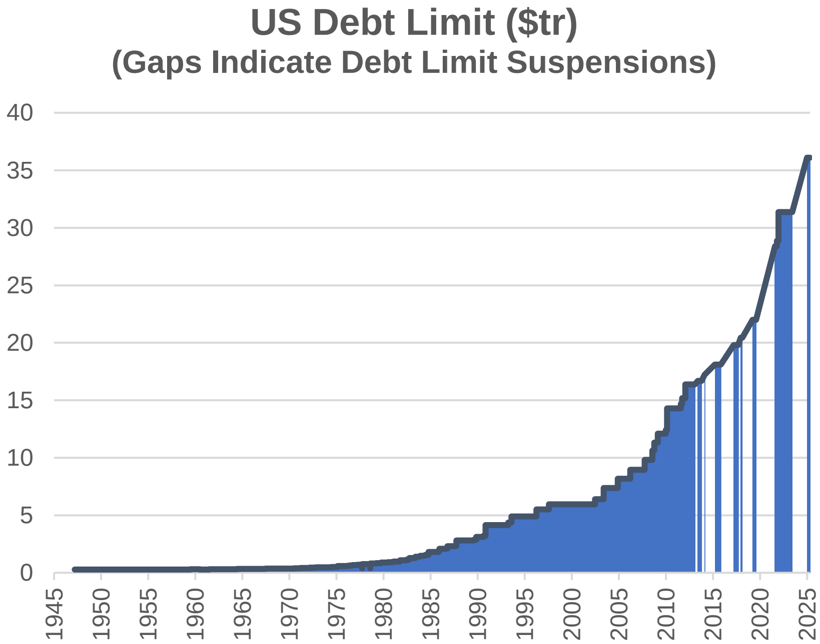


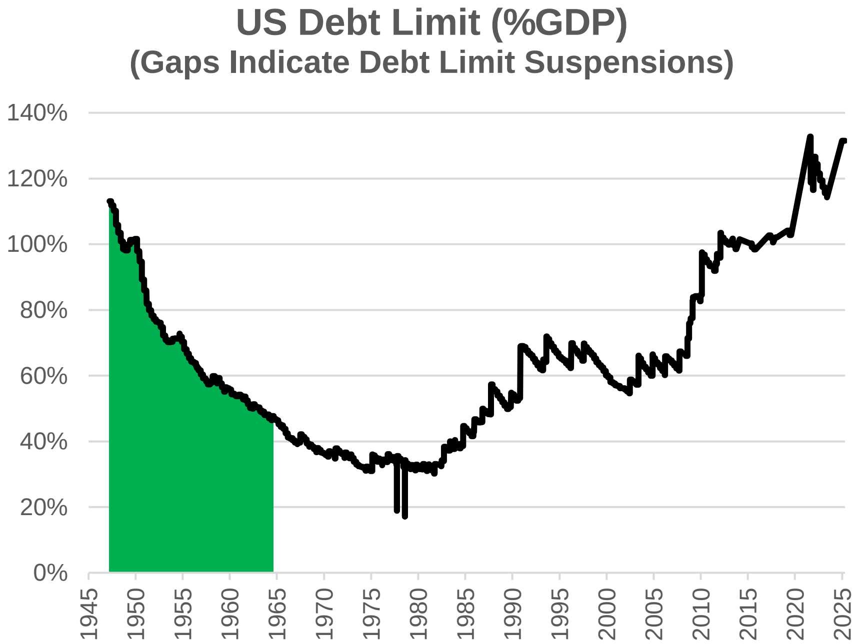
Source: GAO analysis of laws and Department of the Treasury documents. | GAO-25-107089

1. https://www.gao.gov/products/gao-25-107089

Review of Current Debt Limit Process

- ➢ Historically, the debt limit has always been raised or suspended temporarily
- ➢ As a percent of GDP, it reached a low of 30% in the 1980s and stands at 132% today.





1. Bloomberg, Presenter's Calculations

Current Debt Limit Process: Negative Impacts

➢ We see several negative impacts from the current debt limit approach:

1. **Increased Volatility in TGA Balance, Reserves, & Bill Issuance**
2. **Increased Debt Servicing Costs**
3. **Negative Impact on U.S. Credit Rating**
4. **Negative Impact on U.S. Reserve Status**
5. **Increased Risk of Technical Default**
6. **Waste of Resources in Public and Private Sector**

