Higher Education and a Debt Ceiling Default

To understand the impact to American higher education of a failure by the government to raise the national debt limit, causing the United States to default on its obligations, it is important to keep the following points in mind:

- This would be an unprecedented situation, as the United States has never defaulted on its debts.
- As a result, there is not a clear understanding of the likely impact of a default or what specific measures may be taken by the federal government in the event of a default.
- While the impact on higher education will be a small piece of the overall impact of a default across every sector of our economy, it nonetheless has the potential to wreak considerable chaos, uncertainty, and harm on a wide range of institutions and students.

Understanding the Debt Ceiling

While no analogy is perfect, it is helpful to think of the federal debt ceiling as similar to the borrowing limit on a credit card. It is the maximum amount that the federal government can borrow without paying down some of the existing debt. Unlike with a credit card, Congress has the authority to raise the debt limit and expand federal borrowing as needed. According to the Treasury Department (Treasury) "Since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit – 49 times under Republican presidents and 29 times under Democratic presidents."[1] The question of whether the president has the authority to unilaterally raise the debt ceiling without congressional approval has never been litigated, but there has been a legal debate over that issue.

Currently, the debt limit is $31.4 trillion dollars. Since January, Treasury has been using so-called "extraordinary measures" to meet federal obligations without exceeding the debt ceiling. Treasury estimates that the point where extraordinary measures are insufficient, triggering a default (what is often referred to as the "x-date") could be reached as early as June 1. The Congressional Budget Office has estimated that we will hit the x-date in the first two weeks of June.

[1] https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit#:~:text=Since%201960%2C%20Congress%20has%20acted%2078%20separate%20times,both%20parties%20have%20recognized%20that%20this%20is%20necessary.

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Difference Between a Default and a Shutdown

There can be some confusion over what happens if the government defaults as compared to what happens in a federal shutdown. This is understandable as both events share some similarities and both situations can arise as the result of government inaction.

Government shutdowns:

- Shutdowns occur when the government fails to agree on what funding levels to operate on.
- The government is unable to obligate (either spend or commit to spending) money as a result.
- This effectively closes the doors of government, with federal employees (aside from a limited number of employees who perform "essential" functions) furloughed and government services closed.
- Government shutdowns have occurred numerous times over the last three decades, ranging in length from a day to as long as five weeks.
- While shutdowns can have economic impacts, with the uncertainty causing concern in financial markets, they do not generally have lasting impacts on the broader economy.

Defaults:

- In a default, the government remains open but due to the inability to borrow, federal operations may be curtailed due to a lack of available funds.
- Federal employees will be expected to continue working, though payrolls may be delayed and furloughs or other temporary measures to reduce spending may be instituted.
- Existing obligations do not change – the government is still required to meet its statutory obligations, but it may not have the money on hand to make the payments they owe.
- During a default, revenue still comes into the Treasury and money still goes out from the federal government. But these amounts can vary significantly on a day-to-day basis.

Impact of a Default Generally

Other elements distinguish a default from a shutdown, most notably the severity of the crisis a default would precipitate. While there is no certainty as to what may happen in the event of a default, the general consensus is that:

- The credit rating of the United States will be downgraded from the current AAA rating to AA+ or lower.
- Interest rates will increase significantly, making the cost of borrowing and the cost of making payments on existing debt significantly more expensive.
- Financial markets will experience significant volatility, with crashes in value across global markets the most likely outcome.

- The three scenarios above occurred in 2011 when the United States nearly defaulted, so would appear to be highly likely in the event of an actual default.
- Investors will likely move money to what are perceived as safer opportunities, generally identified as international equities and bonds held by foreign governments. This will exacerbate financial circumstances domestically and reduce revenue available to the Treasury to meet obligations.
- In combination, the above factors will precipitate a domestic or global recession. Given the inability of the U.S. government to deficit spend in response to a recession (which is the standard measure taken) the severity of the recession could grow while the government remains in default.
- While a short-term default will have significant negative consequences, an extended default would greatly exacerbate the challenges and magnify the negative impacts. As Moody's Analytics noted:
    - "How much damage would be done would depend on how long the crisis continues. If the default lasts for about a week, then close to one million jobs would be lost, including in the financial sector, which would be hard hit by the stock market declines. Also, the unemployment rate would jump to about 5% and the economy would contract by nearly half a percent."[2]
    - "But if the impasse dragged on for six weeks, then more than seven million jobs would be lost, the unemployment rate would soar above 8% and the economy would decline by more than 4%, according to Moody's. The effects would still be felt a decade from now."[3]

How the Federal Government Will Manage a Default

It is not entirely clear how the federal government will respond in the event of a default. The Biden administration has not yet issued clear guidance at either the agency or whole-of-government level. The best guide so far to how the government would manage a default is from 2011, when the Federal Reserve prepared an approach in response to an impending (but ultimately averted) default.[4]

The key components of that plan were:

- The Treasury would issue new bonds at a level equivalent to those bonds that are due for payment, allowing for a like replacement of obligations with new borrowing that remains under the debt limit threshold.
- Available federal revenue would then be used to make interest payments on existing debt, ensuring that the United States does not default on its current debt. Interest payments represent approximately one-third of all federal obligations.
- With whatever money remains, the Treasury would have to prioritize what payments to make from the remaining available funds.
- Treasury would only make payments it has full funding to make, so it would not make partial payments.

[2] https://www.cnn.com/2023/05/02/politics/debt-ceiling-social-security-economy/index.html
[3] ibid
[4] https://www.federalreserve.gov/monetarypolicy/files/FOMC20110801confcall.pdf

- It is not clear what criteria would be used to prioritize federal payments in a default, though Social Security and national security measures are generally considered to be the highest priorities.

Impact on Higher Education Specifically

Given that much of how the government will manage a default depends on how it prioritizes across the thousands of programs it administers, it is not completely clear what the specific impacts on higher education will be.

- First and foremost, higher education is inextricably linked to the broader economy. So, the negative economic impacts of a default will result in more students and their families' losing jobs or seeing reduced financial circumstances; borrowing costs and the costs of carrying debt will increase significantly for students, staff, and institutions; and likely reductions in local, state and federal support for higher education.
- In addition, timing is critical. If a default is resolved quickly, there should not be a major disruption of the disbursement of federal student aid for the fall and spring semesters. A lengthy default could cause disruptions in the disbursement of aid for the fall semester at a minimum.
- One concern for higher education is that the bulk of federal payments to institutions comes in the form of financial aid disbursement at two points in the year: prior to the start of the traditional fall semester and prior to the start of the traditional spring semester. That timing may make it harder to prioritize financial aid payments.
- It is also unlikely that disbursements of federal financial aid, institutional support programs, scientific research grant funding and other areas of federal support would be as heavily prioritized as other areas of federal obligation, particularly large entitlement programs such as Social Security or Medicare.
- Additionally, due to how the government accounts for federal student loans, there is reason to believe that certain types of federal student loans that are projected to generate a positive return for the government (primarily PLUS Loans) could still be offered while other loans that are offered at a loss (primarily Stafford loans) may not be offered.
- Institutions may need to consider ways to extend support to students in the event of a default. This could include increased institutional aid, greater flexibility around when students make payments, or other options.