What If a Debt Limit Extension is Voted Down?

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(Thanks to DailyKos commenter 2laneIA for suggesting this post and the title)

It's only a few days now until August 2nd. Perhaps a compromise on lifting the debt ceiling will be reached before then. Perhaps none will be reached. Perhaps the President will veto a compromise if it doesn't extend the ceiling sufficiently to support deficit spending until after the 2012 elections. If a debt ceiling extension is voted down, or if the President vetos an unacceptably small extension, then what is to be done? I've now run into six primary options the President can select among to avoid default. The six are:

-- Challenging the debt ceiling based on the 14th Amendment Section 4
-- Selective default
-- Proof Platinum Coin Seigniorage (PPCS)

-- Running an overdraft at the Fed
-- The Fed burning its Treasury Bonds
-- The ?exploding option? plan

Let's look at them in more detail.

1. [no-glossary]The [/no-glossary] 14th Amendment option

This option is the most well-known one right now, having been discussed on the web [20] at least since last Fall.

[no-glossary]The 14[/no-glossary]th Amendment to the Constitution says in part:

> ?Section 4. 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. . . . ?

People, including myself, have claimed that the debt ceiling is in conflict with the 14th Amendment and is therefore unconstitutional, and have called for the President to go ahead and issue more debt and wait for a legal challenge. That challenge may never come, because the House of Representatives alone will lack standing in the Supreme Court. In an article appearing today, at CNN [21], Jack Balkin offers an argument interweaving legal and political considerations, points out that the President would first have prioritize repayment of debt to conform to the Amendment, which might cause an inability to make Social Security payments fully and on time, creating great political pressure on Congress to pass a clean extension of the debt ceiling.

I'm not sure this analysis is entirely correct, since it may be possible [22] for the Social Security Trustees to go to the Treasury with its Bonds, demanding payment for them so that Social Security payments can be made. Since the bonds are debt, and actually count against the debt ceiling, the President may not be able to hold up the payments. In any event, Professor Balkin continue his argument with:

> Assume, however, that even a prolonged government shutdown does not move Congress to act. Eventually paying only interest and vested obligations will prove unsustainable -- first because tax revenues will decrease as the economy sours, and second, because holders of government debt will conclude that a government that cannot act in a crisis is not trustworthy.

> If the President reasonably believes that the public debt will be put in question for either reason, Section 4 comes into play once again. His predicament is caused by the combination of statutes that authorize and limit what he can do: He must pay appropriated monies, but he may not print new currency and he may not float new debt. If this combination of contradictory commands would cause him to violate Section 4, then he has a constitutional duty to treat at least one of the laws as unconstitutional as applied to the current circumstances.
>
> This would be like a statute that ordered the president to hire 50 new employees provided that none of them is a woman. The second requirement violates the Constitution, so the president can hire the 50 employees and ignore the discriminatory provision.
>
> Here the president would argue that existing appropriations plus the debt ceiling create an unconstitutional combination of commands. Therefore he chooses to obey the appropriations bill -- which was passed later in time anyway -- and ignores the debt ceiling. He orders the secretary of the Treasury to issue new debt sufficient to pay the government's bills as they come due.

I'm not at all sure that the President will have to wait for a prolonged Government shutdown, to invoke the 14th Amendment: but whether he waits or invokes it on August 3rd, I think Balkin's argument is too narrow in focusing only on the possibility that the President may invoke the 14th against the debt ceiling. Perhaps, for example, as my friend Beowulf suggests (in e-mail corrspondence), he could make "a flanking attack" on the Congressional limitation of $300,000,000 on Treasury printing US Notes? This limitation is older than either the debt ceiling legislation, or the current appropriations bill, and if he did challenge it successfully, then the Treasury would have its unrestricted power to create currency restored, a very powerful hedge against debt ceiling legislation, and an enabler for ceasing to issue debt at all.

2. Selective Default

The second option, is the Treasury declaring a selective default only on Federal Reserve-owned debt instruments in order to wipe these off the books, and create headroom relative to the debt ceiling. This is clearly an extra-legal procedure. The Federal Reserve Board of Governors is a Government agency; but those bonds are owned by the Fed Regional Banks, which in our system, are not Government agencies, but rather privately owned "Federal instrumentalities." Here's wikipedia [23]:

> "The Federal Reserve Banks have an intermediate legal status, with some features of private corporations and some features of public federal agencies. The United States has an interest in the Federal Reserve Banks as tax-exempt federally-created instrumentalities whose profits belong to the federal government, but this interest is not proprietary.[74] In Lewis v. United States,[75] the United States Court of Appeals for the Ninth Circuit stated that: "The Reserve Banks are not federal instrumentalities

> for purposes of the FTCA [the Federal Tort Claims Act], but are independent, privately owned and locally controlled corporations." The opinion went on to say, however, that: "The Reserve Banks have properly been held to be federal instrumentalities for some purposes." Another relevant decision is Scott v. Federal Reserve Bank of Kansas City,[74] in which the distinction is made between Federal Reserve Banks, which are federally-created instrumentalities, and the Board of Governors, which is a federal agency."

