DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 4, 2011

The Honorable Harry Reid
Democratic Leader
United States Senate
Washington, DC 20510

Dear Mr. Leader:

I am writing to update you on the Treasury Department's projections regarding when the statutory debt limit will be reached and to inform you about the limits of the available measures at our disposal to delay that date temporarily.

In our previous communications to Congress, we provided regular estimates of the likely time period in which the debt limit could be reached. We can now make that projection with more precision. The Treasury Department now projects that the debt limit will be reached no later than May 16, 2011. This is a projection based on the expected level of tax receipts, the timing of our commitments and obligations over the next several weeks, and our judgment concerning the level of cash balances we need to operate. Although these projections could change, we do not believe they are likely to change in a way that would give Congress more time in which to act. Treasury will provide an update of this projection in early May.

If the debt limit is not increased by May 16, the Treasury Department has authority to take certain extraordinary measures, described in detail in the appendix, to temporarily postpone the date that the United States would otherwise default on its obligations. These actions, which have been employed during previous debt limit impasses, would be exhausted after approximately eight weeks, meaning no headroom to borrow within the limit would be available after about July 8, 2011. At that point the Treasury would have no remaining borrowing authority, and the available cash balances would be inadequate for us to operate with a sufficient margin to meet our commitments securely.

As Secretary of the Treasury, I would prefer to avoid resorting to these extraordinary measures. The longer Congress fails to act, the more we risk that investors here and around the world will lose confidence in our ability to meet our commitments and our obligations.

If Congress does not act by May 16, I will take all measures available to me to give Congress additional time to act and to protect the creditworthiness of the country. These measures, however, only provide a limited degree of flexibility—much less flexibility than when our deficits were smaller.

As the leaders of both parties in both houses of Congress have recognized, increasing the limit is necessary to allow the United States to meet obligations that have been previously authorized and appropriated by Congress. Increasing the limit does not increase the obligations we have as a Nation; it simply permits the Treasury to fund those obligations that Congress has already established.

If Congress failed to increase the debt limit, a broad range of government payments would have to be stopped, limited or delayed, including military salaries and retirement benefits, Social Security and Medicare payments, interest on the debt, unemployment benefits and tax refunds. This would cause severe hardship to American families and raise questions about our ability to defend our national security interests. In addition, defaulting on legal obligations of the United States would lead to sharply higher interest rates and borrowing costs, declining home values and reduced retirement savings for Americans. Default would cause a financial crisis potentially more severe than the crisis from which we are only now starting to recover.

For these reasons, default by the United States is unthinkable. This is not a new or partisan judgment; it is a conclusion that has been shared by every Secretary of the Treasury, regardless of political party, in the modern era.

Treasury has been asked whether it would be possible for the Treasury to sell financial assets as a way to avoid or delay congressional action to raise the debt limit. This is not a viable option. To attempt a "fire sale" of financial assets in an effort to buy time for Congress to act would be damaging to financial markets and the economy and would undermine confidence in the United States.

Selling the Nation's gold, for example, would undercut confidence in the United States both here and abroad. A rush to sell other financial assets, such as the remaining financial investments from the Emergency Economic Stabilization Act programs, would impose losses on American taxpayers and risk damaging the value of similar assets held by private investors without generating sufficient revenue to make an appreciable difference in when the debt limit must be raised. Likewise, for both legal and practical reasons, it is not feasible to sell the government's portfolio of student loans.

Nor is it possible to avoid raising the debt limit by cutting spending or raising taxes. Because of the magnitude of past commitments by Congress, immediate cuts in spending or tax increases cannot make the necessary cash available. And, reductions in future spending commitments cannot supply the short-term cash needed. In order to avoid an increase in the debt limit, Congress would need to eliminate annual deficits immediately.

As the Congressional Research Service stated in its February 11, 2011 report:

> "If the debt limit is reached and Treasury is no longer able to issue federal debt, federal spending would have to be decreased or federal revenues would have to be increased by a corresponding amount to cover the gap in what cannot be borrowed. To put this

into context, the federal government would have to eliminate all spending on discretionary programs, cut nearly 70% of outlays for mandatory programs, increase revenue collection by nearly two-thirds, or take some combination of those actions in the second half of FY2011 (April through September 30, 2011) in order to avoid increasing the debt limit. Additional spending cuts and/or revenue increases would be required, under current policy, in FY2012 and beyond to avoid increasing the debt limit."[1]

None of those budget policy choices is feasible or responsible. As a consequence, given that Congress has imposed on itself the requirement for periodic increases, there is no alternative to enactment of an increase in the debt limit.

