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THE PUBLIC DEBT LIMIT

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DISCUSSIONS OF RAISING the public debt beyond the ceiling of $275 billion, as fixed by the Public Debt Act of 1946, have aroused current interest in the history and development of the debt limit. It seems appropriate, therefore, to review the history of congressional restrictions on the size of the public debt. Until World War I, Congress granted specific authority to the Secretary of the Treasury for a certain amount of borrowing whenever there was a need for new funds. At the beginning of World War I, Congress shifted its restrictions from authorizations for specific loans, such as the Panama Canal loan, the terms of which could be readily predetermined, to separate limits for specific types of securities, which would allow a greater choice of issues by the Treasury. This procedure was first altered so that two or more different types of securities could be issued under a single ceiling, and then was replaced by an all inclusive debt limit with a coverage applying to all securities (in the year 1939).[1] These changes reflected the need for greater flexibility in the management of the growing public debt. Since the size of the debt at any one time reflects the cumulative results of fiscal policy as expressed in separate spending and revenue authorizations by Congress, the debt ceiling provides an automatic review of the trend in the results of fiscal policy whenever an increase in borrowing above the current ceiling is necessary or a decrease in borrowing has made a reduction in the ceiling possible.

WORLD WAR I BORROWING

In view of the uncertain national security and defense requirements upon our entry into World War I, Congress established a five billion dollar aggregate limit on new issues of bonds under the First Liberty Loan Act of 1917 (April 24, 1917). Recognizing the immediate need for short-term funds, provision was also made for

* This note represents the personal views of the authors and not necessarily those of the Bank. It covers developments through May 1954.

1. A detailed description of the main characteristics of the several types of public issues currently outstanding is given in articles by H. J. Cooke on the "Cash Borrowing of the United States Treasury: Nonmarketable Issues," "Marketable Issues of the United States Treasury," and "Marketing of Treasury Bills" in a booklet on *The Treasury and the Money Market* published in June, 1954, by the Federal Reserve Bank of New York.

the issuance of one-year certificates of indebtedness in the amount of $2 billion.[2] The limit on bonds was an aggregate total which could be issued over time, whereas that on certificates was a revolving authority applying to the amount outstanding at any one time. In the next move, a $2 billion revolving authority for five-year war savings certificates, with interest discounted in advance, was provided in the act of September 24, 1917. At the same time, the aggregate issue ceiling on Treasury bonds was raised to $9.5 billion (a maximum of $7.5 billion being provided in addition to the Treasury bonds in the amount of $2 billion which were already issued or offered under the act of April 24, 1917). The limit on the revolving fund of certificates of indebtedness was doubled to $4 billion. This law—the well-known Second Liberty Bond Act—remains the basic legislation for the issuance of Treasury securities, but the original provisions have been changed many times by amendments in subsequent acts.

In keeping with the policy of establishing individual limits on specific types of securities, further increases were declared under the amendments to the Second Liberty Bond Act contained in the Third and Fourth Liberty Bond Acts of 1918. Finally, in the Victory Liberty Loan Act of March 3, 1919, provision was made for the issue of one-to-five-year Treasury notes with an aggregate issue limit of $7 billion and the revolving authorization for certificates was raised to $10 billion. The notes provided an important instrument for refunding the relatively substantial volume of short-term debt issued previously; the notes were more manageable than certificates as their maturities could be spaced at convenient intervals.

By including these notes and raising the limit on the certificates of indebtedness, the Victory Liberty Loan Act raised by $17 billion the existing permissible debt of $26 billion, which included $22 billion in Treasury bonds (Fourth Liberty Bond Act of July 9, 1918) and $4 billion for war savings certificates (act of September 24, 1918). The combined potential of $43 billion in Treasury obligations which could then be issued was considerably more than the maximum public debt of slightly over $25 billion actually outstanding in 1919.

Developments in the Twenties

To facilitate the use of short-term borrowing, a small increase of $500 million was added to the existing $7 billion limit on the Treas-

2. The issuance of the unissued portions of bonds authorized by the legislation of 1909 and 1916 was also permitted, but these securities were to be sold for specific purposes.

ury notes, and the authority was changed from an aggregate total to a revolving fund by the act of 1921. No further changes were made until the act of 1929 which authorized issuance of Treasury bills and applied the existing $10 billion revolving authorization for one-year certificates to both types of securities. Treasury bills were introduced to provide a more flexible short-term instrument than certificates. They could be more readily timed to coincide with the Treasury's needs for funds than certificates, which at that time were issued on fixed dates, and since they were not to be sold at fixed interest rates but at discounts fixed by subscribers through competitive bidding, the cost of the borrowing could be adjusted rapidly to changing market conditions. For example, if borrowing became necessary during periods of temporary stringency and high money rates, bills could be issued and then refunded at lower cost when the stringency had passed.

Increases during the "Great Depression"

As the government's financial requirements increased during the thirties with the onset of the depression and the adoption of "pump-priming" programs, changes in fiscal policy were accompanied by increases in the limits permitted on notes and bond issues. In 1935, the authorizations for all issues except bonds were combined under a single revolving ceiling, while that for bonds was reduced somewhat, but here also the old aggregate ceiling on amounts to be issued was replaced by a revolving fund. At the same time, savings bonds were authorized within the bond ceiling, with a limit on the amount an individual might purchase, the Savings bonds to be counted at their maturity value. In May, 1938, however, a combined limit of $45 billion was placed on the authorization for bonds, certificates of indebtedness, Treasury bills, and notes, but a provision was added placing a specific $30 billion limit on bonds within the over-all limit. This change presaged the subsequent over-all limit which seemed to be the logical outcome of the changed fiscal situation. By striking out that $30 billion limit on Treasury bonds in the subsequent act of July 20, 1939, the remaining $45 billion combined limit automatically became the first over-all limitation on the size of the public debt with a general application to all principal types of securities; only a relatively small amount of minor issues were excluded.

