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Common Fallacies in the 2023 Debt-Ceiling Debates

Paul H. Kupiec and Alex J. Pollock*

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Abstract: This article investigates the veracity of three claims made by current and former government officials in the context of the 2023 debt-ceiling debates: it would be unconstitutional to enforce the debt ceiling; the U.S. government has never defaulted; and there are no measures that could be taken to avoid a government default except raising the debt limit. None of these claims is true.

As Congress and the Biden administration carried out the combative negotiations that led to the passage of the Fiscal Responsibility Act of 2023 (H.R. 3746), the news media was replete with stories and opinion pieces about the debt-ceiling debates. Many of these repeated claims made by administration officials and surrogates were designed to promote a political narrative. Such claims included the following: it is unconstitutional for the United States to default on its debt (Blinder 2023); the U.S. has never defaulted on its debt (Biden 2023); there are no additional measures that can be taken to prevent default (Janet Yellen, quoted in Condon and Hordern 2023); and finally, the sole solution to averting a debt crisis is to raise the debt ceiling (Powell 2023). This article will

* Paul H. Kupiec (paul.kupiec@aei.org) is senior fellow at the American Enterprise Institute.

Alex J. Pollock (alexjpollock43@gmail.com) is a senior fellow at the Mises Institute.

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analyze these claims and explain why they are exaggerations, if not demonstrably untrue.

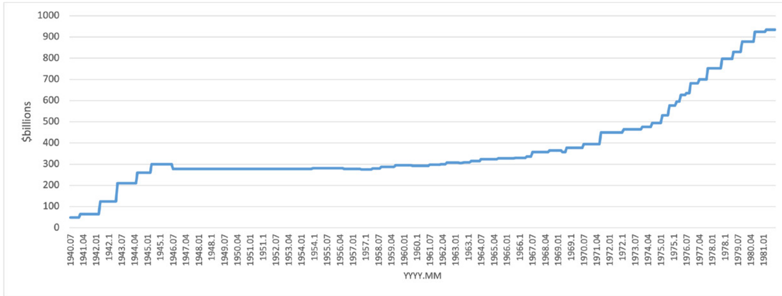
HISTORY OF THE CONGRESSIONAL LIMIT ON FEDERAL DEBT

Before 1917, Congress authorized each individual federal government bond issue. The Second Liberty Bond Act of 1917 retained congressionally set limits on certain types of bond issues but also authorized the secretary of the Treasury "to borrow, from time to time, on the credit of the United States for purposes of this Act, and to meet expenditures authorized for the national security and defense and other public purposes authorized by law, not exceeding in the aggregate $7,538,945,460" (Second Liberty Bond Act, § 1, 40 Stat. 288). Section 5 of the law authorized the secretary to issue up to $4 billion in federal government certificates of indebtedness on a revolving basis. Certificates of indebtedness were short-term coupon-bearing instruments that were gradually replaced by Treasury bills beginning in 1929.

The history of the modern congressional debt limit began in 1939, when Congress amended the Second Liberty Bond Act by replacing the separate limits imposed on particular kinds of Treasury debt instruments with one limit on the total outstanding Treasury debt subject to congressional limitation. This change allowed the Treasury to manage the maturity profile of the outstanding federal debt.

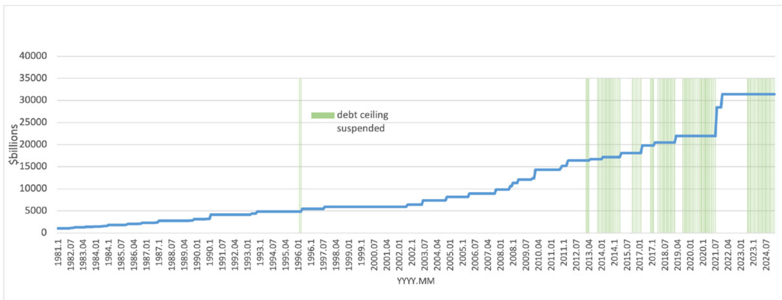
Congress has changed the debt limit ninety-three times since July 1939, not counting the eight contiguous periods, including from June 2, 2023, through January 1, 2025, for which Congress suspended it. Figure 1 plots the debt limit from July 1939 through September 1981. Figure 2 plots the debt limit, and periods for which Congress suspended it, from October 1981 through January 2025. From August 2008 until December 2021, the debt limit grew from $9.4 trillion to $31.4 trillion. From June 2023 through January 2025, the Treasury's ability to issue debt will not be restricted by Congress.