I am encouraged that the leaders of both parties in both houses of Congress have clearly stated in public over the last few weeks and months that we cannot default on our obligations as a nation and therefore have to increase the debt limit. Because the date by which we need to increase the limit is growing nearer, I hope that the leadership in both houses will help us impress upon all Members the gravity of this issue and the imperative of timely action.

President Obama is strongly committed to working with both parties to restore fiscal responsibility, and he looks forward to working with Congress to achieve that critically important objective. In the meantime, it is critical that Congress act to increase the debt limit so that the full faith and credit of the United States is protected.

I hope this information is helpful as you plan the legislative schedule for the coming weeks.

Sincerely,

Timothy F. Geithner

Identical letter sent to:

The Honorable John A. Boehner, Speaker of the House
The Honorable Nancy Pelosi, House Democratic Leader
The Honorable Mitch McConnell, Senate Republican Leader

cc: The Honorable Dave Camp, Chairman, House Committee on Ways and Means
The Honorable Sander M. Levin, Ranking Member, House Committee on Ways and Means
The Honorable Max Baucus, Chairman, Senate Committee on Finance
The Honorable Orrin Hatch, Ranking Member, Senate Committee on Finance
All other Members of the 112th Congress

Enclosure

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[1] CRS Report R41633, February 11, 2011

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APPENDIX

Descriptions of the Extraordinary Measures

Previous Secretaries of the Treasury, in both Republican and Democratic administrations, have taken extraordinary measures in order to prevent the United States from defaulting on its obligations as Congress deliberated on increasing the statutory debt limit.[2] Four of these extraordinary measures are available this year. Other measures taken by previous Treasury Secretaries, however, are either unavailable or of limited use.

The extraordinary measures currently available are: (1) suspending sales of State and Local Government Series (SLGS) Treasury securities; (2) determining that a "debt issuance suspension period" exists, which would permit the redemption of existing, and the suspension of new, investments of the Civil Service Retirement and Disability Fund (CSRDF); (3) suspending reinvestment of the Government Securities Investment Fund (G Fund); and (4) suspending reinvestment of the Exchange Stabilization Fund (ESF). These measures are described in more detail below.

These measures, all of which have been employed during previous debt limit impasses, have the effect of creating or conserving headroom beneath the debt limit. Importantly, these extraordinary measures—even taken together—are of limited use. On average, the public debt of the United States increases by approximately $125 billion per month (although there are significant variations from month to month). In total, the extraordinary measures free up approximately $165 billion in headroom under the limit before June 30, 2011, as described below. In addition, if the United States does not exhaust the $165 billion before June 30, 2011, the law governing the CSRDF permits Treasury to take one more action on June 30, which would create an additional $67 billion in headroom on that date.

Under Treasury's current projections, these extraordinary measures would be exhausted after approximately eight weeks, meaning no headroom to borrow within the limit would be available after about July 8, 2011. This estimate is dependent on a number of factors, such as the total amount of tax receipts, which cannot be known with certainty until they actually come in during the second half of April, and the fact that large payments like Social Security and interest payments on Treasury securities are made at certain times of the month.

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[2] The Treasury Department has already taken an action, relating to the Supplementary Financing Program, that has delayed the date that the debt limit will be reached. In January, Treasury announced that it would allow the outstanding $200 billion in Treasury bills issued under the Supplementary Financing Program (which count against the debt limit) to mature in an orderly fashion without being refunded by new bills. By taking this action, Treasury has reduced the debt by $200 billion, so as to postpone the date the debt limit is reached. This action has already been completed and the resulting reduction in debt has already been factored into Treasury's projections; it cannot further postpone the date the debt limit is reached.

It should also be noted that these extraordinary measures are less useful than in previous debt limit impasses. In the 1995-1996 debt limit impasse, for example, the monthly increase in debt was not as large, and the extraordinary measures were therefore able to postpone the date by which the debt limit needed to be increased for several months. The same was true during the 1985 and 2003 debt limit impasses. And, as noted below, some extraordinary measures that were used in the past are no longer available or of limited use today.