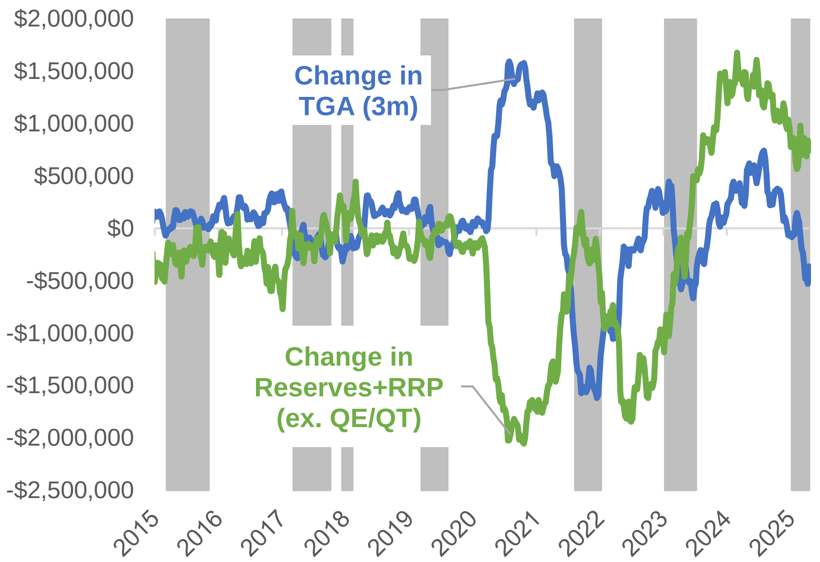
1. https://bipartisanpolicy.org/blog/debt-limit-2025-what-to-know/
2. https://www.federalreserve.gov/econres/feds/take-it-to-the-limit-the-debt-ceiling-and-treasury-yields.htm

Current Debt Limit Process: Impacts & Costs

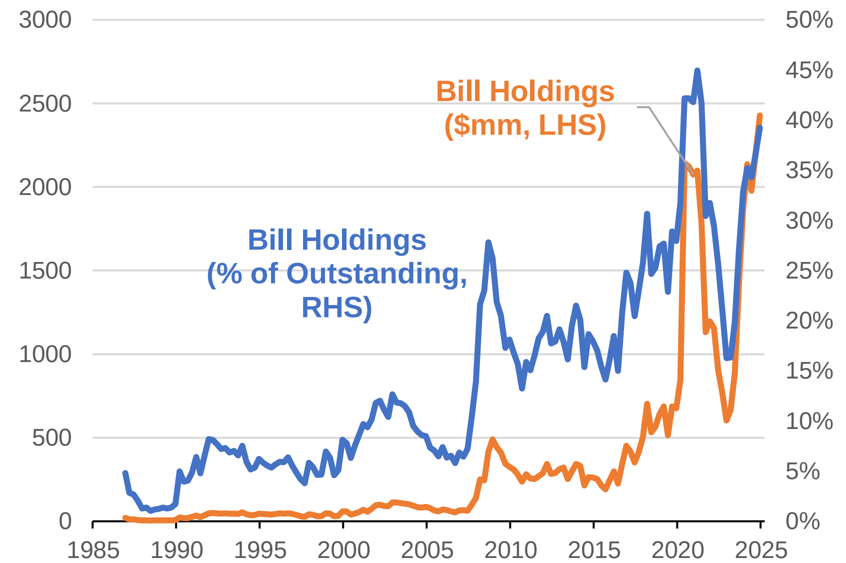
<u>Impact #1</u>: Increased Volatility in TGA Balance, Reserves, & Bill Issuance

- Large changes in the Treasury general account (TGA) can cause fluctuations in reserve balances, altering liquidity conditions in markets.
  - Concerns about the 2025 debt limit debate likely helped motivate the Fed to slow QT sooner than anticipated, to avoid potential funding market disruptions associated with rebuilding TGA.
- Volatility in Treasury bill issuance could create a more unpredictable supply/demand fluctuations for government money market funds, which hold 40% of bills. The overnight RRP is a helpful risk mitigation tool.

Changes in TGA and Reserves[1]
(Shaded Regions Indicate Debt Limit Impasses)



Money Market Funds Bill Holdings[1]