Figure I: Congressional Debt Limit, July 1939–September 1981



Source: Data from *Hearing before the Subcommittee on Taxation and Debt Management of the Committee on Finance*, 97th Cong. 49–50 (1981) (tables A1–A2).

Figure 2: Congressional Debt Limit, October 1981–January 2025



Source: Data from Murray (2022, tables 1–3); and Austin (2022, table 1).

THE CONSTITUTIONALITY OF A FEDERAL GOVERNMENT'S FAILURE TO PAY

The Fourteenth Amendment to the Constitution, ratified in 1868, asserted the validity of any debt incurred by the Union, including for war, but forbade repayment of that incurred by the Confederacy. "The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any state shall assume or pay any debt or obligation incurred in aid of insurrection or

rebellion against the United States . . . but all such debts, obligations and claims shall be held illegal and void" (U.S. Const. amend XIV, § 4). The Civil War context of the amendment is clear in the references to insurrection and rebellion.

Legal scholars and politicians have debated whether this amendment makes it unconstitutional for the federal government to default on its debt. There is a wide range of opinions (Levy 2011; Sharma and D'Amico 2015) about the implications of the Fourteenth Amendment for a government default. Some argue that the amendment makes the congressional debt limit unconstitutional because the limit could keep the government from issuing new debt to avoid default. But this argument is undermined by the fact that the congressional debt limit has existed and been enforced for more than a hundred years. Moreover, the federal government has defaulted on its debt obligations several times since the passage of the Fourteenth Amendment, including a default that was upheld in the Supreme Court case *Perry v. United States* discussed below. Because the court's ruling was based on a technicality, the ruling does not directly address the constitutionality of a federal debt default triggered by a binding congressional debt limit.

In the midst of the 1995–96 debt-ceiling negotiations, President Bill Clinton threatened to use the Fourteenth Amendment to justify ignoring the debt ceiling (Liptak 2011). By contrast, the Obama administration was reluctant to use the amendment in this way. During the 2011 debt-limit negotiations, Treasury general counsel George Madison wrote that Treasury secretary Tim Geithner "has never argued that the 14th Amendment to the U.S. Constitution allows the President to disregard the statutory debt limit . . . the Constitution explicitly places the borrowing authority with Congress, not the President" (Krawzak 2021). When the debt-ceiling debate was revisited in 2013, press secretary Jay Carney told reporters that the "administration does not believe that the 14th Amendment gives the power to ignore the debt ceiling" (Felsenthal 2013).

Some argue that a temporary delay of some promised federal payments would not constitute a debt default and could be used to avert any Fourteenth Amendment issues. The Treasury could decide to meet debt service payments using recurring tax receipts by delaying other non-debt related promised federal payments.

While tax revenue prioritization schemes could have been used to postpone default on federal debt payments without an increase in the debt ceiling, they failed to gain political momentum in the 2023 debt-ceiling negotiations (Folley 2023; Kogan 2023). Some even claim that payment prioritization is technically infeasible. For example, Treasury secretary Janet Yellen said the Treasury could not prioritize debt payments over other payments (Condon and Hawkins 2023). If true, this was a remarkable confession of bureaucratic incompetence.

HISTORY OF FEDERAL GOVERNMENT DEFAULTS

During the 2023 debt-ceiling crisis, the claim that the federal government had never defaulted on its debt was made by high-ranking government officials, including the president. In actuality, the U.S. government has defaulted on its debt three times since the ratification of the Fourteenth Amendment—in 1933, 1968, and 1971—and twice before—in 1814 and in 1862. There was also a mini-default in 1979 when the U.S. Treasury was unable to pay retail investors in Treasury securities on time (Austin and Stiff 2021).