1. State and Local Government Securities (SLGS)

The Treasury Department has authority to suspend its issuance of State and Local Government Series Treasury securities (SLGS). This, however, is a limited measure that does not free up borrowing authority.

SLGS are special purpose Treasury securities issued to state and local government entities. In ordinary times, the Treasury Department issues SLGS to state and local governments to assist these governments in complying with Federal tax laws when they have cash proceeds to invest from their issuance of tax exempt bonds. When Treasury issues these securities, they count against the debt limit.[3] There is no statutory or other requirement for the Treasury Department to issue SLGS; they are issued in order to assist state and local governments, and Treasury may suspend SLGS sales during or in anticipation of a debt limit impasse.

This action does not free up headroom under the debt limit. Rather, it conserves headroom (*i.e.*, it eliminates increases in debt that would count against the debt limit if issued).[4] Utilizing this measure reduces uncertainty in projecting the growth of the debt.[5]

2. Civil Service Retirement and Disability Fund

Once the debt limit has been reached, Treasury has authority to take actions regarding investments under the Civil Service Retirement and Disability Fund (CSRDF). This includes declaring a "debt issuance suspension period" with respect to the CSRDF investments.[6]

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[3] The total amount of SLGS outstanding at the end of February 2011 was $182.4 billion.

[4] In other words: when Treasury issues these securities, these securities count against the debt limit; suspending issuance therefore conserves headroom.

[5] Approximately $3 - $12 billion in SLGS is issued per month although this amount is subject to substantial variation from month to month.

[6] The final three measures—relating to Civil Service Retirement and Disability Fund, the Government Securities Investment Fund of the Thrift Savings Plan, and the Exchange Stabilization Fund—all involve the management of the portion of the debt held by U.S. Government accounts, not the debt that is held by the public. The debt of the United States consists of two components: (1) debt held by the public (*e.g.*, the Treasury securities that are periodically auctioned by Treasury); and (2) debt held by U.S. Government accounts. This second category includes, for example, the investments by the Social Security trust fund and other trust funds, and consists of special Treasury securities that are issued directly to those trust fund accounts. The debt held by U.S. Government accounts is approximately $4.6 trillion—in other words, it constitutes roughly a third of the debt.

a. <u>Declaring a "Debt Issuance Suspension Period"</u>

The CSRDF provides defined benefits to retired and disabled Federal employees covered by the Civil Service Retirement System. The fund is invested in special-issue Treasury securities, which count against the debt limit. Congress has given Treasury statutory authority to take certain actions in the event of a debt limit impasse. Specifically, the statute authorizes the Secretary of the Treasury to determine that a "debt issuance suspension period" exists and, once he has done so, Treasury can (1) redeem certain existing investments in the CSRDF, and (2) suspend new investment.

The Secretary of the Treasury does not have unlimited discretion to declare a debt issuance suspension period. Under the statute that governs the CSRDF, the term "debt issuance suspension period" means the period of time that the Treasury Secretary determines that Treasury securities cannot be issued without exceeding the debt limit. The determination of the length of the period must be based on the facts as they exist at the time.

Declaring a debt issuance suspension period is a limited measure that relates only to the CSRDF; it has no impact on any other investments or any other portion of the debt. Moreover, it only provides limited additional time. Assuming a two-month debt issuance suspension period, this measure would free up approximately $12 billion in headroom.[7]

Even if the Secretary were to declare a much longer debt issuance suspension period, this would provide only limited additional headroom. Declaring a 12-month debt issuance suspension period, for example, would only free up approximately $72 billion in additional headroom.[8] In other words, because the debt increases on average by approximately $125 billion per month, a 12-month debt issuance suspension period (which frees up roughly $72 billion in headroom) would postpone the date by which the debt limit must be increased by only a matter of weeks.

