Federal Debt Limit - Risks and Discussion

May 16, 2023

Federal Government Reached the Debt Limit in January 2023

- The debt limit, or the debt ceiling, is the maximum amount of debt that the U.S. Department of Treasury can issue to the public or to other federal agencies.
- The limit is set by law and has been increased or suspended over the years to allow for additional borrowing to finance the federal government.
- Federal government reached the statutory debt limit in January 2023.
- U.S. Treasury is currently taking administrative measures to continue meeting all federal payment obligations.

Key Differences Between a Debt Ceiling Impasse and a Shutdown

Debt Limit Ceiling	Government Shutdown
No borrowing authority	No discretionary spending authority
All spending impacted	Mandatory spending not impacted (e.g. Social Security, interest on debt)
Agencies may continue operations but Treasury may not be able to make payments	Agencies may continue "essential" operations but may not make payments for any unappropriated activities
U.S. has never failed to raise the limit- five impasses since 2011	U.S. has shutdown three times since 2011

Sources: Congressional Research Service (CRS), "Shutdown of the Federal Government: Causes, Processes, and Effects," December 2018; CRS, "Entitlements and Appropriated Entitlements in the Federal Budget Process," November 2012; Moody's Analytics, "The Debt Limit Drama Heats Up," April 2023.

Multiple Estimates Suggest U.S. will not have Sufficient Cash Flow to Pay All Bills by early June

- U.S. income tax receipts have been less than expected through April, and tax revenue is typically low in July and August.
- Treasury will likely exhaust "extraordinary measures" to extend its borrowing authority in early June.
    - Extraordinary measures include suspending some new debt issuance and temporarily underinvesting in certain longer-term debt commitments, like federal employee retirement plans.
    - Does <u>not</u> include delaying payments or tapping into Social Security or military retirement trust funds.
- It is hard to predict an exact date because of the timing and amount of revenue collections and outlays over the coming weeks.

January 19, 2023
Debt limit reached & Treasury begins extraordinary measures

Early June 2023
Earliest predicted cash shortfall date ("X date")

June 15, 2023
Cash infusion from non-withholding tax payments

Early August 2023
Latest predicted cash shortfall date

Sources: Moody's Analytics, "The Debt Limit Drama Heats Up," April 2023; Moody's Analytics "Debt Limit Scenario Update," May 2023; CRS, "Structure of Federal Debt and Extraordinary Measures," April 2023.

Impacts to Individuals and the Commonwealth

- Direct transfer payments to individuals (e.g., Social Security, Medicare, benefits for veterans), federal employee pay, and interest payments on debt could be delayed.
    - For example, more than 1.6 million Virginians receive Social Security retirement, disability, and survivor payments monthly.
- Federal agencies may delay awarding contracts to federal contractors and miss payments for current contracts.
- Federal grant reimbursement could be delayed, impacting state agency operations, payroll for federally-funded state employees or grant recipients (e.g., Medicaid, SNAP benefit payments, federal education programs).

Federal Grant Programs May be Impacted Depending on the Length of Default and Timing of Grant Payments

Top 10 Federal Grant Programs in Virginia (NGF $ in millions)	Federal Fiscal Year 2022 Enacted
Medicaid Vendor Payments	$13,071.1
SNAP Benefits	2,230.1
National Highway Performance Program (FHWA)	733.5
Pell Grants	675.5
Children's Health Insurance Program	401.1
Medicaid Administration	384.0
Surface Transportation Block Grant (FHWA)	357.3
Special Education Basic State Grant	327.7
Local Education Agencies (Title I)	301.0
SNAP State Administration	220.1
Other	3,414.0
Total	**$22,115.4**