In 1814, the federal government was unable to honor specie payments due on loans taken out to finance the War of 1812. In 1862, struggling to finance the Civil War, the Union government was unable to redeem demand notes, so called because they promised to pay specie on demand. In 1933, a joint resolution of Congress repudiated the obligation of the Treasury to redeem gold bonds. In 1968, the U.S. government refused to redeem silver certificates despite the promise on each certificate that "there has been deposited in the Treasury of the United States of America one silver dollar, payable to the bearer on demand." The federal government again defaulted in 1971 when it repudiated the obligation, promised in the Bretton Woods agreement and approved by Congress in 1945, to maintain the convertibility of the dollar. The 1971 decision to no longer honor the U.S. government's commitment to allow foreign governments to convert dollars into gold at the fixed exchange rate of thirty-five dollars per ounce (U.S. Department of State, n.d.) had global ramifications. This default effectively put the world on a pure fiat currency system which has lasted more than fifty years.

History makes it abundantly clear that any sovereign government can default on its promised debt payments. Worldwide, including the U.S., there have been more than 250 defaults on sovereign debt since 1800 (Reinhart and Rogoff 2009, 111).

Perry v. United States

The 1933 gold bond default is unique in that the government's refusal to make promised gold payments was litigated and upheld by the Supreme Court in a 5–4 decision, *Perry v. United States* (294 U.S. 330 (1935)). The case upheld Congress's legal authority to default on gold redemption for liberty bonds by virtue of its power to regulate currency. Paradoxically, while upholding the government's power to default, the Supreme Court decision simultaneously argued that the federal government had an obligation to honor its debt commitments.

In 1933, the market value of gold had risen above $20.67 per ounce, the official price set by the Gold Standard Act of 1900. Lenders were exercising gold clauses in debt contracts linked to the government's official price and thereby making it more expensive for borrowers to repay their debts. The Roosevelt administration believed that gold clauses should be invalidated because they were impeding economic activity in the midst of a depression.

In April 1933, the Roosevelt administration, citing the emergency powers granted in the Trading with the Enemy Act of 1917, issued an executive order requiring citizens to turn in their gold specie to the government. The order made it illegal for U.S. citizens to use gold for trade and exchange. In June 1933, a joint resolution of Congress invalidated all gold clauses in existing public and private contracts, declaring them to be "against public policy." President Roosevelt indicated he was prepared to defy the Supreme Court should it rule that the invalidation of gold clauses was unconstitutional (Sharma and D'Amico 2015).

Subsequently, Congress passed the Gold Reserve Act of 1934, which made private ownership of gold illegal, prohibited financial institutions from converting dollars into gold, and allowed the president to set the official price of gold and silver by proclamation. Roosevelt thereupon increased the official price of gold from $20.67 to $35 per ounce, depreciating the dollar by 41 percent.

The liberty bonds issued to finance World War I stated their maturity value in dollars but included a gold clause. The amount of gold due at maturity was calculated as the dollar face value of the bond divided by the price of gold set by the government at the time of issuance, or $20.67 per fine troy ounce. Thus, the obligation to pay in gold upon demand for a $1,000 liberty bond required tendering, at maturity, 48.379 fine troy ounces of gold. At $35 per ounce of gold, this was worth $1,693.28 in the depreciated dollars of 1935—a 69.3 percent premium over the $1,000 stated maturity value.

By 1935, Congress had made it illegal for citizens to own gold as a medium of exchange. In *Perry v. United States*, the plaintiff reasonably argued that liberty bonds should, at maturity, pay the dollar equivalent of the gold obligation, calculated at $35 per ounce, to protect the bond holder against inflation as the gold clause intended.

The court ruled, however, that since Congress had made it illegal to use gold in trade and exchange, a liberty bond's maturity value in gold was no longer relevant and requiring payment of the maturity value in the depreciated dollar, the only legal currency at that time, was not an illegal seizure of bondholder wealth. In other words, the court decided that the abrogation of the liberty bond's gold redemption clause did not inflict an economic loss on the holder even though the dollar value at maturity would have been much larger had the government honored the gold clause obligation.