Since the Bonds held by the Fed are held by the regional banks, this second option would involve a major hit to the assets of these banks and also an operating loss. It would involve not just questioning, but also denying a debt of the United States, and would therefore violate the 14th Amendment.

3. Proof Platinum Coin Seigniorage

Congress provided the authority [24], in legislation passed in October 1996, **for the US Mint to create platinum bullion or proof platinum coins with arbitrary fiat face value** having no relationship to the value of the platinum used in these coins. These coins are legal tender. So, when the Mint deposits them in its Public Enterprise Fund account at the Fed, the Fed must credit that account with the face value of these coins. This difference between the Mint's costs in producing the coins and the credit provided by the Fed is the US Mint's profit. The US code also provides [25] for the Treasury to periodically ?sweep? the Mint's account at the Federal Reserve Bank for profits earned from these coins. **Coin seigniorage is just the profits from these coins** , which are then booked as miscellaneous receipts (revenue) to the Treasury and **go into the Treasury General Account (TGA),** narrowing the revenue gap between spending and tax revenues. Platinum coins with huge face values, $1, $1.6, $2, $3, $6.2, $15, and $30 Trillion coins have been mentioned, could close the revenue gap entirely, and, if used often enough, technically end deficit spending, while still retaining the gap between tax revenues and spending.

4. Running an Overdraft at the Fed

This option suddenly got some press this week as people begin to cast about for a solution. John Carney at CNBC [26] says that overdrafts are more like ?gifts? from the Fed than they are the kind of debt instruments the Fed is prohibited from buying from the Treasury, and that's the gist of his argument. The problem with this argument, also quickly echoed by Felix Salmon [27] is outlined by my friend Marshall Auerback in correspondence this way:

> In the past, Treasury had access to both a cash and securities draw authority (hat tip, Cullen Roche of "Pragmatic Capitalism? [28]). Intermittently between 1942 and 1981, Treasury was able to directly sell (and purchase) certain short-term obligations to (and from) the Federal Reserve in exchange for cash. Congress first granted this cash draw authority temporarily in 1942:

> 1. allowed it to lapse several times, and extended it 22 times until 1979, when it modified some of the terms and added controls.
>
> 2. In 1979, Congress also authorized a securities draw authority, which permitted Treasury to borrow securities from the Federal Reserve, sell them, and then repurchase the securities in the open market and return the securities to the Federal Reserve within a specified period.
>
> 3. The securities draw authority was never used. After Congress authorized Treasury to earn interest on its Treasury Tax & Loan (TT&L) account balances in 1977,
>
> Congress allowed both draw authorities to expire [29] in 1981.
>
> That Congress allowed them to lapse would imply that it's no longer operative . . .

In short, in 1981, Congress ended the Treasury's drawing authority by allowing it to expire.

5. The Fed ?Burning? its Treasury Bonds to Get Them off the Books

Ron Paul suggested this one. If the Fed agreed to the proposal, it would create at lead $1.6 Trillion in headroom between debt subject to the limit, and the debt limit. The proposal hasn't been met with notable enthusiasm. In fact, I don't think the Chairman has even dignified it with a reply. However, the objection to it is similar to the objection to Treasury declaring a default on its Fed-owned debt. The result would be a big whole in the Assets of the Fed Banks owning the debt instruments. They're unlikely to support this proposal.

6. The ?Exploding Option?

Jack Balkin presents the ?exploding option? idea this way:

> The government can also raise money through sales: For example, it could sell the Federal Reserve an option to purchase government property for $2 trillion. The Fed would then credit the proceeds to the government's checking account. Once Congress lifts the debt ceiling, the president could buy back the option for a dollar, or the option could simply expire in 90 days. And there are probably other ways that the Fed could achieve a similar result, by analogy to its actions during the 2008 financial crisis, when it made huge loans and purchases to bail out the financial sector.

As near as I can make out, the idea here is for the Fed to pay for an option on the property, that it would not then exercise by some date certain. When the option expires, the Government, having an increase in the debt ceiling by then, would pay back the Fed, give it a small profit, and keep the property.

Presumably, this could be done indefinitely, if Congress has still failed to raise the debt ceiling by the end of the option period, or the option period could be made long enough that it is very improbable that the debt ceiling would not be raised. The ?exploding option? idea is undoubtedly ingenious; but:

-- I wonder whether the option isn't functionally a debt instrument, and also whether
-- the option isn't being ?monetized? by the Fed in complete analogy to the monetization of debt instruments that is expressly prohibited by Congress?