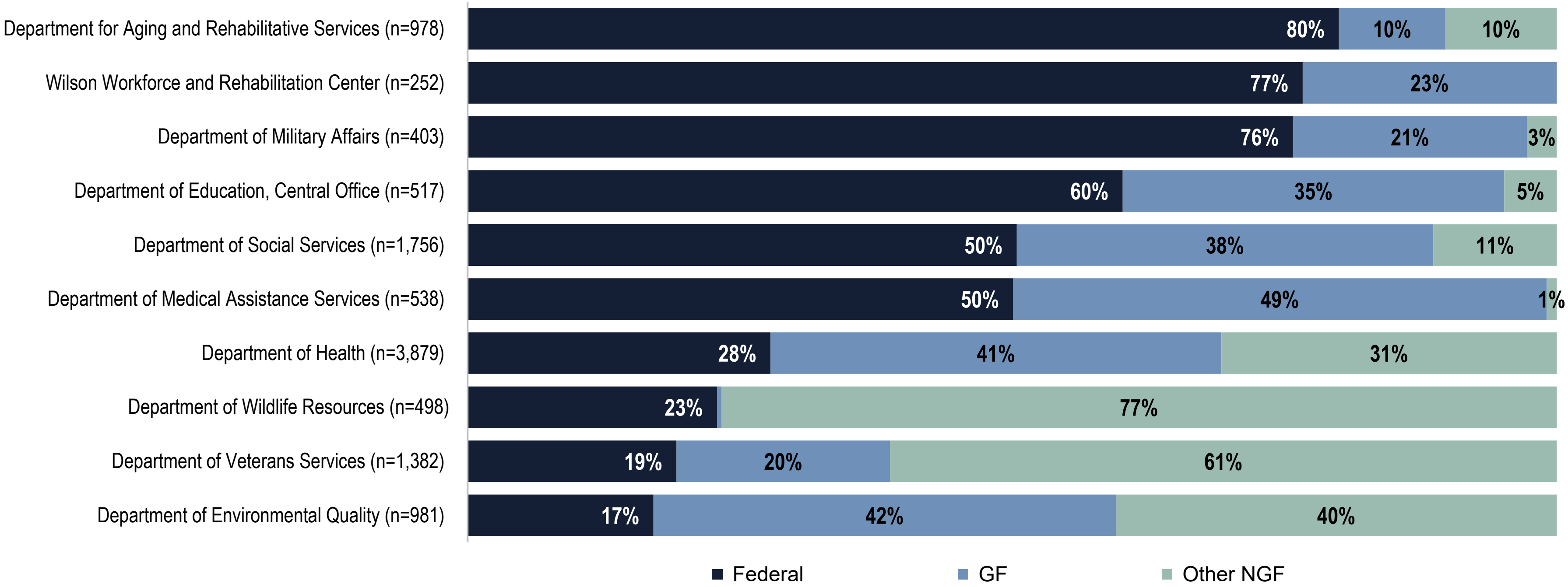
Source: Federal Funds Information for State (FFIS) Grants Database. Excludes federal pandemic relief funds.

Potential Impacts to Medicaid

- Medicaid is the single largest federal grant expending $1.2 billion in federal funding each month (nearly 80 percent of all federal funding received by the state).
- Largest payment is to the Medicaid managed care organizations (MCOs), which occurs on the first week of each month.
  - Department of Medical Assistance Services (DMAS) will likely be able to drawdown the necessary federal funds to make the payment to MCOs in the beginning of June.
- Depending on available federal cash, DMAS may be able to manage remaining June payments.
  - An extended period of reduced federal reimbursement beyond mid-June may result in the inability of the agency to make typical claims payments to both providers and MCOs.

State Agencies with Federally-Funded Employees Could Face Payroll Challenges

Of the 5,150 authorized state employees supported by federal funds, 85 percent of those positions are at ten state agencies; Virginia spends approximately $20.0 million in federal funds for payroll expenses each pay period.



Sources: Chapter 2, 2022 Special Session I, FY 2024 Authorized Position Levels, reflects positions coded under Fund Group Code 10. Staff analysis of DPB's Expendwise database referenced May 15, 2023, excludes special payments such as workers' compensation, leave balances, and Workforce Transition Act payments.