Some legal scholars argue that *Perry v. United States* has not settled whether the Fourteenth Amendment precludes Congress from defaulting on federal government debts. The Supreme Court's decision upheld the constitutional authority of Congress to regulate currency but not to default on federal debts. Indeed, in issuing the *Perry v. United States* decision, the court argued that Congress was required to satisfy its debt obligations under article I, section 8 of the Constitution and section 4 of the Fourteenth Amendment. Chief Justice Hughes wrote the following on behalf of the majority:

> In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money "*on the credit of the United States*," the Congress is authorized to pledge that credit as an assurance of payment as stipulated,—as the highest assurance the government can give, its plighted faith. To say that the Congress may

> withdraw or ignore that pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government. (Perry v. United States, 294 U.S. at 351)

The opinion of Justice McReynolds, writing for the four-member minority, displays the tension in the court's ruling:

> The fundamental problem now presented is whether recent statutes passed by Congress in respect of money and credits were designed to attain a legitimate end. Or whether, under the guise of pursuing a monetary policy, Congress really has inaugurated a plan primarily designed to destroy private obligations, repudiate national debts, and drive into the Treasury all gold within the country in exchange for inconvertible promises to pay, of much less value. Considering all the circumstances, we must conclude they show that the plan disclosed is of the latter description, and its enforcement would deprive the parties before us of their rights under the Constitution. Consequently, the Court should do what it can to afford adequate relief. (Perry v. United States, 294 U.S. at 369–370)

This view is also reflected in a majority concurring opinion written by Justice Stone: "While the government's refusal to make the stipulated payment is a measure taken in exercise of [its] power, this does not disguise the fact that its action is to that extent a repudiation of its undertaking" (Perry v. United States, 294 U.S. at 359).

The Supreme Court had effectively upheld the U.S. government's decision to default on its debt by repudiating its promise to pay in gold. As a contemporary headline summed it up, "Government Wins Gold Victory in 5–4 Supreme Court Ruling" (Edwards 2018, 174).

INCREASING THE DEBT LIMIT IS NOT THE ONLY WAY TO AVOID DEFAULT

Contrary to assertions made by the secretary of the Treasury and the chairman of the Federal Reserve in the context of the 2023 debt-limit negotiations, facing a binding debt limit, several emergency measures involving the Federal Reserve could have been employed to postpone the day the Treasury ran out of cash. While the June 1 passage of the Fiscal Responsibility Act of 2023

negated the need for these extraordinary measures, they were an option and remain one for future debt-ceiling negotiations. The remainder of this essay will detail legal measures other than raising the debt ceiling that could be taken to postpone default. These measures would provide alternative sources of Treasury funding for the federal government to continue paying its bills.

Recognizing the Market Value of the Treasury's Gold

In May 2023, the U.S. Treasury owned 261.5 million ounces, or about eight thousand tons, of gold (U.S. Department of the Treasury 2023, 84), which had a market value of almost $578 billion at the May 2023 price of about $2,000 per ounce. But for government accounting purposes, the value of the Treasury's gold is set by the Par Value Modification Act of 1973 (H.R. 6912), which amends the Gold Reserve Act and "directs the Secretary of the Treasury to take steps necessary to establish a new par value of the dollar . . . of forty-two and two-ninths dollars per fine troy ounce of gold." In other words, the law requires the Treasury to value its gold holdings at $42.22 an ounce. Under powers granted in the Gold Reserve Act, the Treasury has issued $11 billion of outstanding gold certificates against its gold holdings valued at the official price of $42.22 per ounce. The U.S. Treasury created these certificates, deposited them at the Federal Reserve, and spent the proceeds long ago.

According to the narrative of the 2023 debt-ceiling debates, the federal government would have to default by early summer 2023 unless the limit was increased. Given the true market value of the Treasury's current gold reserves, it would have been ridiculous for the U.S. government to default on its debt service payments for lack of an increase of the debt limit. Congress could have simply amended the Par Value Modification Act by striking "forty-two and two-ninths dollars" and replacing it with "the current market value (as determined by the Secretary at the time of issuance)." The Treasury could then have created and monetized more than $500 billion in new gold certificates in May 2023—a simple, efficient transaction with the Federal Reserve, with no increase in outstanding Treasury debt.