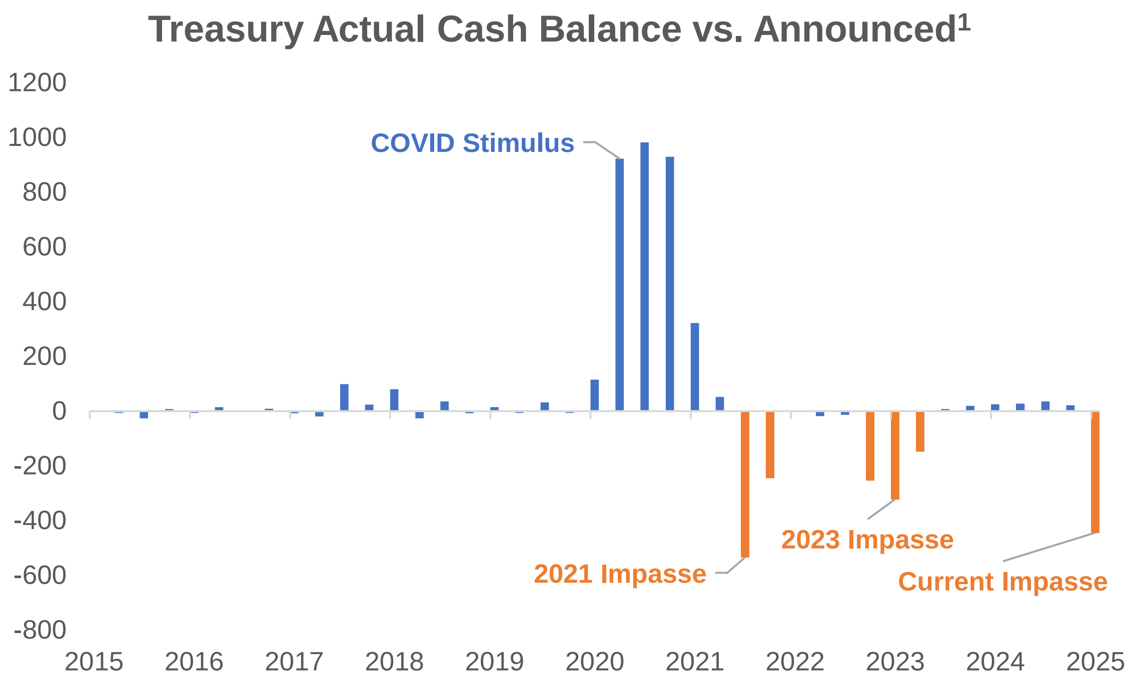


1. *Federal Reserve, Bloomberg*

Current Debt Limit Process: Impacts & Costs

Impact #1: Increased Volatility in TGA Balance, Reserves, & Bill Issuance

- A less predictable cash balance can increase Treasury's operational risk.
  - Recent debt limit impasses have reduced the TGA relative to policy established targets.
  - These reductions increase operational risk for Treasury if unexpected cash needs arise.
    - e.g. a natural disaster or a disruption to market access.



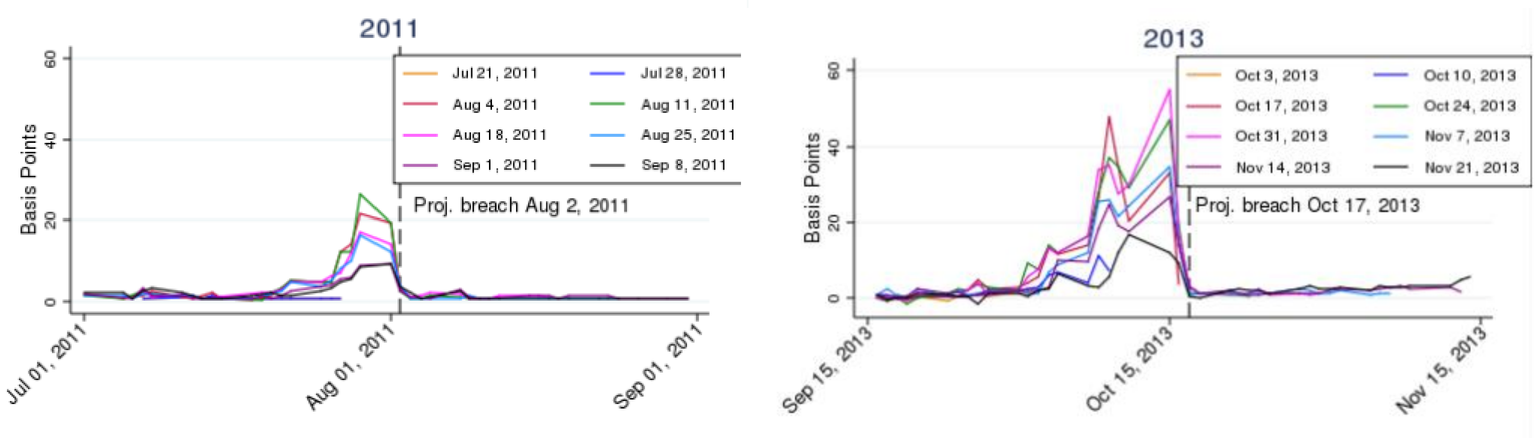
1. *US Treasury*

Current Debt Limit Process: Impacts & Costs

<u>Impact #2</u>: Increased debt servicing cost

- In a study released in 2017, the Federal Reserve examined the debt limit impasses in 2011 and 2013 and found that they may have increased borrowing costs by $500mm.[1]
  - Costs today are likely to be much larger, given debt outstanding has risen more than twofold ($16 tr).
- They observed large effects in Treasury bill yields, but also estimated impact to coupons.

Individual Treasury Bill Yields by Maturity Date[1]