During a debt issuance suspension period, civil service benefit payments would continue to be made as long as the United States has not yet exhausted the extraordinary measures. Once the extraordinary measures have been exhausted, however, the U.S. Government will be limited in

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[7] The statute governing the CSRDF gives Treasury authority to redeem existing Treasury securities held by the CSRDF in an amount up to the amount of civil service benefit payments authorized to be made from the CSRDF during the debt issuance suspension period. 5 U.S.C. § 8348(k). Treasury makes approximately $6 billion in civil service benefit payments from the CSRDF each month. Therefore, declaring a two-month debt issuance suspension period would allow Treasury to redeem approximately $12 billion of the Treasury securities held by the CSRDF, freeing up approximately $12 billion in headroom. The statute also authorizes Treasury to suspend new investments by the CSRDF during a debt issuance suspension period. The CSRDF receives approximately $2 billion in new employer and employee contributions each month. Therefore, during each month of a debt issuance suspension period, approximately $2 billion in headroom that would otherwise be used is conserved.

[8] As explained above, Treasury makes approximately $6 billion in civil service benefit payments each month. A 12-month debt issuance suspension period would allow Treasury to redeem approximately $6 billion 12 times, or approximately $72 billion, of the Treasury securities held by the CSRDF, freeing up approximately $72 billion in headroom. Additionally, each month it would also conserve approximately $2 billion in headroom.

its ability to make payments across the government. After the debt limit impasse has ended, the statute provides that the CSRDF is made whole.[9]

b. <u>One-time measure available on June 30 if the United States has not exhausted the measures before that date</u>

If the United States has not exhausted the measures before June 30, the statute governing the CSRDF provides an additional one-time measure on that date that frees up headroom.

The same statute that authorizes Treasury to redeem existing investments during a debt issuance suspension period also authorizes Treasury to suspend new investments by the CSRDF during such a period. On June 30, approximately $67 billion in CSRDF investments mature. Ordinarily the proceeds of the maturing investments would be reinvested. But with the investment-suspension authority available, Treasury may suspend the reinvestment of the maturing investments. Suspending the reinvestment would free up approximately $67 billion in headroom.

It should be understood that this suspension of reinvestment that frees up headroom is a one-time measure: it is only available on June 30.[10] The benefit of this additional headroom, moreover, is offset in part by the fact that on that same day Treasury is required to make $12 billion in interest payments on certain of its securities held by the public.

3. G Fund

Once the debt limit has been reached, Treasury may also suspend the daily reinvestment of the Treasury securities held by the Government Securities Investment Fund (G Fund) of the Federal Employees' Retirement System Thrift Savings Plan.

The G Fund is a money market defined-contribution retirement fund for Federal employees. The Fund is invested in special-issue Treasury securities, which count against the debt limit. The entire balance matures daily and is ordinarily reinvested. Congress has granted Treasury the statutory authority to suspend reinvestment of all or part of the balance of the G Fund when the Secretary determines that the Fund cannot be fully invested without exceeding the debt limit.[11]

Using this measure immediately frees up headroom under the debt limit. Because the G Fund balance is approximately $130 billion, using this measure can immediately create up to approximately $130 billion in headroom.

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[9] After the debt limit impasse has ended, Treasury is required to put the CSRDF investment portfolio into the position it would have been in if the impasse had not occurred, and to restore lost interest on the next regularly scheduled interest payment date on the Treasury securities held by the CSRDF.

[10] In addition, this measure conserves headroom. On June 30, there is an interest payment of approximately $18 billion scheduled to be made to the fund. If this interest were invested, it would use up headroom. Because the statute governing the CSRDF authorizes Treasury to suspend new investments, Treasury may suspend the investment of this interest payment, which would conserve approximately $18 billion of headroom.

[11] 5 U.S.C. § 8438(g).

During the period of the investment suspension, payments from the G Fund continue to be made as long as the United States has not yet exhausted the extraordinary measures. Once the United States has exhausted the extraordinary measures, however, the U.S. Government will be limited in its ability to make payments across the government. After the debt limit impasse has ended, the G Fund is made whole.[12]

4. Exchange Stabilization Fund

Treasury may also suspend the daily reinvestment of Treasury securities held by the Exchange Stabilization Fund (ESF).

The ESF has a number of uses, including purchasing or selling foreign currencies. A portion of the ESF is held in U.S. dollars, and the dollar-balance of the ESF is invested in special-issue Treasury securities. The entire dollar-balance matures daily. There is no requirement that the Treasury Department invest the ESF, so Treasury may discontinue investing the dollar-balance of the ESF during a debt limit impasse.