This "extraordinary measure" is not just a hypothetical idea. In 1953, when the Eisenhower administration faced a standoff over the debt ceiling, it issued $500 million in new gold certificates to successfully avoid a government default. The transaction worked as intended (Board of Governors of the Federal Reserve System 1953, 5). The Treasury issued gold certificates, used them to repurchase $500 million in Treasury securities held by the Federal Reserve, immediately retired these to reduce the debt, and sold $500 million in new debt securities to replenish its coffers, all without increasing the debt ceiling. The Treasury could have used a similar transaction in the spring of 2023 to issue more than $500 billion in new debt, and it could do so in the future should the need arise.

In 1977, the Fed was employed to help the Treasury avoid default in the face of a binding debt-ceiling constraint. At the time, the Fed retained its authority, first granted during World War II, to make limited direct purchases of securities from the Treasury. On September 30 of that year, a temporary debt ceiling of $700 billion was expiring and Congress had not yet authorized a new limit. The expiration would revert the debt limit from $700 billion to $400 billion. Hours before the expiration, the Treasury made a request, which the Federal Open Market Committee approved, to increase "from $2 billion to $3 billion the limit, specified in paragraph 2 of the authorization for domestic open market operations, on Federal Reserve holdings of special short-term certificates of indebtedness purchased directly from the Treasury" (Broida 1977). The Fed's quick purchase allowed the Treasury to bolster its cash reserves before the temporary debt limit expired.

Amendments to the Federal Reserve Act that were passed in 1979 extended the Fed's purchasing authority until 1981 (Garbade 2014, 21). The Fed can no longer purchase debt directly from the Treasury, but the Treasury's power to issue gold certificates and the Fed's ability to monetize them is still authorized by law.

Prioritizing Treasury Claims Using the Federal Reserve's Balance Sheet

As of May 31, 2023, the Federal Reserve district banks collectively owned $5.2 trillion in U.S. Treasury securities (Board of Governors

of the Federal Reserve System 2023b). These securities count against the debt limit even though these claims are effectively internal to the government. We say "effectively" because the stock of the Federal Reserve district banks is owned by their member banks, which are privately owned and commercial. However, because of the way the Federal Reserve is currently operating, any profits or losses on their Treasury securities portfolio accrue to U.S. taxpayers and not to the member banks. This fact, combined with the federal budget accounting rules and the odd way Congress has allowed the Fed to account for its operating losses, creates the possibility of using the Fed to raise a substantial amount of Treasury cash without raising the debt limit.

The Fed Voluntarily Forgives Treasury Debt Payments

The Treasury could avoid default on publicly held debt by lowering the priority of payments on Treasury securities held by the Federal Reserve, which could in turn forgive the Treasury's obligation to make interest and principal payments on securities the Fed owns. This measure could provide the Treasury with the funds needed to forestall a government default without increasing the debt ceiling. Given current law, federal budget rules, and Federal Reserve practices, such an extraordinary measure is not only permissible but could have been used in 2023 to free up a trillion or more dollars to finance the deficit without raising the debt ceiling or creating any operating difficulties for the Federal Reserve.

Voluntary forbearance on or even total forgiveness of Treasury debt owned by the Federal Reserve would not constitute a federal default. It would affect payment transfers within the federal government, but no external parties would experience a delay or default on federal payment. Fourteenth Amendment arguments, therefore, do not apply to this scenario.

Although the Fed's accounting practices obscure it, taxpayers are liable for Federal Reserve operating losses, including those incurred by forgiving Treasury debt. Section 1101 of the Dodd–Frank Act amended the Federal Reserve Act to require the Federal Reserve Board to "establish . . . policies and procedures . . . designed to ensure that any emergency lending program or

facility . . . protect taxpayers from losses" (Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 1101, 124 Stat. 1376–2223). Taxpayers will suffer a loss should the Fed forgive Treasury securities acquired through an emergency lending program or facility, but other Treasury securities acquired from normal open-market operations would be exempt from this provision. Excepting the Fed's emergency Bank Term Funding Program (Board of Governors of the Federal Reserve System 2023a), most of its emergency lending programs do not involve Treasury security purchases. The vast majority of the Fed's Treasury securities were acquired in normal monetary policy transactions and are thereby exempt from section 1101 restrictions. If member banks, as the owners of Federal Reserve district bank shares, were harmed by the forgiveness of Treasury debt, they might have legal standing to stop such an action. But under Federal Reserve operating policies in place in 2023, member banks would not be harmed if the Fed forgave U.S. Treasury securities it owned.