1. https://www.federalreserve.gov/econres/feds/files/2017052pap.pdf

Current Debt Limit Process: Impacts & Costs

<u>Impact #3</u>: Negative impact on U.S. credit rating

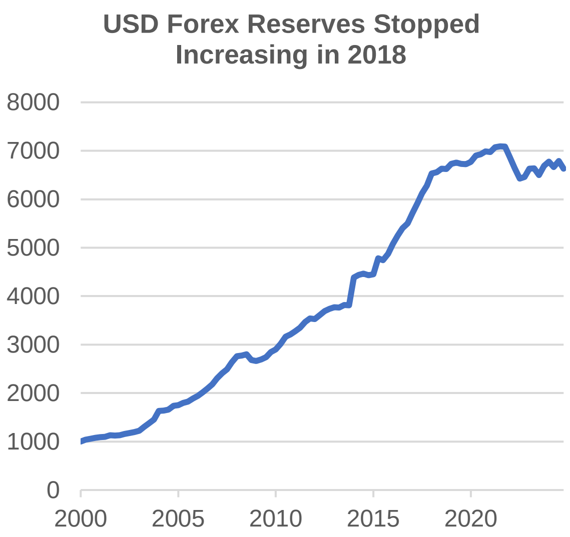
- In 2011, S&P was the first of the credit ratings agencies to downgrade the U.S. government's credit rating, from AAA to AA+. Political brinksmanship played a role in the downgrade:
  - *"The **<u>political brinksmanship</u>** of recent months highlights what we see as America's governance and policymaking becoming less stable, less effective, and less predictable than what we previously believed. **<u>The statutory debt ceiling and the threat of default have become political bargaining chips in the debate over fiscal policy.</u>** Despite this year's wide-ranging debate, in our view, the differences between political parties have proven to be extraordinarily difficult to bridge, and, as we see it, the resulting agreement fell well short of the comprehensive fiscal consolidation program that some proponents had envisaged until quite recently. Republicans and Democrats have only been able to agree to relatively modest savings on discretionary spending while delegating to the Select Committee decisions on more comprehensive measures. It appears that for now, new revenues have dropped down on the menu of policy options. In addition, the plan envisions only minor policy changes on Medicare and little change in other entitlements, the containment of which we and most other independent observers regard as key to long-term fiscal sustainability."*
- Most recently, in August 2023, Fitch downgraded the U.S. government's credit rating to AA+ from AAA. One of the reasons cited in the report was the "erosion of governance."
  - *"**<u>Erosion of Governance</u>:** In Fitch's view, there has been a steady deterioration in standards of governance over the last 20 years, including on fiscal and debt matters, notwithstanding the June bipartisan agreement to suspend the debt limit until January 2025. **<u>The repeated debt-limit political standoffs and last-minute resolutions have eroded confidence in fiscal management.</u>** In addition, the government lacks a medium-term fiscal framework, unlike most peers, and has a complex budgeting process. These factors, along with several economic shocks as well as tax cuts and new spending initiatives, have contributed to successive debt increases over the last decade. Additionally, there has been only limited progress in tackling medium-term challenges related to rising social security and Medicare costs due to an aging population."*

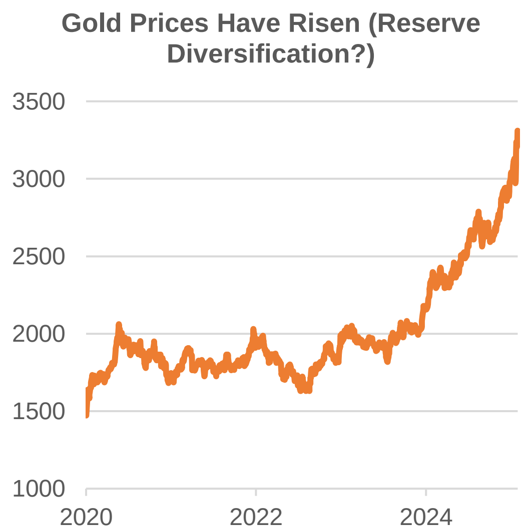
1. https://www.fitchratings.com/research/sovereigns/fitch-downgrades-united-states-long-term-ratings-to-aa-from-aaa-outlook-stable-01-08-2023
2. https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/6802837

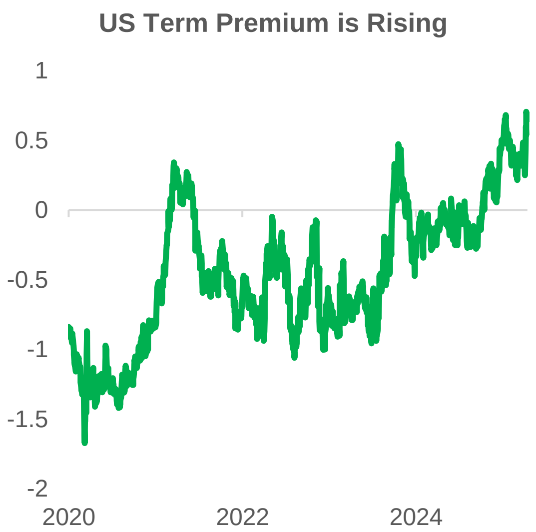
Current Debt Limit Process: Impacts & Costs

<u>Impact #4</u>: Negative impact on US reserve status

- Further credit ratings downgrades, or nervousness about technical defaults, could negatively impact UST safe haven and reserve status, causing foreign buyers to step back from UST and pursue other reserve assets (gold, foreign government bonds).
- If market participants start to question foreign Treasury demand, and foreign buyers step back further, this would likely further increase term premium and debt service costs. We have seen a preview of this recently, as abrupt changes in trade policy have stoked demand concerns and contributed to increased volatility in long term Treasury yields.







