Market angst over raising the debt ceiling and/or shutting down the government is back. As Congress returned from summer recess this week, both issues were pressing. Treasury Secretary Mnuchin stated earlier that “extraordinary measures” currently employed to finance the deficit would be exhausted by September 29, triggering the risk that, at some point afterwards, there might not be enough cash on hand to make a coupon payment (technically defaulting on the debt). And, without a continuing resolution being passed and signed into law by October 1 (the start of fiscal 2018), parts of the U.S. government would shut down.

However, on Wednesday, sidestepping his party and treasury secretary, President Trump supported the Democrats’ proposal to suspend the debt ceiling and authorize discretionary spending at fiscal 2017 levels, augmented by appropriations for disaster relief, until December 8. The Senate passed the ensuing bill on Thursday, with the House of Representatives doing so on Friday. Having kicked these two cans down the road, we proffer a brief primer on both issues.

**On Raising the Debt Ceiling**

Since Congress began setting caps for the aggregate debt limit in 1917 (amid World War I), it has been regularly lifted and not employed as a pawn in partisan budgetary disputes. It was recognized that raising the debt ceiling facilitated the financing of budget shortfalls already approved by Congress (Chart 1). However, the ballooning of the federal deficit owing to the Great Recession and the GOP taking control of the House of Representatives in the 2010 midterm elections set the stage for 2011’s debt-ceiling crisis. The House Republicans sought a deficit-reduction package in return for lifting the limit; and, a pawn was born. The ceiling was hit in mid-May with extraordinary measures expected to be exhausted by early August. The brinkmanship went down to the wire, resulting in the spending-cutting Budget Control Act (BCA) of 2011; and, an effective pawn was born.2

The debt cap set by the BCA of 2011 became binding on December 31, 2012, triggering extraordinary measures again, amid the kerfuffle over averting the “fiscal cliff” (recall the combination of expiring tax cuts from the George Bush era and scheduled broad-based spending cuts that would create a near-$500 billion reduction in the deficit and a huge hit to the economy). Dealing with the latter more pressing,

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1 The extraordinary measures currently available are: (1) suspending sales of State and Local Government Series Treasury securities; (2) redeeming existing, and suspending new, investments of the Civil Service Retirement and Disability Fund and the Postal Service Retiree Health Benefits Fund; (3) suspending reinvestment of the Government Securities Investment Fund; and (4) suspending reinvestment of the Exchange Stabilization Fund. 
2 The fact that it went down to the wire appeared to spook S&P, and they downgraded America’s credit rating to AA+ from AAA after earlier assigning a negative outlook owing to poor fiscal fundamentals. Other major agencies either kept or newly assigned a negative outlook.
issue first, the debt ceiling was subsequently temporarily suspended in February 2013 until May 2013.

The new practice of temporary suspension meant that Congress didn’t have to technically vote to “raise” the debt ceiling to a level that the debt would grow into, even though they had already approved the path. The practice also automatically put the pawn back in place because the new debt ceiling at reinstatement would be the actual accumulated deficit to that point, with no prefunding of future deficits permitted. In consequence, the new debt ceiling would automatically become binding again, triggering extraordinary measures (which would have been paid back during the suspension period). The debt ceiling was suspended again in October 2013, until March 2015 (cue the extraordinary measures), and re-suspended in November 2015 until March 2017, resulting in the current (immediately binding) cap of $19.8 trillion. The just-passed bill again provides the opportunity for Treasury to pay back financing done via extraordinary measures and sets up another countdown to not-enough-cash once the ceiling is reinstated on December 8. Note that February and March tend to be big budget deficit months, partly owing to tax refunds, so extraordinary measures will likely be exhausted by March 2018.³

On Shutting Down the Government

The current U.S. budget and appropriation process was established by the Congressional Budget Act of 1974, and is convoluted on paper and even more so in practice. The President first submits a detailed budget as an opening salvo in negotiations. The Congressional Budget Office then inserts the President’s policy details into its own framework for figuring out the deficit, and also determines a baseline budget projection based on the assumption that current legislation does not change. Armed with these two scenarios, the House and Senate work separately on a common budget resolution. This is an undetailed total appropriations amount and allocation across broad spending buckets. This does not authorize spending, but establishes the amount of mandatory and discretionary spending.⁴ (Chart 2) The agreed-to latter amount is then handed to the House and Senate appropriations committees and subsequently to their various sub-committees to craft 12 individual appropriations bills. Once both bodies agree on the same appropriations, the 12 individual bills make their way (piecemeal or in some combination) to the White House for the President’s signature.

Given ever-present partisan politics and divergent policy biases, it’s easy to envisage situations in which one or more bills get bogged down and not become law by October 1. This would result in spending authority lapsing (a.k.a., a spending or funding gap)

³ Technically, once out of room, Treasury would have to start prioritizing payments, with coupon payments to bondholders probably at the top of the list. But there’s always the risk that there still might not be enough cash on hand to make a full coupon payment on a specific date. Note also that President Trump appears to be in favour of scrapping the debt ceiling all together, which technically occurs during the periods of suspension anyway. The Democrats are on board, but the Republicans are not.

⁴ According to the CBO, for fiscal 2017, among the $4.0 trillion in total outlays, $2.5 trillion is mandatory (e.g., Social Security, Medicare), $1.4 trillion is discretionary and $0.3 trillion is net interest.
for the various government departments and programs covered by the individual bills. These gaps do not immediately trigger partial or complete (in the extreme) government shutdowns, but the more comprehensive the bill is, and the longer the gap persists, the greater is the risk of a shutdown. To avoid these situations, a continuing resolution that keeps appropriations at the prior year’s levels until new bills are completed could be passed by Congress and signed by the President.

Looking back to the mid-1970s, there have been 18 occasions when at least one appropriations bill hasn’t become law in time, or wasn’t reprieved by a continuing resolution, creating a spending gap. Most (13), but not all, involved different political parties in the White House and Congress (one or both bodies). The Carter Administration and the Democratically-controlled Congress suffered five such episodes during the 1977-79 period but none were broad enough to furlough government employees (the ultimate definition of a government shutdown). The two most recent gap episodes/shutdowns were the most significant: (1) 21 days in 1995-96, estimated by the CBO to have cost 0.5 ppts (annualized) of GDP growth in 1996 Q4; and, (2) 16 days in 2013, estimated by Macroeconomic Advisers to have cost more than 0.3 ppts in 2013 Q4.

Unlike the debt ceiling, December 8 is a hard deadline for the end of spending authority. President Trump has said that he would use his veto power if funding for a border wall with Mexico was not included. The Democrats are against funding a wall, and there is some Republican opposition. Is this the issue that could force another shutdown? Stay tuned.
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