Fed Operating Policies Accommodate Treasury Debt Forgiveness

When Federal Reserve district banks suffer losses, the Federal Reserve Act prescribes that member banks share in these losses. Member banks can also be called on to recapitalize their district bank. Notwithstanding these provisions in the Federal Reserve Act and the operating losses incurred by the Fed in 2022–23, member banks have continued to be paid full dividends and interest on their reserve balances and have not been required to share in district bank losses or to purchase additional shares to recapitalize technically insolvent Federal Reserve banks.

The Federal Reserve, on a consolidated basis, had accumulated operating losses of $65 billion at the end of May 2023 but reported its total capital as $42 billion (Board of Governors of the Federal Reserve System 2023b). If the Fed had recognized its accumulated operating losses when calculating its capital, as Fed member banks must, it would have reported negative capital of $23 billion as of May 31, 2023.

Section 5 of the Federal Reserve Act requires each member bank to subscribe to the shares issued by its Federal Reserve district bank

in a dollar value equal to 6 percent of the member's paid-in capital and surplus, but it need only pay the Fed for half the subscribed balance up front; the other half is paid if the Federal Reserve bank calls for it. Presumably, the founders of the Federal Reserve believed that such a request might be made if a district bank suffered losses large enough to erode a district bank's capital.

Section 2 of the Federal Reserve Act states that member banks can be held responsible for district bank losses up to the par value of their stock subscription: "The shareholders of every Federal Reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act" (Federal Reserve Act, 12 U.S.C. § 2). This provision of the Federal Reserve Act has apparently never been exercised, and certainly was not in May 2023.

On their paid-in share capital, each member bank was initially entitled to receive a cumulative dividend of 6 percent (Federal Reserve Act, 12 U.S.C. § 7). Congress later reduced the dividend rate paid to large banks to the lesser of "the high yield of the 10-year Treasury note auctioned at the last auction [3.45 percent as of May 30, 2023, according to TreasuryDirect] held prior to the payment of such dividend," or 6 percent. Since September 2022, the Fed was incurring large operating losses but still paying member banks their full dividends.

Unlike normal shareholders, member banks are not entitled to receive any of their district bank's profits beyond the statutory dividend payment. The Fed is required by law to remit nearly all positive operating earnings after dividends to the Treasury (Federal Reserve Act, 12 U.S.C. § 7), but in May 2023, there were no positive earnings, only operating losses.

The Federal Reserve started posting operating losses beginning in mid-September 2022 (Board of Governors of the Federal Reserve System 2022). Through May 31, 2023, it had accumulated $65 billion in operating losses (Board of Governors of the Federal Reserve System 2023b) but, notwithstanding these, continued to operate as though it had positive operating earnings, with two important

differences—it was borrowing to cover its operating costs, and it had stopped making any remittances to the Treasury. The Fed funds its operating shortfalls by issuing Federal Reserve notes (paper dollars) or by borrowing reserves from banks and other financial institutions through its deposits and reverse repurchase program, but the ability to print paper currency to cover losses is limited by public demand for it.

In spite of its losses, the Fed continued through May 2023 to pay member banks dividends on their shares and interest on their reserve deposits. It did not exercise its power to call the second half of its member banks' stock subscription payments, nor did it require them to share in district bank operating losses. Instead of asking member banks to raise new capital, the Fed used nonstandard, creative accounting to obscure the fact that its accumulating losses had rendered it technically insolvent.

Under the Fed's accounting policies (Bonis, Fiesthumel, and Noonan 2018), the losses were recorded in a so-called "deferred asset" account on its balance sheet. These balances are actually negative retained earnings, but they are booked as assets. The theory is that when the Fed returns to positive operating earnings, it will retain these earnings until it offsets its deferred asset balances. When the latter are offset to zero, the Fed will return to remitting its operating earnings to the Treasury. This treatment of Federal Reserve System losses is inconsistent with generally accepted accounting standards and the Federal Reserve Act's treatment of losses, but Congress had not intervened.