1. *IMF, Bloomberg, Federal Reserve Bank of New York*

Current Debt Limit Process: Impacts & Costs

<u>Impact #5</u>: Increased risk of technical default

- Extensive work has been done thinking through risks of a technical default. The GAO report[1] went into some detail on this, citing numerous risks, including:

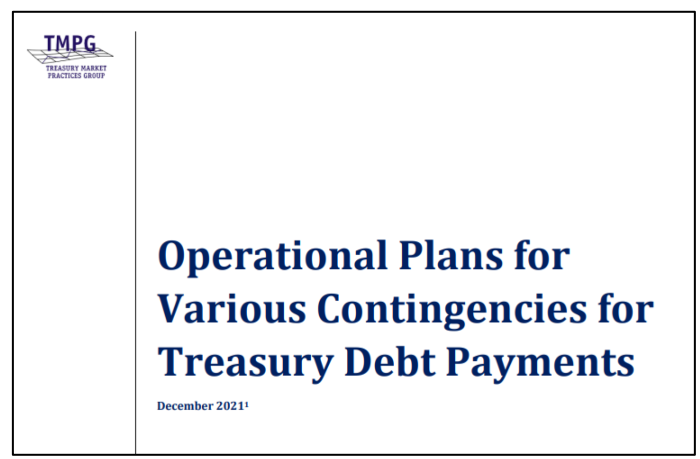
1. "Operational complexities may make default difficult to avoid."
   - Even in situations where the debt limit is raised last minute.
2. "Contingency plans to facilitate market functioning during a default are risky."
   - Discussed TMPG white paper.
   - Extending operational maturity dates.
   - Prioritizing principal and interest payments.
3. "Default could significantly harm financial markets and institutions."
   - Disruptions in short term funding markets.
   - Spread of financial distress to other markets.
   - Risks of runs on banks.
4. "Default could limit tools for protecting bank deposits and preventing runs."
5. "Default would likely reduce lending to households and businesses."
6. "Default could trigger a deep and long-lasting recession in the U.S…"

1. https://www.gao.gov/products/gao-20-561

Current Debt Limit Process: Impacts & Costs

Impact #6: Waste of resources in public and private sector

- A significant amount of time and energy has been put into analyzing each debt limit impasse. Much of this work could be avoided and redirected into more productive efforts.
  1. Major banks run various stress tests for debt limit impasses requiring significant time and effort.
     - Impact on liquidity metrics, margin posting, reviews of hundreds of individual credit support agreements.
     - Impact on margin posting at CCP's, discount window eligibility, standing repo facility.
  2. Bank portfolios and other investors sell securities that mature around x-dates and could be impacted by technical default.
     - Investing cash in other alternatives, like foreign government bonds.
     - Custom exclusions for impacted securities in margin posting agreements.
  3. Various research is done to estimate extraordinary measures and x-dates, as well as operational contingency plans.
     - 2021 TMPG white paper on contingency plans for Treasury debt payments.
     - Operational contingency plans are messy and complicated to deal with in payments systems and settlements.



1. *Bloomberg, Federal Reserve Bank of New York*

Analysis of the GAO's Alternative Debt Limit Approaches

GAO Alternative Debt Limit Approaches

- The GAO report[1] reiterated three alternative approaches to the debt limit (below).
- We note that the GAO also released another report in 2020 addressing *"Effective Use of Fiscal Rules and Targets"*[2]. They suggest integrating these rules into budget decisions as a more effective enforcement mechanism.
  - *"Congress should consider **establishing a long-term fiscal plan that includes fiscal rules and targets**, such as a debt-to-GDP target. In doing so, Congress should weigh the key considerations discussed in this report to help ensure proper design, implementation, and enforcement of those rules and targets."*

GAO Alternative Recommendations[1]

1. *"Link action on the debt limit to the budget resolution."*

2. *"Provide the administration with the authority to increase the debt limit, subject to a congressional motion of disapproval."*

3. *"Delegate broad authority to the administration to borrow as necessary to finance laws enacted by Congress and the President."*

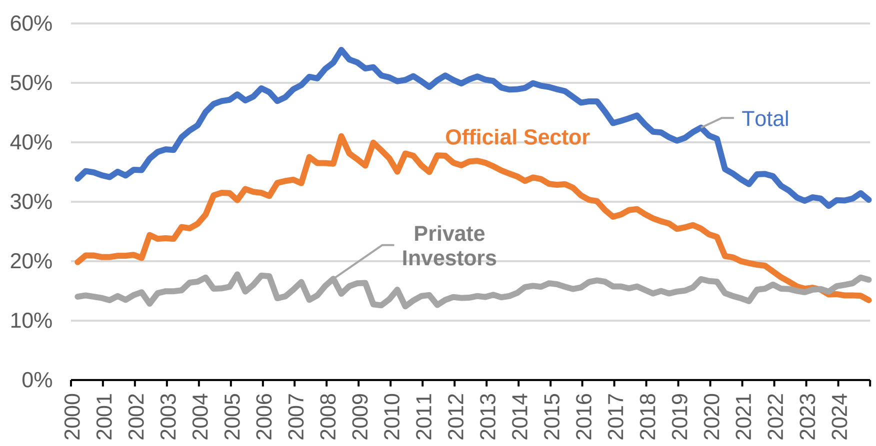
1. https://www.gao.gov/products/gao-25-107089
2. https://www.gao.gov/products/gao-20-561

Who Holds US Treasuries?