U.S. Economic Impacts Vary Based on the Length of Delaying the Debt Limit Increase

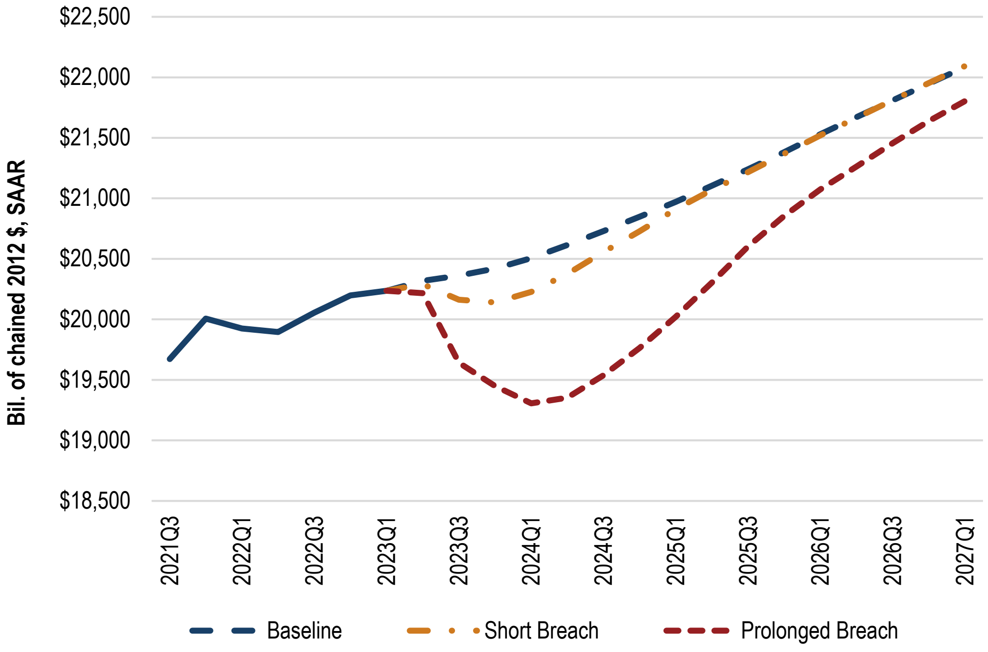
Short Breach:

- Crisis resolved in a week; disrupting financial markets and consumer confidence.
- Real GDP declines 0.7 percent; 1.5 million jobs lost; unemployment rate increases to 5 percent (1.6 percent point increase).

Prolonged Breach:

- Crisis drags on through the end of July; triggering a downturn comparable to the 2008 financial crisis.
- Real GDP declines 4.6 percent, 7.8 million jobs lost; unemployment increases to 8 percent.
- Borrowing rates increase on mortgages, Treasury yields, and consumer & corporate debt.

GDP estimated to decline from peak to trough by 0.7 percent under a short breach or a 4.6 percent decline under a prolonged breach.



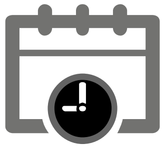
Source: Moody's Analytics, Debt Limit Scenario Update, May 2023.

Virginia's Significant Federal Government Presence Directly and Indirectly Impacts our Economy

Estimated Virginia Employment Impacts				
	Short Breach		Prolonged Breach	
	Near Term (2023 Q1 to 2023 Q3)	Peak to Trough	Near Term (2023 Q1 to 2023 Q3)	Peak to Trough
Total Jobs Lost	18,700	34,500	107,400	195,400
Decline in Payrolls	0.45%	0.83%	2.60%	4.73%
	2023 Q3	**Peak**	**2023 Q3**	**Peak**
Unemployment Rate	3.5%	3.9%	5.5%	6.3%
Change from 2023 Q1 (% point change)	0.4	0.7	2.4	3.2

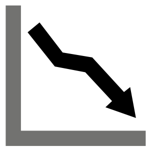
Source: Moody's Analytics, Debt Limit Scenario Update, May 2023. Quarters reflect calendar year. Peak to trough reflects lowest quarterly payroll count from 2023 to 2025.

Key Takeaways



Debt limit could be reached in early June.

Federal payments to individuals and the State would be impacted.



Any delay in increasing the debt limit likely impacts the economy.

Reliance on federal spending would impact Virginia.

State revenues could be impacted.