Comparison of the Options

From my point of view, selective default and the fed burning its bonds are both far out options. I just don't think the accounting rules governing the Fed would allow it to approve procedures that resulted in huge losses for the Fed regional banks. The Fed would never agree to such alternatives.

The overdraft and ?exploding option? alternatives are likely to be much more acceptable to the Fed than options that destroy the financial assets of regional banks. However, both of these options are a bit legally questionable. As I said above, the overdraft procedure appears to have been ended by Congress in 1981, when it had every opportunity to renew the Fed's drawing authority.

Felix Salmon is taken with the Fed allowing overdrafts. He thinks this solution is a realy elegant one because it would allow Treasury to keep on spending until it could arrive at a new debt ceiling. He also thinks that the Fed would have to honor Treasury checks by allowing an overdraft because if it didn't do so, that would ?trigger a massive recession? and violate the Fed's full employment mandate.

I find this unconvincing because the Fed has been violating its full employment mandate since passage of the Humphrey-Hawkins during the 1970s. It has always taken its price stabilization mandate much more seriously than its full employment mandate. So, I think that the Fed may not honor Government overdrafts, because Government special drawing authority was ended in 1981.

The ?exploding option? alternative is certainly inventive. However, if I understand it correctly, it's a transparent artifice for allowing monetization of the functional equivalent of federal debt instruments. So, I think it's legality is questionable, and that the President should be careful before he resorts to it.

In fact, the first four options being compared all propose procedures of questionable legality. All might turn out to be politically feasible, because the House Republicans may not be able to get standing to challenge the President. Nevertheless, if many representatives feel that the President's solution to the debt ceiling problem is of questionable legality, and they also find themselves unable to get standing in Court, they may well feel justified in pursuing impeachment. They won't get far, because the Senate will never sustain them; but nevertheless another impeachment circus is likely to be very costly for an Administration that wants somehow to improve the jobless rate before the elections of 2012.

This brings us to the Constitutional option. This is a legally fascinating option especially since the President might challenge the debt ceiling or other legislation such as the limits on Treasury printing money, or the legislation withdrawing the Treasury's overdraft authority; It's also a politically attractive option, because it makes the President look strong, relative to the House Republicans. It's also interesting because if he issues a constitutional challenge and goes on issuing debt, it's very doubtful that the House Republicans will have a practical legal route to contest what he's done. On the other hand, as with some of the other options, their very inability to get redress from the law may goad them into attempting to impeach the President, and I suspect that the Administration would want to avoid that outcome, with all its distractions.

Coin seigniorage isn't some crazy or radical idea, even though some [30] who want to be considered Very Serious People (VSP) have had that kind of reaction to the idea. Instead, it is a legal instrument that the President may, depending on how things work out, **have to use in a bit more than two weeks to comply with his oath of office.** It may be the only way for him to avoid breaching one of the laws which he is supposed to enforce [31]. As such, it has to be taken seriously, and treated with more than just a few dismissive conclusions, accompanied by a lack of explanation.

Many writers on the current debt ceiling crisis have been taking the view that the 14th Amendment constitutional challenge route is the best thing for the President to do if there is no agreement on the debt ceiling. But, a constitutional challenge requires violating the debt ceiling, or some other legislation, claiming that the chosen law is unconstitutional, and relying heavily on the House's inability to have standing to take the President to Court in order to sustain the President's action. The President may get away with this, but it is radical in the sense that it claims the Executive's right to make a unilateral judgment of constitutionality in opposition to clearly written legislation, without getting a by your leave from the Supreme Court. Surely we can all see how dangerously radical this kind of practice is for the rule of law in the United States?

In other posts [32], I've made the case that the debt ceiling isn't in violation of the 14th Amendment as long as PPCS is an option for the President. Also in an e-mail communication, beowulf, the blogger who wrote the seminal blog on coin seigniorage [33], offered the following opinion on why a 14th amendment-based challenge will not work, given the existence of PPCS.

> . . . No federal judge -- Supreme Court justices included -- will take the extraordinary step of enjoining an Act of Congress if the President who asks them to had an opportunity to sidestep the constitutional issue lawfully but neglected to do so. . . . .
>
> . . . The moral of the story is if the Court thinks there is no alternative to breaching the debt ceiling, it probably would find it unconstitutional (or rather, it would decline to hear the case on Standing grounds, leaving the President's decision to ignore the debt ceiling in place). On the other hand, if the Court thinks the President had a lawful alternative-- like coin seigniorage-- but neglected to use it, they're not going to bail him out.

This argument is compelling to me given the history of the Court. The Court defers to the legislature if it possibly can, and prefers the President to avoid constitutional challenges if he has a means of doing so. In this case, he does, and the means is proof platinum coin seigniorage.

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