The marginal buyer of Treasuries has become more price sensitive. In assessing the impact of changes to the debt limit, its more important than ever to consider the Treasury investor base and potential reactions.

- Investors more exposed to risks of technical default would likely support changes to the debt limit approach.
  - Money market funds and banks in particular.
- All investors would likely welcome reduced risks of ratings downgrades and improved governance processes.
- Some investor classes, like foreign official holders and the US household, might have sensitivity to removing a perceived fiscal guardrail, which could impact term premium.

Foreign ownership of UST[1]



Treasury Holdings by Investor Type and Country[2]

	Amount ($)	% Share
Marketable Tsy outstanding	**28.3 tn**	
Domestic investors	**19.8 tn**	**70%**
Fed	4.3 tn	15%
Household	2.7 tn	9%
Mutual funds & ETFs	2.1 tn	8%
State & local govt	1.6 tn	6%
Banks	1.7 tn	6%
Money mkt funds	3.0 tn	11%
Pension (ex Fed retirement)	1.0 tn	3%
Insurance	0.6 tn	2%
Brokers & dealers	0.4 tn	1%
Other	2.3 tn	8%
Foreign investors	**8.5 tn**	**30%**
Japan	1.1 tn	4%
China mainland	0.8 tn	3%
UK	0.7 tn	3%
Luxembourg	0.4 tn	1%
Cayman	0.4 tn	1%
Ireland	0.3 tn	1%
Switzerland	0.3 tn	1%
Taiwan	0.3 tn	1%
Hong Kong	0.3 tn	1%
Singapore	0.2 tn	1%
Other	3.7 tn	13%
Appendix: China+HK+Lux+Belg	1.8 tn	6%

Foreign Treasury Holdings by Maturity[3]

	Foreign Holdings ($bn)	Total Outstanding ($bn)	Foreign % Ownership
US Treasuries	7,613	24,881	31%
Bill	974	4,467	22%
<1Y Coupon	864	2,998	29%
1-5Y Coupon	3,179	8,943	36%
5-10Y Coupon	1,681	4,169	40%
10-15Y Coupon	24	112	21%
15-20Y Coupon	369	1,689	22%
20-25Y Coupon	199	984	20%
25-30Y Coupon	323	1,519	21%

1. *Federal Reserve as of December 2024*
2. *Federal Reserve & Treasury as of December 2024*
3. *Federal Reserve as of June 2023*

Perception Risk: Fiscal Responsibility

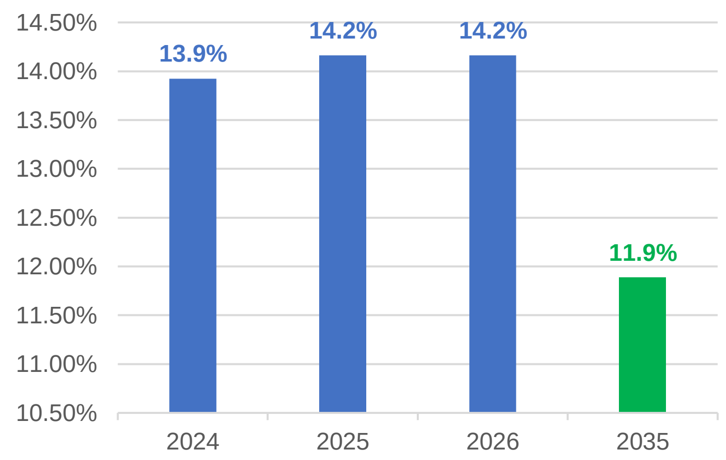
- **We also note that the timing of potential changes to the debt limit matters. In the current environment, markets are likely to be more sensitive to any perceived changes to fiscal responsibility.**

  - US publicly held debt/GDP ratio is around 100% and projected to increase to 119% in 2035.
  - In practice, the debt limit has not been an effective governor on US debt levels.
  - But to instill greater market confidence, it may make sense to attach changes to the debt limit process to a credible plan to get the deficit under control in the long term.
  - Non-defense discretionary spending is only 14% of revenue and projected to drop to 12% by 2035. Reductions in other categories of spending or tax changes may need to be considered.