Defense and War Changes

With the constant rise in deficit financing requirements following the adoption of our preparedness program after the outbreak of

World War II in Europe, the limit on all obligations issued under the Second Liberty Loan Act was raised to $65 billion by the Public Debt Act of February 19, 1941. At the same time an authorization for an additional $4 billion in outstanding debt, under an amendment to the Second Liberty Bond Act added by the First Revenue Act of 1940, was repealed. After our entry into World War II, the limit was raised further in the Public Debt Acts of 1942, 1943, and 1944 ($125, 210, and 260 billion, respectively). Finally, the ceiling was set at $300 billion under the act of April 3, 1945, and at that time obligations issued by government corporations but guaranteed by the federal government and held by private investors were made subject to the comprehensive ceiling. Prior to this time, specific ceilings existed for the respective corporations. However, beginning in October, 1941, the Treasury sought to consolidate all federal borrowing to eliminate any conflicts in the marketing of government direct or guaranteed obligations; a policy was instituted whereby funds needed by government corporations would be borrowed from the Treasury instead of through the sale of guaranteed securities in the open market. When this policy was instituted, nearly $7 billion of guaranteed issues were outstanding and all of these were held by private investors. By the end of March, 1945 (just before these guaranteed, privately held issues were included in the debt ceiling), the securities of government corporations held outside the Treasury amounted to a little over $1 billion in contrast to a little over $11.5 billion held directly by the Treasury. By the end of May, 1954, less than $85 million of fully guaranteed direct issues were in private hands. They consisted almost wholly of obligations of the Federal Housing Administration which were issued in exchange for guaranteed mortgages.

After World War II

The total gross public debt never reached the $300 billion ceiling provided in the act of 1945, but it hit a peak of nearly $289 billion at the end of February, 1946 (including nearly $11 billion in unearned interest in the maturity value of Savings bonds), after which it was reduced $10 billion within four months. At this time, the current redemption value rather than the maturity value of the Savings bonds was made subject to the ceiling, and a $25 billion reduction in the debt limit was made on June 26, 1946, when the present ceiling of $275 billion was established.

The steady climb of the debt from a postwar low of about $251 billion in April, 1949, to a high of over $272 billion at the end of

July, 1953 again raised the question of raising the ceiling above the $275 billion set in 1946. A new ceiling of $290 billion was then requested from Congress. The measure was passed promptly by the House but was side-tracked in the Senate where the ceiling was viewed as an instrument for forcing economy on the executive branch of the government. During subsequent months, the statutory ceiling at times seriously limited the scope for both new money borrowing and refunding transactions, but the Treasury by drawing down the level of its operating cash balance and by relying more heavily on private financing in certain programs held the public debt within the ceiling, although for a time by a small margin. After Congress reconvened early in 1954, the request for an increase in the ceiling was renewed as the prospective requirements in the near future under existing programs exceeded the margin which would then be available.

Debt Not Subject to Ceiling

Despite the existence of the debt ceiling, a small part of federal obligations (amounting to nearly $555 million as of May 31, 1954) is exempt from the comprehensive ceiling which applies to issues sold in accordance with the Second Liberty Bond Act, as amended, and guaranteed obligations of federal agencies held outside the Treasury.[3] The exempt portion consists mainly of obligations connected with the retirement of currency. On May 31, this currency obligation amounted to almost $450 million, or over 80 per cent of the total outside the limitation under the Second Liberty Loan Act. The other debt not subject to this limitation consists for the most part of several old public issues, some of which have matured.

While the obligations included in this class are not subject to the well-known "debt ceiling," they are subject to limitations under other statutes. For example, Postal Savings bonds were last issued July 1, 1935, and no new issue could be made after that date. The Panama Canal loan, issued in 1911, is also a closed issue. Similar restrictions apply to the "currency obligations." United States notes are limited by the act of May 31, 1878, which requires that the notes be reissued when redeemed or received in the Treasury on any account; only slightly over half of the outstanding notes are included in the public debt obligations, however, as a gold bullion

3. Private obligations guaranteed by federal agencies and held by private lending agencies such as home mortgages and loans on farm commodities under the agricultural price support program, are not limited by the terms in the specific program under which such guaranties may be made; they are not covered by the "statutory debt limitations."

reserve (raised mainly in the 1870's through the sale of bonds) covers $156 million of the issue.

The outstanding national and Federal Reserve Bank notes, which have long been in the process of retirement, were assumed as obligations by the federal government upon the deposit of lawful money for their retirement. When the notes become unfit for further circulation they are canceled and retired on receipt at the Treasury. The national bank notes were backed by federal obligations bearing the circulation privilege which have been called or otherwise made unavailable, while authority to issue Federal Reserve Bank notes against any direct United States obligations not bearing the circulation privilege or against eligible commercial paper was repealed by the act of June 12, 1945.