If the Fed wrote off a portion of the Treasury securities it owns, it would assume an additional operating loss equal to their value and would no longer receive interest payments on them. It would likely borrow more from bank reserves and use reverse repurchase agreement loans to replace the lost income from the interest on the canceled securities and then add the losses to its "deferred asset" account. By virtue of the federal budgetary accounting rules, the Fed's deferred asset account balances and operating losses do not count as expenditures in federal government deficit calculations, nor do its borrowings to fund operations count against the congressional debt limit.

Forgiving Treasury debt would not actually reduce the total debt of the consolidated government. The bank deposits and reverse

repurchase agreements used to buy the canceled securities would remain a liability of the Federal Reserve System. Should the Fed forgive, for example, $1 trillion of the securities, its balance sheet would include $1 trillion more in liabilities than in tangible assets. These liabilities would be owed by the consolidated federal government to external parties, but they would not be counted in the Treasury's books or in debt-ceiling calculations. By the government's accounting, the forgiven debt would seem to disappear, but it would remain on the Fed's balance sheet as an intangible deferred asset and affect future income statements.

The accounting transactions could be accomplished as follows. The Fed increases its deferred asset account by $1 trillion and credits the Treasury's account. The Treasury uses these new funds to purchase $1 trillion in securities from the Fed at the Fed's amortized cost, cancels these securities, and thereby becomes free to issue $1 trillion in new debt to the public. Finally, the Fed is left with $1 trillion in additional negative tangible capital.

Limits to Federal Reserve Debt Forgiveness

As of May 31, 2023, the Federal Reserve owned almost $7.8 trillion in U.S. Treasury securities, federal agency–guaranteed mortgage-backed securities (MBS), and U.S. federal agency debt (Board of Governors of the Federal Reserve System 2023b) combined. Treasury securities accounted for $5.2 trillion of that portfolio.

The Fed uses some of these holdings to collateralize the Federal Reserve notes it issues and what it borrows in money markets using reverse repurchase agreements. On May 31, 2023, the Fed had to collateralize $2.3 trillion in Federal Reserve notes issued to the public (Board of Governors of the Federal Reserve System 2023b). These can be collateralized with any of the securities it owns in its $7.8 trillion portfolio, including its MBS holdings. The Fed had borrowed $2.6 trillion using reverse repurchase agreements (Board of Governors of the Federal Reserve System 2023b) that also had to be collateralized.

If, for example, the Fed uses $2.3 trillion of its $2.6 trillion in agency and MBS securities to collateralize publicly circulating Federal Reserve notes, plus $2.6 trillion of its $5.2 trillion U.S.

Treasury securities to collateralize its reverse repurchase agreement borrowing, then that would leave the Fed with $2.6 trillion in unencumbered Treasury securities that could be forgiven. The Fed would want to retain a buffer of Treasury securities for its ongoing monetary policy operations, but, taking this into account, conservatively the Fed could have readily "afforded" to forgive up to $1 trillion of its Treasury securities without any material impact on its ability to conduct monetary policy.

Forgiving $1 trillion in Treasury securities, while feasible, would increase uncounted Federal government debt and delay for decades Fed remittances to the Treasury. To be clear, this article does not recommend that the Fed should have taken this extraordinary step; rather, it identifies a massive loophole in the accounting policies of the Federal Reserve System and the federal government that would have allowed the Treasury and the Fed to raise a significant amount of cash for the Treasury that could have been used to avoid default without an increase in the debt limit.

CONCLUSION

In contrast to claims made in the context of the 2023 debt-ceiling debate, as a practical matter, a default on the federal government's debt does not appear to be constitutionally prohibited despite arguments that appeal to the Fourteenth Amendment. Since the passage if the Fourteenth Amendment, the U.S. government has defaulted on its debt multiple times, including a 1933 default upheld by a Supreme Court ruling. Regardless, and despite claims to the contrary, a default could have been forestalled by executing extraordinary but legal transactions between the U.S. Treasury and the Federal Reserve. These measures could have created enough cash for the Treasury to forestall default for months without an increase in the debt limit. One of these measures was successfully utilized by the Eisenhower administration and remains an option. An alternative extraordinary measure utilizing Federal Reserve debt forgiveness has yet to be attempted but appears possible under current Federal Reserve and federal budget accounting policies.

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