Most Recent CBO Budget Forecasts[1]

	Percentage of GDP					Billions of dollars			
	Average, 1975–2024	Actual, 2024	2025	2026	2035	Actual, 2024	2025	2026	2035
Revenues	**17.3**	**17.1**	**17.1**	**17.8**	**18.3**	**4,918**	**5,163**	**5,580**	**8,031**
Individual income taxes	8.0	8.4	8.7	9.5	10.0	2,426	2,621	2,968	4,413
Payroll taxes	6.0	5.9	5.8	5.9	5.9	1,709	1,759	1,840	2,605
Corporate income taxes	1.8	1.8	1.7	1.6	1.2	530	524	495	517
Other	1.5	0.9	0.9	0.9	1.1	253	259	277	496
Outlays	**21.1**	**23.7**	**23.3**	**23.3**	**24.4**	**6,826**	**7,028**	**7,294**	**10,730**
Mandatory	11.1	14.3	14.0	14.0	15.1	4,130	4,228	4,386	6,626
Social Security	4.4	5.0	5.2	5.3	6.0	1,454	1,572	1,664	2,624
Major health care programs	3.5	5.8	5.8	5.8	6.7	1,669	1,754	1,832	2,949
Medicare	2.1	3.2	3.1	3.2	4.0	910	942	1,000	1,753
Medicaid, CHIP, and marketplace subsidies	1.3	2.6	2.7	2.7	2.7	759	812	831	1,196
Other mandatory	3.2	3.5	3.0	2.8	2.4	1,006	902	891	1,053
Discretionary	7.9	6.3	6.1	6.1	5.3	1,815	1,848	1,897	2,322
Defense	4.2	3.0	2.9	2.8	2.4	855	859	866	1,053
Nondefense	3.7	3.3	3.3	3.3	2.9	960	989	1,031	1,268
Net interest	2.1	3.1	3.2	3.2	4.1	881	952	1,010	1,783
Total deficit (-)	**-3.8**	**-6.6**	**-6.2**	**-5.5**	**-6.1**	**-1,907**	**-1,865**	**-1,713**	**-2,699**
Primary deficit (-)	-1.7	-3.6	-3.0	-2.2	-2.1	-1,026	-913	-703	-916
Debt held by the public at the end of each period	49.7	97.8	99.9	101.7	118.5	28,199	30,103	31,883	52,056

Non-Defense Discretionary Spending %Total Outlays[1]



1. *Congressional Budget Office*

Alternative 1: Link Action on the Debt Limit to the Budget Resolution

- **Impact on debt limit process:**
  - Modest improvement. A direct linkage to the budget process means that Treasury can borrow to meet the requirements of any spending legislation that is enacted. Reduces the ability for Congress to utilize the debt limit as leverage in budget negotiations.
  - Consideration would need to be given to how to handle spending needs that are not part of the annual appropriations process, such as interest on the debt, social security COLA adjustments.
    - Without such considerations, you could still have debt limit impasses
    - In the three years 2022, 2023, and 2024 quarterly borrowing exceeded Treasury's estimates by $74bn on average, with a standard deviation of about $160bn/quarter.[1]
    - Cumulatively over three years, borrowing exceeded preliminary estimates by roughly $1 trillion.

- **Impact on perceptions (fiscal responsibility):**
  - Minimal impact. The debt limit still exists, it's just attached to the legislative process on spending.
  - Congress maintains control over the debt limit.

- **Market & investor impact**
  - Would be a modest positive, likely to reduce the frequency of impasses.

1. *US Treasury Marketable Borrowing Estimates*

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

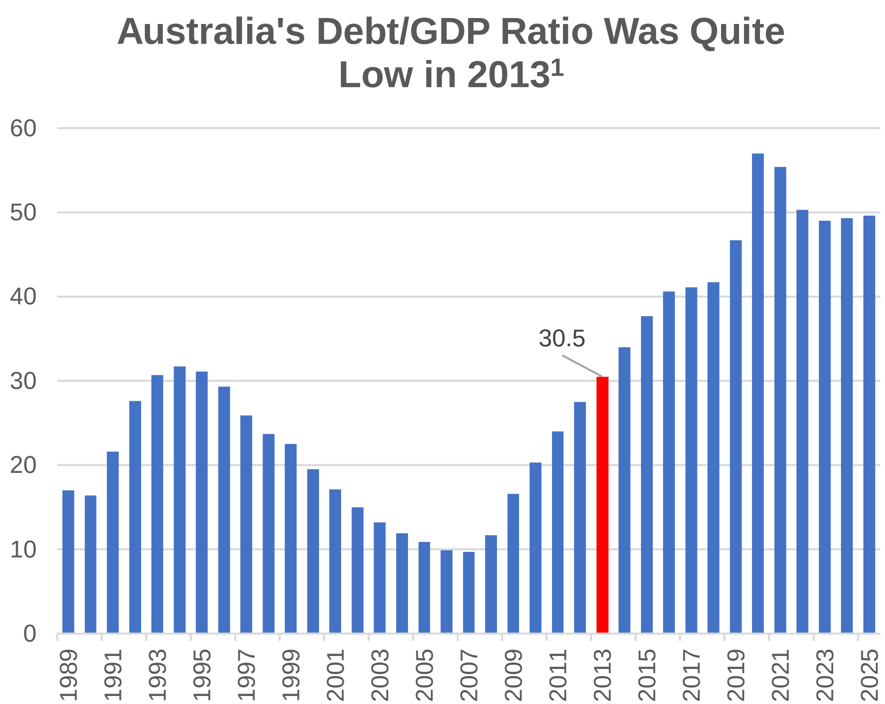
- **Impact on debt limit process:**
  - Improvement, would significantly reduce the ability of Congress to use the debt limit as leverage in budget negotiations.
  - A congressional motion of disapproval would require a majority in Senate and House, but could be vetoed.
  - Overriding a veto would be challenging (requires a two-thirds vote in Congress).
- **Impact on perceptions (fiscal responsibility):**
  - Would be perceived as weakening a fiscal guardrail, but motions of disapproval provide theoretical check & balance.
- **Market & investor impact**
  - Likely positive impact due to significantly reduced probability of impasses.
  - Modest negative impact from perceptions around fiscal responsibility.
  - Supportive of demand for Treasury Bills, front end securities, from MMFs and banks.