Suspending the daily reinvestment of the dollar-balance of the ESF immediately frees up headroom under the debt limit. Because the dollar-balance of the ESF is approximately $23 billion, this would create up to approximately $23 billion in headroom.

After a debt limit impasse, the interest lost by the ESF is not restored: there is no existing authority to reimburse the ESF for lost interest during the period that the dollar-balance is not invested.

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As described above, the four extraordinary measures can free up approximately $230 billion in headroom. This would postpone the date by which the debt limit needs to be increased by approximately 8 weeks, or until about July 8, 2011.

<u>Other Measures Used by Previous Treasury Secretaries Are No Longer Available or of Limited Use</u>

The other measures that previous Treasury Secretaries have used in past debt limit impasses in order to postpone the date by which the debt limit needed to be increased are either not available or of limited use.

First, although previous Treasury Secretaries have suspended the issuance of U.S. savings bonds to the public, doing so now would be of little benefit. Suspending the issuance of U.S. savings bonds would not free up any headroom under the debt limit. As is the case with suspending sales of SLGS, suspending the sales of savings bonds would only eliminate increases in debt that would count against the debt limit if the securities were issued. Moreover, suspending such sales conserves very little headroom.[13] Second, measures relating to the Federal

[12] Treasury is required to restore lost interest on the next business day.
[13] Sales of savings bonds increase the amount of debt by less than $220 million per month on average.

Financing Bank (FFB) are of limited use.[14] Third, a measure previously used, involving the calling in of cash that Treasury kept on deposit at banks, is no longer available: Treasury no longer keeps these balances.[15] Finally, Congress has in the past provided one-time tools in the midst of a debt limit impasse;[16] those authorities expired 15 years ago.

Other Assets

Although the U.S. Government owns other assets, such as gold, there are prudential or legal limitations on its ability to sell these assets. Selling the Nation's gold to meet payment obligations would undercut confidence in the United States both here and abroad, and would be extremely destabilizing to the world financial system.

With respect to the portfolio of mortgage-backed securities owned by Treasury, Treasury recently announced that it would begin gradually selling these assets, at the rate of up to $10 billion per month subject to market conditions.[17] Treasury's assessment is that selling this amount maximizes value to taxpayers without adversely affecting the market or mortgage rates. A "fire sale" of these assets would be adverse to the interests of taxpayers and could jeopardize the still-fragile housing market. Similarly, although the United States retains investments received in connection with the Troubled Asset Relief Program, Treasury is in the process of exiting these investments in an orderly manner. A "fire sale" of these investments would not maximize value for the taxpayer and could be detrimental to the economy in general. Finally, as mentioned above, for both legal and practical reasons, sale of the government's portfolio of student loans is not feasible. Secretaries of the Treasury of both parties have concluded that asset sales are not a prudent or viable alternative to increasing the debt limit.

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[14] In the past, Treasury was able to free up headroom under the debt limit by entering into multi-step exchange transactions with FFB and the CSRDF, swapping obligations that do not count against the debt limit for an equal amount of Treasury securities held by the CSRDF that do count against the debt limit. In each case, FFB used the Treasury securities that it received from the CSRDF to pay down its borrowings from Treasury. When Treasury received from FFB the Treasury securities, they were extinguished, creating the headroom. The potential to use such an exchange transaction is of limited use at this time because FFB has a limited amount of obligations available to exchange.

[15] In the past, Treasury had an ability to increase its cash balance without increasing debt by calling in the non-interest-bearing balances that Treasury formerly kept on deposit at banks to compensate them for fiscal services they provided to Treasury. That option is no longer available because Treasury discontinued keeping those "compensating balances" after Congress appropriated funding to Treasury in 2004 to pay directly for fiscal services.

[16] Specifically, in 1996, in order to enable Treasury to pay the March 1996 Social Security benefits, Congress passed legislation that permitted Treasury to issue a limited amount of Treasury securities that were temporarily excluded from being counted against the debt limit. In addition, Congress passed legislation that temporarily excluded from being counted against the debt limit the new Treasury securities that Treasury issued to federal trust funds in March 1996 to invest new trust fund receipts and to reinvest the proceeds of maturing trust fund investments. Those exclusions from the debt limit expired on March 30, 1996.

[17] The proceeds from these sales are already built into the Treasury projections.