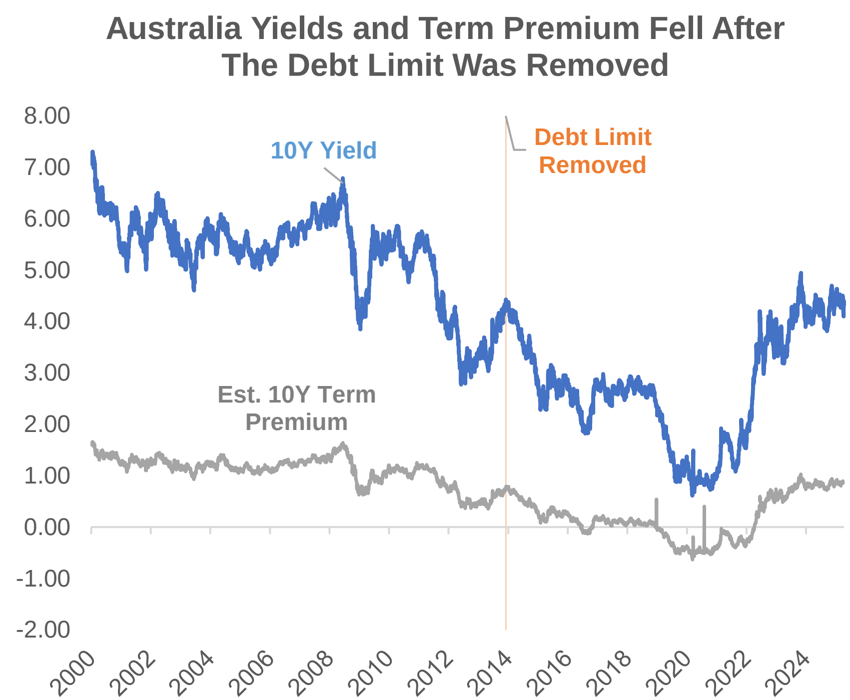
Alternative 3: Delegate Broad Authority to Administration to Borrow as Necessary to Finance Laws Enacted by Congress and President

- **Impact on debt limit process:**
  - Effectively eliminating the debt limit substantially removes risk of brinksmanship and impasses.
- **Impact on perceptions (fiscal responsibility):**
  - This is the riskiest of the three options from a perceptions standpoint.
- **Market & investor impact**
  - Likely positive impact since it fully eliminates impasses that could result in technical default.
  - Uncertain impact from perceptions around fiscal responsibility. Most likely it reduces a known risk around technical defaults and government disruption. But some investor types might fear unchecked fiscal spending. Could be more negative than usual given fiscal risks presented on slide 18.
  - Supportive of demand for Treasury Bills, front end securities, from MMFs and banks.

Case Study: Australia

- In 2013, Australia removed its debt limit in exchange for providing more fiscal transparency when debt increased by more than a specified amount ($50bn)
  - While we haven't done a controlled study, yields and term premium subsequently fell.
  - That said, we note three important differences to the US. (1) Australia debt/GDP ratio was 30% when the debt limit was removed, much lower than in US. (2) Australian government bonds are not a reserve asset (stakes lower). (3) The size of the Australian government bond market is small relative to US.





1. www.imf.org

Conclusions and Other Considerations

- The current approach to the debt limit has had a variety of negative impacts on the global financial system and has likely increased costs to the taxpayer.

- In practice, the debt limit hasn't restrained spending and eliminating it would reduce a variety of known negative impacts. But this comes with increased perceptions risk in the current economic environment.

- If Congress were to eliminate the debt limit, it would be beneficial to also introduce a process around fiscal rules and targets, as outlined in the 2020 GAO report.

- Other considerations for future analysis:

- Should the debt limit be quantified in %GDP terms?

  - As the economy grows, it stands to reason that the debt limit should grow as well.
  - While a change of this type wouldn't be a cure-all, it would contribute towards a smoother approach.
  - There would be some technical issues to resolve (including when GDP data is revised).

- Should the debt limit focus on debt held by the public?

  - US debt held by the government, for example debt that backs social security liabilities, could be excluded from the debt limit calculation.
  - When analyzing debt sustainability or the US fiscal situation, most analysts will focus on "debt held by the public" which excluded intragovernmental debt.
  - In practice this would also eliminate some extraordinary measures that involve temporary reductions of intragovernmental debt.